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The Effects of Corporate Governance and Sustainability of Microfinance Banks (MFBs) on Entrepreneurs and SMEs in Northern Nigeria

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Abstract
Productivity and efficiency management for sustainability involve both maximizing revenue and minimizing costs relative to the volume of business produced and managed. Productivity management includes ensuring that microfinance bank's staff is accountable for its activities provided such staff is given the appropriate incentive for productive and efficient performance. Scholars maintained that microfinance banks can "do well by doing good" such as Godfrey, 2005; Margolis 2007; Porter and Kramer, 2011 maintained that this is also used on assumption that meeting the needs of employees directly creates value for shareholders (Freeman 2010; Porter and Kramer, 2011) thereby enhancing sustainability. In other words, sustainability may simply attract a type of agency cost-microfinance managers receive private benefits from embedding MFBs strategy, but doing so has negative financial implications for the MFB (Baloti and Hanks 1999). This study examined the effects of corporate governance and sustainability of MFBs on entrepreneurs and SMEs in northern Nigeria. Questionnaires and interviews were used to collect data. Data were also collected from secondary sources. Trend analysis and variance analysis were used to analyze the data collected. While the pearson product moment correlation coefficient model was used to test the hypothesis.

Keywords: Corporate Governance, Sustainability, Microfinance, Entrepreneurs, Small and Medium Sized Enterprises

Background to the Study
Corporate governance involves a system by which microfinance institutions relate to their clients and stakeholders to improve their quality of life (Unegbu, 2004). Therefore, good corporate governance ensures transparency, accountability and fairness in financial transactions and reporting. Renee and Hamid (2003), points out that corporate governance is not only limited to corporate efficiency, it also relates to a much wider ranger of a microfinance bank's strategies and life cycle development.

The negative experiences of microfinance bank failures around the world in the recent past gives credence to the need for good corporate governance practices. This view was supported by Harnando and Nicholas (2006) when they pointed out that the 1990s witnessed several failures of Microfinance Institutions (MFIs) around the world. Financial distresses of MFIs in most of these countries were attributed to high incidence of non-performing loans, weak management and poor credit policy. Shleifer, Andrei and Vishny (1997) assert that the sheer scale of fraud, embezzlement and graft in some failed MFBs has brought into question the reliability and effectiveness of present-day operational and compliance control mechanism and financial reporting systems.

The impact of corporate governance of micro finance institution seems unequally dispersed among countries. Some MFIs have become very significant in size and serve a lot of Small and Medium Enterprises (SMEs) clients, like the Grameen Bank in Bangladesh, or BRI in Indonesia, while other MFBs remain small or even cease to exist (Cicea and Hincu, 2009). The governance of an MFB plays a major role in ensuring that the institution keep to its mission of serving Small and Medium Enterprises (SMEs) and other clients (Klapper and Love, 2004, Moauro and Spaggiari, 2011). Good corporate governance in MFBs is expected to underpin effective and efficient social performance within firms (Waithakam, Gakure and Wanjau, 2013).

An important mechanism of governance is the quality of the board of directors. Accordingly, leadership characteristics of MFIs have great impact on their performance (Waithakam Gakure and Wanjau, 2013). The main goal of every Microfinance Bank (MFB) is to operate profitably in order to maintain its stability and improve performance and sustainability (Impact reporting and investment standards, 2010). However, existence of high levels of loan delinquency problem in microfinance industry in most countries negatively affects the level of services to SMEs (Ditcher, 2003).

The financial sector in Turkey is traditionally dominated by microfinance activities, and the industry experience several system crisis in the 1990s (Mordi, 2010). Turkey weathered the financial crisis better than many countries. As a result of strong corporate governance culture in the banking sector, Turkey's Gross Domestic Product (GDP) increased from $230 billion in 2002 o $740 billion in 2008 (Sanusi , 2010). In addition, Turkey's national deficit fell by 40% in the first few months of 2010.

