ABSTRACT

Help Me, I'm Succeeding: A Critical Look at Microfinance Institutions' Measurements of Success

Johanna Lee

Director: Gia Chevis, Ph.D., Accounting

My thesis outlines the origin of microfinance institutions and their "double bottom line" business structure. Working to achieve a social good and a desired profit is worth the investment. Assessing the impact of these two goals educates the public about microfinance's ability to alleviate poverty. I examine the current measures of success and their focus on the institution's operations. These measurements do not always communicate if the borrower has come out of poverty. It is important that these measures are transparent and reflective of the borrower's success in both the short and long term. Without proper measurements, an illusion of success in microfinance lending can hurt the poor. Proving that the poor are credit worthy is not enough to continue microfinance lending if the social mission is not being met. Finally, I survey the success of microfinance, by looking at multiple metrics, that when combined can unambiguously determine the success of the borrower.

APPROVED BY DIRECTOR OF HONORS THESIS:

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Dr. Gia Chevis, Accounting

APPROVED BY THE HONORS PROGRAM:

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Dr. Andrew Wisely, Director

DATE: ________________________

HELP ME, I'M SUCCEEDING: A CRITICAL LOOK AT MICROFINANCE INSTITUTIONS' MEASUREMENTS OF SUCCESS

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By

Johanna Lee

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CHAPTER ONE

Introduction

This paper will investigate how microfinance firms are evaluated currently. Microfinance firms have a desire to achieve profits and social change, and this paper will discuss the effectiveness of whether these measurements evaluate both goals. This paper reviews the beginnings of microfinance and business-charity hybrids, evaluates current measurements for these companies, and finally, proposes novel measurements. The mission of microfinance is to alleviate poverty, but it is hard to verify whether this goal is being met. Determining whether or not microfinance is successful depends upon microfinance helping a borrower get out of poverty. Getting the poor out of poverty is the social goal for which microfinance firms are aiming. However, when focusing in on current measurements, the world does not get a comprehensive picture of whether both goals are accomplished through microfinance as a vehicle of funds for the poor. The question of whether microfinance alleviates poverty is disconnected from what measures are collected and measured. Whether the borrowers rise out of poverty can be overlooked as the microfinance firms strive to continue to make money. The question is important for a number of reasons. When an entity touts a long-term social mission, such as alleviating poverty, it is important to measure whether this mission is being achieved. Because microfinance has a "double bottom line" that tries to achieve both profit goals and social goals, monitoring success in both criteria is needed. Not only are the short-term successes of these goals prevalent but long-term metrics are paramount for linking microfinance to any type of alleviation of poverty.

Microfinance institutions (MFIs) look at repayment rates as a metric for success. Repayment rates are a short-term indicator. By using repayment rates to prove the worth of the microfinance industry, long-term promises for this social goal are missing. MFIs answer a portion of the problem for rural finance: are poor people creditworthy? Measuring success of a borrower based on their repayment rate is akin to measuring a person based on whether they went bankrupt or not. A dollar-for-dollar payback of a loan does not mean that the borrower was successful in pulling himself out of poverty. Repayment rates prove that the poor can indeed be creditworthy, but this measurement only takes into account the short-term “success” of the borrower. A new measurement must therefore be created.

The success of microfinance will be assessed by looking at multiple metrics that, when combined, can determine whether the poor are improving their lives. Focusing on repayment rates diminishes the goal of poverty-alleviation because it is a metric about whether the profit goals are being met, not whether the success of individuals taking out the loan is realized. Thus, the analysis of the success of MFIs should contain comparisons of short-term with long-term metrics, including how the savings rate of clients fluctuates with each loan outstanding. However, averaging the savings rates in microfinance compared with the averages of repayment rates in the industry is not adequate. The purpose of microfinance is to reach individuals and not assess an average that has client large demographic range. Individuals need to have their repayment rates compared with their savings rate to show success, or at least improvement in the life of the borrower.

MFIs are new because of their “double bottom line”, not because they are the first people to give out loans, or even the first people to give loans to the poor. Proving that the poor are creditworthy is not enough to continue microfinance lending if the social mission is not being met. Good intentions cannot substitute for the various business measures that need to be in place for success. A successful microfinance institution is trying to improve wealth of poor people so that their wellbeing will improve. If MFIs track these indicators for their business, several things become demonstrable: microfinance is a needed industry, which institutions are doing poorly, and how to help them better serve people. Helping the institutions ultimately helps the borrower, which is the end. Because of this difference in their bottom line, microfinance needs to be addressed as it is, a profit mission and a social mission combined.

Origin of Microfinance

Anecdotes of success are oftentimes the data that academics use to evaluate business-charity hybrids. What follows is an anecdote that is not publicized as much as others: Naomi has a family of five in Bangladesh. She does not work, but has aspirations of being a cart owner in the central market. Advertisements in her town push ideas of banking to make her dream possible. With high hopes and a newly discovered resource, Naomi takes out a small loan at this bank. Naomi ultimately wants to use the money from her cart for her family. When the loan officers clear Naomi for the loan, Naomi takes the income to first feed her starving kids. After eating a complete meal for the first time in a year, her family becomes excited about the future. Naomi buys supplies for her cart, but at the month’s end she has only sold enough bracelets to cover the cost of her supplies. The bank checks back in with her, and they explain that she has to pay back the money they loaned out in addition to the high interest rate they charge. Naomi does not understand the process; however, she promises she will have the money at the next payment. The idea of being self-sufficient spurs on Naomi, but the fact that millions of women like Naomi are being given this opportunity (many without schooling on finances) will not alleviate poverty. Naomi likes the idea of self-sufficiency, but are these loans directly related to a decrease in poverty? The purpose of the above anecdote is to provide a different perspective on the utility of such anecdotes for evaluation purposes. Anecdotes are a mainstay for discussing ethical implications in topics such as this. They convey a persuasive and heartfelt message in the form of an encouraging story. Microfinance can be the answer. However, there are problems that first need to be solved and addressed.

Every plan must start with a purpose. The point of this section is to establish the purpose of microfinance. Design is established in the microfinance industry in a number of ways. Identifying why microfinance is such a unique idea, explaining a business' double bottom lines, and describing motivators for people investing in this kind of business structure will provide insight into that design. Without knowing the goals of microfinance, there is no way of knowing if the goals are being met. One must ask if the goals have changed and thus changed the design of the industry. If new goals have emerged, then the firms may change in order to accomplish those goals rather than working to improve their previously stated goals.

Microfinance as practiced today started with Muhammad Yunus. Muhammad Yunus, the founder of microfinance, won the Nobel Peace Prize for a reason; he brought validity to the microfinance structure because he believed that “credit is a human right.”[1] His intent for starting the Grameen Bank, a large microfinance bank in Bangladesh, was to fulfill this right for many people. He did this through the service of microcredit loans. Microcredit gives loans to poor people in small amounts without the collateral most banks require.[2] This idea took off in the form of new microcredit institutions as articles were published praising the success of the poor’s ability to pay off these loans. These articles spoke to the heart of the philanthropic investor and became a way for first-world countries to invest their money. Many microfinance websites contain business plans of the poor and reasons that they need the loan to attract attention of the donors. A person can then track the success of the money they invested. This approach to poverty-alleviation seems like a break from charity into a more sustaining difference in poor people’s lives. These are all good motives, but like David Hulme, Director of Chronic Poverty Research Center at the University of Manchester says, “If they [MFI’s] seek access to aid funds targeted on poverty reduction, then they do need to explain what they are doing for poor people, rather than hide behind rhetoric and anecdote.”[3] The idea of microfinance is unique, but it needs to establish hard statistical evidence of efficacy.

Microfinance should solve the problem of low income borrowers being able to access loans. The industry of microfinance should be a viable option for business because

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[1] Thomas Dichter. “Hype and Hope: The Worrisome State of the Microcredit Movement,” *Legal City Legal Magazine*, 2006, 1.

[2] ibid, 2.

[3] David Hulme, "Is Microdebt good for poor people? A note on the dark side of microfinance." Ed. Malcom Harper. *What's Wrong with Microfinance?* Ed. Thomas Dichter. Warwickshire, UK: Intermediate Technologies Publications, Ltd., 2007, 27.

it is rich in its social mandate as well as rich in profits. However, microfinance was not formed for the purpose of profits, but for providing services to the poor in order for them to have the ability to rise out of poverty. The poor require this opportunity. Demand-led organizations are "client-centered" and thus need "product diversification" to meet the demand.[4] People in poverty who have an entrepreneurial idea are the people who are demanding that microfinance. Without it, those same people would be subject to the unethical rates and practices of street moneylenders in these low economic areas. These usurious moneylenders give the desperate fast money, but at a steep price.[5] Therefore, if the clients demand microfinance, then when microfinance services are not working, there needs to be change in the services provided. Microfinance was developed for the purpose of the borrower, not the purpose of the bank. It is important to note this purpose in order to better understand its implications.

"Hidden" Double Bottom Line?

The way microfinance helps and hurts people can be misunderstood. For example, when I tell people that I am writing about microfinance, I get positive feedback of the success and difference that microfinance can make. This is because word-of-mouth can change the perception of success. Due to factors including inability to replicate data, selection bias of samples, and the metrics themselves being inadequate, these "success indicators" can misinform the public.

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[4] James Copestake, "Towards a General Framework for Client Monitoring Within Microfinance Organizations." *Impact Assessment*. 2001, 1.

[5] Jacob Yaron, Benjamin McDonald, and Gerda Piprek. *Rural Finance: Issues, Design, and Best Practices.* Environmentally and Socially Sustainable Development Studies and Monographs Series 14. Washington, D.C.: World Bank, 1997, 25.

Simply because an idea is new does not mean that the idea is good. David Hulme states, "Those who present microfinance as a magic bullet to reduce poverty provide such a simple message for policy formulation that they encourage it to be simple-minded."[6] When measured, the hope of reducing poverty in an empowering way is vague. The success measures are focused on the lending entity, but not on the success of the borrower. The word-of-mouth communication about microfinance needs to include statistics that prove microfinance is meeting the double bottom line it has set for itself.

