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Center for Microfinance

# Measuring Social Performance of Microfinance Institutions in Peru

BA Thesis in Banking and Finance

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# Executive Summary

The microfinance industry, born primarily out of a desire to help the poor, has grown and developed into a for-profit industry. During the past several decades commercial capital has started to flow into this industry and microfinance has become an integral part of the formal financial sector in many countries. But, is microfinance working? The question whether microfinance is achieving its original social goals of improving the lives of the poor has also emerged. Today organizations are developing tools for assessing whether microfinance institutions (MFIs) are fulfilling their social mission. This thesis investigates whether social performance is being measured by MFIs in Peru, and whether microfinance is having social and economic impacts on the Peruvian poor. For this purpose, an in-depth literature research and a survey with MFIs in Peru are conducted. Research shows that there is some awareness of the importance of social performance measurement in the Peruvian microfinance sector. There are few MFIs participating in pilot projects with international organizations to validate their social measurement tools and for implementation in their management system. Overall, social performance measurement in Peru is found to be at a developmental stage.

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## List of Acronyms

| | |
|---|---|
| AIMS | Assessing the Impact of Microenterprise Support |
| CMAC | Cajas Municipales de Ahorro y Credito (Municipal Savings and Loan Institutions) |
| COOPAC | Cooperativas de Ahorro y Crédito (Credit Cooperatives) |
| COPEME | Consorcio de Organizaciones Privadas de Promoción y Desarrollo de la Micro y Pequeña Empresa (Consortium of Private Organizations that Promotes the Development of Small and Medium Enterprise) |
| CRAC | Cajas Rurales de Ahorro y Credito (Rural Savings and Loan Institutions) |
| EDPYME | Entidades de Desarrollo de la Pequeña y Micro Empresa (Entities for the Development of the Small and Microenterprise) |
| FENACREP | Federación Nacional de Cooperativas de Ahorro y Crédito del Perú (National Federation of Credit and Saving Cooperatives) |
| GDP | Gross Domestic Product |
| INEI | Instituto Nacional de Estadisticas e Informatica |
| MFI | Microfinance Institution |
| MFP | Microfinanzas PRISMA |
| MSE | Small and Micro Enterprise |
| NGO | Non-governmental Organization |
| PPI | Progress Out of Poverty Index |
| PROMUC | Consorcio Promoción de la Mujer y de la Comunidad (Promoting Women and the Community) |
| ROA | Return on Assets |
| ROE | Return on Equity |
| SBS | Superintendencia de Banca, Seguros y AFPs (Superintendency of Banking, Insurance, and Private Pension Fund Administrators) |

| | |
|---|---|
| SPM | Social Performance Management |
| SPTF | Social Performance Taskforce |
| USAID | The United States Agency for International Development |

# 1. Introduction

Public awareness of microfinance has grown significantly since the United Nations launched the International Year of Microcredit 2005 “in an effort to build support for making financial services more accessible to poor and low-income people” (UN Department of Public Information, 2004), and Mohammad Yunus and the Grameen Bank were awarded the Nobel Prize 2006 “for their efforts to create economic and social development from below” (The Nobel Foundation, 2006).

Microfinance is the supply of financial services to relatively poor people, who, due to lack of collateral, are ignored by traditional banks and excluded from the financial system. Microfinance is widely considered as a powerful tool to fight poverty (Felder-Kuzu, 2008). Institutions providing these services are called microfinance institutions or MFIs. Microfinance can be trace back to the foundation of the Grameen Bank in 1983 by Mohammad Yunus in Bangladesh. The Grameen Bank is the first bank of its kind to have offered microcredits to the poor. It has also demonstrated not only that the poor are creditworthy but that their repayment rates can be higher than those of traditional commercial banks (Kearney, 2008a).

The success of the Grameen Bank spread rapidly to other nations, and many governments and organizations alike started to implement microfinance and adapted Yunus’ approach to their contexts. Over the past 30 years, the microfinance industry has grown into a vibrant industry. It has become globally very attractive to private investors, and it has begun to access private commercial capital (Leleux & Constantinou, 2007).

The growth of the microfinance industry has been possible primarily through the insistence of MFIs on financial sustainability (Hashemi, 2007). Success in this industry is often measured by the financial performance of the MFIs and not on how well MFIs are meeting their social goals, i.e. social performance (Hashemi & Anand, 2007). In view of the extensive focus on financial – instead of the social – performance up to now, people started to ask whether microfinance is indeed improving lives of low-income people and achieving its social mission.

This paper addresses the social performance question of microfinance in Peru. It investigates whether social performance of microfinance is measured and whether microfinance has made positive impacts on clients´ livelihoods in Peru. In order to investigate the current state of social performance measurement in Peru, a literature review on the impact of microfinance in Peru was conducted, a number of local research centers and organizations supporting MFIs were contacted, and several MFIs in Peru were directly surveyed.

The focus on Peru to address the social performance measurement issue of microfinance can be justified by several factors. Peru is one of the most experienced microfinance markets of the Latin American and the Caribbean region. It possesses the highest number of MFIs, the biggest loan portfolio, and the second highest number of MFI clients (Navajas & Tejerina, 2006). Furthermore, Peru has integrated microfinance in its formal financial system, has a relative strong regulation, and embraces highly profitable MFIs.

Chapter Two presents a theoretical framework, which includes relevant concepts of microfinance. Chapter Three discusses the Peruvian microfinance market, its background and characteristics. Chapter Four explores the social performance of microfinance by presenting the social performance concept, methods of impact evaluation, and international initiatives for social performance measurement. Chapter Five analyzes the social performance in Peru using results of published impact studies, current initiatives on social performance measurement, and a survey conducted with Peruvian MFIs. Chapter six presents two MFIs operating in Peru to compare social and financial performance. Chapter seven provides conclusions

# 2. Introduction to the Microfinance Industry

This chapter presents an introduction to the microfinance industry with three sections. The first section explains the concept of microfinance and its origins. The second section describes the evolution of microfinance to the industry’s current stage. The third section illustrates today’s demand for social performance information.

## 2.1 Concept and Origins of Microfinance

Microfinance operates in poor areas, offering financial services to low-income people through microfinance institutions (MFIs). Felder-Kuzu (2008) defines microfinance as financial services for low-income people who are excluded by traditional financial intermediaries, e.g. banks and insurances. Armendáriz de Aghion and Morduch (2005) define microfinance as the “collection of banking practices built around providing small loans (typically without collateral) and accepting tiny saving deposits" (p.1). In microfinance, loans are significantly smaller, pay-back-length is shorter, and operating costs and interest rates are higher than those from traditional banks.

Armendáriz de Aghion and Morduch (2005) explain that banks do not operate in low-income communities because they lack information to enforce contracts with potential borrowers and therefore experience high default rates. In those areas, the poor borrow from informal moneylenders at extreme high interest rates. Microfinance takes an in-between position combining local information and cost advantages of moneylenders with banks' capital resources from outside the community. Armendáriz de Aghion and Morduch consider microfinance as a new market-based strategy for poverty reduction, where poor household can profit from access to banks and banks can profit even when serving poor customers.

Leleux, Constantinou and Ogunsulire (2007) clarify some common doubts related to microfinance. First, microfinance embraces not only microcredits; but it includes a wide range of financial services like savings, payments, insurance and credit cards– they all constitute a source of revenue for MFIs. Second, microfinance is not charity and microcredits are not grants; instead microcredits are fully repayable loans. In some cases, repayment rates have proved to be significantly higher than those from traditional banks. And third, microfinance institutions are not only nongovernmental organizations (NGOs). Although the majority of MFIs are not commercially viable, most of the successful MFIs are fully commercialized formal financial institutions.

A review of the microfinance literature indicates a tendency to focus microfinance on microcredits for microentrepreneurs. For example, Felder-Kuzu (2008) affirms that microfinance allows the poor to develop their business ideas, and Leleux and Constantineou (2007) use the term microfinance as micro and small business finance. However, Simanowitz (2003) indicates that the focus on credit for enterprise development is an early approach and only one dimension of microfinance for assisting the poor with reducing their risk and vulnerability. As mentioned above there are other financial services of microfinance that help the poor improve their livelihoods.

The special element of microfinance is that pioneering models derive from experiments in low-income countries and not from standard banking models of developed countries (Armendáriz de Aghion & Morduch, 2005). The most famous pioneer of microfinance is Muhammad Yunus. In the mid seventies, Yunus (2007) starts granting microcredits from his own pocket to 42 Bangladeshi poor in response to the extreme unfair conditions imposed by their previous moneylender. As the 42 poor repay their credit, Yunus tries to convince local banks to extend granting credits to the poor; but without success he ends up as their guarantor. Yunus proved that the poor paid back the money lent and that their lives progressively improved. In 1983 Yunus founded the Grameen Bank under a new special law and since then has given loans without collateral to low-income people, has experience higher repayment rates than traditional banks and proved to be sustainable over decades.

Leleux, Constantinou and Ogunsulire (2007) give other pioneer examples of microfinance. They state that ACCION in Brazil and Interdisciplinäre Projekt Consult GmbH (IPC) in Peru were offering small loans to microenterprises at the same time as Yunus in Bangladesh. They claim that microfinance is rooted in a desire to help the poor and that these antecedents induce the widespread image of microfinance within the limits of charity and philanthropy. However, the reality of microfinance has since changed.

## 2.2 Changing Reality of Microfinance

Microfinance began as a social and non-profit oriented industry (Felder-Kuzu, 2008). This industry initially began with charitable and public money from development agencies and non-profit organizations and focused on social rather than financial returns. However, some MFIs started adopting a for-profit approach and gaining access to commercial capital. During the last 30 years, microfinance has grown into a commercial and for-profit world (Felder-Kuzu, 2008).

The number of MFIs has significantly increased and concepts like “upscaling” and “downscaling” have characterized growth and commercialization of the microfinance industry (Leleux, Constantinou, & Ogunsulire, 2007). “Upscaling” refers to the transformation of informal MFIs to formal financial institutions; by which they subject to the same regulation as all other financial intermediaries in the country and gain better access to private commercial capital. On the contrary, “downscaling” refers to the entry of traditional commercial banks to the microfinance sector in view of its profitability.

Leleux, Constantinou and Ogunsulire (2007) affirm that commercial capital has contributed to the market-driven growth of the microfinance sector and to the development of structures to operate profitably. Some of the successful MFIs are very profitable, with

Return on Equities (ROEs) ranging up to 30 percent, but they are rare. The authors consider that commercialization is the only path to sustainability and to the full realization of the potential of microfinance. They conclude that microfinance could be larger and grow faster if it would have only profits as an objective.

As in other financial market sectors, independent rating agencies have emerged to provide objective assessments of MFIs. In general, the microfinance market is growing more structured and transparent. It is also offering more structured investment vehicles that have allowed institutional investors, hedge funds, pension funds, private investors and private foundations to emerge as new important investors of the industry (Felder-Kuzu, 2008).

The development of microfinance can be summarized with three characteristics: (1) the change from subsidized to commercial microfinance; (2) a wider diversity of financial services; and (3) the development of microfinance investment vehicles suitable for social and commercial investors. Felder-Kuzu (2008) speaks therefore of microfinance as a hybrid world placed between the social and the commercial world.

## 2.3 The Double Bottom Line of Microfinance

The rapid growth of the global microfinance sector is mainly due to the focus on financial sustainability (Hashemi, 2007). This can explain why success of microfinance has been often measured solely by financial performance of MFIs. Hashemi (2007) explains that high demand for services and high loan repayment rates have been considered as sufficient proofs of poverty alleviation. However, Hashemi explains that high demand for financial services among the poor is not necessarily a sign of clients' improving conditions. Indeed, clients can demand more credits in order to pay other debts - a concept known as spiraling indebtedness.

Information on financial performance alone gives an incomplete picture of program performance and some knowledge of social impact is necessary to assess overall program effectiveness and to justify microfinance as a tool for poverty reduction (Brau and Woller, 2004). Hence, the fact that microfinance clients are repaying loans and borrowing again does not necessarily imply that the poor are benefiting from those loans. MFIs should therefore gather specific field level evidence of social impact.

Today, there is an increasing interest in how microfinance affects lives of the poor. Foose and Greenberg (2008) report that, as the microfinance industry has become more competitive and commercial, there is greater demand for social performance information to assure that the social roots of microfinance are not abandoned. Investors are insisting on greater transparency and accountability; they want to know if their investments are achieving social improvements throughout the world. Similarly, Hashemi and Anand (2007) note that today the industry is taking a harder look at its ability to improve people's lives and organizations have began to measure social performance and to develop tools for reporting social performance information.

The microfinance field is characterized by two groups (Woller, 1999). The opponents of social performance claim that a social performance bottom line affects financial sustainability negatively, while the supporter of social performance argue that social and financial performance are mutually reinforcing. The latter affirms that strong financial performance allows MFIs to achieve their social objectives and, conversely, social performance enhances financial sustainability. They advocate a double bottom line of microfinance.

# 3. Microfinance in Peru

This chapter illustrates the microfinance sector in Peru and is divided in four parts. Part one illustrates the socioeconomic background of Peru and explains the importance of microfinance. Part two presents characteristics of the Peruvian microfinance sector. Part three compares the different types of microfinance institutions and their distribution within the Peruvian microfinance sector. Part four describes the market regulation in Peru.

