

The Performance of Microfinance: Which Institutional Factors matter?⁴⁸

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Abstract

The paper aims to answer in general "Which MFIs perform better in terms of efficiency and sustainability in particular institutional environment?" and in particular some specific questions:

- i) Which institutional factors are important for an MFI to be efficient?*
- ii) Which MFIs with specific institutional factors are more sustainable and have better outreach? The institutional factors deemed important relate to the institutions' status i.e. NGOs, Bank, Non-banking financial institutions (NBFIs), Rural Banks and cooperatives; lending methodology i.e. Individual, Group, individual+group and Village; regional institutional factors i.e. Asia, Africa, Latin America, East Asia and Middle East; saving features; regulated and Other services providers.*

The paper follows the Yaron's criteria of sustainability and outreach as proxy for evaluating the MFIs performance. Non parametric and parametric analysis have been carried out to investigate the impact of institutional factors on the performance of MFIs. Using data of 204 MFIs taken from the audit reports and Mixmarket website, the paper employs non parametric efficiency technique to estimate the financial efficiency. Further an empirical evidence by employing panel regression analysis has been carried out to determine the impact of institutional factors on the efficiency and sustainability of Microfinance.

The impact of institutional factors on the sustainability of microfinance is relatively a neglected area. From policy perspective, valuable lessons can be drawn for the entire stakeholder in microfinance industry on the basis of this research work. For microfinance practitioners, it serves as a performance evaluation guide to enhance the efficiency and in specific institutional environment. From private investor's perspective, it identifies MFIs with sound institutional environment which are successful in achieving sustainability and efficiency. For academics and researchers, this research opens a new avenue of research by bringing the institutional factors at forefront in their performance evaluation.

This cross country empirical study takes on the impact of institutional factors on the financial performance of MFIs and thus adds to the existing literature on the importance of institutional factors in the sustainability of microfinance.

Introduction

Microfinance promises not only poverty reduction but also financial self-sustainability. After four decades into the business this promise is yet to be fulfilled despite recent surge for commercialization of microfinance⁴⁹. Traditionally the performance of MFIs has been measured using either the welfarist or the institutionalist approach. The former put emphasis on assessing the impact on the welfare of the poor while later argues for the

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⁴⁸ The paper is drawn from my doctoral thesis titled "Issues in the sustainability of Microfinance" written at the University of Goettingen, Germany.

⁴⁹ See for example, Armendáriz de Aghion and Jonathan Morduch (2004, 2005); Morduch (1999a); Morduch (1999b); Goodman (2005); Cull et al. (2007)