DOI: 10.5902/ 19834659 31684

TRANSPARENCY IN AFRICAN MICROFINANCE INSTITUTIONS

Received on: 16/03/2018
Approved on: 14/09/2018

Diego Marconatto[1]
Luciano Barin Cruz[2]
Renaud Legoux[3]

ABSTRACT

The lack of transparency in African microfinance institutions (MFIs) is believed to delay the dissemination of microfinance in the continent. In this study, we focus on the question of how organizational characteristics and governmental corruption influence the transparency of African MFIs. Our results show that MFIs' maturity and larger size improve transparency in African MFIs, while a nonprofit status or a focus on small businesses do not lead to the same improvement. Regulation, in turn, makes African MFIs less transparent. Our findings also reveal the impact of governmental corruption on the relationship between organizational characteristics and MFIs' transparency in Africa: less corruption enhances the transparency of all MFIs, excepting for the regulated ones. Finally, we show that in countries with high levels of corruption, the MFIs that should be supported in becoming more transparent are the nonprofits, those dedicated to small businesses, and the regulated MFIs.

Keywords: Transparency, Microfinance institutions, Africa, Regulation, Corruption.

1 Assistant professor at Unisinos. He holds a PhD from UFRGS. He teaches courses on entrepreneurship and innovation in the Bachelor, MBA and Master degrees. His main research interest is small business growth. Diego has worked as Operations Executive Manager and Business Consultant.
E-mail: dmarconatto@gmail.com

2 Associate Professor at HEC Montréal. He holds a PhD from Jean Moulin Lyon 3 University. He teaches courses on corporate social responsibility and sustainable development in the Bachelor, MBA and Master degrees. His main research interests are corporate social responsibility and sustainable development.
E-mail: luciano.barin-cruz@hec.ca

3 Associate Professor of Marketing at HEC Montre´al. He received his PhD in Management with a concentration in Marketing from McGill University. Before his academic career, he worked as a manager for a professional theater company. His current research interests include longitudinal dimensions of consumer behavior, temporal perceptions, arts marketing, sales promotions, and sponsorship.
E-mail: renaud.legoux@hec.ca

1 INTRODUCTION

With a very large informal sector and one of the lowest levels of bank penetration[1] in the world, Africa is believed to be fertile ground for microfinance (ASHCROFT, 2008). However, only a small fraction of the African population has access to local microfinance institutions (SNOW; BUSS, 2001). According to Dermirguc-Kunt and Klapper (2012), over 90% of the local people remain reliant on friends or family and informal lenders to obtain credit.

Along with the high cost of operating in this environment (NGOBO; FOUDA, 2012; SNOW; BUSS, 2001; WORLD BANK, 2012), which by itself is a challenge to face, there is an important issue hampering the African microfinance sector: lack of transparency – that is, the low degree of visibility and availability of information on MFIs (BUSHMAN; PIOTROSKI; SMITH, 2004; ZHU, 2004). Currently, the African MFIs are ranked, along with the middle-eastern MFIs, as the least transparent in the world (AYAYI; SENE, 2010; MIXMARKET, 2013a).

A low-transparency microfinance environment, together with the presence of institutional corruption have dissuaded donors and investors from channeling more funds into the African MFIs, thus delaying the dissemination, outreach and improvement of microfinance services. According to Ashcroft (2008), the lack of ready information on the actual financial and social performance of institutions usually located in remote and harsh environments has led to allocations by the international microfinance investment vehicles of less than 10% of their total capital for MFIs operating in Africa. Instances of corruption, inadequate collection practices and mismanagement of funds have contributed to the depreciation of the regional sector as a whole.

Various actors and stakeholders have responded to the situation with a persistent demand for more transparency (AUGUSTINE, 2012; CGAP, 2003; ROSENBERG et al., 2003). Easy access to more accurate and reliable data should bring about many benefits for the sector as a whole: more donations, investments and deposits (RENO-WEBER, 2008; SENGUPTA; AUBUCHON, 2008; TUCKER, 2001); more efficient and purposeful allocation of funders' capital, with fewer risks (BUSHMAN; PIOTROSKI; SMITH, 2004; GUTIÉRREZ-NIETO; SERRANO-CINCA, 2009; SENGUPTA; AUBUCHON, 2008); better borrowing decisions by clients (LEDGERWOOD; WHITE, 2006; MFTRANSPARENCY, 2012); increased competition among MFIs (ARENA, 2007); protection of the reputation of the sector (LEDGERWOOD; WHITE, 2006; STEPHENS; TAZI, 2006); and integration within the traditional financial market (LABIE, 2001).

In this paper we address issue of transparency of microfinance in Africa. Given the positive impact of informational disclosure on the performance of MFIs (AUGUSTINE, 2012), we focus on the question of how organizational characteristics and governmental corruption influence the transparency of African MFIs towards external stakeholders such as rating agencies and funders. To do so, we rely on a dataset of 1.115 observations from 309 African MFIs over a 12 year span obtained through MixMarket database. We provide a three-fold contribution to the literature on MFIs in the African context.

First, our work complements studies on the characteristics that make MFIs more appealing to donors and investors (BEISLAND; MERSLAND, 2012; GUTIERREZ-NIETO; SERRANO-CINCA, 2007, 2009; HARTARSKA; NADOLNYAK, 2008) and about the relationship between transparen-

1 Only 18-24% of the African adult population has a formal bank account (Demirguc-Kunt and Klapper 2012).

cy and performance (AUGUSTINE, 2012; STEPHENS; TAZI, 2006). Our results show that whereas maturity and larger size have the potential to improve transparency in MFIs in this region, a nonprofit status or a focus on small businesses does not seem to have the same general influence. We also show that, contrary to the general belief that formalization (regulation) increases informational disclosure (e.g. LEDGERWOOD; WHITE, 2006), regulation of African MFIs tends to make them less transparent.

