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Female leadership, performance, and governance in microfinance institutions

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ABSTRACT

This paper investigates the relations between female leadership, firm performance, and corporate governance in a global panel of 329 Microfinance Institutions (MFIs) in 73 countries covering the years 1998–2008. The microfinance industry is particularly suited for studying the impact of female leadership on governance and performance because of its mission orientation, its entrepreneurial nature, diverse institutional conditions, and high percentage of female leaders. We find female leadership to be significantly associated with larger boards, younger firms, a non-commercial legal status, and more female clientele. Furthermore, we find that a female chief executive officer and a female chairman of the board are positively related to MFI performance, but this result is not driven by improved governance.

1. Introduction

The microfinance institution's (MFI) purpose or mission is to provide access to financial services to poor families and small businesses situated mostly in developing and newly industrialized countries. Microfinance is to a large extent a women's business. Female borrowers are the MFIs' largest market, and lending to women is considered one of the main reasons for microfinance's success (Armendáriz and Morduch, 2010). But microfinance is not only a business *for* women it is to a large extent also a business *by* women. Interestingly, beside Nobel laureate Muhammad Yunus, several women are industry icons: for example, Pilar Ramirez of Banco FIE in Bolivia and Ingrid Munro in Jamii Bora in Kenya. The female proportion of top executives and directors in MFIs is high. In our sample the CEO is female in 27% of MFIs, the chair is female in 23%, and 29% of all board seats are held by women. These proportions are much higher than corresponding figures in traditional firms. For instance, for their very large sample of U.S. companies, Adams and Ferreira (2009) report that only 8.8% of directors are female. In this paper, we investigate whether female leadership improves governance and financial performance in MFIs.

Unlike studies in high-income countries (Smith et al., 2006; Adams and Ferreira, 2009) that often consider only the role of directors, we address these questions for the chief executive officer (CEO), the chair, as well as board directors. Moreover, our study is novel because it surveys entrepreneurial firms (MFIs) in emerging markets. Our data tells us that the MFIs' median time in operation is eight years. In eight years, the weight of tradition has not settled in a firm, so that a masculine culture has not yet become ingrained, and the male network has not had time to become established. Thus, the "glass ceiling" (Kanter, 1977) between men at the top and women in jobs below has not had time to set. This creates opportunities for able women to rise in the MFI's leadership hierarchy. Microfinance is also typically a mission-driven organization (Randøy et al., 2014). Thus, we are able to tell if the leadership's gender matters for governance and performance in circumstances that are different from those usually studied.

The female orientation is often a stated goal in many MFIs. The MFIs in our sample have indicated whether they prefer to lend to women. 44% state that they have such a female bias. This female attention is evident in supporting international organizations for microfinance as well. The objective of the Microcredit Summit Campaign, which plays a central role in the promotion of microfinance, is "to ensure that 175 million of the world's poorest families, **especially women**, receive credit for self-employment and

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other financial and business services" [our emphasis] (www.microcreditsummit.org).

When many MFIs are gender biased, it becomes interesting to study how well female leaders perform. Does a woman bring better governance and better financial performance to the MFIs they run? Mersland and Strøm (2009) argue that because a female CEO is better able to tap into the local, often female information network, female leaders may design product and procedures that better meet the female users' needs. We follow this line of argument here, and extend the analysis to the chair and the board of directors. Our main hypothesis is that female leadership has beneficial consequences for the MFI's governance as well as its financial performance. In gender biased MFIs, female leaders could be better matched to the challenges and opportunities that female customers face.

But female leadership is possibly endogenous, that is, specific MFIs may attract female leaders. If these are also good performers, we cannot attribute good financial performance to female leadership. At most we can state there is a correlation. We attempt to disentangle the reverse causality problem by following the Heckman (1978) dummy endogenous variable method. We also test for sample selectivity bias by the inverse Mill's ratio test.

The research on female leadership is scant in microfinance. Armendáriz and Morduch (2010) argue that female targeting and financial sustainability are perfectly compatible, since female targeting within microfinance has often been attributed to increased efficiency due to higher repayment rates among female borrowers. D'Espallier et al. (2011) confirm that the targeting of women leads to higher repayment rates in MFIs. Both deal with the customer aspect. However, our study investigates whether female leadership has an impact upon the MFI's governance and its financial performance in an industry that to a large extent caters to female customers.

