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The governance of non-profit micro finance institutions: lessons from history

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Abstract Microfinance is high on the public agenda, and better corporate governance has been identified as a key factor for enhancing the viability of the industry. However, recent literature on the subject struggles to identify the corporate governance mechanisms that influence the performance of the Micro Finance Institutions (MFIs). Guided by stakeholder and agency theories, this paper uses a historical parallel found in savings banks to present corporate governance lessons for MFIs, particularly non-profit MFIs, today. The findings indicate that monitoring by bank associations, depositors, donors, and local communities was important in securing the survival of savings banks. In addition, a willingness to expand their mission to serve wealthier customers alongside the poor helped the banks become financially viable. These findings could prompt a rethinking of microfinance governance, which stresses regulation, for-profit ownership, and traditional vertical board control. The paper argues that a broader and more stakeholder-based understanding of corporate governance is necessary. Moreover, the paper demonstrates that historical studies can provide governance lessons for today.

Keywords Microfinance · MFI · Non-profit organisations · Governance · Savings banks · History

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1 Introduction

Microfinance, the supply of banking services to the poor, is high on the public agenda and is attracting increased interest from academics. The development-enhancing aspect of microfinance has been recently recognised with the Nobel Peace Prize awarded to Mohammad Yunus and Grameen Bank. Microfinance is also increasingly becoming an investment opportunity. The total stock of foreign capital investment in microfinance more than tripled between 2004 and 2006, to US$4 billion, with the establishment of 40 new specialised international investment funds (Reille and Foster 2008).

A new type of firm, called a Micro Finance Institution (MFI), has become the provider of microfinance services. A typical characteristic of an MFI is its dual mission to serve the poor and remain financially sustainable. Most MFIs are sponsored by donors, and incorporated as non-profit organizations or member-owned cooperatives (Mersland 2009).

A recent report identified corporate governance as a principal risk facing microfinance, threatening its role as both a business and a social service (CSFI 2008). However, studies by Mersland and Strøm (2009) and Hartarska (2005) find that best practice governance mechanisms from regular firms in mature markets do not generally have much influence on the performance of the MFIs. Thus, there is a need for a different and more original approach to identify and better understand the governance mechanisms that can enhance MFIs' long-term survival. In line with the recommendation in Mersland (2009), this paper uses a historical parallel found in nineteenth century savings banks to identify and present corporate governance lessons for MFIs today. To my knowledge, this type of historical study represents a novel approach in both the microfinance and in the corporate governance literatures.

This paper outlines how non-profit MFIs and savings banks share the ownership premise of being non-profit organizations. A non-profit organisation is influenced by several stakeholders, but no particular group or person can legally claim ownership or receive residual earnings from it (Hansmann 1996; Mersland 2009). Thus, savings banks and non-profit MFIs are similar, both legally and economically. The paper therefore argues that particularly non-profit MFIs could potentially learn important governance lessons from the original savings banks. One challenge in the governance of non-profit organizations is the fact that managers serving as agents are supervised by donor organizations, who also serve as agents (Varian 1990). Thus, traditional board governance may be less effective in non-profit MFIs (Glaeser 2002). A broader perspective is required and attempted in this paper.

Microfinance is not a recent phenomenon. In fact, several pro-poor banking systems preceded it. Some, like savings banks and savings and credit cooperatives, continue to be important banking organisations throughout the world, while others, like Irish and English loan funds, have disappeared (Hollis and Sweetman 1998). Caprio and Vittas (1997) explain how the financial systems in developing countries today can learn from the financial systems of Western countries in the nineteenth century.

Modern microfinance was born as a response to the frustrated development resulting from subsidised rural credit in the 1950s and 1960s (Adams and Fitchett 1992). Thus, learning from history is inherent in its philosophy. However, the importance of learning from banking history is generally unexplored in the microfinance literature, though exceptions do exist. Fälting et al. (2006) drew a parallel between the early development of the Swedish savings banks. Hollis and Sweetman (1998) identify lessons to be learned from six different historic European pro-poor banking systems (not the savings banks though), and these researchers (2004) also drew parallels with the seventeenth-century Irish loan funds. Seibel (2003) and Guinnane (2002) draw attention to how financial history demonstrates the need for appropriate legal frameworks in the development of pro-poor financial systems. However, no previous historical microfinance study has drawn attention to corporate governance.

In order to identify the governance mechanisms that enabled the survival of savings banks, this paper reviews the historical literature on the subject. The findings indicate that bank associations, mismatches in liability/asset maturity (deposits on demand), local communities, and donors risking their personal reputations were important tools to discipline managers and secure the survival of the banks. The banks operated under either a friendly regulatory regime or under no regime at all. In the initial years, the banks did not face much competition. However, competition gradually became a major factor in disciplining the managers, and it is considered one of the main causes for savings banks' continued success in several markets today. The banks' willingness to expand their mission by serving poor customers alongside the more wealthy helped their financial viability.

These findings could prompt a revision in thoughts on microfinance governance, which stresses regulation and traditional vertical board control. The lessons from the savings banks indicate that a broader and stakeholder-based understanding of corporate governance is necessary to secure the long-term survival of a pro-poor banking system. Besides, the pursuit of financial objectives should be pragmatic.

