EFFICIENCY IN NEPALESE MICROFINANCE INSTITUTIONS

1. OVERVIEW

Globally, microfinance industry is evolving quite rapidly. With the rapid spread of best practices principles of microfinance service delivery, increasingly large numbers of institutions are providing micro-finance services with an increased emphasis on sustainability and profitability. Market for microfinance is evolving with increased competition, client sophistication and demand for varied services. Nepalese microfinance movement is imminent to global microfinance development.

Government's attempt to promote microfinance services in Nepal dates back 1975 that commence with the design and implementation of Small Farmer's Development Programme (SFDP). Government recognized microfinance as official poverty alleviation programme only in the Sixth Plan (1980/81-1984/85). Programmes to ensure that poor and particularly poor women and disadvantaged group who traditionally lack access to financial services from formal sector must acquire such services is designed and implemented. Government, semi-government, semi-government and non-governmental organizations are involved in the provision of financial services then after. Nepalese microfinance sector gained momentum after the restoration of democracy in 1991.

Efficiency is one of the pre-requisites for microfinance industry. This has added significance in the context of various commercial and social pressures under which Nepalese microfinance institutions (MFI) should be exposed in the year to come. Efficiency is the function of an institutions ability to utilize inputs or available resources (total administrative or non-financial costs as proxies) to maximize its output (average gross portfolio). Commercialization of microfinance requires increased market penetration and improved profitability, one of the issues related to efficiency. Improvement on efficiency is required to address on social mission of microfinance to the extent that it permits MFIs to reach further down market and/or pass on cost savings in the form of lower interest rates.

Issue of microfinance efficiency has remained to be one of the topics of academic and professional concern among Nepalese microfinance promoters and practitioners. It is commonly argued that Nepalese microfinance industry is inefficient mainly due to followings.

- Many MFIs are not able to fully exploit economics of scale required to maximize efficiency and there are many small MFIs serving too few clients to operate efficiently and
- MFI operates in non-competitive environment with little pressure on efficiency improvement.

Moreover, most Nepalese MFIs do not adopt even most fundamental operating principles on efficiency maximization. The framework conditions under which these MFIs emerged and are currently operating lack enabling environment to maximize efficiency. In this paper, efficiency of some selected[1] MFIs is assessed and factors affecting MFIs' efficiency are identified. The information used in this report was obtained from various sources[2].

[1]The MFIs considered for study are one Western Grameen Bikas Replicators (WGBR), four Small Farmer's Cooperative Limited (SFCLs) and four Savings and Credit Cooperatives (SCCs)

[2]The author is highly indebted to Center for Microfinance, Canadian Center for International Studies and Cooperation (CECI) and Rural Finance Nepal (RUFIN) Partner for Sustainable Financial Services in the Countryside Project for providing financial statement of MFIs they are working with.

This paper is organized into seven sections. After this introductory section, section two provides an overview of Nepalese financial sector. A review of Nepalese microfinance sector is provided in section three while the conceptual framework on efficiency in microfinance is provided in section four. Section five presents and analyses empirical results on current state of efficiency of Nepalese MFIs and factors affecting MFIs' efficiency is discussed in section six. The paper concludes with summary and recommendations in section seven.

2. NEPALESE FINANCIAL SECTOR

Like in other countries, the financial sector in Nepal consists of formal and large informal sector. Both formal and informal sector co-exists in rural financial markets, each providing financial service to large number of clients.

The size of the informal financial market is very high. The informal market consists of either non-commercial or commercial sources. In commercial segment, there are input dealers, crop buyers, landlords and moneylenders that extend lending services using collateral. The non-commercial sources consist of traditional institutions like Dhikuti, Guthi, Dharma Bhakari where friends, relatives and neighbors, extends loans at much lower interest and without collateral.

The Nepalese formal financial sector is small but quite complicated. Table 1 provides information on number and type of institutions operating in Nepalese formal financial sector.

Table 1: Structure of Nepalese Formal Financial Sector

S.N.	Type of formal financial institutions	Number
1	Nepal Rastra Bank (NRB), central bank of Nepal	1
2	Commercial Banks	14 (including 2 state owned)
3	Development Bank	8
4	Grameen Bank Replicators (GBR)	5
5	Finance Companies	48
6	Small Farmer Cooperatives limited (SFCL)	10
7	Savings and Credit Cooperatives (SCCs)	25
8	Financial intermediary NGOs	10

Source: Gorkhapatra, December 22, 2000.

