

Does the number of borrowers per loan officer influence microfinance institution asset quality? A stochastic frontier analysis

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Abstract

Employing stochastic frontier analysis, this paper explores whether there is trade-off between the number of borrowers per loan officer and microfinance institution (MFI) asset quality, represented by the portfolio value at risk. It uses a dataset with information from 1,575 MFIs from 109 countries for the period 2006-2013. We find corroborative evidence that there is no trade-off between the number of borrowers per loan officer and MFI asset quality, which contravenes the conventional wisdom. We show that MFIs have reaped the benefit of economies of scale without compromising asset quality. These findings remain significant across ownership types and regardless of deposit-taking status.

Keywords: Microfinance; asset quality; outreach; stochastic frontier analysis.

JEL Classification: D24; G21.

Resumen

Empleando el análisis de fronteras estocásticas, este trabajo explora si existe un equilibrio entre el número de prestatarios por agente de crédito y la calidad de los activos de las instituciones microfinancieras (IMF), representada por el valor de la cartera en riesgo. Usando un conjunto de datos con información de 1 575 IMF de 109 países para el periodo 2006-2013, encontramos pruebas corroborantes de que no existe un equilibrio entre el número de prestatarios por agente de crédito y la calidad de los activos de las

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IMF, lo que contraviene el saber convencional. Mostramos que las IMF han obtenido el beneficio de las economías de escala sin comprometer la calidad de los activos. Estos hallazgos siguen siendo significativos en todos los tipos de propiedad y sin importar el estado de los depósitos.

Palabras clave: microfinanzas; calidad de los activos; extensión; análisis de frontera estocástica.

Clasificación JEL: D24; G21.

INTRODUCTION

Microfinance institutions (MFIs) arrange for doorstep delivery of financial services to the poor, who do not have access to the formal banking system. MFIs have been praised for their efforts to make financial services available to a wide spectrum of the unreached sections of society. MFIs usually have their roots in development-focused entrepreneurial initiatives by socially oriented promoters, whom Yunus and Weber (2009) described as users of entrepreneurial acumen, providing some essential services to the poor to improve their livelihood. Surpluses from such entrepreneurship are not intended to make the promoters or investors richer but rather to be ploughed back into the business to solve the problems of the poor. Here, “profit” takes a back seat, while “purpose” serves as the prime motive for running the enterprise. Although the model is appreciated for its stand on offering financial services at a subsidized rate, its scalability is always an issue, as the viability of the model depends on the steady flow of soft loans or donors’ fund available at below-market interest rates.

With the drying up of such soft loans and funds from Western donors (Singh, Lal, and Bhat, 2010), MFIs started exploring the possibility of accessing funds at the market rate from investors. To facilitate fund flow from investors while the existing not-for-profit MFIs went through the process of changing their ownership status to for-profit commercial enterprises, a new set of MFIs forayed into the microfinance arena to serve the poor on a purely commercial basis. Hence, in addition to financial inclusion, MFIs focused on making the microfinance operations both operationally and financially self-sustainable in the shortest possible time.

The question that becomes pertinent here is whether and to what extent the motivation to be financially sustainable would affect the outreach and asset quality of an MFI. While outreach is measured as new members offered financial services during a particular period, asset quality is precisely judged by portfolio

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