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REGULATORY RISK MANAGEMENT STRATEGIES AND THE GROWTH OF MICROFINANCE SECTOR IN KENYA

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Abstract

Purpose: The purpose of this study was to determine how the regulatory risk management strategies contribute to growth of MFI sector in Kenya

Methodology: The study adopted a correlation survey research design. The population of this study was fifty seven (57) MFIs. The sampling frame was the list of MFIs provided in the AMFI website www.amfikenya.com. A sample of thirteen (17) MFIs was selected using the random sampling approach. A questionnaire and an interview schedule were the main data collection tools. Qualitative data was analyzed using content analysis whereas the quantitative data was analysed using Statistical Package for Social Sciences (SPSS) where descriptive and regression analysis were conducted to determine the relationship between enterprise risk management strategies and growth of MFIs.

Findings: The study findings indicated that the MFI were compliant with all relevant regulations and that the regulatory environment provided an appropriate framework for the MFIs current and potential operations and legal status. The findings further indicated that the supervisory agency (CBK) provided adequate supervision of the MFI and the MFI has not in the past incurred heavy fines for violating regulations. Furthermore, the study findings indicated that the MFI has no cases pending in court over breach of contract. The regression results indicated that there was a positive effect on MFI growth

Unique contribution to theory, practice and policy: it is recommended that the MFIs should continue practicing effective regulatory risk management practices such as development of appropriate regulatory framework for current and potential operations and legal status. This would significantly improve the growth of the MFI. The study also recommends that embracing

supervision by the supervisory agency- CBK and honoring of contracts to avoid court cases and fines were good practices. It is recommended that compliance with all relevant regulations is crucial as it enhances the growth of MFIs. Study findings recommended that putting measures to prevent collection of illegal deposits and establishing a good working relationship with the regulatory authorities, will improve the growth of MFIs. The study recommends that encouraging open communication with regulators and provision of an opportunity to defuse any potential problems may be a crucial regulatory strategy as it improves the growth of MFIs.

Key words: *compliance, regulatory risk management practices, growth, MFIs*

1.0 INTRODUCTION

The role of MFIs in developing countries cannot be overemphasized. Microfinance Institutions provide financial services to the low-income households and Small and Micro Enterprises (SMEs) who are considered unbanked as they lack the prerequisite collateral for loans (Omino, 2005). As a result of their simplicity in funds access, the MFIs have become very popular with the low income groups and they have played a key role in poverty alleviation. The MFIs have emerged as an effective and proven model for alleviating poverty worldwide (Asian Development Bank, 2003). Micro finance institutions exist in various models. The Grameen Bank (2000a) has identified fourteen (14) models. These models are: Associations, Bank Guarantees, Community Banking, Co-operatives, Credit Unions, Grameen Bank solidarity Group, Individual, Intermediaries, NGOs, Peer Pressure, Rotating Savings and Credit Associations, Small Business and Village Banking. The Grameen Bank solidarity Group lending model is based on group peer pressure whereby loans are made to individuals in groups of four to seven (Berenbach & Guzman, 1994). The Grameen Bank Solidarity Group lending model was developed in Bangladesh to assist rural, landless women to finance income generating activities (Ledgerwood, 1999).

Research and experiences have shown importance of savings and credit facilities for the poor and the SMEs (Omino, 2005). This puts emphasis on sound development of microfinance institutions as vital ingredients for investments, employment and to spur the economic growth. As a result of their flexibility and the way they operate, they are exposed to various risks which include financial risks, operational risks and strategic risks. And as competition increases and the sector mature, MFIs are faced with numerous risks as highlighted above and the sector must mitigate the risks in order to sustain the business and remain relevant in the long run (Omino, 2005). Kombo, Wesonga, Murumba and Mwakoro (2011) identified several risk management strategies, which include risk avoidance, transferring of risk and mitigating risks. The authors further assert that mitigation of risks is regarded as the most effective risk management strategy..

Enterprise Risk Management (ERM) is a new strategic imperative that is gaining momentum. In USA for instance, Organizations are starting to see the value of, and asking for, strategic solutions like integrated ERM software (Gilbert, 2007). Desender et al. (2007) observed that the Enron failure, together with other high profile corporate collapses, has led to a debate concerning the efficiency and the role of corporate governance. These corporate governance failures culminated in the passage of the Sarbanes Oxley Act (SOX) on July 30, 2002, which have emphasized the importance of control and risk management in preventing fraudulent reporting. While strong theoretical arguments exist as to why a firm should employ enterprise risk

management, the main drivers for the implementation have been new corporate governance codes. The author argues that since the corporate scandals and the creation of new corporate governance codes, enterprise risk management has been considered as a valuable element of the corporate governance structure.

ERM, as an increasingly popular concept in the developing countries, is indeed a relatively new term that is catching much today as it is viewed as the ultimate approach to effective Risk Management. Tseng (2007) investigated two research questions arising from the regulation of internal controls required by Sarbanes-Oxley Act of 2002 (SOX).The first research question was on whether better internal controls can enhance firm performance. To address this question, the relation between market-value and internal control was estimated by a residual income model. The empirical results, based on a sample of 708 firms with the disclosures of material weaknesses, showed that firms with weak internal controls have lower market-value.

