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Competition and Commercialisation of Microfinance Institutions: Implications for the Sector

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Abstract *Until 1990s microfinance was mainly seen as an impact – driven development programme based on the support of government and private donors. However, the failure of many subsidy dependent development institutions advocated for microfinance institutions to be self-sufficient and sustainable. This prompted MFIs to be commercially oriented and profit motivated. Also, with the growing proliferation of new providers of microcredit and influx of commercial investment in the sector, there is an increasing intensity of competition in the sector. Increased competition coupled with commercialisation helped in integrating the low-income population into a more formal financial system. But critics view that, this process has led the MFIs to search for better off clientele, thereby in many cases, departing from their social mission. Increasing competition followed by saturation in the sector has led to the mission drift of MFIs and has become a major cause of concern globally. However, some view this process to be a "win-win' scenario whereby there exists scope for widening outreach and attaining sustainability. The present paper is devoted to examine the process of commercialisation and gauge the potential impact of competition and commercialisation of microfinance institutions on MFI performance from a theoretical standpoint.*

Keywords *MFIs, Commercialisation, Competition, Mission Drift, Outreach*

BACKGROUND

Microfinance sector all across the globe has undergone many major transformations. From an impact – driven development programme to a commercially oriented and profit motivated entity. Similarly, there has also been multiplicity of funding sources for MFIs. From primarily funded through donations and grants, microfinance institutions today procure fund from a variety of sources ranging from bank loans to private equity investments. Microfinance sector was primarily dominated by non-governmental organizations (NGOs) working for social development. But with time, many new players have entered the market and microfinance sector today, in most of the countries, is dominated by for-profit institutions working in the form of Non-Bank Finance Companies (NBFCs). This has driven the influx of commercial investment in MFIs (Taylor, 2011). Also, 2000s saw a growing emphasis on the "down-scaling" of commercial banks to serve the poor, and the "transformation" of NGO-MFIs into commercial banks (Sharma & Wright, 2010). In India, NBFC-MFIs account for 80% of the total loan portfolio. A high growth potentiality in the 20th century attracted many new players in the sector resulting into intense competition. However, increased competition is characterised by multiple borrowings, double dipping, non-repayments, etc. Further, it has also resulted into challenges for MFIs to balance sustainability with ultimate mission to reach the poor. Seeking profit by serving the poor in this way has fear of 'mission drift' due to the trade-off between profitability and outreach to the poor (Morduch, 2000; Armendariz & Szafarz, 2011). In Indian context, Hossain, 2013 view that commercialisation translated into deluge of funds for investment in MFIs, caused huge market penetration, market saturation, multiple lending and over lending; and finally, over-indebting their clients. However, there are thinkers who also suggest that only competitive MFIs have long-term sustainability and that commercialisation of microfinance is a win-win scenario of widening outreach and attaining sustainability (Christen, 2001). Thus, this study is devoted to examine the process of commercialisation and gauge the potential impact of competition and commercialisation of microfinance institutions on MFI performance from a theoretical standpoint.

CONCEPTUALISING COMMERCIALISATION

In context of microfinance institutions, commercialisation connotes the process whereby a MFI seeks commercial sources of funding rather than relying on conventional subsidy, grants and donations. It means the MFIs seeking to operate with commercial sources of funding following

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market-based business principles and without direct or indirect subsidy elements in its funding structure (Armendariz & Morduch, 2010). It indicates leveraging interest revenues, mobilising savings deposits and the ability of the MFIs to distribute profits to their shareholders that helps them to access vast pool of capital (Hossain, 2014).

