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Effects of Corporate Governance on Micro Finance Institutions Financial Sustainability in Kenya

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ABSTRACT

The study focused on the effects of corporate governance on Microfinance Institutions financial sustainability in Kenya over a period of eleven years from 2000-2011. The study was necessitated by the lack of documented literature on the effects of corporate governance in Kenya given the dynamic structure in the liability composition of these institutions. The main objective of the study was to investigate the effect of corporate governance on Kenyan Microfinance institutions sustainability. The relevant literature was reviewed for the purposes of this study. Explanatory research design was used in trying to establish the causal effect relationship between corporate governance variable (which were; board size; CEO duality; composition of the board and CEO gender) and the financial sustainability of the MFIs in Kenya (measured using ROA). The target population were the 42 registered Micro Finance Institutions under the umbrella body AMFI where a random sample of ten institutions were selected using the cluster sampling technique. Data was collected from both primary sources and secondary sources. Primary data was captured using structured questionnaires completed by the CEOs and the senior management team as they were in a better position to comment on corporate governance affairs. Secondary data was collected from the Mix market which is the most reliable source of microfinance financial data. The study utilized panel data analysis methodology in drawing conclusions about the study. It was found that the average board size was 8 members with 10% of the institutions having the CEO double up as the chairman.40% of the institutions surveyed had a female CEO. Empirical findings confirmed that board size was significant in affecting financial sustainability at 99% confidence level (t values=2.79), CEO gender was significant at 99% confidence level (t values=2.487), CEO duality was significant at 95% confidence level (t values= 7.69) and board composition significant at 99% confidence level (t values=-2.57). The study recommends moderate board size a higher board independence separation of CEO and chairman and a greater incorporation of women in the board.

Key Words: Micro-Finance Institutions, Sustainability, Board Size, Board Composition, CEO duality, CEO Gender.

1.0 Introduction

According to the Consultative Group to Assist the Poor (CGAP, 2006), Microfinance is the provision of basic financial services to impoverished clients who otherwise lack access to financial institutions. The main activity of microfinance is microcredit, which refers to the extension of very small, uncollateralized loans; usually of less than $100 (Micro Banking Bulletin, 2006). Microfinance institutions are institutions that offer microfinance services to the poor. Corporate governance on the other hand is concerned with maintaining a balance between economic and social goals, and between individual and collective aims, while encouraging efficient use of resources and higher levels of accountability (Kansiime, 2009). Helms, (2006) states that governance was about achieving corporate goals. For MFIs, multiple goals exist. The fundamental goal is to contribute to development which involves reaching more clients and poorer population strata. A second goal is to do this in a way that achieves financial sustainability, preferably independence from donors. While Rhyne (1998) considers these two main goal areas to be a 'win-win' situation, claiming that those MFI institutions that follow the principles of good banking will also be those that alleviate the most poverty. Woller (1999) and Morduch (2000) think that the proposition is far more complicated. This study sought to investigate corporate governance in Kenyan MFIs by studying the impact of corporate governance on financial sustainability.

Financial systems as a whole continue to evolve and find new ways to meet demands for financial services in emerging markets. The innovative and rapid development of many localized efforts to provide financial services to the poor outside of formal channels has generally anticipated government action through new policies and regulations (Kansiime, 2009). MFIs have therefore devised innovative strategies to keep afloat in the competitive realm of retail lending and deposit-taking operations. The liability structure highlights the primary sources of funding for MFIs: equity, donor funds, concessional and commercial borrowings, members' savings, wholesale deposits from institutional investors and retail savings from the public. MFIs differ from each other mainly because of their liabilities, rather than their asset types. It is this liability structure that has forced Kenyan MFIs to pay attention to corporate governance where the Kenyan government has introduced the MFI Act 2006 that stipulates the desired governance structure for the deposit taking MFIs. Apart from the Act, AMFI (Association of Microfinance institutions) provides a guideline on how the MFIs should be governed. The need for Kenyan MFIs to transform into deposit taking institutions has necessitated these institutions to embrace good governance practices. This study traced the effect of corporate governance on Kenyan MFIs financial sustainability.

