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Integrating Market Conditions into Regulatory Decisions on Microfinance Interest Rates: Does Competition Matter?

The microfinance industry has developed and commercialized rapidly since its early days, exacerbating competition and the attention paid to profits. As a response, many governments have been tempted to limit microcredit interest rates. Although such a measure is often considered as socially counterproductive, its outcome has not been investigated through a large econometric study centred on financial inclusion. Using a consolidated dataset including 986 microfinance institutions from 73 countries over the period 2015-2018, we first assess the effect of interest rate restrictions on the size of the loans provided by microfinance institutions, through fixed-effect regressions. Going one step further, we use a moderation analysis with multiple indicators, including the Herfindahl-Hirschman and Lerner indexes, to understand how market conditions affect this initial relationship. The findings not only confirm that institutions subjected to interest rate caps tend to provide larger loans, but also suggest that competition exacerbates this phenomenon. By integrating market conditions into the analysis, this paper investigates the outcome of regulation in a financial inclusion context through a more systemic approach than what is commonly done.

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