At the early stage of its evolution, the principle source of funding was highly subsidised loans (soft loans), donations and grants. MFIs grew with the donor's support and such donations and grants mainly came from World Bank, Government Aid Agencies, Agency for International Development (USAID), Apex Organizations (e.g. Women's World Banking, ACCION, FINCA), etc. But such funding lacked donor's consistency and also raised uncertainty about the self-sustainability of the microfinance institutions in the long run. The high growth potentiality in the sector in 1990s to 2000s attracted private investors and now debt, equity and deposits are the main sources of funding for MFIs. Between the 1990s and early 2000s, for-profit MFIs rapidly emerged on the scene, capitalised increasingly through equity investments from specialised Microfinance Investment Vehicles (MIVs) and mainstream private equity funds (Manahan, 2015) Debt capital dominates the funding of most of the MFIs. For the past three years, debt comprised over 1/3 of the total funding of MFIs, increasing by 7 billion United States dollar (USD) during the same period. However, by 2010, the share of debt shrank and volumes remained constant as investors retreated from markets that experienced internal crises, as well as those affected by the global financial crisis (MicroBanking Bulletin, 2011).

Deposits

In some countries, microfinance institutions are allowed to collect thrifts/small deposits from poor borrowers. However, in many other countries, including India, such a practice is restricted. In India, only microfinance institutions that are registered as banks are allowed to collect deposits in addition to some limited number of NBFC-MFIs. The reasons for restricting microfinance institutions from deposit taking is the regulator's concern to ensure that deposits are made in regulated institutions that can provide instantaneous liquidity. Thus, for most of the developing countries, MFIs are not permitted to redeploy depositor savings until they meet certain minimum capital requirements that for most of the MFIs are immature to attain (Refer Fehr & Hishigsuren, 2006).

Debt Funding for MFIs

Debt capital is often a first choice, either in the form of borrowings from commercial and central banks, or when capital markets are well-developed, long-term debt instruments (Fehr & Hishigsuren, 2006). The objective for such funding from the providers point of view vary viz, social, economic or mixed and the providers may be local (ranging from small local NGO or small local bank) to cross-border (international funds). MIX classifies each major providers of debt financing as *Development Financial Institutions*, *Financial Institutions, Fund, Government and Others*. *Development Financial Instit*utions like IDBI, IFC, and SIDBI, etc. in India raise private capital to finance projects with development objectives whereas *financial institutions* cover the category of commercial banks, co-operative banks/society and other apex banks (e.g. NABARD in India). For commercial banks, the lending is primarily motivated by commercial objective but for countries like India where micro lending is recognised as a priority sector lending, such lending is layered with social objectives too. *Government* sources of funding come from multi/bilateral development aid agencies (e.g. JICA, UNCDF), through government sponsored programmes, through some government departments or agency (Ministry of Finance) or through central bank (e.g. RBI). The category of *Fund* includes professionally managed type of collective investment scheme that pools money from many investors (e.g. India Microfinance Equity Fund, Bellwether Microfinance Fund). Included in the category of *Others* are the sources from private corporations registered legal entities and does not include governments, non-profits, funds or financial institutions, individuals, NGOs and foundation. It is important to note that for countries like India, Mexico, etc. with low deposits volumes debt financing play a vital role in expanding access to credit for poor (MicroBanking Bulletin, 2011). The Small Industries Development Bank of India, an apex financial institution for promotion, financing and development of small-scale industries in India, has launched a major project the SIDBI Foundation for Micro Credit (SFMC) to facilitate the accelerated and orderly growth of the microfinance sector in India. SFMC is emerging as the apex wholesaler for microfinance in India providing a complete range of financial and non-financial services, such as loan funds, grant support, equity and institution building support to the MFIs (Jayadev & Rao, 2012).

Equity Financing for MFIs

Private Equity

High growth potentiality in the sector attracted attention of Private Equity (PE) investors. In fact favourable regulations, economies of scale and significant growth drew PE players in the market since 2007 (ASSOCHAM India, 2016). The most common types of investors are usually the private equity firms, a venture capital firm or an angel investor. PE in microfinance comes generally at the early stage start-up growth capital. Sequoia Capital India was the first traditional venture capital (VC) firm to invest in the space with 11.5

million USD in SKS Microfinance in 2007 (Jayadev & Rao, 2012) and Investments by private equity (PE) investors in India continued to grow ever since Sequoia Capital India invested in SKS (Srinivasan, 2010).

