

External Business Environment and Performance of Microfinance Institutions: Empirical Evidence from Nigeria

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Abstract: This study examined the intensity of competition in the microfinance industry and its relationship performance of MFIs in Nigeria. From a sample of 121 MFIs in Nigeria, data was collected via a structured questionnaire. Data collected was analyzed via Partial Least Squares Structural Equation Modeling (PLS-SEM 3.0) using the Statistical Package for Social Science (SPSS v22) and, findings suggest that MFIs were faced with intense competition in the form of high cost and difficulty of entry, high operational cost and too many players in the industry regardless of the type of product and services they offer or lending policies they embrace. The result further reveal that the intensity of competition has significant negative influence on the amount of loans disbursed and the amount disbursed to women. The study therefore recommends MFI managers to develop operational mechanisms for cost and risk reduction to survive and excel.

Keywords: Business, Environment, Performance, Microfinance Institutions, Nigeria.

I. INTRODUCTION

The dynamism and complexity of competition as one important external factor in the business environment has been found to influence the activities of organizations and the way they choose to structure their business activities. As such, organizations need to organize their activities with more effective structures to maintain a balance between external forces and the internal environment (Gwasi & Ngambi, 2019; Moradi, Velashani, & Omidfar, 2017; Nkundabanyanga, Akankunda, Nalukenge, & Tusiime, 2017). Essentially, management of organizations must not only be aware of competition in the environment but also be able to oversimplify competitive information.

Yet, despite the relevance of the business environment to financial establishments such as microfinance institutions, there seems to be little interest in this study area. In fact, studies that examine the intensity of competition in the service sector or specifically or the degree of relationship between the competitive environment and performance of MFIs in Nigeria are negligible. A review of prior studies indicate concentration of studies in manufacturing firms (Nthigah, Iravo, & Kihoro, 2019; Oyewobi, Windapo, & Rotimi, 2016) and predominately in developed nations (Cull, Demirgüç-kunt, & Morduch, 2011; Gwasi & Ngambi, 2014; Moradi, Velashani, & Omidfar, 2017). Base on this information and research gap, the objective of this paper is to investigate the intensity of competition in microfinance industry and to examine the extent to which competition influence performance of MFIs in Nigeria. The arguments in this paper are presented in five sections. Following the foregoing background is the literature review in section two. Section three presents the research methodology. Section four presents the results ad discussion and in section five conclusions and recommendations are presented.

II. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Previous studies have adopted different approaches, definitions and dimensions of the business environment to examine its effect on organizational performance. For Drucker (1977), environmental influences such as economic forces can set limits to what management can do as well as create opportunities for management's action. Although these forces do not

by themselves determine what a business is or what it does, a business enterprise need to identify, manage and adapt to the forces in the environment. In this regard, Lenz (1980) noted that, there is no widely held consensus concerning how the environment should be assessed and which aspects of the environment affect performance.

According to Lenz (1980) the two methods usually utilized to assess the forces in the environment are usually taken along two dimensions such as from stable to shifting and from homogeneous to heterogeneous which, uses subjective measures to assess environmental complexity and uncertainty. The second method uses relatively objective measures to assess the relevant environmental factors such as demographic trends that can influence the goal attainment of an organization.

In this sense, Porter (1980) developed the five forces model to help explain the nature of a market. The model suggests that there are five specific forces (threat of new entrants or competitors, rivalry among existing firms, threat of substitute products or services, power of buyers, and power of suppliers) combine to drive competition in a particular market. Additionally, Porter (1980) emphasized the need for organizations to determine the intensity of each of the forces as each of the forces can influence the intensity of competition as well as determine the organizations operating in the market.

However, for Hashim (2018) the most common resources that business organizations compete for are customer votes and various organizations in different industries or markets also compete among themselves. It is in this regard that, Miller and Friesen (1983) earlier amplified the need for organizations to develop their capabilities to cope with changes occurring in their business environment. Thus, to cope with their dynamic, competitive and complex business environments, organizations must seek further environmental information to aid their abilities to revise their strategy development process so that they are able match business strategy with challenges of their competitive environments.

For organizations to achieve their objectives, they must be able to perform their operations efficiently and effectively. Organizations need to adopt effective business practices to help them accomplish their objectives as well as sustain their organizational performance. The performance of organizations is measured in terms of their abilities to achieve their specific organizational objectives.

The literature indicates that different organizations use different methods and measurement to determine their level of performance as well as to know the extent to which they are able to achieve the specific organizational objectives. Different organizations in different industry use different methods and measurement of performance because each different organization has different set of organizational objectives to accomplish.

In measuring the performance of an organization, it is necessary to identify as well as know its primary objectives. Organizations establish their primary objectives based on their business mission or the purpose they are created. Once the organizations have determined their specific objectives, they need to work on how best to achieve all of their objectives in a given period of time (Drucker, 1977).

