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EFFECT OF BOARD DIVERSITY ON FINANCIAL PERFORMANCE OF MICRO FINANCE INSTITUTIONS REGULATED BY SASRA IN KENYA

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Abstract

Micro Finance Institutions (MFIs) rejuvenate economic prowess in developing countries, they are a promising tool to tackle poverty and improve food security. Sustainability of MFIs based on their corporate governance to ensure that their objectives and missions in poverty eradication are sustainable. The study focused on effects of Corporate governance on Financial performance of Microfinance Institutions in Kenya over a period of eleven years from 2005-2016. The study was necessitated by the lack of documented literature on effect of board diversity on financial performance of micro finance institutions regulated by SASRA in Kenya. The relevant literature was reviewed for the purposes of this study. Descriptive design was used in trying to establish the causal effect relationship between board diversity and the financial performance of the MFIs regulated by SASRA in Kenya. The target population was the 163 Licensed Micro Finance Institutions under the umbrella body SASRA where a sample size of 116 Microfinance Institutions was selected using stratified sampling technique. Data was collected from both primary sources and secondary sources based on availability and accessibility. Primary data was captured using structured questionnaires completed by CEOs with the help of management team as they were in a better position to comment on corporate governance affairs. Secondary data was collected from the financial reports, newsletters and brochures which is the most reliable source of microfinance financial data. The study found that board diversity is statistically significant to financial performance. The study concluded that board size board diversity is positively related to financial performance micro finance institutions. The organization should ensure that their board members are independent. This can be done by ensuring that the management does not interfere with the board activities and does not act in any way to influence the decisions made by the board.

Keyword: Dividend Policy, Financial Crisis, Micro Finance, Information Asymmetry, Internal Controls and Negative Shocks.

Introduction

Microfinance institutions (MFIs) have existed in many forms for decades, but have only recently garnered global attention as a commercially viable activity that can offer real opportunities for micro-entrepreneurs (Nayir, 2013). In the global scene, world bank report 2015 stipulates that the microfinance industry is estimated at $60 – 100 billion with over 200 million clients, in Canada and the United states Microfinance organizations target marginalized populations unable to access mainstream banking financing, close to 8% of Americans are unbanked meaning around 9million are without any kind of banking accounts or formal financing service most of these institutions are structured as nonprofit organizations with capabilities of extending credit up to $50,000. In Canada, CRA guidelines restrict microfinance loans to a maximum of $25,000. The average microfinance loan size in the US is US$9,732, ten times the size of an average microfinance loan in developing countries (US$973) (Dale & Graham, 2010).

Microfinance operates in developing and transition economies, often called the underserved, this population is composed mainly of the working poor, many of whom live on US$ 2 a day and are either self-employed or are micro-entrepreneurs, operating a micro-business (defined as having 10 or less employees) (Ledgerwood & White, 2006). Most of these people work in the informal sector, which in poorer countries may constitute up to 80 percent or more of the employed. The underserved have various ways to secure financing: from family and friends, from money lenders, and from traditional financing schemes, such as rotating savings and credit associations (ROSCAs). However, they do not usually have access to banks, either for borrowing or, perhaps more importantly, for a safe place to save (Melkamu, 2007).

On the local scene, Kenya is a developing economy with vast resources that necessitates its economic growth. Prominent Listed MFIs Registered by SASRA such as Kenya Bankers Association Sacco Society, Safaricom Sacco Society, Unitas Sacco Society and Waumini Sacco Society are among the most popular in Kenya, despite the relative poverty of their clients and dynamic economic challenges, MFIs have been able to extend credit to poor households, while still maintaining high repayment rates and financial sustainability, (Roy, 2008). Microfinance institutions in Kenya are registered under eight different Acts of Parliament namely: The Non-Governmental Organizations Co-ordination Act, The Building Societies Act, The Trustee Act, The Societies Act, The Co-operative Societies Act, The Companies Act, The Banking Act and The Kenya Post Office Savings Bank (KPOSB) Act. (Hussain, 2012) The proposed Micro Finance Bill has been developed by the Central Bank of Kenya, the Association of Microfinance Institutions in Kenya (AMFI), the Ministry of Finance and the Attorney General. The proposed Bill has been discussed with the stakeholders in various forums and their inputs have been incorporated in the draft. The Sacco Societies Regulatory Authority (SASRA) is a statutory state corporation established under the Sacco Societies Act (Cap 490B) of the Laws of Kenya (the Act) which came into full operation upon the gazettement of the Sacco Societies (Deposit-taking Sacco Business) Regulations, 2010 (the Regulations 2010) on 18th June 2010. The Act (Section 24) and the regulations (Section 4) detail the information required for licensing and among the major requirements are adequate capital ratios, moral and professional suitability of the boards and vetted business plans (Omino, 2012).

