Effect of Corporate Governance on Performance of Microfinance Banks in Nigeria

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Introduction

Microfinance institutions’ need for better governance standards has intensified in recent years as they have developed and specialized. Microfinance banks (MFBs) are experiencing increasing challenges and risks, including changes in market conditions, competitiveness, and technological advances, as well as the privileges that come with such developments, necessitating the development of appropriate institutional arrangements to supervise and mitigate risk (Consultative Group to Assist the Poor, CGAP 2018). Sound risk management and governance require a dynamic, innovative board of directors as well as strong internal processes. The friction created by the MFB’s double-bottom line of social impact and profitability can be managed with well-structured governance mechanisms.

The mechanisms by which organizations are controlled and regulated are referred to as corporate governance. Corporate governance aids organizations in operating more efficiently and increasing access to capital, mitigating risk and preventing wasteful...
management (CGAP, 2018). It is concerned with striking a balance between economic and social objectives, as well as between individual and societal goals, while also fostering resource efficiency and increasing efficiency (Kansime, 2009). Governance, according to Helms (2006), is about fulfilling corporate goals and making corporations more transparent and accessible to investors. The term "governance" was used by CGAP in 1997 to describe a constitutional framework in a microfinance institution where a board serves as the coordinating body. In the settling of agency conflicts, the field of corporate governance emerges. According to agency theory, Kumar (2010) posited that managers are the firm's controllers, while shareholders are the owners. However, their interests are in conflict. Corporate governance is a way to solve problems that arise from agency conflicts and is defined as the system that forces managers to operate in the best interests of shareholders.

Corporate financial malfeasance by bank officials has been a serious issue in the profitability and efficiency of banks around the world, especially in Nigeria. Because of agency problems, Vives (2011) claims that the financial industry suffers from significant market failure as a result of excessive risk-taking. Poor corporate governance, according to Kasum and Etudaiye-Muthar (2014), has been the primary source of problems in Nigeria's banking sector in recent decades. According to Adeyemi (2014), the banking industry's problems are frequently attributable to unsatisfactory corporate governance. The author concluded that CEO ineptitude, organizational misconduct, and boardroom conflicts arising from issues with ownership structure and insufficient internal control had an adverse effect on corporate governance procedures in the Nigerian banking sector.

Moreover, the current wave of crises in Nigeria's microfinance sector has highlighted the need to enhance MFBs' governance processes. The Nigerian Deposit Insurance Commission, in partnership with the Central Bank of Nigeria, examined 731 microfinance banks in 2013 and found that they had serious corporate governance problems (NDIC, 2015). In addition, the Central Bank of Nigeria has acknowledged that unqualified and incompetent boards of directors, high rates of non-performing insider-related credits, insider dealings, fraud, and unethical practices by some directors and management staff have resulted in corporate failures in some MFBs (CBN, 2014). As a result of the ineptitude of board committees, non-adherence to the Central Bank of Nigeria and inadequate ethical standards, some MFBs have been liquidated (NDIC, 2015). However, because of the high level of competition in the sector and MFB's objective to serve the poor while also being profitable, the board's capacity to direct the company toward success is even more crucial. As a result, the research work aims to investigate the effect of corporate governance on MFBs' performance in Nigeria.

Microfinance is the provision of loans and other financial services to the entrepreneurial poor. MFBs emerged to alleviate poverty in mostly rural areas by encouraging self-employment and entrepreneurship. MFBs belong to a vast and rapidly expanding industry that strives to create a double bottom line by providing financial services to the underprivileged (outreach) while also covering its expenditures (sustainability). MFBs have particular issues such as weak internal controls, poor corporate governance, inept boards, and a high rate of insider credit facility misuse (Sanusi, 2010).

Although microfinance operators believe that good corporate governance is critical for MFBs' success (CBN, 2014; NDIC, 2015), few studies on microfinance legislation have focused on governance concerns. Because MFBs' managers make choices, a more thorough examination of the various governance structures' roles is required. This is owing to the likelihood of a conflict of interest among corporate structure participants (shareholders) due to their disparate aims and interests on the one hand, and limited understanding of each other's activities, views, and inclinations on the other hand (Imam & Malik, 2007). As a result, research into MFBs' corporate governance is required, as both stewardship and agency theory advocate the need for a good relationship with management, shareholders, and other stakeholders (Jensen & Meckling, 1976; Kumar, 2010).