Academics must then establish the efficacy of microfinance and the right measurements to accurately depict efficacy. Thomas Dichter, a practitioner of microfinance in three countries, emphasizes, "The reality is that the movement [of microfinance] has in large part shied away from rigorous studies of impact and increasingly turned inward to focus on the performance of the lending entity."[7] This call for study can be fulfilled through academic research.

Problems of Microfinance

As evidenced by the aforementioned anecdote, the way microfinance is currently practiced has the potential of hurting the poor. The purpose of identifying the problems of microfinance is to provide motivation for change in how microfinance addresses long term problems. Relevant problems that are being addressed in the literature are (1) mission drift, (2) the subjective nature of the loan, (3) rate of return that is required from

[6] David Hulme, "Is Microdebt good for poor people? A note on the dark side of microfinance." Ed. Malcom Harper. *What's Wrong with Microfinance?* Ed. Thomas Dichter. Warwickshire, UK: Intermediate Technologies Publications, Ltd., 2007, 28.

[7] Thomas Dichter, "Hype and Hope: The Worrisome State of the Microcredit Movement," *Legal City Legal Magazine*, 2006, 7.

borrowers, and (4) increasing interest rates. Microfinance could be a way to alleviate poverty, but constructive criticism will improve the effectiveness of helping the borrower.

Mission Drift

In the interest of furthering optimistic view of what microfinance accomplishes, media has represented microfinance as an industry comprised of only good people with good intentions. However, since the origination of microcredit, the industry has changed. This change has gone from philanthropic endeavors of prosperous investors, to profit-driven companies. Media does not address this shift in motivation. As microfinancing continues to be presented to the affluent as philanthropic, funding is secured for these institutions regardless of people helped. The impact on the poor may depend on many factors regarding the borrower instead of factors encompassed in microfinance. In fact, Vijay Mahajan, a specialist of microfinance, says that the more disposable income a borrower starts off with, the more the impact of the loan has on their life. Whereas the less income a person has, the less impact the loan has on their life. [8] This means that the bottom edges of poverty are overlooked because they do not add to the profit that microfinance is finding in the untapped sources of income within poverty-stricken areas.

The original mission of microfinance drifts when focus goes off of the borrowers. The problem of mission drift in a business that has a social mission is critical to the integrity of the social change that is trying to be accomplished. Mission drift should be addressed

[8] Vijay Mahajan. "Is Microcredit the Answer to Poverty Eradication?" *AWID Journal,* 1997. <http://www.basixindia.com/publication.asp>, 2.

by the media, as well as discussed in academic settings. In the article "Making a Major Impact with Microfinance," professor Wuerth of Lehigh's Martindale Center for the Study of Private Enterprise takes students overseas to see microfinance first hand. She says this experience changes the students' lives as it opens up their eyes to the poverty, but more importantly the poor's good work ethic.[9] The students' work should change the lives of the poor, not only the lives of the students. Karnani says it clearly, "The reality of microcredit is much less attractive than the promise" [10]. Microfinance institutions use an emotional appeal for their business plan, but not a statistical appeal. The industry highlights access to banks as a factor for poverty-stricken areas, and media continues to broadcast microfinance effectiveness in poverty-alleviation. The original mission of microfinance drifts when focus goes off the borrowers.

Process of giving a loan

Lending in any form has subjective components. Unlike charity, loans are not given out freely. A loan officer inspects loan requests before handing them out. Checking for collateral determines risk for the lender, and corresponds to an appropriate interest rate. If there is any collateral that the poor can offer, it is frequently undervalued[11]. Most micro-lending deals with clients without collateral. This contributes to the loan process being subjective. Obtaining credit is largely based on "unobservable traits" that therefore

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[9]Sharon Shinn. "Making A Major Impact With Microfinance." *Bized* 6.3 (2007): 26-31. *Academic Search Complete*. Web. 26 Oct. 2011, 30.

[10] Aneel Karnani. *Fighting Poverty Together*. New York: Palgrave MacMillan, 2011. Print, 26.

[11] Anis Chowhurdy. "Microfinance as a Poverty Reduction Tool: A Critical Assessment." *Economic and Social Affairs*. Dec. 2009, 298.

lead to selection bias in the industry[12]. Because lending is already subjective in nature, the elimination of the objectivity of collateral can further distort who is receiving loans and understanding why the borrowers are successful.

Selections regarding whom to loan money are made in order to make the industry look beneficial, not on who needs the money more. Hans Dieter Seibel writes, "Loans are uniformly allocated according to defined production goals, which leaves little room for loan appraisal or creditworthiness examination." These loans are even harder to deem creditworthy because the specifics of the loan are not individualized. The maturities, dollar amount, and time to collect are all subjective in nature and not standardized.[13] The lack of collateral and increase in bias makes the mission of microfinance institutions hard to reach. Loans for which the microfinance institutions were made are instead being withheld when the institution decides it is not willing to take a risk.

Through means of microcredit, instead of cultivating a culture of saving, we foster an environment of instant gratification. The goal of a loan is to invest in something that will make returns on your money. Despite this, the poor use microloans for personal reasons. Since the mission of microfinance is to alleviate poverty, the criterion for receiving these loans is being poor. However, as Aneel Karnani states in his book, *Fighting Poverty Together,* people use fifty to ninety percent of microloans for personal purposes rather than as investments to build an entrepreneurial-based job[14]. The

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[12] Beatriz Armendariz de Aghion and Jonathan Morduch. *The Economics of Microfinance*. Hong Kong: Massachusetts Institute of Technology Press, 2005. Print, 223.

[13] Hans Dieter Seibel. "From Cheap Credit to Easy Money." *Microfinance Gateway,* 1994. < http://www.spanish.microfinancegateway.org/files/2382_02382.pdf>, 2-5.

[14] Aneel Karnani. *Fighting Poverty Together*. New York: Palgrave MacMillan, 2011. Print, 31.

microloans borrowers obtain mainly satisfy their individual needs, not in the needs of their business. When banks give a poverty-stricken population the opportunity to borrow money, a poor person will fund his or her survival needs first, above business needs. The Consultative Group to Assist the Poor (CGAP) notes that, "Very poor borrowers take out small, subsistence-protecting loans and seldom invest in new technology, fixed capital, or hiring of labor."[15] Then this money that they use to buy food or clothes will be at a higher cost because of interest expense. A person needs to be self-sustaining before he or she can start a self-sustaining business. This can be done by investing in capital goods instead of consumer goods.

Interest Rates

Microcredit loans charge high interest rates. Globally, the average interest rates for microloans are 26%.[16] But Aneel Karnani, a professor at the business school in the University of Michigan, states that these rates are even 30-60% annual for some microfinance institutions.[17] This rate is much larger than any business pays in the United States. CGAP rationalizes these interest rates by stating, "The higher interest rates charged by financially sustainable institutions screen out borrowers whose projects have

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[15] "Financial Sustainability, Targeting the Poorest, and Income Impact." *Focus*. Version 5. CGAP, Dec. 1996. Web. 12 Feb. 2013, 3. <http://www.eldis.org/vfile/upload/1/document/0708/DOC2936.pdf>.

[16]Julian Evans. "Microfinance's Midlife Crisis; Companies that Provide Banking Services in Developing Countries are Attracting Private Investment. but is the Industry Losing Sight of its Mission to Alleviate Poverty?" *The Wall Street Journal.* Mar 01 2010. Web. 27 Oct. 2011, 3.

[17] Aneel Karnani. "Microfinance Misses Its Mark." *Stanford Social Innovation Review.* 2007, <http://www.ssireview.org/articles/entry/microfinance_misses_its_mark>.

relatively low rates of return."[18] The worry is that without high rates of financial literacy in rural areas, the poor will not be able to identify any rates as high.

Microfinance institutions justify the interest rates by reasoning that competition will lower the rates over time; however, this has yet to be seen. A community is more apt to be taken advantage of when a culture of financial literacy does not exist. Interest rates offered by banks may exceed "on the street" loans if interest rates are expressed in monthly terms versus annual terms. Ten percent per month is significantly more to pay than ten percecnt per year.

These interest rates, at first glance, seem like an exploitation of the poor, but Ayi Gavriel Ayayi and Maty Sene conclude that microfinance institutions' would go bankrupt if they did not charge high interest rates. The microfinance institutions' expenses are too high without collateral securing the loans.[19] Yet repayment rates that are cited later in the paper imply otherwise. If the poor are repaying, should the social goal in a microfinance institution ensure that interest rates decrease over time? The answer is that microfinance institutions act like a monopoly by collectively keeping their interest rates high. Interest rates are supposed to compensate for risk, therefore, in microfinance should be high because of the high risk clients. However, microfinance has a social mission as well as a profitable mission. This social mission needs to delineate microfinance institutions from other higher interest institutions like "Payday Loans" franchises.

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[18] "Financial Sustainability, Targeting the Poorest, and Income Impact." *Focus*. Version 5. CGAP, Dec. 1996. Web. 12 Feb. 2013. <http://www.eldis.org/vfile/upload/1/document/0708/DOC2936.pdf>.

[19] Ayi Gavriel Ayayi and Maty Sene. "What Drives Microfinance Institution's Financial Sustainability." *Journal Of Developing Areas* 44.1 (2010): 303-324. *Academic Search Complete*. Web. 26 Oct. 2011, 306.

Better interest rates are not available as these banks are not regulated.[20] Interest rates are not capped by government intervention, because the losses that may occur from failing to cover operating costs with higher interest rates would have to be covered by government subsidies. The idea is that in a free market for microfinance, competition would drive down the interest rates. However, the demand for microloans is so high that the supply can still charge high interest rates. The poor are then forced to accept such high rates because no one else offers lower rates. Unfortunately, there is no other option for the poor for reasonable rates.

Microfinance institutions, with a mission to alleviate poverty in third world countries, can miss this goal, and deepen poverty by adding debt to poor people. Although microfinance is marketed as philanthropy, it has become a profit-driven industry. When businesses notice the underlying profit of completely new customers they drop the philanthropy standards and adopt profitable procedures. In fact, Vijay Mahajan's review of The Microcredit Summit revealed "those whose starting income was below the poverty line actually end up with less incremental income after getting a microloan, as compared to a control group which did not get the loan."[21] Poor people can be empowered through means of financial independency, but if the learning curve

Many people believe microfinance can correct the inability of poor people to access financial resources. But poverty reflects society's views on saving, not society's

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[20] Aneel Karnani. *Fighting Poverty Together*. New York: Palgrave MacMillan, 2011. Print, 31, 42.

