http://www.fa.ru/projects/rbes/Documents/RoBES_2_2016.pdf

# Review of Business and Economics Studies

*EDITOR-IN-CHIEF*
**Prof. Alexander Ilyinsky**
Dean, International Finance Faculty, Financial University, Moscow, Russia
*ailyinsky@fa.ru*

*DEPUTY EDITOR-IN-CHIEF*
**Prof. Alexander Didenko**
Dean, International Economic Relations Faculty, Financial University, Moscow, Russia
*alexander.didenko@gmail.com*

*EXECUTIVE EDITOR*
**Dr. Zbigniew Mierzwa**

*EDITORIAL BOARD*

**Dr. Mark Aleksanyan**
Adam Smith Business School, The Business School, University of Glasgow, UK

**Prof. Edoardo Croci**
Research Director, IEFE Centre for Research on Energy and Environmental Economics and Policy, Università Bocconi, Italy

**Prof. Moorad Choudhry**
Dept.of Mathematical Sciences, Brunel University, UK

**Prof. David Dickinson**
Department of Economics, Birmingham Business School, University of Birmingham, UK

**Prof. Chien-Te Fan**
Institute of Law for Science and Technology, National Tsing Hua University, Taiwan

**Prof. Wing M. Fok**
Director, Asia Business Studies, College of Business, Loyola University New Orleans, USA

**Prof. Konstantin P. Gluschenko**
Faculty of Economics, Novosibirsk State University, Russia

**Prof. George E. Halkos**
Associate Editor in Environment and Development Economics, Cambridge University Press; Director of Operations Research Laboratory, University of Thessaly, Greece

**Dr. Christopher A. Hartwell**
President, CASE — Center for Social and Economic Research, Warsaw, Poland

**Prof. S. Jaimungal**
Associate Chair of Graduate Studies, Dept. Statistical Sciences & Mathematical Finance Program, University of Toronto, Canada

**Prof. Bartlomiej Kaminski**
University of Maryland, USA; Rzeszow University of Information Technology and Management, Poland

**Prof. Vladimir Kvint**
Chair of Financial Strategy, Moscow School of Economics, Moscow State University, Russia

**Prof. Alexander Melnikov**
Department of Mathematical and Statistical Sciences, University of Alberta, Canada

**Prof. George Kleiner**
Deputy Director, Central Economics and Mathematics Institute, Russian Academy of Sciences, Russia

**Prof. Kwok Kwong**
Director, Asian Pacific Business Institute, California State University, Los Angeles, USA

**Prof. Dimitrios Mavrakis**
Director, Energy Policy and Development Centre, National and Kapodistrian University of Athens, Greece

**Prof. Steve McGuire**
Director, Entrepreneurship Institute, California State University, Los Angeles, USA

**Prof. Rustem Nureev**
Head of the Department of Economic Theory, Financial University, Russia

**Dr. Oleg V. Pavlov**
Associate Professor of Economics and System Dynamics, Department of Social Science and Policy Studies, Worcester Polytechnic Institute, USA

**Prof. Boris Porfiriev**
Deputy Director, Institute of Economic Forecasting, Russian Academy of Sciences, Russia

**Prof. Svetlozar T. Rachev**
Professor of Finance, College of Business, Stony Brook University, USA

**Prof. Boris Rubtsov**
Chair of Financial Markets and Financial Engineering, Financial University, Russia

**Dr. Minghao Shen**
Dean, Center for Cantonese Merchants Research, Guangdong University of Foreign Studies, China
**Prof. Dmitry Sorokin**
Chairman for Research, Financial University, Russia

**Prof. Robert L. Tang**
Vice Chancellor for Academic, De La Salle College of Saint Benilde, Manila, The Philippines

**Dr. Dimitrios Tsomocos**
Saïd Business School, Fellow in Management, University of Oxford; Senior Research Associate, Financial Markets Group, London School of Economics, UK

**Prof. Sun Xiaoqin**
Dean, Graduate School of Business, Guangdong University of Foreign Studies, China

*REVIEW OF BUSINESS AND ECONOMICS STUDIES (ROBES)* is the quarterly peer-reviewed scholarly journal published by the Financial University under the Government of Russian Federation, Moscow. Journal's mission is to provide scientific perspective on wide range of topical economic and business subjects.

*CONTACT INFORMATION*
Financial University
Leningradsky prospekt, 53, office 5.4
123995 Moscow
Russian Federation
Telephone: +7 (499) 943-94-53
Website: www.robes.fa.ru

*AUTHOR INQUIRIES*
Inquiries relating to the submission of articles can be sent by electronic mail to robes@fa.ru.

*COPYRIGHT AND PHOTOCOPYING*
© 2016 Review of Business and Economics Studies. All rights reserved. No part of this publication may be reproduced, stored or transmitted in any form or by any means without the prior permission in writing from the copyright holder. Single photocopies of articles may be made for personal use as allowed by national copyright laws.
ISSN 2308-944X

# Вестник исследований бизнеса и экономики

*ГЛАВНЫЙ РЕДАКТОР*
**А.И. Ильинский,** профессор, декан Международного финансового факультета Финансового университета

*ЗАМЕСТИТЕЛЬ ГЛАВНОГО РЕДАКТОРА*
**А.С. Диденко,** профессор, декан факультета Международных экономических отношений Финансового университета

*ВЫПУСКАЮЩИЙ РЕДАКТОР*
**Збигнев Межва,** д-р экон. наук

*РЕДАКЦИОННЫЙ СОВЕТ*
**М.М. Алексанян,** профессор Бизнес-школы им. Адама Смита, Университет Глазго (Великобритания)

**К. Вонг,** профессор, директор Института азиатско-тихоокеанского бизнеса Университета штата Калифорния, Лос-Анджелес (США)

**К.П. Глущенко,** профессор экономического факультета Новосибирского госуниверситета

**С. Джеимангал,** профессор Департамента статистики и математических финансов Университета Торонто (Канада)

**Д. Дикинсон,** профессор Департамента экономики Бирмингемской бизнес-школы, Бирмингемский университет (Великобритания)

**Б. Каминский,** профессор, Мэрилендский университет (США); Университет информационных технологий и менеджмента в Жешуве (Польша)

**В.Л. Квинт,** заведующий кафедрой финансовой стратегии Московской школы экономики МГУ, профессор Школы бизнеса Лассальского университета (США)

**Г. Б. Клейнер,** профессор, член-корреспондент РАН, заместитель директора Центрального экономико-математического института РАН

**Э. Крочи,** профессор, директор по научной работе Центра исследований в области энергетики и экономики окружающей среды Университета Боккони (Италия)

**Д. Мавракис,** профессор, директор Центра политики и развития энергетики Национального университета Афин (Греция)

**С. Макгвайр,** профессор, директор Института предпринимательства Университета штата Калифорния, Лос-Анджелес (США)

**А. Мельников,** профессор Департамента математических и статистических исследований Университета провинции Альберта (Канада)

**Р.М. Нуреев,** профессор, заведующий кафедрой «Экономическая теория» Финансового университета

**О.В. Павлов,** профессор Департамента политологии и политических исследований Ворчестерского политехнического института (США)

**Б.Н. Порфирьев,** профессор, член-корреспондент РАН, заместитель директора Института народнохозяйственного прогнозирования РАН

**С. Рачев,** профессор Бизнес-колледжа Университета Стони Брук (США)

**Б.Б. Рубцов**, профессор, заведующий кафедрой «Финансовые рынки и финансовый инжиниринг» Финансового университета

**Д.Е. Сорокин,** профессор, член-корреспондент РАН, научный руководитель Финансового университета

**Р. Тан,** профессор, проректор Колледжа Де Ла Саль Св. Бенильды (Филиппины)
**Д. Тсомокос,** Оксфордский университет, старший научный сотрудник Лондонской школы экономики (Великобритания)

**Ч.Т. Фан,** профессор, Институт права в области науки и технологии, национальный университет Цин Хуа (Тайвань)

**В. Фок,** профессор, директор по исследованиям азиатского бизнеса Бизнес-колледжа Университета Лойола (США)

**Д.Е. Халкос,** профессор, Университет Фессалии (Греция)

**К.А. Хартвелл,** президент Центра социальных и экономических исследований CASE (Польша)

**М. Чудри,** профессор, Университет Брунеля (Великобритания)

**Сун Цяокин,** профессор, декан Высшей школы бизнеса Гуандунского университета зарубежных исследований (КНР)

**М. Шен,** декан Центра кантонских рыночных исследований Гуандунского университета (КНР)

Издательство Финансового университета
123995, Москва, ГСП-5, Ленинградский пр-т, 53, комн. 5.4
Тел. 8 (499) 943-94-53.
Интернет: www.robes.fa.ru.

Журнал "Review of Business and Economics Studies" («Вестник исследований бизнеса и экономики») зарегистрирован в Федеральной службе по надзору в сфере связи, информационных технологий и массовых коммуникаций 9 июля 2013 г. Свидетельство о регистрации ПИ № ФС77-54658.

Подписано в печать: **10.06.2016.**
Формат **60 × 84 1/8.**
**Заказ № 647 от 06.06.2016.**
Отпечатано в ООП Издательства Финуниверситета (Ленинградский проспект, д. 49).
16+

# Review of Business and Economics Studies

*Volume 4, Number 2, 2016*


## CONTENTS


**Economic security and economic growth in modern Russia: five key problems**
*Valery Tsvetkov* . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 5

**Microfinance: leverage or quagmire?**
*Zbigniew Mierzwa* . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 15

**The effect of capital structure and legal status on financial sustainability of MFIs in developing countries**
*Nguyen Bich Ngoc*. . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 53

**Acquisition premiums and subsequent impairment of goodwill in 2010–2015 in oil and gas sector**
*Irina Zemskova*. . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 65

**What is not CSR: extremes of CSR perception in the world of business and strategic view on it in the era of conscious capitalism**
*Anastasia Okorochkova* . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 83

# Вестник исследований бизнеса и экономики

*Том 4, № 2, 2016*


## СОДЕРЖАНИЕ


**Пять проблем экономической безопасности и экономического роста в современной России**

*Валерий Цветков* . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . **5**

**Микрофинансирование: рычаг или трясина?**

*Збигнев Межва* . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . **15**

**Влияние структуры капитала и юридического статуса на финансовую устойчивость микрофинансовых институтов в развивающихся странах**

*Нгуен Бих Нгок* . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . **53**

**Премии по сделкам и последующее списание гудвилла в 2010–2015 годах в нефтегазовом секторе**

*Ирина Земскова* . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . **65**

**К чему не следует сводить корпоративную социальную ответственность: экстремумы корпоративной социальной ответственности и стратегическое видение бизнеса в эпоху «сознательного капитализма»**

*Анастасия Окорочкова* . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . **83**

# Economic security and economic growth in modern Russia: five key problems

**VALERY TSVETKOV,**
*PhD in economics, professor, Corresponding Member of Russian Academy of Sciences,*
*Director of Market Economy Institute of Russian Academy of Sciences,*
*Vice-Rector for Research of Financial University under the Government of the Russian Federation, Moscow,*
*VATSvetkov@fa.ru*

**Abstract.** Author examines the most important issues (challenges) that have an impact upon Russia's development prospects in the 21st century, and suggests possible ways to support population and the real economy in the presence of a deepening crisis. The author believes that it is necessary to develop a comprehensive government program and create incentives for the industry to develop. The program, on the one hand, will facilitate the transition to a more balanced structure of production, and, on the other hand, encourage companies produce innovative and competitive products. At the same time, within the framework of the fostering program, it is necessary to compose a list of criteria to be met by the companies that expects to obtain support from the government. In order to improve the labor market situation, first of all, tax incentives for the companies that create new jobs for the highly-qualified people should be created. It is necessary to reimburse the companies' cost of tuition or advanced training of employees and to take steps to support labor mobility.

**Keywords:** crisis, oil process, GDP growth, inflation targeting, import substitution.

# Пять проблем экономической безопасности и экономического роста в современной России

**ЦВЕТКОВ ВАЛЕРИЙ АНАТОЛЬЕВИЧ,**
*доктор экономических наук, профессор, член-корреспондент РАН,*
*директор Института проблем рынка РАН, проректор по научной работе*
*Финансового университета при Правительстве Российской Федерации, Москва,*
*VATSvetkov@fa.ru*

**Аннотация.** В статье исследуются наиболее значимые проблемы (угрозы), предопределяющие перспективы развития России в XXI веке, и предлагаются возможные направления поддержки населения и реального сектора экономики в условиях углубляющегося кризиса. Автор считает, что необходимо разработать комплексную Программу государственного стимулирования развития промышленности, которая, с одной стороны, будет содействовать переходу к более сбалансированной структуре производства, а с другой стороны, подталкивать предприятия к выпуску инновационной и конкурентоспособной продукции. Одновременно в рамках Программы стимулирования следует утвердить перечень критериев, которым должны соответствовать предприятия, рассчитывающие на получение государственной поддержки. Чтобы улучшить ситуацию на рынке труда, в первую очередь нужны налоговые стимулы для компаний, которые создают новые высокопроизводительные рабочие места; необходимы компенсация расходов на обучение или повышение квалификации работников, а также меры по поддержке мобильности рабочей силы.

**Ключевые слова:** кризис, цены на нефть, рост ВВП, таргетирование инфляции, импортозамещение.

Argentina was one of the largest economies of the world in the early 20th century, but it has been gradually losing its influence and now it is seen as one of the regional leaders only. Unfortunately, today there are perfect conditions in Russia for repeating the fate of Argentina during the next decade. The key issues that our country faces predetermine those conditions. The paradox lies in the fact that everyone is aware of the issues but they remain unresolved and cause, in turn, new challenges.

I would like to denote the most important issues (challenges) that affect Russia's development prospects in the 21st century and suggest possible ways to support population and the real economy in the presence of a deepening crisis.

### ISSUE No. 1. The government does not resolve issues in order to ensure the economic security and economic growth.

If one examines the causes of the Russian crisis, one can see that the crisis is *manmade* one largely. The crisis did not emerge momentarily and incidentally. It has been developing for a long time, and the process was going on under the watchful eye of the pseudo-liberals wing in the Russian government.

The crisis has demonstrated clearly that, in fact, our country has turned into a "gas station" kind of a country where the prices of oil just not affect the economy; prices of oil fully shape the economy. The price of oil and the ruble to dollar exchange rate are all that matters. There is no room for real economic development, and for industrial production as well.

The period of 2014–15 has become extremely significant for the Russian economic history. Without exaggerating, one can call this period the time of bitter disappointment, the period of collapse of all hopes for a quick escape from the deepest economic crisis. Today, Russia is no longer the growing and developing country. It is struggling to keep things the way they used to be and not to fall into an abyss. Deepening recession was the pretext used to 'discard' Russia from the BRICS association. According to the Federal State Statistics Service, Russia's GDP fell by 3.7% in 2015 year, the fall in investment was 8.4% and the retail sales fell by 10%. Foreign trade surplus decreased by 23.2% to $145.6 billion (it was $189.7 billion in 2014). According to the official data, inflation growth rate was 13%. However, for certain foodstuffs, the inflation growth rate was at least 30% or higher.

The year 2015 was marketed by the consumer sentiment deterioration. The living standards fell dramatically. During the year, the population has lost almost 10% of the real incomes, and the process will go on. Mortality rate increased due to fall of real spending on health care in Russia. Out of all the sectors, only agro-industrial sector was growing steadily as concerns revenues, and profitability as well. Therefore, the investments are attracted to the sector. Yet, all the other sectors, including the oil production industry, metallurgy, machine building and others see the investment reduction. The real estate market is (stagnant). The demand on the motor vehicle production market fell by 30%. The volatility of foreign currency market is huge.

The continuing drop in oil prices may postpone the recovery of the Russian economy for a year at the very least. The reserves are decreasing, and no one comes up with an idea as to how to replenish them in the future.

Analysts continue making increasingly somber forecasts for the year 2016 with respect to the Russian economy. According to the Bank of Russia, the drop of annual GDP rate in the first quarter of 2016 could reach 1.7 to 2.5%, which is higher than the rate estimated in the earlier forecast (1 to 2%).

None of these issues becomes a reason for the government to doubt the correctness of the policy implemented. What does the government do in order to pull the country out of the crisis abyss? It publishes the new unrealistic GDP growth forecasts. Is it all it is doing? Where are the signs, or at least the shadows of the signs of recovery and the civilized market formation? Where is the mechanism to be used to revive the economy in the name of what everybody should tighten the belts? Only eccentric person would invest in the production development in the presence of furious ruble devaluation?