According to Kyereboah-Coleman and Biekpe (2005), studies on the effects of corporate governance on microfinance institutions (MFIs) financial sustainability are quite few and in most cases these studies have been carried out in developed nations focusing mainly on large and listed firms. It is also believed that good governance brings investor goodwill and confidence. Good corporate governance is important for increasing investor confidence and market liquidity that enhance the performance of the firm (Donaldson, 2003). Corporate-governance mechanisms assure investors in MFIs that they will receive adequate returns on their investments (Shleifer & Vishnys, 1997). In this study, financial sustainability will be measured by the Return on Assets (ROA) in relation to corporate governance of selected institutions in Kenya. The corporate governance characteristics which were identified by this study are the composition of board members, CEO gender and duality and board size.

1.1 Statement of the Problem

Owing to the lack of documented empirical literature on the effect of corporate governance on Kenyan MFI financial sustainability, this study sought to establish whether corporate governance in Kenyan MFIs has an effect on their declining performance which compromises of their financial sustainability. Most MFIs in Kenya derive their funds from donors and wholesale retailers. These two sources of funds are deemed expensive and scarce for the sustainability of these MFIs. As such these institutions have sought alternative sources of funds such as public deposits in order to finance their activities and expansion. It is this venture into public deposits that has necessitated the need for good corporate governance from both the Government and all stakeholders alike. Given the fact that there exists no deposit protection insurance fund for MFI depositors, good corporate governance becomes even more important.

The aspects of governance identified by this study and how they affect financial sustainability of microfinance institutions are; independent directors, board size and duality and gender of CEO. Poor performance of microfinance institutions has become an issue in Africa and majority of these institutions are beginning to embrace corporate governance on their strategic management plans so as to enhance their sustainability. Good corporate governance is deemed instrumental in strengthening performance and sustainability of microfinance institutions (MFIs) as well as increasing outreach of microfinance (Mersland & Strom, 2007). This study investigated the effect of independence of directors, board size and duality on the financial sustainability of Kenyan MFIs.

2.0 Literature Review

2.1 The Concept of Corporate Governance

Governance is concerned with the processes, systems, practices and procedures that govern institutions, the manner in which these rules and regulations are applied and followed, the relationships that these rules and regulations determine or create, and the nature of those relationships. Essentially, governance addresses the leadership role in the institutional framework (Siele, 2009)

Corporate Governance, therefore, refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission. It is concerned with creating a balance between economic and social goals and between individual and communal

goals while encouraging efficient use of resources, accountability in the use of power and stewardship and as far as possible to align the interests of individuals, corporations and society

According to Deakin and Hughs (1997) corporate governance is concerned with the relationship between the internal governance mechanisms of corporations and society's conception of the scope of corporate accountability. Kansiime (2009) observes that corporate governance as the way corporate power is exercised by an organization in the management of its portfolio of assets and resources, with objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its mission. It has been observed that corporate governance include the structures, processes, cultures and systems that engender the successful operation of organizations (Keasey, 1997)

Lapenu and Pierret (2006) argue that when discussing governance, it is necessary to broaden the scope of study to include all stakeholders e.g. employees, managers, elected officials, clients, donors, bank partners, shareholders, the government, etc. however this study was limited to the board of directors and the CEOs of MFIs. Kyereboah-Coleman and Bike (2005) posit that companies have now realized that good governance generates positive returns to a firm and boost customer confidence.

2.2 The Concept of Microfinance

Microfinance is defined as the provision of financial services, mostly savings and credit to the poor and low income households that otherwise don't have access to mainstream commercial banks (Rock *et al.,* 1998). Ledgerwood (1999) defines microfinance as the provision of financial services to low income clients. According to Robinson (2001) Microfinance is financial services primarily credit and savings provided to people who farm, fish or herd at a small scale and those who operate small enterprises.

