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# Innovative Lending Methods and the Growth of Microfinance Institutions in Rwanda: A Case Study of Urwego Opportunity Bank

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**Abstract:** ***To assess the impact of innovative lending methods on the growth of MFI in Rwanda, a case study of Urwego opportunity bank. The specific objectives sought to determine the effects of digital credit services on the growth of Urwego Opportunity bank in Rwanda, to establish the effects of flexible lending services on the growth of Urwego Opportunity bank in Rwanda and to determine the contributions of specific course lending methods on the growth of Urwego Opportunity bank in Rwanda. The researcher used descriptive survey when conducting this study. The study focused on Urwego Opportunity Bank in Kigali city. Urwego Opportunity Bank MFI has eight branches in Rwanda. However, four of them operate within Kigali City. The researcher collected 89 clients and 11 employees. The researcher used cluster method to collect information from the clients whereas stratified sampling was used to collect information from the employees. The exercise was conducted in 2 days. Qualitative data was entered into appropriate analysis program, preferably statistical package for social sciences (SPSS) from which analysis were done using proportions (percentages), rates and descriptive statistics. Descriptive statistics were used to estimate the mean and standard deviations of certain variables to ascertain how close or wider the sample statistics were spread from the mean. Qualitative data was entered into a compilation sheet whereby the information from various respondents were tabulated. Responses which showed similarities were given a theme. Each theme was transferred into one sheet from which final analysis was done in relation to objectives of this study. The study found that that mobile phone applications are one of the main products used to reach out to more clients in MFI. Although MFI have tried to innovate ways of reaching out to clients, majority of the clients still have reservation for adopting the new changes. This was observed when the respondents were asked to state the maximum amount they can deposit using mobile banking and 62.8% stated that they are willing to part with any amount not more than 50,000 Rwandan francs. The study found that product innovation in MFI is very important in ensuring that they reach out to as many as possible clients. This is evident by the response rated at 36.4% of the respondents who supported it arguing that MFI should be in a position to introduce a new good or service to the market. Another important aspect is process innovation whereby a new production process or methodology should be effective and efficient. This was supported by 36.4% of the respondents who stated that process development is equally important as the product development. The study indicates that in average there are similarities between the outcome of the employees who believe that innovative ways of reaching out to customers are effective and efficient, withdrawal and deposit in Letshego Microfinance due to its innovative products as indicated, easy ways to check balance in their accounts, easier ways of opening an account, quick access to MFI services, error free records innovative services, 24hour online services, security of innovative products and time saving. The study recommends that there is a need to put much attention into the technological innovation, infrastructure building, institutional development, and human capital formation which directly increase the productivity and human resources. There is also a need to ensure an appropriate regulatory and prudential framework for the market of Microfinance including capital adequacy ratios, asset quality indicators and unsecured loan limits. It is important to provide a specialized credit bureau for Microfinance that can help financial institutions to have necessary information on clients in order to minimize risks.***

## 1. Background of the study

Innovation in banking sector has really improved over the recent years in most parts of the world. Financial institutions are seeking alternative banking channels to enable them to reach more and more clients as well as increase financial inclusivity especially those who live in the rural areas. According to Rangarajan Committee report (2008) Financial Inclusion is defined "as the process of ensuring access to financial services, timely and adequate credit where needed by vulnerable groups such as the weaker sections and low income groups at an affordable cost". However, it is observed that financial exclusion is highly witnessed in developing countries especially Asia and African countries.

Many countries in developing parts of the world particularly in Asia and Africa are working towards financial inclusiveness by promoting strategies which increase financial outreach to the poor especially in rural areas. Such initiatives have led to the emerging of high number of Micro Finance Institutions (Hannig and Jansen, 2010). Some of them have managed to withstand start-up challenges while others have failed to meet their intended objectives. For instance in India, Porkodi and Aravazh(2013) asserted that 60% of the country's population does not have bank accounts and nearly 90% do not get loans. This has made India to be currently rated as the second-highest number of financially excluded households in the world. According to Andrianaivo and Kpodar (2011) bank penetration is lower than 10 percent in some regions of Africa particularly in rural areas. Although financial institutions play a major role in economic development of the country, majority of the world's poor remains unbankable.