It is unlikely that there is at least one worthy law that would create incentives for the production growth in the private sector. In fact, in forming the "what-to-do" list to deal with the economic issues in the near future sounds like a refrain of the old motif: maximally take advantage of price and tax factor in order to reduce the

budget deficit. If, generally speaking, one wants to formulate the issue in this way, it is not clear where the realm of the government responsibility lies. If the living standards, rate of economic growth, and the real estate prices as the asset as a market condition indicators are not significant for the government, it seems that it oversees the state budget funds distribution only. At the same time, while never doubting the correctness of the policy implemented, the government cuts all the costs except for the bureaucratic machine maintenance costs.

Therefore, without any doubt we can say that the clear unwillingness of the Government to solve the economic growth issues is something new in a modern economic policy, to say the least. At the same time, the government policymakers suffer from the self-sufficiency complex. At best, they agree to listen politely to their opponents' suggestions and, without going into the debate, go their own way.

Perhaps, it is time to take a break and ponder, isn't it? According to a poll conducted by the Public Opinion Foundation, for the first time during the crisis period more than a half of the respondents described the economic situation as 'bad'. Until now, the 'satisfactory' mark has prevailed. In January 2016, almost 60% of the respondents said the situation had deteriorated. For comparison: only 40% of Russians expressed such an opinion a month ago. People not only put an 'F' grade to the economic performance, but also point out on a further deterioration of the situation. It seems that an increasing number of people see themselves as victims of the crisis and the crisis countering measures taken by the government.

I wish to be wrong, but I am afraid that if the situation does not change, then after a while, we might need not yet alternative program to overcome the crisis but a national survival program following a complete degradation of the national economy.

## ISSUE No. 2: Bankrupt, ridiculously deadlocking pattern of economic development leading to gradually transition of Russia into technological boondocks

Despite the presence of various development institutions and mechanisms in Russia, one key thing is absent: the new technologies are introducing in the domestic production sector at an extremely slow rate, or are not introducing at all. All this happens in the background of decommissioning of obsolete equipment from service and even entire companies are closing down.

As the failed liberal reforms have shown, it is unwise and pointless to rely on the omnipotence of the invisible hand of the market. Let us recall the Great Depression of 1929–1934 and the experience gained by the USA, a country that revived its economy while maintaining the democratic tradition and the Roosevelt program of solid market stabilization based on administrative methods use. Let us recall also post-war Germany and Japan that used no monetarist schemes either when overcoming the crisis. On the contrary, the government-backed market construction policy was implemented.

**The government must play a leading part in the process of modernization of manufacturing, especially during such a complex period when the government is demanded for "compulsion to innovations".**

In order to get off the oil needle and redirect the national economy towards innovative development model, it is necessary for the government to develop a ***comprehensive incentives program aimed at encouraging industrial development***. It should, on the one hand, facilitate the transition to a more balanced structure of production, and, on the other hand, induce companies to produce innovative and competitive products. At the same time, at the framework of programme it should be formed a list of criteries to be met by the companies expecting to obtain support from the government.

It is not enough to have an idea alone if we want to expand production and foster import substitution. It needs the "long" and cheap money for a period of 5 years at the rates that are below the inflation rate, but there is no such money. Why? Because the Russian Ministry of Finance and the Bank of Russia have implemented a policy for quite a long time that was not aimed at getting the necessary amount of money for the normal economic development, but, on the contrary, was aimed at cutting the monetary supply.

It seems that the people occupying high government positions do not understand the causal

relationship of the inflation process. It is kind of the theater of the absurd. Since 1992, January the governmental struggle against inflation to date has been implemented according to short thought of "*Burattino*": "The less money, the lower the prices". So, the struggle against inflation — it is the struggle against the money supply for the economy using all possible methods. The government does not endorse any other inflation countering measures.

As a result, loans offered to the large and medium-sized businesses have long been an extremely heavy burden for them (even before the Ukrainian crisis and the imposition of sanctions against the Russian companies). The events that have made the situation significantly more aggravated are the collapse of the ruble in December 2014 and a panic reaction to the collapse demonstrated by the Bank of Russia that raised its key interest rate to 17%. As a result, thousands of businesses across the country at once lost an opportunity to get the loan funds as the rates on loans had become prohibitive.

While the majority of the European banks finance businesses and set the rate at less than 0.5% per annum, and Japanese companies receive money at the rate of 0.01% for the period of 10 years!, Russian enterprises have to borrow at the rate of 30–40% per annum. Yet, it is impossible!

At the same time, large companies that no longer have access to loans on the international market started squeezing the medium-sized businesses and individual proprietors from the market. As a result, many of the ideas connected with the SMEs are not implemented, there is no job creation and that would be very helpful given the complex economic conditions with so high *hidden* unemployment rates. The central state bank of any "golden billion" country has the obligation to promote an economic growth as one of its objectives. For example, the European Central Bank is obliged by law "*to maintain price stability*" and "*to maintain the common economic policy*" within the EU. The US Federal Reserve System, in the framework of a third round of quantitative easing (QE3) program, has implemented the redemption of government and mortgage bonds to the amount of $85 billion per month from the financial market participants, with a main aim to reduce the unemployment rate. In Japan, the monetary policy is the basis of so-called "*Abe*nomics" (the economic policy implemented by Prime Minister Shinzo Abe) what ensures pumping the economy with long and cheap money.

The examples above prove that the contemporary national credit-financial system should correspond to the economic development goals and, what is the most important, to be tuned for developing and expanding loan opportunities offered to the real sector.

However, the Russian Central Bank has an opportunity to ignore carelessly all calls for change of its policy in the interests of economic development. Its main activity is targeted on inflation at any cost, even at the cost of the collapse of the entire industrial sector. Neither the Constitution of the Russian Federation nor the Federal Law "On the Central Bank of the Russian Federation" set the goal of promoting economic growth for the regulator to achieve.

To remedy the situation, it is necessary ***to include into the law "On the Central Bank of the Russian Federation" the foundation of the environment for economic growth, growth of investment and employment as objectives of credit and fiscal policy and overall activity of the Central Bank.***

It should also be noted that the Central Bank of Russia does not obey the executive bodies (the President and the government), but is accountable to the State Duma where it is obliged to present a report every year. But, in fact, the State Duma is deprived of the opportunity to influence the policy of the regulator. The law concerning the Central Bank of Russia prescribes that "the State Duma should view the annual report" and "make a resolution" only. It is virtually not possible to punish or call the Bank of Russia senior executives to account. ***In the framework of execution by Central Bank of Russia of the requirements set by head of state in the annual addresses and presidential decrees,*** it is necessary to make another amendment to the law, allowing the State Duma ***directly control and influence the Bank's policy, in order to create an environment that would foster economic growth, contribute to better investment climate and employment growth.***

If the proposed amendments will be introduced into law, then the solution of other issues

aimed at improving the credit and fiscal system in the name of further economic development will be purely technical matter. The technical solutions aimed at supporting the real sector include the ***reduction of the key interest rate to a level comparable with the level of interest rates found in the EU, US and China***.

However, it is a long-term issue. It is now necessary to quickly ***develop and implement a national credit and financial policy that would be in line with the Russian economy modernization and development goals based on combination of easily accessible loans and the low interest rates***.

The basis of this system creates ***the multichannel real sector company financing based on the bank loan backed by the government's guarantees with the mandatory subsiding provided of a certain part of the interest rate***. At the same time, the company financed in this way should guarantee freezing of the output price at a certain level.

In general, given the current situation, it is necessary to support the business sector in every way. This can be done via ***a fiscal stimulus policy based on the combined tax and investment incentive methods***, that is, via abandoning the haphazard "hole-patching" and implementing a policy of a strategic underpinning of budget expenditures. As far as the *investments* are concerned, it is necessary to invest in the infrastructure development projects with a large multiplier effect that make incentives for the regional SMEs development.

For example, it would be an extremely efficient solution for Russia to invest the project under the name of "Far East-Europe" that building high-speed roads and rail routes as a kind of high-tech "Silk Road' of the 21st century". It will be a project based on the public-private partnership cooperation and it can be an international project as well. It is possible to attract investment from China, Japan, Kazakhstan, and South Korea.

At the same time, the integration of the national transport system into the global flow of goods will create the prerequisites for the regional infrastructure development and will contribute to comprehensive solving of such social issues as new job creation, livelihood infrastructure development, and so on.

If we do not start implementing this project soon as possible, that flow of goods transported from Asia to Europe will bypass Russia. Belarus (our EAEC partner) has joined already the Trans-Caspian transport route that bypasses Russia (delivery of goods to Asia via the Ukrainian port of Odessa). While it is premature to speak about the full-scale operation, the foundation has been laid.

*Long-term development banks should allocate investment loans within the infrastructure projects using the targeted lending principle*. Targeted loans should be offered, and, that is extremely important, paid for specific projects only. The borrowers do not have ready cash. They orders complete of specific works and send the subcontractors' invoices to long-term development banks. If the bank considers the work completed relevant to the investment project, it will pay for.

It is necessary to take special care ***to attract the foreign investor***. It is evident that the foreign investments alone will not save us. However, we cannot do without them, since the foreign investment is related directly to the purchase of advanced technologies and we do not have the time to reinvent the wheel. Here rises the following paradox: any respectable investor will not invest unless we achieve political and economic stability. But, it is impossible to achieve economic stability without the capital inflow.

We can suggest the output from that predicament: ***we invest the money, say, from the Russian funds in an international insurance company that insures foreign investors who invest into the Russian projects from all sorts of political risks***.

As concerns *tax policy* it will be reasonably ***to offer a tax holiday to the newly opened businesses for the period of 5 years; to introduce a regressive profit tax; to consider lowering the VAT rate and to avoid increasing social taxes for the period of 5 to 7 years***.

But all this stuff. It is necessary to raise the question of tax policy changes. Not only taxes should be reduced–the entire tax system should be revised as it has turned into a serious obstacle on the way to a "fair" market.

The tax regulators' treatment of the manufacturers is particularly cruel and outrageous as it is much easier to conceal the revenue in the trade sector or the trade intermediation sector

than in the manufacturing sector. It is necessary to implement a selective tax policy within the framework of the import substitution policy while encouraging the production of the goods that are particularly necessary.

The key point is that the principle of taxation should be changed. The tax should be pegged to the property, to the items that one has obtained on a lease or one has acquired, and not to the profit. If the owner is able to pay the tax for what he/she uses, it means that the owner uses the available resources efficiently. This is the only thing that should be seen as crucial by the government. In addition, if we use such an approach, there would be less opportunity to cheat as one can conceal the revenue or profit but no one can hide the property owned.

A special plan should be created to take steps to support the Russian exporters. Today they are the only providers of currency on the domestic market. Exporting companies are also the major employers and a decrease in exports could lead to a large increase in unemployment. The most rapid decline in exports of products is observed not only in the fuel and energy sector, but also in the metallurgical, chemical industry and machine building; and, volume of export might continue to decline.

In our opinion, the following ought to be done to support the national exporters.

1. *Interest rates on loans should be lowered*.

In order to do this, we should develop a methodology of forming and determine a list of strategic enterprises that will obtain refinanced loans on favorable terms. Those measures should be addressed to individual companies–the best companies in any sectors constitute about 2–3% of the total number of companies. Therefore, we need to redirect the support activity from industry-level approach in order to help the best, most successful and significant companies.

2. *We should freeze the growth of natural monopolies' tariffs for a certain period*.

For the export' companies to operate smoothly, the growth of natural monopolies' tariffs should not exceed 1% a year during the next few years.

### ISSUE No. 3. Strong center–weak periphery.

A country can only achieve sustainability if it is supported by the growth of periphery, and not wasting all the resources to develop the periphery.

The Russian government has chosen the second option. The current Russian wealth redistribution system based on the regional transfers has proven to be inefficient. Russia occupies the third place in the world on the list of countries with the largest regional development gap. The regional development gap is huge. Some of the regions already perform at a level that is comparable to the one observed in the European countries while others, on the contrary, now perform at a level that is comparable to the one observed in the poorest African countries. In fact, being the citizens of one state, different region' residents might just as well feel as if they live in different countries.

As the experience gained by the developed countries has shown, the regional development policy is only efficient if it is not prescriptive, but ***is based on incentives***. The vector of regional development should be changed; we should stop encouraging the weak regions to preserve their status quo and ***build an environment that would encourage their development***. Let us recall that Siberia and the Far East were seen as the new points of economic growth in the late 19th and the early 20th century. This was primarily due to a much greater degree of economic freedom that the local farmers, traders, and manufacturers enjoyed.

The government should make certain reforms concerning the regional policy.

**Firstly**, we need to make solid investment in the infrastructure. This would be an asset for both the ordinary people and for the business climate as well.

**Secondly**, it is high time to change the tax legislation. It is necessary to change the proportion of taxes taken from the federal center, regions and municipalities. It is also important to prescribe that the operating enterprises ought to be register at the location where they really operate.

**Thirdly**, it is very important to facilitate the labor resources reallocation and promote labor force mobility. Today, in Russia we observe a paradoxical situation when in some regions more than a 50% of the population is unemployed, while some other regions struggle to attract labor force from abroad.

**ISSUE No. 4. The social injustice has reached a critical degree and has become an obstacle to the economic development.**

In a developed democratic society, the government assumes the responsibility for ensuring employment, for distributing the gains of economic growth in a fair way, for facilitating access to social protection programs, for expanding access to high-quality educational services and training programs for all categories of people who have various incomes.

Unfortunately, socio-economic policy of Russian government do not take into account for a long time, and even now, the things really important for most people, the things that make them happy. It is the availability of a decent job, equal access to education and health care, true support in the old age peoples, a transparent government, and the right to vote as concerns state governance.

Instead, the policy-makers' attention has been focused on a small list of market indicators that includes such indicators as the public property privatization rate, doubling of GDP, trade openness, accession to the WTO, the external debt reduction and inflation rate.

The economic policy was often inconsistent and absurd, was disengaged from reality, and it was implemented without any proper rationale based on scientific researches. As a result, it is logical that we can observe the situation we have found ourselves in, we can see a country where the people are poor and socially unprotected, a country that is lagging behind other countries economically and is living on the proceeds gained from the sales of energy resources.

According to the living standards ranking, Russia occupied the 61st place among 142 countries of the world in 2015 that is between Sri Lanka and Vietnam. As for the economic indicators ranking, it occupied the 75th place; it ranked 99th in the rating of corruption and public administration efficiency; it was 92nd in the rating of the countries with the best security protection; and it occupied the 89th place, as far as the civil freedoms were concerned. With a reputation like that, Russia is sure to keep pushing away, and not attracting even the allies.

According to some representatives of the Russian government, the Western rankings are "rigged" and "wrong". They say that aim of those rankings is to discredit the success of the "new" Russia. We are ready to agree with this point of view but the question arises — what they mean by the success and achievement that those ranking want to discredit. It is not clear at all.

We should honestly admit that no one is interested in borrowing our model of living or our model of social and economic development. For example, the European Union increased the number of its members from 12 to 28 within the period starting from 1994 and ending in 2013 while Russia that has been promoting the idea of its unique historical path has not managed to "integrate" even Belarus into the so-called Union State during all these 20 years.

It is due to the social injustice that has reached a critical degree and has become an obstacle to the economic development. In Russia, an average rich man is 22 times richer than an average poor person — for Moscow is equal to 55. Meanwhile, the income gap is growing steadily!

According to the experts, 70% of the national wealth belongs to merely 1% of the Russian population. Even according to official statistical data, more than 13% of the population lives below the poverty line.

The low quality of life in Russia manifests itself in the fact that the workers' wages are extremely low. Today, for example, the minimal monthly wage amount is 6,204 rubles in Russia. If we take it as a level wage indicator, the level of the Russian indicator is 17 times lower than in Luxembourg, 14 times lower than in France, 10 times lower than in UK, and 4 times lower than in Estonia. Particularly high poverty indicators are observed in the rural areas–around 45% of total population in rural areas. According to the sociologists, 7% of the rural population is malnourished.

