



Managing the double bottom-line of microfinance

**Summary of a baseline study on Social Performance
Management (SPM) of Cordaid partner MFIs**


Presentation

During the past few years there has been an enormous growth in the field of microfinance. Investors have become increasingly interested in investing their money in this fast developing market.

Ten years ago microfinance was dominated by NGOs and social investors; nowadays, a growing number of NGOs are developing into sustainable Microfinance Institutions (MFIs) and besides social investors we can see a growing number of investors who are also interested in a high financial return in the long run. And the market is big enough for everyone. It seems to be a win-win

situation. But is it? Such is the growth in number and volume of institutes focusing on microfinancing that microfinancing is seen to be a tremendous success. NGOs are turning into MFIs, successful MFIs are, in turn, being bought up by commercial banks and one or two have even ended up on the stock exchange. And at the other end of the market new, fledgling MFIs are emerging. But I feel we do not know enough about how the MFI clients themselves are doing. Are they experiencing the same growth? Are they truly able to develop and escape from the poverty trap? What percentage of clients is actually successful? And not just briefly,





but for an extended period of time? Have their lives actually improved permanently and if so, which parts of their lives?

We expect to do more research into this matter at a later date.

Marjolein Dubbers

Manager Sector Entrepreneurship

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I believe we know too little about the actual, social and financial impact of microfinancing on the lives of very low-income people – despite the many studies into microfinancing. This present study is one of those studies. It describes the link between the financial and social performance of MFIs. To Cordaid, the social performance of an MFI is just as important as its financial performance, if not more so. At the end of the day, we are concerned about improving the lives of low-income people. In Cordaid's view, that is the actual bottom-line of microfinance.

Is there a relationship between social and financial performance of MFIs?

This is a brief summary of a research conducted by Cordaid in 2006-2007. The research focuses on managing the double bottom-line of microfinance by analysing the relationship between the social and financial performance of microfinance institutions (MFIs).

Main question of the research

The research conducted by Cordaid has analysed the relationship between social performance management (SPM) and financial performance of MFIs. The main question to be answered by the research was: 'Does social performance management positively influence

the financial performance of MFIs?'

A number of microfinance authors answered this question with 'yes'. They argued that good SPM can lower financial cost and increase the efficiency of MFIs while ensuring inclusion of the poor. However, statements like these are based on reasoning and have not been empirically tested. For example, practitioners at Imp-Act ¹⁾ believe that social and financial performance are linked and are mutually reinforcing.

Also microfinance authors Pawlak and Matul ³⁾ describe a positive relationship between social and financial performance. They argue that





'combining social and financial measurements can potentially increase financial returns in the long term through a better understanding of target clients and through allocation of scarce resources in a more efficient way, thus avoiding the unnecessary costs of ineffective actions' 3) The research conducted by Cordaid tested the relationship statistically.

Microfinance: the double bottom-line

Since its existence, microfinance has been about the double bottom-line. The concept of microfinance is a mixture of commercial and social thoughts. In relation to this, it is often mentioned that microfinance has two parents, a social and a financial one. This double bottom-line is represented in

the daily operations and management of the microfinance institutions and can be recognised in the vision, mission, objectives and activities of MFIs. MFIs need to run their 'businesses' in a way that allows for costs to be recovered while at the same time allowing for social goals to be reached. Performances on both these objectives should be measured and managed by MFIs. However, in practice, one of the objectives became dominant. 'Microfinance has evolved into a global industry dedicated to commercial principles of operations' 4). Over the years, the main focus has been on financial transparency. In this area, the microfinance sector made significant progress and improvements. Industrial standards for financial performance

management and measurements have been created and implemented by MFIs. In contrast, performance management and measurement of microfinance's second objective has been neglected. Hence, little progress has been made in the development of methods to measure, manage and report on the performance on social objectives 1). Nowadays it is believed, however, that both kinds of performance must be measured and managed. As Pawlak and Matul argue 'Just as there is a need to have financial performance indicators to guide the effort to achieve profitability, the same applies to the social aspects of microfinance' 3).

WEDAC (Women Empowerment and Development Agency) is an NGO that operates

in the North of Tanzania, the heartland of the Maasai tribe. It offers financial services to women in remote Villages, not only as a direct source of funding for their microenterprises (like handicrafts), but also supporting the empowerment of these women in their communities, where traditional gender relations prevail.

