
**Transforming Microfinance Institutions into Regulated Deposit Taking Financial Institutions
Kenya: Does Legal Compliance Matter?**

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Abstract

For the first time, MFIs in Kenya received a legal framework within which to transform into regulated deposit taking microfinance institutions (DTMs) following the enactment of the Microfinance Act of 2006. Based on evidence from other countries like Bolivia and Peru, legal compliance is one of the major challenges faced by transforming MFIs. However, the available information is not conclusive on the significance of legal compliance for successful transformation. Thus, this study sought to determine the specific legal compliance challenges faced during the transformation of microfinance institutions in Kenya. The objectives of the study were to establish the extent to which legal compliance is a significant challenge in the transformation of microfinance institutions into regulated deposit taking institutions in Kenya and to make recommendations for successful transformation. This study used a mixed methods approach. The target population was the 48 member institutions of the Association of Microfinance Institutions of Kenya (AMFI). Using purposive sampling, the study selected 25 MFIs from which 100 respondents were selected through simple random sampling. A questionnaire and an interview schedule were used to collect data. Data entry, storage and analysis were done with the aid of the Scientific Package for Social Statistics (SPSS). The data was first explored for the underlying factor structure through factor analysis followed by descriptive and inferential statistical analyses. The study established a significant association between legal compliance and successful transformation in Kenya. It concluded that legal compliance was a significant challenge in the transformation of microfinance institutions into regulated deposit taking institutions in Kenya. This study recommends that transforming MFIs should first understand the entire licensing process to be prepared well to meet the requirements of each step and to deal with the challenges arising from an application for licensing and documentation, issuance of the license and fit and proper test. This study recommends further research to determine the impact of Microfinance regulation in Kenya; a study to determine the impact of transformation on overall financial inclusion and a study to compare the experience of non-transformed created DTMs and those that have transformed.