Table 1: Equity Deals in Indian MFIs

Financial Year	Amount (USD, million)	No. of Deals
2007-08	52	3
2008-09	178	11
2009-10	209	29
2011-Q1	66	6

Srinivasan, 2010 in Jayadev and Rao (2012) Microfinance India: State of the Sector Report, 2010

Microfinance Investment Vehicle (MIV)

MIVs are private entities which act as intermediaries between investors and MFIs (Jayadev & Rao, 2012). Such funds are structured products that provide debt obligations or take equity stakes in MFIs. (Savat, 2017). Dieckmann (2007) distinguishes three types of MIVs. First *microfinance development funds* that act as non-profit entities or cooperative and primarily target the development of MFIs by granting capital at favourable terms without any commercial return. Second *dual objective MIVs* which seek to balance between social and financial returns and the third category include *commercial funds* that strives to attain a predetermined targeted rate of return and social returns play a secondary role

Equity investment by MIVs is what normalised the sector after the Krishna Crisis of 2005-2006 in India. MIVs have accelerated the growth of the microfinance sector to a significant extent and thereby attracted more equity investments at very high valuations (Arunachalam, 2011). MIVs receive investments through issuance of shares, units, bonds or other financial instruments for further investments to MFIs as equity, debt or guarantees (Jayadev & Rao, 2012).

Equity from Capital Market

Microfinance institutions have also started to explore the capital market through IPOs. It all started with Banco Compartamos of Mexico, which held a public offering of its stock in April 2007 in which insiders sold 30% of their holding. The issue was oversubscribed 13 times that soon made Compartamos a high worth company (with a worth of $1.6 billion). Similarly, in Indian context, SKS floated its first equity offering (IPO) that was oversubscribed 13.7 times. The shares were priced 98 times higher the face value. But later, SKS resorted to preferential allotments and allotted shares to their senior executives and CEO who became millionaires overnight by selling their shares. There are other microfinance institutions like Bank Rakyat at Indonesia (BRI), BRAC Bank in Bangladesh, and Equity Bank in Kenya which have raised equity capital through public issue. Though for supporters, raising capital through public issue has increased liquidity and it is often claimed that it made an attractive investment avenue for private investors. For example, Cull, Demirgüç-Kunt, and Morduch (2008) mentions that *for the supporters of Camportamos, its public offering heralds a future in which microfinance routinely attracts investments from the private sector, freeing it from the ghetto of high-minded, donor-supported initiatives*. However, such a move attracted wide-scale criticism as it is likely to divert the MFIs from social orientation to pure commercialisation. Muhammad Yunus also considered such act as immoral. As stated by Yunus (2007) "When socially responsible investors and the general public learn what is going on in Compartamos (referring to a very high interest rate), there will very likely be a backlash against microfinance" (Cull et al., 2008). For both Compartamos and SKS, several governance issues cropped up and in case of SKS, the share price dropped from Rs 1,100 to Rs 120 (Jayadev & Rao, 2012).

As per the Mix report of 2010, for countries (like India and Mexico) where MFIs are characterised by low volume of deposits, debt financing play a key role. The following Table demonstrates this fact where the top 20 countries in terms of amount of outstanding debt is exhibited:

Table 2: Top Twenty Countries (by Amount of Outstanding Debt)

Country	Debt (mln USD)	Deposits (mln USD)	Equity (mln USD)	Total Borrowings (thousands)
India	4044	247	1196	30318
Peru	2158	5330	1234	3325
Mexico	1514	139	960	5385
Colombia	1135	3991	1080	1491
Brazil	986	322	353	954
Ecuador	789	994	265	729
Chile	701	642	145	241
Bangladesh	681	2028	885	19662

