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# Financial performance and corporate governance in microfinance: Evidence from Asia☆

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ABSTRACT

Good corporate governance is considered a building block of success for microfinance institutions (MFIs) as it is presumed to help them in achieving their social and financial goals. This paper analyzes the corporate governance and financial performance relationship for MFIs in Asia. We make use of a panel dataset involving 173 MFIs in 18 Asian countries for the period 2007–2011. We construct a corporate governance index based on seven measures pertaining to board size and composition, CEO characteristics, and ownership type. We then estimate the two-way relationship between this index and each of five different financial performance indicators. To address the likely simultaneity between corporate governance and financial performance, we adopt a two-stage least squares estimation approach with instrumental variables. Our results confirm the endogenous nature of corporate governance and financial performance. We conclude that profitability and sustainability of MFIs improve with good governance practices and conversely that more profitable and sustainable MFIs have better governance systems.


## 1. Introduction

Poverty is a major problem in many developing countries and many efforts are being made by governments and institutional parties to overcome it. For many decades, subsidized credit was provided to the poor of the society as 'cost of credit' was considered a major problem faced by many poor. However, then came the realization that the major concern of the poor was not the 'cost of credit' but 'access to credit' (Srinivasan & Sriram, 2003). It has been said many times in the literature, that non-access to credit and other financial services is a major obstacle to prosperity of poor people in developing countries (Hermes & Lensink, 2007).

Against this backdrop, microfinance serves as a lifesaving instrument as it provides financial and social services to the underprivileged and excluded members of society, who have no access to traditional financial services offered by conventional financial institutions. The concept of microfinance emerged formally in the 1970s when Muhammad Yunus started his micro-lending program in Bangladesh in response to increased poverty levels (Daher & Le Saout, 2013). Since

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