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The Development of Microfinance in Cameroon: Focus on Regulation

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Development of Microfinance in Cameroon: Focus on Regulation

Short title: Microfinance Regulation in Cameroon

One sentence summary: Focusing on microfinance in Cameroon, this paper shows the positive influence of regulation in professionalizing the microfinance sector and controlling certain derives but at the same time it reveals how it creates hurdles for MFIs to fulfil their social mission of financial inclusion.

Abstract

While the microfinance regulations in Cameroon have a positive influence in professionalizing the microfinance sector, it seems to have also created hurdles for MFIs to fulfil their social mission of financial inclusion. The evolution of activities of the microfinance sector over the years led to changes in the regulatory environment through the establishment of new regulations that progressively professionalize the sector and controlled certain derives. Financial inclusion has been hindered by insufficient supervision and tight regulations in terms of board members' qualifications, loan documentation requirements, and provisioning and liquidity requirements. Regulations still need to reflect more the specificities of the microfinance sector and be matched with adequate supervision in order to achieve its dual role of financial inclusion and safeguarding the financial system.

Keywords: Cameroon, financial inclusion, microfinance regulation

1. Introduction

A significant percentage of the population in developing countries still do not have access to financial services. Microfinance has the potential to fill in this gap especially if provided on a massive scale and on a sustainable basis (Otero and Rhyne, 1994; Drake and Rhyne, 2002; Ayayi, 2012). The provision of financial services to the poor by microfinance institutions (MFIs) on a massive scale calls for the need to regulate and supervise MFIs under specific regulatory frameworks. Those frameworks have a double role. First, it consists in promoting the development of microfinance so it can provide access to financial services to the greatest number of those excluded by the banks. And second, it needs to safeguard savings and the stability of the microfinance sector in general, implying emphasis on the financial sustainability of MFIs.

The conflicting nature of these objectives requires from regulators to effectively accomplish both their promotion and protection role in a way that increased emphasis is not placed on financial viability to the point that it instead favours mission drift in MFIs. Indeed, subjecting MFIs to regulations and the associated supervision can be costly in terms of start-up costs, frequent reporting, skilled labour costs (Cull et al., 2011), and this may negatively impact the financial inclusion mission of microfinance, especially if the regulations are inadequate. Specifically, in developing countries where microfinance is most popular, most central banks lack both a clear understanding of microfinance methodologies and the staff to supervise them (Gallardo et al., 2005). Brownbridge and Kirkpatrick (2000) point out that one of the weaknesses in the prudential systems of developing countries is the lack of the requisite personnel to carry out effective supervision and the weak enforcement of prudential regulations by regulators which can be attributed to regulatory forbearance or regulatory capture. This usually results in

microfinance regulatory frameworks clearly not adapted for the microfinance sector and thus hampering the evolution of the sector (Gallardo et al., 2005; Siwale and Okoye, 2017). Accordingly, it becomes fundamental to examine the implications of the regulatory environment on the operations of MFIs in developing countries, particularly in Sub-Saharan Africa (SSA) which is a region that is largely under-researched (Siwale and Okoye, 2017).

In this study, we focus on a particular country within the SSA region, Cameroun, to shed light on the contribution of regulation in the development of microfinance. Most of the literature on regulation has focused either on describing and comparing existing regulations or, especially in the case of international institutions, on providing guidelines for regulators on the basis of perceptible best practices (Trujillo-Tejada et al., 2015). There is a need for more studies that will explore how microfinance regulation reflects itself on the practices of MFIs. Indeed, existing microfinance regulations are designed with commercial banking in mind and there is still mixed evidence on the impact of regulation in microfinance (Yunus, 2009; Karnani, 2011). Also, there is limited information available on the microfinance sector of a large sample of countries and this points to the relevance of studies that will trace the evolution of the microfinance sector across countries (Hudak, 2012). Therefore, our study is guided by the following research question: What are the perceived effects of regulation on MFIs' ability to provide financial services to the poor? To address this question, we conducted a qualitative exploratory study based on interviews with 27 practitioners from 23 MFIs and six regulators from the ministry of finance in Cameroon.

Our findings show that MFIs are confronted with a certain number of regulatory constraints that makes it difficult for them to effectively serve the poor. We identified

three impediments: the regulatory provisions related to loan documentation, board members' qualifications, and loan loss provisioning and liquidity. We also found that insufficient supervision greatly undermines the confidence in the sector which does not facilitate the achievement of the financial inclusion objective of the MFIs. Our study has direct implications for regulatory authorities. It highlights the importance of well balancing microfinance promotion and prudential supervision objectives in the design of regulatory frameworks. It also warns about the tendency to favour systems with a short-term focus that may undermine long term development objectives (Gallardo et al., 2005). Moreover, by taking the perspective of the MFI actors, this paper attempts to voice the concerns of MFIs and more specifically advocate for improvement with regard to certain rules.

The remaining of this article is structured as follows: The next section reviews the literature on microfinance regulation. The following section presents the methodology used for this study. We then present our findings by first retracing the history and evolution of microfinance in Cameroon and secondly discussing the perceived effects of regulation on microfinance activities. The final section provides concluding comments.

2. Review of the literature on microfinance regulation

The regulation of microfinance can be defined as the rules and mechanisms that govern the functioning of microfinance institutions (Bédécarrats and Marconi 2009). Regulation is the place where is defined a dominant vision of what microfinance should be and through which vector this vision is diffused and imposed to the actors of the sector

(Bédécarrats and Marconi, 2009). As such, it has commonly been considered as one of the factors that influences the practices of microfinance institutions.

Generally, a distinction is made between prudential and non-prudential regulation where the former is more stringent than the latter. Prudential regulation is “aimed specifically at protecting the financial system as a whole as well as protecting the safety of small deposits in individual institutions” (Christen et al., 2003, p. 3). Non-prudential regulation on the other hand has a complementary role making sure financial institutions adopt appropriate business practices. It focuses on transparency and consumer protection through for instance a clear definition of interest rates and audited financial statements (Rosengard, 2011; Trujillo-tejada et al., 2015).