Additionally, not licensed but involved in providing microfinance services are a further 69 SFCLs, 346 SFDP Units, at least 801 SCCs, about 250 NGOs and more than 11,000 Savings and Credit Organizations (SCOs) in various form. At July 2000, there were over 4,349 primary co-operatives and 82 district co-operative unions registered with Department of Co-operatives. These cooperatives also extended financial services to members in the past for agricultural inputs and marketing. As at July 2000, commercial banks and the Agriculture Development Bank of Nepal (ADBN) were responsible for 90.4 percent of total lending and 97.8 percent of agriculture sector lending. Of the balance, GBBs and GBRs have the largest share followed by SCCs and SFCLs.

Formal sector provides microfinance services through mandated government programs. These institutions implement government microfinance programs often with technical and financial support from international donors. The NRB provides capital to NGOs and GBBs for

onlending through Rural Self-Reliance Fund. The NRB also mandates commercial banks to lend directly to microenterpreneurs through Intensive Banking Program. Under NRB mandate, up to 12% loan portfolio of any commercial bank must be lent to priority sector borrowers. Of priority sector requirements (12%), up-to 3% must be lent either directly or indirectly as micro-credits to deprived sector people. NRB also supported the emergence and development of Rural Microfinance Development Center to provide wholesales loans to MFIs. The ADB/N is the specialized financial institution for agricultural and rural credit. It operates SFDP and Institution Development Program wherein SFDP are graduated to SFCL.

The two state owned commercial banks namely Nepal Bank Limited and Rastriya Banijya Bank have a large urban branch network and control over 60% of the deposit mobilised in Nepal. Their loans are primarily short-term in nature and the smaller ones are mostly for trade credit or social obligations, provided against hypothecation of gold and silver. These two banks also participate in the IBP of the NRB and also provided micro-loans to clients of the Production Credit for Rural Women and Micro Credit Project for Women Project.

3. MICROFINANCE SECTOR IN NEPAL

Microfinance sector in Nepal is apparently complicated. Overall structure of Nepalese microfinance sector is depicted in Fig. 1. Rural Credit Review Survey (1994) indicates that less than 10 percent households borrow from formal sector. There is a substantial unmet demand for credit and it is more in the hills and mountains. MFIs in remote hills and mountain neither have business linkages with higher level financial institutions nor have access to prudential regulation and supervision services. They are characterized by small loan sizes, small savings base and higher delivery costs. Limited outreach due to geographic and economic circumstances has resulted on concentration of intermediary NGOs and SCCs in accessible areas.

Micro-finance initiative is used as a key strategy for addressing problems on poverty and women's economic empowerment. It is primarily characterized by social service approach rather than business entity. Microfinance products are not designed to meet client's need and still exhibits supply-led phenomenon. Most I/NGOs has used microfinance services as an entry point activity for implementing social mobilization and community development programs. Outreach of micro-finance services is concentrated in accessible areas. In general, MFIs are losing money on micro lending due to poor repayment. This problem is mainly attributable to following:

- Credit is often viewed as short term phenomenon and project oriented,
- Government interventions are seen as subsidies,
- Clients are encouraged to over borrow,
- No margin are available for credit staff performance incentives,
- Credit services is unsatisfactory and mainly supply-led and
- Political interference is widespread and affecting MFI operation.

  Poor loan recovery, over-lending, poor services, credit subsidies and weak financial institutions are interrelated factors leading to inefficiencies on micro lending. Domestic savings mobilization and development of viable rural financial institutions are severely constrained. Very few MFIs appreciate costs and benefits associated in the delivery of their microfinance products. Due to limited outreach and poor financial management, most MFIs have difficulties on attaining sustainability over long term.

