Research Note N°3 on Microfinance Regulation

Industry Self-Regulation and Microfinance: Exploring Key Issues through the Case of TAMFI in Tanzania[1]

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Regulation is now considered as essential to bring microfinance institutions to formalization and to protect clients. Yet, most studies investigating regulatory issues focus on formal regulation, namely laws, or on the way other forces, just like competition, influence the market. This note presents the key findings of a research exploring a third regulatory mode: industry self-regulation and the role played by professional associations. Through a case study based on the Tanzanian microfinance association, this research draws conclusions on factors that may favor or restrain the potential of such organizations to contribute to the general regulatory framework.

While little attention was paid to regulating microfinance institutions (MFIs) when the industry emerged, regulators now seem to make consensus on the idea that regulation is essential to both bring MFIs to formalization, and to protect clients. Many studies have come up recently on both the use of formal types of regulation (laws), and on market dynamics that may influence MFIs' behavior (competition, typically). Yet, the industry has still gone through severe crises, and doubts and critics regarding multiple issues.

On the one hand, the literature showed that inappropriate or maladapted regulation may lead to no improvement of performances or, even, destabilize the industry (Guérin et al., 2018). On the other hand, some authors explained that competition may, in certain circumstances, jeopardize MFIs' contribution (Karimu et al., 2019).

This note presents a research exploring a still under-covered topic: industry self-regulation and professional associations of MFIs. Through a thorough case study carried out at the Tanzania Association of Microfinance Institutions (TAMFI), this research investigates the following question: *what are the key elements that may favor or restrain the contribution of such organizations to the general regulatory system?* This note introduces the key findings of the research.

Industry self-regulation?

While "regulation" often relates to the definition of rules by authorities, any organization may actually define and apply its own rules, this way practicing "self-regulation". At an industrial level, self-regulation may thus be described as the association of organizations willing to control their collective action by setting, monitoring, and/or enforcing rules or norms (Omarova, 2010). In practice, this typically goes through codes of conduct or other channels.

Self-regulation and microfinance: what do we know?

Developing countries often suffer from weak regulation, and lack of information and management processes to regulate an industry such as microfinance, where there is typically a plethora of diverse actors to control. In this context, associations have been more and more active regarding the definition and dissemination of good practices

[1] The views expressed in this note are those of the author and not necessarily those of ADA. For more details on this research, please contact directly the author at tristan.caballero-montes@umons.ac.be.

in the sector. They have also been essential as mediating structures between MFIs and authorities, to contribute especially to make consumer protection "voluntary-driven", rather than "compliance-driven", and to pass values such as transparency or client centricity that should be incentivized rather than constrained (Coetzee, 2019). Yet, few studies have dug the questions related to self-regulation in microfinance, even less at the industrial level.

Although MFIs seem to integrate better than commercial banks concepts such as common goods, engagement, integrity, or transparency in their codes of practice (Kleyjans & Hudon, 2016), the literature has so far shown that key obstacles remain when it comes to self-regulation and microfinance (Dayson & Vik, 2014; Afonso et al., 2017):

- *Accounting for microfinance diversity*. MFIs present main differences of size, target, mission, funding, costs structure... Self-regulation may be relevant in such industry, but to what extent?
- *Self-regulatory schemes may lack clear standards and metrics* to encourage and judge MFIs progress.
- *Enforcement is key to make sure rules are applied*, but most schemes are voluntary, and do not have the force of law.

While the literature suggest that these critical points remain obstacles for self-regulation at the MFI-level, an association of MFIs may have more strength for developing an efficient self-regulatory mechanism. This case study, as an exploratory research, investigates some of the above issues.

A Tanzanian case study

Through an inductive research using the *Grounded Theory Method*, 17 interviews were carried out with key actors of the Tanzanian microfinance industry, including: CEOs or top managers of MFIs; representatives of the Bank of Tanzania and TAMFI; partners of TAMFI; investors interested in the local market; and local experts. The fieldwork was also the opportunity to benefit from constant observation, as based at TAMFI.

The Tanzanian sector has long been unregulated. This has led to the proliferation of MFIs with a certain lack of professionalism, performance, and customer centricity. Since 2001, TAMFI aims to be a member-driven association facilitating the creation of an enabling environment for the development of Tanzanian MFIs. Among its missions, the association especially aims to link MFIs to regulators, and defend the interests of the sector. In 2010, it created a code of conduct applying to its 152 member MFIs to define and disseminate good practices. The findings below highlight key aspects and obstacles that may potentially favor or refrain an association from developing an efficient framework.

Key conclusions drawn from the Tanzanian case

These findings are structured according to 3 main "levels": the organizational-level, industrial-level and the relationships between TAMFI and its external partners[2].

- *Tensions manifesting in the organizational functioning of TAMFI*. TAMFI members are very diverse, at the image of the sector. This may pose two main issues. First, this may be perceived as a lack of coherence, as basically any institution somewhat related to microfinance can be part of the association. Second, although such heterogeneity (in terms of size, targets…) may be an advantage, especially for knowledge sharing, it may also lead to distinct interests and difficulty for TAMFI to represent the whole market for different motives. Other aspects relate to the organizational dynamic running TAMFI, the geographical disparity, the personification of the association, and the voluntary character of the code.

[2] These points are main aspects. Appendix 1 shows more items. Contact the author for more details.

- *Key factors manifesting in the relationships between TAMFI and its members.* A positive element that emerged is that most MFIs seemed aligned on the mission that TAMFI carries, which links members together. Yet, it was also noted that informational asymmetries between TAMFI and its members may jeopardize the relevance as well as internal and external credibility of the association.
- *Tensions manifesting in the relationships between TAMFI and external partners*. At this level, a key challenge emerged and relates to the ability to combine TAMFI members' interests and objectives, with external partners' (and funders') agenda. Partners/funders have indeed their own agenda that they need to achieve. Yet, some markets, just like the Tanzanian one, may require, prior to their agenda, to focus on capacity building activities allowing to develop, then, further objectives. Making sure that objectives do not mismatch is key, so that MFIs get an efficient support and see the association as relevant to their operations.

Appendix 1 provides a structuration of the findings described above, and the anchorage of these findings on concrete items coming directly from the interviews. It also shows additional aspects. All in all, it allows to understand better some of the key issues and critical factors that should be tackled by a microfinance association willing to define and disseminate rules, norms or values, as part of a self-regulatory scheme.

Acknowledgments

The author thanks *Appui au Développement Autonome* (ADA) for the essential support provided for carrying out this research. The author also thanks the *Fonds pour la Recherche en Sciences Humaines* (FRESH) that enabled this research to be developed.

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Appendix 1. Architecture of the findings