RESPONSES OF MICRO FINANCE INSTITUTIONS TO REGULATION THROUGH
MICROFINANCE ACT 2006

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OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF
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OCTOBER, 2010
DECLARATION

I hereby declare that this research project is my original work and has not been presented for examination in any other institution.

Sign: ............................................ Date: ..............................

ANNE GATWIRI GATHUKU

REG. NO: D61/P/7111/2005

This project has been submitted for examination with my approval as University Supervisor.

Sign: ............................................ Date: ..............................

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ACKNOWLEDGEMENT

I take this opportunity to thank the Almighty God for His grace and my good health, and for bringing me to this far. I wish to express sincere gratitude to all the university lecturers who participated in the course of my study. Special thanks to my project supervisor, Mr. Jackson Maalu, for his consistent guidance, encouragement, and patience in reading, correcting, re-reading and refining this work. I would like to thank all the Chief Executive Officers of Microfinance institutions who took time to provide me with information for the study. I appreciate the support of colleagues who encouraged me when the going got rough and reviewed my project documents, and my husband and children for giving me the space and time to work on this project.
DEDICATION

I dedicate this research project to my dear husband, Samuel for his unwavering support during the study period and to my children Alex and Michelle whom I denied quality time while doing this study.
ABSTRACT

Microfinance institutions are increasingly facing changing environmental conditions arising from government regulation of the industry that demand new strategic and operational responses. The individual microfinance institution's capacity to effectively match its strategies and capabilities to the changing environment will determine its competitive positioning in the microfinance industry.

Kenya's microfinance institutions vary in formality, commercial orientation, professionalism, visibility, size, and geographical coverage. Regulation of the microfinance industry is a government effort to mainstream the industry into the financial sector. The licensing, regulation and supervision of deposit-taking microfinance institutions under the Microfinance Act 2006 is expected to enhance the orderly growth and development of a sound, vibrant and stable microfinance industry in Kenya.

The objectives of the study were to establish the responses of the microfinance institutions to regulation through the Microfinance Act 2006, and also determine the factors influencing their responses to the regulation. The findings show that the most extensively used human resource strategies to respond to regulation included review of staff qualification and skills requirements to match regulatory requirements, and training top management and operational staff on new regulatory requirements and change management. Strategic partnership with telecommunication companies was a major adaptation aimed at increasing penetration and lowering costs. Other strategies employed by microfinance institutions included introduction of new products such as individual loans, technology-based products such as money transfer services to enhance the product-
portfolio mix, and branding of products for differentiation. Long term debt as a source of funding was also a major adaptation making a significant shift from donor funding.

The study utilized a cross-sectional survey design due to time constraints. The target population involved all the 45 micro finance institutions in the Association of the Micro Finance Institutions (AMFI membership). Primary data was collected using questionnaires. The data analysis was done using the Statistical Package for Social Science (SPSS).

The study recommends that microfinance institutions should enhance their understanding of the legal and regulatory requirement to determine the risks in specific context of each regulation to avoid the pitfalls of predecessors. Financial management and reporting should be emphasized in MFIs. MFIs operators should adopt the legal and regulatory requirements in order to responds effectively to the Microfinance regulation. Further research should be done on other finance institutions in Kenya because different financial institutions have unique characteristics and diverse contextual realities that might influence their responses and consequently approach to different response strategies.
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CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Organizations are systems with rational, natural and open characteristics (Scott, 1998). As open systems, organizations are entities that exist in that they can establish relationships with their environments (Gomes and Gomes, 2007). A central proposition of organization theory is that decision makers respond to environmentally induced uncertainty through responses that attempt to adapt their organization in order to reduce uncertainty. As regulatory uncertainty increases, customer uncertainty and competitor uncertainty are expected to increase, and firms will choose strategies that have more predictable outcomes (Birnbaum 1984). Greening & Gray (1994); Oliver, (1991) argue that an organization’s behavior is significantly influenced by external pressures. These pressures come about as they exchange resources with their environment in order to achieve legitimacy. An organization is likely to survive to the extent that it can cope with external demands and expectations (Mwankwo and Richardson, 1996; Oliver, 1991).

The microfinance industry in Kenya is facing new environmental demands arising from the enactment of the Microfinance Act 2006, which seeks to mainstream the operations of the microfinance institutions (MFIs) through regulation. This requires development of new strategies and internal capabilities by MFIs to respond to the new environment. This paper seeks to explore how MFIs which have operated in a widely unregulated environment with support from donor communities (Wainaina 2000), are able to consider their own organizational guiding assumptions in responding to the changing regulatory
environment, and, second find out what factors influence the adaption. In this respect I propose to study MFIs responses by looking at the organizational strategies and capabilities being adopted to build competitive positioning.

1.2. Organizational Response to the Legal Environment

One of the most widely shared and enduring assumptions in strategy formulation literature is that the appropriateness of a firm's strategy can be defined in terms of its fit, match or congruence with the environmental or organizational contingencies facing the firm (Andrews, 1971; Hofer and Schendel, 1978). The pursuit of strategic fit has traditionally been viewed as having desirable performance implications (Ginsberg and Venkhtraman, 1985; Miles and Snow, 1994).

The strategic fit theory postulates that the degree of success for any company depends on how well it interacts with the environment, its ability to match its strategic aggressiveness to the environmental turbulence, and, the responsiveness of its capability to strategic aggression (Ansoff and McDonnell 1990). Organizations depend on the external environmental for their inputs such as raw materials and labour, and for their outputs and markets (Porter 1985, Ansoff and McDonnel, 1990, Johnson and Scholes, 2002). The institutional perspective suggests that an organization gains legitimacy by conforming to the dominant practices within their organizational field (DiMaggio & Powell, 1991). An organizational field includes "those organizations that ...constitute a recognized area of institutional life: key suppliers, resource, product consumers, regulatory agencies, and
other organizations that produce similar services or products” (DiMaggio & Powell, 1983).

To effectively respond to regulation, Rugman and Verbeke demonstrated that organizations must develop capabilities in areas dominated or largely influenced by government regulation such as trade and industrial policy (1998). Teece, Pisano, and Shuen concurs that capabilities reflect the organizations ability to respond effectively, on the basis of its internal strengths/ weaknesses, to external opportunities/ threats (1997). Birnbaum noted that larger organizations are expected to be better able to engage in the more uncertain intervention strategy than smaller firms (1984).

1.3. Microfinance Industry in Kenya

The emergence of the micro finance industry presents an unprecedented opportunity to extend financial services to the vast majority of the economically active population. The World Bank estimates that the potential global market for micro enterprise credit currently stands at 100 million clients. In many developing economies small and micro businesses comprise of nearly ninety percent (90%) of all firms (Berenbach & Churchill, 1997).

The Kenyan microfinance industry emerged in the past 30 years in response to the lack of access to formal financial services for most of Kenya’s low-income people. The contribution of the microfinance sector in the economic development of Kenyan economy cannot be overlooked. It is now widely recognized in Kenya that the promotion
of micro and small enterprises is a viable and dynamic strategy for achieving national
goals, including employment creation and poverty alleviation. According to a baseline
survey conducted in 1999, the micro finance industry contributes at least 13.8% of

Microfinance institutions (MFIs) have largely been a private non-profit sector initiative
that widely operated in unregulated environment. Many Non Governmental
Organizations (NGO) MFIs, with donor funding have attempted to fill some of the
financial gap with credit facilities to low income people. Most of the programs, however,
due to the restrictions in the Banking Act and limited funding, have developed as credit-
led programs (Bett 2005), thus limiting the extent to which these institutions can mobilize
deposits and build clients’ capacities through education to ensure the program’s
sustainability (Dondo 2003).

The Government of Kenya recognizing microfinance as a strategic tool for poverty
alleviation in Kenya owing to its potential of using institutional credit and other financial
services for greater access to, and sustainable flow of financial services, particularly
credit, to the low-income households and micro and small Enterprises, developed an
appropriate policy, legal, and regulatory framework to promote a viable and sustainable
system of microfinance in the country through the Microfinance Act 2006.

1.3.1. Microfinance Regulation

Kenya’s MFIs vary in formality, commercial orientation, professionalism, visibility, size,
and geographical coverage. The legal form of the micro finance industry is quite diverse.
Micro finance institutions can be registered under 9 different Acts of Parliament, namely
the Banking Act, the Company Act (limited liability), Non Governmental Organizations (NGOs) Coordination Act, Building Society Act, Cooperative Act, Trustees Act, Kenya Institute of Education Act, and the Societies Act. Other organizations such as the Self Help Groups, the rotating savings and credit associations, the accumulated savings and credit associations are registered with the relevant ministries and they too practice microfinance (Dondo, 2003).

Transformation of NGO microfinance institutions into regulated deposit-taking institutions has been viewed as one of the key ways to create financial viability and scale among the MFIs, and to establish permanent sources of funding for them (Ledgerwood and White, 2006). The proponents of microfinance regulation such as the World Bank, Consultative Group to Assist the Poor (CGAP) and the international donor communities argue that the future of microfinance lies in developing a well-regulated microfinance environment that will allow the poor to access a wide variety of financial services (Gallardo, 2001).

1.3.2. The Microfinance Act 2006

The Microfinance Act 2006 is a government effort to regulate the industry. The Act has proposed regulation of microfinance on two-tier based on the capital requirements. These are the community banks and the microfinance deposit-taking banks.

The Microfinance Act 2006 is an Act of parliament that makes provision for the licensing, regulation and supervision of microfinance business and for connected purposes. It provides a regulatory framework for MFIs and pro poor programs. The Act
applies to every deposit taking microfinance business and specialized non-deposit taking microfinance business providing loans or other facilities to micro or small enterprises and low-income households. The Act does not apply to companies licensed under the Banking Act Cap 488, Building Societies Act Cap 489 and the Kenya Post Office Savings Bank Act cap 493 B.

It addresses a number of issues such as licensing, governance, supervision, and protection of depositors. The Act sets out the minimum capital requirements and provides for a two-tier regulation for the deposit taking microfinance organizations. Governance issues relate to maintenance of minimum capital requirements, maintenance of minimum liquid assets, declaration of dividends, prohibited activities, insider lending, limits in shareholding, and management of institutions. Supervision aims at ensuring compliance by institutions. The Act provides for inspection of institutions for breach/contravention of the law, irregularities, mismanagement and periodic reporting (Microfinance Act 2006).

1.4. Research Problem

A central proposition of organization theory is that decision makers respond to environmentally induced uncertainty through responses that attempt to adapt their organization in order to reduce uncertainty. As regulatory uncertainty increases, customer uncertainty and competitor uncertainty are expected to increase, and firms will choose strategies that have more predictable outcomes (Birnbaum 1984).
Microfinance institutions have largely been a private non-profit sector initiative that widely operated in unregulated environment. Whereas many micro finance practitioners agree that the enactment of the microfinance legislation allows the qualifying MFIs to mobilize deposits from the public, and develop other financial services that are appropriate, experience in countries where micro finance industry has been regulated indicate a very low response (Berenbach & Churchill, 1997). A good example is Uganda, where five years into regulation of micro finance industry only five institutions had transformed themselves into regulated MFI (Meagher, 2002).

