European Journal of Social Sciences
ISSN 1450-2267 Vol. 55 No 4 December, 2017, pp.384-391
http://www.europeanjournalofsocialsciences.com/

Effects of Governance on Financial Stability of Micro Finance Institutions in Rwanda

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Abstract

The purpose of this research is to determine the effects of Governance on Financial Stability of Micro Finance Institutions in Rwanda.In Rwandan perspective, financial system is still relatively shallow and thus potential impact on financial stability. The sample size of 152 respondents was derived from the target population of 504. The analysis of variance (ANOVA) was checked to reveal the overall model of significance. In particular, the calculated F statistic was compared with the tabulated F statistic. A critical p value of 0.05 was used to determine whether the overall model is significant or not. The results indicated that governance has positive and significant effect on compliance and financial stability on Financial Stability of MFI in Rwanda.

Keywords: The effects of Governance on Financial Stability of Micro Finance Institutions in Rwanda.

1. Introduction

Ramsden, (2003), defines performance measurement as a way of ensuring that resources available are used in the most efficient and effective way. The essence is to provide for the organization the maximum return on the capital employed in the business. Financial performance for banks is very important because managers need to know how well the banks are performing. Most studies divide the determinants of commercial banks performance into two categories, namely internal and external factors. Internal determinants of profitability, which are within the control of bank management, can be broadly classified into two categories, i.e. financial statement variables and nonfinancial statement variables. While financial statement variables relate to the decisions which directly involve items in the balance sheet and income statement; non-financial statement variables involve factors that have no direct relation to the financial statements. The examples of non-financial variables within the this category are number of branches, status of the branch (e.g. limited or full-service branch, unit branch or multiple branches), location and size of the bank. Guyo,. (2013). External factors are those factors that are considered to be beyond the control of the management of a bank. Among the widely discussed external variables are competition, regulation, concentration, and market share, and ownership, scarcity of capital, money supply, inflation and size.

In financial year 2014/15, capital Adequacy Ratio (CAR) remained above the Basel minimum standard of 8% in all countries. Rwandan and Ugandan banks hold highest levels of CAR (24.3 %t, 21.3 %) respectively. Burundian Banks reported CAR of 19.5 %, Kenyan (18.9 %) and Tanzanian (17.7 %). The solvent status of Kenyan banks is of particular importance to the regional financial stability, as Kenyan banks have opened branches in the region. Liquidity ratios in the region averaged around 47.0 Percent (liquid assets to total deposits), way above the prudential limit of 20 Percent.

Specific objective

To examine the effects of Governance on Financial Stability of Micro Finance Institutions in Rwanda.

Research Hypothesis

H01: There is no effect of governance on Financial Stability of Micro Finance Institutions in Rwanda.

2. Statement of the Problem

Over the past decade and in particular since the crisis started, the sector of the non-bank financial institutions (NBFIs) of the EU27 has grown in importance in terms of financial stability, as reflected in its strong increase in size and growing interconnectedness with the banking sector. As result, policy-makers have proceeded in gaining a better understanding of the nature and the role of the various non-bank financial institutions and their potential impact on financial stability. In the Rwandan economy, studies done relating to internal control systems and financial performance do not show directly the effect of governance and financial stability of Micro Finance Institutions(MFI) in Rwanda.For example case study researches done by Guyo, (2013).This study therefore focused on wider scope of Micro Financial Institutions (MFI) in Rwanda and sought to fill existing research gaps to determine the relationship between governance and financial stability of Micro Finance Institutions in Rwanda.