Second, we reveal the impact of governmental corruption on the relationship between organizational characteristics and MFIs' transparency in Africa. We show that corruption moderates the impact of maturity, larger size, nonprofit status, focus on small businesses and regulation on MFIs' transparency. While the first four attributes make African MFIs more transparent in less corrupt countries, organizational regulation decreases the level of informational disclosure where corruption is less of a factor.

Third, our results suggest implications for policy makers and managers working in the field of microfinance in Africa. We explain which types of MFIs demand attention in order to become more transparent. Particularly, we show that in countries with high levels of corruption, the MFIs that should be supported in becoming more transparent are the nonprofits (socially-oriented) those dedicated to small businesses, and the regulated MFIs. Lastly, our findings make clear that the lack of transparency of African MFIs has to be tackled simultaneously at both the organizational and institutional levels.

By providing these contributions we also respond to the calls for more research in developing countries (GAO et al., 2010) and particularly in Africa (EGRI; RALSTON, 2008; KOLK; LENFANT, 2010; KOLK; RIVERA-SANTOS; RUFIN, 2013; KOLK; VAN TULDER, 2010), regions that are historically under-researched and characterized by a lack of consistent knowledge creation for managerial decision.

2 THE AFRICAN CONTEXT, MICROFINANCE AND TRANSPARENCY

Historically, Africa has been known as a harsh business environment in many aspects. Social, political, economic and environmental problems have combined to help create fragile financial and formal business infrastructures (SNOW; BUSS, 2001). Imperfect markets and incomplete information are large problems on the continent, just as it happens in other developing regions of the world. As Table 01 shows, the institutional stability and efficiency is very low, poverty is a major problem and the basic social indicators are critical as well. As presented in Table 02, the general situation of the African MFIs seems to follow the trend of local institutions and society. Thus, these MFIs are generally riskier, less financially sustainable and less transparent than their peers from other regions.

Table 1 - African institutional and social environments compared to the world (data from 2017)

Indicators	Africa	World
1. Strength of legal rights index (0=weak to 10=strong)	4,74	5,41

2. Ease of doing business index (1=most business-friendly regulations)(1)	139	96
3. Time to resolve insolvency (years)	2,82	2,52
4. Cost of business start-up procedures (% of GNI per capita)	46,2%	25,3%
5. Credit depth of information index (0=low to 6=high)	3,07	4,75
6. Control of corruption (-2.5=weak to 2.5=strong)	-0,62	0,00
7. GDP per capita, PPP (constant 2011 international $)	US$ 5.656	US$ 15.080
9. Life expectancy at birth (years)2016	62,8	72
10. Unemployment, total (% of total labor force)2014	12,8%	5,9%

Source: C(1-5, 7, 9, 10) World Bank (2018), (6) World Bank (2018)

Notes: [1]Indicator represents the average world position of all countries within each group.

Table 2 - African microfinance sector compared to other main world regions (data from 2010)

Region	MFIsa	Write-offa	Portfolio at risk > 30 daysb	Operational self sufficiencyb	Gross Loan Portfolio (Billion)a	Active borrowers (Million)a	% of very transparent MFIsc
Africa	366	2,05%	7,11%	102,40%	US$ 07.87	21.49	29,6%
East Asia and the Pacific	192	0.35%	3.31 %	114.54%	US$ 39.94	16.32	49,1%
Eastern Europe and Central Asia	259	0.31%	3.63 %	115.74%	US$ 10.13	02.79	59,9%

Latin America and The Caribbean	433	1.49%	4.89 %	109.40%	US$ 24.16	16.55	74,3%
South Asia(1)	262		2.53 %	109.46%	US$ 09.31	58.90	92,6%

Source: MixMarket (2013a)

Notes: [a]Sum; [b]Median; [c]Percentage of region's MFIs rated with 4 or 5 diamonds (within a transparency scale ranging from 0 – no transparent – to 5 – audited and very transparent). This is the only data from 2011; [1]Median for South Asia's write-off was not available.

Historically, Africa has been known as a harsh business environment in many aspects. Social, political, economic and environmental problems have combined to help create fragile financial and formal business infrastructures (SNOW; BUSS, 2001). Imperfect markets and incomplete information are large problems on the continent, just as it happens in other developing regions of the world. As Table 01 shows, the institutional stability and efficiency is very low, poverty is a major problem and the basic social indicators are critical as well. As presented in Table 02, the general situation of the African MFIs seems to follow the trend of local institutions and society. Thus, these MFIs are generally riskier, less financially sustainable and less transparent than their peers from other regions.

It is no coincidence that this poor performance and lack of transparency has restricted the flow of external resources into local MFIs (ASHCROFT, 2008). The scarcity of capital is a major problem in a high-cost operating environment like Africa. Low population densities, absent infrastructure, ineffective governance systems, lack of skilled manpower, corruption and scandal set strong barriers to the microfinance sector, which struggles to scale up operations to reach more borrowers in need of credit and other financial services. As there are some signs that microfinance can reduce poverty at a macro level (e.g. IMAI et al., 2012), it is important to bring more transparency to the African MFIs in order to reverse this trend.

2.1 Microfinance and transparency

Transparency is the degree of visibility and availability of an organization's information (BUSHMAN; PIOTROSKI; SMITH, 2004; ZHU, 2004). As Augustine (2012) showed, transparency is positively related to a MFI's performance, irrespective of ownership, mission (nonprofit or for-profit) and institutional environment. Hence, transparency is important for the continuous growth of the microfinance sector and consequently for the absorption of the poor communities that cannot gain access to the most basic financial services.