On the other hand, the intensity of competition in the financial sector has increased significantly during the last decade due to low barriers of entry. This has led to a shift in target markets, products, and technologies used to deliver these products to the customers, and there is a possibility of market convergence of informal and formal financial sectors of the economy leading to the sector boundaries being blurred.

A lot of studies have been done in regard to response of organizations to liberalized environments in the public and private sector; and in various aspects of microfinance industry in Kenya. Muturi studied Strategic response by firms facing changed competitive conditions (2000); Maru in studied strategic choices of survival within a changing environment (2004), Bett, in studying “Differentiation strategies used by MFIs in Kenya” noted that the MFIs had flexible rules that posed a major challenge to the formal players making it difficult for the formal players to compete effectively in the lower end of the market (2005). Oriaro (2000) looked at the characteristics of MFIs that supported or hindered regulatory process and identified appropriate regulatory approaches that could be suitable for MFIs in Kenya, but did not consider the responses
of MFIs to regulation. There is no known documented study on organizational response to regulated environment and specifically responses of MFIs to regulation. This research paper seeks to examine the responses of MFIs to regulation through the Microfinance Act 2006 and the factors that are likely to influence their responses.

1.5. Research Objectives

The objectives of this research were to establish:

i. The responses of the MFIs to regulation through the Microfinance Act 2006, and

ii. To determine the factors influencing responses to regulation by MFIs in Kenya.

1.6. Value of the Study

This study once accomplished fills a knowledge gap in regard to responses of microfinance institutions to regulation in Kenya and add to the body of knowledge that exists in regard to the microfinance industry.

Government: There is no question concerning the contribution of microfinance industry to national development as the Government expects to have the highest number of job creation to occur in this sector. This is depicted in the Government’s inclusion of the microfinance sector in its strategic papers such as the Poverty Reduction Strategy Paper (2001) and the Economic Recovery Strategy for Wealth and Employment Creation (2003-2007). The findings of this study will be of interest to the Government in understanding the MFIs’ responses to regulation and in designing policies that facilitate development of the industry.

The regulator of the microfinance institutions: The regulator should be able to understand the responses of MFIs to regulation in order to be able to enforce rules within the
industry. This will enable the regulators to identify the various responses and the factors influencing response and adapt the rules to fit the various categories of MFIs.

*Microfinance practitioners:* This study is important to microfinance practitioners because it will help them understand the industry, the expected changes and be able to position themselves strategically in the long run. It will also benefit the management consultants who may need to advice their clients on organizational responses.

*Academics:* This study will be of interest to researchers and particularly those in strategic management because it will add to the existing body of knowledge and hopefully stimulate further research in this area.
CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

Organizational response refers to the way an organization handles change (Koch and Lindenthal, 2002). The responses are both strategic and operational. Abundant theoretical and empirical literature on organizational response to environment exists. The Strategic fit concept which has theoretical roots in contingency perspectives found in both the strategy and organization theory literatures (Ginsberg and Venkatraman, 1985) stipulates that the process of achieving fit begins, conceptually at least by aligning the organization to its market place. Reger, Duhaime and Stimpert concurs with this view and points out that firms that achieve superior matches with their environments will enjoy superior competitive positions and levels of performance (1992).

Zajac, Kraatz, & Bresser on the other hand argue that the strategy literature's concept of matching and alignment has historically been multidimensional and ambiguous in prediction (2000). They argue that “if environmental conditions change either through the emergence of new opportunities or threats, it is not obvious that the organization should change its strategy to achieve better fit with environmental conditions if such changes would imply a clear ‘misfit’ with established organizational strengths”.

The new institutional perspective suggests that firms obtain legitimacy by conforming to the dominant practices within their institutional fields (DiMaggio & Powell, 1991). Several researchers have integrated the theories of institutional and organizational
dynamics to explain how differences can persist even among organizations that face comparable environmental pressure (Delmas and Toffel, 2007). Oliver (1991) combines institutional and resource dependence perspectives to predict how organizations will strategically respond to various pressures.

2.2. Organizational Environment

According to Andrews (1971) "the environment of a company in business, like that of any other entity, is the pattern of all the external conditions and influences that affect its life and development." The business environment consists of the macro environment, the industry environment and the micro environment (Pearce and Robinson, 1997) also known as institutional fields (Dimaggio & Powell, 1991). The macro environment consists of broad environmental factors that impact on all the organizations. This business environment is diverse, dynamic and complex (Johnson and Scholes, 2002).

Every organizational environment contains more information than the organization can perceive and process (Koch and Lindenthal, 2002). Organizations are not closed systems, sealed off from their environments, but open to and dependent on the flow of resources from outside their own systems (Ansoff, 1979). Their primary function is to supply goods or services to society. They depend on the environment for their inputs such as labour and raw materials, and for their output (Johnson and Scholes, 2002). Organizational environments are dynamic. Organizations face different levels of environmental turbulence such as shifting consumer preferences, changes in government policy, competitors' actions, technological changes and other exogenous shifts that affect the

Regulation of the micro finance industry brings along with it new environmental challenges that the management of the micro finance institutions must contend with. Among the challenges are strategic and operational changes that pose various risks to the organization. These include ownership and governance risk (Lauer, 2008), which occurs if the owners and directors of the MFI do not have the capacity to provide adequate management oversight; management risks (Ledgerwood and White 2006) that are as a result of the specific service delivery methods required to service this market. These methods include decentralized operational systems, management efficiency and management information systems; and credit risk mainly due to unsecured loans, delinquency management and/or sector or geographic concentration risk (Berenbach and Churchill, 1997).

2.3. Organizational Response to Changed Environment

The strategic success formula concept stipulates that an organization's strategy must fit the environment (Ansoff and MacDonnel 1990) and different environmental profiles will require different strategies (Zajac, Kraatz, & Bresser, 2000; Reger, Duaim & Stimpert 1992) and different internal capabilities (Teece, Pisano & Shuen 1997; Chorn 1991) if the organization has to be successful. This concept has theoretical roots in contingency perspectives and found in both the strategy and organizational theory literatures (Ginberg and Venkatraman, 1985). As Venkatraman and Camillus have noted, the process of
achieving fit begins, conceptually by at least aligning the organization to its market place (1984).

Fig 1: Strategic Success Formula Framework

The principle of strategic fit considers the degree of alignment that exists between competitive situation, strategy and organizational capability (Chorn, 1991). Organizational performance and effectiveness will be optimized when an organization responds to a predominantly turbulent environment with an appropriate strategy. The incentive for organizational response to the environment usually results from a perceived misfit between the organization’s expectations and reality (Koch and
Lindenthal, 2002; Dutton and Duncan 1987)). Achieving strategic fit is the primary task of management (Chorn 1991).

The response to a changed environment may either be a reactive adaptation to a problem that has already occurred or an anticipative change to the expected future challenges (Dutton and Duncan 1987; Cook et al 1983). In both cases the response is triggered by a perceived gap between the organizational expectation or vision and the reality, and the need to match its strategies, and organizational capabilities to the changes in the environment (Koch and Lindenthal, 2002).

The responses are determined by both the institutional and the external factors (Pearce and Robinson, 1997). Organizations are viewed as capable of making adaptations to regulation and other environmental constraints through modifications in internal structural arrangements as well as establishment of various types of inter organizational arrangements (Cook et al 1983). Ansoff (1979) argues that when any environment serving organization is faced with prospects of extinction it focuses all its energy on a search for a survival strategy.

The responsiveness of an organization to its environment is influenced by the climate, competence and capacity of both the managers and organization. Climate refers to the will to respond, competence refers to the ability to respond, and capacity refers to the volume of response (Ansoff and MacDonnell, 1990). According to Johnson and Scholes (2002), successful strategies are dependent on the organization having the strategic capability to perform at the level that is required for success. Ansoff and MacDonnell,
(1990) point out that the responsiveness of a firm is measured by the match between the critical capability success factors\(^1\) and the capability profile of the firm. The capability profile is composed of the functional capability such as marketing, production, research and development, finance, as well as the general management know-how such as management of growth, diversification, acquisition, etc. Ansoff and MacDonnell (1990), define general management as “the organizational function responsible for the overall performance of the firm. This responsibility includes strategic positioning of the firm in its environment in a way that assures a coordinated performance towards its near term objective”. Capability of the general management refers to its propensity and its ability to engage in behaviour that will optimize attainment of near and long-term objectives.

When an organization’s operating environment changes, it must conduct a strategic diagnosis to determine the changes that must be made to its strategy and internal capability in order to assure the firm’s success in its future environment. Each organization must change its strategies and its organizational capability to be able to respond to the changes in the environment. If the organization’s strategy does not match the level of environmental turbulence, there will be a strategic gap in the organization (Ansoff and McDonnell, 1990).

Prior to regulation the micro finance industry in Kenya has been operating in an environment that was changing slowly and incrementally (Mutonyi 2003). The MFI responses to environment have been incremental. They minimized departures from

\(^1\) Critical success factors are those product features that are particularly valued by a group of customers and, therefore where the organization must excel to outperform competition.
historical behaviour. Change, was either controlled, or not welcome (Maru, 2004). Most of the firms in the industry have been targeting the same clients with the same products and services, using the same service delivery technology, namely the group based lending. Bett (2005) noted that the competitive strategies used by MFIs were similar. In the absence of threats from competition, MFIs stuck to their historical products and services, while minimizing costs and under pricing competition.

In response to increased competition arising from a liberalized financial sector, commercial banks have entered the micro finance sector by targeting the small and micro entrepreneurs with their products and services, by developing specialized units or divisions within the bank to focus on micro finance (Ledgerwood and White, 2006). On the other hand the micro finance institutions are up scaling their operations to target the market niches currently being served by the commercial banks, by transforming nonprofit entities into formalized, regulated financial institutions that can mediate deposits from the public. This shift in the target markets has been more pronounced. There is a market convergence of informal and formal financial sectors of the economy, leading to the sector boundaries being blurred.

Maru (2004) observed that MFIs are more comfortable choosing or adapting those strategies that build on institutional memory rather than those that would require investment in innovative procedures. This study seeks to explore whether this observation holds in the face of a changed environment.

