European Journal of Accounting, Auditing and Finance Research, 14(1),134-147, 2026
Print ISSN: 2053-4086(Print),
Online ISSN: 2053-4094(Online)
Website: https://www.eajournals.org/
Publication of the European Centre for Research Training and Development-UK

Financial Regulation: Treatment or Threat? A Review of Microfinance Banking in Nigeria

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oi: https://doi.org/10.37745/ejaafr.2013/vol14n1134147 Published February 03, 2026

Citation: Ominyi E.A., Gambo N., Maitala F.H. (2025) Financial Regulation: Treatment or Threat? A Review of Microfinance Banking in Nigeria, *European Journal of Accounting, Auditing and Finance Research*, 14(1),134-147

Abstract: *This study investigates the effect of financial regulation on the performance of microfinance banks in Nigeria, focusing on capital adequacy regulation, risk management regulation, and supervisory policies. Microfinance banks play a critical role in financial inclusion and poverty alleviation; however, stringent regulatory frameworks may simultaneously enhance institutional stability and constrain outreach. Employing an ex-post facto research design, the study analyzed secondary data from selected national and state microfinance banks over a six-year period. The independent variables included capital adequacy ratios, risk management indicators, and supervisory policy metrics. Descriptive and multiple regression analyses were conducted using SPSS version 26. The findings reveal that capital adequacy regulation ($\beta = 0.482$, $p < 0.05$), risk management regulation ($\beta = 0.371$, $p < 0.05$), and supervisory policies ($\beta = 0.426$, $p < 0.05$) each exert a positive and statistically significant effect on microfinance bank performance. These results indicate that financial regulation, when effectively implemented, serves as a stabilizing force that enhances operational efficiency, depositor confidence, and institutional resilience. The study concludes that regulation functions as a treatment rather than a threat to microfinance bank performance, though a balanced, tiered approach is recommended to prevent overburdening smaller institutions. The research contributes to policy discourse by highlighting the dual role of regulation in promoting financial stability and inclusive growth within the Nigerian microfinance sector.*

Keywords: capital adequacy regulation, risk management regulation, supervisory policies, corporate governance, microfinance banks, bank performance

INTRODUCTION

Financial regulation plays a fundamental role in shaping the stability, efficiency, and credibility of financial systems across the globe. In developing economies such as Nigeria, regulation is particularly critical because of weak institutional structures, high levels of financial exclusion, and the vulnerability of low-income populations who depend largely on informal financial services (World Bank, 2022). Microfinance banking emerged as a vital financial inclusion strategy aimed at providing access to credit, savings, insurance, and payment services to the economically active poor and small-scale entrepreneurs who are often excluded from conventional banking systems. In Nigeria, microfinance banks have been positioned as vehicles for poverty alleviation, grassroots economic development, and inclusive growth (Sanusi, 2021; Babajide & Adegboye, 2023). The regulatory framework guiding microfinance banking in Nigeria is designed and enforced by the Central Bank of Nigeria as part of its mandate to ensure monetary and financial system stability. Over the years, the Central Bank has introduced several reforms covering capital requirements, licensing structure, prudential guidelines, corporate governance standards, and risk management controls within the microfinance sub-sector (CBN, 2020; CBN, 2023). These regulations are intended to strengthen institutional soundness, protect depositors, prevent systemic collapse, and improve public confidence in the microfinance industry. In theory, financial regulation therefore serves as a treatment mechanism that corrects market failures, promotes transparency, and ensures sustainable financial intermediation within the sector.

However, the practical outcomes of financial regulation for microfinance banking in Nigeria remain deeply contested. While regulation has helped eliminate poorly managed institutions and improved operational discipline in some microfinance banks, it has also imposed significant financial and operational burdens on many small-scale institutions (Kedir, 2020; Uche & Eze, 2022). Strict capital thresholds, heavy compliance costs, and complex reporting requirements have strained the survival capacity of many unit and state microfinance banks. As a consequence, several microfinance banks have collapsed, merged, or had their operating licenses revoked, raising concerns about the long-term stability of the sector and the effectiveness of regulatory interventions (CBN, 2023; Babajide & Adegboye, 2023).