Furthermore, few researchers look into the relationship between corporate governance and MFB performance, particularly in Nigeria. The majority of these studies have been conducted in advanced countries, with an emphasis on large and publicly traded companies. Prior studies highlighted the significance of innovative lending processes in improving
accessibility and profitability, loan repayment pattern factors, MFBs challenges, MFBs and their impact on borrowers (Abiola & Salami, 2010; Abubakar et al., 2015; Taiwo et al., 2016; Ademola et al., 2020; Ademola & Adegoke, 2021). To close this gap, this study aims to examine the effect of corporate governance on MFBs' performance in order to enhance their performance and promote their long-term sustainability. Generally, the objective of this study is to examine the effect of corporate governance on the performance of MFBs in Nigeria. However, the study specifically seeks to; examine the effect of board size on the performance of MFBs in Nigeria; investigate the influence of board composition on MFBs’ performance in Nigeria; and determine the effect of the audit committee on the performance of MFBs in Nigeria.

**Literature Review**

The literature review provides the base for understanding the fundamentals of the topic. This section is divided into three subsections primarily focusing on conceptual review, empirical review and theoretical review.

**Conceptual Review**

**Corporate Governance**

Corporate governance refers to how the power of a corporation is distributed in the stewardship of the corporation's whole portfolio of securities to enhance shareholders’ value and the satisfaction of other stakeholders to achieve the organization's goals (Chenuos, Mohamed, & Bitok, 2014). Consequently, corporate governance is concerned with achieving a balance between economic and social objectives as well as individual and collective needs. According to Rwegasira (2000), corporate governance is simply concerned with the institutions that provide an entity with essential orientation and direction. As a result, corporate governance includes the relationships between the company's management structure, board of directors functions, shareholders, and stakeholders, as well as the organizational structure for business control and direction. The core theme of corporate governance, according to Kazmi (2008), is regulating the relationship between an organization's directors and management and other stakeholders. The overarching goal of corporate governance is to resolve agency conflict and promote accountability in the institution's operations to improve long-term value for its stakeholders by increasing returns on their invested capital.

**Board Size**

Board size refers to the total number of directors on a board (Panasian, Prevost, & Bhabra, 2003; Levrau & Van den Berghe, 2007). According to Goshi et al. (2002), the number of executive and non-executive directors on a board should be kept to a minimum. Kajola (2008) thinks that limiting board size to a specific level improves a company's performance since the benefits of having a larger board with enhanced monitoring are outweighed by poor communication and slower decision-making. According to Florackis and Ozkan (2004), larger boards may not be productive. According to Mak and Yuanto (2003), companies in Malaysia and Singapore performed best when their boards comprised five members. Furthermore, Uwuigbe and Fakile (2012) claimed that banks with fewer than thirteen board members are more sustainable than those with more than thirteen. They also reported that banks with larger boards of directors earned less than banks with smaller boards of directors. They concluded that board size was strongly linked to bank financial success. In support of this, Manas (2006) discovered that board size had little bearing on corporate governance. As a result of the preceding, it is clear that there is no widely accepted consensus on the impact of board size on a company's performance.

**Audit Committee**

The Audit Committee acts as a "guard dog" to ensure that procedures are adhered to. As the ultimate supervisory mechanism in the assurance process for company financial
reporting, the audit committee is highly relevant (Tsui & Gul, 2003). According to Bhuiyan, Hossain, and Biswas (2007), the audit committee aids the board of directors in assessing and establishing effective internal control systems, as well as monitoring and focusing on financial risk and risk management. As a result, the audit committee supports recognizing and addressing trouble signals, reducing potential damage and boosting shareholder value (Haron, Jantan & Pheng, 2005).

The audit committee serves as a vital link between a company and its external shareholders (Bolton, 2010). Bronson et al. (2009) asserted that accounting scandals and issues about the quality of the financial statements have prompted many calls for enhanced audit committee efficiency in many organizations. However, Klein (2002) found a negative relationship between earnings management and audit committee independence in his study.

