IMPACT OF REGULATIONS ON CORPORATE GOVERNANCE OF MICROFINANCE BANKS IN NIGERIA

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Abstract

The microfinance banking sub-sector of the financial service industry play significant role in Nigeria's national economy. The focus on the regulations as a necessity for effective service delivery by the microfinance banks stems from the uniqueness of financial management function. Weaknesses in internal control systems, fraudulent practices and insider abuses are some of the problems in the micro finance banking sub-sector in Nigeria. This study sought to examine the impact of regulations and supervision on the leadership and operational practices in Microfinance Banks. This study adopted an exploratory approach using a descriptive survey which was conducted in Kaduna and Kano States of Nigeria. The study found that inadequacy of on-site supervision by the regulatory authorities affected efficient functioning of the Microfinance banks. Therefore, the study recommends regular inspection of the Microfinance banks by both the Central Bank of Nigeria and Nigerian Deposit Insurance Corporation.

Keywords: Working Capital Management, Financial Management, Deposit Mobilization Bank, Regulation and Corporate Governance

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Background to the Study

The microfinance banking system play significant role in national economies globally. As an essential sector in the financial service industry, there has been great concern on the corporate governance practices in microfinance banks because of large scale financial distress (Soludo, 2004). The experience of many countries in this regard shows that regulation and supervision are essential for stability in the Microfinance Sector.

In general, the banking sector has always received special attention in the area of safeguard measures because of the vital role played by banks in the promotion of national economies (Austin, 2006). Supervision and regulation of Microfinance banks entails not only the enforcement of rules and regulation, but also the assessment of the bank's assets and capital adequacy level. As noted by Ogunleye (2005) the Nigerian Deposit Insurance policy and the prudential guidelines were adopted to protect and enhance the asset quality of banks and reduce incidences of non-performing loans.

In Nigeria, regulation of Microfinance banks suggest some form of intervention in the bank's overall activities ranging from expressed legal control to informal moral-suasion by government through the relevant regulatory bodies (Nwankwo, 2011). As defined by Adesina (2010), regulation of banks is a body of specific rules or agreed behavior either imposed by government or by the institution implicitly or explicitly to limit the activities and operations of banks. In Nigerian situation, Adesina (2010) observed that these controls and regulations result in less efficiency in the management and allocation of resources.

The CBN Act of 1991 established the regulatory framework for the prudential control of banking for the following 22 years until it was superseded by the 1991 Banking and Other Financial Institutions Act (BOFIA). The prudential system was ineffective in preventing mismanagement and widespread fraud in the banking system for some reasons. Although the CBN was responsible for supervising banks, it lacked independence from the Federal Ministry of Finance (FMF), especially with regard to the licensing of banks (the authority for the granting of banking licenses was with the FMF until this was transferred to the CBN under the 1991 BOFIA, and the enforcement of sanctions when infractions of legislation were discovered. Political considerations, and a lack of technical and supervision in particular because many of the public sector banks were expected to follow development objectives (Christopher, 1994).

The Microfinance Institutions (MFIs) have faced major crisis in various parts of the world. The crisis experienced in the MFI sector in Nigeria in 2005, Nicaragua in 2008, India in 2010, Pakistan in 2010, Kolar in 2009 and in Bosnia and Herzegovina in 2009 all resulted in massive loan default by clients and eventual closure of some MFIs (Waithaka, Gakure & Wanjau, 2013). The impact of weak corporate governance practices in microfinance banks can be seen in decreased profit levels, high staff turnover and high capital expenditure (Mordi, 2010). The Nigerian microfinance banks policy (CBN. 2005) was targeted at creating an environment of financial inclusion to boost capacity of Small and Medium Enterprises (SMEs). This was expected to contribute to economic growth through job creation which would lead to improved standard of living and poverty reduction (NDIC 2010).

In Nigeria, microfinance banks are faced with problems of lack of savings and capital formation (Abereijo & Fayomi, 2005). These challenges have resulted in microfinance banks having greater difficulty in serving Small and Medium Enterprises (SMEs). As observed by Murdoch (2005), microfinance banks in Nigeria find it difficult to serve Small and Medium Enterprises (SMEs) because of high perceived risk, high transaction costs and lack of experienced personnel. The National Deposit Insurance Corporation (NDIC 2011) revealed that in 2010, out of 8,380 applications for loans received from Small and Medium Enterprises (SMEs) for a total of 559.13 million naira, the microfinance banks disbursed only 18 percent for a total of N46.66 million naira. The objective of the study was to examine the impact of regulations on the working capital management, deposit mobilization and financial management practices in Microfinance Banks.

Objective of the Study

The objective of this study sought to examine the impact of regulations and supervision on the leadership and operational practices in Microfinance Banks.

Role of Regulatory Bodies

Also the regulatory concern of the CBN was with ensuring compliance with the allocative controls, such as the sectoral lending guidelines, rather than the prudential controls. The allocative controls weakened loan portfolio quality by diverting loans towards non viable borrowers (Nwankwo, 2011). It is to be noted that in 1988 the NDIC was set up to insure the deposits (up to a maximum of N50,000 per account in 2010) of all deposit money banks, funded by a premium of 15/16 of 1% of total deposit liabilities of each as at 31st of the previous year (NDIC, 2010). NDIC in conjunction with CBN supervise financial institutions using on-shore and off shore surveillance and acts as a liquidation of failed banks.

