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Internal Control and the Dual Performance of Microfinance Institutions: A Managerial Analysis of the West African Context

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Abstract: Microfinance institutions in the West African Economic and Monetary Union operate as hybrid organizations that must reconcile financial sustainability with a mission of social inclusion. Recent supervisory data show rapid growth in the sector alongside a deterioration in portfolio quality and capitalization. This conceptual article examines how the effectiveness of internal control, assessed through the five components of the 2013 framework of the Committee of Sponsoring Organizations of the Treadway Commission, may shape the dual performance of these institutions. Combining hybrid organization theory, agency theory and this internal control framework, it develops an integrated conceptual model linking the control environment, risk assessment, control activities, information and communication, and monitoring activities to financial performance, measured by return on assets and portfolio at risk over 30 days, and to social performance, measured by client protection and depth of outreach. The model yields four testable hypotheses: internal control improves financial performance; it improves social performance; these two effects are complementary rather than conflicting; and their strength depends on institutional size and maturity. The article contributes by reframing internal control as a managerial lever for balancing the two performance logics rather than as an ex post compliance function. It also proposes an empirical research agenda and draws implications for managers and supervisors seeking to strengthen microfinance institutions in West Africa.

Keywords: Internal control, COSO framework, Microfinance institutions, Dual performance, Hybrid organizations, West Africa

INTRODUCTION

For more than three decades, microfinance has held a distinctive place in the financial architecture of the West African Economic and Monetary Union (WAEMU). It emerged from the observation that conventional banking was structurally unable to reach rural populations, micro-entrepreneurs and informal-sector activities. The sector of decentralized financial systems (DFS), as microfinance institutions are known in the Union, has since been institutionalized and brought under the supervision of the Central Bank of West African States (BCEAO) and the WAEMU Banking Commission. At the end of December 2024, DFS in the Union served more than 19.1 million clients through nearly 4,800 service points, with total assets of about XOF 4,022 billion, up more than 12% year on year (Commission Bancaire de l'UMOA, 2025).

This growth, however, comes with recurrent and documented signs of fragility. The gross portfolio degradation rate of large DFS rose from 4.4% to 6.6% between 2023 and 2024,

while the average capitalization ratio fell back below the 15% regulatory threshold, to 13.5%. This combination of rapid quantitative growth and qualitative deterioration of the portfolio raises the central question of this article: to what extent does the quality of internal control in DFS determine their ability to reconcile two structurally competing performance logics, namely financial performance, the condition of their institutional sustainability, and social performance, the very reason for their mission of including vulnerable populations?

This issue, known in the international literature as the "double bottom line" or "dual performance" of microfinance institutions (Armendáriz & Morduch, 2010; Christen & Drake, 2002; Morduch, 2000), is particularly acute in the WAEMU because three factors combine: the speed of sector growth; the wide heterogeneity of institutional maturity between large, supervised institutions and small institutions with informal governance; and the recent intensification of prudential supervision by the BCEAO.

This article advances a specific argument: internal control is not merely a regulatory compliance function deployed downstream of operations, but a managerial regulation lever capable of arbitrating, upstream, between the two poles of dual performance. This view runs counter to a conception still common in part of West African DFS practice, where internal control remains confined to an ex-post compliance audit role and is perceived by commercial teams as an administrative brake on growth rather than as a tool for steering its quality (Ahoussi, 2021; Sène & Diallo, 2020).

The article contributes at three levels. Theoretically and methodologically, it proposes an original articulation between hybrid organization theory (Battilana & Lee, 2014) and agency theory applied to the governance of microfinance institutions (Jensen & Meckling, 1976; Mersland & Strøm, 2009), while drawing on the COSO framework as a normative framework for structuring and operationalizing the dimensions of internal control. This combination of explanatory theories and a management framework remain little explored in research on microfinance institutions in West Africa. Empirically, the study draws on the most recent sector data to shed light on the determinants of dual performance. Managerially, it proposes an operationalizable conceptual model that can guide both DFS managers' practices and future empirical research.

The article is organized as follows. Section 2 presents the theoretical framework. Section 3 situates the research problem in the regulatory and empirical context of the WAEMU. Section 4 offers a critical review of empirical literature. Section 5 formalizes the conceptual model and research hypotheses. Section 6 discusses managerial implications and limitations, and Section 7 concludes with a research agenda.

