ACCESS TO CREDIT, INDEBTEDNESS AND DEBT REFINANCING AMONGST MICROENTERPRISES IN FREETOWN, SIERRA LEONE- AN INSTITUTIONAL APPROACH

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Declaration for SOAS PhD thesis

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ABSTRACT

In Sub-Saharan Africa, expansion of access to formal credit services for microenterprise development has been promoted as a policy prescription for providing the jobs and incomes needed by the poor in this region. In Sierra Leone, historically and especially during the post-war period, there have been efforts by policy makers to improve access to finance for microenterprises in order to assist with job creation.

There have been a number of problems associated with 'this cause' amongst which is over-indebtedness amongst microloan clients.

In Sierra Leone, one of the major contributing factors to over-indebtedness amongst micro loan clients are consequential debt management practices such as cross borrowing, multiple borrowing and debt-refinancing. This thesis makes the claim that institutional factors contribute to the widespread occurrence of these debt management practices which consequently plunges microenterprises into further over-indebtedness.

This thesis hypothesises that increased access to credit is an institutional change that has implications for debt management and over-indebtedness amongst microenterprises. It fills a gap by using an institutional approach to analyse debt problems amongst microenterprises in Freetown, Sierra Leone. By utilising this approach, the thesis shows that microenterprises do not operate in isolation; they operate within institutional framework which impacts on their debt outcomes. Therefore, over-indebtedness that is experienced by clients stems from the operations of key institutions within the microfinance sector i.e. the regulatory body (and environment) and the microfinance institutions that provide credit to microenterprises.

Qualitative research conducted in Freetown, Sierra Leone, finds that the institutional change that has emerged failed to produce the right incentives or provide the environment which allows for microenterprises to access credit without facing the challenge of over-indebtedness. The microfinance sector that currently exists has not resulted in a full transformation in the institutional forms of providing finance to microenterprises, nor the emergence of effective regulatory institutions and microfinance institutions, all of which has debt implications.

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ABCs	Agricultural Business Centres
AfDB	African Development Bank
AFFORD-SL	The African Foundation for Development in Sierra Leone
AFI	Alliance for Financial Inclusion
APC	All Peoples Congress Party
ARC	American Refugee Committee
ARD	Association for Rural Development
BAN	Budget Advocacy Network
BCCI	Bank of Credit and Commerce International
BIP	Bank of Innovation and Partnership
BSDS	Basic Services Delivery Survey
BSL	Bank of Sierra Leone
BSL Act	Bank of Sierra Leone Act
CBBs	Commercial Bank Branches
CBOs	Community Based Organisations
CBs	Community Banks
CEDA	Community Empowerment and Development Agency
CEOs	Chief Executive Officers
CGAP	Consultative Group to Assist the Poor
CMCs	Chiefdom Microcredit Committees
COIs	Credit Only Institutions
CORDAID	Catholic Organisation for Relief and Development Aid
CRB	Credit Reference Bureau
CRB Act	Credit Reference Bureau Act
CRS	Catholic Relief Services
CSOs	Civil Society Organisations
DDMPs	Detrimental Debt Management Practices
DFID, UK	Departmant for International Development, United Kingdom
DSPFSP	Development of Sustainable, Pro-poor Financial Sector programme
EITI	Extractive Industries Transparency Initiative
EPRU	Economic, Policy and Research Unit
EVD	Ebola Virus Disease
FBN	First Bank of Nigeria Limited
FIB	First International Bank
FSAP	Financial Sector Assessment Plan
FSAs	Financial Services Associations
FSDP	Financial Sector Development Plan
GDP	Gross Domestic Product
GGEM	Grassroots Gender Empowerment Movement
GNP	Gross National Product
GoSL	Government of Sierra Leone
HDI	Human Development Index

HELP, SL	Hands Empowering the Less Privileged, Sierra Leone
IADB	Inter-American Development Bank
IBRD	The International Bank for Reconstruction and Development
IE	Institutional Economics
IFAD	International Fund for Agricultural Development
IFC	International Financial Corporation
IFIs	International Financial Institutions
IMF	International Monetary Fund
IRC	International Rescue Committee
KfW	Kreditanstalt für Wiederaufbau
LAPO, SL	Lift Above Poverty Organization, Sierra Leone
LMT	Luma Microfinance Trust
MAFFS	Ministry of Agriculture, Forestry and Food Security
MCC	Millennium Challenge Corporation
MD	Managing Director
MEs	Microenterprises
MF Unit	Microfinance Unit
MFI	Microfinance Institution
MFW4A	Making Finance Work for Africa
MIS	Management and Information System
MITAF 1&2	Microfinance Investment and Technical Assistance Facility 1&2
MIX	Microfinance Information Exchange
MoFED	Ministry of Finance and Economic Development
MSEs	Micro and Small Enterprises
MSMEs	Micro Small Medium-sized Enterprises
MTI	Ministry of Trade and Industry
NACE	National Advocacy Coalition on Extractives
NaCSA	National Commission for Social Action
NATCO	National Confectionary Company Limited
NGO	Non-Governmental Organisation
NIE	New Institutional Economics
NMFP	National Micro Finance Policy
NMSME Strategy	National Micro Small and Medium-sized entreprises Strategy
NPRC	The National Provisional Ruling Council
ODTIs	Other Deposit-Taking Institutions
OFS Act 2001	Other Financial Services Act 2001
OIE	Old Institutional Economics
PACT	Partnership for Capacity Building in Africa
PAR	Portfolio at Risk
PFSDP	Pro-poor Financial Sector Development Project
PLIs	Partner Lending Institutions
PRGF	Poverty Reduction and Growth Facility
PRIMED	Promoting Initiatives for Micro Enterprises Development
PRSP 1 2 & 3	Poverty Reduction Strategy Paper (First, Second and Third)

PSD	Private Sector Development
PSDS	Private Sector Development Strategy
RCB	Rokel Commercial Bank
RFCIP	Rural Finance and Community Improvement Programme
RLTDC	Rokel Leaf Tobacco Development Company
ROSCAs	Rotating Savings and Credit Associations
SAPA	Social Action for Poverty Alleviation
SEND SL	Social Enterprise Development , Sierra Leone
SLAMFI	Sierra Leone Association of Microfinance Institutions
SLCB	Sierra Leone Commercial BanK
SLHIS	Sierra Leone Household Integrated Survey
SLPP	Sierra Leone's People's Party
SMEs	Small and Medium-sized Enterprises
SMT	Salone Microfinance Trust
SSA	Sub-Saharan Africa
SSL	Statistics Sierra Leone
TA	Technical Assistance
UEMOA	West African Economic Monetary Union
UK	United Kingdom
UNAMSL	United Nations Mission in Sierra Leone
UNCDF	United Nations Capital Development Fund
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organisation
US	United States
UTB	Union Trust Bank
VAT	Value Added Tax
VS&LAs	Village Savings & Loans Associations
WBN	Wealth Builders Network
WW2	World War Two

Exchange Rate

£1= Le6, 529.89 is the exchange rate utilised throughout this thesis for purposes of all Leone to Pound conversions. Source: Guaranty Trust Bank Sierra Leone (GTBank, SL) **www.gtb.sl/.May 2014.**

Chapter 1: Introduction

The acclaimed Nigerian writer Chimanda Ngozi Adichie in a recent interview made an obvious but also thought provoking point, that is *'It is very cliché to say unless we know what happened in the past we risk repeating it… but it is also true'.* This thesis will go further to state that we must not only know what happened in the past but we must also learn from the past. This is particularly true with regards the policy efforts towards increasing access to credit to microenterprises in Sierra Leone. Despite the debt problems and failures of past credit initiatives such as the Registrar of Co-operative Societies Scheme in the 1960s and 1970s (Taylor 1972) and the setting up of rural banks in the late 1980s to mid-1990s (Fofana 2004, Fraser 2012), expansion of the microfinance sector in Sierra Leone has been a development policy agenda especially in the post-war period.

Having experienced a ten-year civil war (1992-2002), Sierra Leone remains one of the poorest countries in the world. The low human development index (HDI) rankings and the proportion of the populace that live below the poverty line are amongst the most widely quoted figures when illustrating the poverty situation in Sierra Leone. In 2014, Serra Leone ranked 183 out of 187 countries in the United Nations' Human Development Index, after staying at the bottom for almost two decades. Sixty percent of the population lives below the poverty line (UNDP 2015).[1] In addition, Sierra Leone faces challenges of urbanisation and unemployment where 70% of youths in Sierra Leone are unemployed (UNDP 2015). In consideration of these statistics, it appears that policy makers are clutching to any policy agenda such as 'access to credit' that they hope will provide the much needed jobs. Therefore, policy makers in Sierra Leone have not learnt from history and have strived to be part of the microfinance and financial inclusion movements.

The challenges of microfinance movement by now has been widely recorded and studied and consequently a number of debates relating to the subject have emerged including that microfinance only goes towards consumption spending and not business investments, the claims of microcredit with regards poverty reduction, the gender empowerment implications of microcredit (Kabeer 2005, Garikipati 2010, 2012, and 2013,Vaessen at al 2014) etc. This thesis is however focused on over-indebtedness problems created by microfinance amongst microenterprises in Freetown, Sierra Leone considering the recent debt crises that wreaked havoc in countries such as India, Bolivia, Cambodia, and Bosnia (see the Consultative Group to

[1] In 2004, 70% of the population lived below the poverty line (data.worldbank.org/country/sierra-leone). Accessed April 2013

Assist the Poor's website for case studies).[2] A gap is filled in the literature by taking an institutional approach in analysing debt problems amongst micro loan clients. Through an institutional lens, this study focuses on analysing the debt problems worsened by debt management practices such cross borrowing, multiple-borrowing and debt refinancing. Existing studies on multiple borrowing and debt-refinancing have conducted their analysis in a way that assumes that microenterprises operate in isolation of institutions such as the regulatory environment and the wider financial sector. The approach taken in this thesis illustrates the enabling factors and constraints resulting from other institutions within the microfinance sector in Sierra Leone i.e the regulatory and over-sight bodies and the microfinance institutions.

1.1 Research questions and hypothesis

1.1.1 Main research question and hypothesis

It is against this brief background that this thesis seeks to explore the following hypothesis and research question:

Main hypothesis: *Increased access to credit is an institutional change which has implications for debt management and over-indebtedness amongst microenterprises.*

Main research question: *To what extent do the new institutions widening access to credit led to multiple borrowing and debt refinancing amongst microenterprises?*

In the case of this thesis *multiple borrowing* is when an individual accesses more than one loan from different institutions. *Cross borrowing* involves accessing more than one loan from the same branch of an institution or from different branches of that same institution. *Debt refinancing* is utilising a new loan or loans from one or more sources to repay an old loan or loans from another source/sources. This thesis argues that when <u>these</u> cash flow or debt management tools are employed, in certain contexts the end result is problematic because it throws clients into further indebtedness. In some cases multiple borrowing may initially improve the rate of debt repayments, until the build-up of debt starts to exceed the increase in borrowing for a given borrower.

[2] See www.cgap.org/blog/related/950. They include Rutherford (2011), Kishnaswamy (2011), Barnejee (2010), Chen, Rasmussen and Reille (2010) and Reille (2009).

Indebtedness refers to when clients cannot repay their debts and or when they are struggling to repay their debts.[3] This definition relates to that which is offered by Jessica Schicks (2010); a leading scholar in the microfinance and debt literature. She takes a consumer protection approach in her analysis of debt problems amongst microloan borrowers. This thesis agrees with this approach since the welfare of the client should be the primary concern i.e. how debts are financed should concern policy makers rather than simply putting monies in the hands of the so-called 'repressed entrepreneur'. Schicks makes the case that a client can be indebted not only when they cannot repay the debt but also when debt is repaid. This means, the debt can be repaid only because a client has made certain sacrifices such as reducing food quantity or postpone important health expenses.

In addition, this thesis takes into consideration the suggestion by Garikipati (2012 and 2013) that with regards to credit and its impact, both processes and outcomes are important. Thus, the process of how loans are repaid is equally crucial in addition to debt outcomes. Furthermore, this thesis claims and shows that debt can be repaid as a result of businesses engaging in debt refinancing. In this case, some debt is being repaid not from increased income but through further indebtedness from debt refinancing.

1.1.2 Further research questions

In order to answer the main research question, this thesis seeks to answer the following additional research questions:

Chapter Three and throughout the thesis provide answers to the following research question:

1. What are the main policies, initiatives, and institutions (the institutional change) that have emerged in order to promote increased access to credit in Sierra Leone?

Chapter Four provides answers to the following research question:

2. How do operations of institutions within the microfinance sector at the macro and meso levels i.e. regulatory and over-sight bodies promote indebtedness amongst microenterprises in Freetown, Sierra Leone?

Chapter Five answers the following research question:

[3] Schicks and Rosenberg (2011) includes other ways in which over-indebtedness has been defined in the past while Geurin et al (2014) provides a broad definition of over-indebtedness that takes into account the situational and semantic complexity and diversity of debt.

3. How do operations of institutions within the microfinance sector at the micro level i.e. microfinance institutions promote indebtedness amongst microenterprises in Freetown, Sierra Leone?

1.2 Thesis terminology

The following terms are used interchangeably throughout the thesis except otherwise stated: *Access to finance* is taken to mean access to credit. Similarly, *microfinance* is microcredit or microloan; *indebtedness* can also mean over-indebtedness or debt problems and *clients* are also referred to as microloan borrowers or microcredit borrowers.

In the rest of this introductory chapter further motivation and background is provided for the choice of topic and the context in which the research is situated in Section One. This is done by a) illustrating how the access to credit agenda has become a universal development agenda, b) introducing how the access to finance agenda has evolved in Sierra Leone and in Section Two showing that despite this proliferation of the access to credit programmes across regions, the recent microfinance debt crises have created doubts with regards the acclaimed poverty reduction impact of microcredit. Section Three, provides the reasons why this research is original and significant in the consideration of the exiting literature and context (Sierra Leone). Finally, Section Four outlines how the thesis is organised in order to answer the research questions set out.

1.3 Background and motivation of thesis

1.3.1 Access to formal credit- a universal development agenda

The provision of credit to the poor and other marginalised groups including women and youths, dates back centuries and spans across all continents. Roodman (2012a) provides a rich account of how financial services including credit spread from continent to continent; including Irish loan funds in Dublin from the 1720s onwards, the spread of friendly and building societies across countries in Europe such as Germany and France in the 19th century, the setting up of Credit Cooperatives across countries in Europe, North America and Asia and so on.[4] This thesis notes also that in advanced economies, though based on different policy motivations, improving access to credit for small and medium-sized enterprises (SMEs) still forms part of their SME growth policy agendas and is integral to the post-2007-08 financial crisis economic recovery policy packages. For example, in the United Kingdom (UK), the commissioning of Project

[4] See Chapter four of Roodman (2012a) for a detailed account.

Merlin in 2012 was along the lines of utilising access to credit to stimulate small enterprise development and subsequent growth in the economy.[5]

Other examples include:

Adams (1971), Von Pischke and Adams (1992), Webster (1989), and Boomgard (1989) discuss how credit programmes to farmers and microenterprises were implemented in Latin America as part of the post-World War Two (WW2) reconstruction efforts by the international financial institutions (IFIs) during the 1960s. Adams (1971) explains that from 1960 to 1969, $915 million had been provided by Agency for International Development (AID), Inter-American Development Bank (IADB) and The International Bank for Reconstruction and Development (IBRD), World Bank group to Latin American countries towards credit for agricultural businesses.

Post-independence, in African economies, credit was provided in repressed form-with features such as directed credit and interest rate ceilings. Then, with the implementation of International Monetary Fund's (IMF) structural adjustment programmes during the 1980s and 1990s, Sub-Saharan African (SSA) countries adopted policies aimed at liberalising their economies and financial sectors. This saw a transformation of African financial sectors and hence the provision of credit. Aryeetey and Nissanke (1998) is a comprehensive overview of studies conducted with other authors including Soyibo (1996, 1997) Chipeta and Mkandawire (1996) and Bagachwa (1996) on the expansion of formal credit that is linked with the financial liberalisation agenda.[6]

Bateman (2010) provides an historical account of how the microcredit movement spread from region to region. This book enriches our understanding of how and why the microfinance movement transformed from its grassroots philanthropy roots in the 1970s into a more commercialised form today.[7]

In light of the above, a question one might have at this point is: *why has the expansion of credit to the low income populace been so firmly integral to the development agenda of the major IFIs and consequently the countries they support?* The answer is an obvious and simple one: the IFIs that set the global development policy agenda have a particular conceptualisation of poverty. Therefore, they would draw on any policy tool that seeks to address poverty from their perspective. The World Bank

[5] Project Merlin is the UK government's agreement with four leading UK banks on a number of aspects with regards to the banking sector including increased lending to small businesses (See Financial Times Groom and Pickard, 2012)
[6] Nissanke (1999) also covers this subject.
[7] See also Tyson (2012b) for a discussion of the evolution of microfinance.

(2008) and Taylor (2012) explain that poverty according to the orthodoxy is the result of the exclusion of 'the poor' from having the resources and tools that they require to partake in the economic opportunities that exist in societies in order to empower themselves socially and economically.[8]Access to formal credit is regarded as one such policy tool that can ensure the poor are empowered to take up economic opportunities by setting up enterprises that will provide incomes for the poor so they can be lifted out of poverty. The claims made by the orthodoxy that microcredit empowers the poor have been widely investigated in the literature including Garikipati (2010, 2012 and 2013) for the case of women in India.[9] The heterodoxy are however unconvinced of these types of poverty reduction strategies and authors such as Amsden (2010, 2012) and Chang (2009, 2012a, 2012b) have proposed alternative methods for creating the jobs needed by African economies. Their conceptualisation of poverty is focused on redistribution of wealth and the reduction of income inequality.

Nevertheless, access to credit, especially commercialised microcredit (in recent times), continues to dominate the development agenda. Bateman (2010), Bateman and Chang (2012) and Taylor (2012) show that this form of credit provision caters to the needs of the major IFIs hence its continued expansion especially in developing countries.

The financial inclusion paradigm is the latest (from 2009 onwards) amongst various access to financial policy agendas. Financial inclusion mainly encompasses universal access to and use of financial services at affordable prices by marginalised groups in societies. While a comprehensive approach to financial inclusion according to World Bank (2012) *'addresses at least three aspects: access to financial services and products; usage of financial services and products; and quality of financial services and products, defined by consumer ability to benefit from new financial services and products (and linked to consumer protection and financial capability)'*. In addition Fraser (2012) defines full inclusion as a '*state in which all people have access to a full suite of quality financial services, provided at affordable prices in a convenient manner and with dignity for the clients. Services are delivered by a range of providers, most of them private and reach everyone who can use them, including the disabled, poor, rural and other excluded populations'*.

The Maya Declaration represents a crucial mechanism for the implementation of financial inclusion policies in developing countries. It is a *statement* of common principles for the development of financial inclusion policy made by developing nations' regulatory institutions at the 2011 Alliance for Financial Inclusion (AFI) Global Policy Forum held in Mexico. The

[8] The conceptualisation of poverty in this manner is linked to Modern development theory which is integral to the neoclassical and neoliberal schools of thought (World Bank 2008)
[9] Konadu and Biney-Assan (2007) explore a similar topic in the case of Ghana

Alliance for Financial Inclusion describes the Maya declaration as 'the commitment to unlock the economic and social potential of the 2.5 billion unbanked through financial inclusion' (Alliance for Financial Inclusion, 2015).[10] The main pillars of individual country commitments are around the following themes: *technology, simple accounts, consumer education and improving accessibility*.

As of March 2015, 54 countries had committed to implementing financial inclusion policies through the relevant institutions, mainly their central banks. Table 1.1 shows that the leading regions in terms of number of countries that have signed up to the Maya Declaration are sub-Saharan Africa with 19 countries, followed by 13 countries in Latin America and the Caribbean:[11]

Table 1.1: Regional breakdown of Maya declaration countries:

Region	**Number of countries signed to the Maya Declaration**
Sub-Saharan Africa	19
Latin-American & Caribbean	13
Asia	9
Pacific Islands	6
Europe and Central Asia	5
Middle East and North Africa	2
Total	**54**

Source: Alliance for Financial Inclusion, 2015

Some critics of microfinance notably Taylor (2012) and Gosh (2013) have referred to the financial inclusion agenda as an attempt of the IFIs to 'dress old sheep in new skin'. That is to say, because of all the problems microfinance has faced the idea of inclusion has been brought into the microfinance movement to water down the disastrous consequences it is having on the lives of the poor. To this end, lately in talks given by Milford Bateman, the microfinance movement has been described as a Zombie, meaning it is a policy that creates harm but it cannot be killed off, or rather in the case of microfinance it has not been allowed to die.[12]

1.3.2 Research Context: Sierra Leone-Why the 'need' for increased access to formal credit?

The choice of Sierra Leone as a case study for researching this thesis's questions was made because, more so in the post-war years, access to credit has been the focus of policy makers. However, why does Sierra Leone see the need to increase access to credit for microenterprises?

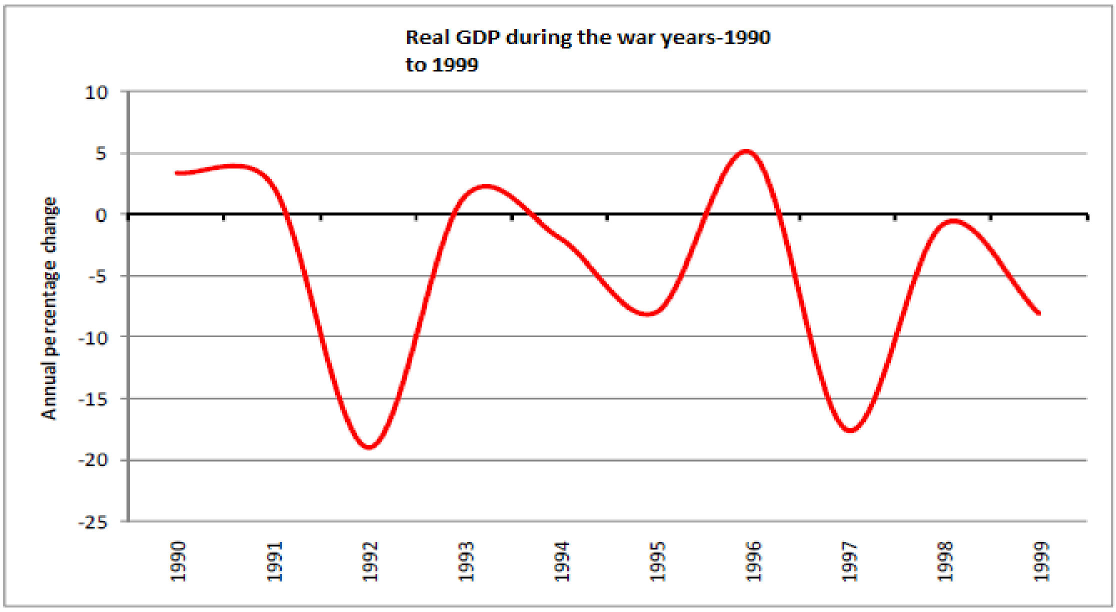
[10] www.afi-global.org/maya-declaration (Accessed March 2013)
[11] Individual country commitments can be seen at the Alliance for Financial Inclusion website: www.afi-global.org/maya-declaration-commitments (Accessed March 2015)
[12] An example is the talk given on November 17th 2015 by Milford Bateman at the School of Oriental and African Studies (SOAS), University of London tilted 'From Zorro to Zombie: The dramatic rise and fall of the microcredit movement as a development policy'.

The answer is that: access to credit is being used as a mechanism through which policy makers believe the much needed jobs can be provided. The brief narrative that follows illustrates why this is the case:

The civil war (1991 to 2002) affected all aspects of life in Sierra Leone -including the economy and the financial sector. It also left millions of Sierra Leoneans internally displaced. Since Freetown (the Capital City) was the last city to be affected by the war, most of the rural populace came to Freetown to seek refuge.[13] Almost half of the population, that is more than two million people, were displaced (Bangura, 2011). This development is the root cause of the urbanisation problem that Freetown is still currently facing.

The economy also slowed down for obvious reasons. As the war progressed, insecurity heightened, and as a result most major companies pulled out of Sierra Leone or temporarily halted their operations. They included major employers of both skilled and unskilled labour such as Aureol Tobacco Company, National Confectionary Company Limited (NATCO), Rokel Leaf Tobacco Development Company (RLTDC), and Sierra Fishing Company. Bangura (2011) reports that the economy contracted by 18% in 1997, stagnated in 1998 and contracted further by 8.1% in 1999. In total, annual GDP declined by 43% during the 1990s. The GDP figures in the diagram below (Figure 1.1), illustrate the deep slump in the economy during the war years.

Figure 1.1: Sierra Leone's Real GDP 1990-1999



Source: Bangura (2011)

[13] See Appendix 1 for Map of Freetown and Sierra Leone

The *agricultural sector* was severely affected as the war spread in the rural areas. According to the 2011 Sierra Leone Integrated Household Survey, 70% of the adult labour force of Sierra Leone was engaged in agriculture. However, farmlands were abandoned when the rural population fled for their lives and in some cases most farmlands were burnt and destroyed by the rebels.[14] Similarly, the *mining sector,* which also accounted for a large proportion of the pre-war jobs, was also affected. Prior to the war in 1991, 250,000 people made a living in the mining and quarrying sector from direct and indirect employment and it accounted for 14% of the country's total labour force (World Bank 2013b). The mines are found in the rural areas and Kono, a major diamond mining town, was a stronghold of the rebels.[15] Therefore, it was not only the major companies like Sieromco and Sierra Rutile Limited that were shut down, but also artisanal mining, a source of jobs for the rural population, had to be abandoned as the war progressed to major diamond mining towns. The 2006 film Blood Diamond, starring Leonardo DiCaprio, depicts the role of illegal diamond sales in funding the war in Sierra Leone. Rebels were engaged in illegal diamond sales in exchange for arms. Thus, during the 1990s (the main period of the war) overall domestic revenue declined to 7% of GDP (Bangura 2011), accounted for partly by the drop in mining revenues.

Sierra Leone's *financial sector* was weak before the war started, but the situation was exacerbated when the war broke out. While the war was contained outside of Freetown, it severely disrupted commercial banking in the rural areas and most banks lost their physical assets during this period. The Sierra Leone Commercial Bank (SLCB) had the highest rural penetration in the country during this period; therefore, together with other banks it increasingly closed its branches in the rural areas as the war spread to different regions. The operations of the financial system came to a more or less complete halt when Freetown was invaded in 1999 because Freetown was, and remains the financial capital of Sierra Leone. It led to the withdrawal of Barclays Bank from the country and other institutions of the financial system were also affected once the war got to Freetown. The end result was that, post-war, Sierra Leone was left with a severely weakened financial system incapable of providing for the financial needs of the populace especially the low-income populace.

Poverty levels increased rapidly due to the war. For example, the 2000 Baseline Service Delivery Survey (BSDS) found that 60% of the population had no access to safe drinking water and health services, and 80% were without access to sanitation. Against this background, in the

[14] The Revolutionary United Front (RUF)
[15] See Appendix 1 for location of Kono.

immediate post-war years Sierra Leone faced problems of *urbanisation* (due to the influx of internally displaced persons), *high unemployment*, and *a weak economy and financial sector*.

A detailed analysis of policies to increase access to credit will be provided in Chapter Three. However, it will be useful to provide a brief overview of these policy efforts in order to provide additional information on the Sierra Leone context of the research.

Towards the end of the war, emergency relief efforts by Government, donors and Non-Governmental Organisations (NGOs) included the provision of cash assistance such as cash hand outs or subsidised credit to internally displaced persons and ex-combatants for them to engage in economically productive activities (Cheru 2002). In the same vein, the Government set up its own microcredit scheme as part of one of its emergency poverty interventions-Social Action for Poverty Alleviation (SAPA).

When the war ended in 2002, the government with the support of donors utilised the provision microcredit as part of its post-war reconstruction efforts. Kangaju (2006), Turay (2008) and Fraser (2012) explain that provision of microfinance to microenterprises was a policy objective of all the early post-war poverty reduction strategies implemented by the Government.

This period saw certain institutional changes within the microfinance sector, most notably the transformation of the sector to a market-based system of microcredit provision. The launching of the National Microfinance policy and the implementation of the Microfinance Investment and Technical Assistance Facility (MITAF 1) programme were major efforts towards this end.

Following on from this, access to credit continued to feature high on subsequent poverty reduction agenda (e.g. in the Second generation Poverty Reduction Strategy, PRSP 2). Likewise, in 2009, a Private Sector Development Strategy and Financial Sector Development Strategy were launched and they included key targets for expanding access to affordable finance.

Most recently, Sierra Leone has also embraced the financial inclusion agenda, and financial inclusion was the central subject of the Governor of the Bank of Sierra Leone's annual speech in 2012 and in 2013 respectively.[16] More significantly, the signing of the Maya declaration by the Bank of Sierra Leone during 2012 formalised policy makers' financial inclusion vision (see Appendix 2 for the full declaration). The commitment that directly relates to improving access to credit in Sierra Leone is as follows: *'A private sector driven rural financing penetration will be encouraged to*

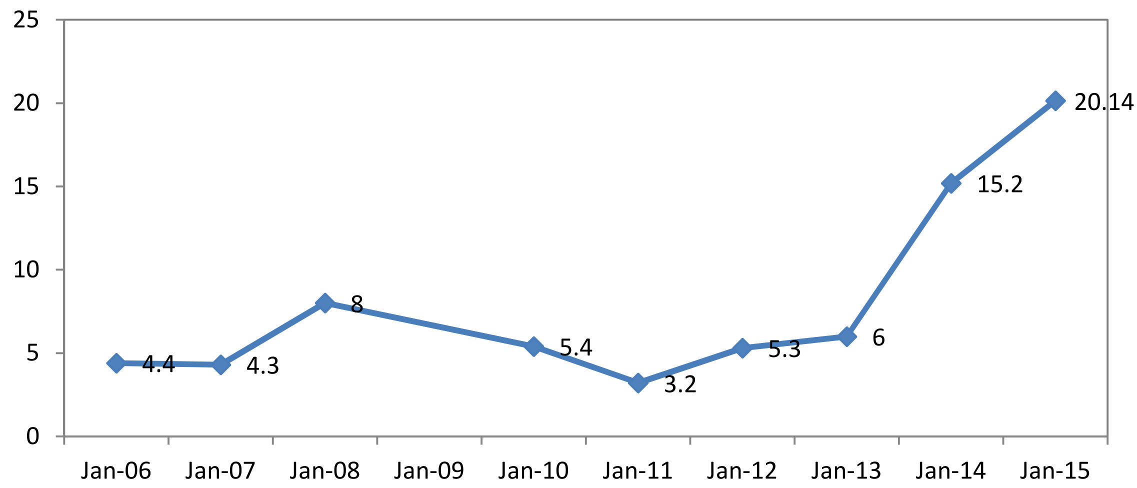
[16] The 2012 speech: "Financial Inclusion as a key enabler to private sector development: The role of the Bank of Sierra Leone". The 2013 speech: Inclusive Growth and Development: The Role of the Bank of Sierra Leone by Sheku Sambadeen Sesay.

increase access to finance through the establishment of additional Financial Services Associations (FSAs), Community Banks (CBs) and commercial bank branches (CBBs). The number of FSAs will increase from 42 to 65, CBs from 13 to 22 and CBBs from 87 to 100. It is envisaged that the additional FSAs, CBs and CBBs will increase financial outreach by about 30% by the end of 2014' (Sierra Leone's Maya Declaration, 2012).

Despite all these policies and projects to expand access to finance, the proportion of the population unbanked remains high. For example, as at end 2011, the number of bank accounts stood at 966,256 accounts out of a population of nearly six million (Sesay 2012). Furthermore, the main reason for such policies was to help Sierra Leone address its unemployment situation. The situation on that front has not improved much either. The most common datum quoted is that 70% of youths in Sierra Leone are either unemployed or underemployed (UNDP 2015). Urbanisation remains a problem; inadequate developmental opportunities in other parts of the country mean that the displaced rural population is reluctant to return to their homes. Thus, the streets of Freetown are overcrowded with petty traders and street vendors who have gone into trading not because they are effective business men or women, or that there are economic opportunities to be exploited, but because no formal jobs exist. These activities are hardly profitable and do not represent any meaningful employment creation.

In recent times, the economy grew rapidly. Figure 1.2 shows that Gross Domestic Product (GDP) growth accelerated from 6% in 2013 to 15.2% in 2014. The production and export of iron ore accounts for the massive change in GDP growth observed.[17]

Figure 1.2: Annual GDP growth of Sierra Leone Jan 06-Jan 15 (in %)



Source: Trading Economics[18]

[17] The recent decrease in world iron ore prices in 2015 and the current Ebola crises in Sierra Leone has resulted in a contraction of the iron ore industry. Therefore, it is expected that the 2015 forecasted GDP growth shown in figure 1.4 will not be achieved.

The government and ordinary Sierra Leoneans were hopeful that this development in the mining sector would help towards contributing to create the much needed jobs. However, iron ore mining is highly mechanised so the sector has only created jobs for a small number of skilled workers. The unskilled section of the populace has not benefited much from the emergence of an iron ore industry, even though this is where the unemployment situation is dire. The mining companies have insisted that the country simply does not have the labour with the prerequisite skills so they have also imported skilled labour rather than employing or training Sierra Leoneans.

In other countries, another channel through which jobs have been created for the local populace as a result of expansion in the extractives sector has been through market linkages with medium-sized or smaller firms.[19] In most cases, local firms act as suppliers of goods and services to large foreign mining companies. To a limited extent, the service sector in Sierra Leone has benefited from this, especially in terms of providing haulage and transportation services to the mining companies. However, the mining companies claim that local firms do not seem to have the capacity to effectively form productive partnerships with them.

It is due to the chronic unemployment situation and other related issues that the Government continues to make access to credit a priority as a policy agenda to continue to increase access to credit.

1.3.3 Microfinance Impact and Debt problems associated with commercialised credit for microenterprises

1.3.3.1 *Microfinance Impact*

'*Virtually every development project I see these days, from maternal and child health, to women's education, to soil conservation, to social forestry, to old fashioned integrated rural development, has a "microcredit component," and everyone from camel herders in Mauritania to peasants in rural China can speak the lingo*' (Ditcher 2006).

The statement above captures how far microcredit provision has spread into many poor economies. Similarly, Tyson (2012a, 2012b) notes the rapid growth in the global microfinance industry (loans and deposits) from its negligible levels in 1995 to $1.2 trillion in 2012. Table 1.2 below also illustrate that by 2008, microfinance was being utilised by a large section of the populace in various countries and across regions including Europe, Asia and Latin America.

[18] www.tradingeconomics.com/sierra-leone/gdp-growth-annual (Accessed in March 2015)
[19]Hussain (2000) and UNIDO (2004) include recommendations and case studies which illustrate how such linkages between multinational corporations and local small enterprises in developing countries can be fostered or have been developed.

Table 1.2: Microfinance penetration by country (and regions) in 2008

Global Ranking	Country	Borrower accounts/population
1	Bangladesh	25%
	(Andhra Pradesh State, India)	16%
2	Bosnia and Herzegovina	15%
3	Mongolia	15%
4	Cambodia	13%
5	Nicaragua	11%
6	Sri Lanka	10%
7	Montenegro	10%
8	Vietnam	10%
9	Peru	10%
10	Armenia	9%

Source: Bateman 2014a

However, alongside this development, similar to the objective of this thesis, questions are now being asked with regards the impact microfinance is having on the lives of the poor. This interest has been intensified mainly because of the debt crises associated with the microfinance movement, especially from 2007.

To this end, a growing body of literature has emerged relating to a number of aspects with regards the impact of microfinance. Duvendack et al (2011) summarises the pathways and outcomes of microcredit as economic (e.g. increase profits and expenditures), social (e.g access to education, increased well-being) and empowerment (women empowerment). Thus, in general, microfinance impact studies are related to assessing the impact of microfinance in relation to these categories of pathways and outcomes of microfinance including its impact on poverty alleviation (Sebstad and Chen 1996, Bateman 2010, Ditcher & Harper 2007, Rosenberg 2009, Marr 2002a & 2012, Stewart et al 2010, Bauchet et al 2011, Awaworyi 2014 and Gopalaswamy et al 2015). In the African context, microfinance impact studies have included Dupas and Robinson (2011), Lanfontaine (2001), Afrane (2002) and Abiola (2011).