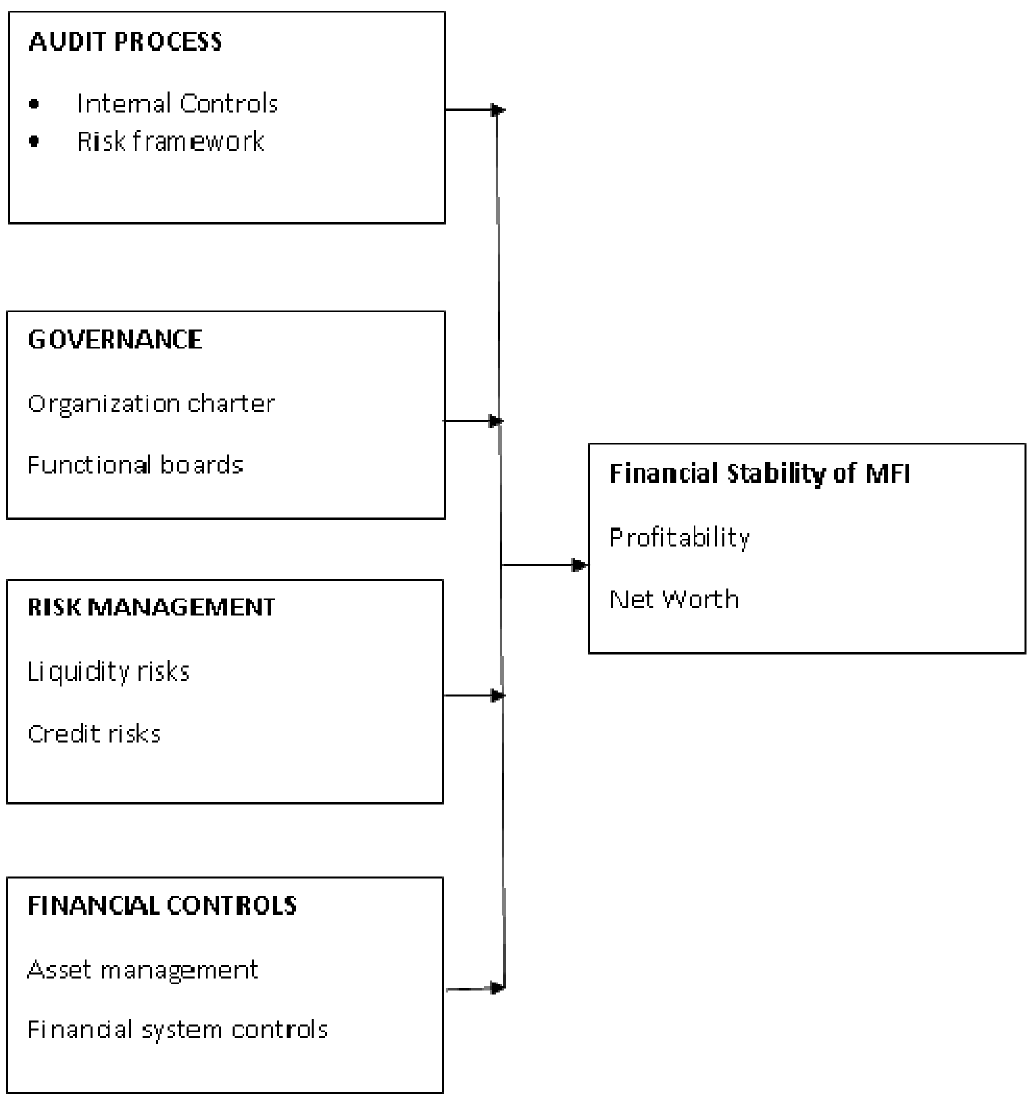
3. Theory

Ethics Theories and Corporate Governance

Other than the fundamental corporate governance theories of agency theory, stewardship theory, stakeholder theory, resource dependency theory, transaction cost theory and political theory, there are other ethical theories that can be closely associated to corporate governance. These include business ethics theory, virtue ethics theory, feminist ethics theory, discourse ethics theory, postmodern ethics theory. Business ethics is a study of business activities, decisions and situations where the right and wrongs are addressed. The main reasons for this are the power and influence of business in any given society is stronger than ever before. Businesses have become a major provider to the society, in terms of jobs, products and services. Business collapse has a greater impact on society than ever before and the demands placed by the firm's stakeholders are more complex and challenging. Only a handful of business giants have had any formal education on business ethics but there seems to be more compromises these days. Business ethics helps us to identify benefits and problems associated with ethical issues within the firm and business ethics is important as it gives us a new light into present and traditional view of ethics (Abdullah, & Valentine, 2009); in their view of understanding the 'right and wrongs' in business ethics, injected morality that is concerned with the norms, values and beliefs fixed in the social process. Further, this helps right and wrong for an individual or social community. Ethics is defined as the study of morality and the application of reason which sheds light on rules and principle, which is called ethical theories that ascertains the right and wrong for a situation. Whilst business ethics theory focuses on the "rights and wrongs' in business, feminist ethics theory emphasizes on empathy, healthy social relationship, loving care for each other and the avoidance of harm. In an organization, to care for one another is a social concern and not merely a profit centered motive. Ethics has also to be seen in the light of the environment in which it is exercised. This is important as an organization is a network of actions, hence influencing trans-communal levels and interactions (Abdullah, & Valentine, 2009). On the other end, discourse ethics theory is concerned with peaceful settlement of conflicts. Discourse ethics, also called argumentation ethics, refers to a type of argument that tries to establish ethical truths by investigating the presuppositions of discourse (Habermas, 1996). Meisenbach (2006) contends that such kind of settlement would be beneficial to promote cultural rationality and cultivate openness (Johnstone, 2017). Virtue ethics theory focuses on moral excellence, goodness, chastity and good character.

4. Conceptual Framework

