Microfinance Institutions as the Catalyst for Financial Inclusion.

How can we prime ourselves to operate at the Next Level?

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Introduction

- ❖ Microfinance institutions (MFIs) have the potential to act as a catalyst to extricate people from poverty, advance economic growth and national development as they are able to;
- tailor made their operations to serve segments that are normally excluded by traditional banks.

- ❖ In order to achieve this, it is important to note that "proper governance of companies are becoming as crucial to the world economy as the proper governance of countries" Jim Wolfenson former World Bank Chief.

- ❖ Most failures in the financial services sector have its roots lie deeper in flawed macro-economic & monetary policies but inadequate regulation & supervision, **bad governance makes these problem worse**.

- ❖ Boards normally **fail to challenge** management & Shareholders **fail** to hold them to **account** for not doing so, Peter Montagnon.

Microfinance & Financial Inclusion

- MFIs act as the first window of opportunity for financially excluded individuals, micro and small businesses to have access to the formal financial system.

- MFIs should aim at increasing access to basic financial services such as insurance, savings accounts, loans, and remittances.

- By doing so MFIs empower the financially excluded to smooth their consumption over time, avoid potentially dangerous shadow markets, undertake entrepreneurial pursuits, and broaden their financial horizons.

- This has the effect of improving quality of life or standard of living and hopefully lift majority out of poverty.

- According to a study by McKinsey & Co, financial inclusion for billions of the world's poor is achievable but it will require scaling and innovation, and mobile banking will play a key role in delivery of financial services.

- MFIs should embrace technology to fully contribute to financial Inclusion

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Governance in Microfinance Institutions

- The "infant" micro-finance industry recorded scores of success the world over, Zimbabwe included and must now institutionalize that success.

- However, like all small enterprises challenges such as issues of power, control, and transparency emerge.

- Governance becomes more important as it helps to marry the various interests of stakeholders and protects the long-term health of the institution.

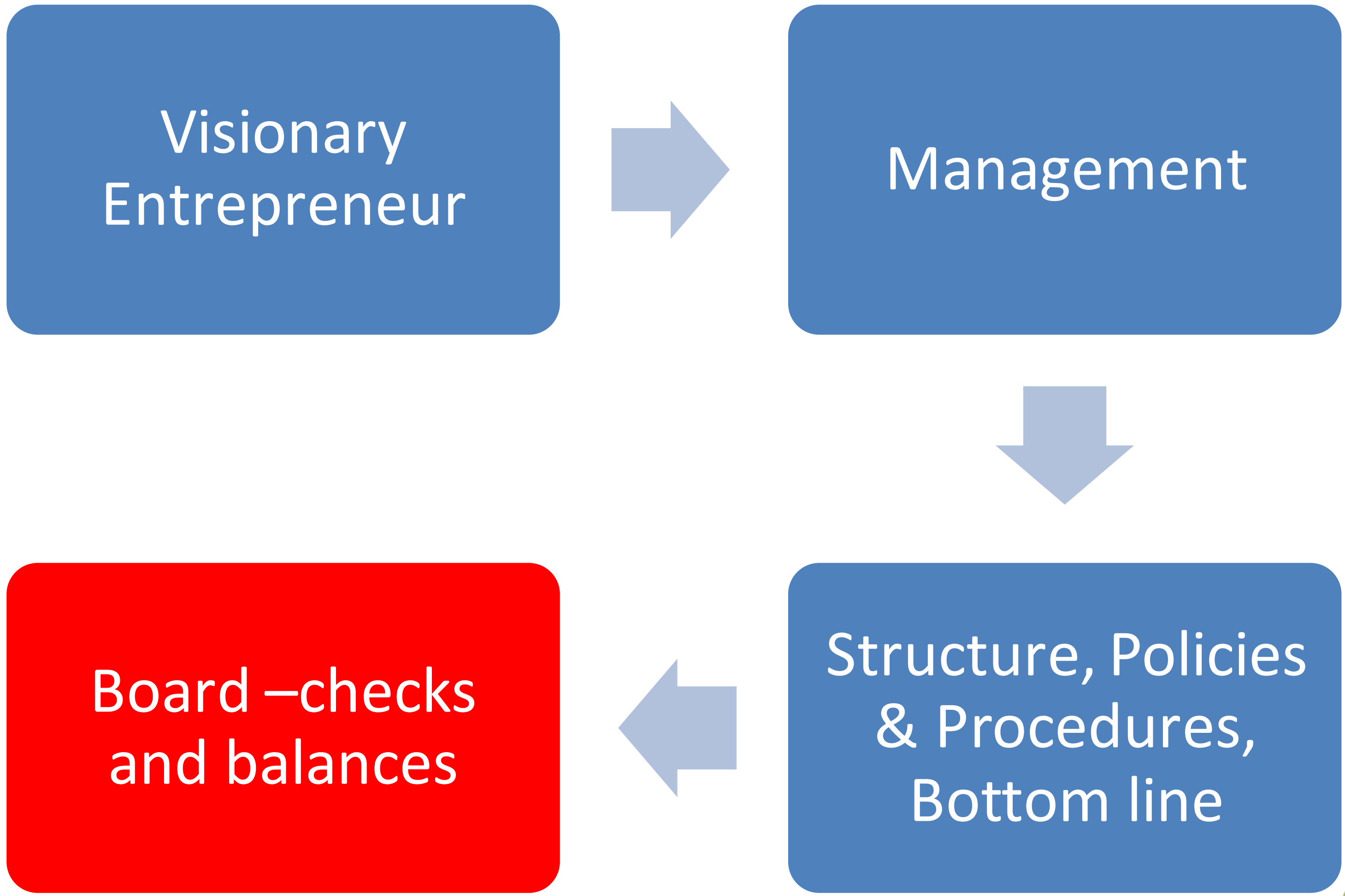
- Since the 1970s, the microfinance industry has been growing and becoming more complex due to financial innovation and emergency of financial technology (fintech) linked products.