It is a growing consensus however that there is no consensus on the findings of the impact of microfinance by the various studies (Roodman and Morduch (2009) and Karlan and Zinman (2009). Studies such as Khander (2005) finds positive effects of microcredit on poverty levels while Weiss and Montegomery (2008) finds negative or no impact at all.[20] It is due to these results that the research has now moved on to taking a closer and more comprehensive look at the impact assessment studies in the form of meta-analysis (Yang and Stanley 2012), systemic reviews (Duvendack at al 2011, Stewart et al 2010, Stewart at al 2012) or in some cases a

[20] While some find mixed results

combination of a systematic review and a meta-analysis (Vaessen et al 2014). These studies have helped to shed light on challenges with conducting impact evaluations such as the restrictive nature of randomised control studies or the fact that these studies suffer from certain shortcomings including weak methodologies and inadequate data (Duvendack at al 2011). In addition, they have come up with findings that if taken on board by practitioners and policymakers, it should help with improving the impact of microfinance. For example, Bauchet et al 2011 concludes that the users of microfinance all have varying needs for credit apart from enterprise development. The paper finds also that borrowers of microfinance have varying capacity to productively utilise the loan. Therefore, in order to improve on the impact of microfinance, the products need to be better designed to suit clients' needs. Bauchet et al (2011) suggests that '*the microfinance industry needs to continue to mature in ways that allow it to view po*or as individuals' (page 19).

Others such as Bateman and Chang (2012), Bateman (2010), Bateman and Chang (2009), Bateman (2014b) attribute the failings of the microfinance movement to the commercialisation of microfinance. Likewise, other authors such as Christen (2001), CGAP (2001) and Campion (2002) have written about the dangers of commercialised credit including its debt implications following their assessments of microfinance industries plagued by debt problems.

Integral to this argument is the claim that the rise of commercialised microfinance is because it serves a neoliberal development agenda which supports market provision of good and services. However, according to Bateman and Chang (2012), the commercialisation of microfinance has some consequences for the impact of microfinance. They claim that this institutional form of microfinance provision ignores the fallacy of composition. Put simply, the authors make the case that the model of microfinance assumes that there will always be a demand for the goods being sold by the ever increasing number of microenterprises. Bateman and Chang (2012) note that a similar point is raised by Amsden (2010), by pointing out that, this type of policy is consistent with supply side polices that are grounded in the economic concept of Say's Law i.e. *supply creates its own demand.*

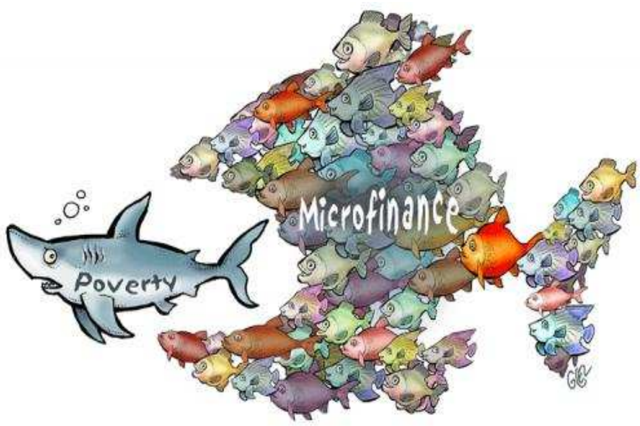
Bateman and Chang (2012) go further to explain that in reality, the fact that the number of goods in the market has increased, does not imply that a corresponding increase in demand will emerge. On the contrary, what happens is that the increased number of firms has to divide the existing market demand amongst them thus leading to issues such as lower turnover, lower prices and a general reduction in income levels. For these reasons, with evidence from Bosnia, India and Mexico, the authors point out that such supply side intervention are ineffective without any intervention on the demand side.

In addition, Bateman Chang (2012) claims that commercialised microfinance ignore the role of economies of scale. The case made is that microenterprises including agricultural units are too small to operate at an efficient level. From this, it is inferred that, these firms will be unable to generate adequate cash flows to finance their debts because they are so small, inefficient and cannot reap the benefits of economies of scale. In fact, Bateman and Chang (2012) make an additional point that microcredit expansion is making matters even worse by supporting the emergence of more inefficient microenterprises which is not only a source of more competition in the microenterprise sector but also for small and medium enterprises, thus eating into the already minimal sales and cash flow of businesses. Bateman and Chang (2012) provide examples of countries such as Zambia, Bangladesh, India and Mexico where large numbers of microenterprises have been set up because of large sums of resources that have been put into providing credit for these businesses. However, this has not resulted into any form of sustainable development. Rather the business sectors in these economies are dominated by survivalist firms operating way below efficient levels. It can be concluded that the concern raised here is also because of the debt implications for microenterprises that are unable to raise adequate cash flows to service their debts.

1.3.3.2 *Multiple borrowing and microfinance over-indebtedness*

Despite the associated challenges with measuring microfinance impact, as has already been stated it is increasingly becoming the accepted view that the poverty reduction potential of microfinance (illustrated in figure 1.3 below) was exaggerated.

Figure 1.3: Poverty reduction potential of microfinance



Source: Bateman (2014a)

In the same vein, one aspect of microfinance impact that has become a problem is the creation of over-indebtedness amongst microenterprises. Today, the reality is far from the 'repressed entrepreneur' ideology that is part of the access to finance discourse. This discourse claims that access to credit unlocks blockages or breaks down all the barriers that prevent 'the repressed entrepreneur' from owning successful businesses and hence earn incomes that allow them to cope with financial shocks and eventually lift themselves out of poverty (World Bank, 2008). This thesis questions this line of reasoning and shows that some forms of credit provision can hamper enterprise development.

The evidence from 2007 onwards for countries such as Morroco, Nicaragua, Bangladesh and India has shown that beneficiaries of credit can run into debt problems, which have serious impacts on not just the individual borrower or the lender but also communities and society at large. Schicks and Rosenberg (2011) point out that the effects of over-indebtedness can range from material effects to psychological effects- even suicides as committed by some microcredit beneficiaries in Andhra Pradesh, India, following the debt crises experienced in that region.

Similarly, in a recent conversation with a PhD colleague from the Open University researching technological choice by furniture manufacturers in Kenya, he explained that during his fieldwork in 2012, he did not meet as many tree farmers as he was expecting in some of the farms that he visited.[21] The farmers that were not present had abandoned their farmlands because they had borrowed loans from microfinance institutions and were unable to repay due to factors such as high interest rates and inappropriate products that did not match the cash flow cycles of farmers. Faced with such a situation, some farmers had no choice but to abandon their farmlands and in some instances they fled their villages too, in fear of what would happen to them after defaulting on their repayments. This example, gives a human face to the consequences for loan recipients, their families and society as a whole when loans cannot be repaid.

This thesis argues that the impact of indebtedness on the recipients needs to be at the forefront of the minds of policy makers dedicated to credit expansion. A common accusation levied at the orthodoxy is that their focus has been more on the outreach and financial sustainability of the institutions that provide credit rather than the clients (Zeller and Meyer (2002). In other words consumer protection is neglected.

Multiple borrowing has been identified in the literature as one of the major contributing factors to over-indebtedness hence limiting the impact, if at all, of microcredit. It is important to point

[21] Thesis title: Chinese Presence in Developing Countries 'Technology Basket': The Case of Furniture Manufacturing in Kenya.

out that multiple borrowing can be a symptom of over-indebtedness. This is so especially when additional loans are used as a debt-management tool.

The resulting debt problems that accompany accessing multiple loans are also acknowledged by this literature especially in relation to the criticism that the model of microfinance promotes an oversupply of loans to clients. The oversupply of loans is linked with it being a means of justifying the microfinance projects (giving more loans out to the poor are regarded as a good thing amongst supporters of the neoliberal development agenda). In addition, it is a way for MFI managers to make more money especially those that invest in the institutions they run. This criticism is similar to that made by Bateman (2014b) for the case of South Africa and the Von Pischke et al literature[22]; that institutions are more concerned about disbursing credit as opposed to providing credit to those businesses that are capable of putting the loans to productive use.[23]

Multiple borrowing however has serious debt ramifications including that clients may obtain loans far above the amounts they can manage. One of the ultimate consequences of this is that clients are simply thrown into indebtedness as they struggle to repay the loan or in most cases are unable to repay the loans at all. Another source of indebtedness that stems from multiple borrowing is when some clients obtain new loans to repay other outstanding loans. For example, the excess supply of loans in some instances created an artificial increase in demand for loans in Andhra Pradesh, India. However, clients were using new loans to offset existing loans according to Bateman and Chang (2012).

The studies discussed thus far discuss multiple borrowing in the context of situations wherein clients access more than one microfinance loan. However, the beneficiaries that are usually the target group for microcredit have a wide range of other sources of loans that they utilise (Guerin et al 2012) especially from the informal sector. Accessing loans from these sources concurrently with a microcredit is also another form of multiple borrowing. This point is made because; in this thesis it argued that the policy efforts to exterminate the use of informal finance have not been successful due to evidence of its continued use (as shown for example by Nissanke and Aryeetey 1998, 2006). In addition, more relevant to this thesis is that it also adds to the debt burden of microenterprises because it is a source of multiple borrowing and debt refinancing (Jain 1999, Khander 2000, Guerin et al 2012, Jain and Mansuri 2003).

22 Including studies by Von Pischke and some of his co-authors Dale Adams and Douglas Graham. Von Pischke (19991, 1997) and Von Pischke et al (1980, 1983, 1984, 1992)

23 As debt crisis after debt crisis occurred, this criticism has been more widely levied against the proponents of access to credit.

The literature has identified a number of reasons why microcredit borrowers have had to access informal loans in addition to their existing debts with microfinance institutions. Tight repayment schedules enforced by MFIs were found by Jain and Mansuri (2003) to be pushing micro loan borrowers to access informal loans. The paper explains that since the terms of a microcredit stipulates monthly, weekly or by-weekly payments in addition to starting to pay for some loans as soon as the loan is received. However, MFIs impose these rigid repayment policies in order to deal with asymmetric information and to impart credit discipline on their clients. It will force them to access loan from informal sources to repay their MFI loan especially if the loan terms do not match their cash flows. Jain (1999) finds that clients are using informal loans to make up for the additional finance they require for their investments. MFIs were found to be restricting the amount of credit they give out as a way of screening clients in order to deal with not having full information on clients.

In Chapter 5, this thesis will argue and show that informal loans can also serve as a competition for cash flows of microenterprises. Some clients will rather pay off their informal loans than pay off their microcredit. This is another way in which informal loans can be a source of over-indebtedness and debt refinancing.

Taking into account the above short-comings of the existing microfinance impact studies, broadly this thesis concludes that they include; a) no agreement on the actual impact of microfinance in terms of whether it has an impact, and if at all, what is the scale of the impact, b) inadequacies with the unit of analysis of these studies (heavily focused on clients) and c) the associated challenges with the methods of assessing impact. The next Section 1.3 will outline how this thesis is different thus making it an original and significant research especially in relation to the relevant stakeholders trying to make sense of the all-important challenge of microfinance debt. In sum, there is a need for microfinance impact assessments that are focused on microfinance debt to shift the analysis towards understanding the institutions and the institutional factors that are fundamental to debt management and debt outcomes.

1.4 Significance and Originality

The thesis is original and significant for the following reasons:

Firstly, from this brief literature review in Section 1.2.3, the analysis of microfinance over-indebtedness is devoid of an institutional approach. It is obvious that institutional factors (such as over-supply of loans which is a market failure) have contributed to debt problems experienced in the various microfinance industries. However, the studies examined have only identified these factors without appreciating or acknowledging that 'institutions' play a crucial role in debt outcomes. Additionally, because an institutional approach is not being utilised, aspects of the evolution of microfinance sector and operations of institutions are discussed without showing the implications for the ability of the recipients of loans to finance their loans and engage in detrimental debt management practices (DDMPs).[24] A major contribution of this research is that it clearly illustrates how institutional change and functions can directly or indirectly impact and foster microcredit over-indebtedness in the context of Sierra Leone.

Secondly, microfinance debt in Sierra Leone is under-researched compared to other activities in the country. The war (1991-2002) gave rise to an enormous amount of research relating to governance and the politics of Sierra Leone. However, financial sector related subjects such as the focus of this thesis have not been as thoroughly researched. This thesis therefore makes a novel contribution to the literature on the financial sector in Sierra Leone. In addition, the fieldwork undertaken for this thesis produces qualitative data that has never been collected before. No study exists on Sierra Leone that focuses on understanding the operations of key institutions that make up the microfinance sector including regulatory and policy environment governing the sector. Neither is there any study on Sierra Leone that explicitly focuses on making the link between 'microfinance institutions' and microfinance debt in Sierra Leone.[25]

Thirdly, another significant contribution to the literature on access to finance in Sierra Leone is that this thesis addresses the very important subject matter of how microenterprises finance their debts and the debt management strategies they employ. The literature on access to finance in Sierra Leone including Fraser (2012) and Kooi and Tucker (2003) usually provides descriptions of the process of increasing access to finance without illustrating how these debts are financed. The discussions earlier pointed out the importance of acknowledging the difference between processes and outcomes in relation to credit.

Fourthly, this thesis will count as a microfinance impact study and one does not yet exist for Sierra Leone. Whilst the wider microfinance literature now includes studies on the impact of microfinance on a range of issues such as development, women, and microenterprises. In this regard, the literature on microfinance in Sierra Leone needs to play catch up especially with regards the debt impact of access to credit.

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[24] The DDMPs focused on in this thesis are cross-borrowing, multiple-borrowing and debt refinancing as defined in Section 1.2. This is an expressed coined for the purposes of this thesis.

[25] Microfinance Institutions here refers to ALL institutions that are part of the microfinance sector. It follows from Douglas North's (1990,1991) widely quoted definition of institutions i.e. Institutions are humanly devised constraints that structure political, economic and social interaction,

Lastly, the institutions analysis conducted is of value to broader the literature on access to finance and debt problems. This thesis offers some unique insights into the factors that can contribute to over-indebting businesses in a post-war context, and one that is specific to West Africa. Certain institutional factors that are creating debt problems in Sierra Leone are unique to post-war microfinance contexts. This will help shape financial sector development policies in similar contexts.

1.5 Chapter outline of the thesis:

This first Introductory Chapter has set out the main objectives of the thesis, providing some background on the access to credit agenda. This chapter has also presented the context of the study and motivation for undertaking the research. To answer the research questions outlined above in Sections 1.1, the rest of the thesis is organised as follows:

Chapter 2 provides the theoretical framework for the thesis. The main objective of this chapter is to review the existing literature that applies institutional economics analysis to understand or analyse financial sector development and microfinance. The chapter however includes a brief discussion on Institutional Economics theories (Old and New). A conclusion is drawn that while there are different strands of institutional analysis in economics broadly institutional analysis entails providing explanation for how institutions develop and change over time as well as how institutions function given certain institutional constraints. The main institutional factors identified by the literature examined such as informational challenges, efficiency of the legal and regulatory environment, property and contract rights etc frames the analysis that is undertaken in the rest of this thesis (Chapters 3, 4 and 5). Guided by findings from the framework offered in the literature reviewed, the analysis recognises the need to factor into the analysis not just formal institutions (rules and regulations), informal institutions (customs, traditions and social norms) must also be accounted since they also impact on financial sector outcomes.

Chapter 3 represents the start of the institutional economics analytical process by **illustrating how the access to finance as an institutional change emerged and has developed overtime**. In the first part of this chapter, the policies, laws and various institutional forms of credit provision that have emerged in the sector during the post-war are discussed. These analyses provide additional context for the research and also it unearths some of the lessons that could have been learnt by policy makers. The institutional factors preventing the proper use of credit and more so those factors that promoted and contributed to over-indebtedness in past access to credit programmes are highlighted. The second part of this chapter discusses and illustrates the widespread existence of debt problems such as multiple borrowing and debt refinancing in the current microfinance sector of Sierra Leone. The analysis here provides additional justification for the research undertaken on the institutional factors contributing to indebtedness presently in Sierra Leone. On the whole, this Chapter contributes to the evidence for the case made that providing credit as a means of job creation has always been problematic (debt wise) in the Sierra Leonean context. This chapter answers the following research question posed in Section 1.1.2: *What are the main policies, initiatives, and institutions-the institutional change- that has emerged in order to promote increased access to credit in Sierra Leone?*

Chapters 4, and 5, present the original research on Sierra Leone. Following on from the institutional economics approach utilised in this thesis, these two chapters focus on analysing empirical data (mostly qualitative) obtained by the researcher from fieldwork conducted in Sierra Leone**.** The main objective of these chapters is to show how the institutional factors and challenges that presently exist in the microfinance sector are contributing and fostering the debt problems that are prevalent in the microfinance sector in Sierra Leone. These two chapters also include a discussion of and the justifications for the **methodology** utilised for undertaken the research in this thesis including data collection methods such as self-administered semi-structured and unstructured interviews, participant observation and data triangulation.

Chapter 4 analyses the role of oversight bodies within the microfinance sector in promoting debt problems amongst microenterprises using an institutions' approach. The regulatory and oversight bodies that are the focus of this Chapter are the Bank of Sierra Leone and the Sierra Leone Association of Microfinance Institutions (SLAMFI). In addition, this chapter examines the role played by other institutions such as the regulatory and policy environment in promoting detrimental debt management practices (DDMPs).

Chapter 5 focuses on the institutional factors that promote indebtedness which stem from loan operations of the institutions that provide credit to microenterprises, or the Microfinance Institutions (MFIs). The main objective of this Chapter is to trace how loan operations of MFIs lead to over-indebtedness amongst their clients (microenterprises). Thus, the Chapter examines various aspects of loan operations including MFIs' sources of funds, disbursement procedures and policies, pre-loan meetings, loan monitoring and collection. The role of donors is also recognised and highlighted throughout the analysis.

Finally, **Chapter 6** summarises the main findings of the research, draws some policy implications and also offers some areas for further research.

Chapter 2: Institutions, financial sector development and microfinance-A Theoretical Framework

The theories and analytical tools offered by Institutional Economics (IE) have been drawn on in finding the explanations for differences in levels of financial sector development. Regardless of which side of the debate one stands with regards the importance of the financial sector in promoting growth or vice versa, the functions provided by financial institutions such as financial intermediation, diversification of risks, producing information and allocating capital to productive ventures etc (Levine 1997, 2005) are always important providing for the financial services needs of every society. From an Institutional Economics point of view, the ability of the financial system to perform these functions depends on certain institutional attributes and the quality of institutions that are present and govern the workings of the financial sector (Marcelin and Mathur 2014, Anayiotos and Toroyan 2009).

However, as the microfinance sector gains prominence in terms of providing for the financial services needs of the poor, this thesis argues that it follows that research needs to focus more on 'the institutions' that make up the microfinance sector- including rules and regulations, norms, and perceptions. Moreover, impact studies on microfinance need to account for the role of institutions in promoting or hindering microfinance impact. The literature to some extent has started to move in that direction. It includes some institutional economics analysis that has been applied to explain development of the microfinance sector more broadly (Einarsson 2003, Goodwin-Groen 2012, Daley and Badiola 2003 and Allaire et al 2009) including some specific institutions within the microfinance sector such as the impact of regulations on the microfinance sector (Gallardo 2001, Staschen 2010).

In the introductory chapter, it was noted that this thesis extends the microfinance impact literature by illustrating how the institutions that make up the microfinance sector in Sierra Leone impacts on microenterprises by indebting them. A review of the literature that has applied institutional economics to explain how the interactions of institutions or institutional factors has impacted financial sector development and microfinance will form the theoretical basis of the analysis to be undertaken later in Chapters 3, 4, and 5 of this thesis. Therefore in this chapter the main factors that are relevant and crucial to exchanges within the financial sector and microfinance sector are of interest.

In Section One of this chapter the main theories and strands within Institutional Economics are briefly discussed. Section Two discusses the literature that has applied Institutional Economics to explain financial sector development. Section Three focuses on the literature on institutions and microfinance. Section Four draws some conclusions and explains how the theories and explanations offered by the studies reviewed will frame the analysis undertaken in this thesis.

2.1 Institutional Economics- the theories

The various strands of theories within the institutional economics emphasise on a range of factors that should be focused on when conducting analysis within the area of economics. However, the literature is commonly broadly grouped into two main strands i. e. Old Institutional Economics (OIE) whose main proponents include Walton Hamilton, J R Commons and Thorstein Veblen and New Institutional Economics (NIE) put forward by authors such as Douglas North and O.E. Williamson.

2.1.1 Old Institutional Economics (OIE)

The overarching theory put forward by Old Institutional Economics is that institutions are evolutionary in nature. Within this school of thought, emphasis is put on the influence of the social setting (including cultural and historical factors) on economic exchanges (Scott, 2008, page 2). The role played by habits has also been incorporated in Old Institutional Economics. Some definitions of institutions offered by this body of literature include: a) institutions are systems of established and prevalent social rules that structure social interactions (Hodgson 2004), b) Thorstein Veblen in Rodgers (1996), postulates that institutions are settled habits of thought common to the generality of men and c) Commons (1931) stresses the dual nature of institutions and states that institutions are collective action in the control and the liberation of the individual action.

From these definitions, it shows that a unified theory of institutions and institutional change do not exist within OIE. However, the common principles within this school of thought are the emphasis of culture, beliefs, social norms in explaining economic behaviour. Another common principle is that this school of thought departs from the neoclassical economic theory of methodological individualism.

2.1.2 New Institutional Economics (NIE)

The main interest within New Institutional Economics (NIE) is the efficiency of institutions and as such the focus here is the functional efficiency of institutions in reducing transaction costs when economic exchanges take place. It must be highlighted that NIE is not a new version of Old Institutional economics. This school of thought offers a different theory of institutions although it accommodates OIE. One major difference between the two schools (OIE and NIE) however is that NIE is in fact based on methodological individualism. While this school of thought is closely aligned with neoclassical economic theories it opposes the assumption of instrumental rationality which is the assumption that makes neoclassical theories institutions free. What this means is that there is an implicit assumption that economic players have perfect information which thus means there are no costs involved when transactions and exchanges take place. This stems from the assumption that what exists objectively in the world and an economic agent's subjective perception are aligned (North 1995). Therefore the market place is seen as efficient and hence there is no need for institutions to organise production and exchange. The main foundation of this school of thought is that there are costs incurred in making transactions.

Like the OIE there is no unified theory within NIE, a number of theories are offered in guiding institutional analysis within economics. Furubotn and Ritcher (1997) explain that the different theories within NIE are as a result of differences in the process of institutional change how institutions are selected and the extent to which the influence of the social environment is accounted for.

Some theories within NIE include:

2.1.2.1 *Transaction Cost Economics*

Transaction Cost Economics– as the name implies the main variable of interest here is transactions costs. According to Williamson (1981), a transaction has occurred when goods and services are exchanged between two technologically separable interfaces. This strand of institutional economics is usually drawn on when analysis regarding how exchange between firms are executed.

Central also to the NIE school of thought is that efficient economic institutions usually arise out of the need to ensure exchange occurs. Williamson (1985) explains that these institutions arise because the different parties involved in an exchange have the objective of minimising transaction costs including costs associated with executing constraints. In the process of exchange also, economic institutions impose certain constraints on different levels-hence efficient institutions emerge to effect the exchange.

The explanations offered by this school of thought are based on certain assumptions with regards the characteristics of the agents involved in an exchange, the goods or services that is exchanged and the context in which the exchange is taking place. The assumptions include that the parties involved in an exchange are limited by bounded rationality i.e. according to

Williamson (1981), they are limited to the extent to which process and utilise all the information with regards a transaction. This follows on to the other key assumption that the parties involved in the exchange have asymmetric information and also imperfect information. A further assumption is thus made that asymmetric information drives opportunistic behaviour. Opportunism is what also drives that need for efficient economic institutions to enforce contracts. Due to the nature of the analysis undertaken in this thesis, the theoretical concepts and explanations offered by this school of thought will be drawn on amongst others.

2.1.2.2 *Economic History*

Economic History- another theory of how institutions and institutional change occurs is provided within the NIE by Douglas North an economic historian. According to North (1990, 1991) institutions structure human exchange whether social, cultural, economic or political. Thus, he defines institutions as 'the rules of the game in a society, or more formally institutions are the humanly devised constraints that shape human interaction'. An idea that is fundamental to this strand of literature is that institutions are man-made and can thus be transformed by human actions.

North (1990) also proposes that institutions can be formal (property rights, laws) or informal (social norms and customs), While their main role is to reduce uncertainty amongst parties involved in an exchange, hence the institutions (rules) governing economic exchanges are not removed from social, cultural and political institutions. For Douglas North, transaction costs are those costs associated with developing, monitoring and enforcement of formal and informal rules. Thus, if the benefits of having institutions outweigh there costs, when institutions emerge they will also persist even if they will not be necessarily efficient.

While the Transaction Costs and Economic Growth theories are referred to in the literature as theories which view institutions as hierarchy-of-rules i.e. the conception that the enforcement of institutions happens exogenously. On the other hand, other strands of literature such as the institutions-as-equilibria school of thought found within NIE—e.g. Grief (2006) and Aoki (2007)—believe that institutions are enforced endogenously. Another difference between these two sub-strands of NIE is the position of whether institutions are followed (institutions-as-equilibria) or that they emerge (hierarchy-of-rules).

2.1.2.3 ***Game Theoretic forms of Institutions***

Game theoretic forms of institutions belong to the institutions-as-equilibria school of thought. Aoki 2006 and Grief 2007 explain that institutions are self-enforcing due to the regularity of behaviour of parties involved in an exchange. The players involved in the game are said to possess complete information on the game, they are rational and are motivated by promoting their own-interests and can thus predict the moves made by each other. This allows players to arrive at equilibrium where in no player in the game wants to change their move because it is the best when taking into account the available resources and moves of other players in the game. In sum, players in the game behave in a certain way due to how they believe the other players will behave. This regularity of behaviour is what makes institutions self-enforcing.

2.1.2.4 *Comparative and Historical Institutional Analysis and Comparative Institutional Analysis*

The other two theories closely related to Game theory school of thought are Comparative and Historical Institutional Analysis and Comparative Institutional Analysis. Therefore, proponents of these theories also argue that institutions are endogenously enforced. The difference here is that, it is not assumed that players in the game always make the best move due to that factor of bounded rationality which comes into play. As such when equilibrium is reached it is not necessarily the most efficient state. Institutional change is explained as the results of players in the game constantly changing their behaviour taking into account both self-interest and social expectations. Thus, the outcome will be different if the same institutions are faced by a number of players.

2.1.2.5 *Agency Theory*

Agency theory explained by Einarsson (2003) also falls within the NIE theories. Two theories fall within agency theory i.e. positive of agency which relates to organisations and it explains why organisations are the way they are. This theory views organisations as 'a nexus of contracts' (Einarsson 2003, page 4). The other theory relates to contemporary agency theory i.e. the theory of principal and agent and it takes into account the risk involved in an exchange. In an exchange, there lies a relationship between the principal and the agent. Usually the agent will incur costs for the activities undertaken on behalf of the principal. The level of costs incurred and the outcome of the exchange depends on the efforts made by the agent.

The above literature has been examined in recognition that they form the basis for the application of Institutional Economic analysis applied to financial sector development and microfinance to be examined in the rest of this Chapter. Broadly, however in the rest of this thesis a combination of OIE and NIE analysis is undertaken because in analysing over-indebtedness this thesis accounts for and is interested in both the evolutionary nature (explored in Chapter 3) and the functionality of institutions within Sierra Leone's microfinance sector (as seen in Chapters 4 and 5).

2.2 Institutional Economics and Financial Sector Development

Marcelin and Mathur (2014) provide a succinct review of the various explanations provided by the Institutional Economics literature on variations in financial sector development. The fundamental message of the paper is that the quality of institutions (formal and informal institutions) does impact on the financial sectors' ability to perform its financial intermediation function (including access to finance) effectively. The level and quality of financial intermediation is in turn one indicator of financial sector development. It is along these lines that the paper concludes that those factors which impact on a financial sector intermediation such as transaction costs, cost of funds, informational issues, enforcement of contracts, adverse selection etc are minimised in economies or sectors with good quality institutions.

The existing explanations for the role of institutions in promoting financial sector has been categorised into three strands of literature by Marcelin and Mathur (2014). They are as follows:

- The law and finance literature- the strand of literature which examines how the heritage of a country's legal system and institutional infrastructure affects its ability to protect the rights of investors and minorities (La Porta et al 1997, 1998).
- The literature which focuses on property rights (Acemoglu, Johnson and Robinson (2001, 2005)
- The literature which offers a broad view on financial sector development (Levine 1997 and 1999, Rajan and Zingales 1998).

The framework offered by this paper through which to understand how institutions impact on financial sector development brings to the fore that the interaction between the different kinds of political, legal, and property rights institutions are critical to the level of financial sector development of a country. All of these institutions impact on financial outcomes (in case of this thesis debt outcomes amongst microenterprises will be the relevant impact). An important contribution of this framework in relation to other existing literature is the importance it places on accounting for the role of informal institutions and the contracting rights of institutions.

Going to the specifics, the framework presented by Marcelin and Mathur (2014) shows that one major factor preventing access to finance (hence financial sector development) is having 'rules enforcement mechanisms' (Marcelin and Mathur 2014, page 27) that enforce financial contracts amongst the various players involved in an exchange. In this regard, the independence and efficiency of the judiciary, customs and culture will enable the creation of viable and valid contracts. The paper argues that weak judiciary systems and where the judiciary lacks the ability to enforce debt contracts it increases the costs of financial intermediation thereby preventing access to finance. It is for these reasons that the authors highlight the importance that private and informal forms of enforcing contracts have emerged in certain societies with weak formal institutions to enforce and monitor debt contracts. It proposes that these forms of contract enforcement have emerged as a way of getting around inefficient legal and institutional systems and to some extent has facilitated private flow of finance.

This thesis would like to point out that whilst it is apt to point out that informal and private mechanisms have emerged in enforcing contracts with the various institutional forms of informal finance provision being an example, it is important to acknowledge the problems of informal finance such as predatory lending terms and conditions of some informal money lenders. The challenges presented by mechanisms such as group lending and peer to peer monitoring also comes to mind.

The other factor considered by this framework is the role of costs of funds i.e net interest margins and interest rates spread. The cost of finance is one indicator of the amount and level of risks associated with contracts. Ordinarily, one of the main functions of a financial system is to minimise system risks (Levine 1999). In financial systems were interest rate margins and spreads are high, it is due to the inefficiency of financial institutions to minimise risks. Moreover, this represents costs of doing business hence financial institutions are not likely to provide the level of financial services required especially when the gains from loans outweigh the costs. Perhaps one important point to note is that Marcelin and Mathur (2014) show that other external factors contribute to risks present in partaking in an exchange. The paper reiterates the importance of an efficient judiciary system in assisting with curtailing financing costs. Having considered the range of negative consequences of weak institutional settings especially the judiciary, the paper states that '*the most economically consequence may be an increase in financial disintermediation, backwardness, or sustained under-development; and, as a result, new financial markets and products fail to emerge*' (Marcelin and Mathur, 2014). In fact, Sierra Leone-the case study of this thesis- is cited in the paper as example of a country where inefficient institutions exists and has led to high interest rate spreads. Furthermore, Sierra Leone is noted as a financial sector where access to finance is a problem due to Commercial Banks' preference to invest in risk free lending to the State due to the high costs involved in lending to individuals. This point certainly relates to this thesis's finding in Chapter 5 with regards the ability of microfinance institutions in Sierra Leone to source wholesale loans from the local financial system.

The nature of a country's legal system is another factor which the framework presents as a contributor to the level of financial access. The paper makes the case that the type of legal system that is inherited by a country has implications for its financial sector. In the sense that, certain legal systems differ in the priority they give to providing finance for the State as opposed to individuals. While there are also legal systems that will evolve in manner that does not support financial sector development because they rely on changes to the statutory law rather than jurisprudence. Lastly, the paper states that legal formalism also affects financial access because it implies delays in court, higher costs associated with contract enforcement etc. The framework also recognises the interactions between property rights and contracting rights and their roles in enforcing contracts.

The framework further incorporates the role of information in promoting financial services access. In particular the role played by credit registry (public or private). Informational challenges have prevented the achievement of financial sector deepening as well as financial outcomes. This is because in such contexts information costs and transactions costs are high and ultimately information asymmetry will prevail. Evidence is provided for the usefulness of credit registries in promoting financial sector development and innovation, especially in societies where banks have to deal with businesses that do not keep records. This is what leads the paper to recommend informational reforms as a key means of removing banking inefficiencies and to prevent financial disintermediation.

Creditor rights are also highlighted as a contributing factor to better financial intermediation. In sum, in countries where creditors cannot exercise their rights in some cases due to weak judicial systems, contract enforcement is a problem. The upshot of that is financial disintermediation including poor access to financial services.

The institutions and factors that have been discussed which Marcelin and Mathur (2014) believes are crucial to financial sector development and financial outcomes will be borne in mind when conducting this thesis's analysis in latter chapters.

2.2.1 The State and Financial Sector Development

Engerer and and Schronton (2002) also examines the relationship between institutions and financial sector transformation and concurs that the quality of institutions impacts on countries' financial sector development. The paper conceptualises financial markets and the financial system as internal and external institutions respectively. In this framework, the financial sector imposes the rules of interaction between the players in the financial system. For example, contracts are negotiated amongst players in the financial market but it is the financial system that imposes the rules to ensure the transactions are concluded and executed. The framework identifies similar factors to Marcelin and Mathur (2014) that prevent financial sector transformation including the efficiency with which contracts are enforced, the presence of asymmetric information (leading to moral hazard and adverse selection), and then type of legal system. The role of regulatory and supervisory institutions in enforcing contracts and governing the financial sector is also discussed.

Another dimension introduced by this paper is the role of the State in promoting financial sector development. The State is said to be in some cases a creator of the financial system which involves setting the rules of the game for the other players in the financial sector in recognition of the existence of limitations such as asymmetric information. On the other hand, the State can also be a player in the sector; this is because in some instances the State intervenes in the financial sector. The existence of financial repressive policies is one example of how the State can be a player in the financial sector in order to promote financial intermediation or other financial sector related development.

Engerer and and Schronton (2002) is right in pointing out the role of the State in promoting developments in the financial sector. In consideration of the role of operations of the shadow banking system in the recent financial crises, Institutional Economics analysis has been applied in the literature in understanding shadow banking systems that exists in economies. This research shows that the institutional structures and incentives that exist in various financial systems give rise to the existence of shadow banking systems. Likewise, Wiegelmann and Peterssen (2013) illustrates that the institutions that exists also impact on the nature of the type of shadow banking that will emerge and more importantly the nature of the risks posed by this system. The findings of Wiegelmann and Peterssen (2013) make clear that shadow banking systems arise from restrictive policies (institutions) posed by the State with regards credit allocation. Furthermore, institutional problems are also created when such alternative institutional arrangements arise (shadow banking system) as a response of the financial system to restrictive government policies. A major challenge which arises is the problem of asymmetric information which thus leads to agency problems, adverse selection and moral hazard. Consequently, the 'alternative institutions' thus represent system risks not just to the local financial systems but at a global level seen in the form of the 2007/8 financial crises. In China for example, another dimension is the incentive structures created by government policies such as government guarantees which affect credit allocation.

From this what this thesis takes away is the critical role of institutions such as the policy and regulatory environment in shaping the type of financial system which arises. These findings will be factored into the analysis undertaken in Chapter Three where this thesis analyses how policies over the years have shaped Sierra Leone's microfinance sector.

While the argument that existing institutions do contribute to financial sector development and outcomes has gained traction in the literature, the literature also includes a line of argument presented by Demetredias and Fielding (2012) i.e. the institutions are impacted by certain developments within the financial system based on their institutional characteristics. One such aspect examined by the paper is loan defaults and how they affect the loan and asset structures of banks. Using data from the eight countries that make up the West African Economic Monetary Union (UEMOA) where the countries all have a uniform banking structure, the paper finds that smaller, privately owned banks are impacted by institutional challenges i.e. informational challenges, compared to older, State owned banks.[26] This finding is linked to the relative differences of how established banks are and their knowledge of the local context which are important factors that can determine the quality of loans offered by banks.

Another relevant conclusion drawn by this paper is that financial sector development is not necessarily impacted on by the creditworthiness of clients but due to the severity of information problems faced by banks. That is to say, since most less developed financial systems have not developed appropriate and adequate mechanisms to collect information on loan clients, loan defaults are likely to be prevalent and hence impact on loan portfolios of banks. Similar to, Demetredias and Fielding (2012) belabour the point that credit registries are essential in aiding banks to effectively monitor and screen clients. In addition, the importance of other institutions such as political institutions and effective legal systems are highlighted.

