

Banks & Microbanks

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The Financial Access Initiative is a consortium of researchers at New York University, Harvard, Yale and Innovations for Poverty Action.

FULL PAPER:

Cull, Robert, Asli Demirgüç-Kunt, and Jonathan Morduch. 2009. "Banks & Microbanks." Working Paper.

Microfinance initially was conceived of as a way to expand access to financial services to people who mainstream commercial banks wouldn't take on as clients. But as microfinance institutions demonstrate that lending to the poor can be commercially viable, mainstream commercial banks are taking note and opening up services to the formerly "unbanked." With Robert Cull and Asli Demirgüç-Kunt of the World Bank, Financial Access Initiative managing director Jonathan Morduch examines the industrial organization of microfinance, asking how competition from banks is affecting the profitability and outreach of microbanks. The authors analyze the impact of bank penetration on the performance of microbanks and find that greater competition is associated with deeper outreach, but it seems to have little effect on their profitability.

Analyzing Bank Penetration & Microbank Performance

Increased competition from formal sector banks could change the profile of microfinance in a number of ways. For example, microbanks facing greater competition from mainstream commercial banks could attempt to compensate by shifting their loan portfolios away from segments of the population that are more costly to serve, i.e. the very poor and women. However, competition could instead encourage deeper outreach by supporting the financial self-sufficiency of microbanks through the benefits of agglomeration and stronger regulatory environments. Cull, Demirgüç-Kunt, and Morduch investigate the relationship between competition and microbank performance.

The authors combine data on 346 leading microbanks in 67 developing countries, collected by the MIX Market for the MicroBanking Bulletin, with data on bank penetration from 99 developed and developing countries from Beck, Demirgüç-Kunt, and Martinez Peria (2007). The key explanatory variables in their analysis are measures of bank penetration: the per capita number of bank branches in a country, and the number of branches per square kilometer. They control for institutional characteristics of the microbanks, such as

lending method and measures of productivity, as well as country-specific characteristics, including banking sector ownership and the share of the population residing in rural areas.

Results

The authors find that competition from the formal financial sector does not have a significant effect on the profitability of microbanks. Increased competition is associated with deeper outreach, however. Microbanks in economies with deeper bank penetration serve relatively poorer customers (as proxied by loan size) and more women than microbanks facing less competition from the formal sector. The evidence is particularly strong for microbanks that rely on commercial funding and use traditional bilateral lending agreements (as opposed to group lending arrangements).

Policy Implications

This study is the first empirical analysis of the effects of competition from mainstream commercial banks on the performance of microbanks. The findings serve as a first step in understanding questions around the industrial organization of microfinance and its role in building inclusive financial sectors,