Moreover, regulation appears to have altered the original social mission of microfinance banking. Rather than focusing primarily on the poorest and most financially excluded segments of society, many microfinance banks now target relatively safer and more commercially viable clients in order to meet regulatory and profitability demands (Karlan & Morduch, 2020; Uche & Eze, 2022). This commercial shift has raised questions about whether financial regulation is gradually transforming microfinance banks from poverty-focused institutions into miniature commercial banks, thereby weakening their developmental role. Critics argue that excessive regulation may be crowding out small informal borrowers, undermining outreach to rural communities, and restricting access to microcredit for the very population the sector was created to serve (Sanusi, 2021; World Bank, 2022). Despite the continuous regulatory reforms introduced by the Central Bank of Nigeria to strengthen the microfinance banking sector, the industry continues to experience high rates of institutional failure, shrinking outreach to the poor, rising compliance costs, and persistent financial instability. While regulation is intended to serve as a treatment that enhances transparency, discipline, and depositor protection, it increasingly appears to function as a threat to the survival and social mission of many microfinance banks. The problem therefore lies in the unresolved tension between financial regulation and the developmental objectives of microfinance banking in Nigeria, creating uncertainty as to whether regulation is truly strengthening the sector or constraining its ability to deliver financial inclusion and poverty reduction.

The main aim of this study is to critically examine whether financial regulation serves as a treatment or a threat to the performance of microfinance banks in Nigeria. Specifically, the study seeks to evaluate how key regulatory instruments—namely capital adequacy requirements, risk management regulations, and supervisory policies enforced by the Central Bank of Nigeria—influence the operational stability, financial sustainability, and overall performance of microfinance banks in the country. While the specific objectives are to;

i. examine the effect of capital adequacy regulation on the performance of microfinance banks in Nigeria.

ii. evaluate the effect of risk management regulations on the performance of microfinance banks in Nigeria.

iii. assess the effect of supervisory policies of the Central Bank of Nigeria on the performance of microfinance banks in Nigeria.

To achieve theses objectives, the following hypotheses are stated in null form.

H_{01}: Capital adequacy regulation has no significant effect on the performance of microfinance banks in Nigeria.

H_{02}: Risk management regulations have no significant effect on the performance of microfinance banks in Nigeria.

H_{03}: Supervisory policies of the Central Bank of Nigeria have no significant effect on the performance of microfinance banks in Nigeria.

The remainder of the paper is organised as follows. Section 2 provides the conceptual review and clarifies key constructs. Discusses theoretical foundations and empirical review, followed by the literature gap. Section 3 outlines the methodology of the literature-based study. Sections 4 synthesize results, test the hypotheses qualitatively and discuss the findings. Section 5 concludes with recommendations for policy, practice and further research.

LITERATURE REVIEW

Capital Adequacy Regulation

Capital adequacy regulation refers to the set of regulatory standards that require banks to hold a minimum proportion of capital relative to their risk-weighted assets in order to absorb unexpected losses and protect depositors. The conceptual foundation of capital adequacy is rooted in financial stability theory, which holds that well-capitalized financial institutions are more resilient to economic shocks and less likely to transmit systemic risk to the wider economy (BIS, 2019; Ghosh, 2021). In microfinance banking, capital adequacy is particularly critical because these institutions operate in volatile markets, deal with high default risk, and serve economically vulnerable clients whose deposits require strong protection. Capital adequacy regulation is designed to ensure that microfinance banks maintain sufficient financial buffers to support their operations and withstand credit and liquidity risks. The regulatory framework governing microfinance banks is issued and enforced by the Central Bank of Nigeria, which differentiates capital requirements based on the operational scope of each microfinance bank, such as unit, state, and national categories (CBN, 2020; CBN, 2023). Conceptually, this tiered structure reflects the principle that risk exposure increases with operational coverage and should therefore be matched with higher capital strength.

From a performance perspective, adequate capitalization enhances the credibility of microfinance banks and strengthens stakeholder confidence. Well-capitalized microfinance banks are better able to mobilize deposits, attract investors, expand outreach, and invest in technology and human capital, which ultimately improves service delivery and financial performance (Kedir, 2020; Babajide & Adegboye, 2023). Capital also serves as a shock absorber during periods of financial stress, protecting institutions from insolvency and promoting sustainable growth. However, capital adequacy regulation also introduces significant operational challenges. Raising and maintaining regulatory capital often imposes a heavy burden on microfinance banks, particularly small unit institutions with limited access to external funding. High recapitalization thresholds may exclude small community-based microfinance banks from the formal financial system, thereby reducing financial inclusion in rural and underserved areas (Uche & Eze, 2022). This creates a conceptual tension between financial stability and social outreach, as stricter capital rules may strengthen the system but weaken access to finance for the poor.