THEORETICAL FRAMEWORK

Microfinance Institutions as Hybrid Organizations

The notion of hybrid organization, as developed by Battilana and Lee (2014) in their seminal review, refers to structures that combine several socially legitimate but historically distinct organizational forms. West African DFS typically fall into this category: they combine the market logic of financial intermediation with the social logic of fighting financial exclusion (Battilana & Dorado, 2010; Pache & Santos, 2013). This hybridity generates concrete

managerial tensions that play out in daily operational decisions, particularly in trade-offs along the credit cycle.

For West African DFS, this tension takes a specific form. The clients targeted by the social mission (rural populations, women entrepreneurs, informal micro-activities) are structurally those with the highest credit risk profile and the highest management cost per loan. The pursuit of financial performance therefore exerts structural pressure toward a gradual rebalancing of the portfolio in favor of less vulnerable but more creditworthy clients, a mechanism documented in the international literature as mission drift (Cull et al., 2011; D'Espallier et al., 2011; Mersland & Strøm, 2010).

Agency Theory

Agency theory (Jensen & Meckling, 1976) offers a second relevant lens for analyzing the internal functioning of DFS. These organizations are characterized by multiple principal-agent relationships, each carrying specific information asymmetries and moral hazard risks: between governance bodies and executive management; between general management and the network of loan officers; and between the institution and its depositors (Hartarska, 2005; Mersland & Strøm, 2009). At the level of loan officers, compensation is frequently tied to disbursement volume targets, which can directly conflict with the quality of loan appraisal and the rigor of repayment capacity assessment.

In a study of a large international sample of microfinance institutions, Mersland and Strøm (2009) show that governance mechanisms (separation of functions, board size and composition, degree of local market competition) significantly influence the outreach and financial performance of the institutions studied. This result opens the way to a managerial reading of microfinance performance, as opposed to a strictly institutional or structural one. Fama and Jensen (1983) further showed that separating decision functions from control functions is a fundamental mechanism for reducing agency costs, a mechanism directly applicable to the organization of the credit cycle in DFS.

The COSO Internal Control Framework

The revised 2013 version of the COSO framework (*Internal Control – Integrated Framework*) defines internal control as a process effected by the board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in three categories: the effectiveness and efficiency of operations, the reliability of financial and non-financial reporting, and compliance with applicable laws and regulations (Committee of Sponsoring Organizations of the Treadway Commission [COSO], 2013). It organizes this purpose around five interdependent components: the control of environment, risk assessment, control activities, information and communication, and monitoring activities.

This framework makes it possible to move beyond the restrictive view of internal control as a simple ex post verification function, a view still dominant in part of West African DFS (Doumbia, 2011). The COSO framework invites us to see internal control as embedded in decision-making, particularly through its risk assessment component, directly applicable to loan appraisal and monitoring, and its control environment component, directly

applicable to formalizing ethical sales and collection practices toward vulnerable clients. The adaptation of this framework to the specific features of microfinance institutions has been documented by CGAP (2005), Christen et al. (2012) and Ledgerwood et al. (2013), who stress the need for an approach that takes into account the constraints specific to microfinance.

An Integrated Framework

Combining these two theoretical bodies with the COSO 2013 framework, used as a normative framework for structuring and operationalizing internal control, leads to the central proposition of this article. Hybrid organization theory establishes that the tension between financial and social performance is constitutive of the very nature of DFS, not an occasional dysfunction to be corrected. Agency theory establishes that this tension is played out concretely through internal principal–agent relationships that carry risks of opportunism at every level of the organization. The COSO framework provides the operational grid for understanding how an internal management system can structure these agency relationships so as to contain financial risk and social risk simultaneously. Internal control thus constitutes the operational junction between the structural tension identified by hybrid organization theory and the governance mechanisms analyzed by agency theory.

EMPIRICAL CONTEXT: THE DFS SECTOR IN THE WAEMU

Regulatory Framework

The regulatory framework governing decentralised financial systems (SFDs) within the West African Economic and Monetary Union (WAEMU) has progressively evolved, from the 1993 PARMEC framework to the 2007 Uniform Law. The 2007 reform was supplemented by several instructions issued by the Central Bank of West African States (BCEAO), establishing prudential, accounting and organisational requirements applicable to SFDs according to the specific scope of each regulatory instrument. In particular, the reform introduced specific prudential requirements, including a minimum capital adequacy ratio of 15%, alongside mechanisms for monitoring credit portfolio quality through indicators tailored to microfinance activities, notably the portfolio at risk over 30 days (PAR30), a measure derived from international standards promoted by the Consultative Group to Assist the Poor (CGAP) and adopted by the BCEAO (Ledgerwood, 2013; CGAP, 2010).