Country	Debt (mln USD)	Deposits (mln USD)	Equity (mln USD)	Total Borrowings (thousands)
Bolivia	598	2019	363	918
Azerbaijan	585	440	228	354
South Africa	548	1031	502	4
Morocco	512	-	128	706
Bosnia and Herzengovina	463	150	151	273
Cambodia	461	952	238	1239
Armenia	384	197	201	247
Serbia	363	489	134	113
Malaysia	329	57	74	242
Kenya	318	1528	402	1146
Mongolia	291	1232	131	390
Phillipines	289	439	158	2901
Total	17150	22228	8826	70638
Total on MixMarket	21342	30072	11504	83433

Mix Market 2010

It is evident from the above discussion that commercialisation of microfinance institutions has increased the inflow of commercial funds into the sector. Such commercialisation is characterised by profitability, competition and regulation (Olivares, 2005). The wave of commercialisation has resulted into entry of many new profit-driven MFIs. Despite many other factors, commercialisation remained the major driver for entry of new players and increased competition in the market. There have been three emerging trends in the proliferation of microfinance service providers recognised as Downscaling, Up-scaling and Greenfield.

Downscaling

Downscaling takes place when banks or other financial institutions expand its services to work with clients traditionally served by microfinance institutions. The increased popularity of microfinance among different commercial banks is due to the underlying belief that involvements in microfinance programme help them to retain credibility as development agencies (Remenyi & Quinones, 2000). The experience of different countries suggests downscaling as a profitable venture especially for commercial banks. Internationally, Barclays, Deutsche Bank, ING Group, Bank Rayat Indonesia, etc. are some of the banks that have invested in microfinance. However, commercial finance, as it is mostly referred to as, is a complementary to and not a substitute for government and donor alleviation and employment generation programme for the extremely poor (Delfiner & Peron, 2007). But as a matter of fact, commercial banks are in a competitive position when it comes to micro lending. As pointed by Rosengard (2004), banks are more experienced in managing a number of financial risks including interest rates, liquidity, maturity, and foreign exchange and credit risks. Further, banks also enjoy the strength of physical and human infrastructure as required, market presence and brand recognition, the access to plentiful and low cost funds and a low cost structure (USAD, 2005). However, downscaling of banks to micro lending has intensified competition in the sector and has raised concern about mission sustainability of microfinance operation.

Scaling-Up

While downscaling brings banks or other financial institutions in the arena of microfinance, upscaling or scaling up allows a microfinance institutions to enter into other commercial line of businesses which is otherwise conventionally beyond the scope of microfinance. It means MFIs that are mainly functional as NGOs are transformed into formal financial institutions and venture into new areas of operation viz; micro leasing, micro-insurance, savings, housing loans, etc. Such a move is mainly initiated by well-managed microfinance institutions that have shown a capacity to wean themselves off of subsidies and became sustainable within a few years (Economic Times, 15-06-2016). In Indian context, Bandhan makes a leading example in the process of upscaling which originally registered as non-banking financial company was granted banking license by RBI in 2015. Since then, its network spread from 501 branches and 50 ATMs to 840 branches and 383 ATMs across the country as of September 2017. With a customer base of 11 million, it has managed to expand its loan book to Rs 20,800 crores and has also mobilised Rs 23,500 crores of deposits. Till September 2017, about 90% of the bank's business was still made up of the small loans extended to small entrepreneurs (Quartz India, March 7, 2018).