This paper proceeds as follows. Section 2 explores the early history of savings banks; Sect. 3 discusses theoretical views on microfinance governance; Sect. 4 identifies potential corporate governance mechanisms in pro-poor banking and discusses their relevance to historic savings banks and modern non-profit MFIs; Sect. 5 discusses previous findings in order to identify lessons for today; and Sect. 6 concludes.

2 The early history of the savings banks

To understand the birth of savings banks, one must analyse their initial context. The ideological movement out of which savings banks were born was a search for new initiatives to improve the living conditions of the poor (Tucker 1991; Rønning 1972). Thrift and savings were introduced as means to avoid poverty and become rich (Tucker 1991). Therefore, the establishment of the first savings banks was a response to a new doctrine of self-help (Horne 1947). At the same time, this doctrine was convenient for the wealthy and the local authorities, who were able to continue a laissez faire policy of poverty assistance (Fishlow 1961; Clemmensen 1985).

Industrialisation was another driving force behind the establishment of savings banks. Low wage earners arriving in the cities needed a safe and convenient place to deposit their money. The existing commercial banks showed little interest in serving the wage earners with savings facilities (Teck 1968). At the same time, the lack of regulation, in combination with banks' reputation for speculation and exploitation of customers, made contracting with investor-owned commercial banks too risky for poor depositors (Hansmann 1996, 1989).

The first savings banks emerged in the late eighteenth century in Europe. By the second half of the nineteenth century, there were hundreds of banks in most European countries, as well as in the US (Pampillon 2003; Teck 1968; Horne 1947). The pattern was the same in all countries: banks were first established in the cities and spread to smaller villages after some decades (Rønning 1972; Clemmensen 1985). The banks were not organised by the poor themselves, but by the upper class, often in coordination with the local authorities and the priesthood (Rønning 1972; Pohl 2003; Clemmensen 1985; Horne 1947). The initiators were motivated by a combination of altruistic philanthropy and the self-interest of letting the poor help themselves. During the initial years, the management of savings banks was typically based on the promoters' voluntary work. Banks were only open a few hours during the month (Rønning 1972; Clemmensen 1985; Horne 1947), and this low-cost operational mode made it possible for the savings banks to rapidly become financially sustainable.

Governments actively supported the establishment of savings banks. Subsidies in the form of sponsored earnings on public bonds, exemption on stamp duties, or permission to charge loan interest above the legal ceiling were common. However, they were not imperative in securing the banks' operations, as most operations were carried out by volunteers, and operational income covered other costs (Pampillon 2003; Rønning 1972; Horne 1947).

The investment policy of the savings banks followed two main patterns, referred to as the Continental and Atlantic models. The Continental model canalised the captured savings into local loans while the Atlantic model canalised the funds into public bonds only (Pampillon 2003). The models used by different European countries are presented in Table 1. The Continental model is divided into two parts:

Table 1 Savings banks models in different European countries (adapted from Pampillon 2003)

Atlantic	Continental	
	Guaranteed	Pure
United Kingdom	Germany (municipality)	Germany (private)
Belgium	Austria (municipality)	Austria (private)
Ireland	Denmark (municipality)	Denmark (private)
France		Spain
Portugal		Finland
Luxemburg		Holland
Greece		Italy
		Portugal
		Sweden
		Norway

the guaranteed model and the pure model whereas in the first a public entity (normally the local municipality) guarantees the deposits while the second does not contain a public guarantee scheme.

Savings banks have been criticised for their claim that they successfully reached the poorest members of the community (Fälting et al. 2006; Ograda 2003; Rønning 1972). For example, Fishlow (1961) presents evidence that, in some of the UK savings banks in 1830, only 11.2% of the deposits were made to accounts of less than £20, which represented nearly 1 year's wage for a manufacturing operative or agricultural labourer. However, (Horne 1947) argues that most of the customers in England belonged to the poorer classes, and for Germany, Guinnane (2002) claims that savings banks were able to fulfil their mission to reach the poorer classes relatively well, which ran parallel to serving the middle class. In Scandinavia the banks attracted deposits from both the poor and the not so poor and rapidly penetrated society. In 1884, 18.8% of the Norwegian population, 19.8% of the Swedish population, and 32.3% of the Danish population had their own account in a savings bank (Egge 1972).

In the banks where deposits were recycled into loans, emphasis was placed upon safety. Most of the initial lending was supplied to relatively wealthy borrowers who could offer formal collateral (Fälting et al. 2006; Rønning 1972; Clemmensen 1985; Vittas 1997). Over time, lending was gradually extended to include mortgages, as well as farming and manufacturing loans to less wealthy customers (Fälting et al. 2006; Guinnane 2002).

Altogether it seems clear that in most savings banks the poor were served alongside the not so poor. Thus, instead of arguing that the inclusion of wealthier customers led to a drift away from the savings banks' mission, one can argue that such a policy of inclusion was required for savings banks to survive as a financial system. Through the inclusion of wealthier customers, the savings banks managed to increase their assets, thereby improving their operational costs and enabling their long-term sustainability. Besides, loans funded by deposits of the poor were more secure in the hands of those who could offer formal collateral.

2.1 Comparing the historic savings banks with today's non-profit MFIs

The brief description of the origins of the savings banks invites a comparison with today's non-profit MFIs. First, both types of organisations have a mission to fight poverty, operating as non-profits without any legal owners. As with savings banks, the doctrine behind MFIs is self-help, and the promoters are people outside the target population. However, while the savings banks were promoted by the local elite, non-profit MFIs are mainly promoted by international donor organizations (C-GAP 2006; Helms 2006).

