New Actors in Microfinance Lending: The Role of Regulation and Competition in Latin America

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Abstract
Microfinance institutions (MFIs) provide funds to poor communities that were previously excluded from credit, and to the surprise of many, these institutions often boast high returns for investors. As a result, new actors are beginning to play a more prominent role in the microfinance sector, providing financial services for low-income citizens around the world. In addition, the state is increasingly involved in regulating this sector. Using firm-level data on microfinance institutions in Latin America, this article assesses the role that increased competition, state actors, international actors, and macro-political variables play in MFIs’ ability to attract borrowers. The analysis illustrates that while increased competition and domestic political economy factors decrease the number of borrowers at each firm, regulation and international involvement have a positive effect on MFIs’ ability to attract borrowers.

Keywords
microfinance, regulation, nongovernmental organizations, non-banking financial institutions, Latin America

Introduction
Over the past decade, domestic and international actors have become advocates of microfinance and its perceived capacity to alleviate poverty and inequality. Muhammad Yunus, for example, won the Nobel Prize in 2006 for his work with microfinance offered by the Grameen Bank in Bangladesh (Giridharadas and Bradsher 2006). The United Nations considers microfinance crucial to the Millennium Development Goal of poverty eradication (UNCDF 2005), and the World Bank has launched an initiative to promote a development strategy through microfinance (Thomas 2006). The trend toward supporting microfinance initiatives is also clear at the state-level.
Nearly seventy percent of emerging and developing countries have adopted some form of microfinance. Yet this increased recognition has caused the composition of the microfinance sector to shift rapidly.

As a result, new actors—both formal financial institutions and government regulators—are beginning to play a more prominent role. Using firm-level data on microfinance institutions (MFIs) in Latin America, this article assesses the influence of these new actors and analyzes the extent to which they play a part in microfinance outreach. In doing so, this work provides a snapshot of how, and to what extent, the ability of MFIs to attract borrowers is influenced by the changing landscape of Latin American microfinance.

The microfinance equation is straightforward: to alleviate poverty and promote development, MFIs provide funds at a relatively low cost to poor communities and populations that previously were excluded from credit. This process aims to reduce the role of the state in providing costly social services, raise the income level of the poor, and expand consumption to stimulate the economy. Domestic, international, and government actors work to implement microfinance across the globe. Yet the variation in government policy surrounding microfinance and the entrance of new microfinance lenders (and hence increased competition) has generated a number of important changes within the sector. This work seeks to shed light on how recent transformations—namely, increased involvement of government regulators, additional MFIs, and international actors—affect the ability of MFIs to attract borrowers. Understanding these processes and mechanisms will, in turn, help explain some of the cross-national variation in microfinance.

Specifically, this article aims to answer the following question: Of recent changes within the microfinance sector, which factors are important in influencing MFI growth? MFI growth, for the purpose of this analysis, is understood to be the ability of MFIs to attract borrowers. This indicator is discussed at length later in the paper, and while imperfect, it also avoids some of the complications inherent in other commonly used measures. Attracting borrowers, while perhaps not the stated goal of many MFIs, is certainly an inherent goal in reaching sustainability, or generating a profit. Understanding how the regulatory environment and within-sector competition affects this process is an important, timely puzzle.

Why is there interest in explaining the effect of these factors? With regards to microfinance regulation, government involvement in microfinance can be

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1 Of the 152 emerging and development countries listed by the IMF’s World Economic Outlook (2008), MIX Market (an organization that tracks microfinance activity) lists active portfolios in 106.