## 3.1 Importance of Microfinance in Peru

In order to understand the importance of microfinance in Peru, it is necessary to describe its social and economic situation. Peru ranks as a middle-income country, but distribution of income is highly unequal and poverty incidence is still high (Copestake, Dawson, Fanning, McKay, & Wright-Revolledo, 2005). Table 1 lists some of the country profile indicators. It shows that almost 40 percent Peruvians are living below the national poverty line, and almost 14 percent are considered extreme poor.

**Table 1: Country Profile of Peru**

| Indicator | Source | Amount |
|---|---|---|
| Urban population (%) | CIA | 71 |
| Life expectancy (years) | CIA | 70.74 |
| HDI | Planet Rating | 0.788 |
| Literacy (%) | CIA | 92.9 |
| School enrollment (%) | World Bank | 86.4 |
| Poverty (%) | INEI | 39.3 |
| Extreme poverty (%) | INEI | 13.7 |

**Source: Own research**

There is marked variation in the geographical distribution of poverty, with urban areas recording the lower percentages of poverty and rural areas the higher. The capital of Lima presents the lowest percentage of poverty and the rural areas of the Andes present the highest (Instituto Nacional de Estadística e Informática [INEI], 2007). INEI (2007) reports that poor households are mainly indigenous, which have a higher number of family members, lower levels of education, and they work mostly in small and microenterprises (MSEs).

Peru has shown an increasing gross domestic product (GDP) growth during the past six years, which has ranked the country as one of the best economies in Latin America; the GDP growth was 9.8 percent in 2008 (The World Bank Group, 2009). The World Bank reports that sustained economic growth has positive impacts on reducing poverty and creating jobs even outside the metropolitan capital of Lima. It states that Peru possesses a healthy financial industry and a strong portfolio of foreign investment commitment. Thus, poverty percentage fell from 48.7 percent in 2005 to 39.3 percent in 2007 (INEI, 2007) and extreme poverty fell from 17.1 percent in 2004 to 13.7 percent in 2007 (The World Bank Group, 2009).

However, the picture of Peru was different during the previous decades. The eighties are characterized by economic recession, a bloody guerrilla war, collapsed infrastructure, political corruption and illicit drug trade expansion (Kearny, 2008b). In 1990, a radical structural adjustment program, characterized by privatization and elimination of governmental social support, was implemented in order to stabilize the economy, and bring inflation under control.

By the mid nineties, macroeconomic indicators show a better performance of the Peruvian economy: inflation is controlled, foreign investment increases, and political violence diminishes. However, unemployment and underemployment grow rapidly affecting negatively the vulnerable members of the society. Kearny (2008b) affirms that this group faces the barriers to accessing the capital needed to start up their microenterprises, and microcredit becomes a means to address the needs of those abandoned by the state.

It appears that the small and microenterprise sector plays a relevant role in the social and economic development of Peru because it forms the principal source of income for the majority of the population. According to the Department of Labor and Promotion of Employment (Ministerio de Trabajo y Promoción del Empleo, 2008) approximately 60 percent of the economically active population in Peru works in MSEs and generates only 40 percent of the GDP. This indicates that although most Peruvians work in MSEs, they are less productive than other industries.

In sum, small and microenterprises (MSEs) in Peru occupy mainly the poor, show relative low productivity and offer precarious work conditions. Therefore, an increase in productivity of MSEs would help the poor to have more sustainable and profitable businesses, earn more income, and reduce poverty. One of the factors that help increase the productivity of the MSEs is financial capital, e.g. through microcredit. Aramburú and Portocarrero (2002) affirm that the promotion of microcredit plays a leading role in poverty alleviation in Peru. They explain that microcredit helps improve the productivity of MSEs, which leads to increases in the household's income and employment; these allow more people to be able to satisfy their basic necessities.

The importance of MSEs for the development of the Peruvian economy has been well recognized by the government, which since the mid-nineties has regularly introduced policies that support and promote the development of the MSEs. Central components of these policies have been the expansion of credit to MSEs and the normalization of MSEs into the official Peruvian economy (Burnett, Cuevas, & Paxton, 1999).

## 3.2 The Microfinance Sector in Peru

In Peru, microfinance refers to the application of finance within the small and microenterprise sector (Vontrat, 2008), where microentrepreneurs are not considered only clients of microfinance but also an integral part of the Peruvian financial system. Kane, Nair, Orozco, and Sinha (2005) affirm similarly that most of the credit provided by the microfinance sector has been directed to microenterprises as opposed to consumer credit. A review of the microfinance literature corroborates these affirmations because most of the literature focuses on microcredit granted to microentrepreneurs.

A microfinance institution is any institution, regulated or non-regulated, that has a relatively large proportion of their operations dedicated to offering financial services to small, rural or urban, microentrepreneurs (Valdivia and Bauchet, 2003). Moreover, the Superintendencia de Banca, Seguros y AFPs [SBS] (2003) defines loans to small and microenterprises (MSEs) as loans granted for productive purposes that are less than US$ 30,000.

Furthermore, the Peruvian Department of Labor and Employment explains the definition of small and microenterprises (MSEs) as declared by the Law of Promotion and Formalization of the Micro and Small Enterprise of 2003, the law N° 28015. According to this law, MSE is any natural person or legal entity under any organizational form, which realizes extraction, transformation, production, commercialization or service activities. In addition, a microenterprise comprises a number of 1 to 10 employees and total sales of up to 150 UIT[1]; and a small enterprise comprises a number of 1 to 50 employees and total sales from 151 to 850 UIT (Ministerio de Trabajo y Promoción del Empleo, 2008).

Origins of microfinance in Peru date from 1980, when the government promulgated the law to create publicly owned municipal saving and credit banks (CMACs) in areas outside of the greater metropolitan region of Lima. The objectives included the decentralization of financial services and the expansion of formal financial services to low income clients without previous access to formal financial institutions. Throughout the eighties and with the support of a German consulting group, Interdisciplinäre Projekt Consult GmbH (IPC), a nation-wide network of CMACs was successfully established. Due to its sustainable growth, this network is considered one of the most significant cases of microfinance in Latin America (Burnett et al., 1999).

Since 1990, the supply of microfinance services has greatly increased and improved in Peru (Valdivia & Bauchet, 2003). The growth is characterized by the increase in the number of service providers, clients, loan portfolio, and a wider range of microfinance

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[1] UIT, or Unidad Impositiva Tributaria, is an official established tax unit and a benchmark figure established to maintain the taxes, deductions, etc. at constant proportions to income. The UIT value for 2009 is PEN 3550 (“MEF fija valor de la UIT”, 2008)

services. The structure of the market has been changing; commercial banks have down-scaled and MFIs have commercialized. As a result, competition has increased among service providers in the microfinance industry. Although Portocarrero and Byrne (2004) stated that the market of microcredit presents low levels of competition and efficiency, Del Pozo (2008) shows evidence of increasing levels of competition over the period from 2003 and 2008.

The significant development of the microfinance sector has been mainly possible through financial reforms by the Peruvian government of the nineties. After the crisis of the late eighties, the Peruvian economy underwent a process of stabilization, which was characterized by reforms in the legal framework. With respect to the financial sector, in 1996 the government promulgated a new General Banking Law that liberalized and re-structured the financial sector. The reform liberalizes financial transactions, strengthens the regulatory power of the SBS, and eliminates state development banks and subsidized funds (Valdivia & Bauchet, 2003). More information about the regulation system is offered in section 3.4.

Despite the growth of the last decades, access to credit remains low and informal for the poorest segment of the population and thus, financing of agriculture remains insufficient. Kane et al. (2005) report that rural microfinance is considered both unprofitable and highly risky. Kane et al. further indicate that the demand for foreign capital can be greater because commercial banks with already greater access to foreign capital have entered the market, and because approximately only 30 percent of the microcredit market is served. The latter can be explained by the fact that the greater part of the market without microfinance is poorer and more difficult to serve. Thus, additional capital is needed, so that MFIs are able to obtain economies of scale and serve this poorer segment in a sustainable way.

There are four factors which have contributed to the significant development of the microfinance sector in Peru: (1) the significant economic growth of the past years; (2) the recognition of the importance of MSEs for the development of the country; (3) the financial reforms of the Peruvian government; and (4) the strict regulation and supervision of MFIs through the SBS.

## 3.3 Microfinance Institutions in Peru

There are seven categories of microfinance institutions in Peru: Cajas Municipales de Ahorro y Crédito (CMACs), Cajas Rurales de Ahorro y Crédito (CRACs), EDPYMEs, Financial entities, Commercial banks, Cooperativas de Ahorro y Crédito (COOPACs), and Credit NGOs (NGOs). CMACs were created during the eighties in Peru with a financial decentralization objective. They were originally owned by provincial governments to offer a wide range of credit and saving products in provinces. They have reached remarkable success (Valdivia & Bauchet, 2003).

CRACs are decentralized, for-profit, financial entities owned by local private entrepreneurs. They were created in the early nineties in response to the closure of the Agrarian Bank, so they currently operate in rural areas supplying credit to small agricultural producers. The legal organizational form of EDPYME was created in the financial reform of 1996 to offer a possibility for NGOs to normalize into the formal sector. They offer a wide range of credits to MSEs but are not allowed to collect savings (Ebentreich, 2005).

Commercial banks can be specialized banks in microfinance that provide a wide range of financial services to small low-income entrepreneurs, or they can be traditional banks, which in view of the sustainability of microfinance, have downscaled and so expanded their services to low-income people. Financial entities are very similar to commercial banks, but operate in a relative smaller scale.

All above mentioned categories constitute the formal sector of microfinance in Peru. The semi-formal sector is composed by COOPACs and NGOs, which operate in smaller scales than formal MFIs and have a more local focus (Del Pozo, 2008). COOPACs are closed credit unions that offer loans only to its members (Ebentreich, 2005). NGOs are non-profit oriented institutions that encourage social and economical development of microentrepreneurs. Trivelli (2004) indicates that NGOs constitute a significant finance source for the poorest segment of Peru. An overview of all explained MFI-categories is offered in table 2.

**Table 2: Types of Microfinance Institutions in Peru**

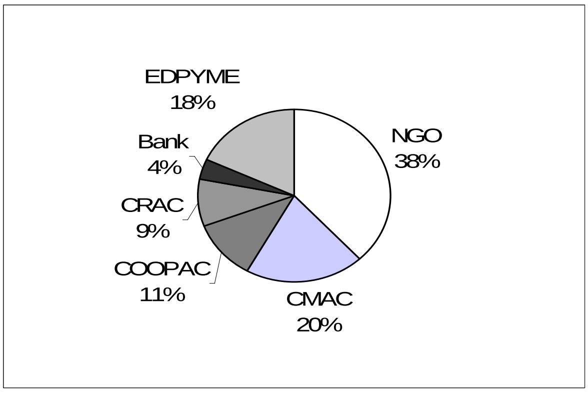
| Category | Sector | Products | Legal Organization |
|---|---|---|---|
| Commercial Bank | formal | all types of loans and saving products | corporate, private |
| Financial Entity | formal | all types of loans and saving products | corporate, private |
| CMAC | formal | loans to MSEs, consumer loans and saving products in provinces | state, owned by local provincial governments |
| CRAC | formal | credit and saving products to MSEs in rural areas | corporate, often owned by local entrepreneurs |
| EDPYME | formal | loans to MSEs in urban areas, no deposits | corporate, often owned by NGOs (Upscaled NGOs) |
| COOPAC | semi-formal | consumer loans to members | closed credit unions |
| NGO | semi-formal | loans to MSEs | non governmental, non profit organization |

**Source: Own Research**

Table 2 summarizes all characteristics that originally distinguish one MFI-category from another; however they change as the microfinance sector grows. Reforms have for example adapted to the needs of the MFIs. MFIs are now allowed to expand and diversify financial services or transform their legal organizational form once they fulfill particular requirements (Portocarrero, 2002). Moreover, growth is also characterized by increasing numbers of MFIs, regulated and non-regulated, resulting in difficulty to determine the exact numbers of operating MFIs in Peru at the moment.

For the purpose of this paper, the analysis of the Peruvian microfinance market is based on the MFIs listed in the MIX Market. The MIX Market is a leading microfinance information platform, which provides financial data and profile on MFIs and the global microfinance sector. It ensures the validity of information by demanding yearly updates from MFIs and verifying posted information for coherency and consistency (The MIX Market, 2005). In addition to that, COPEME, the consortium of private organizations that promotes the development of MSEs in Peru, cooperates with the MIX Market to promote the transparency and publication of information of all MFIs in Peru. On April 27, 2009 the MIX Market reported 55 MFIs in Peru and the distribution is shown in Figure 1.

**Figure 1: Composition of the Microfinance Sector in Peru by Number of Institutions**




**Source: adapted from The MIX Market (2005)**

Figure 1 shows the six types of MFIs operating in Peru and listed in the MIX Market. The biggest MFI category is represented by the NGOs, which at 38 percent is the largest part of the microfinance suppliers. CMACs, with 20 percent, is the second largest category, while EDPYMEs, with 18 percent, is the third largest group of MFIs. The rest of the categories are comprised by a lower number of participants, where banks represent the smallest number of microfinance suppliers. The Peruvian microfinance market appears to be half represented by the semi-formal sector (NGOs and COOPACs) and half represented by the formal sector (CMACs, CRACs, EDPYMEs, and banks), with 49 percent and 51 percent respectively.