[21] Vijay Mahajan. "From Microcredit to Livelihood Finance." *AWID Journal.* Aug. 2005. <http://www.microfinancegateway.org/gm/document-1.9.25359/34431_file_06.pdf>.

access to banking.[22] The illusion of success in this industry (provided by the media and participating banks) allows funding from outside sources, while there is no empirical evidence poverty is relieved in the long-term. Poverty continues to be a problem, and these microfinance institutions further this debt hole by trapping upcoming business entrepreneurs in high interest rates. In order for a microfinance firm to achieve its social goal of alleviating poverty, those involved in policy and implementation of microfinance firms need to be aware that mission can be lost if not measured.

Introduction to Current Measures of Microfinance

Like any business problems, the problems of microfinance can be traced to specific causes. The measurements of microfinance are the means to detect these causes. Yet problems can only be fixed if they are detected. The main measure of microfinance needs to be (1) transparent, (2) relevant, and (3) indicative of borrower success. Standards should include guidelines for data collection, metrics, and how to trace results to specific outcomes of the firm. Current methods of arriving at repayment rates are ascertained differently across firms. There needs to be a standard set of measurements that are collected by microfinance institutions, but some institutions do not collect any measurements. These variances between firms misrepresent what is going on in the life of the borrower. Ambiguous measures focus on maintaining a profit and establishing financial stability of microfinance institutions. Thus, the life and success of the borrower becomes a lesser goal that may or may not arise from the efforts of these institutions.

[22] Thierry van Bastelaer. "Does Social Capital Facilitate the Poor's Access to Credit? A review of the Microeconomic Literature" Social Capital Initiative Working Paper #8, World Bank, April 1999, 16.

Because measurements need to be clear about what they say in regards to the borrower, there needs to be a standard.

Microfinance firms collect repayment rates as a measure. The purpose of collection is to prove borrowers' improvement in wellbeing. Repayment rates are outlined by Joanna Ledgerwood in her book *Microfinance Handbook* as measurements of "historical rates of loan recovery"[23]. The borrower is paying back what they owe in principal and in interest. These figures can tell if a community of borrowers can repay what they owe.

Repayment rates need to be transparent. The current methods of arriving at repayment rates are ascertained differently across firms. Some are using "total loans" due over "total loans outstanding", others "loan loss", and others "portfolio at risk". This fluctuation misrepresents what is going on in a firm. Loaning more can unfairly alter the numbers in the favor of the firm, depending on what measurement ratio they claim as repayment rates. For example, the portfolio at risk measures loans that are outstanding after 30 days in the numerator and total outstanding loans in the denominator.[24] When a microfinance institution keeps giving out loans, as long as they are loaning more in quantity in the new 30 day period, their ratio will be in reasonable. In publicly-traded companies, investors base their decisions on the financial transparency of the firms in which they are interested. Microfinance institutions (MFI's) need a reputation for producing honest and reliable information because of their committing to a social goal.

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[23] Joanna Ledgerwood. *Microfinance Handbook: an institutional and financial perspective.* Washington, D.C.: World Bank, 1999. Print, 206.

[24] "Technical Guide: Section on Portfolio Quality." *Performance Indicators for Microfinance Institutions*. Version 3. Inter-American Development Bank, Aug 2005. Web. 2 Apr. 2013. <http://media.microfinancelessons.com/resources/tech_guide_IADB_portfolio_quality.pdf>, 6.

Repayment rates, if recorded in such a way to be faithfully represented, must also be relevant. A repayment rate does not have a clear definition. However, the dollar-for-dollar payback of a loan does not mean that the borrower was successful. The industry is, in essence, focusing on whether or not the firm is going bankrupt. If the firm did not go bankrupt, then the firm is successful, whereas if they did, the firm is not successful. The firms need a measurement in their business to reveal long-term success of the borrower. Additionally, repayment rates do not directly correlate with the poor. In an article discussing the hype of microfinance, it is stated, "In others the ease of repayment may reflect the fact that the client is fairly well-off and not really poor."[25] The industry is hopeful that the poor will take advantage of these services when they have an entrepreneurial idea.

Repayment rates need to be significantly linked to the success of the borrower. Focusing on repayment rates skews the goal. The probability of repayment does not equal the assessment of the probability of a self-sustaining businessperson. A person can repay and be as well-off as the person who never took out a loan. Put flatly, we need a different measure. The goal of microfinance is about the borrowers, not the bank. In John Hauser and Gerald Katz's article, "Metrics: You Are What You Measure!" they argue that every measure a firm tracks influences decisions and actions.[26] Microfinance is measuring short-term success. Microfinance has been a short-term success. Microfinance is not measuring long-term success. Microfinance battles sustainability issues. If we can get a

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[25] Thomas Dichter. "Hype and Hope: The Worrisome State of the Microcredit Movement," *Legal City Legal Magazine*, 2006, 3.

[26] John R. Hauser and Gerry Katz. "Metrics: You Are What You Measure!." *European Management Journal*, April 1998, 2.

measure of success more consistent with the mission of microfinance, the industry can improve to help the community of the poor. A business' shareholders determine the stock price of the firm; unlike MFI's, value for these institutions should be derived from the success and return of the borrowers. Thus the analysis of the success of MFI should contain analysis including how often borrowers take out a second loan, and retention rate of the entire firm.

Microfinance has more than one main objective to meet. Microfinance is touted as having a double bottom line. It works to achieve a social good and a desired profit. Therefore, the metrics used to identify success in microfinance are fundamentally different from those that measure success in a for-profit industry. In a systematic review of the literature of microfinance, metrics currently used to determine success have been identified. These metrics provide information on whether or not the borrower is successful in getting out of poverty.

Repayment tells a third-party bystander a brief story. These short-term factors indicate whether borrowers can pay off debt, but not whether borrowers will succeed in the pursuit for which they took out the loan. However, microfinance long-term indicators are more linked to the success of the borrower in terms of poverty-alleviation. That is why this measure is almost more important than a short-term measure. Repayment rates are like a balance sheet; they are important but are only a "snap-shot" in time. On the other hand, the income statement is recorded as a period of time. In conjunction with the income statement, the balance sheet becomes a transparent and relevant measure that is indicative of the borrower's success.

The double bottom line needs to capture both the long-term and short-term. A combination of ambiguous metrics may become unambiguous when together. For example, the combination of repayment rates (which is a fairly good indication of the short-term success of the borrower) and savings rates (which can be a good indication of self-sufficiency in the future) can be used to paint that clear picture.

Support from public funds must be addressed because it can perpetuate problems. It is important that the measures are transparent and reflective of the borrower's success. This is important because the assessment of the impact educates where public funds are spent. When an industry measures success incorrectly, it will mislead both the public and management. The public may be misled into thinking that the industry is successful, and management may be misled into making decisions to compliment the misstated measures. If a better measure or combination of measures is identified, there can be new obtainable goals and microfinance can be more successful overall. Unambiguous measurements help to elucidate the present and the future of ideas like microfinance lending. Additionally, repayment rates need to be transparent, faithfully represented, correlated only to the short-term success of the borrower.

CHAPTER TWO

Business-Charity Hybrids

The purpose of this section is to identify the purpose of a business-charity hybrid. This will be done by the following: (1) pinpointing microfinance institutions, (2) identifying relevant issues with business-charity hybrids, and (3) identifying current measures and the implications of these measures when assessing success. Business-charity hybrids utilize the resources of a business for social change and social good. When combining business and charity, the models of a business-charity emerge. Charity, coupled with the financial stability that a business provides, can help the poor by overcoming economies of scale. Charities try to make a difference but still have large amounts of administrative costs to cover at their genesis.

Businesses and businesspeople are not always categorically trustworthy in the eyes of the public. During the economic downturn, many businesses were blamed for the stock market crash. Scandals like Enron and WorldCom resulted in negative reputations for businessmen and businesswomen. During a business' race for more money, ethics appear trivial to aggressive accounting and income-generating activities. However, businesses do have the capacity to help people. As Helen Coster, writer for Forbes Magazine, states, "Helping people starts with financial due diligence."[1] Businesses may

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[1] Helen Coster. "Can Venture Capital Save the World?" *Forbes.com LLC*. 30 Nov. 2011. <http://www.forbes.com/sites/helencoster/2011/11/30/novogratz/>.

practice financial due diligence, but, on their own, they may not have a reputation strong enough to carry a social mission as a measure of output in their company.

The practice of charity, in regards to poverty-alleviation, has come under significant criticism. It is argued that charity can perpetuate poverty in opposition to its noble intent by taking initiative away from the poor. Muhammad Yunus writes:

> "Charity is no solution to poverty. Charity only perpetuates poverty by taking the initiative away from the poor. Charity allows us to go ahead with our own lives without worrying about those of the poor. It appeases our consciences…"[2]

This reasoning has become the basis for social entrepreneurship. It is a concern that poor people are in fact underestimated by the act of charity. Charity accomplished through nonprofits endures only as long as donors continue to give. This can be a problem as funds are never guaranteed, but are merely budgeted. However, nonprofits positively position themselves against businesses, claiming to be less systematic and more flexible. They focus instead on giving with the heart.

Because of the pitfalls in these two systems in accomplishing positive social change, business-charity hybrids have emerged. In *Organizational Dynamics'* article, "Hybrid Organizations: The Next Chapter of Sustainable Business", hybrids are said to be "built on the assertion that neither traditional for-profit or nonprofit models adequately address the social and environmental problems we currently face." This article later brings up three activities that a hybrid organization must accomplish to both be classified as a business-charity hybrid and also to be placed above business and charity separately. These three activities are: "(1) Driving positive social change as an organizational

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[2] J. Gregory Dees. "A Tale of Two Cultures: Charity, Problem Solving, and the Future of Social Entrepreneurship." *Springer Science and Business Media*. 17 Aug 2012, 1.

objective, (2) creating mutually beneficial relationships with stakeholders and (3) interacting progressively with the market, competitors, and industry institutions."[3] A true business-charity should always contain these three elements. Combining business with charity has the potential to significantly impact social change on a worldwide scale.