Regulation and supervision of the microfinance sector is expected to lead to quality growth, broaden the funding base for MFIs eligible to mobilize and administer deposits, credit facilities, other financial services, and initiate the process of integrating these institutions into the formal

financial system. The regulation of the sector will enable authorities to define procedures for their operations, entrance, exit, and ultimately create an environment for fair competition and efficiency in the sector. On the other hand, supervision encompasses all means by which regulators enforce compliance with a given legal and regulatory framework (McGee, 2010).

Following challenges such as mismanagement, conflicting mandates among regulatory bodies and poor corporate governance, the Savings and Credit Co-operative Societies (SACCO) Societies Act No. 14 of 2008 was put in place to address some of these challenges. (Rezaee, 2012) Good Corporate Governance entails effectiveness, competitiveness and sustainability of the society. It also ensures the achievement of objectives, innovation (improvement/new creations), quality production/products, competitive edge and credibility which would attract investments. It emphasis the use of resources efficiently, preserves physical and social environment, sensitivity to society's needs and social responsibility.

According to the SASRA Report of 2009, access to financial services improved with access to MFIs service doubling from 1.7% in 2006 to 3.4% in 2009, the picture has changed drastically by now. These improvements, however small, are an indication that financial sector transformations and reforms being undertaken based on the three pillars of stability, efficiency and access are translating into increased financial inclusion and consequently spreading financial services to the poor (Brickley *et al.*, 2009). Microfinance related services play a vital role in Kenya's economy. An estimated 10 percent to 15 percent of the population relies entirely on NGOs and informal associations for financial services. A national survey by Levitsky, (2007) estimated that 20 percent of the country's total employment was involved in microenterprises, contributing more than 25 percent of non-agricultural GDP. In 2007, Kenya passed the Microfinance Bill to regulate microfinance institutions in conjunction with the Association for Microfinance Institutions (AMFI), based in Nairobi and funded by a large USAID grant, (Ndung'u, 2014)

Statement of the Problem

Microfinance institutions in Kenya have gained low popularity in the recent past as potential investment prospects for local investors in Kenya, Corporate governance challenges have taken over business headlines with problems that need addressing (Herbling, 2015). Pursuant to Section 28 of the Sacco Societies Act as read with regulation 8 of the Sacco Societies (Deposit-Taking Sacco Business) Regulations, 2010, the Sacco Societies Regulatory Authority, published a notification to the general public a list of SACCO Societies whose licenses had been revoked due to non-compliance in accordance with Section 27 of the Act, the list had 6 microfinance institutions, among them, Banana Hill SACCO Society Limited and Jijenge SACCO (Mwaka, 2013).

12 credit unions were issued provisional permits to continue taking deposits and offering banking services as their regulators probed their compliance to capital and corporate governance requirements, Banana Hill Sacco had its deposit taking license revoked while Jijenge Sacco remained under statutory management, Kiambu based Jijenge Sacco was placed under statutory management on October 2014 due to high liquidity challenges, high external borrowing and inability to meet obligations to depositors and other third parties (Karanja, 2013).

It is only in 2012 that CMA began implementing corporate governance reforms which culminated in enactment of the new corporate governance codes, it comes in the wake of

scandals in listed firms and financial corporations with issued corporate bonds where at least 30 directors have been implicated, it is hard to ignore the common cases of imperial bank and chase bank which have been put under receivership by the Central bank of Kenya (Ngugi, 2014). According to Mwaniki, (2014) Kenyan MFIs score below average on gender board inclusivity with a percentage of women in boards going up to 16% in 2014 from 11% in 2013 and 6% in 2012, despite the improvements; the number of women in the boards remains a low which indicates a problem in Board diversity. 62% of the 52 companies reviewed companies had a non-Kenyan on their board out of which were multinational against a global non-national representation average of 79%. The Capital Markets Authority code of corporate governance guidelines recommends that a board shall have a policy to ensure the achievement of diversity in its composition based on academic qualification, technical expertise relevant industrial knowledge, experience, nationality age, race and gender. It is unfortunate that these guidelines are applied by companies based on a voluntary basis which creates a problem in that the shift to diversify boards can only be driven by individual firms as the law cannot compel companies to embrace it. Most Kenyan MFIs lag behind in appointment of non-national to board, thus denying themselves a chance to bench mark against global expertise (Juma, 2012).