Microfinance industry is the primary source of credit and saving to low income earners. The industry is currently growing rapidly and how they are governed therefore matters (Kyereboah-Coleman & Biekpe, 2005). Stakeholders in the industry have recognized that good governance is an important element in the success of the MFIs (Campion, 1998); (Rock, 1998). In spite this observation, only a few studies have focused on governance and the examination of the linkage between various governance mechanism and performance (McGuire, 1999).

Over the years, the success of MFI in Kenya has been found to depend on one person or a small group of people who are committed to the long term goals of the organization. But as the institution develops, new skills become necessary and the management team may need to expand and reinforce its skills and put good governance structures in place. MFIs in Kenya include Rotating Savings and Credit Associations (ROSCAs), Accumulating Savings and Credit Associations. (ASCAs), Savings and Credit Cooperatives (SACCOs), Non-Governmental Organizations NGOs as well as informal money lenders. Some of the MFIs are transforming to regulated MFIs (incorporated MFIs) where they can be taking deposit from the public and this call for effective corporate governance especially for deposit taking MFIs to protect small unsophisticated depositors (Siele, 2009).

2.3 Corporate Governance and MFI Financial Sustainability

The ultimate goal of microfinance sector is to contribute to development and alleviation of poverty. This involves reaching more clients and poorer population strata; the so-called main outreach 'frontier' of microfinance or hardcore poor (Siele, 2009; Helms, 2006). MFIs target is to achieve its main goals in a way that achieves financial sustainability, preferably independence from donors. Rhyne (1998) claims that MFI that follow the principles of good banking will also be those that contribute significantly to poverty reduction.

It has been noted that after two decades of inactivity, governments in Africa have demonstrated new commitment to reforms and a correspondingly enhanced potential for national development (Kansiime, 2009).These reforms have targeted governance, decentralization, democratization, economic liberalization and contributing to the emergence of a competitive private sector.

According to Lafourcade *et al.* (2005), even though MFIs in Africa lags behind other global regions in terms of financial performance, a growing number of MFIs, especially regulated and cooperative MFIs are profitable. MFIs also lead the world in savings mobilization, in both the number of clients served and the absolute volume of savings on deposit. MFIs still face several challenges which include working in rural areas where population density and poor infrastructure result in high operating costs. As a result, institutions continue to seek ways to

increase efficiency through better communication, improved lending products that respond to clients' needs and modern technology (Siele, 2009)

According to Brickley (1994) and Byrd and Hickman (1992) good corporate governance enhances MFI performance. In spite of the generally accepted notion that effective corporate governance enhances MFI performance, other studies have reported a negative relationship between corporate governance and MFI performance (Hutchinson, 2002). Accounting based measures for example return on asset, return on equity and return on capital employed or market value of equities could also contribute to this inconsistency (Gani & Jermias, 2006).

From the previous research it has been observed that performance improves when the roles of chief executive officer and chairman are split, the CEO is a woman and the loans are made to individuals (Mersland & Strom, 2007; Siele, 2009).

2.4 Board Size and MFI Financial Sustainability

It has been noted from the previous studies that board capacity to function effectively partly depends on its size (Rock *et al.,* 1998). Although there is no optimum number of board members, the number should not be too small or too big. A microfinance board should be large enough to incorporate the various skills, including audit skills, legal knowledge, knowledge of the target market and social perspective in order to complete their work effectively (without overburdening members), to provide continuity, and to ensure quorums for meetings (Council of Microfinance Equity Funds, 2005; Rock *et al.,* 1998; Siele, 2009). It was further stated by the Council of Microfinance Equity Funds (2005) that it is important to have people in the board that are politically influential so that they can assist with political issues, tap funding, and to enhance public image.

Jensen (1993), Lipton and Lorsch (1992) and Siele (2009) observe that large boards can be less effective than small boards for a CEO to control. The idea is that when boards become too big, agency problems, such as director free-riding, increase within the board and the board becomes more symbolic and less a part of the management process. To add on that, Raheja (2005) observes that larger boards have higher coordination costs and decision making process takes long time though the decision is of equality. Arguably, board size must be small enough to accommodate the need for frequent meetings and for the group to work together to make substantive decisions (Council of Microfinance Equity Funds, 2005); (Rock *et al.,* 1998). Lipton and Lorsch (1992) supported the same number of board size 7-9 members, though effective boards may also have eleven or more members.