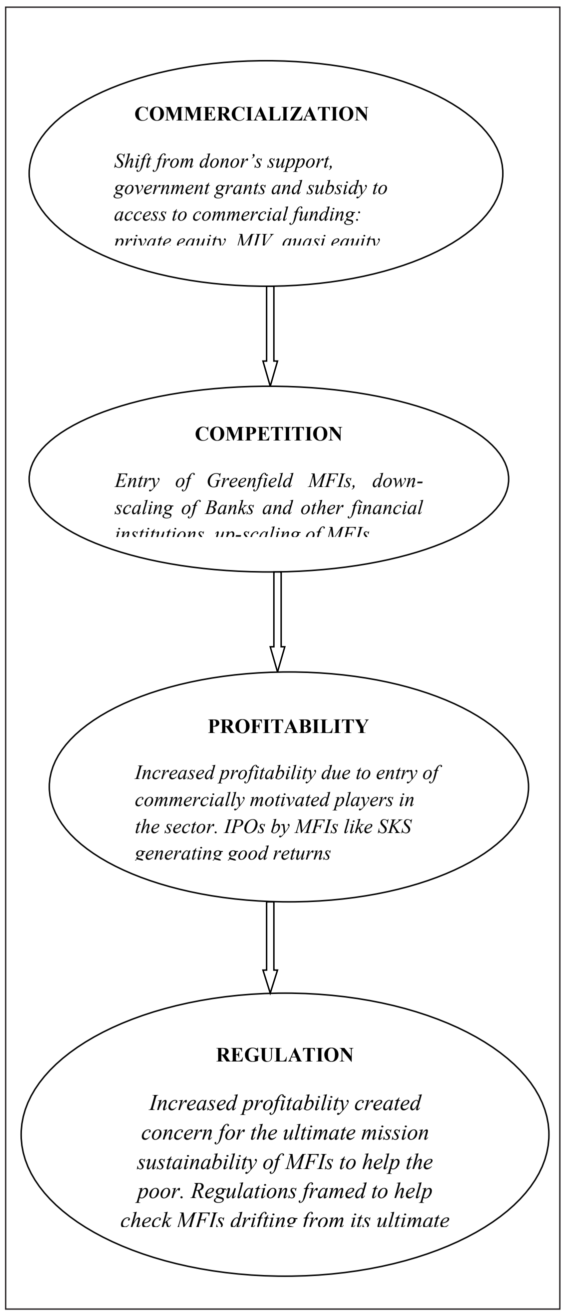
Greenfield Microfinance Institutions

The Bureau of Economic Analysis (BEA) defines Greenfield investments in the United States as an investment by a foreign entity to either establish a new business or expand an existing foreign owned business (www.investopedia.com).

Greenfield microfinance is considered to be a strategic solution to entering the business of microfinance through a Greenfield business model. The Greenfield model according to Earne, Tor, Antorique, and Mark (2014) envisages:

1. Creation of a group of "Greenfield MFIs defined as institutions that are newly created without pre-existing infrastructure, staff clients, or portfolios and
2. Central organising bodies – often holding companies – that create these MFIs through common ownership and management.

The Greenfield bank approach was first applied to Eastern European countries in transition and the first MFI called Micro Enterprise Bank (MEB) was founded in Bosnia and Herzegovina in 1997 (Terbager, 2003). According to Earne et al. (2014), the Greenfield's most significant effect is the professional development of staff, introducing human resources practices that positively affect the financial sector.



Competition and its Impact on Microfinance Sector: Gauging the Theoretical viewpoint

Kar and Swain (2014) view that degree of competitiveness matters for productive efficiency of financial services and quality, diversity and innovativeness of financial products. Further, Claessens (2009) argues that competition impacts financial stability of an organisation. It is purported that competition in context of microfinance institutions is necessary to enhance households' access to financial services that is likely to impact consumers' wealth and economic growth which in turn results into social welfare in an economy. Increasing competition may contribute to lowering production costs and lower prices of goods and services (Assefa, Hermes, & Meesters, 2013) coupled with new products and efficient technologies (Motta, 2004). Further, competition allows technological change and financial market policies that focus on strengthening market forces and improving the stability of MFIs, which may positively contribute to efficiency of microfinance institutions (Hermes, Lensink, & Meesters, 2008). Christen (2001) suggests that only competitive MFIs have long-term sustainability and supports the institutionalist view of win-win scenario of widening outreach and attaining sustainability. However, increased competition in the sector has drawn serious criticisms. First and foremost increase in the number of microfinance players results in multiple lending which is recognised as the problem of '*double dipping'*. As noted by Kar and Swain (2014) increased competition weakens the functioning of dynamic incentive mechanism and leads to a decline in the borrower quality and increase in loan defaults. Besides, owing to increased interest rates profitability declines. In this situation, it becomes difficult for the MFIs to cross subsidise less profitable projects. Competition often leads to switching over of clients from socially motivated MFIs to profit motivated MFIs. It may also provoke the clients to substitute their loans from MFIs for loans from commercial banks (Hermes, Lensink, & Meesters, 2009). This substitution effect reduces the demand for services of MFIs, which impedes their sustainability that induces them too to shift from social orientation to profit motivation.

