EFFECTS OF CORPORATE GOVERNANCE OF MICROFINANCE INSTITUTIONS ON SMALL PRODUCERS IN NORTHERN NIGERIA

[1]John N. Aliu, [2]Dr. Grace Ngozi Ekpunobi, [3]Prof. Roselyn W. Gakure & [4]Yakubu Shinkut
[1]Department of Banking & Finance
[2]Department of Management Studies,
Kaduna Polytechnic, Kaduna, Nigeria
[3]School of Human Resource Development,
Jomo Kenyatta University of Agric and Tech. (JKUAT,)
Nairobi, Kenya.
[4]Department of Business Administration,
Kaduna Polytechnic, Kaduna - Nigeria

Abstract
Microfinance Banks (MFBs) have become accountable to all stakeholders not just their shareholders. Codes of good corporate governance and ethics that exist in Nigerian Microfinance banking sector significantly provided for how the MFBs should be governed and how practitioners should practice banking in order to impact on small producers. Notwithstanding the existence of these corporate governance codes, the governance in microfinance banks has been acknowledged, at the highest regulatory and operational levels of leadership to have failed (Sanusi, 2010). This range from problems of insider abuses to outright fraud. The main objective of the study is to examine the impact of corporate governance practices of MFBs on small producers. The population consists of 200 small producers and twenty (20) microfinance banks each in Kaduna and Niger States. The descriptive research design was employed in this study. The study explored correlation and other socio-economic variables to analyze results. Findings revealed that bad leadership practices in MFBs have greatly affected their inability to provide services to small producers. The study recommended strict deterrent and control measures that will encourage sound corporate governance practices in the MFBs.

Keywords: *Corporate governance, Microfinance Institutions, Leadership, Small Producers.*

Background to the Study

Microfinance Institutions (MFIs) are playing an important role in the delivery of financial services to small entrepreneurs and the poor. In Nigeria, the Microfinance Banks (MFBs) are profit making limited liability companies, therefore, their ownership are in the hands of multiple shareholders. In most of the MFBs in Nigeria, shares are privately held (that is, they are not publicly traded). As licensed banks, MFBs accept deposit from their customers (Christen, 1997).

In the Nigerian Microfinance Banks (MFBs) as in most microfinance institutions (MFIs) around the world, the governance structure closely relates to ownership. The MFBs are typically owned by a small group of investors, often no single person in a controlling position, and with most board members directly representing specific shareholders (Churchill, 1997). The close link between owners and governance creates unique strength and weaknesses among MFIs board. According to Phyne (1995), good governance is the ability of the board members to monitor the status of a Microfinance Bank (MFB), make good strategic decisions, and hold executives accountable for their actions. Ultimately, that comes down to the quality of the board members, the culture and practice of the board, and the power relationship among board members and MFB managers.

Analytical Framework

It is appropriate to have a framework with which to understand how MFB's corporate governance can impact on the performance of SMEs before looking at the relationship between MFB's corporate governance practices, their performance and the SMEs growth. One of the problems with the current debate on MFI's corporate governance is that there are conflicting views on the nature and purpose of Microfinance Institutions (MFIs). This varying views ranges from the real issues on how MFIs actually work, to normative issues concerning what should be their purpose (Eroke, 2007). To make sense of this argument, it is useful to consider the different analytical approaches that are often used. Corporate governance is a term that is used in different ways depending on the subject. In economics argument regarding the effect of corporate governance on performance, the common models used are the shareholder model and the stakeholder model.

i. **The Shareholder Model**

Maher and Thomas (1999) note that in the shareholder model, the objective of the firm is to maximize profits. Therefore, microfinance bank managers and directors have an implicit obligation to ensure that the MFBs are run in the interest of shareholders. According to Sanakue (2002), the underlying problem of corporate governance in the shareholder model stems from the principal agent relationship arising from the separation of beneficial ownership and executive decision making. Whenever there is separation of ownership and control, the interests and objectives of the principal (investors) and agent (the MFB managers) will differ.

ii. **The Stakeholder Model**

The stakeholder model takes a broader view of the firm. The traditional stakeholder model sees the microfinance banks as being responsible to a wider constituency of stakeholders (Shleifer and Vishny, 1997). Other stakeholders may include employees, customers, creditors and social constituents such as members of the community in which the microfinance bank is located, government agencies and the society at large (Masher and Andersson, 1999).

The problem with the stakeholder model of the firm is that it is difficult, if not impossible, to ensure that corporations fulfill these wider objectives. According to Blair (1995), this model failed to give clear guidance to help managers and directors set priorities and decide among competing socially beneficial uses of corporate resources, and provided no obvious enforcement mechanisms to ensure that corporations live up to their social obligations. As a result of these inadequacies, few academics and policy makers still espouse this model (Blair, 1995).