**Board Composition**

The board of directors is frequently the governing body of an organization. Its primary responsibility is to ensure that the organization achieves its shareholders' goals. Consequently, these stockholders hold the board of directors accountable (Al-Baidhani, 2015). Top executives are appointed, fired, and compensated by the board of directors (Johnson, Scholes, & Whittington, 2008). The organization's assets and invested capital are therefore safeguarded. In addition to determining the bank's objectives (including earning returns for shareholders), the board of directors' senior management influences how banks operate their daily operations, meet their requirements for shareholder accountability, and considers the interests of other recognized stakeholders. Independent directors on boards are usually seen as essential because they act as true monitors who can discipline management and enhance business performance (Duchin, Matsusaka, & Ozbas, 2010). Inside directors are better than outside directors at enhancing shareholder wealth. One of the aspects that can help to reduce agency disputes within the organization is the board's composition (Patelli & Prencipe, 2007).

**Empirical Review**

Belete (2015) examined the impact of corporate governance on Ethiopian MFBs' performance. Return on Assets was the financial performance metric. Results showed that the profitability of microfinance institutions is influenced by board size, board competency, board experience in the financial industry, and board meeting frequency. Moreover, in Cameroon, Léopold et al. (2017) investigated the impact of governance measures on MFB performance. Following their investigation, the researchers discovered two major findings. First, relatively few governance methods had a substantial impact on MFBs' performance at the worldwide level. Secondly, comparative analysis revealed that differentiating governance procedures based on MFBs' legal status (cooperative and mutual benefit companies; nonprofit NGOs; private companies; and profit-seeking NGOs) increases their effectiveness.

Eyob (2016) also investigated the impact of corporate governance frameworks on Ethiopian MFBs' performance. Findings revealed that board size, gender diversity, and audit committee size all have a negative and significant impact on MFB's financial performance. In addition, the impact of corporate governance on the performance of listed financial institutions in Sri Lanka was explored by Danoshana and Ravivathani (2015). From 2008 through 2012, a total of 25 financial institutions were reviewed. It was discovered that corporate governance factors have a considerable impact on firm performance, with board size and audit committee size having a beneficial impact. Meeting frequency, on the other hand, was found to have a detrimental impact on the firm's success.

Adeabah et al. (2018) analyzed the performance of 21 Ghanaian banks in the context of board gender diversity. Findings revealed that, up to a point, gender diversity enhances a bank's performance and board size boosts bank efficiency, whereas powerful chief executives have the reverse effect. Nonetheless, Nyarko et al. (2017) opined that board size, long-serving CEOs, audit committee size, audit committee independence, foreign ownership,
institutional ownership, annual general meeting, and dividend policy are all positively related and associated with bank financial performance. Frimpong et al. (2015) also investigated the effect of corporate governance on the performance of Ghanaian banks. Analysis revealed that ROA exhibits a strong and positive correlation with non-executive directors, bank size, and bank growth. Contrastingly, audit committee size, board gender diversity, board business management, and board member education had a significant and negative association with ROA.

Okoye, Adedayo, Ahmed, and Isibor (2017) examined the relationship between corporate governance and financial sustainability of MFBs in Nigeria during the period from 2011 to 2015. Findings reveal that corporate governance mechanisms (board independence, gender diversity) have no relationship with financial sustainability. Only board size shows a positive relationship with financial sustainability. However, Aliu and Gakure (2014) found a significant relationship between corporate governance and MFBs’ sustainability. Uwuigbe (2011) investigated the corporate governance and financial performance of 21 Nigerian banks. It was discovered that board size and return on equity have an adverse relationship. It was also shown that banks that publish more information about corporate governance issues do better than those that do not. Moreover, Isaac and Nkemdilim (2016) while investigating the relationship between corporate governance and the performance of Nigerian commercial banks found a strong negative association between board size, board composition, and bank financial performance, while directors’ stock holding correlates positively and significantly with bank performance.

