

Helping to Improve Donor Effectiveness in Microfinance

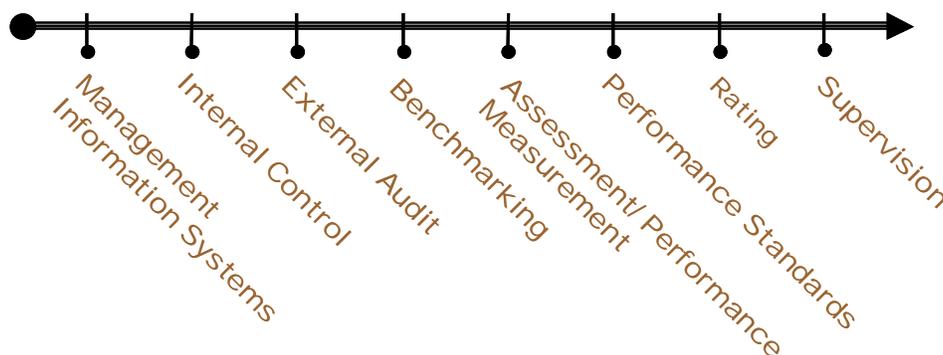
MICROFINANCE TRANSPARENCY AND REPORTING TO DONORS

Most microfinance institutions (MFIs) have trouble producing accurate and meaningful reports about their financial and social performance. Without timely tracking of the right performance indicators, it is hard for MFIs and their donors to judge progress and manage risk.

Donors often want to track how their specific funds are used by MFIs (how many computers purchased? how many loans made?). Because money is fungible, such reporting is less meaningful than reporting on the performance of the institution as a whole. Reports for donors often leave out the key institutional indicators needed to manage an MFI, to judge its performance, and to compare it with others. Finally, preparing separate reports for each donor's project imposes an unreasonable burden on many MFIs.

Nevertheless, the donor reporting process can be a powerful tool to improve MFI performance and transparency when it includes presentation—and credible independent confirmation—of core indicators such as loan collection (e.g., portfolio at risk), financial sustainability (e.g. adjusted return on assets), and client poverty levels.

What is transparency in microfinance? “Transparency” refers to accurate, timely information about the financial and social performance of an MFI, including the production, verification, reporting, and use of that information.



As illustrated in the diagram above, financial transparency relies on the proper functioning of several distinct processes:

- **information systems** that gather and report timely, accurate, and useful data
- **internal controls** and **external audits** that ensure data integrity
- **benchmarking** against industry standards, based on the performance of peer institutions
- **assessment** of performance quality, and, ultimately,
- **supervision** of deposit-taking MFIs by financial authorities to ensure compliance with applicable standards.

Transparency with respect to social performance should embrace, at the very least, information on the poverty levels of MFI clients. Some donors will also want information on the specific techniques used to target poor clients. Credible “impact” information that quantifies client benefits attributable to financial services is expensive to produce and should not be required as a part of normal periodic reporting.

Benefits of Transparency

- **Transparency improves performance.** The right information helps MFI managers to identify areas for improvement and make better decisions. Freely available information also allows managers to compare themselves to industry benchmarks and peers, giving them strong incentives to boost their performance.
- **Transparency attracts funders.** Accurate, standardized information lets donors and other investors understand the performance of an MFI and make informed funding decisions. They can then track financial and social indicators to determine whether expected results are forthcoming.
- **Transparency protects clients.** MFI clients deserve clear, straightforward disclosure of product terms, especially interest rates. In client-owned cooperatives and other deposit-taking institutions, published performance information tells clients about the quality of management and the safety of their deposits.

Donor Reports – One Key to Transparency

As principal funders, donors drive the reporting of many MFIs. Recommended guidelines include:

- De-emphasize project-specific reporting that focuses on how donor funds are used. Instead, concentrate on core indicators of MFI institutional performance such as loan portfolio quality, efficiency, financial sustainability, and poverty outreach.
- Reach agreement with other donors on common MFI reporting standards and, where possible, common reporting formats. Minimum information for financial reporting is suggested by CGAP's *Financial Statement Disclosure Guidelines*.
- Get periodic confirmation of performance reports by an independent party such as an auditor, rater, or other expert consultant.
- Require MFIs to share performance data with others working in microfinance through MFI networks, benchmarking publications such as the *MicroBanking Bulletin*, or web-based services such as the Microfinance Information eXchange.
- Avoid unnecessary reporting, particularly if donor staff do not have the time to carefully review reports.

	Project-Oriented Reporting	Institutional, Performance-Based Reporting
Focus	Specific project funded by donor	MFI institutional performance
Indicators	Outputs of specific donor project, such as loans financed or other uses of donor funds	Bottom-line institutional performance indicators like repayment, sustainability, efficiency, and client poverty levels
Utility of Data	Useful primarily for donor's internal purposes	Useful to MFI, donor, and sector as a whole: drives efficient performance, allows for benchmarking
Format	Multiple formats for multiple donors	Common standards or formats

How can donors further enhance transparency in microfinance? By making available **flexible funds** to develop local expertise to analyze, collect, and report MFI financial information. Local expertise at all levels, from national networks, evaluators and auditors, to bank regulators and supervisors, is needed to ensure a transparent industry.

Where to go for more information. Articles/Periodicals: "Financial Transparency: A Glossary of Terms," (CGAP Glossary, November 2001); "Focus on Financial Transparency: Building the Infrastructure of a Microfinance Industry," CGAP Update Brochure (November 2001); Tor Jansson, "Microfinance: From Village to Wall Street," (Washington, DC: Inter-American Development Bank, 2002); *MicroBanking Bulletin*, No. 7 (November 2001); "Resource Guide to Microfinance Assessments" (CGAP Focus Note No. 22, November 2001); Jean Steege, "The Rise and Fall of Corposol: Lessons Learned from the Challenges of Managing Growth," (Washington, DC: USAID Microfinance Best Practice, August 1998).

Websites: CGAP Phase III Strategy - http://www.cgap.org/html/p_other_documents.html#cgap_strategy. Microfinance Information eXchange - www.themix.org. The MIX Market - www.mixmarket.org. *MicroBanking Bulletin* - <http://www.mixmbb.org/en/home.asp>