

## Benchmarks Methodology

---

### Peer Groups

These tables are designed to present performance benchmarks against which managers and directors of microfinance institutions can compare their institution's performance with that of similar MFIs. Since the microfinance industry consists of a range of institutions and operating environments, some with very different characteristics, an MFI should be compared to similar institutions - peer groups - for the reference points to be useful.

Peer groups are sets of programs that have similar characteristics - similar enough that their managers find utility in comparing their results with those of other organizations within their peer groups. The benchmark tables present peer groups on two bases: simple and compound.

**Simple Peer Groups** look at MFIs based on a single characteristic. This allows users to analyze performance based on a common factor, such as age, location or scale of operations. MFIs have been grouped according to the following ten characteristics:

1. **Age:** MIX benchmark tables classify MFIs into three categories (new, young and mature) based on the maturity of their microfinance operations. This is calculated as the difference between the year they started their microfinance operations and the year of data submitted by the institutions.
2. **Charter Type:** The charter under which the MFI is registered is used to classify the organization as a bank, credit union/cooperative, NGO, and non bank financial institution.
3. **Financial Intermediation:** This classification measures the extent to which an MFI intermediates between savers and borrowers, funding its assets through mobilized deposits. It is calculated as a percentage of total assets funded by voluntary savings.
4. **Lending Methodology:** Performance may vary by the way the institution delivers its loan products and serves borrowers. MIX tables present MFIs based on the primary methodology used, determined by the number and volume of loans outstanding.
5. **Outreach:** Scale of outreach is measured as the total number of borrowers served.
6. **Profit Status:** According to an MFI's registration, an institution is classified as "not for profit" and "for profit" institutions.
7. **Region:** MFIs are divided into five primary geographic regions: Africa, Asia, Eastern Europe and Central Asia (ECA), Latin America, Middle East and North Africa (MENA).
8. **Scale:** Institutional scale is measured by the size of an institution's loan portfolio in US Dollars (USD). The measure of scale is regionalized to reflect differences in income levels across regions.
9. **Sustainability:** MFIs are grouped according to their level of financial self-sufficiency, representing their ability to cover all costs on an adjusted basis.
10. **Target Market:** MIX tables classify MFIs into three categories based on the average balance of loans served: low-end, broad, and high-end. For international comparison, this balance is stated as a percentage of local income levels (GNI per capita).

**MIX**  
**Benchmarks Methodology**

**Compound Peer Groups** use a more complex set of variables to analyze MFI performance. This creates benchmarks where institutions have a greater number of similar factors affecting performance.

The tables present compound peer groups based on three main factors: Region, Scale, Sustainability.

**Peer Group Composition**

The quantitative criteria used to categorize these groups are summarized in the table below.

<b>Group</b>	<b>Categories</b>	<b>Criteria</b>
Age	New Young Mature	1 to 4 years 5 to 8 years More than 8 years
Charter Type	Bank Credit Union NBFi NGO Rural Bank	
Financial Intermediation	Non FI Low FI High FI	No voluntary savings Voluntary savings <20% of total assets Voluntary savings >20% of total assets
Lending Methodology	Individual Solidarity Group Individual/Solidarity Village Banking	
Outreach	Large Medium Small	Number of borrowers >30,000 Number of borrowers 10,000 to 30,000 Number of borrowers <10,000
Profit Status	For Profit Not for Profit	Registered as a for profit institution Registered in a non profit status
Region	Africa Asia ECA LAC MENA	Sub-Saharan Africa South and East Asia Eastern Europe and Central Asia Latin America and the Caribbean Middle East and North Africa
Scale (Gross Loan Portfolio in USD)	Large  Medium  Small	Africa, Asia, ECA, MENA: >8 million; LAC: >15 million Africa, Asia, ECA, MENA: 2 million - 8 million LAC: 4 million - 15 million Africa, Asia, ECA, MENA: <2 million LAC: <4 million
Sustainability	Non FSS FSS	Financial Self-Sufficiency <100% Financial Self-Sufficiency =100%
Target Market (Depth = Avg. Loan Balance per Borrower/GNI per Capita)	Low end Broad High end Small business	Depth <20% OR average loan size <USD 150 Depth between 20% and 149% Depth between 150% and 250% Depth over 250%