This impact is seen because business-charity hybrids have a synergistic effect. Non-profits identify with the needs of the human heart, while for-profits identify with the needs of money and progress. Combining these two seemingly divergent methodologies provides returns in both social and financial ways. Yet, skepticism remains that each entity must compromise when combined and therefore cannot be as effective as they are apart. Dr. Dees, a clinical business professor for Duke University for social entrepreneurship and nonprofit management, states in his article, "A Tale of Two Cultures: Charity, Problem Solving, and the Future of Social Entrepreneurship", that charity can be "uncomfortable". The poor will benefit more by becoming customers of a service or product that adds value to their life and financial position.[4] The charitable causes that businesses pursue influence the funds that are available to them. Sometimes preexisting business structures can be an obstacle to more effective ways of affecting the most change for the cause with which the business is partnering.

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[3] Nardia Haigh and Andrew J. Hoffman. "Hybrid Organizations: The Next Chapter of Sustainable Business." *Organizational Dynamics* (2012) No. 41, <http://www.sciencedirect.com>, 126.
[4] J. Gregory Dees. "A Tale of Two Cultures: Charity, Problem Solving, and the Future of Social Entrepreneurship." *Springer Science and Business Media*. 17 Aug 2012, 325.

Microfinance as a Business-Charity Hybrid

Microfinance institutions are a good example of the synergistic effects of business-charity hybrids. Microfinance gives added value to the lives of the poor. Combining the commercial aspect of banks and the charitable "overlooking" of a lack of collateral provides the basis of microfinance. In order to bypass the limits on structures of existing banks and lending institutions, microfinance institutions have become unique and separate entities. Some modes of lending even take place inside the lender's homes[5]. Routine meetings within a community of a lending group allow members to follow simple rules set by microfinance practitioners. But once financially-sustainable, hybrid organizations gain the synergy hoped for by the general public. However, a hybrid's mission-based structure is not conducive to large-scale operations provided by businesses.

A microfinance institutions' product creates social good. A microloan has the purpose of allowing a poor person to become self-reliant. Microloans give grace in terms of collateral in order to give the poor an opportunity to become self-sustaining. When money will be borrowed by entrepreneurs and others regardless of existing microfinance institutions, the microfinance industry eases debt burdens.[6] This social good allows the

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[5] Matthew Lee and Julie Battilana. "How the Zebra Got Its Stripes: Imprinting of Individuals and Hybrid Social Ventures." *Harvard Business School Working Papers No. 14-005.* 3 Sept. 2013. <hbswk.hbs.edu/item/7309.html>.

[6] Karol Boudreaux and Tyler Cowen. "The Micromagic of Microcredit." The Wilson Quarterly Winter 2008. <http://www.wilsoncenter.org/index.cfm?essay_id=361250&fuseaction=wq.essay>.

poor to build financial literacy while legitimizing the relevancy of the poor in the marketplace of goods.

Progress in both social and financial means is another aspect of this issue that is presented in anecdote form. Referencing the requirements to be classified as a hybrid organization, microfinance is a great platform. Microfinance drives social change by deeming the poor creditworthy and makes repayment a desired, objective, and heavily-measured metric of microfinance institutions. Secondly, the microfinance firm's relationship with the borrower is mutually beneficial. As the borrower succeeds in paying back their original investment, the microfinance firm becomes more and more sustainable and able to help more people. Finally, microfinance institutions focus on their beneficial interest rates, especially in comparison with high-profile Africans leveraging their availability of money and charging usurious interest rates. A person can see the comparison of interest rates with commercial banks and analysis of organizational costs in order to continue operating without client collateral. .

Problems with Business-Charity Hybrids

Business-charity hybrids are hard to fund. Since business-charity hybrids do not exactly meet the requirements of a business, venture capitalists are generally hesitant to provide capital. Likewise, business-charity hybrids do not exactly meet the requirements of a charity, so philanthropic donors can be wary of the idea of a business-propelled charity as well.

There are many psychological constructs that must be present for a poor person to get out of poverty. The development of these constructs might be stymied by the merging of business with charity initiatives. As indicated above, charity can perpetuate poverty by "taking initiative away from the poor". This problem is not solved by partnering with a business. In fact, the initiative problem might be exacerbated when a poor person does not pay back a loan and the capital-heavy business is unaffected by their inaction.

Another potential problem is that business-charity hybrids can drift into becoming completely for-profit. This concern has been receiving increased press lately because of recent IPO announcements for microfinance banks. SKS Microfinance Ltd. and Banco Compartamos are two of a number of microfinance firms that have recently gone public.[7] Going public provides potential for interest rates to decrease, thus helping the poor. But this also draws concern for business-charity double bottom lines to morph into only focusing on profits. Microfinance institutions need to be loyal to the poor people that they are serving. Similarly, public companies need to be loyal to their investors. These facts can cause concern for the borrowers when a decision in favor of the investor might not lead to a decision that positively impacts the net wealth of the poor.

However, the commercialization of microfinance does not always indicate a decrease in the empowerment of the poor. CGAP's look at Latin American financial institutions that have gone public reveals that commercializing microfinance institutions provides the availability of larger loans.[8] Whether microfinance IPOs fuel larger loans for the poor or decrease interest rates that clients have to pay, these stock listings may help

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[7] Michael Schlein and Michael Chu. "Microfinance Goes Public." *Forbes.com* 30 April 2010. <http://www.forbes.com/2010/04/30/india-microfinance-sks-ipo-markets-emerging-markets-accion.html>.

[8] "Commercialization and Mission Drift:: The Transformation of Microfinance in Latin America." *Occasional Paper No. 5.* Jan 2001. <http://www.cgap.org>, 13.

microfinance. As long as there are measures that still indicate people reached and administrative costs, exploitative usage of significant inflow of capital can be minimal.

Current Measures of Business-Charity Hybrids

Accurate measures dictate a firm's success. Jacob Yaron, senior rural finance advisor for World Bank, developed a structure for assessing microfinance firms with two key indicators in mind; the first being repayment rate and the second being the sustainability of the firm.[9] This statement has caused the focus of microfinance firms to be on these two measures. Appropriately so, most literature about microfinance institutions discusses these indicators. Examining what John Hauser and Gerry Katz said about measurements closely, "A firm becomes what it measures,"[10] these indicators have set the groundwork for the structure of the microfinance industry. When a company measures something, it takes an interest in that measure. If that measure does not affect the customer, resources are diverted away from what actually does matter in that business.

Measurements are subject to flaws of scope and timing. John Hauser and Gerry Katz also say, "Rewards will be under-valued if they occur too far in the future."[11] The social goal of microfinance is the long-term feat to alleviate poverty, or at minimum,

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[9] Jacob Yaron, Benjamin McDonald, and Gerda Piprek. *Rural Finance: Issues, Design, and Best Practices.* Environmentally and Socially Sustainable Development Studies and Monographs Series 14. Washington, D.C.: World Bank, 1997, 5.

[10] John R. Hauser and Gerry Katz. "Metrics: You Are What You Measure!." *European Management Journal*, April 1998, 2.

[11] ibid, 4.

lessen the debt of underdeveloped rural areas. Repayment rates are a short-term measure, and sustainability of microfinance does not relate to the long-term success of social goals, but rather, financial goals. Social results need to be seen short-term and long-term. From the conclusions of a case study in Cambodia, Andrew Crawford, Michael Skully, and David Tripe write, "While it is possible to be both profitable and socially efficient, it is by no means inevitable."[12] The current measurements that were set into motion for the microfinance industry do not have indisputable ties to demonstrate success of the business and the poor in the areas reached.

Measurements can imply success of both a firm and its shareholders. The purpose of this section is to identify the measures discussed: measures that are already being recorded in conjunction with each other for a better overall view of poverty-alleviation. In the Financial Accounting Standards Board's (FASB) Concept statement number 8, the concept of fundamentals in financial reporting is discussed. Microfinance is touted as having a double bottom line: a social good and a desired profit. The industry may need to be looked at completely separately from the for-profit industry, as the metrics used to measure do not currently overlap specifically to each measure. The conceptual framework for accounting provides good grounds for understanding why the investors need these measures to be transparent.

Understandability of financial statements flows into decision usefulness of the investor. The Financial Accounting Standards Board has issued a Conceptual Framework for Financial Reporting that designates Decision usefulness by looking at two

[12] Andrew Crawford, Michael T. Skully and David W.L. Tripe. "Are Profitable Microfinance Programs Less Efficient at Reaching the Poor? A Case Study in Cambodia." *Third European Research Conference on Microfinance*. 5 Dec. 2011, 22.

dimensions: relevance and faithful representation.[13] Relevance encompasses the necessity of predictive value, feedback value, and timeliness. At the same time, faithful representation of the company's statements encompasses verifiability and neutrality. Each qualitative characteristics of useful financial information gives insight into the fallibility of measures that are identified within practitioners' guides. Ambiguity within any of these measures is a red flag that a causal relationship does not exist between recorded data and desired effect.

What a company measures dictates the employee performance. John Hauser and Gerald Katz collaborated to come document how measurements affect behavior in an organization. A main point that they share is that the measurements chosen to record change behavior. They write, "Metrics are chosen so that actions and decisions which move the metrics in the desired direction also move the firm's desired outcomes in the same direction."[14] Furthermore, good metrics will enable sustainability and identify when sustainability is a concern for a microfinance firm, or any firm. Goal congruence between the multiple goals of microfinance firms aligns the success of borrowers and the success of management. Every decision within an organization must be made in line with the organization's strategy. This becomes complex with hybrid organizations because the strategy is two-fold. Additionally, the behaviors that microfinance institutions want its managers to partake in dictates how the managers perform. Just by measuring a metric in

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[13] FASB Accounting Standards Codification Conceptual Framework. Statement of Financial Accounting Concepts No. 8. September 2010, Chapters 1& 2.

[14] John R. Hauser and Gerry Katz. "Metrics: You Are What You Measure!." *European Management Journal*, April 1998, 6.

a company impacts behavior. The obstacle is to make those measures indicative of two goals in one. Institutions should choose behavior that is in the best interest of the managers and employees and also in the best interest of the company. This job is certainly easier said than done. Useful decisions like these need to encompass many characteristics.

Uniformity of measurement collection allows systematic detection of material monetary errors and fraud within these institutions. Without a uniform measurement system, fraud can continue undetected. If losses are realized in microfinance, operating costs increase. If operating costs increase, interest rates increase for the borrower. As interest rates increase, disposable income of the borrower decreases.