A major difference between the organisations is that savings banks focused on savings, whereas most non-profit MFIs focus on credit. Thus, capital for on-lending stems from local depositors in savings banks, while it stems from international donors and lenders in non-profit MFIs. The lack of savings mobilisation and the dependency upon outside funding has long been a major concern in microfinance

Table 2 Comparison between the savings banks and non-profit MFIs

Issue	Savings banks	Non-profit MFIs
Mission	To fight poverty	To fight poverty
Doctrine	Self-help	Self-help
Promoters	Local individual philanthropists	International donors
Type of ownership	Non-profit	Non-profit
Dependence on subsidies	Low, but some	High, but decreasing
Level of sustainability	High	Low/medium, but improving
Financial service in focus	Savings first and credit later	Credit only due to regulation
Capital for on-lending	From local depositors	From international donors and lenders
Success in reaching the poorest	Questioned in credit delivery. Relatively good in savings	Relatively good, but do not reach the very poorest

(Helms 2006), and the current international financial crisis has revived the debate.[1] MFIs struggle to reach the poorest customers (Helms 2006). Yet, compared to savings banks, they have been more successful in issuing credit to the target population. The level of financial sustainability in savings banks was high due to the low cost of operations. However, many MFIs struggle to become financially sustainable. A recent survey of 704 MFIs by the Microbanking Bulletin (2007) reveals that 41% are not financially self-sustainable. Table 2 summarises the main similarities and differences between the two types of organisations.

3 Corporate governance literature and theory

There have been two recent, rigorous studies on corporate governance in relation to MFIs. Hartarska (2005) uses different datasets spanning 46–144 observations from East European MFIs, while Mersland and Strøm (2009) use a global dataset including 278 rated MFIs from 60 countries. These studies explore the effect of traditional governance mechanisms such as board composition and size, managerial incentives, ownership type, and regulation. However, consistency in findings within and across studies is rare. Both studies struggle to identify significant governance influence. For example, consider the results from Mersland and Strøm (2009) presented in Table 3.

As indicated in Table 3, Mersland and Strøm (2009) find that a female CEO and an internal auditor reporting to the board is associated with better financial performance, while international directors on the board increase costs and reduce operational self-sufficiency. Other governance variables are insignificant or

[1] Currently (November 2008) the effect of the credit crunch and the international financial crisis on microfinance is being heavily debated (for example at the European Microfinance Week, 12–14 November, 2008 in Luxembourg). Preliminary conclusions seem to be that the crisis may actually increase the demand for microfinance services as wage earners will be pushed into self-employment. However, the crisis may hit hard those MFIs that depend on international funding, thus the importance of being funded locally and with deposits will be revived.

Table 3 The effect of corporate governance on the financial performance of MFIs

	ROA	OSS	PY	OC
Constant	−0.418**	−0.411	−0.104**	1.140**
CEO/chairman duality	−0.032	−0.154	0.118**	0.074
International directors	−0.010	−0.095**	0.010	0.037**
Internal board auditor	0.022	0.133*	−0.034	−0.018
Board size	−0.001	−0.005	−0.001	0.001
Share holder ownership	−0.012	−0.129	−0.011	0.027
Female CEO	0.053**	0.215**	0.059	−0.036
Individual loan methodology	0.034	0.014	−0.026	−0.039
Competition index	0.011	−0.011	0.022*	0.004
Bank regulation	0.005	0.056	0.019	0.015
Urban market	0.001	0.090	0.066*	0.044
MFI experience	0.000	−0.010**	−0.002	−0.003
Portfolio at risk (30)	−0.085	0.436**	−0.132*	−0.131**
Firm size	0.026**	0.119**	0.006	−0.078**
Human dev. index	−0.100	−0.194	0.279	0.413**
Wald F (sign.)	0.002	0.000	0.000	0.000
Firm years	342	303	343	352

Results from Mersland and Strøm (2009), Table 5

Return on assets (ROA), operational self-sufficiency (OSS), portfolio yield (PY), and operational costs (OC) explained by board characteristics, internal and external governance mechanisms, and firm and economy characteristics. Random effects panel data 3SLS estimation spanning the period 1998–2007

Significant results at the 5% (10%) level are marked with ** (*)

inconsistent. Hartarska (2005) finds strong support for independent boards with limited employee participation. None of the variables significant in the two studies are explored in both.

The non-findings in the two studies are actually the most interesting. For example, both Hartarska (2005) and Mersland and Strøm (2009) find that neither regulation, nor a for-profit ownership structure advance MFIs' performance. Hartarska and Nadolnyak (2007) confirm the finding that regulation has no effect, while Mersland and Strøm (2008) confirm that ownership of MFIs does not matter. Both Hartarska (2005) and Mersland and Strøm (2009) conclude that governance matters, but the traditional governance mechanisms seem to matter less in MFIs relative to firms in mature markets. They call for better data and the study of alternative governance mechanisms in order to better understand the effect of corporate governance in the microfinance industry.