Capital regulation also influences the risk appetite of microfinance banks. Institutions facing strong capital pressure tend to adopt conservative lending practices in order to preserve their capital base. This often leads to a shift away from high-risk micro-entrepreneurs toward lower-risk salaried borrowers and small formal businesses (Karlan & Morduch, 2020; Ghosh, 2021). While this improves portfolio quality and profitability, it undermines the poverty alleviation mission of microfinance.

Risk Management Regulation

Risk management regulation refers to the rules and supervisory standards that guide how financial institutions identify, assess, monitor, and control risks inherent in their operations. In microfinance banking, risk management is fundamental because of high exposure to credit risk, liquidity risk, operational risk, and fraud risk arising from unsecured lending and weak borrower documentation (Salas & Gorton, 2020; Nwankwo & Eze, 2021). Conceptually, risk management regulation seeks to ensure that microfinance banks operate within acceptable risk boundaries while safeguarding depositors and maintaining financial stability. Credit risk remains the most dominant risk in microfinance banking due to the nature of micro-loans, which are often unsecured and extended to low-income borrowers with unstable income streams. Regulatory guidelines therefore require microfinance banks to establish strong loan appraisal systems, portfolio diversification strategies, and loan loss provisioning frameworks (CBN, 2020; Kedir, 2020). When these regulations are effectively implemented, they promote asset quality, reduce non-performing loans, and enhance financial performance.

Liquidity risk regulation is also critical in the microfinance sub-sector. Microfinance banks must be able to meet withdrawal demands from depositors at all times. Weak liquidity management exposes institutions to the risk of bank runs and operational collapse (Ghosh, 2021). Regulatory requirements on minimum liquidity ratios and cash reserve maintenance are therefore intended to ensure financial soundness and depositor protection. Regulators require institutions to establish internal audit units, separation of duties, sound corporate governance structures, and secure digital platforms to minimize losses arising from system failures and human error (Nwankwo & Eze, 2021; Uche & Eze, 2022). Effective operational risk management improves efficiency, transparency, and public confidence in microfinance institutions. Risk management regulation can impose significant compliance costs on microfinance banks. Investment in risk management systems, professional staff, audit structures, and technology demands substantial financial resources, which small microfinance banks often struggle to provide (Kedir, 2020). As a result, risk management regulation may improve institutional stability while simultaneously reducing profitability in the short run. Risk management regulation remains indispensable to the sustainability of microfinance banks. Its impact on performance depends largely on the balance between prudential discipline and operational flexibility. In the Nigerian context, persistent cases of loan default, fraud, and weak governance continue to highlight the central role of risk management regulation in protecting the microfinance system and supporting long-term performance.

Supervisory Policies

Supervisory policies refer to the monitoring, inspection, enforcement, and corrective mechanisms used by financial regulators to ensure that banks comply with established laws and prudential guidelines. Conceptually, supervision is the operational arm of regulation that translates formal policies into practical institutional discipline (BIS, 2019; World Bank, 2022). In microfinance banking, supervisory policies play a particularly vital role because these institutions are prone to weak governance, insider abuse, and poor record-keeping. Supervision takes several forms, including off-site surveillance through periodic financial reporting and on-site examinations through physical inspection of bank operations. These processes enable regulators to assess capital adequacy, asset quality, liquidity position, earnings performance, and managerial competence (CBN, 2020; CBN, 2023). Effective supervision helps to detect early warning signals of financial distress and allows for timely corrective intervention.

From a performance perspective, strong supervisory policies promote discipline and accountability among microfinance bank managers. The presence of active supervision discourages reckless lending, misappropriation of funds, and regulatory arbitrage. Institutions that operate under consistent regulatory scrutiny are more likely to maintain sound internal controls and prudent financial practices, which enhances long-term performance and stability (Uche & Eze, 2022; Babajide & Adegboye, 2023). However, supervisory policies may also impose operational pressure on microfinance banks. Frequent examinations, strict reporting requirements, and regulatory enforcement actions often disrupt routine operations and increase administrative costs (Kedir, 2020). For small microfinance banks with limited staff and infrastructure, regulatory compliance can become a significant burden.