Good corporate governance promotes goodwill and confidence in the financial system. Studies show that good corporate governance leads to increased valuation, higher profit levels, increased sales growth and lower capital expenditure (Wolfgang, 2003). This view way supported by Lam, Tin and Lee (2008).

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 first took place in the late 1930s and early 1950s, mainly as a result of lack of regulation, inadequate capital, fraudulent practices and bad management (Mordi, 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 (Mordi, 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 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 (Mordi, 2010). The third stage was the post Structural Adjustment Programme (SAP) 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 2009), with emphasis on recapitalization. The fifth stage is the post-consolidation era of reforms hinged on proactive risk management and corporate governance best 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 earnings 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 affairs 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 (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.

Literature Review

Studies have not been done on effects of corporate governance of Micro-Finance Banks (MFBs) on performance of Small and Medium Enterprises (SMEs) in Nigeria. Some studies have been carried out on micro-finance banks in relation to savings mobilization and 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 Micro-Finance 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). This mixed conclusion necessitates a study in the Nigerian context to establish the effect of corporate governance of Microfinance Banks (MFBs) on financial performance of Small and Medium Enterprise (SMEs).

Sustainability

The Longman active study dictionary (2006) defines sustainability as making something existing continuously without becoming weak. To achieve sustainability, microfinance institutions must ensure that the services they offer meet the demands of clients. They must also ensure that operations are as efficient as possible, costs are minimized and that clients are motivated to repay loans (Ledgerwood, 1999).

Melean, Doug and Gamser (1995) observed that microfinance institutions can be sustainable provided they have enough funds to continue operating in the long-term. Good corporate governance practices can lead to increase in operational revenue for the microfinance institutions (Krambia, Maria and Jim, 2006).

However, past crisis and closures in the microfinance sub-sector were found to have occurred as a result of weaknesses or failures in corporate governance.

1. Insider Dealings: According to (Rock, 2007) insider dealings cover act of Micro-Finance Banks (MFBs) directors who unlawfully use their position to gain personal benefits.

2. Fraud and Irregularities: The Black law dictionary (1990) defines fraud as an act done with intent to give some advantage inconsistent with official duty and rights of others. Hashimu (2008) describes fraud as an illegal act or series of illegal acts committed by non-physical means and by concealment to obtain money or property.

The management of microfinance institutions should adopt control measures that will deter fraudulent practices.

3. Recruitment Procedures: According to Megginson, Byrd and Megginson (2006), recruitment is reaching out to attract a supply of potential employees. It is generally done by advertising but may also be accomplished using employee referrals and temporary help services (Armstrong, 2007).

The management of microfinance banks should be very careful when carrying out recruitment and selection exercises.

4. Leadership Practices: an essential part of corporate governance is guiding efforts towards achieving the goals and objectives of the organization (Armstrong, 2007). This involves the process of leadership. Leadership can be interpreted in simple terms as getting others to follow or getting people to do things willingly or interpreted more specifically as the use of authority in decision-making (Mullins, 2010).

Notwithstanding the existence of code of corporate governance for Microfinance Banks in Nigeria (CBN, 2006), Sanusi (2010) observed that the governance in Microfinance Banks has been acknowledged at the highest regulatory and operational levels of leadership to have failed. Microfinance institutions should embrace best leadership practices in order to ensure sustainability.

Research Objectives

The study seeks to investigate the effects of corporate governance and sustainability of Microfinance Banks (MFBs) on entrepreneurs and SMEs in Nigeria.
Spherically, the study seeks to:

1. Establish the rate of loans disbursed by MFBs in relation to the amount of loan applied for by SMEs and other clients.
2. Examine corporate governance issues that could determine MFB's ability to extend credit facilities to entrepreneurs, SMEs and other clients on a sustainable basis.

Hypothesis

H_1: There is a significant relationship between loans disbursement by MFBs and their sustainability.

H_2: There is a significant relationship between corporate governance practices and the ability of MFBs to extend services to entrepreneurs and SMEs on a sustainable basis.