The results of opinion polls indirectly confirm the reliability of the information about the disastrous state the population; 61% of the respondents say they have no savings. Therefore, 45% of the respondents say that they are not interested in knowing the currency exchange rates. According to the Federal State Statistics Service, almost 20 million people in the country are now below the poverty line. However, sociologists claim that the official statistical data do not reflect the reality, as we should multiply the figure by three.

***Adam Smith spoke about the consequences of poverty in the 18th century. In particular, he has noted that the meager existence of the working poor is a natural symbol of the country that is stagnant and their fasting — that it goes quickly to the decline.***

We should not underestimate the consequences of the social injustice for the country's development prospects. The impoverished population makes a negative impact upon the demand because lack of demand shrinks supply, i. e. production of goods and services. Absence of interest in producing goods leads to investors' apathy. There is a lack of money. The production sector development is shrinking too, and this affects the country's GDP. The fired employees leave the companies and the unemployed enter the labor market. Another consequence of this is the tax revenues reduction.

The social injustice means not only an uneven distribution of wealth, but also an uneven distribution of needs related to accommodation, health, education, etc. According to the data gathered by the All-Russia Center for Living Standards Studies, 40% of the people in our country consider themselves poor. In their opinion, it is not possible for them to live a long life, to maintain health, to be educated themselves and to educate their children; they do not have access to the funds that would ensure a decent standard of living.

Quality of life deterioration leads to the collapse of the social and community sector, depopulation, and this, in turn, leads to a demographic disaster, the growth of the number of unpopulated territories that might get out of control. When the latest census was organized, records fixed numerous abandoned villages and ghost-towns, and the growth in their number was recorded too. This happens because of continuing decline in the number of ethnic Russians.

Social injustice is related directly to constrained labor force migration ("brain drain"). According to official data, more than 1.2 million people left Russia and went to work abroad during the three years' period, 40% of them are the people who have a tertiary degree (researchers and university graduates). Those are the ones who could "file a request" for the political and economic system modernization.

Low wages and poverty of the vast majority of the population is an insurmountable obstacle on the way to forming the middle class, the main "consumer" of the civil rights. As a result, we can observe an unaccountable to society government, a bureaucracy class that has "privatized" their powers, a systemic corruption and civic apathy.

As the population impoverishment process continues, the above issues will become increasingly pressing until they reach a critical level, and this would be a great danger. Most people willingly put up with the difference in incomes, which is determined by the market, skills, knowledge, abilities, and personal preferences. Yet, there is always a limit. If the degree of inequality goes beyond all possible boundaries, a feeling of injustice emerges, thus increasing social tensions, and the disagreement begins to grow.

*We would like to add the following for those who are interested in the relationship between politics and the economy. The Gini index that represents the income distribution of a nation's residents increased from 0.35 in 1905 to 0.39 by 1916. The Gini index was 0.26 in 1991 — today it is 0.42.*

In order to stop the social and economic degradation, it is necessary, firstly, to develop a ***government program aimed at countering poverty*** and define the timeframes, identify the measures, and the persons in charge of the project implementation. This is a complex comprehensive program. Here we should take into account the impact on solvent demand such indicators as the tax burden growth, inflation rate, price increase, rising unemployment rate, fall in real wages, etc.

One of the ways to resolve the issue should be the progressive taxation scheme that is in place in developed countries. The tax on the windfall is 40% in the USA and 60% in Sweden and France. Unfortunately, the redistribution process does not exist in Russia as the flat tax scale (of 13%) is in place for the rich and the poor, and the government does not intend to abolish it.

There is one more point we would like to make. There should be ***employment support*** programs in place. The unemployment is one of the main characteristics of the economic condition. We should not underestimate the impact it makes upon the national development prospects.

In order to improve the labor market situation, first, ***it is necessary to create tax incentives***

***for the companies that create jobs for the high-qualified personnel, and to reimburse the companies' cost of tuition or advanced training of employees while taking steps to support labor mobility*.**

Another step that should be taken to support the people is creation of affordable housing market. Affordable housing construction will not only mend the social injustice, but will also create incentives for the economy to develop, create jobs, improve the tax base and contribute to developing the adjacent industries. Therefore, the apartment buildings should be constructed rapidly in large quantities and on a vast territory in order to achieve economic recovery in the period of a crisis. Construction of buildings to be used by the people who leave the old and substandard housing relieves the social tension and makes the houses where the living conditions are unsuitable disappear. In the end, comfortable housing is needed for a normal family to be built.

## ISSUE No. 5: Corruption

Key issues that contemporary Russia faces are either caused by corruption or greatly aggravated by it. Although this social evil has been actively discussed over the past 10 years, not all the people are aware of the fact that corruption is one of the main reasons why our country is degrading. What are the ways to counter corruption? There are many methods available. There should be a will to do it, and, by the way, there is no such will.

For example, Lee Kuan Yew, ex-Prime Minister of Singapore (1965–90), made everyone recognize corruption as the major threat to society in an attempt to eradicate this evil. He consistently dismissed his closest associates involved in corruption from the civil service and brought them to justice. As a result, the country has managed to get out of the third world country category, join the club of the first world countries and acquire influence in global politics over a relatively short period of time. During the period of 1965–90, the country saw a 32-fold increase in the GDP per capita; it was $36,897 in 2014. You can compare it with the Russian figures. The indicator was $6,923 in 2014 and $3,784 in 1990. This means the difference is only 1.8 times. As they say — eel the difference.

## CONCLUSIONS

1. We should admit that the national economic development program chosen by the liberal financial and economic wing of the Government has gone bankrupt. This is a fact and not the subject of a researchers' dispute. Today's Russia is no longer a growing and developing superpower. It is merely trying to maintain the status quo and not to collapse. We drove our economy into a severe crisis. As a result, we are among the developing countries as far as the level of consumption is concerned.

2. The goal we should achieve just now is to break the trend of decline in production. We need to take all economic measures to encourage the investment into the production sector through preferential taxation of profits, preferential lending and by taking other steps, including the government funding. We need to create an environment where the people who are able to produce the products that the country needs have an opportunity to do so. After the WWII, all the major capitalist countries' governments implemented the policy of investment process regulation at the macro level, and it was never a barrier to market orientation.

3. We will revive the country and occupy a place we deserve in the world economy and politics. Yet, to do so, we should not use a scheme aimed at destructing the entire economic sectors, occupations and regions developed by the IMF experts for the so-called third world countries. If we do not make corrections in the economic development program, we might just not talk about moving towards the market, but start developing a mere survival program of the nation. We will have to take non-market measures in this case.

4. The biggest liberals' political failure is the discreditation of concepts of a market and democracy. Everyone has the right to be wrong. No one is immune from making a mistake. However, the pseudo-liberal economic and finance wing of the government should bear the responsibility before the country, and it should reintroduce the concept of a market as well. The reformers acting in 1992–93 years have discredited the market concept. The reason for this was not the reformers' mistakes (as anyone can make a mistake) but their stubbornness in defending the wrong decisions. As a result, we have discarded the totali-

tarian economy and built not a market economy but an economy backed by the mafia people and other criminals.

We have been engaged in reforms for 25 years. Nevertheless, there is to date consistent social protection program and national industrial development program in place. We used to focus on the primary industry sector development and we still focus on this. There has been no high-tech exports industry, and the sector is still non-existent. We have no class of property owners who can stabilize the society. People start perceiving the concept of a market in a negative way as they focus on the negative aspects of life (profiteering, unfair enrichment, unjustified social differentiation, etc.)

5. Today, once again the government demonstrates contempt for the people when they are doing an economic experiment where people are involved. They revive such Bolshevism characteristic features as scolding of the people who are allegedly immature and who do not allow the government to carry out reforms, the old term "a bright future" is used again. The best example of such attitude is a speech pronounced at the Gaidar Forum in 2016, where without any hesitation the Russian people were named the *downshifters* ("to downshift" means "to change to a lower gear when driving"). The downshifters are the people who prefer leave well-paid jobs and top post to spend quiet evenings at home, be engaged in their hobbies, to spend their Saturdays at cottage houses or their holidays in Goa–to each his own.

I sincerely wish the government success. However, I am afraid that the stubbornness demonstrated by it when it comes to the economic policy can compromise the market concept and lead to a social upheaval. Yet, that would be a tragedy.

# Microfinance: leverage or quagmire?

***Zbigniew MIERZWA,***
*PhD in economics, Financial University under the Government of Russian Federation, Moscow,*
*ZEMezhva@fa.ru*

**Abstract.** Whether microfinance is all that its proponents claim? Promoters have hailed microfinance as the silver bullet of development. Advocates say that providing small amounts of credit to the world's poor can break their cycle of poverty. However, the mixed results of a wide array of impact assessments leave skeptics wondering whether microfinance really does alleviate poverty beyond anecdotal instances. Some experts have suggested that no more than five percent of microfinance institutions (MFIs) worldwide will ever be sustainable. Maybe, the reality is that microfinance may be guilty of over-promising and under-delivering, but it is still an effective development tool. A number of studies have reached what is now perhaps an obvious conclusion: programs that focus on poverty alleviation rather than those that focus on financial results are more effective at reaching the very poor. The world is still full of poor people, and the problem of underdevelopment remains one of the intractable challenges of the global economy. For the time being we only put questions. In the next issues of journal we will try to find answers on these questions.

**Keywords:** microfinance, poverty alleviation, microfinance institutions, financial inclusion, social inclusion, middle class, self-employment, extreme poverty, microcredit, inclusive finance sector, debt-trap.

# Микрофинансирование: рычаг или трясина?

***Збигнев МЕЖВА,***
*доктор экономических наук, Финансовый университет при Правительстве Российской Федерации,*
*ZEMezhva@fa.ru*

**Аннотация**. Является ли микрофинансирование тем, о чем говорят его сторонники? Сторонники микрофинансирования провозглашают его чуть ли не «серебряной пулей», стимулирующей экономическое развитие. Они утверждают, что предоставление небольших сумм кредита бедным может преломить замкнутый круг нищеты. Однако противоречивые результаты оценки влияния микрофинансирования приводят скептиков к заключению, что микрофинансирование действительно способно устранить нищету. Часть экспертов придерживается мнения, что во всем мире не более 5% микрофинансовых организаций являются устойчивыми. Может быть, в действительности от микрофинансирования слишком многого ожидали, а результаты оказались менее значительными, но, тем не менее, оно оказалось и остается довольно эффективным средством стимулирования развития. Проведенные исследования обнаружили факт, который кажется сегодня очевидным, что программы, нацеленные на устранение нищеты, в отличие от программ, нацеленных на достижение высоких финансовых результатов, являются более эффективным способом борьбы с нищетой. В этой статье автор лишь обозначает вопросы для дальнейшего обсуждения в последующих выпусках журнала.

**Ключевые слова:** микрофинансирование, устранение нищеты, микрофинансовые организации, финансовое включение, социальное включение, средний класс, самозанятость, крайняя нищета, микрокредит, инклюзивный финансовый сектор, долговая ловушка.

The modern use of the expression "*micro-financing*" has roots in the 1970s when organizations, such as Grameen Bank of Bangladesh with the microfinance pioneer Muhammad Yunus, were starting and shaping the modern industry of micro-financing. Another pioneer in this sector is Akhtar Hameed Khan. The history of micro-financing can be traced back as far as the middle of the 1800s, when the theorist Lysander Spooner was writing about the benefits of small credits to entrepreneurs and farmers as a way of getting the people out of poverty. Independently of Spooner, Friedrich Wilhelm Raiffeisen founded the first cooperative lending banks to support farmers in rural Germany.

Microfinance finds fertile ground in countries and markets where traditional financial institutions have failed to reach the poor. In these countries, the supply of capital to micro-entrepreneurs and low-income households is far below demand. Microfinance addresses this gap by providing previously excluded populations with access to formal financial services such as credit loans, savings accounts and payment transfers. The alternatives to microfinance are either lack of access to these services or reliance on informal sources. The latter includes, at best, family and friends under similar economic duress or, at worst, unregulated private lenders with potentially predatory and usurious practices.

Today microfinance is a source of financial services for entrepreneurs and small businesses lacking access to banking and related services. The two main mechanisms for the delivery of financial services to such clients are: (**1**) relationship-based banking for individual entrepreneurs and small businesses; and (**2**) group-based models, where several entrepreneurs come together to apply for loans and other services as a group. In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which is closer to the *retail finance model* prevalent in mainstream banking. So, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses.

In paper "The Paradigm Shift in Microfinance: A Perspective from HIID," which was presented by Marguerite Robinson at the HIID History Conference held in Bermuda in March 1995, she analyzes HIID's role in the *development of sustainable microfinance*. The Harvard Institute for International Development (HIID) was a center within Harvard University between 1974 and 2000. It is about the history of an idea– that the massive demand for microfinance in developing countries can be supplied by **sustainable institutions** providing financial services commercially, and that these services can have important effects on *social* and *economic development*. She stressed that derived from supply-leading finance theory, the "*old paradigm*" of ***subsidized credit*** for lower-income borrowers, especially in rural areas, was well entrenched in most of the developing world. Microfinance as a commercial institutional activity was generally perceived by policymakers and by the formal financial sector as unimportant for the economy, unprofitable for financial institutions, and unnecessary for the poor. This remains the prevailing view in most developing countries today. However, the ***paradigm shift*** in microfinance in the developing world was marked by the change from government and donor-funded subsidized credit to ***sustainable financial intermediation***. Despite the widespread demand for financial services — for both credit and savings facilities– it is estimated that *institutional finance* is unavailable to about **90 percent** of all households in developing countries.

**Very small enterprises** (**VSEs**) over the world represent a broad and heterogeneous segment, often underserved by formal financial institutions[1]. They are generally informal and often family businesses. The financial needs of these enterprises are typically overlooked by "downscaling" banks, which find larger and often more formal small and medium enterprises (SMEs) to be a more natural market for their products and services. ***Microfinance Institutions*** (MFIs) are starting to move upmarket to serve SMEs, and in particular, VSEs within this segment. However, they use varying definitions, methodologies and products to do so and to date there has been little research or documentation of their experiences. VSEs are considered to be those businesses with financing needs of

[1] See, for example, Experiences of microfinance institutions serving very small to small enterprises in Latin America. International Finance Corporation in Partnership with Dutch Government, 2014.

between US$7,000 and US$30,000. It is a starting point for an institution considering entering the segment, or for one that finds itself having grown into the segment "organically" but with a view to strengthen its position.

For some, microfinance is a movement whose object is "*a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers*"[2]. Many of those who promote microfinance generally believe that such access will help poor people out of poverty, including participants in the **Microcredit Summit Campaign**.

For others, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses.

Microfinance is a broad category of services, which includes microcredit. Microcredit is provision of credit services to poor clients. Microcredit is one of the aspects of microfinance and the two are often confused. Critics may attack microcredit while referring to it indiscriminately as either "microcredit" or "microfinance". Due to the broad range of microfinance services, it is difficult to assess ***impact***, and very few studies have tried to assess its full impact.[3] Proponents often claim that microfinance lifts people out of ***poverty***, but the evidence is mixed. What it does do, however, is to enhance ***financial inclusion***.

**Accion International** (2015) defines ***microfinance*** as the provision of financial products and services, focused on serving low-income clients, who often lack access to formal financial services. Microfinance is sometimes used as a synonym for microcredit, although microfinance refers to the provision of services beyond credit, including savings, insurance and payments. Microfinance as a segment has evolved from the first microcredit pilots a few decades ago that proved that the poor need to, and can, use *financial services*. Microfinance as a segment has its roots in and advocates the use of financial services in a way that enhances and does not harm the lives of its low-income clients. Despite its rapid growth, there are still over 2bn people who lack access to financial services, and this has inspired the more recent push for financial inclusion.

***Microfinance institutions*** **(MFIs) Accion International** (2015) defines as institutions that provide financial services to low-income populations. MFIs can take many forms including, bank, nonbank financial institution (NBFI), CUs or nongovernmental organisation (NGO). The term MFI often refers to institutions primarily focused on serving low-income populations and who self-identify with the microfinance movement, often with a focus on ***microenterprise credit***. The term can also be used to refer to any financial institution serving low-income populations.

[2] Robert Peck Christen, Richard Rosenberg & Veena Jayadeva. Financial institutions with a double-bottom line: implications for the future of microfinance. *CGAP Occasional Paper*, July 2004, pp. 2–3.

[3] Feigenberg, Benjamin; Field, Erica M.; Pande, Rohini. (2010). Building Social Capital Through Micro Finance. *NBER Working Paper No. 16 018*.