Theoretical Review

Stewardship theory

The assumptions that underpin agency theory and transaction cost economics theory are used in stewardship theory. This theory emphasizes the positive effects of facilitative power arrangements on shareholder returns, which unify command by having the CEO and Chair be the same person. Returns to shareholders may be safeguarded by empowering managers to take autonomous executive action (Mallin, 2010) rather than placing management under greater oversight by owners (Kumar, 2010). The stewardship idea supports the agency theory in that it allows management more flexibility and opportunities rather than tightening oversight on senior management, which may create a climate of subordination to the chief, with the company suffering as a result.

Agency Theory

When it comes to companies and concerns about corporate control, agency theory sees corporate governance systems, particularly the board of directors, as an important monitoring device that guarantees that any difficulties caused by the principal-agent relationship are mitigated (Kumar, 2010). Managers are likely to be the owners’ agents, but they must be supervised, and institutional frameworks must provide certain checks and balances to ensure that they do not misuse their position. The costs of abusing their position, and also the costs associated with monitoring and regulating them to avoid exploitation, are referred to as agency costs (Kim, 2010).

The agency theory serves as the underpinning theory as it applies to corporate governance in the banking sector. This theory connotes how the alignment of the audit committees, board composition, and size successively improve MFB’s performance (Grove et al., 2011). A gap in the literature was evident because little research has been conducted on the effect of corporate governance on Nigerian MFBs. This study entailed research that seeks to fill the void in the literature, thus contributing to the existing body of academic literature.

Hypotheses of the Study

H0: Board size has no significant effect on the performance of MFBs in Nigeria.
**Hypotheses**

1. Board composition does not affect MFBs' performance in Nigeria.

2. The audit committee has no significant effect on the performance of MFBs in Nigeria.

**Fig 1: Theoretical Framework**

![Diagram](image)

**Methodology**

**Research Design**

The study used a longitudinal research design to conduct the investigation. A longitudinal design is a sort of correlational research in which a variable is studied over a long period. The population of the study consists of all the licensed microfinance banks operating in Nigeria as of December 31st, 2020. A simple random technique was used to select the 12 MFBs from Oyo, Osun, Lagos, and Ogun states in the South West region of Nigeria. Secondary data was obtained from the annually published reports of the selected licensed microfinance banks in Nigeria between the ten (10) year period of 2011 and 2020. The data was analyzed using regression and correlation techniques.

**Model Specification**

Regression analysis was used to evaluate the effect of corporate governance practices on the performance of MFBs in Nigeria. The model was specified as follows;

\[ Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon \]

Where: \( \alpha \) = intercept

\( Y \) = performance of MFBs (ROE). Return on Equity (ROE) is used as a performance metric in the study because it is a comparison between net ratio and equity capital. Shareholders can determine how much an investment returns on each amount they invest. Kasmir (2016) asserted that ROE growth indicates that the organization’s prospects are getting better.

The included variables \( X_1 - X_3 \) represent the audit committee, board size, and board composition. The audit committee refers to the number of audit members for the MFBs. Board size refers to the number of board members for the MFBs. Board composition refers to the number of outside directors and women out of a total number of directors for the MFBs. \( \beta_1 - \beta_3 \) are the slope coefficients of the regressors, and \( \epsilon \) represents the stochastic residual term aimed to account for the effect of unidentified variables in the model, which has a normal distribution with a mean value of zero.

**Results and Discussions**

Table 1 displays the relationship between board size and MFB performance in Nigeria. The results revealed that board size has a positive and significant relationship.

Table 1: Relationship between board size and MFB performance in Nigeria.

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>Dependent Variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Size</td>
<td>Financial Performance of MFBs</td>
</tr>
<tr>
<td>Board Composition</td>
<td></td>
</tr>
<tr>
<td>Audit Committee</td>
<td></td>
</tr>
</tbody>
</table>

\[ R = 0.717, \]
p<0.01) with MFB performance. This implies that the larger the board of directors, the better the bank's performance. This could be related to the fact that as the size of the board grows, more productive ideas emerge. According to Siele (2009), as board size increases, board activity also increases to accommodate increased process inefficiencies. Furthermore, as MFBs in Nigeria expand and meet regulatory criteria, their management becomes more difficult as a result of increased outreach and product diversity. Larger boards may conduct more intensive monitoring and provide the necessary experience and knowledge.

