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The Effects of Financial Control Systems of Micro Finance Banks (MFBS) on the Performance of Entrepreneurs and SMEs in Nigeria.

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Abstract
Microfinance banks exist to supply services to Entrepreneurs and Small and Medium Enterprises (SMEsa) clients. It has been estimated that there are over 500 million economically active poor in the world operating microenterprises and small businesses (Women's World Banking 19995). Most of them do not have access to adequate financial services (Ledgerwood, 2000). In order to meet this substantial demand for financial services by entrepreneurs and small businesses, microfinance practitioners must adopt sound financial management practices. Unfortunately existing literature suggest that absence of good corporate governance practices remain a problem in many Microfinance Banks. This ranges from insider dealings, financial mismanagement, weak or inadequate capital to massive loan defaults amongst others. This study examined the effects of these practices on entrepreneurs and small businesses in Northern Nigeria. Descriptive research was adopted. Questionnaires and interviews schedules form the main instruments for the study. The findings indicate that where good financial management and internal controls are in place, the microfinance banks' ability to extend financial services to entrepreneurs is greatly enhanced. The study recommends the adoption of strong accounting and internal control systems by the MFBs as well as the strengthening of supervisory mechanisms by the regulatory bodies.

Keywords: Microfinance, Financial Management, Corporate Governance, Entrepreneurs and Internal Controls.

Background to the Study
Microfinance gained popularity and began to attract attention in 1980s as a response to doubts and research findings about government delivery of subsidized credit to the poor and entrepreneurs. In the 1970s government agencies and state-owned banks were the predominant source of providing credit to small businesses and farmers who had little or no access to such credit facilities (Ledgerwood, 1997). Poor farmers had hitherto been forced to pay “usurious” interest rates or were subject to rent seeking people.

Government and international donor agencies felt that the poor required cheap credit facilities and therefore, provided subsidized agricultural credit. Infact, inspired by the success story of Raifeisaen Model developed in Germany in 1864 donors set up credit Unions (FAO, 1995).

However, in the Mid-1980s, the subsidized, targeted credit model supported by many donors became the object of steady criticisms, because most programmes accumulated large loan losses and required frequent recapitalization to continue operating. It became apparent that a market-based approach was the required solution. This led to a new approach that considered microfinance as an integral part of the overall financial system.

The Nigerian Microfinance Banking Sector

There have been various episodes of banking crisis in Nigeria. Since commercial banking business commenced in 1892, the Nigerian banking system has witnessed episodes of crisis. The fist took place in the late 1930s and early 1950s, mainly as a result of lack of regulation, inadequate capital, fraudulent practices and bad management (Mordy, 2010). Consequently, about 21 of the 25 indigenous banks in existence by 1954 failed. Adesina and Ayo (2010), observed that the introduction of banking ordinance of 1952, the establishment of the Central Bank of Nigeria (CBN) in 1959 as well as the Banking Act of 1962, appeared to have brought sanity into the corporate governance practices in Nigerian banking system.

However, Systemic crisis resurfaced in the Nigerian microfinance banking Industry in the mid-1990s and 2000s (Mordy, 2010). Sanusi (2010), noted that the Nigerian microfinance banking crisis situation was the manifestation of a complex state of inter-related corporate governance problems including a weak policy environment, capital and financial management inadequacies and economic down-turn.

Sanusi (2010), pointed that the banking sector in Nigeria has evolved in five stages. The first stage was the pre-existence of the Central Bank of Nigeria (1930-1959), during which several poorly- capitalized and unsupervised indigenous banks failed in their infancy. The second stage was the control regime (1960-1985), during which the Central Bank of Nigeria (CBN) ensured that only “fit and proper” persons were granted license, subject to the prescribed minimum paid up capital and in line with the provisions of Banking Act (Mordy, 2010). The third stage was the post Structural Adjustment Programme (SAAP) or de-control regime (1986-2004), during which the liberal philosophy of “free entry” was over stretched. This period marked the beginning of formal micro-finance banking (community banks) in Nigeria (Sanusi-2010). The fourth stage was the era of banking consolidation (2004 to 2006), with emphasis on recapitalization. The fifth stage is the post-consolidation era of reforms hinged on proactive financial risk management and good corporate governance practices.

The creation of Micro-Finance Banks (MFBs) in 2005 in Nigeria marked the beginning of the transformation of Community Banks (CBS) which had been in existence since 1990. The report sheet for 334 community banks whose operations were analyzed by December, 1992 revealed the total assets was N981 million, total deposit mobilization was N640 million, loans advances amounted to N150 million while gross earrings was N107 million (NDIC 2010). Central Bank of Nigeria (CBN, 2011) also reported that a total of N205 million was realized as aggregate gross earnings by 435 community banks out of 753 community banks that were fully operational 1994.