However, some researchers (Siele, 2009) argue that as board size rises, board activity is expected to rise to compensate for rising process losses. Besides, fewer than seven is not generally advisable, as the quorum may be small, especially if the management is included in the board. In addition, boards should consist of an odd number of members to curb potential deadlocks when votes are taken but in some cases where the size of board members in an even number, one would not vote and in most cases the board secretary who happens to be the institution manager. The size of the board is measured by the number of directors on such boards. *Thus this led to our first hypothesis that Board composition has no significant effect on Kenya's Microfinance institutions financial sustainability.*

2.5 Board Composition and MFI Financial Sustainability

Independence of the board members is particularly important because the board holds management accountable and to respond to external actors and issues of external accountability. Investors and donors consider the character and independence of the board as assurance that their funds will be used properly (Rock *et al*., 1998; Siele, 2009). Many researchers have underscored the vital role of outside directors in protecting shareholders' interest through effective decision control (Weisbach, 1988). John and Senbet (1998) argued that boards of directors are more independent as the proportion of their outside (non-executive) directors are more than executive members. Even though it has been argued that the effectiveness of a board depends on the optimal mix of inside and outside directors (Baysinger & Butler, 1985), the available details on the determination of optimal board composition is scanty.

According to Kyereboah-Coleman and Biekpe (2005), executive directors are more familiar with MFI activities and therefore are in a better position to act as monitors with regard to the top management. On the other hand, it is contested that non-executive (external) directors may act as professional referees to ensure that competition

among insiders stimulates action consistent with shareholder value maximization. Most prior research has focused on board composition and has underscored the important role of outside directors in protecting shareholders' interest through effective decision control (Siele, 2009).

There is no significant relationship, as previously discovered by researchers (Kyereboah-Coleman & Biekpe, 2005) between the number of non-executive directors and MFI performance. Hermalin and Weisbach (1991) failed to obtain the connection between board composition and firm performance. They argue that inside and outside directors have their respective merits and de-merits. If each board is optimally weighted, insiders and outsiders, there would be no cross-sectional relation between board composition and performance equilibrium. Another explanation advanced by them is that firms reduce their agency problems to the same residual levels. Since residual agency problems are all that matter for performance, variation in performance will be uncorrelated with mechanism used (for instance board composition) to reduce the underlying agency problems. The independence of the board was measured by getting the ratio of non-executive directors to board size and it was expected to have a positive relationship with MFI performance. *Thus this led to our second hypothesis that CEO-Chairman duality has no significant effect on Kenya's Microfinance institutions financial sustainability.*

2.6 CEO'S Gender and MFI Financial Sustainability

Women CEOs enhance performance of microfinance institutions and improve sustainability (Kyereboah-Coleman & Biekpe 2005; Mersland & Strom 2007). Women it is believed could add value by bringing different perspectives, experiences and opinions (Siele, 2009). Also it is believed that women generally have higher expectations in terms of responsibilities as directors which could influence the board's effectiveness towards productivity (Fonda & Sassalos, 2000). According to Mersland and Strom (2007) having a high fraction of women on the board would help the MFI understand its customers better; which is expected to translate into better MFI performance due to the fact that many clients in MFI are women.

Studies on gender diversity in the boardroom showed that female directors have fewer attendance problems at board meetings than their male counterparts suggesting that diverse boards could be more effective and productive than homogenous boards. Gender composition also plays a vital role in organization design for corporate board (Adams & Ferreira, 2004; Siele, 2009).