With regard to governance, BCEAO Instruction No. 017-12-2010 of 29 December 2010, concerning the organisation of internal control within SFDs, established the requirement for institutions to maintain an internal control system proportionate to the nature, scale and risks of their activities. This system is intended, in particular, to ensure regulatory compliance, the reliability of financial information, the safeguarding of assets and the prevention of risks. Supervision is structured around an institutional framework involving internal oversight bodies, competent national authorities, the BCEAO and the WAEMU Banking Commission, in accordance with their respective mandates. Under the supervisory arrangements established by the 2007 Uniform Law, a distinction is made between larger institutions falling within the scope of Article 44, which are subject to oversight by the BCEAO and the WAEMU Banking Commission, and other SFDs, which are primarily supervised by the competent national authorities.

Recent Sector Trends

The most recent data from the WAEMU Banking Commission and the BCEAO make it possible to document empirically the theoretical tension described in Section 2. On the one hand, activity continues to grow strongly: net uses of funds rose by 10.3% in 2024, resources collected by 13.5%, and the number of clients served increased by more than one million in one year, from 18,015,354 to 19,121,754 (Commission Bancaire de l'UMOA, 2025). On the other hand, the simultaneous deterioration of two major prudential indicators reflects a weakening of financial performance. The gross portfolio degradation rate of large DFS rose from 4.4% to 6.6% between 2023 and 2024; the average capitalization ratio fell back below the 15% regulatory threshold, to 13.5% compared with 14.5% a year earlier; and the cumulative net income of large DFS declined from XOF 23.5 billion to XOF 16.7 billion.

Beyond quantitative indicators, supervisory reports and the professional literature repeatedly document concrete operational failures of internal control in West African DFS: insufficiently formalized loan approval procedures; weak management information systems that make real-time monitoring of portfolio at risk by segment difficult; inadequate separation of functions between loan appraisal, decision and disbursement; and a lack of internal risk management skills (Ahoussi, 2021; Doumbia, 2011; Koffi & Sossou, 2018). This empirical configuration (strong quantitative growth, concurrent qualitative deterioration and documented internal control failures) forms the context from which this article develops its conceptual proposition.

CRITICAL REVIEW OF EMPIRICAL LITERATURE

Governance and Microfinance Performance

The empirical literature on the relationship between internal governance mechanisms and microfinance performance developed mainly from the 2000s onward, as the sector professionalized and international databases became available. Using a large international sample, Cull et al. (2007) examine the relationship between financial performance and outreach and highlight substantial heterogeneity of business models depending on the lending methodology. In a study of microfinance institutions in Central and Eastern Europe and the Newly Independent States, Hartarska (2005) shows that board characteristics, including the presence of independent members and executive compensation, significantly influence the financial and social performance of the institutions studied.

Mersland and Strøm (2009, 2010) provide a decisive complementary perspective: by showing that internal governance variables explain a significant share of the observed variance in dual performance, they open the way to a managerial reading of performance as opposed to a strictly structural one.

Tchakoute-Tchuigoua (2010) shows that the financial and social performance of microfinance institutions differs according to their legal status, which underlines the importance of institutional and contextual factors. Gonzalez (2011) and Cull et al. (2011), using MIX Market data on more than 2,000 institutions in 109 countries, establishing significant relationships between governance quality and credit risk control as measured by PAR30.

Internal Control in West African Microfinance

While the relationship between governance and performance has been widely documented, the more specific relationship between the maturity of internal control, understood in the sense of the COSO framework, and the dual performance of microfinance institutions remains comparatively less explored, particularly in West Africa. Mintzberg (1979) and Simons (1995) established, in a general setting, that organizational control systems play a central role in aligning members' behavior with the strategic objectives set by governance, a proposition whose application to West African microfinance remains largely unexplored.