In microfinance, when regulation is warranted, it requires coherent prudential guidelines that will allow the growth of the microfinance sector while protecting the interests of small savers and supporting the integrity of the financial sector as a whole (Berenbach and Churchill, 1999). Basically, the regulation of the microfinance sector may be justified for a number of reasons notably the possibility for regulated MFIs to access other sources of funding through increased credibility and legitimacy. Indeed, a regulated MFI is perceived as more secure and trustworthy than a non-regulated one, with consumers feeling secured with the deposits and investors more attracted to regulated MFIs who demonstrate better accountability through proper and systematic reporting (Arun and Murinde, 2011). Also, regulation may allow to control opportunistic behaviour that may arise as a result of asymmetry of information associated with financial transactions carried out between the MFIs and the clients. Moreover, it can also be argued that regulation of microfinance as an external governance mechanism is necessary to ensure an effective governance of MFIs. Through regulation, MFIs are rendered

accountable and need to meet higher standards of control and reporting, thereby improving MFI business and operations. Consensus seem to have emerged that there should be a clear differentiation between the regulations to which are subject credit-only MFIs and deposit taking MFIs. Indeed, there is an agreement that as opposed to deposit-taking MFIs, credit-only MFIs should not be supervised on an ongoing basis due to the limited level of risks they pose to the individual clients and the industry as whole (Hartarska and Nadolnyak, 2007). As such, deposit taking MFIs should be subjected to both non-prudential and prudential regulation and supervision while credit-only institutions should comply only to non-prudential regulation. This has led to different approaches to regulating microfinance with a predominant use of the “tiered approach” by regulators where tiers are defined based on the products and services an institution offers (Ledgerwood and White, 2006). As an MFI graduate between tiers, it can offer more services and may have fewer or more restrictive regulations (Ledgerwood and White, 2006). This implies that, there is a need to adapt regulation to the specificities of the microfinance sector. Applying a broad regulation to all MFIs may repress the innovation and flexibility possible with the informality that characterizes microfinance institutions (Van Greuning et al., 1998). The danger is that, regulations designed for the risk profile of commercial banks may box MFIs into practices that require replicating traditional banking practices, thereby losing their ability to reach their target market (Berenbach and Churchill, 1999).

There are a certain number of empirical studies that have examine the impact of regulation in microfinance, particularly related to the profitability and outreach of microfinance institutions. We note Hartarska and Nadolnyak, (2007) who tried to determine whether the performance of MFIs is enhanced by the regulatory environment

by exploring the differences in performance between regulated and unregulated MFIs using data available from the MIXMARKET database. They found that regulatory status has no direct impact on MFI performance in terms of operational self-sufficiency and outreach. This goes in line with the findings of Mersland and Øystein Strøm (2009) regarding the impact of regulation on the performance of microfinance institutions. However, Hataraska and Nadolnyak (2007) found that MFIs with higher proportion of savings reach more borrowers, thereby suggesting an indirect effect of regulation on outreach if regulation is the only way for MFIs to have access to savings. Also, Okoye and Siwale (2017) found that the Nigerian and Zambian regulatory provisions on the boards of MFIs had a positive impact on the governance of MFI with the MFIs interviewed demonstrating established boards and board committees. However, the authors also point out that regulatory provisions with regard to board membership and diversity may not be beneficial to MFIs and thus limit the effectiveness of the regulatory provisions. Halouani and Boujelbène, (2015), in their study on the relation between external governance mechanisms and the dual mission of African MFIs, tested the hypothesis that regulation promotes the financial performance of MFIs but neglects the social needs of borrowers. Surprisingly, they found that in Kenya, despite the fact that their MFIs adopt mostly commercial legal forms, regulation had a positive and significant impact on the number of active borrowers and percentage of women borrowers. They also found that control by external audit, which is usually required for regulated MFIs, had a negative and significant impact on the financial performance of MFIs but positive impact on the social performance. This makes sense given the fact that external audit entails costs that directly affects the profitability of the institution. This is in line with Bakker et al., (2014) and Hartarska (2004) findings that regulation significantly predicts sustainability

in a negative way. However, external audits also control the opportunistic behaviours that MFIs may have towards their clients. The presence of a regulatory system that protects investors against expropriation attempts may have a disciplinary role on the behaviour of managers by limiting their opportunistic actions (Meagher, 2002). Similarly, Bassem, (2009) found that external governance mechanisms especially auditing and regulation improve the financial sustainability of Euro-mediterranean MFIs. Further, Cull et al. (2011) investigated the impact of prudential regulation on the profitability and financial sustainability of microfinance institutions. They found that regulation doesn't affect profitability but that the regulated MFIs were characterized by larger average loan sizes and less lending to women, suggesting a reduction in outreach to segments of the population that are costlier to serve. Thus, regulated MFIs may have to curtail outreach in order to maintain profitability. Moreover, in their study on the influence of regulation on the ability of microfinance to contribute to development in Bolivia, Bedecarrats and Marconi (2010) demonstrate that regulation in Bolivia adopted a dominant commercial approach which promoted profit oriented institutions and prioritize the stability and the profitability of the microfinance sector. This resulted not only in MFIs targeting in priority less risky clients with qualified collaterals but also in a regulatory framework not adequate for the specialized nature of the microfinance sector. This is in line with Halouani and Boujelbène, (2013) who found that microfinance institutions which were sustainable and regulated demonstrated mission drift through higher average loan sizes. Thus, regulation tend to influence the emergence of the development of microfinance institutions into self-sustaining and commercial MFIs or reinforce commercial based practices without taking into account the social dimension of the activities.

Despite the number of studies that have been conducted on the issue of regulation in microfinance, there are still limited empirical studies that examine microfinance regulation in most developing countries (Anku-Tsedde, 2014; Okoye and Siwale, 2017; Ayayi and Peprah, 2018), including Cameroon. Also, questions related to the role played by regulation in the increased profit orientation of microfinance institutions has been left aside. Indeed, the role of regulation aimed at ensuring the financial sustainability of microfinance institutions may push these MFIs to resort to practices targeted towards maximizing profits at the expense of the financial inclusion of the poor (Gallardo et al., 2005; Khachatryan and Avestiyan, 2017; Siwale and Okoye, 2017). This suggests the relevance of studies that will focus on the perceptions of MFIs with regard to the effects of regulation on their microfinance activities as it may help regulatory authorities to review their policies in order to accommodate the needs of the microfinance sector.

