

## ABSTRACT

Financial development contributes to increased protection of creditor rights, due contract enforcement, elimination of information asymmetry and removal of unnecessary intermediaries which affects the sustainability and efficiency of the Micro Financial Institutions (MFIs). Microfinance sector's ability to achieve financial inclusion and credit provision to the poor sectors of the economy is impacted by the financial development of the economy because financial institutions' have immense importance in the financial stability of a country. MFIs are considered to be the instruments for development of the economy's financial sector which renders the question whether MFIs' sustainability and efficiency is crucial for their prospect as intermediaries to serve the credit requirements of the financially excluded sectors? Addressing this gap, this thesis aims to assess the country specific and MFI specific factors affecting the efficiency and sustainability of the MFIs of Bangladesh, India and Pakistan. The research is being conducted on panel data collected from top 4 MFIs of Bangladesh, India and Pakistan over a time period of 10 years from FY2008 to FY2018 for the purpose of studying the effect of financial development.

The financial development of the economy has been measured by the ratio of bank deposits to GDP while efficiency and sustainability of MFIs measured by Return on Equity (ROE) and Operational Self Sufficiency (OSS) has further been evaluated through financial risks namely credit risk, market risk and liquidity risk, poverty alleviation, lending methodology and DFIs' funding management. The study utilizing Stochastic Frontier Analysis (SFA) has shown that financial development significantly contributes to the efficiency and sustainability of MFIs in all the three economies that is Pakistan, India and Bangladesh. MFIs of Bangladesh and Pakistan show a negative relationship between the financial development and the efficiency measured through return on equity which can be attributed to more stringent tax collection and implementation of rules and regulations required for the financial institutions while the MFIs in India have shown improved efficiency with the financial development of the economy. On the other hand, sustainability of MFIs in Bangladesh and Pakistan increased with the increase in the financial development while MFIs of India showed negative relationship between the increase in sustainability of the MFIs and the financial development.

The regression analysis for MFIs of Bangladesh has shown that increase in the effect of financial development on the market risk leads to increase in MFI sustainability. The poverty alleviation variable for MFIs of Bangladesh is positively related with the efficiency of MFIs whereas the MFI efficiency is negatively affected by the increase in financial outreach of MFIs. The lending methodology variable measured by operating expense ratio shows that MFIs should emphasize on the selection of lending methodology because it affects the credit risk faced by MFIs for Bangladesh. The increase in liquidity risk leads to decreased MFIs' efficiency while the proper management of DFIs' funding leads to decrease in the effect of liquidity risk on the MFIs' return on equity which improves MFIs' efficiency.

The regression analysis for MFIs of India shows that MFIs sustainability is negatively related to market risk while increase in financial development decrease in the effect of market risk on the sustainability of MFIs. The coefficient value for poverty alleviation of variables is positive implying that increase in MFI efficiency contributes to increasing GNI per capita for the economy of India but the MFIs' financial outreach variable decreases with the increase in MFI return on equity. MFIs' lending methodology leads to increase in MFIs' sustainability because proper concentration on MFIs' lending methodology decreases the effect of the credit risk on MFI sustainability. The DFI funding management variable for MFIs of India showed MFIs' efficiency increased with the increase in the funding expense ratio proxy for the DFIs' funding management.

The regression analysis for MFIs of Pakistan shows that increase in the effect of financial development on market risk positively affects the sustainability of MFIs of Pakistan. The coefficient for poverty alleviation of the MFIs is positive showing GNI per capita increased with the increase in MFI efficiency while MFI efficiency decreased with the increase in the financial outreach of the MFIs. The increase in MFI sustainability is positively affected by the effect of the lending methodology implying that MFIs' sustainability increased with the increase in the operating expense ratio. The increase in the effect of liquidity risk on DFIs' funding management decreased MFIs' efficiency meaning MFIs experienced deterioration in DFIs' funding management negatively affecting the MFIs' efficiency due to the increase in funding expense ratio.