

FINDINGS FROM SOCIAL RATINGS

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Social and financial performance

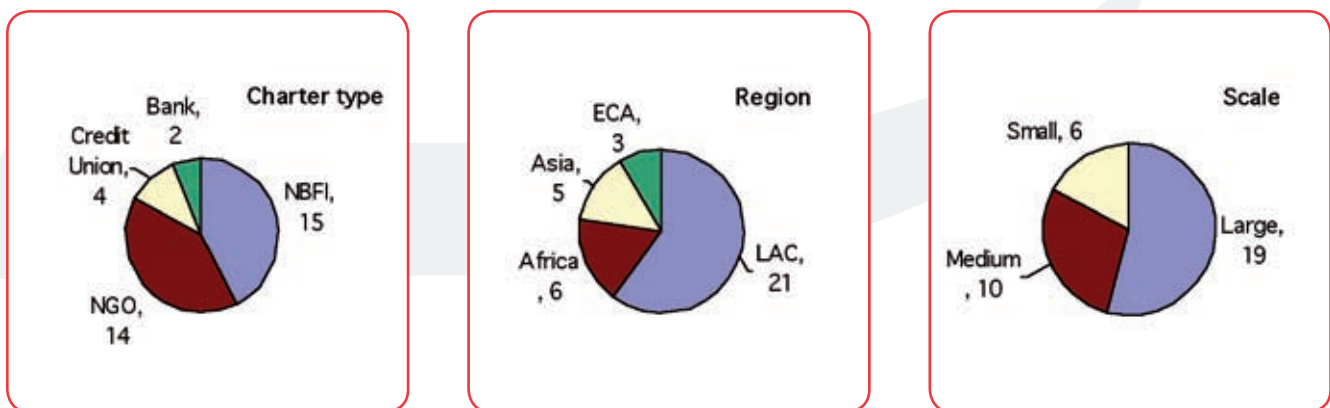
INTRODUCTION

Investigating the relation between social and financial performance is key in a sector aiming at contributing to social development in a financially sustainable way.

The question if there is a trade-off between social and financial performance is still an open debate. On the one hand, the experience of a number of large and regulated MFIs, diversifying their target markets and increasing their average loan size, seems to suggest that a higher financial performance is achieved at the expense of the institutions' social performance. On the other hand, several social performance aspects are instead expected to strengthen the financial performance; as an instance an improved level of clients' satisfaction yields a positive effect on the level of operating expenses through a reduced client drop-out rate.

An increasing number of studies have been produced in recent years reflecting the progress made on social performance assessment tools. The importance of the subject calls for additional effort from the sector in investigating the relation between social and financial performance. The significance of the results will improve as the sector makes further progress on the accuracy of the social performance indicators. Moreover, MFIs present different strengths and weaknesses in the several areas of social performance, confirming the importance of complementing the analysis of comprehensive indicators on social and financial performance with a more specific research at disaggregated level.

MicroFinanza Rating is willing to contribute to the discussion by sharing some of the findings arising from the social ratings conducted so far, bringing in particular the added value of accurate data collected through client surveys. The results are based on data from 36 MFIs in 21 Countries, showing varied profiles in terms of region, size and legal form, as it can be observed from the graphs 1, 2 and 3.

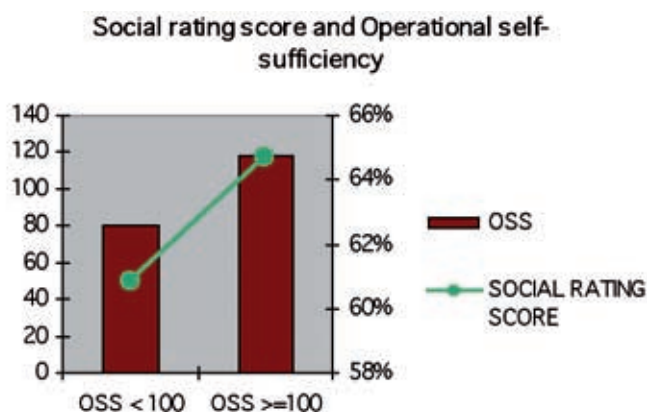


Graph 1, 2, 3: MFIs by Charter type, Region and Scale.

The social performance indicators considered are taken from MicroFinanza Rating's methodology, according to which four main areas of analysis contribute to the overall assessment: social performance management systems, social responsibility, outreach and quality of the services. With reference to financial performance, the main indicator considered is the Operational Self Sufficiency (OSS) ratio, mainly collected through financial ratings.

¹ Weights by area: 30% SP management system, 20% social responsibility, 25% outreach, 25% quality of the services.

SOCIAL RATING FINDINGS



Graph 4: Social rating score and Operational Self-Sufficiency (OSS)

Classifying the cases by operationally self-sufficient MFIs and non-operationally self-sufficient MFIs seems to indicate that social and financial performances are compatible. On average, **operationally self-sufficient MFIs show a higher social performance score** (graph 4). However, the small size of the sample hampers the statistical significance of the correlation, calling for a future replication of the analysis on a larger database.