In consideration that developments and outcomes in the microfinance sector are the main focus of this thesis, the main critic of the literature discussed so far is its omission of the microfinance sector. Considering also that microfinance sectors do exist as part of most developing economies' financial sectors, financial sector development should not be discussed without accounting for

[26] The eight countries that make up the West African Economic and Monetary Union are Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo.

institutions and their impact on the microfinance industry. Notwithstanding, the implications of these analysis for access to finance has been most welcome.

In the next section, the literature which has attempted to apply Institutional Economics to microfinance is reviewed. It is hoped that this will throw some light into institutions and outcomes in the microfinance sector.

2.3 Institutional Economics and Microfinance

The importance of entrepreneurship through microenterprises has gained prominence especially with the rise and dominance of the neoliberal development model which puts emphasis on empowering the poor to partake in economic activities. Similar to the argument made already by this thesis, increasing also with the use of analytical tools offered by Institutional Economics, it has also been acknowledged that the institutional environment in which entrepreneurs operate also impacts them. One such way is with regards their access to and use and payment of finance (loans). One of the theories provided by the literature (Daley and Badiola 2002) for the rise of microfinance is the institutional challenges faced by conventional commercial banks such as imperfect information and transaction costs which prevent them from wanting to serve certain sections of the populace that are deemed risky. Secure property and contract rights are key institutional factors that have impacted on the level of credit accessed by marginalised groups from the banking sector.

The limited literature available which applies Institutional Economic Analysis to microfinance seriously emphasises the role of property rights and how this impacts on the performance of microfinance. In order to illustrate this impact, Daley and Badiola (2002) examine the performance of microfinance in the context of the Philippines. Even though Microfinance Institutions (MFIs) through their more personal methods of provision of finance have found ways of dealing with some of the institutional problems facing conventional commercial banks, the paper advocates for more market based forms of microfinance provision. The reason being market-based or more impersonal modes of financing are more capable of providing finance that will create more sustainable businesses that are more capable of contributing to economic growth. This is illustrated by the challenges faced by more subsidised forms of microfinance programmes. However, despite recommendation of the need to move towards market forms of microfinance it is recognised that the presence of insecure and uncertain property and contract rights impacts the ability of microfinance sectors to move towards market-based microfinance provision.

A valid observation is made that the lack of well-defined rights to property which makes collateral an issue restricts the ability of microfinance institutions to extent credit. However, this thesis departs from the view that more market-based forms of microfinance provision finance more sustainable and productive businesses. This thesis argues that in the light of the current debt crises experienced in certain microfinance industries amongst other challenges that are associated with commercialised market-based forms of microfinance.

A case is made for the need to address property right challenges by Einarsson (2003) when it comes to expending more microfinance to potential borrowers. The argument stems from the point made that in developing economies similar to industrial economies one hundred and fifty to two hundred years ago, most economic activities takes place extralegally i.e. outside any legal arrangement and system. One such activity is the ownership of assets including real estates and moveable assets. Usually assets are not registered and the titles to said assets are not clear. Therefore, untitled and unregistered assets are not appropriate to be used as collateral to obtain loans from microfinance institutions because it is impossible to ascertain the ownership of these assets definitively and officially.

To illustrate the effect of property rights on access to microcredit, a comparison is made between an entrepreneur from a western country and one from a developing nation. It is easy for a western entrepreneur to obtain loans against his or her assets because the assets are registered. For the developing country entrepreneur it is in most cases impossible to establish property rights because the procedures for registering assets, operating licences are inefficient hence the entrepreneur loses out on access to finance. The paper argues that other factors such as the lack of rules and the frequent movement of people between the rural and urban areas makes it difficult for microfinance institutions to cater to more borrowers.

2.4 Conclusion

The theories relating to Old Institutional Economics and New Institutional Economics were reviewed because they form the foundations of the prescriptions given by the literature on the implications of institutions and financial sector and microfinance development. The two strands of literature enrich our understanding of how institutions evolve overtime (in response to addressing a market failure or in other words in response to some form of institutional constraint). In addition, it provides insight into how the functional efficiency of institutions can be assessed i.e. this relates to whether institutions are constraining or addressing the institutional factors that impact on an exchange.

The literature discussed in Section 2.1 has given us broadly the main factors through the Institutional Economics lens that are seen to explain the variations in the level of financial sector development. It is important to reiterate here that, this thesis's interest in institutions and how they impact on financial sector and banking sector development is due to the implications for access to finance which is a central topic to this thesis. These factors include rules enforcement mechanism (the rule of law or the effectiveness of the legal system in enforcing contracts and property rights), information challenges or costs and their implications (due to the assumption of bounded rationality and agency problems), transaction costs, cost of funds (interest margins and rates), and the importance of political, historical and social institutions.

There are other insightful factors highlighted as crucial to financial sector outcomes such as the role of the State in creating or being a participant in the financial sector. This is relevant in particular as the State is only meant to provide an enabling environment for the private sector to provide goods and services including financial services.

The literature also points to the fact that the magnitude of impact institutional constraints imposed by the financial system affects institutions varyingly depending on the institutional characteristics of institutions.

A major point stressed on by the literature on institutions and microfinance is the need to address issues associated with enforcing property and contract rights. The implications for microfinance development and outcomes are particularly relevant for this thesis.

The above prescriptions and conclusions drawn by the literature reviewed provide a framework for the analysis undertaken in the rest of this thesis. The analysis undertaken will account for the institutional factors and constraints highlighted in explaining how institutions impact microenterprises ability to service their debts and to undertake DDMPs. The constraints presented by both formal and informal institution will also be accounted for in the analysis of debt outcomes.

The next Chapter will address how the microfinance sector has evolved over the years bearing in mind the lessons from the Institutional Economics literature.

Chapter 3: The Evolution of Access to credit in Sierra Leone and over-indebtedness amongst microenterprises

Credit provision and debt relations have always been integral to Sierra Leone's social, religious, historical, political and economic aspects of life. Similarly, access to credit for developing Sierra Leone's indigenous small scale businesses in the form of cash or kind has been part of the developmental debate since immediate post-colonial days to present, evidenced by studies such as Cox-George (1960, 1969), Stober (1968) and Taylor (1979), and in more recent policy documents like the Financial Sector Development Plan (2011).[27] Debt relations are also rooted in Sierra Leone's long history of small scale entrepreneurship and enterprise which is illustrated in discussions of the historical nature of entrepreneurship in Sierra Leone by White (1981), Magbailey Fyle (1988), Kallon (1990), and Kamara (2008).

A number of aspects have however changed with regards access to and provision of credit. There have been policy efforts towards formalising credit provision, from predominantly through informal arrangements such as Osusu[28] in the pre-war years to a more formalised system of provision by a range of Microfinance Institutions (MFIs) that are currently part of Sierra Leone's financial sector. Its role has also been changing too, that is, from mainly performing a social role by bringing different sections of the community together, it then played a role in the post-war reconstruction. Presently, it is anchored in the development agenda through promoting domestic private sector development, financial sector development and financial inclusion of the poor including microenterprises. Credit provision has also over the years had elements of political economy features, where it has played a role in electioneering at different levels of government, over the history of Sierra Leone. Jalloh (1999, 2003), Jalloh and Skinner (1997) focus on the role of credit in Sierra Leone's religious and political aspects of life.

In spite of credit relations and policies to improve credit access being entrenched in society and the development agenda of Sierra Leone, in this Chapter it is shown that historically debt problems have resulted from most credit initiatives over the years and they have resulted on account of certain institutional constraints. The current microfinance sector is no exception. This Chapter is split into two parts; the first part i.e Sections 3.1 and 3.2) provides an analysis of the efforts towards access to credit efforts in the post-war era. This first part highlights amongst other developments; donor and government efforts towards transforming and expanding the

[27] A number of other policy documents relating to access to credit will feature in this thesis, including Sierra Leone's Private Sector Development Strategy, and the National Microfinance Policies (2003, 2010).

[28] Osusu is the local word for a group of individuals who agree to come together for a defined period in order to save and borrow. It is a form of combined peer-to-peer banking and peer-to-peer lending.

microfinance sector and the influx of foreign banks experienced during that period. It shows that the access to credit agenda is an institutional change that has given rise to various policies and institutional forms of credit provision. It also concludes that for as long as credit expansion continues in the face of existing institutional challenges such as informational challenges and the role of the State, it is likely for debt problems will be repeated.

The second part of the Chapter i.e. Section 3.3 discusses the debt problems such as multiple borrowing and debt-refinancing that currently plagues the microfinance sector. In this section, evidence is provided to back this thesis's claim that detrimental debt management practices (DDMPs) throw microcredit clients into further indebtedness.

3.1 Post-war access to credit for indigenous microenterprises (MEs)

3.1.1 End of the war to Immediate post-war

It was alluded to in Chapter 1 that a post-war nation like Sierra Leone draws on policies that it believes will help with post-war reconstruction including improving access to credit. Hence, the provision of cash hand outs and subsidised credit were integral to the emergency post war relief programmes that were implemented by the Government, donors, and Non-Governmental Organisations (NGOs).

The Government's microcredit scheme for emergency relief efforts mentioned in Chapter 1 was composed of an NGO program and a Chiefdom programme. The NGO programme entailed Social Action for Poverty Alleviation (SAPA) giving wholesale loans to NGOs for them to on-lend to individuals and groups who had been affected by the war. While, the Chiefdom programme; involved SAPA providing grants to communities through Chiefdom Microcredit Committees (CMCs).[29] Total outreach of the SAPA microcredit programmes were over a hundred thousand but they faced some challenges that are well documented and are backed up by findings by this thesis's research from fieldwork interviews with former SAPA staff members.[30]

The Chief programme was marred mainly by criticisms such as: it being used as a tool for gaining political support by the then Government especially due to the timing of the intervention, the year preceding the 2002 general elections in Sierra Leone. The repressive nature of the NGO program was not in line with financial liberalisation policies that were being implemented; in addition a number of the NGOs did not have the expertise to implement microfinance projects.

[29] The CMCs were made up of a paramount chief, a section chief and other representative residents of the community.
[30] As at 2004, 6500 under the NGO programme and 100,000 clients were reached with the Chiefdom programme (UNCTAD 2007).

An ex-SAPA staff in an interview during the fieldwork, explained that 'some of the NGOs that were part of SAPA's NGO programme later proved to be unreliable and dishonest whilst others simply lacked the capacity to administer microfinance programs'. With regards the Chiefdom program, the interview highlighted that 'poor loan recovery, some Paramount Chiefs misappropriating the funds and accusations that the Government was using the scheme to buy votes' were issues that were associated with the programme *(Ex-SAPA staff as related to the author on 27th May, 2013).*

In general, during this period, it was also quite common for NGOs to have microfinance as part of their wider programmes set up to help the populace cope with the effects of the war and widespread poverty. The major NGOs at that time included the Association for Rural Development (ARD) and American Refugee Committee (ARC). However, after their emergency and relief mandate had been executed, these NGOs transformed into either solely microfinance NGOs or retained microfinance as part of their portfolio. As a result, a number of the larger microfinance institutions that currently operate in the sector have their roots in providing post-war relief support.

3.1.2 Post-war efforts to improve access to credit

Post-2001, the Government's priority turned towards mainly reconstruction rather than emergency relief, owing to the poverty situation that the country was faced with including high levels of unemployment especially amongst women and youths. With support from donors such as the World Bank and the United Nations Development Programme (UNDP) provision of microcredit became a key mechanism for providing incomes and livelihoods for families. The literature such as Kangaju (2006), Turay (2008) and Fraser (2012) explains that, provision of microfinance to microenterprises was a policy objective in the Government's Interim Poverty Reduction Strategy paper (2001) and The Government's National Recovery Strategy (2002-2003). It remained a priority, featuring prominently as part of pillar two within the first Poverty Reduction Strategy Paper (PRSP 1).

Development of the microfinance sector formed part of a joint donor-government project; the Pro-poor Financial Sector Development Project (PFSDP) as a way of rebuilding the 'scanty' rural financial infrastructure that existed prior to the war and that which was later damaged as a result of the war. Furthermore, emphasis was laid on developing this sector due to the need to expand the outreach of financial services to the rural areas as part of the Government of Sierra Leone's (GoSL's) economic development priorities during that time (NaCSA 2008). In addition 65% of Sierra Leone's population lived in the rural areas whilst the informal sector which had the majority of the potential microfinance clients formed about two thirds of the labour force according to NaCSA (2008).

With the support of donors, *the launch of the National Microfinance Policy in 2003* represented a major institutional development towards trying to improve access to credit in the rural areas and also to micro, small and medium-sized enterprises that the conventional commercial banks continued to exclude from the formal banking system. The situation was made worse by the fact that many potential borrowers had lost their assets that could have been used as collateral to access loans from the commercial banks. The microfinance policy was developed to provide the guidelines for conducting microfinance operations. It had a number of objectives that Fofana (2004) summarizes as follows '*to develop and integrate micro-finance into the national financial services mainstream and facilitate the provision of viable and sustainable micro-finance services to low income Sierra Leoneans in a transparent and accountable manner for meaningful productive activities and thereby contribute to economic growth and poverty reduction'*. It is important to note that the policy also represented efforts by donors to prevent Government from being directly involved in the provision of microcredit as seen in the past. Kooi and Tucker (2003) notes that the National Microfinance policy stipulated that the Government should have no direct involvement in the provision of retail microfinance.

Concurrently however, in order to improve the rural populace's access to financial services including credit-to help them cope with the poverty situation they were facing, the Bank of Sierra Leone reestablished the rural banks to replace those that had been defunct due to the war (and for other reasons discussed in section 3.2.1.3). The re-established banks were now known as Community banks. Fofana (2004) explains that, the concept of community banks is based on establishing 'simple financial intermediaries' for the provision of credit and other services to small enterprises in the rural areas. Kangaju (2006) sums up the rational for setting up community banks in Sierra Leone as *"To promote, develop and expand the rural economy by carrying on the business of banking including borrowing, holding securities and administering property, accepting deposits of money for savings, current account etc"*. Two pilot community banks were set up in 2002; Yoni Community Bank and Marampa Community Bank followed by another two, that is, Mattru and Segbewema Community Banks in 2003.

3.1.3 Influx of foreign banks

Following the restoration of peace to Sierra Leone, another noticeable institutional development in the formal financial system which had potential implications for access to credit to microenterprises was the rapid influx of foreign owned commercial banks (*indicating continued financial liberalisation*). Due to this development, Sierra Leone's banking sector has received attention; Ecobank (2013) refers to the Sierra Leone's banking sector as '*a magnet for foreign banks*' and whilst an article in the African Economy (May-July 2015 Issue) captures the trend in the influx of foreign banks in Sierra Leone's financial system by referring to it as the '*new hotspot for banks*'.

Decker (2012) states that the number of commercial banks almost trebled during the period 2001 to 2010 i.e. from five to thirteen banks. The influx of foreign owned banks grew steadily between 1999 and 2004 but grew rapidly from 2007 to 2009; six out of the ten foreign owned banks made their entry then.

The table below shows the different categories of commercial banks operating in the sector. Of the thirteen banks in Sierra Leone seen in Table 3.1, ten are foreign private owned of which seven are Nigerian subsidiaries, and the other three being Malaysian (International Commercial Bank) and United Kingdom (Standard Chartered Bank) and Ghanaian (Ecobank) subsidiaries respectively. There is one State owned bank i.e. Sierra Leone Commercial Bank, one part state and privately owned (Rokel Commercial Bank formally Barclays Bank SL) and one fully privately owned by Sierra Leoneans (Union Trust Bank). The number of commercial bank branches also increased six-fold as found by Decker (2012), from thirteen in 2001 and eighty-one in 2010.

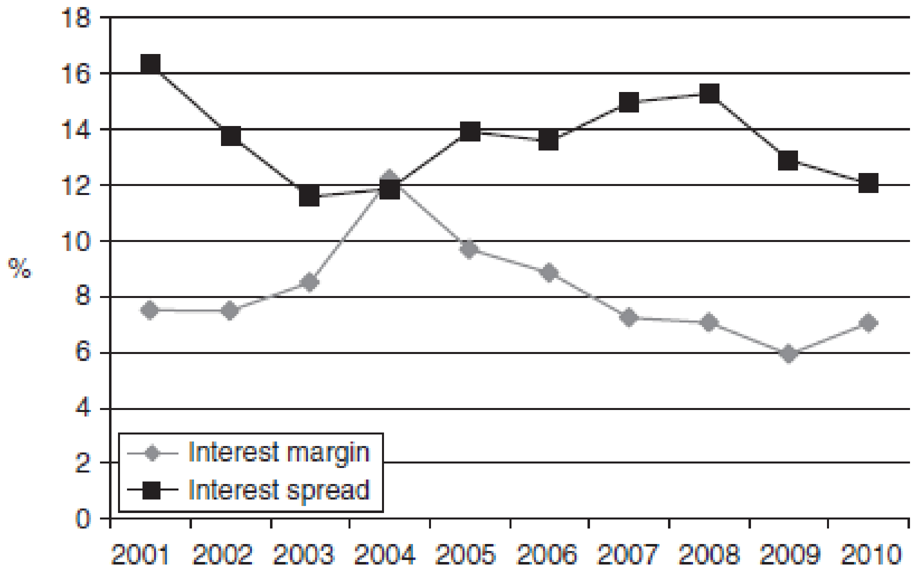
Table 3.1: Commercial Banks and Ownership Structure

Bank	**Ownership structure**
Ecobank	Foreign Owned (Ghanaian subsidiary)
Skye Bank	Foreign Owned (Nigerian subsidiary)
United Bank Africa (UBA)	Foreign Owned (Nigerian subsidiary)
Sierra Leone Commercial Bank	State Owned (Government of Sierra Leone)
International Commercial Bank	Foreign Owned (Malaysian subsidiary)
Rokel Commercial Bank	Part State Owned, Part Public Owned
Guaranty Trust Bank (SL) Ltd	Foreign Owned (Nigerian subsidiary)
Zenith Bank	Foreign Owned (Nigerian subsidiary)
Access Bank	Foreign Owned (Nigerian subsidiary)
Union Trust Bank	Indigenous Bank (Locally owned)
First International Bank	Foreign Owned (Nigerian subsidiary)
Standard Chartered Bank	Foreign Owned (United Kingdom subsidiary)
Keystone Bank	Foreign Owned (Nigerian subsidiary)

Source: Author 2015

With the influx of the new banks and increase in branch network, it was expected that this would introduce some competition into the banking system thus lowering interest rates, and hence increase the provision of affordable loans for small domestic businesses. However, as seen in Figure 3.1 after a decline by 4.8% from 2001 to 2004, the interest rate spread widened from 2004 to 2008 when it stood at 15.28%. It dropped to 12.89% in 2009. Commercial bank lending rates as at December 2011 were between 21-29% (Sesay 2012). The spread between lending and deposit rates were above 10% during 2011.

Figure 3.1: Interest rate spreads and interest rate margins 2001-10



Source: Decker 2012

On the whole, it can be seen in the diagram above that interest rates did not decrease despite the increased competition and banks still preferred to invest in treasury bills rather than making loans available to customers that are perceived to be highly risky, as was the case before the new entrants in the sector (recall similar observations made by Marcelin and Mathur, 2014 in Chapter 3). Decker (2012), notes that the widening interest rate spreads was due to low and declining deposit rates while lending rates increased. In addition, the study finds that, overall, during 2001-2010; foreign banks had a larger share of deposits than loans when compared to the domestic banks. Foreign banks were less likely to expand credit facilities to locals due to institutional constraints such as informational disadvantages. Decker (2012) also recommends that the types of financial service providers must be diversified, in order for competition to produce the desired results in Sierra Leone. Competition amongst the same type of institution, it claims is likely to be more destructive than beneficial.

3.1.4 Reigniting the microfinance sector

Despite the rapid influx of commercial banks, the above analysis in Section 3.1.3 demonstrates that the 'problem' of inadequate access to credit for micro and small businesses had still not been addressed. United Nations Capital Development Fund (UNCDF 2004) estimates that at that time, out of the 90,000 to 160,000 customers that demanded microcredit, only the needs of just 13,000 customers were being met. This was even after the Government had launched a microfinance policy and also with the existence of a nascent commercialised microfinance sector (a few community banks and NGO MFIs). These institutions were weak, small and their client outreach was far from the desired levels. According to UNCDF (2004), other institutional factors affected the then microfinance sector that existed. They include; (a) there was no market leader to demonstrate to other prospective MFIs that the business of microfinance was worth investing in, and that they could do business with people at the lower level of the pyramid, (b) lack of funding for MFIs (c) the wrong perception of microfinance, that is, it was still relief grants being provided by the government and (d) lack of coordination and regulation of the sector.

In addition to the above mentioned challenges, the worsening of poverty levels and social indicators prompted the government with support from donors to launch the Development of a Sustainable Pro-poor Financial Sector programme (DSPFS 2004-2009). This programme became the channel through which the government with the support of donors will amongst other things; achieve the objectives of the National Microfinance Policy, transform the microfinance sector from its growth stage to its expansion stage, as well as actualising the goal of restructuring the sector from a government-led to a market-based sector.

This project gave rise to the setting up of a joint donor-government facility, that is, *Microfinance Investment Technical Assistance Facility (commonly known as MITAF 1)* as a mechanism for funding and coordinating the activities as set out in the DSPFS programme document. In the post-war era, this project represents one of the largest programmes of support towards developing the microfinance industry. MITAF mainly focused on capacity building and loan capitalisation of MFIs.[31] The initial targets of MITAF 1 as stated on their website were:

1. Expand outreach to 100,000 microfinance clients by 2009.
2. Build strategic partnerships with donors and investors to enable MFIs access to at least $12 million in capital by 2009.

[31] Not all MFIs in the sector received support from MITAF, only those that were sourced as potential market leaders.

3. Support the Bank of Sierra Leone to develop a professional Microfinance Unit.
4. Disseminate best practices throughout the microfinance sector of Sierra Leone

3.2 Access to credit for domestic private sector development

In the introductory chapter, this thesis discussed how the Government of Sierra Leone has also embraced the financial inclusion agenda most notably by the signing of the MAYA declaration in 2012.

Prior to the signing of the MAYA declaration, from 2005 onwards, the Government was keen to rebrand Sierra Leone from its war-torn image to a country that is ready for foreign investment. This mission continued until a new Government (the All Peoples Congress Party) came into power in 2007, and private sector development and job creation also featured prominently in Sierra Leone's second generation Poverty Reduction Strategy Paper (PRSP 2 or An Agenda for Change).

The determination to create a booming domestic private sector which is high on the current government's development agenda cannot be divorced from the priorities of President Ernest Bai Koroma who worked in the private sector (insurance industry) before going into politics. President Koroma famously stated during his inaugural speech that he intended 'to run Sierra Leone like a business'. This is an illustration of his business mindedness and thus his tendency towards encouraging the development of a thriving domestic private sector. According to Newstime Africa 2013, President Koroma's government 'has become the most investor friendly administration in Africa'.[32]

Following on from the renewed focus on domestic private sector development, during 2009, with the assistance from donors, policies aimed at creating a thriving private sector and the development of the financial sector were launched: The Private Sector Development Strategy (PSDS 2009-2014) and Financial Sector development Plan (FSDP) respectively.[33] Embedded in these policies were objectives aimed at increasing access to finance for domestic micro and small businesses.

The Private Sector Development Strategy (PSDS) prescribed ways of developing the domestic private sector, outlining amongst its priorities steps towards: *increasing access to affordable finance* by

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[32] Running a government like a business-Something the Sierra Leone President has done effectively. News time Africa, by Ahmed M Kamara. 3rd February 2013. Accessed 19th Febraury,2013

[33] The PSDS highlighted the need to develop a policy for developing the financial sector as a complementary policy for promoting the advancement of the domestic private sector.

providing technical assistance to Commercial banks to help them develop products suitable for small enterprises and establish a market for commercial microfinance. The indicators of success under the objective of increasing access to affordable finance were: firstly, the level of credit that the private sector receives more than doubles; secondly, the number of businesses with access to formal sources of finance more than doubles in the five years (of policy implementation); and thirdly, the percentage of businesses that have cost of finance as a major constraint to business development halves.

The main objective of the FSDP is '*to provide a framework for creating a sound, diversified, responsive and well-functioning financial system that would provide appropriate support to productive activities, thereby contributing to economic growth and poverty alleviation*' (FSDP 2009).

The priority areas of focus of the FSDP are summarized by Johnson (2011). The priorities include *increasing access to finance which comprises*: (a) Broadening microfinance and rural credit delivery outreach; (b) Strengthening microfinance and rural credit governance and supervision; and (c) Restructuring and improving community banks.

The above institutions i.e. the reforms and policies, paved the way for the continued expansion of the microfinance sector and this gave rise to new institutional forms of providing microfinance and programmes aimed at formalising, mainstreaming and commercialising the provision of financial services to micro and small businesses.

The rest of this section will discuss the various institutional forms of credit provision that have subsequently emerged in the sector. The discussions, illustrates and confirms that the policy agenda of improving access to credit represents an institutional change in the way in the financial sector's institutional landscape is transformed and the ways in which credit is provided.

3.2.1 Community banks, Financial Services Associations (FSAs), and Village Saving and Loan Associations (VS&LAs).

3.2.1.1 *Financial Services Associations & Village Saving & Loans Association (VS&LAs)*

The advent of Financial Services Associations (FSAs) came about as a result of the Rural Finance and Community Improvement Programme (RFCIP) which was launched in 2007 as a result of collaboration with International Fund for Agricultural Development (IFAD) and the Ministry of Agriculture, Forestry and Food Security (MAFFS). As the name of the project indicates, it was aimed at promoting rural access to credit.

FSAs or village banks as they are widely known, are grass root organisations and according to Neel (2010), they were set up in Sierra Leone to give access to those sections of the rural populace that were not being served by existing community banks and other microfinance institutions. They were also set up to fill in the gap of the community banks that were under reform. IFAD (2013) notes that the pilot phase of the project (2007-2009), comprised, the setting up of six FSAs in four districts, with funds provided partly by both the Italian government (Ministry of Foreign Affairs) and IFAD.

Neel (2010) and Fraser (2012) explain that FSAs are owned and managed by the local community and they are registered as community based organisations who are also shareholders of the FSA. Thus, the services provided by FSAs can only be accessed by shareholders. Funds are pooled and mobilised from local residents which are transformed into loan capital and used to make credit available to shareholders who need and meet the loan appraisal standards. Loan sizes do not exceed four times the shares owned.

An IFAD assessment reported 51 FSAs (of which 42 were fully operational). The report further noted some successes of the RFCIP, which included a total of 39,186 shareholders, of which, 5,677 were the total active loan clients. The total loan outstanding was 1.2 million dollars, with the loan size per person not exceeding two hundred dollars.

Neel (2010), in an earlier independent evaluation of FSAs, had acknowledged that there is potential for FSAs in Sierra Leone. It also found that there was a general acceptance of FSAs by communities. However, the study recommended that challenges around funding gaps and the need for more training and support (logistics and supplies) for managers of the FSAs must be examined.

Despite, the potential of FSAs to assist in addressing access to credit challenge in theory, fieldwork interviews for this thesis with managers of MFIs, revealed that, there was a sense that the FSA format will not work in Sierra Leone due to its lack of flexibility; for example, only shareholders can access loans and members must have been shareholders for a certain period before they can access loans.

In Sierra Leone VS & LAs served as a complementary institution to FSAs in terms of their target group (clients). VS & LAs are groups of self-selected people that pool their monies into a fund which can then be borrowed by members of the group.[34] They are being promoted by donors

[34] Hendricks and Chidiac (2011) offer a detailed discussion of the role of Village Savings and Loans in promoting financial inclusion in Africa.

such as CARE International (through CARE Sierra Leone); Catholic Relief Services (CRS), Plan International and the International Rescue Committee (IRC) (AYANI (2013). The donors provide the groups with training and then link them up with formal financial institutions.

This thesis argues that VS & LAs are yet to make a significant in-road in improving rural finance. For example, the CARE programme, as at 2009 had 11,000 members from the 350 groups it had set up (Fraser 2012). Under this programme, CARE aims to form 900 groups in order to reach 22,500 clients in 40 chiefdoms in Bombali and Koinadugu Districts[35] (AYANI 2013). The Plan International programme started in 2010 and aims to benefit 16,500 youths while the IRC has formed 75 groups with a total number of members of 1,827.

3.2.1.2 *Community Banks*

Under the RCFIP, more community banks were set up, while the Bank of Sierra Leone with assistance from IFAD undertook a restructuring of existing banks that were facing a number of challenges hence limiting their ability to significantly contribute to addressing the gap in rural financial services especially credit. Fraser (2012) summarises the challenges which include inadequate liquidity, high operating costs, inadequate computerization, untrained and inexperienced staff, inexperienced directors and management, lack of shared resources and services and inadequate supervision. This thesis infers that these challenges can be classified as institutional constraints that will impact on the quality and quantity of the financial services provided by Community banks. This invariably will have an impact on their clients including the potential to create debt problems for them.

As at end 2013, there were 13 community banks and AYANI (2013) explains that of these six were established from 2005 to 2009, and a further seven from 2010 to 2012 under the RFCIP. In 2014, an additional four were opened. The total community banks to date (2015) are seventeen (BSL 2015).[36]

The main focus of this thesis's fieldwork was not on the operations of community banks, the opportunity was however taken to meet and interview staff of two community banks. The interviews threw some further light into the experiences and challenges of community banks in the early 2000s already highlighted. During fieldwork, other stakeholders in the sector were also asked some questions with regards the performance of community banks.

[35] See Appendix 1 for locations of Bombali and Koinadugu.
[36] www.bsl.gov.sl/financial_institutions.html. Accessed July 2015

Of the two banks, during the period which the fieldwork was conducted, one was in a healthy financial position (having gone through some operational difficulties in the past), whilst the other was amongst the high performing banks in the early 2000s, but was now in distress operationally.[37] However, from the interviews, it was deduced that both banks shared some common experiences and challenges.

The research found that some of the positive aspects with regard community banks' operations:

Firstly, at the time of their opening, they were both the first formal banking service to have existed in their respective rural communities (they also served nearby districts). One of them still remains the only bank available in the locality. Therefore, community banks have served as a mechanism for introducing the rural population to formal banking services.

Secondly, the intervention of IFAD has contributed to improving the performance of banks that were in distress. The IFAD support includes funding and technical assistance for developing products, procedures and funding proposals, as well as training for staff and clients.

Noting that both banks have at some point gone through operational difficulties (institutional constraints); the challenges highlighted by staff interviewed by the researcher were:

1. *Poor portfolio performance due to problems with loan recovery*
2. Rapid expansion of the community banks when there were not enough resources to handle the portfolio growth.
3. High overhead costs due to poor infrastructure accounted for factors such as very limited electricity supply and bad roads.
4. Inadequate monitoring and supervision by the regulatory body; infrequent onsite visits and limited feedback on offsite monitoring.
5. Limited interaction and collaboration with other community banks.[38] With the setting up of the Apex Bank during late 2013, there are plans to foster collaboration amongst community banks.[39]

3.2.1.3 *Other Microfinance Institutions (MFIs)*

Post war, a large number of MFI NGOs continued to exist in Sierra Leone, though these were generally small and did not have a significant client base.[40] However, the landscape of *MFIs* that

[37] Fieldwork was conducted during May to November 2013
[38] For example, customers of one community bank could not access the services of another community bank and this limited their ability to attract clients (more so big businesses) who needed that facility.
[39] The Apex Bank will serve as a 'central bank' to all Community banks

previously dominated the microfinance sector continued to change. New MFIs entered the sector and some existing MFIs exited the sector. Some NGO MFIs transformed to non-bank financial institutions (NBFI) or limited liability companies and others from international NGOs to local NGOs.

However, going back to the years leading up to the end of the war and in the immediate post-war years, the dominant NGO MFIs included: Association for Rural Development (ARD), World Hope International, American Refugee Committee (ARC) and Promoting Initiatives for Micro Enterprises Development (PRIMED). At the inception stage of MITAF 1 in 2004, the major MFIs were Finance Salone (used to be ARC an international NGO now transformed into local limited liability company), Hope Micro (formerly World Hope International an international NGO that later transformed into a local NGO), Christian Children's Fund, ARD, and Community Empowerment and Development Agency (CEDA). Other MFIs later entered the sector including BRAC, Grassroot Gender Empowerment Movement (GGEM) Microfinance, Hands Empowering the Less Privileged (HELP), Lift Above Poverty Organisation (LAPO SL), Luma Microfinance Trust (LMT).

Fraser (2012) lists nine active microfinance institutions in Sierra Leone as at 2011: ARD, BRAC, CEDA, Finance Salone, GGEM, Hope Micro, LAPO SL, LMT, and Sierra Leone Microfinance Trust (SMT).

While AYANI (2013) records the following active MFIs in Sierra Leone: ARD, BRAC SL, Bank for Innovation and Partnership (BIP), Call to Business Microfinance, CEDA, Ecobank Microfinance, Finance Salone, Grassroot Gender Empowerment Movement (GGEM) Lift Above Poverty Organisation (LAPO), Social Enterprise Development (SEND SL) and SMT.[41] It must be noted that there are new entrants in the sector such as Call to Business, Bank for Innovation and Partnership whilst others such as PRIMED, Hope Micro and Luma had folded up.

3.2.1.4 *Commercial banks and microfinance*

Another noteworthy institutional change in the sector was the entrance of *commercial banks* into the microfinance industry. Prior to Ecobank Microfinance (subsidiary of Ecobank, Sierra Leone), other commercial banks had ventured into provision of microfinance. In 2007, Procredit Bank (a German subsidiary) was the first commercial bank to offer microfinance services. Being a

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[40] Kooi and Tucker (2003) estimates that their outreach was less than 200 clients

[41] In 2014, two new credit only microfinance institutions entered the sector: Capitol Finance Company Ltd and SAFE Microfinance (Bank of Sierra Leone 2014)

microfinance bank, it provided the services of a bank but the target group were micro, small and medium-sized enterprises (MSMEs). However, it is widely documented and was confirmed from fieldwork interviews for this thesis that the bank faced wide ranging challenges. The obstacles included a lack of knowledge of the local context, attitudes of clients towards debt, dishonest staff and *high non-performing loans*. As a result, Procredit Bank closed its operations in 2010 and the bank's assets were sold over to Ecobank Microfinance. Currently, part of Ecobank Microfinance's client base includes some clients that were taken over from Procredit. During fieldwork, an Ecobank Microfinance official explained that a complete cleanup was done on the Procredit Bank loan portfolio. Only those clients that they felt could do business were taken over.

This was followed by First International Bank (FIB), who introduced a group microfinance scheme as part of their operations AYANI (2013). The scheme was however not sustained.

Finance Salone, currently operates as the microfinance arm of the only indigenous commercial bank in Sierra Leone, Union Trust Bank (UTB). UTB took over the microfinance operations of ARC and now runs Finance Salone as a subsidiary. The bank also has a small and medium-sized enterprise (SME) financing window, which is unlike the other commercial banks.

Rokel Commercial Bank had a microfinance window from 2010 onwards, in order to provide credit for micro and small businesses. After, three years of implementation, the management and Board of the bank, decided to suspend operations and review the programme. Huge losses were incurred due to *high delinquency, loan arrears and non-performing loans* especially in the Makeni and Kono districts.[42] Interviews with managers and staff of Rokel Commercial bank during fieldwork mainly pointed towards problems with: perception of microfinance as 'free money', multiple borrowing, inadequate regulations to appropriately penalise delinquent customers and competition from other MFIs, as reasons for the failure of their microfinance scheme.

Sierra Leone commercial bank (SLCB), a state owned bank, has since the post war years from time to time been used by the State to provide microcredit. In 2013, with support from the International Finance Corporation (IFC, World Bank), the Ministry of Trade and Industry (MTI) launched a National Micro Small and Medium Enterprise Development Strategy. Following on from the launch of the strategy, the MTI is channelling funds to MSMEs through the SLCB. Officials at the MTI informed the researcher during fieldwork that the initiative seeks to assist the Ministry to achieve the objectives of pillar three of the strategy: '*Link financial markets to*

[42] The following article "Makeni customers undermine Rokel Commercial Bank' Awoko Newspaper, August 13th 2013, highlight the problems with the bank's microfinance initiative experienced in Makeni. awoko.org/2013/08/16/makeni-customers-undermine-rokel-bank. Accessed September 2013.

