

Do Institutions Matter For Microfinance Profitability? Evidence from Africa

Muriu, P

Date: 2013

Abstract

There have been profound changes in both political and economic institutions in Africa economies over the last 20 years. These changes vary from one country to another. This study contributes to the literature on microfinance profitability by examining whether profitability depends on the institutional environment of the host country. System GMM Estimator in Dynamic Panel Data Models is applied to determine the extent to which institutions affect microfinance profitability. We test the robustness of the models with different specifications that confirm the general result. Our estimation shows that microfinance profitability is non-negligibly driven by the surrounding institutional environment. Specifically, the results indicate that on average, microfinance institutions (MFIs) are more profitable when there is political stability. Upon interaction with MFI age, we show that political stability may make it more conducive for young MFIs to form relationships with reliable new borrowers. Rule of law is associated with greater MFI profitability while corruption makes it harder for MFIs to realize profits, irrespective of age. Well developed institutions may therefore make it less costly for MFIs to operate in a fully compliant way. Based on the study findings, it is prudent that policymakers prioritize institutional reforms that are critical for microfinance development in Africa.