In order to be transparent to their external stakeholders, MFIs should be exposed to appropriate incentives. The strongest motivation for African MFIs to divulge sensitive information involves the attraction of external funding, as most of the local microfinance sector absolutely needs a third party resources in order to continue operating (MIXMARKET, 2013a, 2013b). Organizational transparency may raise the trust of investors and other stakeholders in general (AUGUSTINE, 2012; DIAMOND; VERRECCHIA, 1991) and thus provide MFIs with more donations and investments (RENO-WEBER, 2008; SENGUPTA; AUBUCHON, 2008; TUCKER, 2001). A transparent microfinance sector helps donors and investors to allocate their capital according to their purpose, and at the same time mitigate their risks (AUGUSTINE, 2012; GUTIÉRREZ-NIETO; SERRA-

NO-CINCA, 2009; SENGUPTA; AUBUCHON, 2008). A more visible microfinance panorama should also spur its integration into the traditional financial market (LABIE, 2001). Furthermore, other stakeholders benefit from higher levels of transparency. It allows clients to make borrowing decisions based on accurate and comparable pricing information (LEDGERWOOD; WHITE, 2006; MFTRANSPARENCY, 2012). The good reputation of the whole sector can be better protected in a transparent environment (LEDGERWOOD; WHITE, 2006).

To harvest and cultivate such benefits, MFIs have to be capable of abiding by the informational demands of funders and of coping with the regulatory pressures of local governments. These two are amongst the strongest actors pushing for a more transparent microfinance sector (ARENA, 2007; CAUDILL; GROPPER; HARTARSKA, 2009; ROSENBERG et al., 2003).

Funders may use third party organizations, such as microfinance rating agencies, to pressure MFIs them for more transparency. As Beisland and Mersland (2012) state, independent rating schemes have become a necessity, especially for those MFIs in need of international funding. Thus, microfinance rating agencies are expected to ameliorate the problems associated with asymmetric information plaguing the field (HARTARSKA; NADOLNYAK, 2008).

The quality of governments is also expected to have some impact on MFIs' transparency. For example, lower levels of institutional corruption and higher levels of law and order seem to "enhance the transparency and openness necessary to ensure sufficient levels of governance that would allow for the infusion of needed capital into the nation's business environment as well as promote the deployment of that capital in an efficient and effective way" (JUDGE; DOUGLAS; KUTAN, 2008, p. 778-779). As the institutional situation in Africa is different – corrupt governments[2] and governance weaknesses are two recurrent problems in Africa (TRANSPARENCY INTERNATIONAL, 2013a; WORLD BANK, 2012, 2013) – the potential influence of these factors on the transparency of local MFIs deserves greater attention.

So far, the literature has given some attention to the importance and impact of transparency on the microfinance sector. For example, Augustine (2012) provided empirical evidence about the real relevance of the informational exposure of MFIs to their performance. Others have implicitly suggested the utility of informational disclosure for these organizations for attracting more funds (BEISLAND; MERSLAND, 2012; GUTIERREZ-NIETO; SERRANO-CINCA, 2007, 2009; HARTARSKA; NADOLNYAK, 2008). But there is a lack of formal investigations into how transparency blossoms among MFIs. Uncovering the predictors of African MFIs' transparency should bolster the efforts of funders, governments, microfinance rating agencies and MFIs themselves to promote a more transparent and stronger sector, and thus put a major dent in the regional poverty.

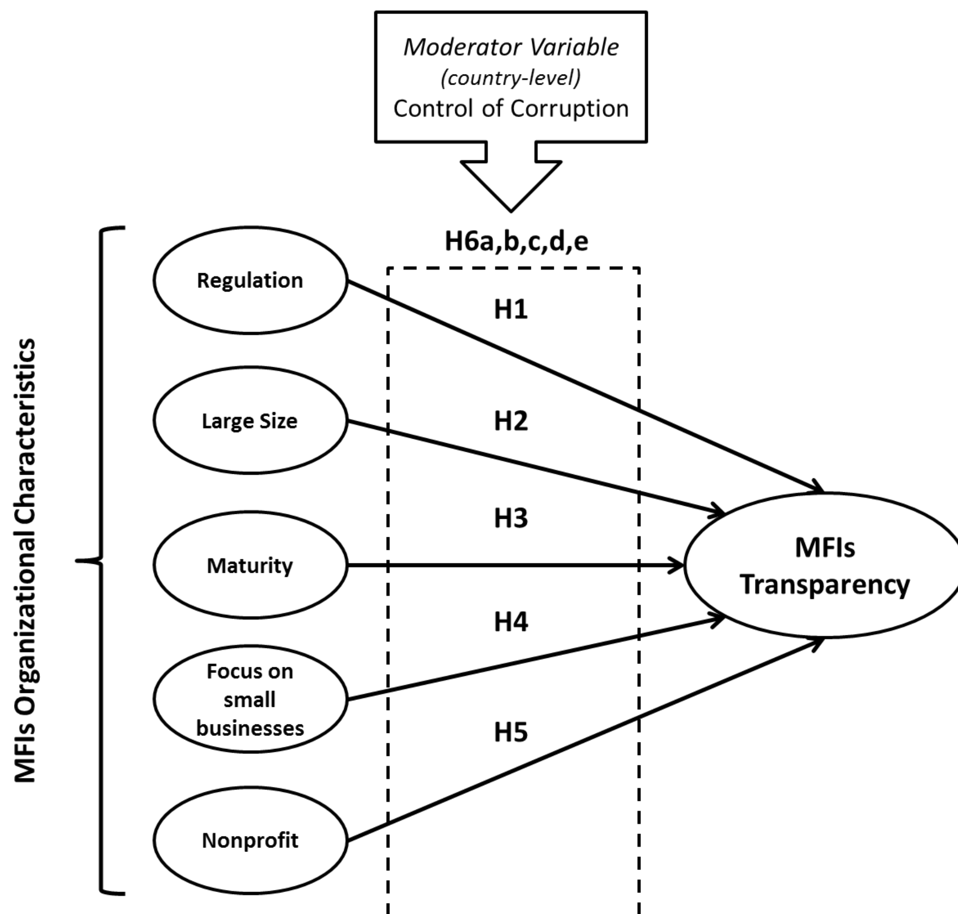
Because the transparency of MFIs can be affected through both individual organizational and broader institutional aspects (AUGUSTINE, 2012), we address this issue taking both levels into account. In the following section we hypothesize the potential role of the organizational characteristics of MFIs (H1, H2, H3, H4 and H5) on their level of transparency and the moderator role of corruption (H6a, b, c, d and e) on this previous relationship, as depicted in Figure 1.