MSMEs; increasing the number of micro, small and medium enterprises that receive formal financial services' (National Micro Small and Medium Enterprise Development Strategy, 2013).

As at the time of conducting fieldwork (May to November 2013), it was too early to assess how effective this scheme has been. However, from interviews with other MFI managers, the research finds that, MFIs have not welcomed the government's initiative. Citing the point that, the microfinance policy states that the Government's role in the sector is to provide an enabling environment for the growth of the microfinance sector rather than being a competitor. The MFIs also claimed that by participating in the sector in this way, the Government is contributing further to the perception that microfinance is a charitable gift (free money) just as it was during the period after the war when Government and NGOs used microcredit as a mechanism to provide emergency relief for displaced persons discussed earlier and in Chapter 1.

During fieldwork meetings held with the staff of the Ministry of Trade and Industry (MTI) responsible for the programme, the existing concerns with regards the programme was raised by the researcher. From their point of view, the MTI's programme is being implemented 'simply to complement efforts of the private sector' *(MTI official as related to the author on 27th November, 2013).*

On the whole, from the preceding discussions relating to commercial banks, there is indication that most microfinance programmes run by the commercial banks have not been successful. Though, there are a number of reasons for this, the general consensus amongst other stakeholders in the sector however is that, commercial banks generally lack the expertise required to administer a microfinance programme. The reason being, providing loans to micro and small businesses requires specialised skills and techniques which commercial banks do not utilise when conducting their usual banking activities.

3.2.1.5 *Mobile money transfer facilities*

Another development in recent years that has accompanied the entrance of new commercial banks in the sector (see Section 3.1.3) is the provision of mobile money transfer facilities. Mobile money transfer has facilitated the provision of credit to a minimal extent and there is potential for it to contribute further to promoting access to credit as suggested by Fraser (2012). Most commercial banks provide this service while Airtel Money and Splash have partnered with some MFIs such as SMT and Ecobank Microfinance.[43] Hope Micro (before it collapsed), in early 2011, in partnership with Splash and Kopo Kopo a software company, were the first to make loans available via mobile money transfer. The then managing director gave the following rational for

[43] Splash is Sierra Leone's first mobile payment system company, started operations in 2009.

utilisation of this innovative method of providing loans: "*Making payments at our office takes the client away from their business. We partnered with Splash and Kopo Kopo in order to make our services as convenient as possible and put more money into the pockets of our customers.*"[44] This thesis argues that it is unlikely that this form of credit provision will take off at the rate it has in countries like Kenya (see The Economist 2013), because there are still areas in Sierra Leone that are yet to have mobile phone network coverage.

3.2.2 Part 1 Conclusion

Having examined the post-war efforts towards increasing access to credit, the discussions above have shown that the policy agenda to improve access to finance in itself is an institutional change. It has given rise to the development of policies such as National microfinance policy and the private sector development strategy which is to guide and 'govern' the ways in which this policy agenda is achieved. Likewise, the research finds that this policy agenda is responsible for the emergence of various institutional forms of credit provision such as FSAs and profit-making microfinance institutions.

The research also finds that integral to the institutional change with regards access to credit in Sierra Leone is the policy objective of commercialising the microcredit sector. This is the case also in other microfinance industries that underwent such an institutional change which authors such as Bateman (2010) claim is part of a neoliberal development agenda. In Sierra Leone, since subsidised credit were part of the immediate post-war emergency relief efforts (seen in section 3.1.1), donors had to find a way of ensuring policy was directed towards commercialisation of microcredit. The launching of the National microfinance policy and the MITAF project were notable milestones towards commercialising the sector.

An important finding however of this thesis is that policy has not been effective in fully transforming the sector. In other words, 'complete' institutional change has not happened, in the sense that the Government was found to have a continued role in credit provision. More importantly, this thesis would like to point out that this has consequences for indebting micro-credit clients in Sierra Leone. The research finds the Government's actions is creating confusion in the sector and a continued perverse perception that even some monies provided by private MFIs are government money which should not be repaid. Hence, clients misuse the loan and later struggle to repay it. Perhaps, this development is linked to the discourse in development economics that for policies to be effective there needs to be *ownership* by its beneficiaries. The

[44] www.sierraexpressmedia.com/archives/20112. Accessed in May, 2012

discussions above shows that most of the policies and institutions developed have come about through donors' support or the opponents of the contemporary microfinance movement might refer to it as donor imposition. Another reason might be that political economy realities might go against what donors think are ideal for developing countries. If the allegations are true that various Governments have used credit provision to appease voters then no matter how much donors believe it will be ideal for countries to commercialise microcredit, this policy objective will not be achieved. It therefore shows that institutional change can be hampered by political economy related factors.

While a more diverse array of institutions have emerged for credit provision to microenterprises, the research finds that these institutions have been ineffective due to certain institutional factors. The institutions have been ineffective in the sense that they have led to debt problems which in some cases have led to the demise of some institutions. The discussions highlighted that debt problems resulted from almost all the credit initiatives and programmes discussed. Institutional factors such as poor regulatory framework, high transaction costs, weak institutions have all led to default and indebtedness problems in the past.

A point made in the introduction was that credit expansion continues to feature high in the post-war development agenda despite bottlenecks experienced including indebting beneficiaries of credit services. This thesis argues therefore that as long as the credit expansion continues without addressing the institutional issues existent in the sector, Sierra Leone will continue to indebt microfinance clients. The next part of this chapter will discuss the debt problems that are occurring in the current microfinance sector.

3.3 Microcredit indebtedness in the current microfinance sector

To effectively undertake an institutional analysis of debt problems amongst microenterprises, it is useful that the research also includes an understanding of the how indebtedness arises amongst microenterprises. Hence this section discusses the research findings with regards the channels of over-indebtedness or how debt over-indebtedness is manifested amongst microcredit clients.

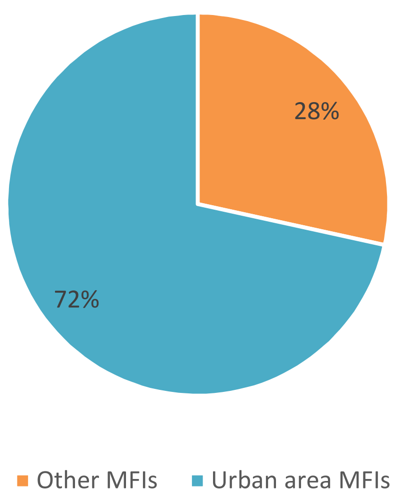
3.3.1 Multiple borrowing, cross borrowing and debt refinancing

In the introduction to this thesis it was argued that when clients are struggling to repay their debts, they would engage in detrimental debt practices such as cross borrowing and multiple borrowing (already defined in Chapter One) which has the potential to further over-indebt MFI clients. From Chapter One also, this thesis shows how multiple borrowing has manifested in other microfinance industries was discussed.

In Sierra Leone evidence of the occurrence of multiple and cross borrowing has been documented by assessments undertaken of the microfinance sector. For example, Duval and Bendu (2009), which is the final review of the MITAF 1 project, found that MFIs continued experience of *poor quality portfolios* amongst MFIs (similar to findings of the mid-term review i.e Duval and Bendu, 2006). The final evaluation states that '*at June 2009, only two of MITAF's partner lending institutions (PLIs) were meeting the criteria of Portfolio at Risk more than 30 days (PAR>30) of 5% or less, with the overall average of the 13 PLIs exceeding 10%*'[45] (Duval and Bendu, 2009). The assessment found that one of the main reasons accounting for poor portfolio performance was because *multiple borrowing* was on the increase. The evaluation further describes the problem of multiple borrowing as one of the unintended consequences that have resulted from the expansion of the microfinance sector.

The evaluation cited two main reasons for the existence of multiple borrowing that is the need for MFIs to meet outreach targets given by donors and also the high presence of MFIs in urban areas. Figure 3.2, illustrates the findings of the evaluation on the concentration of MFIs in the urban centres. Out of the 30 MFIs-community banks, commercial banks and other MFIs-that were active in Sierra Leone at that time, 23 operated in the urban centres.

Figure 3.2: Location distribution of MFIs



Source: Author 2015

[45] Portfolio at Risk (PAR) refers to the total outstanding loans divided by the active loan portfolio.

3.3.2 Detrimental Debt Management Practices (DDMPs)

In discussions with a range of stakeholders in the microfinance sector, this research finds that DDMPs had now been widespread compared to Duval and Bendu (2009)'s finding that multiple borrowing was on the increase. It was a concern for the regulators, policy makers, and donors due to its potential to create instability in the financial sector and worsen financial position of the microenterprises.

From the interviews conducted by the researcher with the regulatory body, another important reason for their concerns was the rate at which microenterprises were engaging in multiple borrowing and cross borrowing. The authorities intimated the researcher that DDMPs were posing a threat to being a barrier to '*successful financial inclusion*'. The authorities were pleased to report that more sections of marginalised groups were now gaining access to credit as a result of their efforts to create an enabling environment for the expansion of the microfinance sector. However, they also admitted that the resulting over-indebtedness goes against the notion of financial inclusion and it might deter clients to take up microcredit. In addition, due to the portfolio problems resulting from multiple borrowing it will hinder MFIs' ability and willingness to extend credit to their clients thus leading to financial disintermediation.

According to the regulatory body, a number of institutional factors were making it possible for microcredit clients to engage in such practices including: (a) microfinance institutions do not benefit from the services provided by the Credit Reference Bureau (b) high concentration of microfinance institutions within certain localities that has led to unhealthy competition amongst MFIs for clients, and (c) the absence of a proper address system in Freetown (and Sierra Leone generally). At the earlier stages of this research, these concerns over multiple borrowing served as evidence that clients were engaging in harmful debt management practices.

On the other hand, interviews with MFI personnel also revealed that these practices contributed to the portfolio problems they continued to experience. Recall from the discussions above those debt problems that had experienced in the past (prior to this thesis's fieldwork) led to the closure of some MFIs (Hope Micro and Procredit Bank) and the suspension of some commercial banks' microcredit programmes (including Rokel Commercial Bank).

For the purposes of this research, the figure 3.3 below shows that a total of 24 MFI personnels were interviewed. Of which 15 were loan officers and 9 were senior management including branch managers, and managing directors.

Figure 3.3: Distribution of MFI personnel interviewed

Source: Author 2015

In interviews with these personnel, a question was put to them with regards the reasons why clients struggle to repay the loans. Top most amongst the reasons provided was that it was due to clients engaging in multiple borrowing or cross borrowing. Another reason was when clients misuse their loans by accessing one loan to repay another loan (engage in debt refinancing).

Of the 15 loan officers interviewed 90% had a direct experience with their clients engaging in multiple borrowing and the remaining could cite experiences of other colleagues. Appendix 3.4 includes extracts from interviews with some MFI personnel and officials from the regulatory body providing evidence for the existence of widespread existence of DDMPs.

In sum however, when loan officers begin to observe that a certain client is struggling to repay his or her loan, their suspicions of clients engaging in DDMPs are usually confirmed by the following: a) most commonly when a loan officer, say from MFI A, visits a client to collect a loan payment or loan monitoring and there is a loan officer from another MFI (MFI D) also there to collect payment for a loan obtained from MFI D b) Loan officers conduct interviews with people who know the client well and they reveal that the client is accessing loan from another MFI c) Collaboration in terms of information on clients between loan officers operating in certain areas leads them to discover that a certain individual is accessing loans from other MFIs.

With regards cross borrowing, there was evidence provided that certain clients especially group leaders 'hire' group members to access loans on their behalf. Usually the other group members are only given a token amount and the group leader utilises the rest of the 'loan pot'. However, the fraudulent client struggles to repay the loans on behalf of the four other group members in addition to his or her own loan. The client would not be able to generate adequate cash flows to finance all these debts concurrently. Loan officers also gave accounts of clients that were discovered to have accessed loans from two different branches of the same organisation. The loan might be accessed from different branches in the same town or from two different towns. Information exchange amongst loan officers of the same institution facilitates the discovery of such practices.

MFI personnel further explained that one of the main motivations for clients to engage in multiple borrowing was to use the new loan or loans to pay off an existing debt. It however, becomes a struggle for clients to finance both loans because in the first place based on the qualitative assessments loan officers have conducted most clients will not be able to finance two or three loans concurrently. Also, in most cases the loans will have similar repayment schedules due to a lack of variety of loan products offered by MFIs (to be discussed further in Chapter 5). If a client has two or three loans that are due to be repaid at the same time or within a week of each other then they are bound to struggle to finance these loans.

Poor business and debt management skills along with low financial literacy is another reason why clients will need to engage in debt refinancing and subsequently find it difficult to sustain this type of practice without going into a state of over-indebtedness. Loan officers explained that most of the clients do not possess these skills; hence it creates debt problems for them. Their clients usually do not keep records and in most cases do not separate their business related expenses from their personal expenses. In such circumstances, it is easy to see how further debt problems will emerge.

In light of some of the arguments put forward by this thesis including that it is important for proponents of access to credit to concern themselves more on understanding how clients go about financing their loans rather than just increasing outreach. Another question put to the loan officers was with regards to how clients finance their loans. How did clients ensure they have the money to make their payments daily, weekly or monthly as the case may be? Much to MFIs' dislike, they reported that 90% of their clients relied on loans and savings obtained from informal means. *They were members of Osusu groups.* Amongst the reasons why MFIs discouraged their clients from relying on Osusus was because contributions to these informal arrangements were now a source of competition to loan payments to MFIs. Put simply, most clients will prefer to contribute towards their Osusu fund rather than make their weekly payment. More worrying was that it contributed to debt refinancing. Clients are believed to access loans from MFIs to make Osusu contributions. Eventually clients struggle to keep up with payments from their MFI especially when they are waiting for their turn to collect from their Osusus. A number of things can also go wrong which might lead to a client not eventually receiving their full or total contribution. An example that is common is when the Osusu Master disappears with monies MFI clients have been saving with them.[46] Such a situation has the potential to also lead clients to access another MFI loan to repay their existing MFI debt. Hence the cycle of debt refinancing and further indebtedness continues.

The Appendices include narrations from MFI officials highlighting the problems created by Osusus.

3.3.3 Part 2 Conclusion

From the evidence presented so far, this thesis concludes that the institutional change that is increased access to finance has brought along with it major challenges. Featured high amongst these challenges is widespread multiple borrowing, cross borrowing, and debt-refinancing which has been responsible for indebting microcredit clients in Freetown, Sierra Leone. The analysis thus far confirms the argument made earlier that if certain institutional challenges and barriers are allowed to persist in the current microfinance sector then debt problems will continue to thrive. The rest of the thesis (Chapters 4 and 5) focuses on the current institutional factors that are fostering and resulting to DMMPs and over-indebtedness amongst MEs in Sierra Leone.

[46] The Osusu master is usually in charge of managing the funds on behalf of the group

Chapter 4: Formal Regulatory and Oversight Institutions, and microenterprise indebtedness.

The Chapter seeks to provide answers to the following research question posed in Chapter 1: *How are the operations of institutions within the microfinance sector at the macro and meso levels, promoting indebtedness amongst microenterprises in Freetown, Sierra Leone?*[47]

For the purposes of this thesis, the definition of regulation provided by Staschen (2010) is adopted i.e. 'establishment of rules of behaviour, which can again be broken down into the parent law or act and its statutory regulations, supervision (observing compliance with rules) and enforcement (ensuring that the rules are obeyed)' (Staschen 2010, page 14). As a result, the analysis in this chapter focuses on the institutions that have emerged as a result of policy makers' efforts to regulate and supervise the microfinance sector. They include the regulatory body i.e. the Bank of Sierra Leone, bottom-up oversight bodies: the Sierra Leone Association of Microfinance Institutions (SLAMFI) and the regulatory and policy environment including policies and guidelines governing the microfinance sector.

Owing to the importance of regulating microfinance institutions as the industry explodes globally, there is a growing literature focusing on the impact of regulation. It includes studies such as Gallado (2001), Fernando (2004), Chiumya (2006), Okumu (2007), Obara et al (2007), Staschen (2010), and Yu et al (2014). These studies have focused on various aspects of the impact of regulation including on outreach and sustainability whilst Staschen (2010) amongst other research objectives measures the costs versus the benefits of regulation. The existing regulatory impact studies have not addressed the institutional related factors emerging from microfinance regulation contributing to over-indebtedness amongst microcredit clients. Hence, the research and analysis in this Chapter makes an original contribution to the literature on the regulatory impact on microfinance.

The insights gained from the Institutional Economics literature reviewed in Chapter 2, frames and provides the basis for the institutional analysis that is undertaken in this chapter.

Section One provides a brief description of the data utilised and data collection methods for this stage of the research. Sections Two and Three focuses on the Bank of Sierra Leone (BSL) and its role in contributing to indebtedness. The analysis also includes a discussion of acts and guidelines utilised by the BSL to regulate and supervise the sector. A description of how the

[47] A meso-level analysis relates to a population size that falls between the micro and macro levels. For example, a community or organization.

Bank performs its regulatory and supervisory role is also provided. Section Four looks at the bottom-up oversight institutions focusing on SLAMFI. Section Five examines and highlights the policy environment's role towards promoting on microfinance over-indebtedness. In Section Six conclusions are drawn.

4.1 Qualitative data: data collection and research methodology

The institutional analysis undertaken in this chapter relies on both primary and secondary qualitative data. Qualitative data is utilised since quantifying the institutional factors that contribute to micro indebtedness as a result of regulation is almost impossible.

Data collection was undertaken by the researcher during fieldwork in Sierra Leone from May to November 2013 and subsequently a follow up field visit was made April to May 2014.

Secondary data sources included policy documents relating to policies on regulating the microfinance sector, past assessments of the regulatory environment, Acts and Guidelines governing the supervision and regulation of MFIs in Sierra Leone. The following are some of the documents reviewed for the analysis:

- Acts: The Banking Act 1963, the Bank of Sierra Leone Act 2011 and the Other Financial Services Act 2001.
- Microfinance Guidelines: Guidelines for the operations of Credit-Only Microfinance Institutions (COIs) and Operating guidelines for Other Deposit Taking Institutions (ODTIs).
- Microfinance related policies: including National Microfinance Policy (2003, 2010), Private Sector Development Strategy, the Financial Sector Development Plan and National Micro Small and Medium Enterprise Development Strategy (2013).
- Academic papers and articles that are referenced within the text.
- Newspaper articles from the local press in Sierra Leone and speeches from policy makers.[48]

4.1.1 Interviews

Primary data was obtained by the researcher by self-administering unstructured interviews with a range of actors involved in policy making, regulation and oversight of the microfinance sector. Specifically officials from the following institutions: Bank of Sierra Leone's Banking Supervision

[48] A reflection of the scarcity of academic articles on topics relating to the financial sector of Sierra Leone, This will count as one of the challenges encountered when conducting this thesis's research.

department and the Credit Reference Bureau (CRB), and Sierra Leone Association of Microfinance Institutions (SLAMFI). In total 12 officials from the Bank of Sierra Leone and 7 SLAMFI officials respectively were interviewed. Table 4.1 below is a breakdown of the officials interviewed. The other stakeholders interviewed for this stage of the research include donors and officials from other financial institutions.

Table 4.1: Breakdown of Interviewees: Oversight Institutions

Institution	Position of Interviewees	Number of Interviewees
Bank of Sierra Leone (CRB and Banking Supervision)	Director & Assistant Directors	5
Bank of Sierra Leone (CRB and Banking Supervision)	Staff	7
SLAMFI	Interim Director	1
SLAMFI	Directors of 'member institutions'	6

Source: Author 2015

The interviews with Bank of Sierra Leone and SLAMFI officials were aimed at finding out how the Bank undertakes its role of regulating and supervising the microfinance sector and how effectively this role is being performed. In the process the institutional factors and constraints related to these institutions are unearthed. Some of these officials were interviewed more than once. For example, the Bank of Sierra Leone was visited 16 times during May to November 2013 i.e. on average twice a month.

Interviews were recorded, and the instances when they were not recorded, the researcher took notes during and after interviews to capture the discussions.

4.1.2 Participant observation

A qualitative research of this nature stands to benefit from participant observation as a research technique because it gives further insight into the research. Similar studies of this nature (Staschen 2010, Chiumya (2006)) have utilised this data collection method. The researcher consciously or unconsciously made observations when conducting interviews and when interacting with various interviewees. Regular visits to the regulatory institution (the BSL) gave the researcher the opportunity to witness and observe first hand some of the challenges faced by the authorities and their limitations in regulating the sector. Some of the conclusions drawn regarding the relationship between the regulatory body and the MFIs are as a result of observations made by the researcher.

The researcher was able to rely on participation observation as a data collection strategy because coming from Sierra Leone provided a level of access to policy makers and openness from regulatory authorities. In this sense, interviewees spoke freely about their roles and experiences in regulating the sector. Participant observation was also aided by speaking and understanding the local language that is widely spoken in Sierra Leone i.e Krio. Understanding the culture also proved useful for accurately interpreting and analysing the research findings.

At this stage of the research, since most of the interviews was with well-educated officials my position as a researcher was not a barrier for obtaining the information required. In most cases, the researcher was considered as 'an insider' especially because the researcher comes from Sierra Leone. In addition, the researcher knew some of the policy makers and donors operating in the sector already having worked with them in the past when the researcher worked in Sierra Leone.

4.1.3 Triangulation

Triangulation is another research method utilised at this stage of the research to obtain additional primary data and furthermore to crosscheck some of the information obtained from policy makers and regulators. The interviews conducted with donors and officials from other financial institutions (commercial banks) mentioned earlier were to that effect. Likewise, the interviews and questionnaires completed by MFIs included questions on the amount and quality of supervision received from the Bank of Sierra Leone. Despite, having the privilege of being seen as 'one of them', the researcher still went further to always try to cross-check information provided by utilising triangulating research findings at each stage of the research.

4.2 Regulation and Supervision of the microfinance sector

An insight into how the Bank of Sierra Leone regulates the sector follows in this section. It includes a review of the formal institutions i.e. the main acts and guidelines that are used to govern the sector and a brief description of the main forms of supervision conducted by the Bank of Sierra Leone.

Ordinarily these institutions serve as constraints and incentives that structure exchanges in the microfinance sector and hence will have an impact on microcredit debt outcomes.

4.2.1 Acts and guidelines governing the regulation and supervision of the microfinance sector

Supervision and regulation of financial institutions within Sierra Leone's financial sector has always been part of the Bank of Sierra Leone's mandate since its inception in 1963. This is illustrated by the relevant provisions in the Bank of Sierra Leone Act, 1963 and all subsequent revisions of this Act; the latest being the Bank of Sierra Leone Act, 2011.

Sections 7(2h) and 36 of the Banking Act, 2011 stipulate the following:

a) The Bank shall- license, register, regulate and supervise financial institutions as specified in this Act or any other enactment; and (b) The Bank shall be responsible for the regulation, licensing, registration and supervision, including the imposition of remedial measures and administrative sanctions, of commercial banks and other financial institutions in accordance with this Act or any other enactment.

Due to institutional changes in the landscape of the financial sector in the form of MFIs, and in particular with the vision of mainstreaming the provision of financial services for micro and small businesses, in addition to the Bank of Sierra Leone Act, the Other Financial Services Act, 2001 (OFS Act 2001) was enacted.[49] This OFS Act 2001 provides for the Central Bank to handle all aspects of licencing, regulation, and supervision of all other institutions that are not banks but are engaged in the provision of financial services. This includes foreign exchange bureaux, insurance companies, discount houses, mobile money companies and institutions engaged in the provision of microfinance services. Thus, requirements of the OFS Act 2001 broadly apply to all these institutions.

With the provision of Section 53 of the OFS Act 2001, in 2011 the central bank developed guidelines which lay down the requirements specifically tailored to the needs of supervising and regulating microfinance institutions. These are: 'Guidelines for the operations of Credit-Only Microfinance Institutions (COIs)' and 'Operating guidelines for Other Deposit Taking Institutions (ODTIs)' respectively. These two guidelines are complementary to the OFS Act 2001 even though there are certain aspects of the OFS 2001 Act that do not apply to credit only MFIs. As the name implies, COIs by law are not allowed to accept deposits.

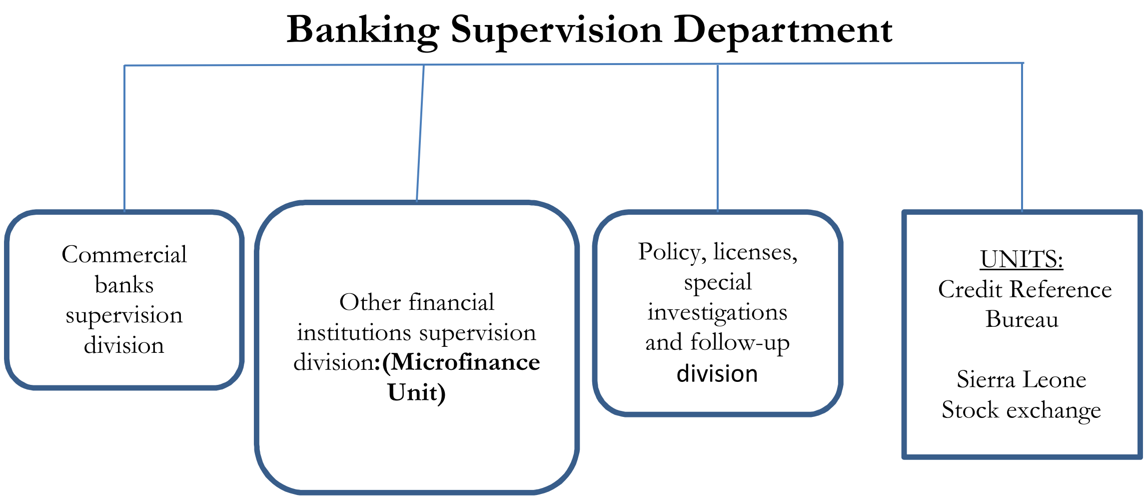
The guidelines for the operations of COIs encompass the following: Firstly, the procedure for registration by credit only MFIs stating those institutions that are exempted from registration

[49] See Chapters 1 and 3 discussions of the rationale for mainstreaming access to financial services for micro and small enterprises in Sierra Leone.

such as Rotating Savings and Credit Associations (ROCSAs); Secondly, reporting requirements of the Central Bank, specifying the reports that should be submitted monthly, quarterly, annually and bi-annually; Thirdly, the requirements for displaying MFIs' registration certificate, interest rates and their financial statements; Fourthly, the requirement that any director, manager or official of an MFI must undergo a fit and proper test; and Lastly, the activities that credit only MFIs' are prohibited to undertake including not accepting deposits and dealing in foreign currency.

There are currently only two deposit-taking MFIs in Sierra Leone (Ecobank Microfinance and Bank for Innovation and Partnership), with the potential for other existing COIs to transform into deposit taking MFIs.[50] The rules and regulations governing MFIs that also accept deposits are contained in the 'Guidelines for operations of Other Deposit-Taking Institutions'.[51]

Figure 4.1: Organogram of the Banking Supervision Department, Bank of Sierra Leone



Source: Author, 2015

Within the Banking Supervision department, the Other Financial Institutions Division and the Microfinance Unit within it has the main responsibility of supervising, monitoring and regulating the microfinance sector. Recall that, the setting up of the Microfinance Unit was one of the outputs of the MITAF 1 project described in Chapter 3. Through the support (i.e technical assistance and training) from the MITAF donors, this objective was achieved in the first phase of the project's implementation according to an independent mid-term review in 2006 (Duval and

[50] As at fieldwork during 2013 and 2014, then crossed checked again in 2015

[51] The operations of Community banks are also governed by these guidelines. Community banks also provide microcredit services already discussed in Chapter 3, however, they are not the focus of this thesis.

Bendu 2006). The Other Financial Institutions Division is currently headed by an assistant director within the Banking supervision department. Figure 4.1 above is an organogram of the Banking supervision department, showing its various divisions and units including the Microfinance Unit within the Other Financial Services division.

4.2.2 Forms of supervision undertaken by the regulatory body

Supervision, monitoring and regulation of the microfinance institutions are broadly administered by the regulatory body in two forms: onsite and offsite monitoring.

On-site monitoring involves; visiting the premises of MFIs to review their accounting books, premises (including other fixed assets) and databases (if applicable). On the other hand, *off-site monitoring* in general usually entails submission of the various monthly (number of active borrowers, average loan size outstanding), quarterly (adjusted net profit margin, cost per borrower), and annual (Audited Balance Sheet and Profit and Loss Account) bi-annual reports (Portfolio at Risk, Loan per Sector) by MFIs to the Bank as stipulated in the guidelines mentioned above.

Below is the list of institutions supervised by the BSL as at 2013 when fieldwork was undertaken:[52]

Table 4.2: Deposit taking MFIs regulated by the Bank of Sierra Leone as at 2013:

NO	NAME
1	Ecobank Microfinance(SL) Limited
2	Bank for Innovation and Partnership Microfinance

Source: Bank of Sierra Leone[53]

Table 4.3: Credit only MFIs regulated by the Bank of Sierra Leone as at 2013:

NO	NAME
1	Brac Microfinance (SL) Limited
2	A Call to Business Trading (SL) Limited
3	Finance Salone (SL) Limited
4	Salone Microfinance Trust
5	Counterpart in Community Development and Microfinance Company Limited
6	Grassroots Gender Empowerment Movement (GGEM) Microfinance Limited

Source: Bank of Sierra Leone

[52] Table excludes Community Banks that also provide microcredit services and are supervised by the Central Bank.
[53] www.bsl.gov.sl/financial_institutions.html (Accessed June 2013)

As at 2015, an additional two Credit-only institutions were being supervised by the Bank, seen in the Table 4.4 below:

Table 4.4: Additional credit only institutions regulated by Bank of Sierra Leone as at 2015:

NO	NAME
1	Capitol Finance Company Limited
2	SAFE Microfinance

Source: Bank of Sierra Leone

4.3 The institutional factors: Supervision and regulation of the microfinance sector

The analysis so far and especially the literature reviewed in Chapter 2 illustrates that there is a wide range of institutional factors that impact on economic processes in relation to the types of institutions and effectiveness of the institutions that emerge within financial sectors and microfinance sectors respectively. These institutions however have the potential to further impact on outcomes in the financial sector and microfinance sectors. Regulations like has been made clear, are part of the institutional changes that emerge as a consequence of other institutional changes. In other words, as the microfinance sector expands formal institutions in the form of laws, acts and regulatory bodies develop in order to govern the workings of these institutions. In this regard Staschen (2010) states that regulations evolve to address market failures.

Using an institutional economics lens, the research and analysis in this section shows how the Bank of Sierra Leone-as an institution-creates an environment that are likely to promote indebtedness through multiple borrowing, cross borrowing and debt refinancing amongst microenterprises in its interaction i.e. regulation and supervision of MFIs. The Bank of Sierra Leone has the potential to affect debt outcomes through the efficiency with which they regulate and supervise the microfinance sector.

4.3.1 Asymmetric information on MFIs operating in the sector

This research finds that one of the fundamental institutional factors that prevent effective regulation of the sector was with regards lack of full knowledge by the regulatory body on the number of MFIs operating in the sector. In Sierra Leone, no comprehensive list of all MFIs operating in the country exists. The Non-Governmental Organisation (NGO) section of the Ministry of Finance and Economic Development (MoFED) has a list of MFIs registered with their department and the Bank of Sierra Leone (BSL) which is the main regulatory body has a completely different list of MFIs registered and regulated by them. This discovery was made by the researcher at the start of fieldwork when trying to determine a sample of MFIs that will form part of in-depth interviews. In the process two completely different lists were obtained from both institutions.

The MFI guidelines and OFS Act 2001 clearly states that all institutions engaged in the provision of micro finance services are to be registered with the central bank and by implication regulated by this body. The research finds that NGO-MFIs in particular are not complying with these provisions. Although 90% of the NGO-MFIs have negligible credit programmes, there are some NGO-MFIs that are market leaders in the industry but are not registered with BSL at the time of conducting fieldwork. It also turns out that, there is hardly any collaboration between the NGO section at MoFED and BSL. Thus, information sharing between the two institutions with regards operators in the microfinance sector was found to be non-existent as evidenced by narrations to the researcher by the authorities from the respective institutions on the question of collaboration by the two entities. This research concludes that information asymmetry is a challenge that the regulatory body faces. From Chapter 2, it was seen that in such a situation, problems of moral hazard and adverse selection will face the regulatory authorities.

To recall from Chapter 2, information asymmetry is one of the widely cited institutional factors that prevents the effective functioning of institutions. Therefore the situation that currently exists raises a number of concerns in the context of this research. Firstly, the BSL as the regulatory body is not aware of all the MFIs that exist in the sector; they will not have a full comprehension of developments in the sector. Secondly, since not all the MFIs operating in the sector are registered with the BSL, by implication not all MFIs in the sector are being supervised by the regulatory body. This is some form of adverse selection. Since the authorities do not have information on all the institutions operating in the sector and not all institutions are registered with BSL, how would the regulator know that the right institutions are being supervised?

This research finding has far reaching consequences on the stability of the sector as a whole and in particular on the clients of those MFIs that are not being regulated by the BSL. In the event that the unregulated institutions are conducting their businesses in ways that are detrimental to their clients; for example impacting on their clients' ability to repay their debts, then this will never be known to the regulatory body.

Also, as is the case that some of the NGO MFIs have large microcredit programmes (client base of more than seven thousand), any problems they face such as funding shortfalls or bankruptcies, can have spill over effects on the sector as a whole.

The consequences of this institutional bottleneck described above have in the past manifested itself in Sierra Leone. During 2009 to 2010, the Wealth Builders Network (WBN)-*an illegal financial entity*- infiltrated the financial sector and started operations without registering with the Bank of Sierra Leone. At the start of their operations, the WBN presented an attractive wealth making scheme to the people of Sierra Leone. To the extent that clients of MFIs and Commercial banks took monies accessed from these institutions and invested it with the Wealth Builders for it to be doubled or tripled depending on the contract agreement. Ishmail Dumbuya, writing in the Sierra Leone Standard Times Newspaper in 2011, notes that '*for instance if investor A deposits Le5, 000,000 (£765.71), for a period of three months he will get a profit of Le2, 500,000 (£382.85)*'.[54]

Initially all obligations were honoured by the Wealth builders, but then it later became obvious to clients that the WBN were fraudulent when the institution began defaulting on subsequent obligations. The situation continued until after immense financial damage had been done that the Government and the BSL became aware of the activities of the WBN-they became aware far too late. The BSL made press releases notifying the public about the Wealth builders' fraudulent activities.[55] Cross sections of the populace were victims of this scam and this was widely covered by the local press.[56]

All the MFIs interviewed during fieldwork by the researcher, mentioned the problems created for their respective institutions and their clients by the WBN.[57] Clients used loans obtained from

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[54] Recall exchange rate stated at the beginning of the thesis: £1= Le6, 529.89. This exchange rate will be used throughout this thesis for the purposes of making all conversions of Leone amounts to Pounds Sterling.

[55] *Sierra Leone Government Press Release on Wealth builders' scam.* Awareness Times, June 30, 2011.

[56] Examples include: *Wealth builders operating illegally-Bank of Sierra Leone.* Awoko Newspaper,by Abibatu Kamara http://awoko.org/2010/09/30/wealth-builders-was-operating-illegally-bank-of-sierra-leone/. Accessed 17/05/2014

Wealth Builders Network and the fall of the Banking System in Sierra Leone. Standard Times. Posted by Ishmail Kindama Dumbuya on August 28 2010. http://www.standardtimespress.org/artman/publish/article_4821.shtml. Accessed 17/05/2014

Makeni traders cry over 'frozen' Wealth Builders accounts. Cotton Tree News. 21 August,2010

http://www.cottontreenews.org/economy/3481-makeni-traders-cry-over-frozen-wealth-builders-accounts Accessed 17/05/2014

[57]The conventional Commercial banks were also affected by the operations of the WBN. They also experienced defaults on their loans. An example, being the case of Rokel Commercial bank (RCB); found by interviews with

MFIs to invest with the WBN, and eventually, these clients could not repay their loans owed to MFIs since they could not retrieve their investments from the WBN. The large amounts of defaults experienced during this period by MFIs, impacted on the quality of their loan portfolios especially in 2010. The resulting debt problems that were experienced by MEs and portfolio problems experienced by MFIs could have been prevented by the Bank of Sierra Leone, if they had a better handle of the totality and the nature of the operations of the institutions operating in the sector.