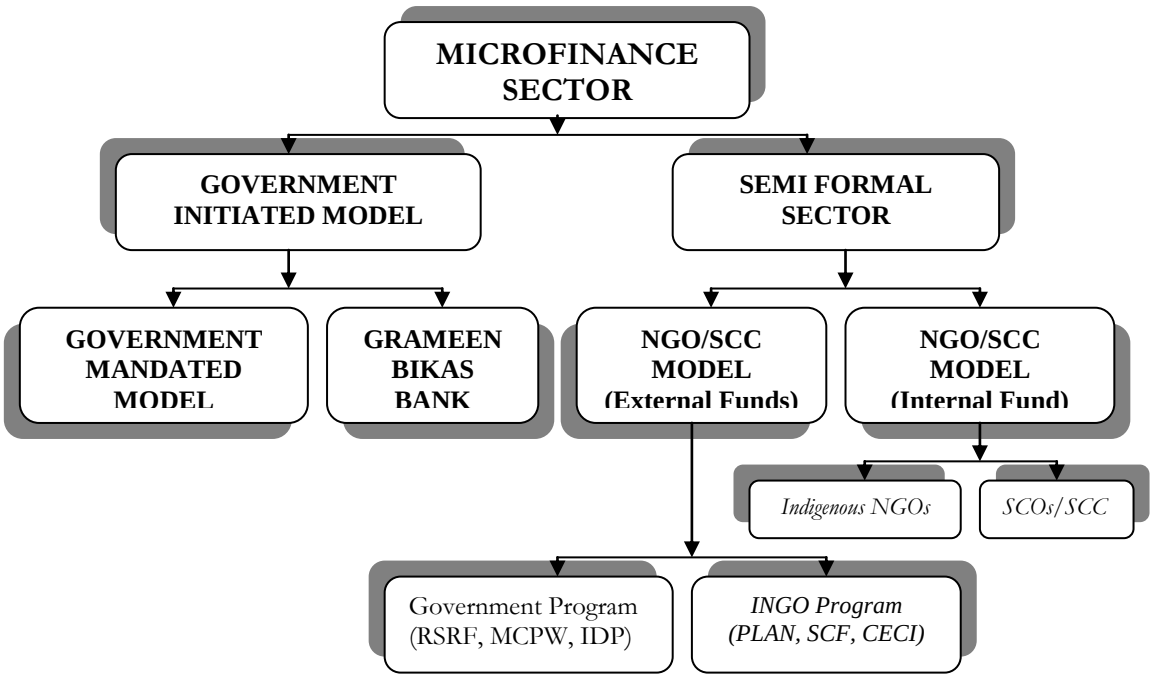

Fig. 1: Microfinance Sector in Nepal

MFIs provide little attention to accurately assess loan losses and corresponding reduced interest revenue. Financial viability is less likely due to substantial loan losses, low interest spread, lack of well-trained staff, small client base and inefficient delivery mechanism. High loan loss is mainly due to absence of credit discipline and "*ownership*" feeling among clients. The clients groups, who do not expect continued access to financial services, often, fail to repay their loans.

Microfinance sector is still subsidized in the form of capital for on-lending, meeting operational losses and technical assistance. For most MFIs, these subsidies are considered necessary for developing sustainable financial and social intermediation, particularly, for organizations working in remote hills and mountains while for other they are proved to be counterproductive on attaining efficiency and viability. Some MFIs continually rely on subsidies thereby impeding their ability to reach financial viability. Capable and well-behaved MFIs have access to adequate capital funds from NRB and RMDC.

Indigenous NGOs/SCCs operating using internal fund demonstrated to be sustainable MFIs. However, these MFIs have very limited outreach and lack access to capital funding. Mechanism to enable these MFIs to access such fund is lacking and this has been felt to be a prerequisite for expanding the frontier of microfinance in remote hills and mountains.

In some MFIs, there exist instance that most lending from "*internal funds*" is done at significantly higher interest rates than that of lending using "*external funds*". Repayment performance is better in lending using internal loans. Mostly MFIs do not allow members to withdraw their savings, resulting in substantially higher effective borrowing cost.

4. EFFICIENCY IN MICROFINANCE: A CONCEPTUAL FRAMEWORK

Efficiency is defined as the amount of outputs per unit of cost. Cost is the expenses recorded in the MFI's accounts along with any unrecorded expenses or implicit subsidies. Outputs of a MFI may be the amount of the loan portfolio or number of loans outstanding or number and amount of loans disbursed. *Productivity* is defined as the amount of outputs per unit of input. Inputs can be expressed in units like branches, credit officers, value of assets, etc. Thus evolution of productivity helps understand changes in efficiency that directly influences profitability.