The MIX Market also shows financial indicators, and allows comparisons across institutions. Regulated MFIs show, on average, a bigger gross loan portfolio, higher number of borrowers, and higher ROE than non-regulated MFIs. Although banks constitute the minority of the MFIs, they show an extreme bigger size of loan portfolio and a higher number of borrowers in comparison with other MFI categories. This fact indicates that banks operate under economies of scale. Contrary to banks, NGOs show the smallest gross loan portfolio and the second smallest number of borrowers, although the number of NGOs is the highest. This characteristic is typical for specialized institutions focused on small target markets and without economies of scale. In Appendix I average loan portfolio, number of borrowers, and ROE are depicted for each MFI-category.

## 3.4 Regulation in Peru

Formal MFIs are supervised and regulated by the SBS. This public agency regulates MFIs and commercial banks under the same financial law. Thus, MFIs have to report financial information, realize own internal auditing, accept external auditors and conduct strict loan loss provisioning, like commercial banks do (Kane et al., 2005).

Credit Cooperatives (COOPACs) are registered but not regulated by the SBS. They are indirectly supervised through a national federation of cooperatives (FENACREP) that provides supervision, technical support, and an information reporting system (Valdivia & Bauchet, 2003). NGOs are not regulated, but they can voluntarily share their financial information with the Consortium of Private Organizations that Promotes the Development of Small and Medium Enterprises (COPEME).

COPEME is an institution that was created in 1990 to promote the development of small and medium enterprises at regional and national level. One of COPEME's main objectives is that NGOs meet the same financial tracking and disclosure standards as formal institutions. Due to the voluntary basis of the information reporting system, COPEME's regulation is less effective than the one by SBS (Kane et al., 2005). The network of COPEME includes all regulated MFIs and 17 unregulated MFIs (COPEME, 2008). In order to encourage the transparency of all unregulated MFIs, COPEME cooperates with the MIX Market granting Transparency Awards to all MFIs that disclose sufficient information.

Valdivia and Bauchet (2003) reports that since the reform of 1996, all regulated MFIs have to report to the public credit bureau system, and have the right to consult information for free. A credit bureau is an institution that gathers information about the credit history of borrowers of all financial institutions. The presence of credit bureaus is relevant in competitive markets, where more MFIs operate in the same community. In such a market, borrowers receive a wider range of lower cost services. A credit bureau allows each MFI to observe if potential borrowers are, for example, simultaneously indebted with other MFIs, or have previously defaulted. As a result, the MFIs can avoid high risk borrowers. The access to credit risk information can reduce selection costs and improve loan portfolio quality of the lending institutions.

The law of 1996, which integrates microcredit information in the credit bureau, is an effort of the Peruvian government to facilitate a sustainable development of the microfinance sector. In Peru the public credit bureau is operated by the SBS, but there are also private credit bureaus operating in the industry. The largest private credit bureau of Peru is Infocorp. In order to assure an extensive credit history of borrowers, Infocorp gathers, besides the information of the public credit bureau, information from commercial houses, telephone, electricity companies, etc. Infocorp has been recently working with COPEME to include information of non-regulated MFIs into the sharing system. In 2003 there were already 34 NGOs registered in Infocorp (Valdivia & Bauchet, 2003).

Another important characteristic of the Peruvian regulatory system is that it is open to foreign investment. Foreign investors are treated under the same conditions as national investors. Also, there are strict rules against fraud and corruption. In Peru, each MFI must be audited yearly and if fraudulent operations are found, the SBS must press criminal charges against it (Kane et al., 2005).

# 4. Social Performance of Microfinance

Opponents of social performance work solely toward a financial bottom line. Similar to typical formal financial institutions, measuring financial returns is relatively straightforward because financial performance measurements have been largely standardized across the industry (Sinha, 2006). However, MFIs that work toward a double bottom line, financial and social, find themselves encountering the difficulties and cost inherent of social impact assessments and the early development stage of the industry regarding social performance measurement. These issues are discussed in this chapter.

This chapter consists of three sections: section one gives relevant background on social performance, section two focuses on impact assessment of microfinance by presenting methods of impact assessments and their challenges, section three covers social performance of microfinance by discussing in-depth the concept of social performance and comparing different social performance measurement tools and current initiatives.

## 4.1 Contextual Framework of Social Performance

This section discusses a wide range of microfinance impacts, identifies the demand for impact information, and explains the difference between impact assessment and social performance.

*Wider Impact of Microfinance*

Microfinance is broadly considered a powerful tool for poverty reduction. However, poverty can be understood in different ways. Simanowitz (2003) presents a difference between a narrow definition of poverty in income terms and a broader definition of poverty containing diverse social and economic impacts like employment, education, nutrition, fertility, contraception, self-esteem, etc. Furthermore, Brau and Woller (2004) classify microfinance impacts on the following levels: clients, enterprises, households, communities and regions. And Ledgerwood (1998) classifies microfinance impacts in three categories: economic, sociopolitical or cultural, and personal or psychological impacts. Finally, Kearny (2008b) points out that the popularity of microcredit lies on its potential not only to impact material conditions of borrower's lives but to affect immaterial conditions like self-perceptions, attitudes and behaviors. Hence, microfinance can have a wide range of impacts and should not be restricted to the typical impact on the poor's income.

*Demand for Information on Microfinance Impact*

There are two groups of people demanding information on microfinance impact (Copestake, Johnson and Wright, 2002). The first group consists of MFIs themselves, who are interested in improving the quality of their services and their organizational development. The second group, made of donors and regulators, are interested in program effectiveness for public policy purposes. Foose and Greenberg (2008) add social investors to the second group and explain that they have a legitimate interest in assessing the social returns of their investments. Furthermore, Foose and Greenberg explain that the first group, MFIs themselves, has interest in assessing whether their dedication and commitment are indeed contributing to the achievement of their social goals, and is conscious of positive effects that transparency can have on potential investors.

Simanowitz (2003) notes that impact assessments have moved from a proving to an improving agenda and explains that, until recently, most impact studies were done primarily to justify donor funding. Now, many impact studies are oriented to the operational needs of the MFIs. As the industry matures and grows more competitive, MFIs have learned that retaining clients and attracting new ones increasingly depends on their ability to meet clients' needs with appropriate products and services (Imp-Act, 2005).

*Difference between Impact Assessment and Social Performance*

Impact assessment is used to determine the effects of microfinance as an intervention (Ledgerwood, 1998). Impact assessments are research studies that examine a causal relationship between financial services and socioeconomic changes in clients. On the contrary, social performance is defined as the effective translation of an MFI's social mission into practice and focuses on a process that leads to social impact (Sinha, 2006). Thus, whereas impact assessment refers to the end results of microfinance, social performance measurement analyses additionally the quality and management of the MFI. This concept is analyzed in-depth in section 4.3.

## 4.2 Impact Assessment of Microfinance

This section presents the different methods available for executing impact assessments, and discusses methodological challenges of impact evaluations and presents some solutions.

### 4.2.1 Methods for Impact Assessment

The microfinance industry is characterized by a diverse number of methodological options available to execute impact evaluations. Hulme (2000) identifies three main approaches: the scientific method, the humanities tradition, and the participatory learning and action approach. The first method uses a before and after comparison of a population under a microfinance program against an identical population without microfinance, which is called a quasi-experimental approach. The humanities tradition bases on qualitative data and infers causality from the information previously collected. The participatory learning and action (PLA) approach integrates microfinance clients in the analysis, asking them to identify and analyze problems by themselves.

These three main methods are similarly identified by Revolledo-Wright (2004). Revolledo-Wright speaks rather from positivist, qualitative and participatory methods instead of scientific, humanistic, and PLA approaches. She explains that positivist methods are based on sample surveys using closed questionnaires to collect quantitative data, which are then analyzed statistically. Positivist or quasi-experimental methods are scientifically rigorous and ideal to convince skeptical outsiders as it is based on "hard number" data. However, they are relative expensive and are restricted to measurable impact indicators. By contrast, qualitative methods collect data through semi-structured interviews.

They are rich in detail and allow indirect, unexpected and immeasurable impact to reveal. However, they are not rigorous enough for skeptical outsiders. Participatory methods are based on case studies, group discussions, and semi-structured games with clients. While the participatory methods have shorten feedback loops, the presence of third parties constraints discussion of individual experience leading possibly to biased responses.

Armendáriz de Aghion and Morduch (2005) argue that every careful evaluation should address the question of how borrowers would have done without microfinance. This approach corresponds to the scientific or positivist approach and compares outcomes of microfinance clients against a control group. A control group is a comparison group of people identical to the program members except for the effect of microfinance and is usually very difficult to find (Goldberg, 2005). Ideally, statistical tests are used to show whether the differences between the groups are significant or not.

While many methodologies exist, there is minimal consensus across the sector on how to assess social impact. Thus, Simanowitz (2003) affirms that many NGOs and aid organizations have their own in-house methods. The quality of methodologies has a great influence on results of impact studies and therefore only well designed evaluations can lead to reliable results. The combination of methods to overcome methodological weakness is broadly suggested. For example, Ledgerwood (1998) suggests using multiple methods and combine qualitative and quantitative approaches. Hulme (2000) suggests a mix of different methods that can meet the objectives of the specific assessment at an acceptable level of rigor, is compatible with the context and feasible in terms of costs, timing and human resource availability.

### 4.2.2 Methodological Problems of Impact Assessments

Armendáriz de Aghion and Morduch (2005) indicate that there is not yet a study that robustly shows strong impacts of microfinance. They affirm that selection bias and reverse causation bias are the most common challenges of all impact evaluations. Goldberg (2005) states similarly that the selection bias is a persisting limiting factor of all microfinance impact studies undertaken to date.

Selection bias refers to the fact that participation in microfinance programs is voluntary. MFIs select villages in which to work and clients to whom to lend according to specific criteria, a concept known as non-random program placement. And conversely, clients decide whether and when to join a microfinance program; this is called self-selection. Thus, because clients are self-selected as well as selected by the MFIs themselves, clients may differ systematically from non-clients. Therefore, differential outcomes might be attributable to differences among people, rather than to participation in the microfinance program (Brau & Woller 2004).

Armendáriz de Aghion and Morduch (2005) suggest three solutions to selection bias. The first is measuring impact of access rather than impact of participation in microfinance programs. The second solution is comparing future with current borrowers. This implies identifying future borrowers before the microfinance program starts and delay credit disbursement for a period. Because the process is complicated and the conditions are difficult to fulfill, a third solution was suggested. The third solution is a comparison between old and new borrowers. However, a problem associated with this solution is that borrower characteristics do not remain constant over time because some borrowers drop out. Drop-outs usually have specific characteristics, which make old borrowers differ systematically from the new ones. If, for example, only better-off clients drop out, the pool of borrowers become "worse" and a comparison against new borrowers would probably underestimate impact effects.

This problem constitutes the second methodological challenge: the attrition problem. In longitudinal studies, data is collected at several points in time, and usually not all original participants remain until the end. To address this problem, Armendáriz de Aghion and Morduch (2005) suggest collecting data of drop outs and including them in the analysis.

The third challenge is the reverse causation bias. Armendáriz de Aghion and Morduch (2005) explain that when richer households have larger loans, this can well be attributable to microloans or to the better access of richer households to microloans. They suggest the use of instrumental variables to address this problem. An instrumental variable is one that explains levels of credit received but has no direct relationship with the outcomes. Interest rate is an example of instrumental variable because it can explain how much credit is desired but is not a direct determinant of income.

Krauss (2008) lists three more methodological challenges of impact assessments to the three discussed above. The first refer to the ethical concerns of choosing a control group. The second challenge concerns factors that are difficult or impossible to measure and can influence the differential outcomes of the comparison between treatment and control group. Entrepreneurial skills are an example of an unobservable factor. The last challenge refers to the fact that statistical correlations do not necessarily imply causality.

Finally, Snodgrass and Sebstad (2002) mention a fungibility problem of microcredit that can also invalidate findings of impact assessments. They explain that because loans are fungible in form of cash, they can be used for something else entirely than for the stated purpose, for example for paying off previous debts or for relative's sickness.

The methodological problems of impact assessments discussed in this section can illustrate why, in the past years, MFIs did not report on social goals achievements, and instead, left research and reporting to specialists. New initiatives explore therefore social impact of microfinance with a broader view of the whole process by which impact is achieved (Sinha, 2006). This concept is called social performance.

## 4.3 Social Performance of Microfinance in Practice

This section is divided in three parts. The first part analyses the social performance concept. The second part illustrates the current stage of the microfinance industry with regard to measurement tools, and presents some of the different tools available for social performance measurement. The third part presents two initiatives of organizations working towards a standard social performance assessment system for all countries across the globe.

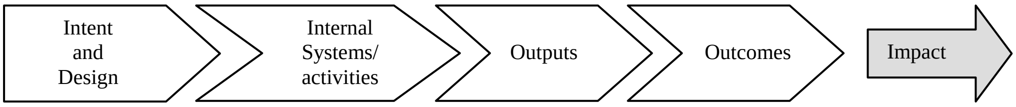
### 4.3.1 Social Performance Concept

The term social performance is product of a discussion about the methodological difficulties and cost inherent to microfinance impact assessments. A worldwide community of professionals, donors, and practitioners conclude that assessment of MFI's social objectives and the alignment of the MFI's activities with them are more relevant than executing impact assessments. This new approach encourages MFIs to measure social performance in a practical and cost-effective way (Interview partner).