Although the literature reveals that different organizations in different industries and countries tend to emphasize on different performance measurement, findings of past studies indicated that financial profitability and growth to be the most common measures of organizational performance.

For instance, the earlier study by Nash (1993) claimed that profitability is the best indicator to measure whether an organization is performing. According to the author, profitability can be used as the primary measure of organizational success. Doyle (1994) further considered profitability not only as the most common measure of performance but also claimed that western companies primarily used profitability measures to determine the extent to which their companies are performing.

The studies by Robinson (1982) and Galbraith and Schendel (1983) specifically found that financial indicators such as profit margin, return on assets, return on equity and return on sales are considered to be the common measures of financial performance of organizations. Similarly, in the context of the performance of manufacturing firms in Malaysia, the study by Abu Kasim, Minai and Chun (1989) found sales, sales growth, net profit and gross profit as the common financial measures.

However, in the case of MFIs, practitioners and researchers agree that these firms need to adopt different measures of organizational performance. As social business, MFIs have both financial as well as social objectives. Given this, the performance of MFIs should be measured by using not only financial but also non-financial or social measures (Thomasa & Kumara, 2016).

MFIs have different organizational objectives as compared to the commercial banks. Their organizational objectives are not only confined to financial profitability and sustainability but they also include social objectives such as social outreach as well as the impact of their loans on the lives of the poor people that borrowed from them. The need to measure the performance of MFIs by using both financial and social measures has also been supported by organizations such as the Consultative Group to Assist the Poor (CGAP), The Small Enterprise Education and Promotion Network (SEEP) and the impact network organization (Mustafa & Saat, 2013; Thomasa & Kumara, 2016). The following section explains briefly the financial and social performance relevant and applicable to MFIs.

The Financial performance involves measuring the progress of the operations and policies of an organization in monetary terms. The financial performance of an organization focuses on the extent to which the organization is able to achieve financial objectives such as amount of revenue and profitability. For instance, financial profitability can be measured by using net profit, return on investment, return on assets, return on equity and return on sales. In MFIs, financial performance can be assessed in terms of financial profitability, financial sustainability, return on assets, operational self-sufficiency, revenues portfolio yield, and operational costs (Barry & Tacneng, 2014; Christen, 2000; Mersland & Strøm, 2019).

From a review of literature on the impact, challenges of Micro Finance Institutions policies, prior studies largely focused on internal factors such as governance, ICT, ownership and capital structure with negligible research attention on the effects of external environmental forces such as competition. Especially when, to survive organizations must adapt their internal operations to the conditions that exist in their external business environment (Bluedorn, Johnson, Cartwright, & Barringer, 2019; Oyewobi, Windapo, & Rotimi, 2016). In view of the significance of competition and its suggested relationship with organizational performance, we hypothesize that;

Hi: Business environment does not significantly influence performance of micro-finance institutions

Figure 1 present the research model for the study. In the figure 1, the independent variable is intensity of competition and the dependent variable is performance. The model was proposed to examine the influence of Intensity of competition on the performance of MFIs in Nigeria.

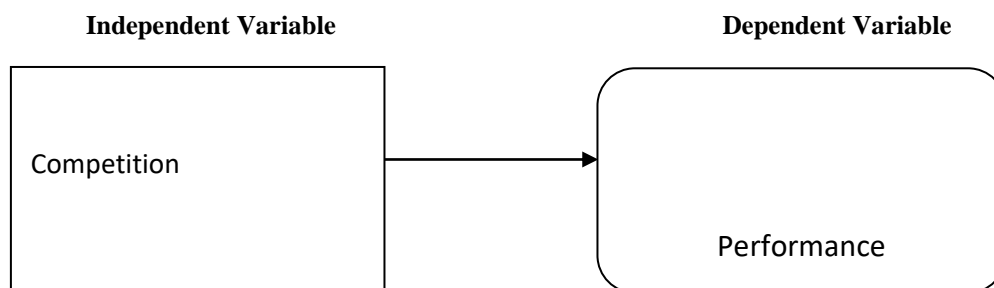


Fig 1: The research model

III. METHODOLOGY

The study is longitudinal given that data was collected for three years (2015-2017) to measure performance of all 872 MFIs licensed to operate microcredit businesses in Nigeria as its sample. According to the Central Bank of Nigeria (CBN) Directory, there are currently 872 MFIs in Nigeria located in 37 states. These include; Community Bank MFIs, Private MFIs, Government owned MFIs as well as Non-Governmental Organizations MFIs, and Foreign MFIs.