Supervisory interventions such as license suspension, forced mergers, and liquidation exercises also reshape the competitive landscape of the microfinance sector. While these actions protect depositors and restore confidence in the system, they may also weaken financial inclusion if many small institutions are forced out of the market (World Bank, 2022; CBN, 2023). Conceptually, this reflects the tension between regulatory protection and market access. Supervisory policies therefore function as both corrective and preventive tools within the microfinance system. Their effectiveness depends on transparency, consistency, institutional capacity, and the absence of political interference. In Nigeria, repeated regulatory interventions underscore the central role of supervision in determining whether financial regulation ultimately strengthens or constrains microfinance banking performance.

Corporate Governance

Corporate governance has continued to attract significant scholarly attention due to its critical role in promoting accountability, transparency, and sustainable corporate performance. Modern governance literature extends beyond the traditional agency theory perspective, which focuses on resolving conflicts between managers and shareholders, to incorporate stakeholder and institutional viewpoints that emphasize long-term value creation and social responsibility. According to Aguilera, Judge, and Terjesen (2020), corporate governance today is best understood as a system of rules, practices, and relationships that balance the interests of shareholders, boards, management, and a widening array of stakeholders. This shift reflects the growing complexity of corporate environments and the rising expectations placed on corporations to act responsibly in society. Recent empirical studies consistently affirm that strong corporate governance mechanisms enhance firm performance and reduce agency costs. For example, Bhagat and Bolton (2019) found that firms with effective board oversight and well-structured executive compensation systems tend to display superior operating performance and lower financial distress. Similarly, Nguyen, Soobaroyen, and Uyar (2020) reported that board independence significantly improves financial reporting quality, thereby limiting earnings manipulation and strengthening investor confidence. These findings reinforce the argument that governance structures remain fundamental in safeguarding shareholders' interests and ensuring managerial discipline.

Studies highlight that governance quality directly influences environmental, social, and governance (ESG) performance. According to Friede, Busch, and Bassen (2020), firms with robust governance frameworks are significantly more likely to adopt responsible environmental and social practices. Likewise, Alareeni and Hamdan (2020) demonstrated that governance mechanisms, particularly board size, audit committee effectiveness, and ownership structure, play a key role in improving ESG disclosures among listed firms. These findings confirm that governance now serves not only as a control mechanism but also as a strategic driver of sustainable corporate behavior. Institutional and regulatory frameworks continue to shape governance outcomes, especially in developing economies. According to OECD (2023), countries with stronger investor protection laws and enforcement mechanisms record higher levels of corporate transparency and accountability. Empirical evidence from Sub-Saharan Africa by Ntim, Opong, and Danbolt (2020) confirms that regulatory reforms significantly improve board practices, disclosure quality, and shareholder rights. However, the authors caution that legal reforms alone are insufficient without strong political will and institutional capacity to ensure compliance.

Microfinance Banks

Microfinance banks are specialized financial institutions designed to provide financial services to low-income individuals, micro-entrepreneurs, and small-scale businesses that are excluded from conventional banking systems. Conceptually, microfinance banking is rooted in the theory of financial inclusion, which emphasizes that access to financial services is a fundamental driver of poverty reduction, entrepreneurship development, and inclusive economic growth (World Bank, 2022; Karlan & Morduch, 2020). Microfinance banks in Nigeria evolved from community banks and informal financial schemes established to mobilize rural savings and provide microcredit to the unbanked population. They serve as intermediaries between surplus and deficit economic units at the grassroots level, offering services such as micro-loans, savings accounts, payments, and small-scale insurance products (Babajide & Adegboye, 2023). Their operations are guided by a dual objective of financial sustainability and social development. From a conceptual standpoint, microfinance banks differ from conventional banks in terms of clientele, loan size, collateral structure, and operational model. Loans are typically small, short-term, and issued without traditional collateral, relying instead on group lending mechanisms, trust-based arrangements, and social guarantees (Karlan & Morduch, 2020). These features increase financial access but also heighten exposure to credit risk.

The performance of microfinance banks is closely tied to their ability to balance financial viability with developmental outreach. Institutions that focus excessively on social objectives without maintaining sound financial discipline often experience high default rates, liquidity problems, and eventual collapse (Kedir, 2020). Conversely, microfinance banks that pursue aggressive profitability may drift away from their poverty-alleviation mission and exclude the poorest borrowers. Regulatory reforms, capitalization requirements, and supervisory interventions have significantly reshaped the Nigerian microfinance landscape over the past decade. While these reforms have improved institutional discipline and eliminated weak operators, they have also reduced the number of operating microfinance banks and limited access to finance in some rural communities (CBN, 2023; Uche & Eze, 2022).

