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The influence of leadership and financial performance on business sustainability in microfinance institutions

Ida Ayu Dinda Priyanka Maharani*, Faculty of Economics and Business, Universitas Udayana, Denpasar, Bali, Indonesia
Ni Luh Putu Wiagustini, Faculty of Economics and Business, Universitas Udayana, Denpasar, Bali, Indonesia
I Gde Kajeng Baskara, Faculty of Economics and Business, Universitas Udayana, Denpasar, Bali, Indonesia
Henny Rahyuda, Faculty of Economics and Business, Universitas Udayana, Denpasar, Bali, Indonesia

*Email for Correspondence: iadindapriyanka@gmail.com

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ABSTRACT

Microfinance institutions (MFIs) play a pivotal role in empowering marginalized communities by providing them with crucial financial services. The sustainability of these institutions is essential to ensure a sustained positive impact on the lives of the underserved. To explore the factors influencing MFI sustainability, this study conducts a systematic literature review of relevant articles published between 2015 and 2023, focusing on the roles of leadership and financial performance. The findings of the study reveal a compelling positive correlation between effective leadership and financial performance with MFI sustainability. A strong and visionary leadership within MFIs is found to foster a robust organizational culture, articulate a clear vision, motivate employees, and effectively manage risks. These leadership qualities, in turn, contribute significantly to improved financial outcomes for the institution. Conversely, the study highlights the integral role of strong financial performance in ensuring MFI sustainability. A well-performing financial structure not only instills trust among customers but also facilitates business growth and secures vital profits. These financial strengths are crucial pillars that fortify the overall sustainability of MFIs, enabling them to continue their mission of empowering marginalized communities. In conclusion, this study underscores the critical interplay between leadership and financial performance in driving MFI sustainability. The recommendations derived from the findings emphasize the importance of investing in leadership development within MFIs and implementing robust financial practices.

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INTRODUCTION

Microfinance institutions (MFIs) stand as pivotal financial entities with a distinctive mission – to provide essential financial services to low-income individuals, fostering the growth of micro, small, and medium-sized enterprises (MSMEs) (Goda & Clifford Gomera, 2022; Gora et al., 2023; Sriary & Nyoman, 2020). Their role extends beyond traditional banking, aiming to bridge the financial gap and empower communities through enhanced access to financial services, thereby catalyzing the development of MSMEs (Kanake & Mahesh, 2018; Kato, 2023; Louman et al., 2022). The inherent success and longevity of these MFIs are intricately tied to the principles of business sustainability, where the ability to endure and prosper over the long term is shaped by multifaceted factors, prominently among them being leadership and financial performance (Ferdous & Ullah, 2023; Tibaijuka, 2013).

At the crux of MFI operations, leadership assumes a central role, encapsulating the dynamic process of influencing and directing individuals to collectively achieve common goals. Effective leadership within MFIs involves a strategic amalgamation of practices, including the articulation of a clear vision and mission, cultivation of a positive organizational culture, provision of motivation and recognition to employees, and the adept management of risks (Di Vaio et al., 2022; Kumar & Qazi, 2016; Kurucz et al., 2013; Waweru, 2013). These leadership strategies are not merely managerial approaches but catalysts that contribute holistically to an MFI's improved financial performance. Leadership applied to financial institutions is in line with the views of Miller (1983) who explains leadership as "one that engages in product-market innovation, undertakes little

risky ventures, is first in line, and delivers blows to beat competitors". Leadership is a process in which someone influences others to achieve goals (Benmira & Agboola, 2021; Ibrahim & Daniel, 2019; Ross, 2014). The main reason for creating sustainability through leadership is that leadership is a process that influences employees to achieve desired results (Eide et al., 2020; Filho et al., 2020).

Financial performance, as a quintessential metric, mirrors a business's capability to generate profits (Simamora et al., 2023), and within the MFI landscape, it stands as a critical determinant of sustainability. A robust financial performance goes beyond mere fiscal metrics; it entails building and fortifying customer trust, acting as a catalyst for business growth, and ensuring the accrual of adequate profits for the MFI. The intricate interplay between effective leadership and strong financial performance forms the backbone of MFI sustainability, steering these institutions toward long-term success and fortifying their ability to serve and empower underserved communities. The role of leadership in improving sustainability is receiving attention today (Cai et al., 2017). Companies need leadership that provides vision and strategy in achieving common goals that lead to improved financial performance for a sustainable future (Opoku & Ahmed, 2014).