Central Bank of Kenya (CBK) has also emphasized the importance of ERM. As the banking sector continues to embrace innovations, the intensity and variety of risks that the players are exposed also continue to increase in tandem. To ensure that the growth in the banking sector does not jeopardize its stability, risk management is crucial. In view of this, the CBK carried out a risk management survey on the Kenyan banking sector in the year 2004 (CBK, 2010). The survey's objective was to determine the needs of the local banking sector with regard to risk management. The survey was necessitated by the drive to fully adopt Risk Based Supervision and to incorporate the international risk management best practices envisioned in the 25 Basel Core Principles for Effective Banking Supervision. The survey culminated in the issuance of the Risk Management Guidelines (RMGs) in 2005 and the adoption of the Risk Based Supervision approach of supervising financial institutions in 2005 (CBK, 2010). Kombo, Wesonga, Murumba and Mwakoro (2011) asserted that strategic risk alongside credit risk and liquidity risk were the most frequent risks that occurred among MFIs. The authors argued that to tone down these risks, the MFIs employ various management strategies, which include risk avoidance, transferring of risk and mitigating risks. Mitigation of risks was regarded as the most effective risk management strategy.

Gonzalez (2011) uses the term growth of MFI to mean the increase or decrease in the number of MFI borrowers. CGAP (2009) uses the same measure (the number of clients served) as a measure of MFI performance. In this aspect, the term growth and performance seem to be synonymous. However, the term performance seems to be more popular in literature focusing on MFIs. For instance, CGAP (2009) uses the term performance to describe the following key indicators: outreach, client poverty level, collection performance, financial sustainability and efficiency. Despite the popularity of performance as a concept, the current study will restrict itself to the growth concept.

1.1 Statement of the Problem

Given the ever dynamic and challenging business environment, a Micro Finance Institutions (MFI) is bound to be exposed to various risks. The problem is that Micro Finance Institutions that do not adapt and/or institutionalize ERM strategies are likely to witness poor growth patterns compared with those that adapt ERM. The poor growth or failure of the MFIs may lead to serious negative consequences as far as the achievement of Vision 2030 is concerned owing to

the important role MFIs are expected to play in supporting employment creation through their clients (the SME sector).

The threat that MFIs may experience stunted growth or collapse as a result of poor risk management is not without any basis. The threat is so real such that some well- known Micro Finance Institutions (MFIs) have collapsed in the past. In 2005, for example, government regulators in Kenya closed Akiba Micro Finance on the grounds that it had unlawfully taken customers' deposits and reneged on the repayments (Ellie et al., 2007). The report by the Task force on Pyramid Schemes (2008) was formed to investigate the collapse of pyramid schemes in Kenya (pyramids are a form of microfinance). The taskforce found that Kenyans lost more than Sh34 billion to schemes such as Developing Enterprise Community Initiative (DECI).

The closest research to the current study is from Kombo et al. (2010) who asserted that strategic risk, credit risk and liquidity risk are the most frequent risks; whereas reputation and subsidy dependence risks occur at a very low incidence for Micro Finance Institutions (MFIs) located in Kisii area. The authors argued that to tone down these risks, the Micro Finance Institutions (MFIs) employ various management strategies, which include risk avoidance, transferring of risk and mitigating risks and also regard mitigation of risks as the most effective risk management strategy. Mokoro, Nyaonga, Magutu, Khoya and Onsongo, (2010) in an investigation of the various challenges facing the transition of informal MFIs into formal MFIs recognize the existence of risks emanating from both the external and internal stakeholders of the MFI.

The current study noted that the reviewed studies, Mokoro et al. (2010), CBK (2010) have gaps in terms of generalized conclusions due to a tendency to research on all factors that affect the growth of MFIs and the absolute disregard of the role of risk management strategies on the growth of MFIs. On the other hand, those studies that focus on risk management in MFIs are purely descriptive for instance, Kombo et al. (2010) and lack the statistical rigor that is supposed to accompany such studies. The current study differed significantly from the above reviewed studies as it built a case for adopting regulatory risk management strategies as part of ERM strategies and the effect such adoption would have on the growth of MFI sector. The current research hoped to bridge all these research gaps by analyzing the effect of regulatory risk management strategies on the growth of MFI sector.

1.2 Research Objective

i. To determine how the regulatory risk management strategies contribute to growth of MFI sector in Kenya

2.0 LITERATURE REVIEW

2.1 Theoretical Review

2.1.1 Stakeholder Theory

Stakeholder theory, developed originally by Freeman (1984) as a managerial instrument, has since evolved into a theory of the firm with high explanatory potential. Stakeholder theory focuses explicitly on equilibrium of stakeholder interests as the main determinant of corporate policy. The most promising contribution to risk management is the extension of implicit contracts theory from employment to other contracts, including sales and financing (Cornell &

Shapiro, 1987). In certain industries, particularly high-technology services, consumers trust in the company being able to continue offering its services in the future and can substantially contribute to company value. However, the value of these implicit claims is highly sensitive to expected costs of financial distress and bankruptcy. Since corporate risk management practices lead to a decrease in these expected costs, company value rises (Klimczak, 2005). Some of stakeholders who are a source of risk include; customers, suppliers, employees, management, government and civil society. Stakeholder theory is important in explaining regulatory risk e.g. a ban on the activities of the firm and regulations that impact negatively to the firm.