Theoretical Framework

This study is anchored on agency theory and complimented by stewardship theory. One of the objectives of corporate governance is the reduction of potential conflicts between the principal and agent (Ashbaught, 2004). The principal provides the finance and the agents' task is to manage the finance in an efficient manner so that maximum returns are provided for the principal. This agency conflict can lead to agency cost in terms of monetary loss (Meckling, 1976). Good governance practice can be used to improve economic efficiency and confidence building on the part of investors (Sanusi, 2010). Microfinance institutions can use good corporate governance mechanisms to improve profitability.

The stewardship model supports the view that managers are good stewards of the firms resources (Georgious, 2010). It asserts that if managers are left alone they will act responsibly and will effectively manage the assets they control (Donaldson and Davis, 1991). In contrast to the agency model, the stewardship model implies that there is no need for corporate governance mechanism to be implemented in order to obtain financial benefits.

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 Bosnia 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 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 and Fayomi, 2005). These challenges have resulted in microfinance banks having greater difficulty in serving entrepreneurs as well as small and medium enterprises (SMEs) or even identifying fundable ones. 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.

Other 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 is a key part of enhancing business sustainability today, it's impact on Microfinance Banks (MFB's) performance is still misunderstood. This is because the effect of corporate governance of microfinance banks remains untested.

Methodology

Questionnaires and interviews were used to collect data. Data were also collected from secondary sources. The study was carried out in northern state of Kaduna. The area is densely populated with average population density of 354 persons per square kilometer as against the national average of 96 (NPC, 2006). The choice of the area is because of the intense activities of entrepreneurs and SMEs.

Trend analysis and variance analysis were used to analyze the data collected. While the Pearson product moment correlation coefficient model was used to test the hypothesis that measures the degree of correlation that existed between the actual loans disbursed and the amount under application by the SMEs.

This model was used because it is a good model to determine the strength of the relationship between two variables that have been measured on interval scales and the model is very easy to understand. The decision rule is that if the obtained correlation coefficient (r) is greater or equal to 0.5 the relationship is significant.

The Pearson product moment correlation coefficient (r) was defined by the expression.

$$r = \frac{N?XY - ?X?Y}{\sqrt{N\sum X2 - (\sum X)2}\sqrt{N\sum Y2 - (\sum Y)2}}$$

Where:
r = correlation coefficient
N = number of years
X = actual loans disbursement
Y = loan applications
? = summation

Discussion of Results

Data Presentation

The actual loans disbursed to SMEs and the amount applied for which were approximated to the nearest million naira (N million) were presented in the table 1 below.

Table 1: Actual and Amount of Loans Applied for by Entrepreneurs and SMEs

Year	2006	2007	2008	2009	2010
Actual (Nm)	32.9	48.1	95.0	139.6	153.9
Application (Nm)	138.4	155.4	244.8	200.0	200.0

Source: Computed from Financial Statements of MFBs

Performance Analysis

In predicting the performance and trend of the amount of loans granted by the MFBs to SMEs and entrepreneurs between 2006 and 2010, table 2 and 3 shows the percentage changes over the preceding year and variance analysis respectively.

Table 2: Percentage Changes in Actual Loan Disbursement

Year	Amount N million	Percentage (%) Change Over the Preceding Year
2006	32.9	-
2007	48.1	46.2
2008	95.0	97.5
2009	139.6	46.9
2010	153.9	10.2

Source: Compiled from Financial Statements of SMEs

Table 3: Variance Analysis

Year	Actual Disbursed ₦ Million	Loan Applications ₦ Million	Variance ₦ Million
2006	32.9	138.4	105.5 (A)
2007	48.1	155.4	107.3 (A)
20 08	95.0	244.8	149.8 (A)
2009	139.6	200.0	60.4 (A)
2010	153.9	200.0	46.1 (A)
Total	469.5	938.6	469.1 (A)

Source: Compiled from Financial Statements of MFBs
Key: (A = Adverse (unfavourable) variance

Table 2 above shows general increase in disbursement of loans from 2006 to 2010 of N32.9 million to N153.9 million respectively, but the yearly percentage changes rose to highest of 97.5% in 2008 but declined to 10.2% in 2010 which signifies the adverse trend of loan disbursements between 2009 and 2010.

