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# Role of Competition and Stakeholders in Driving Financial Performance: A Case of Microfinance Banks of Pakistan.

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**_Abstract_**

*Theoretical and conceptual literature shows that stakeholder integration has some impact on the financial performance of the non-financial firms, while this study tests the above relationship in microfinance bank setting in Pakistan. The mediating role of competitive intensity has also been tested. The results shows that stakeholder integration has strong positive impact on financial performance while competitive intensity magnifies the impact on financial performance.*

***Keywords:*** *Stakeholder Integration, Competitive Intensity, Financial Performance, Microfinance Banks, Pakistan.*

## Introduction

Microfinancing is a key tool to bring in a systematic and cultural change in the economies around the world. It empowers the poor people and small and medium enterprises to flourish. Microfinancing improves employment, productivity and earning capacity of poor by alleviating poverty and improving living as well as social standard. The overall impact is targeted not only to economy but in general to health, food and education sectors as well.

Microfinancing is not new in Pakistan but rather young, starting with agriculture based loans in 1960 to other individuals and business now. Geographically Pakistan lives on the crossroads of South Asia, Central Asia, China and Middle East, with more than 212 million population, untapped resources and can become a central regional market for trade. But unfortunately economic growth is restrained because of unemployment, economic, governance and security failures. The government of Pakistan in the past 20 years has taken serious steps towards promoting Micro financing which include not only recognizing microfinance as a separate financial sector but also passing microfinance institution ordinance 2001 on 16$^{th}$ October 2001. This ordinance not only regulates and promotes micro financing but also safeguards the interest of depositors and customers from political interference. There are currently 10 microfinance bank operating under guidelines from State Bank of Pakistan. The competition among them has become fierce since the launch of digital financial services. Since micro financing has become more challenging, the banks as corporate firms are now engaging in efficient resource and management practices to optimally utilize capital and perform better financially.

Firms in Asia are sometimes synonymous of institutional weakness such as weak legal environment, corporate malfeasance, weak policies, stakeholder integration. All of them adds fire to corporate behaviours and firms financial and non-financial performance (Mair & Marti, 2009). The later weakness i-e stakeholder integration is reflected in partnerships where firm brings on board their customers and suppliers on their organizational practices for better performance (Amankwah-Amoah, Danso, & Adomako, 2019; Plaza-Úbeda, de Burgos-Jiménez, & Carmona-Moreno, 2010) . Stakeholder integration has recently become an important aspect of improved firm performance and competitive advantage. This has also been evident through research studies (Vachon & Klassen, 2008).

## Conceptual Framework & Hypothesis Development

Although stakeholder integration is widely adopted in financial and non-financial firm across the globe but not much literature is available which can support theoretically and empirically, especially with relation to financial performance (Li, Xia, & Zajac, 2018).

This research has proposed that by stimulating and sensitizing stakeholder integration, financial performance can be triggered. Further this research study will also take into account the mediating role of competitive intensity faced by the firms. So this research postulates that stakeholder integration with mediating role of competition can lead to high financial performance.

This study seek to address these gaps in the literature by developing and testing a model in an emerging economy i-e Pakistan. Being still in the phase of developing economy, firms in Pakistan face many institutional challenges, especially in financial firms where stakeholder integration is still a rare phenomenon. So, it is suggested that stakeholder integration can help to mitigate the structural and policy issues as well as will eventually improve the financial performance of the firms. This research takes into account ten micro financing banks in Pakistan.

This research has conducted literature inquiry in two parts. First it examined the stakeholder theory and its possible effect on financial performance (Bridoux & Stoelhorst, 2014; Patel, Manley, Hair Jr, Ferrell, & Pieper, 2016). Secondly it examined whether the above relationship can be mediated by industry completion (Eskerod, Huemann, & Ringhofer, 2015). Thus this work will highlight the importance of stakeholder integration and industry competition in firms over financial success.

This paper is simply structured with Introduction followed by theoretical background and hypothesis development, which is followed by analysis, methodology and findings. Finally in the last part result are discussed with conclusions, limitations and possible future research direction.