Contrary to the findings in Hartarska (2005) and Mersland and Strøm (2009), the practitioner-oriented literature on governance in MFIs emphasises traditional, vertical governance, like the composition and role of boards (Rock et al. 1998; Otero and Chu 2002). This body of literature also emphasises a need to transform from non-profit to for-profit ownership (Ledgerwood and White 2006). The practitioner literature generally follows the logic of agency theory, where the aim is to reduce agency costs stemming from vertical relationships between owners and management (Jensen and Meckling 1976; Fama and Jensen 1983). MFIs are recommended to set up governance systems in order to mitigate agency costs by aligning top management with owners' goals and putting controls into place (Rock et al. 1998; Otero and Chu 2002; Helms 2006). Despite the fact that Hartarska (2005) and Mersland and Strøm (2009) do not find empirical support for the effect of these recommendations, they are not necessarily wrong. However, they do not sufficiently account for the fact that most MFIs do not intend to be shareholder owned, have multiple goals, and do not have an inherent profit motive. Moreover, MFIs differ from regular firms in that they encounter horizontal agency problems between the bank and its customers (Adams and Mehran 2003), and donor-funded MFIs face agency costs in their relationships with donors.

Thomsen (2008) and Hansmann (1996) suggest that the importance of owners monitoring management has been overstated. The degree of product market competition and customer-firm relationships seems to discipline managers more effectively than owners (Hansmann 1996). The problem is exacerbated in microfinance, since the customer has little or no collateral or credit history, low education level, and little knowledge of the MFI. Moreover, the regulatory ability of local regimes is generally low. Under such conditions, issues such as closeness to the customer and mutual trust are paramount. There is thus a need for a broader set of governance mechanisms that account for agency costs stemming from multiple stakeholders.

Stakeholder theorists widen the approach of agency costs in arguing that, in addition to responding to owners' interests, manager must balance the needs of several stakeholders, such as employees, customers, local communities, authorities and debt holders (Freeman 1984; Mitchell et al. 1997). For the non-profit MFIs as for the savings banks, stakeholder theory helps establish a broader understanding and identifies who and what counts in the governance of these organisations (Mersland 2009).

4 Governance mechanisms in the savings banks and the MFIs

This section uses theory to identify and understand corporate governance mechanisms in pro-poor banking. For each mechanism identified, the historical literature on savings banks is studied in order to analyse its effect upon governance. The analysis of each mechanism is concluded by assessing whether it has affect in the governance of non-profit MFIs today. The mechanisms covered were identified through a review of the historic savings banks literature and are comprised of the following: the organisation's mission, boards, donors, public regulation, apex associations, market competition, maturity mismatches in liabilities/assets, and the influence of local communities and governments.

4.1 The mission of the organisation

Non-profit organisations do not have owners and are accountable to their missions (Hansmann 1996). Stakeholders influence a non-profit organisation's mission and monitor its fulfilment. The stakeholders with the most bargaining power are those with the most influence over the organisation's mission. A clearly defined and well-informed mission reduces the cost of disagreements and bargaining between stakeholders (Speckbacher 2008).

4.1.1 The mission in the savings banks

A striking feature in the history of savings banks is the ability of the banks to change their mission at an early stage of development. Vittas (1997) explains how savings banks were created to serve the poor through saving services, but they quickly reoriented their services to include the middle class and facilitated credit when legislation allowed. However, most banks continued to serve the poor, expanding their mission rather than departing from it. This shift made savings banks more financially sustainable, and at the same time it helped them reach out to larger markets. Altogether the banks went through a process of reorientation. In the beginning, there was the belief that savings and thrift could eliminate poverty and that the poor would be easily recruited. This enthusiastic phase was soon replaced by a more realistic understanding of the possibilities. Many of the poor were not able or willing to save and handling only small customers led to high operational costs. Loans were issued to wealthier clients in order to be secured. There was no lack of critical voices as the savings banks expanded their mission, but the pragmatic approach was approved by all surviving banks.

4.1.2 Mission in the MFIs

As with the savings banks, modern microfinance experienced an enthusiastic first stage, culminating in the Nobel Peace Prize being awarded to Mohammad Yunus and Grameen Bank in 2006. However, insiders in the industry have long been aware of the limitations (Dichter and Harper 2007). Reaching the poorest is a struggle, and the impact from access to services is often low, especially for those with limited access to assets, knowledge, and networks before contracting loans (Hulme 2000). Some MFIs are comfortably serving some wealthier clients alongside the poor, but as a whole the industry has still not reached the pragmatic stage and the mission drift debate remain lively (Morduch 2000).

4.2 Boards

Boards are a generic corporate governance mechanism to minimise agency costs stemming from the separation of owners/donors and management (Fama and Jensen 1983). Boards monitor, replace management, ratify major decisions, and bring in important networks and knowledge. Well-functioning boards ought to reduce agency costs and enhance organisational performance. However, the empirical evidence from for-profit firms indicates that, on average, boards matter little (Thomsen 2008). Speckbacher (2008) argues that, since non-profit organisations lack owners, their boards play a more important role than those of for-profit firms.

Board members of non-profit organisations offer their reputation as collateral to the public and try to minimise the risk of losing it (Handy 1995).

4.2.1 Boards in the savings banks

Since the origin of savings banks, boards have overseen their operations (Teck 1968; Fishlow 1961; Rønning 1972). Initially, board members would not have any direct or indirect business relationship with the bank, implying full independence. Later, however, it became normal in some banks to provide loans to board or founding members, and their children and servants were often depositors (Horne 1947; Rønning 1972). A board position was fully voluntary, and the boards were formed by the upper class including pastors and teachers (Fishlow 1961; Fälting et al. 2006; Rønning 1972; Ograda 2003; Horne 1947). As time went by, the bourgeoisie were gradually replaced by professionals, such as lawyers, accountants, and business managers (Clemmensen 1985; Rønning 1972). During the initial years, the participation of the target group, the poor, in the board was unthinkable.