Portfolio efficiency is the most critical indicator of efficiency and it is expressed as average portfolio outstanding per unit of cost. Portfolio efficiency, measured as ratio of outstanding portfolio with respect to costs can be expressed as product of number of loans per unit of cost (transactions efficiency) times average loan size.

Portfolio efficiency	=	Transaction efficiency x loan size
L/C	=	N/C * L/N

where L = Total portfolio outstanding, C = total cost and N = number of outstanding balances. Portfolio efficiency can be interpreted as the product of number of loans outstanding per unit of cost or of increases in loan size.

Increases in loan size dilute fixed costs over a larger outstanding balance. Transaction efficiency reflects improvements in physical productivity, that is, in number of transactions carried out at a given level of total expenditures. Increases in transaction efficiency can be achieved by several means, including a lengthening of average terms to maturity of outstanding loans. This allows fewer producers per outstanding balance over a period of time.

There are other proxies to measure MFIs efficiency. These are more direct and easy to monitor during their day to day transactions. Some of the proxies for MFI's efficiencies are the following.

The administrative expenses ratio: This is also known as operating expenses ratio and calculated as ratio of average administrative expenses to average gross portfolio. The ratio takes into account the amount of inputs, outputs, price and value.

The number of loans per credit officer: This ratio measures the productivity of the field staff. This reflects the institution's ability to streamline credit operations. For institutions that allow clients with strong credit records to borrow multiple loans concurrently, a more revealing measures is the number of clients managed by each credit officer.

The Outstanding portfolio per credit officer ratio: In combination with low staff costs, this ratio is a key indicator of financial viability. This also signifies the financial productivity of credit officers and this is an important determinant of loan revenues.

The ratio of loan offers to total staff: This is a proxy for institution's ability to allocate resources to its core business activity (i.e. lending). Remarkably, even in most efficient institutions fewer than half of staff members are credit officers. In fact, the ratio decrease as MFI matures signifying higher financial product management cost.

5. EFFICIENCY IN MICROFINANCE INSTITUTIONS: ANALYSIS OF FINANCIAL STATEMENT

Case studies were conducted on nine MFIs including one GBRs (WGBB), four SFCLs and four SCCs. Table 2 provides information on basis features of the MFI covered in the case study.

Table 2: Overview of the MFIs included in this Study

Microfinance Institutions	Financial Ratio (%)			
	Location	Estb. (Year)	Active clients	Members
Western Grameen Bikas Bank	Western Devt. Region	1995	26420	27512
Small Farmers' Cooperatives Ltd.				
♦ Prithivinagar	Jhapa	1996	1517	1517
♦ Uttarganga	Surkhet	1996	479	479
♦ Anandaban	Rupandehi	1997	580	580
♦ Dumarbana	Bara	1997	572	572
Savings and Credit Cooperatives				
♦ Navajagaran	Dadeldhura	1996	46	219
♦ Basulinga	Baitadi	1996	55	402
♦ Chandan-nath	Jumla	1996	83	369
♦ Sahoyagi	Bhaktapur	1992	42	109

Source: Financial statement of Concerned MFIs, July 2000

MFI included for analysis represents MFIs located in diverse geographical region. Efficiency of these MFIs is assessed on aspects related to finance, production and portfolio efficiency.

5.1 Financial Efficiency

Financial efficiency measures MFI's ability to attain operational and financial sufficiency. This is analyzed using ratios like return on average performing assets (APA), financial cost ratio, operational self-sufficiency (OSS) and financial self-sufficiency (FSS) – *See Table 3*.

Return on Average Performing Assets
Return on APA of these MFIs range between 14.8 and 30.7. Return on APA is more in SCCs, followed by SFCL and GBR. Return on APA is significantly lower than effective interest rate charged by WGBB (19%) and SCCs (24%). This indicates the prevalence of one or combination of following in these MFIs:

- Borrowers' inability to repay loans on-time,
- Misappropriation of loan recovered,
- Reporting inaccuracy and
- Low capital mobilization rate.

In contract, return on APA in SFCL is higher than average effective interest rate (16%) charged. This was possible due to their ability to collect past due and current interest income effectively. Return on APA is considered to be a high portfolio yield in view of interest rate charged and signifies the efficiency of SFCL to manage to past due accrual interest income.