Bank Performance

Bank performance refers to the extent to which a financial institution achieves its financial, operational, and developmental objectives within a given period. Conceptually, bank performance is multidimensional and includes profitability, efficiency, asset quality, liquidity, and outreach (Ghosh, 2021; Babajide & Adegboye, 2023). For microfinance banks, performance also encompasses social indicators such as poverty outreach, financial inclusion, and support for micro-enterprises. Financial performance is typically measured using indicators such as return on assets, return on equity, earnings stability, and loan portfolio quality. High-performing microfinance banks demonstrate strong profitability, low non-performing loan ratios, and adequate liquidity to meet customer obligations (Kedir, 2020). These indicators reflect the institution's ability to manage costs, generate income, and sustain operations over time. Operational performance relates to internal efficiency, service delivery quality, staff productivity, and technological capacity. Microfinance banks that invest in digital platforms, customer relationship management, and staff training tend to achieve higher efficiency and customer satisfaction (Nwankwo & Eze, 2021). Operational performance therefore directly influences competitiveness and market confidence.

Social performance measures the extent to which microfinance banks achieve their developmental mission. This includes outreach to low-income groups, support for women entrepreneurs, rural financial inclusion, and contribution to small business growth (Karlan & Morduch, 2020; World Bank, 2022). Strong social performance enhances the legitimacy and policy relevance of microfinance institutions. Regulation plays a central role in shaping all dimensions of microfinance bank performance. Capital adequacy strengthens financial resilience, risk management ensures asset quality, and supervision enforces discipline and accountability (CBN, 2023). However, excessive regulation can increase compliance costs and restrict credit expansion, thereby weakening both financial and social performance.

Theoretical Review

This study is anchored on the Financial Intermediation Theory, which serves as the underpinning theory for examining whether financial regulation acts as a treatment or a threat to the performance of microfinance banks in Nigeria. The theory provides a strong conceptual foundation for understanding how regulated financial institutions mobilize savings from surplus economic units and allocate such resources to deficit units in the form of credit for productive investment. The relevance of this theory to this study lies in its ability to explain how capital adequacy regulation, risk management regulation, and supervisory policies influence the capacity of microfinance banks to perform their intermediation function efficiently and sustainably.

Financial Intermediation Theory

The Financial Intermediation Theory is originally associated with the seminal works of Joseph Schumpeter (1934), who emphasized the critical role of financial institutions in driving economic development through credit creation and entrepreneurial support. Schumpeter's early contribution established the idea that banks are not merely passive financiers but active agents of economic growth through their ability to mobilize savings and channel them into productive investment. The theory was later expanded by modern financial economists such as Gurley and Shaw (1960) and Goldsmith (1969), and further refined by theories addressing information asymmetry, notably Akerlof (1970) and Stiglitz and Weiss (1981). These developments positioned financial intermediation as the backbone of modern banking operations and financial stability.

At the core of the Financial Intermediation Theory is the assumption that financial institutions exist because of market imperfections such as information asymmetry between borrowers and lenders, high transaction costs, and the inability of individuals to directly diversify risk on their own (Allen & Santomero, 1997). Banks therefore emerge as specialized institutions that reduce these imperfections by screening borrowers, monitoring loan use, pooling risks, and transforming short-term deposits into long-term credit (Diamond & Dybvig, 1983). In the context of microfinance banking, this intermediation role becomes even more critical because microfinance institutions serve borrowers who are typically excluded from formal credit markets due to lack of collateral, unstable income, and high perceived risk (Ledgerwood, 1999; Robinson, 2001). Through intermediation, microfinance banks bridge this gap by extending small-scale credit to micro-entrepreneurs and low-income households.

Regulation occupies a central position within the Financial Intermediation Theory because unregulated financial intermediation can expose depositors to excessive risk and threaten the stability of the entire financial system. Capital adequacy regulation ensures that banks maintain sufficient financial buffers to absorb unexpected losses and protect depositors, thereby strengthening confidence in the intermediation process (Basel Committee on Banking Supervision, 2011). Risk management regulation enhances the ability of banks to properly assess, monitor, and control credit, liquidity, and operational risks associated with lending activities, while supervisory policies enforce compliance and discipline within the banking system (Demirgüç-Kunt & Levine, 2008). From the perspective of the theory, these regulatory mechanisms are designed to strengthen the efficiency and safety of financial intermediation rather than weaken it.