According to Ledgerhood (2009) there has been many more Microfinance Institutions (MFI) which has failed than those which have succeeded. He pointed out some of the challenges citing that some of MFIs target a segment of the population that has no access to business opportunities because of lack of market, inputs and demands, others never reach either the minimal scale or the efficiency necessary to cover costs, many of them also face non-supportive policy frameworks and daunting physical, social, and economic challenges, internal management challenges, and finally replication of successful models has at times proved difficult, due to differences in social contexts and lack of local adoptions. Such sentiments are also in line with beliefs of the traditional banking institutions who consider this group of people being served by MFIs as "too risk to trade with". However, traditional banking institutions have recently been providing some of the products offered by MFIs to its clients considering that there are many MFIs which have developed to becoming banks.

Such scenarios has set precedence for scholars to conduct studies in this field in order to provide a profound understanding of success factors contributing to a micro-finance institution (MFI) in a developing country. According to Ngumbo, (2012) a key success factor can be a specific skill or talent; a competitive capability and something a firm must do to satisfy customers. MFIs provide various products ranging from cash loans, money transfers, direct deposits, savings and insurance particularly targeting the poor people in the society. MFIs are characterized by short repayment periods graduated increase of loan size, sustainability and non-conventional collateral. Rwanda has a sizeable Small and Micro Enterprise sector which the government is seeking to promote. This sector is estimated to employ 3.2 million people. In spite of this the sector has a problem in accessing financial services.

## 2. Statement of the Problem

The concept of financial innovation is fundamental as it spurs growth of MFIs worldwide. Presently, innovation is a continuous process geared toward providing a wider range of financial products and financial intermediation which is a crucial factor in determining competitiveness and the progress of financial institutions (Mohanty & Panda, 2004). Studies have been conducted to assess whether innovative lending methods promotes financial inclusion in other countries but there few studies which have been done in Rwandan context to assess whether micro finance innovation present opportunities to seize new markets from the unsatisfied or unbanked market segment in Rwanda.

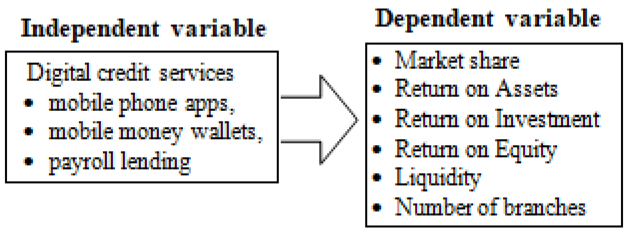
Amid the witnessed economic growth, increased population and the technological advancement over the last decade, only a few innovative MFIs have recorded remarkable growth, while the majority has remained sluggish. The Micro Finance Institutions are expected to grow in size, products, merge or have partnerships with other industries geared towards growing firms' products portfolio, the markets share and the profitability. Although innovation in financial sector is considered as the way to go in as far as financial inclusion is concern, very few studies have been conducted to establish the relationship of these two variables from MFI perspective.

Most of the existing studies have repeatedly focused in commercial banks. It is therefore not evident as to whether innovative micro-financing increase financial outreach. This study sought to assess the measures undertaken by MFI in Rwanda to increase their outreach in order to address such challenges of financial inclusivity in Rwanda.

## 3. Objective of the Study

To determine the effects of digital credit services on the growth of Urwego Opportunity bank in Rwanda

## 4. Conceptual Framework




**Research Design**

The researcher used descriptive survey when conducting this study. Zuelueta and Costales (2003) cited that descriptive research is a quantitative research design that describes phenomena as they exist, taking care not to influence subjects or events in any way. Descriptive and survey research designs are used by social scientists to describe human behaviors, by market analysts to look at the habits of customers, and by businesses seeking insight about company practices.

**Population of the Study**

The study was focused on Urwego Opportunity Bank in Kigali city. Urwego Opportunity Bank MFI has eight branches in Rwanda. However, four of them operate within Kigali City. The researcher collected the data from the head office branches in Nyarugenge district which served 800 estimated number of SMEs. Therefore, the researcher targeted 800 SMEs who are the clients of UOB in Nyarugenge district.

**Sample size**

To determine the sample size, the researcher was applied Solvin's formula. The sampling error was10% in order to attain a desired or a recognizable level of accuracy.

Formulae: $n = N/ (1 + N*e^2)$

$= 800/ (1+800*0.1*0.1)$

$= 800/1+8$

$= 800/9$

= **89 SMEs clients**

For the employees, census was uses whereby all of the employees dealing with product development and innovation in the bank were sampled. There are 11 employees in these departments and all of them were issued with questionnaires.

