The Structure of the Microfinance Market and Its Adoption to the EU Accession: A Comparative Empirical Study for Western Balkans

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Abstract: *The objective of this paper is to examine the microfinance market structure and its adoption in the EU accession in Western Balkan Countries (WBCs). This objective is pursued by employing survey data from 31 MFIs operating in WBCs. The survey aims to assess MFI's representatives' views on competition policy, measure surveillance, identify influencing factors of firm performance, and recognize institutional challenges. The findings show the microfinance market remains transitional with various difficulties that need to be addressed. The study gives a contribution to the existing literature by filling the gaps in the microfinance market in WBCs and making a comparative analysis. Policymakers, stakeholders, and researchers can based on the paper's findings, recommendations, and future research directions for further sustainable improvement of the microfinance market in the WBCs.*

1. INTRODUCTION

The purpose of this paper is to examine the microfinance market structure in the Western Balkan region and its adoption in EU accession. The motivation originates from the lack of knowledge in the existing literature and to further investigate this post-communism region which still is in economic and political transitions.

The microfinance literature documents that microfinance, despite its seemingly minor nature, has significant effects, with roots in East Asia and Europe dating back to the eighteenth century (Bika et al., 2021). Microfinance is widely known for alleviating poverty and boosting regional wealth, by offering capital to the poor and the financially excluded who face a lack of collateral from main financial institutions like commercial banks (Chikwira et al., 2022). Consequently, compared to the loans offered by main financial institutions, these loans are smaller. MFIs face challenges like the absence of formal records and some of them operate in under-developed law and property rights systems countries that as a result, make difficult loan recovery via the court system (Lieberman, 2020; Suesse & Wolf, 2020; Terberger & Winkler, 2021). Henceforth, it intimidates their sustainability.

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The Western Bakan region faces a lack of knowledge and available data is limited. So, the main questions of this paper are, how can the microfinance market adapt to EU laws and regulations? What are the challenges faced by MFIs in WBCs?

This paper seeks to contribute to the research of the microfinance market sector and its adoption in EU accession by conducting a comparative analysis of MFIs in the Western Balkan region. To the best of our knowledge, no investigations have been done to examine its structure and its adoption in EU accession. This paper attempts to bridge the knowledge gap. In doing this, the paper employs original survey data and conducts a comparative analysis of MFIs in the Western Balkan region. By critically analyzing the literature and conducting a comparative analysis, this study aims to offer novelty findings within the microfinance sector in the Western Balkans region.

The rest of the paper follows this order. The next section presents the literature review. The methodology section follows. Next is the result section. The final section presents concluding remarks.

2. LITERATURE REVIEW

Several studies have investigated the structure of the microfinance market and its shaping factors. The literature abounds with factors that influence this market. Regulatory frameworks and policies are one of them. However, their role is heterogeneous. Mia (2018), Navin and Sinha (2019), Aguilar and Portilla (2020), emphasize that the regulatory and policies environment drives the microfinance market positively, while (Alper et al., 2020; Parvin et al., 2020) report negative effects such as the rise in the interest rates that MFIs charge in their microcredit services and the need of their control. Market demand is another influencing factor. It helps in the needed product design and reaching out to the targeted population. Generally, the studies that have investigated this relationship have reported some positive effects (Karugu et al., 2020; Pati, 2019). The institutional factors' impact is considered as mixed. As part of it, the efficiency wage (Mia et al., 2023) is positive for large MFIs that aim to attract skilled staff, and negative for small MFIs as it strains financial resources and decreases overall efficiency and sustainability. The number and types of MFIs in the market, determine the level of competition. In recent years in developing countries, the competition level has increased due to the rise of both MFIs types, development-oriented MFIs and commercial-oriented MFIs (Bateman, 2018). This increase brings both positive and negative effects. Karimu et al. (2021) emphasize higher competition as positive as it brings a decrease in prices of products with lower cost of production, higher output, and welfare improvement. On the other hand, (Bateman, 2018) reports that higher competition is unhealthy, as long as it takes unnecessary risks and overall business strategies that bring risk exposure.