With the introduction of regulation MFIs can display a spectrum of responses that include acknowledgement, compromise, avoidance, rejection and ignorance (Koch and Lindenthal, 2002). Porter (1980) argues that competitive strategy is about taking
offensive or defensive actions to create a defendable position in an industry. There are many ways of combining environmental assessment with organizational capability assessment to determine strategy. To simplify the discussion on their interactions, four combinations or assessment outcomes are represented in a 2x2 matrix in figure 2. The cells show the link between the assessments in environmental changes and the organizational responses based on their perceived capability.

**Assessment of Changed Environment**

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<tr>
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<th>Favourable</th>
<th>Unfavourable</th>
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<tbody>
<tr>
<td>Acknowledgement</td>
<td></td>
<td>Avoidance</td>
</tr>
<tr>
<td>High</td>
<td>I</td>
<td>II</td>
</tr>
<tr>
<td>Compromise</td>
<td>III</td>
<td>IV</td>
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<tr>
<td>Low</td>
<td></td>
<td>Resistance</td>
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Figure 2: Interaction of Environmental and Organizational capacity Assessment and their relationship to organizational response (Koch and Lindenthal, 2002).

Cell I Acknowledgement represents a situation whereby the MFI views the environmental change (regulation) as favourable and it has the capacity to be regulated. Acknowledgement can be defined as a response that validates the micro finance regulation principle and accepts and acknowledges its underlying assumptions and goals. The MFIs would change in a congruent way. Some possible generic strategies include mergers, consolidations, and multiunit system involvement (Cook et al 1983).
Cell II: Avoidance represents a situation where the MFI views environmental change as unfavourable but it has the capacity to respond to the environment. Avoidance is a form of resistance that reflects conformity on the symbolic level without compliance or fully implementation to the requirements on the material level (Koch and Lindenthal, 2002). Intra organizational responses include lawsuits and trustee education programs at the institutional level; greater level of boundary spanning activities such as designating certain administrative people to work with regulatory agencies, and consultants and making changes in MFI staff organizations at the managerial level; and development of new services and programs and changes in staffing ratios at the technical level (Cook et al 1983). Large and small firms will seek to reduce the uncertainty by increasing the less risky strategies such as diversification, outsiders on the board, board size, and trade association activities, and reducing riskier strategies such as invention of new products (Birnbaum 1984).

Cell III Compromise represents a situation whereby the MFI views the environmental change (regulation) as favourable but it lacks the capacity to be regulated. Organizations that compromise agree partially to the new environmental demands and response is characterized by adaptations or imitative behaviour. MFIs that adopt this type of response will most likely identify other MFIs have successfully transformed and copy the transformation process.
Cell IV Resistance is a strategic response based on reflected opposition towards modifications within the organization. MFIs falling under this category will not seek to be regulated and will not make any adaptations to their products, markets or technologies.

Birnbaum (1984) observes that regulations increase consumer and competitor uncertainty, with the consequence that firms select less risky strategies and decrease the riskier new product invention strategy. These will be reflected in the generic and grand strategies that the MFIs will adapt. Growing markets with high future potential, perhaps because of higher profits margins, new technologies, or unexploited market segments, might attract new firms in spite of present regulatory and customer uncertainty.

The basic assumption underlying this theory of regulatory response is that all organizations strive to maintain their autonomy and identity, reduce uncertainty, and prevent unnecessary dependence on their regulatory environments (Aldrich 1979). Organizational forms with a lesser 'fit' to the environmental contingencies or constraints will tend to be eliminated through a process of selection in a competitive environment, or the process will result in the creation or adoption of new organizational forms (Hannan and Freeman, 1978).

2.4. Microfinance Industry

The microfinance sector has evolved over the past three decades. It came to prominence in the 1980s, although subsidized credit programs to targeted communities date back to the 1950s and early experiments in Bangladesh, Brazil and a few other countries began in the 1970s. The important difference of microfinance sector was that it avoided the pitfalls
of an earlier generation of targeted development lending, by insisting on repayment, by charging interest rates that could cover the costs of credit delivery and by focusing on client groups whose alternative source of credit was the informal sector (Aghion and Morduch, 2005).

Microfinance has largely been a private (non-profit) sector initiative that avoided becoming overtly political, and as a consequence, has outperformed virtually all other forms of development lending. A significant proportion of microfinance institutions (MFIs) in the developing countries operate either as nongovernmental organizations (NGOs) or as projects run by international NGOs (Lauer, 2008). Traditionally microfinance was focused on providing a very standardized credit product through the use of group lending methodology. Most microfinance institutions offer a single product (credit only) to a single market segment comprising of operators of Micro and Small Enterprises. They use a single methodology of delivering the service (that is group-based lending), thus reaching a limited segment of the MFI market (Ledgerwood and White 2006).

The typical microfinance clients are low-income persons that do not have access to formal financial institutions. Their "micro enterprises" represent an estimated 80% of the total enterprises in the world, 50% of urban enterprises and 20% of the GNP of their countries ((Aghion and Morduch, 2005). Microfinance clients are typically self-employed, often household-based entrepreneurs. In rural areas, they are usually small farmers and others who are engaged in small income-generating activities such as food processing and petty trade.
In Kenya, microfinance services and products are provided by a variety of institutions of different institutional forms under more than nine different Acts of Parliament (Dondo 2003). These microfinance providers can be clustered into three broad categories, notably, formal, semiformal and informal institutions, with the level of formality defined by the degree of formal regulation and supervision. The formal category includes banks and financial institutions licensed under the Banking Act, building societies and the Kenya Post Office Savings Bank. The semi-formal category includes SACCOs, Development Finance Institutions Agricultural Finance Corporation (AFC), Industrial and Commercial Development Corporation (ICDC), Kenya Industrial Estates (KIE), Industrial Development Bank (IDB), and Kenya Tourist Development Corporation (KTDC)} and microfinance institutions; while Accumulating and Rotating Savings and Credit Associations (ASCAS, and ROSCAs), shopkeepers and money-lenders dominate the informal category.

2.5. The regulation of Micro Finance industry: A Global perspective

Regulation and supervision of the microfinance sector is a Government effort to mainstream the microfinance operations. It expected to lead to quality growth, broaden the funding base for MFIs eligible to mobilize and administer deposits, credit facilities, other financial services, and initiate the process of integrating these institutions into the formal financial system (Ledgerwood and White 2006). The regulation of the sector will enable authorities to define procedures for their operations, entrance, exit, and ultimately create an environment for fair competition and efficiency in the sector.
The two primary objectives of NGO MFIs that seek to be regulated are one to provide clients with a range of financial services beyond credit, and including savings and transfer services and second to increase access to capital, whether through commercial borrowing, deposits, or raising equity (Lauer, 2008).

The licensing, regulation and supervision of deposit-taking microfinance institutions under the Microfinance Act 2006 is expected to enhance the orderly growth and development of a sound, vibrant and stable microfinance industry in Kenya.

The Microfinance Act was enacted in December 2006 to provide a level playing field and the appropriate legal, regulatory and supervisory framework for the microfinance industry. The Act was expected to promote the growth and development of the microfinance industry in Kenya, set prudential standards, create an enabling environment and act as a road map and catalyst towards achieving the desired objectives of increased outreach and sustainability of MFIs.

The regulation and supervision of institutions is anchored on a legal and regulatory framework that requires, first and foremost, the assessment of the adequacy of the institutions' capital to meet their business requirements to match their risk profiles and to protect the interests of their depositors (Microfinance Act 2006). Although prudential regulations, which subscribe minimum corporate governance standards, capital adequacy levels, liquidity requirements and adequate provisioning for loan losses etc, create a stringent regime, it is essentially necessary for deposit-taking microfinance institutions. This is to ensure the protection of their financial soundness in order to protect depositors' funds and uphold confidence in the financial system.
The policy underpinning the regime is based on a three tiered approach to regulation and supervision of the microfinance industry, with the deposit-taking MFIs taking MFIs falling under the Act. Informal microfinance institutions remain unregulated. The deposit-taking MFIs are categorized into two: the community MFIs and the nationwide MFIs with a minimum capital requirement of Kenya shillings twenty and sixty million, respectively. The nationwide MFIs operate countrywide, while the community MFIs operates with one Government Administrative District or Division if operating in a City (Microfinance Act 2006).

2.6. Implications of Regulation on Microfinance Institutions

Regulation of the microfinance industry brings fundamental strategic and operational changes in all aspects of the institution. These changes have implications as they affect the original vision and mission of the MFI (Ledgerwood and White, 2006). It leads to a shift in the operating environments of MFIs over the coming years. It leads to convergence of the formal and semi formal financial sector target markets, demand changes in the products and services being offered by the industry, and a change in the technologies being used to deliver the products and services to its customers.

Transformation implies ceding control to a broader group of stakeholders. With transformation of MFIs the ownership structure changes from NGO or a project capitalized by donors and governed by socially minded founders to a shareholding structure with investors who demand financial returns (Ledgerwood and White, 2006). This has serious implications because according to Maru (2004) MFIs are still quite reluctant to make meaningful changes in the some areas especially in ownership and governance. Wainaina (2002) observed that in most MFIs, the Chief Executive Officer
and the Chair of the Board was one and the same person. Most NGOs in developing countries suffer from lack of separation of ownership and control and extent of dispersion.

Regulation of MFIs facilitates an expanded target market and product offering, thus broadening the institutions client base. MFIs can mobilize deposits from wealthier clients and institutions that are higher income savers, and expand their product mix beyond credit. It will also affect the service delivery methodologies. Most MFIs currently offer only group loans. They will need to develop individual loan products, more comprehensive technical ways of accurately assessing the creditworthiness of clients. Alternative forms of collateral will need to be identified and the entire process of securing and recovering collateral reviewed. New policies and procedures must be established and staff be provided with additional training. However, MFIs that are transforming into profit making institutions have generally been accused of neglecting their social mission of providing credit to below average income earners (Wainaina, 2002).

Transformation leads to significant changes in human resource requirements. The organizational chart changes significantly as new positions are created as old ones are scrapped. The MFI will need to closely evaluate the senior management staff capacity and skills. In addition MFIs need to strengthen their management information systems and procurement policies. Regulation has significant cost implications to operations as the institution seeks compliance with regulatory requirements (Ledgerwood and White, 2006).
2.7. Factors Affecting Organizational Response

Several authors have shown empirically that organizations' responses to environmental pressure are affected by organizational characteristics such as ownership structure (Goodrick & Salancik, 1996), trust and identity (Kostova & Roth, 2002) size and technology (Montanari, 1978), as well as board of directors interlocks and geographical proximity to peer organizations (Davis & Greve, 1997).

Bateman and Zeithaml (1993) point out that the strategic choice of an organization is influenced by the commitment to the current strategy, the degree of organizational dependence to the environment, the attitude of the leadership towards risk, and the internal political considerations. They observed that the level of investment to the current strategy would determine the level of organizational adaptation. If there exists an environment of risk taking within the institution, then the number of alternative responses increases and vice versa. Powerful individuals would use power to influence the choice in order to propagate individual or group interests.