**BOX 1**

***Microcredit Summit Campaign***

Founded: 1997

Type: Non-profit

Focus: Microfinance education, Health education, Poverty measurement

Location: Washington, DC

Area served: Asia, Africa, the Americas, Middle East

Key people: Larry Reed, Director; co-Founders are Sam Daley-Harris (also former Director), Professor Muhammad Yunus (Grameen Bank), and John Hatch (FINCA)

Website: http://www.microcreditsummit.org

The Microcredit Summit Campaign, an American non-profit organization, started as an effort to bring together microcredit practitioners, advocates, educational institutions, donor agencies, international financial institutions, non-governmental organizations and others involved with microcredit around the goal of alleviating world poverty through microfinance. The Campaign was founded by Muhammad Yunus, Sam Daley-Harris, and John Hatch on a principle that empha-

sized a citizen-led approach of establishing and meeting a collective global goal. The Campaign represents more than a single organization and is a social movement that aims to advance the microfinance field and foster a productive learning community.

The first Microcredit Summit was held February 2–4, 1997 in Washington, DC. The first summit had approximately 3,000 in attendance from 137 countries. The outcome of the first Summit was the launch of a "campaign" to reach **100 million** of the world's poorest families, especially the women of those families, with credit for self-employment and other financial and business services by the year 2005. In January 2009, to coincide with the release of the *State of the Microcredit Summit Campaign Report 2009* (SOCR), the Microcredit Summit Campaign announced that over 100 million of the world's poorest families had received a microloan.

*List of Microcredit Summit Campaign Conferences*

1997, Microcredit Summit, Washington, DC, February 2–4.
1998, Global Microcredit Summit, New York City, June 24–27.
1999, Global Microcredit Summit, Abidjan, Côte d'Ivoire, June 24–27.
2000, Middle East/Africa Regional Microcredit Summit, Harare, Zimbabwe, October 8–13.
2001, Asia/Pacific Regional Microcredit Summit, New Delhi, India, February 2–5.
2001, 1st Latin America/Caribbean Regional Microcredit Summit, Puebla, Mexico, October 9–12.
2002, Global Microcredit Summit +5, New York City, November 12–13.
2004, Asia/Pacific Regional Microcredit Summit, Dhaka, Bangladesh, February 16–19.
2004, Middle East/Africa Regional Microcredit Summit, Amman, Jordan, October 10–13.
2005 Latin America/Caribbean Regional Microcredit Summit, Santiago, Chile, April 19–22.
2006, Global Microcredit Summit, Halifax, Canada, November 12–15.
2008, Asia/Pacific Regional Microcredit Summit, Bali, Indonesia, July 28–30.
2009, Latin America/Caribbean Regional Microcredit Summit, Cartagena, Colombia, June 8–10.
2010, Africa/Middle East Regional Microcredit Summit, Nairobi, Kenya, April 4–7.
2011, Global Microcredit Summit, Valladolid, Spain, November 14–17.
2013, Partnerships against Poverty Summit, Manila, Philippines, October 9–11.

## MICROFINANCE AND POVERTY

Microfinance as the best way of tackling poverty is under attack. It has been accused of failing to help the poor, of treating its clients badly, of charging high interest rates and of encouraging poor people to take on excessive debt burdens. The paradox is that the discussions on the downturn start in South Asia, where microfinance began and has flourished since the 1970s. The reality is that microfinance may be guilty of over-promising and under-delivering, but it is still an effective development tool.

Questions arise: What has all this money bought for so many people? Has the incidence of poverty measurably declined? Can it be said that these hundreds of millions of individuals and their families have lifted themselves out of poverty on the basis of the microloans they have received?

The concept of poverty is complex and strongly influenced by local cultural and socio-economic conditions. The poverty assessment approach ought to support a flexible definition of poverty that can be adapted to fit local perceptions and conditions of poverty. The tool for poverty assessment has to be used as a means neither to target new clients nor to assess the impact of microfinance services on the lives of existing clients. It can provide a useful means to verify — both for the donor and the MFI — the extent to which an existing strategy results in poor clients joining the MFI.

In developing economies and particularly in rural areas, many activities that would be classified in the developed world as financial are not-monetized: that is, money is not used to carry them out. This is often the case when people need the services money can provide but do not have dispensable funds required for those services, forcing them to revert to other means of acquiring them. In their book "*The Poor and Their Money*", Stuart Rutherford and Sukhwinder Arora[4] cite several types of needs:

[4] Rutherford, Stuart; Arora, Sukhwinder (2009). The poor and their money: micro finance from a twenty-first century consumer's perspective. Second edition. Warwickshire, UK: Practical Action Publishing.

*Lifecycle Needs*: such as weddings, funerals, childbirth, education, home building, widowhood and old age.

*Personal Emergencies*: such as sickness, injury, unemployment, theft, harassment or death.

*Disasters*: such as fires, floods, cyclones and man-made events like war or bulldozing of dwellings.

*Investment Opportunities*: expanding a business, buying land or equipment, improving housing, securing a job (which often requires paying a large bribe), etc.

People find creative and often collaborative ways to meet these needs, primarily through creating and exchanging different forms of non-cash value. Common substitutes for cash vary from country to country but typically include livestock, grains, jewelry and precious metals. As Marguerite Robinson describes in "*The Micro finance Revolution*", the 1980s demonstrated that "micro finance could provide large-scale outreach profitably," and in the 1990s,[5] "micro finance began to develop as an industry". In the 2000s, the microfinance industry's objective is to satisfy the unmet demand on a much larger scale, and to play a role in reducing poverty. While much progress has been made in developing a viable, commercial microfinance sector in the last few decades, several issues remain that need to be addressed before the industry will be able to satisfy massive worldwide demand. The obstacles or challenges to building a sound commercial microfinance industry include:

- Inappropriate donor subsidies.
- Poor regulation and supervision of deposit-taking microfinance institutions (MFIs).
- Few MFIs that meet the needs for savings, remittances or insurance.
- Limited management capacity in MFIs.
- Institutional inefficiencies.
- Need for more dissemination and adoption of rural, agricultural micro finance methodologies.

Microfinance is also the proper tool to reduce ***income inequality***, allowing citizens from lower socio-economical classes to participate in the economy. Moreover, its involvement has shown to lead to a downward trend in income inequality[6].

*Microfinance Poverty Assessment Tool*

**The Consultative Group to Assist the Poor** is a global partnership of 34 leading organizations

[5] Robinson, Marguerite. (2001).The Microfinance Revolution: Sustainable Finance for the Poor (Lessons from Indonesia. The Emerging Industry). The International Bank for Reconstruction and Development/The World Bank, Communications Development Incorporated, Washington, D.C. and San Francisco, California.

[6] Hermes, Niels. (2014). Does microfinance affect income inequality? Applied Economics, 46(9), 1021–1034. Also: Yunus, Muhammad & Jolis, Alan (contributor). (2008). Banker to the Poor: Micro-Lending and the Battle Against World Poverty. Public Affairs.

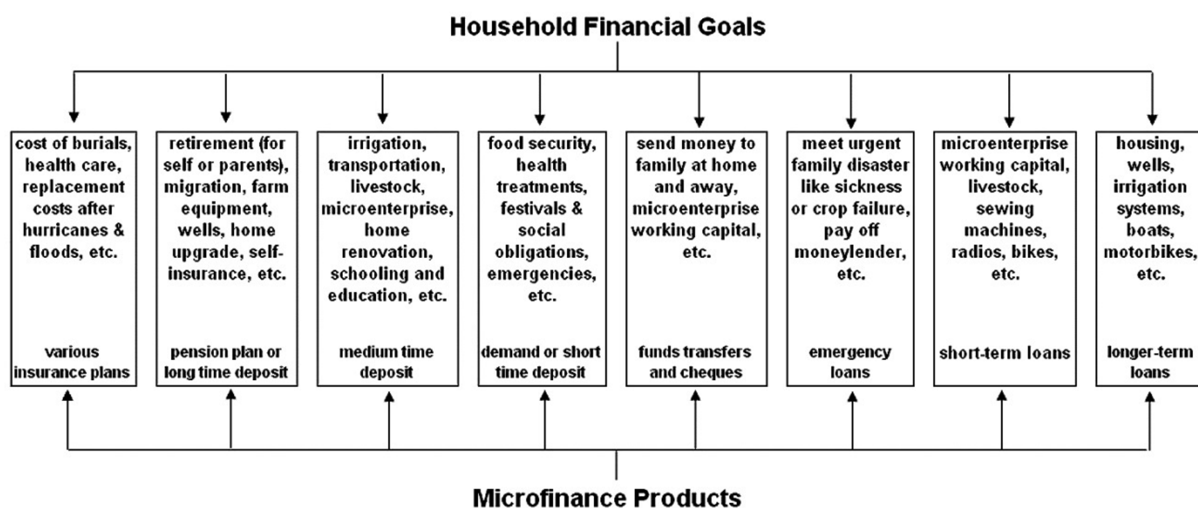



*Figure 1.* **Financial needs and financial services**

that seek to advance financial inclusion. CGAP develops innovative solutions through practical research and active engagement with financial service providers, policy makers, and funders to enable approaches at scale. Housed at the World Bank, CGAP combines a pragmatic approach to responsible market development with an evidence-based advocacy platform to increase access to the financial services the poor need to improve their lives.

The Consultative Group to Assist the Poor (CGAP) is committed to the twin objectives of increasing the **financial sustainability** of MFIs and deepening their poverty focus — that is, increasing their *outreach* and *impact* on the lives of poorer people. As part of this commitment, CGAP has continually endeavored to provide tools that allow for greater transparency on the performance of microfinance institutions (MFIs) in meeting these objectives. To date, the focus on *transparency* in microfinance has centered primarily on *financial performance*. The *Microfinance Poverty Assessment Tool* was developed as a much-needed tool to improve transparency on the depth of MFI *poverty outreach*[7].

In addition, the tool supports the comparison of ***poverty outreach*** among MFIs and across countries. The methodology is applicable to all MFIs, regardless of their location, client structure, or outreach approach. When used in conjunction with the *CGAP Format for Appraisal of Microfinance Institutions* (1999), the *Microfinance Poverty Assessment Tool* provides a straightforward means of gauging the likelihood than an MFI can reach poor clients while relying predominantly on *commercial funding*.

In recent years, several tools have emerged to assist donors in their assessment of the institutional performance of MFIs. One example is the *CGAP Format for Appraisal of Microfinance Institutions*, which contains practical guidelines and indicators for measuring MFI performance on a range of issues, including governance, management and leadership, mission and plans, systems, operations, human resource management, products, portfolio quality, and financial analysis. Analysis of these institutional features allows an appraisal to consider an institution's potential for viability and/or sustainability.

At the same time, the proliferation of tools such as the *CGAP Appraisal Format* has encouraged transparency and the development of standards for financial sustainability in microfinance. Currently, no rigorous tool exists to measure the poverty level of MFI clients. In order to gain more transparency on the depth of poverty outreach, CGAP collaborated with the **International Food Policy Research Institute** (**IFPRI**) to design and test a simple, low-cost operational tool to measure the poverty level of MFI clients relative to non-clients. This tool is a companion piece to the *CGAP Appraisal Format;* donors should not use the poverty assessment tool without also conducting a larger institutional appraisal.

*Micro-enterprise loans*

Grameen Bank is an excellent example of microfinance institution which has steered many poor to cross over the poverty line. The Bank continues to stand by them to help them reach even higher echelons of prosperity. The Bank provides larger loans, called ***micro-enterprise loans***, to these fast moving members. There is no restriction on the loan size. So far 8,640,225 members availed of the micro-enterprise loans. Average loan size is BDT 33,726 (USD 435). The maximum size of a single loan taken so far is BDT 4.0 million (USD 51,606) for fish feed, poultry feed, fish cultivation and fish business. The other major categories of activities financed are grocery shops, pharmacy, dairy farms, auto-rickshaw for transportation and stone business for construction. This programme has initiated a silent revolution in rural Bangladesh by encouraging leadership and entrepreneurial qualities and self-employment opportunities.

The interest rates of the Bank are structured with an eye on the financial status and repayment capacity of the borrowers. It does not subscribe to the conventional wisdom of loading the cost of funds for calculating interest rates for lending to the ultra-poor. On the basis of this principle the interest rates on loans for the 4 categories of Grameen Bank borrowers are as follows[8]:

[7] Henry, Carla; Sharma, Manohar; Lapenu, Cecile; Zeller, Manfred. (2003). Microfinance Poverty Assessment Tool. Consultative Group to Assist the Poor. Technical Tools Series, No. 5.

[8] ANNUAL REPORT 2014. Grameen Bank.

*Table 1*
**Grameen Bank's interest rates**

| Loan Category | Interest Rate per annum |
|---|---|
| Loans for Income Generating Activities (IGA) | 20% |
| Housing Loans | 8% |
| Higher Education Loans | |
| i. During the study period of about 3–5 years | 0% |
| ii. After the study period | 5% |
| Struggling Members (beggars) Loans | 0% |

*Source: ANNUAL REPORT 2014. Grameen Bank.*

**BOX 2**

The Grameen Bank is a Nobel Peace Prize-winning microfinance organization and community development bank founded in Bangladesh. It makes small loans (known as microcredit or "grameencredit") to the impoverished without requiring collateral. The name Grameen is derived from the word gram which means "rural" or "village" in the Bengali Language.

Grameen Bank originated in 1976, in the work of Professor Muhammad Yunus at University of Chittagong, who launched a research project to study how to design a credit delivery system to provide banking services to the rural poor. Based on his results, in October 1983 the Grameen Bank was authorized by national legislation as an independent bank. In 1994, Grameen Bank received the ***Independence Day Award*** in 1994, which is the highest government award. In 2006, the bank and its founder, Muhammad Yunus, were jointly awarded the ***Nobel Peace Prize***. In 1998 the Bank's "Low-cost Housing Program" won a ***World Habitat Award***. In 2011, the Bangladesh Government forced Yunus to resign from Grameen Bank, saying that at age 72, he was years beyond the legal limit for the position.

Last book of Muhammad Yunus with Alan Jolis. (2013). *"Banker to the Poor: The Story of the Grameen Bank"* is enthralling story of how he did it: how the terrible famine in Bangladesh in 1974 focused his ideas on the need to enable its victims to grow more food; how he overcame the sceptics in many governments and among traditional economic thinking; and how he saw his micro-credit extended even outside the Third World into credit unions in the West. Such is the importance of his book that HRH the Prince of Wales has contributed a Foreword in which he hails "a remarkable man [who] spoke the greatest good sense".

The Bank's 2,568 branches serve over 81,000 villages constituting close to 97% of the country's landscape. About 100,000 new members joined Grameen Bank in 2014 swelling the aggregate number of members to a staggering **8.64 million**. Women continue to remain in the forefront to carry forward the Bank's mission for empowerment of the poor. During the year 2014 their ratio grew further to 96.26% from 96.19% of 2013. More detailed information you can find at "ANNUAL REPORT 2014" of Grameen Bank.

While the success of the Grameen Bank has inspired the world, it has proved difficult to replicate this success. In nations with lower population densities, meeting the operating costs of a retail branch by serving nearby customers has proven considerably more challenging. Hans Dieter Seibel, board member of the *European Microfinance Platform*, is in favour of the ***group model***. This particular model (used by many microfinance institutions) makes financial sense, he says, because it reduces ***transaction costs***. Very poor people only ever make minimum payments, so if you work with groups of five clients, for example, your expenses are spread accordingly. That is why many MFIs work that way. Once the most urgent need has been met, however, the

need for individual loans grows, and customers no longer want to guarantee payments of other customers. Microfinance programmes also need to be based on local funds.

The fundamental error is to believe that development can be achieved in the same way as reconstruction. Development, however, is quite different — and far more difficult. The idea was that developing countries first and foremost needed capital which their banks would distribute sensibly. Accordingly, no serious attempts were made to mobilize capital in the countries themselves. Furthermore, there were hardly any private-sector banks, so government-run banks distributed the funds. For political reasons, they would grant loans at very low interest rates or even simply cancel debts. They made funds available for large prestige projects, but did not finance a broad range of small-scale and mid-sized industries. So, says professor Seibel, the financial systems of most developing countries never served their main purpose: they failed to **mobilize savings** in order to enable local investment and thus get self-supporting economic development going[9].