Unfortunately, there is still a huge Knowledge gap on Corporate governance issues facing microfinance institutions in Kenya since most focus is on the well-established commercial bank that hit most of our today's business headlines, In addition the past few years many Kenyans have lost confidence in boards of MFIs, in some instances this has been due to cases of fraud and mismanagement, in under five years, high profile scandals and company collapses have led to massive losses and spelt doom for shareholders in Kenya which have ignited corporate governance reforms as those introduced by the Capital markets Authority in 2015, most importantly the CMA's revised code of corporate governance practices applies to all issue (Eckbo, 2001).

Various local studies have been carried out to ascertain the Corporate governance facets in various ventures of business, (Moenga, 2013) researched the effect of corporate governance on financial performance of Companies Listed in the Nairobi Stock Exchange in Kenya, (Karanja, 2013) looked into the effect of Corporate Governance on financial performance of small and medium enterprises. However, few contributions have been directed to enhancement of corporate governance on financial performance of MFIs in Kenya. On the global perspective, studies on the effect of Corporate governance on financial performance have also been insufficient and scarce with notable studies by Zegeye, (2010) looked into The Impact of corporate governance on Microfinance Institution Financial Performance in Ethiopia, Whereas Melkamu, (2007), empirically examined the effects of Corporate governance on Small Business Enterprises Growth in Ethiopia.

This study sought to fill the existing knowledge gap by providing acceptable corporate governance standards that suggests the best strategies, enhance value maximization of the firm, ensure cost minimization and enhance investments of shareholders of MFIs in Kenya. Understanding the effects of corporate governance is crucial in establishment of good sustainable MFIs in Kenya. The knowledge is largely missed in literature and constitutes a knowledge gap in Kenya; hence studying the field is important. The study contributed to development both existing and upcoming MFIs in Kenya and ensure that they adopt a favorable Corporate Governance Standards that maximizes value and ensure that they are competitive.

Objectives of the Study

The objective of the study is to examine the effect of board diversity on financial performance of micro finance institutions regulated by SASRA in Kenya

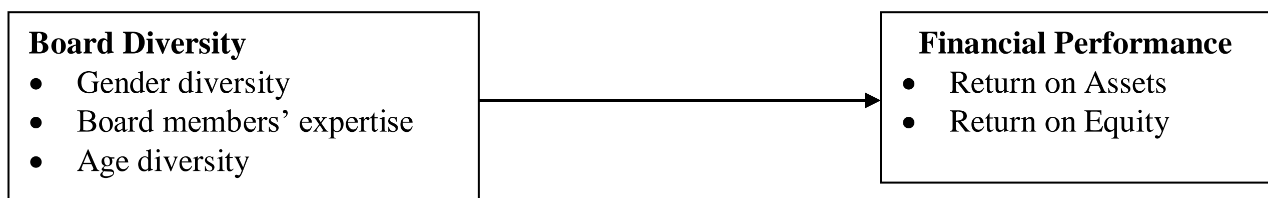
Theoretical Review

Stewardship Theory

This theory stipulates that managers left on their own will act as responsible stewards of the assets they control; this theory is an alternative theory to agency theory in which managers are assumed to act in their own self-interest at the expense of shareholders, it specifies certain mechanisms which reduce agency loss including tie executive compensation, level of benefits and also managers incentive schemes by rewarding the financially or offering shares that align financial interests of executives to motivate them for better performance (Donaldson & Davis, 2003). Stewardship theory is a theory which supports the CEO duality in a company and this theory is the rejection of the agency theory which explaining the negative effects of the duality role and suggests duality role should be separated. Stewardship theory emphasizes that a firm should apply the duality role where BOD is also the CEO of a company Stewardship theory is associated with board independence in that the board is able to pursue its independent agenda without interference from its founders (Bondigas, 2009).