MFIs seek to be regulated for various reasons. These include the need to offer financial services beyond lending, access to capital, comply with new legislation requiring or permitting transformation, to gain legitimacy and to enable employees, clients, and other stakeholders to become owners (Lauer, 2008, Ledgerwood and White 2006).

Size of the organization: The firm’s environment presents constraints within which the decision maker must make size, technology, structure, and human resource decisions (Montanari 1978). A large sized firm and its resulting formalization and standardization
(Child, 1973), decrease organization’s ability to innovate (Scherer, 1970). Birnbaum (1984) however argues that large organizations should have greater slack because they have greater sales, more capital and human assets and consequently a greater capacity to absorb uncertainties posed by regulation.

Leadership orientation: There is a general consensus that characteristics of the Top management team have important impact on organizational outcomes because top executives are empowered to make strategic decisions for organizations (Knight et al, 1999). Since top management make executive decisions consistent with their cognition, which is in part a function of the values and experiences they commonly share, their experiences and values may be associated with organizational outcomes and their firm’s performance (Pegels et al 2000). The decision by MFIs to be regulated or not will depend in part on the strategic orientation of top management (Wiersema and Bantel, 1992), risk taking propensity (Bantel and Jackson, 1989), consensus building (Knight et al 1999), and industry experiences (Pesels et al,2000).

Miles et al (1974) proposes that the manager’s perceived environmental uncertainty and predisposition towards change define the manager’s discretionary range of responses. Montanari (1978) points out that a manager’s personality exerts influence in the form of predispositions brought to the decision making situations.

Vision and Mission: Some MFIs have social missions to help the poor while others have commercial missions to make profit for their shareholders. Regulation leads to a drift in the original vision and mission as it gains a commercial orientation and aims to maximize
shareholder value. MFIs that are transforming into profit making institutions have generally been accused of neglecting their social mission of providing credit to below average income earners (Wainaina, 2002). The MFI may be owned by shareholders whose objectives differ significantly from those of the NGO founders (Lauer 2008).

Need for capital: One of the primary objectives of MFIs seeking regulation is to increase access to capital, whether through commercial borrowing, which remains inaccessible for many NGO MFIs today, deposits, raising equity or all the three options (Lauer 2008). In regulation, MFIs bring in outside investors usually to access new capital or specific expertise.

Legal and regulatory requirements: Oriaro (2001) established that the dominant characteristics of MFIs that hinder regulation are targeting low-income asset less clients, extending unsecured loans based on group guarantee, and capitalization by donors. A significant number of MFIs in developing countries operate either as NGOs or as projects run by international NGOs. A key component of regulation of MFIs is the establishment of ownership. This presents issues for the NGO MFI as well as the founders and funders. These issues include the legal limits on NGO ownership of the regulated institution, legal restriction

Cost of transforming: Regulation as a set of constraints and a source of uncertainty, imposes on the organization a number of transaction cost decisions (Cook et al 1983).
Establishment of regulated financial institutions, in particular a depository institution, often required more time and been more costly and disruptive than planned (Lauer 2008).

Human resource requirements: As regulation persists organizations are forced to develop more stable and ongoing responses by acquiring additional expertise and input and thereby developing greater boundary spanning capability for dealing with the regulatory environment (Cook et al 1983). With regulation the senior management may change either voluntarily or because of legal requirements; the governance and the board structure will likely change.

Orientation of the owners: Several authors have shown empirically that organizations’ responses to institutional pressure are affected by institutional characteristics including ownership structure (Goodrick and Salancik, 1996). Wainaina (2002) observed that in most MFIs, the Chief Executive Officer and the Chair of the Board was one and the same person. Most NGOs in developing countries suffer from lack of separation of ownership and control and extent of dispersion. Regulation implies ceding control of the MFI to a broader group of stakeholder (Ledgerwood and White 2006).

Owners of MFIs own passionately the vision which is promoted both within and outside the organization.
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Research Design

The study utilized a cross-sectional survey design. The survey method was chosen because "it allows the collection of large amounts of data from a sizeable population in a highly economical way" (Saunders et. al, 2003). People perceive the survey design as authoritative in general because it is easily understood. The cross sectional survey was chosen because of the time constraint.

3.2 Population

The target population for the study was all the 39 out of 45 micro finance institutions that are members of the Association of the Micro Finance Institutions (AMFI membership) the umbrella body for microfinance institutions. The study did not include six banking institutions because the Microfinance Act 2006 does not apply to companies licensed under the banking Act Cap 488, building societies Act Cap 489 and the Kenya post office savings bank Act cap 493 B. AMFI membership comprises of six commercial banks, two wholesale MFIs, 34 retail MFIs, two insurance Companies and one Development institution. This target population was chosen because they have micro finance as their core business. Since the target population is small, a census was conducted. The target respondents were the Chief Executive Officers as they are the ones charged with the responsibility of strategic management of the institutions.
3.3 Data collection Instruments and Procedure

Primary data was collected using questionnaires. The use of a questionnaires ensured that data is standardized, allowing easy comparison. The questionnaires used were structured open and close-ended questions. The questionnaires were prepared and circulated using emails to the Chief Executive Officers (CEOs) of entire 39 institutions with a cover letter explaining the purpose of the study. The CEOs were requested to complete the questionnaire online and email it back within a specified timeframe. The researcher attempted to telephone all the Chief Executive officers of the MFIs to encourage them to respond. Reminders were also sent to the CEOs who had not responded through emails within two weeks.

A total of 22 responses were received from the total population of 39. This is 56.4% response rate. This response rate is comparable to other recent survey-based strategy research (Delmas and Toffel 2007).

3.4 Variables

A Variable is a measure of characteristic that assumes different values among subjects (Mugenda and Mugenda, 2003). The study identified the environmental factor, regulation as the independent variable under study, and strategies and organizational capabilities as the dependent variables.

To determine the responses of MFIs to regulation through the Microfinance Act 2006, the main dependent variables under study was the strategic and operational responses and the factors that influenced responses. In looking at the strategic responses the researcher sought to know the extent to which the organizations were adapting their product range
offering, the service delivery technology and channels, human resources and sources of funds to regulation.

In evaluating operational responses, the study looked at the level of adaptation the MFIs had made to the branch operations, customer service, management information systems, organizational structure, staffing levels, financial management and reporting, policy and procedures document, and risk management.

In looking at the factors that influence response, the study looked at the size of the organization, leadership orientation, vision and mission of MFIs, need for capital, legal and regulatory requirements, responses of other MFIs, organizational culture, cost of transforming, human resource requirements, and orientation of the owners.
CHAPTER FOUR
DATA ANALYSIS AND FINDINGS

4.1. Introduction

This chapter presents the data that was gathered on responses of micro finance institutions to regulation through Microfinance Act 2006. The research was conducted among the Chief Executive Officers of various microfinance institutions that are members of the Association of the Micro Finance Institutions (AMFI membership) in Kenya. From the 45 micro finance institutions, 39 of them were served with a questionnaire; however, only 22 questionnaires were returned duly filled-in by the respondents. This makes a response rate of 56.4% which is within Mugenda and Mugenda’s (2003) prescribed significant response rate for statistical analysis which they established at a minimal value of 50%.

Data was analyzed using descriptive statistics such as frequencies (absolute and relative) on single response questions; and on multiple response questions, the study used Likert scale in collecting and analyzing data where a scale of 5 points were used in computing the means and standard deviations. The independent variable was measured using the nominal measurements. This involved looking at the presence or absence of intention to regulate for each organization. The dependent variables were measured using selected descriptive statistics.

The study looked at the extent to which the organizations were adapting their products and markets to meet the regulatory requirements as well as position themselves
competitively in the financial sector. The organization is viewed as capable of making adaptations to regulation and other environmental constraints through modification of its products, markets, and technologies. The strategies adapted would be penetration and product development.

4.2. Profiles of Respondent Organizations

The Chief Executive Officers were asked to indicate their organizations profile based on the Name of the organization, the year it was established, the legal form, number of employees, number of customers and the ownership.

4.2.1. Years in operation

There is a relationship between the organizational responses with the age of the firm. To establish the age of the organization the respondents were asked to indicate the year of establishment. These results are shown in Table 4.1.

<table>
<thead>
<tr>
<th>Year of Establishment</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 1900</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>1990-2000</td>
<td>9</td>
<td>39</td>
</tr>
<tr>
<td>2000-2010</td>
<td>12</td>
<td>56</td>
</tr>
<tr>
<td>Total</td>
<td>22</td>
<td>100</td>
</tr>
</tbody>
</table>

The study found that 56% of the MFIs were established between 2000 and 2010, 39% were established between 1990 and 2000 while 5% were established before 1990. The
results suggest that the MFIs have gained experience and understanding of the operating environment and are therefore in a position to interpret and respond to the changes in their environment. The results also suggest that there has been more than a 100% increase in the number of new entrants into the microfinance market in the last decade leading to an increase in competition and rivalry in the sector. This suggests that the microfinance industry is a growing market with high future potential, and might attract new firms in spite of present regulatory uncertainty.

4.2.2. Organizations’ legal Form

The legal form of MFIs determines the way they are likely to respond. The study sought to identify the legal form of the respondents’ organization. They were required to indicate this from Non Governmental Organizations, Banks, Companies limited by shares or guarantee, Building Society and SACCOs list. The findings are presented by Table 4.2 below.

Table 4.2: Legal form

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>CO(Ltd by share/guarantee</td>
<td>14</td>
<td>65</td>
</tr>
<tr>
<td>NGOs</td>
<td>8</td>
<td>35</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>22</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

From the findings the majority (65%) of the MFIs surveyed were companies limited by either shares or guarantees, while 35% were Non Governmental Organizations.
This was a significant departure from the MFI literature that shows that a significant number of MFIs in developing countries operate either as nongovernmental organizations (NGOs) or as projects run by NGOs (Lauer, 2008).

4.2.3. Organizational Size

The organizational size as measured by the number of employees and the number of customers is a firm specific variable, and will be directly related to the nature and timing of MFI response to regulation. The study further sought to determine the number of employees and the number of customers the respondents had in their respective organizations. These results are shown in Tables 4.3 and 4.4 respectively.

Table 4.3: Number of employees

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-50 employees</td>
<td>14</td>
<td>63.7</td>
</tr>
<tr>
<td>51-100 employees</td>
<td>6</td>
<td>27.2</td>
</tr>
<tr>
<td>101-150 employees</td>
<td>2</td>
<td>9.1</td>
</tr>
<tr>
<td>Total</td>
<td>22</td>
<td>100</td>
</tr>
</tbody>
</table>

The majority of the MFIs, 63.7% had between 1 and 50 employees, 27.2% of the surveyed companies had between 51 and 100 employees while only 9.1% of the companies had 101 to 150 employees.