The five characteristics of MFIs were selected because, excepting for those targeting small businesses, they are the most representative for the African microfinance sector, attending the absolute majority (over 75%) of local clients (MIXMARKET, 2013a). The MFIs targeting small

2 According to a Transparency International (2013b) study, for example, only one African country (Botswana) scores more than five points, in a scale ranging from 0 (high levels of corruption) to 10 (low levels of corruption).

businesses are the only ones among these that serve a smaller number of clients. They were included in the present study because of the representativeness of the small enterprise sector for the African economy and labor market. The International Labor Office (2009) informs that almost the entire African population works in the informal sector, formed mainly by micro urban and rural businesses.

Figure 1 – Transparency Model for African MFIs



3 HYPOTHESES DEVELOPMENT

3.1 MFIs organizational characteristics

Regulation

Regulation is meant to be umbilically linked to transparency in the microfinance industry: one of the main objectives of regulating MFIs is to guarantee that they will disclosure their financial accounting and general practices to external parties (HAQ; HOQUE; PATHAN, 2008; MEAGHER, 2002).

Although microfinance has been a largely unregulated industry (MCALLISTER, 2003), the constant need for credibility and transparency has led many MFIs to opt for an official financial status (HUDON, 2008). Indeed, some authors affirm that the microfinance industry can-

not continue to develop without a regulatory framework conducive to their growth (GALLARDO, 2001; GREUNING; GALLARDO; RANDHAWA, 1998; SHANKAR; ASHER, 2010).

Regulation is believed to favor transparency in many forms. First, formalization provides direct incentives for MFIs to disclose themselves to external agencies and other shareholders. Hartarska and Nadolnyak (2008), for example, have found that creditors prefer to lend money to regulated MFIs evaluated through microfinance ratings.

Second, regulation allows African MFIs to collect and transact deposits, which requires transparency towards savers, regulatory bodies and other involved actors (HARTARSKA; NADOLNYAK, 2008; MIXMARKET, 2013b). These resources can help the MFIs to scale up their operations and reduce the dependency on external debt. Today, African regulated MFIs may build up over 70% of their funds through costumer deposits (MIXMARKET, 2013b).

Lastly, regulation should discourage to some extent opportunistic behaviors of MFI managers and staff. External audits, supervision, control and accounting systems are expected to deflect actions which could be deleterious to customers and other stakeholders (LEDGERWOOD; WHITE, 2006). Thus, we propose that:

H1: Regulated African MFIs are more transparent than unregulated ones.

Size

Larger African MFIs have clear incentives to be more transparent to external publics, such as microfinance ratings. As studies have shown, larger size is key for MFIs to score well in these agencies and consequently attract and maintain funders (BEISLAND; MERSLAND, 2012; GUTIÉRREZ-NIETO; SERRANO-CINCA, 2007; HARTARSKA; NADOLNYAK, 2008). Many of these donors and investors seem to be driven by the ideal of the microfinance revolution (ROBINSON, 2001) that advocates, along with specialized agencies (e.g. CGAP and World Bank) and authors (e.g. MCGUIRE; CONROY, 2000), that only MFIs which demonstrate a capacity to reach large numbers of poor clients on a financially sustainable basis should receive monetary support. According to Ledgerwood and White (2006, p. 4), “MFIs can operate profitably on a large scale (...). But this requires (...) a corporate culture of transparency and accountability”.

That is a plausible explanation for the fact that the larger African MFIs are amongst the most productive ones and can more easily contract foreign capital and pay lower interest rates (MIXMARKET, 2013b). The local small MFIs, however, continue to struggle to cover costs and diversify their product offerings (ASHCROFT, 2008). Other studies corroborate this evidence. Using data from Mediterranean countries, Bassem (2009) found that larger MFIs perform better than younger and smaller ones. Caudill, Gropper and Hartarska (2009) found similar results for Eastern Europe and Central Asia. Hence, because the higher attractiveness of larger MFIs for funders should provide incentive to disclose their sensitive information, we propose:

H2: Large African MFIs are more transparent than medium and small ones.

Age

Naturally, MFIs operating for longer periods have had more time to start an interaction and to understand the nature of the demands of a microfinance rating, and to create the informational capacity to produce technical reports. The fact that more mature MFIs have passed the

test of time may also imply some managerial capacity. The technical experience accumulated throughout the years makes it easier for MFIs to deal with more complex technological tools and abstract concepts (CHURCHILL, 1999). These skills may help them to deal with the requirements of microfinance ratings.