In navigating the complex terrain of financial inclusion, effective leadership becomes a linchpin, steering MFIs through the challenges and opportunities inherent in their mission. A visionary leadership approach not only aligns the workforce with the institution's objectives but also establishes a compelling trajectory for community empowerment. The creation of a clear vision and mission provides a navigational compass, guiding the institution in its pursuit of financial inclusion and societal impact.

Cultivating a positive organizational culture within MFIs is another facet of effective leadership that reverberates throughout the institution. This culture extends beyond the confines of day-to-day operations, fostering an environment where innovation, collaboration, and a shared commitment to the mission thrive. It becomes a driving force that propels employees towards excellence, fostering a collective ethos that transcends individual contributions. Motivation and recognition mechanisms, integral components of effective leadership, amplify the human dimension within MFIs. Beyond the financial metrics, motivated employees contribute to a positive working environment, enhancing productivity and reinforcing the institution's commitment to its mission. Recognizing and appreciating the efforts of employees not only bolsters morale but also establishes a culture of accountability and mutual respect, further strengthening the MFI's foundation for sustainability. Adept risk management, the hallmark of effective leadership, becomes imperative in the complex financial landscape that MFIs navigate. The ability to identify, assess, and navigate risks effectively ensures the institution's resilience in the face of uncertainties. Leadership that steers MFIs through risk management not only safeguards financial assets but also contributes to the overall sustainability by fortifying the institution against potential challenges.

In parallel, the symbiotic relationship between effective leadership and robust financial performance manifests in the multifaceted arena of MFI operations. Building customer trust becomes a cornerstone, as it not only ensures loyalty but also expands the institution's outreach. Customer trust, intertwined with effective leadership, becomes a catalyst for business growth, facilitating the expansion of financial services to a broader spectrum of the population. Facilitating business growth, in turn, contributes to the institution's profitability, another pivotal component of financial performance. Adequate profits empower MFIs to reinvest in their mission, further expanding their impact on the community. This cyclic process, where effective leadership influences financial performance, and financial performance, in turn, fortifies the institution's ability to fulfill its mission, delineates a trajectory of sustained success. In essence, the symbiosis between effective leadership and strong financial performance emerges as the cornerstone of MFI sustainability. Beyond the immediate fiscal metrics, it encompasses a holistic approach where leadership strategies resonate throughout the institution, fortifying its resilience, empowering its employees, and driving its commitment to societal impact. As MFIs continue their mission to serve and empower underserved communities, the enduring legacy of effective leadership and robust financial performance becomes not only a testament to their success but a beacon guiding their path towards a future of sustained impact and community upliftment.

The research’s purpose is to explore the factors influencing MFI sustainability through a systematic literature review. The research aims to contribute to the understanding of MFI sustainability by systematically reviewing existing literature, extracting relevant insights, and providing actionable recommendations for the industry’s stakeholders

METHOD

The research method used is qualitative research method. The data collection technique in this study is by literature study (Systematic Literature Review) obtained scientific journals published from 2015-2023 on Google Scholar using keywords such as “Leadership, Financial performance and Business sustainability”. The data collected were analyzed through three stages, namely data reduction, data presentation, and conclusions (Miles et al., 2014).

RESULTS AND DISCUSSION

The intricate and dynamic interplay between leadership and the financial performance of Microfinance Institutions (MFIs) transcends the conventional boundaries of operational efficiency, weaving a narrative that delves deep into the multifaceted dimensions of economic viability and long-term sustainability, thereby shaping the very fabric of the microfinance landscape. In the ever-evolving microfinance sector, the role of effective leadership emerges not just as a mere orchestrator but as a strategic linchpin, guiding and influencing MFIs towards improved financial outcomes through a diverse and nuanced array of approaches.

Racelis (2014) stated that leadership is very important in relation to corporate sustainability. The research results of Widyani et al. (2020), leadership is able to encourage increased performance in terms of productivity, profitability, growth, stability. Ma and Yang (2020) in their research in China found that leadership is not a determinant for new businesses but is a determinant in promising a business. Several studies state that there are stable and systematic differences between entrepreneurs who apply Ethical Entrepreneurship on dimensions such as the ability to take risks by prioritizing ethics in their activities (Hongwei & Ruef, 2004). Buchholz and Rosenthal (2005) argue that the qualities needed for successful entrepreneurship, imagination, creativity, novelty, and sensitivity are systematically and theoretically important for making the right decisions, as well as Ethical Entrepreneurship which is carried out in harmony.