Stewardship theorists argue that there is an important role for directors. Directors should empower governance structures and mechanisms to maximize the benefits of a steward. For CEOs who are stewards, their pro-organizational actions are best facilitated when the corporate governance structures give them high authority and discretion (Donaldson & Davis, 1991). Structurally, this situation is attained more readily if the CEO is also chair of the board of directors. The CEO-chair who is unambiguously responsible for the fate of the corporation will have the power to determine strategy without fear of countermand by an outside chair of the board. Thus, stewardship theorists argued that directors should play a greater role in facilitating and empowering managers instead of monitoring and control (Lehman, 2004)

Conceptual Framework



Independent Variable Dependent Variable

Figure 1: Conceptual framework

Board Diversity

According to findings of Carter, *et al.*, (2003), based on the fact that one of the key elements of agency theory is that board independence is critical for its functioning in the best interests of

shareholders, they examined this relation in 637 large American companies, considering the percentage of women and minorities (African Americans, Asians and Hispanics) on the board of directors as the measure of diversity and Tobin's q as the measure of firm value. The empirical results supported the existence of a positive relationship of participation on the board and also on committees of the board, Adams & Ferreira (2009), however, observed that the presence of women appears to have a significant impact on governance of boards, with women being more willing to join committees that monitor executive performance. This behavior can be explained by the investigation carried out by Sapienza *et al*., (2009), who using samples composed of MBA students concluded that women on average are more averse to risk than men in making financial decisions.

One of the important aspects of these results is that they were obtained with data on listed American firms without a majority controller, where the agency problem is essentially between executives and stockholders, with the board of directors having the function of mediation and control. When a company has a majority controller or controlling group, the fundamental governance problem is the controller's possible opportunism in detriment to the minority shareholders (Bebchuk & Weisbach, 2010). Working with data from companies listed on the Istanbul Stock Exchange, in which firms with majority control predominate, Ararat, *et al.,* (2010) did not find evidence that diversity in the board composition in relation to gender, age and education influence the market performance of Turkish companies.

Rost and Osterloh (2009) argue that the main reason why the directors of financial institutions did not foresee the fragility of their balance sheets in the run-up to the 2008 crisis was the growing homogeneity of the boards, with a lack of varied educational backgrounds and different viewpoints, leading to herd behavior and uniform group thinking (groupthink). Campbell *et al*., (2008). On the other hand, other arguments suggest that greater gender diversity may bring disadvantages to the firm. Greater gender diversity may increase the likelihood of conflicts. According to the census conducted by Australia's Equal Opportunity for Women in the Workplace Agency (EOWA), the percentage of female directors in Australia, the US, and the UK is estimated at 10.7, 15.4, and 12.2 percent, respectively. Scandinavian countries are leaders in terms of female representation in the boardroom, with the average percentage of 22.5 percent, as the result of gender quota policy (European Professional Women's Network—EPWN, 2006).

Financial Performance

Financial performance refers to the act of performing financial activity. In broader sense, financial performance refers to the degree to which financial objectives being or has been accomplished. It is the process of measuring the results of a firm's policies and operations in monetary terms. It is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. (Bertoneche & Knight, 2006). Financial performance is one of the indicators used to measure the success of a microfinance institution in terms of its financial returns. It is often considered a yardstick used by investors to conduct due diligence and assess the status of an investment; it is also used as a tool by government supervisors to assess compliance with regulatory measures and monitor the overall health of the financial sector, (Eshna, 2012) Each country issues its own accounting standards and reporting format for its constituents; however, several common financial performance indicators are used by most MFIs.

The financial performance assessment is devoid of such a multitude of options and methodologies despite critical importance of financial sustainability. Though an ambition for sustainable institutions has been often articulated, there is also an opinion that most microfinance institutions working in this field have been unsustainable (Cataldo, 2003). Studies have shown that this is predominantly connected to the perception of local micro borrowers. Risk and creditworthiness, and the diseconomies of scale in making small loans have been driving factors derived from these perceptions. Microfinance has been attractive to lending agencies because of demonstrated sustainability and low cost of operations. In Kenya, the engagement of shows see long term prospect for this sector (Eckbo, 2001).

Research Methodology

The design which was adopted for this study was descriptive design. The population for this study consisted of the 163 licensed Microfinance institutions registered with SASRA according to the SASRA annual report 2016. The study adopted a sample size of 116 which was arrived at using Sloven's formula for finite populations. The study adopted stratified sampling technique to give each element in the population an equal chance of being selected thereby eliminating bias.

The study utilized both primary and secondary data. Primary data was mainly collected through self-administered questionnaires, which contained structured and non-structured questions for directors. The data was analyzed using descriptive statistical techniques and frequency distribution percentages. Inferential statistics analysis was determined. The study conducted a correlation analysis to establish the strength of the relationship between board independence and financial performance. Multiple regressions were done to analyze the effect of board diversity on financial performance of micro finance institutions regulated by SASRA in Kenya. Data was presented using tables, and pie charts to make them reader friendly. In addition, a multiple regression was used to measure the quantitative data and was analyzed using SPSS too.