Doumbia (2011), on Malian microfinance institutions, documents internal control weaknesses and their link with the deterioration of portfolio quality, without proposing an integrated theoretical framework or operationalizing internal control through the five COSO components. Kablan (2014), using data envelopment analysis on WAEMU microfinance institutions, shows that regulatory reforms increased their financial efficiency at the expense of their social efficiency, but does not examine the internal control mechanisms through which this shift operates. Ahoussi (2021), in a recent study of Ivorian DFS, finds a positive and significant relationship between governance quality and financial performance, but does not explore social performance or the internal mechanisms of internal control. These studies mark the frontier of knowledge from which this article seeks to advance.

A strand of the literature focused more specifically on African contexts emphasizes concrete operational failures of internal control in DFS without always linking them systematically to financial and social performance indicators (Bédécarrats et al., 2011; Fall, 2011; Lapenu & Doligez, 2007). These studies document the human and budgetary constraints faced by small and medium-sized institutions in establishing an internal control function that is both independent and competent, in contrast with the resources of large, professionalized institutions. In a comparative study of Senegalese and Togolese DFS, Sène and Diallo (2020) confirm that the strong institutional heterogeneity between large institutions and small structures is a potential explanatory variable for the dispersion of performance observed at the aggregate sector level.

Research Gaps

This review reveals three main gaps that this article seeks to address. First, an explicit link between the five components of the COSO framework and the two distinct dimensions of DFS performance is absent from the existing literature, which most often treats performance as an aggregate variable or focuses on the financial dimension alone (Ahoussi, 2021; Mersland & Strøm, 2009).

Second, the literature tends implicitly to oppose financial and social performance in line with the mission drift paradigm (Armendáriz & Morduch, 2010; Morduch, 2000), without always questioning the possibility of complementarity mechanisms that the COSO framework makes it possible to explore. Third, the specific WAEMU context remains insufficiently used as an empirical anchor for theoretical models developed internationally, as most foundational studies rely on aggregate samples that poorly represent West African institutional specificities.

CONCEPTUAL MODEL AND RESEARCH HYPOTHESES

Conceptual Model

The proposed conceptual model posits that the effectiveness of the internal control system, a latent variable operationalized through the five components of the COSO framework, has a direct influence on both the financial and the social performance of DFS, differentiated according to the components involved (Figure 1). These two dimensions are not necessarily antagonistic: they respond to distinct transmission mechanisms for some internal control components and to common mechanisms for others. The independent variable is internal control effectiveness, measured through its five components: control environment (CE), risk assessment (RA), control activities (CA), information and communication (IC) and monitoring activities (MO). The dependent variables are financial performance (return on assets [ROA] and PAR30) and social performance (client protection and depth of outreach). Table 1 summarizes the main transmission mechanism of each component. Control variables for the future empirical phase are institutional size (total assets), age, supervisory status (large DFS versus others), dominant lending methodology (individual versus group lending with joint liability) and geographical location.

Research Hypotheses

Internal Control and Financial Performance

The effectiveness of internal control, particularly its risk assessment and control activities components, is expected to be positively associated with credit portfolio quality (lower PAR30) and return on assets (higher ROA). The transmission mechanism operates through securing the loan approval cycle (separating appraisal, decision and disbursement functions) and through early detection of loan deterioration. This hypothesis extends the work of Hartarska (2005), Mersland and Strøm (2009) and Gonzalez (2011).

- **H1:** The effectiveness of internal control, particularly risk assessment and control activities, is positively associated with the financial performance of DFS.

Internal Control and Social Performance

The effectiveness of internal control, particularly its control environment and information and communication components, is expected to be positively associated with the protection of vulnerable clients against over-indebtedness and with the preservation of the institution's social outreach. The transmission mechanism operates through the formalization of ethical sales practices and the centralization of information on borrowers' cross-indebtedness. This hypothesis extends the work of Cull et al. (2007) and D'Espallier et al. (2011).

- **H2:** The effectiveness of internal control, particularly the control environment and information and communication, is positively associated with the social performance of DFS.

Complementarity Between the Two Mechanisms

In contrast to a strictly competitive reading of the two missions, structured around the paradigm of a systematic trade-off between financial and social performance (Morduch,

2000), this article posits that the internal control components acting on financial performance (H1) and those acting on social performance (H2) can converge. The same mature system can simultaneously reduce credit risk and protect vulnerable clients, insofar as over-indebtedness is, from the lender's perspective, a default risk factor. This hypothesis calls for empirically testing a relationship of complementarity rather than trade-off between the two performance dimensions.