In line with the governance used in previous studies on financial stability, this study proposes a conceptual framework in Figure 2.1 to link the relationship between governance and financial stability of Micro Finance Institutions in Rwanda (which are the independent variables of the study) to financial stability (which is the dependent variable) in order to show the existing relationship.



5. Research Design

Kangangi, G. W. (2014). Aver that descriptive study has several advantages such as; helps in understanding the characteristics of a group in a given situation, assists in systematic thinking about aspects in a given situation. It also offers idea for further probe and research and helps in making certain simple decisions. Sekaran, and Bougie, (2016). Say that descriptive research is to describe characteristics of objects, people, groups, organizations, or environments. In other words, descriptive research tries to "paint a picture" of a given situation by addressing who, what, when, where, and how questions. Descriptive research design is appropriate for this study as it helped in understanding the relationship between governance and Financial Stability of Micro Finance Institutions in Rwanda and therefore answer the "what" question of the study. The researcher will use longitudinal survey design since the nature of research also shall rely on secondary data of published financial reports of Micro Finance Institutions in Rwanda. The data will be for the last seven years namely year 2010 to year 2016.

6. Target Population

The target population of this study will be senior managements of Micro Finance Institutions in Rwanda. In Rwanda, there are eighteen Micro Finance Institution according to National Bank of Rwanda Financial Stability Rao et al. (2017). For the sake of this research, the researcher will target the micro financial institutions (MFI) senior management (Chief executive officer, finance manager, credit manager, risk manager and senior accountant), seven MFI directors and twelve shareholders of the MFI.

7. Sampling Frame

Sampling is the procedure a researcher uses to gather people, places or things to study. It is a process of selecting a number of individuals or objects from a population such that the selected group contains elements representative of the characteristics found in the entire group (Orodho, 2003). The researcher adopted stratified random sampling technique where all units from the sampling frame have an equal chance to be drawn and to occur in the sample. The following formula was used to get the sample size. The first step is involved in the use of stratified random sampling of three levels of Senior Management, Board of Directors and Shareholders. Stratified random sampling according to Acharya, Prakash, Saxena and Nigam. (2013). Sampling is a probability sampling technique in which the defined target population is divided into groups. The researcher used a sample representation of thirty (30%) from each of the strata identified and to ensure equal representation totaling to 152 from each of the strata identified and to ensure equal representation.