Research Findings And Discussion

Descriptive and inferential statistics have been used to discuss the findings of the study. The study targeted 116 respondents, 105 of the respondents filled and returned the questionnaire, forming a response rate of 90.5%. A response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent (Mugenda & Mugenda (2003).

Reliability analysis was done to determine the reliability of the questionnaire. The study used the Cronbach's Alpha. Gliem and Gliem (2003) established the Alpha value threshold at 0.7, thus forming a benchmark for the study. The Cronbach's alpha was used to determine the reliability of each objective. The findings board diversity as an alpha of 0.791. This shows that that board diversity was reliable.

Board Diversity and Financial Performance

The respondents were asked to indicate the number of women in the Board of the organization. The findings were as shown in Table 1. From the findings 44.8% of the respondents indicated that they had between 5-10 women in the Board of organization, 28.6% indicated that they had less than 5 women in the Board of organization and 26.7% indicated that they had more than 10 women in the Board of organization. This shows that the organization had several women in the Board of organization. Sapienza *et al*., (2009), using samples composed of MBA students concluded that women on average are more averse to risk than men in making financial decisions. However these findings disagree with Ararat, *et al.,* (2010) who did not find evidence that diversity in the board composition in relation to gender, age and education influence the market performance of Turkish companies

Table 1: Number of women in the Board of organization

Category	Frequency	Percent
Less than 5	30	28.6
5-10	47	44.8
More than 10	28	26.7
Total	**105**	**100.0**

The respondents were asked to indicate the number of men in the Board of the organization. The findings were as shown in Table 2. From the findings 46.7% of the respondents indicated that they had more than 10 men in the Board of organization, 36.2% indicated that they had between 5-10 men in the Board of organization and 17.1% indicated that they had less than 5 men in the Board of organization. This shows that the organization had several men in the Board of organization. Adams & Ferreira (2009), however, observed that the presence of women appears to have a significant impact on governance of boards, with women being more willing to join committees that monitor executive performance.

Table 2: Number of men in the Board of the Organization

Category	Frequency	Percent
Less than 5	18	17.1
5-10	38	36.2
More than 10	49	46.7
Total	**105**	**100.0**

The respondents were asked to indicate whether the organization's Board had Board members in different areas of profession. The results were as shown in Figure 2. From the results 56.2% of the respondents indicated that they had board members in different areas of profession and 43.8% respondents indicated that they had no board members in different areas of profession. This implies that organizations have board members in different areas of profession. These findings agree with Rost and Osterloh (2009) who, in his research found that most companies in East Africa are dominated by men with a 76% participation.

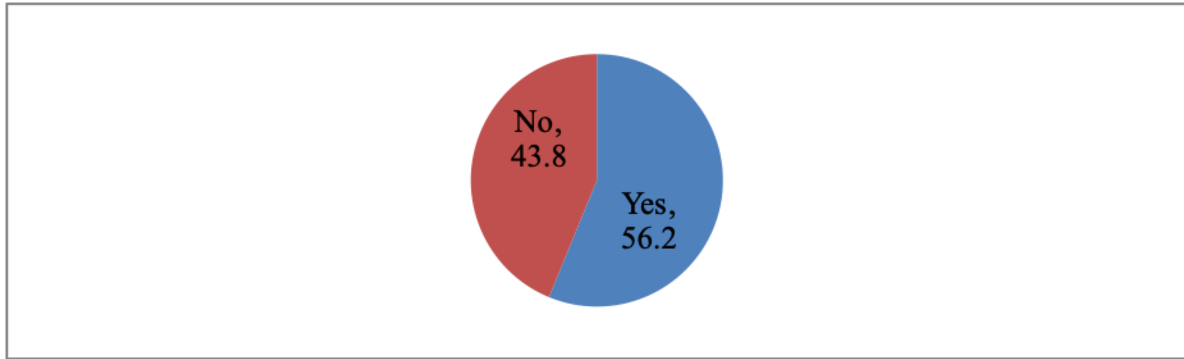


Figure 2: Composition of Board members

The respondents were requested to indicate the average age bracket of board members in the Organization. The results were as shown in Table 3. From the findings 45.7% of the respondents indicated that average age bracket of board members in the organization is between 30 to 45 years, 35.2% indicated that average age bracket of board members in the organization is above 50 years and 19% indicated that average age bracket of board members in the organization is less than 30 years. However, Ararat, *et al.,* (2010) did not find evidence that diversity in the board composition in relation to gender, age and education influence the market performance of Turkish companies.