Return on assets as a measure of firm performance is positively and significantly correlated with the ratio of women on corporate boards. According to microfinance, polices to promote gender diversity in governance have proved appropriate. In regard to gender, prior studies captured female CEOs as a dummy with a value of 1 when a CEO is a female and a value of 0,otherwise while gender composition was measured as the proportion of women serving on a board to total board size (Siele, 2009). Adams and Ferreira (2004) show that female directors are able to concentrate on the institution wellbeing and are able to represent the clients' needs since majority of them are women. *Thus this led to our third hypothesis that CEO gender has no significant effect on Kenya's Microfinance Institutions financial sustainability.*

3.0 MATERIALS AND METHODS

The study employed an explanatory survey design. This study utilized cluster random sampling technique where a representative sample of ten MFIs was selected from the 52 MFIs in Kenya. This sampling method was used due to the distinctive nature of the MFIs operating in the country. On one hand, there were the deposit taking Microfinance institutions that had distinctive governance requirements due to their liability structures and regulatory requirements. On the other hand there were the donor funded MFIs that had no stipulated governance structures.

The primary data was obtained through administered questionnaires that targeted the Chief Executive Officers, the senior management team, since they are in a better position to have all the information pertaining corporate governance in their organizations.

On the other hand, secondary data was collected using a data collection schedule and was mainly derived from the annual financial reports starting from the year 2000 to the year 2011 and board meetings minutes. Additionally, vital financial data was obtained from the Mix Market which is the most reliable source of microfinance financial data.

The general regression model adopted by the study is outlined below;

$ROA_{it}= \alpha_{it} +\beta it\ GOV+ \mu_{it}$……………………………………………………………**Equation: 1**

ROA is the proxy for MFIs sustainability (dependent variable) and represents Return on Assets (ROA) of the MFIs under study.

α is the **intercept (**y intercept), βit is **slope** coefficients of explanatory variables. Where subscript *i* denote the individual institutions characteristics across time dimension *t.*

GOV is vector of governance (independent) variables which are; board size, board composition, CEO gender and CEO duality.

Board Size (B.S), is the number of board members for the MFIs during the period under review.

Board Composition (B.C), number of outside directors and women out of total number of directors for the MFIs during the period under review.

Gender (CEOGEN) captured whether a CEO was a female or otherwise, it adopted a dummy variable where, 1 was if CEO was a female and 0 if otherwise for the MFIs under review.

CEO duality (CEOD) captured if the board chairperson was the same as the CEO or otherwise. 1 if CEO doubles as chairman and 0 if does not double as chair.

μ_{it} was the **error term** (residual variable) and represents the unobservable MFIs characteristics not captured in the model. The error term was a two way error component model which is specified in equation 2 below and was used to test the robustness of the estimation model.

$\mu_{it} = \alpha_i + \lambda_t + v_{it}$……………………………………………………2

Where; α_i denotes the unobservable individual MFI specific effects, λ_t denotes the unobservable time effect and v_{it} is the remainder stochastic disturbance term. The robustness of the model was tested using the fixed effects and random effect two way error component models. Under the fixed effect model, the α_i *and* the λ_t are assumed to be fixed parameters to be estimated and the remainder disturbances stochastic with vi_t~ IID (0, $\sigma^2 v$). The *Xi t* are assumed independent of the v_{it} for all *i* and *t* (Batalagi, 2005). in this case,the juijMFI specific unobserved variables such as culture experience and regulation are taken care of. The random effects model on the other hand the α_i ~ IID (0, $\sigma^2\alpha$), λ_t ~ IID (0, $\sigma^2\lambda$) and v_{it} ~ IID(0, $\sigma 2\ v$) are independent of each other. In addition, X_{it} is independent of μ_i, λ_t and v_{it} for all *i* accordingly any correlations between the error term and the independent variables is taken care of.

4.0 RESULTS AND DISCUSSION

4.1 Correlation Analysis Results

4.1.1 Correlation between Board Size, Board Composition and MFI financial sustainability

The study objective was to examine the board size and its composition and the effect on the financial sustainability of the MFIs. The result shown on the table 1 shows that the average size of MFIs directors is 8 members which is well within the recommendation of council of microfinance equity funds which is 7 to 9 members. The standard deviation was 2.68 and maximum board size of 18 and a minimum of 4 board members suggesting that they were widely dispersed. Jensen (1993) and Lipton and Lorsch (1992) observed that large board size are less effective for the firm financial sustainability because board members take long to make decisions and to agree on matters concerning the organization. Coordination of large board is also difficult especially when they are required for meetings. This pushes the cost up especially if there are many international directors whose travel and other expenses the MFI must facilitate (Raheja, 2005).