3. Methodology

The purpose of this study is to explore the role played by regulation in the development of microfinance in Cameroon. To achieve that objective, between September 2017 and January 2018 we conducted an exploratory qualitative study based primarily on semi-structured interviews with microfinance practitioners and regulators from the ministry of finance in Cameroon. Participant MFIs were located in the two largest cities of Cameroon and were purposively selected based on the desire to get the views of a diverse range of MFIs. The sample was composed of cooperative MFIs and shareholder-owned MFIs because they account for the majority of MFIs, the other category of MFI, that is credit-only MFIs, being limited to two or three institutions. Interviews were conducted with 27 managers and directors from 23 MFIs, and six

regulators. Separate interview guides were developed for the MFIs and the regulators. During interviews, we were interested in knowing participants' perceptions with regulations and its implications for the MFIs and the microfinance sector in general. The interviews also aimed to gather information about the evolution of regulation in the country. The interviews were recorded, transcribed verbatim and subsequently analysed to identify the key themes in the data that can be used to describe and explain the phenomenon being studied (Miles and Huberman, 1994). Specifically, during the analysis of the interview data, we coded the data with the main objective of identifying the main regulatory changes that has happen in the microfinance sector over the years and the regulatory challenges faced by MFIs in their everyday activities. We also draw on secondary data such as articles, reports, obtained from regulators and relevant websites, to complement our findings on the history and evolution of the microfinance sector in Cameroon. From our analysis of the data emerged four phases or temporal brackets (Langley, 1999) in the history and evolution of the Cameroonian microfinance sector. The temporal bracketing strategy allow us to see how the actions of events that happen in one phase led to changes in the context that later on affected actions in subsequent phases (Langley, 1999). In our study, we observed how the evolution of activities of the microfinance sector over the years led to changes in the regulatory environment through the establishment of new regulations. As such, major regulatory changes over the years was the point of departure for each phase. Also, analysis of key themes in the data enabled us to identify four main regulatory challenges faced by MFIs as they attempt to achieve their social mission.

4. Findings and discussion

In this section, we present and discuss the findings of this study. We first present the evolution of the microfinance in sector in Cameroon and then discuss the perceptions regarding the effects of regulation on the activities of MFIs.

4.1 History and Evolution of microfinance in Cameroon

Over the years, as the sector developed and expanded with an increasing number of MFIs and clients, there was a number of governance failures which prompted the regulators to progressively amend the regulatory norms, and thus changing the landscape of microfinance in Cameroon. In this section, we will attempt to trace the evolution of the Cameroonian microfinance sector guided by the major regulatory changes that happened in the sector during the past years. As pointed earlier, our analysis of the interviews and secondary data allowed us to identify four main phases.

The first phase corresponds to the emergence of the microfinance sector through the law on cooperatives that led to a surge of cooperatives who were supposed to respond to the needs of the poor, excluded by banks, to have access to formal financial services. The second phase correspond to the formalization of the microfinance sector, with the introduction of an actual microfinance regulatory framework. In the third phase, the expansion of the microfinance sector coupled with the governance failures that characterized a good number of MFIs led to increasing formalization of the sector through the tightening of the regulations. This ultimately resulted in the revision of the microfinance regulatory framework, which constitute the fourth phase. It is important to note that our intention here is not to be exhaustive but to point to major regulatory changes in the Cameroonian microfinance sector over the years.

Phase 1 (Before 2002): The development and burst of cooperatives - the laws on associations and cooperatives

The creation of savings and loans cooperatives first started in Cameroon in 1963, with CAMCULL¹, which is in 2018 the largest network of cooperatives in the Country. Before that, has always existed tontines. Tontines are informal associations in local areas, through which people borrow and save money. The creation of cooperatives marked the first step towards the formalization of inclusive banking. The first cooperatives were, for most of them, agricultural cooperatives. This is the reason why they were under the supervision of the ministry of agriculture and not the ministry of finance that supervised banking activities. In addition to supervising them, the ministry of agriculture sometimes provided the cooperatives with funds that the MFIs later on redistributed at low rates to their members who were farmers or breeders.

“At the beginning when MFIs was developing, it was the ministry of agriculture that was dealing with them...since it was agricultural cooperatives, rearing, farming, that was that at the beginning, that’s even how microfinance emerged. There was a need to finance those activities and the ministry of agriculture was doing that.” (Regulator 6)

Through these cooperatives, the Cameroonian government wished to develop the agricultural sector on which a greater part of the population relied on. These cooperatives

¹ The network started in 1963 as a credit union named “the St. Anthony Discussion Group” located in a small village called Njinikom. Then, the founder progressively spread the credit union idea, creating other credit unions in neighbouring villages. In 1968, the cooperative network was officially established as WCCUL before changing its name to CamCCUL in 1973. (source: GM’s conference presentation, WOCCU, Glasgow, 2011)

not only proved to be useful for local development but also became of utmost importance given the banking crisis in the late 80's and early 90's that resulted in banks closing their branches in rural areas. To further promote cooperatives, the government established the laws n°90/053 of December 1990 and N° 92/006 of august 1992 regarding respectively freedom of association, and cooperatives and common initiative groups. The law n°90/053 authorizes saving and loans activities to association and cooperatives, and the law n° 92/006 focus specifically on the case of non-bank institutions engaging in financial intermediation, notably saving and loans cooperatives. The creation of cooperatives was no longer conditioned by an authorization of relevant authorities but by a simple registration to the ministry of agriculture (Mayoukou, 2000). Also, cooperatives could now be independent and were no longer required to be affiliated to CAMCULL (Mayoukou, 2000). These laws were at the origin of the surge of financial cooperatives. Indeed, many of the cooperatives created after the implementation of these laws used to be tontines. These tontines seized the opportunity offered by the new law to formalize their activities. This was, for instance, the case of one participant MFI, which started as a tontine:

“When we talk of creation, I am one of the members that created, it started as a tontine...we always had treasury problems...well the government had already launched this opportunity to create credit unions. At the time, it depended on the ministry of agriculture, so we asked the registration of the coopgic (cooperatives and common initiative groups) and we created the cooperative.” (Founding member, MFI C)

The government through the two laws had facilitated the creation of financial cooperatives, demanding little requirements with the objective of increasing access to

financial services to those in the agricultural sector who were mostly excluded from the financial system. This was the first milestone of the microfinance movement. Cooperatives were legally allowed to provide savings and loans to the people at the margin of the traditional financial sector. COBAC report in 2000 pointed to 652 MFIs in the Cameroonian microfinance sector (Creusot, 2006).