Its clear focus on poor and excluded members of remote communities leads to high operation costs for the organisation. Travelling to the clients is expensive and time consuming. For that reason, the organisation has a cleverly designed delivery process in place. Village associations that unite all clients in a Village through groups of five handle all transactions with WEDAC's head office on behalf of the



clients in the Village. This, but also economies of scale thanks to a steady growth, should help to reduce the costs to a level at which affordable interest rates can be charged without jeopardising a modest financial return. The organisation is still struggling to reach operational and financial self-sufficiency.

External factors

The research empirically tested the relationship between multiple dimensions of SPM and financial performance of MFIs. Results proved to be inconclusive. The research question cannot be answered with an outright 'yes' or 'no'. The relationships are influenced by external factors such as the legal status and geographic location of the MFI. It is recommended that a time element and context-specific factors are considered in future follow-up research. The research, however, can be insightful to

practitioners and academics in the field of microfinance. Practitioners can use the information when allocating resources between the multiple dimensions of SPM: academics can use the results to gain more insight into the relation between social and financial performance or as a starting point for further research.

The four dimensions of SPM

Social performance is the effective translation of an institution's social mission into practice 2). Accordingly, social performance management (SPM) can be described as the systematic assessment of performance relative to social goals, as well as the use of information to improve performance. Information concerning the achievement of the social goals must be used for decision-making and will increase learning within the organisation.



In the research SPM is divided into four dimensions. The divisions are based on the Social Performance Indicator Initiative of CERISE (Comité d’Echange de Réflexion et d’Information sur les Systèmes d’Epargne et de Crédit). CERISE constructed the concepts shown in the table below indicating the difference between performance and impact. The concepts in the left upper quarter (in orange) represent the four SPM dimensions used in the research. The first dimension of SPM measured the MFIs’ focus on the poor and the excluded. The research measured whether the management of the MFIs strives for depth instead of breadth of outreach. In relation to depth of outreach MFIs, for example, were asked about the use

of targeting devices in client selection and average sizes of (firsttime) loans and savings. The second dimension focused on the fit between the clients’ needs and the services and products offered by the MFI. For example, it was measured whether MFIs conduct market and drop-out surveys to find out about clients’ satisfaction and adapt their product offerings to the findings of these surveys. The third dimension emphasised the MFIs’ management related to improving the social and political capital of its clients. This dimension focused on transparency to clients and client participation in the decisionmaking and governance of the MFI. The fourth and last dimension measured whether the MFI is managed in a socially responsible manner. In the research socially






Global performance of the institution

	Core social issues	Economic/financial issues
Performance monitoring (intentions and actions of the MFI)	<ol style="list-style-type: none"> 1. Outreach to the poor and excluded: Who are the clients? 2. Adaptation of the services and products to the target clients 3. Social and political capital of the clients / Empowerment: participation in MFI decision making; “voice” for those being served to avoid “mission drift” 4. Social responsibility of the MFI; relation with client and community 	<ul style="list-style-type: none"> • Portfolio quality • Efficacy and productivity • Financial management • Profitability • Quality and diversity of the financial services offered
Impact assessment (outcome)	<ul style="list-style-type: none"> • Employment creation for the excluded population • Empowerment: position of individuals in their family and communities; social capital building • Health improvement • Child education, etc. 	<ul style="list-style-type: none"> • Change in income and expenditure • Change in assets and living standard • Food security • Employment creation at community level

Figure 1: The link between the four dimensions of SPM and financial issues and impact assessment (based on Figure 1: Economic and social performances and impact for MFI's). 5)




responsible behaviour of MFIs was related to an adequate human resource policy and adaptation to the local context and culture.

Financial performance

In the research, financial performance is measured with the financial self-sustainability (FSS) of the MFIs. The FSS of an organisation indicates to what extent the organisation's costs are covered by revenues. The FSS measures whether operational, financial and loan loss expenses can be covered by revenues and at the same time if these revenues are enough to maintain the value of the equity and quasi-equity of the organisation in relation to inflation.