However, by 2005 many of the community banks had become distressed as a result of weak capital base, insider abuses and large amount of non-performing loans among other factors (Folake, 2005). This state of affair led to the creation of present day Microfinance Banks (MFBs).

According to Central Bank of Nigeria (CBN, 2011), weak corporate governance practices in microfinance banks s(MFBs) in Nigeria resulted in the liquidation of 84 MFBs as at 2010. The total deposit liabilities of these 84 MFBs as at 2010 was N8.999 billion for 668,214 depositors (NDIC, 2010.). The total deposit liabilities comprised insured sum of N4.467 billion and uninsured amount of N4.531 billion. Such is the negative consequences of weak corporate governance practices in the MFBs sector.

Statement of the Problem

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 Bosina and Herzegovina in 2009 all resulted in massive loan default by clients and eventual closure of some MFIs (Waithaka, Gakure and 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 (Wolfgang, 2003).

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 improve standard of living and poverty reduction (NDIC, 2010).

Challenges faced by Microfinance Institutions (MFIs) include high personnel turnover, inefficiencies in Loan administration, poor liquidity management resulting in payments of staff salaries from demand deposits and expensive overdraft facilities and inability to meet customers' maturing demands (Mordi, 2010).despite the fact that strong good corporate governance and risks management is a key part of successful financial system in the world today, it's impact on Microfinance Banks (MFB's) performance is still misunderstood. This is because; the effect of financial controls in of microfinance banks' performance remains untested.

Studies have not been done on effects of financial control systems of micro finance banks (MFBs) on performance of Small and Medium Enterprises (SMEs) in Nigeria. Studies have been carried out on micro-finance banks in relation to poverty reduction (Ledgerwood, 1999, Oladeji, 2001; Robinson, 2001; Schreiner, 2002; Ukeje, 2005, Wooler and Schreiner, 2006). However, the extent to which micro-finance banks can impact on the poor through financial services will depend on sound corporate governance practices. Studies on corporate governance in the microfinance banking sector are very few.

Studies earlier carried out (Osotimehin and Jegede 2011, Murdoch 2005) focused on impact analysis of microfinance banks in relation to their outreach services. These studies have produced mixed results. Osotimehin and Jegede (2011) concluded that the outreach impact have not been felt while Murdoch (2005) points out that Microfinance Banks (MFBs) have been achieving stable healthy position and growth as a result of granting credit facilities on a sustainable basis. Sustainability is synonymous with outreach (Yaron 1999).

Research Objective

To investigate the effects of financial control systems of microfinance banks (MFBs) on the performance of entrepreneurs and Small and Medium Enterprises (SMEs) in Nigeria.

Specifically, the study seeks to:

1. Establish the effects of MFBs management controls on their ability to provide services to entrepreneurs and SMEs in Nigeria.
2. Examine the effects of MFBs liquidity management controls on their ability to provide services to entrepreneurs and SMEs in Nigeria.

Research Hypothesis

H_1: There is a relationship between MFBs management controls and the performance of SMEs in Nigeria.

H_2: There is a relationship between MFBs liquidity management controls and the performance of SMEs in Nigeria.

Effects of Financial Control Systems

The rating of microfinance bank is a standard measurement for the assessments of its performance in providing services to entrepreneurs, SMEs and other clients. This is seen in its capital adequacy, asset quality, management control efficiency, earnings capacity and liquidity management position (CBN, 2005).The weightings allocated to these factors by the Central Bank of Nigeria are:

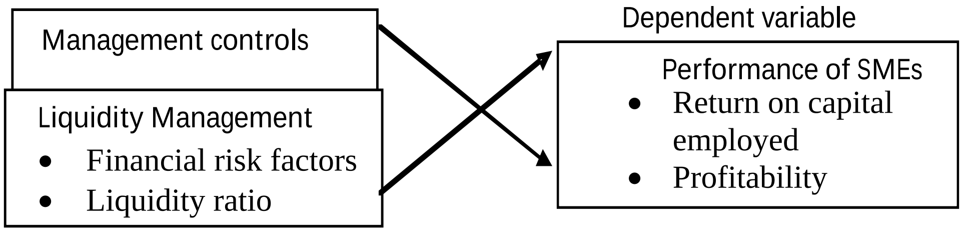
Key Indicators	% rating
Capital adequate	30%
Asset quality	30%
Management control efficiency	20%
Earnings capacity	10%
Liquidity management position	10%
Total	100%

According to Sanusi (2010), most corporate governance factors that affected rating are violation of legal lending limit and judgmental factors. CBN (2005) observed that judgmental factors reduced bank's rating to unsound as a result of window dressing, unsound banking practices and financial mismanagement.