The composition of non-executive board members is measured as a ratio of total non-executive members divided by total board members while composition of women serving in the board was taken as a ratio of total women in the board divided by total board members. Descriptive results from table 1 show that women who serve in the board are fewer than men at an average of 34% of total board members. In some of the MFIs there were no women serving in the board in particular years and that is why the minimum number is 0%. Since MFIs in Kenya offer services to both men and women men have dominated these boards. A point to note is that majority of MFIs clientele are women because of the position they hold in the society. In one MFI (KWFT) there were 100% women in the board since that MFI was offering services to women only. It has been observed Hartarsaka (2004) that boards that have higher number of women reach more poor borrowers as well as being more profitable.

Most MFIs have a higher degree of independence since they have more non-executive directors in the board. The average mean percentage of non-executive directors is 83% while median is 87%. Non-executive directors are

able to make independent decisions without the influence of management and they play an oversight role since management cannot check itself (Kyereboah-Coleman & Biekpe, 2005). Jensen (1993) observes that boards that have non-executive directors from diverse background and skills perform better.

4.1.2 Correlation between Duality and Gender of CEO and MFI financial sustainability

The study showed that 10% of all MFIs had CEOs who also doubled as the board chairperson which generated a lot of conflict since the management could not check itself especially when decision control and decision management functions were embedded in one position. On the other hand 90% of MFIs had two individuals occupying the positions of board chairperson and CEO which gave the board enough power to make independent decision and also act as oversight body for the management. CEO duality was a dummy variable which was allocated 1 when CEO combined as the board chairperson and 0 if otherwise.

The study also examined the effects of gender as proxy for corporate board diversity on performance of MFIs. The gender of CEO was a dummy variable which was allocated 1 when CEO was a woman and 0 when otherwise. The table 2 shows that 75% of MFIs were led by male CEOs this is despite the fact that their target clientele were mainly women. This left only 35% of selected MFIs led by women. MFIs perform better when CEO is a woman because she able to connects well with clients who are mostly women (Mersland & Strom, 2007). Most of the selected MFIs were owned by NGOs and personnel appointed to run affairs of these organizations were from within these NGOs and in most cases the chances of recruiting a man was highly likely since most of workers in these NGOs were men.

4.1.3 Correlation between CEO Attributes and MFI financial sustainability

ROA represent the performance of MFI which is a dependent variable and it is measured by total profit divided by total assets. CEOD is CEO duality and it was a dummy variable which was allocated 1 when the CEO doubled as board chairperson and 0 if otherwise; CEOGEN represented the gender of CEO and since it was qualitative it was allocated dummy variable 1 when CEO was a woman and 0 if otherwise.

The table 3 shows that there is negative correlation between CEO duality and MFI financial sustainability because of conflict of interest since the CEO cannot check himself. When CEO doubles as chairperson there is a high chance of managerialism and agency problem (Fama & Jensen, 1983). Bickley, Coles and Jarrel (1997) also observe that when decision management and control are left to the CEO, it reduces board's effectiveness in monitoring the management impacting negatively on financial sustainability of MFI. According to this study there should be a separation of roles between CEO and chairperson of the board for these institutions to boost their performance. It has also been observed that firms are more valuable when there is separation of roles between CEO and chairperson (Siele, 2009; Yermack, 1996; Sanda, 2003).

As shown from table 3 CEOGEN which represent CEOs, gender has a positive correlation with performance (ROA). This can be attributed by the fact that most of the MFIs clients are women and they are likely to be attracted more to those institutions where CEO is a woman. Other studies for instance Mersland and Strom (2007) also support this finding that MFI is likely to perform better when CEO is a woman

4.2 Empirical Results

Table 4 shows the panel estimation results based on the baseline model where return on asset is the dependent variable and the governance variables are the independent variables. To check for robustness of the results, fixed and random effects estimates are regressed as shown in table 4. The regressions were aimed at fulfilling the objectives of the study which entailed testing the hypothesis. The first hypothesis set out by the study was that board size had no effect on the financial sustainability of Kenyan MFIs. The results of the study rejected this null hypothesis as board size (B.S) had a positive and significant relationship (t values=2.74) on the MFIs financial sustainability at 99% level of confidence. After conducting robustness checks using the fixed effects model where the MFIs specific characteristics were taken care of, board size still remained significant.