Other studies have considered additional factors such as economic environment and social context regarding this relationship. Ashraf et al. (2022) focus on the economic environment and social context of MFIs' locations. The study uses a sample of 2,064 MFIs from 94 states, from 2007-2018. Findings show the key role of the factors and report that countries with higher socio-economic freedom, bring superior environmental, social and governance integration. Appietu et al. (2021) use qualitative and quantitative data collected from the top five MFIs in Ghana. The study results show that economic and social support has a significant impact on MFIs along with the overall structure of microfinance. It advocates the need for government intervention and fair policies.

This paper seeks to contribute to the microfinance market structure and its adoption to EU accession by conducting a comparative analysis of MFIs in the Western Balkan region. What is the current

situation of the microfinance market in WBCs? Microfinance flourished in WBCs post-1990s economic and political transitions, meeting the demand for financial services among previously excluded communities (EIB, 2019). Over the past years, the microfinance market has grown (EIB, 2019), with MFIs providing tailored services to minority groups, microenterprises, and individuals with limited resources. MFIs in WBCs span diverse nations, each with unique industries shaped by legislative frameworks, economic development stages, and financial systems (EIB, 2023). A good reference is the study (Smolo, 2023), which explores and finds a positive impact of the microfinance market and its institutions on the economy of Bosnia and Herzegovina by analyzing quantitative data from 2010 to 2022. MFIs in WBCs are still in a developing phase and are mainly influenced by socioeconomic, cultural and institutional factors. Adhering to EU regulatory standards during the accession process enhances credibility and access to international funding (Battaggia, 2021). However, MFIs encounter substantial challenges in achieving their potential and effectively serving consumers (Milana & Ashta, 2020), as there exist limited and costly financing options, a complex and fragmented regulatory framework, and a lack of regional regulatory harmonization (Battaggia, 2021).

This paper seeks to contribute to the microfinance market structure and its adoption to EU accession by conducting a comparative analysis of MFIs in the Western Balkan region. To the best of our knowledge, not much investigation has been done to examine the structure of the microfinance market and its adoption in EU accession. This paper attempts to bridge the knowledge gap. In doing this, the paper employs original survey data and conducts a comparative analysis of MFIs in the Western Balkan region. This brings also the novelty of our paper.

Table 1 shows an overview of the microfinance market structure in the WB region. It focuses on key points such as EU membership status, number of competitors, type of ownership, competition ratio, country competitiveness index, adaption phase in EU competition law and the regulator actor along with the competition agency. The national competitiveness indexes are retrieved from WB's Global Competitiveness Index (GCI) for 2019, the latest year with available data. All the information is based on the country's central banks, competition agencies and official national websites.

Table 1. Microfinance market structure in WBCs

WBs	EU Membership Status	Nr. of competitors	Type of Ownership	Competition degree/ratio	Country competitiveness, Index/score/rank	Adapting to EU competition law in the market	Regulatory actor and competition agency
ALBANIA	Candidate	Large	Franchise + Private and Public institutions	Monopolistic competitive / Perfect competitive	57.61 points in 2019	NA	BoA – Bank of Albania & ACA –Albania Competition Authority
NORTH MACEDONIA	Candidate	Large	Franchise + Private and Public institutions	Monopolistic competitive	57.33 points in 2019	No progress	NBRM – National Bank of the Republic of North Macedonia & CPC –Commission for Protection of Competition

MONTENE-GRO	Candidate	Large	Franchise + Private and Public institutions	Monopolistic competitive	60.82 Points in 2019	Some progress	CBCG – Central Bank of Montenegro & APC –Agency for Protection of Competition
SERBIA	Candidate	Large	Franchise + Private and Public institutions	Monopolistic competitive	60.85 points in 2019	Some progress	NBS – National Bank of Serbia & CPC –Commission for Protection of Competition
BOSNIA AND HER-CEGOVINA	Candidate	Large	Franchise + Private and Public institutions	Monopolistic competitive	54.73 points in 2019	NA	CBBH -Central Bank of Bosnia and Herzegovina & Council of Competition
KOSOVO*	Potential Candidate	Large	Franchise + Private and Public institutions	Monopolistic competitive/ Perfect competitive	-	Some progress	BQK – Central Bank of Republic of Kosovo & Competition Authority

* Kosovo - Under the UN Resolution 1244.

