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TRANSACTION COST AND TECHNICAL EFFICIENCY: THE CASE OF INDIAN MICROFINANCE INSTITUTIONS

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ABSTRACT

The present paper analyse the technical efficiency of 78 MFIs operating in India by using the stochastic production frontier approach, which incorporates a model for technical inefficiency effects including administrative expenses, borrowings per loan officer, debt-equity ratio and cost per borrower. The study revealed that the traditional average response function is inadequate representation of the data related to MFIs. The mean technical efficiency showed wide variation across sampled firms ranging from 36 per cent to 99 per cent with overall mean technical efficiency being 63 per cent. However, our findings show that microfinance institutions can increase their output level by 36 per cent without increasing the quantum of inputs. The study pin points that reduction in administrative cost will be very handy in enhancing the efficiency of MFIs operating in India. Similar actions also required in case of cost per borrowers and borrowings per loan officer. The study recommends that transaction costs needs to be taken into account while examining the interest rates charged by microfinance institutions. The spatial variation in transaction costs as well as level of maturity may be significant factors for enhancing the efficiency and performance of MFIs.

KEYWORDS: *Technical Efficiency, Stochastic Frontier, Transaction Cost, Microfinance Institutions.*