The microfinance industry needs to look to FASB's accounting fundamentals to identify metrics to collect. When an idea is flawed in theory, the practice of this idea will not reach the goals the idea set out to accomplish. Vijay Mahajan emphasizes this by stating that the year 2010 and onward is now focused on questions for microfinance that are not applicable but are over researched, while the questions that matter to the success of poverty-alleviation are not being asked.[15] The questions that I believe he is referring to is whether or not the borrower is benefitting from the opportunity of microloans.

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[15] Vijay Mahajan. "Research in Microfinance: A Practitioner's Perspective." PowerPoint presentation. Centre for European Research in Microfinance, Brussels. 18 March 2013, slide 13.

CHAPTER THREE

Analysis of Current Measurements

I have discussed why metrics are important to a company and a business-charity hybrid company especially. The purpose of this section is to analyze the thought process of current measurements for microfinance firms, then to address the connection (or lack thereof) to the success of the borrower. It is important to look at (1) number of people served, (2) amount loaned per year, (3) repayment rate, (4) interest rates, (5) level of savings, (6) accumulation of non-land assets, (7) client retention, and (8) portfolio ratios and decide whether these commonly used measures indicate borrower success. If the borrower is not successful in the microfinance industry, then the microfinance firm that served them is not successful.

If firms really are what they measure, then these metrics need validation. These metrics have been identified in relevant articles regarding the success of the microfinance industry. They are looked to for relevant information on whether the borrower is successful or not in getting out of poverty. However, the same information provided about the success of microfinance may be used to prove the lack of success of those that are wanted to be raised out of poverty. The ambiguousness of these metrics can be due to inability to replicate data or selection bias of samples. However, it can also be because the metric is inadequate. Finally, the question remains as to whether there is a similar measure, recorded in for-profit businesses, that indicates success that can be shared with microfinance. Answering this is done by looking at the "customer" of the business.

The "people served" metric misrepresents what serves the borrower well. The number of people who come into a microfinance facility is indicative of the word-of-mouth success of what the microfinance facility has done for the people who get out of poverty. The higher the number of people served, the higher the impact the organization has had on the community. [1] However, this is not always what this indicates. The word-of-mouth that provides the nonprofit organization with business could be that they are giving out free money. There might be correlation with portfolio at risk being higher for those places that have a higher number of people served. Additionally, there is ability to skew the statistic if a firm looks at "served" differently than simply sheer amount of people that walk into the door. In a for-profit scenario, more customers means that each individual customer will be better off. This is not necessarily true because the customer may need to locate a cheaper brand or spend less time in the checkout in order to make money outside of shopping.

Microfinance firms and businesses have different target markets. Microfinance firms are focused on the borrower for microfinance and that is analogous to the success of a person who buys an item in a store. For-profit businesses want to save the customer money so that they can continue shopping at their particular store, whereas not-for-profits want to save the customer money, so that they can improve their quality of life and stop "shopping" at the nonprofit "store". The question which must then be asked is as follows:

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[1] Elizabeth Coffey. *Agricultural Finance: Getting the Policies Right*, Agricultural Finance Revisited No. 2, FAO and GTZ, Rome, June 1998, 12.

Are the goals of these businesses too different to look for measures that align with each other?

Because microfinance firms target different markets, client retention is one of the metrics that seems out of place. When analyzing a business-charity hybrid, the metrics that are arising are “stolen” from business firms or from charity. This happens because there are multiple aspects of business-charity hybrids that relate to one or the other business model. Client retention is important for a business retailer. The business receives profits and the customer receives satisfaction. This is tracked by how many times the customer comes back. The people who come back and take out another loan are doing well because they are building capital and have managed how to use debt and how to leverage themselves in order to increase their income. Dean Karlan and Martin Valdivia, professors who work on poverty specifically state that microfinance institutions need to “maintain a stable client base…for the sustainability of the organization.”[2] Although microfinance needs clients to be in existence, this metric can encourage dependence. The adverse effect this metric has is in relation to the charity part of this hybrid. Charities help others and therefore, once helped should be on their way out of financial instability.

Client retention is not desired in charity-based business models. The purpose of microfinance is to raise people out of poverty so they can become independent and resourceful after a small investment in something that can give them a better return on investment. If a customer keeps coming back, they may have become dependent on the source of income that was otherwise unavailable to them. This instant-gratification status

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[2] Dean S. Karlan and Martin Valdivia. "Teaching Entrepreneurship: Impact of Business Training on Microfinance Clients and Institutions." Yale University Economic Growth Center Discussion Paper No. 941 Working Paper. 2006. <http://aida.econ.yale.edu/karlan/papers.html>, 8.

is unhealthy for the overall success of the borrower. Nonprofits definitely want to make "customers" happy by giving them ways to help themselves. Therein lies the difference. Nonprofits do not necessarily want repeat customers. Rather, this could be a bad thing. For example, the American Red Cross does not want to help the same people twice, this means that these people had traumatic events happen more than once in their lives.

Amount loaned per year and number of loans funded appears to accomplish a microfinance firm's mission of reaching a lot of people. The higher the number should mean that the bank has higher capital and is doing better. Financial support from investors supposedly fuels these firms' abilities to help others. If their investors support, then the borrowers will have less pressure and better ability to pay on time because there is not dire pressure on the firms to recover the money. Not only is this an ambiguous measure because the amount loaned out does not measure the success the borrower has with the money it is allotted. The amount loaned per year indicates that borrowers in the surrounding area are struggling paying interest rates and are thus borrowing more money to pay off other microfinance loans. Some citizens will never need a loan, but the push to make this metric larger, and therefore, make the firms look better is harmful to the whole community. In a similar manner, countries represented has been a metric that proclaims it indicates what the needs for loans are in a particular area. It also links the amount of microfinance outlets available to the interest rates of the firm. However, countries may have isolated different ways of conducting the microfinance loans. This also has nothing to do with getting people out of poverty. Just because a firm expands domestically or internationally does not mean their customers are better served.

Repayment rate, as discussed previously, indicates whether a person can pay on credit. The borrower who is doing well can repay a loan and do so on time. This is not a great measurement because there could be people who take out a loan, do not excel in the area of the business for which they took out the loan, borrow from another microfinance institution, and then repay using the money from the second bank. This attempt to be free from the debt of one firm only starts a cycle of debt. This copycat method reduces income as a whole because no one is making money, but instead making a link in the debt chain that is made by a series of people.[3] This behavior is not caused by having repayment rates be a measure for success in microfinance firms, because this measure does not account for common discrepancies. Additionally, the repayment rate metric can be diluted through group-based microfinance. When James Dailey discusses standards for data in businesses and charities, he mentions that individual payments should be recorded and analyzed when paid by part or the entire group.[4] A person may be able to pay on credit, but only with the help of a group. This person has repaid, but has not demonstrated independence financially.

Proving that the poor are creditworthy is not enough to continue microfinance lending if the social mission is not being met. In the article "Measuring Transformation: Assessing and Improving the Impact of Microcredit" it states that there needs to be a focus on improvement, not a focus on proving a point. Microfinance is important and has the purpose of "helping empower the poor to account properly and independently for

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[3] Thomas Dichter. "Hype and Hope: The Worrisome State of the Microcredit Movement," *Legal City Legal Magazine*, 2006, 4.

[4] James Dailey. "Data Standards for Connecting to Commercial Sources of Capital." Journal of Microfinance Vol 7, No, 2 (2005), 43.

their small businesses and thus manage their livelihoods better." Repayment rates are measuring the firm's success in financial sustainability.

Interest rates are also being used as a metric for monitoring a microfinance firm. When interest rates drop, microfinance borrowers are better off, because they are proving they can pay without collateral. Therefore, the firm does not have to inflate interest rates in order to make a profit on loaning money. This is not linked to the success of the borrower's ability to use the funds borrowed. In a minor way, interest rates can tell if the borrowers in the firm are successful. If borrowers continue to default, microfinance firms must increase rates in order to meet the cost of paying off outstanding loans.

Level of savings can be a strong measure that the firms are thinking about using. The amount a person has in savings can indicate how successful their business is becoming. The higher the number, the less risky the client is for defaulting. Specific microfinance firms mandate savings accounts, but that tool needs to be used and monitored. Savings accounts reveal if a person is becoming prosperous from microfinance's "hand-up" in capital. Additionally, the savings might be for longer-term investments and ideas that will perpetuate an entrepreneurial spirit.

Consumption can sometimes indicate prosperity. Accumulation of non-land assets is cited in a few practitioners' guides to microfinance like any review from Thomas Dichter. With the help of microfinance, people can build capital. That is the purpose of credit, so that there is a greater return in the long run. If a client is creating and holding assets, then they are being successful in entrepreneurial ways. In the same manner, expenditure can be tracked for a person taking out a microloan to determine that those who spend money have money. Therefore, they must be said to have excess money from the success of their implementation of their loans, and they can buy things they need. This measure is a fairly good one, but the way to measure this is very subjective. Additionally, the non-land assets could be things that the family or individual does not need, but has, because they had the funds to buy it at that time. Expenditure may be unhelpful to the success of the family and the availability of funds through a loan, and this may promote unhealthy spending over saving money.

Analyzing the portfolio of microfinance firms can lead to ideal adjustments for the borrower. Portfolio ratios allow a firm to allocate resources efficiently. The portfolio of the business is indicative of the success of the borrower, because if the portfolio is doing well, then the people are repaying at adequate rates. This measure is a way to account for all of the loans together.[5] On average, are the loans at risk for being defaulted? This is the questions that the investors want answered. If this rate is low, then borrowers are doing well. Portfolio at risk is still a repayment issue that the borrowers may be paying, but they may not be better off because of their state of depressed funds due to paying interest rates. Similarly, the loans that are not going to be collected are bad outright. Therefore, the amount of write-offs will tell an investor that the success of borrowers depends on whether they can eventually pay off their loan, even if it is late. When an individual gets into trouble with a loan, the portfolio at risk measurement can be buffered by extending credit to more people in that period.[6] Banks can provide more loans to people who do not need these loans in order to decrease their "at risk" number

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[5] ibid, 37.

