

The Trade-off between Financial and Social Performance



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The Trade-off between Financial and Social Performance

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Introduction

- Grameen Bank 2007
- ING Microfinance 2009
- Graduated from Tilburg University 2009
- Winner University Meets Microfinance Award 2009
- Consultant & researcher
- www.responsiblemicrofinance.org



Microfinance: the Current Tide

A positive note

- Microfinance industry is growing
 - Number of institutions is growing, so is the number of clients in Latin-America, Africa and Asia
 - Surveyed the food (2007) and financial & economic (2008) crisis ([CGAP, 2010](#))
- Yet, challenges remain
 - Financial & economic turmoil
 - 2,5 bil are without formal financial service ([FAI, 2009](#))

Microfinance: the Current Tide

A 'less' positive note

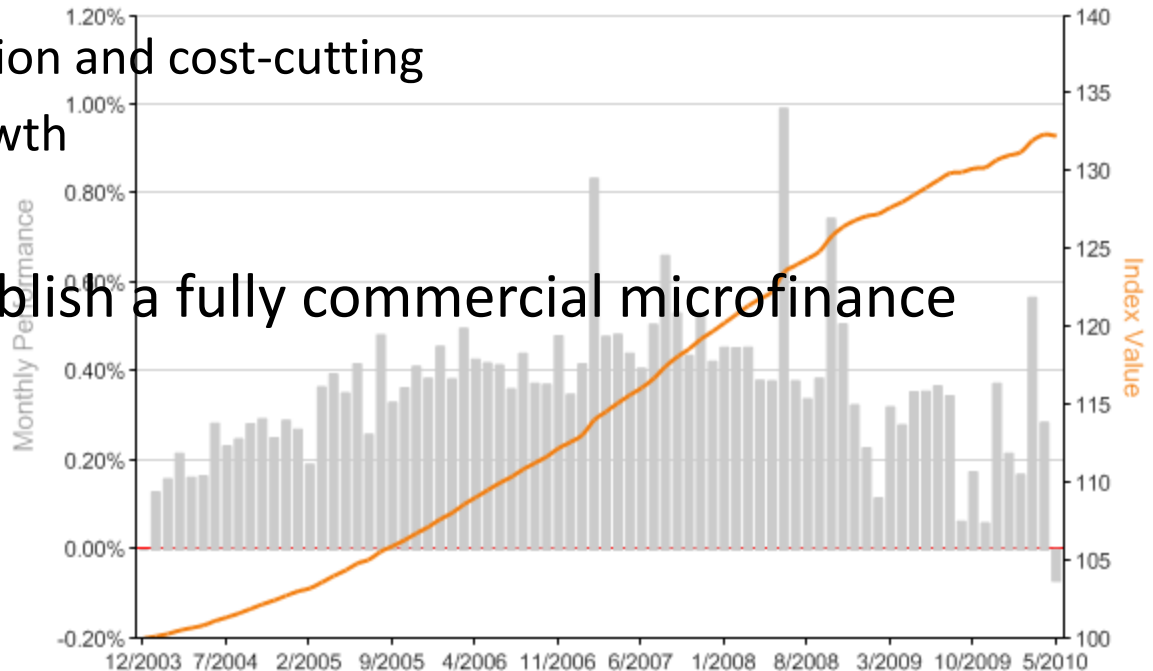
- Downsides and weakness of microfinance
 - Development impact
 - Excessive (?) profit-making behavior in the industry
 - Exorbitant (?) interest rates
 - Over-indebtedness
 - Initial Public Offerings
 - Microfinance bubbles

*“We created microcredit to fight the loan sharks;
we didn't create microcredit to encourage new loan sharks”*

[\(Yunus, 2010\)](#)

Financial Performance and Social Performance

- Financial performance measurement
 - 80's and 90's: increasing attention for financially sustainable microfinance, to:
 - Enhance outreach
 - Allow for innovation and cost-cutting
 - Fuel ongoing growth
 - Objective: to establish a fully commercial microfinance market