Table 3: Financial Efficiency of the MFIs

Microfinance Institutions	Financial Ratio (%)			
	Return on APA	Financial cost	OSS	FSS
Western Grameen Bikas Bank	15.2	6.2	100.5	87.6
Small Farmers' Cooperatives Ltd.	16.8	9.2	147.5	144.2
♦ Prithivinagar	14.8	9.9	128.7	126.2
♦ Uttarganga	15.8	8.1	133.9	128.2
♦ Anandaban	20.9	7.7	203.7	202.2
♦ Dumarbana	18.6	9.3	156.5	151.2
Savings and Credit Cooperatives	20.9	8.9	144.1	128.0
♦ Navajagaran	25.1	4.1	230.2	131.8
♦ Basulinga	30.7	6.4	130.8	125.5
♦ Chandan-nath	19.8	5.6	230.4	213.5
♦ Sahoyagi	18.9	10.4	132.4	121.2

Source: Financial statement of Concerned MFIs, July 2000

Financial Cost

Financial cost is largest for SFCLs (9.2%), followed by SCCs (8.9%) and WGBB (6.2%). This indicates a relative imperfection on access to loanable fund to MFIs in Nepalese financial market. WGBB has opportunity to acquire financial capital for managing lending activities from cheap sources, mainly borrowing under deprived sector lending, while MFIs like SCCs and SFCLs devoid of such opportunity. Borrowing from ADBN is the only sources of fund to SFCLs while SCCs exclusive rely on deposit mobilization for managing loanable fund.

Operational Self-sufficiency

All the MFIs are operationally self-sufficient. OSS ratio is highest in SFCLs (146%) followed by SCCs (144%) and lowest in WGBB. WGBB have attained OSS level mainly due to their ability to manage loanable fund at cheaper rate.

Financial Self-sufficiency

Only SFCLs and SCCs are financially self-sufficient. FSS ratio is highest in SFCLs (144%) followed by SCCs (126%). This was mainly due to ability to operate these MFI under low equity base. WGBB is not financially self-sufficient. This is mainly due to significant cost involved on maintaining the value of equity.

5.2 Production Efficiency

Production efficiency relates to the MFI's ability to maintain their non-financial cost to a reasonable level. Some of the proxies for production efficiency assessment are ratios like operating cost to APA, salary cost to APA, loans per credit officer (CO), gross loan portfolio to credit officer and CO total staff ratio - *Table 4*.

Table 4: Production Efficiency of the MFIs Analyzed

Microfinance Institutions	Productivity Ratio				
	OC/APA (%)	SC/APA (%)	Loans/CO (No)	GLP/CO (Rs. '000)	CO/Total Staff (%)
Western Grameen Bikas Bank	8.9	6.3	186	1419	67
Small Farmers' Cooperatives Ltd.	2.1	1.3	244	3345	80
♦ Prithivinagar	1.5	1.0	303	4519	80

Microfinance Institutions	Productivity Ratio				
	OC/APA (%)	SC/APA (%)	Loans/CO (No)	GLP/CO (Rs. '000)	CO/Total Staff (%)
♦ Uttarganga	3.7	2.8	240	1869	67
♦ Anandaban	2.6	1.2	290	4001	67
♦ Dumarbana	2.6	1.6	143	2301	80
Savings and Credit Cooperatives	5.6	1.4	57	952	88
♦ Navajagaran	6.8	0.5	46	363	100
♦ Basulinga	17.0	6.1	55	456	100
♦ Chandan-nath	3.0	1.2	83	297	100
♦ Sahoyagi	3.9	0.8	42	2691	50

Source: Financial statement of Concerned MFIs, July 2000
Note: OC = Operating cost, APA = Average performing asset, SC = Salary cost, CO = Credit Officer, GLP = Gross loan portfolio

Operating Cost to Average Performing Asset Ratio
Operating cost to APA ratio is highest in WGBB, followed by SCCs and SFCLs. WGBB is not efficient in providing financial services due to high cost involved on social preparation and frequent supervision and follow-up. In contract, SFCLs had opportunities to learn from mistakes done during SFDP operation and SFCLs capitalize the lessons learned towards selling financial services efficiently. Further, both SFCLs and SCCs obtained start-up support and free technical advice from outside to set-up their operations.