2.1.2 Growth Theory

According to Jovanovich (2000), growth theory offers two explanations for growth. One stresses the supply of productive ideas and says that the growth of living standards depends on the growth of science. The other explanation invokes incentives: growth could begin only when hard work and business enterprise were free of interference by authority i.e. free from taxation, social stigma and other interference by government. Cortright (2001) emphasizes that economic growth results from the increasing returns associated with new knowledge. Knowledge has different properties than other economic goods (being non-rival and partly excludable). The ability to grow the economy by increasing knowledge rather than labor or capital creates opportunities for nearly boundless growth.

Firm growth can be studied as a dynamic process of management interacting with resources. The dynamic process is best expressed in the extract from Penrose (1985): “As management tries to make the best use of resources available, a truly dynamic interacting process occurs which encourages continuous growth but limits the rate of growth” (Penrose, 1959:24). Arkolakis (2011) asserts that a firm-level growth is the result of idiosyncratic productivity improvements while there is continuous arrival of new potential producers.

2.1.3 Sustainability Theory

Sustainability means a capacity to maintain some entity, outcome or process over time. Financial investment might be deemed sustainable which means that activities do not exhaust the material resources on which it depends. Sustainability in general refers to the property of being sustainable. The widely accepted definition of sustainability or sustainable development was given by World Commission on Environment and Development in 1987. It defined sustainable development as "forms of progress that meet the needs of the present without compromising the ability of future generations to meet their needs." Practically, sustainability refers to three broad themes, economic, social and environmental, that must all be coordinated and addressed to ensure the long term viability of our community and the planet.

These well-established definitions set an ideal premise, but do not clarify specific human and environmental parameters for modeling and measuring sustainable developments. The following definitions are more specific: Sustainable means using methods, systems and materials that will not deplete resources or harm natural cycles (Rosenbaum, 1993); Sustainability identifies a concept and attitude in development that looks at a site's natural land, water, and energy resources as integral aspects of the development (Vieira, 1993); Sustainability integrates natural systems with human patterns and celebrates continuity, uniqueness and place making (Early, 1993).

2.2 Growth

The current study attempted to define growth in the context of microfinance institutions. According to Barkham (1996) there is no general agreement on how firm growth should be measured and therefore there is a wide variation on the growth variables used by researchers. A firm growth (size) may be measured according to its revenue or profits or by the amount of human and physical capital it employs. Delmar (1998) considers sales and employment as growth indicators for the reasons that the use of sales and employment measures are the most widely used in empirical growth research. Sales are a relatively good indicator of size and therefore growth. Sales may be considered a precise indicator of how a firm is competing within a market, and indeed firms themselves tend to use it as a measure of their own performance. An analysis of firm growth should at least in part be based on changes in turnover. McKelvie and Wiklund (2010) have a more comprehensive definition of firm growth. They argue that firm growth may be defined as an outcome or process. The term growth when used as an outcome is a dependent variable and is usually explained by a set of independent variables. For the most part, this approach uses growth as the dependent variable and essentially has as its primary goal to explain varying growth rates and/or increments of growth. On the other hand, when the term growth is used as a process, then growth is neither as an independent variable, nor as a dependent variable.

Gonzalez-Vega, Claudio, Schreiner, Meyer, Rodriguez-Meza, and Navaja (1997) describe two types of MFI growth: intensive and extensive. Intensive growth, or adding depth, results from increased productivity of existing capacity. This may be possible through technological innovations; improvement in the utilization of capacity, such as increasing loan officer productivity; or introduction of new products. Extensive growth, in contrast, adds breadth by increasing capacity, such as hiring new staff and opening new offices. According to Churchill (1997), one key factor determining the growth strategy of an MFI is its stage in development. Christen, Robert, Elisabeth, and Robert (1995) outline three stages of institutional development, as shown in Table 1.

Table 1: Stages of Development for Microfinance Institutions

Stage of development	Observed Pattern of growth
Level I **Start-up Programs and MFIs that Are Heavily Subsidy Dependent.** They require frequent injections of funds. If these injections are not forthcoming, the program will quickly consume its capital in financing routine operations.	These programs should rely on **intensive growth** by finding ways to increase the productivity of its existing capacity
Level II Programs that Have Achieved Operational Efficiency but Not Full Self-Sufficiency. The range of MFIs at this level includes those that rely extensively on soft money to those on the verge of unsubsidized profitability.	Their market-penetration strategy requires they have their staff training, management information, and other operational systems in place to initiate an **Extensive growth strategy** that replicates a successful branch model in new geographic areas.
Level III **MFIs that Have Achieved Full Self-Sufficiency.** They generate enough revenues to cover both nonfinancial and financial costs, calculated on a commercial basis. Subsidies in the form of concessional funds are no longer needed, and investors can expect a return on equity equivalent to returns available elsewhere in the private sector.	**Extensive growth.** It is important for institutions at this stage to reduce their concentration risk by diversifying their products or markets

Source: Churchill (1997)