Younger MFIs, on the other hand, commonly lack technical capabilities, considering that many of them are still managed by rule of thumb and have no technological systems, advanced knowledge about bookkeeping and credit administration (ROBINSON, 2001). That is a major problem in Africa, where illiteracy and lack of knowledge about the most basic financial concepts is still commonplace amidst small organizations (SNOW; BUSS, 2001). Considering this, we argue:

H3: More mature African MFIs are more transparent than younger ones.

Focus on small businesses

MFIs are interesting for small African businesses because they allow them to circumvent government corruption, bureaucracy and lack of transparency and then access credit with lower transaction costs (SNOW; BUSS, 2001). This fact works as an incentive for savers to pressure their MFIs for a constant transparency.

Besides the incentive from clients, MFIs focused on small businesses also encounter benefits in being more transparent to investors and donors. African MFIs targeting this segment are the most cost-effective, most financially sustainable, have the highest average loan balance per borrower and one of the lowest portfolio risks in the region (MIXMARKET, 2013a) – all characteristics that make these organizations more appealing to investors collecting information on microfinance ratings (BEISLAND; MERSLAND, 2012; GUTIÉRREZ-NIETO; SERRANO-CINCA, 2007, 2009; HARTARSKA; NADOLNYAK, 2008).

Finally, the stronger foundations of these MFIs may provide more resources for them to meet transparency requirements. The higher financial sufficiency and lower risk of MFIs attending small businesses can allow them to hire better skilled workers and to train them to use the forms and other informational devices used to produce microfinance ratings. Thus, we propose:

H4: African MFIs targeting small businesses are more transparent then others focused on individual borrowers.

Nonprofit status

African nonprofit MFIs, such as NGOs and some other socially-oriented financial institutions are particularly pressured to be transparent. These are the organizations which most need external resources to keep afloat. According to MixMarket (2013b), the nonprofit Sub-Saharian African MFIs have the lowest average loan balance but the highest operating expenses of all MFIs in the region. Those are also the organizations most reliant on external debt, not to mention that they pay the highest prices for it (MIXMARKET, 2013b). Despite this situation, funders, especially investors, channel most of their money into for-profit MFIs, which are more likely to give returns on investments (BEISLAND; MERSLAND, 2012; GUTIÉRREZ-NIETO; SERRANO-CINCA, 2009). Moreover, as mentioned before, larger for-profit MFIs are the organizations that most benefit from microfinance ratings (BEISLAND; MERSLAND, 2012; GUTIÉRREZ-NIETO; SERRANO-CINCA, 2007; HARTARSKA; NADOLNYAK, 2008).

Unfortunately, as the same authors point out, they still seem to mimic the traditional rating agencies and stress the financial performance of MFIs while overlooking their social achievements. Additionally, as Cull, Demiguc-Kunt, and Morduch (2007) found, there's a clear tradeoff between profitability and serving the poorest – the largest microfinance public in Africa – which means that the African nonprofit MFIs will tend to be further undervalued by the microfinance ratings.

With the odds against them, nonprofit MFIs have to make extra efforts to enhance their credibility among fund providers and show that the acquired resources have been used to fight poverty (AYAYI; SENE, 2010). Thus, considering this, we propose:

H5: African nonprofit MFIs are more transparent then profit-focused MFIs.

3.2 Institutional environment: The moderating role of corruption

Governmental corruption is a major problem in Africa (AYITTEY, 1997; MBAKU, 1996). The phenomenon has been extensively studied in the region. However, the influence of governmental corruption on African MFIs and, most specifically, on their level of transparency remains unknown. As corruption entails a "pervasive lack of transparency and accountability in governance" (AGBIBOA, 2011, p. 329) it should bring negative results to the degree of informational disclosure of local MFIs.

The widespread inefficiency and lack of transparency of the business and legal systems in developing economies make it difficult for the exchanging parties to protect themselves against varied forms of opportunism (PENG, 2003; PUTNAM, 1994). This scenario can affect the transparency of MFIs in serious ways. The widespread belief among managers of MFIs that revealing financial data can hurt the firm (AUGUSTINE, 2012) can be strengthened in negative contexts lacking clear and stable laws, such as in Africa (AGBIBOA, 2011; TRANSPARENCY INTERNATIONAL, 2013a). Considering this situation, it is not a surprise that in Africa the depth of credit information – a measure of the transparency and accessibility of the financial information on local economic actors – is about 40% shallower than the world average (WORLD BANK, 2012).

Less corrupt and more efficient governments, on the contrary, usually design and enforce laws that mitigate risk, lower information costs and, consequently, support more transparent financial markets (NORTH, 1991). More competitive microfinance markets are usually more transparent and promote innovation (LEDGERWOOD; WHITE, 2006), which is so needed in Africa and other poor regions. New technological solutions, for example, are becoming common in the continent, where mobile systems have been rapidly introduced into the microfinance panorama, bringing more information and transparency to the sector (ECONOMIST INTELLIGENCE UNIT, 2010).

Good governance can also reduce uncertainty, lower transaction, search and production costs, and ultimately affect firm performance. Analyzing 21 African countries over four years, Ngobo and Fouda (2012) found that more governmental transparency, stability, accountability and effectiveness, along with less corruption, reduces the variability of the local company's profitability, leading to high-return and low-risk investments.

For all these reasons, African countries with less corrupted governments are expected to amplify the positive effect of those predictors which drive to a higher informational disclosure from local MFIs. For example, regulated African MFIs can be more transparent because they do not need to protect their assets from unscrupulous officials who could use the law tying formal

enterprises to the state to intimidate them, as it usually happens in contexts with bad governance (BERGARA; HENISZ; SPILLER, 1998).