Source: Own research

3. METHODOLOGY

3.1. Theoretical Framework

This paper applies the theory of Industrial Organization (IO) to the microfinance sector as it aids in comprehending the dynamics of MFIs and their broader market structure. This theory studies how firms operate within markets and includes key concepts such as market concentration, degree of product differentiation, market performance, barriers to entry, and market conduct (Mburu & Namusonge, 2023; Oikawa Cordeiro, 2020). This theory is applied to the microfinance market of WBCs case, based on the obtained survey results. Figure 1, shows the retrieved results for this case.
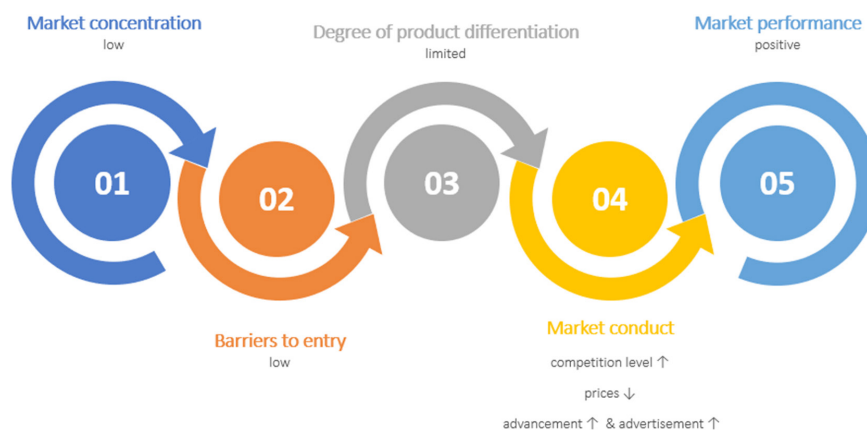

Figure 1. Application of IO theory on MFIs in WBCs
Source: Own processing

3.2. Data

The study utilizes data (2022-2023) from 31 private and public MFIs across the WB region. Notwithstanding, it is a primary data collection from an online survey distributed to MFI representatives. Using this purposive sampling approach, 31 valid responses (after data cleaning and preparation) are retrieved from all the WBCs except Serbia. The analysis part includes descriptive statistics, a T-test, an ANOVA test, a crosstabulation analysis and a correlation matrix.

Table 2. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
EU membership status	31	1.00	3.00	1.2903	.69251
Microfinance institution's progress	31	1.00	3.00	1.9032	.94357
Helpfulness of the government	31	1.00	4.00	2.5806	.76482
Valid N (listwise)	31				

Source: Own calculations

The descriptive statistics of the data are reported in Table 2. It highlights three key factors. The mean of the EU membership status is 1.29, which shows that MFIs are in the process of applying, or their preliminary status. Its standard deviation is 0.69 and reports that there exists a moderate variation between MFIs in terms of their EU membership status. The mean of MFI progress is 1.9, which shows a moderate level of progress, likely in financial performance, outreach, or client impact. Its standard deviation is 0.94 and highlights a notable variability in their progress. The mean of government helpfulness is 2.85 and shows a moderately positive view in the support of government or providing facilitating services. Its standard deviation is 0.76 and reports that opinions regarding it depend between surveyed MFI representatives.

Table 3. ANOVA test of differences in the mean level of adaptation of the microfinance sector to the EU law and regulations by countries

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Albania	12	1.9167	.99620	.28758	1.2837	2.5496	1.00	3.00
Kosovo*	11	1.9091	.94388	.28459	1.2750	2.5432	1.00	3.00
Montenegro	2	2.5000	.70711	.50000	-3.8531	8.8531	2.00	3.00
North Macedonia	2	2.0000	1.41421	1.00000	-10.7062	14.7062	1.00	3.00
Bosnia and Herzegovina	4	1.5000	1.00000	.50000	-.0912	3.0912	1.00	3.00
Total	31	1.9032	.94357	.16947	1.5571	2.2493	1.00	3.00

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	1.384	4	.346	.355	.838
Within Groups	25.326	26	.974		
Total	26.710	30			

* Kosovo-Under the UN Resolution 1244.

Source: Own calculations

Table 3 shows the ANOVA test that aims to check if there are significant differences among countries regarding the adaptation of the microfinance sector to the EU accession. The results show that there are no statistically significant differences between the states due to the p-value being greater than .05 (p > .05). The highest average is obtained from Montenegro with a mean of 2.5.

