The Relationship Between Social and Financial Performance in Microfinance
Evidence from 126 Assessments

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Is social performance profitable?

The question may be cynical, but nevertheless relevant for microfinance to keep its "promise" of being an economically viable development tool (Morduch, 1999). For years, the sector focused on sustainability and growth, measured in terms of financial performance. For the most part, sSocial performance was taken for granted, which led many microfinance institutions (MFIs) to neglect its measure and management. Concerned by this trend, pioneer practitioners, investors and donors have taken steps to address social performance by developing tools, methodologies and assessment frameworks. As criticism of the sector has increased, social performance has been mainstreamed (Copestake, 2007). But has it been expense of financial performance?There are contradicting viewpoints regarding the pairing of financial sustainability and social objectives. Some observers suggest an incompatibility, pointing to problems of mission drift experienced by MFIs that pursue profitability by insisting on physical guarantees, increasing loan amounts and targeting the better-off (Christen, 2001). Others emphasize synergy, arguing that social performance improves mutual trust, client participation and satisfaction, which translates into higher repayment rates and lower transaction costs (Lapenu, 2007). While these assertions draw on case studies, the research has not been extensive enough to draw sector-wide conclusions.Insufficient data has long been the main obstacle to answering this question. Reliable results are simply not easy to come by. Impact studies are limited, costly to replicate and difficult to compare (Copestake, 2003). Recent works using sophisticated techniques (Cornée, 2006; Gurtierrez-Nieto & al., 2007; Cull et al., 2009; Mersland & Strøm, 2009; Lensink & Niels, 2009) have mainly used financial data and inadequate social performance indicators such as portfolio size, average loan size or number of women clients (Armendariz & Szafarz, 2009; Dunford, 2002). These proxies offer little more than a vague idea of depth of outreach--only one of the many dimensions of social performance. Moreover, they only account for credit operations, effectively ignoring other aspects of microfinance. **Methodology**

CERISE, a microfinance knowledge exchange network, has been developing the SPI (Social Performance Indicators) tool to assess social performance since 2002. CERISE has worked with the Social Performance Task Force to define Social Performance Standards (SPS) for reporting to the MIX Market1. Thanks to contributions of practitioners, investors and donors, CERISE has collected the results of 230 SPI assessments2.


1 http://www.mixmarket.org/mix-market-development-roadmap/social-performance-data

The Social Performance Task Force defines social performance as "the effective implementation of an institution's social mission into practice. This mission may include serving larger numbers of poor and excluded people; delivering high-quality and appropriate financial services; creating benefits for clients; and improving the social responsibility of an MFI" (Hashemi 2007). This notion, at the very heart of microfinance's mandate ("do good"), goes beyond the concept of social responsability ("do no harm"). Social responsbility applies to all economic sectors and refers to an organization's responsibility for the impact of its decisions and activities on society and the environment through transparent and ethical behavior (Gendron, 2009).

Figure 1: Sample Distribution

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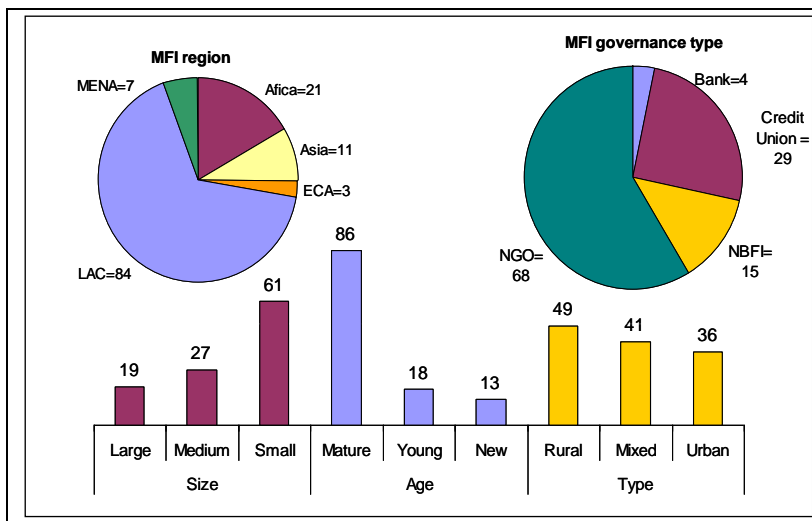
CERISE analyzed the results of 126 social performance assessments conducted between 2005 and 2008. Data sets were selected for their reliability and comparability3. They are representative of the sector as a whole, as the table below shows.