8. Data Processing and Analysis

This chapter focuses on presenting the findings and discussions of the study by detailing the general characteristics of the study sample, the descriptive study, the aggregates of the variables, the correlation analysis and the logistic regression of the dependent and independent variables. The chapter details the research findings and discussions on the strength of the model; test of hypothesis and the summary. The research findings are presented in the form of tables, charts and graphs.

Governance

Governance was measured using eight items. Each item was rated on a five points Likert scale with 1 being "strongly agree", and 5 being "strongly disagree".

Table 4. 1 Governance (G)

Governance	Strongly disagree (%)	Disagree (%)	Not sure (%)	Agree (%)	Strongly agree (%)	Mean
Governance (G1)	1	2	36	45	15	3.71
Governance (G 2)	0	3	21	49	27	3.99

The table above indicates that all items manifest a mean greater than 3.85 which assures that the Governance is well done. In total, agree and strongly agree responses are beyond 60%.

On being asked, the governing body approves the mission and values and assesses all proposed activities against them. From table 4.1, majority (60%) of respondents agreed and strongly agreed, while 36% were not sure, 2% disagreed and 1% strongly disagreed with the statement. This is in line with the findings by Hess, and Date, (2012). Whose study was that strong mission is vital to effectiveness as the organization might otherwise lack identity, cohesion, a clear sense of its unique value and a sharp focus for its activities. It could, for example, try to work on too broad a front and become overstretched.

The findings of the study showed that 76% strongly agreed and agreed that the governing body reviews short-, medium- and long term goals to monitor agreed strategies, while 21% were not sure and 3% disagreed with the statement. According to Shawyun, (2012).Any organization embarking on strategic planning must first decide if it is to be a major, onetime an event or a significant though periodic process, or geared towards outlining a change in roles or the way day-to-day operations are run.

Governance

Governance construct was measured using eight items. Each item was rated on a five points Likert scale with 1 being "strongly agree", and 5 being "strongly disagree".

Table 4. 2 Governance

Governance	Strongly disagree (%)	Disagree (%)	Not sure (%)	Agree (%)	Strongly agree (%)	Mean
Governance (G3)	0	1	20	49	30	4.08
Governance (G4)	0	4	21	47	28	3.98

The table above indicates that all items manifest a mean greater than 4.005 which assures that the Governance is well done. In total, agree and strongly agree responses are beyond 60%.

The respondents were also required to address the question in G3 of the governing body reviews short-, medium- and long term goals to monitor agreed strategies. Majority (79%), 21% were not sure and 3% disagreed with the statement. The results are in line with those of Shawyun, (2012), any organization embarking on strategic planning must first decide if it is to be a major, onetime an event or a significant though periodic process, or geared towards outlining a change in roles or the way day-to-day operations are run.

The study also sought to perform Governance (G 4), in table 4.2, shows that a significant majority (75%) agreed and strongly agreed, while 21% were not sure and 4 % disagreed that the governing body members receive the advice and information that they need to make good decisions. The findings are in agreement by Azevedo, (2017), Consensus decision making is possible within an organizational setting, but to achieve it, the chair of the governing body needs to take on the role of a facilitator, negotiator and mediator, rather than acting as someone making the final decision.

Table 4. 3. Governance

Governance (G)	Strongly disagree (%)	Disagree (%)	Not sure (%)	Agree (%)	Strongly agree (%)	Mean
Governance (G5)	0	1	13	53	32	4.17
Governance (G6)	0	9	17	51	24	3.89

The findings also show that 85% of the respondents agreed and strongly agreed that Data output controls are used to ensure the integrity of output, and the correct and timely distribution of output produced, while 13% are not sure and 1% disagreed with the idea. Consistently, Meester, and Pinciroli (2012) Someone should be assigned responsibilities for seeing that all outputs are produced and distributed in accordance with the requirements and design of the application system. In larger organizations with mainframe computer environments, this responsibility is typically assigned as part of the responsibilities of a data control group, which falls within the information systems department.