As the savings banks started serving also less poor customers, some banks struggled to maintain the interest of their initial philanthropic founders (Rønning 1972). This is illustrated in the first annual report of the Cork Saving Banks in Ireland (founded in 1817):

> this species of deposits [high amounts], if continued, could eventually close the Bank, as no gentleman could be got to give their time gratuitously as mangers to conduct the money dealing of their equals and in many cases their superiors in rank and property (cited in Ograda 2003, p. 35).

However, even if the savings banks struggled to maintain the interest of their board members and gradually became more and more management dominated, it seems likely that they indirectly continued to provide some basic monitoring in order to protect their own reputation. Moreover, it seems likely that the banks capitalised upon the reputation of their founders. Gradually other stakeholders, like representatives from local governments and later customers and employees, were invited on the boards (Fälting et al. 2006; Guinnane 2002).

4.2.2 Boards in MFIs

MFIs today follow a traditional separation of management and board. Board members of non-profit MFIs are generally upper- or middle-class professionals. Similar to the savings banks, many MFIs struggle to identify board members with an appropriate background who are able and willing to dedicate the time that effective monitoring requires (Labie 2001). Stakeholders like donors, customers, employees, and debt holders are generally absent from MFI boards (Mersland and Strøm 2009).

4.3 Donors

Donors monitor organizations to verify that their donations are used in accordance with their wishes (Fama and Jensen 1983). When donors are individuals, they have a direct agency relationship with the firm. However, when donors are organisations funded by back-donors or taxpayers, the firm is monitored by an agent rather than a principal (Varian 1990).

4.3.1 Donors to the savings banks

Savings banks were founded by wealthy philanthropists who donated initial capital. However, this initial capital was rarely substantial (Hansmann 1996). Still, donor involvement was important, and they often took seats on the board. The monitoring they offered, the social capital, and their reputations were more important than their financial capital (Fälting et al. 2006). Donations were largely confined to the formation of the banks. After their establishment, the banks were fully dependent upon operational income and voluntary work (Hansmann 1996). After their initial donations, the donors contributed knowledge, reputation, and governance, but generally not additional funding.

4.3.2 Donors to the MFIs

While non-profit ownership of the savings banks was chosen in order to protect customers (Hansmann 1996), most MFIs seem to have chosen non-profit ownership as a means to tap into donors' pockets (Mersland 2009). The term 'briefcase NGO,' referring to organisations formed by private individuals, is well-known. The term also indicates that several donors practice slack control, permitting personal benefits to individuals.

Donors play a major role in the microfinance industry (C-GAP 2006). Donations stem from international NGOs and the bilateral and multilateral donor communities. These organisations are funded by back-donors, either private philanthropists or taxpayers. Therefore, MFIs face the governance challenge that managers serving as agents are supervised by donors, who also serve as agents (Varian 1990). This structure differs from that of savings banks, where the donors of initial capital were private individuals who often took a board position in addition. In contrast, few donors take board seats in MFIs (Mersland and Strøm 2009).

4.4 Regulation

Bank regulation has the potential to seriously affect the performance of a bank or an MFI. However, developing economies suffer from very weak institutional frameworks, imperfect markets, and incomplete information. Weak regulatory ability is a major reason for the existence of non-profit organisations. While privately-owned banks have strong incentives to invest in risky projects, a non-profit bank is less likely to employ depositors' money in risky endeavours (Hansmann 1996).

4.4.1 Regulation in the savings banks

Except that some countries obliged the savings banks to invest in public bonds, the banks were generally unregulated or operated under a friendly regulatory regime.

The necessary trust was generated not by law, but by the reputation offered by the local elite who actively promoted the banks. Where regulation was introduced the objective was often to let the banks adhere to a few basic rules to insure that operations were concentrated on non-wealthy customers (Guinnane 2002). In other countries the main purpose of regulation was to allow the banks subsidised interest on public bonds or to exempt them from stamp duties (Fishlow 1961; Rønning 1972).

However, as the level of savings grew and investment in less secure assets became more common, legislators gradually responded with additional regulation (Fälting et al. 2006; Rønning 1972). Yet the regulatory framework installed was friendly, intended to strengthen public confidence in banks. However, in some countries, like Spain and Denmark, where regulation was introduced as a means to enhance public trust, the result was often the opposite leading to withdrawal of deposits (Martinez 1998) or lowered expansion (Hansen 2001).

4.4.2 Regulation of MFIs

Many have issued calls for more prudent regulation of MFIs (Christen et al. 2003). Non-profit MFIs are generally unregulated and not allowed to intermediate deposits. The main argument is that, since non-profit organisations do not have owners with monitoring incentives, they are weaker and riskier (Jansson et al. 2004). As a consequence, non-profit MFIs are prompted to transform themselves into shareholder banks in order to become regulated. However, Mersland and Strøm (2008) find that ownership type doesn't matter for MFI performance, and Hartarska and Nadolnyak (2007) and Mersland and Strøm (2009) find that regulation has no direct effect upon MFI performance, and can only indirectly help increase scale and scope if the MFI is allowed to mobilise deposits (Hartarska and Nadolnyak 2007).