***Self-supporting*** **financial institutions with strong local roots are of utmost importance for economic development — and, as a consequence, for poverty reduction too**. Today, there is a trend away from long-term donor-dependent models, even though these models are very convenient for donors with their chronic need to disburse massive funds.

## ILO: MAKING MICROFINANCE WORK

ILO vision for the 21st century is **decent work for all**[10]. Decent work embraces various aspects of daily life of the working poor — productive employment, safe working conditions, equitable access to employment opportunities, absence of child labour, abolition of bonded labour, formalization of informal enterprises, access to social protection and the right to organize. The International Labour Organization (ILO) invests in microfinance, and in the capacity building of MFI managers in particular, because it believes that microfinance can help realize its vision of decent work for all.

Microfinance is an important strategy for the ILO because it contributes to the decent work agenda in a variety of ways. Microcredit and micro-leasing products provide opportunities for small investments in *self-employment* and *job creation*. Emergency loans, savings and micro insurance provide the means for poor people to better cope with risk. When microfinance is delivered through group-based models, it can provide opportunities for the poor to organize and have a voice. Some MFIs, particularly those that partner with other public or private actors in pursuit of a social mission, are actively discouraging child and bonded labour, and helping micro entrepreneurs to grow and formalize.

Entrepreneurs in the informal economy, and the employees that work in those businesses, are often exposed to difficult and dangerous working conditions. The tools used to identify, prevent and rectify such conditions in the formal economy — including social dialogue between employers and employees, labour inspection and other applications of labour law–generally do not apply to the unregistered enterprises that proliferate in many emerging economies. Consequently, alternative approaches are required. But how can one reach these enterprises and influence their conditions?

***Microfinance institutions*** (MFIs) are a potential conduit. In many emerging markets, they have significant outreach, providing financial services to thousands, if not millions of small and micro enterprises. Since their primary relationship with these entrepreneurs often involves an enterprise loan, they could theoretically use that leverage to encourage or entice improvements to conditions in the business.

From 2008 to 2012 the International Labour Organization collaborated with 16 microfinance institutions (MFI) to test a range of approaches to foster social impact through the delivery of innovative financial and non-financial services. Eliminating child labour, fostering the formalization of enterprises, reducing vulnerability and enhancing business performance through improved working conditions — these are decent work objectives that the MFIs addressed in the

[9] "Local roots". Interview with Hans Dieter Seibel. D+C/E+Z, 2010 at: http://www.dandc.eu/en/article/why-microcredit-programmes-should-be-based-local-savings.

[10] ILO. (2014). Microfinance for Decent Work. Enhancing the impact of microfinance: Evidence from an action research programme. Social Finance Programme & Mannheim University 2014.

framework of the "*Microfinance for Decent Work*" (MF4DW) action research programme.

As the focal point for microfinance within the ILO, the ***Social Finance Programme*** initiated also the development of the Making Microfinance Work training series in 2003, building on another area of ILO expertise and concern–***management***. The ILO has a long history of involvement in strengthening management practices as a strategy for improving labour relations and working conditions. Its **International Training Centre** (**ITCILO**) in Turin, Italy has been developing and delivering management training curricula for more than four decades. The ITCILO brought this experience to bear when it joined forces with the Social Finance Programme to produce this book and its accompanying training curriculum.

The end result is a quality product that draws from management experiences both within and outside of the microfinance industry. It incorporates the perspective of a wide range of actors, including regulated financial institutions, governments, trade unions and non-governmental organizations. The ILO's unique governance structure, in which workers, employers and governments participate equally in decision-making, puts it in a privileged position to explore how public and private sector actors can work together to expand the outreach and impact of microfinance. With this course, the ILO hopes to facilitate broader and more innovative use of financial services to help create decent work for all low-income people. The course is a natural complement to other training packages created by the Social Finance Programme and ITCILO, most notably on leasing, micro insurance and guarantee funds.

*What is Making Microfinance Work?*

**Making Microfinance Work** (MMW) is a management training program that is designed to strengthen microfinance managers' ability to increase the quality and scale of their institution's outreach. The program consists of two volumes:

**Volume I: Managing for Improved Performance.** This course, supported by a 400-page manual, helps managers develop a holistic understanding of the different functions that contribute to successful microfinance operations. It provides tools and guidance that managers can use to improve the strategy, marketing, risk management, organizational architecture, efficiency and productivity of their unit, branch or institution.

**Volume II: Managing Product Diversification.** This course, supported by a 600-page manual, aims to inspire and prepare managers to expand their institutions' outreach beyond what has already been achieved. It explores the opportunities and challenges presented by ten different types of products and eight market segments. It provides tools and guidance for managing the product diversification process as well as the ongoing delivery and maintenance of a diverse product portfolio.

The MMW program draws from the experiences and techniques of microfinance service providers worldwide. It is delivered through a network of more than 100 ITC ILO certified trainers in 38 countries and nine languages (Arabic, Bahasa Indonesia, Chinese, English, French, Portuguese, Russian, Spanish, and Vietnamese).

In 2000, the International Labour Organization began providing management training courses to MFIs, both at its International Training Centre in Turin and in developing and transition countries. However, it soon became evident that the demand for this type of training far exceeded what could be supplied by the ILO itself. MFIs were growing and were typically staffing their growth by promoting their best loan officers into middle management positions. Very few received training or systematic coaching on how to manage before assuming their management responsibilities, and this was increasing MFIs' risk exposure as well as limiting their growth. Weak middle managers were liable not only to make poor decisions, but also to be ineffective at empowering others to implement wise decisions. Institutions needed a quick and cost-effective mechanism for strengthening their middle management capacity.

Although numerous training curricula existed for microfinance managers, they tended to focus on specific technical areas, were delivered only in one country, or were available only in one or two languages. To quickly and massively build capacity at the middle management level, the industry needed a holistic curriculum that could be delivered with quality by local trainers

in many locations and in many languages with adaptations that were appropriate for the local environment.

Between 2003 and 2006, the ILO re-packaged its microfinance management training materials into a format that could be rolled out to training providers in developing and transition countries, and it created a rigorous three-phase certification process for building the capacity of local resource persons to deliver the content with specific quality standards.

The first volume of training materials was published as *Making Microfinance Work: Managing for Improved Performance* in 2006. The second volume was published as *Making Microfinance Work: Managing Product Diversification* in 2011. Originally designed as a sixth section of the first volume, the content of the second volume was removed and elaborated after participants in the Volume I pilot tests asked for more information on product options and more time to discuss issues related to product diversification.

*Is MMW needed today?*

Despite its well-known accomplishments, the microfinance industry has come under increasing criticism for failing to meet expectations. More than 2.5 billion people still have no access to formal financial services and those who do have access are not necessarily moving out of poverty. This begs an important question: why is microfinance not meeting its potential as a mechanism for facilitating *financial inclusion* and *poverty alleviation*?

There are many answers to this question, some of which include:

- Sustainability and profitability pressures that have led MFIs to prioritize growth in the most familiar and easy-to-reach markets.
- A heavy focus on microenterprise credit rather than on meeting the varied financial service needs of low-income households.
- Limited skills and strategies for survival in increasingly competitive markets.
- Systems and staff development that do not keep pace with growth.
- Inadequate MFI and client risk management.
- A lack of awareness about products and delivery strategies that can meet the needs of more difficult-to-reach markets cost-effectively; and
- Lack of interest and/or investment in systems that can measure the impact of microfinance on the incomes and poverty rates of clients.

The *Making Microfinance Work* training curriculum helps microfinance managers recognize these performance gaps and acquire knowledge, skills and attitudes that enable them to do something about those gaps. The program is designed to get managers away from their offices and day-to-day responsibilities to a place where they can question their assumptions, see alternatives to the status quo, and be inspired by what others have proven to be possible. It creates a space within which managers can refocus on their mission and collaborate with others to identify ways of making their microfinance operations work better for the clients they already serve, as well as those who are still waiting to be served, while simultaneously strengthening their institutional performance.

Microfinance is no panacea for poverty alleviation, but it has demonstrated the potential to facilitate risk management, asset acquisition and decent work for low-income households. Until it realizes that potential for all low-income households, there is a role for MMW to play in making microfinance work better.

**BOX 3**

**Accion International**

Accion was founded in 1961 to empower the poor with the knowledge and tools to improve their lives. Begun as a grassroots community development initiative in 22 shantytowns in Venezuela, Accion today is one of the premier microfinance organizations in the world, with a network of lending partners that spans Latin America, Africa, Asia and the United States. Though Accion's approach has changed over the years, the driving force behind our mission remains the same. Accion still aim to serve hardworking men and women left behind by the world's economic systems. It is their courage and ingenuity, and the tremendous power of their dreams that continue to inspire in the search for ***full financial inclusion***.

*2000: New Millennium, New Horizons*

In October 2000, Accion began working in partnership with micro-lending organizations in sub-Saharan Africa, marking its first initiative outside the Americas. Recognizing the vital need for microcredit throughout Africa, Accion committed itself to increasing financial inclusion for poor, self-employed Africans throughout the continent. In 2006, Accion launched a landmark partnership with Ecobank, the leading regional bank in West Africa. EB-Accion Savings and Loans launched operations in Ghana in 2007 and is expanding to neighboring countries.

In 2005, Accion set off on a new venture to reach another vast, underserved group: urban small business owners in India. Since establishing an office in Bangalore, Accion has partnered with local financial institutions in Patna and Mumbai, guiding them in applying individual and group lending and tailored credit scoring, among other microfinance methodologies. In India, as elsewhere, Accion's work is built on the premise that sustainable, responsible institutions beget empowered clients able to improve their futures for the long term.

Aided by returns from our investment, through the **Accion Gateway Fund**, in Mexican partner Compartamos Banco, Accion began pursuing new projects, including creating a critical strategic reserve, developing new products and technologies, increasing staff recruitment and training, launching new initiatives around the world, and investing in less-mature MFIs to bring microfinance to even more of the world's entrepreneurial poor. In particular, Accion established the **Center for Financial Inclusion** in 2008, an "action tank" focused on advancing the commercial model of microfinance while upholding the interests and needs of poor clients worldwide.

Today, the Center works with a wide variety of actors–microfinance experts, banks, investors, regulators, technology firms, universities and others–to address challenges related to financial inclusion. Center staff members collaborate with experts across industries, many of whom have not yet applied their strengths to microfinance or worked at the same table; to research, develop and share solutions that enhance the lives of the world's poor. The Center's goal is to connect the microfinance community with the major drivers of the global economy–capital markets and technology–and harness their capabilities to address the financial needs of poor people. By bringing these elements together, the Center for Financial Inclusion serves as a bridge between today's microfinance and a future of economic opportunity for all.

*2010s: Focusing on Full Financial Inclusion*

In 2009 and 2010, Accion continued to expand its reach around the globe. Key milestones included helping to start microfinance institutions in underserved areas of Inner Mongolia, Cameroon and Brazil to empower the vulnerable poor in those regions with economic opportunity. In December 2009, Accion inaugurated **Accion Microfinance China** (AMC) in Chifeng Prefecture, Inner Mongolia, to deliver financial services in a region where 40 percent of the population remains below the poverty line. In January 2010, Accion received the green light from the Brazilian government to launch microfinance operations in Manaus, in the poor Amazonas region of the country. And in April of that year, Accion worked with Ecobank to establish EB-Accion Microfinance in Cameroon.

Today, Accion's work is far from over. More than 2 billion of the world's poor still lack access to financial services. Accion is more committed than ever to using its 50 years of experience in order to help build a more financially inclusive world. To this end, Accion will continue to focus sharply on reducing vulnerability and on increasing opportunity for poor households by helping to deliver full financial inclusion–credit, savings, insurance, payments, remittances, financial education, and more–provided at affordable prices, in a convenient manner, and with dignity for clients.

Accion's goal is to build microfinance institutions that are committed to generating both social and financial value. It seeks partner institutions that demonstrate the potential to be the industry's future leaders in financial inclusion. This includes both institutions with a focus on low-income households and other retail organizations and technologies that provide financial products and services to this same market segment in various ways.

*Who supports MMW?*
MMW is a collaborative effort. The original design was made possible by the ILO's Social Finance Unit and International Training Center with financial support from AGFUND, the Government of Italy and USAID. With additional core support from the EU/ACP Microfinance Programme, and with local support from numerous other donors and partners, Volume I was translated into multiple languages and 25 certification processes were implemented. Volume II was later developed and pilot tested with funding from the EU/ACP Microfinance Programme, the Government of Luxembourg, the Government of Italy and the United Nations Capital Development Fund (UNCDF).

Much of the content presented in MMW was originally developed by other organizations and individuals who generously allowed their ideas and tools to be repackaged for the purpose of this training curriculum. This made it possible for the MMW authors to weave together the best of what already existed and to build on that expertise rather than start from scratch. Numerous content experts contributed original material for the course and dozens more professionals helped review it. Certified trainers from around the world invest their own time and energy to keep the materials relevant and up-to-date. Participants often contribute suggestions that make the course stronger.

Course delivery is decentralized so that content can be made available in multiple languages and locations simultaneously at an affordable price. Trainings are organized and implemented by a network of certified trainers and local partners in 40 countries. In general, courses are priced at local market rates to cover their costs. In some cases, donor support makes it possible for those with very limited resources to participate.

*Managing Product Diversification* course evolved from material that was originally included in the International Labour Organization (ILO) 's training package, *Making Microfinance Work: Managing for Improved Performance*. In that training, product diversification was discussed as one of the strategies through which microfinance managers can improve their institution's outreach. By expanding the range of products offered, MFIs can serve more poor people, meet more of their clients' financial service needs and, as a result, make greater progress towards the achievement of their commercial and social objectives.

During pilot testing of the original training, participants requested that more time be devoted to the discussion of various product options and the management of product diversification. Rather than lengthen an already intense two-week course, the ILO responded by removing product diversification content from the original curriculum and creating a separate training to explore that material in more depth. The book *Making Microfinance Work: Managing Product Diversification* is the outcome of that decision. Readers can find detailed information at the course website: http://mmw.itcilo.org.

The book *Managing Product Diversification* and the training course it supports are designed to achieve four main objectives: 1) raise awareness of the opportunities and risks that product diversification presents; 2) explore options for improving the outreach of microfinance institutions (MFIs) through product diversification; 3) provide tools and strategies for managing the product diversification process success fully; and 4) encourage more proactive management of MFI product portfolios over time. The term "microfinance institution" is used to describe a wide range of regulated and non-regulated providers of microfinance services. This includes commercial banks that have a microfinance window, non-bank financial institutions that specialize in microfinance, cooperatives and credit unions that serve the low-income market and non-governmental organizations that provide financial as well as non-financial services to the poor, among others.

## WHY MFIs OUGHT TO SERVE SMALL ENTERPRISES?

The top two reasons why MFIs are moving into serving small enterprises is to grow their business and to follow their micro clients as they themselves grow. External incentives from funders and governments are not a major driver. Opportunities for MFIs to grow their organizations and their continued relationships with established clients lead the reasons MFIs do business with small enterprises. This is the point much discussed by Dani Rodrik in his "*Work and*

*Human Development in a Deindustrializing World*" and other Rodrik's publications. The question is whether small enterprises tend to be the sectors that generate the technological benefits and growth effects. The countries that create and support those export-oriented, tradable enterprises profitable tend to induce in turn more investments from the private sector and therefore more dynamic benefits, more economic growth. It generates structural change, structural transformation, which is what these developing countries need most: to get resources from low-productive economic activities towards higher-productivity activities which can serve world markets. And that ***process of structural transformation*** **is what lies at the heart of the growth process in developing countries**.

The key implication of the structural transformation imperative from a policy perspective is that while the **composition of output** may be of second-order importance in a rich country, it is of first-order importance for economic performance and economic growth in a developing country. **It is crucial for developing countries to achieve the right mix of economic activities.**

We ought to investigate one of the most surprising things that we have seen in the last few decades–that in large parts of the world today, structural transformation is taking place in reverse. People are moving from high-productivity activities to low-productivity activities and not the other way around. What is the role of microfinance in this process? So, we have to ask what happens to the workers who are displaced from these firms that become more productive by rationalizing production, upgrading technology, and substituting capital for labor. These workers end up not in more productive activities but in less productive activities.