As a result of some political constraints some banks decided to flout the banking laws. In 1989, twenty seven banks failed to meet the minimum capital requirements (Olowe, 2012). It was also clear that the restrictions on unsecured insider lending were flouted. The de factor liberalizing of licensing policy before prudential regulations and supervisory capacities were strengthened allowed under-capitalize and poorly managed banks to be set up in large numbers, and this contributed to the financial fragility which subsequently afflicted the banking industry.

The necessity for banking regulation in the economy has traditionally been justified by the need to correct market imperfections and unfair distribution of resources (Yigrem, 2010). Hence, the main objectives of such intervention: pursuit of stability, equity of resource allocation to SMEs sector and efficient use of resources. From this perspective, financial regulatory mechanisms and regulation of the Microfinance Banks in particular can be considered significant. Provision of financial and other services to SMEs is vital for economic growth of any nation (Adam, 2009).

Research Methodology

The study examined the impact of regulations on corporate governance of Microfinance Banks in Nigerian. Fifty five micro finance banks in Kaduna and Kano states were sampled for data collection. In addition to observation and interview techniques, questionnaires were designed and used as instrument for data collection. The data was analyzed using both descriptive and intervention statistics. A total of 130 questionnaires were administered out of which 102 were successfully returned. The success response rate represent 82%.

Working Capital Management

Result in Table 1 indicate that 92% (n=100) of the respondents agreed that Central Bank of Nigeria (CBN) had actually put in place regulations on working capital for the Microfinance banks. However, 8% (n=8) of the respondents believed otherwise. Furthermore, an overwhelming majority of those respondents 90% (n=90), who believed in the existence of the policy also agreed that it has enhanced service delivery to SMEs by the MFBs. Only 10% (n=10) held contrary view. On the part of those respondents that disagreed on the existence of CBN's working capital policy, 75% of them believed that this non-existence had significant negative impact on the service provision. Only 25% felt the negative impact was mild.

Table 1: Regulatory Authority's Response on Financial Management

		Count	%
Does the central bank of Nigeria have regulations on working capital for MFBs?	Yes	100	92%
	No	8	9%
If yes, how did this enhanced the MFBs services to SMEs	Greatly	90	90%
	Mildly	10	10%
if no, how did this affect service provision by MFBs?	Greatly	6	75%
	Mildly	2	25%

Deposit Mobilization

Table 1 contain results on responses regarding regulations for deposit mobilization. Asked on whether MFBs policy framework provides for deposit mobilization measures, 94% (n=102) attest to this provision, while 6% (n=6) felt otherwise. Similarly, 78% of those respondents that believed in the existence of the working capital provision also agreed that, it had facilitated extension of services to SMEs. Only 22% disagreed with this position. One-half (50%) of the respondents that held the view of non-existence of specific deposit mobilization measures also believed that this had no significant effect on service provision by the MFBs.

Table 2: Regulatory Authority's Response on Deposit Mobilization

		Count	%
Does the MFBs policy in Nigeria provides for deposit mobilization measures?	Yes	102	94%
	No	06	6%
If yes, how did this facilitate the extension of services to SMEs?	Greatly	80	78%
	Mildly	22	22%
If no, how did this affect MFBs service to SMEs?	Greatly	2	50%
	Mildly	3	50%

Financial Control Measures

Result in Table 3 contain responses from regulatory authorities on financial control measures in MFBs. Reacting to question on CBN's operational framework for MBF in relation to financial controls, 91% (n=98) of the respondents answered that CBN's operational framework for MFBs contain financial control measures. Only 9% (n=10) held an opposite view. Of the respondents that agreed on the existence of these measures, 91% (n=90) submitted that this had significantly strengthened the internal control systems in MFBs for enhanced service delivery. Only 9% (n=9) claimed that the effect on MFBs internal control systems was mild.

Table 3: Regulatory Authority's Response on Financial Controls

		Count	%
Does the CBN's operational framework for MFBs contain financial control measures?	Yes	98	91%
	No	10	9%
If yes, how did this strengthen the MFBs internal control systems for enhanced services to SMEs	Greatly	90	91%
	Mildly	8	9%

The results of this study regarding working capital management and deposit mobilization are consistent with results of a study by Ogunleye and Akambi (2014) who found that there was a low level of savings culture with microfinance banks in Nigeria. They attributed this to two factors, namely; low level of income, and low level of confidence of the savings public in Microfinance institutions. In Kenya, Abd Elrahman (2015) reported that there are primary and secondary legislation regulating the microfinance industry in that country. These separate laws were issued to promote microfinance in Kenya. Cassian (2008) found that Kenya government encourages the regulator to formulate a system that ensures standards of performance that assist the microfinance sector in moving from a less regulated sector to a tightly-regulated one.