The Empirical Evidences from Received Literature

The impact of increased competition was found to negative on all the measures of performance viz; Outreach, Default Rates, Efficiency and Financial Performance. Assefa et al. (2010) in their study attempted to identify how competition is associated with outreach, default rates, efficiency and profitability of Microfinance Institutions. Lerner Index is used to measure competition that captures competition as a difference between the output price and marginal cost of production (scaled by the output price) at the firm level. Cull, Demirgüç-Kunt, and Morduch (2014) recognised the potential influence of the presence of formal, regulated providers of financial services in an economy on profitability and outreach of microfinance institutions. Further, analysis was also made in relation to the funding pattern (commercially funded or subsidised) of MFIs and MFI outcome. The study was based on 342 observations from 238 microfinance institutions in 38 developing countries. The results of the study revealed a negative relationship between bank penetration and average loan size in case of demographic branch penetration variable and a positive relationship with the share of women borrowers in case of geographic penetration variable. The relationship between bank branch penetration and average loan size is found much stronger for MFIs that faced stronger competition from banks viz; the commercially funded MFIs which are mainly individual lender and deposit taker. Also, such institutions increase outreach to women in response to competition from banks. Their results reveal strong supportive evidence that there is a positive relationship between MFI efficiency and domestic financial development. Thus, the authors conclude that more developed financial system create more efficient MFIs. In a similar attempt, Hermes et al. (2009) investigated in the context of Latin America, whether in the country-level financial environment in which MFIs operate affect their operations. The authors argue that efficiency of MFIs is determined by the extent to which financial markets of countries are developed. The study is carried over 435 MFIs over the period 1997-2007. Gwasi and Ngambi (2014) attempted to examine the impact of competition and institutional characteristics on MFIs financial performance in Cameroon. The authors acknowledge the justification of SCPI (Structure, Conduct, Performance, Impact) path to gauge the social performance of the MFIs. The authors also affirm that social/economic performance is not equal to social/economic impact. Rather, social/economic performance precedes social/economic impact. The study uses multivariate linear regression model to examine the significant determinants of microfinance performance. ROA was taken as a measure of financial performance whereas Competition (measures by HHI), Portfolio at Risk>30 days, Staff Productivity, Savings Mobilization Ratio, Concentration Index (representing industry competition) and other macroeconomic indicators like GDP growth rate and Inflation were taken as explanatory variables. The results revealed a positive impact of competition on MFI performance but statistically insignificant whereas other variables viz; operational expense ratio, portfolio at risk, and staff productivity were found to be the major determinants of performance for microfinance institutions. Further, the study ascribes a negative impact of Inflation and positive impact of GDP growth on the growth and sustainability of MFIs. Christen (2001) in his paper addressed the impact of commercialisation on the strategy and performance of

MFIs in Latin America. He evaluated the profitability of the MFIs and impact of as well as the response to competition. The author identifies three key elements of a commercial approach viz; profitability, competition and regulation. Study identified clear trend towards individual lending as well as improved delivery mechanism. Author views that competition has spawned much product diversification. It was thus concluded that larger loan sizes are not necessarily an indication of mission drift and could be a function of different factors including the 'generational factor', e.g. choice of strategy, period of entry into the market or natural evolution of the target group.