	Borrowers per Staff Member	PaR-30 (%)	Operating Expenses Ratio (%)	OSS (%)	ROA (%)	Number of Active Borrowers	Total Portfolio
CERISE sample (Median)	127	2.6%	15.82	111.10	2.55	7165	4249112
MBB (Median)	112	2.7	19.2	113.6	0.6	11041	4800765

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3 The assessments used the SPI 2.0. The current version (3.0), released in 2009, was revised to include the Social Performance Standards (except for the outcome indicators which are outside of the SPI's purview.)

Thirty-nine countries are represented by a well-balanced mix of rural, urban and mixed MFIs. Latin American institutions and NGOs are nonetheless over represented compared to other regions and charter types (Figure 1).

The SPI collects data on 70 indicators that measure the objectives, processes and immediate outputs of four key **dimensions** of social performance. Each dimension is broken down into twelve *criteria4.*

Targeting and outreach (D1) refers to the MFI's strategies to reach the poor and excluded. Targeting can be *geographic* (1.1), such a when an institution decides to operate in an area where no other financial services are available. It can be *individual* (1.2), when it purposely selects clients based on poverty levels or exclusion. It can be *methodological* (1.3), when services are designed specifically to reach the poor or excluded.

Appropriate services (D2) assesses an institution's ability provide products tailored to client needs. This entails offering a *range of financial services* (2.1) of high *quality* (2.2) as well as *innovative and non-financial services* (2.3)

Some MFIs strive to build **social capital** (D3)5, by fostering *trust and transparency* (3.1), encouraging *participation* (3.2) and developing activities that promote *empowerment* (3.3).

Social responsibility (D4) extends to *employees* through appropriate human resource policies (4.1), to *clients* by guaranteeing respect of consumer protection principles (4.2), to *the community and the environment* by respecting the context where the MFI operates (4.3)

Financial data from the MIX Market and MFIs was used to complete social performance data. The following ratios were selected for analysis: Borrowers per staff members, Operating expenses ratio (OER), Portfolio at Risk (PAR) Operational Self-Sufficiency (OSS) and Return on Assets (ROA).

This data was only available for roughly 100 MFIs in the sample (see Table 2). Analysis involved calculating means for peer groups defined by MBB criteria, conducting Spearman tests and generating a classification tree.

Social Performance Profiles

Rather than focus on the aggregated score for each institution, it is more telling to look at results per dimension. Indeed, it is unrealistic to expect maximum score for each criteria. Different institutions prioritize different facets of social performance, depending on their objectives and context. For example, analysis shows MFIs operating in remote regions where they are often the only financial institution, do not target the poorest of the poor but are frequently based on participatory models. Similarly, institutions targeting the very poor tend to have a less diversified product mix than those serving higher income populations. In the graphs shown here, the total surface area represents the MFIs' efforts to achieve their social mission, while the diagram shape reveals the nature of their social strategy.

Peer group analysis reveals several interesting trends in terms of region and charter type. Latin American institutions are relatively balanced in their social performance while Sub-Saharan

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4 See details for the indicators at www.cerise-microfinance.org
5 This dimension was considerably revised in the SPI's new version, where it appears as **Benefits to Clients**. The three criteria are *economic benefits, client participation* and *empowerment*.

African institutions are distinguished by their focus on geographic targeting and strong participation, and a lack of non-financial/innovative services and weak social responsibility to users. In Asia, targeting is methodological (e.g., small loan amounts, social collateral); non-financial and innovative services (insurance, transfers) are well developed.