With regards to the regulatory body's thoughts on the implications of institutions operating in the sector but not registered with the Bank of Sierra Leone; a Banking supervision official stated the following during an interview with the researcher:

'The implications can be devastating to the financial system if anything goes wrong at MFI A, because as you said MFI X is a big microfinance and for it not to be registered with Bank of Sierra Leone, it's a problem, I think it's a problem. There is what you may want to call a regulatory arbitrage between the Bank of Sierra Leone and NGO section at the MoFED. Some microfinance institutions think because they are registered with Ministry of Finance, there is no need to come to the Bank'.

'In fact, very recently we received a letter from the national security office raising concerns about the operations of some of these MFIs. That some of them may be involved in some financial malpractices. You know it's bad that they are not under the regulatory body' (Bank of Sierra Leone official, related to the researcher on 16th August, 2013).[58]

4.3.2 On-site monitoring focused on depositing taking MFIs

Interviews with MFIs and questionnaires completed by MFIs revealed that the BSL mainly focuses its onsite monitoring (described in 4.2.2) on deposit-taking MFIs. From Table 4.2, it was seen that currently there are only two deposit taking MFIs operating in the sector. Thus only 20% of the market leaders (two of ten institutions) receive on-site monitoring. All seven of the Credit-only MFIs that were part of fieldwork during 2013 explained that the BSL focused their on-site monitoring on those MFIs that accept deposits.

RCB staff during fieldwork and already discussed in Chapter 4. The problems experienced by RCB are partly accounted for by the activities of the WBN.

[58] ***All quotes throughout this thesis are used as evidence for claims made in this thesis. They are translated as related to the researcher, therefore no copy editing was undertaken to the quotes in order to as best as possible preserve the true accounts of all interviewees****. Where relevant the Appendices contain further interview transcripts.*

From the point of view of the regulatory body, the justification for this is that, deposit taking institutions were using the public's money to create loans, as opposed to donor funds that are mostly used by the Credit-only institutions.

This thesis argues that on-site monitoring of credit-only MFIs could give the regulatory body the opportunity to provide more in-depth-monitoring. The regulator can use the opportunity to cross check some of the information that had been provided to them by MFIs as part of their off-site monitoring. In the process they can address some of the informational challenges they have.

In the current situation that obtains, Credit-only MFIs are likely to be undertaking activities that have debt consequences for their clients, which can only be adequately delved into if on-site monitoring were being additionally undertaken.

It must be stated that during follow-up fieldwork in 2014, one Credit-only MFI noted that BSL officials had met with them at their premises but had not undertaken an in-depth audit of their credit operations. Thus, there is still need for improvement in this area of the regulatory body's operations.

Another noteworthy finding was that, for institutions where on-site monitoring was being undertaken, receipt of reports from the regulatory body was not always timely. This meant that acting on the recommendations of the reports by deposit taking MFIs were also not timely. Therefore, limiting the effectiveness of regulation and supervision received by deposit-taking MFIs also.

4.3.3 Lack of follow-up on off-site monitoring:

It was stated earlier that, off-site monitoring involves submission of various reports in the frequency stated by the guidelines for Credit-only MFIs. On submission of these reports, during fieldwork, it was observed by the researcher that not much follow up was being done. There is a lapse, in terms of undertaking a detailed review of the reports and getting back to the relevant institutions with any queries or concerns that the regulatory authorities may have. This also limits the adequacy and effectiveness of the supervision that is being undertaken by the BSL of Credit-only MFIs.

In the interviews, late submissions of reports from MFIs were cited by the regulatory authority, as one contributing factor to inadequate supervision. Reports can only be submitted in-person, and since some MFIs operate in remote rural areas, timely submission of their reports remains a challenge.

4.3.4 Inadequate manpower and resources to undertake effective monitoring:

The institutional challenges highlighted above with regards undertaking on-site and off-site monitoring to a very large extent can be attributed to inadequate staffing and resources as was found by the research. Of the 12 officials interviewed at the regulatory body, they all highlighted resources as a major constraint in performing their role. The Other Financial Institutions division and consequently the Microfinance Unit (MF Unit) has serious limitations in terms of the quality and quantity of the staff responsible for undertaking the monitoring of MFIs. With inadequate man power, it is almost impossible for example to travel to the rural areas to conduct on-site monitoring of MFIs and also to produce reports in a timely manner.

In addition, the availability of other resources such as appropriate software and highly skilled staff to analyse reports received from MFIs could have assisted BSL with more effective monitoring. Unfortunately reports are simply reviewed manually and the rigorousness with which this activity is undertaken is highly dependent on the work load of staff at the time of submission of reports.

This thesis would like to point out that the regulatory body itself also operates within certain institutions which constraints their performance. The Banking supervision department operates within a country and part of a department within the Bank of Sierra Leone. Poor man power stems from a problem of low middle level that generally exists in Sierra Leone. Microfinance being an emerging sector also means there is not a mass of workers out there that have the skills with regards microfinance regulation. Similarly, the department has to compete for resources (including qualified or trained staff) with other departments at the Central Bank.

During the implementation of the MITAF 1 programme, donors helped with addressing these institutional constraints. MITAF donors funded regular training and provided capacity building tools for staff of the Microfinance Unit of the Banking supervision department. Since the programme came to an end in 2011 and with no successor programme, evidently, a gap for training of staff generally in the sector has been created and this is impacting on the quality of staff in the sector including at the MF Unit.

Appendix 3.1 includes some quotes from officials of the regulatory body on the effect low man power and resources are having on their performance in regulating the sector.

4.3.5 Contract enforcement between BSL and MFIs

Regulations are usually not effective when the penalties for none compliance are almost non-existent. Even if the regulatory body had sufficient man power, if the institutions such as the laws do not exist to guide and back up the regulatory body's actions, it will impact on their ability to effectively regulate the sector. The Institutional Economies literature reviewed in Chapter 2 emphasises the essence of having adequate contract enforcement mechanisms. Otherwise, the wrong incentives are given and it can result to inefficiencies.

Although the ODTIs guidelines state penalties for none compliance of certain prescriptions of the guidelines, the OFS Act 2001 and COIs guidelines however do not include any provision for penalties that can be implemented in the event MFIs are in breach of the guidelines governing the sector. It follows therefore that the institutions that will ensure the contracts between the regulatory body and MFIs are enforced do not exist. This further weakens the performance of the regulatory body, and it is of particular concern mainly because apart from the two deposit taking MFIs (excluding also the Community banks) in Sierra Leone; the remaining 8 MFIs regulated by the BSL are Credit-only Institutions. From this, the research also concludes that the main focus of the regulatory body is the deposit-taking MFIs, which leaves the credit-only MFIs being insufficiently supervised.

This thesis suggests that the debt consequences are grave where MFIs are operating with the knowledge that the BSL is not capable of performing its regulatory and supervisory role to its full potential. This presents a moral hazard problem. Some have already been mentioned (the Wealth Builders Network incident), in addition, it can lead to lack of innovation in terms of operating procedures, product development and so on by MFIs. In Chapter 3, the regulatory body's concerns over widespread multiple borrowing that exists in the sector have been discussed. Ultimately, where supervision and monitoring is inadequate, an operating environment that allows for MFIs to conduct business in a way that fosters debt problems amongst microenterprises (MEs) in Sierra Leone is being created.

Table 4.5 below is a summary of the findings of the research conducted as part of the thesis's research at the regulatory body level:

Table 4.5: Summary of findings on microfinance regulation & supervision

No	Finding	Debt implication
1	Not all MFIs operating in the sector are registered with the regulatory body according to stipulated regulations governing the sector	The regulatory body will be unaware when an unregistered MFI operates in ways that indebts their clients; there is past evidence of this.
2	On-site monitoring by the regulatory body focused on depositing taking MFIs	Majority of the market leaders in Sierra Leone are Credit-only MFIs and they do not receive in-depth, scrutiny from the regulatory body. Therefore the COIs can be operating in ways that will indebt their clients.
3	Lack of follow-up on off-site monitoring by the regulatory body	No thorough review takes place of reports submitted to the regulatory body and since no on-site monitoring is undertaken, it limits the effectiveness of off-site monitoring, in order to be able detect if MFIs are operating in ways that are indebting their clients.
4	The regulatory body has inadequate man power and resources to undertake effective monitoring	Inadequate staffing (quality and quantity) and resources such as software to analyse reports, limits both the adequacy and efficiency of on-site and off-site monitoring which are crucial mechanisms that should be utilised to detect and address current debt problems in the sector.
5	Insufficient support tools such as laws to assist the regulatory body to perform its duties	Laws governing the sector do not make provisions for the regulatory body to enforce penalties if MFIs do not comply with the requirements of the regulations. MFIs can therefore act in ways that indebts their clients without much consequence.
6	Earlier on in the research, accounts from interviews with the regulatory body indicate there are concerns about multiple borrowing and cross borrowing being rife in Freetown, Sierra Leone.	<u>ALL</u> interviewees at the regulatory body level provide a range of examples which illustrate how clients are accessing multiple loans which is then throwing them into over-indebtedness (see Appendices). <u>Therefore, at the early stages of the research evidence of over-indebtedness of clients started to emerge.</u>

Source: Author, 2015

4.4 The microfinance policy environment

The main policies that are the driving forces behind the access to credit agenda for microenterprises (MEs) in Sierra Leone have already been highlighted in the discussions held in previous chapters (1&3). To reiterate these policies are in themselves institutions since they are meant to shape developments in the microfinance sector. In addition they have emerged as a product of the wider institutional change of access to finance. The analysis in this section is done through the following lens:

First, are microfinance related policies demand or supply driven? The main interest here, is to assess whether access to credit was being promoted because Sierra Leone needed it or it was due to donor influence and or donor pressure? This is in line with the literature such as (Aoki 2006) that argues that institutions will work better if they emerge endogenously as opposed to exogenously. It follows therefore that if policies are demand driven by a country it tends to yield more desirable results. If supply driven by donors then said policies are likely to contribute to indebting the beneficiaries of increased credit;

Second, as institutions that are supposed to assist with developing the microfinance sector, these policies should take into consideration the potential problems that can result due to increased access to finance including indebtedness of the microcredit clients.

To briefly recap, at the country policy level, all the post-war Poverty Reduction Strategy Papers including the current Agenda for Prosperity (PRSP 3) proposes access to finance as a key tool for poverty reduction through the creation of jobs, incomes and the uptake of social necessities.[59] Following on from the Interim Poverty Reduction Plan and the PRSP 1, the National Microfinance Policy was developed and launched in 2003 in order to mainstream the provision of financial services to the poor and microenterprises (MEs).

In 2010, the National Microfinance Policy was revised to accommodate developments in the sector. The National Microfinance Policy 2010 (NMFP 2010) currently represents the main policy guiding the promotion of micro financial services in Sierra Leone.

The Poverty Reduction Strategy (1&2) also forms the basis of the Private Sector Development Strategy and the Financial Sector Development Plan respectively. Both these policy documents have access to finance as policy objectives with the overall objective of feeding into the Government's poverty reduction agenda.

[59] The poor will now be able to afford to pay for social services such as health and sanitation services.

The recently developed National Micro Small and Medium Enterprise Development Strategy (2013) currently serves as a guide to various stakeholders in providing support to the development of MEs. It prioritises the promotion of increased access to credit as a means of achieving domestic business development.[60] Pillar 3 of the strategy is: *'Link micro, small and medium sized enterprises (MSMEs) to financial markets; increasing the number of MSMEs that receive formal financial services*'. The strategies for achieving this pillar are: *(a) To increase the number of SMEs that receives affordable short and medium term loans; and (b) To increase the number of microenterprises that receives deposit, savings and credit services.*

Lastly, the signing of the Maya declaration is one of most recent policy commitments to financial inclusion including increasing access to finance.

4.4.1 The microfinance policy environment and debt problems

After reviewing the above policies, the research finds that the policies have all been introduced and developed with the involvement of donors. The discussions in Chapter 3 provide some evidence for this claim. The involvement of donors has generally taken the form of either provision of technical assistance (TA) and or the funding required for developing the policies. More importantly, the development of the aforementioned policies has been embedded as key outputs of donor funded projects.

For example, Poverty Reduction Strategies Papers (PRSPs) were developed in line with International Monetary Fund (IMF) and World Bank programmes.[61] They form the current basis for IMF support to most countries in which they operate. In Sierra Leone, the development of the Financial Sector Development Plan (FSDP) was a structural benchmark of the IMF's Poverty Reduction and Growth Facility (PRGF) that was being implemented at the time. In most cases also, the studies that contributed to the development of access to credit related policies are usually carried out by donor-funded consultants due to low capacity in-country.

This thesis argues that another factor for consideration lies with the tone of language that surrounds the rationale for promoting the policies above-mentioned; it speaks to a neoliberal school of thought. Similar to most sub-Saharan African (SSA) economies, in Sierra Leone, credit that is provided by the private sector is being drawn on as a means of (a) reducing the role of the

[60] The National Micro Small and Medium Enterprise Development Strategy 2013 was developed by the Ministry of Trade and Industry (MTI) with support from the International Finance Corporation (IFC), World Bank.
[61] 'Poverty Reduction Strategy Papers (PRSPs) were introduced in 1999 by the World Bank and the IMF as a new framework to enhance domestic accountability for poverty reduction reform efforts. They are a means to improve the coordination of development assistance between governments and development partners. They are also a precondition or access to debt relief and concessional financing from the World Bank and the IMF.

State, (b) reducing poverty by giving the poor the means to empower themselves and benefit from the economic development process (c) transforming microfinance from its subsidised nature to a more commercialised form.[62]

The lead donors with regards financial sector and private sector development in Sierra Leone have been the IMF, World Bank (mainly through the IFC) and the United Nations (mainly through the UNDP and UNCDF). It is well documented and widely known that these agencies are the lead promoters of neoliberal policies in the World and more so in SSA countries that are deemed to lack the capacity to develop and implement 'beneficial policies'. It has been highlighted, MITAF 1 which to-date represents the largest joint donor-government project with regards promoting access to credit amongst other financial services, was purposefully introduced to reduce the State's role in credit provision, and also to commercialise microfinance. This was clearly stated on MITAF's website.[63]

Whilst it is difficult to ascertain and claim that donors coerced Sierra Leone to develop such policies or to adopt these institutions, this thesis argues that perhaps the question that needs to be answered is: will the donors have been willing to fund projects that were not aligned to their neoliberal thinking?[64] Some studies (example NaCSA 2008) have found and made the claims that the volume of demand for microfinance in Sierra Leone that is stated by some scoping studies has been grossly overestimated. In this regard, the push for continued increase in the volume of credit to microenterprises is questionable. Similarly, one of the criticisms of the MITAF 1 project which was noted by Duval and Bendu (2006) was that, the project was putting more emphasis on expanding outreach rather than taking into consideration the impact credit was having on clients. These are similar to criticisms of Von Pischke and Adams (1992), with regards to credit programmes in Latin America post WW2, where they found that there was a compromise in the quality of credit services as well as the repetition of previously failed programmes due to the need to increase the quantity of credit that was being provided. The compromise between outreach and quality of loan services is a lively debate even in relation to the contemporary microfinance sector (Olivares-Polanco 2005 and Cull et al 2007).

These findings with regards the policy environment governing the microfinance sector have debt implications. Credit is likely to be given to clients who do not know how to run a business

[62] See for example CGAP (2001), Campion (2002), Frank (2008) and Rhyne (2002 and 2009) for detailed discussions of the commercialisation of microfinance.
[63] www.mitaf.esglobal.com/site/index.php. This website no longer exists likely because the project had ended but was in existence prior to embarking on fieldwork (Accessed up until March 2013).
[64] Taking into consideration that, implementation of some of these policies were preconditions for accessing certain donor funds.

enterprise or to clients that are not in need of the capital at all. It becomes very difficult for such clients to be willing or able to repay loans and thus causing indebtedness.

The analysis will now turn to whether the policies factor in the problems associated with increased access to credit by MEs. After reviewing each policy document, only the National Microfinance Policies (NMFP 2003 & 2010) consider the challenge of delinquency control. The NMFP lay down the best practices relating to aspects of microfinance provision such as design of appropriate loan products and careful selection of clients that should be followed by MFIs in order to achieve delinquency control. The other policy documents do not address the potential for the access to credit programmes not achieving its intended results and how to deal with it. Robust policies are meant to factor in the potential challenges that can arise when implementing the policy, while also including measures to mitigate any resulting problems.

Another factor to consider is that, for policies to work especially in developing countries it requires the good will of policy makers and regulators. From the researcher's observations and from discussions with all seven MFIs during fieldwork, it was found that the 'State' sees MFIs as being involved in predatory lending. Some top Government (GoSL) officials in Sierra Leone have in the past made pronouncements that are unhelpful to promoting responsible use of credit. The term *'micro jail'* was used to describe microfinance by an official; the term was used in the context of portraying MFIs as being heavy-handed in their handling of clients. In Chapter 4, it was found that that even though the National Microfinance Policy (2003, 2010) states that the role of Government is simply to create the appropriate environment for MFIs to conduct their business; GoSL has over the years been involved in microcredit provision albeit in the subsidised form. Therefore, the Government tends to view MFIs as competitors.

In addition, because GoSL's schemes are subsidised, there is a view amongst some Sierra Leoneans that monies obtained from some MFIs are provided by the Government and should therefore not be repaid. All the MFIs interviewed highlighted this as a major challenge to the financial viability of their businesses. The State's view of MFIs and their involvement in the provision of microfinance; is creating a lot of confusion in the sector and this point cannot be overemphasised by this thesis. Apart from this, the situation depicts that a full institutional change has not occurred in Sierra Leone (explained in Chapter 4). It is also an example of where political economy challenges have been a barrier to institutional development.

The existence of such a situation also has been highlighted due to its debt implications. If clients access loans with the perception that it is 'free money', it serves as a disincentive to utilise loans productively and hence hinders their abilities to repay loans. It can be inferred from the discussions in Chapter 2 that, the perception of microfinance as 'free money' also stems from the immediate post-war years when subsidised microfinance was used to assist with emergency relief to displaced and war affected persons. The perception, has not totally changed because the Government still continues to run its own credit programmes from time to time. The latest being a Le 2 billion (£306,283.87) project by the Ministry of Trade, channelling credit to MSEs through a commercial bank during 2013.

Table 4.6 provides a summary of findings on the policy environment that exists for the microfinance sector in Sierra Leone.

Table 4.6: Summary of findings the Policy environment and debt problems

No	Finding	Debt Implication
1	All policies governing the sector were developed with donor involvement through including: • Provision of funding to develop policies • Provision of technical assistance to develop and implement policies • Policies being outputs of donor funded projects	• Major donor involvement in the sector brings to question whether the expansion of access to finance was a policy that was needed by Sierra Leone. It impacts on the effectiveness of the policies including creating debt problems for its beneficiaries. • Donor involvement also makes MFIs more focused on credit expansion to meet targets rather than giving credit to those clients who would put it into productive use. Thus, this promotes indebtedness amongst clients. • In some cases, the high interest rates charged by donors for wholesale loans are passed on to clients. It therefore affects clients' ability to service their debts.
2	Mechanisms for mitigating or addressing debt challenges are not incorporated into policies governing the sector	If and when debt problems arise (as they have in the past) there are no laid down context specific ways of addressing them, this has the potential of further exacerbating debt problems.
3	Government's involvement in the sector: • Government's role in the sector is still unclear, there is a conflict between the government creating an enabling policy environment for private MFIs to thrive and providing its own	Government comments and actions contribute to some clients viewing microfinance as free money. Therefore, these clients will not put loans into good use which creates debt problems when payments are due. There is limited interaction between MFIs

	microfinance from time to time; • Government sees MFIs as competitors and makes unhelpful public pronouncements about microfinance; • Limited interaction between Government/policymakers and MFIs.	and GoSL. It means Government is unaware of the policy needs of MFIs especially in helping them address the debt challenges their clients face.

Source: Author, 2015

4.5 Bottom up oversight in Sierra Leone's microfinance sector

4.5.1 Civil Society Organisations (CSOs)

In addition to the top-down oversight mechanisms (regulatory bodies and laws) bottom-up oversight mechanisms are institutions that have proven to be useful in providing an extra layer of scrutiny in policy implementation. In most cases, non-state actors such as civil society groups are relied on to fulfil this function.

As African economies and their financial systems develop, it is not uncommon to find civil society groups that are holding their governments accountable with regards matters relating to subjects such as public financial management and natural resource management. Donors including the International Monetary Fund (IMF), World Bank and UK's Department for International Development (DFID, UK) now have support to civil societies integral to their country programmes.[65] In Sierra Leone for example, in the past, support was provided by DFID, UK to a CSO; the Budget Advocacy Network (BAN).[66] The support was in the form of capacity building for enhancing scrutiny and oversight of GoSL's budgeting and expenditure in order to enhance transparency and accountability on the part of the Government. The National Advocacy Coalition on Extractives (NACE) is a civil society organisation in Sierra Leone that focuses on achieving transparency with regards mining revenues and is active in ensuring the

[65] Examples include Partnership for Capacity Building in Africa (PACT) a World Bank funding which provide capacity building of African civil societies.
[66] BAN is made up of seven civil society groups

Government adheres to the prescriptions of the 2009 Mines and Mineral Act[67] and also maintain its commitment to the Extractive Industries Transparency Initiative (EITI).[68]

With regards to the financial sector, this research found no evidence that civil society groups are taking an active role in scrutinising the relevant stakeholders in the sector. However, the research finds evidence of the use of Community Based Organisations (CBOs) historically as a channel for reaching grassroots businesses.[69] Wholesale loans are usually made available to CBOs, in order for them to on-lend to their community members. An example is GoSL's Chiefdom project that was discussed in Chapter 3. CBOs were involved in deciding on the beneficiaries of these funds. During fieldwork, it was learnt that some MFIs such as the Agricultural Rural Development (ARD) channel loans through CBOs in order to reach their rural clients. In some cases, CBOs are being used other MFIs such as A Call to Business to reach clients where they do not have an office (a physical structure) especially in the more remote rural areas.

This thesis argues that bottom-up scrutiny of the main stakeholders in the financial sector especially with regards credit provision needs to be supported by policy makers. In relation to this research, the absence of these forms of institutions implies that there is 'a missing voice' in terms of raising concerns relating to indebtedness of MFI clients. The implication is that MFIs are not as accountable as they should be had there been civil society groups regularly monitoring developments in the sector.

There are invaluable benefits to be gained from such an intervention, it includes; making MFIs act more responsibly if needs be; and having an input in developing policies that take into account clients' own perspectives. In countries such as Malaysia, the benefits of civil society's promotion of consumer protection policies have been felt in the microfinance sector; found by a 2009 CGAP report.[70] In general, most civil society organisations (CSOs) in Sierra Leone as institutions have been found by the research to be weak in terms of their capacity to rigorously address certain concerns (hence capacity building support by donors such as DFID, UK). This is a common accusation levied against CSOs that are involved with other sectors in Sierra Leone. Therefore, providing some existing CSOs with the right skills to analyse reports produced by MFIs for example will foster increased scrutiny in the sector and will help to curtail existing debt problems in the sector. More so, since CSOs are closest to the beneficiaries of microcredit, they

[67] 2009 Mines and Minerals Act was passed in order to make provisions for the latest developments in the mining sector including iron ore discovery.
[68] A global coalition of governments, companies and civil society working together to improve openness and accountable management of revenues from natural resources. See eiti.org/eiti (Accessed May 2014)
[69] In some communities CBOs serve a similar function to civil society groups
[70] CGAP, Consumer Protection Policy Diagnostic Report: Malaysia.(Brix, 2009)

can serve as a mediator between MFIs and their clients in terms of relaying feedback between the two parties. This will contribute towards improving the credit services that are currently being offered by MFIs as well as enhance productive loan use by the clients.

4.5.2 The Sierra Leone Association of Microfinance (SLAMFI)

Currently SLAMFI is the umbrella association which seeks to promote financial inclusion through collaboration, information sharing, capacity building, and scrutiny amongst the leading MFIs and all other stakeholders in the sector.

SLAMFI an institution that originally emerged as a product of the first phase of the MITAF 1 project (from 2004 to 2006). It shortly became defunct because some MFIs were unwilling to share information freely with one another for fear that it will be used by their competitors to poach their clients. Another, contributing factor to the suspension of the operations of SLAMFI was because the member MFIs also took on the secretarial duties of SLAMFI. The chief executive officers (CEOs) of MFIs could not find time to dedicate to the running of another organisation in addition to running their respective institutions.

At the time of conducting fieldwork, efforts were being made to reconstitute this organisation. SLAMFI had accessed funding from Catholic Organisation for Relief and Development Aid (CORDIAD) and had taken certain steps towards re-launching the group including: registering the organisation as a company, reconstituting the Board, recruitment of members, and completion of a business plan. This time around, it was found that the future plans are for a Secretariat to handle all administrative duties, thus allowing MFIs to focus on achieving the objectives that are set out in SLAMFI's business plan. There had been a delay in formerly launching the organisation and SLAMFI are yet to start undertaking its set out activities for 2014 (as at follow up fieldwork in April to May 2014).

The main objectives of SLAMFI include promoting research and advocacy, capacity building, and collaboration amongst all stakeholders.

The activities set out for 2014 included: (a) setting up a Secretariat; (b) recruiting a Coordinator to run the Secretariat; (c) setting up of a website and (d) making sector data available on the website.

From the objectives and planned activities outlined above, the potential benefits of having such an organisation are clear. The institution can serve as a platform for addressing debt related matters that are being manifested in the sector. This thesis notes the collaborative approach that

SLAMFI hopes to take this time around.[71] It aspires to work closely with the regulatory body and the relevant Government agencies in order to change the perception of microcredit. SLAMFI is an institution that has the potential to assist with addressing the problem of information asymmetry that exists in the sector. It is also hoped that this will assist in improving the policy environment by developing appropriate policies required by the MFIs thereby fully enhancing the growth of the sector.

There are also gains to be realized from the training and sensitisation SLAMFI aims to provide to a number of stakeholders in the microfinance sector with support from donors. Hopefully, this will help to begin to contribute towards closing the gap left by MITAF with regards training of staff and clients of the sector.

Ordinarily, if the relevant stakeholders buy into SLAMFI's mandate, it will go a long way towards assisting with mitigating the institutional factors that are contributing towards indebting microenterprises in Sierra Leone. If the status quo remains as it is, debt problems will continue to exist.[72]

Table 4.7 summarises the findings of the research at this stage of the research:

Table 4.7: Summary of research findings on bottom-up oversight in the microfinance sector-Meso level

No	Finding	Debt implication
1	The research finds no evidence of civil society organisations performing this role	The overall conclusion is that there is a missing voice of scrutiny in the industry. CSOs are closest to the beneficiaries and their voice would have helped with raising debt concerns of clients to MFIs and other relevant authorities. CSOs would have assisted with alleviating and addressing existing debt problems.
2	Sierra Leone Association of Microfinance Institutions (SLAMFI) hopes to perform an over-sight function in the near future	SLAMFI is yet to be fully functional; therefore there is currently no formal platform for MFIs to share information and collaborate on addressing challenges posed by multiple borrowing and debt refinancing. Also, until SLAMFI becomes functional again, then there remains a gap in the sector in terms of an added layer of scrutiny to prevent debt problems.

Source: Author, 2015

[71] The researcher saw the benefits of collaborative work during the preliminary field visit 'upcountry' (local lingua meaning the rural areas). In one locality, the MFIs had decided to collaborate in terms of sharing information on loan clients. This approach helped tremendously in curtailing the problems that were emanating from cross and multiple borrowing which the MFIs had been experiencing prior to their collaborative approach.

[72] In a follow meeting with SLAMFI during 2015, some of activities set out for 2014 had been achieved including setting up of their website; www.slamfi.sl. However, SLAMFI is yet to engage in any formalised regulation of the sector.

4.6 Summary and Conclusion

One of the important findings of the literature review undertaken in Chapter 2 and also the historical analysis conducted in Chapter 3 is that multiplicities of institutions and institutional factors and players contribute to creating and causing debt problems. The research and analysis undertaken in this first empirical chapter illustrates that this is also the case in Freetown, Sierra Leone.

The findings of this chapter show that institutions at every level in the access to finance infrastructure have a crucial role in promoting or mitigating indebtedness including the oversight bodies that were assessed. By taking a more holistic approach in this thesis, the research has unearthed some of the key reasons and contributing factors specifically relating to Sierra Leone that foster indebtedness and debt refinancing (further indebtedness) amongst microenterprises at the macro and meso levels.

At the macro level (regulatory body), the research finds that challenges such as inadequate staff (quality and quantity) and limited follow up on off-site monitoring, limit the adequacy and efficiency of supervision that is being provided to the sector by the regulatory body. Thus having the potential of impacting on the services that MFIs are providing to their customers, especially from the point of view of the likelihood of indebting their customers. In addition, it was found that, the policy environment that exists seems to be donor driven and it does not offer the appropriate institutions in the form of policies and laws to support the work of the regulatory body (and MFIs at large). Such a policy environment will definitely have the potential of limiting the growth and advancement of the sector and above all it has created an environment that enables harmful debt management practices such as multiple borrowing to thrive.

At the meso level, the importance of bottom-up monitoring mechanisms in curtailing and addressing debt problems has also been demonstrated from the analysis. The role of civil society groups in the microfinance sector needs to be broadened through capacity building in order to empower them to undertake a 'scrutinising and monitoring role'. There are numerous benefits to be gained from this added layer of oversight including serving as a mechanism for addressing any debt related matters that may arise through the interaction of MFIs and clients.

An effective microfinance association will promote information sharing and a more collaborative approach in dealing with the current debt problems. It is hoped that the reconstitution of SLAMFI through its planned advocacy and training for staff and clients amongst its other activities will contribute towards mitigating the existing debt problems in the country.

This thesis concludes that inadequate and ineffective regulation and supervision of MFIs and the non-existence of bottom up oversight in the sector, create an environment that fosters over-indebtedness by impacting on how debt sensitive MFIs undertake their loan operations. The findings in this chapter will feed into the research and analysis that is undertaken in the next chapter, where the thesis investigates the role of MFIs in contributing to the problem of over-indebtedness that exists amongst microenterprises in Freetown, Sierra Leone.

Chapter 5: The Institutional factors: Microfinance Institutions and Microenterprise Indebtedness.

In this next main Chapter the research and analysis undertaken was aimed at answering the following research question set out in Chapter 1: *How do operations of institutions within the microfinance sector at the micro level i.e. microfinance institutions promote indebtedness amongst microenterprises in Freetown, Sierra Leone?*

Ordinarily in a context where the mainstreaming of access to finance for microenterprises is a development policy objective the institutions that provide the credit i.e. Microfinance Institutions (MFIs) are expected to emerge due to support from other institutions (laws and policies) that support this development. Over the years, a range of MFIs have been part of the financial sector of Sierra Leone according to the discussions thus far. . At the time of undertaking fieldwork in 2013, there were 10 market leaders operating in the sector with an overall estimated client base of about 77,400 clients. A more recent report by SLAMFI (2015) states that on average the total clients being served by the market leaders are 100,000 clients with a loan portfolio of about $ 180 million.

The loan operations of MFIs in Freetown, Sierra Leone will be the main focus in this Chapter. Since they deal with microenterprises directly, it follows therefore that these institutions contribute to the indebtedness that is experienced by their microcredit clients. Based on the theoretical framework in Chapter 2, an Institutional Economics lens is utilised and the analysis will provide the institutional factors stemming from MFIs which create and or enable debt problems through multiple borrowing, cross borrowing and debt refinancing for microenterprises. Are the present MFIs that have emerged operating in ways that indebt their clients? The answer to this question is offered bearing in mind that MFIs also operate within other institutions which impose restrictions and constraints on their loan operations.

Section One describes the data from microfinance institutions that is utilised at this stage of the research including also the research methodology employed. Section Two highlights and analyses the institutional factors specific to the loan operations of MFIs and shows how they affect indebtedness of their clients. Section Three discusses further challenges faced by MFIs in providing loans to microenterprises, which also represent additional institutional factors with debt consequences. Section Four concludes based on the findings of the research.

5.1 Quantitative and Qualitative Data: Collection and Research Methodology

The data for this stage of the research was obtained during fieldwork in Sierra Leone from May to November 2013 and a follow up fieldwork was completed from April to May 2014.

5.1.1 Data collection sights:

In-depth interviews were conducted with seven microfinance institutions that provide credit to micro businesses in Freetown and only one in Makeni.

Freetown is the capital and largest city of Sierra Leone. It has one of the world's natural harbours thus making it a major port city in Western part of Sierra Leone. The city is Sierra Leone's major urban, economic, financial, cultural, educational and political centre. The population of Freetown is estimated at 1.2 million in 2010.[73]

Makeni is the fourth largest city in Sierra Leone (after Freetown, Bo and Kenema). Makeni is the capital and administrative center of Bombali District and it is the economic centre in the Northern Province. Makeni is close to Freetown, just 85 miles away. Makeni is a major educational, trading, transportation and economic centre. The city currently has a population of 112,489.

Most relevant to this thesis is that Freetown is also the financial capital of Sierra Leone. 'The City'[74] of Sierra Leone is based in Freetown, because the headquarters and large branches of all major financial institutions operate from Freetown.[75] With the exception of two of the leading MFIs, all the other market leaders have their headquarters and a significant branch network in Freetown. Therefore, access to these institutions-both in terms of the numbers and what was logistically plausible-was a major deciding factor in choosing to interview institutions based in Freetown for in-depth research. Logistics had to be factored into the decision mainly due to the limited funds available to the researcher to undertake the fieldwork. Travelling outside Freetown for an extended period to undertake in-depth interviews would have required a significant financial outlay which was above the funding accessed for the research. Nonetheless, not conducting in-depth studies outside of Freetown did not take anything away from the research

[73] A population census will be conducted in 2016 and more recent estimates will be available then,
[74] The financial city, similar to London being referred to and the financial city of the United Kingdom
[75] Sierra Leone faces issues with infrastructure including bad roads (though this has improved significantly post 2012), irregular electricity supply (some areas go for weeks without electricity), and insufficient internet network coverage

because with the exception of one of the MFIs chosen for in-depth studies all leading MFIs are based in Freetown.

It must be noted however that in collaboration with the Millennium Challenge Corporation (MCC, Sierra Leone), a brief visit was made outside of Freetown. The visit was part of the preparatory work conducted for the fieldwork. The MCC were conducting regional consultations mainly across the North of Sierra Leone on a policy document they were developing at the time. The MCC provided all the required logistics for this visit, thus there was no need to utilise the limited funds that was available for undertaking the main fieldwork.

5.1.2 The Institutions

It has already been mentioned that there are ten major players or market leaders in the industry providing credit to microenterprises in Sierra Leone as at the period when fieldwork was undertaken. Community banks and Financial Services Associations (FSAs) also provide microfinance services, however all community banks and FSAs are based in the rural areas. Due to accessibility and funding considerations explained above, Community banks and FSAs did not form part of the in-depth interviews for the study. However, interviews with two community banks formed part of the preliminary research during the upcountry visit.