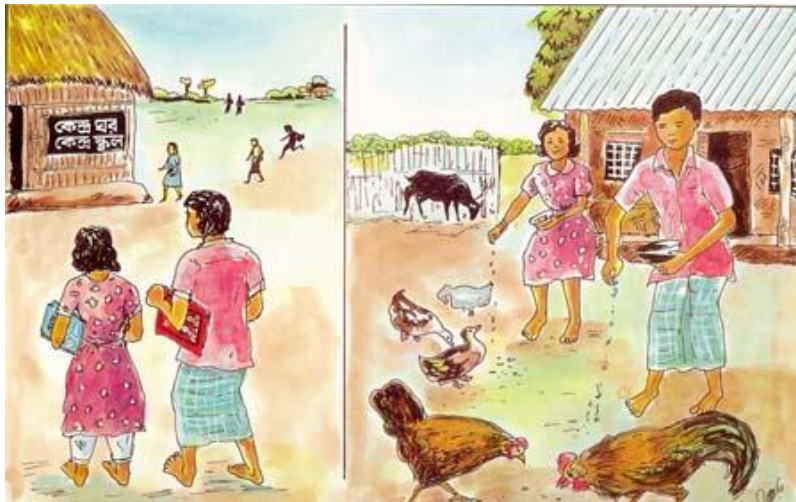


Financial Performance and Social Performance

- More recent challenges
 - Increase in local competition amongst MFIs
 - Increase in competition from local commercial banks
 - Growing interest of international banks and investors
 - Greater transparency, allows for measurement and benchmarking of financial performance
 - Increasing role played by microfinance rating agencies

Financial Performance and Social Performance

- The social performance movement
 - Several initiatives and attempts to integrate social performance measurement are taken
 - 2005, the [Social Performance Task Force](#)
 - 2008, the [Smart Campaign](#) on client protection principles
 - Next: implementation of measurement and management tools, reporting and enforcement



*A new movement?
Remember the [16 Decisions](#)
of Grameen Bank*

Financial Performance versus (?) Social Performance



"We have to note that some microcredit providers have increased their earnings while their costs decreased. In such cases, financial gain has become more important than sustainable development."

(Princess Máxima, 2010)

Mission Drift in Microfinance

[Cull, Demirgüç-Kunt, and Morduch \(2007\)](#) define mission drift as “... a shift in the composition of new clients, or a reorientation from poorer to wealthier clients among existing clients.”

[Armendáriz and Szafarz \(2009\)](#) define mission drift as “... a phenomenon whereby an MFI increases its average loan size by reaching out wealthier clients neither for progressive lending nor for cross subsidization reasons.”

Empirical Insights in Mission Drift

<i>Author(s) (year)</i>	<i>Empirical evidence of mission drift found?</i>	<i>Approach</i>
Cull, Demirgüç-Kunt & Morduch (2007)	Yes, but based on very weak evidence.	Ordinary least squares
Olivares-Polanco (2004)	Yes	Ordinary least squares
Hermes, Lensink & Meesters (2007)	Yes, find strong evidence	Stochastic frontier analysis
Gutiérrez-Nieto, Serrano-Cinca & Mar Molinero (2009)	Yes, financial performance is prioritized above social performance.	Data envelopment analysis
Mersland & Strøm (2009)	Yes, but cost efficiency improvements may outweigh the negative effect of profitability.	Panel data

Thesis 'Mission Drift in Microfinance'

- Objective

Find empirical evidence on mission drift, allowing institutional investors to recognize and prevent mission drift taking place in their portfolios

- Problem statement

➤ *First, what is the explanatory function of the institutional and country risk indicators in predicting the financial and social performance of MFIs?*

➤ *Second, how do institutional and country risk indicators affect the trade-off between the financial and social performance of MFIs?*

Thesis 'Mission Drift in Microfinance'