“After the two major laws were established in the 90’s, there was an abundance of microfinance activities, there was no intervention of the ministry of finance at the time. To create an association, you just needed to go and do a declaration at the prefecture, for the cooperatives, you needed to declare to the ministry of agriculture, after which the cooperative acquired a legal status”. (Regulator 1)

However, with this burst of cooperatives facilitated by the laws on associations and cooperatives, previous bankers and businessmen from diverse sectors saw it as another business opportunity to make money. Newly created cooperatives and even existing ones started engaging in activities that resemble those of banks, opening branches across the country and providing financial services to the general public rather than only to their members, the people excluded from the financial system. This period also saw the emergence of another form of microfinance institution that attempted to function like banks, by providing loan and savings services to the general public, without necessarily having the requirements to do so. This new type of institution was not functioning like cooperatives as per regulation and this prompted the government to issue a decree in 1998, that placed MFIs under the supervision of the ministry of finance (MINFI).

“Over the years, we noticed that these cooperatives were involved in savings and credit activities which was not under the control of the ministry of finance. So, we decided that if you are an agricultural cooperative, then you can stay under the

control of the ministry of agriculture, but in other cases, you were under the supervision of MINFP". (Regulator 1)

Moreover, as these new types of institutions fitted nowhere, neither as cooperatives nor as banks, no rules were governing their activities. During this period, many of those institutions engaged in risky practices endangering the entire financial sector and there was lack of control by relevant authorities. There were cases, for instance, of institutions practicing levels of interest rates on loans up to 78% per annum (Fouda Owoundi, 2010), resulting in high delinquency rates. Another regulator explained:

"When the government found out that the microfinance phenomenon was gaining momentum, that they (MFIs) even went beyond agricultural activities, were already financing SMEs, it became necessary to pay more attention, but damages had already been done". (Regulator 6)

Witnessing the increase of fraudulent cases and the apparent disorder and lack of professionalism that characterized the microfinance sector, the government decided to take some measures to establish some order in the industry. It became imperative to account for all the forms of microfinance institutions regulatory wise and strengthen the control and supervision of the microfinance sector (Creusot, 2006). This led to the establishment of the current microfinance regulatory framework and mark the start of the second phase of the development of microfinance in Cameroon.

Phase 2 (2002-2008): The introduction of the microfinance regulatory framework

As pointed above, the microfinance law came as a response to the challenges the government faced with regard to the activities carried out by cooperatives. The ministry of finance, in charge of supervising MFIs since the 1998 decree, started to work with the

Central African banking commission (COBAC). From this collaboration, a new law (n° 01/02/CEMAC/UMAC/COBAC) emerged in April 2002. It regulated the conditions of exercise and control of the activities of microfinance in the Central African Economic and Monetary Community (CEMAC) region. This law formally recognized the concept of microfinance and defined it as “an activity exercised by licensed entities which do not have the status of bank or financial institution and which regularly offers specific financial services including credit services and/or savings services to population that have been excluded from traditional banks”. The regulation distinguished three categories of MFIs: category one composed mainly of cooperatives and mutual associations that offer financial services only to those that become members of the MFI; category two are public limited companies that offer specific financial services to the general public; and category three MFIs that are credit-only institutions. The law was ratified by the seven CEMAC countries, and COBAC was in charge of supervising the microfinance sector in all seven countries. However, the execution of the control and supervision mission had been delegated to the ministry of finance in each of the countries. One regulator explains the respective roles of COBAC and the ministry of finance:

“In terms of supervision, we are talking more about oversight here. Oversight is primarily the responsibility of COBAC, who exercises more of a prudential oversight. The MFIs send documents to the COBAC through the Sesame (online platform) and from there the COBAC can detect the anomalies relative to the respect of the prudential norms, then correct. We at the MINFI, we monitor daily, users come to see us if they cannot withdraw their money and then we go on the field to control. Observations made on the basis of the controls carried out are transmitted to the COBAC.” (Regulator 1)

The regulatory framework aimed at directing the actions of practitioners in the microfinance sector and addressing the increasing risky practices that accompanied the expansion of the microfinance sector. This new regulation resulted in the closure of many cooperatives that were not in accordance with the law. Data collected by the ministry of finance between December 2004 and April 2005 pointed to 558 MFIs as opposed to 652 in 2000 (Creusot, 2006). With the new regulation, all MFIs needed to be licensed and a minimum capital requirement was imposed on category two and three MFIs. A regulator pointed:

“The microfinance boom originates from the banking crisis. It is those (banking) executives who all migrated to the sector and then arise the dysfunction that happened. And the regulation has made it possible to refine the number of MFIs.”

(Regulator 3)

Given the fact that MFIs were providing financial services as banks, but on a smaller scale, the 2002 regulatory framework has defined 21 prudential norms including norms related to capital adequacy, liquidity, and portfolio quality. MFIs were given five years to conform with the prudential rules. Just after the 2002 microfinance regulatory framework, a new professional association was created for MFIs: ANEMCAM. The purpose of this association was to defend the interests of the microfinance profession and all MFIs were required by the 2002 law to be member of the professional association of microfinance institutions of their country.

Despite its shortcomings, the 2002 regulatory framework served as a basis for structuring the microfinance sector. As one regulator summarized:

“The 2002 regulation achieved its objectives in a general sense, globally to a certain extent. There was a clean-up of the sector, this regulation remains

perfectible. But again, fewer and fewer cooperatives are closing, it (regulation) professionalized the sector.” (Regulator 1)

Phase 3 (2008-2016): The Tightening of regulations

During this phase, additional laws for MFIs were introduced with the objective of further formalizing the activities of the MFIs. Indeed, the microfinance sector remains weak with an extremely high average rate of outstanding payments, excessive exposure to related parties, ongoing liquidation of some MFIs, triggered by severe governance problems that are affecting thousands of low-income savers (IMF, 2016). Our analysis of the data revealed three important laws that were implemented during this period.