However, the theory also recognizes that excessive regulation may distort the intermediation process by increasing operating costs, restricting credit supply, and discouraging lending to high-risk but productive borrowers such as micro-entrepreneurs (Barth, Caprio & Levine, 2006). For microfinance banks, which are inherently exposed to higher credit risk due to the nature of their clientele, overly stringent capital and risk regulations may lead to conservative lending behavior and mission drift away from poverty-oriented objectives (Cull, Demirgüç-Kunt & Morduch, 2011). This theoretical tension makes the Financial Intermediation Theory particularly suitable for examining the dual nature of financial regulation as either a treatment that strengthens performance or a threat that constrains outreach and sustainability.

Empirical Review

A recent empirical investigation by Babajide and Adegboye (2023) examined the effect of regulatory capital requirements on the performance of microfinance banks in Nigeria using panel data from 2012 to 2020. The study employed fixed-effects regression analysis to assess how capital adequacy influences profitability, asset quality, and outreach. The findings revealed that capital adequacy ratio had a significant positive effect on return on assets and deposit mobilization of microfinance banks. Well-capitalized institutions were found to be more resilient to loan defaults and liquidity shocks, thereby enhancing overall performance. However, the study also reported that excessive capital requirements constrained the lending capacity of smaller microfinance banks, leading to reduced credit access for low-income borrowers. The authors concluded that while capital regulation strengthens financial stability, it must be carefully calibrated to avoid weakening financial inclusion. This study is highly relevant to the current research as it empirically links capital adequacy regulation to microfinance bank performance within the Nigerian financial system regulated by the Central Bank of Nigeria.

Uche and Eze (2022) conducted an empirical study on the impact of risk management regulation on the sustainability of microfinance banks in Nigeria. Using survey data from 246 managers of licensed microfinance banks and applying structural equation modeling, the study examined the influence of credit risk control, liquidity risk management, and operational risk policies on financial performance. The results showed that effective credit risk management and loan monitoring frameworks significantly reduced the level of non-performing loans and improved profitability. Liquidity risk regulation was also found to have a strong positive influence on bank solvency and customer confidence. However, operational risk compliance increased operating expenses in the short run, thereby exerting mild pressure on profitability. The study concluded that risk management regulation is essential for enhancing long-term performance and survival of microfinance banks despite its short-term cost implications. This finding directly supports the second objective of the present study.

Nwankwo and Eze (2021) empirically investigated the effect of supervisory policies and corporate governance regulation on microfinance bank performance in Nigeria. The study adopted a correlational research design and analyzed audited financial statements of selected microfinance banks over a seven-year period. The findings indicated that frequent regulatory examinations, compliance with governance codes, and timely submission of regulatory reports had a significant positive effect on earnings stability and asset quality. The study further revealed that microfinance banks subjected to consistent regulatory supervision recorded lower cases of fraud, insider abuse, and financial mismanagement. However, some respondents reported that continuous supervisory visits disrupted routine operations and increased administrative costs. The study concluded that supervisory policies enhance accountability and institutional discipline, which ultimately improves long-term performance. This outcome provides empirical validation for the supervisory policy variable in the present research.

At the international level, Kedir (2020) examined the relationship between financial regulation and the sustainability of microfinance institutions across selected developing economies using World Development Indicators and institution-level data. The study employed dynamic panel regression techniques and found that capital adequacy and prudential risk regulations significantly improved institutional stability, reduced insolvency risk, and strengthened depositor confidence. However, the study also revealed that stringent regulatory compliance costs negatively affected outreach to rural and low-income borrowers. The study concluded that regulation has a dual effect on microfinance institutions by strengthening financial soundness while constraining social performance. This dual-outcome finding provides strong empirical support for the central theme of the present study, which seeks to determine whether financial regulation functions as a treatment or a threat to the performance of microfinance banks.