2.3 Regulatory Risk Management Strategies

Effective regulatory risk management strategies are expected to improve MFI growth. Ergas, Hornby, Little, and Small (2001) assert that regulatory risk arises when the interaction of uncertainty and regulation changes the cost of financing the operations of a firm. This definition is broad enough to include all of the important sources of uncertainty, but restricted to those for which the effect on the firm arises from, or is magnified by, the existence of regulation. Business Dictionary (2010) defines regulatory risk as exposure to financial loss arising from the probability that regulatory agencies will make changes in the current rules (or will impose new rules) that will negatively affect the already-taken trading positions. According to Kolbe, Tye, and Myers (1993, p. 33) “there appears to be no generally accepted definition of regulatory risk”. However, the analysis of different versions of regulatory risks has a long tradition within the economic theory of regulation (e.g. Ahn & Thompson, 1989), and becomes increasingly relevant within debates of regulatory reform of network industries (e.g. Ergas et al., 2001). Several definitions of regulatory risks are known from the literature.

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2.4 Empirical Review

Ergas et al. (2001) argues that when government agencies administer controls over the commercial activities of private firms, capital invested in those firms is exposed to an additional source of risk. Because the nature of these controls varies across industries and regulators, the resulting "regulatory risk" has many different forms and consequences. One consequence of this diversity of causes and effects is that the nature of regulatory risk is not well understood. This in turn limits the extent to which the costs of regulatory risk can be estimated, and measures can be designed to minimize these costs.

GTZ (2000) asserts that regulatory or compliance risk arises out of violations of or non-conformance with laws, rules, and regulations, prescribed practices, or ethical standards, which vary from country to country. The costs of non-conformance to norms, rules, regulations or laws range from fines and lawsuits to the voiding of contracts, loss of reputation or business opportunities, or shut-down by the regulatory authorities. Many non-government organizations that provide microfinance are choosing to transform into regulated entities, which exposes them to regulatory and compliance risks. Even those microfinance NGOs that are not transforming are increasingly subjected to external regulations. GTZ (2000) recommend that the most effective strategy to safeguard against regulatory risk is for MFIs to establish a good working relationship with the regulatory authorities. Regardless of their formal regulatory status, MFI should encourage open communication with regulators to ensure their full understanding of the MFI and provide an opportunity to defuse any potential problems.

Mokoro et al. (2010) carried out a study on the MFIs in Kenya in an attempt to establish the factors influencing the transformation from micro financing to formal banking .The research used a survey strategy, simple random sampling in finding the number of schools, and simple stratified sampling in finding the respondents. Questionnaire and interviews were used to collect data from the respondents and out of the fifty managers (50) who were sampled, fourthly nine (49) of them responded, giving a response rate of ninety eight (98) percent. Mokoro et al (2010) recognizes that operational, regulatory and financial risks that Micro Finance Institutions (MFIs) face in order to grow from an informal level to the formal level could be hindering the development of the sector. In addition, the authors noted that the serious challenges facing Micro Finance Institutions (MFIs) in the transformation from micro financing to formal banking are: strict rules from the Central Bank; inadequate regulatory and loan management systems, rivalry and competition in the industry, poor customer care, high operation cost to central banks cost levies and unscrupulous nature of Micro Finance Institutions (MFIs).

3.0 RESEARCH METHODOLOGY

The study used correlational survey design. The target population of this study was at two levels. The first level comprised of all micro finance institutions in Kenya who are members of AMFI. The total number of the firms that were registered members of AMFI are fifty seven (57) as at 23 August 2011 as shown in Appendix. The main reason for this choice was that these firms are likely to exhibit an elaborate relationship between the study variables while at the same time they were very vulnerable to risk. The second level of target population was the employees of the MFIs. As at the study date, there were over 10,000 employees of MFIs. Stratified sampling technique was used. The population comprised of two types of categories or strata of MFIs. The

first stratum included all MFIs which are licensed by CBK. Census was used to identify the number of licensed MFIs. The number of licensed MFIs was 6. The second stratum comprised of MFIs that were not licensed by CBK. Both quantitative and qualitative data were collected, hence calling for primary and secondary data sources. Primary data was collected by using the questionnaire as the main research instrument. In this study, a semi-structured interview schedule was also used. Qualitative data was analyzed using content analysis whereas the quantitative data was analysed using Statistical Package for Social Sciences (SPSS) where descriptive and regression analysis were conducted to determine the relationship between regulatory risk management strategies and growth of MFIs.

4.0 RESULTS AND DISCUSSIONS

4.1 Response Rate

The number of questionnaires that were administered was 51 which were derived from three (3) respondents each representing the three level of management from each of the 17 MFIs. A total of 40 questionnaires were properly filled and returned. This represented an overall successful response rate of 78%. According to Mugenda and Mugenda (2003), a response rate of more than 50% is adequate for analysis. Babbie (2004) also asserted that return rates of 50% are acceptable to analyze and publish, 60% is good and 70% is very good.

