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# WORKING TOWARDS A DEFINITION OF SOCIAL RETURNS

With some microfinance institutions (MFIs) generating healthy financial returns, microfinance as an asset class recently attracted attention from investors. The social performance of MFIs came into focus and since 2005 the microfinance sector has made progress in reaching consensus on social performance indicators, setting social performance reporting standards and promoting social rating. The issue arises, though, whether MFIs can report on their social returns (SR) on a regular basis, in the same manner as they report on their financial returns (FR).

Social returns (SR) should be defined and measured in a way that is comparable to return on equity (ROE) and expressed as percentage growth of clients' financial resources, with verifiable data available from a MFI's management information system on a regular basis.

Financial services have impact in terms of poverty reduction if they result in increased savings of the poor, which will help them deal with emergencies, smooth consumption and allow investment in household assets. Tracking the change in clients' savings over time reflects whether the clients' vulnerability is reduced and whether they progress from subsistence to growth. MFIs - as they develop the savings habit of the poor and provide loans for productive activities - should aim that clients' savings become capital for these clients to invest in their own productive activities and other types of capital such as land, equipment, education, and health.

We propose to define SR as change in clients' savings over time.

The definition works better for deposit-taking MFIs. In non-deposit-taking MFIs, data must be collected, processed, analysed and reported on a regular basis by trained staff. Even with deposit-taking MFIs borrowers should clearly prefer to save with the MFI where they borrow from and not with its competitors.

Clients' savings change may temporarily become negative whenever investment in the clients' assets occurs. However, if the number of clients is large, the trends are tracked over time, and seasonality is taken into account, clients' savings change will average out and indicate whether potential for asset growth at the client level and thus potential for poverty alleviation were created.

In addition to tracking the change in savings, MFIs can also track the changes over time in other assets and expenditure of microfinance clients. But the change in clients' financial assets over time would still be a priority for an institution that offers financial services. It is logical for MFIs to focus on the change in clients' financial assets, since this is the area where they are directly involved.

Using data from the MIX Market website database, we carried out analysis of the MFIs that met the following selection criteria: MFI data come from audited financial statements; MFIs are financially sustainable and engage in a high level of financial intermediation; the depth of outreach is broad, number of borrowers is greater than 1,000 and data for analysis are available for 2005-2008 with no gaps. In the analysis an assumption was made that clients borrow and save with the same MFI, however, this information is not available from the dataset.

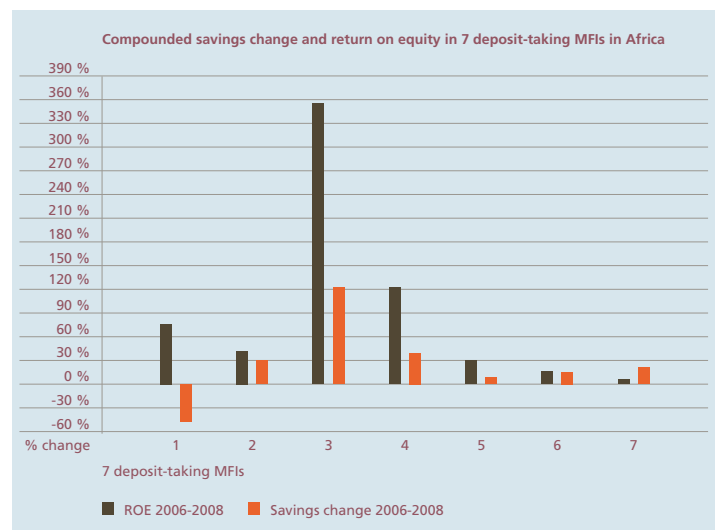
56 MFIs met the criteria from over a thousand organisations, with most from the Latin America and the Caribbean (LAC) region (31) and Asia (14), with a few from Africa (7) and Eastern Europe and Central Asia (4).

The MFIs' average deposit change was compared with the ROE for 2006-2008. From the data, an observation was made that microfinance clients' savings change (SR) was negative in 61% MFIs in 2008, while their ROE (FR) was positive. The same was true for 16% of MFIs in 2007 and 18% of MFIs in 2006. Furthermore, most of the MFIs sustained a ROE at a higher rate than their clients' savings growth, as in the graph below.



Another observation was made from 31 MFIs from the LAC region that met the above criteria: their SR and FR were not found to be correlated.

A question arises from these findings about the balance between FR and SR. As can be seen from the graph below, in 7 African MFIs that met the above selection criteria the FR and SR balance varies - some had modest, but equal FR and SR (e.g. MFI 6), while others obviously enjoyed significantly higher FR than their clients' savings growth (MFIs 1, 3 and 4).



In fact, four scenarios are possible that can prompt goal setting in MFIs that are willing to track their SR: SR can exceed FR, be at the same or lower level than FR, or be negative. The MFI stakeholders will face a number of decisions to be made, such as which returns should be maximised - financial or social and what the desired balance is. We hope that the suggested SR definition should facilitate deliberations among MFI stakeholders to strike a balance between social and financial returns.