On the other hand, **significant statistical correlations** are found when considering some specific indicators within the overall social performance, as shown in table 1.

Table 1: Significant correlations between social and financial performance

NO.	SOCIAL INDICATOR	FINANCIAL INDICATOR	CORRELATION**
1	Outreach breadth*	OSS	0.39
2	Social responsibility towards staff*	OSS	0.32
3	Clients below the national poverty line (%)	Staff productivity (no. borrowers)	0.38
4	Social responsibility towards the clients*	Client drop-out rate	-0.44

*Social Rating score. **Pearson correlation coefficient, significant at the 5% level.

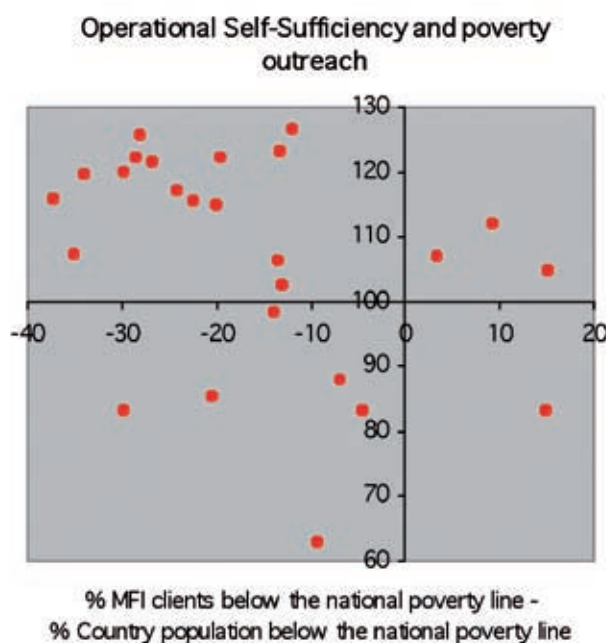
The results provide the **evidence** of specific mechanisms **mutually reinforcing** the **social and financial performance**:

1. The positive correlation between OSS and the **breadth of outreach** score² confirms the double positive effect of growth on the economies of scale and on the coverage.
2. OSS and the score attributed to the **social responsibility towards staff**³ are also positively correlated, possibly indicating a virtuous circle between providing the staff with adequate working and developing conditions, therefore enhancing staff productivity and loyalty, and improving the financial performance.
3. The service delivery systems adapted to reach poor segments of the population, based on client participation and meetings, may be the reason of the positive correlation between **staff productivity** (number of borrowers per staff) and the percentage of clients below the national poverty line.

² Size of operations (clients, portfolio and savings) compared to the benchmark, as well as the growth trend.

³ Contractual and economic conditions, training, internal career, climate, staff turn-over, communication and participation.

4. Considering the higher operating costs and risks entailed by the client drop-out rate, the negative correlation between such indicator and the score assigned to the **social responsibility towards the clients** indicates possible positive financial spillovers of good consumer protection practices.



Graph 5: Poverty outreach and Operational Self-Sufficiency

On the other hand, the analysis shows that **poverty outreach**, one of the pillars of the social value attributed to microfinance, may entail a **financial cost**. Graph 5 shows that the higher the poverty index⁴ of the MFIs, the lower is the operational self-sufficiency, possibly reflecting the higher costs and risks involved in reaching poorer segments of the population. Even if the correlation is not significant due to the small size of the sample, the general trend should be better analyzed. Such result could be due to a combination of several factors, including, among others, the higher unitary costs of small loans, the more expensive delivery systems to reach remote areas, the non-financial services which can be additionally provided, and the exposure to higher risks due to the niche vulnerability. Scale could also play a role in some MFIs as the achievement of economies of scale is sometimes accompanied by a diversification of segments served and a reduction of the share of more disadvantaged clients.

CONCLUSIONS

The analysis shows that the social-financial trade off question needs an articulated answer in order to better inform the sector's decisions. A twofold conclusion can be drawn from the results:

- **Social** and **financial performances** are **mutually reinforced** by a variety of mechanisms, which should be strengthened by the sector. Such synergies involve the breadth of outreach and economies of scale, poverty orientation and staff productivity as well as consumer protection and client drop-out rate.
- **Poverty outreach** seems to involve a **financial cost**. However, the existence of an additional cost should not necessarily suggest the drifting of the microfinance sector from poverty outreach objectives. Rather, the trade-off should be managed: the desired levels of poverty outreach cost and benefit should be intentionally set in order to balance the social and financial performance in the overall strategy.

In other words, the **social** and **financial performances** are **compatible** thanks to a variety of **synergies** and provided that those **trade-offs** which may exist are **adequately managed** through a balanced strategy.

The relations between the social and the financial performance in microfinance and the direction of such relations should be further investigated in the future, once larger databases are made available and additional contributions have joined the debate.

⁴ % MFI clients below the national poverty line - % population in the country below the national poverty line.

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