A structured questionnaire comprising one hundred and sixty-six (166) items on a five numerical scale ranging from “least applicable” (1) to “most applicable” (5) and in four sections was utilized to collect intelligence from selected heads of the MFIs. In section one, nine items collected respondents demographic data. Thirty-five (35) items in section two collected data of MFI characteristics. With one hundred and thirteen items, section three collected data on the management practices of the MFIs. Finally in section four, thirteen items collected data of the dependent variables. Of this number, nine items measured competition, and four items collected both financial and social performance data.

In measuring MFI performance, both practitioners and researchers agree that, MFIs as social businesses have both financial as well as social objectives (Thomasa & Kumara, 2016). Thus, the performance of MFIs will be measured using both financial and social measures. The need for measuring performance of MFIs using financial and social measures has been supported by many reputable organizations such as the Consultative Group to Assist the Poor (CGAP), The Small Enterprise Education and Promotion Network (SEEP) and the Impact Network Organization (Mustafa & Saat, 2013). Thus, value of loans disbursed, loans repayment, number of borrowers, and number of women borrowers for the period of three years (2015-2017) will be proxies of performance in this study in which, the average performance is utilized to assess the performance of MFIs.

To analyze collected data both descriptive and inferential statistics were utilized. In the first instance, data analysis presented descriptive statistics to determine the percentages, mean, mode, standard deviation, minimum and maximum values to make sense of the data sets. Furthermore, the Least Squares Structural Equation Modeling (PLS-SEM) was used to test the hypotheses of the study and to establish the extent of relationship among the variables of the study. The PLS analyses used in this study first, involved the assessment of measurement as well as the structural models. In the PLS regression analysis, assessment of measurement model was required for testing hypotheses. The assessment of measurement model involved examining individual item reliability, ascertaining internal consistency, convergent as well as discriminant validity. The results returned loadings greater than 0.70 and composite reliability value (CRV) of all constructs greater than 0.70. Additionally, both the Composite Reliability values Average Variance Extracted (AVE) values of all constructs were also greater than 0.50. Taken together, these results statistically confirm the convergent validity criteria as recommended by Hair et al. (2011). Furthermore, the Cronbach's Alpha scores of all items returned scores higher than 0.70. In addition, the study also assessed the structural model applying 5000 bootstrap samples and 121 cases as required by the standard bootstrapping technique (Hair, Hult, Ringle & Sarstedt, 2014) to validate the reliability of the model and measures used for the study in Nigeria.

Table 1: Composite Reliability, R square and Cronbachs Alph.

| | AVE | Composite Reliability | R Square | Cronbachs Alpha |
|-----|--------|-----------------------|----------|-----------------|
| COM | 0.6564 | 0.9299 | 0 | 0.9125 |
| PER | 0.7249 | 0.9271 | 0.2177 | 0.902 |

IV. RESULTS AND DISCUSSION

Descriptive Results

Table 2 presents the profile of 121 respondents that participated in the study. Of this number, 58 are general managers, 47 are senior managers and 16 are managing directors and chief executive Officers. With regards to their experience in the MF industry, 26 respondents (21.5 percent) have 10 years of experience and above in the industry, 92 respondents (76 percent) have between 5-9 years work experience in the industry, and 3 respondents (2.5 percent) have 1-4 years work experience in the industry. This is indicative of the fact that respondents are fit to satisfactorily respond to the questionnaire.

Table 2: Profile of the respondents

| Profile | Frequency | Percentage |
|----------------|-----------|------------|
| Gender: | | |
| Male | 90 | 74.4 |
| Female | 31 | 25.6 |
| Age: | | |
| 30-40 years | 52 | 43 |
| 41-50 years | 52 | 43 |
| 51-60 years | 17 | 14 |
| Ethnic: | | |
| Hausa | 25 | 20.7 |
| Yoruba | 44 | 36.4 |

International Journal of Novel Research in Marketing Management and Economics

 Vol. 8, Issue 1, pp: (19-25), Month: January - April 2021, Available at: www.noveltyjournals.com

| | | |
|----------------------------|----|------|
| Igbo | 28 | 23.1 |
| Other tribes | 24 | 19.8 |
| Level of Education: | | |
| Masters | 41 | 33.9 |
| Bachelor | 51 | 42.1 |
| Diploma/NCE | 29 | 24 |

Ninety respondents (74.4 percent) are male with only (25.6 percent) 31 respondents female. With regards respondents' education levels, 51 respondents possess various bachelor degrees, 41 others hold master degrees and 29 respondents had Diplomas or National Certificate of Education (NCE). This further confirms respondents' ability to adequately and satisfactorily respond to the questionnaire.

Furthermore, Table 2 presents the descriptive scores of the intensity of competition in the MFI industry in Nigeria. The mean and standard deviation scores of each item reveal the intensity of competition. The items mean scores ranging from 3.10 to 3.55 are above average value on a numerical scale of 5, indicating a high competitive intensity rate in the MF industry on every measure of competition intensity. The returned standard deviation scores ranging from 1.103 to 1.355.