Recently, a common consensus around the definition of social performance was reached by an industry-wide task force (Reddy, 2007). Social Performance is defined as the effective translation of an MFI's social mission into practice in line with accepted social values. These values include increasing outreach, improving quality and appropriateness of services, improving economic and social conditions of clients, and enhancing social responsibility of the MFI towards clients, employees and community (Hashemi & Anand, 2007).

This definition reflects the concept of a pathway containing several steps to work through in order to achieve change systematically. Social performance includes impact as end result and emphasizes the deliberate process of getting there. Figure 2 presents the path or process for translating an MFI's mission into practice. It shows impact as one element of social performance.

**Figure 2: Social Performance Pathway**




**Source: Adapted from Hashemi (2007)**

The first step of the social performance pathway refers to the analysis of the mission and social objectives of the MFI. MFIs should first ensure that their objectives are clearly defined and conformed to the social mission. In the second step, internal systems and activities of the MFI should be evaluated according to their appropriateness to fulfill the stated social objectives. Activities of MFIs should be linked to their social goals and progress should be continually tracked. The third step analyzes if MFIs are reaching large numbers of intended clients and if products are appropriate to fulfill their needs. The fourth step evaluates the outcome, and verifies that clients are indeed improving their social and economical situation. Finally, the fifth step examines the impact to see if the improvements can be attributed to participation in the microfinance program (Hashemi, 2007).

This concept of social performance applies to every MFI regardless of the specific mission, organizational type, and the context of operation. Hence, a microfinance bank offering credit and saving services at a national level as well as an NGO in a rural environment offering microloans along with educational trainings solely to women can make use of this concept. Simanowitz (2003) states that social performance is used to cover the broad concern with social and economic impact, including poverty.

### 4.3.2 Social Performance Measurement Tools

Unlike financial reporting that has been developed over many years, social performance measurement is fairly new (Hashemi, 2007). Simanowitz (2003) states that systems for social performance measurement are at an early stage of development. In 2003, at a meeting hosted by the Rockefeller Foundation and the Goldman Sachs Foundation, the broad diversity of theories of change, goals and reporting requirements within founders and grantees was highlighted and it was agreed that "the field as a whole lacks a common vocabulary" (Carlson, 2003, p.5).

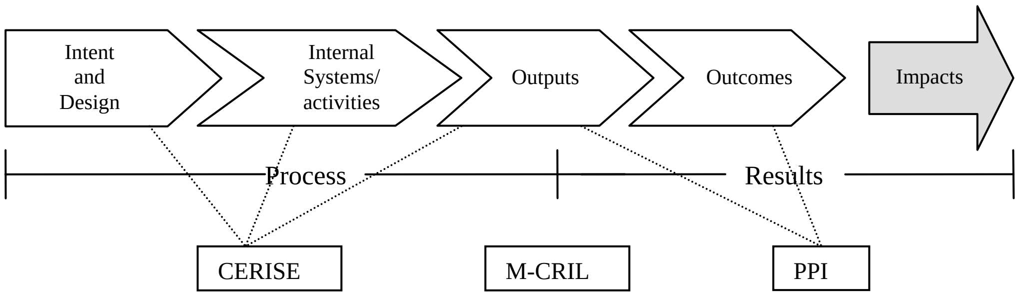
In the recent past, important but separate attempts to integrate assessment of social performance into MFI's regular management systems have been developed (Hashemi, 2007). Foose and Greenberg (2008) affirm similarly that many different organizations have independently developed methodologies and tools for evaluating social performance with their own frameworks and levels of detail. However, no widely adopted standards for social performance reporting exist at this time.

The absence of consensus in social performance reporting can be partly explained by the wide variety of specific social missions and contexts of each MFI around the globe. As opposed to social objectives that vary widely, financial goals are very similar. Most MFIs aim for efficiency and sustainability. Sinha (2006) explains that in financial reporting, standards apply whatever the social mission of the MFI is. One of the biggest challenges for social reporting is whether it is possible to agree on certain generic values that apply to all MFIs, which can enable direct comparison and benchmarking across different contexts. Foose and Greenberg (2008) list some challenges for creating a common set of social indicators. Social indicators must be meaningful to a variety of contexts from all areas of the world, cannot be burdensome to collect, must be practical to apply, and should be useful to the MFI as part of an internal system of reporting and management.

In response to the growing demand from donors and commercial, socially responsible investors for transparency of social outcomes, a range of tools have been developed, including social performance assessment, social audits, and social rating tools. This section presents social performance measurement tools with different focus on specific areas of the social performance pathway.

The social performance pathway can be classified in three main areas: intent, process, and results. Intent and process aspects of social performance correspond to information at the institutional level, and results correspond to information at the client level. The latter is more difficult to collect because it requires collecting client-or household-level data on living standards (Hashemi & Anand, 2007). Social performance tools can focus on information at the institutional level, on client-level information, or on all dimensions of social performance. Figure 3 presents the social performance pathway and locates examples of assessment tools aligned with their focus areas. The examples are the assesment tools of CERISE, M-CRIL and PPI. These tools and two more examples are discussed subsequently.

**Figure 3: Examples of Social Performance Assessment Tools**




**Source: Adapted from Hashemi (2007)**

*CERISE*

The CERISE tool analyzes organizational process and internal systems to indirectly determine if institutions have the means to achieve their social mission. It analyzes intent, activities and outputs, rather than information at the client or household level. Hence, it analyzes the mission statement, staff commitment, and methods to approximate outreach. The advantages of the tool are that it is easy to use and can be administered by the MFI (Hashemi, 2007).

*Micro-Credit Ratings International Limited (M-CRIL)*

M-CRIL is a specialized rating agency that offers credit and social performance ratings. Social performance ratings can encompass all dimensions of social performance. Information at the institutional level is collected to determine the likelihood of MFIs achieving their social missions and clients are surveyed to empirically determine economic and social changes. Opposite to CERISE, M-CRIL collects information both at the institutional and at the client-level (Hashemi & Anand, 2007).

*Progress out of Poverty Index (PPI)*

PPI was developed by CGAP, the Grameen Foundation, and the Ford Foundation. It assesses social performance at the client level through information related to outputs and change outcomes. The PPI tool uses national household survey data to create a small set of simple, easily observable indicators to estimate the share of poor clients; this is called a poverty scorecard. The scorecard consists of 10 simple questions regarding housing conditions, use of toilets, asset ownerships, etc. An example of PPI Index for Peru is presented in Appendix II. Answers are scored according to a point system and then percentage of clients living below the national poverty line or on less than $1 or $2 a day is determined. Tracking clients over time provide changes in client conditions (Hashemi, 2007).

PPI does not prove causality and scorecards vary across countries. However, it allows easy global comparisons of MFIs across countries because they all report on common benchmarks of national poverty lines, or $1 or $2 a day (Hashemi & Anand, 2007). The poverty scorecard is simple, inexpensive, transparent and intuitive.

*AIMS/SEED Tools*

The Assessing the Impact of Microenterprise Services (AIMS) project team of the United States Agency for International Development (USAID) and the Small Enterprise Education and Promotion (SEEP) Network developed a mid-range approach to impact assessment that is credible, valid, thorough, and at the same time useful and cost-effective for practitioners in terms of time, financial resources and expertise (Nelson et al., 2004).

The approach is designed for practitioners and it comprises five tools from which practitioners are encouraged to use individually, in combination, or to adapt to fit their needs (Goldberg, 2005). There are two quantitative and three qualitative tools. The first is an impact survey to be administered to a sample group of clients and a comparison group. The second is a client exit survey to be administered to drop-outs, in order to identify why clients leave and what effects they have experienced. The third is an in-depth individual interview focusing on how the client has used his or her loans, business profits and savings over time. The fourth is a focus group discussion to explore client satisfaction. And the last is an in-depth interview to determine empowerment of women (Nelson et al., 2004).

*CGAP Poverty Assessment Tool*

The Poverty Assessment Tool (PAT) was developed for CGAP and allows constructing a multidimensional poverty index that is appropriate for donors and investors who require a standardized, globally applicable set of poverty indicators. This provides the ability to make poverty-focused funding decisions and to compare MFIs across regions and countries. It is complex and expensive but it yields rigorous data on the poverty levels of MFI clients relative to people living in the same community, and can also be used to rank large populations to determine the poorest inhabitants of large geographical regions (Henry, Sharma, Lapenu, & Zeller, 2003).

The social performance measurement tools presented in this section show different approaches of measuring social performance. Each of them can focus on the institutional-level, client-level, or both. Hence, there is no consensus in the microfinance industry on how to measure social performance. Each organization has created a specific methodology that best suits its own objectives.

### 4.3.3 Social Performance Initiatives

This section presents two current global social performance initiatives. The first one is a project of the Imp-Act Consortium that aims to implement a social performance management system in all MFIs across the globe. The second one is the Social Performance Taskforce (SPTF) that is working on the development of a common global social performance reporting.

*Imp-Act Consortium*

The Imp-Act program at the Institute of Development Studies at the University of Sussex in the UK is a global action-research program that supports the monitoring and management of social performance. Imp-Act has developed a framework for social performance management (SPM) that focuses on assessing each aspect of the process by which an MFI translates its social objectives into practice. Imp-Act supports MFIs to develop their own systems so that they gain greater knowledge on their clients and learn how to respond more appropriately to their needs (Imp-Act, 2005).

Campion, Linder and Knotts (2008) explain SPM as an institutionalized process of translating social mission into practice. It refers to the alignment of an MFI’s strategic planning and operational systems to an understanding of client vulnerability and poverty. It has three components: (1) setting clear social objectives and creating a deliberate strategy to achieve them, (2) monitoring and assessing progress towards achieving social objectives, and (3) using social performance information to improve overall organizational performance. This new approach encourages MFIs to measure social performance in a practical and cost-effective way, so that financial and social goals are simultaneously achieved (Interview partner).

Imp-Act connects practitioners around the globe, trains and supports MFIs to implement SPM, builds capacity to support SPM by training and certifying local trainers in all regions of the world, shares lessons learnt and good practice by documenting evidence, and promotes reporting on social performance (Imp-Act Consortium, 2009).

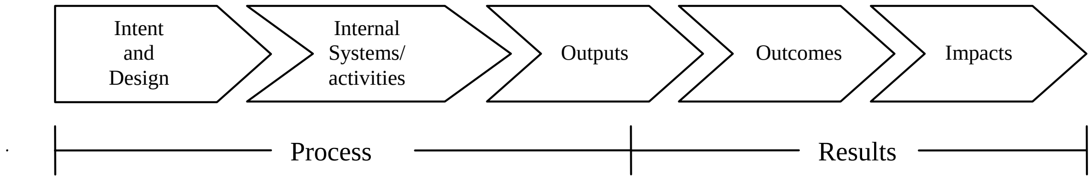
*Social Performance Taskforce*

In 2005, leaders from various social performance initiatives in microfinance met to share experiences and created the Social Performance Task Force (SPTF). The SPTF is a collaborative group of more than 250 microfinance professionals, financial service providers, rating agencies, donors and social investors. The SPTF adopted a common definition of social performance (presented in section 4.2.1) to promote stronger industry focus on social performance and is working towards a common reporting and rating framework (Hashemi, 2007).

The common reporting format is a set of social indicators, which measures the degree to which MFIs are effectively putting their social missions into practice. Social indicators should cover all ranges of the social performance pathway and can be divided in process and result indicators. Whereas the first requires information at the institutional level, the latter requires information at the client level (Hashemi & Anand, 2007).

The indicators are designed to be clear, simple and practical to report; they also should be cost-effective, statistically rigorous, and comparable across countries (Hashemi, 2007). In June 2008 members of the SPTF agreed on a group of 23 social indicators categories, on which MFIs should begin reporting in early 2009 to the MIX Market (Foose & Greenberg, 2008). Figure 4 shows the agreed social indicators aligned with the social performance pathway.

**Figure 4: Social Performance Indicators**




| | *Intent* | *Strategies and Systems* | *Policies and Compliance* | *Achievement of Social Goals* |
|---|---|---|---|---|
| Agree to Do | Mission & Social Goals | Range of Services (financial and non-financial) | Governance | Geographic Outreach |
| Agree to Do | Social Responsibility (SR) | Use of social performance information by Management | SR to Clients | Women Outreach |
| Agree to Do | | Training on mission | Costs to clients | |
| Agree to Do | | Staff Incentives and satisfaction | SR to Staff | |
| Agree to Do | | Market research | | |
| Agreed to Work On | | Measuring client Retention | SR to Community | Poor and very poor clients |
| Agreed to Work On | | Poverty Assessment | SR to Environment | Clients outreach by products and services |
| Agreed to Work On | | | | Households in poverty |
| Agreed to Work On | | | | Households out of poverty |
| Agreed to Work On | | | | Employment |
| Agreed to Work On | | | | Children in school |

**Source: Adapted from Foose and Greenberg (2008)**

Figure 4 presents two general categories of social indicators: Agree to Do and Agreed to Work On. The first category covers social indicators which were considered relevant, easy to obtain and to verify by the SPTF. It covers the majority of internal process indicators. The second category contains mainly results indicators, which are more difficult to obtain but are considered highly relevant by the SPTF.