### Stakeholder Theory

Foundations of Stakeholder theory go deep into strategic management (Rhenman, 1968). The theory suggests that firm's long-term goals are dependent on the strategic directions of the stakeholders (Theodoulidis, Diaz, Crotto, & Rancati, 2017). Although, the operational definition of stakeholders is still debatable (S. Miles, 2017). This is because the researchers are defining stakeholders scope as deemed fit to them, but still there is no fine line, which tell who are the stakeholders and what do they do (Derry, 2012).

While, Mitchell, Agle, and Wood (1997) suggested that in order to identify stakeholders, three key factors can be examined i-e power, legitimacy, and urgency. A Powerful and legitimate stakeholder can influence management to take prompt and urgent decisions as compared to a stakeholder which lack the above attribute factors. Freeman (2001) classified stakeholders as primary and secondary, where primary stakeholders are more vital to firms survival and performance and vice versa. Also there has been evidence of resource dependence theory for prioritization of stakeholders (Eskerod et al., 2015).

The literature suggests that there is also a conflict of interest which exists between stakeholders and the organization's interests, while the stakeholder interest which the organization perceive and that what the stakeholders perceive can differ as well (Bryson, 2004). This can cause resistance between the organization and the stakeholders. De Gooyert, Rouwette, Van Kranenburg, and Freeman (2017) suggested that in order to mitigate the above situation, the organization should consider stakeholders as part of the broader organization. Thus it gives foundation to the concept of mutual exchange and coalition on potential operational as well as strategic communication, which will lead to improved organizational efficiency. This will also leads to a success triangle for the organization, where informing, consulting and co-deciding will form the angle of the triangle (Green & Hunton-Clarke, 2003). Evidence also suggests that stakeholders discussion for a strategic decision are sometime a necessity due to the complexity of business functions (Calton & Payne, 2003). So, it is evident from the research that stakeholders integration gives rises to longer and mutually beneficial (Greenwood, 2007), relations which leads to greater financial returns (Henisz, Dorobantu, & Nartey, 2014).

**Stakeholder Integration and Financial Performance**

The amalgam of stakeholders and organization work together toward a common objective of profit maximization (Harrison & Wicks, 2013). Stakeholders contribute actively to manage resources, while investors provides finances and sometimes advisory and customers help the firm through purchasing products (Bridoux & Stoelhorst, 2014). This cycle, if it keeps running helps avoid bankruptcy and leads to customer focused innovation as well (Von Hippel, 1994). Stakeholder integration is conceptualized as a process where the stakeholders are active part of the organization's network (Greenwood, 2007).

Stakeholders are sometimes not given equal importance, one reason of which is scarce resources of the organization, which poses a threat to restrain financial performance. In developed economies, country of origin liabilities of a firm i-e poor organizational policies and management of the organization back in their home country, gives negative impression to international stakeholders which in turn translates into credibility and legitimacy deficits (Fiaschi, Giuliani, & Nieri, 2017). So many a times the firms in other countries face liability of origin, which restrains their ability to mutual cooperation with other firms and stakeholders.

This study after extended literature (Hategan, Sirghi, Curea-Pitorac, & Hategan, 2018; Platonova, Asutay, Dixon, & Mohammad, 2018), operationalizes performance, i-e 'doing good' socially leads to 'doing well' financially, through six financial indicators (Hategan et al., 2018).

Theoretically it is also evident that stakeholder integration leads to better corporate performance (Rivera, Muñoz, & Moneva, 2017). (Chernev & Blair, 2015) suggests that good relations with stakeholders should strengthen financial performance. Also, there is evidence that firms achieve stronger financial performance in the form of long-run stock performance when quality management practices are integrated into management systems (Ferreira, Sinha, & Varble, 2008). This indicates that stakeholder integration leads to financial performance. This study suggest the following hypothesis:

**$H_1$:** How strong is the relationship between stakeholder's integration and financial performance?

**The Moderating Effect of Competitive Intensity**

Profitability, net margins and competitive intensity are the critical factors of financial performance. Literature suggests that institutional, infrastructural, policy, legal, regulatory and resource constraints can hinder firm's financial performance and also restrict innovation and survival (van Burg, Podoynitsyna, Beck, & Lommelen, 2012). However, in developing economies, organizations are forced to adopt innovative solution to improve their performance.