In table 4.3, the results show that 75% agreed and strongly agreed that Information and communication is the component of internal control that ensures that pertinent information is identified, captured, and communicated in a form and timeframe that enables people to carry out their job responsibilities, while 17% disagreed and 9% disagreed with the issue. This is line with the study by Vos, Flaxman, Naghavi, Lozano, Michaud, Ezzati, and Abraham, (2012), who revealed out that internal Controls begins with ensuring the accuracy, relevance and reliability of accounting information. Basic processing of accounting data is achieved through computer systems ranging from individual personal computers to large-scale enterprise servers.

Table 4.4 Governance

Governance	Strongly disagree (%)	Disagree (%)	Not sure (%)	Agree (%)	Strongly agree (%)	Mean
Governance (G7)	0	1	20	49	30	4.08
Governance (G 8)	0	17	22	43	18	3.61

The result in table 4.4. Show that 79% agreed and strongly agreed that Board has full and common understanding of the roles and responsibilities of a board of directors, while 20% are not sure and 1% disagree with the statement. The study occur by Moeller, (2013), urged that Board members are the fiduciaries who steer the organization towards a sustainable future by adopting sound, ethical, and legal governance and financial management policies, as well as by making sure the nonprofit has adequate resources to advance its mission.

Result from table 4.4, revealed out that most of respondents agreed and strongly agreed 61%, while 22 were not sure and 17% disagreed that Board regularly monitors and evaluates progress on important organizational matters. This is in agreement by (Randall, 2016).Who urged that the planning stage, is essential in order to carry out monitoring and evaluation systematically.

9. Anova

Table results of ANOVA test which reveal that Governance has significant effect on financial stability in Micro financial institutions in Rwanda since the P value is actual 0.000 which is less than 5% level of significance. Shows the coefficient of determination (R Square) of 0.562 which indicates Governance can explain 56.2 % of the variations or changes in the dependent variable (Financial Stability) in the relationship between governance and Financial Stability of Micro Financial Institutions in Rwanda. This implies that all independent variables uses have an impact on the dependent variables since 0.562=56.20% means that the model used has been able to compute only 56.20% variation of the dependent variable.

Table 4.5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.591[a]	.349	.346	.65837

a. Predictors: (Constant), Governance

Table 4.5. ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	48.153	1	48.153	111.092	.000[b]
	Residual	89.725	207	.433		
	Total	**137.878**	**208**			

Overall Model

Regression analysis was carried out in order to determine whether independent variables (**Governance**) can be relied on in explaining the dependent variable-financial stability. Table 4.5 shows the coefficient of determination (R Square) of 0.562 which indicates that governance can explain 56.2 % of the variations or changes in the dependent variable- financial stability in the Micro Finance Institutions in Rwanda. In other words governance can explain 56.2 % of changes in financial stability in the Micro Financial Institutions in Rwanda.

Influence of governance in organization on financial stability

The study responded to the objective which sought to examine the effects of Governance on Financial Stability of Micro Finance Institutions in Rwanda.

Correlation for governance and financial stability

Table 4.5 shows the Pearson correlation coefficients between the independent variable governance and the dependent variable financial stability. The findings indicate a positive significant correlation of 0.591 since the level of significant is less than the set 0.05.

10. Research Hypothesis

There is significant relationship between Governance on Financial Stability in the Micro Financial Institutions in Rwanda. H1; at least one β is $\neq 0$. From the ANOVA table, it is clear that p-value = 0.000 <0.05, prompting the rejection of HO in favour of H_I at 5% level of significance.

11. Recommendation

The specific objective two was to examine the activities done in the management of Micro financial institutions of Rwanda and the study found that the satisfaction of clients, the quality management (work plans, financial policies and financial procedures.), effectiveness and efficiency are fulfilled with a mean greater than 3.4 which is a tangible proof of their existence.

12. Conclusion

Findings also showed that the results of ANOVA test revealed that governance has significant effect on financial stability in the Micro financial institutions of Rwanda and thus the study rejects that the null hypothesis concluded that there is significant relationship between governance and financial stability in the Micro Financial Institutions of Rwanda.

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