Correction

In the Fall 1999 issue of the Journal of Microfinance, incorrect information concerning CRECER's annual percentage rate and portfolio yield (APR) appeared on pages 174 to 176. The error is the responsibility of the Journal staff and we regret the error. The section should have read as follows:

Gap Analysis—Ensuring an MFI Receives the Income It Expects

Setting an appropriate interest rate is a key step in getting on the path toward IFS, but ensuring that the loan portfolio and assets yield the expected rate of return is another challenge. Up to this point in the paper we have focused on managing expenses as a means to increase efficiency. However there are three tools available to measure our efficiency in managing income. In other words, is an MFI generating the expected level of income from the loan portfolio, as measured by the appropriate interest rate? If this is the case, it assuredly has a strong overall management. If not, regardless of how well it manages its costs, it will be very difficult to achieve IFS.

The best way to measure income efficiency is to compare annual effective interest rate, also known as the annual percentage rate (APR)—the total cost the borrower must pay for credit services in a year—with the actual portfolio yield. The portfolio yield attempts to measure how well an MFI is collecting from its clients by comparing interest and fees received from loan clients during a specific period of time (up to one year) to the average loan portfolio for the same period. Differences between the APR and the portfolio yield can imply poor loan portfolio quality or difficulty in collecting interest. Particularly for MFIs with loan cycles of less than one year, they can also imply slow administrative "role-over" of the lending
product(s) due to increasing dormancy among clients on subsequent loans, among other factors, or inefficient management techniques leading to delays in subsequent loan disbursements. Taking the gap analysis one step further, an MFI should also compare interest and fee income received from loan clients during a specific period of time (up to one year) to the average total assets for the same period—referred to as the asset yield. The difference between the portfolio yield and the asset yield indicates how well an MFI has invested its other funds, those not out in the hands of the borrowers.
via loans, in income producing activities. For example, are other funds being kept in noninterest bearing bank accounts, or have they been placed in interest-bearing investments such as cash deposits (CDs) or savings accounts? If there is a large difference between the two, it can indicate that assets other than loans are not being managed properly.

The best-managed MFIs will show very little difference between each of these measurement tools. Institutions with moderate to large differences will note that administrative changes may be in order—of which they may already be aware based on their cost management techniques. Tracking efficiency in managing both expenses and income allows an MFI to ensure it does not stray from the path towards IFS.

The annualized effective interest rates, portfolio yields, and asset yields of our case study MFIs are shown in Figure 5. Here we see that of the three FINCA Uganda has the smallest gap between the APR and the loan portfolio yield, a spread of approximately 1.8% at December 31, 1998. This dramatic reduction in the gap from 12.7% at December 31, 1996 reflects FINCA Uganda’s specific efforts to improve turnover of its loan portfolio by introducing the “17 Week Recapitalisation” incentive to field staff, described in the Staff Incentive section above. However, the difference between FINCA Uganda’s loan portfolio and asset yields was the largest among our case study MFIs, a spread of 25.2%, reflecting high liquidity at FINCA Uganda. As of December 31, 1998, nearly 34% of FINCA Uganda’s total assets were held in cash and cash equivalents; as FINCA Uganda gets this money out in the hands of the poor, the gap should shrink. CARD’s yield gap at December 31, 1998 was approximately 5.6%, which it credits to dormancy among general loan and other basic loan products, which has, in turn, slowed turnover of the loan
portfolio. CRECER is not far behind CARD with a yield gap of 6.6% at December 31, 1998; the gap likely results from slow turnover of 16-week loans with some credit associations.

Based on this analysis, FINCA Uganda will not be able to consider lowering its high effective interest rate of 62.3% until it can be sure that its low administrative efficiency of 71.8% can improve substantially. Given CARD’s current administrative efficiency of 38.7%, there appears to be no case for reducing its effective interest rate of 42.8%. A similar conclusion can be drawn with respect to CRECER given its current administrative efficiency of 33.7% and effective interest rate of 42.0%.