Table 4.4: Number of active clients

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1&lt;30,000</td>
<td>54.5</td>
</tr>
<tr>
<td>30,001-60,000</td>
<td>27.3</td>
</tr>
<tr>
<td>&gt;120,000</td>
<td>18.2</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>
The findings as represented indicate that majority of the MFIs surveyed had less than 30,000 active clients. In 6 out of the 22 companies, this number was between 30,001 and 60,000 while in 4 companies this number was more than 120,000.

The findings suggest that majority of the MFIs are fairly small in size and may find it challenging to comply with the regulations.

4.2.4. Ownership

The ownership of the MFI is critical in determining the orientation of the MFI towards regulation. MFIs that have owners with a commercial orientation are more likely to respond to regulation than those whose ownership has a social orientation. The study found that in terms of ownership, 4.5% of the organisations were owned by individuals, 9.1% were group owned, 27.3% were owned by nongovernmental organizations and 59.1% were owned by limited Liability companies. These results are shown in Table 4.5.

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>1</td>
<td>4.5</td>
</tr>
<tr>
<td>Group</td>
<td>2</td>
<td>9.1</td>
</tr>
<tr>
<td>Nongovernmental organization</td>
<td>6</td>
<td>27.3</td>
</tr>
<tr>
<td>Limited Liability Companies</td>
<td>13</td>
<td>59.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>22</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
4.3. Organizational Responses to Regulation through Microfinance Act 2006

4.3.1. Awareness of the Microfinance Act 2006

This area of the study sought to determine the response of MFIs to Microfinance Act 2006. All the respondents from the various MFIs admitted to have read the Microfinance Act 2006. The suggests that the Chief Executive Officers of MFIs are aware of the environmental changes taking place in the industry in regard to regulations and they understand the new requirements. This is important because strategies are influenced by two perceptions: first the perception of environmental uncertainty, and second, the perception of the need for change in strategic properties of the organizations. The perceptions are driven by the managers.

4.3.2. Response to Regulation

The decision by MFIs to be regulated or not is critical in determining how they position themselves in the changing environment. The respondents were required to indicate the presence or absence of their intention to seek regulation. The study found that 86.4% of the respondents were planning to respond to regulations by seeking to be regulated while 13.6% would not seek to be regulated. These results are shown in Table 4.6.

Table 4.6: How MFIs plan to respond to regulation

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Will seek to be regulated</td>
<td>19</td>
<td>86.4</td>
</tr>
<tr>
<td>Will not seek to be regulated</td>
<td>3</td>
<td>13.6</td>
</tr>
<tr>
<td>Total</td>
<td>22</td>
<td>100.0</td>
</tr>
</tbody>
</table>
This confirms that the Chief Executive Officers are adapting their organizations to the changes in the environment. This strategic choice is critical because it aims at seeking a new strategic fit with their environmental conditions in order to maintain or improve competitive positioning. 13.6% who would not seek to be regulated are maintaining their form.

4.4. Strategic Responses

The theory of organizational response postulated that organizations initially will make changes in their own internal structure, managerial strategies, and mix of products and services in order to adapt to regulation. Continued environmental pressure will lead eventually to the formation of various types of inter organizational arrangements.

4.4.1. Product range offering

Product range offering is one of the possible strategic decisions a firm faced with changed environment is expected to make in a bid match its strategies and capabilities to the new environmental conditions and to attain a strategic fit. The study sought to identify the extent to which the MFIs were adapting their product range offering to meet the requirements of Microfinance Act 2006 and remain competitive. The respondents were required to indicate by ticking where the allocated key designed in a Likert scale was as follows: 1 no change, 2 to a very small extent, 3 some extent, 4 to a large extent and 5 to a very large extent. The findings are as indicated by table 4.7 below.
Table 4.7: Product range offering

<table>
<thead>
<tr>
<th>Product</th>
<th>No change</th>
<th>Small extent</th>
<th>Some extent</th>
<th>Large extent</th>
<th>Very large extent</th>
<th>Mean</th>
<th>STDEVV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduced technology based</td>
<td>6</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>2.76</td>
<td>1.50</td>
</tr>
<tr>
<td>products e.g M-pesa</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Introduced new loan products</td>
<td>4</td>
<td>3</td>
<td>6</td>
<td>4</td>
<td>5</td>
<td>3.24</td>
<td>1.33</td>
</tr>
<tr>
<td>Introduced saving product</td>
<td>14</td>
<td>0</td>
<td>0</td>
<td>4</td>
<td>4</td>
<td>2.24</td>
<td>1.72</td>
</tr>
<tr>
<td>Introduced insurance product</td>
<td>9</td>
<td>3</td>
<td>1</td>
<td>3</td>
<td>6</td>
<td>2.74</td>
<td>1.68</td>
</tr>
<tr>
<td>Introduced custodial services</td>
<td>13</td>
<td>1</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>1.91</td>
<td>1.24</td>
</tr>
<tr>
<td>Introduced banking agency</td>
<td>14</td>
<td>2</td>
<td>5</td>
<td>1</td>
<td>2</td>
<td>1.62</td>
<td>0.99</td>
</tr>
<tr>
<td>services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Branded our products</td>
<td>6</td>
<td>1</td>
<td>1</td>
<td>11</td>
<td>3</td>
<td>3.15</td>
<td>1.46</td>
</tr>
</tbody>
</table>

From the table, branding of products had a mean score of 3.15 and a standard deviation of 1.46. Introducing new loan products had a mean score of 3.24 and a standard deviation of 1.33. Introducing new technology based products such as M-pesa had a mean score of 2.76. Introduction of insurance product, and saving products had mean scores of 2.74 and 2.24 respectively. Lower mean scores of 1.91, and 1.62 were recorded for the introduction custodial services and banking agency services respectively.

The results concur with the strategy literature that suggest that organizations will develop strategic and marketing capabilities through new products, product differentiation, and changes in the portfolio mix as part of the adaptation strategies. Most MFIs adapted their
products to the new changed environment by introducing new loan products, branding their products in an effort to differentiate them, and introducing technology based products such as M-pesa.

4.4.2. Delivery channels and methodologies

Delivery channels and methodologies are key strategic decisions that top management must make in face of a changing environment. Technological capability is built through how innovative high quality, state-of-the art products and services that customers receive are built or delivered. There is a relationship between the delivery channels and methodologies used by MFIs and their competitive positioning.

The study sought to identify the extent to which the various MFIs have adapted to their delivery channels and methodologies to suit to the new environment created by microfinance regulation through the Microfinance Act 2006. The respondents were also required to tick in a Likert scale itemized factors 1-5, where 1 represented no adaptations, 2 very small adaptations, 3 some adaptations, 4 major adaptations, and 5 very major adaptations. The findings are as indicated by table 4.8 below.
## Table 4.8: Delivery channels and methodologies

<table>
<thead>
<tr>
<th>Delivery channels</th>
<th>No adaptation</th>
<th>Very small adaptations</th>
<th>Some adaptations</th>
<th>Major adaptations</th>
<th>Very major adaptations</th>
<th>Mean</th>
<th>STDEV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduced individual lending with collateral</td>
<td>6</td>
<td>1</td>
<td>6</td>
<td>1</td>
<td>8</td>
<td>3.1176</td>
<td>1.59076</td>
</tr>
<tr>
<td>Opened new outlets</td>
<td>8</td>
<td>0</td>
<td>5</td>
<td>7</td>
<td>2</td>
<td>2.7059</td>
<td>1.46741</td>
</tr>
<tr>
<td>Partnered with a strategic partner to increase delivery channels</td>
<td>9</td>
<td>1</td>
<td>6</td>
<td>1</td>
<td>5</td>
<td>2.4706</td>
<td>1.54204</td>
</tr>
<tr>
<td>Closed some outlets that are not viable</td>
<td>16</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td>0</td>
<td>1.7059</td>
<td>1.19416</td>
</tr>
<tr>
<td>Using branches outlets that are technology based</td>
<td>10</td>
<td>2</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>2.4412</td>
<td>1.50134</td>
</tr>
<tr>
<td>acquired new business channel from competition</td>
<td>16</td>
<td>0</td>
<td>3</td>
<td>0</td>
<td>3</td>
<td>1.7059</td>
<td>1.38234</td>
</tr>
</tbody>
</table>

From the table 4.8 above, Introduced individual lending with collateral had a mean of 3.11176 and a standard deviation of 1.590; Opened new outlets had a mean score of 2.705 and a standard deviation of 1.4674; Partnered with a strategic partner to increase delivery channels and using branches outlets that are technology based are other delivery channels with mean scores of 2.4706 and 2.441 respectively. Lower mean scores of 1.7059 were indicated for both closed some outlets that are not viable and acquired new business channel from competition delivery channels.
These findings indicate that MFIs in Kenya have began adapting their delivery channels and methodologies to the new environment by introducing individual lending with collateral, opening new outlets, partnering with a strategic partner to increase delivery channels and using branches outlets that are technology based.

The findings are consistent with existing strategy and microfinance literature that postulates that use of technology is a powerful strategy of extending the distribution of financial services to low income households as it lowers the cost of delivery, including costs to MFIs to build and maintain delivery channels and to customers of accessing the services (Ivatury and Mas, 2008).

4.4.3. Human resource strategies

Human resource is one of the key areas of creating competitive advantage as it cannot be easily duplicated. Organizational capabilities are built through ensuring that human resource skills and efforts are directed towards achieving organizational goals and strategies. The study sought to establish the extent to which the surveyed organizations used human resources strategies to adapt to new environment created by Microfinance regulation through Microfinance Act 2006. The findings are as indicated by table 4.9 below.
### Table 4.9: Human Resource Strategies

<table>
<thead>
<tr>
<th>Strategies</th>
<th>No changes</th>
<th>To a very small extent</th>
<th>Some extent</th>
<th>To a large extent</th>
<th>To a very large extent</th>
<th>Mean</th>
<th>STDEV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hired new top manager with experience</td>
<td>10</td>
<td>1</td>
<td>0</td>
<td>6</td>
<td>5</td>
<td>2.7647</td>
<td>1.72431</td>
</tr>
<tr>
<td>Trained experienced top level managers on regulatory requirements and change management</td>
<td>7</td>
<td>2</td>
<td>2</td>
<td>6</td>
<td>5</td>
<td>2.9706</td>
<td>1.56641</td>
</tr>
<tr>
<td>Incorporated new board members with experience in regulation and change management</td>
<td>11</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>9</td>
<td>2.8235</td>
<td>1.91439</td>
</tr>
<tr>
<td>Trained operational staff on change management</td>
<td>8</td>
<td>1</td>
<td>2</td>
<td>4</td>
<td>7</td>
<td>3.0588</td>
<td>1.65037</td>
</tr>
<tr>
<td>Retrenched some staff</td>
<td>20</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1.1765</td>
<td>0.52052</td>
</tr>
<tr>
<td>Review staffing qualification and skills requirements to match regulatory requirements</td>
<td>6</td>
<td>1</td>
<td>2</td>
<td>6</td>
<td>7</td>
<td>3.5</td>
<td>1.48222</td>
</tr>
</tbody>
</table>

According to the findings, review staffing qualification and skills requirements to match regulatory requirements was the most extensively applied human resource strategy as shown by a mean of 3.5. Trained operational staff on change management, trained experienced top level managers on regulatory requirements and change management, incorporated new board members with experience in regulation and change management, hired new top manager with experience and retrenched some staff with mean score of
3.06, 2.97, 2.82, 2.76, 1.176 respectively were the other human resource strategies employed by organizations to adapt to new environment created by Microfinance regulation. The findings suggest that MFIs prefer to build their human resources capacity through training as opposed to hiring new staff.