**Data Collection Instruments**

According to Kothari (2004) there are two types of data namely the primary data and the secondary data. Data was collected using these two basic methods. Primary data is the data which is obtained directly from the selected respondents while secondary data implies to the data collected from the documented sources. Primary data was collected using questionnaire while secondary data was collected using documented evidence.

## 5. Research Findings and Discussion

### 5.1 Digital credit services and the growth of Urwego Opportunity bank in Rwanda

The first objective of this study was to assess the specific innovative approaches available in microfinance institutions which are meant to reach out to more clients who do not have access to banking services. The following section presents the findings and discuses about some of these innovative products.

**Table 1:** Innovative products offered in MFI

| | | Frequency | Percent |
|---|---|---|---|
| | Mobile banking | 6 | 54.6 |
| | ATMs | 2 | 18.2 |
| | Message alerts from the MFI | 3 | 27.3 |
| | **Total** | **11** | **100.0** |

Source: Primary data, 2018

It was observed that 54.6% of the employees stated that mobile banking is one of the innovative products offered by the MFI to facilitate financial inclusion, 18.2% stated that ATMs are some of the means used by MFI to improve financial inclusion and finally message alerts to customers was rated with 27.3% of the employees as some of the recent innovativeness used to facilitate financial innovation. In general it is observed that mobile phone applications are one of the main products used to reach out to more clients in MFI.

**Table 2:** Urwego Opportunity Microfinance offers their products to the clients using the following methods

| | | Frequency | Percent |
|---|---|---|---|
| | Mobile Banking | 2 | 18.2 |
| | Point of Sale-POS | 7 | 63.6 |
| | Others | 2 | 18.2 |
| | **Total** | **11** | **100.0** |

Source: Primary data, 2018

The study established that MFI deliver their products using innovative ways such as easy 24/7 rated at 18%, point of service rated at 63.6% and others such as ATMs, over the counter services rated at 18.2%. There are several more specific motivations for diversifying an MFI's channels beyond the branch: Customer acquisition and retention: penetrating new markets or servicing hard-to-reach areas. Product diversification Customer acquisition and retention: offering valuable products, such as micro-savings and remittances, profitably and efficiently. Operational efficiency: reducing branch congestion and maximizing efficiency of branch tellers and loan officers. Cash reduction: reducing cash in the financial system to save money, provide more transparency, be less vulnerable to fraud risk, and be safer for the client. With few established models even in the retail-banking industry, many of these alternative channels are new to microfinance, and thus a high degree of experimentation is currently underway. It remains to be seen which channels will have the transformational impact described above.

## 6. Conclusion

Rarely a day goes by without someone mentioning how financial inclusion can be boosted by new delivery channels, such as ATMs, banking agents, and mobile phones. Yet for all the talk about reaching the "unbanked" and other low-income groups, it is banks, mobile operators, and retailers that have been experimenting with new delivery systems to reach the poor. As the group that is closest to the niche segment, microfinance institutions (MFIs) seem conspicuously absent from the discussion. This study intended to unveil the importance of innovative products on financial inclusion by assessing it through the perspective of MFI.

Poor people need a variety of financial services, not just loans. In addition to credit, they want savings, insurance, and money transfer services. It is clear from this study that the poor benefit more from a wider range of options in financial services. MFIs have tried to diversify risks and develop new business lines where traditional banks used to refer to a risk group to invest into. The advances and refinements in lending technologies in microcredit as well as in mobile banking MFIs can be applied in other financial services for the poor.

One of the challenges is that other functions, such as risk management, branch operations, or marketing, alternative channels is a relatively new field, even in the banking sector. There are few reference points, especially in the microfinance sector, and even fewer success stories and almost none are widely communicated across borders or regions. This means that senior executives at MFIs often have an incomplete understanding of alternative channels and how they might fit in their businesses and unclear ideas of what benefits they may bring.

## 7. Recommendations

- R1. To put much attention into the technological innovation, infrastructure building, institutional development, and human capital formation which directly increase the productivity and human resources.
- R2. To ensure an appropriate regulatory and prudential framework for the market of Microfinance including capital adequacy ratios, asset quality indicators and unsecured loan limits.
- R3. To provide a specialized credit bureau for Microfinance that can help financial institutions to have necessary information on clients in order to minimize risks.
- R4. To introduce agency microfinancing since this model is popularly used by commercial banks to reach out to their clients and also clients are familiar with it.

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