Secondly, the study postulated that board composition has no effect on Kenya's Microfinance institutions financial sustainability. The results of the study rejected this hypothesis at 95% confidence level, where the coefficient of 0.09 (t values=-2.57) was found to have a positive and significant effect on the MFIs financial

sustainability. The robust checks using fixed effects models confirmed these results as indicated by column six on our output table where the board composition remained significant at 90%.

Thirdly, the study predicted that CEO-Chairperson duality had no effect on Kenya's Microfinance institutions financial sustainability. The null hypothesis was rejected by the results of the study where CEO-Chairperson duality was found to have a positive and significant effect on the financial sustainability of MFIs. Column one that presents the pooled model results indicate that CEO duality coefficient of 1.06 was significant at 95% in determining the financial sustainability of the Kenyan MFIs. The robust checks as presented by column five where the MFI specific unobservable characteristics are taken care of confirmed the results of the statistical findings although they gave a negative coefficient. Finally, the study hypothesized that CEO gender had no significant effect on Kenya's Microfinance Institutions financial sustainability. The results of the study rejected this hypothesis at 99% confidence level where the coefficient of 0.045 was found to be statistically significant in determining the financial sustainability of MFIs financial sustainability. Under the fixed effects model, the same findings revealed that CEO- gender was quite significant in determining the financial sustainability of the MFIs. It is worth noting that the pooled model takes care of any correlation between the error term and the independent variables. Also the fixed effect estimates allow for cross sectional weighting of the variables as opposed to the pooled model and hence the reason as to why the r squared was high under the fixed effect model as opposed to the random effect model.

5.0 CONCLUSION

Corporate governance practices plays an important role in the operation of Microfinance institutions for enhanced financial sustainability, the findings of the study reveal that board diversity of a moderate board size with a considerable number of women is better placed to ensure independence of the board hence boosting financial sustainability. From the study it was also clear that MFI boards could enhance financial sustainability by having directors with diverse expertise and skills. A moderate board size is likely to improve whereas more diverse board is likely to have better relations with other stakeholders.

According to the findings of CEO duality, it was established that separation of board chairman and CEO positions is vital in MFIs because this minimizes the tension between CEO and board members thus influencing positively the financial sustainability of MFIs and it also reduces conflict of interest from the CEO. Several scholars, mostly notably (Jensen, 1993; Siele, 2009), have argued that the lack of independent leadership in firms where the CEO is also the chairman results in less monitoring of top management and consequently more severe agency problems. Given that a key function of the board is to determine who should serve as CEO, Jensen and other scholars argue that the board cannot effectively replace poorly performing Managers when the CEO and chairman tittles are vested in one individual. The study concluded there should be a separation of roles between CEO and chairperson of the board for these institutions to boost their performance. It has also been noted that firms are more valuable when there is separation of roles between CEO and chairperson (Siele, 2009; Yermack, 1996; Sanda, 2003).

From the findings it was also evident that MFI financial sustainability is enhanced when the CEO is a female this could be true as most of the MFIs customers in Kenya are women and the CEO being a woman is likely to attract more women to invest in MFI, thus, allows the MFIs to increase its profitability. Fondas and Sassalos (2000) have also argued that women generally have higher expectations in terms of their responsibilities as CEOs which could influence the board's effectiveness towards productivity.

The results of the study show that good governance structure is important in the young and immature microfinance industry as it has an effect on the institution performance. The observations of the study does not only aim at fine-tuning governance in MFIs in terms of policy direction, but equally important to ensure collapse of MFIs as a result of governance is forestalled so as not to dent the critical process of poverty reduction and development.