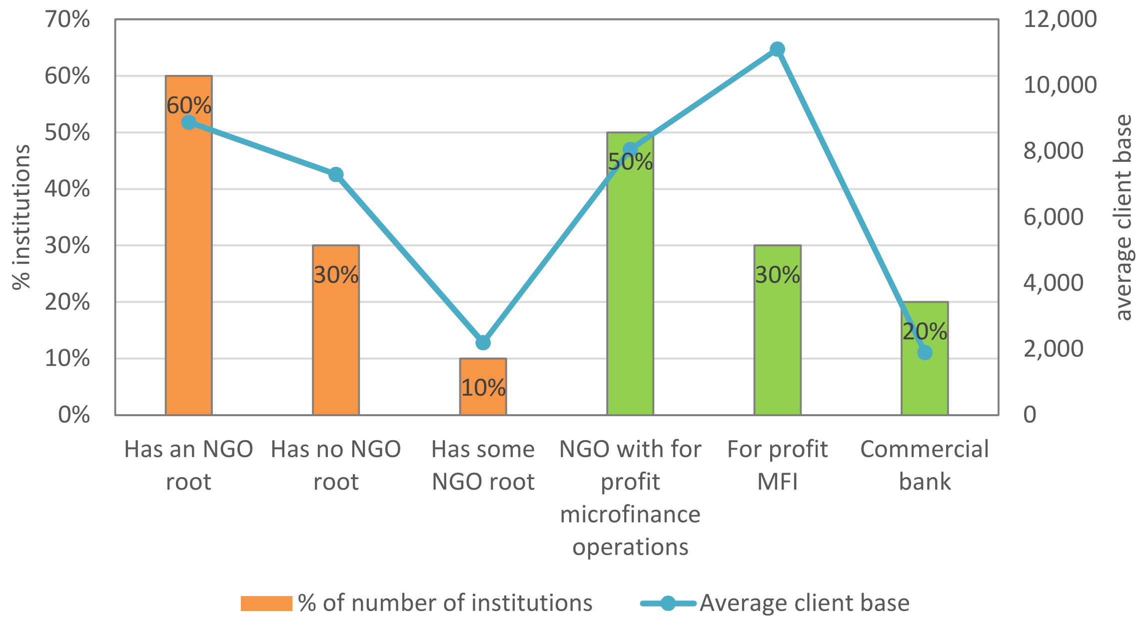
Table 5.1 and figure 5.1 below provides some basic information on the 10 market leaders that operated in the sector as at fieldwork (2013-2014). They show a reduction in the role of NGO MFIs and that the market leaders all have a client base of above seven thousand clients. Stakeholders in the sector especially the regulatory body have identified these institutions as the market leaders mainly based on the size of their client base. Data on the microfinance sector does exist on the MIX Market but it was not utilised to determine the current market leaders and subsequently the final sample for this study. The data contained on MIX Market contains institutions that no longer operate in the sector example Hope Micro, Luma and Procredit Bank. In addition, the data was updated at different years for the various institutions. For example, Finance Salone's data was updated in 2007, Lift Above Poverty Organisation's in 2009 and Association for Rural Development's in 2012.

Table 5.1: Market leaders in Sierra Leone's Microfinance Sector

Code Name of Institution*	Type of Institution	Has an NGO root?	Client base as at December 2012
MFI A	NGO with for profit microfinance operations	Yes	7,000
MFI B	For profit MFI	No	10,000
MFI C	Commercial bank	Partly	2,200
MFI D	For profit MFI	Yes	13,000
MFI E	NGO with for profit microfinance operations	Yes	3,200
MFI F	For profit MFI	No	10,300
MFI G	NGO with For profit microfinance operations	Yes	6,600
MFI H	NGO with for profit microfinance operations	Yes	22,000
MFI I	Commercial bank	No	1,600
MFI J	NGO with for profit microfinance operations	Yes	1,500

**Coded as per anonymity agreed in fieldwork interview consent form, Source: Author 2015*

Figure 5.1: Market leaders in the microfinance sector of Sierra Leone



Source: Author, 2015

For obvious reasons, the market leaders in the microfinance sector were chosen for the research because they had significant credit operations that proved useful to the research. Out of the ten market leaders, at the time of undertaking fieldwork, MFI I was a newcomer to the industry. It was judged that this institution would not have had enough experience in conducting their loan operations; therefore, excluding them from the research would not impact on the findings of the research. Therefore, nine institutions had the potential to form part of the final sample for this stage of the research. From table 5.1 above, it can be seen that the institutions that currently operate in the sector include a mix of various types of microfinance institutions such as commercial banks with microfinance windows, NGO with commercialised microfinance as part of their wider operations MFIs and For profit MFIs. However, table 5.1 shows and further confirms that 70% of the leading MFIs in Sierra Leone have NGO roots. It has already been stated that this particular factor affects micro loan clients' attitudes towards debt and hence their debt outcomes.

5.1.3 Preliminary Fieldwork

A one week visit was made in July 2013, to the Northern and Eastern parts of Sierra Leone covering five towns namely Kono, Kabala, Magboruka, Port Loko (Lunsar) and Makeni.[76] The institutions visited included two Community banks and four MFIs (six institutions in total). Interviews were held by the researcher with Branch managers, loan officers, Management and Information Systems (MIS) officers and the clients.

This visit was made for a number of reasons such as:

1. Although the main focus of fieldwork was Freetown, there was need to get a better understanding of experiences in the rural areas with regards credit and debt related matters.
2. To pre-test the questionnaires that had been developed for interviews with microfinance institutions and in the process develop and practice interview skills and techniques.
3. In addition, the questionnaires were piloted in order to see which questions worked. That is: (a) whether the questions originally developed were in line with the research being carried out, and (b) to assess how comfortable respondents will be with being recorded.

5.1.4 Study design

For the main research, ***seven MFIs (MFIs A to F from Table 5.1)*** were chosen to be part of this stage of the research. These institutions were chosen based on the follo.wing criteria: (a***)*** ***location-*** the MFI must be operating in Freetown (b) ***market leader***, i.e. the MFI had a loan client base of more than seven thousand and (c) ***length of time*** in operations- the MFI should have been in operations before 2011. This was in order to adequately capture all elements of their loan operations bearing in mind scale of operations and length of time of being in operations. The remaining three market leaders did not form part of the study because one was a new entrant in the sector at the time of conducting interviews; the other has its headquarters in

[76] See map of Sierra Leone in Appendix 1 for the locations of these towns in Sierra Leone.

Bo (Southern part of Sierra Leone). Due to timing and limited funds these institutions could not be accessed. Lastly, despite efforts made to contact one of the MFIs that were based in Freetown, they could not be reached.

Of the seven institutions that formed the final sample, efforts were made to have an east/west mix or a central/west mix. That is for each of the seven institutions, the researcher conducted interviews in the MFIs' branch located in the East (or Central) of Freetown and another branch in the West of Freetown. This was done in order to get a more holistic picture of what obtained in Freetown, and trying to capture any variances in credit-debt relations (if there were any) depending on the institutions' location within Freetown. ***Fourteen institutions*** were visited including all the head offices of the seven institutions chosen for in-depth field research. The total goes to ***eighteen*** if the four MFIs visited during the upcountry preliminary fieldwork are added.

Within the institutions, the main participants in the interviews were the managing directors, managers, branch managers, operations managers, loan officers and MIS officers. In total ***twenty-four MFI personnel*** were interviewed.

5.1.5 Data collection methods

5.1.5.1 *Interviews including triangulation*

The qualitative data were collected through self-administered interviews using semi-structured questionnaires or unstructured interviews conducted by the researcher. This method of data collection was particularly useful because it allowed the researcher to explore certain topics in detail. It also made it possible for the researcher to modify future interviews by taking into account subject matters that had come up earlier in the research process. This method also facilitated the triangulation of qualitative data obtained from other stakeholders earlier in the research.

MFIs B and D submitted their questionnaires electronically. However, almost all aspects covered by the questions had been addressed in the unstructured face-to-face interviews with these same institutions.

Interviews with MFI personnel took place between June to November 2013 and two MFI managing directors were interviewed (unstructured interviews) for follow up purposes during May 2014.

Of the twenty-four personnel with whom interviews were conducted**, nine** were either **managing directors or branch managers** while the **remaining fifteen** were **loan officers and MIS officers**. It must be stated that most of these personnel were interviewed more than once and MFIs' office premises were also in most cases visited more than once.

The questionnaires and interviews were mainly focused on the loan operations of MFIs i.e. sources of funding, the loan application and award process, loan repayment process and monitoring process, the operating environment and opportunities and challenges in conducting loan operations in Sierra Leone.

Interviews on average lasted for an hour and fifteen minutes and oral consent was obtained at the start of each recorded interview, with assurance that interviewees will remain anonymous when writing up the results of the research.

5.1.5.2 *Participant Observation*

Participant observation was also utilised for data collection. Some very relevant and useful observations were made by the researcher by undertaking the following activities: (a) regularly visiting the offices of the microfinance institutions, (b) witnessing a number of loan disbursement meetings or training sessions for clients, (c) accompanying loan officers to the field whilst they conducted loan collections or monitoring of clients.

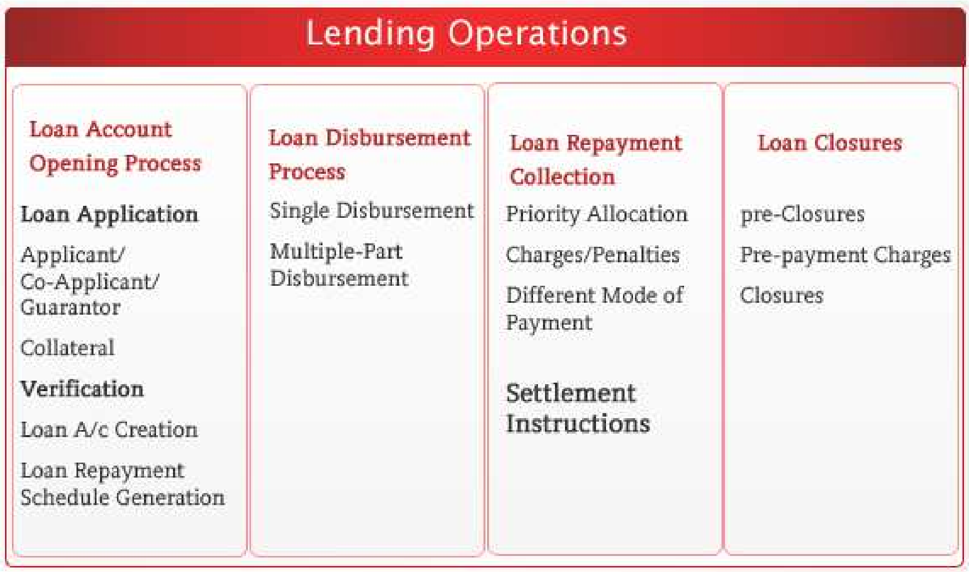
The rationale for utilising this particular research method and the researcher's positionality during the fieldwork research has been accounted for in Chapter 4 (Section 4.1.3). In addition, for this stage of the research especially while accompanying the loan officers on the field, the research had to factor in that their positionality would have changed. Accompany the loan officers on the filed involved also interacting with clients who are likely to perceive the researcher as 'an outsider' i.e. a Sierra Leonean studying abroad and from a different educational level within the Sierra Leonean society. To navigate these potential barriers, the researcher dressed differently i.e. wore local attire in order to blend in. In addition, whilst on the field the local researcher used the local transportation including taxis, 'poda podas' (mini-buses) and 'okodas' (motorcycles) as opposed to driving their own car.[77] Lastly, conscious effort was made to always converse in the local language whilst out on the field.

[77] In the local language

5.2 The Institutional factors

In order to guide the analysis of the data obtained from MFIs, the discussions will follow broadly or address a number factors relating to the loan cycle of MFIs seen in figure 5.2 below. A number of other aspects relating to loan operations that are not found in the typical loan cycle are also accounted for. This includes subjects such as how MFIs source their funds and staffing related matters

Figure 5.2: A typical microfinance loan cycle



Source: www.encoretheme.com/microfinance.php

5.2.1 Externally sourced funding:

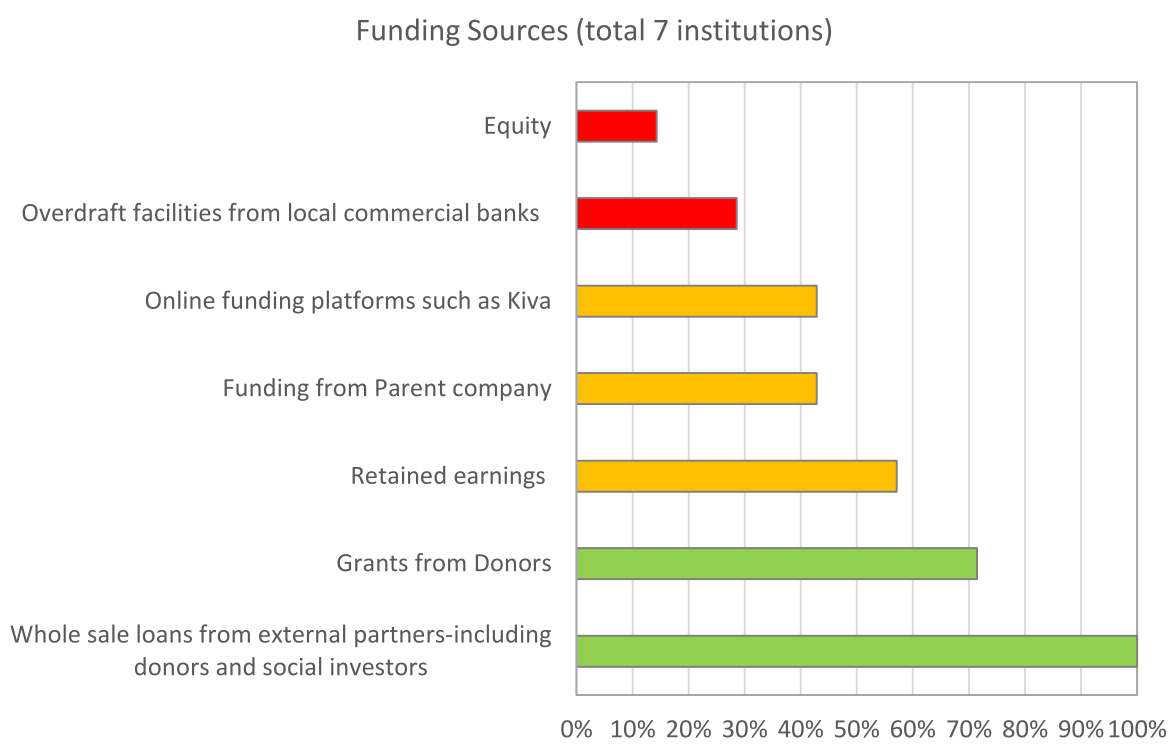
The funding for any loan operation must come from somewhere either internally through retained earnings or externally including grants, loans, equity, and overdraft facilities. Alongside the expansion of global microfinance industry, other innovative methods of funding MFIs have emerged such as the methodology employed by organisations like Kiva. Kiva funds MFIs by accumulating funds obtained from individuals through an online platform (using PayPal as the payment method). The individual funds are accumulated and transformed into bulk wholesale loans that are channelled to MFIs through Kiva's field partners.[78]

In more advanced economies, external funds are usually sourced from the domestic financial market. However, in developing markets like Sierra Leone external funds have to be sourced from external funding agencies. For the seven institutions that formed part of the final sample

[78] For more details on how this funding mechanism works, see the Kiva's Homepage: www.kiva.org/about/how. Accessed July, 2012

for the thesis's research at this stage; retained earnings play a minor role in terms of funding. Of the seven institutions, all of them received funding from an external source. They include wholesale loans from donors while some institutions (MFI A and MFI B) have in the past raised money in the open market from social investors such as Alterfin and ADA Luxemburg Microfinance. Grants from donors also serve as a source of funding. However, it must be stated that the research found that grants played a bigger role in the immediate post-war years when most MFIs had an emergency relief focus. Where relevant, the research also found that some MFIs also receive part of their funding from their parent companies (MFI B, MFI C and MFI F). The figure below shows the various funding sources utilised by MFIs in Sierra Leone.

Figure 5.3: Summary of sources of funds for loans provided by MFIs in Sierra Leone



Source: Author, 2015

Presently, within Sierra Leone's financial sector there are certain commercial banks that have the potential to provide funds to the conventional MFIs. However, some commercial banks are also in the business of providing loans to micro, small and medium-sized enterprises (MSMEs). They more or less regard other MFIs as competitors and are therefore reluctant to fund other MFIs. This situation is a difficult one from the point of view of the other MFIs, because in their opinion commercial banks lack the expertise and capacity to administer loans of this nature. Therefore, they should not be providing this service. In interviews with conventional MFIs, they argued that commercial banks are accustomed to undertaking the conventional banking procedures, therefore activities such as scrutinising 'groups' of micro loan clients when they are formed and performing the monitoring required (visiting clients) after loans have been disbursed, cannot be effectively undertaken by a commercial bank. In order to support their case, MFIs always hastened to point out the challenges that have been experienced by some commercial banks that have in the past ventured into lending to micro and small businesses.[79] Recall the finding with regards Sierra Leone's commercial banks and their reluctance to fund local businesses. The discussions in chapter 2 illustrated that this is one institutional factor which impacts financial intermediation.

From this, it is deduced that although Sierra Leone's microfinance sector is growing, the financial sector is yet to reach the level of development that will spur the rise of microfinance funding institutions and agencies to operate locally. Therefore, in consideration that MFIs have to source their funding 'internationally' it means the MFIs have to adhere to certain terms and conditions of their funding partners. In addition, these type of relationships present certain institutional risks and constraints within which MFIs have to operate.

Firstly, the wholesale loans are denominated in a foreign currency (mainly the US dollar) and accessed on a commercial basis, which affects the MFIs' costs. Therefore, interest repayments on wholesale loans are taken into consideration when setting the interest rates MFIs charge to their clients. The interest rates charged by MFIs on the surface seem reasonable however, when calculated per annum their rates are not that different from those charged by commercial banks (ranging between 25-35% per annum). Schicks and Rosernberg (2011) make the point that MFI interest rates are in fact high when quoted annually but seem low when MFIs quote interest rates on a monthly basis like they usually do. Rosenberg (2009a, 2009b) and Harper (2012) are part of the wider debate of whether MFIs charge excessive interest rates considering MFIs are supposed to be serving the poor.

This thesis notes that it only makes business sense for MFIs to charge interest rates that cover their costs. However, this adds to their clients' costs which will impact on their ability to repay the microcredit. The balancing act MFIs face from accessing commercial funds whilst trying to maintain their mandate of serving the poor is also analysed by Reed (2006).

The research finds that MFIs also levy some other one-off charges including for example; cash collateral, risk management fees and administration fees. Table 5.3 below illustrates an example of all the charges levied by MFI D. The charges are usually levied as one-off payments payable

[79] See Chapter 3, for a discussion of the past problems experienced by Commercial banks.

on the day the loan is disbursed. The cash collateral is usually returned to clients (a form of savings) when clients decide not to continue lending from the particular institution. However, during fieldwork, through participant observation it was gathered that some clients saw these charges as a form of tax because they had to be paid upfront as soon as the loan is approved or in the case of some institutions before the loan is approved. Furthermore, in some cases, the research found that clients have experienced severe delays in receiving their 'savings' back from the MFI. It is clear that these fees add to the costs incurred by the clients and it can be attributed to the need for MFIs to operate their businesses in a commercially viable manner. From the point of view of the MFI, it is 'justified' to charge the additional fees (to cover their costs) but clients are being subjected to repay loans with high interest rates plus additional fees, which have implications on their ability to finance their debts. The costs of funds incurred by microenterprises were of particular interest following the guide provided by the Institutional Economics literature. It features as one of the major institutional factors which impacts on financial sector outcomes. The findings in this section have confirmed the predictions of the theoretical framework utilised.

Table 5.2: Example of additional fees levied by an MFI in Sierra Leone:

Loan amount of Le 500,000 (£76.57)	Interest rate and fees (%)
Interest rate	2.5% (monthly)
Cash collateral	10% (up front))
Risk management fees	2% (up-front)
Administrative fees	2% (up front)

Source: Author, 2015

During 2013, the Government reduced interest rates on treasury bills and bonds twice from between 20-23% to single digits (AfDB 2014). A Director at the Ministry of Finance explained to the researcher that the policy had a number of objectives including 'making it less attractive for commercial banks to invest in treasury bills and so they will be forced to make more loans available to the private sector including small businesses' *(Director at Ministry of Finance, as related to the author on 22nd April, 2014).* Subsequently, the commercial banks revised their lending rates downwards and their clients benefited from lower interest rates on their obligations. The clients of MFIs have not benefited from this fall in interest rates because the rates on the liabilities MFIs have with their external funders remained the same. Therefore, MFIs still need to charge their clients the same interest rates as before (pre-April 2013) in order to be able to honour their own loan obligations owed to external funders.

Externally sourced wholesale loans raise some other concerns from 'a debt perspective'. Since the wholesale loans obtained by MFIs are mainly denominated in foreign currency, these external funds therefore come with associated foreign currency and exchange rate risks. According to the Institutional Economics literature such risks that represent transaction costs impact on the services provided by institutions (Nissanke and Aryeetey 1998, Einarsson 2003). For example, the research found that there have been instances where MFIs have experienced a drop in the value of the Leone equivalent of the wholesale loan obtained from the funder. However, their obligations to the funder remained the same even though the value and volume of the loans they can lend out to clients had reduced. In the light of this, exchange rate and foreign currency risks impacts on the costs of MFIs. It follows therefore, that these risks are considered by MFIs when setting interest rates on their loans. Consequently, the risks are passed on to the clients in the form of the high interest rates, thus impacting on clients' ability to service their debts. During 2015, in a catch up meeting with a Manager of MFI B, the impact on cost of MFIs resulting from foreign denominated loans manifested itself during the current Ebola Crisis. The manager explained to the researcher that the value of the Leones fell considerably during this period, therefore their dollar payments increased by 1.4 times. Consequently, their costs were seriously affected and the situation was worsened because during this period most MFIs experienced portfolio problems because their clients were unable to repay their loans as a result of a slowdown in business activities (SLAMFI 2015).

Another potential contributing institutional factor to clients' over-indebtedness is that some funders such as donors tend to have an indirect influence on loan operations of MFIs. For example, in order to cover costs MFIs tend to focus on expanding their outreach rather than awarding loans to productive investments. It has already been mentioned that this point came up as one of the areas of concern as part of the negative aspects of the MITAF 1 project. The literature reviewed in Chapter 1 also showed that this was a contributing factor to the debt problems associated with multiple borrowing experienced in other microfinance industries such as Bosnia and India.

5.2.2 MFIs loan application and disbursement process

The loan cycle typically starts with the loan application and disbursement process (recall from Figure 5.1). It generally involves receipt of applications from potential clients, assessing the applications and awarding loans to the successful applicants. In between these stages there are other activities that are undertaken by the MFIs, in order to ensure that the loans are awarded to the most productive and viable business ventures.

In Sierra Leone, clients are generally recruited either through 'sensitisation drives' conducted by the institutions typically in business centres, or clients finding out by 'word of mouth' from other existing MFI clients. If it is a group loan, applicants sometimes apply as a group or they are put in a group by their loan officer. On completion of the application forms which will include details of their business, passport-sized photos of applicants and the name of a guarantor, the loan officer and managers then carry out separate verification visits to conduct some qualitative background checks and business assessments. A decision on which application to approve is taken and prior to disbursement of loans; a loan agreement is signed.

All clients are then required to attend a mandatory meeting. During fieldwork, the researcher witnessed a number of these meeting sessions conducted by the seven MFIs in the sample, in order to observe and assess the loan disbursement process (participant observation). The meetings are mainly to explain to customers about the terms and conditions of the loans as well as any penalties associated with the loans. Ideally, these meetings should be replaced by MFIs providing clients with business management and debt management training. It must be flagged that an observation made by the researcher was that in all these meetings clients were warned by loan officers not to access loans to engage in multiple borrowing or debt refinancing. This provides evidence that these practices were occurring and it was a worry for MFIs, since it impacted on clients' ability to repay their loans. Figure 5.4 below depicts clients at a meeting session:

Figure 5.4: Meeting with MFI clients

Source: Author, 2015

The above narration is just a brief summary of the application and disbursement process. In executing the research, a number of challenges related to the application and disbursement process were deemed by the researcher to be factors that could promote indebtedness as well as debt refinancing amongst MEs in Freetown, Sierra Leone. These will now be discussed in turn:

5.2.2.1 *Limited support institutions for loan appraisals*

From an 'institutions' and 'microfinance indebtedness' point of view, one of the startling finding of this research is that the MFIs in Sierra Leone are not served by the Credit Reference Bureau (CRB) which currently sits in the Central Bank (as seen in Chapter 4, Figure 4.1). It does not appear that there are plans for this to be made possible anytime in the near future. The CRB became operational following the enactment of the Credit Reference Act in 2011. It only caters to the needs of the Commercial banking sector and one mortgage company.[80] Thus, MFIs have very limited tools available to them to utilise when conducting appraisals prior to loan approval. This is another example wherein regardless of the institutional change of mainstreaming access to credit for microenterprises certain vital institutions are still absent in the sector. In addition, this represents a serious informational challenge for the microfinance sector according to the Institutional Economics literature reviewed earlier in Chapter 2. Therefore its implications within the context of Sierra Leone are of interest for this thesis.

A CRB staff provided the following reasoning for not serving the microfinance sector:

'Lack of a standard national identification system, a national identification like the social security number in the United States or the National Insurance number in the United Kingdom, since that is missing here it's been a big challenge. That is what has been the major obstacle preventing us from going down to the microfinance sector. And they are worse; most of them do group lending say Tamaraneh loan and Tawopaneh loan.[81] How do you identify them? You see, so it's difficult and almost it's impossible. So we don't want to go there (microfinance sector) and we lose the good will that we are not doing a good job because we can't catch the people. So we are waiting on the government to come up with a standard ID system and see how that will help'. *(Credit Reference Bureau staff as related to the author on 9th September 2013)* [82]

The absence of credit reference checks in appraising businesses is posing a number of challenges for obvious reasons such as MFIs not being able to award loans to creditworthy businesses.

[80] This does not however include the microfinance operations of commercial banks
[81] Two group loan products that are usually provided by some MFIs. The Lunsar Community bank for example, offers these two loan products.
[82] See Appendix X for the rest of the interview

Loans are being awarded mainly by relying on the qualitative checks that MFI officials undertake. Under such circumstances, the likelihood of an MFI approving a loan for a client that cannot repay their debt in the future is very high. Hence, indebting those clients that will struggle to repay. The benefits of CRBs in curtailing debt problems are explained further in de Janvry et al (2005) and Mckintosh et al (2006).

During fieldwork, the researcher observed that the evidence of the debt implications of the lack of credit reference checks were very clear on the ground. For example, it is a regular occurrence for 'clients' to put forward a loan application for a business that does not belong to them. There have been instances also where so-called group leaders have formed fictitious groups and it does not get picked up by loan officers until there are arrears on the loan week after week. Only then will the loan officers realise that an incident of 'cross borrowing' has occurred.[83] For example, four other group members can obtain loans on behalf of their group leader. According to narrations by loan officers to the researcher (see Appendix 3.3), the other members obtain loans on behalf of the group leader usually in exchange for a small fee paid to them by the group leader. The group leader is now obligated to repay the loans of four other members to the MFI. Where he or she is not generating adequate cash flows to service the debt, they then become over-indebted which forces them to borrow from other sources to repay their loans. Unfortunately, these same clients circulate in the system and are likely to repeat their actions with another MFI in the absence of a CRB to provide past credit history.

A major consequence that the lack of a CRB that covers MFIs produces is the widespread existence of the problem of multiple borrowing and over-indebtedness of clients. Very early on in the research (alluded to in Chapters 3 and 4 of this thesis) it became obvious to the researcher that multiple borrowing was affecting the quality of MFIs' loan portfolio (although to varying degrees) and on the indebtedness of clients. All twenty-four MFI officials interviewed highlighted multiple borrowing was a major challenge and the absence of a CRB was provided as a major contributing factor to the existence of the problem.[84]

To put the existence of such a situation into context, apart from there being a CRB that does not cover the MFI sector, another contributing institutional factor is the environment in which MFIs operate. The operating environment in Sierra Leone that MFIs face can best be described as that which fosters 'unhealthy competition'. The research finds that there are a reasonable number of

[83] Cross borrowing in this case refers to one customer (A) obtaining loans on behalf of another customer (B) in the same group. Customer A is now obligated for loan A and B, and this then impacts on their ability to repay loans.
[84] Interviewees at the institutional level included MFI managers, loan officers, officials from the central bank, donors and other MFI practitioners.

major MFIs (10) but they are all offering similar products and are all after the same clients, because MFIs usually operate in the same locality.

Due to challenges such as poor infrastructure, MFIs in Sierra Leone operate mostly only in certain localities. More importantly, with the exception of MFI J, all the other major MFIs operate in Freetown (the main locality of interest for this thesis), for obvious reasons such as the ease of setting up shop due to the availability of basic infrastructure relative to the rural locations. Present in the sector also, are none conventional players, in this case specifically referring to commercial banks. Of the 13 commercial banks at least five have in the past or are currently operating in the sector. In the light of this sort of 'unhealthy competition', MFIs in their haste to expand their outreach have offered loans to customers that did not have the capacity to repay these loans thus indebting them. In fact, this was one of the main reasons for the collapse of some the major MFIs referred to earlier in Chapter 3. The high saturation of MFIs in the urban area (i.e Freetown) is pointed out as a crucial cause for concern in almost any report or assessment of Sierra Leone's financial sector such as by Duval and Bendu (2006) and NaCSA (2008).

In addition, during fieldwork interviews, when the researcher asked a major donor in the financial sector that in their opinion what the challenges were in promoting access to credit for micro and small businesses? First on their list was: 'the high saturation of MFIs in the major headquarter towns' *(Financial Sector Donor as related to author on 6th May, 2013)*. The high saturation of MFIs in Freetown is of concern to this thesis because the research finds that it is a major contributing factor to the ease at which clients can engage in cross borrowing, multiple borrowing and debt refinancing which later over-indebts them when they cannot finance multiple loans.

Appendix 3.4 is a compilation of a sample of evidence for the existence of cross borrowing, multiple borrowing, and debt refinancing. It includes views, accounts and narrations from all stakeholders interviewed during fieldwork. These explanations illustrate that at all levels, the widespread existence of multiple borrowing is a common view amongst all stakeholders in the financial sector. Also, the greater is the concentration of different MFIs in a particular locality, the more rapidly loans can be refinanced; making it appear that loans are performing well because they are repaid. However, it masks the fact that clients are being further indebted in the long run. The table in Appendix 3.2 shows that all interviewees at the institution level (regulatory body and MFIs) raised concerns about the effect multiple borrowing was having by indebting clients.

5.2.2.2 *Limited loan products available*

For the purposes of this study, one measure of MFIs' functional efficiency that is taken into consideration is the loan products offered to microenterprises. The main issues of consideration here are the variety of products offered to clients. Closely related to this also is the important issue of whether the products offered suit the clients' needs and cash flow. This will be further delved into later on in this Chapter.

From the research, a concern lies with the finding that there is lack of diversity in the loan products offered by MFIs. All seven MFIs in the sample have a standard set of products that they offer including individual loans, group loans and salary loans. Only MFI C and MFI A offer other products such as fixed asset loans, agricultural loans and solar loans.

Table 5.3 below includes a list of loan products of an MFI in Sierra Leone. It can be seen from the table that the MFI only offer the standard loan products stated earlier:

Table 5.3: Example loan products of an MFI in Sierra Leone:

Name of Product	Type of loan	Minimum & Maximum loan amounts
Mega Loan	group loan (between 2 to 5 members)	Le 400,000 (£61.26) to Le,4,000,000 (£612.57)
Single Enterprise Loan (SEL)	Individual loan	Le4,000,000 (£612.57) Le 50,000,000 (£7,657.10)
Salary Loan (SALO)	Individual loan (salaried worker)	Determined according to the worker's salary

Source: Author, 2015

The standard loan products have similar terms and conditions (repayment structures) across the various MFIs. For example, if Client X has loans from two different MFIs with similar repayment due dates, then it becomes very difficult to honour these debts concurrently. The client is then forced to obtain debt from a third MFI or from the informal sector in order to pay off at least one of the existing debts.

From the discussions thus far, two adverse effects of multiple borrowing are starting to be evident. The research finds that it promotes indebtedness and also debt refinancing. These findings provides evidence for this thesis's claims that credit can function as a debt management instrument- in other words, it can be used for debt refinancing. However also, debt refinancing as a debt management strategy has grave indebtedness consequences for the clients, as is evident in the narrations obtained on multiple borrowing as seen in Appendix 3.4. In general, clients eventually struggle or are unable to repay their debts when the debt becomes too big to be refinanced.

5.2.2.3 *Disbursement: Limitations of MFIs' credit policies*

When a loan committee at the MFIs' Head office level has approved loans, clients will attend a briefing meeting (described earlier in Section 5.2.2) and they are then handed their cheques.[85] In general, the MFIs have a policy of disbursing only a fixed amount at the start of a 'loan round'.[86]

For example, for a new customer, MFI A will only start them off with a loan of Le400, 000 (£61.27), even if the customer has applied for Le600, 000 (£91.89) and the pre-loan assessment indicates that the customer can repay a loan of Le600, 000 (£91.89). MFIs usually will strictly follow their policy of only awarding a new customer a certain amount, the research finds. In this case, the customer is forced to make up for the remaining Le 200,000 (£30.63) they required by borrowing from another MFI who also only starts a new customer at Le400, 000 (£61.26). Thus, the client now has a total liability of Le800, 000 (£122.51) rather than Le600, 000 (£91.89) which he needs. Considering that the client has the capacity of only servicing a debt of Le600, 000 (£91.89) based on the pre-loan assessment, he or she will now struggle to pay off a debt of Le800, 000 (£122.51).

Closely related to this research finding, is that the credit policies of MFIs generally prescribe for only fixed amounts to be awarded to clients at each stage of the 'loan round'.

For example, one of the MFIs researched will only provide the following amounts at each stage of the loan round seen in Table 5.4:

Table 5.4: Loan amounts provided at each loan round:

Loan round	Loan amount	£ Equivalent in current prices (£1=Le 6,529.89)
1	Le400,000	£61.27
2	Le500,000	£76.57
3	Le600,000	£91.89
4	Le800,000	£122.51
5	Le1,000,000	£153.14

Source: Author, 2015

[85] The loan committee usually comprises of the head of the organisation, branch manager and a board member (in some cases)

[86] For every time a customer takes out a loan, that is referred to as a loan round for the purposes of thesis. The MFIs in Sierra Leone refer to this as a loan cycle but in order not to mix it up with the loan cycle illustrated in Figure 5.2. The thesis uses the term 'loan round' instead.

Following on from the explanation previously provided, from Table 5.4 above, even if the client can handle Le600,000 (£91.89) at round 2, he will only be awarded Le500,000 (£76.57). Thus, he is being forced to look either to informal sources or from another MFI to make up for the extra amount required to undertake the investment. This policy contributes to fostering multiple borrowing and its associated risks.

The rationale for the policy of only providing a specific amount at each loan round from the MFIs' point of view is because at round 1 the borrower needs to prove that he is creditworthy. This is in consideration that MFIs have limited tools available to them for conducting pre-loan assessments. Whilst this thesis agrees with the reasoning, but in order to avoid the risks of multiple borrowing, some flexibility should be introduced in awarding loans in future loan rounds. Otherwise, the analysis has revealed that the existence of such restrictive institutions (or policies) governing the credit operations of MFIs in Sierra Leone, impose constraints on their clients which has debt implications.

The MFIs are aware that this aspect of their credit policies has its associated negative consequences; however, there does not seem to be any plans to revise this policy as at during the period when fieldwork was conducted.

5.2.2.4 *Disbursement delays*

Another aspect with regards MFIs' disbursements that has debt implications relates to delays in disbursing loans after approval. The research finds that the general timeframe for processing applications by MFIs in Sierra Leone is two to three weeks. However, whilst conducting the research, it was observed from participant observation that some MFIs were delaying their disbursements to clients for a number of reasons. In the main disbursement interruptions were due to delays by head office in approving the requests from the branch.[87] Usually, it is as a result of poor portfolio performance of the branch as deemed by the head office or in some cases due to funding constraints at the head office level. This finding relates to the finding in section 5.2.1 with regards the lack of local sources of funds. MFIs from time to time experience delays in receiving funds from their external funding partners. In some cases, this is because, the MFI has not met certain requirements of their funding partner or if the MFI simply cannot find an institution willing to fund its operations. This is further evidence that when institutions operate within other institutions it imposes constraints on them.

[87] Recall that the researcher visited MFI branches and by accompanied loan officers when conducting loan monitoring and payment collections on the field

During follow up fieldwork in April 2014 an MFI manager explained to the researcher that they were currently experiencing funding challenges and this was hampering their capacity to extend loans to their customers. In the manager's opinion 'the local commercial banks should not look to us as competitors but we can collaborate. The commercial banks can provide us with wholesale loans and we can then undertake microloan operations on the behalf of the commercial banks' *(Manager of MFI E, as related to the author on 21st April, 2014)*

However, when customers experience such delays, this thesis argues that eventually when their loans are approved the client is likely to have already acquired loans from other sources because the nature of the petty trading business. For example, traders sometimes require 'quick capital' or liquidity. In future, it then becomes a struggle to pay off both debts at the same time. Or in some cases the loan is no longer required, thus when the customer receives the loan, it will not be put into productive use, making it difficult to repay the loan when it is due.