H6a: The level of transparency of regulated African MFIs increases when the control of corruption increases in a country.

Larger African MFIs, in turn, can disclose more sensitive information in less corrupt countries because their higher amounts of valuable resources and regional influence are not expected to be confiscated or misused by unscrupulous politicians and public offices (CHURCHILL, 1999).

H6b: The level of transparency of large African MFIs increases when the control of corruption increases in a country.

The mature MFIs also have reasons to become more transparent in less corrupt countries. Incumbent firms operating in economies characterized by their weak institutional systems for longer periods of time, can use political ties to build institutional barriers against competitors and take advantage of long term competitive advantages (WAN, 2005). As the governance of the countries improves, first entrants decrease their dependence on the artificial guaranties of governments and must face stiffer competition. Because funders have more options for where to allocate their capital in such cases, mature MFIs may lose their prominence and will need to open themselves up scrutiny by to microfinance rating agencies in order to compete with their younger counterparts.

H6c: The level of transparency of more mature African MFIs increases when the control of corruption increases in a country.

As the African small enterprises comprehend the least risky and most economically attractive markets in the local microfinance sector (MIXMARKET, 2013), newcomers seeking profit are expected to come to Africa if the perceived institutional risks decrease (ASHCROFT, 2008). Thus, higher competition may increase further the level of transparency of African MFIs focused on small businesses.

H6d: The level of transparency of African MFIs targeting small businesses increases when the control of corruption increases in a country.

Nonprofit African MFIs may become more transparent in less corrupt countries for a different reason. Because of their socially-oriented mission, these MFIs are usually deeply embedded in local societies (BHATT; TANG, 2002). Thus, as less corruption and better governance systems discourage opportunism and encourage cooperation and transparency throughout social bodies and civil organizations (PUTNAM, 1994), nonprofit African MFIs may also become more open to external partners and screeners in contexts like these.

H6e: The level of transparency of African nonprofit MFIs increases when the control of corruption increases in a country.

4 METHOD

The final dataset for this study is comprised of 1115 observations from 309 MFIs over a 12 year span (from 1996 to 2008) obtained through the MixMarket database. We used data from MixMarket, because it is one of the most complete and reliable sources of microfinance data for the African region and it has been used for several other studies on MFIs (e.g. AHLIN et al., 2010; AUGUSTINE, 2012; BASSEM, 2009; HARTARSKA; NADOLNYAK, 2008; IMAI et al., 2012).

4.1 Measures

Dependent variable. Transparency of African MFIs was measured using the diamond rating developed by MixMarket (2013c). This rating ranges from 0 to 5. The higher the score the more transparent is the MFI and the more reliable is the information provided by it. A level 1 rating corresponds to an MFI that has only made its profile visible to the rating agency. Level 2 corresponds to inclusion of data on products and clients for the year. Level 3 recognizes integration of some financial data for the year. Level 4 applies with inclusion of audited financial statements that are published yearly. Finally, MFIs proceed to a level 5 rating with a due diligence report that is published yearly.

Independent Variables. Our two models have five organizational characteristics as independent variables, all of them extracted from MixMarket (2013a) and measured through dichotomous variables.

Regulation. On the one hand, the MFIs under some kind of official regulatory scheme were considered regulated and, on the other, all the informal MFIs were accounted for as unregulated.

Size. Whereas the MFIs with a gross loan portfolio over US$ 8 million were considered large, all the others MFIs with smaller portfolios were regarded as small.

Maturity. All MFIs reporting data to MixMarket for over 8 years are mature; all others are young.

Small business target MFIs. All MFIs that have micro and small entrepreneurs as their main target public were considered small business focused MFIs; the others were marked as targeting other markets.

Nonprofit. The MFIs that self-reported as not being focused on profits were regarded as nonprofit, while the rest of them were considered as profit seeking MFIs.

Moderating variable. The single moderating variable used in our models is control of corruption. It was measured through a continuous variable, extracted from the World Bank (2013). According to this source, control of corruption “reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as ‘capture’ of the state by elites and private interests”. It ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance.

4.2 Analytical Techniques

We used the following random effect specification to test the predictors of transparency, $Yict = \alpha t + \beta 1Cct + \beta 2Rict + \beta 3Lict + \beta 4Mict + \beta 5Sict + \beta 6Nict + \beta 7Rict \cdot Cct + B8Lict \cdot Cct + B9Mict \cdot Cct + \beta 10Sct \cdot Cct + \beta 11Nict \cdot Cct + \mu ic + \mu c + \varepsilon ict$, here $Yict$ is the outcome variable, transparency, for microfinance institution i in country c at time t. αt is a fixed effect for every year, accounting for

common macro-shocks. Cct is a continuous variable reflecting the control of corruption of each country. Cct is mean centered to facilitate the interpretation of the parameters. Mict, Lict, Sict, Nict, and Rict are dichotomous MFI level variables. Mict indicates whether the MFI is mature or young, Lict if it is large or small, Sict if it is targeted at small businesses or not, Nict if it is non-profit, and Rict if it is regulated or not. All the MFI level variables are allowed to interact with the country level measure (control of corruption) (Cct). µic is the MFI-specific random term and µc is the country-specific random term. These random terms take into account the shared covariance between observations stemming from the same MFI and country over time (Singer, 1998). Finally εict is the random error term.

We use a linear model approach to test our hypotheses even though the dependent variable only assumes 3 values (3, 4 and 5 diamonds). A linear specification is more readily interpretable than a multinomial one. However, a multinomial logit specification was tested and yielded analogous results to the ones presented below.