In the general governance literature, only Adams and Ferreira (2009) address both the governance and performance issues related to female management, but limit the study to directors. They find that female directors are "tougher" monitors than men, but also that a positive effect of female directors on performance is only detectable for firms with weak governance structures when instrumental variables (IV) methodology is employed. Furthermore, Smith et al. (2006), and Francoeur et al. (2008) investigate the relationships between a female CEO and female directors on the one hand and financial performance on the other. These studies do not look into corporate governance issues. All studies cited here use data from diverse industries in Western countries. In contrast, we investigate the effects of three leadership types (CEO, Chair and Directors) upon both corporate governance and financial performance in an homogeneous industry in many developing countries.

The sample consists of 329 MFIs in 73 countries from 1998 to 2008. The data are from rating agencies and cover up to six years of data per individual MFI. The sample is drawn from the same industry, where MFIs largely follow the same mode of operation, focusing on loans to poor people and small enterprises, granting small loans with a short maturity, and demanding frequent repayments (Helms, 2006). Borrowers often have little or no collateral or credit history. Frequent repayments enable the MFI to quickly assess the borrower's repayment ability. Nevertheless, heterogeneity may arise due to different firm and country characteristics, in particular attitudes to women. We control for heterogeneity by firm and country background variables. Firm controls include the MFI's business practice, differences in institutional background, and commonly used controls such as MFI size, age, and risk. The country controls encompass a set of country variables, and also include world regional dummies. It turns out that despite cultural diversity, the fraction of female leadership positions is remarkably similar across countries. By controlling for country differences, our findings are relevant for corporate governance in other than emerging markets (Aguilera and Jackson, 2010).

We find that female leadership is negatively related to such governance measures as the number of board meetings, internal audits, and the separation of the CEO's and chair's roles, but positively related to MFI financial performance. This is contrary to what Adams and Ferreira (2009) find for female directors. Thus, the quality of an MFI's CEO and chair seems to be more important for the MFI's success than general corporate governance. Country specific variables complement these findings, as they are correlated with corporate governance but not financial performance. The results are robust to variations in estimating methodology, variable definition, and regression specification.

This article proceeds as follows. Section 2 develops hypotheses from former literature on female top executives' and board members' influence on firm performance and corporate governance. Section 3 gives a brief introduction to the microfinance industry and its special focus on women together with data descriptives. Section 4 lays out the estimating methodologies and also defines variables. Section 5 covers the conditions under which female leadership tends to arise, and Section 6 examines the relations between female leadership and corporate governance. Section 7 deals with the relations between female leadership and the MFI's financial performance. In Section 8 we perform a number of robustness checks, and Section 9 presents our conclusions.

2. Gender, governance and performance

Mersland and Strøm (2009) find that a female CEO induces a higher financial performance in the MFI. They assume this is due to the female CEO's better understanding of the market in which the MFI operates. This is a matching, or sorting, argument implying that an MFI that is matched with a leadership that has the same traits will perform better. In this case, the "same traits" refers to gender, so that for instance an MFI favoring female clients is matched with female leadership. The underlying theory for this is the Becker (1973) model for the marriage market.[1] Thus, the hypothesis is that female managers and directors will improve the MFI's governance and financial performance due to the better match between the MFI's leadership team and its market conditions. In microfinance, Ghatak (2000) shows how the Becker model may be applied to the matching of good borrowers in a group lending scheme. In Thomas and Ramaswamy (1996) the matching of leaders with specific traits and the firm's strategy increases firm performance.

The matching hypothesis of female leadership and the MFI contains two sub-hypotheses. The first is that female leadership is more likely to be found in MFIs with a bias towards female customers. The second is that an MFI's governance and financial performance improves with female managers and directors. But we hereby encounter two potential endogeneity problems. The first is the reverse causality case (Hermalin and Weisbach, 1998) when the MFI performing financially well attracts a female CEO. We control for reverse causation of female leadership in financial performance regressions by the Heckman (1978) model for an endogenous dummy variable. The second endogeneity problem is sample selectivity, that is, the selection of a female CEO, chair or director might be related to the emphasized focus on female customers i.e. MFIs hire a female leader because most clients are women, not because of their qualifications. We handle this second endogeneity problem by the inverse Mill's ratio (IMR) test. In the

[1] Becker gives various examples of matching: "...the optimal sorting of more able workers and more able firms, more "modern" farms and more able farmers, or more informed customers and more honest shopkeepers".