5.2.2.5 *Inappropriate loan products*

The findings with regards the credit policies of the MFIs discussed earlier began to point towards one of the most important findings of this research, i.e. with regards the appropriateness of the products offered by MFIs. The other stakeholders interviewed by the researcher such as donors, the regulatory body and other commercial banks, expressed their concerns with regards the lack of diversity in the loan products available for micro and small businesses. This problem is linked with the unhealthy competition that exists in the sector already highlighted. Even though there is competition in terms of the number of players in the sector, it has not resulted in the development of appropriate loan products-the competition has not spurred on innovation. Thus, inappropriate loan products remain an institutional hazard that fosters indebtedness amongst microloan users.

5.2.2.6 *Repayments schedule do not match cash flows*

Of relevance to this research is that limited efforts are made to develop loan products that match the cash flow pattern of certain groups of clients with the repayment structure of the loan. For example, petty traders do not have consistent level of cash flow every week, but the loans offered by MFIs in Sierra Leone are to be repaid weekly, bi-weekly, and in some instances daily. There is a lot of reliance being placed on the clients' ability to save towards their loan obligations. However, where there are competing social priorities (such as children's school fees, contributing towards a funeral), it is highly unlikely that clients will not use the money saved (if at all) towards repayment of their loans.

5.2.2.7 *Products do not account for seasonality*

Another closely related research finding is that the products of MFIs do not take into account seasonal factors. During the rainy season which usually lasts from June to September, it was observed whilst undertaking the research that clients' cash flow during that period was not as regular compared to during the dry season. It must be stated that this is an annual occurrence. For example, some petty traders who move around with their products (i.e. street hawking) were severely affected during the rains, because their movements were limited. Similarly, fieldwork also coincided with the 2013 Ramadan period and the school long holiday break (late July to early September).[88] During Ramadan and the school break, those businesses that are involved in food and drink petty trading always experience a fall in their sales and thus struggle to repay their loans from MFIs during these periods. However, the products offered by MFIs do not take into account these realities; therefore to keep up with payments during these periods of slow cash flow, clients are forced to borrow from other sources thus promoting debt refinancing and further indebtedness. A final example relates to the agricultural sector; 90% of the MFIs interviewed do not have specific agricultural loan products. Hence, farmers are offered the same loan products available to petty traders or those from the services sector. However, as farmers' cash flows are seasonal in nature, during the planting season when they are not making any sales, farmers are still required to make weekly payments in order to service their loans.

5.2.2.8 *High MFI Interest Rates*

Another aspect of the loan products which has debt implications relates to the interest rates charged by MFIs. As highlighted already, MFI interest rates are hardly different from those charged by commercial banks. One reason for the high interest rates which relates to expensive wholesale loans that the MFIs acquire externally was already discussed. High overhead costs facing MFIs is another contributing institutional factor. The literature acknowledges that making small loans is an expensive business due to high administrative costs involved (Nissanke 2012). In the case of Sierra Leone, in addition to high administrative costs because most functions have to be carried out manually, the situation is exacerbated by poor infrastructure. Irregular electricity supply for example meant that in ninety per cent of the office premises visited during fieldwork, a generator was relied on for electricity. High fuel costs from running generators add up to MFIs' overall costs which are taken into consideration when setting interest rates in order to ensure their businesses remain financially sustainable. Hence, high interest rates naturally impacts on

[88] Fasting period for the Muslims, thus they do not eat during the day. To note is that Sierra Leone is a predominantly Muslim country. According to the 2013 Demographic Health Survey 78.2% of respondents are Muslims (Sierra Leone Demographic and Health Survey, 2013).

clients' ability to repay their loans and this feeds into the wider debate of whether these loans are indeed 'cheap finance' (see Bateman 2010) as they are meant to be, considering the segment of the population that are the targets for such loans. Admittedly, however, in an operating environment like that which exists in Sierra Leone, it is almost impossible not to charge high interest rates. High administrative and transactions costs are commonly cited institutional factors that affect the performance of financial institutions generally in providing their services (Anayiotos and Toroyan 2009). This finding also goes to show that because MFIs themselves operate within other institutions that have to create the right incentives for efficient institutions to emerge and be sustained. Issues related to poor infrastructure and fuel costs are beyond the control of MFIs but they do affect the quality of the service they provide.

However, overwhelmingly, the point concerning inappropriateness of loan products to the customers' needs and lack of product innovation came up as a crucial concern amongst all other stakeholders interviewed during the field research. This finding is very relevant to any research that is focused on debt problems that are linked with increased access to credit. The research finds that when products are not in line with cash flows or impact on clients' cash flows, they struggle to repay the debt while also being forced to look to other sources in order to keep up with payments. Accumulation of debts from various sources promotes debt refinancing which poses further debt problems for clients in the future.

A former MITAF 1 Technical Assistant (TA) made the following observation: 'The MFIs lack creativity; their products are not flexible. Their loans do not match needs and preferences of their clients' *(Former MITAF 1 TA, as related to the author on 6th May, 2013)*

Another former MITAF 1 official also shared similar views: 'the MFIs lack innovation with loan products; they have limited type of loan products that do not suit all their clients' needs, such as farmers who can only repay after harvest and sales. Therefore products that require starting repayment two weeks after loan if obtained will not be suitable for farmers' *(Former MITAF 1 official as related to the author on 27th May, 2014).*

5.2.2.9 *Monitoring of loan use*

The expression 'there are no bad clients only bad loans' (Community Development Financial Institutions Fund, 2012) applies to every aspect of loan operations of an institution. More so, it relates to ensuring loan use is effectively monitored and the client receives adequate 'after-sales' support by the MFI from which the loan was obtained. This is crucial because, it has a bearing on whether a loan will be repaid or not i.e. the debt outcome of the loan. It affects the quality of the institution's loan portfolio whilst also affecting the debt position of the client. Thus, effective institutions must find ways of ensuring their after sales services are adequate in order to prevent debt problems for their clients.

The research finds that monitoring of loan use generally comprises visits by loan officers to the business premise of their clients; most of these visits are unannounced and can be informal in nature. The loan officer usually has an informal chat with the customer to find out about their sales or any business related challenge they might be facing. During these visits, the loan officers observe the business's growth (stock of goods) to ascertain whether the loans are being utilised productively.

It follows therefore that the mechanisms utilised for providing monitoring of loan use and support to the clients relies heavily on the discretion of the loan officers, which the research finds comes with some challenges. Firstly, it relies heavily on the expertise, commitment and integrity of the loan officer. If a loan officer does not have the required expertise to detect whether the client's business is not growing or if the cash flow does not correspond with the repayment structure of the loan. The loan officer is then unable to provide the customer with the required support to prevent the loan from going bad. Thus, the client becomes indebted because they will struggle to repay the loan in such a situation.

Perhaps more vital are the tools available to loan officers to carry out monitoring. The research finds that typically in Sierra Leone especially in Freetown where it is perceived that transportation is widely available; loan officers are simply given a monthly allowance towards their transportation to visit their clients at their businesses. From interviews with loan officers, the amount provided towards transportation was assessed by the researcher to be inadequate. Most of the loan officers also explained that there are areas even within Freetown that cannot be accessed by car especially during the rainy season; therefore their jobs could be made easier if they were provided with motorcycles.

Another challenge lies with the number of client per loan officer ratio in terms of monitoring. Each loan officer has a set number of clients that they are responsible for. Most loan officers had far more clients than they had the capacity to monitor. This makes the monitoring undertaken ineffective and can lead to debt problems. In such cases, it becomes easy for clients to divert funds to unproductive use. Since fieldwork was undertaken during the rainy season, it was very clear how effective monitoring of clients was hindered as a result of high client/loan officer ratio. From accompanying loan officers on the field, the researcher could see how it was almost impossible to cover a large number of clients in unfavourable weather conditions and in areas that became almost inaccessible during the rainy season (the roads get worse). It is inferred that the outlook is worse in the rural areas where the roads are far more inaccessible than in Freetown.

5.2.2.10 *Contract enforcement between the MFIs and microloan clients*

In any formal debt relationship, there are generally laid down penalties to be enforced in the event of payment delays or defaults. In the context of Institutional Economics, penalties serve as incentives or rules of the game not to delay payment or default on payments. Therefore, the institutions that are involved in providing credit services to microbusinesses have their set out penalties or institutions that govern their interactions with their clients. For example, one of the MFIs interviewed (MFI D) 'levies' a monthly charge of an equivalent of 5% of the amount in arrears.

From the fieldwork, it was found that hardly any of the microfinance institutions studied enforced their penalties. A number of reasons were given for this by MFIs; firstly, because they deal with poor clients they do not want to further impoverish their clients by levying penalties. MFIs also explained that they do not have the backing of contract enforcement institutions such as the police nor the law.

A thought provoking research finding is that in Sierra Leone, if a customer refuses to pay any loan amount of up to two million Leones (£306.1), it is not considered to be a criminal offense but rather a 'civil matter'. A civil matter means that it should be settled out of court without the involvement of the law authorities. Considering that the majority of MFI loans are usually below two million Leones (£306.1), this factor therefore contributes to clients not putting loans into productive use.

With regards loans above two million Leones (£306.1), there is disincentive on the part of MFIs to take customers to court due to the length of time it will take to get a judgement for a case against a delinquent client. The administrative costs involved in taking a matter to court mostly outweigh the amounts that are owed to the institution. The MFIs argue that it therefore makes no financial sense to prosecute offending clients in most cases. Lastly, due to the perception that MFIs can be heavy handed with their customers; going back to the 'micro jail point made earlier in Chapter 4, MFIs are usually not inclined to implement their penalties.

Generally, since MFIs do not enforce their penalties, it creates a certain lackadaisical attitude amongst clients and do not invest their loans wisely which can impact on their capacity to service their debts. This research finding is similar to findings by authors such as Von Pischke and Adams (1992) that credit discipline is required in order to prevent adverse debt outcomes amongst microloan clients.

These findings in addition to the findings in Chapter 5 further point towards the existence of weak institutions that govern a number of activities in the microfinance sector. In this case, the institutions that govern the loan operations of MFIs are weak; hence, microfinance clients are not likely to put loans into productive use which creates debt problems for them. Linking the analysis here back to the Institutional Economics literature reviewed in Chapter 2, inefficient legal systems would produce negative consequences for the financial sector.

Table 5.5 is a summary of the findings with on loan operations of MFIs and the impact on indebtedness of their clients:

Table 5.5: Summary of Institutional factors at the MFI level contributing to over-indebtedness

No	Findings	Debt implication
1	Funding for loans are mainly externally sourced which comes with associated foreign currency and exchange rate risks	Interest rates on wholesale loans accessed externally are high because funders factor in local risks. MFIs pass this cost on to their clients which impacts on clients' ability to repay their loans
2	The Credit Reference Bureau does not serve the microfinance sector in Sierra Leone. Therefore, limited tools are available to MFIs for undertaking loan appraisals	Loan officers mainly rely on qualitative checks to ascertain whether a business qualifies for a loan. Qualitative checks have serious limitations and increase the possibility of giving a loan to a client that is above their repayment capacity. The research finds that clients have in the past obtained loans for fictitious businesses which have then impacted on their ability to repay their loans. In addition there is significant evidence that the lack of a CRB in the sector is one major institutional factor contributing to the debt problems that face MFI clients.
3	Limited loan products offered by MFIs	Overwhelmingly, other stakeholders interviewed complained of the lack of innovation by MFIs in offering a variety of products that better match clients' cash flow. In such a context wherein multiple lending and borrowing are rife, clients access other loans that better match their cash flows. If a client accesses three loans with similar repayment structures; they will be thrown into indebtedness because they will struggle to cope with simultaneous repayments.
4	Restrictive MFI credit policies	For example, the MFIs' policy of starting off clients only at a certain amount implies that in some cases clients are given loans below their requirement which forces them to borrow from another institution. The combined loans will now be above the client's repayment capacity which throws them into indebtedness and the need for debt refinancing.

5	Disbursement delays by MFIs	MFIs sometimes delay disbursements to clients due to funding delays from headquarters or in some cases external funders. Clients are forced to access loans from other sources in the interim. Eventually the combined loan amount is above the client's repayment capacity thus over-indebting clients.
6	Challenges with monitoring of loan use	This thesis argues that monitoring of loan use heavily relies on the loan officers' expertise, integrity and commitment. Loan officers complain of lack of resources to visit clients' business premises; the task becomes harder during the rainy season where some areas become difficult to access. These challenges hamper the effectiveness of loan monitoring which therefore makes clients more prone to over-indebtedness
7	Inappropriate loan products	This finding relates to findings 3 and 4 above. It was also found that loan products do not always match the client's cash flow. For example, loan products were not seasonally sensitive. Considering that it is the rainy season for six months of the year in Sierra Leone. Annually MFIs experienced a drop and delays in repayments during the rains because clients experience a considerable drop in their level of sales due to disruptions of their business activities. Thus, clients are indebted during this period. Also in some cases some farmers are offered loans similar to those provided for petty traders even though their cash flow pattern of a farmer is far different from a petty trader.
8	Lack of enforcement of penalties	MFIs rarely enforce their penalties on delinquent clients or those that are in arrears. This promotes unproductive use of loans amongst clients and eventually over-indebtedness. It also promotes multiple borrowing and debt refinancing because clients are aware that they can be involved in risky debt management practices and they might not be penalised by MFIs but they are eventually thrown into further indebtedness.
9	**Accounts from interviews with personnel at the MFI level indicate that multiple borrowing, cross borrowing and debt refinancing is rife in Freetown, Sierra Leone(evidenced by Appendix 3.4 and more)**	**ALL interviewees at the MFI level provide a range of examples which illustrate how clients are accessing multiple loans and engaging in debt refinancing, which is then throwing them into over-indebtedness.**

Source: Author, 2015

The research finds that MFIs in Sierra Leone have without a doubt provided access to credit to microenterprises that otherwise will not be served by the traditional commercial banks excluding the two commercial banks with microfinance windows. However, there are still large numbers not being served by MFIs hence the rationale given by policy makers for starting Financial Services Associations (FSAs) or village banks in Sierra Leone. For a population of almost six million, the current estimates put the total loan clients of the leading MFIs at just 100,000.

In addition, a pertinent observation made by the researcher whiles carrying out this research, was that when it came to 'large' amounts in relation to the Sierra Leone context (say a million Leones or £153.14 and above) borrowing from family and friends was becoming less attractive mainly because family and friends are becoming less inclined to lend out large sums of money. This is most probably due to the poverty situation in the country.

Despite the improved access to credit, to recall one of the main arguments of this thesis is that access to finance as an institutional change that should not result in increased indebtedness amongst its beneficiaries. If the increased credit is being used for debt management purposes through debt refinancing, then this severely limits the gains in terms of creating jobs and incomes that could be gained from increased access to credit. The preceding discussions have highlighted aspects of the loan operations of MFIs that were found by the research to promote indebtedness. In addition, in the interviews with MFIs, some of the challenges they faced in operating their businesses was an area of interest for the research. A number of such challenges highlighted also represent further institutional factors that have some implications for this thesis's analysis because they also have the potential of fostering indebtedness amongst MFI clients. The challenges are discussed in turn:

5.3 Further institutional challenges with MFIs' loan operations

5.3.1 Staffing quality and quantity

Similar to the research's finding at the regulatory body level, MFIs also suffer from poor staff quality, low levels of staffing and high staff turnover. The loan officers are at the core of any loan operations, it is therefore imperative that they possess the right skills and for them to be retained within the sector. The seven MFIs studied overwhelming emphasised staffing as a major challenge to the successful implementation of their loan operations.

During follow up fieldwork in 2014, a managing director of one of the leading MFIs explained that: 'Most of my other colleagues whenever we meet will say our biggest challenge are the non-performing loans (high portfolio at risk-PARs)[89] that we are experiencing, I always tell them that for me, with my vast experience in conducting microloan operations, I believe the biggest challenge the sector faces is that of the poor quality of staff available to us to conduct our operations' *(Head of MFI B, as related to the author on 22nd April, 2014)*

[89] PAR is the value of all loans outstanding that have one or more instalments of principal past due more than a certain number of days (CGAP, 2003). The research finds that for the context of Sierra Leone having a PAR above 5% is regarded as poor portfolio performance.

The lack of a successor project to MITAF 1 discussed in Chapter 3, left a huge gap in the sector in a number of areas including training and technical assistance for MFI staff. A major component of MITAF 1 was capacity building for staff in the microfinance sector, therefore it made up for MFIs not being able to afford to provide training for their staff.

In the face of high overhead costs (already discussed) and without the support of MITAF, most MFIs cannot afford to provide their staff with the prerequisite specialised training related to loan operations for micro and small enterprises. Training is mostly available internationally and involves expensive overseas travel. Therefore, without the right skills a number of aspects with regards loan operations cannot be undertaken efficiently including screening of clients and monitoring of loan use. This adverse selection challenge has obvious debt implications because the 'wrong' clients will be accessing loans which they will struggle to repay. In addition, staff will not be able to provide clients with the required support and scrutiny that is needed by clients whilst loans are being utilised. As a result, clients will mismanage the loan which impacts on their capacity to service their debts.

Another unintended consequence of having a growing financial sector in Sierra Leone is low staff retention, which is a widespread problem that is also mentioned in the interviews with the regulatory body. The MFI managers interviewed complained of losing staff to other services sectors such as the commercial banks and the mobile phone companies. When staff cannot be retained, it also contributes to the poor quality of staff. If newly recruited replacement loan officers are inexperienced, it usually takes time for them to master the trade of microfinance loan operations.

The research finds that the challenges with staffing in terms of quality and retention are a common institutional problem in most sectors in Sierra Leone. The education system deteriorated badly as a result of the war Sierra Leone experienced. Generally, educational standards have dropped and the effect of brain drain due to the war is still being experienced nationwide. In addition to this, because the microfinance sector in its current form (commercialised) is an emerging sector, it will take time for the required pool of talent to be nurtured and found locally. For now, technical assistance from international consultants is being relied on for certain skill sets that cannot be found locally example product development. For example, International Fund for Agricultural Development (IFAD) has consultants attached to community banks to help them in areas such as product development and improving management and information systems. MITAF had in the past provided similar support to its partner lending institutions.

5.3.2 Staff integrity

The research found that there are also serious concerns over the integrity of staff, which was briefly mentioned earlier. Every institution studied has had their fair share of problems due to dishonest staff. From interviews with the seven MFIs, lack of integrity of MFI staff was evident in the following ways:

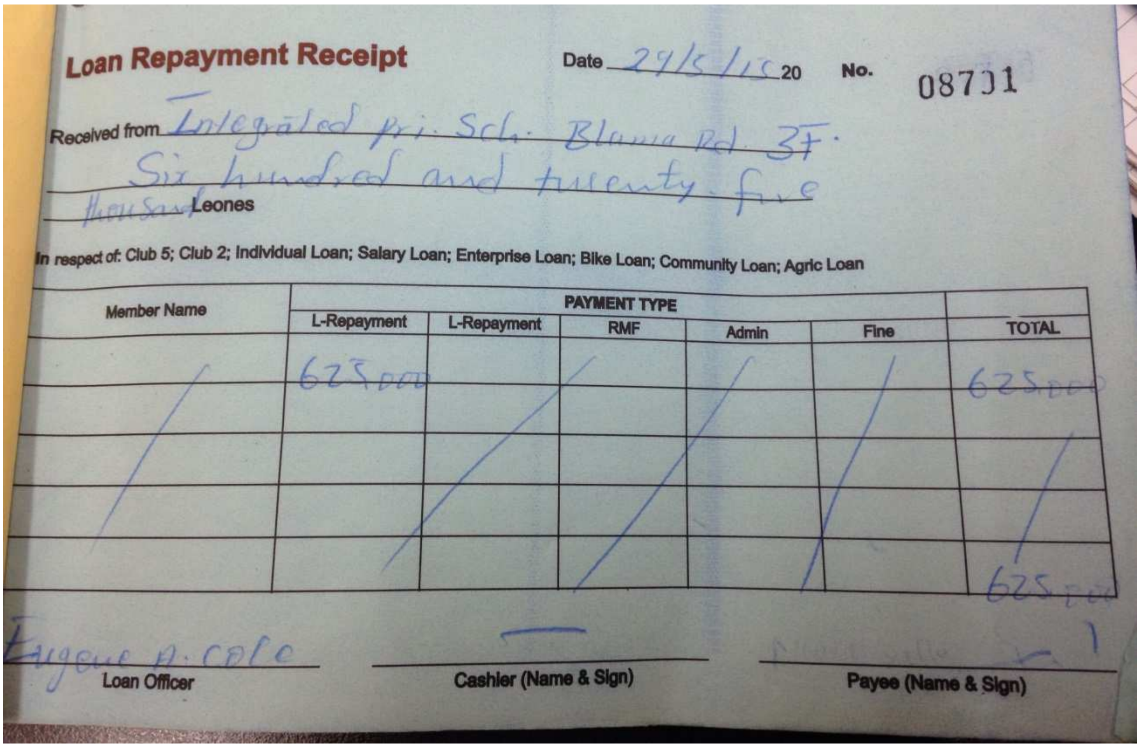
1. Loan officers conniving with clients to form fictitious groups in order to obtain loans on their behalf for a certain percentage of the loan amount
2. Monitoring and evaluation staff such as the Management Information System (MIS) officers 'massaging' loan performance figures
3. Staff running away with huge sums from loan collections.

In addition, the researcher also found the following evidence with regards poor staff integrity:

In one of MFI D's branch there was a notice up pleading for anyone with useful information to assist in finding an accountant that had defrauded the institutions of millions of Leones. In the west end branch of the same MFI, whilst waiting to conduct an interview the branch manager, a number of clients came into the branch to make loan payments begrudgingly. They had made payments to their loan officer who did not make the payment to the head office, and had run away. Unfortunately, these clients did not have receipts to prove that they had made payments to the loan officer; as a result the branch manager was holding them accountable for the loan repayments. Almost in tears a client explained to the researcher 'we had trusted him so much, he never gave us receipts. It is unfair that we now have to make these payments which we already made in the past' *(MFI D Client, as related to the author on 30th September, 2013)*

The image below is an example of the receipt that is usually issued to a client/clients for a loan payment:

Figure 5.5: MFI Loan repayment receipt



Loan Repayment Receipt Date 29/5/15 20 No. 08731

Received from Integrated pri. Sch. Blama Rd. 3F.

Six hundred and twenty five thousand Leones

In respect of: Club 5; Club 2; Individual Loan; Salary Loan; Enterprise Loan; Bike Loan; Community Loan; Agric Loan

Member Name	PAYMENT TYPE					
	L-Repayment	L-Repayment	RMF	Admin	Fine	TOTAL
	625,000					625,000
						625,000

Eugene A. Cole
Loan Officer

Cashier (Name & Sign)

Payee (Name & Sign)

Source: MFI E

The research found that lack of integrity of staff members was part of the reasons for the collapse of Procredit Bank mentioned in Chapter 3. Most of the staff members were aware that the Bank at that time had a policy of writing off all debts that were above one hundred days explained a current MFI manager (MFI B). With this in mind, the loan officers will make loans to themselves, their relatives or customers that they knew were not creditworthy. After one hundred days, these debts were declared as bad debts and were written off, however, this seriously affected the financial position of the Bank and eventually contributed to its collapse.

From the point of view of the staff of MFIs, this sector cannot attract high quality staff nor retain them due to low remuneration for staff in the sector. One loan officer from MFI D during pre-field work interviews asked the following question: 'When they say some of us do not do our jobs properly, did they also tell you that our salaries are very poor?' *(MFI D Loan officer rural branch, as related to the author on 23rd July, 2013)*

5.3.3 The Government's role in the sector

The earlier findings of the research with regards the government's involvement in the sector also came up as a challenge for institutions in the sector. Of all the twenty-four MFI personnel interviewed, they all expressed their concerns over the government's role in the sector. The discussions will not be repeated in this Chapter (see Chapter 3 and 4). However, it must be reiterated that if this matter is not addressed it will continue to pose an institutional bottleneck to the successful implementation of access to credit programmes. The attitude of clients that microcredit is 'free money' is creating debt problems for those clients who access monies thinking that they do not have to repay it. This leads to bad investment decisions and in some cases complete diversion of funds.

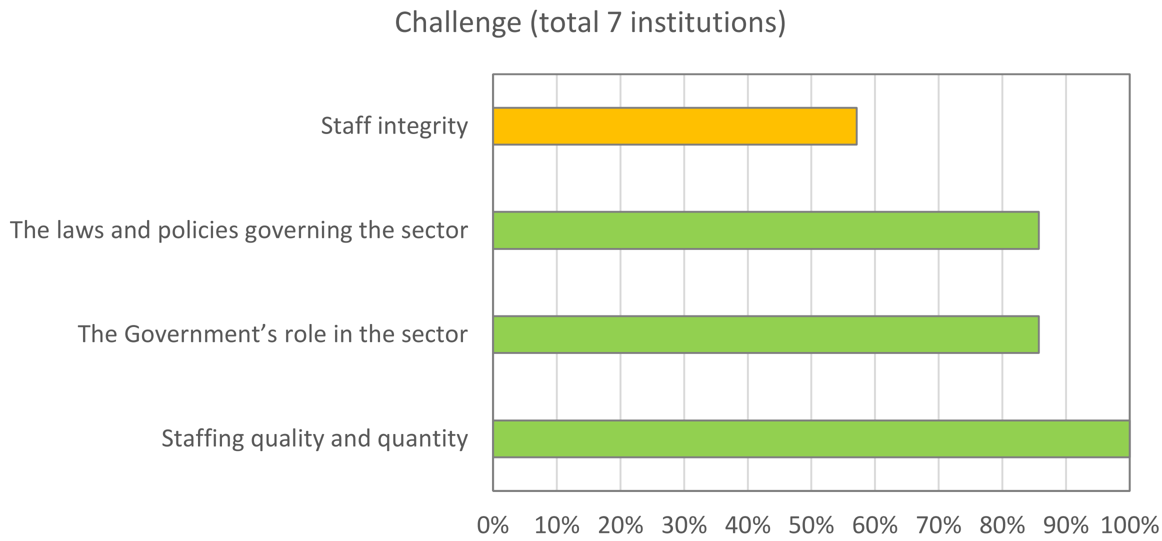
It is not the case that customers of commercialised MFIs are not expected to repay their debts. If loans have not been invested productively, this is when customers will really struggle to repay their loans because they would not have generated the required cash flow. Customers will then be forced to access loans from other sources to repay their loans and this will further worsen their debt positions. Appendix 3.5 includes transcripts from interviews with MFI on this matter. They provide further evidence of the claim made by this thesis that complete institutional change has not yet occurred despite intense efforts by donors to transform the provision of microcredit to a purely private sector function.

5.3.4 The laws and policies governing the sector

The lack of appropriate laws and policies governing the sector came out strongly as a challenge to conducting business in the microfinance sector. This finding links in with the research's earlier finding relating to the inadequate policy environment that exists. As such, it is hampering the growth and advancement of the sector. This point was also made by all the MFIs (seven) and donors interviewed during fieldwork. This thesis reemphasises the point that there are serious debt consequences that come along with policies that do not focus on dealing with over-indebtedness.

Figure 5.6 below summarises the additional challenges faced by MFIs in performing their loan operations.

Figure 5.6: Additional challenges facing MFIs when conducting loan operations



Source: Author, 2015

5.4 Summary and Conclusion

Having examined the loan operations of seven of the leading MFIs in Freetown, Sierra Leone, the research found that a number of factors had debt repercussions for microenterprises. The credit polices of MFIs which in most cases do not permit MFIs to disburse the requested loan amounts by clients. It makes it difficult for clients to fund their business ventures and hence pushes them into multiple borrowing. It thus impacts on their abilities to repay their debts.

It is also of grave concern of this thesis that the Credit Reference Bureau does not serve the microfinance sector. Under such circumstances, there is a high likelihood of awarding loans to businesses that are not creditworthy, which has serious debt consequences. Above all, the research finds that this factor hugely contributes to the continued prevalence of multiple borrowing in Sierra Leone's microfinance sector and therefore promotes an environment where over-indebtedness thrives amongst microenterprises.

The research finds that staffing challenges are also a limitation to the effective operations of MFIs. It is acknowledged that low capacity is a problem in Sierra Leone, the case of 'a missing middle' is said to exist in terms of the quality of staff both in the public and private sectors. However, poor quality staff and inadequate staff (in terms of numbers) are creating problems when it comes to executing credit programmes. For a credit programme to be successful especially in terms of not creating and exacerbating debt problem), a lot relies on the staff undertaking the loan operations. The examples provided in the analysis illustrate how poor quality staff and in some cases staff that do not conduct their roles with integrity can impact on debt levels of clients and the portfolio performance of MFIs. The provision of limited and inappropriate products to clients was found to also impact on the capacity of the clients to service their debts. This can further lead to debt refinancing which has even more grave consequences in terms of further indebting the clients. The high concentration of MFIs in certain localities in particular Freetown, was found to be another major contributing factor to creating an environment where it was easy to engage in accessing multiple loans from the same institution or from different organisations. In such a context, it makes it very easy for businesses to engage in harmful debt refinancing when loans become a struggle to repay.

Other aspects such as the Government's involvement in credit provision as well as a judicial system that does not provide the required support mechanisms to the microfinance sector in the form of relevant laws and effective commercial courts, were found to further create an environment that will enable and worsen debt problems. For as long as clients have the perception that microcredit is 'free money' because of the Government's subsidised form of credit provided over the years or that there are no serious consequences for misusing funds, then debt problems will arise as they have.

The findings discussed throughout this chapter including the evidence presented in Appendix 3.4, sufficiently demonstrates the debt problems which this thesis argues will exist due to increased access to credit in a context like Freetown, Sierra Leone. The narrations confirm that increased access to finance in combination with the institutional factors discussed in this Chapter, have led to clients engaging in cross borrowing and multiple borrowing and that has made it difficult for clients to service multiple loans concurrently. The end result is that clients either struggle to repay their debts or are unable to repay them at all. In other words, clients have been led to over-indebtedness as per the definition followed in this thesis.

Chapter 6: Thesis Conclusion

This thesis set itself the task of providing answers to the following main research question: *To what extent do the new institutions widening access to credit led to multiple borrowing and debt refinancing amongst microenterprises?*

To this end, this thesis's research and analysis is being guided by the prescriptions and theories of the literature that has applied Institutional Economics analysis to explain developments in the microfinance sector and the financial sector more broadly.

The main motivation for undertaking this research is because upon review of the microfinance impact literature, it was found that the scholarship would benefit from understanding the problem of microcredit over-indebtedness through an Institutional economics lens. This is the gap that this research has filled by using Sierra Leone as a case study. In addition, literature on access to finance in Sierra Leone does not include a microfinance impact analysis. Owing to the continued policy efforts to expand the microfinance sector a study such as this one is both relevant and significant.

A qualitative analysis has been completed in order to show how access to finance as an institutional change has led to a change in the institutional landscape of the financial sector. The analysis also goes further to assess the functional efficiencies of the regulatory body and microfinance institutions as they were deemed as crucial institutions that contribute to indebtedness amongst microenterprises. Self-administered structured and unstructured interviews, triangulation and participant observation are research techniques drawn on to conduct this research.

In Section 6.1, the thesis's main conclusions will be drawn, after which the research's policy implications will be outlined in Section 6.2. The limitations of the research are pointed out in Section 6.3 and avenues for further research are provided in Section 6.4.

6.1 Conclusions

In Chapter One it was found that Sierra Leone faces problems of high unemployment, urbanisation, weak financial and economics systems. From the policymakers' point of view, this has provided the rationale for focusing on promoting access to credit as a policy tool to create jobs and incomes. Hence, making Sierra Leone a befitting case study to prove the debt implications resulting from increased access to credit.

In Chapter One it was also concluded that institutions within the microfinance sector do contribute to over-indebtedness in recognition that microenterprises operate within certain institutions. These institutions represent constraints and incentives that impact on debt outcomes. Another pertinent conclusion is reached with regards assessing access to credit. Contrary to the neoliberal development agenda where gaining access to credit is the end goal. Taking into consideration that credit accessed needs to be repaid, it was about time emphasis was put on understanding the processes involved in financing a debt as opposed to just being content with providing more access to credit.

In Chapter Two, the Institutional Economics literature is discussed in order to provide a theoretical basis for framing the analysis that was undertaken in the rest of the thesis. It entailed a discussion of the various theories within the Old and New Institutional Economics. The literature that applies the Institutional Economics to understanding financial sector and microfinance development is also reviewed.

From the literature reviewed it is gathered that a number of factors must be accounted for when using Institutional Economics analysis to understand financial sector outcomes. They include informational challenges, contract enforcement mechanisms, effectiveness of the legal system, property rights, transaction costs, the role of the state cost of funds i.e. interest rates and margins. Other lessons learnt from the literature are incorporated in the thesis's analysis including a) institutions operate within other institutions, b) informal institutions also play an important role in effecting financial sector outcomes and c) political, social and historical are as important as economic institutions.

Chapter Three shows the various institutions that have been developed or have emerged as a result of policy efforts to promote microfinance. It includes discussions of changes in the policy environment as well as the institutional landscape. From the research undertaken, it was found that concerted effort was being made to commercialise the provision of microfinance. However, in most cases donors had some role to play in developing these policies. Therefore, this thesis questions whether access to finance as a policy was demand or supply driven. It is argued that there are debt implications if the adoption of access to finance policies is 'forced' on a country.

Another pertinent finding for a thesis that is focused on microfinance indebtedness is that almost all access to credit programmes or initiatives implemented in the past were riddled with debt problems. Institutional problems such as poor staffing and weak contract enforcement mechanisms were amongst the reasons for indebtedness. Two main conclusions are drawn in the

Chapter: a) Debt problems will continue to exist because the research finds that lessons were not learnt in relation to the institutional factors that promoted indebtedness in the past. b) a complete transformation of the sector has not occurred because it was found that the State continues to provide microfinance. The implication here being that the perception that microfinance debt should not be repaid is perpetuated. This is an example of how political institutions are impacting on economic outcomes.

Chapter Four conducts an analysis of the effectiveness of the regulatory body. This was of interest because as an institution, the regulatory body including the regulatory and policy environment do have the capacity to mitigate or promote indebtedness. The laws, policies and acts used to govern the microfinance sector impact on how exchanges are structured. An added layer of oversight function is usually provided by non-state actors such as civil societies. The research accounts for this added monitoring mechanism and its effectiveness.

It is concluded the institutional challenges that the central bank is experiencing contribute towards fostering detrimental debt management practices (DDMPs) such as multiple borrowing. The regulatory authority lack adequate resources and staff to conduct its work effectively. Informational challenges the regulatory body faces come in the form of the Bank Sierra Leone (BSL) not being aware of all the institutions operating in the sector or not being able to conduct in-depth off-sight monitoring of microfinance institutions. The policy environment contributes to the regulatory body not being able to perform its functions effectively. The policies and guidelines utilised by the Bank of Sierra Leone do not make provisions for the regulators to impose penalties on none compliant MFIs. Therefore contract enforcement between the MFIs and the regulator is weak. The policies do not factor measures to be taken when access to finance policies do not produce the right outcomes including indebting clients. This is a serious institutional flaw.

There was no evidence of civil society playing a part in scrutinising the operations of MFIs. The thesis concludes that this is a missed opportunity to exert the level of scrutiny required to curtail existing debt problems.

Chapter Five examines the loan operations of seven MFIs that made up the sample for this research. MFIs are the institutions that have the most direct impact on microenterprises. It is therefore important that they create the right incentives if debt outcomes are not to be unfavourable. Guided by the institutional economics literature, the research conducted a thorough qualitative assessment of all aspects relating to the loan operations. An overall conclusion is arrived at that the institutional challenges of MFIs is a crucial contributing factor to indebting clients. The ways in which MFIs operate fosters over-indebtedness.

In the first place, MFIs in major headquarter towns operate in the same locality. As a result, MFIs will water-down their policies due to the competition to acquire customers from a very limited pool. In such a context, it is easy to engage in multiple borrowing, cross borrowing and debt refinancing.

The credit policies of MFIs are inflexible and in some cases inappropriate. In addition, MFIs are found to not be innovative with developing varied loan products especially those that better match their clients' needs and cash flows. The seasonal nature of clients' cash flows is not factored into MFIs' product development. These findings signify institutional weaknesses of MFIs that certainly have profound implications on clients' ability to service their loans.

The thesis also concludes that huge costs incurred by MFIs means they have to pass on the inefficiencies to their clients. There are high costs and risks involved in obtaining external loans. Also, the transactions costs incurred in their day to day business are high due to poor infrastructure in Sierra Leone. These costs are passed on to clients in the form of high interest rates and poor services.