The poor governance practices that characterized the microfinance sector pushed the government to pass a new law in 2008 (Law n° 04/08/CEMAC/UMAC/COBAC) to stimulate best practices in terms of governance of microfinance institution, particularly regarding the characteristics and functioning of the board of directors.

In 2010, following the guidelines of the OHADA² law on commercial enterprises and economic interest group, COBAC established a regulation with regard to the accounting plan of MFIs. This meant that MFIs, were now required to establish their mandatory declarative statements and annual accounts in line with the accounting plan of MFIs that was established in 2010. These reporting requirements was to ensure uniformity of the account statements across MFIs.

Moreover, in 2014, the regulatory bodies established the law n° 02/14/CEMAC/UMAC/COBAC/CM relative to the treatment of financial institutions,

² Organization for the Harmonization of Corporate Law in Africa, which governs the creation, organization and functioning of MFIs having the status of public limited companies.

including MFIs, in difficulties in the CEMAC region. This law came as a response to the fact that a good number of licensed MFIs were experiencing financial difficulties, with some large MFIs being under temporary government administration. Indeed, at the end of 2009, three microfinance providers were placed under government administration and more institutions were in critical situations and compelled to submit recovery plans to the regulator (CGAP and MIX, 2011). There was a need to pave a way forward to those kinds of situations regulatory wise.

“As soon as there was a problem, COBAC established an instruction to respond to this problem. For example, they issued a regulation for institutions in difficulty for banks, but it is applicable to MFIs.” (Regulator, 1)

In sum, the number of MFIs kept increasing but a large number of them were adopting poor governance practices putting at risk their financial stability. This motivated the regulators to progressively tighten regulation over this period and proceed to major license withdrawals between 2011 and 2013 due to non-respect of regulation or bankruptcy.

The changing microfinance environment in addition to the limited resources of regulators given the high number of MFIs to be supervised (IMF, 2016) ultimately resulted in regulators undertaking actions to amend in a substantial way the 2002 regulatory framework.

Phase 4 (2016-): The revision of the 2002 regulatory framework

After more than ten years of existence, the 2002 regulatory framework became obsolete. Developing complementary laws was no longer enough. The regulatory framework needed major changes. In 2016, COBAC launched a significant revision of

the 2002 regulatory framework to match the realities and evolution of the microfinance sector. In November 2016, a concertation was organized between the regulators (MINFI and COBAC), ANEMCAM, and representatives of MFIs. They discussed the potential changes that could be made to the regulation to enhance its effectiveness.

A new regulation was adopted at the end of 2017 and was supposed to be implemented on January 1st, 2018. The new regulation emphasizes the need for MFIs to be financially sustainable as they want to avoid the numerous bankruptcies that had happened in the past. For instance, one of the major regulatory changes is relative to the minimum capital requirement which will increase from 50 million to 500 million CFA francs for the second category. The second category MFI particularly, proved to be vulnerable to shady businessmen who saw microfinance as a profit-making business and could easily come up with the 50 million CFA francs.

“At 50 million, there were too much adventurers, a person or a group of persons could decide to gather 50 million, create an MFI and after collect the public’s savings up to 150 million, then close and go with the money of the savers. Technically, we could say that he realized a profit of 100 million, you see.”
(Regulator 1)

This view is shared by microfinance practitioners. One of them noted:

“The new rules that are coming into play will do more to get out all the adventurers, the black sheep of the sector” (Strategy director, MFI L)

Other major changes include, but not limited to, the fact that the first category MFIs will only be cooperatives or mutual societies. Associations will no longer be allowed in microfinance activities. All cooperatives will be required to belong to an

umbrella organization. The objective is to mutualise and minimize risks since umbrella organizations have a supervisory role towards their affiliates MFIs.

To further consolidate the microfinance sector, the regulatory bodies have been working over the years on the establishment of a credit reporting system. This is a database that will make it possible to register all the borrowers in the financial sector. This credit reporting system became operational end June 2018 and is supposed to help reduce credit risk and over-indebtedness in the microfinance sector. Indeed, without the credit information bureau, MFIs were not aware of the credit history of a new borrower, which resulted in some borrowers being able to take multiple loans from different MFIs or banks. This database will help prevent that and bring in some stability in the sector.

At the time of writing this article, the new regulatory framework was not yet implemented and still other measures were being undertaken or were under study including the reduction of the number of prudential norms (from 21 to 11) and the setting of a formal effective interest rate. These measures have for main aim of both ensuring the financial stability of the microfinance sector and promoting the financial inclusion mission of MFIs. As one practitioner summarizes:

“The regulation of microfinance in Cameroon is evolving and in the current state, we are preparing for a new law that will for example cap credits to 50 million, which will set an effective interest rate for microfinance that is not yet in application. It's evolving, at the beginning we had nothing, there are already some first rules that are established but there are the new laws, they sent us the drafts for proofreading, so that we know, so that we start to prepare for the transition. But we think that the law that is coming will be much stricter, protects more consumers but at the same time professionalizes the sector because there are

MFIs that give credit to a single individual 250 million, that's no longer microfinance, that's banking.” (Marketing director, MFI D)

To sum up, the regulation of the Cameroonian microfinance sector has been evolving over the years with the regulators trying to control and supervise more the field as they become familiar with the peculiarities of the microfinance sector. The main objective being to avoid failures of the past through a stricter regulation while also ensuring that MFIs can achieve their financial inclusion mission. The main events in each phase are summarized in figure 1. Although the regulation has progressively clean up and professionalized the microfinance sector, there remain areas of concern regulatory wise that constraints MFIs as they attempt to achieve their social mission. The purpose of the next section is to discuss the perceptions of respondents with regard to how regulation affects the ability of MFIs to fulfil their social mission of financial inclusion