Also, table 3 above indicates that there were adverse or unfavourable variances between the actual loan disbursements compared to amounts applied for by the SMEs and entrepreneurs throughout the period under review that signifies poor rate of disbursements of loans from MFBs.

The unfavourable variances started from N105.5 million in 2006 and reached the peak of N149.8 million in 2008 but dropped to N46.1 million in the year 2010.

The negative performance exhibited as observed from table 3 above might be due to non-identification of the good entrepreneurs spread across the state, poor financial management practices to inside abuses on the part of MFB officers.

Test of Hypothesis

Based on table 1 actual disbursement were regarded as variable X and loan application figures as variable Y. therefore, table 4 shows the computed variables for correlation analysis as shown below.

Table 4: Computation of Variables for Correlation Analysis

Year	X (Actual) Nm	Y Loan Applications Nm	Xy Nm	X^2 NM	Y^2 Nm
2006	32.9	138.4	4,553.36	1,082.41	19,154.56
2007	48.1	155.4	7,474.74	2,313.61	24,149.16
2007	95.0	244.8	23,256.0	9,025.0	59,927.04
2009	139.6	200.0	27,920.0	19,488.16	40,000.0
2010	153.9	200.0	30.780.0	23,685.21	40,000.0
Total (?)	469.5	938.6	93,984.10	55,594.39	18 3,230.76

$$r = \frac{N\sum XY - \sum X \sum Y}{\sqrt{N\sum X2 - (\sum X)2}\sqrt{N\sum Y2 - (\sum Y)2}}$$

$$= \frac{5(93,984.10) - (469.5 \times 938.6)}{\sqrt{5\ (55,594.39) - 469.5^2} \times \sqrt{5\ (183,230.76) - 938.6^2}}$$

$$= \frac{469,920.5 - 440,672.7}{\sqrt{57,541.7} \times \sqrt{35,183.84}}$$

$$= \frac{29,247.8}{239.88 \times 187.57}$$

$$= \frac{29,247.8}{44,994.29}$$

$$= \underline{0.6500}$$

Given the calculated correlation coefficient (r) of 0.6500 which agreed with 0.0650049 determined using SPS 20, there is significant relationship between the loan applications and actual disbursement by the MFBs on one hand and the sustainability of the MFBs on the other hand.

Conclusion

Microfinance banks trade largely in cash. That is money is the main stock-in-trade. The ability to raise income through loans determines to a large extent an MFB's long-term survival of great significance is the role of deposit mobilization which assures availability of funds for loan disbursements. The sustainability of an MFBs operations lies heavily on the confidence reposed on it by clients. This confidence level is enhanced by the bank's ability to meet the client's demands including loan requests. Poor corporate governance practices can hinder an MFBs ability to grant credit facilities to entrepreneurs, SMEs and other clients. Adherence to good leadership practices is indeed necessary to guarantee long-term sustainability of Microfinance Banks.

Recommendations

From the foregoing conclusions, the following steps will required to ensure goof corporate governance and sustainability of microfinance banks in Nigeria.

1. Microfinance banks should strengthen their deposit mobilization drive by engaging in aggressive marketing.
2. The regulatory body (central bank of Nigeria) should closely monitor the credit administration practices of MFBs by conducting regular inspections.
3. The Central Bank of Nigeria (CBN) should insist on rendition of monthly returns by the MFBs detailing sectoral distribution of loans and advances to clients.
4. Management and staff of microfinance banks found engaging in fraudulent practices and other insider abuses should be adequately punished to serve as deterrent to others.
5. The central bank should institute awards (recognition) for microfinance banks that excelled in extending credit facilities to entrepreneurs and SMEs in Nigeria.

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