MICROFINANCE SCHISM

There exists two school of thoughts relating to microfinance viz; Welfarist and Institutionalist. Morduch (2000) refers it to as *microfinance schism.* The Welfarists believe that Microfinance performance should be assessed in terms of the impact on the welfare (Olivares, 2005) that is poverty alleviation. Therefore, this approach is also known as *Poverty Lending Approach*. Welfarists assess the impact of the program on their clients by measuring changes in their level of income, production, sales, assets or the general well-being of the client (Bhatt & Tang, 2005). In other words, the welfarists view strictly requires microfinance institutions to work towards poverty alleviation through outreach depth that may require MFIs to work on subsidies and donations. It targets very poor clients and donations are expected to cover the shortfall between revenue from clients and the cost of supply (Schreiner). On the contrary, institutionalists stress on attaining MFIs' sustainability through financial sustainability. This is the reason for which this approach is also referred to as *financial sustainability* approach. Hence under this approach, institutions success emanates from broadening outreach breadth. The proponents consider it to be a win-win proposition as it would result into increased profits through broader outreach and at the same time would contribute to the social objective of poverty alleviation (Brau & Woller, 2004) without being dependent on donors fund. However, this calls for adherence to the code of 'Best Practices' by the providers of microfinance. Microfinance sector has witnessed a gradual shift from socially oriented "poverty lending" approach to "financial system approach" focusing on institutional self-sufficiency.

The existing literature on impact of competition on MFI performance is mixed. The impact of competition can be both ways, positive as well as negative and hence there exists lack of consensus about the likely impact of competition. However, this matter has been widely discussed and covered in academic literature. The potential impact of competition on the microfinance sector can be discussed under the following heads:

- Competition and Outreach
- Competition and Sustainability
- Competition and Financial Performance
- Competition and MFI Efficiency
- Competition and Spillover Effect

Competition and Outreach

Outreach represents the extent to which MFI is able to reach the poorest of the poor clientele. There are various measures of outreach. However, the most popular measures as found in most of the analysis on MFI outreach are number of active borrowers, average loan balance per borrowers, percentage of female borrowers, etc. (this is discussed in greater details in the later part). Competition may drive the MFIs to target the less poor client. This is so because as the market becomes highly competitive followed by saturation, it becomes difficult for MFIs to gain and retain clients as the latter is exposed to alternatives and can exercise choice of selecting MFIs. This process results in multiple borrowings and cross lending in view of information asymmetry. Such multiple borrowings and lending without considering past borrowing records of the clients results in repayment problems. This erodes financial sustainability of the MFIs who therefore look for better off clients who have greater repayment capacity. Secondly, socially motivated microfinance institutions generally intend to wider their outreach mainly through external subsidies and cross-subsidisation (use of gains from profitable borrowers to subsidise loans to unprofitable borrowers (McIntosh & Wydick, 2004 assuming that profitability of clients differs based on their initial wealth and widest outreach is least profitable (Hisako, 2009 Quote)). But as competition becomes fierce profitable clients withdraw from socially motivated MFIs to profit-motivated MFIs declining profitability and cross-subsidisation of socially motivated MFIs. Thus, in order to satisfy budget constraints, socially motivated MFIs need to limit their wide outreach in competitive markets (Hisako, 2009 Quote).

Competition and Sustainability

Increased competition lays challenges for microfinance institutions, which primarily work with development motive to help the poor, to balance its social objective (widening its outreach) with its commercial objective (maintaining adequate returns so as to reduce dependency on external grants, donations and subsidies and become self-sufficient). It is argued in academic literature that MFIs cannot become sustainable by serving the poor. Several reasons account for such lacking self-sufficiency. For example, making very small loans involve high transaction costs in terms of screening, monitoring and administration costs per unit of loan (Hermes et al., 2008). This cost is much higher than the unit cost of larger loans (Hulme & Mosley, 1996; Conning, 1999; Lapenu & Zeller, 2002) as typically advanced by banks and other financial institutions. Despite high interest charged by MFIs for such loans, they still remain dependent on external subsidies and donations. With growing competition, this problem gets worsen as the profitable borrowers (as discussed in previous point) moves from socially oriented MFIs to profit motivated MFIs due to dynamic incentive plans. This leaves the socially oriented MFIs with less profitable borrowers rendering the MFI's sustainability questionable. Thus, in order to remain sustainable in a highly competitive scenario, MFIs "scales up" their services, or stop targeting the poorest of the poor. But it is also argued that with increased competition the financial sustainability of MFIs improves due to the spillover effect from new providers of microfinance that have proficiency in loan management and other forms of financial services.