Hashemi (2007) states that the SPTF acknowledges flexibility in what MFIs choose as social objectives and tools to assess progress on them; however, the use of the IRIS Poverty Assessment tools and the PPI are recommended to collect results indicators. It is known that the number of indicators will grow and data will become more robust. Sinha (2006) indicates that social reporting will have a similar process as financial reporting: at the early stage, social indicators seem complex and difficult, but after several years, they find acceptance and standardize. The development of a core set of common indicators demonstrates the commitment to create global transparency on social performance.

# 5. Social Performance in Peru

The last chapter presented a theoretical framework and a basis for a consciously investigation of the current state of social performance assessment in Peru; which is the topic of this chapter. In order to gain a deep insight in social performance in Peru, information is gathered from different agents of the Peruvian microfinance industry. This approach allows collecting different points of view of the same phenomenon and comparing information with different agents for confirmation or verification of data. Ledgerwood (1998) defines this method as triangulation and argues that its use can help to deal with untrustworthy respondent and causality.

The first source of information is the literature on impact evaluation published in scholarly journals, international organizations, and national research centers. A comprehensive literature research was conducted and published impact studies with evaluations in Peru were reviewed. A second source of information is the microfinance institutions operating in Peru themselves. They were surveyed to find out whether they are familiar with impact assessment and social performance, and whether they measure it. The last source of information consists of organizations in Peru supporting microfinance institutions, which are encouraging social performance through different projects.

Trivelli (2002) affirms that microfinance literature in Peru has grown in recent years, but studies have focused on the supply side of microfinance, i.e. sustainability and technology of the MFIs. There are neither impact evaluations nor studies that identify clients' characteristics. She explains on one side that the majority of MFIs are currently struggling to be sustainable and cannot afford to evaluate impact of their services because this is too costly and they lack the knowledge to execute it. On the other side, she explains that success is measured by financial results and impact on clients is wrongly assumed to correlate with them.

Trivelli's perspective coincides with the global trend of microfinance of the past decades, when the market industry was focused mainly on financial performance. As explained in the second chapter, concern for social performance and the question, whether microfinance institutions are in fact achieving their social goals, arose in recent years. The literature found for this chapter can account for this fact, because all articles were published in this decade.

## 5.1 Impact Studies of Peru

This section presents five impact studies that evaluate impact of microfinance programs in different areas of Peru. The first three studies evaluate multiple impacts of microfinance programs and the last two studies deal with the supply of education along with loans. The latter address the question whether offering microcredit with education helps improve clients' lives and whether it is cost-effective for the microfinance institution.

### 5.1.1 Mibanco

As part of the AIMS Project of USAID, Dunn and Arbuckle (2001) conducted an impact evaluation between 1997 and 1999 with Acción Comunitaria del Peru (ACP), which later became Mibanco. At that time, Mibanco only provided microcredits with a maximum duration of four months and repayments were made weekly, biweekly or monthly. Mibanco did not offer additional financial or non-financial services. Clients of Mibanco were households in the metropolitan capital of Lima with at least one microenterprise. Snodgrass and Sebstad (2002) point out that Mibanco did not primarily focus on very poor clients.

Dunn and Arbuckle (2001) combine quantitative and qualitative approaches to evaluate impact of microcredit. The quantitative or survey approach compares a treatment group of 305 clients of Mibanco against 175 non-client households with similar characteristics (control group) using several statistical methods. Dunn and Arbuckle (2001) list the following techniques: t-tests, chi-square tests, ANOVA, gain score analysis and the analysis of covariance (ANCOVA) to test impact hypotheses. This quasi-experimental approach provides information on the direction and magnitude of impacts. The qualitative or case study approach bases on interviews done with 11 households in 1998 and again in 1999 to investigate the process by which program services contribute to changes in the impact variables. The case study results complement and strengthen the survey results and help to improve the case for attribution.

Dunn and Arbuckle (2001) find positive impacts on enterprise, household and individual levels. On the enterprise level the following positive impacts are found: increase in enterprise net revenues, fixed assets accumulation, employment, ownership and formalization, and improvement of sources of input supplies. On the household level, positive impacts on total annual household income and in the diversification of income sources are found. The latter refers to the idea of managing risk by having several sources of income, so that even when one source fails, income can still be earned. Finally, on the individual level positive impacts on entrepreneurs' feelings of preparedness for the future are found, which refers to increased levels of self-esteem, self confidence, and an optimistic attitude.

### 5.1.2 Caritas, Afider and Gcod

Revolledo-Wright (2004) assesses socioeconomic impacts of three different MFIs belonging to the PROMUC network and located in three provinces of Peru: Caritas in Chimbote, Gcod in Huancayo, and Afider in Cajamarca. PROMUC is a partnership of twelve nongovernmental, not-for-profit organizations, which promote microenterprise development as a strategy for poverty reduction and empowerment of women. Members of PROMUC operate under the village banking methodology (Copestake et al., 2005).

The village banking methodology consists of a group lending approach by which MFIs grant loans to groups of 20 to 40 borrowers. These borrowers are then referred to as the village bank. The village bank receives a loan as a joint liability group, and divides it among the members however they see fit. All members are expected to pay back the loan with the interest. If all members repay, the village bank can qualify for a larger loan. Ideas behind this technology are the peer-pressure to comply with repayments and the creation of a sharing environment to improve knowledge of the members (Kearney, 2008b).

The impact evaluation is done through a qualitative approach. One year after a baseline survey, qualitative in-depth individual interviews are executed with a small sample of 60 clients. The interviews are designed to obtain unrestricted explanations of changes respondents experienced during the past year, and reasons for those changes. An experienced analyst assesses the reliability of impact attributable to their interaction with the MFIs (Copestake et al., 2005).

Revolledo-Wright (2004) finds that many of the interviewed clients did not use their credits exclusively in their business; instead, microcredits were used for education, recovery from illness, support business of relatives, food, house improvements, or to pay off previous debts. This is known as the fungibility problem of microcredit and refers to the fact that, once microcredits are granted, they can be used for purposes other than the one declared to the MFI. Client exit is also an issue; in total, 6 of 60 exited and 12 were considering exiting. Reasons for exit are illnesses of relatives, poor investments or dissatisfaction with their village bank.

Impact of microcredit on employment generation is not clearly demonstrated through this study. While some clients indeed hire external staff in their businesses, some hire unpaid family members. Impacts on housing well-being are mainly positive; thus, many clients invest in education, in house construction and in better diets. In terms of non-material impacts, clients mainly agree having higher levels of self-confidence, self-esteem, and motivation to begin new enterprises, they also report less fearfulness at managing loans (Revolledo-Wright, 2004).

### 5.1.3 Alternativa and Arariwa

Alternativa in Lima and Arariwa in Cusco are two MFIs members of PROMUC. They operate under the village banking methodology and offer services mainly to women. The impact is assessed through a quasi-experimental or difference-in-difference approach. The attribution problem is addressed by econometric analysis of differences between client and non-client samples. The size of the treatment group was 547 clients and the control group was 388 non-clients (Copestake et al., 2005).

Impacts of microfinance are based on the significance level of variables' coefficients. The study shows significant effects of the microfinance program on individual and household income, but not on business sales or profits. Overall, results suggest that the MFIs have a positive effect on the income of clients.

### 5.1.4 FINCA

Karlan and Valdivia (2009) evaluate the impact of adding business training on both clients and the microfinance institution. The study is done with the Foundation for International Community Assistance in Peru (FINCA). This foundation is an MFI that seeks to improve the socioeconomic situation of the poor and empowers women through the implementation of village banks for poor, female entrepreneurs. FINCA operates in three poor districts of Lima, and in two Andean provinces, Ayacucho and Huancavelica.

In this study, pre-existing lending groups are randomly assigned to either treatment or control groups. Treatment groups receive training as part of their mandatory weekly meetings and control groups remain as before, credit and savings only groups. A baseline survey before the intervention and a follow-up survey between one and two years later are conducted.

They find improvements on both institutional outcome and clients' business outcomes and welfare. FINCA benefits from higher client retention and repayment rates, and clients report implementing the practices taught in the program in their business and having higher levels of revenues and profits. The study shows that training leads to better business knowledge and business practices, which seem to help clients to increase business income.

### 5.1.5 Arariwa

Arariwa is a non governmental MFI in Cusco and offers microcredit along with education to low-income people in the form of village banks. Education does not only comprise business but also health, self-esteem and confidence lessons. Kearny (2008b) evaluates the impact of microfinance program by collecting qualitative data during three months in 2006 and focusing on rural, less educated, and even excluded indigenous clients of Arariwa. Kearny analyzed institutional documents, observed clients and trainers at village bank meetings, and interviewed the borrowers and staff of Arariwa.

Kearney (2008b) finds that lessons on self-esteem and confidence have positive influence on attitudes and self-image of the interviewed clients. Clients report having less fear, a more optimistic view of life and greater autonomy. Better health, nutrition and family relationships are also found. The latter refers to experience better communication and fewer conflicts with family members. Moreover, clients report being able to better manage their money and business. Impacts at the group-level, like experiencing an enjoyable social space for exchange, strengthening relationships among group members, lead to improvements in bank functioning and greater customer satisfaction. Kearny affirms that all these outcomes interact and reinforce each other.

### 5.1.6 Contextual and Methodological Variety

*Variety of Contexts*

The impact studies reflect the variety of contexts, in which microfinance can take place, and the variety of microfinance programs that can be offered. Microfinance programs take place in the metropolitan capital of Lima, as well as in urban and rural areas of Peruvian provinces. Each of which is characterized by different cultures, poverty and educational levels. Microfinance programs offer individual or group loans, and comprise financial alone or non-financial services additionally.

The variety of programs offered can be seen as an attempt of the MFIs to adapt to the needs of the poor in a specific region. For example, the microfinance program of Arariwa in Cusco includes an education program that comprises business, hygiene and self-esteem lessons, possibly because Arariwa targets the very poor, uneducated and social excluded indigenous in rural communities. Trivelli (2002) indicates that overall impact depends on the ability of microfinance programs to adapt to the problems and demands of the poor in their own context. Similarly, Simanowitz (2003) illustrates that for a poor, socially excluded, economically exploited and politically disfranchised community, focus on credit for microenterprise development is inappropriate. Instead, members of such a community would need a combination of credits and education.

The positive findings of the two impact evaluations of education illustrate that poverty is not only a financial problem, which can be alleviated solely by microcredit. They also illustrated that educational trainings should be provided when the poor lacks the knowledge of how to manage money or run a business productively. Trivelli (2002) assures that microcredit can indeed improve life's conditions of the poor but it is not the panacea of a multidimensional problem like poverty.

Although the five impact studies present positive findings, they can not be generalized to other settings for the following reasons. First, neither microfinance programs nor target clients are equal across MFIs; conditions are hence not the same. Second, the environment in which evaluation is conducted can bias impact results. For example the Mibanco impact evaluation was executed during a Peruvian recession time, which could have led to underestimating the results of the impact. Similarly, the current economic growth in Peru can influence recent impact evaluations by overestimating or inducing impacts that are solely attributed to economic growth. Finally, evaluation over time is needed to assess the ongoing sustainability of impact results (Karlan & Valdivia, 2009).

*Variety of Methods*

The variety of methods discussed in the fourth chapter is reflected in the impact studies. Each has its own methodological approach: qualitative, quantitative, participatory, or even a combination of the aforementioned. All approaches have strengths and weaknesses and a critical standpoint towards methodological approaches is therefore always necessary when evaluating and interpreting impact studies.

Some of the methodological challenges encountered in the impact studies are discussed in this section. The first challenge is the inability to remove all influences of selection bias from the impact results, which can be explained by the fact that both MFIs and people always choose where and when to participate. The second problem is the difficulty to find appropriate indicators that can measure impact appropriately. A third challenge is that baseline surveys may already include positive or negative impacts of microcredit, when it includes data from old clients (Dunn & Arbuckle, 2001). When these problems are not controlled, impact results lead to a biased conclusion.

In qualitative approaches, the design of the interview, the vocabulary used and the language and cultural barriers can also lead to biased answers. Moreover, the reliability of impact hinges on the clients' own explanations and the special skills of the qualitative researcher in both interviews and analysis for the consistency of the answers (Copestake et al., 2005).

## 5.2 Social Performance Initiatives in Peru

This section presents two current initiatives for social performance in Peru. The first one is the SERFI Project conducted by Swisscontact Perú and the second one is the MISSION project.

### 5.2.1 SERFI Project

Swisscontact is a Swiss NGO that promotes sustainable social, economic and environmental development in urban and rural areas around the globe. Swisscontact executes projects in Africa, Asia, Eastern Europe and Latin America and has operated in Peru since 1966. Currently, Swisscontact Perú is executing the "Profundización de las microfinanzas en la región sierra del Perú" or SERFI project, which promotes greater outreach and the development of appropriate financial services for the poor in Andean provinces of Peru, through which economic activities and income of the poor can be improved.

The SERFI project started on January 1st, 2007 and lasts four years until December 31th, 2010. Its approach bases on the provision of technical assistance and training to three MFIs, so that they learn to recognize the needs of their target clients, improve the quality of their financial services and reach a wider group of low-income people in rural areas, while achieving a sustainable growth (Swisscontact, 2009). Due to the short time since the execution of SERFI, two years, no impacts can be yet detected (Interview partner). However, by end of 2011, a system of impact evaluation should be developed in order to assess concrete results of the project (Interview partner).