Literature Gap

The reviewed empirical and conceptual studies demonstrate that financial regulation plays a significant role in shaping the performance and sustainability of microfinance banks. Prior studies have extensively examined the effects of capital adequacy, risk management practices, and supervisory frameworks on bank performance, both within Nigeria and in other developing economies. Evidence from existing literature indicates that capital adequacy regulation enhances financial stability and depositor confidence, while effective risk management reduces non-performing loans and improves profitability. Similarly, supervisory policies have been shown to strengthen corporate governance and institutional discipline. However, despite these contributions, several critical gaps remain. First, many existing studies examine regulatory variables in isolation, without jointly assessing the combined influence of capital adequacy, risk management regulation, and supervisory policies on microfinance bank performance within a single model. Second, there is limited emphasis on the dual nature of regulation as both a stabilizing force and a potential constraint, particularly within the Nigerian microfinance sector. Third, most previous studies rely heavily on secondary financial data, with limited use of primary data from operators of microfinance banks who directly experience regulatory pressures. Finally, few studies provide recent post-recapitalization evidence reflecting the current regulatory environment shaped by the Central Bank of Nigeria. These gaps justify the need for the present study.

METHODOLOGY

This study adopted an ex-post facto research design in examining the effect of financial regulation on the performance of microfinance banks in Nigeria. The choice of this research design is justified on the grounds that the variables examined in the study already exist and cannot be manipulated by the researcher. The relationship between financial regulation indicators and performance of microfinance banks is therefore observed as it naturally occurs. The design is considered appropriate for studies that rely on secondary data and focus on cause–effect relationships. The population of the study consists of all licensed microfinance banks operating in Nigeria as regulated by the Central Bank of Nigeria. However, due to data accessibility and consistency in reporting standards, the study focuses on selected national and state microfinance banks with complete and verifiable financial statements within the period under review. The study adopts a purposive sampling technique to select microfinance banks that meet the criteria of continuous operation and availability of complete annual financial reports within the study period. This approach ensures reliability and uniformity of the dataset.

The study relied solely on secondary sources of data. Data were obtained from the published annual reports and accounts of the selected microfinance banks, Central Bank of Nigeria statistical bulletins, prudential guideline reports, and supervisory publications. The period covered in the study spans six years, which is considered adequate for capturing regulatory and performance trends in the microfinance sector. The use of secondary data ensures objectivity, verifiability, and consistency in measurement. The dependent variable for this study is microfinance bank performance, which is measured using Return on Assets (ROA) and Return on Equity (ROE). These indicators capture both operational efficiency and shareholders' returns and are widely accepted measures of bank performance in empirical literature. The independent variables are capital adequacy regulation, risk management regulation, and supervisory policies. Capital adequacy regulation is proxied by the minimum capital requirement and capital-to-risk weighted assets ratio. Risk management regulation is measured using indicators such as non-performing loan ratio and liquidity ratio, while supervisory policies are captured using frequency of regulatory examinations and compliance sanctions. Inferential analysis was conducted using multiple regression analysis, which enables the study to assess the individual and joint effect of capital adequacy regulation, risk management regulation, and supervisory policies on the performance of microfinance banks in Nigeria.

The model for the study is specified as follows:

$$BPF = \alpha + \beta_1 CAR + \beta_2 RMR + \beta_3 SP + \mu$$

Where: BPF = Bank Performance (ROA, ROE); CAR = Capital Adequacy Regulation; RMR = Risk Management Regulation; SP = Supervisory Policies; α = Intercept; $\beta_1 - \beta_3$ = Regression coefficients; μ = Error term.

All statistical analyses were carried out using Statistical Package for Social Sciences (SPSS) version 26. The decision rule for hypothesis testing was based on a 5% level of significance. Thus, any probability value (p-value) less than or equal to 0.05 implies a statistically significant relationship, while a p-value greater than 0.05 indicates insignificance.

RESULTS AND DISCUSSION

Table 1: Effect of Capital Adequacy Regulation on Microfinance Bank Performance

Variable	Beta	T-Value	P-Value	Decision
Capital Adequacy Regulation	0.482	4.215	0.000	Significant

Source: Authors' Computation, 2026

The result in Table 1 shows that capital adequacy regulation has a positive and statistically significant effect on the performance of microfinance banks in Nigeria. The beta coefficient of 0.482 indicates that an increase in capital adequacy regulation leads to a corresponding increase in bank performance. The p-value of 0.000 is less than the 0.05 level of significance, implying that the null hypothesis is rejected. This finding suggests that well-capitalized microfinance banks are better positioned to absorb financial shocks, improve depositor confidence, and enhance profitability.

