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Managing the social performance of microfinance institutions

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Microfinance is booming. Beyond financial performance, it is essential for the sector not to lose sight of its social objective. The most innovative MFIs are reacting quickly to the first cases of abuse, implementing tools to manage and increase the sector's necessary social footprint. Such endeavours need to be underwritten by the regulators, who have a critical role to play – particularly in terms of increasing the transparency of lending conditions.

Microfinance can succeed only if it does not lose sight of its social objective. For a few years, some have believed that microfinance would be the proverbial silver bullet: a tool through which Wall Street could be kept satisfied and world poverty could be eradicated simultaneously – all of this while looking only at financial indicators as a criterion of success. In the euphoria that followed the International Year of microcredit and the awarding of the Nobel Peace Prize to Muhammad Yunus and Grameen Bank, inevitably simplistic slogans – "Loans that change lives", "Access to credit for all" – have at times been so feted as to almost become substitutes for sound management principles. Some of these institutions have forgotten that for a loan to "positively change" a life, it needs to be granted with much caution and rigorous analysis. Credit is not a right – it can actually be a hazard for those with too little secure income and those already drowning in debt. It also has become particularly clear that loans that aren't applied to supporting income-generating activities are embedded with real dangers for vulnerable people.

The sector's coming of age has, in certain areas, led to increased competition on the market for the supply of credit to the poorest. It has also favoured the appearance of the now ubiquitous "microfinance avenues", where four, five or ten MFIs are lined up over a few hundred meters in some of the commercial districts of large cities in developing countries. Vulnerable people are therefore highly enticed, and often tempted to take up loans. Unfortunately, this vulnerability also invites abuse. The few cases of clear abuse – as evidenced by the charging of extortionate interest rates, insolvencies caused by debt, and, in some of the worst cases, coercive and illegal debt recovery practices – serve as a reminder that neither social nor financial performance are coincidental by-products of business. Indeed, what would financial performance be without the armies of accountants, controllers, internal and external auditors who work for their companies, produce financial indicators and ensure their reliability? What would financial performance be without the circumspection of controllers and other risk managers, without the constant attention of executive managers and performance analysts, without the study and circulation of best practices by consultants and researchers? While none of this guarantees that businesses won't ever fall prey to accidents or bad decisions, such management processes at least allow bona fide actors to do everything within their means to deliver financial results in line with the expectations of all the stakeholders involved.

Microfinance stakeholders, confronted to the first signs of trouble, are proving their ability to react promptly. They are demonstrating their commitment to the dual objectives of financial and social sustainability. Indeed, for a number of years already, some of the stakeholders anticipated the troubles mentioned earlier. As a result, the sector has started fine-tuning and reconfiguring the different components that make up the microfinance ecosystem. Such measures will, ultimately, allow the sector to manage both its financial and social performance.

Some specific tools currently being developed include:

- Focused impact studies, conducted in an efficient manner, helping to understand how the social impact of microfinance services can be optimised : Which target-groups enjoy the most benefits from credit or savings services? At what level of interest rate does the cost/benefit ratio make it difficult for a microentrepreneur to make use of microfinance services? Are joint guarantees effective?
- Surveys conducted with current and past customers to understand what services people actually need, by speaking to the supposed beneficiaries themselves.
- Donors specialised in microfinance, or holding a "socially responsible" label, are defining standards of transparency; standardised financial performance indicators are being established.
- Ethics charters and consumer protection codes are appearing, their implementation could be certified and will make it possible to draw a clear distinction between socially responsible microfinance institutions and loan sharks, pawn shops or consumer credit organisations.
- Monitoring and evaluation methods on social performance that will guarantee the comparability of efforts realised and results obtained in the social arena. Such appraisals will allow for priority investments in the most efficient organisations, or for assistance to underachieving institutions.

More or less accomplished forms of these tools are already available thanks to the often collective endeavours conducted by ground-breaking MFIs and their technical and financial partners. Those MFI managers who consider their social objectives to be at least as important as their financial bottom line can readily use these tools. Such increased attention for the well-being and satisfaction of their customers should translate into more sustainability – something that can only be achieved through a better overall command of credit risk, an easier prediction of possible reputational risks, and increased competitiveness of their services. The most advanced MFIs in this area advocate better management of social performance and alert the stakeholders – discreetly but sometimes also publicly – on the possibility of abusive practices.

Regulators have, of course, an important role to play in this regard: they have to set the ground rules in a manner that respects the fundamental rights of all consumers. There is a pressing need, among other things, to set standards on the transparency of terms and conditions of microfinance services. Of late, there has been clear evidence that the absence of transparency on loan conditions has sometimes led to the development of toxic products (such as subprime mortgages). Establishing credit bureaus capable of limiting cases of insolvency is an equally crucial need for the sector.

It is of prime importance, finally, to remember that the fight against poverty is also closely linked to the development of democracy. Failing that, no amount of social or financial regulation can escape a certain level of arbitrariness. Microfinance most certainly contributes to the development of democracy, by helping citizens to take control of their lives.