- Inorder to migrate to good corporate governance this myth of the ***"Visionary being the CEO and Board"*** has to be broken

Corporate Governance

Governance in Microfinance Institutions

❖ **Ideal Structure Evolution in MFIs**



Governance in Microfinance Institutions

Weaknesses in Most MFIs Boards

- ❖ Board dynamics – skills gap due to poor remuneration to attract right caliber.
- ❖ Risk Management – insufficient internal regulations or policies on governance.
- ❖ Challenges in assessing technologies and new business models – competition from fintechs is increasing
- Partnerships with fintech service providers.
- ❖ Managing market and financial risks - lack effectiveness in monitoring market and financial risks due to deficiencies in skills and microfinance knowledge on the part of the Board.
- ❖ Independence - board does not have sufficient background on the necessities of its role in stabilizing management within the institution.
- ❖ Board Term Limits – there is need to injector new blood with new perspectives at the same time ensuring continuity in leadership.

NB: There are circumstances where social considerations rule at the expense of normal process for example appointing family representatives on the Board.

Is there A Case for Good Governance in MFIs?

- Globally, there is theoretical and empirical evidence that good governance is essential for the prosperity of nations and their citizens.

- It has been accepted that there is a business case for good corporate governance.

- In a bid to encourage good corporate governance, it is now enshrined in the new Constitution of the country. Good governance is now a constitutional imperative, the constitution enjoins companies to be good corporate citizens.

- In Chapter 2, Section 9, Good Governance, the Constitution says "The State must adopt & implement policies & legislation to develop efficiency, competence, accountability, transparency, personal integrity & financial probity in all institutions & agencies of government at every level and in every public institution….."

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The Case for Good Corporate Citizens

- Ladies and gentleman, with such a national and global acknowledgement and acceptance that there is a business case for good corporate governance, why do we continue to see corporate governance challenges dogging the corporate sector including the microfinance sector?

- In the main, the difference is in the **people, that is, Boards & Executives** charged with governance.

- A company is a legal fiction but the law permits it to do things which natural persons can do. It can sue and be sued. Directors and the Executives are the heart and soul of this incapacitated person.

- What kind of corporate citizens are our MFIs? How could they
- be described, in terms of their behavior & characteristics?

Guidance on Corporate Governance

Many draw on different sources:

- King Reports.
- UK Code on Corporate Governance.
- OECD Principles of Corporate Governance.
- National Code on Corporate Governance, Zimbabwe.

Our discussion will be based on the **Zimbabwean National Code**.

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Chapter 3, Clause 57: Conduct & Responsibilities of Board & Directors

"In the discharge of its role and functions, every Board must conduct itself with honesty and integrity and, above all, it must always act in the best interests of the company....."

- Can Directors and the Executives' interests compete with the interests of the MFI?
- Can Directors and Executives make a secret profit benefiting from their positions as Directors?
- Directors have legal duties of good faith, loyalty, care, skill and diligence in the discharge of their functions.

*continued...*Conduct & Responsibilities of Board & Directors

- The duty of good faith requires Directors to honestly apply their minds and act in the best interests of the MFI at all times. One needs to be loyal and avoid conflict of interest.