Table 3: Descriptive Scores of the Intensity of Competition

| Item | Mean | SD |
|---------------------------------|-------------|--------------|
| Cost of Entry | 3.36 | 1.285 |
| Difficulty of entry | 3.50 | 1.355 |
| Approval difficulties | 3.47 | 1.329 |
| Many players | 3.27 | 1.183 |
| Competitors are equal | 3.18 | 1.245 |
| High operational cost | 3.55 | 1.103 |
| Easy switching by customers | 3.14 | 1.247 |
| Firms must succeed or fail | 3.21 | 1.251 |
| Firms are here to stay | 3.10 | 1.207 |
| intensity of Competition | 3.31 | 1.245 |

Results in Table 3 indicate an average mean score of 3.31 and standard deviation of 1.245 suggesting empirical evidence of high degree of intensity of competition in the MF industry in Nigeria. More specifically, the intensity of competition measured by difficulty of entry, many number of players, equality of players, high operational costs, easy switching by customers, and firms must succeed or fail. The implication is that, regardless of the type of products and/or services the MFIs offer or the lending policies they embrace risks are high in this industry. Thus, to survive and excel, managers of MFIs must be able to develop mechanisms to reduce costs to enhance competitiveness in order to achieve sustained performance.

Inferential Results

Having conducted ascertained the measurement model. Table 1 and 4 presents the regression results of the extent to which competition influence amount of loans generally disbursed, the amount disbursed to women as well as the quantum of loan repaid. The results indicate that there was a negative and significant influence between competition and performance as ($\beta = -0.467$, $t = 6.35$, $p < 0.000$). From the results we find that, there was a 46 per cent negative influence of competition on the amount of loans generally disbursed, amount disbursed to women which also negatively affect the amount of loan repaid in the MFI industry.

Table 4: Regression Analyses of the Relationship between Competition and Performance

| Hypothesis | Beta | Standard Error | T-Statistics | P-Value | Decision |
|---------------|-------|----------------|--------------|---------|-----------|
| H: COM -> PER | 0.467 | 0.013 | 6.35*** | 0.000 | Supported |

Note: ***P<0.01, **P<0.05, *P<0.1

Table 5: Performance Measures

| Indicators | Minimum | Maximum | Mean (M) | Std. Deviation (SD) |
|-----------------|---------|-----------|-----------|---------------------|
| Loans repayment | 4839.50 | 236353.60 | 18445.230 | 5764.065 |
| Loans disbursed | 6740.20 | 251440.00 | 21323.962 | 3173.023 |
| Total Borrowers | 4680.00 | 226500.00 | 11583.802 | 25642.217 |
| Women borrowers | 2060.20 | 24940.00 | 9740.160 | 5730.806 |

The findings from the analyses provides further support for the submissions of Cull et al. (2011), Gwasi and Ngambi (2014) Nkundabanyanga et al. (2017). Together they advance that in the MF industry, the intensity of competition affect the ability of firms to disburse funds to large number of beneficiaries, especially women. This generally affects the success of MFIs. This finding also supports the rejection of the study hypothesis that, competition is not a significant positive influence to MFI performance.

V. CONCLUSION

This study attempted to investigate the intensity of competition in microfinance industry and examine the influence of completion on performance of MFIs in Nigeria. The result of the analysis indicated that MFIs that participated in this study are faced by high intensity of competition in the industry. As shown in table 5, the result indicated mean score of 3.31 and standard deviation of 1.25. This reveals some evidence of high degree of intensity of competition in the MF industry. The finding is in line with the previous studies by Cull et al. (2011), Gwasi and Ngambi (2014) Nkundabanyanga et al. (2017). According to these studies, MFIs is faced by the intensity of competition in the market, and this competition affecting their success. More specifically, the intensity of competition items are *Great deal to get in business, Many competitor in the business, Competitors in the business are equal, Great overhead for the business, Easy switching by customers, and Firms must succeed or will go out*. The result also indicates that intensity of competition has influence on the performance of MFIs ($\beta = -0.467$, $t = 6.35$, $p < 0.000$). The result of shows that, the higher the intensity of competition the low will be the performance of MFIs. The implication is that, regardless of the type of product and services the MFIs offers or lending policies they embrace. Owner and managers of MFIs should be able to cope with their competition in the industry in order not only to improve their performance but also to sustain their success.

The owner and managers must be aware of the need to match their business practices with changes occurring in their business environment. In order to ensure that their financial institutions would perform better, owner and managers must ensure that their business practices can adapt to their changing business environment, particularly in terms of coping with the competition. In addition, owner and managers must realize that measurement of organizational performance of MFIs is complex construct.

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