Table 2: Response Rate

Category	Returned (%)	Unreturned (%)	Total(n)
CEO/Senior Managers	71	29	17
Middle Level Management	82	18	17
Non Managerial	82	18	17
Total	**78**	**22**	**51**

4.2 Regulatory Risk Management Strategy

The study sought to establish whether regulatory risk management strategies have led to growth of MFI sector in Kenya. Specifically, the study investigated the following elements of regulatory risk management strategies:- compliance with all relevant regulations, illegal collection of deposits, appropriate regulatory framework for the MFI's current and potential operations and legal status, provision of adequate supervision of MFI by the supervisory agency (CBK), heavy fines for violating regulations, cases pending in court over breach of contract.

4.2.1 Compliance with all Relevant Regulations

The study sought to establish whether the MFI is compliant with all relevant regulations. Results in table 3 reveal that 37.5% of the respondents strongly agreed while another 35% agreed bringing to a total of 72.5% of those who agreed with the statement that the MFI is compliant with all relevant regulations. Meanwhile 22.5% of the respondents neither agreed nor disagreed and another 5% disagreed with the statement.

The findings concur with those in Ergas et al (2001), CBK (2010) and CFSI (2011) which asserted that MFIs which comply with all relevant regulations face a lower regulatory risk than those MFIs which do not comply with all regulatory requirements. The findings also concur with those in GTZ (2000) which asserts that MFIs should comply with all relevant regulations to avoid regulatory risk exposure. The findings imply that the MFIs under study had complied with all relevant regulations. Compliance with regulations reduces the regularity exposure of MFIs. The compliance with all relevant regulations may have contributed positively to the growth of MFIs.

4.2.2 Illegal Collection of Deposits

The study sought to establish whether the MFI does not collect deposits illegally. As illustrated in table 3, 47.5% respondents agreed while another 35% strongly agreed bringing to a total of 82.5% of those who agreed with the statement that the MFI does not collect deposits illegally. Meanwhile 12.5% respondents neither agreed nor disagreed and another 5% disagreed with the statement. The findings concur with those in GTZ (2000), Basel Committee on Bank Supervision (2001) and The Basel Committee (2004) which argued that illegal collections of deposits by MFIs constitute a material illegality which may cause expose the MFIs to fines and penalties.

The findings imply that the MFIs under study did not collect deposits illegally. Enhancement of legality in collection of deposits is part of the overall regulatory risk management strategy. This further implied that adherence to regulation on collecting deposits might have contributed positively to the growth of MFIs.

4.2.3 Appropriate Regulatory Framework for the MFI's Current and Potential Operations and Legal Status

The study sought to establish whether the regulatory environment provides an appropriate framework for the MFIs current and potential operations and legal status. Table 3 reveals that 40% respondents agreed while another 35% strongly agreed bringing to a total of 75% of those who agreed with the statement that the regulatory environment provides an appropriate framework for the MFIs current and potential operations and legal status. Meanwhile 17.5% respondents neither agreed nor disagreed and another 7.5% disagreed with the statement.

The findings concur with those in CBK (2010) which assert that Central Bank of Kenya has put in place a proper regulatory environment for the MFIs. The findings also concur with those in Mwakoro (2011) and Ndulu (2010) which noted that a proper regulatory environment for the MFIs in Kenya exists. The findings imply that MFIs under the study had complied with the regulatory environment which provided an appropriate framework for the MFIs current and potential operations and legal status.

4.2.4 Provision of Adequate Supervision of MFI by the Supervisory Agency (CBK)

The study sought to establish whether the supervisory agency (CBK) provides adequate supervision of the MFI. The findings in table 3 further revealed that half of the respondents 50% agreed while 22.5% strongly agreed bringing to a total of 72.5% of those who agreed with the statement that stated the supervisory agency (CBK) provides adequate supervision of the MFI. Meanwhile 20% respondents neither agreed nor disagreed and another 7.5% disagreed with the statement.

The findings concur with those in CBK (2010) which asserted that Central Bank of Kenya is responsible for the registration of deposit taking MFIs and the issuance of supervisory guidelines. The findings further concur with those in Jensen and Meckling (1976) which asserted that managers will not act to maximize returns of shareholders unless appropriate governance structures supported by a proper regulatory framework are in place and implemented to safeguard the interest of shareholders. The findings also agree with Meagher and Rhyne (2002) who asserted that MFIs regulation is a matter of strengthening MFI reputation and preventing fraudulent activities through increasing transparency in financial accounting and transaction reporting and increasing operational and financial sustainability. The findings imply that the MFIs under study had adequate supervision from the supervisory agency (CBK). This may have influenced the growth of the MFIs.

4.2.5 Heavy Fines for Violating Regulations

The study sought to establish whether the MFI has not in the past incurred heavy fines for violating regulations. As illustrated in table 3, 52.5% of the respondents agreed while another 20% strongly agreed bringing to a total of 72.5% of those who agreed with the statement that the MFI has not in the past incurred heavy fines for violating regulations. Meanwhile 25% respondents neither agreed nor disagreed and another 2.5% strongly disagreed with the statement.

The findings concur with those in GTZ (2000), Ergas et al. (2001), CBK (2010) and which asserted that MFIS may ensure compliance with relevant laws as failure to do so expose them to regulatory risk in form of fines and penalties. The findings imply that the MFIs under study have not incurred heavy fines for violating regulations. The compliance with all relevant regulations may have contributed to the growth of MFIs.