However, given the potential consequences of corporate governance for economic performance, the notion that corporations have responsibilities to parties other than shareholders merits consideration. This study seeks to investigate the effects of MFBs corporate governance practices on the performance of SMEs in Nigeria. To guide this research enterprise, we pose the following research questions:

i. Do the MFB's financial management practices influence the performance of the SMEs in Northern Nigeria?
ii. Do sustainable growth of the MFBs have any effect on the performance of SMEs in Northern Nigeria?

Literature Review

The idea behind corporate governance is an all encompassing one. It is often defined as a field in economics

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that investigates how to secure and motivate "efficient management" of microfinance institutions by the use of incentive mechanisms, such as organizational designs and legislation (Mathiesen, 2002). According to Shleifer and Vishny (1997), corporate governance deals with the ways in which suppliers of finance to Small and Medium Enterprises (SMEs) assure themselves of getting a return on their investment.
The issue of corporate governance has become extremely important in the last decades. This is as a result of well known corporate failures of such corporations as Maxwell group, Enron and worldcom (Shleifer and Vishny, 1986). The corporate governance issue has thus become one of the central issues with regards to securing continuous economic development globally. The problem of corporate governance is even more critical in developing economics like Nigeria (Mukaila & Garba, 2003). Although quite a good number of studies have been carried out on the association of corporate governance and firms performance, many papers focused on developed countries (e.g. Bhagat & Black, 2002; Lehn, Patro and Zhao, 2003).

Much less research exists for developing countries (e.g. Black, Jang and Kim, 2004) and even at that, microfinance institutions are not the main focus. The major goal of corporate governance system is to ensure that Microfinance Banks is working efficiently as well as maximizing its values in the interest of its stakeholders (Shleifer and Vishny, 1997). Chukwuemeka, Nzewi and Ezenyilimba (2011) observe that in Nigeria, there has been several corporate failures and large-scale misappropriation of funds involving corporate organizations in the recent past. Bies (2004) notes that the sheer scale of fraud, embezzlement and graft noticed in some corporate failures has brought doubt on the reliability and effectiveness of present-day operational and compliance control mechanism as well as financial reporting standards.

Chukwuemeka et al (2011) also points out that inspite of the fact that there exist regulatory bodies (such as central bank of Nigeria) in Nigeria to ensure compliance with standards of best practices, yet corporate failures have "escalated". The authors therefore concluded that the regulatory agencies need to be reformed in order to reposition them for the challenges of the 21st century. Osisioma and Osisioma (2002) defined a properly governed corporate entity as one that had mostly outside directors, who had no management ties, and who undertook formal assessment of its directors. They see this as one that will be responsive to investor's requests for information on governance issues. Rwgasira (2003) points to the fact that the effectiveness of any board is seen on how well the board undertakes its performance and conformance roles. On his part, Akinboade (2003) observes that the board of directors provides rules, policies and direction for the staff of the organization.

Methodology

Collis and Hussey observe that there are two main research paradigms namely: positivistic and phenomenological. A quantitative methodology that seeks to find out the causes of social phenomena without much emphasis on the subjective state of an individual falls under the positivistic paradigm (Collis and Hussey, 2003). However, where the emphasis is on understanding human behaviour from the participant's frame of reference, such qualitative methodology comes under the phenomenological paradigm. Creswell (1994) points out that the assumption of a positivistic paradigm considers the researcher as independent from what is being researched. But under a phenomenological paradigm (qualitative) the researcher interacts with what is being researched upon.

The research philosophies adopted in this study is based on bothpositivistic paradigm where emphasis is on empirical findings as well as phenomenological since this study also aims to understand human behaviour

from the participant's own frame of reference through the use of interviews and questionnaires.
This study used a combination of both quantitative and qualitative research designs. The quasi-experiment design was used to analyse the relationship between independent variables of corporate governance of MFIs against the dependent variable of the SMEs performance in Northern Nigeria. A quasi-experiment is the investigation of an environment that existed, or events that have occurred naturally, without the researchers' direct intervention (Gill and Johnson, 1997). The population consists of 200 small producers and 20 microfinance banks each in Kaduna and Niger States. The study also made use of data obtained from the financial reports of the microfinance banks for a period of five years (2008 to 2012). Data were analyzed using multiple regression analysis.

Hypothesis

H_0: Corporate governance of MFIs does not significantly affect the performance of small producers in northern Nigeria.

H_1: corporate governance of MFIs significantly affect the performance of small producers in northern Nigeria.

Model Specification

The effect of corporate governance practices of the MFIs on the performance of small producers in Northern Nigeria was estimated using panel data analytical method. Since microfinance banks are heterogeneous, some specific factors other than the explanatory variables may explain the MFIs ability to render services to small producers. Accordingly this study employed random effect panel method of analysis. This assumes heterogeneity in cross-sectional units under analysis. In addition, this method assumes that the characteristics that are unobserved are not correlated with the error term.
The random model is specified as follows:

$SPP_{it} = \&_i + BLP_{it} + \&LDR_{it} + E_{it}$

Where:

SPP_{it} = Performance of small producers at time t, measured by return on capital employed (ROCE).