Relationships between social and financial performance

In testing the relation between social and financial performance, individual SPM dimensions are linked to the financial performance of MFIs. Furthermore, some interesting characteristics are added to the research. An analysis is done as to whether the MFI's legal status and geographic origin influence the link between social and financial performance. In relation to legal status, MFIs are divided into two groups. The division is based on the commercial orientation related to the legal statuses of the MFIs. The first group consists of NGOs and cooperatives. (an example is Credinka) The second group consists of MFIs with

A woman with a blue headscarf and a blue and white striped top is carrying a large, bright orange basket filled with yellow bananas on her head. She is looking towards the right of the frame.

more commercially-oriented legal statuses like limited companies, nonbanking financial companies or banks (an example is FDL). In relation to geographic origin, the MFIs are divided by continent such as Africa, Asia, Latin America and Central and Eastern Europe.

Credinka (Caja Rural de Ahorro y Credito Quillabamba S.A.) is a Peruvian limited company providing banking services to the rural areas of Cusco and Quillabamba. The organisation is owned by a number of wealthy inhabitants of the region who receive dividends every year. One of Credinka's services is a group lending programme for the rural poor in its area of operation,

which is managed according to principles of corporate social responsibility.

FDL (Fondo de Desarrollo Local) of Nicaragua is an example of an MFI that started out as a members association, founded in 1997 by a poverty-focused (jesuit) church organisation. Though FDL has shown a remarkable growth and reached a portfolio size of USD 37 million by 2006, it is still very much committed to its focus on relieving rural poverty. All financial surpluses are ploughed back into the organisation in order to develop new products specifically geared to the needs of the rural poor.

All relationships were statistically tested. The data were solicited by sending out questionnaires to Cordaid's partner MFIs. There were 69 out of 92 respondents which resulted in a diverse dataset.

Research findings

There was some difficulty in arriving at a general answer to the link between the dimensions of SPM and FSS. Firstly, not all SPM dimensions positively influenced the financial performance of MFIs. There were negative correlations for two of the four dimensions of SPM and FSS. Secondly, significant relationships that were identified were heavily influenced by external factors like legal status and geographic origin.

The dataset was analysed in two steps with the following results:

The first step consisted of testing direct relationships between the four SPM dimensions and FSS for the entire dataset of 69 MFIs. Two dimensions were found to have a positive relation with FSS, while the other two dimensions indicated a negative relationship. Three out of these four relationships turned out to be significant. The first dimension of SPM, outreach to the poor and the excluded, and FSS is found to have no significant relationship. The second dimension, adaptation of services and products to clients' needs, positively related to the financial performance of MFIs implying that when MFIs focused on adapting



products to client need and client satisfaction, the financial performance was enhanced. A positive relationship between the fourth dimension, socially responsible behaviour, and FSS was also found.

In other words, the financial performances of MFIs improve when the MFIs are socially responsible in their management. On the other hand, a negative relationship was found between the third dimension, building social and political capital of clients, and FSS. Focussing on the social and political capital of clients might negatively impact an MFI's financial performance. In this first step, all MFIs were included in the analysis. In the second step the dataset was split up based on subgroups of legal

status and geographic origin. In the second step, possible intervening effects of these external factors were tested in order to analyse whether the findings could be generalised to all MFIs worldwide.

After the second step, it was concluded that both factors have large effects on the prior analysed relationships. The results indicated multiple changes in the correlations of the individual subgroups of legal status and geographic origin.

In the first step, no relationship was found between outreach to the poor and the excluded and FSS. After subdividing the dataset, a significant negative relationship was found for MFIs located in Africa, implying that a focus on depth of outreach negatively



influences the financial performance of the MFIs. The positive relationship between adaptation of services and products to clients' needs and FSS remained significant only for MFIs located in Latin America and not for the rest. This implies that in Latin America a focus on adaptation of services and products results in better financial performance. The relationship between the third SPM dimension, building social and political capital of clients, and FSS could not be found for the geographic regions or the subgroups of legal status. Based on this finding, it can be concluded that social and political capital building has no significant relationship to the financial performance of MFIs. The relationship between the last

dimension of SPM, socially responsible behaviour, and FSS remained positive and significant for MFIs in Latin America and Asia and for MFIs with less commercially-oriented legal statuses. For these subgroups, socially responsible behaviour led to better financial performance. For MFIs in Africa, Central and East Europe, and MFIs with more commercial forms of legal status, the relationship could no longer be found. The results found after the second step should be received with caution as subdividing the dataset has led to smaller sample sizes. These results are reflected in the research report