4.2.6 Cases Pending in Court over Breach of Contract

The study sought to establish whether the MFI has no cases pending in court over breach of contract. The study findings in table 3 indicate that 50% of the respondents agreed while another 30% strongly agreed bringing to a total of 80% of those who agreed with the statement that the MFI has no cases pending in court over breach of contract. Meanwhile 15% respondents neither agreed nor disagreed and another 5% disagreed with the statement.

The findings concur with those in Ergas et al (2001), CFSI (2011) and Ndulu (2010) who assert that pending cases in court constitute a regulatory risk exposure. Therefore, MFIs need to avoid pending cases by settling out of court as doing so would reduce the risk exposure. The findings imply that the MFIs under the study do not have pending cases in court over breach of contract. This also implies that MFIs have put in place an effective regulatory risk management strategy. The effectiveness of the regulatory risk management strategy may have influenced the growth of MFIs.

Table 3: Regulatory Risk Management Strategy

	Strongly Disagree (%)	Disagree (%)	Neither Agree nor Disagree (%)	Agree (%)	Strongly Agree (%)
The MFI is compliant with all relevant regulations	0	5	22.5	35	37.5
The MFI does not collect deposits illegally	0	5	12.5	47.5	35
The regulatory environment provides an appropriate framework for the MFI's current and potential operations and legal status	2.5	5	17.5	40	35
The supervisory agency (CBK) provides adequate supervision of the MFI	0	7.5	20	50	22.5
The MFI has not in the past incurred heavy fines for violating regulations	2.5	0	25	52.5	20
The MFI has no cases pending in court over breach of contract	2.5	2.5	15	50	30

4.3 MFI Growth Indicators

The study sought to determine the growth of MFI sector in Kenya. The specific elements of growth that were investigated included the following; increase in capital base, increase in the loan portfolio/Turnover, increase in the number of employees, increase in branch network, and attainment of registration with CBK as a DTM.

4.3.1 Increase in Capital Base

The study sought to determine whether the MFI has experienced increase in capital base. Results in table 4 reveal that that 45% of the respondents agreed while 37.5% strongly agreed, bringing to a total of 82.5% indicated that the MFI has experienced a significant increase in capital base. Results also reveal that 17.5% of the respondents could not make up their minds on the statement. The findings concur with those in Mckelvie and Wiklund (2010) which asserted that firm's growth may be defined as an outcome or process. The findings also concur with CBK (2010) and Ndulu (2010) which note that MFIs in Kenya have experienced an increase in capital base. The findings imply that the MFIs under study have grown by increasing in capital base. The growth in capital base could have been as a result of attempting to comply with regulatory requirements on capital adequacy. The growth could also be attributed to the enterprise risk management strategies employed by MFIs.

4.3.2 Increase in the Loan Portfolio/Turnover

The study sought to determine whether the MFI has experienced increase in the loan portfolio or turnover. Results in table 4 revealed that 60% agreed while 25% strongly agreed bringing to a total of 85% of the respondents who agreed with the statement that the MFI has experienced a significant increase in the loan portfolio or turnover. Results further reveal that 15% of respondents could not make up their mind on the statement. The findings concur with those in Delmar (1998) who asserted that growth of micro finance may be measured through the growth of individual micro finance institutions and changes in the loan portfolio. The findings agree with those in Financial Sector Deepening (FSD) (2012), CBK (2010) and in Association of Microfinance Institutions of Kenya (2011) which noted that MFIs have increased their loan portfolios. According to AMFI (2011), MFIs serves over 6.5 million clients with an outstanding loan portfolio of over US $ 310 million. The finding imply that MFIs have grown in terms of loan portfolio and this could be attributed to expansionary policies pursued by the government, the improved macroeconomic environment, the desire by the government to improve financial inclusion and deepening and the enterprise risk management strategies employed by MFIs.

4.3.3 Increase in the Number of Employees

The study sought to determine whether the MFI has experienced increase in number of employees. The study findings in table 4 revealed that 40% of the respondents strongly agreed while a further 35% agreed bringing to a total of 75% of those respondents who agreed with the statement that the MFI has experienced a significant increase in number of employees. Results also reveal that 20% could not make up their mind while 5% disagreed with the statement. The findings agree with those in Barkham (1996) who asserted that growth of micro finance can be measured through the growth or changes of workforce. The findings also agree with those in Omino (2005) and CFSI (2011) which noted that MFIs have grown through the increase in number of employees. The findings imply that the MFIs under study have experienced a significant increase in number of employees. The growth of MFIs as shown by number of employees could have been attributed to the enterprise risk management strategies employed by MFIs.

4.3.4 Increase in Branch Network

The study sought to find out whether the MFI has experienced an increase in branch network. The findings in table 4 reveal that 47.5% of the respondents agreed while another 32.5% agreed bringing to a total of 80% of those respondents that agreed with the statement that the MFI has experienced a significant increase in branch network. Results also reveal that 12.5% of respondents could not make up their mind while 7.5% of respondents disagreed with the statement. The findings agree with those in McKelvie and Wiklund (2010) who asserts that growth of microfinance sector will be measured through the growth of individual micro finance institutions and changes in branch network. The finding also agree with those in Ndungu (2010) and Ngigi (2010) which note that MFIs have increased their branch network in order to effectively meet the financial demands of borrowers. The findings imply that the MFIs under study have experienced a significant increase in branch network. The growth in branch network could be attributed to the enterprise risk management strategies employed by MFIs.