BLP = MFIs leadership practices at time t, measured by non-performing loan to total credit.

E_{it} = error term

& = constant

B,& are coefficients

Results Analysis and Discussion

The result from the panel data regression shows that bad leadership practices (defined as the ratio of non-performing loans to credit) and loan deposit ratios have negative effect on services rendered to small producers and by extension on their performance. A unit increase in each of the leadership practices and loan to deposit ratio reduces financial performance by 0.19 and 0.0001 respectively. Although the effect of loan deposit ratio appears not to be significant, that of leadership practices is significant. After all, the model of analysis, as clearly depicted above, explains the performance of small producers in the light of the explanatory variables. The p-value of 0.002 of the chi-square test indicates that the explanatory variables of the model explain the dependent variables.

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The result of this analysis is quite relevant in the light of the views expressed in the literature. The higher the value of non-performing loans the greater the need fro loan provisions and the less the amount of profits. Therefore, the more the performance of the MFIs themselves slows down, there by hindering their ability to serve the small producers.

It is to be noted that the quality of corporate governance of MFIs have significant bearing on the level of loaning and other support services to the small producers. The continuous increase in the amount of non-performance loans in an indication of bad leadership practices and poor corporate governance put differently, the higher the ratio of non-performing loans, the lower the level of good corporate governance practices; and by implication limited services to the small producers by the MFIs. The detail is presented in the regression output below in appendix 1. In order to provide answers to the research questions, table 1 and table 2 below give a clear picture of respondents view.

Question Item: The MFB's financial management practices influence the performance of SMEs in Northern Nigeria.

Options	Number of Respondents	Percentage (%)
Strongly agree	41	59
Agree	23	33
Disagree	05	7
Strongly disagree	01	1
Total	**70**	**100**

Source: *Authors field survey, 2013*

Out of the 70 respondents, 41 representing 59% strongly agreed with the fact that MFBs financial management practices does influence the performance of SMEs in Northern Nigeria. A further 33% also agreed with this notion, while only 7% disagreed with this question item. The implication of this is that small producers and other SMEs operators will benefit from sound corporate governance practices of the MFBs. Weak financial management practices of the MFBs will therefore, have extended negative consequences on the performance of SMEs in Nigeria.

Question Item: Sustainable growth of the MFBs have effect on the performance of SMEs in Northern Nigeria.

Options	Number of Respondents	Percentage (%)
Strongly agree	50	71
Agree	19	28
Disagree	01	1
Strongly disagree	-	-
Total	**70**	**100**

Source: *Authors field survey, 2013*

Table 2 above reveals respondents opinion on whether sustainable growth of the MFBs have any effect on the performance of the SMEs in Northern Nigeria. From the table, it is clear that 71% of the respondents strongly agree with the question item while only 1% of the 70 respondents disagreed.

It follows therefore, that the growth of MFBs on a sustainable basis will impact positively on the performance of small producers and other SMEs operators. Since sustainability of MFBs is closely linked to good corporate governance practices, the need for the directors of MFB's to imbibe good leadership practices cannot be over emphasized.

Conclusion and Recommendation

It is clear from the analysis of the results that ensuring more effective corporate governance practices will not only enhance the performance of the microfinance banks, but it will also guarantee efficient services to their clients, especially small producers. Furthermore, the results of this study generally suggest that the adoption of corporate governance mechanisms has some important implications for the microfinance banks. Good corporate governance can greatly assist the MFBs via the introduction of better management practices and greater opportunities for business growth of small producers through the utilization of efficient services rendered by the MFBs. Bank losses attributed to corporate governance failures is enormous. Controls should be instituted to safeguard against fraudulent practices and insider abuses. Deterrent measures through regular audits and inspection procedures should be emphasized.

Finally, the codes of best practices and governance codes in Nigeria should be reviewed to meet international standards. Specific code of corporate governance should be instituted for microfinance banks because of the unique nature of these banks.

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Appendix 1

Random-effects GLS regression		Number of obs	= 100
Group variable: id		Number of groups	= 10
R-sq:	Within = 0.1528	Obs per group: min	= 10
	Between = 0.1475	avg	= 10.0
	Overall = 0.1425	max	= 10
Random effects u_i~ Gaussian		Wald chi2(2)	= 16.69
Corr (u_i, x)	= 0 (assumed)	Prob > chi 2	=0.0002

roa	Coef.	Std. Err.	Z	P>|z|	[95% Conf. Interval]	
asqcr	-.1936673	.04795	-4.04	0.000	-.2876476	-.0996871
Idr	-.0005564	.0463713	-0.01	0.990	-.0912466	.0901337
_cons	4.970895	2.453806	2.03	0.043	.1615233	9.780266
sigma_u	3.4220278					
sigma_e	9.2139075					
rho	.12121639	(fraction of variance due to u_i)				