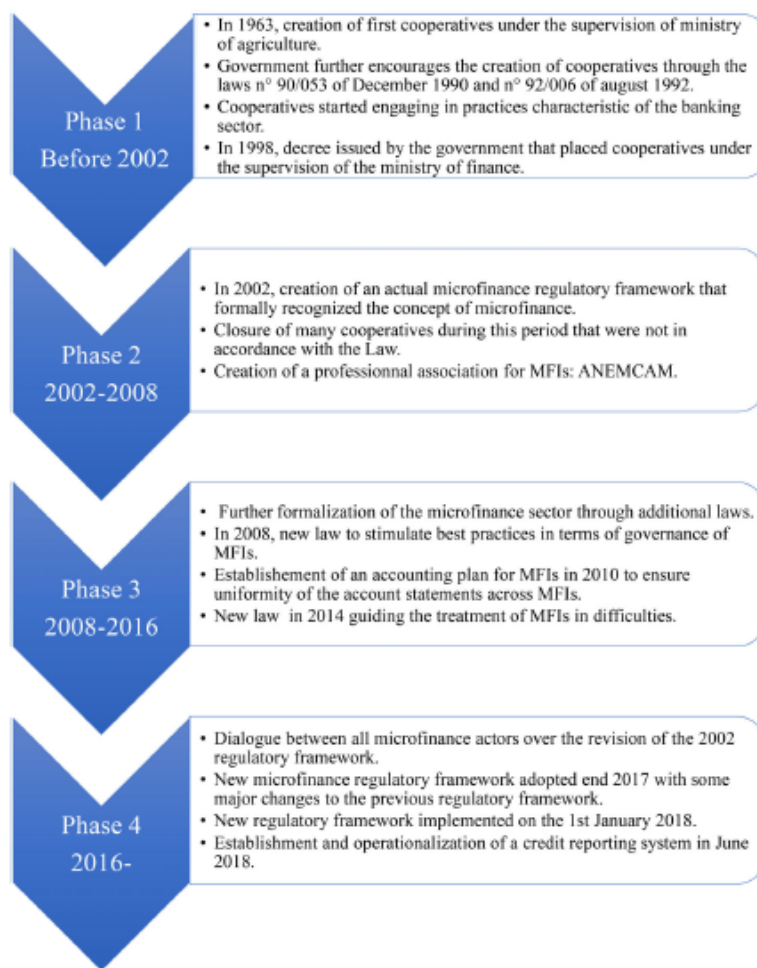


FIGURE 1 Main phases and events in the evolution of the Cameroonian microfinance sector [Color figure can be viewed at wileyonlinelibrary.com]

4.2 Microfinance regulation and financial inclusion

This section presents and discusses the perceptions of the participants on the effects of regulation on their activities. From the analysis of our data, we identified four key issues regulatory and supervisory wise that may have detrimental effects on the ability of MFIs to effectively serve the poor.

Board members' qualifications

Bad governance practices at the origin of failures in the microfinance sector was met with stricter rules with regard to board members' qualifications.

“Because just recently COBAC decided that all board members have to be authorised, so you do not just appoint any board member, now COBAC won’t accept that if the person don’t have the qualification or experience to become a board member. So that was one of the problem that all institutions had and which I think now COBAC is trying to rectify” (Credit director, MFI I)

This change was highly criticised by practitioners of category one MFIs. They argued that their board members ought to be representatives of their target clientele, that is mostly small petty traders who did not necessarily went very far in terms of education. The high qualification requested by law represent a complete different part of society. As pointed by the CEO of MFI T:

“And then, the law even requires that board members have a certain qualification which is an abuse because normally in a cooperative, a board member is not necessarily one who has a PhD because the problems, normally in a cooperative all sectors of activities should be represented on the board. We do a lot more of micro-businesses, petty trading and we should have for example representatives of buyams sellam but the regulation says there should be more and more people who have a certain qualification to be on the board. But it is a drift of the cooperative mission.” (CEO of MFI T)

According to the regulators, the lack of qualification of the board members of some MFIs is the cause of the poor governance and risk management practices as they do not have the capacity to properly monitor management. Ensuring a minimum level of qualification would prevent problems and help financial stability of the MFIs. As pointed by one regulator:

“The capital providers without the ability to manage the MFIs will end up managing them simply because they are the ones who brought in the money. We will find boards where it is traders or I do not know what who are members, ignoring the role of that is attributed to the board. the MFI can take a competent CEO but who can dupe them because there is no one on the board with the necessary skills to exercise control.” (Regulator 1)

The argument of regulators may be valid on a certain point as regulators need to consider the quality of proposed managers and board members, and their capacity to administer and govern a regulated microfinance institution (Berenbach and Churchill, 1999) so as to avoid bad governance issues and mismanagement practices. However, the regulation relative to board member qualifications may negatively affect the performance of category one MFIs where board members are important resource providers. Indeed, the essence of a cooperative rely on members knowing each other with existing members bringing in new members. These members feel safe and confident of their MFI when they know there is someone they elected that represent their interests on the board. It's in this atmosphere of trust that the MFI can achieve high repayment rates despite the fact that most of the loans are granted without proper collateral. So, requiring board members of cooperatives to have a certain educational level may actually impede these cooperatives from achieving their financial inclusion or even the poverty alleviation mission. The opinion of the MFIs goes in line with Vogel and Schulz (2011), who reported in their study that some of the credit unions disagreed with the application by regulators of “fit and proper” rules for board members and other high-level credit union officials, given that the democratic ideal of credit unions wants that no members be excluded from these important positions.

Loan documentation requirements

Informants reported that regulation requires from them to take secure guarantees from borrowers to cover the loan in case of default. The credit director of an MFI explains the difficulties she faces daily when handling loan files of clients that don't have appropriate guarantees:

“I will take a simple example right, let's say MFIs and other banks had almost the same regulation like one of the characteristics of MFIs is the fact they finance small enterprises and small enterprises will actually mean people that do not have guarantees for example. They don't have guarantees to present for a loan but COBAC expect us to only give loans to someone that has a guarantee. So, you see that it just actually blurs out what microfinance is all about. So, it starts right from there, and then you realise you have to comply to what they are asking and then you are asking a customer guarantee, that customer that do not have guarantee will go back home whereas that is the person you are normally supposed to serve, you understand. In places like India, the Asian countries they have understood the concept better, and they know how to deal with it, we don't unfortunately.” (Credit director, MFI I)

Another practitioner pointed:

“As the days are going ahead, that's how laws are coming out to actually force the credit unions, my office in particular, to deviate from its original purpose of helping everybody that belongs here. Because now, here it is very very difficult for a lay man to have credit from my bank. Why? Because of the need for what, collateral security, and that in itself is an issue that has cost so many of my

members not to have access to that credit because most of them do not have what to present here as collateral for a loan. You have a case whereby a member has a very good financial capacity but he has nothing to give you, place aside as collateral and as of now, we are not allowed again to give credit that is not completely secured, 100% secured.” (Branch manager, MFI S)

As demonstrated by the quotes above, the regulatory constraints in terms of collateral requirements may actually push MFIs to deviate from their original target. However, the bad faith that characterizes a certain number of microfinance clients puts greatly client savings at risk if these savings are intermediated to borrowers without requiring a guarantee. With the objective to protect clients' savings and reduce credit risks, regulators have imposed a number of rules relative to guarantees. If those rules would be adequate in the mainstream financial sector, they are not in microfinance. Microfinance's clients are, normally, poors who do not have material guarantees. Therefore, asking for material guarantees reflect a lack of understanding of the microfinance field. Credit risk is generally mitigated through social or psychological pressure. This resonates with Meagher (2002) who puts into question the rationale for documentation requirements, given the fact that MFIs would normally have an incentive to use the types of documents that best ensure repayment. Regulated MFIs subjected to minimum loan documentation requirements find it expensive and time consuming for efficient and effective micro lending activities (Satta, 2004). As a result, loan documentation requirements for MFIs needs to be differentiated from those of banks since as opposed to banks, MFIs handle small loan sizes with short terms to maturity. Indeed, Rhyne (2002) argues that some of the best practices of microfinance conflict with standard banking regulations to which most regulated MFIs are subject to, notably

increased loan documentation requirements not suitable for informal business and the non-recognition of standard forms of guarantee used in microfinance, such as group guarantees or non-standard collateral. Thus, requiring specific loan documentation may exclude the target clientele of microfinance thereby restricting the outreach of MFIs.

Provisioning and Liquidity requirements

Informants reported being greatly affected by the loan loss provisioning and liquidity reserves which they find difficult to comply with, since it implies keeping money aside whereas this money can be given as loans, and thus earning money. As pointed by one branch manager:

“The highest difficulty we face in this business is the issue of provision of bad debts. Even from my way of presentation, you will come to discover that, most of the loans that we give out here in this set up are not very very secured per se like in the other commercial banks. And as such, we end up provisioning most of those loans, most of what we collect as interest we end up cuffing it again as provision for bad debts.” (MFI S)

Indeed, regulated institutions are generally required to make high levels of provisioning and this has an effect on their cost of lending and interest rates (Ayayi and Peprah, 2018). High costs of operations are translated into higher interest rates which reduce accessibility of microfinance services to those who are not able to afford the interest rates. For this reason, some of the informants admitted ignoring sometimes the rules in order to be able to achieve their financial inclusion objective.

“Meaning that if you look at my portfolio, its not actually in accordance with what the government expect me to do. There are difficulties at the lending department,

even at the level of liquidity issues. We are expected by law to hold at least 30 percent of our balance sheet as typical cash, but in terms of difficulty it's something that at times, its not very attainable. Because, when you look at that idea of matching up your expenses with your income and you think of it and also given the minimum, that is the small interest rate that we collect from our members, and you think of stocking that amount of money in the bank somewhere to just lie there idle without doing anything, it actually doesn't make sense. It doesn't sound like business at all, so most at times, we are forced to go below what they expect". (branch manager, MFI S)

Portfolio risks is inherent to microfinance institutions due to the nature of their loan portfolios which are more volatile since mainly composed of unsecured loans or loans backed-up by unconventional collateral that may be difficult to enforce legally. This may explain why regulators usually poses limits on the amount of unsecured loans in an MFI's portfolio and require their provisioning. However, high loan loss provisions are not appropriate for microfinance, who mostly have uncollateralized loan portfolios, since the requirement may render micro-lending impractical. The accumulated charge (as a result of the provision expense) for current loans would produce a massive under-representation of the MFI's real net worth (CGAP, 2012). This may thus penalize MFIs which have to include additional provisions in their expense statements. In addition, as the quote above indicates, MFIs are also subjected to higher reserve requirements to guard against liquidity risk. Indeed, liquidity risk in MFIs is higher than normal in financial institutions because of the strong contagion effect of repayment problems in the microfinance market (Meagher, 2002). Thus, MFIs are required to hold a certain amount of deposits as reserves. The reserve obligations earns little or no interest thereby affecting

the profitability of MFIs since the money could be used elsewhere (Lhériaux, 2005). Also, if set too high, the reserve requirements can come at a cost because the available resources are held as idle funds instead of investing them in earning assets (Braun and Hannig, 2006) or distributing them as loans to the poor.

Insufficient supervision

Considering that regulation and supervision goes in pair, it seems logical that supervision came up as major issue during the interviews. The MFIs essentially pointed to the limits of regulators with regard to the supervision of the microfinance sector. They don't seem to understand how despite the reporting requirements they fulfil, there is still some MFIs closing and the presence of unlicensed MFIs in the sector. The fact is, there are many MFIs operating without a proper license and those MFIs that even possess a license fail to display their license number and corresponding category. This contribute to the confusion that exist in the sector between category one and category two MFIs where the former engages in activities strictly reserved to the latter without being authorized. Category one MFIs engaging in the activities of category two without them having the necessary capacity is part of the problem that lead to the failure of these MFIs. The closures of MFIs actually undermine the public's trust with regard to the microfinance sector and thus makes it difficult for those MFIs who really want to sustainably provide financial services to the poor. One branch manager noted:

“they don't even trust MFIs anymore because those opening microfinances now are adventurers as well, they come to mobilize customers' funds and run away because that's what happens but where are these regulatory bodies, what are they doing, microfinance close every day and the public they are dying everyday with

frustration. Dying of heart attack because they kept money and the next day is not there, so they need to review that.” (Branch manager, MFI J)

The branch manager further added:

“people don’t trust microfinance anymore, why, it’s because there is no regulation now anybody can get a license that’s why anybody, some people even exist without license; so that’s why it’s making the sector even more feared, that’s not supposed to be like that. Those, there are people that really want to do business, they really want to do banking but the others are just tainting the name otherwise.” (Branch manager, MFI J)