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4.3.5 Attainment of Registration with CBK as a DTM

The study sought to determine whether the MFI has attained registration with CBK as a DTM deposit taking microfinance institution. Results in table 4 revealed that 42.5% of the respondents agreed while a further 22.5% strongly agreed with the statement that the MFI has attained registration with CBK as a deposit taking microfinance institution (DTM). Results also reveal that 22.5% could not make up their mind on the statement while 12.5% disagreed with the statement. The study findings are in line with those of CBK (2010), Omino (2005) and Financial Sector Deepening (FSD) (2012) who asserts that MFIs sector has grown and this has been demonstrated by the registration of deposit taking MFIs and the conversion of non DTMs to fully fledged DTMs. The findings imply that MFI sector has grown as witnessed by the increase in number of registered DTMs and the conversion of non DTMs to fully fledged DTMs. This growth may have been as result of the enterprise risk management strategies that MFIs have put in place.

Table 4: MFI Growth Indicators

Statement	Strongly Disagree (%)	Disagree (%)	Neither Agree nor Disagree (%)	Agree (%)	Strongly Agree (%)
The MFI has experienced a significant increase in capital base	0	0	17.5	45	37.5
The MFI has experienced a significant increase in the loan portfolio/Turnover	0	0	15	60	25
The MFI has experienced a significant increase the number of employees	0	5	20	35	40
The MFI has experienced a significant increase in branch network	2.5	5	12.5	47.5	32.5
The MFI has attained registration with CBK as a DTM	5	7.5	22.5	42.5	22.5

4.3.6 CEOs Response on Growth of MFIs

The CEO interviews sought to establish how the MFIs have handled growth and their preparedness to manage (often rapid) growth, in terms of staffing, products, and funding. The qualitative responses were organized into subthemes, analyzed quantitatively and presented in table 5. Results in table 5 reveal that 41.7% of respondents indicated that they were very much prepared for growth. 8.3% of respondents indicated that this was their third year and they were still developing systems as they moved along. Another 8.3% indicated that they were experiencing gradual growth through referrals from both shareholders and customers. Meanwhile, 16.7% indicated that they have handled growth through acquisition of additional

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capital and opening more branches, 8.3% indicated that they handled growth through emphasis on quality management on product and services, and 16% indicated that had experienced organic growth and were always prepared to adapt quickly to change.

The finding agree with those in Financial Sector Deepening (FSD) (2012), Ndungu (2010), Ngigi (2010) and Association of Microfinance Institutions of Kenya (2011) which noted that MFIs are prepared to manage growth and are always prepared to adapt quickly to change. In addition, they note that MFIs have managed growth by growing their customer base, quality product management and developing systems. The findings imply that MFIs have managed growth effectively by put in place effective systems, additional capital and opening more branches, developing and managing quality products and services. This further implies that MFIs have put in place effective enterprise risk management strategies to manage growth.

Table 5: CEO Response on how the MFIs have Handled Growth

CEO Response on how the MFIs have handled growth and their preparedness to manage (often rapid) growth	count	%
Yes. We are very much prepared to manage growth	5	41.7
This is our third year and we are still developing systems as we move along	1	8.3
Gradual growth through referrals from both shareholders and customers	1	8.3
Through acquisition of additional capital and opening more branches.	2	16.7
Emphasis on quality management on product and services	1	8.3
We have had an organic growth and we are always prepared to adapt quickly to change	2	16.7
Total	**12**	**100**

4.4 Relationship between Regulatory Risk Management Strategies and Growth

Regression analysis was conducted to empirically determine whether regulatory risk management strategies were a significant determinant of growth in MFIs. Regression results in table 5 indicated the goodness of fit for the regression between regulatory risk management strategies and growth is satisfactory. An R squared of 0.337 indicates that 33.7% of the variations in growth are explained by regulatory risk management strategies.

The overall model significance is also presented in table 5. An F statistic of 19.342 is larger than the tabulated statistic of 4.08 (df1; 1, df2; 38, p value; 0.05). This is also supported by a probability value of 0.00. Since $F_{calculated} > f_{critical}$ and the reported probability of 0.00 is less than the conventional probability of 0.05 ($p\ value_{calculated} < p\ value_{critical}$), the overall model was significant. In other words, the independent variable (regulatory risk management strategy) does a better job in predicting MFI growth compared to predicting MFI growth through its mean.