Table 2: Effect of Risk Management Regulation on Microfinance Bank Performance

Variable	Beta	T-Value	P-Value	Decision
Risk Management Regulation	0.371	3.584	0.002	Significant

Source: Authors' Computation, 2026

The result in Table 2 reveals that risk management regulation exerts a positive and significant influence on the performance of microfinance banks. The beta coefficient of 0.371 indicates a strong contribution of risk management practices to improved operational efficiency. With a p-value of 0.002, the effect is statistically significant, leading to the rejection of the null hypothesis. This implies that effective credit risk assessment, liquidity management, and loan monitoring reduce default risks and enhance profitability in microfinance banks.

Table 3: Effect of Supervisory Policies on Microfinance Bank Performance

Variable	Beta	T-Value	P-Value	Decision
Supervisory Policies	0.426	3.891	0.001	Significant

Source: Authors' Computation, 2026

The result in Table 3 shows that supervisory policies have a positive and statistically significant effect on microfinance bank performance. The beta value of 0.426 indicates that stronger supervision leads to improved accountability and financial discipline. With a p-value of 0.001, the relationship is significant at the 5 percent level, leading to the rejection of the null hypothesis. This suggests that consistent regulatory examination, compliance enforcement, and reporting requirements enhance sound banking practices.

DISCUSSION OF FINDINGS

The findings of this study reveal that financial regulation—specifically capital adequacy regulation, risk management regulation, and supervisory policies—significantly enhances the performance of microfinance banks in Nigeria. The positive effect of capital adequacy regulation aligns strongly with the findings of Babajide and Adegboye (2023), who argue that well-capitalized microfinance banks exhibit greater resilience, improved depositor confidence, and stronger profitability. Similarly, Ghosh (2021) posits that adequate capitalization enhances financial stability and reduces insolvency risks, supporting the outcome of this study. The result showing that risk management regulation positively influences bank performance is consistent with Uche and Eze (2022), who demonstrate that effective credit and liquidity risk controls significantly reduce non-performing loans and improve operational efficiency. This also agrees with Nwankwo and Eze (2021), who observed that sound risk management frameworks promote long-term sustainability in microfinance institutions. Furthermore, the significant effect of supervisory policies corroborates the findings of Kedir (2020), who notes that regulatory supervision strengthens governance structures, reduces fraud, and enhances financial performance. The results also align with Sanusi (2021), who emphasized that continuous regulatory oversight improves institutional discipline and accountability in microfinance banks. Collectively, these findings demonstrate that regulation functions as a stabilizing force that enhances performance when properly implemented.

CONCLUSION AND RECOMMENDATIONS

This study examined the effect of financial regulation—capital adequacy regulation, risk management regulation, and supervisory policies—on the performance of microfinance banks in Nigeria. The findings clearly show that all three regulatory dimensions exert significant and positive effects on microfinance bank performance. Capital adequacy regulation enhances financial stability by ensuring that institutions maintain sufficient buffers to absorb shocks and sustain operations. Risk management regulation improves asset quality, reduces loan default, and strengthens operational efficiency, while supervisory policies promote transparency, discipline, and compliance with prudential guidelines. The outcome of the study therefore supports the view that financial regulation, when properly enforced, functions as a treatment rather than a threat to the performance of microfinance banks. Regulation enhances accountability, reduces institutional vulnerability, and promotes confidence among depositors and investors. However, the findings also highlight the need for a balanced regulatory approach that strengthens institutional stability without overburdening smaller microfinance banks with excessive compliance costs. The study concludes that effective regulation is indispensable for sustaining the performance and developmental mission of microfinance banks in Nigeria. Strengthened regulatory frameworks must therefore be accompanied by capacity-building strategies that enable microfinance institutions to meet compliance obligations while expanding financial inclusion.

Based on the findings, the following recommendations were made:

1. The Central Bank of Nigeria should adopt a tiered and flexible capital adequacy framework that considers the size and operational capacity of microfinance banks to avoid overburdening smaller institutions while still maintaining financial stability.
2. Microfinance banks should invest in modern risk management systems and staff training, especially in credit appraisal, loan monitoring, and digital risk controls, to ensure effective compliance and minimize default risks.
3. Regulatory authorities should strengthen supervisory support rather than solely enforcement, by providing technical assistance, periodic training, and early-warning

feedback mechanisms that help microfinance banks comply without excessive disruption to operations.

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