The practitioners not only point to the limited number of regulators when compared to the large number of MFIs, but also to the inexperience of the regulators who they argue don’t usually know what microfinance is all about, leading to insufficient and probably ineffective supervision. One practitioner pointed:

“And then for the COBAC to come back in the same MFI after a control, I think we have to wait even 5 years. For some, COBAC never go to control. Yet the work of COBAC as a gendarme, as a regulator is highly important. So, my perception shows that there are texts that are pretty good but the means of implementation are slow.” (Legal Director, MFI D)

Similarly,

“believe me there are some people that work at the banking commission, there are some people that are sent out as administrators whereas they do not know microfinance.” (Credit director, MFI I)

The regulators on their side acknowledge the necessity to increase supervision so as to further limit the risky practices in the sector. But they point to resource constraints,

which particularly affect onsite supervision. So, availability of resources and other factors such as complaints from clients, donor organizations, newspaper articles constitute the criteria for onsite supervision. Our findings resonate with past research that has pointed that in developing countries, regulatory authorities lack a clear understanding of microfinance methodologies and a requisite staff to carry out effective supervision (Brownbridge and Kirkpatrick, 2000; Gallardo, 2005). For this reason, regulators face enormous challenges when it comes to supervising the microfinance sector (Okoye and Siwale, 2017; Chaves and Vega, 1992). Also, our findings suggest that it is the insufficient supervision in the sector that has resulted in the growing lack of trust in the microfinance sector. And this greatly affects the ability of MFIs to achieve their financial inclusion mission because every time they go towards a potential client, the latter has a negative perception of MFIs may be due to what the client has heard from others or due to the negative experience the client had in the past with an MFI who closed. The Strategy director of an MFI explained:

“if you do a survey of the population, the major part don’t really have trust in microfinance anymore. Why, because they say they can close overnight because there have been black sheep in the past who joked with the public’s money, including money from savers. It has tarnished the image of microfinance, and I think it is on that basis that they are changing the regulations.” (MFI L)

Similarly, the CEO of MFI R pointed:

“it is true that the state gendarme should also be more present on the ground and when an MFI opens without being approved, they shouldn’t let her evolve. Well, the state should do it because we still see MFIs that evolve two, three years before they are given an injunction to close but why wait two or three years. If the state

was more present on the ground, then quickly he would see that and the microfinance sector today is totally handicapped by that. Because when we approach people, "oooh microfinance, no no, do not talk to us about microfinance, you open today, you close tomorrow". So, black sheep did that." (CEO of MFI R)

In summary, analysis of our data suggests that insufficient supervision led to an influx of private individuals adventuring themselves in the microfinance sector with the hope of making money while escaping to the supervision of overburdened regulators. It becomes crucial for regulators to not only adopt a more conservative regulation with regard to entry requirements but also to increase their supervisory capacity so as to ensure the sustainability of the microfinance sector.

5. Conclusion

Due to its specific methodology in terms of group lending models, mobile and decentralized structures, focus on women as clients (Hudak, 2012), microfinance presents itself as a useful tool that offers the possibility to cater for people that have been excluded from the traditional banking sector in a sustainable manner. Regulation plays an important role in the development of microfinance (Arun and Murinde, 2011) but in order for the regulation to be effective, it needs to be appropriate for the microfinance sector and matched with sufficient supervision. The findings of this study have shown that there are specific regulatory aspects that poses a great problem to participant MFIs as they seek to achieve their financial inclusion mission. This suggests that regulatory requirements that don't account for the specificities of the microfinance sector put MFIs in an odd position between increasing outreach to the excluded or strictly respecting the regulation. In this regard, the microfinance regulations in Cameroon may have encourage a

commercialization process that have pushed a great number of MFIs to focalize on financial performance. One may argue that MFIs offer similar services as banks, although limited to a certain level. But the requirements that are applicable both to banks and MFIs create serious challenges for the MFIs who find it difficult to provide loans to the poor with all these stringent regulations which they feel are not adapted to the activities of microfinance. Meagher (2002) argued that applying standard banking regulation and supervision on MFIs without modification will result in ineffective and overly burdensome requirements for the MFIs. This was the case in Siwale and Okoye's (2017) study that demonstrated that existing regulations in Zambia particularly were too similar to banking laws in such a way that they negatively affected microfinance outreach. Indeed, too strict regulation may lead to a drift in the social mission although it guarantees the savings of the clients and probably a better financial performance on the part of the MFI.

Over the years, the Cameroonian government, through its central bank and ministry of finance, have put in considerable efforts in developing the microfinance sector mainly due to its potential benefits in terms of poverty alleviation and unemployment reduction. However, more efforts still need to be done for the harmonization of the microfinance sector and the development of regulations adapted to microfinance methodologies. For this to be done, the regulators need to gain an in-depth understanding of microfinance in practice (Siwale and Okoye, 2017) so as to depart from that of the banking sector, and also mobilize the necessary resources to enforce the regulations. Indeed, the fact that microfinance institutions employ methods and adopt specific governance and ownership structure in order to cater for their specific clientele, distinguishes them from normal commercial banks in ways which are relevant from a

regulatory and supervisory standpoint (Cuevas, 1996). Requiring MFIs to comply to regulations that are similar to banks tend to make microfinance more of a business than a social venture. Inappropriate regulation tends to reinforce commercial based practices without taking into account the social dimension of the activities of microfinance (Halouani and Boujelbène, 2013). The new regulatory and supervisory framework that is under review may be a positive step towards achieving the goals of microfinance in the future. For instance, according to the regulators interviewed, with the new regulatory framework, maximum loan size will be set at 50 million FCFA. Previous regulation did not set a loan cap amount which allowed successful MFIs to continue serving their best clients as their financing requirements increase. Although this new rule will cut off prosperous MFIs from their most profitable borrowers, it will make sure that MFIs focus on their original target clientele and stop dealing with clients that can easily have access to banks. (Berenbach and Churchill, 1998). In this regard, future research should extend our study to examine the impact of the new regulations on the activities of MFIs and the microfinance sector in general. More specifically on how these new regulations contribute to the ability of MFIs to better achieve their financial inclusion mission while at the same time allowing regulators to achieve their prudential objective.

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