- The **duty of care** requires a degree of care expected of a reasonable person in charge of assets of an incapacitated person.

- The **duty of diligence** requires directors to come prepared and well informed to make decisions

Chapter 2: Ownership & Control (Preamble):

"In a company ***shareholders*** *provide risk capital which the* ***management*** *controls under the leadership of a* ***board of directors****. There must be a functional balance of power among these three groups for the company to prosper......"*

Chapter 3 Clause 103: Shadow Directors:

"A Board should be composed & structured in such a way that it excludes the influence of ***shadow directors****, that is to say, persons who are not Board members but are somehow able to give instructions to directors".*

•Remember a director's fiduciary duty is to the **company** and not the constituency that appointed you, or that you represent.

Independent Non-Executive Directors, Clause 109

- Non-Executive Directors should be independent in character and judgment and should not have relationships or circumstances which are likely to affect or appear to affect their independence.

- If we are a director and we provide a service for which we are paid by the company can we still remain independent?

- Many a times we also hear of Non-Executive Directors and Executives setting up companies on the side that supply goods or services to the corporate, or borrow money from the bank with no intention to repay, a clear abuse of position and conflict of interest.

- Unholy alliances have been established in the sector where in order to circumvent regulatory restrictions on insider loans, two MFIs work together. MFI A staff members and Directors get loans from MFI B and vice versa.

Remuneration of Board Members & Senior Management

- Clause 161: The remuneration of board members and senior management should be fair, in order to enhance their motivation, commitment and effectiveness, promote the creation of value for the company and advance its short and long term interests.

- Clause 162 talks about long term performance related rewards.

Shareholder Activism

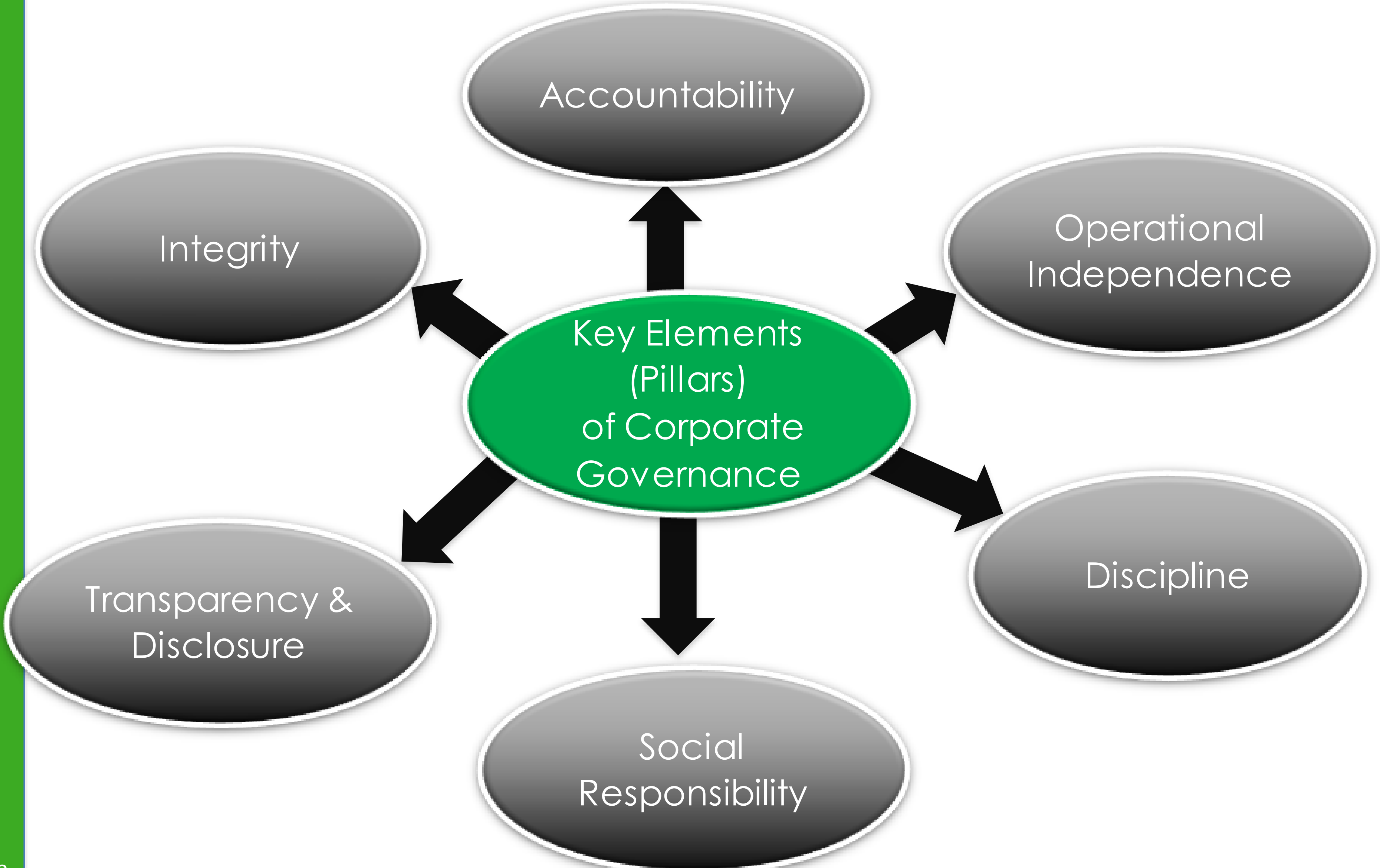
- This has been one of the missing links in Zimbabwe's corporate governance practices. Many institutional investors have invested public funds in numerous entities, but have not been active in corporate governance in the invested companies.