Lending operations of SFCLs and SCCs are characterized by a relentless pursuit of efficiency. They adopt quarterly or half-yearly repayment cycle and loan monitoring visits are made only if there are signs of trouble. In SFCLs and SCCs, Board of directors (BoD) manages loans of good clients requiring little follow-up. BoD's involvement along with their constant supervision and follow-up, felling of ownership, constant attention on cost reduction and efficiency resulted in high productivity and low operating expenses. This phenomenon is almost non-existent in WGBB.

Salary Cost to Average Performing Assets Ratio
Salary cost to APA ratio has related with operating cost to APA ratio. This ratio is high in WGBB, followed by SCCs and SFCLs. Both SFCLs and SCCs work under low staff structure and are characterized by voluntary orientation of BoD towards managing financial services. This culture is almost non-existent among WGBB. Salary structure is high in WGBB than in SFCLs and SCCs. Higher salary cost to APA ratio in WGBB is partly due to lack of ownership among staff while member-based nature in SCCs and SFCLs including their higher accountability among shareholders enabled them operate in low salary cost. Further, this ratio has directly related to lending methodology. The lending methodology of WGBR insists on weekly repayment, demand weekly loan-monitoring visits and field staff's intensive involvement in every stage of operation. Constant efforts by committed local management to streamline lending methodology complemented by refined and job oriented technical backstopping support from outside enabled SFCLs and SCCs to undertake their transaction in an efficient manner.

Loans per Credit Officer
Loans per credit officer are highest in SFCLs, followed by WGBB and SCCs. One credit officer can manage more number of clients in SFCL than in WGBB mainly due to difference on lending methodology. Nevertheless, loan per credit officer ratio is lower as per best practice norms and standards in all three MFIs. Credit officers lack basic facilities to undertake monitoring and

supervision efficiently. Proximity of working areas along with high concentration of active loan clients has enabled SFCLs to attain higher loans per credit officer. Loans to credit officer ratio in SCCs are low mainly due to lack of market and being at the early stage of development.

Gross Loan Portfolio to Credit Officer Ratio
This ratio is highest in SFCLs, followed by WGBB and SCCs. This provides indication on credit officer's financial productivity. Credit officer in SFCLs are more productive compared to WGBB and SCCs. This ratio is the determinant of loan revenues and has bearing on viability. Simplified lending methodology and intensive approach adopted for expansion enabled SFCLs to achieve relatively high gross loan portfolio to credit officer ratio. In contract, this ratio is low in WGBB owing to complicated lending methodology and extensive approach adopted in expanding microfinance services. Despite adoption of intensive approach on expansion, gross loan portfolio to credit officer ratio is low in SCCs on the absence of sufficient loanable fund.

Credit Officer to Total Staff Ratio
Credit officer to total staff ratio is lowest in WGBB, followed by SFCLs and SCCs. This indicates the SCCs and SFCLs' ability to allocate resources to its core business activity (lending) fairly effectively compared to WGBB. Of the MFI analyzed, WGBB is quite mature with complicated management structure and this ratio seems a requisite for its overall management.

5.3 Portfolio Efficiency

Portfolio efficiency is a critical indicator for efficiency assessment. It is a function of loan size and transaction efficiency. As loan size increases, it dilutes fixed costs over a larger outstanding balance and transaction efficiency reflects improvements in physical productivity - *Table 5*.

Table 5: Portfolio Efficiency of the MFIs Analyzed

Microfinance Institutions	Portfolio Indicators		
	Loan size (Rs. '000)	Transaction efficiency	Portfolio efficiency
Western Grameen Bikas Bank	7.6	0.7	5.5
Small Farmers' Cooperatives Ltd.	16.1	0.5	8.6
♦ Prithivinagar	14.9	0.6	8.5
♦ Uttarganga	7.8	1.0	8.2
♦ Anandaban	13.8	0.7	9.7
♦ Dumarbana	16.1	0.5	8.2
Savings and Credit Cooperatives	16.8	0.3	5.8
♦ Navajagaran	7.9	1.1	8.4
♦ Basulinga	8.3	0.5	3.8
♦ Chandan-nath	3.6	2.2	8.0
♦ Sahoyagi	64.1	0.1	5.9

Source: Financial statement of Concerned MFIs, July 2000

Loan size
Loan size is a proxy of depth of outreach and this connotes MFI's success in overcoming difficulties of selling services to target clientele. Usually these difficulties are correlated with clients' poverty level. Average loan size of these MFIs ranged between Rs. 3600 and Rs. 64,100. It is more in SCCs, followed by SFCL and WGBB. This indicates WGBB ability to serve poorest of poor clients compared to SFCLs and SCCs. Given identical status of target clients, larger loan size contributes towards attaining efficiency.