**Adjustments to Financial Data**

MIX adjusts the financial data we receive to ensure comparable results. The financial statements of each organization are converted to the standard financial statement presentation used by MIX and as seen in the benchmark tables of the MIBB. This presentation can be simpler than that used by most MFIs, so the conversion consists mainly of consolidation into fewer, more general accounts. In some instances, and where the original accounts did not have appropriate disclosure, the MIX's accounts reveal more details on the financial service operations than did the originals. After this reclassification, three analytical adjustments are applied to produce a common treatment for the effect of: a) inflation, b) subsidies, c) loan loss provisioning and write-off.

## **MIX** **Benchmarks Methodology**

### ***Inflation***

MIX reports the net effect of inflation by calculating increases in expenses and revenues due to inflation. Inflation decreases the value of net monetary assets, represented by MIX as the difference between equity and fixed assets. This erosion in the value of net monetary assets is obtained by multiplying the prior year-end equity balance by the current-year inflation rate (inflation data are obtained from line 64x of the International Financial Statistics, International Monetary Fund, various years). Fixed asset accounts, on the other hand, are revalued upward by the current year's inflation rate, which results in inflation adjustment income, offsetting to some degree the expense generated by adjusting equity (in fact, an institution that holds fixed assets equal to its equity avoids the cost of inflation that affects MFIs which hold much of their equity in financial form). On the balance sheet, this inflation adjustment results in a reordering of equity accounts: profits are redistributed between real profit and the nominal profits required to maintain the real value of equity.

MFIs that borrow from banks or mobilize savings have an actual interest expense, which is an operating cost. In comparison, similar MFIs that lend only their equity have no interest expense and therefore have lower operating costs. If an MFI focuses on sustainability and the maintenance of its capital/asset ratio, it must increase the size of its equity in nominal terms to continue to make the same value of loans in real (inflation-adjusted) terms. Inflation increases the cost of tangible items over time, so that a borrower needs more money to purchase them. MFIs that want to maintain their support to clients must therefore offer larger loans. Employees' salaries go up with inflation, so the average loan balance and portfolio must increase to compensate, assuming no increase in interest margin. Therefore, an institution that funds its loans with its equity must maintain the real value of that equity, and pass along the cost of doing so to the client. This expectation implies MFIs should charge interest rates that include the inflation adjustment expense as a cost of funds, even if this cost is not actually paid to anyone outside the institution.

Some countries with high or volatile levels of inflation require businesses to use inflation-based accounting on their audited financial statements. We understand that in countries where high or volatile inflation is a new experience, MFIs may find it difficult to pass on the full cost of inflation to clients. These adjustments do not reflect policy recommendations; rather, they provide a common analytical framework that compares real financial performance meaningfully.

### ***Subsidies***

We adjust participating institutions' financial statements for the effect of subsidies by presenting them as they would look on an unsubsidized basis. These adjustments do not intend to suggest that MFIs should or should not be subsidized. Rather, they allow MIX to see how each MFI would look without subsidies for comparative purposes. Most of the participating MFIs indicate a desire to grow beyond the limitations imposed by subsidized funding. The subsidy adjustment permits an MFI to judge whether it is on track toward such an outcome. A focus on sustainable expansion suggests that subsidies should be used to defray start-up costs or support innovation. The subsidy adjustment simply indicates the extent to which the subsidy is being passed on to clients through lower interest rates or whether it is building the MFI's capital base for further expansion.

MIX adjusts for three types of subsidies: 1) a cost-of-funds subsidy from loans at below-market rates, 2) current-year cash donations to fund portfolio and cover expenses, 3) in-kind subsidies, such as rent-free office space or the services of personnel who are not paid by the MFI and thus not reflected on the income statement. Additionally, for multipurpose institutions, MIX attempts to isolate the performance of the financial services program, removing the effect of any cross subsidization.

The cost-of-funds adjustment reflects the impact of soft loans on the financial performance of the institution. MIX calculates the difference between what the MFI actually paid in interest on its subsidized liabilities and what it would have paid at market terms.<sup>1</sup> This difference represents the value of the subsidy, which we treat as an additional financial expense. We apply this subsidy adjustment to the average balance of borrowings carried by the MFI over the year. The decreased profit is offset by generating a "cost of funds adjustment" account on the balance sheet.