4.4.4. Sources of funds

One of the primary objectives of MFIs seeking regulation is to increase access to capital, whether through commercial borrowing, which remains inaccessible for many NGO MFIs today, deposits, raising equity or all the three options (Lauer 2008). The respondents were required to state the extent to which their organizations had adapted its source of funds to suit to the new environment created by Microfinance regulation through the microfinance Act 2006. The findings were presented in the table 4.10 below.

Table 4.10: Sources of Funds

<table>
<thead>
<tr>
<th>Sources of funds</th>
<th>No changes</th>
<th>To a very small extent</th>
<th>To a large extent</th>
<th>To a very large extent</th>
<th>Mean</th>
<th>STDEV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partnered with strategic equity investors</td>
<td>11</td>
<td>2</td>
<td>3</td>
<td>6</td>
<td>0</td>
<td>2.1111</td>
</tr>
<tr>
<td>Equity from new shareholders</td>
<td>12</td>
<td>1</td>
<td>1</td>
<td>6</td>
<td>2</td>
<td>2.2778</td>
</tr>
<tr>
<td>Rights issue to existing shareholders</td>
<td>17</td>
<td>0</td>
<td>5</td>
<td>0</td>
<td>0</td>
<td>1.3333</td>
</tr>
<tr>
<td>long term debt</td>
<td>7</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>8</td>
<td>2.9444</td>
</tr>
<tr>
<td>Issued bonds</td>
<td>21</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1.1111</td>
</tr>
</tbody>
</table>

44
The findings indicated that long term debt was the most used source of fund for majority of the respondents shown by a mean score of 2.94. Other sources of funds applied in order for the organizations to adapt to the new environment created by Microfinance regulation through the microfinance Act 2006 included equity from new shareholders, partnership with strategic equity investors, rights issue to existing shareholders and issue of bonds with mean scores of 2.27, 2.11, 1.13 and 1.11 respectively.

The finding indicate that majority of the MFI had significantly shifted their sources of funding from donations and were assessing funds commercially. These findings are in agreement with the funding strategies employed by MFIs that seek to be regulated and they are already positioning themselves to receive commercial funds.

4.5. Operational Responses

Operational responses affect the efficiency of the MFIs. These responses focus on the internal processes and systems for meeting customer needs. In evaluating operational responses, the study looked at the level of adaptation the MFIs had made to the branch operations, customer service, management information systems, organizational structure, staffing levels, financial management ad reporting, policy and procedures document, and risk management. Table 4.11 below gives a summary of the findings.
Table 4.11: Operational responses

<table>
<thead>
<tr>
<th>Responses</th>
<th>No changes</th>
<th>To a very small changes</th>
<th>Some changes</th>
<th>Major changes</th>
<th>Very major changes</th>
<th>Mean</th>
<th>STDEV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch operations</td>
<td>7</td>
<td>3</td>
<td>2</td>
<td>6</td>
<td>4</td>
<td>2.889</td>
<td>1.64098</td>
</tr>
<tr>
<td>Customer service</td>
<td>4</td>
<td>2</td>
<td>3</td>
<td>5</td>
<td>8</td>
<td>3.278</td>
<td>1.56452</td>
</tr>
<tr>
<td>Management information systems</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>5</td>
<td>12</td>
<td>3.889</td>
<td>1.36722</td>
</tr>
<tr>
<td>Staffing levels</td>
<td>2</td>
<td>2</td>
<td>8</td>
<td>4</td>
<td>6</td>
<td>3.444</td>
<td>1.33823</td>
</tr>
<tr>
<td>Financial management and reporting</td>
<td>0</td>
<td>0</td>
<td>6</td>
<td>6</td>
<td>10</td>
<td>4.222</td>
<td>0.80845</td>
</tr>
<tr>
<td>Policy and procedures documents</td>
<td>1</td>
<td>0</td>
<td>7</td>
<td>5</td>
<td>9</td>
<td>3.889</td>
<td>1.13183</td>
</tr>
<tr>
<td>Risk management</td>
<td>2</td>
<td>0</td>
<td>3</td>
<td>6</td>
<td>11</td>
<td>3.944</td>
<td>1.30484</td>
</tr>
<tr>
<td>Lending policy and procedure</td>
<td>2</td>
<td>1</td>
<td>7</td>
<td>3</td>
<td>9</td>
<td>3.667</td>
<td>1.37199</td>
</tr>
</tbody>
</table>

On the extent to which the organizations are making changes in different operational areas to adapt to the requirements of Microfinance Act 2006, financial management and reporting was the operational response being adapted in majority of the organizations as shown by a mean score of 4.22 in above table 4.11. Risk management, policy and procedures documents, management information system, lending policy and procedure, customer service and branch operations were the other operational responses applied by organizations with mean scores of 3.94, 3.89, 3.89, 3.67, 3.28 and 2.88 respectively.
Table 4.11: Operational responses

<table>
<thead>
<tr>
<th>Responses</th>
<th>No changes</th>
<th>To a very small changes</th>
<th>Some changes</th>
<th>Major changes</th>
<th>Very major changes</th>
<th>Mean</th>
<th>STDEVB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch operations</td>
<td>7</td>
<td>3</td>
<td>2</td>
<td>6</td>
<td>4</td>
<td>2.8889</td>
<td>1.64098</td>
</tr>
<tr>
<td>Customer service</td>
<td>4</td>
<td>2</td>
<td>3</td>
<td>5</td>
<td>8</td>
<td>3.2778</td>
<td>1.56452</td>
</tr>
<tr>
<td>Management information systems</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>5</td>
<td>12</td>
<td>3.8889</td>
<td>1.36722</td>
</tr>
<tr>
<td>Staffing levels</td>
<td>2</td>
<td>2</td>
<td>8</td>
<td>4</td>
<td>6</td>
<td>3.4444</td>
<td>1.33823</td>
</tr>
<tr>
<td>Financial management and reporting</td>
<td>0</td>
<td>0</td>
<td>6</td>
<td>6</td>
<td>10</td>
<td>4.2222</td>
<td>0.80845</td>
</tr>
<tr>
<td>Policy and procedures documents</td>
<td>1</td>
<td>0</td>
<td>7</td>
<td>5</td>
<td>9</td>
<td>3.8889</td>
<td>1.13183</td>
</tr>
<tr>
<td>Risk management</td>
<td>2</td>
<td>0</td>
<td>3</td>
<td>6</td>
<td>11</td>
<td>3.9444</td>
<td>1.30484</td>
</tr>
<tr>
<td>Lending policy and procedure</td>
<td>2</td>
<td>1</td>
<td>7</td>
<td>3</td>
<td>9</td>
<td>3.6667</td>
<td>1.37199</td>
</tr>
</tbody>
</table>

On the extent to which the organizations are making changes in different operational areas to adapt to the requirements of Microfinance Act 2006, financial management and reporting was the operational response being adapted in majority of the organizations as shown by a mean score of 4.22 in above table 4.11. Risk management, policy and procedures documents, management information system, lending policy and procedure, customer service and branch operations were the other operational responses applied by organizations with mean scores of 3.94, 3.89, 3.89, 3.67, 3.28 and 2.88 respectively.
The changes are consistent with the requirements of the Microfinance Act 2006.

4.6. Factors Influencing Responses

The respondents were also required to state their opinion on the extent to which different factors influenced the way their organizations responded to Microfinance regulation. The study used Likert scale in collecting and analysing the data on a scale of 1 to 5 with 1 point being assigned to no extent and 5 points to a very great extent. The results were then presented in table 4.12 below.

Table 4.12: Factors influencing response

<table>
<thead>
<tr>
<th>Factors</th>
<th>No extent</th>
<th>Small extent</th>
<th>Some extent</th>
<th>A large extent</th>
<th>A very large extent</th>
<th>Mean</th>
<th>STDEV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size of the organization</td>
<td>8</td>
<td>1</td>
<td>8</td>
<td>3</td>
<td>2</td>
<td>2.6667</td>
<td>1.41421</td>
</tr>
<tr>
<td>Leadership orientation</td>
<td>3</td>
<td>2</td>
<td>7</td>
<td>6</td>
<td>4</td>
<td>3.1111</td>
<td>1.32349</td>
</tr>
<tr>
<td>Our vision and mission</td>
<td>2</td>
<td>2</td>
<td>8</td>
<td>7</td>
<td>3</td>
<td>3.3333</td>
<td>1.23669</td>
</tr>
<tr>
<td>Legal and regulatory</td>
<td>2</td>
<td>0</td>
<td>6</td>
<td>4</td>
<td>10</td>
<td>4.0556</td>
<td>1.25895</td>
</tr>
<tr>
<td>requirements</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Responses of other MFIs</td>
<td>7</td>
<td>3</td>
<td>8</td>
<td>3</td>
<td>1</td>
<td>3.7778</td>
<td>1.30859</td>
</tr>
<tr>
<td>Organizational structure</td>
<td>3</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>1</td>
<td>2.9444</td>
<td>1.10997</td>
</tr>
<tr>
<td>Cost of transforming</td>
<td>6</td>
<td>0</td>
<td>1</td>
<td>9</td>
<td>6</td>
<td>3.4444</td>
<td>1.65288</td>
</tr>
<tr>
<td>Human resource requirements</td>
<td>5</td>
<td>0</td>
<td>8</td>
<td>4</td>
<td>5</td>
<td>3.2222</td>
<td>1.43714</td>
</tr>
<tr>
<td>Orientation of the owners</td>
<td>6</td>
<td>0</td>
<td>3</td>
<td>9</td>
<td>4</td>
<td>3.1667</td>
<td>1.50489</td>
</tr>
</tbody>
</table>
4.6.1. Legal and regulatory requirements

Legal and regulatory requirements as relates to governance include the minimum capital requirements, minimum liquid assets, prohibited declaration of dividends, limit of shares, insider lending, limits of loan and credit facilities, limit of shares, management of institutions disqualification of directors and officers submission of accounts, disclosures in financial statements, appointment of internal and external auditors, exhibition and publication of audited accounts rectification of audited accounts, and publication of information.

