

REGULATION

HOW CAN REGULATORS AND PROFESSIONAL ASSOCIATIONS BETTER SUPPORT MICROFINANCE?

FINDINGS AND CONCRETE SUGGESTIONS FOR THE INCLUSIVE FINANCE SECTOR FROM THE DOCTORAL THESIS OF TRISTAN CABALLERO-MONTES, SUPPORTED BY ADA.

CONTEXT

How to combine financial and social objectives while avoiding the excesses of the inclusive finance sector? This is the question Tristan Caballero-Montes addressed in his doctoral thesis on 'Microfinance Industry Dynamics: Analyses of Regulation, Competition, and Collective Action'. Faced with recurrent criticism of high interest rates, the emergence of crises, or the problem of over-indebtedness, this issue is crucial for practitioners in the sector.

In addition to its organisational functioning such as strategic decision-making or its governance structure, each microfinance institution (MFI) is **influenced by sectoral dynamics** that strongly condition its practices and performance. The PhD thesis consists of four studies examining three sectoral dynamics affecting MFI practices: **regulation, competition and the functioning of professional associations**. This thesis adopts a 'systems' approach, in which the significant interactions between these three dynamics must be considered to support the regulation of the sector. Furthermore, the research carried out in this thesis is based on solid theoretical foundations, while at the same time proposing concrete contributions to the sector and avenues of reflection for regulators, professional associations, or organisations supporting the sector.

OBJECTIVES

The thesis has four objectives:

1. To draw lessons from the impact of strengthening microfinance regulation on the financial and social performance of MFIs
2. To identify the effect of interest rate caps for the financial inclusion of the poorest
3. To understand the reaction of MFIs to the imposition of an interest rate cap in a competitive market
4. To analyse the organisational obstacles faced by professional associations

RESULTS



WHAT ARE THE EFFECTS OF INCREASED REGULATION IN BENIN?

Law 2012-14, on the regulation of decentralised financial systems in the Republic of Benin, aimed to support the formalisation and financial viability of MFIs, the protection of clients, and the development of actors other than cooperatives. By analysing data from the local supervisory agency through various performance indicators, the research recognises that the regulation makes sense in terms of the goals pursued and that it has indeed fostered the confidence of donors and clients, and thus reduced funding costs. However, **the study found that the main objectives have not been achieved and that regulation has not promoted financial and social sustainability**. In practice, the study stresses the need to reflect on **how to regulate the sector without "over-regulating"** it and suggests avenues of reflection such as taking social aspects into account in regulations, by valuing the roles taken on by MFIs such as financial education, and the choice of more incentive-based mechanisms to complement restrictive regulations. Regulation must also take into account major developments, such as the digitalisation of services and its consequences for MFIs and clients.



Tristan Caballero-Montes defended his thesis in January 2022. © Tristan

Duration of the project

October 2018 - January 2022

Geographical areas

Benin, Cambodia, Tanzania



Donors

ADA and Fonds pour la Recherche Scientifique (Scientific Research Fund)



Stakeholders and partners

Important contribution of microfinance networks to the case studies:

Cambodia Microfinance Association (CMA) and Tanzania Association of Microfinance Institutions (TAMFI)



Contribution through the provision of data:

National Association for the Supervision of Decentralised Financial Systems in Benin (ANSSFD)





WHAT ARE THE EFFECTS OF RATE CAPS IN MICROFINANCE?

This study examines the effects of interest rate caps in microfinance. With extensive data collection on the use of caps, the research shows that **MFIs facing restrictions offer larger loans, suggesting that they serve less marginalized clients**. The study also shows that competition exacerbates this phenomenon for two reasons: the deterioration of MFIs' ability to *cross-subsidise loans* and the exacerbation of risk-taking in their strategies, leading, for example, to large refinancing of existing loans. The study argues against the use of rate caps in microfinance because of the negative effect they have. It is essential to strike a **balance between the potential to increase efficiency, reduce costs and prices, and the risk of exacerbating exclusion and reducing transparency through interest rate controls**. The study also highlights the importance of considering new elements, such as market conditions and the level of competition.



HOW DO MFIS REACT TO THE CAP IN CAMBODIA?

Through a case study conducted in collaboration with the Cambodian Microfinance Association (CMA), the research analyses the imposition of an interest rate cap in the Cambodian market. It suggests that in a competitive market, a rate cap favours the commercial priorities of MFIs at the expense of their social mission. This study suggests that **the cap introduced in 2017 has probably not achieved its objectives of protecting the poor and of slowing down the overheated market**, and that it has contributed to the targeting of cheaper and less marginalised clients by some MFIs, or to the massive refinancing of existing clients' loans. In doing so, the study proposes an analytical framework based on the assessment of the market according to two criteria, the level of interest rates and the degree of competition, to best judge the decisions to be taken in terms of interest rate restrictions. This framework is then applied in an exploratory manner to 53 countries.



HOW CAN PROFESSIONAL ASSOCIATIONS BE BETTER SUPPORTED?

The case study of the Tanzanian microfinance association (TAMFI) identifies **obstacles to its collective management by member MFIs, such as the heterogeneity of MFIs and their needs, the difficulty of balancing the benefits and costs** of association membership, and the integration of the association into regulatory activities. **The research suggests key institutional design questions** that associations can ask themselves to better understand the organisational challenges they face and the interdependence of these. It suggests a prioritisation of these questions for operationalisation. In the case of TAMFI, the study suggests strengthening the relationship between the regulators and the association, acting to change the regulators' perspective on the role of the association, and better aligning the interests of the partners and members.

OUTLOOK

Following his PhD thesis defended in January 2022, Tristan has been accepted at the Harvard Kennedy School of Government (HKS) to continue his research in microfinance. His work at HKS aims to explore the interdependencies between the different missions of MFIs, namely financial, social and environmental. Specifically, his research aims to better understand the links between different dimensions of financial, social, and environmental performance in microfinance, and to identify potential synergies and/or trade-offs between these dimensions. To this end, Tristan is interested in network theory and analysis, which allows for the quantification and analysis of the relationships between numerous MFI performance indicators. This work aims to explore an original approach that will ultimately lead to a better understanding of how to support the different missions of the sector.

ADA's support

As a field partner, ADA reinforced the credibility of Tristan's research project and helped him to obtain funding for his thesis. ADA also provided funding for certain missions and facilitated his participation in various conferences and training courses. Collaboration with ADA was also essential for conducting the case study with different NGO partners and to establish key contacts for field missions.

ADA also provided technical support and guidance on the approaches and findings of the thesis. Through seminars, meetings, or simple contacts with ADA, the thesis benefited from important feedback from experts in the sector. Finally, the role of ADA is essential in the dissemination of the research results, including to practitioners.

For ADA, research is a relevant way to produce new knowledge for the inclusive finance sector, provided that this research addresses issues faced by the sector and uses data from the field. This thesis is in line with this logic: by collaborating with Tristan from the outset on the definition of a common project, ADA ensured that the research meets the needs of practitioners in the sector and facilitates access to data from the field. Ultimately, this new knowledge will feed into current and future projects of ADA and the sector.

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ADA is associated with the CERMI - Centre for European Research in Microfinance, of which the University of Mons is a founding member, to develop research projects, academic publications and knowledge sharing workshops between CERMI researchers and field practitioners.