Many economists believe that **poverty** itself is a barrier to development, given the limitations of credit and insurance markets — the poor are too poor to save or invest in either human capital or businesses that spur growth. Such a view takes as given financial institutions, however. And it is true that existing formal institutions such as banks find it unprofitable to offer financial services to the poor, and the poor also appear not to be interested in insurance products and to have low ***savings rates***.

We know that poor people don't have access to credit, they don't have access to health facilities, they can't or don't send their children to school and therefore they tend not to get educated and skilled. So **there is a whole set of syndromes associated with poverty**. And the fundamental question here is — are people poor because they don't have access to credit, because of their health status or their education, or are those things really the consequence of poverty? This complicated relationship between poverty and its syndromes has to be untangled before we can actually make progress. Because in development it has been really tried everything–from massive state intervention to massive foreign aid, to massive scale microfinance. The issue is that these interactions are fairly complicated and also tend to be fairly *context-specific* and therefore it's very hard to go anywhere with very general, blanket recommendations and grand strategies without understanding that the details on the ground are what really differentiates countries and what determines success.

Maybe, the principal barrier to providing the poor with financial resources is the absence of delivery mechanisms that appropriately take into account market imperfections, informal institutions, and behavior. One well-known institutional innovation in finance was "***microcredit***," but evidence of its success is mixed and an understanding of why and whether the specific features of microcredit mechanisms contribute to solving the fundamental problems of credit markets is incomplete. Designing the appropriate financial institutions and delivery mechanisms, of course, requires a deep understanding of behavior and informal sources of finance. So, it is important to look at how differing mechanisms of delivery for savings, insurance, and loan products affect both ***take-up rates*** and ***sustainability*** (e. g., repayment rates in the case of loans), as well as how such products affect savings, contribute to consumption smoothing, and spur business investment.

However, in the absence of effective *social programs*, high growth may not deliver much real development. So, in assessment of impact of microfinance we ought to take into consideration the **human capital effects on growth**. For example, a program redistributing income to the poor alleviates poverty to some extent, but it

does not address the root cause of poverty and thus may not be sustainable in the long run. In most low-income countries, school attendance and school inputs are also at low levels. There may be many ways in which schooling can be increased, and there is now increased evidence on the "effectiveness" of various mechanisms, through cash transfers that condition on schooling, via polices that relieve credit constraints, or through improvements in school availability or school quality. But **if schooling demand is low**, principally because payoffs to schooling are low, such interventions will have little effect on poverty reduction and growth. So, an understanding of the contexts in which schooling and health contribute to long-term growth is needed along with evidence on the effectiveness of polices that induce increased schooling demand or increase healthiness.

Another question, on the demand side, is whether development of MFIs activities can create a ***middle class*** and spur its development. Recently, the middle classes have been (re) discovered as innovators and bearers of new values and life-styles on a global scale. Middle classes are believed to boost economic growth, promote desirable social dynamics, and safeguard democracy. They are regarded as *modernizers* who embody a positive vision of social mobility. With respect to the middle classes in Europe and North America, pessimistic narratives of stagnation, if not deprivation and victimization due to transformations of the world economy dominate. Do these middle classes in different parts of the world nevertheless share some characteristics and experiences? Those commonly grouped under this label seem to constitute a heterogeneous collection of people with a wide range of occupations, income levels, lifestyles and political ambitions. Are they really to be viewed as a single social formation, whose members share situational characteristics, a sense of belonging together, common attitudes and values, as well as a disposition for common behavior and actions?

One of the major features shared by all middle classes is their "**boundary work**". The history and current dynamics of the middle classes have been, and continue to be, marked by the drawing of boundaries vis-à-vis those "above" and those "below", although who precisely constitutes this "below" and "above" vary. Furthermore, **work is a central boundary marker**. Belonging to the middle class is generally regarded as an achieved, rather than an inherited status. **Employment and work** thus are central themes. Further aspects concerned the role of education in the intergenerational transmission of middle-class status; intra-class distinctions through certain ideals of domesticity; gender relations; the role of consumption for demonstrating middle-classness; and the interrelationship between the state and the middle classes.

The next question is whether microfinance can help a country to become a **democratic** country. Democracy was a sort of meta-institution, allowing each society to choose and shape its institutions in contextually appropriate ways. Democracies do indeed generate high-quality growth, providing greater predictability, stability, and resilience and better distributional outcomes[11].

Rodrik also stated that ***manufacturing* might be an escalator for poor countries for several important reasons**. *First*, there tends to be a positive productivity dynamic in many manufacturing industries. Establish a beachhead in one of the "easy" manufacturing sectors — such as garments — and the chances are that you will experience steady increases in productivity, and will be able to jump on to other, more sophisticated industries in time. *Second*, manufacturing is a **tradable sector**. This means that your successful manufacturing industries can expand almost indefinitely, by gaining market share in world markets, without running into demand constraints. *Third*, manufacturing is a great absorber of unskilled labour, a low-income country's most plentiful resource. Activities such as garments, footwear, toys and electronics assembly require few skills, so farmers can easily be transformed into assembly line workers.

However, **today this path looks both less desirable and less feasible. A new path will have to be invented**. The broad contours of this alternative are easy to state. It will be a model based on services. It will focus more on ***soft infrastructure*** — learning and institutional capa-

[11] Dani Rodrik. (2016). Is Liberal Democracy Feasible in Developing Countries? Springer Science+Business Media, New York (Paper was prepared for the 50th Fiftieth Anniversary Conference of Studies in Comparative International Development, Brown University, October 30, 2015).

bilities — and less on physical capital accumulation — plants and equipment in manufacturing industries. Beyond that, however, much remains up for grabs.

What is clear, therefore, is that policy makers will face an altogether new challenge when they turn to the future of work and human development. More of economic growth will have to come from **productivity advances in services**. This means in turn that the partial, sectoral approaches that worked so well to stimulate export-oriented industrialization during the early stages of rapid growth in Asia and beyond will have to be replaced (or at least complemented) by **massive economy-wide investments in human capital and institutions**. When manufacturing is the engine of the economy, selective reforms such as export incentives, special economic zones or incentives to foreign investors can be highly effective. After all, it is enough to have a few export successes, facing nearly infinite demand on world markets, to pull the economy along. But when growth has to rely on (mostly) *non-tradable services*, selective efforts will not work. **Reform efforts will have to be more comprehensive, targeting productivity growth in all services simultaneously**. The leader will take all.

## MICROFINANCE UNDER MICROSCOPE

The Economist Intelligence Unit (EIU) issued last time "Global Microscope 2015: The enabling environment for financial inclusion." This work was supported by funding from the Multilateral Investment Fund (MIF), a member of the Inter-American Development Bank (IDB) Group; CAF — Development Bank of Latin America; the Center for Financial Inclusion at Accion, and the MetLIfe Foundation.

As recognition of the role of accessible and diverse financial services has grown in recent years, The Economist Intelligence Unit's Microscope series has become an important tool for those seeking to understand the field.

*The Global Microscope 2015: The enabling environment for financial inclusion*, formerly known as the *Global Microscope on the Microfinance Business Environment*, assesses the **regulatory environment** for financial inclusion across 12 indicators and 55 countries. The Microscope was originally developed for countries in the Latin America and Caribbean region in 2007 and was expanded into a global study in 2009. Most of the research for report, which included interviews and desk analysis, was conducted between June and September 2015.

*About The Global Microscope 2015*

***Financial inclusion***, in its broadest sense, requires much wider access to a range of financial products for traditionally underserved or excluded populations. Accordingly, in the past few years, the substantial importance to economic development — and the potential to improve the lives of individuals — of tools such as savings instruments, payment systems (notably electronic cash), and micro-insurance has become increasingly well understood.

Financial inclusion has come a long way. A little less than a decade ago, discussion in this area centred almost entirely around ***microcredit*** — small loans allowing entrepreneurs at the bottom of the pyramid to expand their activities. While still a crucial service for these individuals, research by many institutions globally has shown that this was only one element of broadening access to *financial services* for the world's poor. Today, the ability of financial inclusion to empower low-income populations worldwide has pushed it near the top of the ***sustainable-development agenda***.

The latest demonstration of the growing consensus of the importance of financial inclusion is found in "***Transforming our world: The 2030 Agenda for Sustainable Development***" — the unanimously adopted UN General Assembly plan that succeeds the *Millennium Development Goals*. Not only does its preamble specifically mention financial inclusion, but five of the 17 overarching *Global Sustainable Development Goals* that the agenda champions (specifically, Ending Poverty; Ending Hunger; Gender Equality; Sustainable, Inclusive Economic Growth, and Sustainable, Inclusive Industrialization) note the need for improved or universal access to financial services. In short, financial inclusion is now recognized as one of several essential building blocks supporting key elements of the sustainable-development agenda. As such, it is part of the foundation for the world's wider hopes for progress.

**BOX 4**

***Global Sustainable Development Goals***

This year the Global Goals for Sustainable Development come into effect to achieve three extraordinary things by 2030 — end poverty, combat climate change and fight injustice and inequality.

1. End poverty in all its forms everywhere
2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture
3. Ensure healthy lives and promote well-being for all at all ages
4. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
5. Achieve gender equality and empower all women and girls
6. Ensure availability and sustainable management of water and sanitation for all
7. Ensure access to affordable, reliable, sustainable and modern energy for all
8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
9. Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
10. Reduce inequality within and among countries
11. Make cities and human settlements inclusive, safe, resilient and sustainable
12. Ensure sustainable consumption and production patterns
13. Take urgent action to combat climate change and its impacts*
14. Conserve and sustainably use the oceans, seas and marine resources for sustainable development
15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
17. Strengthen the means of implementation and revitalize the global partnership for sustainable development

Financial Inclusion is such an important topic that organizations like the IDB/MIF, Accion, CAF and the MetLife Foundation support the Microscope. As with the sector itself, the publication has evolved and broadened from an initial focus on *credit* and *savings*. *Microscope 2015* is the second edition to offer this expanded scope, which assesses the overall environment for financial inclusion in more than 50 countries. To do so, it examines policies and regulations for a range of financial products and services; a wider set of institutions providing these services; the full array of delivery methods; and the institutional support that ensures the safe provision of services to low-income populations. These criteria are scored using a dozen indicators, based on more than 40 individual data points, which look at the existence and implementation of *formal policy and regulation* around different aspects of financial inclusion. The *overall score* is then adjusted for the effects of political, economic, and policy stability. Together, these give a nuanced picture of the practical realities of financial inclusion in the markets covered.

As with earlier editions, *Microscope 2015* is directed towards practitioners, policymakers, investors, and other stakeholders in the area of financial inclusion — to help them evaluate a country's progress in these areas and to establish where further efforts should be made in order to yield additional benefits.

It does this in two ways. *First*, using a detailed and transparent scoring system, its results provide a useful comparison between countries on financial inclusion overall, as well as on specific elements of it. *Second*, *Microscope 2015* allows readers to track changes in the performance of countries since 2014 in a world in which the pace of change is quite rapid. (Comparisons to previous years are less valuable due to a major revision of methodology.)

Without pre-empting the presentation of findings, one point is worth noting here. Despite a growing appreciation of the importance,

and potential value, of financial inclusion, most countries can still improve their enabling environment. Only a handful score more than 75 out of 100 in our rankings, and a majority finish at or below 50. The intellectual argument for financial inclusion may have become conventional wisdom; putting it into practice will require ever more innovative and effective policies and tools — a process that future editions of *Microscope* will follow with interest.

*Explanation of the report's methodology*

The latest edition of the Index includes a small number of data revisions, although not enough to disrupt comparisons between the two years. The most important of these revisions were additional indicators, or adjusted scoring methods, that yield a better picture of insurance targeting low-income consumers, regulation of electronic payments, and consumer protection.

For seven years (2008–13), the *Microscope* has evaluated the regulatory and structural framework for microfinance institutions (MFIs), as well as the business operating environment for microfinance across 55 countries. In 2014 The Economist Intelligence Unit expanded the analytic framework of the *Microscope*, going beyond microfinance to incorporate indicators reflecting the enablers of financial inclusion. The intention is to maintain the *Microscope*'s relevance to stakeholders who serve low-income populations and broaden the scope of the index to financial inclusion — an important emerging topic and a driver of economic development.

Although microfinance remains an important way of providing financing to individuals, the methods and tools for accessing finance continue to develop. Indeed, financial inclusion has emerged as a key public-policy theme[12].

For the first time the indicators and methodologies used to evaluate the microfinance environment were developed in 2007, in co-ordination with MIF and CAF. The real-world relevance of these indicators was evaluated through in-depth interviews with country experts and microfinance practitioners from the Latin American/Caribbean (LAC) region. The indicators were further validated in 2007 and 2008 by their high positive correlation with some microfinance-penetration figures. The original index included 15 countries in the LAC region, which was subsequently expanded to 21 LAC countries, plus an additional 34 countries around the globe, in co-operation with the IFC. The 2011, 2012, 2013 and 2014 versions of the index cover 55 countries.

As a first step in revising the methodology, we convened an expert panel in January 2014 to discuss changes to the Microscope benchmarking framework, so as to capture financial inclusion. Around 20 experts were drawn from international research organizations and from among independent consultants in the financial inclusion community. The experts discussed key financial inclusion topics and their suitability for use in the revised indicator framework that forms the foundation of the *Microscope*. After gathering inputs from the panel and consulting the funding organizations, we revised the indicator framework and methodology for this year's report. The revised *Microscope* includes 12 indicators, which assess a country's government, and its political, regulatory and supervisory capacity to enable an environment of financial inclusion, as well as a 13th indicator used as an adjustment factor to reflect political instability, which impacts the country's financial inclusion environment.

Examining the various definitions of financial inclusion across countries, regulators and financial institutions revealed several common elements essential to achieving financial inclusion. For financial services to be more inclusive, the financial and regulatory environments need to:

- **Offer a wide range of products**: There is a consensus that financial inclusion goes beyond microcredit. The environment needs to expand its financial services to include access to savings, insurance, payment systems and pensions.
- **Have a wider range of providers**: Technological advancement demonstrates that many types of companies can provide non-traditional financial services, such as mobile-banking and payment systems (M-Pesa and payments).
- **Target diverse groups and sub-populations**: An inclusive financial environment is one in which people are not solely defined by income. Although the literature on financial inclusion has not reached a consensus as to whom,

[12] There are many definitions of financial inclusion and this report does not adopt any particular one. The aim is to measure the enablers of financial inclusion and not the outcome per se. In this report, we characterize "financial inclusion" as the availability of a wide range of financial services to all populations, especially the disadvantaged.

specifically, financial inclusion should target, the *Global Microscope on Financial Inclusion* will focus on the underserved market for financial products (people "at the bottom of the pyramid", minorities and micro-businesses).

- **Facilitate new ways to deliver financial products or services**: The concept of financial inclusion entails innovative approaches to the way financial services are delivered to traditionally excluded or underserved populations. In this sense, the role of technology is key; the development of platforms using digital technologies means that, for example, transactions can be processed through mobile devices in remote areas.
- **Provide adequate financial education**: In order to expand financial products and services to the traditionally underserved and under-banked populations, it is essential also to provide proper education and information about the financial system, consumer rights and pricing, so consumers can make informed decisions. Financial literacy is an important and growing part of consumer protection in microfinance and expanded access to low-income populations.

*Microscope indicators*

While the indicator scores and the data behind them tell an important story, it is, inevitably, incomplete. Therefore, as in past editions, Microscope 2015 includes country summaries describing the specific efforts to enhance financial inclusion, as well as the factors that might assist or impede these efforts. The study also includes an Excel-based model of the Index, which allows users to evaluate and compare results by indicators, sub-indicators, countries, or regions.