- **H3:** The effects of internal control on financial performance and on social performance are complementary rather than conflicting.

Moderating Role of Size and Institutional Maturity

The strength of the relationships posited in H1 and H2 is expected to be moderated by the size and institutional maturity of the DFS. These relationships should be stronger in large DFS, which are subject to enhanced prudential supervision and have more resources to build an independent internal control function, than in small and medium-sized institutions, where internal control relies more on informal mechanisms. This expectation is consistent with the findings of Sène and Diallo (2020) and with evidence that performance differs across institutional types (Tchakoute-Tchuigoua, 2010).

- **H4:** The relationships posited in H1 and H2 are stronger in large, more mature DFS than in small and medium-sized DFS.

Methodological Avenues for Testing the Model

Empirical validation of this conceptual model would require developing a scale measuring the maturity of internal control in DFS, aligned with the five COSO components and adapted to the operational features of West African microfinance, following standard scale development procedures (Churchill, 1979; Fornell & Larcker, 1981): item generation, validation by sector experts, and exploratory then confirmatory factor analysis. Hypotheses H1 to H4 could be tested using structural equation modeling (partial least squares or maximum likelihood, depending on sample size; Hair et al., 2019), which makes it possible to model simultaneously the posited direct relationships and the moderating effect of institutional size (H4). The sample should be stratified by institutional size and country to ensure that conclusions are representative of the WAEMU as a whole.

DISCUSSION

Managerial and Supervisory Implications

The proposed conceptual model leads to several concrete implications for the managerial practice of West African DFS. First, it invites executive management and governance bodies to stop treating internal control as a compartmentalized support function mobilized after loan disbursement for verification purposes, and to integrate it upstream of the decision cycle, particularly through risk assessment. In practice, this means involving the internal control function in the design of loan appraisal grids and early warning systems, not only during periodic audit missions (Roussy & Brivot, 2016; Simons, 1995).

Second, the model suggests that investment in internal control maturity should not be seen as a cost that burdens the social mission for the sole benefit of financial compliance, a view still common in some managerial discourse in the sector (Ahoussi, 2021). It should rather be seen as an investment with joint benefits, capable of reducing both credit risk and clients' over-indebtedness risk, provided the complementarity hypothesis (H3) is empirically confirmed.

Third, the moderating hypothesis (H4) invites supervisory authorities and support organizations to differentiate their support according to the size and institutional maturity of DFS. Small and medium-sized institutions could benefit as a priority from programs supporting the structuring of their internal control function, rather than from a uniform tightening of regulatory requirements that may be disproportionate to their current capacities.

This reading complements, without replacing, the recommendations already issued by WAEMU supervisory authorities on strengthening the governance and risk function of DFS, while giving them a more explicit theoretical foundation. In particular, it suggests that the prudential indicators currently monitored (portfolio at risk, capitalization ratio) could be supplemented by indicators of internal control maturity itself, upstream of their financial manifestations, in a preventive rather than solely corrective logic, drawing on approaches already developed by CGAP (Christen et al., 2012) and by social performance rating networks such as CERISE and the Social Performance Task Force (Lapenu & Doligez, 2007).

Limitations

This work has limitations that should be acknowledged explicitly. First, it is a conceptual article: the proposed model has not been empirically validated on primary data, and the posited relationships remain theoretical propositions to be tested. Second, operationalizing social performance will require, in the empirical phase, specific work to build robust indicators, potentially inspired by the social performance assessment tools already used internationally (such as the CERISE SPI4 tool), whose adaptation to the WAEMU context remains to be documented. Third, the literature review could be enriched in a later version by academic work conducted specifically in the WAEMU, including theses and dissertations defended in the region's financial-sector training institutions.

CONCLUSION

This article has proposed a managerial, rather than strictly regulatory, reading of internal control in West African microfinance institutions, explicitly linking it to the COSO framework, hybrid organization theory and agency theory. Its central argument, that internal control is a managerial lever for regulating dual performance rather than a mere ex post compliance instrument, finds tangible empirical grounding in recent trends in the WAEMU DFS sector, marked by sustained quantitative growth but a concurrent deterioration in portfolio quality and capitalization (BCEAO, 2025; Commission Bancaire de l'UMOA, 2025).