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Figure 2: Means of social performance by region 6
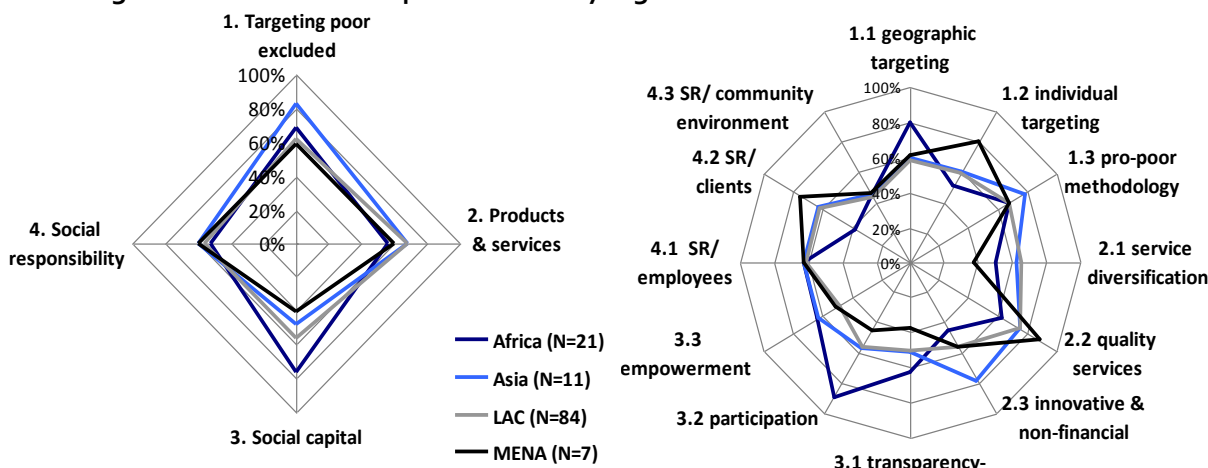
Cooperatives stand out in their efforts to build social capital. However, they are less likely to target the very poor and excluded. Commercial banks score well on product diversity and social responsibility to clients and employees, but do not serve the poor or encourage client participation. NGOs and NBFIs have relatively balanced profiles. The former stand out in terms of individual targeting, while the latter distinguish themselves with high-quality services.

Figure 3: Means of social performance by charter type
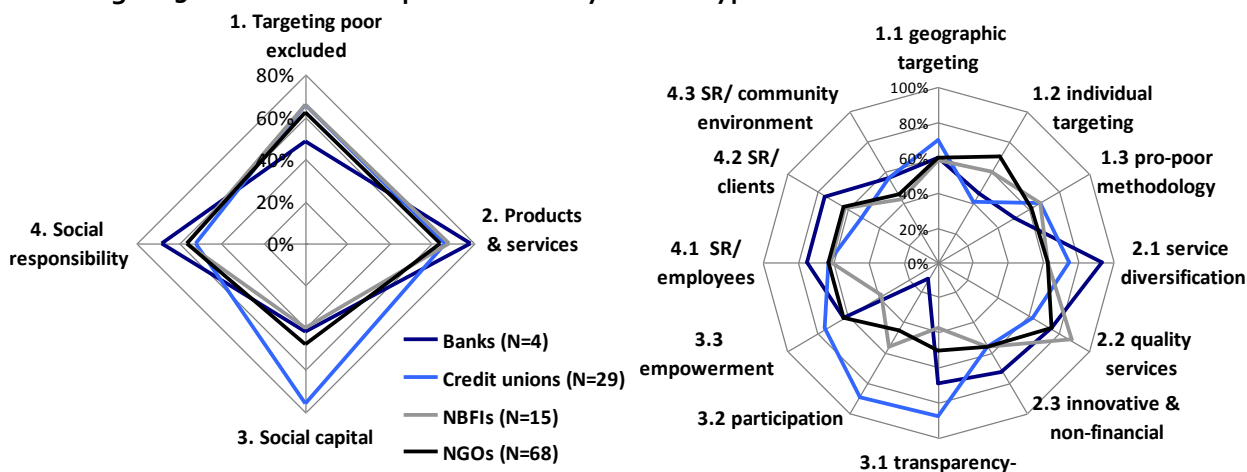
With regard to interactions between the different dimensions, aanalysis of the ccorrelation coefficients confirms what some have long predicted (Gonzalez-Vega, 1998). The four dimensions

6 Europe and Central Asia were not included in analysis because it was too small to be significant (3 MFIs).

mutually reinforce each other, just as high productivity and low PAR often translate into lower costs and higher profitability. Nonetheless, there are some distinct trends.

As Table 1 shows, there is often a trade-off between geographic (1.1) and individual targeting (1.2). As some studies suggest (Hirschland et al., 2008), MFIs that target geographically are more likely to emphasize client participation (3.2) to reduce costs and diversify their product mix (2.1) to manage risk . Those that target individually[7] tend to have less diverse products, but are more likely to offer non-financial services (2.3) and actively promote empowerment (3.3).

Some institutions choose to emphasize pro-poor methodologies, although methodological targeting (1.3) does not preclude the other two. MFIs that allow clients to borrow and save very small sums without physical guarantees often using solidarity groups tend to be highly transparent (3.1) and committed to client protection (4.2). Unfortunately, they appear to do so at the expense of social responsibility to employees (4.1). Nevertheless, institutions tend to drop this approach as their portfolios grow.

Analysis of appropriate services (2.2) and social responsibility (D4) confirms the importance of economies of scale in social performance (Copestake, 2007): large institutions clearly score higher in these areas.