Table 3: Average age bracket of board members in the Organization

Category	Frequency	Percent
Less than 30	20	19.0
30-45	48	45.7
above 50	37	35.2
Total	**105**	**100.0**

The respondents were asked to indicate their level of agreement with the following statements about the effect of board diversity on financial performance of micro finance institutions regulated by SASRA in Kenya. The results were as shown in Table 4. The respondents agreed that a gender-diverse board provides easier access to resources as shown by a mean of 3.971, greater diversity promotes the independence of the board as shown by a mean of 3.810, gender diversity promotes fast decision making as shown by a mean of 3.771, a diverse board allows the company to serve an increasingly diverse workers as shown by a mean of 3.686 and gender diversity ensures that different ideas are gathered before a decision is made as shown by a mean of 3.657. Adams & Ferreira (2009) observed that the presence of women appears to have a significant impact on governance of boards, with women being more willing to join committees that monitor executive performance.

Table 4: Effect of board diversity on financial performance

Statements	SD	D	M	A	SA	Mean	Std.
Greater diversity promotes the independence of the board	6	9	17	40	33	3.810	0.734
A gender-diverse board provides easier access to resources	5	10	11	36	43	3.971	0.874
Gender diversity promotes fast decision making	7	8	14	49	27	3.771	0.787
Gender diversity ensures that different ideas are gathered before a decision is made	8	11	15	46	25	3.657	0.715
A diverse board allows the company to serve an increasingly diverse worker	9	9	16	43	28	3.686	0.705

Correlation Analysis

The correlation analysis is used to analyze the association between independent and dependent variables. The results revealed that there was a positive correlation between board diversity and financial performance as shown by $\gamma = 0.781$, statistically significant $\varepsilon = 0.05$. This implies that board diversity postively correrate with financial performance is related.

Table 5: Correlation Analysis

		Financial performance	Board diversity
Financial performance	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	105	
Board diversity	Pearson Correlation	.781**	1
	Sig. (2-tailed)	.001	
	N	105	105

**. Correlation is significant at the 0.01 level (2-tailed).

Regression Analysis

Model Summary

Model summary is used to analyze the variation of dependent variable due to the changes of independent variables. The study analyzed the variations of financial performance due to the

changes in board diversity. Adjusted R squared was 0.693 implying that there was 69.3% variation of financial performance, due to the changes in board diversity. The remaining 30.7% imply that there are other factors that lead to financial performance which were not discussed in the study. R is the correlation coefficient which shows the relationship between the study variables. From the findings, the study found out that there was a strong positive relationship between the study variables as shown by 0.833.

Table 6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.833[a]	0.693	0.651	0.01643

Analysis of Variance

The analysis of variance ANOVA is used to determine whether the data used in the study is significant. From the ANOVA statistics, the processed data (population parameters) had a significance level of 0.008. This shows that the data is ideal for making conclusions on the population's parameter as the value of significance (ε value) is less than 5%. The F calculated was greater than F critical (44.425 < 2.463). This shows that board diversity significantly influence financial performance of micro finance institutions.

Table 7: Analysis of variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	17.763	4	4.441	44.425	0.008[b]
	Residual	9.996	100	0.100		
	Total	27.759	105			

Beta Coefficients

The regression equation was

$$\gamma = 1.117 + 0.696 X_2$$

The equation above reveals that holding board diversity to a constant, the variables will significantly influence financial performance of micro finance institutions as shown by constant = 1.117. Board diversity are statistically significant to financial performance as shown by (β = 0.696, P = 0.000). This indicates that board diversity had significant positive relationship with financial performance. This implies that a unit increase in board diversity will result to increase in financial performance.

Table 8: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.117	0.198		5.641	0.002
	Board diversity	0.696	0.112	0.563	6.214	0.000

Conclusions

Board diversity is statistically significant to financial performance. This indicates that board diversity had significant positive relationship with financial performance. The study concludes that board diversity is positively related to financial performance micro finance institutions.

Recommendations

The organization should ensure that their board members are independent. This can be done by ensuring that the management does not interfere with the board activities and does not act in any way to influence the decisions made by the board.

Areas for Further Research

The study objective was to examine effects of corporate governance on financial performance of micro finance institutions regulated by SASRA in Kenya. The study recommends that other studies should be carried on to examine effects of corporate governance on financial performance on insurance companies listed in the Nairobi Stock Exchange.

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