From the finding, legal and regulatory requirements with a mean of 4.06, was cited the most important factor that influenced the way their organizations responded to Microfinance regulation. This could be explained by the fact that transformations, especially those involving the introduction of new owners and/or the establishment of a regulated financial institution have often required more time and have been more costly and disruptive than planned. According to Lauer (2008), almost without exception, participants in past MFI transformations have encountered unexpected restrictions and problems, often with serious negative consequences. The Microfinance Act requires regulatory approval of any acquisition that would result in an individual or legal entity owning a "significant interest".

4.6.2. Responses of other MFIs

Responses of other MFIs to regulation were cited as the second most important factor influencing the MFI response with a mean of 3.78. This finding indicates that majority of MFIs would pursue a compromise strategy. Compromise represents a situation whereby
the MFI views the environmental change (regulation) as favourable but it lacks the capacity to be regulated. Organizations that compromise agree partially to the new environmental demands and response is characterized by adaptations or imitative behaviour. MFIs that adopt this type of response will most likely identify other MFIs have successfully transformed and copy the transformation process (Koch and Lindenthal, 2002).

4.6.3. Costs of transforming

Cost of transforming ranked as the third most important factor influencing MFIs response to regulation with a mean of 3.44. This could be attributed to the fact that prudential regulation and supervision of MFIs is not only intrusive, but has cost implications, not only to the regulator, but also for the regulated institutions.

4.6.4. Leadership orientation

From the findings, leadership orientation was ranked forth with a mean of 3.11. The role of top management team in influencing the strategic direction of the MFI cannot be overemphasized. Since top management make executive decisions consistent with their cognition, which is in part a function of the values and experiences they commonly share, their experiences and values may be associated with organizational outcomes and their firm's performance (Pegels et al 2000). The decision by MFIs to be regulated or not will depend in part on the strategic orientation of top management (Wiersema and Bantel, 1992), risk taking propensity (Bantel and Jackson, 1989), consensus building (Knight et al 1999), and industry experiences (Pesels et al, 2000).
4.6.5. Vision and mission

The vision and mission of the MFI was named as an important factor that influenced the responses of the MFI to regulation with a mean of 3.33. This finding could be attributed to the fact that some MFIs have social missions to help the poor while others have commercial missions to make profit for their shareholders. Regulation leads to a drift in the original vision and mission as it gains a commercial orientation and aims to maximize shareholder value. MFIs that are transforming into profit making institutions have generally been accused of neglecting their social mission of providing credit to below average income earners (Wainaina, 2002).

4.6.6. Human resource requirements

The findings indicated that human resource requirements, with a mean of 3.22, were an important contributing factor in the way the MFI responded to regulation. This finding is consistent with the transformation and strategic management literature that postulates that a changed environmental condition requires new internal capabilities and strategies to match the new environment. Regulation leads to significant changes in human resource requirements. The organizational chart changes significantly as new positions are created as old ones are scrapped. The MFI will need to closely evaluate the senior management staff capacity and skills.

4.6.7. Orientation of the owners

Orientation of the owners scored a mean of 3.16. This factor is important to MFIs because in most MFIs, the Chief Executive Officer and the Chair of the Board was one
and the same person. Most NGOs in developing countries suffer from lack of separation of ownership and control and extent of dispersion.

This finding is consistent with the existing literature that indicates that regulation implies ceding control to a broader group of stakeholders. With transformation of MFIs the ownership structure changes from NGO or a project capitalized by donors and governed by socially minded founders to a shareholding structure with investors who demand financial returns (Ledgerwood and White, 2006).

4.6.8. Organizational structure

The respondents ranked organizational structure among the least factors with a mean 2.94. This finding could be explained by the fact that most of the MFIs are fairly small with employees of between one to fifty. This implies that their organizational structure are flexible and can easily be flexed to accommodate changes arising from the changed environment.

4.6.9. Size of the organization

Size of the organization was ranked the least factor influencing response of MFIs with a mean of 2.67. This could be attributed to the fact that most MFI are small as measured in terms of number of employees and the number of active customers.
4.7 Discussion of findings

4.7.1. Organizational Response to Regulation through Microfinance Act 2006

From the findings, it is evident that Chief Executive Officers of MFIs scan their environments and they are aware of the environmental changes taking place in the microfinance industry in regard to regulations through the Microfinance Act 2006, and they understand the new requirements. The MFIs are adapting their products and delivery technologies to build their internal capacity to respond to changes in the environment. This is consistent with the strategy literature that stipulates that organizations are entities that exist in that they can establish relationships with their environments (Gomes and Gomes, 2007); and different environmental profiles will require different strategies (Zajac, Kraatz, & Bresser, 2000; Reger, Duaim & Stimpert 1992) and different internal capabilities (Teece, Pisano & Shuen 1997; Chorn 1991) if the organization has to be successful.

The responses are incremental and though the awareness in environmental changes is very high, the actual response to be deposit-taking remains quite low. (Maru (2004) observed that MFIs are more comfortable choosing or adapting those strategies that build on institutional memory rather than those that would require investment in innovative procedures. Four years since the introduction of microfinance regulation, only two institutions have transformed themselves into deposit-taking.

4.7.2. Strategic Responses

The findings indicate that MFIs in Kenya have begun adapting their delivery channels and methodologies to the new environment by introducing individual lending with
collateral, opening new outlets, partnering with a strategic partner to increase delivery channels and using branches outlets that are technology based. The findings are consistent with existing microfinance transformation literature that postulates that use of technology is a powerful strategy of extending the distribution of financial services to low income households as it lowers the cost of delivery, including costs to MFIs to build and maintain delivery channels and to customers of accessing the services (Ivatury and Mas, 2008); and strategy literature that organizations are viewed as capable of making adaptations to regulation and other environmental constraints through modifications in internal structural arrangements as well as establishment of various types of interorganizational arrangements (Cook et al 1983).

I regard to human resources development strategy, the findings suggest MFIs prefer to build the organizational capacity of their staff through training of senior management and operational staff as opposed to hiring new staff. They have also reviewed their staffing qualification and skills requirements to match regulatory requirements. Changes in board of directors’ composition such as including new directors with competences in regulatory requirements is also a strategy pursued by majority of MFIs; and review staffing qualification and skills requirements to match regulatory requirements. These strategies are consistent with the findings in other studies (Ledgerwood and White, 2006) that indicate that transformation leads to significant changes in human resource requirements. The organizational chart changes significantly as new positions are created as old ones are scrapped.

Most MFIs adapted their product range offerings to the changed environment by introducing new loan products, differentiating their products through branding, and
introducing technology based products such as mobile money transfer services like Mpesa.

One of the primary objective of MFI seeking regulation is to increase access to capital, whether through commercial borrowing, deposits, or raising equity (Lauer, 2008). The finding indicate that majority of the MFI had significantly shifted their sources of funding from donations and were assessing funds commercially through long term debt.

4.7.3. Operational Responses

Financial management and reporting, risk management, management information systems emerged as the most frequent operational responses adopted by MFI. This finding concurs with Oraro (2000) and (Ledgerwood and White, 2006) that regulation of the microfinance industry leads to a shift in the operating environments of MFIs over the coming years.

From the findings, legal and regulatory requirements with a mean of 4.06, was cited the most important factor that influenced the way their organizations responded to Microfinance regulation. This could be explained by the fact that transformations, especially those involving the introduction of new owners and/or the establishment of a regulated financial institution have often required more time and have been more costly and disruptive than planned. According to Lauer (2008), almost without exception, participants in past MFI transformations have encountered unexpected restrictions and problems, often with serious negative consequences.
CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
The following summary of findings, conclusions and recommendations were made from the data collected and analysis. The responses were based on the objectives of the study aimed at determining responses of MFIs to regulation through Microfinance Act 2006, and the factors influencing the responses.

5.2 Summary of Findings
In regard to the profiles of respondent organizations, the study established that majority of the MFIs surveyed were companies limited by either shares or guarantees while the rest were NGOs. The majority of the organizations had between 1 and 50 employees, while only a small proportion of the companies had 101 to 150 employees. On the number of active clients served by the organization, majority of the MFIs surveyed had less than 30,000. Further the study on the ownership profile of the company, found that out of the 22 companies surveyed, 13 were limited liability companies, 6 were nongovernmental organization, 2 were group owned while only one was individually owned. All the respondents from the various MFIs admitted to have read the Microfinance Act 2006. The findings showed that the majority of the MFIs would seek to be regulated as a response to the Act.

Strategic responses adapted by MFIs in response to regulation were varied and consistent to the existing literature. The study revealed in regard to the products offering, MFIs had adapted their product range offering by introducing new products into their product
portfolio mix such as insurance products, savings product (for those already regulated) and technology-based products such as money transfer services through Mpesa. MFIs had attempted to differentiate their products through branding.

MFIs were using Delivery channels and methodologies strategies to position themselves in the new environment. Some of the adaptations made included introduction individual lending with collateral, which was applied to very great extent; Opened new outlets, and strategic partnership with telecommunication companies to increase penetration and lower cost through use of branchless outlets that are technology based. In a bid to consolidate their position some MFIs have closed some outlets.

Some human resources strategies used by MFIs to adapt to new environment created by Microfinance regulation included review staffing qualification and skills requirements to match regulatory requirements, which was the most extensively applied human resource strategy. Trained operational staff on change management, trained experienced top level managers on regulatory requirements and change management, incorporated new board members with experience in regulation and change management, hired new top manager with experience and retrenched some staff were the other human resource strategies employed by organizations to adapt to new environment created by Microfinance regulation. Majority of MFIs adapted training as a strategy for capacity building as opposed to hiring new staff. Changes in Board of Directors' composition such as including new directors with competences in regulatory requirements were also used.

Regarding source of funds as a strategic response, the survey established that long term debt was the most applied by majority of the MFIs. Equity from new shareholders,
partnership with strategic equity investors, and rights issue to existing shareholders and issued bonds were the other sources of funds applied in order for the organizations to meet the new regulatory requirements created by Microfinance Act 2006.

The study further established that in regard to operational response to the regulatory requirements of Microfinance Act 2006, financial management and reporting, risk management, and management of information systems respectively, were the areas that had received very major adaptations by majority of the organizations.

On the extent to which different factors influenced the way MFIs responded to Microfinance regulation, the study revealed that legal and regulatory requirements had the greatest influence following by responses of other MFIs. cost of transforming, vision and mission, human resource requirements, orientation of the owners, leadership orientation, organizational structure, size of the organization in that order.