4.5 Apex associations

Moore and Stewart (1998) suggest that the use of collective self-regulation can help remedy agency costs in non-profits. National and voluntary associations of non-profits can improve managerial practices and organisational performance through self-policing. Since non-profit organisations lack owners with strong monitoring incentives, Speckbacher (2008) argues that they are in special need of external reporting systems in order to reduce informational asymmetry between management and the various stakeholders. Such external reporting systems can be organised through auditing or self-regulation apex systems.

4.5.1 Apex associations in the savings banks

National apex associations were important in the early savings banks. The aim was typically threefold: first, to increase the overall power of negotiation with authorities and commercial competitors; second, to help the banks achieve economies of scale in service provisions (e.g. money transfer systems across the savings banks); and third, to act as a bank for the banks (Comin and Torres 2003; Guinnane 2002). In order to uphold membership in the association, minimum performance standards and self-regulation by the apex were common. Seibel (2003) points out that effective auditing carried out by the apex associations was an important mechanism in savings bank governance.

4.5.2 Apex associations among MFIs

Apex associations among MFIs are common (SEEP Network 2005). They play a representative role and to some degree, they are also active in building the professional capacity of their members. In some networks, such as Red Financiera Rural in Ecuador and FINRURAL in Bolivia, they have installed a self-reporting monitoring system, though formal types of self-regulation are uncommon. The argument is that self-regulation cannot be prudent, as free riders are an obvious problem (Christen et al. 2003). Also, the networks of MFIs seldom serve their members with tangible services like wholesale lending, IT, or giro systems. As a consequence, the network becomes less important in the governance of the MFIs relative to the governance role of the savings bank associations.

4.6 Competition

Market competition is an external governance mechanism. In general, the more intense the competition, the less the owners need internal governance mechanisms (Schmidt 1997; Hart 1983). Hansmann (1996) argues that, in markets with trustworthy regulation and deposit insurance, ownerless savings banks can compete with their commercial peers due to the disciplinary effect of market competition.

4.6.1 Competition in savings banks

In their early years, savings banks did not encounter much competition. People in urban areas did not trust the commercial banks, and local savings banks were generally alone in offering banking services in rural areas. However, gradually more savings banks were established, implying greater competition (Clemmensen 1985), and more trustworthy regulation of commercial banks made them an alternative for poorer customers (Hansmann 1989). Furthermore, since the mid-nineteenth century, member-based savings and credit cooperatives in many countries became important competitors of savings banks (Wolff 1919; Hansmann 1996). Today, several observers argue that market competition is probably the number one mechanism enabling savings banks to continue as competitive organisations (Crespi et al. 2004; Altunbas et al. 2001).

4.6.2 Competition in today's microfinance markets

Many microfinance markets, especially those in rural locations, still have no formal financial service supplier (Robinson 2001; Christen et al. 2004). Where MFIs exist, markets are often characterised by a severe lack of competition, and most clients have limited bargaining power vis-à-vis microfinance providers. However, there are exceptions. In Bolivia, where competition has been increasing, the average annual yield has decreased during the last decade, from 50% in the leading MFIs to just above 20% (Porteous 2006).

4.7 Demand deposits

Most savings in banks are in accounts where the depositor can withdraw money on demand. Most theoretical models assume that the role of such demandable debt is to provide flexibility to the depositors (Freixas and Rochet 1997). Calomiris and Kahn (1991) offer an alternative explanation. They point out that allowing on-demand withdrawals implies a mismatch between the maturity of assets and liabilities. Such a financial structure is an optimal instrument for management control. In the event of bank trouble, depositors can immediately withdraw their money, causing the bank to fall. Calomiris and Kahn (1991) further point out that the disciplining mechanism works as long as the maturity of liabilities is less than the maturity of assets. Hollis and Sweetman (2007) tested Calomiris and Kahn's (1991) theory on an historic case from Ireland. They found that institutions with more deposits were better at controlling expenses than those with less funding stemming from deposits.

4.7.1 Demandable debt in savings banks

Historians have long recognised the importance of demandable debt in disciplining managers of savings banks:

> if the saver had any dissatisfaction with the way the organization was being managed, he simply terminated his relationship by withdrawing his funds (Teck 1968, p. 33).

This is recognised by Hollis and Sweetman (1998), who point out that the importance of depositor monitoring on the sustainability of pro-poor banks should not be underestimated.

4.7.2 Savings in MFIs

Non-profit MFIs are generally not allowed to intermediate deposits and consequently excluded from offering savings and funding their portfolios locally. Instead non-profit MFIs are funded by donations and medium-term international debt. Thus, since micro-credit is lent on short terms, the maturity of MFIs' debt generally exceeds that of their assets. As a result, non-profit MFIs lack the disciplinary effect stemming from monitoring by depositors or debt holders.

4.8 Local governments and communities

From a stakeholder's perspective, local governments and communities have important influence on the firm's opportunities and behaviour.

4.8.1 Local government and community influence on savings banks

Savings banks have always been tied to and promoted by local communities in general, and by the local authorities in particular. In most countries, the local authorities helped organise the banks, and they have often provided some of the initial capital. In several local communities, the first savings banks merged with existing social services. In Spain, the banks joined forces with the Montes de Piedad, a relief fund for the poor (Sanchez 2003). In Norway, several savings banks were merged with the community corn chambers intended for lean years (Rønning 1972). At the same time, however, it was important for the banks to remain private entities, rather than public. Hence, the local authority was only one stakeholder alongside others, and attempts to tie the banks more closely to the public sector were punished by massive withdrawals of deposits (Martinez 1998).