6.0 RECOMMENDATIONS

From the study it is clear that corporate governance practices have an influence on MFI performance in Kenya. Hence, there is a need to strike a good balance between quality and quantity with regards to board sizes. It is recommended that MFI board size should be fairly large and not too large that will discourage investors especially shareholders. Also, the board size should be of quality with board members having diverse skills and experience. It is recommended in tandem with others, that MFIs should make more use of non-executive

directors, also policies to promote gender diversity in governance have deemed appropriate therefore MFIs are required to increase the ratio of women on the board so as to ensure board independence, promote shareholder value by enhancing institution financial sustainability as this send a positive signal to potential investors and shareholders.

As a result of positive effect of CEO duality on MFI financial sustainability, there is need for firms to separate the post of CEO and Chair in order to ensure optimal performance. The separation of position of CEO and Chair will encourage efficiency in decision-making mechanisms. It would also serve as monitoring mechanism to ensure that the agent does not indulge in opportunistic behavior. Also, the MFI need to maintain and operate with relatively independent boards.

6.1 RECOMMENDATION FOR FUTURE RESEARCH

The debate on corporate governance continues both in academic circles and popular press, and both at domestic and international levels this shows that this field needs more attention. Although this study contributes to the body of literature on various dimensions, the results are not conclusive. Observations covering a period of five years and in one country may not be representative, and the results may not be generally applicable to developing countries.

The sample in this study was dictated by the availability of data and the choice of statistical analysis was determined by the period and MFI covered. Also the results must also be carefully handled since many specific environmental factors can impact MFI's working process. It would therefore, be desirable to extend the present study by complementing it with studies using other methods and including comparative data. The inclusion of other corporate governance and performance variables such social performance indicators as this would also merit further considerations. More research on practices of board is needed to assess the effects on MFIs performance.

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TABLES

Table 1 Board Size, Board Composition and MFI financial sustainability

variable	Obs	Mean	Std.Dev.	Median	Min	Max	Skewness
Board Size	75	7.8500	2.6819	8	4	17	1.0249
Female Composition	75	0.3405	0.2468	0.286	0	1	1.4258
Non executive director	75	0.8257	0.1648	0.875	0.25	1	-2.5310

Source: Survey Data, 2012

Table 2 Duality and Gender of CEO and MFI financial sustainability

Variable	Obs	Mean	Std.Dev	Median	Min.	Max	Skewness
CEO Duality	75	0.1000	0.3019	0	0	1	2.6667
CEO Gender	75	0.3525	0.4838	0	0	1	0.5721

Source: Survey Data, 2012

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Table 3 Correlation Coefficients Matrix of CEO Attributes and MFI financial sustainability

The table shows correlation exists between CEO attributes and MFI financial sustainability (ROA) for the period from 2000 to 2011

	ROA	CEOGEN	CEOD
ROA	1		
CEOGEN	0.493822	1	
CEOD	-0.245747	-0.339933	1

Source: Survey Data, 2012

Table 4: Baseline model: Dependent variable: Return on Assets (ROA)

POOLED MODEL (Random effects)					FIXED EFFECTS MODEL			
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**
B.S	0.021*** (2.741)	-	-	0.020*** (3.026)	0.0026*** (5.386)			0.025*** (5.305)
B.C		0.009** (-2.57)		0.002 (0.738)		0.004* (1.691)		0.003 (1.112)
CEOGEN			0.04502** (2.487)	0.034** (3.456)			0.0265** (2.77)	0.012*** (-2.453)
CEOI	1.06*** (7.69)			1.21*** (5.464)	-1.42*** (-1.884)			1.394*** (-1.744)
C	2.6*** (25.74)	3.04** (11.8)	2.2*** (31.4)	2.289** (9.36)				
R^2	0.75	0.77	0.71	0.67	0.96	0.97	0.94	0.91
N	10	10	10	10	10	10	10	10
T	11	11	11	11	11	11	11	11

*** 1 percent level of significance; ** 5 percent level of significance; * 10 percent level of significance

Source: survey data 2012

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