Although, the Nigerian Monetary Authorities do have operational guidelines for the Microfinance Banks, a set of enforceable binding rules in the form of prudential regulations that governs working capital management, deposit generation and financial controls are essential. A study covering eleven (11) countries by Stefan (2003) showed that many countries are applying different preventive and protective regulations to ensure prudential financial management in Microfinance banks. It can be inferred that half hearted enforcement of rules had devastating consequences on microfinance bank in Nigeria. This view is supported by Omachonu (2009) who assert that weak regulations had negative effects on banks' ability to extend services to their clients in Nigeria. Adoption of sound system of regulations and supervision will minimize financial losses in Microfinance banks and ensure strong systems of financial management that will ensure effective service delivery to SMEs.

Data on table 4 indicates that p-value (0.041) is less than the chosen significant level of 0.05 implying that MFBs working capital adequacy is determined by the CBN's regulations on working capital.

Table 4: Chi-Square Test on CBN's Regulations on Working Capital

	Value	DF	Asymp. Sig(2-sided)	Exact sig. (2-sided)	Exact Sig. (1-sided)
Pearson chi-square	6.789	1	0.041		
continuity correction	2.111	1	0.256		
likelihood ratio	4.897	1	0.142		
fisher's Exact test				0.12	0.12
linear-by-linear association	5.767	1	0.072		
N of valid cases	108				

Data on table 5 reveals that p-value (0.031) is less than the significant value (0.05) signifying that deposit mobilization by the microfinance banks depends CBNs regulations.

Table 5 Chi-Square Test on Deposit Mobilization MFBs

	Value	DF	Asymp. Sig(2-sided)	Exact sig. (2-sided)	Exact Sig. (1-sided)
Pearson chi-square	6.079	1	0.031		
continuity correction	3.011	1	0.231		
likelihood ratio	4.258	1	0.112		
fisher's Exact test				0.332	0.332
linear-by-linear association	4.017	1	0.032		
N of valid cases	108				

Data on table 6 shows the independent sample t-test for the internal financial control measures in MFBs. It indicates that the p-value (0.010) is less than the significant value (0.05). This implies that there are significant differences in the mean of MFBs with Weak Financial Controls (WFC) and MFBs with Strong Financial Controls (SFC).

Table 6 Independent Sample t-test

	Types of Financial Control	**N**	**Mean**	**Std. Deviation**	**T**	**sig**
Financial control	Strong internal financial control	5	63.0000	12.04159	3.390	0.010
	Weak internal financial control	5	301.0000	156.54073		

Data on table 7 reveals that the value of the correlation coefficient 0.90, and *p*-value= 0.037<0.05, implying that the number of MFBs with WFC is higher than those with SFC

Table 7: Correlations Analysis

	Types of Financial Control	N	Mean	Std. Deviation	T	sig
Financial control	Strong internal financial control	5	63.0000	12.04159	3.390	0.010
	Weak internal financial control	5	301.0000	156.54073		

Data on table 7 reveals that the value of the correlation coefficient 0.90, and *p*-value= 0.037<0.05, implying that the number of MFBs with WFC is higher than those with SFC

			MFBs with WFC	MFBs with SFC
Spearman's rho	MFBs with WFC	Correlation Coefficient	1.000	.900*
		Sig. (2-tailed)	.	.037
		N	5	5
	MFBs with SFC	Correlation Coefficient	.900*	1.000
		Sig. (2-tailed)	.037	.
		N	5	5

***. Correlation is significant at the 0.05 level (2-tailed).**

Financial management is an essential ingredient for sustenance of operational wheel of microfinance banks. As observed by Pandey, an important component of financial management is cash management which is a set of guidelines established to ensure that banks maintain optimal cash balance at any time to meet customers' demands. The findings in this study that many microfinance banks operate without due regard to liquidity management rules corroborates results of Stefan's (2003) comparative study of microfinance in 11 country. That research findings indicate that some microfinance banks do not comply with cash management standards.

Deposit mobilization and cash management is acknowledged to be associated with achieving working capital requirements in microfinance banks (Olowe, 2008). As observed by Akande (2013), banks that meet the financial needs of SMEs are those that build adequate control measures around their liquidity. It can be deduced that weak financial controls, deficient cash management practices and improper deposit mobilization strategies by MFBs have had devastating consequences on service delivery by the MFBs.

Conclusion

In conclusion, Central Bank of Nigeria's policy framework for microfinance banks contained measures for working capital and deposit mobilization in MFBs. Enforcement of compliance by the monetary authorities. This study investigated the impact of regulations on corporate governance of microfinance banks in Nigeria. The corporate governance issues that were studied are; working capital, financial management and deposit mobilization.

Recommendations

Strong good corporate governance and financial management has become key part of successful microfinance institutions in the world. Specifically, compliance with International Reporting Standards and Nigeria's prudential guidelines remain important component of safe financial management practices. Microfinance banks should adhere to the cash flow features recognized in prudential guidelines. The MFBs should always maintain adequate capital to cushion the level of risks in their operations. The regulatory bodies should place emphasis on enforcement of compliance by microfinance banks.

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