If the MFI passes on the interest rate subsidy to its clients through a lower final rate of interest, this adjustment may result in an operating loss. If the MFI does not pass on this subsidy, but instead uses it to increase its equity base, the adjustment indicates the amount of the institution's profits that were attributable to the subsidy rather than operations.

---

<sup>1</sup> Data for shadow interest rates are obtained from line 60I of the International Financial Statistics, IMF, various years. The deposit rate is used because it is a published benchmark in most countries.

**MIX**  
**Benchmarks Methodology**

**Loan Loss Provisioning**

Finally, we apply standardized policies for loan loss provisioning and write-offs. MFIs vary tremendously in accounting for loan delinquency. Some count the entire loan balance as overdue the day a payment is missed. Others do not consider a loan delinquent until its full term has expired. Some MFIs write off bad debt within one year of the initial delinquency, while others never write off bad loans, thus carrying forward a defaulted loan that they have little chance of ever recovering.

We classify as "at risk" any loan with a payment over 90 days late. We provision 50 percent of the outstanding balance for loans between 90 and 180 days late, and 100 percent for loans over 180 days late. Some institutions also renegotiate (refinance or reschedule) delinquent loans. As these loans present a higher probability of default, we provision all renegotiated balances at 50 percent. Where ever we have adequate information, we adjust to assure that all loans are fully written off within one year of their becoming delinquent. (Note: We apply these provisioning and write-off policies for benchmarking purposes only. We do not recommend that all MFIs use exactly the same policies.) In most cases, these adjustments are a rough approximation of risk. They are intended only to create an even playing field, at the most minimal of levels, for cross institutional comparison and benchmarking. Nevertheless, most participating MFIs have high-quality loan portfolios, so loan loss provision expense is not an important contributor to their overall cost structure. If we felt that a program did not fairly represent its general level of delinquency, and we were unable to adjust it accordingly, we would simply exclude it from the peer group.

**Financial statement adjustments and their effects:**

<b>Adjustment</b>	<b>Effect on Financial Statements</b>	<b>Type of Institution Most Affected by Adjustment</b>
Inflation adjustment of equity (minus net fixed assets)	Increases financial expense accounts on income statement, to some degree offset by inflation income account for revaluation of fixed assets. Generates a reserve in the balance sheet's equity account, reflecting that portion of the MFI's retained earnings that has been consumed by the effects of inflation. Decreases profitability and "real" retained earnings.	>MFIs funded more by equity than by liabilities will be hardest hit, especially in high inflation countries.
Reclassification of certain long term liabilities into equity, and subsequent inflation adjustment	Decreases concessional loan account and increases equity account; increases inflation adjustment on income statement and balance sheet.	NGOs that have very long-term, very low-interest "loans" from international agencies that function more as donations than loans, or transformed institutions with subordinated debt.
Cost of funds adjustment	Increases financial expense on income statement to the extent that the MFI's liabilities carry a below-market rate of interest. Decreases net income and increases subsidy adjustment account on balance sheet.	MFIs with heavily subsidized loans (i.e. large lines of credit from governments or international agencies at highly subsidized rates).
Reclassification of donations below net operating income	Reduces net operating income on the income statement. Increases accumulated donations account under equity on the balance sheet.	NGOs during their start-up phase. This adjustment is relatively less important for mature institutions.
In-kind subsidy adjustment (e.g., donation of goods or services: line staff paid by technical assistant providers)	Increases administrative expense on income statement to the extent that the MFI is receiving subsidized or donated goods or services. Decreases net income, increases subsidy adjustment account on balance sheet.	MFIs using goods or services which they are not paying a market based cost (i.e. MFIs during their start-up phase).
Loan loss provisioning adjustment	Usually increases loan loss provision expense on income statement and loan loss reserve on balance sheet.	MFIs that have unrealistic loan loss provisioning policies.
Write-off adjustment	On balance sheet, reduces gross loan portfolio and loan loss reserve by an equal amount, so that neither net loan portfolio nor total assets is affected.	MFIs that leave non-performing loans on their books for over a year.