The conceptual model and the four hypotheses open the way to an empirical research agenda structured around four priorities:

1. developing and validating a scale measuring the maturity of internal control in DFS, adapted to the West African context and aligned with the five COSO components;
2. collecting matched data on financial performance indicators (ROA, PAR30) and social performance indicators from a representative sample of WAEMU DFS stratified by institutional size;
3. testing, through structural equation modeling, the complementarity relationship posited in H3, whose confirmation or rejection would contribute significantly to the theoretical debate on mission drift in West African microfinance;
4. exploring the moderating effect of institutional size (H4), which could inform the design of differentiated support policies by supervisory authorities and the Union's technical and financial support organizations.

Ultimately, this article argues that internal control is not only a regulatory compliance tool but an infrastructure of institutional trust on which the ability of DFS to keep their dual promise rests: financial sustainability and social impact. This dual promise justifies the renewed attention that management research should pay to the distinctive hybrid organizations that WAEMU DFS represent.

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Author contributions: Conceptualization: …; Writing – original draft: …; Writing – review and editing: …; Supervision: … (CRediT taxonomy; to be completed by the authors).

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Table 1: Internal control components, transmission mechanisms and targeted performance dimensions

COSO component	Main transmission mechanism	Targeted performance dimension
Control environment	Ethical culture, independence of the risk function, formalization of sales and collection practices	Social performance (client protection)
Risk assessment	Early identification of portfolio deterioration factors, credit scoring, risk mapping	Financial performance (PAR30, ROA)
Control activities	Separation of appraisal, decision and disbursement functions; loan file validation; reconciliations	Financial and social performance
Information and communication	Centralization of information on cross-indebtedness; management information system; pricing transparency	Social performance (over-indebtedness prevention)
Monitoring activities	Periodic review, early warning system, independent internal audit, follow-up of recommendations	Financial performance (PAR30, ROA)

Note. PAR30 = portfolio at risk over 30 days; ROA = return on assets. Source: Authors.

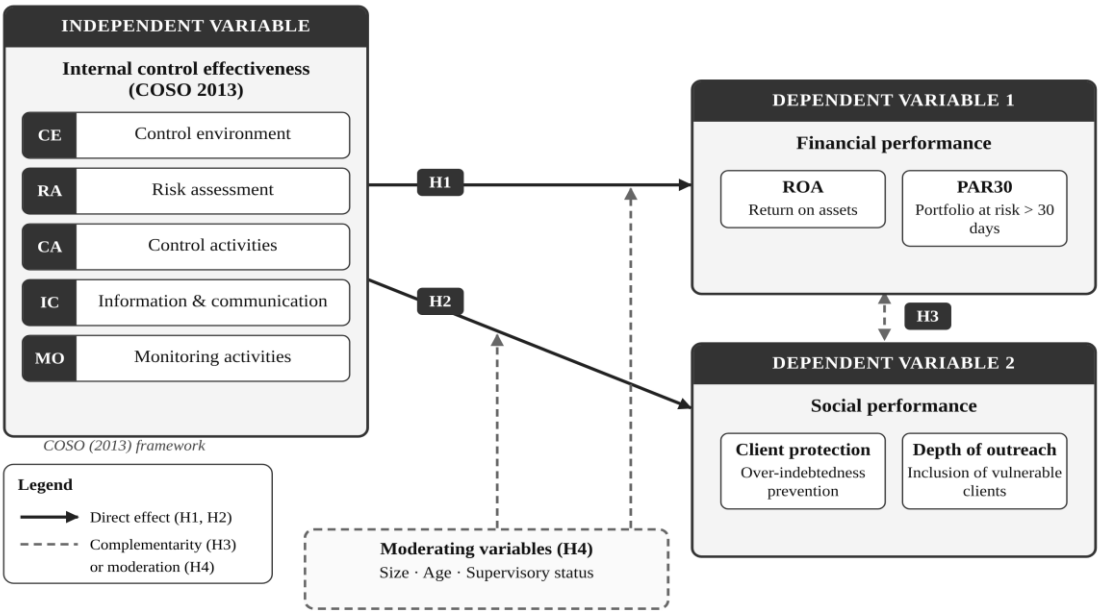


Figure 1: Conceptual model: Internal control and the dual performance of decentralized financial systems

Source: Authors, based on COSO (2013), Battilana and Lee (2014), and Mersland and Strøm (2009).