Transaction efficiency
This is the indicator of physical productivity and provides information on number of transactions carried out at a given expenditures level. Transaction efficiency of the MFIs range between 0.3 and 0.7. This means that average number of loans held in portfolio per Rs. 1000 of cost is 0.3 in SCCs, 0.5 in SFCLs and 0.7 in WGBB. WGBB has higher physical productivity compared to SFCLs and SCCs. Increases in transaction efficiency can be achieved by several means, including a lengthening of average terms to maturity of outstanding loans.

Portfolio efficiency
Portfolio efficiency is the ratio of outstanding portfolio with respect to costs. It is obtained as a product of transaction efficiency and average loan size. Portfolio efficiency of MFI analyzed is high in SFCLs, followed by SCCs and WGBB. Larger average portfolio per unit cost signifies better efficiency to manage microfinance services.

6. FACTORS AFFECTING EFFICIENCY IN NEPALESE MICROFINANCE INSTITUTIONS

The analysis done in last section indicates that efficiency in MFIs is a function of *portfolio size, loan size, lending methodology, salary structure, sources of fund and ownership.* A discussion on these factors vis-a-vis the status of the MFIs' analyzed follows hereunder.

Portfolio Size
Below certain portfolio size, it is less likely for MFI to attain efficiency. Mostly MFIs unable to obtain profit are those with smallest loan portfolios and the highest costs like young SCCs and SFCLs. Once these institutions grow and increase operational and financial leverage, profitability is likely. Profitability is a function of efficiency and not of size only up-to a point. Once MFI reach certain level of portfolio size, economies of scale do not seem to be a significant factor in determining efficiency. After this threshold, the largest MFIs are by no means the most efficient. In general portfolio growth reflect two different processes in the MFIs.

- *Extensive growth*: This results to increased installed capacity, leading to a larger organization and more sources of fixed cost on headquarters, branches or credit officers as in WGBB. Extensive growth can have a negative impact on MFI's productivity due to reduction on average productivity and indivisible nature of the existing installed capacity.

- *Intensive growth*: This result to increased productivity of existing capacity like larger balances and/or number of loans per branch or credit officer. SFCLs and SCCs demonstrate this type of augmentation. Intensive growth results from learning and accumulation of experience, externalities due to having done a good job in the past and improved capacity utilization either through larger numbers of loans or increased loan sizes. WGBB lack this type of orientation.

Loan Size
MFIs with average loans below certain size (Rs. 10000) have difficulty on achieving reasonable efficiency. MFIs with smallest loans usually have high administrative expences compared to other similar institutions. When expences ratio is high, donor dependency is required for viability. As MFI matures, loan size typically increases. There are at least three reasons on why MFI's increases loan sizes throughout their life.

- *Policy-induced increase*: This occurs due to changes in loan-supply criteria adopted by MFI as a response to threats on their sustainability or redefinition of its market niche. These increases may reflect search for wealthier clients, who *ceteris paribus,* demand larger loans than poorer clients as in the case of SCCs.

- *Information-induced increases*: Usually, accumulated knowledge and experience in the market and revised perceptions of risk enable MFIs to increase initial loan size and/or accelerate growth of loan size for additional repetitions along with the sequence for a client with a given, imperfectly observed repayment capacity and level of poverty. Information induced increase exist in all three types of MFI analyzed.

- *Client-induced increases*: Most MFI works in an environment wherein once an individual customer grows and improves their repayment capacity, s/he demands for larger loans. For the MFI, the maturing of its portfolio increases share of these established clients among the total number of borrowers. Product diversification strategies adopted by GBR and policy of setting loan limit to Rs. 30,000 per client in SFCLs is the instances in response to such changes.

Further, loan size has direct relationship on MFIs' portfolio efficiency. Usually larger loan sizes increase portfolio efficiency at given level of transaction efficiency. The average balance of individual clients increases with additional repetitions thereby contributing towards efficiency improvement.