Table 1: Correlation between social and financial performance (results of Spearman tests on data from 126 MFIs)

	1.1	1.2	1.3	D2	2.1	2.2	2.3	D3	3.1	3.2	3.3	D4	4.1	4.2	4.3	Total portfolio
D1	++	++	++					++	++		++				++	
1.1			++		+			++	++	++	+				++	
1.2			++				+				+				+	
1.3									+				--	+		-
D2					++	++	++	++	++	++	++	++	++	++	++	++
2.1						+		++	++	++		++	+	++	++	++
2.2											++	++	++			++
2.3								++	++		++					
D3									++	++	++	++				
3.1										++	++	++				++
3.2											++					++
3.3												++	++		++	
D4													++	++	++	++
4.1														+		++
4.2															+	++
4.3																++

++	Convergence significant at 0.01, 2-tailed	--	Divergence significant at 0.01, 2-tailed
+	Convergence significant at 0.05, 2-tailed	-	Divergence significant at 0.05, 2-tailled

Individual targeting is costly, but other aspects of social performance are "profitable"

By crossing data from SPI audits with financial indicators, it is possible to determine the relationship between social and financial performance.

Table 2: Correlation between social and financial performance

	Borrowers/ staff N=95	PaR 30 N=100	OER N=96	OSS N=83	RoA N=99	Total portfolio N=101
1. Targeting	0,302		0,259			
1.1 geographic	0,381					
1.2 individual			0,422			
1.3 methodological	0,275					0,243
2. Services			-0,253			0,426
2.1 diversity	-0,237		-0,290			0,204
2.2 quality						0,391
2.3 innov. non fin.						
3. Benefits	0,216		-0,245			
3.1 transparency-trust			-0,326	-0,220	-0,206	
3.2 participation				-0,255		
3.3 empowerment						
4. CSR		-0,275				0,566
4.1 SR/staff		-0,200				0,404
4.2 SR/clients						0,353
4.3 SR/community		-0,197				0,376
Total Social	0,210					++

++	Convergence signif. at 1% 2-tailled	- -	Divergence signif. at 1% 2-tailled
+	Convergence signif. at 5% 2-tailled	-	Divergence signif. at 5%, 2-tailled

Table 2 confirms what some studies on outreach have suggested (Cull et al., 2009; Lensink et al., 2009): institutions that actively target the poor tend to have higher operational costs. Hashemi and Rosenberg (2006) explain this phenomenon by the higher risks and lack of guarantees inherent to this clientele, reticence to join microfinance programs and the challenges of providing the non-financial support this population requires.

The divergence is limited to individual targeting, however. Geographical and methodological targeting approaches are correlated with higher staff productivity. This is likely because they are often associated with greater client participation (see Table 1), and they allow MFIs to operate in less competitive markets. Clearly, when social performance is understood as simply targeting the poor, its value-added is limited (Lapenu, 2007, Armendariz and Szafarz, 2009).

Participatory institutions tend to have lower rates of operational self-sufficiency, perhaps due to member pressure to keep interest rates low (Ouatara et al., 1998, p. 3). This finding requires more in-depth analysis.

Our analysis confirms Copestake's (2007) hypothesis regarding the importance of economies of scale for improved social performance. MFIs with the largest loan portfolios score highest in range and quality of services (2.1 and 2.2) and social responsibility (D4). These same institutions have the best repayment rates and lowest operational costs.