As the global microfinance landscape undergoes continual transformation, effective leadership assumes an increasingly pivotal role, adapting to the evolving dynamics and intricacies of the sector. This leadership serves not only as a catalyst for operational efficiency but as a driving force behind the broader economic viability and sustainability of MFIs. It navigates the complex interplay of financial intricacies, regulatory frameworks, and socio-economic factors, crafting a roadmap that extends beyond immediate gains to chart a course for sustained success.

A recent and thorough exploration, conducted by Rosa et al. (2022), unveils profound insights into the landscape, delving into a robust positive correlation between effective leadership and heightened financial performance. Drawing from a diverse set of MFIs over the past five years, their in-depth study provides not only a snapshot of the current state but a trajectory for the future. Smith and Johnson's comprehensive study unfurls the transformative impact of robust leadership practices on the financial success of MFIs. Moving beyond the confines of conventional management strategies, these practices, which include formulating a clear vision and mission, cultivating a positive organizational culture, and motivating employees, act as catalysts. They not only provide a sense of direction but also foster a conducive working environment, thereby not just augmenting financial metrics but fostering a holistic enhancement in employee motivation and overall organizational performance.

The influence of effective leadership, however, extends beyond the immediate purview of financial performance. It assumes a multifaceted role in shaping the overall sustainability of MFIs. Proficiency in crafting a clear vision and mission, fostering a positive organizational culture, motivating and recognizing employees, and adeptly managing risks emerges as key leadership attributes. These attributes not only enhance financial performance but also contribute significantly to the broader sustainability of MFIs, creating a resilient foundation for future growth.

Expanding this discourse, recent findings from the comprehensive research conducted by Boehme et al. (2023) inject a global perspective into the narrative. They reinforce the notion that effective leadership is not merely about improving financial metrics; it significantly contributes to the broader sustainability of MFIs. The nuanced analysis from this research underscores that MFIs characterized by robust leadership practices tend to exhibit elevated levels of sustainability, manifested in notable growth rates, enhanced profitability, and heightened customer satisfaction.

In essence, the symbiotic relationship between leadership and the financial performance of MFIs is nuanced, profound, and far-reaching. Effective leadership is not merely a catalyst for immediate financial gains; it stands as a cornerstone for sustained success. It fosters an environment where MFIs can not only weather economic challenges but also actively contribute to broader societal development. This convergence of effective leadership and financial prowess delineates a trajectory where MFIs become not just financial entities but pillars of positive societal impact, ensuring a legacy of resilience and prosperity.

CONCLUSION

In conclusion, the research unwaveringly illuminates the intertwined destinies of leadership and financial performance in ensuring the robust sustainability of MFIs. Effective leadership, a potent catalyst, acts as the bedrock upon which success is built. It crafts a clear and compelling vision, nurturing a positive organizational culture where employees not only thrive but also dedicate themselves to achieving shared goals. By fostering a spirit of motivation through strategic rewards and incentives, effective leadership simultaneously cultivates a risk-conscious ethos, minimizing potential pitfalls and safeguarding financial wellbeing. This

potent cocktail of vision, culture, motivation, and risk management ultimately translates into enhanced financial performance – the lifeblood of MFI longevity.

Conversely, robust financial performance acts as a powerful engine, propelling MFIs towards a sustainable future. By fostering customer trust through a demonstrably strong track record, it opens doors to increased loan volume and vital third-party funding, paving the way for growth and expansion. This financial stability acts as a fuel, enabling MFIs to reach out to new communities and broaden their impact. Importantly, it also secures adequate profits, not merely for self-preservation but for reinvestment in strengthening capital and enhancing services to customers, a virtuous cycle that perpetuates success and empowers communities.

Recognizing this undeniable interdependence, MFIs must prioritize the proactive cultivation of both effective leadership and robust financial performance. This can be achieved through a two-pronged approach. The first prong involves investing in targeted leadership development programs, specifically designed to equip existing and aspiring leaders with the skills and vision necessary to navigate the unique challenges and opportunities of the MFI landscape. The second prong entails the meticulous implementation of robust financial practices, employing risk-mitigation strategies, transparent reporting, and responsible funding allocation. By embracing this comprehensive approach, MFIs can not only secure their own enduring success but also continue to act as beacons of hope and empowerment for marginalized communities, lighting the way towards a more inclusive and prosperous future. The ripple effects of such sustainable development will not only benefit individual lives but also contribute to a more equitable and thriving society, leaving a lasting legacy that extends far beyond the walls of any MFI.

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