Table 4. T-test of mean differences in adaptation of the microfinance sector to the EU law and regulations according to the type of products

Group Statistics					
	Type of products	N	Mean	Std. Deviation	Std. Error Mean
Microfinance institution's progress	Both financial and non-financial products and services	6	1.8333	.98319	.40139
	Only financial products	25	1.9200	.95394	.19079

Independent Samples Test										
		Levene's Test for Equality of Variances		t-test for Equality of Means						
									95% Confidence Interval of the Difference	
		F	Sig.	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	Lower	Upper
Microfinance institution's progress	Equal variances assumed	.116	.736	-.199	29	.844	-.08667	.43599	-.97836	.80503
	Equal variances not assumed.			-.195	7.435	.851	-.08667	.44442	-1.12521	.95188

Source: Own calculations

Table 4, shows the T-test that aims to examine significant differences among product types and the sector's adaptation to EU regulations. No statistically significant differences exist between product types, since the p-value is greater than 0.05 significance level (t = -.199, p ≥ .05). Different from what was expected, the findings report a higher adaptation rate for "only financial products" (M = 1.92, sd = .95) compared to "both financial and non-financial products and services" (M = 1.83, sd = .98).

Table 5. Years of operating * Type of digital solutions Crosstabulation

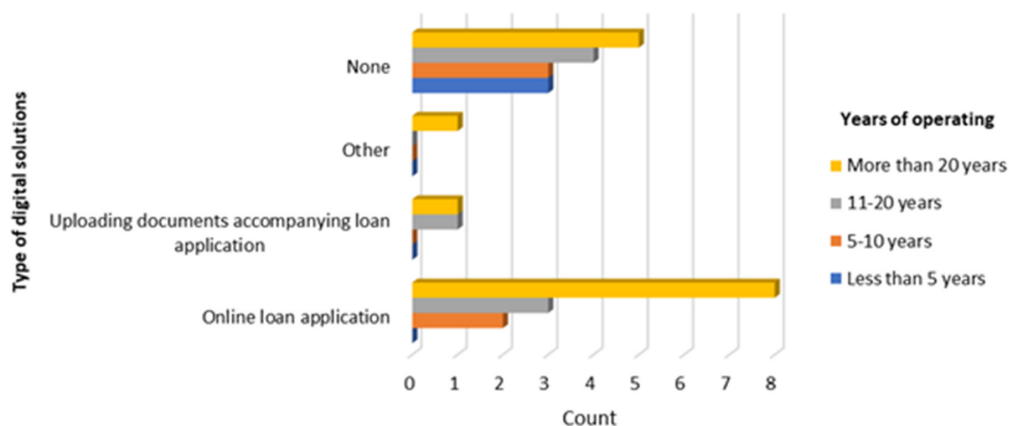|		Type of digital solutions				
		Online loan application	Uploading documents accompanying loan application	Other	None	Total
Years of operating	Less than 5 years	2	1	0	5	8
	5-10 years	0	0	0	3	3
	11-20 years	3	0	0	3	6
	More than 20 years	8	1	1	4	14
Total		13	2	1	15	31

Source: Own calculations

Table 5, shows a crosstabulation analysis between the years of operating and the type of digital solutions of their respective MFIs. This type of analysis is beneficial since it identifies relationships and helps in insight generation. The selection of the "none" option is each alternative of years of operation, reports an issue of not owning any digital solution and should be properly considered by policymakers.