The 12 indicators and supporting sub-indicators for this index are as follows:

**1. Government support for financial inclusion**

Sub-indicator 1: Existence and implementation of a strategy

Sub-indicator 2: Data collection

**2. Regulatory and supervisory capacity for financial inclusion**

Sub-indicator 1: Technical capacity to supervise

**3. Prudential regulation**

Sub-indicator 1: Appropriate entry and licensing requirements

Sub-indicator 2: Ease of operation

**4. Regulation and supervision of credit portfolios**

Sub-indicator 1: Interest rates

Sub-indicator 2: Risk management of credit portfolios

Sub-indicator 3: Risk management framework for microcredit portfolios

**5. Regulation and supervision of deposit-taking activities**

Sub-indicator 1: Ease of offering savings products by regulated institutions

Sub-indicator 2: Existence of in-depth deposit-insurance coverage

**6. Regulation of insurance targeting low-income populations**

Sub-indicator 1: Existence of regulation of insurance for low-income populations

Sub-indicator 2: Delivery channels for insurance targeting low-income populations

Sub-indicator 3: Consumer protection for insurance targeting low-income populations

**7. Regulation and supervision of branches and agents**

Sub-indicator 1: Ease of setting up a branch

Sub-indicator 2: Ease of agent operation

**8. Requirements for non-regulated lenders**

Sub-indicator 1: Information reporting and operational guidelines

**9. Electronic payments**

Sub-indicator 1: Available infrastructure for financial inclusion

Sub-indicator 2: Digital financial services

**10. Credit-reporting systems**

Sub-indicator 1: Comprehensiveness of information

Sub-indicator 2: Privacy protection for both borrowers and lenders

**11. Market-conduct rules**

Sub-indicator 1: Existence of a framework and institutional capacity to protect the financial consumer

Sub-indicator 2: Existence and content of disclosure rules

Sub-indicator 3: Existence of fair treatment rules

**12. Grievance redress and operation of dispute-resolution mechanisms**

Sub-indicator 1: Internal complaint mechanisms

Sub-indicator 2: Existence and effectiveness of a third-party-redress entity

## ADJUSTMENT FACTOR: STABILITY

Sub-indicator 1: General political stability

Sub-indicator 2: Shocks and policies impacting financial inclusion

***Scoring methodology***. Each of the indicators contains between one and three sub-indicators and, in turn, each sub-indicator is composed of between one and four questions that were scored from 0–4, 0–3 or 0–2 where the highest number is the best and 0=worst. Once indicator scores had been assigned, these were normalized and weighted according to a consensus among clients and experts, then aggregated to produce an overall scoring range of 0–100, where **100 = best** and **0 = worst**. Each of the 12 indicators was given equal weight, while sub-indicator weights varied according to importance and the number of sub-indicators included.

Finally, the adjustment factor, Stability, adjusts each country's score for political stability and policies that impact financial inclusion.

*The index*

The *Microscope* is an exercise in benchmarking countries, with the goal of identifying areas for improvement in the legislative and regulatory frameworks that support financial inclusion, as well as a means by which to evaluate conditions that may be conducive to, or inhibit, expanded access to, and understanding and usage of, financial services. The *Microscope* focuses on the enablers of financial inclusion: the laws, regulations and types of products being offered that support or demonstrate financial inclusiveness.

The *Microscope* is broadly patterned after other indices that measure the openness of the regulatory, legal and business environment to private-sector participation. However, the *Microscope* relies to a larger extent on qualitative measures of the financial inclusion environment. This places a special obligation on researchers to design an index that captures relevant aspects of the environment, and that does so in a defensible and consistent manner. Despite insufficient and often incomplete data regarding the financial inclusion environment, much effort has been made to combine available secondary sources and primary legal texts with insights and information from segment stakeholders in each national context. Additional measures are taken to ensure that the qualitative scores are consistent across countries and regions.

*Sources*

To score the indicators in this index, data were gathered from the following sources:

- In-depth, personal interviews with regional and country experts, as well as practitioners and regulators.
- Texts of laws, regulations and other legal documents.
- Economist Intelligence Unit proprietary country rankings and reports.
- Scholarly studies.
- Websites of governmental authorities and international organisations.
- Websites of industry associations.
- Local and international news-media reports.

A goal for this year's *Microscope* was to increase the number and scope of practitioners interviewed per country, to obtain the widest possible range of perspectives on the financial inclusion environment.

This year, we interviewed over 200 experts. A large proportion of these interviewees were drawn from in-country sources, especially local banks and MFIs, national microfinance networks and financial regulators, mobile-network operators (MNOs), and local offices of multilateral organisations.

These additional consultations provide a multifaceted perspective and a nuanced portrait of the environment for financial inclusion. Moreover, the 2015 report continues to draw on new data and secondary sources, so as to be able to provide the most up-to-date and in-depth analysis of the financial inclusion environment in 55 developing countries around the world.

*Scoring criteria*

Indicators in the *Microscope* index are qualitative in nature, and defined through a set of 41 questions. These questions seek to measure not only the laws and standards governing the segment, but also their enforcement, implementation and effectiveness. An experienced team of international-development researchers, microfinance practitioners and country experts analyzed regulations, laws, news articles, government sites and other resources to provide objective, com-

prehensive, informed answers to each question. In addition, the researchers interviewed over 200 experts to provide color and insight into the overall environment of financial inclusion in each country. Economist Intelligence Unit research staff supplied sources, contacts and a detailed set of guidelines outlining the criteria and goals, as well as a scoring scheme for each question.

While the criteria are detailed, they are subjective in nature. Economist Intelligence Unit research staff reviewed each response thoroughly, calibrated scores and conducted cross-country comparisons, so as to ensure that scores were properly justified and consistent across all countries. Consequently, scores are best understood by reading both the scoring criteria and the written justifications provided for each indicator found in the accompanying excel model available at: www.eiu.com/microscope2015. The indicators and scoring scheme are outlined below.

***1. Government support for financial inclusion***

**1. Existence and implementation of a strategy:**

*a) Is there a documented strategy on financial inclusion?*

Scoring: 0 = There is no documented strategy for financial inclusion OR recent activities in two or more areas of financial inclusion; 1 = The government has a documented financial inclusion strategy, but it does not contain specific commitments OR there is no documented strategy, but there are recent activities in two or more areas of financial inclusion; 2 = The government has a documented financial inclusion strategy, containing specific commitments that have been partially implemented; 3 = The government has a documented financial inclusion strategy containing specific commitments, including G2P payments and financial capability, and it has been substantially implemented.

**2. Data collection:**

*a) Does the government collect customer-level data that helps to understand low-income populations' demand for financial services?*

Scoring: 0 = The government does not collect customer-level data from financial institutions; 1 = The government collects EITHER customer-level data from regulated institutions or household data; 2 = The government collects customer-level data and household data.

***2. Regulatory and supervisory capacity for financial inclusion***

**1. Technical capacity to supervise:**

*a) Is there a specialized capacity in place in the regulatory agency?*

Scoring: 0 = There is no specific mandate to supervise financial services and products that facilitate financial inclusion OR there is no specialized capacity for financial inclusion in place; 1 = Limited specialized capacity for financial inclusion is in place; 2 = Some specialized capacity for financial inclusion is in place; 3 = Specialized capacity for financial inclusion is in place.

*b) Is the financial regulator politically independent?*

Scoring: 0 = The financial regulator is often influenced by political dynamics; 1 = The financial regulator is generally independent of political influence; 2 = The financial regulator is always independent of political influence.

***3. Prudential regulation***

**1. Appropriate entry and licensing requirement:**

*a) Are minimum-capital requirements appropriate to allow new entrants and ensure the safe provision of financial services?*

Scoring: 0 = Minimum-capital requirements are not appropriate; 1 = Minimum-capital requirements are somewhat appropriate; 2 = Minimum-capital requirements are appropriate, but not effective; 3 = Minimum-capital requirements are appropriate and effective.

b) Are there any impediments to entering the market, such as funding or ownership restrictions?

Scoring: 0 = BOTH funding restrictions and ownership restrictions are barriers to entering the market; 1 = EITHER funding restrictions or ownership restrictions are barriers to entering the market; 2 = There are no funding and ownership restrictions to entering the market.

**2. Ease of operation:**

*a) Are capital-adequacy standards appropriate to ensure both financial stability and the operation of a variety of providers?*

Scoring: 0 = Capital-adequacy standards are not appropriate; 1 = Capital-adequacy standards are somewhat appropriate; 2 = Capital-adequacy standards are appropriate.

*b) Are reporting requirements reasonable in light of the specific nature of the services provided?*

Scoring: 0 = Reporting requirements are not reasonable; 1 = Reporting requirements are somewhat reasonable; 2 = Reporting requirements are reasonable.

***4. Regulation and supervision of credit portfolios***

**1. Interest rates:**

*a) If there are interest-rate caps for credit, do they distort the market?*

Scoring: 0 = There are interest-rate caps and they affect the provision of all types of credit; 1 = There are interest-rate caps and they affect the provision of microcredit and consumer credit; 2 = There are interest-rate caps and they affect EITHER microcredit OR consumer-credit provision; 3 = There are no interest-rate caps OR they do not distort the market for microcredit and consumer credit

**2. Risk management of credit portfolios:**

*a) Does the regulator actively supervise the status of over-indebtedness for credit portfolios?*

Scoring: 0 = There is no evidence of over-indebtedness monitoring in the past year; 1 = There is some evidence of over-indebtedness monitoring in the past year; 2 = There is clear evidence of over-indebtedness monitoring in the past year.

*b) Is there a differentiated risk-management framework for consumer-credit portfolios? Does the regulator supervise the status of consumer-credit portfolios?*

Scoring: 0 = There is no differentiated risk management framework for consumer credit; 1 = There is a differentiated risk-management framework for consumer credit, but supervision of its status is limited; 2 = There is a differentiated risk-management framework for consumer credit and the regulator supervises its status.

**3. Risk-management framework for microcredit portfolios:**

*a) Is there a differentiated and comprehensive risk management framework for microcredit?*

Scoring: 0 = There is no definition of microcredit; 1 = There is a definition of microcredit, but no differentiated risk-management framework; 2 = Differentiated risk-management framework is not comprehensive; 3 = Differentiated risk management framework is comprehensive.

***5. Regulation and supervision of deposit-taking activities***

**1. Ease of offering savings products by regulated institutions:**

*a) Are account-opening requirements for savings products proportionate?*

Scoring: 0 = Account-opening requirements are not proportionate; 1 = Account-opening requirements are somewhat proportionate; 2 = Account-opening requirements are proportionate.

*b) Are there any interest-rate restrictions on deposits that generate market distortions?*

Scoring: 0 = There are interest-rate restrictions and they discourage deposits (from savings) in general; 1 = There are interest-rate restrictions and they discourage deposits (from savings) from low-income populations; 2 = There are interest-rate restrictions and they discourage some deposits (from savings) from low-income populations; 3 = There are no interest-rate restrictions OR they do not discourage deposits (from savings) from low-income populations.

**2. Existence of in-depth deposit-insurance coverage:**

*a) Is deposit insurance applicable to all institutions authorized to take deposits and with the same conditions?*

Scoring: 0 = There is no deposit-insurance system in place for small depositors; 1 = There is a deposit-insurance system in place that gives differentiated treatment to deposits in terms of institutions AND in terms of coverage; 2 = There is a deposit-insurance system in place that gives differentiated treatment to deposits in terms of institutions OR in terms of coverage; 3 = There is a deposit-insurance system in place with no differentiated treatment for any client.

***6. Regulation of insurance targeting low-income populations***

**1. Existence of regulation of insurance targeting low-income populations:**

*a) Is the regulation comprehensive and has it been implemented?*

Scoring: 0 = There is no regulation of insurance for low-income population, nor any incipient activity under a general insurance law; 1 = There is no specific regulation of insurance for low-income population, but there is some incipient activity OR regulation exists, but it is not comprehensive and it has not been implemented; 2 = Specific regulation exists, it is not comprehensive and has only been partially implemented; 3 = Specific regulation exists, it is comprehensive, but has only been partially implemented; 4 = Specific regulation exists, it is comprehensive and has been fully implemented.

**2. Delivery channels for insurance targeting low-income populations**

*a) Do regulations facilitate a variety of channels for distribution?*

Scoring: 0 = There is no regulation; 1 = There is regulation BUT it does not facilitate a variety of distribution channels for micro-insurance; 2 = There is regulation AND it facilitates a variety of distribution channels for micro-insurance.

**3. Consumer protection for insurance targeting low-income populations**

*a) Does the regulator monitor key indicators for consumer protection?*

Scoring: 0 = There are no consumer-protection standards for insurance targeting low-income customers or the regulator does not monitor any data on consumer protection; 1 = The regulator monitors key indicators, BUT it does not take any action; 2 = The regulator monitors key indicators AND it takes action.

*b) Are there clear rules that require insurance providers to disclose information about the overall cost of the products and consumers' rights and obligations*

Scoring: 0 = There are no disclosure rules; 1 = Disclosure rules exist, BUT they are either not comprehensive or not enforced; 2 = Disclosure rules exist, they are comprehensive AND they are enforced.

*c) Are there any dispute-resolution mechanisms available for insurance targeting low-income customers?*

Scoring: 0 = No, there are no dispute-resolution mechanisms; 1 = There are general dispute-resolutions mechanisms that work for insurance for low-income population, or there are specific dispute-resolution mechanisms for micro-insurance, BUT they are not effective; 2 = There are dispute-resolutions mechanisms AND they are effective.

***7. Regulation and supervision of branches and agents***

**1. Ease of setting up a branch:**

*a) How easy is it for financial-services providers to open a branch or direct-service outlet owned and operated by the financial institution?*

Scoring: 0 = There are significant obstacles to opening a branch or financial outlet; 1 = There are some obstacles to opening a branch or financial outlet; 2 = There are no significant obstacles to opening a branch or financial outlet.

**2. Ease of agent operation:**

*a) Does the regulation allow a wide range of actors to serve as agents and does it enable all providers of financial services to have agents?*

Scoring: 0 = Regulations on agent banking are non-existent; 1 = Regulations on agent banking are limited; 2 = Regulations are limited and agents are active in the field OR regulations are comprehensive and agents are not active in the field; 3 = Regulations are comprehensive and agents are active in the field.

*b) Are agents allowed to perform a wide range of activities?*

Scoring: 0 = Agents cannot perform cash-in transactions and account-opening activities; 1 = Agents can perform some activities, but cannot perform EITHER cash-in transactions OR account opening; 2 = Agents can perform a wide range of activities, including cash-in/cash-out transactions AND account opening.

*c) Do regulations on agent exclusivity constrain the market?*

Scoring: 0 = There is no regulation of agent exclusivity or regulation on agent exclusivity constrains the market; 1 = Regulation on agent exclusivity partly constrains the market; 2 = regulation of agent exclusivity does not constrain the market.

*d) Do financial institutions retain responsibility for the actions of their agents?*

Scoring: 0 = Financial institutions do not retain any responsibility for the actions of their agents; 1 = Financial institutions retain responsibility for some of the actions of their agents; 2 = Financial institutions retain responsibility for all of the actions of their agents

***8. Requirements for non-regulated lenders***

**1. Information reporting and operational guidelines:**

*a) Are reporting requirements reasonable?*

Scoring: 0 = Non-regulated credit providers are not required to report any information to the regulator; 1 = Reporting requirements for non-regulated credit providers are not reasonable; 2 = Reporting requirements for non-regulated credit providers are somewhat reasonable; 3 = Reporting requirements for non-regulated credit providers are reasonable

*b) Do these providers comply with accounting-transparency standards?*

Scoring: 0 = Non-regulated providers are not required to have good accounting practices OR some of the non-regulated credit providers are required to have good accounting practices, but compliance is low; 1 = Some of the non-regulated credit providers are required to have good accounting practices and compliance is moderate; 2 = All non-regulated credit providers are required to have good accounting practices, but few of them comply; 3 = All non-regulated credit providers are required to have good accounting practices and most comply.

***9. Electronic payments***

**1. Available infrastructure for financial inclusion:**

*a) Does the payment infrastructure serve the needs of the low-income population?*

Scoring: 0 = The payment infrastructure is unreliable and does not serve the needs of the low-income population; 1 = The payment infrastructure is reliable and partly addresses the needs of the low-income population; 2 = The payment infrastructure is reliable and effectively addresses the needs of the low-income population.

**2. Digital Financial Services:**

*a) Are regulations on e-money or similar digital financial services adequate and are not constraining the market?*

Scoring: 0 = Regulations on e-money or digital financial services do not exist OR they are in the early stages of development; 1 = Regulations on e-money or digital financial services are inadequate OR they constrain the market; 2 = Regulations on e-money or digital financial services are adequate AND they do not constrain the market.

***10. Credit-reporting systems***

**1. Comprehensiveness of information:**

*a) Is the information stored by credit-reporting systems comprehensive, regularly updated and accessed by providers?*

Scoring: 0 = Credit-reporting systems do not exist OR credit bureaus store information that has none of the items required for a score of "3"; 1 = Credit-reporting systems store information that has one of the items needed for a score of "3"; 2 = Credit-reporting systems store information and it is both comprehensive and accessed by providers, but not updated regularly OR is regularly updated, but not comprehensive; 3 = Credit-reporting systems store information that is comprehensive, regularly updated and accessed by providers.