Research Framework

The primary variable of interest of this study is the dependent variable of SMEs performance which is measured by return on capital employed and profitability. The independent variables that may influence the dependent variable are management controls and liquidity management. The relationships between the dependent and independent variables are shown in figure

Independent variables



Research method

A survey questionnaire was designed and administered for purpose of data collection. The questionnaire was divided into sections and designed mainly based on Likert's scale of five ordinary measures from one(1) to five (5) according to levels of performance. In order to test the content validity, the questionnaire was initially distributed to three (3) experts, namely: a professional banker, a statistician and an Academic whose specialty is in Entrepreneurship development. This was followed by a pilot survey to obtain an initial feedback on the quality of the questionnaire's contents. Relevant amendments were made on the questionnaire based on comments received from the pilot survey. In the main research survey, 140 questionnaires were sent out. A total of 102 representing 72% of the questionnaires were duly completed and returned. The data was analyzed using standard regression analysis.

Data Analysis / Results

Regression model

$Y = B_0 + B_1 X_1 + B_2 X_2 + E$

Where y = performance of SMEs

B_0	=	Constant
B_1	=	Corresponding Coefficient for effects of management controls.
X_1	=	Management control effects
B_2	=	Corresponding coefficient for effect of liquidity Management.
X_2	=	Liquidity management
E	=	Error term
Æ	=	0.05

Assumptions

1. Coefficients must be linear in nature
2. Responses error should follow a normal distribution
3. Errors should have a common distribution the statistical test was conduct using statistical package for social science (SSPS) version 20.

Table 1: Rate of effects on the performance of SMEs in Nigeria

Variable	Coefficient	Std. Error	t. statistic	Prob.
C	32.744	26.582	1.232	0.258
X_1	0.577	0.862	0.669	0.525
X_2	-0.089	1.761	-0.050	0.961

R-squared	0.113	mean dependent var.	50.600
Adjusted R-squared	0.141	S.D. dependent var.	7.849
S.E. of regression	8.382	Akaike in for criterion	7.333
Sum square rasid	491.801	Schwary criterion	7.445
Long Likelihood	-33.667	F-statistics	0.445
Durbin-Watson stat	1.174	Prob (F-statistics)	0.657

Conclusion

Effective financial management practice remains a sure way to improve MFB's performance. The ability of the microfinance banks to meet credit demands from entrepreneurs, SMEs and other client rest heavily on their ability to observe good corporate governance practices demonstrated in skillful liquidity and management control functions. Inability of many MFBs to mobilize sufficient savings and capital formation has resulted in greater difficulties in serving SMEs and entrepreneurs (Abereijo and Fayomi 2005). From the result of this study, it is clear that effective financial controls are essentials for risk mitigation and proper accountability as summarized below:

Liquidity Risk Factor: Liquidity refers to the amount of available cash relative to the microfinance banks (MFB) demand for cash. According to Kiel and Nicholson (2003), microfinance banks are exposed to high levels of liquidity risk because seasonal factors influence many of their clients (Kiel, 1997). The operators of microfinance institutions should be very careful in managing liquidity in order to avoid financial distress.

Accountability: proper and adequate record keeping are essential for accountability and transparency. An effective way to promote accountability is to do periodic audits of microfinance institutions records. Churchill (1997) suggest that the audit should include a review of operational procedures and periodic visits to SMEs.

Recommendations

From the findings of this study sand in view of the significance of good corporate governance practices, the following steps should be taken to ensure adequate financial control in MFBs:

1. Government should set up a separate regulatory agency (Bankers bank for microfinance

banks) to ensure adequate supervision of MFBs.

2. The operations of MFBs require the maintenance of high level of liquidity assets to meet frequent requests for loans from entrepreneurs and SMEs client. The Central Bank of Nigeria (CBN) should raise the liquidity ratio requirements from the present 20% to 25%.
3. The Central Bank of Nigeria should ensure that the MFBs comply strictly with the compulsory investment of 5% of deposit liabilities in Treasury Bills (in liquid assets). This will boost their earnings and liquidity position.
4. Management of MFBs should intensify their monitoring mechanisms bys raising functional audit committees from amongst the board members.
5. Any management or staff members of an MFB involved in fraudulent practice(s) should be sanctioned accordingly to serve as determent to others.
6. The regulatory bodies should insist that the MFBs renders monthly returns to enable early detection of errors or defalcations.
7. Government should provide necessary support facilities (such as uninterrupted power supply) to reduce cost of operations and enhance MFBs earning capacity.

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