[6] Malcolm Harper and Sukhwinder Singh Arora. *Small Customers, Big Market: Commercial Banks in Microfinance.* Warwickshire, UK: ITDG Pub, 2005. Print, 7.

for donors to keep providing funds. Theoretically, portfolio at risk measures when a person cannot pay. There is a possibility for a person to pay off their loan and stay at subsistence and there is a possibility for those that pay off their loans to be self-sustaining.

Because these aforementioned metrics are not telling an entire story, subjective measures are made and relied on to show microfinance's efficacy. Microfinance teaches a person to make good choices in regarding spending and saving. Therefore, some firms track "decision making power" of the client. Because the poor who have access to credit become more confident in who they are, there is a major change in levels of self-esteem and confidence among those that utilize microfinance to put an idea into motion. However, this is a hugely subjective metric to measure, because the people who have confidence enough to take out a loan are already unreliable measuring points on which to determine if they are empowered and have high self-esteem.

Another subjective metric that is becoming more popular is satisfaction level within the family. Without the authority of money usage in the family, the male will continue dominating the funds, and the woman will have no say in the poverty of the household. Microfinance's main clientele are women. The women can now have a voice in the investments, savings, and expenditure decisions. Without microfinance, males do not dominate but instead the household will have an understanding of compromise and consulting. However, locating the point when a family is satisfied can tell if the firm is making a difference in the culture. Because microfinance wants to foster a culture of savings, this cultural change is a positive sign. However, this measure is extremely difficult to track. Regardless of the method in which to record this measure, the male may feel emasculated and either take the money from the woman or treat her poorly. The culture has to change towards equality before this method of investment indicates whether or not microfinance is making a difference in the home. Empowerment improvement is hard to track, as those taking out loans have to be somewhat empowered already to think that they can pay back the loans with full certainty of success.[7] Although some of these metrics do not paint a clear picture of what borrowers have gained from the help of microfinance loan, they might provide a short-term indication of whether microfinance can work.

Short-term measurements in conjunction with long-term measurements

The purpose of this section is to show how the various identified measures can impact the institutions on a small scale as well as the borrowers on a large scale. Another purpose is to identify interventions on both the short-term implications and long-term implications based on what measure is not being met and what can be done to alleviate the poverty in one borrower's life at a time.

Short-term measurements help relevant decision making for the institutions. The short-term measure literature has conclusively identified is repayment rates. "Economic development is often conflated with short-term poverty reduction, which in turn confused with a more lightening of the burden of poverty."[8] Dean Karlan of Yale's Innovations for

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[7] Dean S. Karlan and Martin Valdivia. "Teaching Entrepreneurship: Impact of Business Training on Microfinance Clients and Institutions." Yale University Economic Growth Center Discussion Paper No. 941 Working Paper. 2006. <http://aida.econ.yale.edu/karlan/papers.html>, 18.

[8] Thomas Dichter. "Hype and Hope: The Worrisome State of the Microcredit Movement," *Legal City Legal Magazine*, 2006, 2.

Poverty Action Lab asserts that "maintaining a stable client base" is critical for microfinance institutions in order to emphasize "the sustainability of the organization".

Short-term measurements, if recorded, explain the internal profit of the company. They do not measure whether the borrower is better off. The only reason why microfinance exists is for the borrower to be helped out of poverty. Microfinance was not developed to make money alone. Institutions are happy because they are being repaid. The industry is shortsightedly saying, "Hooray, people are repaying what they owe." However, this should be in no way surprising.

The long-term measure that is indicative of success of the borrower is savings rates. Long-term measures help the institution identify whether they are or are not achieving their goals. "Savings are particularly important, as they provide the 'equity' for borrowing; act as a cushion for sudden demands of cash such as due to illness in the family or natural disasters; and finally, to some extent act as a guarantee for repayment of loans, where savings are deposited with lenders."[9] Hans Dieter Seibel emphasizes the necessity for savings rates in microfinance institutions by stating, "Savings have served as the foundation of self-reliance and the motor of growth."[10] Growth in borrower savings can indicate success long-term by providing an assurance of repayment during unexpected circumstances.

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[9] Vijay Mahajan. "Is Microcredit the Answer to Poverty Eradication?" *AWID Journal,* 1997. <http://www.basixindia.com/publication.asp>, 1.

[10] Hans Dieter Seibel. "Does History Matter?: The Old and the New World of Microfinance in Europe and Asia." *Asia Research Institute, Department of Economics, and Department of Sociology National University of Singapore.* Oct. 2005, 13.

Alleviating poverty is a huge social task that microfinance should not claim they are achieving. That is not to say that microfinance is not doing a social good. The social good that they are partaking in is building entrepreneurs. Microfinance is giving an opportunity to the poor to get out of poverty. Microfinance can be a very effective means of helping entrepreneurs gain resources. The United States is a highly leveraged society, but loans should not be encouraged for a growing economy.[11] Microfinance has affected some borrowers and given them a source of income, but it has also attributed to borrowers being in a deeper debt. Microfinance needs to track positive progress as well as negative.

Microfinance is needed. *Small Customers, Big Market: Commercial Banks in Microfinance* was one of the first comprehensive reviews of microfinance on a global scale. The book analyzes existing research and states, "Research has confirmed how access to financial services helps reduce vulnerability and enables people to seize economic opportunities."[12] Alleviating poverty while attaining a profit can happen through microfinance but poverty has to be assessed and understood before that can be done.

Poverty is a state of mind. Jesus said there will always be the poor in spirit which leads to financial poverty. There will always be people who are poor in spirit and mind, but microfinance institutions is reaching out to those that are rich in spirit but poor in resources. There are people who have nothing to their name but a work ethic, and they

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[11] Thomas Dichter. "Hype and Hope: The Worrisome State of the Microcredit Movement," *Legal City Legal Magazine*, 2006, 3.

[12] Malcolm Harper and Sukhwinder Singh Arora. *Small Customers, Big Market: Commercial Banks in Microfinance.* Warwickshire, UK: ITDG Pub, 2005. Print, 1.

would certainly not view themselves as "poor". However, these are the people that make microfinance a success.

The only way that poverty can be alleviated is by affirming that work is a virtue. Helping the poor is done by affirming that work is a virtue. A person is a better person because he or she is a worker. It is not just a necessity or a need to work, but a person is a better human being because he or she works. When people work, they are better versions of themselves. If a person believes that work is a virtue they are in the process of making themselves a better person. To retire means to withdraw, but to withdraw from what? From engagement and being relied on. To combat this feeling, people volunteer, they work for free. They are retired so they can afford it, but they want to work, and they enjoy it. Making this evident to borrowers creates a culture of excitement in the area in which they are taking out the loans. It is for them both mentally and financially.

Borrower's Views of Microfinance

Microfinance firms benefit from borrowers benefitting. If the borrower sees microfinance as another way to get money, the firm will not be successful. It does not matter what those who are providing the funds of microfinance beginnings think their funds provide. The desired empowerment from lending is only realized if the borrowers recognize how the money is different from charity.

How the borrower views microfinance affects the financial sustainability of the firm. In some nations, communities see others getting money from the "bank" and think that these funds are free handouts. Culture plays a big role in this importance of borrower vantage point. Misperceptions that microfinance charges interest or is charity can bankrupt an institution. Rob Dixon et al bring this misperception to life in an example:

> "Another loan officer added: you see, the Zambian culture is different from that of Uganda. In Zambia, clients have no fear of defaulting. Clients tend to have an "I don't care attitude" towards the loans disbursed to them. Most of them still think that an NGO like us are Charity and therefore they need not pay back. In addition clients have also seen the weaknesses of CETZAM's credit policy and have taken advantage. They know we cannot take them to court for failing to pay back their loans."[13]

Not only are these ambiguous measures, but they can hurt the view of how microfinance is progressing. Viewing efficiency as lower operating costs not only fails to tell the success of the borrower, but having it as a measure distracts attention from what the institutions are trying to teach others. Efficiency is important but not as important as effectiveness. Efficiency related to improving the business, effectiveness related to improving the life of the borrower.

Just like borrowers "demanded" credit, borrowers are demanding other financial instruments. During the early 2000's the microfinance sector started to recognize the various financial needs supplementary to credit that the poor could use.[14] Aneel Karnani has been quoted saying that the success of microfinance depends on other services that are not focused on currently in microfinance institutions. These services include insurance, investment portfolios, and savings. The borrowers want to pull themselves out of poverty. Insurance and savings are other vehicles that allow a poor person to become

[13] Rob Dixon, John Ritchie, and Juliana Siwale. "Microfinance: Accountability from the Grassroots," *Accounting, Auditing & Accountability Journal,* Vol. 19. No. 3, 2006, 415.

[14] Vijay Mahajan. "Research in Microfinance: A Practitioner's Perspective." PowerPoint presentation. Centre for European Research in Microfinance, Brussels. 18 March 2013, slide 16.

more affluent. These services exist today but are not utilized as extensively as loans. As explained before, Muhammed Yunus brought attention to microloans which were then demanded by the poor. Attention now needs to be brought to the importance of tools like insurance and savings.

Marketing microfinance appropriately helps banks and benefits clients. Emerging economies of rural countries may need more than credit. In the Policy Studies Jounral in 2001, Nitin Bhatt and Shui-Yan Tang discussed the idea of needing multiple services for the poor in microfinance institutions. They identify that the outcomes of microfinance will be minimal unless offered "in conjunction with other supporting services that can help solve other non-credit problems" in these poor communities.[15] Just like measurements must reflect the goals of the institutions, so too must the marketing of the institution reflect the goals of the institution. Microfinance institutions are trying to benefit borrowers by making them financially stable. Telling the poor what microfinance institutions do must be consistent with this message of financial stability outside of the institutions.

[15] Nitin Bhatt and Shui-Yan Tang. "Delivering Microfinance in Developing Countries: Controversies and Policy Perspectives." *Policy Studies Journal* 29.2 (2001), 323.

CHAPTER FOUR

Formulation of New Measurements

This section will identify success measures of businesses, charities, and business-charity hybrids. The purpose of this exercise is to further explain that business-charity hybrids, especially microfinance firms, must develop unique metrics for investors to judge whether or not their goals are being accomplished. With this in mind, I will recommend two measures that are consistent with the framework of general reporting of the FASB concepts for decision-usefulness in financial statements.