### 5.2.2 Programa Misión

The Mission project or Programa Misión provides MFIs with a social performance management (SPM) system that enables them to measure, monitor, and report on their social performance by offering appropriate services to a wider group of vulnerable low-income people. SPM helps an MFI to achieve social goals and financial sustainability simultaneously. The objective of Programa Misión is to implement a SPM system to over 100 MFIs in 12 Latin American countries and Senegal in Africa. Programa Misión is executed by CRS, Redcamif and COPEME, is member of the Imp-Act Consortium and participates in the SPTF (Gestión del Desempeño Social, 2008).

Peru participated with Nicaragua in the pilot phase of Programa Misión with five MFIs and with COPEME as a leading institution supporting the execution of the project. COPEME is currently working on the expansion of the project to other Latin-American countries. The project in Peru initiated in November 2006 and is currently working with 8 MFIs. The process follows the social performance pathway discussed in chapter four. MFIs are first helped to align their institutional strategy and afterwards helped to develop systems and activities that allow them to fulfill their social goals. Since information on how clients' lives change is measured annually, with the first time being after two years of the intervention, impact assessment information is yet to be developed (Interview partner).

The statements of the interview partners illustrate the lengthy time commitment needed to get concrete results from any intervention. Neither of the projects was able to provide impact results, although they have been more than two years in execution.

## 5.3 Survey of MFIs in Peru

This section presents a survey of MFIs operating in Peru. It first presents how MFIs are contacted, how the survey is presented, and which data is collected. Then data collected is analyzed based on the questions of the survey. The third part presents challenges and important problems that should be taken into account when interpreting the data. The last part brings out the important findings.

### 5.3.1 Collection of Data

On April 27, 2009 the MIX Market listed 55 MFIs operating in Peru. The aim is a complete data collection of all 55 MFIs, therefore all 55 MFIs are sent a survey on their e-mail address as published on the MIX Market. The survey can be seen in Appendix IV and consists of seven questions. The first question asks whether the MFI is familiar with the term social performance or social impact. The second question asks whether the MFI measures impact on clients and why. The third question asks the MFI to list impact measurement indicators it uses. The fourth and fifth questions ask the MFI to estimate the importance of social impact measurement with regard to financial sustainability and access to financial capital. The last two questions of the survey assess the readiness of the MFI to share more information on social performance.

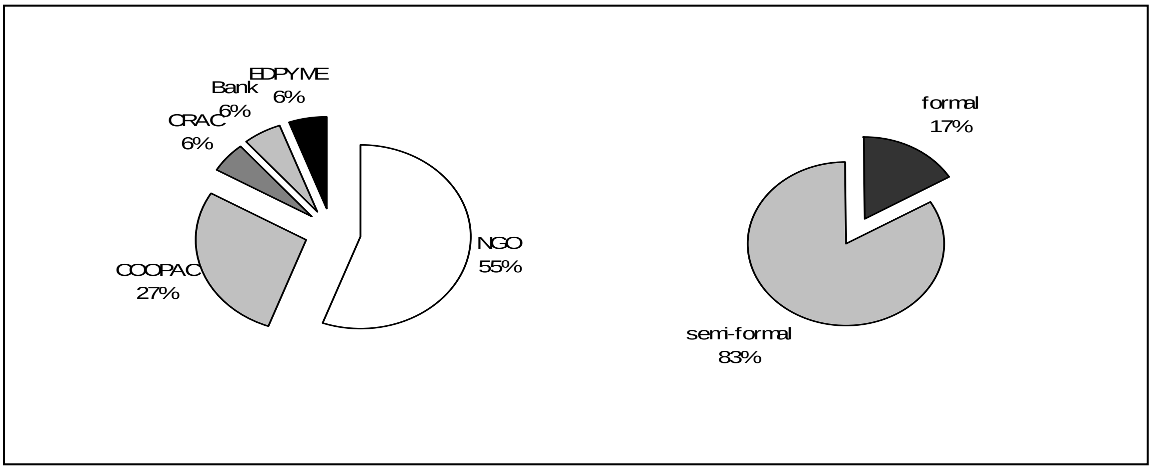
It is noticeable that the survey contains only questions on social performance and not on financial performance. As previously discussed, in comparison with a widely standardized financial reporting, social reporting is fairly new and social performance measurement tools are currently at a developmental stage. On that account and due to the fact that almost all 55 MFIs report financial indicators to the MIX Market; it was assumed that financial performance is well measured by all surveyed MFIs.

After a period of one week, only seven MFIs returned the survey successfully and the mail delivery system returned six e-mails, possibly because the e-mail address of the intended recipients were not up-to-date. Aiming for complete data collection, an attempt was made to reach the rest of the MFIs via telephone surveys and by organizations executing microfinance projects with MFIs in Peru. The latter were asked to deliver the survey to the MFIs they were working with.

There were 18 MFIs that successfully participate in the survey, and of which, 5 MFIs are not registered at the MIX Market and from which financial performance data is not available. Since the aim of this section is to present the knowledge and approach of the MFIs with regard to social performance measurement, there is no reason to exclude MFIs that are not listed on the MIX Market from the following analysis. Appendix V presents a list of the 18 MFI-participants.

The group is composed by 10 NGOs, 5 COOPACs, 1 EDPYME, 1CRAC, and 1 bank. Figure 5 illustrates the distribution of the data source per type of MFI and per sector. It shows that more than half of the data come from NGOs and over a quarter from COOPACs; they contribute with 55 and 27 percent respectively. NGOs and COOPACs constitute the semi-formal sector of the Peruvian microfinance industry. Hence, 83 percent of the data come from the semi-formal sector. Only a small percentage, 17 percent, of the data comes from the formal sector; which is represented by the three remaining MFIs. Data from CMACs is not available. These outcomes should be taken into account when analyzing and interpreting the data.

**Figure 5: Distribution of Survey Data Source**




**Source: Own research**

### 5.3.2 Results of the Survey

There is a unanimous positive answer to the question whether the MFI knows the term social impact or social performance. The question does not intend to assess whether the MFI can distinguish between the concepts of impact assessment and social performance, as explained in the previous chapters. Instead the question assesses whether the MFI is familiar with the social impact that microfinance can or should have. According to the responses, all 18 participants are aware of the social changes that microfinance can generate. Moreover, the question does not specify the kind of social impacts that microfinance can generate, so positive as well as negative social impacts can be meant by the MFIs.

The second question of the survey assesses whether the MFI measures social impact of its financial services on clients. Only seven responses are affirmative, which represent approximately 40 percent of the total responses; on the contrary, 60 percent are negative. All positive responses come from NGOs, except by one. Five of seven MFIs that give positive responses explain that measurement is important, so that they know how clients benefit from the program. One MFI explains measuring impact because it is taking part of an international pilot project and the other MFI does not specify why. It was observed that most of the positive responses came from NGOs members of the PROMUC network. This is consistent with the statement of an interview partner, who states that all members of PROMUC are currently implementing a social performance management system.

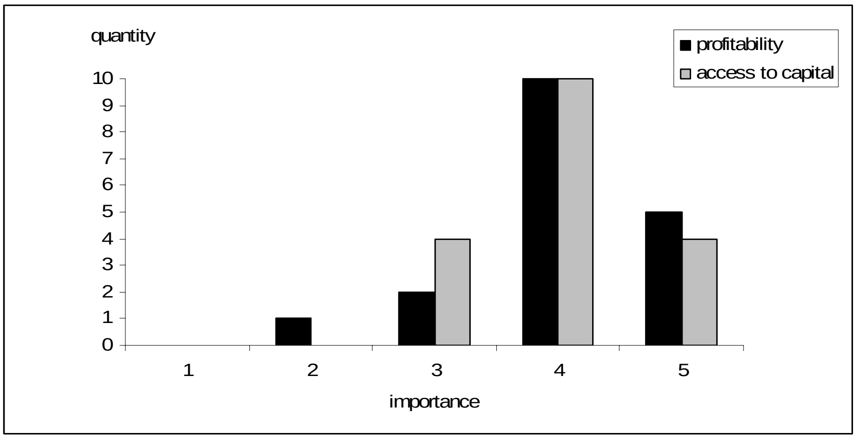
MFIs that do not measure social impact give the following reasons: lack of human capital, lack of time, and lack of financial resources to develop an appropriate measurement system. Some MFIs in this group state that the implementation of social impact measurements will occur in the near future, while others assure being aware of the impacts on their clients because they are in permanent contact with them.

There is no common measurement tool among the MFIs that measure social impact of their services. MFIs use different social indicators. The Progress Out of Poverty Index (PPI) is used by three MFIs of the sample. Other measurement tools mentioned are the AIMS/SEEP tools and the indicators of the GRI. Some MFIs report measuring retention rate and satisfaction of clients, microenterprise growth, household income, clothes, food, education of children and business skills.

It is then clear that MFIs measure what they consider relevant and use different measurement approaches. While this is consistent with the fact that MFIs work in different contexts and have different social objectives, it also illustrates the early development stage of the microfinance industry that is currently characterized by a great variety of social performance measurement tools and the lack of a standard social reporting.

The fourth and fifth questions of the survey assess whether social performance measurement is relevant for access to financial capital and for the profitability of the institution. MFIs choose from a rank of (1) “not important”, (2) “somewhat important”, (3) “important”, (4) “very important”, and (5) “indispensable” the option that best represent their opinion about how relevant social performance measurement is to financial sustainability and access to capital. The result is an average response of “very important” for both criteria. Figure 6 shows all MFIs state that social performance measurement is at least “important” for accessing financial capital. This can illustrate that MFIs are aware of the transparency needed to attract social investors and to account for their investments.

**Figure 6: Importance of Social Performance Measurement**




**Source: Own research**

Figure 6 shows a similar pattern for the response with regard to profitability. Except for one MFI who states social performance measurement is somewhat important for financial sustainability, all MFIs consider social performance measurement at least "important" for the profitability of the institution. As discussed in previous chapters, in the microfinance industry, there is a group of people who thinks of a trade-off between social and financial performance and there is another group who demands a double bottom line. This survey shows a clear trend towards a double bottom line: social performance measurement is "very important" for the profitability of the institution; however it is important to remark that the majority of participants belong to the semi-formal sector and specifically to the NGO-sector. Therefore the response is not representative for the entire industry.

### 5.3.3 Methodological Challenges

Most NGOs focus on an integral development of the poorest and excluded societies (Trivelli, 2004), rather than on institutional effectiveness, competitiveness and profitability like, for example, CMACs do. When reviewing and comparing the mission statements of the MFIs published at the MIX Market trends can be identified. NGOs' mission statements focus on sustainable economic and social development of the vulnerable and very poor people. By comparison, mission statements of CMACs focus on the supply side of microfinance. They accentuate the quality and efficiency of the services and an appropriate technology that assures the profitability of stakeholders (The MIX Market, 2005). This reinforces the statement of an interview partner who affirms that whereas many MFIs are focused on making a lucrative business, NGOs tend to focus primarily on social and economic development of excluded social groups. Hence, analysis and interpretation of the data collected in this survey should be done carefully because it mainly contains information from the most social and non-profit oriented institutions of the Peruvian microfinance industry.

Neither the data collected through the survey is a representative sample of the microfinance market distribution based on the MIX Market nor does the MIX Market represents the real Peruvian microfinance market. The latter can be explained by the fact that contact data listed on the MIX Market were not fully correct, which is the case of few e-mail addresses and telephone numbers. Moreover, social performance projects in Peru are working with MFIs that are not listed on the MIX Market, FENACREP, the national network of cooperatives, lists a bigger list of 160 cooperatives in Peru (FENACREP, 2009), and COFIDE[2] currently lists more CMACs and CRACs than the MIX Market (COFIDE, 2009).

Outcome of the survey participation can be explained by the fact that NGOs have a more accentuated focus on social goals or concern towards social problems in comparison with other types of MFIs in Peru. This can make them more willing to participate in social investigations, like this survey. Furthermore, the fact that the PROMUC network has been working with international organizations in the past years, e.g. USAID and Imp-Act, could have sensibilized them towards international investigations and make them more supportive and transparent than other types of MFIs when providing information. This problem is known as self-selection bias; it refers to the fact that individuals who participate in a survey are the ones with special wishes and characteristics, so they can not make a representative sample of the population.

It is also important to consider that responses of MFIs may have been intentionally distorted in an attempt to respond that what is socially desired (Bühner, 2004). This can be represented by the MFIs that do not assess social performance but state implementing it in the near future. Finally, the survey was not executed in the same way among the

[2] COFIDE, Corporación Financiera de Desarrollo S.A, is a national development bank that grants financial capital to MFIs of the formal sector (COFIDE, 2009)

MFIs (Bühner, 2004). Surveys were sent by e-mails, done by phone or sent by the project manager of the project working with the MFIs; each of which can influence responses in different ways.

### 5.3.4 Important Findings of the Survey

Despite the misrepresentative survey sample and other potential biases, it can be concluded that in Peru, there is awareness of the potential for microfinance to generate social changes. There is also awareness of the importance of social performance measurement towards social investors or donors. And finally, there is a clear interest and effort for implementing social performance measurements in order to assess changes in clients' lives. The latter is drawn by a small group of MFIs measuring social performance and by the understandable reasons given by the MFIs who do not currently measure it. The reasons are based solely on the lack of knowledge and financial resources and not on the unwillingness or irrelevance of social performance measurement itself. There are thus no responses that are in conflict with the mission statements of the surveyed MFIs.

