FINANCIAL STRUCTURE AND PERFORMANCE OF MICROFINANCE: A CONCEPTUAL FRAMEWORK

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Abstract: Microfinance Institutions (MFIs) are considered not only as important institutions in the financial system but also play a significant role in the country’s social as well as economic development. This paper aimed at investigating the influence of financial structure on performance of MFIs. The review of the literature and findings of past studies shows that financial structure is not only linked to financial performance of microfinance institutions but its social performance as well. The paper recommends that, microfinance that need to perform both financially and socially should focused on enhancement of its financial structure. Furthermore, the paper suggests future research should investigate the influence of the financial structure on social and financial performance from empirical perspectives.

Keywords: Financial Structure, MFIs, Performance, Nigeria.

1. INTRODUCTION

Findings of past research suggest that effective capital structure is related to organizational performance in developed nations. Both previous conceptual as well as empirical studies have provided the evidence that indicate the linkage between capital structure and organizational performance (Daud & Mohamad, 2010; Hassan, 2010; June & Mahmood, 2011; Subramaniam, Shamsudin & Ibrahim, 2011). However, there is not much information on the nature of the relationship between capital structure and the financial performance of conglomerates firms in developing nations, specifically Nigeria. More especially, the studies by Asaolu (2011), Okpara (2018), Aliyu, Jamil and Mohamed (2014) and Adewuyi and Olowookere (2013), have suggested that more studies are needed to investigate the linkage between capital structure and financial performance of conglomerate in Nigeria.

Furthermore, previous studies that examined the relationship between capital structure and organizational performance have concentrated on investigating on performance as whole, the past studies have failed to investigate the capital structure on the individual dimensions of the performance (Mersland & Strøm, 2009; Tchakoute-Tchuigoua, 2010; Thrikawala, Locke, & Reddy, 2013; Chena, Wangb, Nevoc, Benitez-Amadod, & Koua, 2015; Madrara, 2012; Moradi, Velashani, & Omidfar, 2017).

Based on this information and research gaps, the objective of this paper is to investigate the influence of lending practices on financial and social performance of MFIs. The paper is presented in five sections. The following Section Two is literature review. Section Three is research methodology. Section Four is the result. Finally, Section Five presents discussion and conclusion of the paper.
2. LITERATURE REVIEW

Different organizations have different capital structures that are suitable for different debt to equity mix ratios. The basic goal of every organization is to set optimal capital structure that increase the firm’s value in terms of performance and increasing share price as well as minimum cost of capital to pay to borrowers.

The basic definition of optimal capital structure is setting the most suitable mix of equity and debt financing for the firms that can contribute in the overall performance of the firm and its profitability by decreasing the cost of capital normally referred to as Weighted Average Cost of Capital (Taiwo, 2012), the firm’s capital structure which increases the shareholder’s wealth and decreases the firm’s cost of capital is referred to optimal capital structure of the firm. The basic goal of optimal capital structure is to decrease the firms cost of capital and increase the shareholders wealth and firms overall performance.

Financial Structure

The term financial structure according to Kennon (2010) refers to the percentage of finance at work in a business by type. There are two forms of capital: equity capital and debt capital. Alfred (2007) stated that a firm’s capital structure implies the proportion of debt and equity in the total capital structure of the firm. Pandey (1999) differentiated between capital structure and financial structure of a firm by affirming that the various means used to raise funds represent the firm’s financial structure, while the capital structure represents the proportionate relationship between long-term debt and equity. The capital structure of a firm as discussed by Inanga and Ajayi (1999) does not include short-term credit, but means the composite of a firm’s long-term funds obtained from various sources. Therefore, a firm’s capital structure is described as the capital mix of both equity and debt capital in financing its assets.

However, whether or not an optimal capital structure exists is one of the most important and complex issues in corporate finance. Capital structure, preferred stock and common equity are mostly used by firms to raise needed funds. Capital structure policy seeks a trade-off between risk and expected return. The firm must consider its business risk, tax positions, financial flexibility and managerial conservatism or aggressiveness, while these factors are crucial in determining the target capital structure, operating conditions may cause the actual capital structure to differ from the optimal capital structure.

Capital structure decisions have always been considered as very important for every business organization, especially in corporate firms where these decisions are taken by management with an aim to maximize firm value. It should be noted that the aim of maximizing firm value is a very important one as it is concerned mainly with choosing a balanced ratio of debt and equity securities in a way that considers the expense and benefits associated with these securities. Also, a poor judgment in selecting the right mix of debt and equity could result in financial distress and may lead to bankruptcy eventually (Sheikh and Wang, 2011).