Sometimes firms implement goals for profit, not for corporate responsibility. Within the last decade many “green initiatives” were seen in business companies that wanted their investors to know that they care about the environment. With this came the issue of “green washing” and how companies are saving money for “going green”. A simple example is switching to fluorescent bulbs from incandescent. Incandescent bulbs are more costly to the company and therefore this change, although a good one, was in search of profits and not necessarily for helping the environment. Some “green initiatives” taken by companies were for the sole purpose of saving the company money, not for the purposes of helping the environment.

Likewise, many companies have been adding social missions to their businesses. This common trend recognizes that businesses are partners in making the world a better place. Again this trend appeals emotionally to consumers and helps the business financially as their profits increase. Companies can then get away with charging a high price for “fair trade” products or products whose proceeds help orphans in Africa. Microfinance is thrown into the mix of philanthropies that businesses support. This is especially appealing when the business can conduct microfinance lending because it gets interest on the money it invests. Not all businesses that adopt a social mission do so to increase their profits. But it must be addressed how an investor/consumer can differentiate between those businesses that do want to help and are helping, from those that want to help and are not making a difference. It must be determined how can we prevent this ambiguity from affecting investor decision standards for microfinance, and what we can use as a benchmark.

Businesses have benchmarks like net income, operating expenses, and inventory turnover. These metrics tell an investor whether or not to invest in a company. A change in their numbers draws concern and could even affect the future of the company. Additionally, as argued by John Hauser, a Professor of Marketing at Massachusetts Institute of Technology and Gerald Katz, Vice President of Applied Marketing Science Inc., every metric in a business impacts decisions of that business. They propose the standard, “the firm becomes what it measures.”[1] Because businesses focus on their profitability, they are either profitable or unprofitable by classification of metrics. The transparency in business financial statements inform the user whether or not the business is making the investor money. If the business is not making money the transparency reveals where that money is going.

[1] John R. Hauser and Gerry Katz. “Metrics: You Are What You Measure!” *European Management Journal*, April 1998, 3.

Non-profits on the other hand are not as concerned with their revenue. Charities record percentage of dollars that go to their philanthropy versus administrative costs, people served, and fundraising costs as important metrics. Non-profit metrics also need transparency in order to show where the money of the organization is going. However, the investor's money needs to be traceable not back to the investor as a return on investment, but back to the cause that charity is supporting. Tracing the funds and how these organizations are helping others is important.

Business-charity hybrids are completely separate from businesses and from charities. Business charity hybrids are defined by Michael Troilo in the *Journal of Markets and Morality* as, "Businesses that consider profit as a means toward authentic human development rather than as an end in and of itself."[2] The way that microfinance spurs on human development is through promoting financial acumen of the poor. Since the microfinance industry is subjective in loan approval, metrics for determining success in reaching goals of these institutions is difficult. Phil Buchanan, a writer for the Chronicle of Higher Education, Inc. debates the existence of business-charity hybrids by stating, "Corporate self-interest frequently runs counter to the public good."[3] The question of whether microfinance firms are improving the life of the borrower is just as important to answer as the question of whether businesses can be business-charity

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[2] Michael Troilo. "Caritas in Veritate, hybrid firms, and institutional arrangements." *Journal of Markets & Morality*14.1 (2011): 23. *Academic OneFile*. Web. 19 Sept. 2013, 32.

[3] Phil Buchanan. "Charities Should Resist Drinking the 'Kool-Aid' of Business Superiority." *Chronicle of Philanthropy* 16 Sept. 2012. *Academic OneFile*. Web. 19 Sept. 2013, 2.

hybrids without duping the general public. I hypothesize that when one question is answered, the other question will be answered as well.

Business-charity hybrids are concerned with both profits and social change. The purpose of a business-charity hybrid is to make a social change and operate as a business at the same time. Forbes asked a question printed on the cover of one of their recent editions: "Can Venture Capital Save the World?"[4] Some businesses believe that because of their resources that they are better equipped to make a social change than a philanthropic organization could. Therefore, metrics for business-charity hybrids are more important than ever, because there is debate as to whether or not business and charity lines should be blurred. The question must then be posed: Does the blurring make a more effective social change or does it diminish the work and purpose of non-profits?

An investor is looking how to evaluate a business-charity hybrid, not how to evaluate a business or a charity. Businesses are for making money. Charities are for promoting and allocating money for social causes. Hybrids serve neither of these purposes. Hybrids are more complicated than both a business and a charity because business-charity hybrids really speak to the heart, but cannot be devoid of a way to earn money. Businesses declare, "I make money", while charities declare, "I help people." Now business-charity hybrids need a driving theme. Are they making things worse or better? It is all based on perspective, which is why metrics are that important.

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[4] Helen Coster. "Can Venture Capital Save the World?" *Forbes.com LLC*. 30 Nov. 2011. <http://www.forbes.com/sites/helencoster/2011/11/30/novogratz/>.

What is the purpose of a business-charity hybrid that performs microlending? The purpose of a hybrid is to work to achieve a social good and a desired profit that is worth the investment. Assessing the impact of these two goals educates the public about microfinance's ability to alleviate poverty. What the business-charity hybrid of microfinance is trying to accomplish is (1) teach people how to save and (2) teach people how to be self-sufficient. The two measures that accomplish these goals must be understood in the context of these two assumptions. The business-charity hybrid is a complex undertaking and there are at least two different concepts that it utilizes. First, teaching a person how to save can be done by teaching them how to borrow; second, work is a virtue.

First, microfinance should teach a person to save by teaching them how to borrow. This concept might seem counterproductive on the surface, but this concept is the mission of microfinance. Showing the poor to borrow a sum of money will hopefully show them how to save an even larger sum of money. If an investor does not think that a person can learn how to save by learning how to borrow, then the investment should stop funding microfinance. Malcolm Harper, board of director member of Micro-Credit Ratings International Ltd., and Sukhwinder Singh Arora praise microcredit institutions, but only if they have multiple modes of services for the poor:

> "Institutions offering appropriate and diversified savings and loan products have found that saving deposits outnumber the borrowers and the deposits mobilized are more than adequate to fund loan demand."[5]

[5] Malcolm Harper and Sukhwinder Singh Arora. *Small Customers, Big Market: Commercial Banks in Microfinance.* Warwickshire, UK: ITDG Pub, 2005. Print, 7.

Borrowing is often presented to be the opposite of saving. However, microfinance can show a person how to be a good steward of what resources they are given. Borrowing on interest forces a person to learn how to save in order to pay the excess cash owed.

To save means that a person learns to live beneath their means. They have the ability to set aside funds while maintaining a constant level of lifestyle. Vijay Mahajan discusses that savings are essential to a borrower. Savings provide ability to pay unexpected demands.[6] Borrowing can allow a person to conceive needing more money than they would typically spend in order to pay off the loan. The thought is that this mindset would continue after the loan is paid and there would be a nature of saving after experiencing help with a microloan.

The second concept revolves around the idea that microfinance should teach people to be self-sufficient by having them rely on a microfinance loan for a brief advantage. For example, microfinance is helpful for farmers who need a loan for supplies that are almost guaranteed to have a high yield. This is prevalent for farmers in buying seeds. Microlending is about giving a farmer his first bag of seeds. It is more than simply giving them seeds. It is giving them ownership over their production. They can pay off the bag of seeds as soon as they reap the yield that they sowed at the beginning of the season. Teaching a farmer to be dependent on a microloan can be an effective way to give them an opportunity to be self-reliant.

Both concepts affirm the idea that work is a virtue, which is how one alleviates poverty. Work fosters diligence and setting goals. People must use the resources they are

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[6] Vijay Mahajan. "From Microcredit to Livelihood Finance." *AWID Journal.* Aug. 2005. <http://www.microfinancegateway.org/gm/document-1.9.25359/34431_file_06.pdf>.

given innately or given through experience to achieve a mission. Virtues are fundamentals that make a person better. Work makes people better by making them feel appreciated, needed, and productive. A counterargument could be made that if the preceding statement is true, then retirement means that a person is no longer virtuous. The veracity of this counterargument notwithstanding, this only helps affirm that people need work. In retirement, hobbies are developed and volunteering, or working without pay, is a common way to pass time. Not only is a person better when they work but they are combatting a victim mentality. Viewing oneself as a victim provides no means for things to get better. Perpetual poverty can be altered by breaking the victim mentality and applying oneself toward working hard. One must ask, is a specific microfinance firm teaching a person to save by teaching that person how to borrow or is the firm supplying "seeds to farmers" in order to support a self-sustaining venture? With these concepts as the foundation, there are metrics that correlate to whether a microfinance institution is doing both financial and social good.

The metrics that direct microfinance decisions are made by the same people that loan out the money. Therefore, these metrics are reflective of how best an institution needs to make the money and keep the investor investing. An institution telling the general public how many loans it has loaned out does not tell the public if the poor are saving or if they are being self-sufficient. Moreover, telling people if the borrowers have repaid their loans does not tell a person if either one of those goals is met. One would be well-served to dispassionately ask, is the world a better place after microfinance has reached 500,000 people, and if so, how? But both measures that are currently recorded play on the emotional appeal for donors. These business-charity hybrids need to have a better way to be evaluated than repayment rates.

Implementation of New Measurements

Comprehensive sets of measurements of business-charity hybrids need to be established. Once measures are relevant in analyzing microfinance firms, measures can be established for tracking financial literacy of borrowers throughout their interactions with the microfinance firms. This can be accomplished in banking and also self-help groups within the home. Supplementary services to the poor need a correlation score to identify success in linking these services with loan default rates.[7] Furthermore, "Microfinance is a necessary but not sufficient condition for microenterprise promotion," there needs to be these "supplementary services" to link borrowing with saving.[8] Therefore, the first metric of change in savings account balance can be used to analyze savings deposits and withdrawals in correlation of those loans that do end up defaulting.

Microfinance institutions heavily emphasize borrowing because of the subsidies made available to them. However, they do not have to be only borrowing institutions. There should be a balance, if not an equal amount of savings accounts and loans outstanding. In Elizabeth Coffey's article on agricultural finance, she states that a new approach will "stress the importance of mobilizing local deposits". Her article was

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[7] Vijay Mahajan. "Research in Microfinance: A Practitioner's Perspective." PowerPoint presentation. Centre for European Research in Microfinance, Brussels. 18 March 2013, slide 18.