- In UK, there is the UK Stewardship Code which sets out principles of effective stewardship by investors. The Code goes beyond voting to include monitoring and engaging with investee companies in matters of strategy, performance, risk, capital structure and corporate governance including culture and remuneration.

- Institutional investors are required to disclose their policy on how they will discharge their stewardship responsibilities, disclose policies on managing conflict of interests and how they monitor investee companies.

- It's heartwarming, we have started to see activities in this area here.

Key Elements/Pillars in Corporate Governance



Need for Accountability

- Directors as the heart and soul of organisations, make decisions and take action on behalf of the MFI. They must account to someone about those decisions and actions.

- They have a duty or obligation to the company, shareholders and other stakeholders.

- They are entrusted with resources and power; they must render an account on how these resources and power have been used.

- Directors need to be more engaged, more effective and more accountable than they have been if we are to take the economy of Zimbabwe to the next level.

Improving Governance in MFIs?

- There is need to have regulations which mandates the criteria for MFIs
  - board structure/composition.
  - skills.
  - base level of professionalism.
  - this may include prescribing that MFIs must undertake board reforms, board should have at least one person with a financial/commercial background.
- This is common but there is need to adhere to its provisions: Board Charter - various Board committees.
- Rating of MFLs – unlock investment opportunities – properly rated by recognized international rating agencies.
- Regulations on addressing issues of conflict of interest which is rampant in MFIs.

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How Do MFIs Compete with Banks

- ❖ The 2012 FinScope MSME Survey and the 2014 FinScope Consumer Survey show that;
- ✓ 23% of Zimbabwean adult population is financially excluded.
- ✓ 30% use banking services as at 2014.
- ✓ only 14% of MSME owners were banked.
- ✓ only 1% of adult population made use of capital market services.
- ✓ Zimbabwe has a high general literacy level but very low financial literacy level (World Bank Consumer Protection and Financial Literacy Diagnostic Report of 2014).
- ❖ The above statistics show huge potential for MFIs to compete with banks as most of the excluded normally are at the bottom of the pyramid (low income and the poor).

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How Do MFIs Compete with Banks

- MFIs must focus on meeting consumer needs and also on educating consumers on the benefits of financial inclusion.
- Ensure that financial advice is appropriate and in line with the financial circumstances of the consumer.
- Brach network
- Penetrate the bottom of the pyramid by finding innovative ways to meet KYC requirements for example in South Africa Mukuru agents visit prospective clients at their homes to verify their addresses and thereby remove the requirement for an official proof of residence document.
- Take-up of micro insurance is very low: reduce the burden of premium payments lets say to quarterly or once in two months etc. This is happening across the boarder in SA.

Conclusion

- The Kumar Mangalam Birla Committee (1999) report observed that "the strong Corporate Governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure."

- Good governance is not simply about corporate excellence but is the key to economic and social transformation.

- Many of the current economic challenges faced by the countries of the world are a result of "failures on oversight, financial regulation and accountability, all of which are elements of good governance.

Conclusion

- There is no singular approach to governance that can be applied to every country or corporate with the same result.
- However, more often than not, the countries with participatory, transparent, accountable, equitable and meaningful governance are the most successful.
- Only when good governance is practiced can individuals and businesses across a nation take advantage of state resources, leading to development and prosperity for all.
- A stable and resilient banking sector requires sound governance practices, which is a product of good corporate citizens. This can only be delivered by the right caliber of Directors & Executives

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Thank you

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