One of the most engaging factor which can improve firm's competitiveness is stakeholder integration (Leonidou, Christodoulides, Kyrgidou, & Palihawadana, 2017). Competition triggers the firm to improve operational efficiency through better industry practices, which will enhance product and process innovation, by engaging stakeholders leading to improved firm performance. Competition enables a firm to innovate and improve product quality, service and brand image, which will set the direction for improved sales and revenue (Narasimhan & Schoenherr, 2012).

Corporate decisions and strategies with inputs from stakeholders is an ethical practice and a source of innovation which leads to sustainable competitive advantages (Jones & Kierzkowski, 2018). Organization's survival is also evident from literature (Patel et al., 2016). Sustainable competitive advantage escorts the firm to continuously create more value than the competitors in the economy (Peteraf & Barney, 2003). M. P. Miles, Munilla, and Darroch (2006) contended that argue stakeholders play an essential role in organization through mutual interest and CSR outlook (Nidumolu, Prahalad, & Rangaswami, 2009). One situation can be, where the alignment of stakeholder and firm can take first mover product advantage in the market thus by capitalizing the share and the returns. This study further proposes that:

**$H_2$**: Competitive intensity moderates the relationship between stakeholder integration and financial performance.
**$H_3$**: Competitive intensity has a relationship with the financial performance.

## Theoretical Model

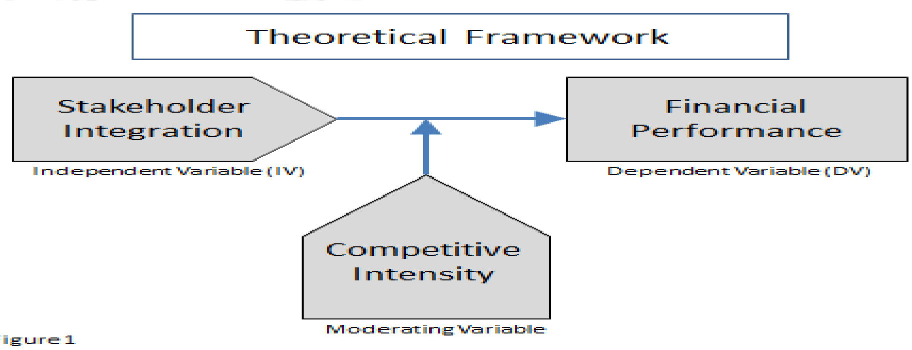

Figure 1

## Research Methodology

This study uses all 10 Pakistani microfinance banks as a sample to test our hypothesis. Micro financing is considered to be an effective tool to fight poverty, as they provide financial services to people who cannot obtain them from commercial banks and financial institutions or are mostly ignored by them. It is estimated that 67.61 million people worldwide have access to microfinance. Secondly, In Pakistan, the poor usually get loans from informal sources. Lack of income and resources forces them to borrow to meet basic necessities, and barriers to collateral make them only resort to informal channels. According to State Bank of Pakistan, friends and relatives are the main sources of loans, followed by shop owners and landlords. Therefore, studying stakeholder integration and corporate financial performance in Pakistan provides a typical market perspective for the advocating on how stakeholder theory affects the financial performance of Pakistan's microfinance banks.

### Data Collection and Sample

There are total 10 microfinance banks, licensed by State Bank of Pakistan. Total 250 questionnaires were sent, i-e 25 questionnaires to each micro finance bank. Data was collected in the months of March to October, 2020. Total number of 233 questionnaires were received which were complete and deemed fit for use.