5 RESULTS

The random effect specification appears appropriate for taking into account the shared covariance of the observations. The covariance parameters associated with the MFI-specific random term and to the country-specific term are significant ($\sigma 2ic$ =.42, SE=.02, Z=22.00, $p<.0001$; $\sigma 2c$ =.12, SE=.04, Z=3.05, $p<.01$).

Table 03 shows two models. The first one incorporates only the main effects while the second one integrates all the interaction terms. In the model without interactions, results suggest that regulated MFIs are less transparent than unregulated ones ($\beta 2$ = -.11, t(1066) = -1.74, $p<.10$). Large MFIs are more transparent than smaller ones ($\beta 3$ = .40, t(1066) = 7.33, $p<.0001$). Mature MFIs appear more transparent than younger ones ($\beta 4$ = .23, t(1066) = 5.22, $p<.0001$). Also, a small business targeting and a nonprofit status do not appear to generally affect MFI transparency ($p>.40$). Thus, H1, H2 and H3 are supported while H4 and H5 are not.

However, the second model shows that country control of corruption interacts with all the effects of MFI level predictors on transparency. Regulated MFIs, when compared to unregulated ones, are even less transparent in countries that show a better level of corruption ($\beta 7$ = -.11, t(1061) = -2.11, $p<.05$). The effect of size of an MFI on its transparency is improved in less corrupt countries ($\beta 8$ = .36, t(1061) = 2.70, $p<.01$). In other words, large MFIs in a less corrupt country are more transparent than ones of equal size in countries where corruption is less controlled. Although marginally significant ($p<.10$), the positive effect of MFI age is augmented by the country level control of corruption ($\beta 9$ = .19, t(1061) = 1.82, $p<.10$). Finally, MFIs targeting small businesses and nonprofit MFIs also tend to be more transparent in countries where corruption is more controlled ($\beta 10$ = .38, t(1061) = 2.10, $p<.05$; $\beta 11$ = .47, t(1061) = 3.96, $p<.0001$). Hypothesis 06 is generally supported.

Table 3 - Analysis of the parameters

	Model 1 No interactions			Model 2 With interactions		
Effect	**Estimate**	**S.E.**		**Estimate**	**S.E.**	
Year fixed effect	Yes			Yes		
Control of corruption (Cct)	-.08	(.11)		-.40	(.19)	**
Mature MFI (Mict)	.23	(.04)	***	.44	(.13)	***
Large MFI (L ict)	.40	(.05)	***	.84	(.16)	***
Small business target MFI (Sict)	-.01	(.07)		.43	(.23)	*
Nonprofit MFI (Nict)	.03	(.05)		.60	(.16)	***
Regulated MFI (Rict)	-.11	(.06)	*	-.47	(.19)	**
Mict·Cct				.19	(.10)	*
Lict·Cct				.36	(.13)	***
Sict·Cct				.38	(.18)	**
Nict·Cct				.47	(.12)	***
Rict·Cct				-.30	(.14)	**

Notes: *p<.10; **p<.05; ***p<.01.

6 DISCUSSION

6.1 Predictors of MFIs transparency in Africa

We found that although maturity and larger size have the potential to improve transparency of MFIs in this region, the focus on small businesses and the nonprofit status do not have a general influence on an MFI's transparency. We also found that regulation of African MFIs tend to make them less open to external screening. This finding is particularly interesting, as it challenges the belief that formalization (regulation) automatically increases informational disclosure (e.g. LEDGERWOOD; WHITE, 2006).

The configuration of the African MFIs focused on small business may reduce their incentives to report to microfinance rating agencies. Their higher financial autonomy can strengthen the perception of managers that compliance with the demands of external actors is not worth the cost. Compared to the local MFIs dedicated to all the other markets (low end, high end and broad), MFIs focused on small business have the highest operational self-sufficiency, least risky portfolios and largest profit margins, and provide the biggest loans (MIXMARKET, 2013a). Thus, microfinance ratings have less appeal for them than for other African MFIs more dependent on external funding.

Nonprofit MFIs in Africa, in turn, can lack both incentives and resources to become more transparent. Donors, the source of most of their funds, may not pay as much attention to ratings as creditors, because donors may care more about the mission of the MFI, while creditors want to assure themselves that their loans will be repaid (HARTARSKA; NADOLNYAK, 2007, 2008). Besides, as already mentioned, microfinance ratings generally benefit financially sustainable MFIs – which is the case of very few nonprofit MFIs on the continent (MIXMARKET, 2013b) – and tend to either overlook or disregard their social performance (BEISLAND; MERSLAND, 2011, 2012; GUTIÉRREZ-NIETO; SERRANO-CINCA, 2007, 2009; HARTARSKA; NADOLNYAK, 2008). Thus, African MFIs which do not pursue financial gains may regard the efforts to meet the informational requirements of ratings agencies as not worth the trouble.

Another possible cause is the lack of resources that nonprofit MFIs may face in the provision of transparent and reliable data. African nonprofit MFIs could simply lack the minimum managerial requirements needed to meet the expectations of microfinance rating agencies regarding the quality of inputs.

Interestingly, the test of H1 yielded a result contrary to what we expected. Instead of increasing, regulation actually decreases the level of transparency of African MFIs. We point out some possible explanations for such outcome.

First, the database which we extracted our results from – Mixmarket – allocate all African MFIs under two broad categories – regulated our unregulated. The former are those that self-reported themselves as being subjected to any kind of regulation which may vary widely. One can expect that the specificity the different types of regulations may bring about different effects over the transparency of MFIs. In this sense, it is possible that the type of regulation affecting the majority of the African IMFs analyzed in this study simply do not offer them enough incentives to report their data.