On the other hand, (Adams & Ferreira, 2009; Dabor, Isiavwe, Ajagbe, & Oke, 2015) found a negative relationship between board size and firm performance, claiming that larger boards cause firms to lose commercial opportunities due to slower and longer decision-making. However, the conclusions of this study may not come as a surprise because a larger board of directors delivers greater knowledge and competence than a smaller board and helps to reduce the CEO's dominating influence. This finding supports the findings of Singh and Davidson III (2003; Urhoghide & Korolo 2017), who claimed that larger boards boost firm performance whereas smaller boards are less effective, negatively impacting firm performance. Results also showed that board composition has a substantial positive relationship with MFBs' performance (R = 0.623, p< 0.01). This suggests that the composition of the board has a major impact on MFB's performance. This could be due to the fact that more independent directors on the board tend to be a motivating factor behind MFB's performance because they function as oversight mechanisms to protect shareholders from the managers' interests. This finding supports the assertions of Olabisi & Omoyele (2011) and Urhoghide & Korolo (2017), who found a strong link between board composition and business performance. Kajola (2008), on the other hand, claimed that board composition has a minimal impact on company performance and so should be less emphasized.

Nonetheless, Patelli & Prencipe (2007) claim that board composition is one of the factors that can help an organization reduce agency disputes. The findings of the study thus revealed that the board composition of MFBs in Nigeria is a significant determinant of their performance; therefore, board composition should be strongly emphasized in any organization. Furthermore, a strong positive association exists between the audit committee and MFBs' performance. This backs up the agency theory that adopting the corporate governance code in terms of having the correct number of audit committees in place improves the transparency, integrity, and soundness of a company's financial reporting process. This result confirms the findings of Kyereboah-Coleman & Biekpe (2006); Adewuyi & Olowookere (2008); and Nyarko et al. (2017), who asserted that a sufficient number of audit committees enhances the performance of firms and reduces the risk of insolvency, resulting in an abundant reward for shareholders.

The conclusion opposes the findings of Ndum and Oranefo (2021), which found a negative and statistically insignificant influence of the audit committee on firm performance. The positive association between the audit committee and MFB performance is expected because the audit committee's monitoring function plays an important part in assuring the quality oversight that firms seek to achieve in their financial reporting methods. Audit committees also provide confidence in the accuracy of publicly published accounting information and help to engage external stakeholders (Klein, 2002; Peasnell, Pope, & Young, 2005). Mersland and Strom (2009) also supported the assertion that audited financial statements enhance MFBs' performance.

Table I: Relationship Between Proxies of Corporate Governance and Performance of MFBs In Nigeria

<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>BS</th>
<th>BC</th>
<th>AC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sig (2-tailed)</td>
<td>120</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Regression analysis was employed to determine the effect of corporate governance on the performance of MFBs in Nigeria. The regression line is written as:

\[ \text{Performance} = 2.103 + 0.665x_1 + 0.636x_2 + 0.632x_3 + e_0 \]

The adjusted R\(^2\) was 0.816, indicating that the three variables considered in the model explained 81.6 per cent of the changes in performance. Specifically, an effective audit committee had a significant and positive effect (\(t = 4.618, p < 0.05\)) on the performance of MFBs in Nigeria. This reveals that an increase in audit committee functions tends to increase MFBs' performance. This suggests that a competent audit committee is an important part of the corporate governance structure and a powerful predictor of MFBs' performance. According to Bhuiyan, Hossain, and Biswas (2007), the audit committee assists the board of directors in reviewing and implementing effective internal control systems, as well as overseeing and focusing on financial risk and risk management. This conclusion is consistent with the submissions of Tsui & Gul (2003) and Haron, Jantan, & Pheng (2005) that audit committees have a positive and significant effect on MFBs' performance. Furthermore, results revealed that board size has a favourable and significant effect on MFBs' performance (\(t = 3.806, p < 0.05\)). MFBs' financial performance would improve by 0.636 units for every unit increase in board size. This suggests that as board size grows, MFBs' performance improves as well. This is because larger boards oversee MFBs more closely and provide the necessary experience and knowledge to ensure their long-term viability. Additionally, as the board grows larger, agency costs decrease. This finding is in line with Singh & Davidson III (2003), Belkhir (2009), and Urhoghide & Korolo (2017), who asserted there is a positive relationship between board size and MFB performance. Moreover, board composition had a positive and significant effect on MFBs performance (\(t = 3.877, p < 0.05\)) indicating that board composition is a strong driver of MFBs performance as it helps to reduce agency conflicts in an organization (Patelli & Precipe 2007). This result conforms to the position of Olabisi & O moyele (2011) and Urhoghide & Korolo (2017), who posited that board composition had a significant and positive effect on firm performance.