## Measures used for Hypothesis Testing

### Stakeholder integration

This study conceptualized and adapted the instrument (Plaza-Úbeda et al., 2010) for the integration of stakeholders through a three-dimensional structure, comprised of bank's understanding of stakeholders, interaction with stakeholders, and adaptation to the needs of stakeholders. The study measured understanding and interaction of stakeholder, using four items on 7-point likert scale, while bank's adaptability to the needs of stakeholders on five items on 7-point likert scale.

### Competitive intensity

Using, (Auh & Menguc, 2005) conceptualization of competitive intensity, the study used four items 7-point likert scale (Jansen, Van Den Bosch, & Volberda, 2006) as a fierce competition, which leads to insufficient opportunities for further expansion.

### Financial performance

This study measured financial performance, through data collected from financial managers of microfinance banks using six items 7-point likert scale adopted from (de Bussy & Suprawan, 2012).

### Control variables

In order to enhance the accuracy of the tests used, five control variable are also used in the model. The size of the company is measured by the logarithmic conversion of many full-time employees, and the age of the company is the logarithmic conversion of the company that has been in business for many years since its first sale. Finally, we controlled the age, education, and level of the respondents. ("1" = "high school", "2" = "college degree", "3" = "bachelor degree", "4" = "master degree" and " 5" = "PhD degree").

## Statistical Tools and Techniques

### Multicollinearity

Before analyzing any model multi-collinearity is recommended to be checked (Olivia & Ilie, 2013), so that if there is a collinearity issue, the impact of variables will not be accurate. The below table shows that there are no multi-collinearity issues since the value is less than 5, which is reported in Table 1.

Table 1. Multicollinearity Test for Exogenous Latent Constructs.

| **Items** | **VIF** |
|---|---|
| Stakeholder integration | 1.139 |
| Competitive intensity | 1.701 |
| Financial Performance | 2.002 |

**Content Validity**

Content validity test is used to measure the ability of the items to measure variables (Hair, Sarstedt, Pieper, & Ringle, 2012). If the value of latent variable is lesser than the cross loading, test results are favorable, which is the case the below in Table 2.

Table 2. Factor analysis and loading of the items (cross loadings).

| Variables | SKI | CI | FP |
|---|---|---|---|
| SKI1 | **0.735** | 0.105 | 0.123 |
| SKI2 | **0.775** | 0.107 | 0.275 |
| SKI3 | **0.747** | 0.217 | 0.358 |
| SKI4 | **0.850** | 0.306 | 0.464 |
| **CI1** | 0.302 | **0.893** | 0.590 |
| CI2 | 0.332 | **0.917** | 0.583 |
| CI3 | 0.121 | **0.831** | 0.424 |
| CI4 | 0.089 | **0.745** | 0.406 |
| **FP1** | 0.280 | 0.440 | **0.664** |
| **FP2** | 0.256 | 0.478 | **0.766** |
| FP3 | 0.316 | 0.482 | **0.813** |
| FP4 | 0.349 | 0.602 | **0.857** |
| FP5 | 0.602 | 0.232 | **0.832** |
| FP6 | 0.441 | 0.040 | **0.844** |

Convergent Validity

Convergent validity test demonstrates the correlation between the two variables (Janadari, Sri Ramalu, & Wei, 2016). To test the Convergent validity values of Cronbach Alpha (0.7 or above), CR (0.7 or above) and AVE (0.5 above) are the threshold. The below table shows that all values are above threshold (Cronbach Alpha (0.7 or above), CR (0.7 or above) and AVE (0.5 above)).