The second possible explanation is that governmental authorities already tend to impose their own set of disclosure requirements over regulated MFIs (AUGUSTINE, 2012; ROSENBERG et al., 2003). Donors and investors can eventually rely on the monitoring and enforcement capacity of governments to reduce the risk, such that ratings become less important.

Finally, corrupt government agents can use the regulatory body of the State for the purpose of rent seeking. When the state is perceived as illegitimate regulated MFIs may hide sensitive information for fear of being extorted by corrupt free riders. Conversely, it is possible that MFIs subjected to formal regulation profit from its ties to spurious governments, so that it is not either necessary or advisable for them to disclose internal information.

Our findings also complement studies about the informed characteristics that make MFIs more appealing to donors and investors (BEISLAND; MERSLAND, 2012; GUTIERREZ-NIETO; SERRANO-CINCA, 2007, 2009; HARTARSKA; NADOLNYAK, 2008) and about the relationship between transparency and performance (AUGUSTINE, 2012). These works implicitly or explicitly indicate the importance of transparency for MFIs. We instead show which organizational characteristics are most associated with transparency in the specific context of Africa. This is important for three reasons.

The first one is that informational disclosure has a real impact on MFIs' performance (AUGUSTINE, 2012). Secondly, the actual influence of microfinance ratings on MFIs is still not clear (HARTARSKA; NADOLNYAK, 2008). Thirdly, some authors (e.g. BEISLAND; MERSLAND, 2011; HARTARSKA; NADOLNYAK, 2007, 2008) express concern about the quality of ratings and their capacity to diffuse a deeper level of transparency throughout the microfinance field.

6.2 The moderating role of corruption

Our study reveals the impact of country-level corruption on the relationship between organizational characteristics and MFIs' transparency in Africa. Larger, mature, focused on small business and nonprofit African MFIs increase their level of disclosure when operating in less corrupt countries. Thus, all H6b, H6c, H6d and H6e are validated. Again, the regulation of MFIs yielded a result opposite to what we expected from H6a. According to our findings, regulated MFIs conceal more information in the less corrupted African countries.

The overall message conveyed by the moderating effects of governmental corruption is that a less corrupt environment provides an adequate context for transparency to blossom amongst African MFIs that together represent the absolute majority of the microfinance sector in the continent (regulated, large, mature, small business focused and nonprofit MFIs). Thus, if policy makers, funders and other stakeholders are to increase the availability of information about African MFIs in general, they should work at both levels, organizational and institutional, at the same time.

6.3 Managerial implications

We explain which types of MFIs demand more attention to be more transparent and by consequence, become more suitable to receive additional funds. Particularly, we show that in countries with high levels of corruption, nonprofit (socially-oriented), dedicated to small businesses and regulated MFIs are the ones that should be supported in becoming more transparent.

The nonprofit MFIs reach the poorest clients of microfinance (Morduch, 2000; Schicks, 2007) and those small businesses-focused MFIs serve the wide African economic informal sector of the continent. Helping these MFIs to increase their informational disclosure should convey more funds to them and bring positive results for the whole continent. Also, a higher transparency can support the growth of regulated institutions which altogether serve over 70% of the African microfinance clients (MIXMARKET, 2013a).

Secondly, we have produced insights for the microfinance rating agencies. Our results corroborate the findings of other authors who identified that these organizations place excessive attention on the financial performance of MFIs while they may overlook their social impacts (BEISLAND; MERSLAND, 2011; GUTIÉRREZ-NIETO; SERRANO-CINCA, 2007, 2009; HARTARSKA; NADOLNYAK, 2008). Thus, we agree with Beisland and Mersland (2012) when they posit that it is important that microfinance rating agencies assess the double mission of MFIs and integrate their social impact in their scores and reports provided to external publics. Microfinance ratings must also be aware of their disciplinary power (HARTARSKA; NADOLNYAK, 2008) and adapt their score systems in order to avoid mission drift and not dwarf the nonprofit MFIs. Our results also provide evidence that the African regulated MFIs and those focused on small businesses are passing out of the microfinance ratings' radar. Thus, it is important for these organizations to derive specific incentives for such MFIs to expose their information in order to produce broader and more reliable information about them for funders and other shareholders in general.

Lastly, our findings on the detrimental effects of corruption make clear that the lack of transparency in the African microfinance sector has to be tackled simultaneously on both the organizational (MFIs) and institutional (government) levels. Policy makers, funders, microfinance ratings and managers should all work together to derive more effective policies for increasing the transparency of African MFIs. If Augustine (2012, p. 672) is correct and "the secret to successful performance and longevity for all firms that choose to operate within the microfinance industry is to have 'no secrecy'", then this joint effort promises to be a fruitful endeavor.

6.4 Limitations of the study

Africa is a vast continent with more than fifty countries and a total population that exceeds one billion people. Certainly, there is a wide variation of lifestyles, economic matrixes and cultures amongst all of its nations. Although we have taken into account some of such variations while calculating or results, we have not considered the internal discrepancies of each country. Future studies can analyze how regional specificities affect the transparency of local microfinance initiatives.

Secondly, our dataset ranges from 1996 to 2008. More recent data might provide new trends and insights regarding transparency within the context of African MFIs. We encourage scholar to advance our analytical framework as new data becomes available.

Finally, we found that regulation makes African MFIs less transparent. However, we have not been able to consider the many internal variations of regulatory apparatuses amongst the African MFIs. New studies could confirm such finding and offer ground for the assertion that the regulation schemes devised for African MFIs are ineffective.

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