Finally, high scores in social responsibility, especially to employees and the community, are correlated with lower PAR. It would appear that when employees and the community feel respected by the MFI, they are willing to respect the MFI in return.
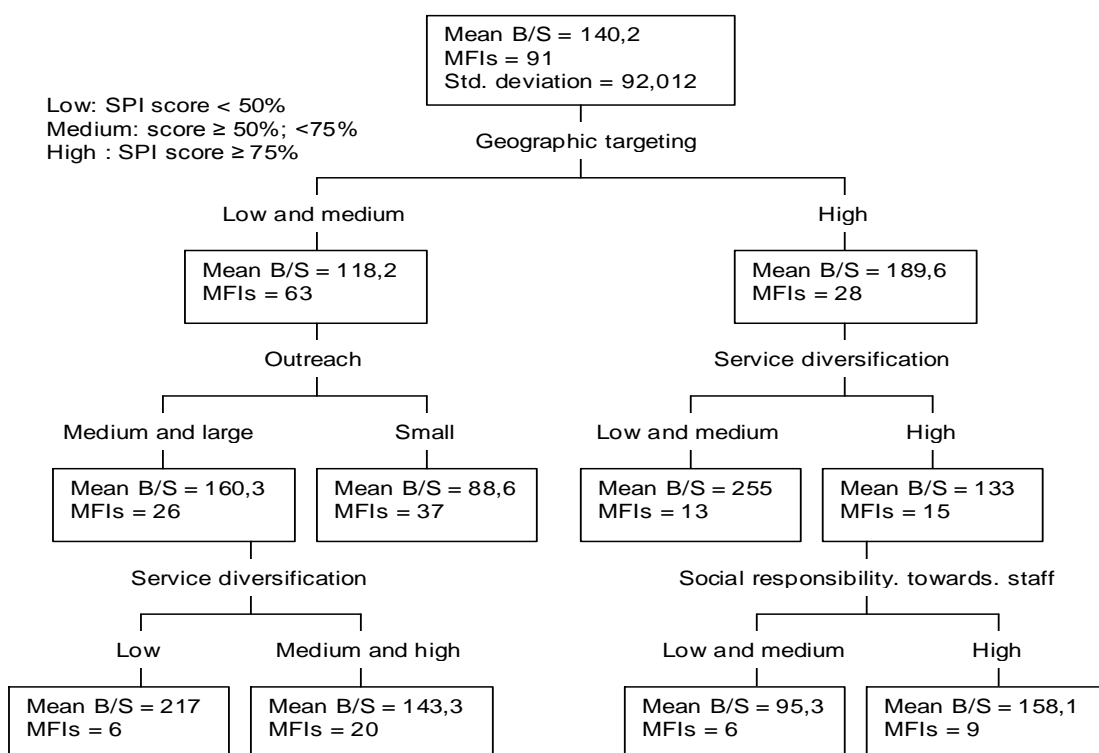
Crossing variables

Simple correlation analysis of each social and financial variable is limited. Microfinance institutions must make choices based on a multitude of factors that are intertwined and not necessarily independent of each other. Classification trees help make sense of this complexity by selecting variables, taking into account their interactions and combining them to classify institutions into groups.

In a classification tree analysis, an dependent variable is identified along with all the factors likely to influence it. Statistical analysis then ranks the factors with the most influence on the variable. In this example, selected for its for its performance prediction (84% of MFIs in our sample), staff productivity is analyzed based on institutional characteristics[8] and social performance results (by dimension and criteria).

Geographic targeting emerges as the main predictor variable. Institutions in very poor or excluded areas generally make efficient use of their workforce: almost 189 borrowers per staff. This ratio rises to 255 for MFIs with little diversity and generally no savings products. For institutions with a wider product range, social responsibility to employees becomes a decisive criteria of effectiveness. Employees of MFIs with an advantageous human resources policy serve an average of 158 borrowers compared to 95 for the others.

For institutions that do not work in marginalized areas, size is crucial. Staff productivity at smaller institutions reaches only 89 borrowers per staff. Conversely, MFIs with over 10,000 borrowers, limited product mix and no savings manage to reach 217 per employee while large MFIs with a more diversified offer reach 143 borrowers per staff member.

Factors Determining Borrowers Per Staff Ratio (B/S), organized by classification tree

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Looking ahead

Thanks to recently developed simple and reliable methods to assess social performance, we can now evaluate microfinance's ability to achieve the double bottom line.

This analysis confirms what many studies have suggested based on incomplete data: social performance and financial performance are compatible. Targeting the poor clearly implies higher costs for MFIs. However other aspects of social performance—namely geographical targeting when associated with participatory models, well-adapted loan technologies and social responsibility—are positively correlated with good operational and financial performance. The correlation is even stronger for large MFIs, which benefit from economies of scale.

FFurther analysis is needed to clarify the relationship between social performance and more complex financial performance indicators like OSS, ROE and ROA. Nonetheless, our analysis echoes the call to go "back to the basics": the pillars of microfinance's social utility (include the excluded, offer appropriate services, benefit clients) clearly impact the fundamentals of financial sustainability: productivity, efficiency and portfolio quality.

CERISE will continue to refine this research agenda, as our database of social performance assessements grows and the new social performance reporting format on the MIX Market gets underway9. The microfinance industry must now rise to the challenge of finding ways to exploit synergies between social and financial performance in order to truly achieve the "revolution" (Robinson, 2001.)

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9 Because the CERISE SPI is fully compatible with the MIX SPS format, MFIs conducting an SPI audit can easily report to the MIX Market.

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