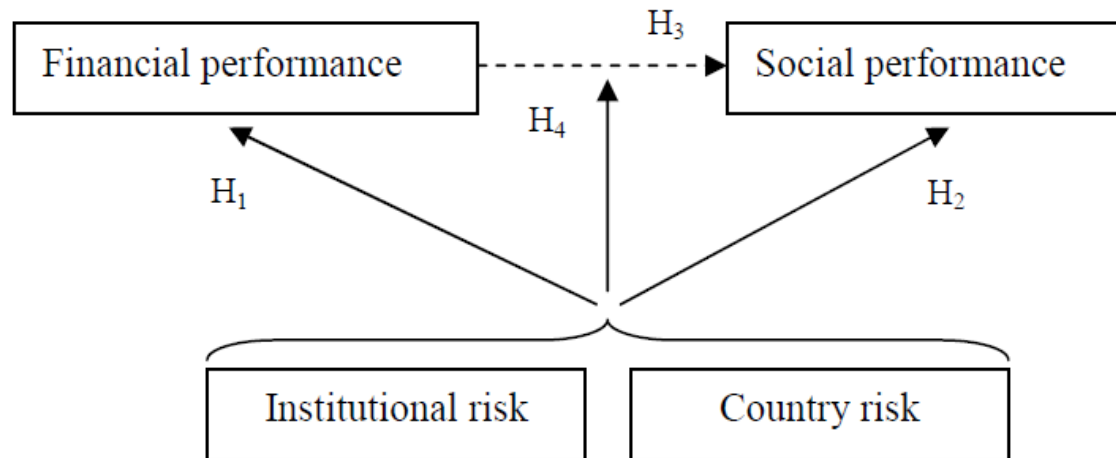
- Dataset
 - 600 MFIs, 84 countries, reaching app. 50 mln. microfinance clients people, of whom app. 75% are women
 - Observation for the year 2007 (MIX Market)
- Regression approach: ordinary least squares
 - Financial performance regression (H_1)
 - Social performance regression (H_2)
 - Mission drift regression (H_3 & H_4)

Thesis 'Mission Drift in Microfinance'

- Research model & indicators

- Operational-self sufficiency
- Return on assets
- Profit margin

- Average loan size / GDP per capita
- Average loan size / GDP per capita 20% poorest
- Percentage women borrowers



- Type of institution
- Regulation
- Network membership
- Age of MFI
- Size of MFI
- Country risk indicator

Thesis 'Mission Drift in Microfinance'