[8] Vijay Mahan. "Is Microcredit the Answer to Poverty-alleviation?" *AWID Journal,* 1997. <http://www.basixindia.com/publication.asp>, 2.

written over ten years ago. There needs to be more progress towards improving the mix of services available to the poor.

When business-charity hybrids realize that they are going to be measured, they will set up these savings accounts because the accounts are for the betterment of the borrowers. Although microfinance has reached many people, 87% of rural farmers have no access to microfinance loans and over 70% have no savings account.[9] A borrower should be required to save to be a part of microfinance. A person is not a saver until they learn to live beneath their means. Providing savings accounts benefits the borrower and the firm. Additionally, financial measures can be stabilized by requiring a minimum cash balance in savings accounts.[10] This minimum balance is both important for microfinance institutions to mitigate risks of default loans as well as helpful for clients to plan not to have access to cash that belongs to them. Some microfinance institutions even add extra incentive for savers by entering clients into drawings for prizes.[11] Not only do savings accounts need to be available, but they also need to be encouraged. If borrowing really teaches people how to save, savings accounts are essential in a microfinance institution providing microloans.

The success of teaching a person how to save by teaching them how to borrow can be confirmed by seeing if the clients are making more capital. Stuart Rutherford,

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[9] Rajarshi Ghosh. "Microfinance in India: A Critique." *Microfinance Gateway.* 2006. < http://www.spanish.microfinancegateway.org/files/35726_file_14.pdf.>, 9.

[10] Ruth Goodwin-Groen. "Success in Rural Savings: How One Donor Led the Way." *Case Studies in Donor Good Practices.* CGAP Direct Donor Information Resource Center. April 2003. <http://www.ruralfinance.org/fileadmin/templates/rflc/documents/1143470306317_BAAC_rural_savings_brief.pdf> , 2.

[11] ibid, 2.

chairman of SafeSave in Bangladesh expresses the concern for savings accounts by stating, “Saving is where financial services begin and end.”[12] When a borrower comes to a microfinance institution wanting a loan, this means the borrower has to set up a bank account. The loans will be given out in checks that must be cashed through a savings account. The institution will know how much money is in the bank at the beginning of the year and again at the end of the year. There should be more cash in their bank account a year after they received a loan. If there is not, then microfinance staff didn’t teach them to save.

Data about client’s savings accounts should be collected. The milieu of questions that need to be asked about monitoring savings should include: How much money has the client saved at the end of the year? (Are they building capital?) Have they built on their savings account from the beginning of the year (assuming they never had a savings account before microfinance)? If they are at the end of the year, that is something to be celebrated. It is a big deal because Americans do not even save money. Teaching to borrow makes someone a better saver.

The second metric for self-sufficiency can be monitored through loan history. Maybe those who want loans for consumption basis could be required to save for a designated amount of time before taking out any loan. Otherwise, loans termed “emergency loans” for consumption are no different from charity. Charity reinforces dependence, and social change is not accomplished. If the institution gave the people in question “seed” money to start their business, then the borrowers need to be self-

[12] Stuart Rutherford. “The Economics of Poverty: How Poor People Manage Their Money.” *Ideas in Development Journal: Communities Without Boarders.*2002. Corporation for Enterprise Development. <http://ruralfinance.co.uk/lesson1.3/resources/Economics_poverty_rutherford>.

perpetuating within a year. In Hans Dieter's review of microfinance's history he concludes, "Savings have served as the foundation of self-reliance and the motor of growth."[13] If a person has not made money enough to pay for their seed at the end of the harvesting season, then the question is not how to get more money, but how to be a better farmer or maybe even how to switch professions.

Data about clients becoming self-reliant should be collected. The questions to be asked in order to understand whether or not this goal was accomplished include: How many businesses are self-perpetuating/self-sufficient at the end of the loan period? Does the client's business idea need more money to keep going? How many businesses for whom the microfinance institution provides loans became self-perpetuating at the end of the loan payment period? At the end of the loan period, a borrower's income has to be greater than their expenses for them to be deemed successful. This money does not just give a person seeds, but it gives him or her work. From the people who have repaid their loan, how many have learned to affirm that work is a virtue?

Tighter monitoring and regulation of measurements can turn the microfinance industry into a comprehensive movement towards social change. Business faculty members at the University of Zaragoza in Spain are concerned with this issue stating in a paper discussing microfinance institutions:

> "Given the social aim of MFI's, it is necessary to encourage rating agencies to engage in the development of social ratings. These social ratings should

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[13] Hans Dieter Seibel. "Does History Matter?: The Old and the New World of Microfinance in Europe and Asia." *Asia Research Institute, Department of Economics, and Department of Sociology National University of Singapore.* Oct. 2005, 13.

> complement financial ratings, giving information about the accomplishment degree of the MFI's social goals."[14]

Financial ratings can be implemented objectively and only have to be audited in order to provide assurance to investors. However, social ratings tend to restricted in scope. Social factors need to become more heavily used and analyzed, especially with the introduction of business-charity hybrids.

Avenues for Further Research

The more material I study about microfinance the more I realize that I do not know. In the future I would like to provide more quantitative data to the field of microfinance. I would seek to accomplish this through surveys indicating how to identify positive changes in quality of life. The purpose of collecting such sample surveys is to provide data that can be used to further the cause of finding a way to alleviate poverty through microfinance. Questions that need to be asked in relation to quality of life could include progression in Maslow's "hierarchy of needs". As loans are repaid, are there positive changes in physiological, safety, sense of belonging, and self-esteem?[15] This data can be collected in the future as correlations develop between client portfolios and client life decisions and changes.

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[14] Begoña Gutiérrez Nieto and Carlos Serrano Cinca. "Factors Explaining the Rating of Microfinance Institutions." *Science Faculty of Economics and Business for University of Zaragoza.* March 2006. <http://www.dteconz.unizar.es/DT2006-03.pdf>.

[15] Mahmoud A., Wahba, and Lawrence G. Bridwell. "Maslow Reconsidered: A Review on the Need Hierarchy Theory." *Orgaizational Behavior and Human Performance* 212th ser. 15.2 (1976): 212-40. Web, 213.

Also for further research, I would love to study the combining of business and charity in comparison and with tools used to study mergers and acquisitions. I think there are a great number of similarities between these processes. Mergers and acquisitions are presented to employees in a company as a good and progressive thing. However, these events often occur with much protest. Sometimes the merger does not reach efficiencies because the cultures are too incompatible. Similarly, I think that business-charity hybrids are presented to investors as a good and progressive thing. However, these events occur and the poor may have protests based on how they are seeing the benefits of the proposed progressive model. Can business-charity hybrids overcome the cultural difference? There is a lot of research on how to make mergers happen smoothly and how to identify whether a merger was successful or not. I estimate there might be overlap between these two concepts.

In the future, I would also like to research the effects of a microfinance institution's IPO. With the recent IPOs for microfinance firms, skeptics of the idea of mission drift occurring in microfinance are fueled by the returns that are made from public investors. I think that it would be interesting to study relationships in outcomes of these firms like SKS Microfinance in India and Banco Compartamos in Mexico.

Value can exist outside of financial statement indicators. A nonprofit may be providing to the poor while they are not getting as many donations as usual. This does not mean that the nonprofit is faulty because the application of another metric can tell the success of nonfinancial measures. I think there is some validity to the subjective metrics like "feelings of empowerment" that some practitioners gather. I would like there to be a standardized means to attain these measurements instead of ambiguity in the collection and interpretation of these measures. There are outcomes to microfinance, but identifications must be made through what inputs the institutions provide. The more information that is collected about inputs, the higher the likelihood is that these inputs can correlate to a proper output. Organizations should couple their mission and general information with efficacy measures like savings accounts analysis and time toward self-sufficiency of clients.

Conclusion

This paper discusses the idea of synergism when business combines with charitable institutions. When mergers happen, not all results are positive. Because the effects can be negative, it is important that measurements of success accurately depict whether goals are being met. In the microfinance industry there is a double bottom line. Therefore, two goals need to be accurately tracked with measurements that reflect whether these goals are being accomplished.

It is proposed that business measures can encompass both business goals and social goals. This thought process leads to the heavy reliance by microfinance institutions toward using repayment rates as a measurement of success. Although repayment rates depict business success, they only depict social success in the short run. With microfinance institutions gaining popularity in recent years, the long-term effects of microfinance's social goal (i.e. getting people out of poverty) is not adequately measured. Business-charity hybrids are becoming more prevalent and need their own metrics in order to rank efficacy and performance of these entities.

The importance on measurements is paramount to whether microfinance institutions are effective in both goals. What a firm measures determines what a firm stands for. If more resources are concentrated on the wrong measure, the focus and goal of the firm can be lost altogether.

The metrics that I propose to implement in microfinance institutions are as follows: (1) changes in savings prior to and post loan and (2) business self-sufficiency of borrower at the end of the loan period. These measurements give insight into whether the social goal of microfinance is being met by tracking both short- and long-term success of a borrower. The savings measurement also indicates whether the business goals are likely to be met. A positive change in savings increases the ability of the borrower to repay their loan principal and interest because there is evidence of income.

These measurements are not comprehensive characteristics of business-charity hybrids. What these measurements do is indicate a need for a new set of metrics for business-charity hybrids and identify part of the thought process that must go into these new measures of success. Business-charity hybrids are too unique and complex to evaluate on a scale based solely on businesses or solely on charities.

Looking at repayment rates and short-term success factors of microfinance tells a success story; this story needs to be supplemented. Businesses and charitable institutions can be better together than they are separately. However, skeptics can only be overridden with quantitative data. Therefore, measurements are essential in evaluating firm performance.

Microfinance institutions need help. These institutions need proof that they are helping poor people improve their lives. Heartwarming stories exist to persuade beneficiaries in microfinance. The stories contain fragments of progress, but add a sense of inconsequential testimony when looking at big-picture qualifiers. Now, empirical data needs to persuade investors to invest in microfinance's two goals. As more microfinance institutions become publicly traded, this need increases as ambiguity prevails for quantitative data that exists. A final question remains: Microfinance currently yields high profits, but will the lack of long-term indicators critically affect the social goals of these institutions?

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