Another feature tying savings banks to local communities has been the banks' funding of charity work and community projects (Sanchez 2003). Institutionalising the partial return of profits to local communities has created a mechanism by which the local community helps to steward the banks. In addition, similar to dividends of for-profit firms, the funding of local projects reduces the bank's free cash flow and management's power, creating a governance mechanism (Jensen and Meckling 1976).

4.8.2 Local government and community influence on MFIs today

Today, few MFIs relate closely to the local authorities. The local authorities are more often seen as obstacles, creating difficulties in issuing permits or imposing taxes. In Peru, however, the Cajas Municipales represent an interesting exception. Over the last couple of decades, most of the Cajas have been successful MFIs (rating reports available at www.ratingfund.org).

In their contact with local communities, except the member based organizations, most MFIs enter into a traditional bank-customer contractual relationship. The community is seldom a driving force behind the establishment of a non-profit MFI, nor is it invited to take a more active stake in its governance. However, there are exceptions. In the Bolivian non-profit MFI Diaconia FRIF, they have a conscious strategy of being part of the Indian Aymara community. The staff is largely Aymara, and several of them are involved in different Aymara organisations. According to Diaconia FRIF, the close relationship with the Aymara community has been instrumental in securing its success.

5 Discussion

The differences in governance mechanisms between the historic savings banks and today's non-profit MFIs invite deeper discussion. The previous section is summarised in Table 4.

One of the most puzzling questions is why the non-profit ownership structure of savings banks was seen as a guarantee for avoiding excessively risky behaviour, whereas it is considered inappropriate and excessively risky today (Jansson et al.

Table 4 The governance mechanisms of the historic savings banks and today's non-profit MFIs

Governance mechanism	Historic savings banks	Today's non-profit MFIs
Mission	Pragmatic willingness to broaden the mission and include wealthier clients	Mission drift debate still ongoing
Boards	Composed of upper-class people who also took part in the management. Gradually the board became less important	Composed of upper-/middle-class professionals. Are considered important, but still most MFIs struggle to have active and competent boards
Donors	Took an active role in governance through board seats and personal reputation	Monitoring efforts vary, but few donors are willing to take on an active governance role or sit on boards
Regulation	Either unregulated or operated under friendly regulatory regimes	Unregulated because of non-profit ownership.
Apex associations	Were important in monitoring the banks and were a self-regulation mechanism. Also provided important services	Important, but still much less than in the savings banks. Do not provide much self-regulation and tangible services
Competition	Low or no competition in the beginning, but today this is considered to be the number-one governance mechanism	Still low competition, but increasing.
Mismatch in liability/asset maturity	Mismatch in liability/asset maturity important in disciplining the managers	Non-existent due to the regulatory regimes
Local communities and authorities	Were important stakeholders in the banks and took active part in their governance	The interaction with local authorities is generally low and the relationship with the communities is normally only of the customer-firm contract type

2004). Hansmann (1996) argues that since savings banks face a non-distribution constraint, they are generally more trustworthy than for-profit banks. Part of the answer is likely found in the fact that many non-profit MFIs today have simply become 'briefcases' of their founders or managers. Another part may be that donors today are often too generous in their funding and too slack in their monitoring. The lack of a broader understanding of governance in general, and of non-profit ownership in particular, is also important.

It is a fact that the microfinance industry has many well-performing non-profit MFIs, demonstrating that non-profit ownership does not necessarily imply slack performance and donor dependence (Mersland and Strøm 2008). However, since the current credit crunch is assumed to hit non-deposit taking MFIs relatively harder, it may become increasingly important to establish regulatory frameworks allowing well performing non-profit MFIs to intermediate deposits. Governance lessons from the savings banks may turn out to be particularly relevant. In this regard the recent initiatives in Bolivia are interesting, where non-profit MFIs, members of the apex FINRURAL, are about to become regulated and allowed to intermediate deposits.

The survival of savings banks can be attributed to pragmatism and their willingness to expand their missions. Several of the most commercial MFIs today will probably argue that this has also enabled their viability. Some, such as Procredit in Bolivia, provide loans above US$100,000 and are criticised by some for having left their original mission behind. However, Procredit states the opposite: most of their customers take very small loans, implying that they have expanded their mission but not abandoned it. However, few MFIs are as pragmatic as Procredit. The lesson from savings banks is that MFIs may need to become more pragmatic in order to survive over the longer term.

This study reveals that there is clearly much more to governance than boards. Of course boards are important for MFIs today as they were in the initial stage of savings banks, but other mechanisms must substitute and reinforce boards in the disciplining of managers. Upper class board members in the savings banks were gradually replaced by groups with a more direct stake in the banks. Whether the inclusion of stakeholders like customers, employers, local communities, donors and debt holders could enhance the performance of non-profit MFIs should be subject for research efforts.