Finally, corporate governance variables (audit committees, board composition, and size) had a favorable and significant effect on MFB performance. This aligns with CGAP's (2018) assertion that excellent corporate governance aids organizations in operating more efficiently, improving access to finance, mitigating risk, and avoiding mismanagement. Enobakhare (2010), Chenuos et al. (2014), and Belete (2015) all came to similar conclusions. As a result, the premise that corporate governance has no impact on the performance of
MFBs is disproved. According to the findings, corporate governance has a favourable and significant effect on MFBs' performance in Nigeria.

Table 2: Effect of Corporate Governance on the Performance of MFBs in Nigeria

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coeff.</th>
<th>Std Error</th>
<th>t-value</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>2.103</td>
<td>.938</td>
<td>2.243</td>
<td>0.030</td>
</tr>
<tr>
<td>Audit Committee</td>
<td>.665</td>
<td>.144</td>
<td>4.618</td>
<td>0.002*</td>
</tr>
<tr>
<td>Board size</td>
<td>.636</td>
<td>.167</td>
<td>3.806</td>
<td>0.004*</td>
</tr>
<tr>
<td>Board composition</td>
<td>.632</td>
<td>.163</td>
<td>3.877</td>
<td>0.016*</td>
</tr>
</tbody>
</table>

Source: Author's computation, 2022
Dependent variable: Performance (ROE)
R-square = 0.860; Adjusted R square = 0.816; Durbin-Watson value = 2.338
Note: *denotes 5% level of Significance

Conclusion and Recommendations

The Central Bank of Nigeria’s enactment of the Microfinance Policy, Regulatory and Supervisory Framework, and the code of corporate governance for financial institutions has increased the relevance of corporate governance in the Nigerian microfinance sector in recent years. As a result, the effect of corporate governance on MFBs' performance in Nigeria was investigated in this study. Corporate governance was proxied by audit committees, board size and composition, and financial performance was evaluated by Return on Equity (ROE). Twelve MFBs were chosen randomly from Lagos, Osun, and the Oyo States in Nigeria. The results demonstrated that board size correlates favourably and significantly (R=0.717, p<0.01) with MFB performance, implying that larger boards improve bank performance. It was revealed that board composition and MFBs performance had a highly positive relationship (R = 0.623, p<0.01), implying that board composition improves MFBs performance significantly. Furthermore, the performance of MFBs is positively and significantly correlated with the effectiveness of audit committees (R=0.793, p<0.01), demonstrating that a successful audit committee is an important component of corporate governance. Finally, the study found that corporate governance has a favourable and significant effect on MFBs' performance in Nigeria. This means that corporate governance aids in the achievement of corporate objectives and makes firms more accountable and transparent to investors.

As a result, this study suggests that a functional audit committee be established if MFBs' accountability, transparency, profitability, and growth are to be ensured. MFBs should also maintain a fair and balanced board composition to ensure proper strategic direction and long-term profit maximization.

Contribution to the Knowledge

The study added to the body of knowledge by investigating the effect of corporate governance on MFBs' performance in Nigeria, a topic to which past studies had paid little attention over the years.

Suggestions for Future Research

The effect of corporate governance on MFBs' performance in South West Nigeria was examined using audit committees, the board size, and composition as proxies. However, other corporate governance variables such as board independence, gender diversity, and social performance indicators should be considered as well. Furthermore, as the current study focused on the southwestern part of Nigeria, more research could be conducted in other parts of the country.
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