The drivers of the financial integration of microfinance Institutions: Do financial development, agency costs and microfinance performance matter?

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This analysis marks a preliminary endeavor to highlight how important financial integration in the microfinance sector is as a factor for the growth and sustainability of microfinance institutions.
Several studies have defined financial integration as internal financial connections and international financial connections. Our concern is focusing mainly on how microfinance institutions are financially integrated through interbank markets. What are the drivers that favor microfinance institutions' integration? The aim of this paper is to identify the drivers that could increase the financial integration of microfinance institutions with commercial banks. One advantage of financial integration through the interbank market is an increase in the amount and volume of loans granted at lower related costs. The main channels that impede these favorable financial transactions are an increase in competition to supply bank loans, a reduction in costs for external funding for banks and a great diversification of risks.
The sample set used to identify these drivers is the panel dataset of 953 MFIs from the MIX market dataset and country-level data from the World Bank dataset, both collected for the 2003-2016 period. To achieve our goals, we applied a panel quantile approach with nonadditive fixed effects, which helped to organize our microfinance institution sample into subgroups with similar financial integration levels. One of the advantages of estimating a quantile model is its technical ability to reveal distributional effects that can be significantly different across quantiles. This econometric approach is an innovative one applied for microfinance analyses.
The results reveal that an increase in financial development slows the financial integration of MFIs. However, by taking into consideration the transitory aspect of financial integration by each quantile, it appears that financial development positively impacts the financial integration of MFIs. The impact of financial development increases as the financial integration level increases. Similar results show a positive link between agency costs and financial integration. More financial interconnections with commercial banks justify the appearance of high agency costs due to an increased interest of commercial banks. The conflicting interests of commercial banks as loan providers will obstruct holders of internal funds. As a result, MFIs may have difficult fulfilling their objectives by taking into account the role played by financial integration. Our results clearly show that MFIs with low profit levels will interact more with commercial banks by demanding loans. There is a significant and negative link between the profitability of MFIs and their financial integration. Moreover, increasing the average amount of loans, the burden of which is mainly borne by better-off clients, induces a significant increase in financial interactions between commercial banks and MFIs. Finally, an increase in the number of active borrowers significantly increases the degree of financial integration.

Keywords: Financial integration, Microfinance, Financial development, Agency costs.