The survey also shows that social performance measurement in Peru is at a developmental stage. This is illustrated by the lack of standard measurement tools among the MFIs, each of which lists different social indicators. The most common social performance measurement tool of the sample is the PPI, which is listed by three MFIs. Nevertheless the PPI started its pilot phase in 2008 (Fernández, 2008), and has only been recently updated in March 2009 (Progress out of Poverty, 2008). This means that MFIs using PPI were referring to its pilot phase or have only started implementing this year. Since the evaluation of any change requires the use of the PPI over a period of time, no impact can yet be assessed. More years will be required to find any lasting impacts of microfinance in Peru.

# 6. The Double Bottom Line of Two Peruvian MFIs

This chapter presents two MFIs in Peru to compare financial and social performance. The criteria used to select the two institutions is based on the amount of good, quality information available from different sources, so as to compare and validate the information collected. Both MFIs publish external audits, execute ratings with independent rating agencies, participate in projects with international organizations, offer the highest level of information according to the MIX Market and, most importantly, were available for an interview.

In order to present different perspectives of the Peruvian microfinance market, two different types of MFIs are selected. One MFI belongs to the formal sector and the other one to the semi-formal sector. The first example is an NGO called Microfinanzas PRISMA (MFP), and the second one is Mibanco, a commercial bank specializing in microfinance and is the largest MFI in Peru.

## 6.1 Microfinanzas PRISMA

PRISMA is a non governmental organization established in Peru in 1986. Its mission is to strengthen the capabilities of the vulnerable and poor, so that they can become self-sustainable, both in the economic and in the social development front (PRISMA, 2009). PRISMA initiated microcredit activities in 1994. A decade later they consolidated all microfinance programs into a new institutional department, Microfinanzas PRISMA (MFP). MFP focuses on the poorest and excluded segments in rural and marginal urban areas by offering financial and non-financial services in 12 of the 25 regions in Peru. Since 2008, MFP has been working to transform into a regulated MFI, a CRAC.

Financial services include microcredit and microinsurances. Microcredits are granted in form of village banks, solidarity groups, individual credits, and agricultural credits. Microinsurances comprise of life microinsurances, insurance for credit payment protection, and insurance for agricultural drawbacks. Non-financial services include education on basic health issues, and finance and technical assistance for women entrepreneurs (Microfinanzas PRISMA [MFP], 2009).

*Financial Performance*

MFP publishes extensive financial performance information on the MIX Market. Table 3 summarizes some relevant financial indicators from 2004 to 2008 illustrating an interesting institutional development. While 2004 numbers indicate an unprofitable business, 2008 indicates that the overall financial performance is extensively improved, and that financial sustainability has been reached. At the end of 2004 Return on Assets (ROA) was -23.5 percent, Return on Equity (ROE) -27.72 percent, and the write-off ratio was 41.83 percent. In sum, in 2004, MFP was holding big losses and was not financial sustainable.

**Table 3: Financial Indicators of MFP**

| Indicator | Dec 04 | Dec 05 | Dec 06 | Dec 07 | Dec 08 |
|---|---|---|---|---|---|
| Gross loan Portfolio (US$) | 4,246,960 | 4,065,417 | 4,526,755 | 7,349,227 | 10,461,665 |
| ROA | -23.50% | -14.74% | -0.13% | 2.24% | 1.27% |
| ROE | -27.72% | -20.77% | -0.23% | 5.76% | 4.96% |
| Portfolio at risk (>30 days) ratio | 7.75% | 8.58% | 2.44% | 1.47% | 1.89% |
| Write-off ratio | 41.83% | 1.47% | 6.33% | 0.55% | 0.36% |
| Number of borrowers | 14,706 | 15,222 | 15,625 | 19,470 | 21,455 |

**Source: Adapted from the MIX Market (2005)**

In 2005, MFP improves somewhat; gross loan portfolio slightly decreased, but write-off ratio turns drastically positive with less than 2 percent. In 2006 MFP shows clearly a positive development; profitability indicators are approaching a break even point. By 2007 MFI continues on its positive, sustainable growth. Gross loan portfolio and number of borrowers significantly increased without having negative effect in the portfolio quality. Indeed, portfolio at risk and write-off ratio showed lower numbers than the year before. The last year, in 2008, MFP continued to grow with a bigger loan portfolio and number of borrowers, and business remains sustainable, although overall financial performance is slightly lower than the year before. PRISMA (2009) provides a reason for the events in 2007. The sustainable growth of 54% was partially attributed to the new financial funds received from many national and international organizations in the amount of 4 million US dollars.

The financial performance evolution of these years can also be seen in MFP's financial ratings. Financial ratings for MFP are executed by Planet Rating. Planet Rating (2009) uses the GIRAFE methodology. GIRAFE is an acronym for the 6 areas of evaluation; these are Governance, Information, Risk management, Activities and services, Financing and liquidity, and Efficiency and profitability. Planet Rating's ranks are "excellent" (A+, A, or A-), "good" (B+, B, or B-), "minimum required" (C+, C, or C-), "insufficient" (D), or "immediate risk of default or very insufficient" (E). Whereas MFP obtains a C+ in May 2005, it obtains a B- in December 2006, B in January 2008, and B in January 2009.

Javoy (2008) reports that by the end of 2007 MFP concluded its recovery phase and the funds obtained in the same year allowed significant improvements in its operational efficiency. This is reflected in a bigger loan portfolio, with same portfolio quality, and shows MFP has reached economies of scale. In other words, MFP has reached a good position in the rural and semi-urban market. In 2009 the overall financial performance contains a lower level of profitability and this is due to the devaluation of the national currency showing (Flores, 2009). Flores reports that MFP continues to strengthen its institution through organizational restructures and human capital improvements.

*Social Performance*

In 2007 MFP created a Social Performance Department and begun to offer educational services to clients. MFP was interested in implementing a poverty measurement tool to estimate changes on poverty levels of clients. This approach would extend the microfinance program among the poor by tailoring services to their needs (Fernández, 2008). For that matter, MFP participated in two pilot projects for the validation and comparison of two assessment tools recommended by the Social Performance Taskforce (SPTF). These are the Poverty Assessment Tools (PAT) and PPI.

The Poverty Assessment Tools (PAT), developed by the IRIS Center of the University of Maryland and certified by USAID, was tested in May 2007, and the PPI was tested between February and March 2008. MFP considers the PPI more appropriate than the PAT and decides to implement the PPI in 2009 in all offices for a regular poverty assessment measurement of all clients (Valikai, 2009).

MFP executes social ratings yearly with Planet Rating, whose social performance ratings are based on an internal analysis of the institution, i.e. an audit of the social performance management systems. Planet Rating's methodology is aligned with the common social rating framework of SPTF and bases on the following areas: institutionalization of the social mission, targeting and service offering and social responsibility (Planet Rating, 2009). The rating scale has five ranks to describe the capacity of an MFI to achieve its social goals; these are: advanced (5), convincing (4), in progress (3), incipient (2), and intangible (1).

Planet Rating publishes MFP's social ratings for the year 2008 and 2009. The rank obtained in both years is "3 +" or "in progress". Valikai (2009) reports that MFP has a clear mission shared among its principal stakeholders but it is not yet wide spread among the members of the operational level. Since 2008 MFP has made good progress on the implementation of a social performance management system, which assures the achievement of its social mission also under the new legal form. As mentioned earlier, in 2008, MFP decides to implement the PPI in all offices, begins to work on the formalization of a system to measure clients' satisfaction, and implements business and health lessons in village banks.

Finally, in March 2009, MFP publishes for the first time social performance information on the MIX Market. It reports on all "Agree to Do" and a few "Agreed to Work On" social indicators defined by the SPTF.

## 6.2 Mibanco

In May 1998 Acción Comunitaria del Perú (ACP), a nongovernmental organization supporting the development of low-income Peruvians since 1969, transformed to a commercial bank, Mibanco (Fernando, 2003). Mibanco is the first commercial bank and second in Latin America that specialized in microfinance, one of the largest MFIs in Latin America, and one of the most successful examples of MFI in Latin America (Horn & Lee, 2003).

After the transformation, Mibanco has experienced strong growth, expanded its depth and breadth of outreach and scope of services, but has remained loyal to its original mission of serving the poor and low-income entrepreneurs. Mibanco has increased its reliance on deposits, has diversified its sources of funds, even through bonds and commercial papers on the local capital market (Fernando, 2003).

Mibanco started its operations in the metropolitan capital of Lima offering loans only to urban microentrepreneurs. Now, Mibanco operates with 103 agencies in 20 of the 25 regions of Peru, both in urban and rural areas (Mejía, 2009). Mibanco provides savings, a range of credit products, including working capital, housing, and consumer loans, a range of insurance products, and also business training to microentrepreneurs (Mibanco, 2009).

*Financial Performance*

The financial indicators on the Mix Market reinforce the statements mentioned above. Table 4 summarizes a group of relevant financial indicators and shows an overall sustainable growth during the past five years. Gross loan portfolio, number of active borrowers grows every year while maintaining a good level of portfolio quality. Portfolio at risk over 30 days is lower than 5 percent and write-off ratio under 5 percent during this period. Overall financial performance is significantly higher than national and worldwide benchmarks. Whereas ROA decreased from 5.10 percent in 2004 to 3.42 percent in 2008, ROE constantly increases from 21.6 percent in 2004 to 36.22 percent in 2008.

**Table 4: Financial Indicators of Mibanco**

| Indicator | Dec 04 | Dec 05 | Dec 06 | Dec 07 | Dec 08 |
|---|---|---|---|---|---|
| Gross loan Portfolio (US$) | 128,686,859 | 207,424,921 | 320,419,273 | 500,566,315 | 780,717,676 |
| ROA | 5.10% | 6.74% | 5.13% | 4.43% | 3.42% |
| ROE | 21.60% | 34.36%% | 34.44% | 37.09% | 36.22% |
| Portfolio at risk (>30 days) ratio | 3.43% | 2.04% | 2.90% | 1.80% | 2.85% |
| Write-off ratio | 4.18% | 2.96% | 4.49% | 4.06% | 3.39% |
| Number of active borrowers | 113,505 | 154,541 | 221,802 | 286,246 | 380,804 |

**Source: Adapted from the MIX Market (2005)**

Mibanco executes ratings with Pacific Credit Rating and Class & Asociados S.A. Both rating agencies give Mibanco the highest rank in financial performance. Mejía (2009) remark a high quality of the biggest loan portfolio in Peru, and a national-wide diversified business. Zelvaggio and Agüero (2009) remark a sustainable business with exceptional financial performance, excellent repayment capacity and total risk covering. Bonds are ranked with a high certainty of payment and insignificant risks.

*Social Performance*

An impact evaluation of Mibanco's microfinance program was conducted between 1997 and 1999 by Dunn and Arbuckle (2001) as part of the AIMS Project of USAID. As presented in the fifth chapter, impact results were positive. Efforts for measuring social performance by Mibanco itself can not be found. An interview partner affirms that Mibanco started measuring social performance three years ago with Management & Excellence. Management & Excellence [M&E] (2009) is a research and rating company in the areas of ethics, sustainability, corporate governance, transparency and corporate social responsibility specialized in Latin America. M&E compares banks according to 330 accepted standards of the banking business. In 2008 Mibanco is given the second place of the Top-20 ranking of the most sustainable Latin American Mid-cap banks (M&E, 2009).

This year, Mibanco started working on a project with Global Reporting Initiative (GRI) to incorporate the GRI guidelines and indicators. This partnership would thus allow Mibanco to evaluate its impact on the environment, society and economy. The PPI is included as one of the relevant indicators of the project, so that Mibanco can assess the poverty level of its low-income clients (Interview Partner).

## 6.3 A Double Bottom Line or a Trade-Off

The two case studies present two experienced and financially sustainable institutions in Peru that are making efforts to assess their social performance. MFP has recently implemented a social performance management system and Mibanco is currently working on it. These examples reflect clearly the commitment of both MFIs to achieve their social mission and assess social performance. They also signal the possibility to achieve positive social and financial returns simultaneously, and to manage a double bottom line efficiently. Moreover, the examples show the importance of international organizations for bringing knowledge to MFIs and support the restructure of their management systems.

Due to the early stage of development of the social performance management, it is not yet possible to state whether financial and social performance reinforce or negatively affect each other for either of the two case studies. A long-term evaluation is needed to be able to compare results and to state whether managing a double bottom line is possible or not.

Evidently, financial and social performance of MFIs varies across the Peruvian microfinance industry. Kearny (2008b) states that microcredit involves an essential trade-off between breadth and depth of outreach. He explains that while depth of outreach or "lending to the poorest of the poor" is difficult, costly and inefficient, breadth of outreach or "servicing more clients" implies targeting the better-off poor and reaching economies of scale. However, there can be also MFIs that are both socially strong and financial sustainable or both socially weak and financial non-sustainable.

Balkenhol (2007) explains that financial non-sustainability of MFIs can not be always attributable to poor management of the MFI but also to external factors in the local market where it operates. Balkenhol suggests that in cases where MFIs are contributing to poverty reduction but are not financial sustainable, public policy should play an important role. However, national governments and the donor community should not evaluate poverty focus and financial sufficiency of MFIs, they should instead evaluate the MFIs' efficiency to produce the maximum output in its context.