5.3 Conclusions

Based on the findings, the study concludes that all the Chief Executive Officers of MFIs have read the Microfinance Act 2006 and that the majority of the MFIs would seek to be regulated in response to the Act.

The study also concludes MFIs acknowledge the changed environmental conditions introduced by regulation and are responding to the microfinance regulation by competitively positioning themselves through adapting strategies that include strategic alliance telecommunication companies to increase penetration and lower costs; consolidation of their operations through closure of non profitable outlets; differentiation
through branding of products, and product-portfolio mix as a diversification and risk management strategy.

The study concludes that technology is the future driver of the microfinance industry as it offers basic financial services to customers at a rate that is half the cost of branch networks. It is expected that organizations that intend to pursue a low-cost broad focus strategy cannot afford to ignore the opportunities presented by the technology.

5.4 Recommendations

Based on the findings the following recommendations were made:

There is need for the MFIs to enhance their understanding of the legal and regulatory requirement to determine the risks and constraints in specific context of each regulatory environment and avoid the pitfalls of predecessors. This could be done through engaging regulatory agencies in reviewing the regulatory requirements and constraints. This is critical because though majority expressed their intention to be regulated, they still lack capacity because four years into the regulation, only two institutions have transformed into deposit-taking microfinance.

The study recommends that in order for the MFIs to remain highly competitive, financial management and reporting, and risk management as operational responses should be emphasized by the MFIs.

The researcher also recommends that for profitability and sustainability of MFIs, the MFIs should adopt appropriate legal and regulatory requirements in order to respond effectively to the Microfinance regulation.
5.5. Areas for Further Research

The study recommends that further research on the same be done on other finance institutions in Kenya. This is because different financial institutions have unique characteristics and diverse contextual realities that might influence their responses and consequently the approach to different response strategies. This would bring out comprehensive empirical findings on the responses of financial institutions to regulation and factors that influence such responses.
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60


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“Micro banking bulletin” available online in: [http://www.mixmbb.org](http://www.mixmbb.org)


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Porter M.E. (1980), Competitive Strategy, the Free Press

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Appendices
### APPENDIX I: AMFI MEMBERS LIST

<table>
<thead>
<tr>
<th>No.</th>
<th>MEMBER NAME</th>
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<tr>
<td>1</td>
<td>K-rep Bank Ltd</td>
<td>Mr. Kimanthi Mutua</td>
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</tr>
<tr>
<td>2</td>
<td>Equity Bank</td>
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<td>P.O BOX 75104-00200 NAIROBI Tel: 27366620/17 <a href="mailto:james.mwangi@equitybank.co.ke">james.mwangi@equitybank.co.ke</a></td>
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<tr>
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<td>5</td>
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<td><strong>WHOLESALE MFIs</strong></td>
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<td>Jitegemee Trust</td>
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<td>Faulu Kenya DTM</td>
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<td>SISDO</td>
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<td>Juhudi Kilimo Co.Ltd</td>
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<td>Kenya Entrepreneur Empowerment Foundation (KEEF)</td>
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<td>Bruce House 9th Floor Standard Street P.O. Box 10144-00100 Nairobi Tel : 310726 Email : <a href="mailto:info@molyn.co.ke">info@molyn.co.ke</a></td>
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<td>Orion East Africa Ltd</td>
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<td>Francis Macharia Mwangi</td>
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<td>Greenland Fedha Ltd</td>
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<td>Youth Initiatives - Kenya (YIKE)</td>
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<td>CIC Insurance</td>
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September, 2010

Dear Respondent,

RE: COLLECTION OF SURVEY DATA

I am a postgraduate student at the University of Nairobi, at the School of Business. In order to fulfil the degree requirement, I am undertaking a management research project on “Responses of Microfinance Institutions to Regulation through the Microfinance Act 2006”.

Your Institution has been selected to form part of this study. By this letter I kindly request that you assist me to collect data by filing out the accompanying questionnaire, which I will then collect from you.

The information you provide will be used exclusively for academic purposes. My supervisor and I assure you that the information collected will be treated with strict confidence. Your name or that of your institution will at no time appear in my report. A copy of the final paper will be availed to you on request.

Your cooperation will be highly appreciated.

Thank you,

Yours faithfully,

Anne Gathuku
MBA Student, University of Nairobi.
APPENDIX III: QUESTIONNAIRE
RESPONSES OF MICRO FINANCE INSTITUTIONS TO REGULATION

ORGANIZATIONAL PROFILE

1. Name of the Organization: _____________________________________________

2. Year Established: ____________________________________________________

   Please tick the appropriate answer from the choices provided

3. Legal Form: 1. NGO [ ] , 2. Bank [ ] , 3. Co. (Ltd by Share/Guarantee) [ ],
   4. Building Society [ ], 5. SACCO [ ]

4. Number of employees: 1. 1-50 employees [ ] , 2. 51-100 [ ], 3. 101-150 [ ]
   4. 151-200 [ ], 5. Over 200 [ ].

5. Total number of active clients: 1. < 30,000 [ ], 2. 30,001 - 60,000 [ ],
   3. 60,001 - 90,000 [ ], 4. 90,001 - 120,000 [ ], 5. > 120,000 [ ]

6. Ownership: 1. Individual [ ], 2. Group [ ], 3. Non Governmental Organization [ ],
   4. Limited Liability Company [ ]

ORGANIZATIONAL RESPONSE TO MICROFINANCE ACT 2006

8. Have you read the Microfinance Act 2006? Yes [ ] , No [ ]

9. How is your organization planning to respond to Microfinance regulation through the
   Microfinance Act 2006? Please tick as appropriate
   1. Will seek to be regulated [ ]
   2. We will not seek to be regulated [ ]

STRATEGIC RESPONSES
10. To what extent has your organization made changes to its **product range offering** to adapt to the requirements of Microfinance Act 2006 and remain competitive? *Please tick as appropriate between a scale of 1-5, where 1 no changes, 2 to a very small extent, 3 some extent, 4 to a large extent 5. To a very large extent*

   | 1 | 2 | 3 | 4 | 5 |
---|---|---|---|---|---|
   a. Introduced Technology-based Products e.g. M-Pesa |
   b. Introduced new loan products |
   c. Introduced savings Products |
   d. Introduced Insurance products |
   e. Introduced custodial services |
   f. Introduced Banking agency services |
   g. Branded our products |

11. To what extent has your organization adapted its **delivery channels and methodologies** to suit to the new environment created by Microfinance regulation through the microfinance Act 2006? *Please tick as appropriate between a scale of 1-5, where 1 no adaptations, 2 very small adaptations, 3 some adaptations, 4 Major adaptations 5 very major adaptations*

   | 1 | 2 | 3 | 4 | 5 |
---|---|---|---|---|---|
   a. Introduced individual lending with collateral |
   b. Opened new outlets |
   c. Partnered with a strategic partner to increase delivery channels |
   d. Closed some outlets that are not viable |
   e. Using branchless outlets that are technology based |
   f. Acquired new business channels from competition |

12. To what extent has your organization used the following **human resource** strategies to adapt to the new environment created by Microfinance regulation through the microfinance Act 2006? *Please tick as appropriate between a scale of 1-5, where 1 no
changes, 2 to a very small extent, 3 some extent, 4 to a large extent 5. To a very large extent

a. Hired new top level manager with experience


b. Trained existing top level managers on regulatory requirements and change management


c. Incorporated new board members with experience in regulation and change management


d. Trained operational staff on change management


e. Retrenched some staff


f. Review staffing qualification & skills requirements to match regulatory requirements


13. To what extent has your organization adapted its Sources of funds to suit to the new environment created by Microfinance regulation through the microfinance Act 2006? Please tick as appropriate between a scale of 1-5, where 1 no changes, 2 to a very small extent, 3 some extent, 4 to a large extent 5. To a very large extent

a. Partnered with strategic Equity investors


b. Equity from new shareholders


c. Rights Issue to existing shareholders


d. Long term debt


e. Issued bonds


OPERATIONAL RESPONSES

14. To what extent has your organization made/ is making changes in the following operational areas to adapt to the requirements of Microfinance Act 2006? Please tick as appropriate between a scale of 1-5, where 1 no changes, 2 to a very small changes, 3 some changes, 4 Major changes 5 very major changes


13. To what extent has your organization adapted its Sources of funds to suit to the new environment created by Microfinance regulation through the microfinance Act 2006? Please tick as appropriate between a scale of 1-5, where 1 no changes, 2 to a very small extent, 3 some extent, 4 to a large extent 5. To a very large extent

a. Partnered with strategic Equity investors [ ] [ ] [ ] [ ] [ ] [ ]
b. Equity from new shareholders [ ] [ ] [ ] [ ] [ ] [ ]
c. Rights Issue to existing shareholders [ ] [ ] [ ] [ ] [ ] [ ]
d. Long term debt [ ] [ ] [ ] [ ] [ ] [ ]
e. Issued bonds

OPERATIONAL RESPONSES

14. To what extent has your organization made/ is making changes in the following operational areas to adapt to the requirements of Microfinance Act 2006? Please tick as appropriate between a scale of 1-5, where 1 no changes, 2 to a very small changes, 3 some changes, 4 Major changes 5 very major changes

a. Hired new top level manager with experience [ ] [ ] [ ] [ ] [ ] [ ]
b. Trained existing top level managers on regulatory requirements and change management [ ] [ ] [ ] [ ] [ ] [ ]
c. Incorporated new board members with experience in regulation and change management [ ] [ ] [ ] [ ] [ ] [ ]
d. Trained operational staff on change management [ ] [ ] [ ] [ ] [ ] [ ]
e. Retrenched some staff [ ] [ ] [ ] [ ] [ ] [ ]
f. Review staffing qualification & skills requirements to match regulatory requirements [ ] [ ] [ ] [ ] [ ] [ ]
a. Branch operations
b. Customer service
c. Management information systems
d. Organizational structure
e. Staffing levels
f. Financial management and reporting
g. Policy and procedures documents
h. Risk management
i. Lending policies and procedure

<table>
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<tr>
<th>FACTORS INFLUENCING RESPONSE</th>
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<tr>
<td>15. In your opinion, to what extent do the following factors influence the way your organization responds/ has responded to Microfinance regulation? Please tick as appropriate between a scale of 1-5, where 1 no extent, 2 small extent, 3 some extent, 4 a large extent and 5 a very large extent</td>
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<th>Factor</th>
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<td>a. Size of the organization</td>
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<td>b. Leadership orientation</td>
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<td>c. Our Vision and mission</td>
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<td>d. Need for capital</td>
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<td>e. Legal and regulatory requirements</td>
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<td>f. Responses of other MFIs</td>
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<td>g. Organizational structure</td>
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<td>h. Costs of transforming</td>
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<td>i. Human resource requirements</td>
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<td>j. Orientation of the owners</td>
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Thank you for responding to the questions.