Weak institutions that enforce contracts between MFIs and clients are a major contributing factor to portfolio problems that MFIs experience. The judicial system fails to address commercial matters on a timely basis. In most cases, the MFIs do not see the need to take matters to court and the clients are aware of this, hence, it contributes to their poor attitudes towards debt. It cannot be overemphasised that the Institutional Economics literature stipulates the effectiveness of legal systems can hinder or promote financial sector outcomes.

This Chapter also accounts for the role of informal institutions and their role in promoting indebtedness. Perceptions regarding MFI loans have been found to create some debt problems. Based on certain historical and political factors some clients believe microfinance is 'free money' that should not be repaid. This is however not the case and it has caused portfolio problems for MFIs.

Lastly, this thesis concludes that there is an urgent need to address the informational challenges facing MFIs. The Credit Reference Bureau does not serve the microfinance sector and this is hampering the effectiveness of MFIs. Needless to say that debt problems experienced by microenterprises can be curtailed if the CRB expands its service to the microfinance sector.

From the above Chapter conclusions the following are some general conclusions of the thesis:

Lessons were not learnt by policy makers with regards to the debt problems amongst microenterprises that in the past plagued the various access to credit programmes and initiatives. In some cases it led to the collapse of a number of programmes and institutions with the mandate of credit expansion. Therefore policy makers continued to expand access to finance and hence this thesis argues that there is a likelihood of the recurrence of over-indebtedness problems in future programmes.

An environment that fosters over-indebtedness exists at the institutional level in the present microfinance sector. Given that microenterprises operate within other institutions, they will impact on their ability to function effectively. Factors such, most notably, a Credit Reference Bureau that does not serve the microfinance sector as well as other institutional challenges and limitations faced by oversight bodies and microfinance institutions were found to promote DDMPs.

Multiple borrowing and debt refinancing is widespread amongst microenterprises and there was consistent evidence to show that it was over-indebting clients based on the accounts provided by the various groups of interviewees.

Finally, **the conclusion is that this thesis's hypothesis has been proven** for the context of Freetown, Sierra Leone, given all the evidence presented in the earlier chapters. That is, *increased access to credit is an institutional change which has implications for debt management and over-indebtedness amongst microenterprises.*

6.2 Policy Implications

It has been demonstrated that increased access to credit in the context of Sierra Leone promotes over indebtedness, both historically and in the current microfinance sector. This means that increased access to credit as policy tool to create jobs and incomes has been ineffective because it has not led to business expansion, especially amongst microenterprises that were its main target group of said policies. It is argued that the major problem is that credit is money that has to be repaid in future and, when not repaid, credit is simply debt. The detrimental debt management practices employed by microenterprises increase the destructive potential of credit in the context of Sierra Leone. Therefore, an argument was made that there is a difference between earning an income and having access to credit that is debt that has to be repaid.

In consideration of this thesis's findings, the *main policy implication* is that microenterprises and microenterprise financing are poor substitutes for formal employment and that they may worsen debt problems. Provision of jobs for this section of the populace will be more effective in contributing towards poverty reduction - the overall intended objective - than giving them credit that creates an over indebtedness problem. Karnani (2013) also shares these sentiments.

Another policy implication of the research findings is that policy efforts to curtail the use of informal finance through the increased expansion of access to formal credit do not seem to be effective. This is evidenced by the high dependence of microfinance clients on informal mechanisms, specifically the Osusu and cash box methods to make savings towards their loan repayments. Despite policy makers' apprehension with regards the operations of informal finance, there needs to be an acceptance that informal finance is still relevant and useful in Sierra Leonean society. Soyibo (1997) makes a similar case. Therefore, more context specific ways of *curtailing* the use of informal finance must be developed.

Lastly, it was found the State continues to provide credit to microenterprises and hence it was concluded that a full transformation as was intended by policy makers have not been achieved. Aside from the debt implications this is having, this thesis concludes that political economy factors play a role in effecting policy change. Two policy implications arise, a) policies need strong political will to be sustained, and b) the political will to sustain policies is better obtained when the policy agenda is set by the implementers rather than external parties.

6.3 Research limitations

This research could have benefited from existing academic research on financial sector and the microfinance sector in Sierra Leone. In academia it is always useful to be in possession of competing schools of thought on a certain subject. The research in some cases had to rely on newspaper articles and speeches which have a different scope in most cases compared to academic writing.

Data constraints were another challenge faced in conducting this research. Existing data on the financial sector is scarce. In cases where data exist such as the MIX Market data on Sierra Leone's microfinance sector, no meaningful analysis can be done with the data. Usually existing data are out of date or are missing for certain years. More research needs to be done on microfinance in Sierra Leone.

6.4 Directions for further research

An emerging area of interest in the literature has been the ownership structure of microfinance institutions and how that affects the stability of the sector and general developments in the sector. For example Bateman (2014b) explores this subject for case of South Africa. It is possible that this aspect of microfinance also has debt implications for microenterprises in Sierra Leone. Therefore, this is an area that can be explored by future research.

It has been suggested that to credit is not being the most effective way of promoting access to finance due to the debt implications. An area of interest is in conducting an analytical piece of work that assesses savings products that will be appropriate for the Sierra Leonean context as a mechanism for improving financial inclusion. Since savings do not require any future repayments, thus it can be a more useful method of promoting financial inclusion.

Lastly, a complementary piece to the research can be a study assessing the role of clients in promoting detrimental debt management practices. This research should explore the role of factors such as financial literacy and debt management skills in promoting microfinance indebtedness in the context of Sierra Leone. Other institutional factors such as the operating business environment of microenterprises and attitudes towards debt must also be accounted.

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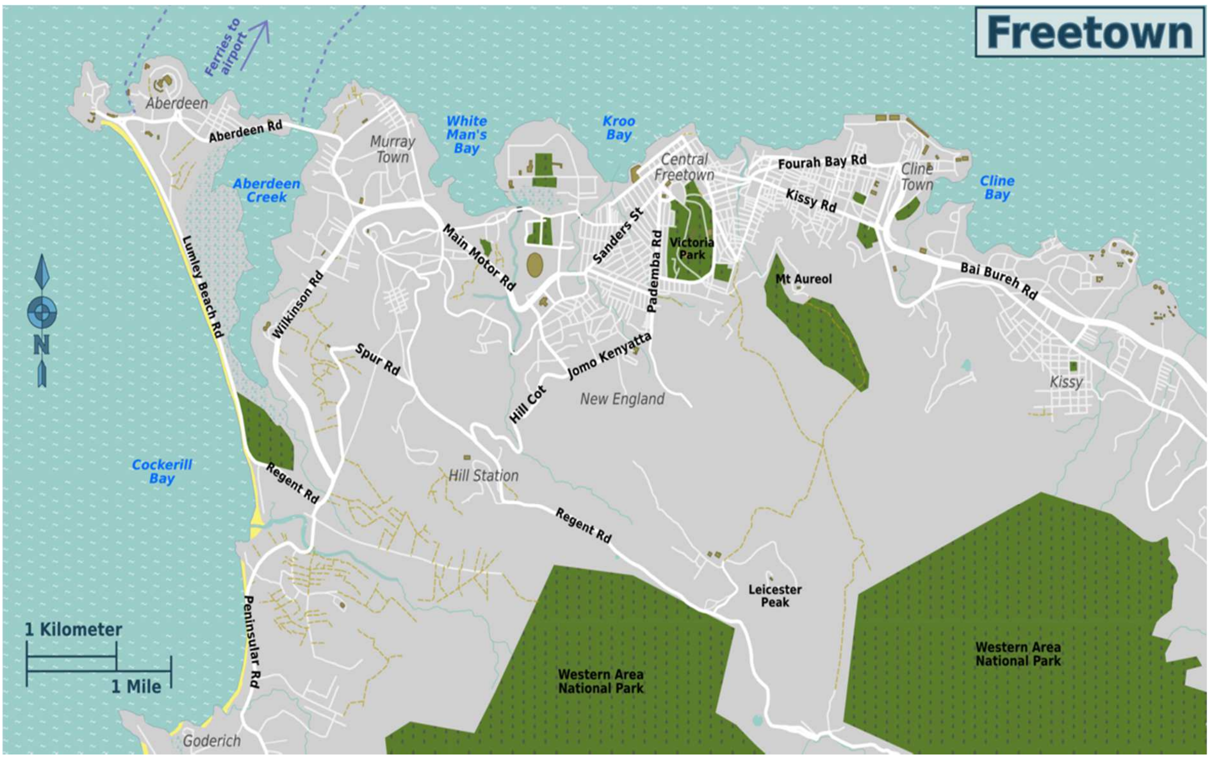
APPENDICES

Appendix 1: Maps

Map of Sierra Leone

Map of Freetown



Appendix 2: Sierra Leone's MAYA Declaration

The Maya Declaration
The AFI member commitment to financial inclusion

afi Alliance for Financial Inclusion
Bringing smart policies to life

Maya Declaration

The AFI network commitment to financial inclusion

Commitment made by the Bank of Sierra Leone

Pursuant to a Declaration of Commitment as required of AFI Members following the Maya Declaration of September 2011, the Bank of Sierra Leone commits to pursue the under-mentioned activities within the timeframe indicated as immediate short-term steps to enhance financial inclusion in Sierra Leone:

1. A framework for collecting financial inclusion data will be developed by end of 2013 and will culminate in the setting up of a database by the end of 2014 to monitor financial inclusion indicators.

2. Modernize the national payments system and "Go live" by the end of the second quarter of 2013.

3. Put in place a regulatory framework with specific guidelines on mobile financial services by mid 2013.

4. A private sector driven rural financing penetration will be encouraged to increase access to finance through the establishment of additional Financial Services Associations (FSAs), Community Banks (CBs) and commercial bank branches (CBBs). The number of FSAs will increase from 42 to 65, CBs from 13 to 22 and CBBs from 87 to 100. It is envisaged that the additional FSAs, CBs and CBBs will increase financial outreach by about 30% by the end of 2014.

The Bank is also committed to periodically interact with the Alliance for Financial Inclusion (AFI) to report on progress made towards eradicating financial exclusion.

Appendix 3: Quotations from fieldwork interviews

Appendix 3.1: Quotations on the regulatory body's staffing challenge

In an interview with a staff of the Other Financial Services division the following explanation was provided to the researcher with regards producing reports in a timely manner:

'Sometimes it's timely if we don't have interruptions, but sometimes we have interruptions. You see the staff strength is very very thin in the department. In fact we just recruited about four staff to join the department. Sometimes one staff will be doing 'A' and will have some interruptions and have to do 'B'. If a kind of special investigations comes up, you are sent there and you have to run there and it's actually telling on the lapse in the time they do the examination and the report. It is not always the case that as soon as you finish your examination the report goes out immediately. But sometimes we have some reports, I'll give you an example a report was here, they did it on Tuesday and the report is out now (Friday). The Governor has reviewed it and we are writing back to the people today. So, the report will go out depending on what is happening (work load) in the office at that moment' *(Banking Supervision Staff, related to researcher on 16th August, 2013).*

Later in the interview, the challenge of poor staffing came up again and the interviewee stated that:

'The four new staff recently recruited are for the whole department, not all of them are going to be for the Other Financial Institutions division, we will share them, maybe one will go to Commercial Banks division. You see, most of the staff in the other financial services division are new, we only have three people who have been there more than five or six years. All the rest are new'.

'We really have those challenges, staffing is really our problem, let me tell you most times those staff who have been trained and really know how to do the job are head hunted to go to other institutions and the staff, they are looking for greener pastures, so we really have a staffing problem' *(Banking Supervision Staff as related to researcher on 16th August, 2013).*

In addition, in interviews with other stakeholders in the financial sector, the Bank's limitation in providing scrutiny and oversight of the sector due to inadequate staffing and resources was a recurrent concern that was raised. In all the interviews and meetings held with microfinance institutions, this point was repeatedly and vehemently raised.

The thoughts of a donor with regards the Bank of Sierra Leone's performance was as follows:

‘The Bank of Sierra Leone is doing their best but their hands are full and they lack the man power. In addition the microfinance sector is not being prioritized by the Bank as the bulk of the financial resources are not in this sector’ *(Financial Sector Donor as related to author on 6th May, 2013)*

Appendix 3.2 : Continuation of Interview with Credit Reference Bureau official:

‘Right now what we are observing is that when we shot them down from the commercial banks they are moving to the microcredit and when they move down there, they are just going to kill the whole microfinance sector, when they take money that they can’t pay ,that will be the end of the MFIs. But we do not want to move down there and become ineffective. The commercial banks deal with major businesses which are easier to identify but microcredit deal with individuals so if you make a mistake by not correctly identifying the individuals then the MFIs will begin to doubt you and you lose your credibility’*(Credit Reference Bureau staff as related to the author on 9th September,2013)*

Appendix 3.3: Quotations from MFI officials on the need for a Credit Reference Bureau

The following are two instances of ‘cross borrowing’ provided by an MFI manager during fieldwork interviews when providing reasons to the researcher for client defaults on loans obtained from his organisation:

Instance 1:

‘There were also issues with the methodology: group leaders will choose like four other group members but do not give them the money. The group leaders soon saw microfinance as a profitable ‘business’. The women at Malama Thomas Street began to organise ‘fake groups’. Therefore they could get two million Leones (£306.38) each per group’.[90] *(Former Head of MFI X, as related to the author on 7th July, 2013)*

Instance 2:

‘We operated in markets, for example in Congo market the chair lady became aware of how much money they could make. They will hire ‘poda poda’[91] full of people, give food for the day. They will come in and collect monies but the group leader will only give them just a token amount. It then became a business for them (the group leaders). 10 people will get 5 million Leones (£765.71), 15 will get 7.5 million Leones (£ 1,148.56) and 20 will get 10 million Leones

[90] Le500,000 (£76.57) each for a group of four members
[91] Name for a commercial bus in the local lingua-Krio

(£1,531.42)[92], they soon saw it as good business. *(Former Head of MFI X, as related to the author on 7th July, 2013)*

[92] This example was provided based on the fact that each client in this instant accessed five hundred thousand Leones (£76.57) each.

Appendix 3.4: Cross-section of narrations of evidence of widespread Detrimental Debt Management Practices (DDMPs)

Type of stakeholder	**View on the existence of multiple borrowing , debt refinancing and its consequences**
Bank of Sierra Leone official	Even if they are not concentrated in one area, some people do it wherever the MFI is located, because I'll give you an instance, somebody took a loan from one MFI in Makeni and then came to the head office here (Freetown) and applied again for loan from the same MFI, but you know how it was picked up because the MFI was using Splash[93] to disburse the loans. So when they keyed in the details of the client, the Splash programme flagged it up that he was already a debtor to that particular MFI and so they stopped the loan.
Ex-MITAF official	The issue of multiple borrowing is very evident and this leads to over-indebtedness of the clients. The MFIs have limited means of knowing that this is going on. This issue is sometimes dealt with by MFIs in the same locality collaborating, however very limited amount is done through SLAMFI to address this issue. The Credit Reference Bureau which could have helped does not work with MFIs.
A Manager from a collapsed MFI X	What the clients will do is that they will take Le500, 000 (£76.57) from one MFI use it as collateral from another MFI to access Le 1 million (£153.14), they will then use this one million to collect a larger amount from another institution. They will keep going like this until they are indebted to six or seven MFIs. Then they will take the last big sum to access a much larger loan from the commercial banks. One lady took about Le 10 million (£1,531.41) from a commercial bank after collecting loans from various MFIs. They will use some of the monies from the MFIs; buy some stock, so when we go there to check it will appear as if they have enough stock, but it later becomes a problem for the clients to pay us.
Branch Manager in MFI A	**Researcher:** You spoke about this issue of over-indebtedness how does this manifest itself? **Branch manager:** 'They take monies from various institutions. Our own strategy is that we appraise the client and determine their repayment capacity and that's the amount of loan we will give them. But they usually feel that whatever loan we give them is insufficient and they go somewhere else and take another loan. Also, for some of them it's not that they will go to another MFI and take but you know the industry is going on an outreach for more clients. Other MFIs approach these clients, and clients are never satisfied, they always want money so they will go for the loan, and then when it's time to repay these loans they run into difficulties.'
Loan officer in	**Researcher:** You referred to your clients as recycling clients who are everywhere, have you ever found a client to be involved in

93 A mobile money transfer service.

MFI B	multiple borrowing? **Loan officer:** Yes, we had a client; he was supposed to come to the office to make payment for a particular month. We waited a few days and we decided to visit the client. When we went there, coincidentally we met another loan officer from MFI E. This MFI is located at X Street. Similar to what happened to us, the client had to pay MFI E but they did not pay them.
Head of Credit MFI C	What we do we analyse their businesses and give them a loan. When we have given them the money based on our own analysis, sometimes we do not give them the full amount they have requested and this is due to the analysis we undertook. They (clients) believe that the money we have given them is small and they will go to other institutions. So this is a problem, when someone has multiple of loans from different banks. That creates problems for us. For instance, if the date to pay to us is the 1st of the month and other loan is due on the 15th or 16th, just imagine having to pay these two loans, they usually prioritize where they feel they want to make a good impression. And of course we do not have a centralized bureau to help us monitor every client. Sometimes for the bigger businesses, we tell them: we know you are banking with another bank, so bring your bank statement from that bank. We review it and if we see that the money outstanding from the other bank is bigger than our own liability we usually take it that the customer wants to use our own loan to pay off the loan in another bank.
Loan officer MFI D	**Researcher:** Have you observed or experienced any customer that has more than one loan and that affects their ability to repay? **Loan officer:** I have not had that experience but I know it happens. When I was at our Wellington (East end) branch, my colleague had experienced that. What happened was that the client had gone to a take loan at MFI G, my colleague had not given him our own loan but she had applied and my colleague was about to give her the loan. One day at the branch, when the client visited our branch after she had left another client asked my colleague: was that client here for a loan? My colleague said yes. Then he said don't give her the loan, I am aware that she is operating with two other MFIs and I usually see these institutions after her for their own money. I believe she still owes them money, maybe this money she wants from you is to repay the loan she has with the other MFIs. If she uses this loan to repay the other MFIs she won't have any money to repay your own loan when it is due. That's how my colleague was guided, we did our own investigations, we found someone who was close to the client and we interviewed them, the person told us the same thing. So we ended up not giving her the loan. If we had given her the loan it would have ended up being a bad loan. The lady would have found it difficult to repay the loan. So, I have not had that experience but I know it goes on.
Senior loan officer MFI E	**Researcher:** Amongst the clients that you are responsible for, which area (location wise) do you experience high default, from your observation? **Loan officer:** In the areas that are far away, the area of Kabia Lot, close to PZ. You know, in that location there are a lot businesses in that area and the MFIs are highly concentrated there too. You have MFI G and various other MFIs operating there. Therefore, some clients take loans from all these institutions. **Researcher:** This is the reason why you have experienced defaults? **Loan officer:** The reason being the clients usually access loan from up to three to four MFIs.

	Researcher: Do you have evidence that your own customers are involved in multiple borrowing? **Loan officer:** Yes, yes. I have clients I have visited and I met a loan officer from MFI G, I have also met a loan officer from MFI B from with another client, at Kabia Lot. Even in Kroobay the same thing has happened. Even the lady that you (the researcher) just interviewed she's with another MFI. The two areas Kroobay and Kabia Lot we've experienced defaults due to multiple borrowing.
Loan officer MFI G (East end branch)	**Researcher:** What are the reasons why clients give you problems with loan payments? **Loan officer:** Sometimes the clients form fake groups and it now becomes the burden of the group member whom the loans were taken on behalf of. Then he/she starts experiencing difficulty to repay. Also over-indebtedness due to multiple borrowing. **Researcher:** Ok so is multiple borrowing an issue? **Loan officer:** Yes, I would say 30% of clients in this branch are engaged in it. Another reason clients can struggle to repay their debts is when they have used our loan to repay other debts. But we apply pressure on them to repay our loans; they will then sometimes borrow from other sources to pay us.
<u>Branch Manager MFI G:</u>	Sometimes we delay disbursements because we want to take our time to carry out checks because in some cases clients simply just want to use the money to offset an outstanding debt from another MFI…so you have to be very careful if you want to avoid that.
<u>Branch Manager MFI B:</u>	**Researcher:** How long does the whole process of verification and approval take place? **Manager:** Between two weeks and up to a month. **Researcher:** Is one month not too long? You know these business people sometimes need money urgently. **Branch Manager:** Well if you want to go by that you will do the wrong thing, because there are some clients who are in debt and when they've been put under pressure they rush to us to take money. So as soon as you give them the loan they will use it to offset their existing debt, then they create problems for you, but if you carefully do your verification then you will get the facts.
Loan officer from MFI E	Another reason why payment issues arise is incorrect use of the money, if they use the money to pay off other debts, at the end of the day they run into difficulties to pay the MFI's loan.

Appendix 3.5: Narrations from MFI officials on Osusu:

The narrations that follow highlight the problems created by clients due to the reliance on Ososus to pay for their MFI loans:

<u>Interview with a loan officer at a Community Bank (Comm Bank A):</u>

Researcher: Do you work closely with other informal groups like the Osusu groups and Village Saving Organisations?

Loan officer from Comm bank A: **'**The osusu groups are the ones we are having problems with, and they are the very ones that are preventing these small business people from depositing money into their account. The clients prefer at the end of the day after selling to save Le 20,000 (£3.06) with the Osusu rather than depositing it into their account. It's not until someone has learnt a lesson, then they come running to us saying 'they never knew it would have been better for them to be depositing their monies with us**'** *(Community Bank A Loan officer, as related to the researcher on 24th July,2013)*

<u>Interview with Branch Manager of MFI A (East end branch):</u>

Researcher: For a lot of the clients, when you ask them how they finance their loans, they tell you that they are members of an Osusu group. Is this a problem or is it ok for them to be doing that?

MFI A Branch Manager: **'**It's an issue, it's an issue**'**

Researcher: How?

Branch Manager: **'**Usually when our clients are ready to collect the Osusu money to come and pay us, at that time the Osusu Master would not have finished collecting from the other members. The clients would have been saving over the course of the month with the Osusu Master assuming that at the end of the month everyone would have paid and they would just collect their own contribution and use it to pay us. But if the Osusu Master has not collected or if he disappears, then it's problem**'**.

Researcher: Are you having these problems?

Branch Manager: **'**Yes we do, it's always an issue except if they are with a reliable Osusu Master, otherwise it creates problems for us and the clients too**'** *(MFI A East end branch, Branch Manager, as related to the researcher on 14th November, 2013)*

Appendix 3.5: Quotations on Government's role in the Microfinance sector

In an interview with a former head of a now defunct MFI, the following exchange was had when asked about the challenges faced by MFIs in providing credit to micro and small businesses in Sierra Leone:

Former MFI X Managing Director: 'Another challenge which I had forgotten to mention is the issue of government interference in the microfinance sector'.

Researcher: 'What do you mean by interference?'

Former MFI X Managing Director: 'Government gave out loans during the recent elections. They did it in 2007 and in 2012. Currently, I understand (through hearsay) that the Ministry of Trade is giving out loans through the Traders Association, and the government has no mechanisms to monitor these loans. Therefore, people think all microfinance is free money. The Agriculture Ministry is also giving monies to farmers and traders without enforcing any monitoring' *(Extracts from interview with Former Managing Director of MFI X, as related to the researcher on 7th July, 2013)*

Appendix 4: Sample of Questionnaire for interviews with Microfinance Institutions (MFIs)[94]

Questionnaire No……

DATE:

TIME STARTED:

TIME ENDED:

INTERVIEWER'S NAME:

Name of Institution: ……………………………………………………………………………………..

Branch/Main office…………………………………………………….

Address :……………………………………………………………………………………………… …… …………………………………………………

Town and Province:………………………………………………………..

Telephone number:……………………………………

Email address of institution: …………………………………………..

Type of institution: Yes=1, No=2

- **NGO,MFI ………………………..**
- **For profit MFI ……………………………..**
- **Community bank …………………………..**
- **Commercial bank …………………………**
- **Limited liability Company ………………………………**
- **Other, please specify………………………………**

How would you classify this institution?

a. **Formal …………………………..**
b. **Semi-formal ………………………………..**
c. **Informal ………………………………**

[94] Questionnaire includes the researcher's notes to guide the interviews

Name(s) of Interviewee(s) and position (s):

SECTION 1: BASIC INFORMATION ABOUT THE ORGANISATION

2. What year was your institution:

a) Founded? …………………………………..

b) Registered? …………………………….

c) Started Operations?................................

3. Is your organisation registered with:

a) Bank of Sierra Leone (yes=1 No=2)…………………….

b) Ministry of Finance (yes=1 No=2)………………………

c) MITAF (yes=1 No=2)…………………

d) Other, please specify………………………….

4. Total number of staff? ……………………………….

5. Do you have any Resident Technical Assistants (RTAs) currently? (Yes=1 No=2) ……….. If yes go to 15, if no go to 16

6. How many RTAs (RTAs) and their role?...................................

7. Have you had TAs in the past? Role of TA and when?

8. Do you have board directors? (Yes=1 No=2)……. If yes answer question 18, if no skip 18 go to 19

9. What are the main functions of the board of directors?

10. Does your institution offer the following services (yes=1, No=2)

Loans? ………………… tick relevant option below

a) Personal

b) Business

Savings?.................. Tick relevant option below

a) Passbook Savings:

b) Term deposits

c) Required savings linked to loans

Money transfer………………….

Insurance……………… tick relevant option below

a) Health

b) Life

c) Accident

d) Non-life (e.g. property)

e) Other (please specify)……………………………

Training ……………………… (Yes=1, No=2)

a) Financial literacy

b) Business development support (BDS)

c) Gender and social issues

d) Health and nutrition

e) Environment

f) Other training, please specify……………………..

11. If any of the above services are not yet provided, do you plan to offer them? Please provide brief explanation of your plans below:

12. …Please list down the two services that form a major part of your portfolio?

<u>MAIN SUBJECTS INTERVIEW SHOULD COVER:</u>

I am mainly interested in how you conduct your business in general but more specifically your loan operations.

<u>Sources of funding for making loans:</u>

1) **Main question: What are your main sources of funding**? What are these funding used for?

- Including all grants, loans, overdraft facilities, equity (who owns these equities), loans made on behalf of agency organisations.

- Terms and conditions attached to accessing funds

- Procedure for accessing funds: too costly or too rigorous? Any delays in receiving funds from sources? Reason for delays?

2) According to the data provided on Mix market, I can see that you also have some software providers such as……………………………... Briefly explain to me the nature the relationship with these software providers?

3) Physical assets how are/were they financed?

Data: List of institutions or organisations that provide all forms of support identified including amounts and years

<u>LOAN CYCLE: application, awarding of loans, monitoring, after sales services, payment; penalties, clients.</u>

<u>Loan application process:</u>

4) Main question: Please talk me through your loan application process?

- How are clients sourced, period between application and approval, who makes decision to approve and on what basis (eligibility criteria: does it include an assessment of the ability to service debts), forms of acceptable collateral (are savings required?), timely provision of loans, reasons for non-approval of loans, how are loans made available?, **sufficient loan amounts provided**? Loans made in dollar also? Do the interest rate charged change with changes in Leone/dollar exchange rate?

- How well trained are loan officers to assess loan applications? Do you have adequate resources to help you with decision making on loan applications?

- Who are your clients? From what sector typically? Both groups and individuals?

Data on loan amounts (denomination of loans)

Data on total loans

<u>Terms and conditions attached to loans:</u>

5) **Main question: What are the terms and conditions attached to your loans; i.e interest rates and loan repayment periods and procedures?**

Interest rates: how are they determined, how they compare to interest rates charged by other MFIs , commercial banks(non MFI) and the informal sector. Do you factor your costs when determining interest rates?

Repayment of loans: length of repayment period (reasonable or not), procedures for repayment (accessible forms or too rigorous and costly, voluntary or pressured)

Do the terms and conditions change with the loan amount?

To what extent do they ensure customers understand the terms and conditions of the loans?

Data on interest rates and repayment period

<u>Monitoring of loan customers:</u>

6) **Main question: What procedures do you have in place to monitor client's use of loans?**

How do they ensure loan is used for what it was accessed?

What are the monitoring procedures in place?

4a) Do clients need to provide you with any regular information or reports? What info and the frequency? Why do you collect this information? Are customers compliant with this requirement and what is the consequences of none compliance? Do clients feel it is a burden?

Do you have sufficient tools and personnel to undertake monitoring of loan use and repayment?

Recommendation for improving monitoring of loans

Sample form or list of information requirements?

<u>After sales services</u>:

7) **Main question: Do you provide any support to businesses that access loans from you? Including training, business development support or any other support?**

Training and support on investing finance and business development?

Do you provide it yourself or someone does it on your behalf? Does this impact on your costs (costs of training too high)

<u>Procedures for settling payment issues:</u>

8) **Main question: What are the established rules and regulations with regards late payment, partial payment and non-payment?**

How were they developed/by whom? Who is responsible for enforcing these penalties? What is the scope for enforcement? **Are current penalties sufficient**? Are they deterring repayments or putting too much pressure on customers?

A number of MFIs failed due to the issue of **bad debts**: the procedure for writing off bad debts, who makes the final decision with regards bad debts?

What are the main reasons for issues with loan payments?

Recommendations for improving enforcement of penalties

Data on portfolio at risk

Data on levels of bad debts

<u>Repeat loans:</u>

9) **<u>Main question:</u>** Proportion of clients with repeat loans. What is the basis for providing repeat loans?

<u>Work with informal financial institutions:</u>

10) **Main question: Do you work closely with informal institutions such as local money lenders, osusu groups, village loans and saving organisations etc?**

    a. Nature of the collaboration and rational for collaboration

<u>CLIENTS:</u>

<u>I would now, like to talk to you a bit about your clients</u>

11) **Main question: From your experience, do your customers always use the loan for the business purposes which it was obtained?**

Possible reasons for not using loans for intended purposes

12) **Main question: Do you think your customer's access loans from other sources?**

Which sources? Which is the most common source?

a) NGO MFI………………………………..

b) Other MITAF supported MFI……………………………………

c) Commercial banks with microfinance windows……………………………

d) Other Commercial banks…………………………………………….

e) Financial Services Associations…………………………………………

f) Osusu groups…………………………………………….

g) Cooperatives……………………….

h) Friends and Family…………………………………………….

i) Other (please specify)……………………………………….

13) Main question: From the documents I have reviewed I gather that the issue of multiple lending from more than one microfinance institution is quiet common amongst businesses. Is this also an issue of concern for your institution?

What are the main reasons for multiple lending? How does it impact on client ability to repay your loans?

a) Loan from just one source is insufficient…………………

b) The terms and conditions of one MFI might be better compared to the other……………………………..

c) It is common practice…………………………….

d) There is no tool to deter businesses from doing so…………………

e) There is too much supply of loans to micro and small businesses from microfinance institutions…………………

f) Other, please explain……………………………………………

Relationships with other bodies (local or international)

14) Main question: Apart from access to finance which you are addressing, what do you think are some of the factors that are affecting businesses' ability to start up or expand?

a) Registration process too rigorous……………………………..

b) Registration process too expensive……………

c) Informal nature of these businesses………………………………………

d) Low sales……………………………..

e) The impact on the dollar/Leone exchange rate on prices in general…………………….

f) High prices for other services like electricity, transportation………………………………..

g) High taxes………………………………

h) Too much competition in the sector…………………………………

i) High indebtedness……………………………………..

j) Lack of infrastructure such as roads, markets stalls …………………………………

k) Poor business acumen and entrepreneurial skills……………………………………..

l) Low level of education………………………………………

m) Other, please state……………………………………………….

15) **Main question: When loans payments from your institutions are due and customers have not made enough money from their business operations, where do they get money to ensure they make payments?**

Borrow from other sources, negotiate loan repayment date etc

<u>Questions related to your business in general</u>

16) **Apart from funding do you receive any other support from the institutions/organisations you mentioned in question one, do you receive any other support from them? Are the current funding, resources and logistics sufficient to conduct your business?**

17) **How do you usually find out about your loan outreach targets? What are the consequences of not reaching these targets?**

18) **What main documents, information and reports do you need to provide any institution? How this impact on your costs? What are the consequences of not providing this information? Recommendations for improving these reporting requirements.**

19) **Please state any international standards and reporting requirements that you have to comply with:**

20) **The documents I have reviewed also point towards that the conflicting objectives of achieving Financial Self-Sufficiency and improving outreach hence you have to charge high interest rates?** Is this an issue for your organisation? Please give reasons for this. The issue of high **overhead costs** and how it is impacting on their business? Do they factor these in setting interest rates

21) **The Bank of Sierra Leone currently plays the role of supervision and monitoring, what is the nature of your relationship with BSL?** Current regulatory and supervisory structure sufficient? Recommendation for effective regulation of the sector?

22) **Credit Reference Bureau**: Exchange of information? Would you like to and how do you believe this would help?

23) **Are you a member of SLAMFI?** What are the main advantages and disadvantages being a member? Recommendations for improving its role?

24) The formal/semi-formal financial sector has expanded considerably in the past ten years, what have been the positive and negative impacts of this on your business's operations?

25) Would you say the following are also challenges that your organisation has experienced?

a) High saturation of microfinance institutions in this area……………………

b) High loan default rates…………………………………….

c) Lack of trained staff……………………………………

d) High staff turnover………………………………………

e) High overhead costs……………………………………………..

f) Customers cannot cope with interest rates……………………………………………..

g) Costumers think microfinance is a gift or aid………………………………………….

h) Insufficient tools and resources to effectively monitor clients……………………………….

i) Insufficient regulations for the industry………………………………………………………..

j) Clients not being able to generate enough sales; hence cannot repay loans………………………………………

k) Poor infrastructure; office space, poor internet etc……………………………………..

l) Too much influence by MITAF or funding body……………………………………………

m) Delays in receiving funds from funder…………………..

n) Too much influence by Funding Agency………………………………………………..

o) Poor economic performance……………………………………..

p) The exchange rate/inflation…………………………………………..

q) Social stigma against those who access microfinance………………………………………

r) **Any other specific challenges your institution faces, please specify**……………………………..

26) What are your recommendations in resolving the issues you mentioned?

27) Any other aspect of your operations that you will like to discuss?

Appendix 5: Consent Form

SAMPLE OF ORAL CONSENT FORM:

FINANCIAL INCLUSION THROUGH ACCESS TO CREDIT: DEBT MANAGEMENT AMONGST MICRO AND SMALL ENTERPRISES (MSEs) IN SIERRA LEONE (Working Title)

My name is Ilara Mahdi. I am a PhD researcher from the School of Oriental and African Studies (SOAS), University of London.

I am inviting you to participate in a study on Financial Inclusion and debt management amongst micro and small businesses in Sierra Leone. Would you like to participate?

This study is aimed at gaining a better understanding regarding access to finance for small and micro businesses as well as debt management of these businesses. Should you wish to participate in this study, it will involve answering questions about your loan operations (if you are a microfinance institution) or loan obtained from a microfinance institution (if you are a microenterprise). The interview will last for at least 60 minutes. This interview will be audiotaped and recordings will be used only for transcription and documentation purposes. Is it o.k for me to record this interview? Do you have any questions?

Your participation in the study will be strictly confidential and the information you will provide will not be linked to you in any way.

All audio-taped recordings will be erased and written transcripts destroyed upon completion of this study. A copy of this oral script will be given to each participant in this study.

Please note that you can stop any line of questioning that you are uncomfortable with or stop the interview all together. In the event that the entire interview is stopped, none of the responses will be included in the study.

If you have any questions with regards this research project as a participant, please call Professor Jan Toporowski (project supervisor) on +44 207 898 4757or email jt29@soas.ac.uk. If you have further questions regarding this research, you can also contact SOAS's Postgraduate Registry Research Section on pgresearch@soas.ac.uk

Appendix 6: Letter from Thesis supervisor to facilitate fieldwork

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7 May 2013

Ms. Ilara Mahdi

Ms. Ilara Mahdi is working under my supervision on her PhD thesis at the School of Oriental and African Studies, University of London. The subject of her thesis is formal and informal finance for small and medium-sized enterprises in Sierra Leone. This research is supported by the Commonwealth Scholarships Commission.

Ms. Mahdi will be visiting Sierra Leone to gather material and interview people and institutions directly involved in the provision, as well as beneficiaries, of such finance in Sierra Leone. I would be grateful if you and your staff would give Ms. Mahdi every assistance that may facilitate her research.

Yours sincerely,

Dr. Jan Toporowski

Professor of Economics and Finance