Competition and Financial Performance

In the parlance of microfinance institutions, financial performance is often studied through financial self-sufficiency ratio. This ratio reflects the extent to which MFI is able to generate revenue so as to meet its cost. While estimating, the 'subsidies' component is adjusted for in order to arrive at the true figure. While increased competition is likely to impact social performance (expressed in terms of outreach) of MFIs negatively, but it is likely to impact financial performance positively. This is so because in a competitive market, the MFIs tend to focus on less poor but profitable clients. This positively impacts the recovery performances resulting into healthier loan portfolio and reduced risk. But this occurrence is restricted to profit oriented MFIs only. For incumbent MFIs, increased competition worsens loan portfolio owing to double dipping, given the problem of information asymmetry. Such MFIs also face the problem of cross-subsidisation.

Competition and MFI Efficiency

In addition to bringing their commercial and social objectives into balance, MFIs should strive for cost-efficient operations. The emphasis on cost efficiency is in line with the MFI's social objectives in that increases in cost efficiency allow commensurate reduction in the interest rate needed for cost recovery. It is argued in the literature on competition that monopolistic power is associated with allocative and technical inefficiencies, leading to welfare losses and it acts as deterrent for firms to invest in efficient technology and introduce new products (Assefa et al., 2013). In contrast, increased competition among MFIs may contribute to well-functioning markets, protection of consumers, promotion of allocative and technical efficiency, and the provision of incentives to develop new products (Motta, 2004). Decrease in monopoly power and market share may compel MFIs to explore new markets dealing with new clients in a cost effective manner thereby increasing efficiency. The increased competition may stimulate MFIs to reduce costs and increase the efficiency of their operations by improving the quality of their services in order to retain clients (Hermes et al., 2009). However, there exists limited empirical evidence of association between competition and MFI efficiency.

Competition and Spillover Effect

It is argued that performance of microfinance sector is greatly dependent on level of financial development. Hermes et al. (2009), view that MFI performance is related to the level of financial development and more specifically with the development of the banking sector of a country. Rising competition has revolutionised the microfinance sector through spillover of new banking techniques and financial innovation. With downscaling of financial institutions, microfinance sector is increasingly exposed to improved and innovative delivery means and modes of financial services. Much of these practices are emulated by the incumbent MFIs leading to higher efficiency. Hermes et al. (2009) further views that the presence and growth of commercial banks may also improve the skills of loan officers and managers working at MFIs, since this enlarges the pool of financially educated people. This again may help improving the efficiency of MFIs.

CONCLUDING REMARK

Microfinance emerged as an important developmental tool for the poor and underprivileged section of the society. It has proved to be an effective means of bringing the poor from far flanged areas under the formal financial coverage which is otherwise not possible under formal financial system. Microfinance plays a crucial role, especially in developing countries, in combating poverty and contributing towards inclusive growth. With time, its scope has extended reasonably and presently microfinance is not just viewed as a poverty alleviation tool but is viewed as a source of individual development through empowerment, entrepreneurship and several other developmental services providing economic growth opportunities. There has been growing volume of literature, encompassing several dimensions of microfinance, studying its contribution in socioeconomic wellbeing. The 20th Century witnessed expansion of microfinance sector globally. With time there has been growing commercialisation and competition in the sector. This process of commercialisation coupled with competition has led the MFIs to search for better off clientele, thereby in many cases, departing from their social mission. Increasing competition followed by saturation in the sector has led to mission drift of MFIs and has become a major cause of concern globally. However, there exists need for more empirical studies linking commercialisation and competition of microfinance sector with their social and financial performances.

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