# 7. Conclusion

Like the global microfinance industry, the microfinance sector in Peru has significantly grown during the past two decades. The factors contributing to the increasing growth of the Peruvian microfinance sector are the governmental support of the MSE as an important factor for the development of the country, the economic growth of the country in the past years, and the financial reforms of the nineties that integrated microfinance in the formal financial sector and created a favorable environment for a sustainable microfinance development.

The Peruvian microfinance sector is characterized by an increasing number of MFIs, which have spread throughout the country. These MFIs operate in different contexts, service different groups of low-income people, follow different social objectives, offer different services, and experience financial and social performance differently. Although efforts on promoting MFI's transparency for the international audience have started, more effort is needed so that all MFIs operating in Peru can share their information on an international platform and have more access to capital.

The lack of transparency of the sector is reflected in the difficulty in determining the exact total number of MFIs operating in Peru. These difficulties were apparent in the initial phase of the survey, where not all MFIs could be successfully reached. Although only a small misrepresentative sample could be collected, it was found that there exists some effort to implement social performance measurement in the Peruvian microfinance industry.

The survey participants are aware of the potential of microfinance to generate social changes, of the importance of social performance measurement to attract social investors or donors, and of the importance of social performance with regard to the profitability of their institution. The survey shows a clear interest and effort of some MFIs for implementing social performance measurement and to manage a double bottom line.

A few MFIs state they are currently measuring social performance and participating in pilot projects of international organizations. These MFIs understand the need to validate and implement international social performance measurement tools. MFIs who do not measure social performance argue that they lack knowledge and financial resources to develop an appropriate system, or that they will be implementing social performance measurement in the near future. Thus, arguments are neither based on the unwillingness of MFIs to measure social performance nor based on the irrelevance of social performance measurement itself.

The lack of common measurement tools and standard social reporting of the global microfinance industry are well reflected in the Peruvian microfinance sector. The social performance measurement tools in use vary among the Peruvian MFIs. This also reflects the early stage of development of the Peruvian microfinance industry with regard to social performance measurement. Nevertheless, the tools reported in the survey are tools developed by international organizations and illustrate the willingness of Peruvian MFIs to implement the tools and receive support of international organizations because they need the knowledge and information of lessons-learned and best practices. Furthermore, the existence of projects encouraging social performance measurement across the Peruvian microfinance sector and supporting MFIs with the implementation of an appropriate social performance management system also illustrate the early development stage and the lack of knowledge of social performance measurement in Peru.

The question whether microfinance is having positive social and economic impacts on Peruvian clients cannot be answered, because social performance measurement is still in a pilot phase. Few more years are needed to be able to get impact results and to evaluate them for the long-term effect. Nevertheless, some positive hints can be found in the impact studies reviewed. Positive impacts are found at the individual, business, and household level, and can be material and non-material. For example, business sales, employment, income, asset ownership, education, self-esteem, and attitude were observed as positive impact results.

Although impact studies may contain methodological weaknesses, they suggest that alignment of microfinance programs is critical to match with the different needs of the poor and in their specific context. The study shows that poverty is a multidimensional problem than can not always be solved solely by offering microcredits, but also with other financial and non-financial services.

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## List of Interview Partners

Burga Carmona, Jack: Catholich Relief Services (CRS), Director of Mission Project in Peru, 12th May 2009, E-mail

Avalos, Vicente: Swisscontact Perú, Director SERFI project, 29th April 2009, E-mail

Tan, Ana: Swisscontact Perú, SERFI project, 24th April 2009, E-mail

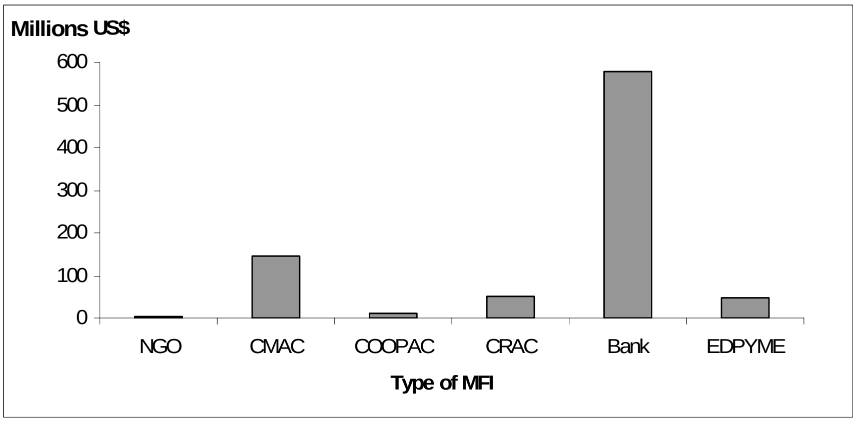
Loayza Pacheco, José Andres: Alternativa Microfinanzas, Chief of the Microfinance Department, 12th May 2009, phone call

Melgar Salazar, Indira: ADRA, Chief of Microfinance Portfolio, 11th May 2009, phone call

Lama, Natali: Mi Banco, Planeamiento Department, 13th-14th May 2009, E-mail

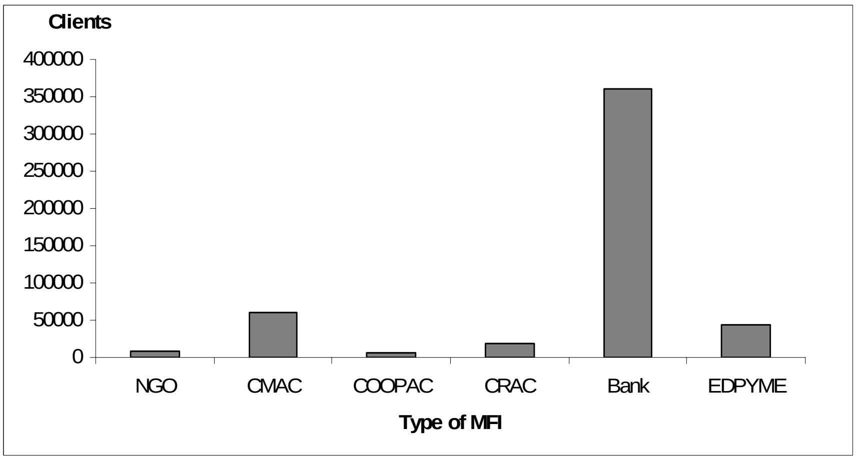
# Appendix I: Financial indicators per MFI category

## Figure 1.1: Average gross loan portfolio per type of MFI



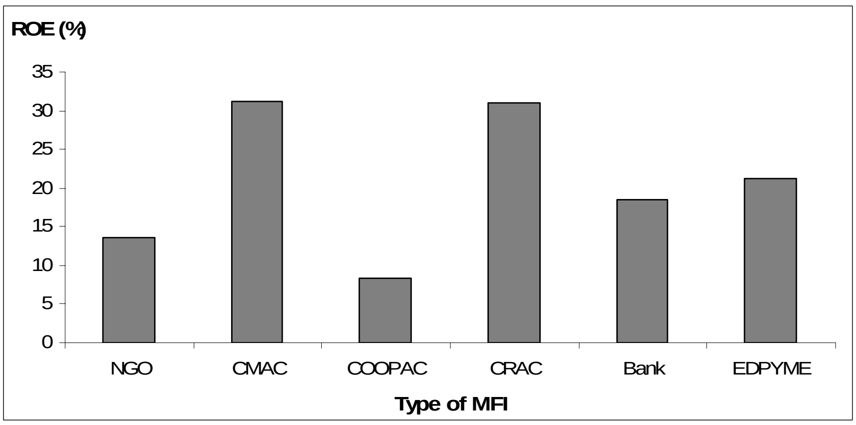

**Source: Own Research**

## Figure 1.2: Average Clients per Type of MFI




**Source: Own research**

## Figure 1.3 Average Return of Equity (ROE) per type of MFI




**Source: Own research**

# Appendix II: Progress Out of Poverty Index for Peru

## Figure 2: PPI for Peru

| Indicator | Value | Points | Score |
|---|---|---|---|
| 1. How many household members are 17-years-old or younger? | A. Four or more | 0 | |
| | B. Three | 5 | |
| | C. Two | 9 | |
| | D. One | 16 | |
| | E. None | 24 | |
| 2. What is the highest educational level that the female head/spouse completed? | A. None, pre-school, or kindergarten | 0 | |
| | B. Grade school (incomplete) | 5 | |
| | C. Grade school (complete) | 7 | |
| | D. High school (incomplete) | 9 | |
| | E. High school (complete), non-university superior (incomplete) or no female head | 10 | |
| | F. Non-university superior (complete) or higher | 16 | |
| 3. What is the main material of the floors? | A. Earth, wood planks, other, or no residence | 0 | |
| | B. Cement | 2 | |
| | C. Parquet, polished wood, linoleum, vinyl, tile, or similar | 15 | |
| 4. What is the main material of the exterior walls? | A. Adobe, mud, or matting | 0 | |
| | B. Wattle and daub, wood, matting, brick or cement blocks, stone blocks with lime or cement, other, or no residence | 2 | |
| 5. Excluding bathrooms, kitchen, hallways, and garage, how many rooms does the residence have? | A. One | 0 | |
| | B. Two | 1 | |
| | C. Three, four, or five | 5 | |
| | D. Six or more | 10 | |
| 6. What fuel does the household most frequently use for cooking? | A. Other | 0 | |
| | B. Firewood, charcoal, or kerosene | 5 | |
| | C. Gas (LPG or natural) | 9 | |
| | D. Electricity or does not cook | 16 | |
| 7. Does the household have a refrigerator/freezer? | A. No | 0 | |
| | B. Yes | 5 | |
| 8. How many color televisions does the household have? | A. None | 0 | |
| | B. One | 3 | |
| | C. Two or more | 7 | |
| 9. Does the household have a blender? | A. No | 0 | |
| | B. Yes | 3 | |
| 10. Does the household have an iron? | A. No | 0 | |
| | B. Yes | 2 | |

**Source: Progress out of Poverty (http://www.progressoutofpoverty.org/peru)**

## Appendix III: Survey – Spanish version

1. ¿Conoce Usted el término ***Desempeño Social*** o ***Impacto Social*** de las microfinanzas?
   - ☐ Si
   - ☐ No

2. ¿Mide Usted el Impacto Social que sus servicios financieros originan en sus clientes?
   - ☐ Si
   - ☐ No

   ¿Porque Si o Porque No?

Si su respuesta fue negativa, responda sólo las preguntas 4,5 y 7.

3. ¿Qué indicadores utiliza para medir el Impacto Social?

   *Por favor borre y luego escriba sobre éste texto*

4. ¿Qué tan importante considera asegurar y medir el impacto social en sus clientes para la ***rentabilidad*** de su institución?
   - ☐ Sin importancia
   - ☐ Poca importancia
   - ☐ Importante
   - ☐ Muy importante
   - ☐ Indispensable

5. ¿Qué tan importante considera asegurar y medir el impacto social en sus clientes para la ***recaudación de capital***?
   - ☐ Sin importancia
   - ☐ Poca importancia
   - ☐ Importante
   - ☐ Muy importante
   - ☐ Indispensable

6. ¿Estaría Usted dispuesto a mandarnos los resultados del impacto social y las medidas de impacto de su institución?
   - ☐ Si
   - ☐ No

7. ¿Está Usted disponible para una conversación telefónica?
   - ☐ Si
   - ☐ No

Si Usted respondió afirmativamente las preguntas 6 o 7, por favor escriba nombre, teléfono y dirección electrónica de contacto:

| | |
|---|---|
| Nombre: | |
| Teléfono: | |
| E-mail: | |

# Appendix IV: Survey – English version

1. Are you acquainted with the term ***Social Performance*** or ***Social impact*** of microfinance?
   - ☐ Yes
   - ☐ No

2. Do you measure the social impact of your services on clients?
   - ☐ Yes
   - ☐ No

   Why?

3. Which indicators do your MFI use to measure social impact?

4. ¿How important do you consider social impact measurement with regard to the profitability of your institution?
   - ☐ not important
   - ☐ somewhat important
   - ☐ important
   - ☐ very important
   - ☐ indispensable

5. How important do you consider social impact measurement with regard to access to financial capital?
   - ☐ not important
   - ☐ somewhat important
   - ☐ important
   - ☐ very important
   - ☐ indispensable

6. Are you willing to share social impact results of your institution?
   - ☐ Yes
   - ☐ No

7. Are your available for a phone call?
   - ☐ Yes
   - ☐ No

Please, give the following contact data if you answer either 6 or 7 with yes.

| | |
|---|---|
| Name: | |
| Phone no.: | |
| E-mail: | |

## Appendix V: List of Surveyed MFIs

ADRA (NGO)

Alternativa Microfinanzas (NGO)

AMA (NGO)

Caritas (NGO)

Fondesurco (NGO)

IDESPA (NGO)

PRISMA (NGO)

Sinergia (NGO)

Institución Servicios Educativos El Agustino (NGO)

RED Rural Sondondo (NGO)

Cooperativa de Ahorro y Crédito Leon XIII (COOPAC)

COOPAC Norandino (COOPAC)

Cooperativa de Ahorro y Crédito Señor de los Temblores del Cusco (COOPAC)

Cooperativa Virgen de las Nieves (COOPAC)

Cooperativa de Ahorro y Crédito los Andes (COOPAC)

Caja Rural los Andes (CRAC)

Mibanco (Bank)

EDPYME Confianza (EDPYME)