Conclusion

The relationship between social and financial performance is inconclusive. It cannot be considered as either positive or negative owing to influences from external factors like legal status and geographic origin. The relationship between the SPM dimensions and FSS found in the first step of analysis, changed after control variables such as legal status and geographic origin were introduced. It is, therefore, recommended to have further research focus on context-specific characteristics of MFIs. Furthermore, it must be kept in mind that some relationships between SPM dimensions and FSS might not have been found because of the time span. As the

authors of Imp-Act and Pawlak and Matul argued, it may take a while before a focus on SPM results in positive financial effects for MFIs. It is, therefore, recommended that research be repeatedly conducted on the link between social and financial performance. Timeseries research is recommended.

More information

A complete version of the research report *Managing the double bottom-line of microfinance. Base-line study on Social Performance Management of Cordaid partner MFIs* can be obtained from the Cordaid website: www.cordaid.nl or from www.cordaidpartners.com.

References

- 1) Imp-Act (2005a), Social performance management in microfinance; guidelines, Institute of Development Studies University of Sussex, pg. 1-48 (23-8-2006)
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The links to the web pages where the mentioned documents can be found, are indicated in the main report and on www.cordaid.nl.



Cordaid

Cordaid is a Dutch development organisation with more than 90 years of experience and expertise. We have a worldwide network of passionate partner organisations. We are inspired by dreams, ideas and actions for a better society. Cordaid devotes its heart and soul to the fight against poverty.

Cordaid focuses on ten programmes: Minorities, Slum Dwellers, Women and Violence, Disaster Prevention and Emergency Aid, Reconciliation and Reconstruction, Access to Health Care, Care for Vulnerable Groups, HIV/Aids, Small Producers and Microfinance.

Cordaid and microfinance

Over the past 15 years, microfinance has been found to be an effective means for offering poor people, both men and women, in developing countries adequate financial services with a low entry threshold and at relatively low cost. Carefully structured microfinance can help to improve the position of women. Nongovernmental organisations and cooperatives in many countries have started to offer microcredit, and specialist microfinance institutions (MFIs) are developing



We have also seen growing interest in microfinance among commercial banks in recent years. It is particularly people who work in the informal sector who have no access to the normal services provided by banks and insurance companies due to lack of collateral and small volumes. As a result they are denied the funds they need for production or consumption, or they are dependent on unregulated and often expensive forms of credit provision. Small start-up businesses also have virtually no access to financial (and other specialist) services which they need for operating capital for investments and working capital. Cordaid's Microfinance programme focuses on expanding the scope and

quality of the financial services of MFIs in developing countries. Cordaid concentrates on building capacity and start-up financing of new and emerging MFIs. That can be done through direct financing to individual MFIs, sometimes on the basis of seed capital. Cordaid also acts as an initiator and catalyst in the development of funds which are aimed, in part, at financing emerging MFIs.

In a number of countries Cordaid wants to contribute to the development of the microfinance sector at national level, where work is also being done to support national associations and lobby for a better 'enabling environment' where MFIs





can develop in a healthy way. Cordaid also monitors developments within the Netherlands and Europe in the area of microfinance and strives to influence the policy of the Dutch government and the European and international institutions by lobbying.

Cordaid encourages collaboration between MFIs in developing countries, in order to strengthen their negotiating position, the quality of their service to customers and their financial sustainability. Whilst the emphasis in the last decade was primarily on MFIs' financial performance and quality improvement, over the past few years active efforts have been made within the

sector to achieve a good balance between the financial and social performance of MFIs. Cordaid wants to contribute to this by supporting pilot initiatives in social performance management and training in this field. Just like MFIs undergo regular external auditing on their financial performance, so too should they undergo a social audit; therefore, introduction of the latter is being promoted.



Cordaid is a Catholic Organisation for Relief and Development Aid, member of Cidse and Caritas Internationalis.

Cordaid

*Lutherse Burgwal 10
2512 CB The Hague
P.O. Box 16440
2500 BK The Hague*

*Telephone +31 (0)70 3136 300
Fax +31 (0)70 3136 301
Website www.cordaid.nl
www.cordaidpartners.com
E-mail cordaid@cordaid.nl*

Colophon

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Marieke van Loon

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