Figure 3, shows a graphical representation of a correlation matrix generated through Power BI that focuses on depicting the governmental support for EU accession among WBCs, alongside the number of participating institutions. Responses are scaled from 1 to 5, with Kosovo's* rating
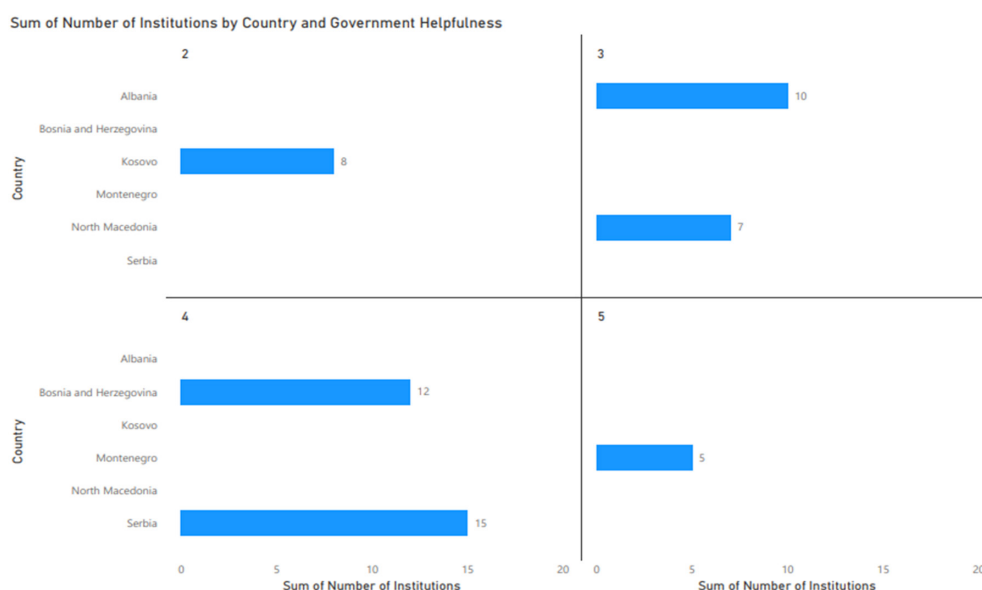
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*   Under the UN Resolution 1244.

at 2, Albania and North Macedonia at 3, Bosnia and Herzegovina at 4, and Montenegro at 5. This correlation matrix shows governments' proactive measures to assist and sheds light on public perception of these efforts.

Figure 2. Years of operating & Type of digital solutions Crosstabulation
Source: Own processing

Figure 3. Correlation Matrix
Source: Own processing

As the survey is conducted with a focus on learning more about MFIs in WBCs, the retrieved findings lead to a more comprehensive framework. Data reports that NBFIs and NGOs dominate the market, with a presence of more than 20 years. With NBFIs as the oldest and cooperatives as the youngest, they generally, are offering only financial products which mostly include business loans and personal income. Despite providing online loan applications, over half of MFIs lack digital solutions. The competition is still in the evolving phase and faces many challenges that need to be addressed by policymakers. Additionally, inadequate capacity building, regulatory mechanisms and limited funding access are considered to be the main challenges of MFIs. These findings may be similar to the survey report on microfinance in Europe (Pytkowska, 2020), which focused (2020-2021) on 156 MFIs across 30 countries. However, there are some differences among the studies' findings like the provision of financial and non-financial products, owning various digital solutions and cooperatives to be the youngest in this market. The rest is the same.

4. FUTURE RESEARCH DIRECTIONS

Future research should prioritize longitudinal studies to investigate the long-term impact of EU accession on microfinance advancements and its broader socio-economic impacts in the WBCs.

5. CONCLUSION

MFI's role consists of providing financial and non-financial services to those at the bottom of the economic pyramid and conducting it in a sustainable financial approach. However, the regional factor is a key component when discussing it, as it makes the difference. This paper attempts to bridge the knowledge gap for the WB region, which lacks information and data. In doing this, the paper employs survey data (2022-2023) from 31 private and public MFIs across the WB region. The formation and distribution of this survey is one of the unique points of this paper. Data is retrieved from all the WBCs except Serbia, due to no responses. The existing literature is facing a lack of knowledge regarding the microfinance structure and based on our knowledge there is no available information on it for the whole WB region. This represents the main contribution of this paper by analysing this market, considering the region (not by country separately), and its adoption of EU accession. One of the critical questions that flows from this study is, what are the challenges faced by MFIs in WBCs? It is notwithstanding, that MFIs of this region differentiate a lot compared to other ones. Surely, there are various factors affecting (socioeconomic, political, regional) as discussed above in the literature section. The survey data reports a lack of digital solutions, inadequate capacity building, regulatory mechanisms and limited funding access. This is directly related to the second critical question of how can the microfinance market adapt to EU laws and regulations? Considering these challenges, it is difficult for MFIs to meet EU accession demands. There exist improvements compared to the previous years, but still are limited and insufficient. In conclusion, it is essential to invest in the microfinance sector and achieve its alignment with EU standards and practices. EU's support and targeted national policies have the potential to significantly have a positive impact on this market.

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