Lending Methodology
Lending methodology has implications on efficiency. Credit officer of GBR and SFCL consider social preparation, group formation and maintenance to cost high. As far lending methodology, multiple factor contributes to efficiency thereby making generalizations difficult.

MFIs loose money in the absence of timely repayment and high operating cost prelude self-sustainability. In SFCL, inadequate technologies lead to high levels of defaults (> 15%) while WGBB keeps arrears at reasonable levels (< 8%) by increasing operating cost too much. SCCs to some extent are able to strike a balance between costs and risks at a level that allows self-sufficiency. This can be possible by refining lending technology appropriate for its market. SCCs incorporates component of timely disbursement to increase value of client-organization relationship by reducing borrower transaction costs. Further, lending simple procedures adopted by SCCs lowers transaction costs.

Salary Structure
Salaries are usually the largest component of MFI's administrative expenses. SCCs and SFCLs operating under low-wage environment are more efficient than WGBB. In contract, credit officer's productivity is also affected by wage rates and structure, although less directly.

Sources of fund
Financial cost constitutes major cost in MFIs operation. WGBB has managed loanable fund from commercial sources at lower rate while SFCL relied on ADBN for fund and cost of fund is higher. In contrast, all SCCs relied on mobilised savings to manage loanable fund. Thus, the sources of funds have a clear bearing on enabling MFIs to attain efficiency.

Ownership
Ownership of MFIs has to do on their efficiency. Member-managed and controlled MFIs like SFCLs and SCCs are more efficient than government owned WGBB. Due to government corporate ownership structure, WGBB is confronted with many mis-guided policies thereby distorting markets through political interference. In contrast, SFCL and SCCs are credit unions, where owners are also their client exhibit higher efficiency.

7. SUMMARY AND CONCLUSIONS

Improving efficiency must be one of the priority aspects for Nepalese MFIs. The concept is rather new and need to be institutionalized. MFIs must undergo for systematic operational restructuring to achieve efficiency if they are to survive.

Efficiency problems in MFI stem from methodological rigidity. Due to complex methodology, high social preparation cost and inability to transfer fee to cover services provided, GBR became inefficient. Mostly Nepalese MFI adopted "*zero tolerance*' policy towards credit risk, because loans were unsecured and borrowers lacked credit histories. This risk averse approach necessitates the need to design most tailored lending methodology that takes efficiency parameter into accounts.

SFCLs are more efficient, followed by SCCs and GBR. Factors like portfolio size, loan size, lending methodology, ownership, financial cost and salary structure affects in MFI's efficiency. Root cause of inefficiency in GBR lies on its lending methodology. Lending methodology of SFCLs is simpler than GBR and that of SCCs is the simplest and most efficient. Mainly social preparation cost is high in GBR. In case of SFCLs and SCCs, social preparation cost is directly or indirectly subsidized and this opportunities does not exist among government owned GBR.

SFCLs have realized higher return on APA compared to SCCs and GBR. The financial cost to average gross portfolio ratio is lowest in GBR and almost same for SCCs and SFCLs. SFCLs and SCCs relied on expensive source of fund compared to GBR. Administrative cost to gross portfolio ratio is high in GBR, moderate in SCCs and low in SFCLs. The administrative cost has strong correlation on lending methodology.

The framework condition, under which MFIs emerged and are currently operating, provides basis on causes of their inefficiency. Nevertheless, all three types of MFIs analyzed are operationally self-sufficient. SFCLs and SCCs are financially self-sufficient while WGBB is not. Low return on APA has constrained GBR to attain FSS. Unless return on APA is realized at effective interest rate level, it is less likely that MFI can maintain OSS and FSS level already attained.

Administrative expenses constitute single largest components in MFI's cost structure. Improving efficiency is an effective way of reducing lending rate charged. In the context of limited prospects of increasing effective interest rate, improvement in efficiency is one of the options to attain OSS and FSS. SFCLs are relatively successful to transfer this idea into action and attained OSS and FSS. Maintaining the efficiency level attained is a challenges for future.

In order to improve efficiency, Nepalese MFI must set standards on (i) return on APA, (ii) ratios like financial cost and operating cost to APA, number of loan to credit officer, outstanding portfolio to credit officer, credit officer to total staff ratio and loan size and (iii) amount of

transactions to be carried out at a given level of expenditures. A system to monitor and evaluate their status and performance based on these standards should be initiated and institutionalized.

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