The relationship between regulatory risk management strategies and growth is positive and significant (b_1=0.355, p value, 0.00). The hypothesis was therefore accepted. This implies that an increase in the effectiveness of regulatory risk management strategies by 1 unit leads to an increase in growth by 0.355 units. The regression equation is as follows;

$$Growth = 4.810 + 0.355\ Regulatory\ Risk\ Management\ Strategy$$

Table 5: Regulatory Risk Management Strategy and Growth

Parameter estimate	**Coefficient**	**P value**
Constant	4.810	0.00
Regulatory Risk Management Strategy	0.355	0.00
R Squared	0.337	
F statistic (ANOVA) (df ; 1; 38; 0.05)	19.342	0.00

Figure 1 is a diagrammatic representation of the relationship between regulatory risk management strategies and MFI growth. The figure indicates that a positive relationship exists. Therefore, an increase in the effectiveness of regulatory risk management strategies positively affects MFI growth. The findings agree with those in Mokoro et al (2010), Diamantini (2010) and Ekka, Chaudhary and Sinha (2011), GTZ (2000) and CBK (2010) which noted that effective regulatory risk management strategies lead to positive growth of financial institutions.

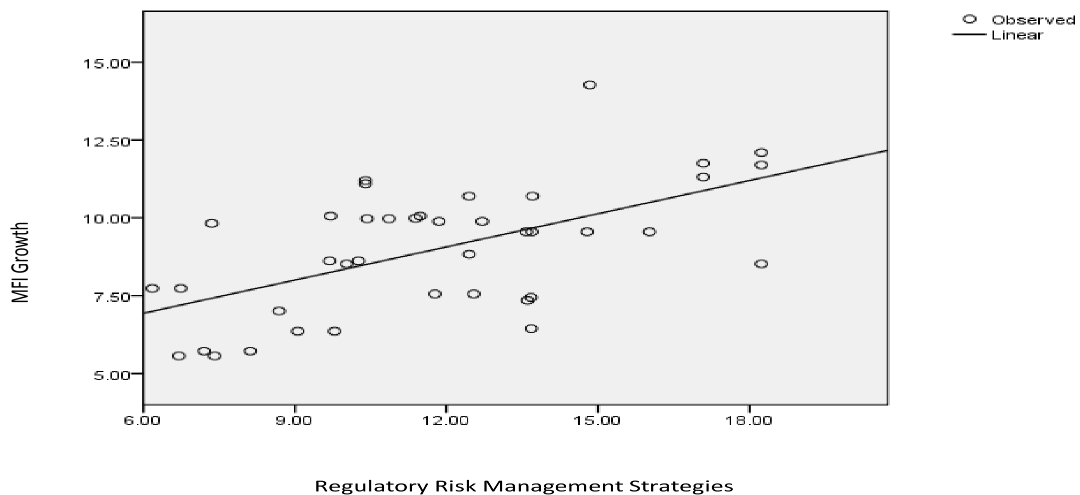

Figure 1: Regulatory Risk Management Strategies and Growth

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of Findings

The study attempted to determine whether the regulatory risk management strategies contribute to growth of MFI sector in Kenya. The study findings indicated that the MFI were compliant with all relevant regulations and that the regulatory environment provided an appropriate framework for the MFIs current and potential operations and legal status. The findings further indicated that the supervisory agency (CBK) provided adequate supervision of the MFI and the MFI has not in the past incurred heavy fines for violating regulations. Furthermore, the study findings indicated that the MFI has no cases pending in court over breach of contract. The regression results indicated that there was a positive effect on MFI growth due to implementation of effective regulatory risk management strategies.

5.2 Conclusions

The study concluded that the MFI were compliant with all relevant regulations. Results led to the observation that the regulatory environment provided an appropriate framework for the MFIs current and potential operations and legal status. It was inferred for the findings that the supervisory agency (Central Bank of Kenya-CBK) provided adequate supervision of the MFI. It was noted that MFI has not in the past incurred heavy fines for violating regulations. Results from the study led to the observation that MFIs has no cases pending in court over breach of contract. Overall, it was concluded that regulatory risk management strategies were significant determinant of growth in MFIs. There was a positive effect on growth due to effective regulatory management strategies.

5.3 Recommendations

In line with findings and conclusions of this study, it was recommended that the MFIs should continue practicing effective regulatory risk management practices such as development of appropriate regulatory framework for current and potential operations and legal status. This would significantly improve the growth of the MFI. Study findings recommended that embracing supervision by the supervisory agency- CBK and honoring of contracts to avoid court cases and fines were good practice. It is recommended that compliance with all relevant regulations is crucial as it enhances the growth of MFIs. Study findings recommended that putting measures to prevent collection of illegal deposits and establishing a good working relationship with the regulatory authorities, will improve the growth of MFIs. The study recommends that encouraging open communication with regulators and provision of an opportunity to defuse any potential problems may be a crucial regulatory strategy as it improves the growth of MFIs.

5.4 Suggested Areas for Further Study

Further studies can be done on the area of environmental factors that influence the performance and growth of the MFIs. The models that would be used in such studies include PESTEL, Porters Five Framework. In addition further studies are recommended in the area of competitive strategies and strategic responses adopted by MFIs in an effort to counter environmental challenges. In addition, further studies may investigate the influence of demographic factors on the enterprise risk management strategies. For instance, are MFIs with a high male gender composition more likely to put in place effective strategic risk management strategies? What is

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the potential impact of capital base on strategic risk management strategies? Are DTMS more likely to grow faster than non DTMs? What is the impact of gender composition, experience, age of MFI employees on MFI growth? Studies may be carried out to find answers to these questions.

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