The need to determine the right mix of debt and equity or the optimal capital structure for a firm has led to the development of alternative capital structure in recent times, though this has not led to the realization of a major methodology for the determination of an optimal debt level. Sheikh and Wang (2011) suggest that this could be attributed to the fact that most of the theories related to capital structure vary in their focus. Sheikh & Wang (2011) noted that despite these differences, these theories still help in providing an understanding of the funding behavior of firms.

There is a huge number of works focused on developed or industrialized nations and only a few have touched developing nations. Chen (2004) notes that research on capital structure has, in recent years become more internationalized. Worthy of note is the research by Rajan & Zingales (1995), which used models of capital structure taken from research on US firms (Mouamer 2011). Wald (1999) in his assessment of the characteristics of firms that were not correlated with debt ratios among countries also showed that a country’s institutional structure may have a huge effect on firm’s capital structure decision and also that agency and monitoring problems that exists in different countries had the potential of bringing varying outcomes.

In addition, the review of past research on capital structure shows that there are several issues related to the methodology adopted in prior empirical studies. Among the issues identified in previous research include the following: too much use of company group accounts to analyses individual company performance, limited formulation and testing of research
Financial and Social Performance of Microfinance

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, 2009).

The social performance of MFIs emphasizes social objectives such as their ability to provide loans to larger numbers of very poor family and also the impact of the loans on their lives. The outreach of loans and their impact on the borrowers are measured in terms of breadth, depth, length, scope, cost and number of poor people served, the number of women borrowers, how well the MFIs reaches the poorest and the variety of financial services available (Barry & Tacneng, 2014; Navajas, Schreiner, Meyer, Gonzales-Vega & Meza, 2000; Schreiner, 2002; Zelle & Meyer, 2002).

The Welfarist approach also emphasizes on the need to primarily focus on the social performance of MFIs. According to this approach, the funds and grants given to MFIs are equities donated by social investors and other voluntaries bodies for the purpose of social lending. These investors forgo the financial returns of their investments for the pleasure they derive from helping the poor people. They expect the MFIs to uplift the lives of the poor and improve their social welfare. The Welfarist approach measures the performance of MFIs based on the level of social impact achieved by them. As far as the performance of MFIs is concerned, the approach views the social impact as more important than their financial sustainability. This is because the purpose or mission of MFIs is to provide positive social impact on the lives of the poor people (Mustafa & Saat, 2013; Bosire et al., 2014; Cinca & Nieto, 2014).

Yaron (1992) proposed a two core criterion dimension framework for measuring the performance of MFIs. The two core include: outreach and sustainability. The outreach refers to the numbers of loans provided to the poor while the sustainability involves the total cost of providing the microloans. The outreach criteria measure the performance of MFIs in terms of the financial services provided to the poor people and those targeted for the loans. Sustainability measures MFIs dependency on subsidies based on the Subsidy Dependent Index (SDI). This framework has gained much acceptance and has been adopted by researchers (Nanayakkara, 2012; Schreiner, 1997).

Zelle and Meyer (2002) developed the three dimension criteria structure by including the welfare impact to the two criteria framework developed earlier by Yaron (1992). According to Zelle and Meyer, the three criteria needed to measure the performance of MFIs include: delivery of their services and outreach, financial sustainability and welfare impact. The performance of the microfinance programmes should be measured based on the three criteria. The Zelle and Meyer model involved three circles and triangles. The inner circle of the triangle of microfinance represents the microfinance institution’s innovations in technology, policy, organisation and management that can affect how well each objective is met. However, there is a trade-off in meeting the objectives of achieving financial sustainability, reaching the poorest and in ensuring the borrower is impacted positively. Nonetheless, there are people who believe that it is not possible for a microfinance institution to achieve financial sustainability and reach very high numbers of the poorest borrowers at the same time.

The study by Mayoux (2001) evaluated the impact of microloans schemes by adopting the donor-led and the practitioner-led prospects. Donor led involves assessing the impact on poverty at the levels of the enterprise and the family. This approach is useful in improving the microfinance services, encouraging innovation, determining the impact of microcredit services in reduction of poverty and women empowerment. The practitioner-led approach however was introduced for gathering the information needed to improve microfinance programs relatively rather than substantiating the impact at the levels of enterprises, families, individuals and communities.
3. CONCLUSIONS

This study attempted to examine influence of financial structure on performance of MFIs. Based on the review of past study and literature, the study suggest association between financial structure and organizational performance of MFIs. These findings add support to previous studies that suggest MFIs do practice some form of lending practices. This finding is consistent with the earlier observations made by Yunus and Yusus (1998) and Olanike and Adeola (2014). These indicates that MFIs that practices a good financial structure, will perform not only financially, but socially as well. The paper suggests future research should investigate the influence of the financial structure on social and financial performance from empirical perspectives.

REFERENCES