The Calomiris and Kahn's (1991) model is important for understanding how agency costs in banking can be reduced. This is particularly true when there is no takeover market (a non-profit organisation cannot be taken over) and in an unregulated environment where the public has little confidence in the regulator's willingness and ability to closely monitor the bank. However, it may sound too risky to introduce deposit intermediation in MFIs as a means to discipline managers through monitoring by depositors. And, of course, this would not be without any kind of pre-screening and monitoring of MFIs. However, microfinance customers operate in an informal economy, where they are already well acquainted with the need to monitor their deposits in informal rotating savings and credit associations (ROSCAs; Bouman 1995) or pre-payments made to the local construction shops. They are also well aware of the risks involved. For example, a study in Uganda revealed that 99% of the participants in ROSCAs had experienced losses (Wright and Mutesasira 2001). Still, poor people prefer these schemes because the alternative of keeping cash at home is worse due to countless claims and needs (Rutherford 2000). Thus, the alternative of allowing well-performing non-profit MFIs to offer deposit services, and thereby introducing a new stakeholder to monitor operations, sounds like a solid bet. Furthermore, savings banks offer historical evidence that it might work.

The lessons from savings banks present a message for donors. Their role is not only to donate, but to monitor. Donors generally avoid board seats in MFIs, probably due to the culture of the donors, who generally play the role of supporting local civil society rather than being part of it. However, MFIs are not advocacy organisations fighting for people's rights. They are banks, and those who provide them with funds should monitor their operations. Moreover, dedicated donors risk their reputation. Unfortunately, microfinance donors are organisations acting on behalf of back-donors and taxpayers, which makes fleeing from difficulties easier.

Though Mersland and Strøm (2009) could not confirm the governance effect of competition, the evidence from savings banks suggests that competition does discipline managers. We expect that as markets mature increased competition will bring along customer benefits as experienced in Bolivia. Besides, policy makers and regulators should not forget the fact that multiple types of providers offer additional customer benefits compared to a single type of bank. Guinnane (2002) points out that historically diversity in the type of banks was important in generating a type of competition that fostered sound management. In addition, Normark (1996) points out that a combination of organisational types operating in the same market enhances competition and customer benefits. Thus, differences in missions and ownership structures stimulate competition and drive the actors towards different market segments (Mersland 2009). However, this requires a supportive regulatory environment across organisational types.

An interesting aspect of the historic savings banks is their close relationship with local governments. Whether such a relationship would be positive in today's politicised environment is uncertain. This should be a subject of further research effort, as should MFIs' ties to local communities. Will the geographical expansion observed in many MFIs be beneficial in the long run? Would they be better off with a more integrated relationship with major stakeholders in a more limited local community where monitoring is more likely?

Apex bank associations were instrumental in both governing the savings banks through self-regulatory efforts and improving economies of scope through service provision. Even today, spin-off companies, such as giro centrals or investment funds, are important apex structures, providing important services to savings banks. For the MFIs, starting off with better self-regulation efforts, as they have done in Bolivia and Ecuador, could be a natural first step. Self-regulation cannot be a full substitute for prudent regulation by banking authorities, but it will be an extra mechanism playing a role in the overall governance system of MFIs. Besides this, independent MFIs will need to devise strategies to enable better economies of scope (e.g. IT systems). Thus, in the years to come, apex associations could probably play an increasingly important role, just as they did and continue to do for savings banks.

6 Conclusion

Microfinance is high on the public agenda. Better corporate governance of MFIs has been identified as a key to enhancing the viability of the industry. However, the recent literature on the subject has struggled to identify the corporate governance mechanisms influencing the performance of MFIs (Mersland and Strøm 2009, Hartarska 2005). In line with recommendations provided in Mersland (2009), this paper uses a historical parallel found in savings banks to present corporate governance lessons for today's MFIs. There are several similarities between nineteenth century savings banks and today's non-profit MFIs. Both legally and economically, due to their non-profit status and non-distribution constraints, they are similar types of organisations. The corporate governance mechanisms affecting one type of organisation may therefore affect the other. Guided by stakeholder and agency theories, this paper reviews the historical literature on the subject to identify the important governance mechanisms that allowed savings banks to survive, and it analyses whether MFIs, particularly non-profit MFIs, can learn something from their example.

The findings indicate that monitoring by bank associations, depositors, donors, and local communities were important in disciplining managers and securing the survival of savings banks. External governance in the form of public regulation was generally absent, while product market competition became an increasingly major factor in disciplining the managers. The willingness to expand their mission to serve wealthier customers alongside the poor helped the banks to become financially viable.

This paper demonstrates that historical studies can lend governance lessons today. The findings could prompt a revision in the thought surrounding microfinance governance, which stresses for-profit ownership, regulation, and traditional vertical board control. The lessons from savings banks indicate that a broader and more stakeholder-based understanding of corporate governance is necessary. Stakeholders like depositors, donors, local communities, and bank associations can together provide a monitoring system that can enhance the long-term survival of MFIs. The findings also indicate that the need to transform ownership and limit regulation to for-profit MFIs could be mitigated, and a pragmatic attitude toward financial objectives may improve the financial viability of the MFIs.

The importance placed on microfinance as a development instrument, combined with the increasing inflow of capital to the industry, indicate a need to better understand governance systems for MFIs. Further studies are needed. In particular, future research could consider how a combination of organisational types enhances competition in the microfinance market and how competition affects MFIs' performance. Studies are also needed on how donor monitoring, apex organizations, and mismatches in the maturity of liabilities and assets influence management behaviour and MFI performance. A historical study, similar to this, on how member based cooperative MFIs can learn governance lessons from their nineteenth century cooperative peers (Wolff 1919), is also recommended.

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