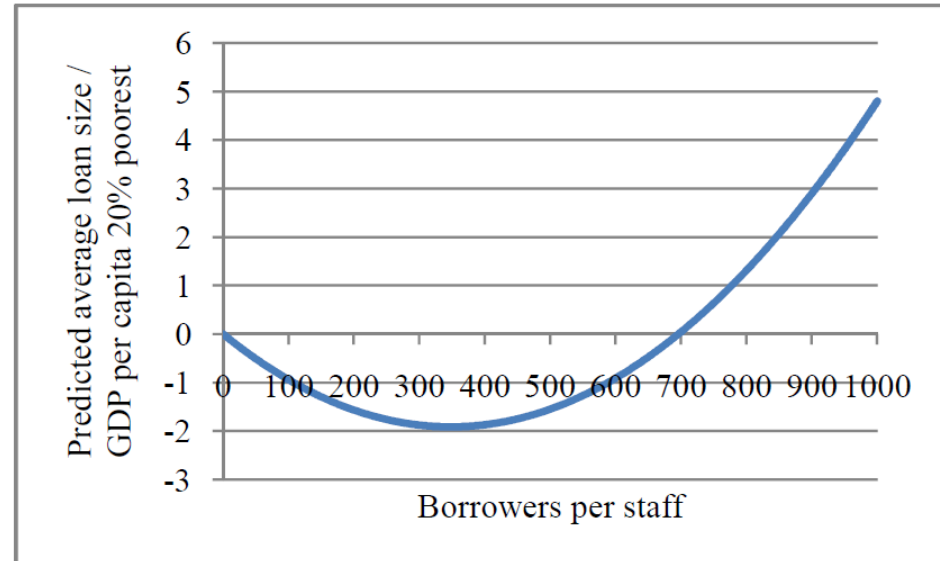
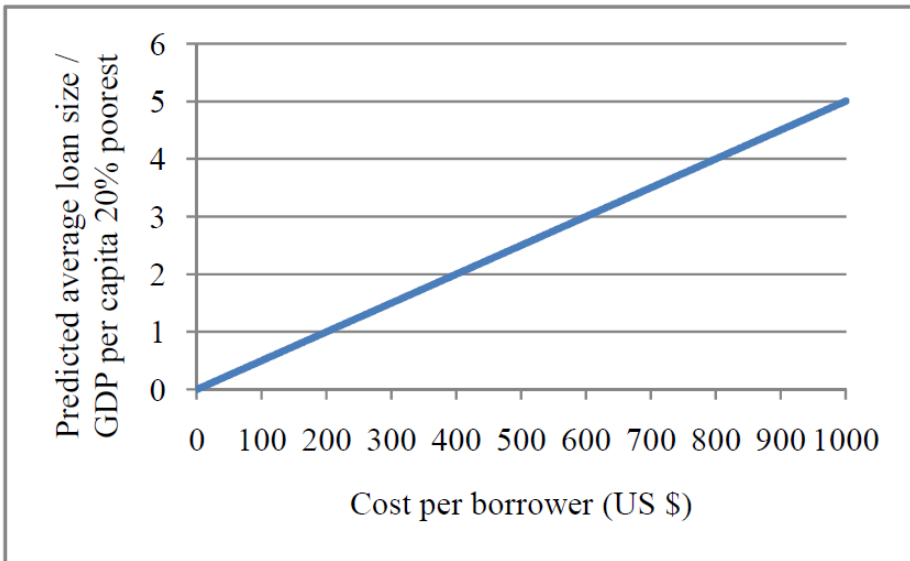
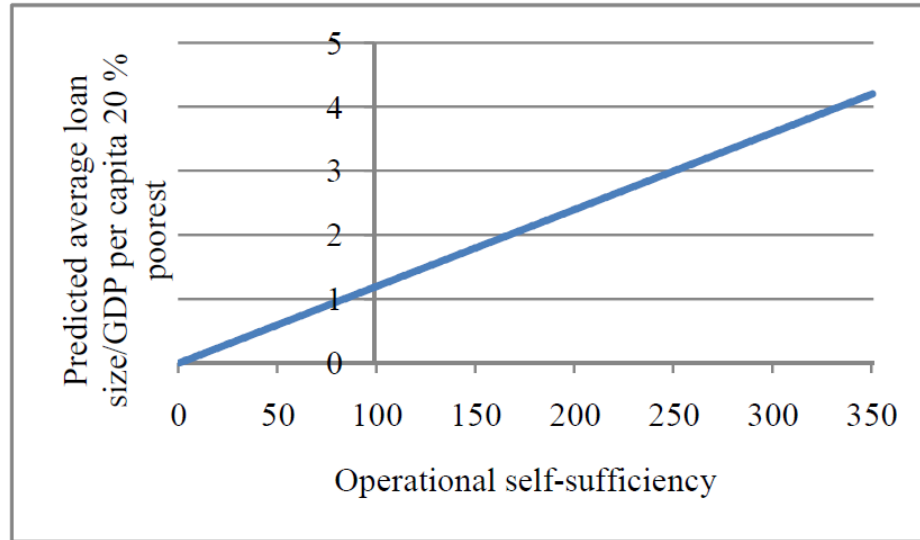
- Regression models on mission drift are performing reasonable

	<i>Effect on the social performance of MFIs*</i>
Operational self-sufficiency	Negative
Cost per borrower	Negative
Borrowers per staff	Positive -> Negative
Regulation	Negative
Network membership	Positive
Years of age	No relation
Size	Negative
Country risk indicator	Negative

* *Affecting either the average loan size measures or the percentage of women borrowers measure.*

- Similar results are found using return to assets or profit margin

Thesis 'Mission Drift in Microfinance'



Thesis 'Mission Drift in Microfinance'

- Conclusions

	<i>Effect on the financial performance of MFIs</i>	<i>Effect on the social performance of MFIs*</i>	<i>Influence on the susceptibility of MFIs to the occurrence of mission drift</i>
Operational self-sufficiency	-	Negative	More susceptible
Cost per borrower	-	Negative	More susceptible
Borrowers per staff	-	Positive -> Negative	Less susceptible -> More susceptible
Regulation	No relation	Negative	More susceptible
Network membership	No relation	Positive	Less susceptible
Years of age	Positive -> Negative	No relation	More susceptible -> Less susceptible
Size	No relation	Negative	More susceptible
Country risk indicator	Negative	Negative	No relation

* *Affecting either the average loan size measures or the percentage of women borrowers measure.*

Final Thoughts for the Dialogues 2010

- ‘Trade-off’? The is question: how to ‘balance’ financial and social objectives?
- On the win-win proposition of microfinance: the (more) fundamental question is: excessive profit-making behavior or responsible profit-making behavior?
- On social performance tools: more tools or more common sense?
- On implementing social performance tools: a top-down or bottom-up process?