Table 3. Convergent Validity

| Variables | Loading | AVE | CR | Cronbach's Alpha |
|---|---|---|---|---|
| SKI1 | 0.845 | 0.736 | 0.916 | 0.881 |
| SKI2 | 0.851 | | | |
| SKI3 | 0.869 | | | |
| SKI4 | 0.868 | | | |
| **CI1** | 0.875 | 0.796 | 0.938 | 0.915 |

| | | | | |
|---|---|---|---|---|
| CI2 | 0.938 | | | |
| CI3 | 0.879 | | | |
| CI4 | 0.877 | | | |
| **FP1** | 0.893 | 0.680 | 0.928 | 0.916 |
| **FP2** | 0.917 | | | |
| FP3 | 0.831 | | | |
| FP4 | 0.745 | | | |
| FP5 | 0.733 | | | |
| FP6 | 0.815 | | | |

**Discriminant Validity**

The discriminant validity tests, unrelated relationship, where the value of outer loading should be greater than the latent variable. Below table shows that all value in cross loadings are greater than the respective variable.

Table 4. Discriminant Validity

| Items | SKI | CI | FP |
|---|---|---|---|
| SKI | **0.788** | | |
| CI | 0.283 | **0.825** | |
| FP | 0.390 | 0.648 | **0.779** |

## Results

All hypothesis are accepted as Beta value is positive, T values are greater than 1.96 and p values are also less than the 0.05.

Table 5. Results

| Hypothesis | Variables | Beta (ß) | T-Value | P-Value | Findings |
|---|---|---|---|---|---|
| **H1** | Stakeholder Integration -> FP | 0.201 | 2.044 | 0.043 | **Supported*** ** |
| **H2** | Competitive intensity -> FP | 0.105 | 2.375 | 0.018 | **Supported*** ** |
| **H3** | Competitive intensity ***SKI -> FP | 0.135 | 1.970 | 0.015 | **Supported*** ** |

**Note:** ***Significant at 0.01 (1-tailed), **significant at 0.05 (1-tailed), *significant at 0.1 (1-tailed), (FP) Financial Performance.

## Discussion and Conclusion

This study embarked to investigate the relationship of stakeholder integration and financial performance, in micro financing institutions in Pakistan. The literature supports the framework but this setting has never been tested before in a developing economy like Pakistan.

This study finds that there is a strong relationship between stakeholder integration and financial performance. The most important reason is, Microfinance banks in Pakistan are few and they cater to the demand of poor people and SMEs. Mostly the customers are agriculture income based, who take out loans for seeds and agriculture machinery. Also the priority of the stakeholders in this scenario is informal loans, which leads the banks to reach out to the stakeholders to tailor the products according to their comfort and needs. This proposition in terms leads to a better understanding of their customers, developing informal relationships and giving out credit to them. The more the sales, the more revenue will be coming into the banks, which will promise better financial performance. Also competition plays a vital part in improved micro financial services. Since 63% of the population is rural in Pakistan, according to World Bank report 2019, there are huge untapped opportunities for giving microcredit for the banks but the poor population relies on friends and family for deficits and loans rather than using formal channels of credit. So the customer willing to avail micro financing are less, which intensifies the competition among the micro financing institutions. But this competition leads to better financial performance as is evident from this research because the banks manage their operations more efficiently through stakeholder integration. So this study finds that in the fierce industry competition, the level of stakeholder integration has a stronger indirect impact on financial performance.

As to contribute towards the literature on stakeholder integration, this study shows that bringing onboard the stakeholders in decision making and developing initiatives of the banks, positive results can be achieved (Zheng, Luo, & Maksimov, 2015). Microfinance banks can improve their financial performance by networking with their stakeholders. Especially in the case of developing economies, where the institutions have weak structures.

This study has opened a new insight and dimension of empirical research by studying stakeholder theory and competitive intensity and their relationship with financial performance. Additionally this research, demonstrates the role of bank's competition in enhancing the indirect impact of stakeholder integration on financial performance.

The study concludes that with higher degree of integration of stakeholder, the financial performance will be magnified. Also the intensity of competition will enhance the relation of stakeholder integration and financial performance. Therefore, microfinance banks can improve their, innovation capabilities, competitive advantages, to ultimately succeed in the developing economies.

## Limitations and Suggestions for Future Research

This research has few limitations which are opportunities for future research. This study is conducted in Pakistan, a comparative analysis of other developing economies, as well as developing economies versus developed economies comparison can be conducted, which will enhance the horizon of the literature.

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