**2. Privacy protection for both borrowers and lenders:**

*a) Are privacy rights respected?*

Scoring: 0 = Credit-reporting systems do not actively protect privacy rights; 1 = Credit-reporting systems have rules in place to protect privacy rights for EITHER borrowers or lenders, but these rules are not well enforced; 2 = Credit-reporting systems have rules in place to protect privacy rights for BOTH borrowers and lenders, but these rules are not well enforced; 3 = Credit-reporting systems have rules in place to protect privacy rights for both borrowers and lenders and these rules are well enforced.

*b) Can individuals access their records and are they able to correct any errors?*

Scoring: 0 = Individuals cannot access their records or correct any errors; 1 = Individuals may access their records, but may not correct any errors; 2 = Individuals may access their records, but the error-correction process is difficult OR expensive; 3 = Individuals may access their records and the error-correction process is easy and inexpensive.

***11. Market-conduct rules***

**1. Existence of a framework and institutional capacity to protect the financial consumer:**

*a) Are there a framework and a specialized capacity in place for financial-consumer protection?*

Scoring: 0 = No consumer-rights framework is in place; 1 = Consumer-rights framework exists, but no specialized capacity is in place; 2 = Consumer rights framework exists and some specialized capacity is in place; 3 = Consumer-rights framework exists and specialized capacity is in place.

**2. Existence and content of disclosure rules:**

*a) Does the regulator collect information about pricing and make relevant information easily accessible to consumers for comparison purposes?*

Scoring: 0 = The regulator does not collect information OR information collected is not easily accessible; 1 = The regulator collects information that is easily accessible, BUT it is either incomplete or difficult to understand; 2 =The regulator collects information that is easily accessible, complete and easy to understand.

*b) Are there clear rules that require providers of financial services to disclose information about the overall cost of the products and consumers' rights and obligations?*

Scoring: 0 = Disclosure rules exist EITHER for some products OR apply to some providers; 1 = Disclosure rules exist for all products AND providers; 2 = Disclosure rules exist for all products AND providers AND they are comprehensive.

**3. Existence of fair-treatment rules:**

*a) Are there clear rules requiring non-discrimination in financial-service provision in terms of gender, race, religion, caste, ethnicity, etc.?*

Scoring: 0 = There are no clear rules; 1 = = There are clear rules, but compliance is low; 2 = There are clear rules and compliance is high.

*b) Are there clear rules set by the regulator aimed at preventing aggressive sales and unreasonable collection practices?*

Scoring: 0 = There are no clear rules set by the regulator; 1 = There are clear rules set by the regulator, but compliance is low; 2 = There are clear rules set by the regulator and compliance is high.

***12. Grievance redress and operation of dispute-resolution mechanisms***

**1. Internal complaint mechanisms:**

*a) Are there clear rules in place requiring financial-services providers to set up internal mechanisms to deal with consumer complaints?*

Scoring: 0 = There are no clear rules; 1 = There are clear rules, but compliance is low; 2 = There are clear rules and compliance is high.

**2. Existence and effectiveness of a third-party-redress entity:**

*a) Is there a third-party entity empowered with oversight where consumers can seek redress, and is it effective?*

Scoring: 0 = No third-party entity exists; 1 = Third-party entity exists, but redress is ineffective; 2 = Third-party entity exists and redress is somewhat effective; 3 = Third-party entity exists and redress is effective.

## ADJUSTMENT FACTOR: *STABILITY*

**1. General political stability:**

*a) To what extent are political institutions sufficiently stable to support the needs of businesses and investors?*

Scoring: 0 = Very unstable, and 100 = Very stable

**2. Shocks and restrictive policies impacting financial inclusion:**

*a) To what extent have any shocks or restrictive policies affected market development?*

Scoring: 0 = There have been shocks or restrictive policies that have affected the market; 1 = There have been shocks or restrictive policies that have had a broad, negative impact in the market; 2 = There have been shocks or restrictive policies that have had a limited, negative impact in the market (either geographically or on a specific type of institutions); 3 = There have been no shocks or restrictive policies affecting market development.

*Regional representation*

This index builds on earlier studies of Latin America and the Caribbean; as a result, countries from that region are numerically over-represented in the global *Microscope* study (21 of 55 countries). Countries in other regions were then selected on the basis of the importance of

their existing microfinance segments or the potential for future market development. For the 2015 edition, we still have a total of 55 countries, but have added Russia, Ethiopia, South Africa and Jordan, and have removed Azerbaijan, Armenia, Georgia and Yemen. The study, therefore, provides differing levels of geographic coverage: 21 countries from Latin America and the Caribbean, 13 countries from Sub-Saharan Africa, 12 from Asia, four from the Middle East and North Africa, and five from Eastern Europe and Central Asia. These differences in coverage impact regional conclusions and should be considered carefully when evaluating index results beyond individual country scores.

*Normalization and weights*

Once the raw scores are assigned, each score is then normalized to a 0–100 range and then aggregated across categories. Normalization rebases the raw indicator data to a common unit, to make them comparable, so that they can be aggregated. The data in the *Microscope* are already in a fixed range, for example, 0–100, 0–4, so they have been transformed using the min/max of the fixed range. For example, if the indicator is in a 0–100 range, a raw data value of 0 gives a score of 0, and a raw data value of 100 gives a score of 100. If the indicator is in a 0–4 range, a raw data value of 0 gives a score of 0, and a raw data value of 4 gives a score of 100.

Assigning weights to categories and indicators is a final and critical step in the construction of the index. In a benchmarking model such as the Microscope, weights are assigned to categories and/or indicators to reflect different assumptions about their relative importance. There are various methods that can be used to determine these weights.

There are 12 Financial Inclusion Indicators relating to different regulations and business activities conducive to financial inclusion. Each Financial Inclusion Indicator is composed of between one and three sub-indicators, and *all 12 indicators are weighted equally*, or 8.33% each (100%/12).

The sub-indicators are weighted individually, depending on their overall importance to the Financial Inclusion Indicator. These weights were determined by a consensus between the project team, clients and industry experts. The sub-indicators are composed of between one and four

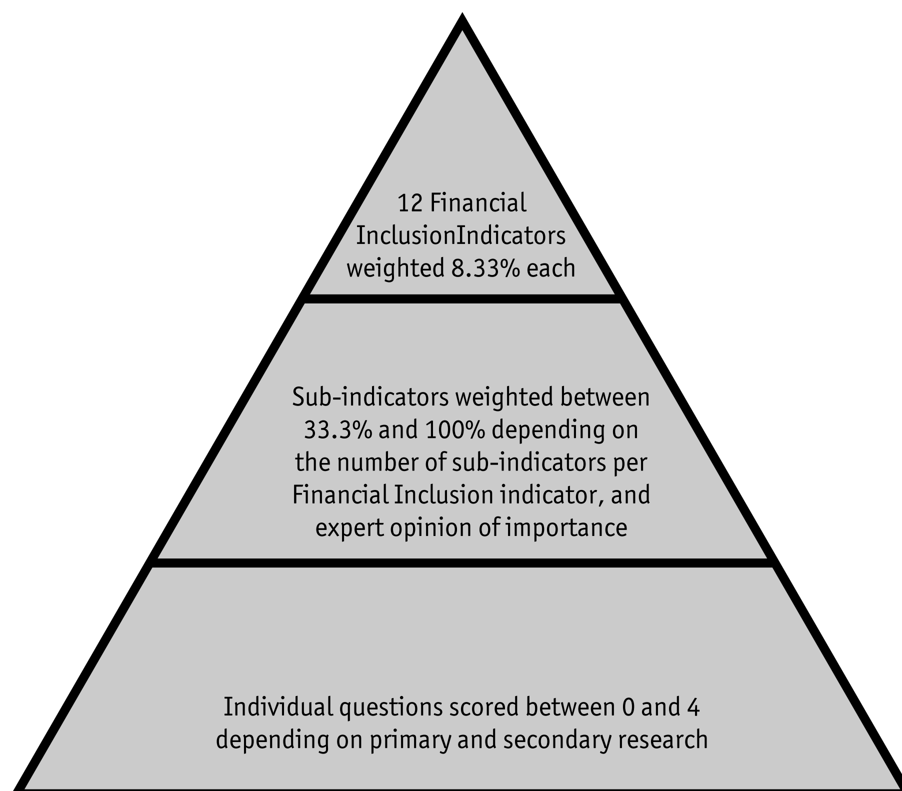



*Figure 2.* **Indicators pyramid**

*Source: Global Microscope 2015.*

*Table 2*
**Indicator and Sub-indicator Weights**

| Indicator | Sub-indicator | Question |
|---|---|---|
| **1. Government support for financial inclusion**<br>Considers a country's formal commitment and actions towards achieving financial inclusion.<br>*Weight: 1/12= 8.33%* | 1. Existence and implementation of a strategy<br>*Weight: 66.7%* | 1. Is there a documented strategy on financial inclusion? |
| | 2. Collection of data<br>*Weight: 33.3%* | 1. Does the government collect customer-level data that help understanding of low-income populations' demand of financial services? |
| **2. Regulatory and supervisory capacity for financial inclusion**<br>Considers whether regulatory institutions possess an adequate capacity, independence and readiness for the regulation and supervision of products and services related to financial inclusion.<br>*Weight: 1/12= 8.33%* | 1. Technical capacity to supervise<br>*Weight: 100%* | 1. Is there a specialised and adequate capacity in place in the regulatory agency? |
| | | 2. Is the financial regulator politically independent? |
| **3. Prudential regulation**<br>Considers how conducive the financial regulation is to allowing the entrance and operation of institutions that offer savings and credit products<br>*Weight: 1/12= 8.33%* | 1. Appropriate entry and licensing requirements<br>*Weight: 50%* | 1. Are minimum capital requirements appropriate to allow new entrants and ensure the safe provision of financial services?<br>2. Are there any impediments imposed on foreign funding or through ownership restrictions? |
| | 2. Ease of operation<br>*Weight: 50%* | 1. Are capital-adequacy standards appropriate to ensure both financial stability and the operation of a variety of providers?<br>2. Are reporting requirements reasonable in light of the specific nature of the services provided? |
| **4. Regulation and supervision of credit portfolios**<br>Considers whether regulations and supervision in the country are conducive to the responsible provision of credit<br>*Weight: 1/12= 8.33%* | 1. Interest Rates<br>*Weight: 33.3%* | 1. If there are interest-rate caps; if so, do they distort the market? |
| | 2. Risk management of credit portfolios<br>*Weight: 33.3%* | 1. Does the regulator actively supervise the status of overindebtedness for credit portfolios?<br>2. Is there a differentiated risk-management framework for consumer-credit portfolios? Does the regulator supervise the status of consumer-credit portfolios? |
| | 3. Risk-management framework for microcredit portfolios<br>*Weight: 33.3%* | 1. Is there a differentiated and comprehensive risk-management framework for microcredit? |
| **5. Regulation and supervision of deposit-taking activities** | 1. Ease of offering savings products by regulated institutions<br>*Weight: 50%* | 1. Are account-opening requirements for savings products proportionate? |

*Table 2 continued*

| Indicator | Sub-indicator | Question |
|---|---|---|
| Considers how conducive the regulation for deposit-taking is (the assessment focuses on commercial banks and non-bank financial institutions.)<br>*Weight: 1/12= 8.33%* | | 2. Are there any interest-rate restrictions that generate market distortions? |
| | 2. Existence of an in-depth deposit-insurance coverage<br>*Weight: 50%* | 1. Is deposit insurance applicable to all institutions authorised to take deposits and with the same conditions? |
| **6. Regulation of insurance targeting low-income populations***<br>Considers the existence of regulation and promotion of insurance to low-income populations by the regulator and/or government<br>*Weight: 1/12= 8.33%* | 1. Existence of regulation of insurance targeting low-income populations<br>*Weight: 33.3%* | 1. Is the regulation comprehensive and has it been implemented? |
| | 2. Delivery channels for insurance targeting low-income populations<br>*Weight: 33.3%* | 1. Do regulations facilitate a variety of channels for distribution? |
| | 3. Consumer protection for insurance targeting low-income populations<br>*Weight: 33.3%* | 1. Does the regulator monitor key indicators for consumer protection?<br>2. Are there clear rules that require insurance providers to disclose information about the overall cost of the products and consumers' rights and obligations?<br>3. Are there any dispute-resolution mechanisms available for insurance targeting low-income customers? |
| **7. Regulation and supervision of branches and agents**<br>Considers whether regulation is conducive to the delivery of financial services through physical branches and non-financial banking outlets.<br>*Weight: 1/12= 8.33%* | 1. Ease of setting up a branch<br>*Weight: 33.3%* | 1. How easy is it for financial-services providers to open a branch or direct-service outlet owned and operated by the financial institution? |
| | 2. Ease of agent operation<br>*Weight: 66.7%* | 1. Does the regulation allow a wide range of actors to serve as agents and does it enable all providers of financial services to have agents?<br>2. Are agents allowed to perform a wide range of activities?<br>3. Do regulations on agent exclusivity constrain the market?<br>4. Do financial institutions retain responsibility for the actions of their agents? |
| **8. Requirements for non-regulated lenders**<br>Considers whether the legal framework is conducive to the entrance and functioning of specialized institutions not prudentially regulated by the | 1. Information reporting and operational guidelines<br>*Weight: 100%* | 1. Are reporting requirements reasonable?<br>2. Do these providers comply with accounting transparency standards? |

*Table 2 continued*

| Indicator | Sub-indicator | Question |
|---|---|---|
| financial regulator. (NGOs, non-regulated co-operatives, retail lenders and other providers of credit)<br>*Weight: 1/12= 8.33%* | | |
| **9. Electronic payments**<br>Considers the regulation and infrastructure that facilitates electronic transactions to the low-income population.<br>*Weight: 1/12= 8.33%* | 1. Available infrastructure for financial inclusion<br>*Weight: 50%* | 1. Does the payment infrastructure serve the needs of the low-income population? |
| | 2. Digital financial services<br>*Weight: 50%* | 1. Are regulations on e-money or similar digital financial services adequate and are not constraining the market? |
| **10. Credit-reporting systems**<br>Considers the effectiveness and reliability of credit-reporting systems for the provision of credit<br>*Weight: 1/12= 8.33%* | 1. Comprehensiveness of information<br>*Weight: 50%* | 1. Is the information stored by credit-reporting systems comprehensive, regularly updated and accessed by providers? |
| | 2. Privacy protection for both borrowers and lenders<br>*Weight: 50.0%* | 1. Are privacy rights respected? |
| | | 2. Can individuals access their records and are they able to correct any errors? |
| **11. Market-conduct rules**<br>Considers institutional capacity as well as transparency, disclosure and fair treatment, with the aim of protecting financial-services consumers that use products and financial services<br>*Weight: 1/12= 8.33%* | 1. Existence of a framework and institutional capacity to protect the financial consumer<br>*Weight: 33.3%* | 1. Are there a framework and a specialised capacity in place for financial-consumer protection? |
| | 2. Existence and content of disclosure rules<br>*Weight: 33.3%* | 1. Does the regulator collect information about pricing and make relevant information easily accessible to consumers for comparison purposes?<br>2. Are there clear rules that require providers of financial services to disclose information about the overall cost of the products and consumers' rights and obligations? |
| | 3. Existence of fair-treatment rules<br>*Weight: 33.3%* | 1. Are there clear rules requiring non-discrimination in financial services provision in terms of gender, race, religion, cast, ethnicity, etc.?<br>2. Are there clear rules set by the regulator aimed at preventing aggressive sales and unreasonable collection practices? |
| **12. Grievance redress and operation of dispute-resolution mechanisms**<br>Considers availability of dispute-resolution mechanisms, client awareness of the grievance | 1. Internal complaint mechanisms<br>*Weight: 50%* | 1. Are there clear rules in place requiring financial-service providers to set up internal mechanisms to deal with consumer complaints? |

*Table 2 continued*

| Indicator | Sub-indicator | Question |
|---|---|---|
| processes and ease of access. *Weight: 1/12= 8.33%* | | |
| | 2. Existence and effectiveness of a third party-redress entity *Weight: 50%* | 1. Is there a third-party entity empowered with oversight where consumers can seek redress, and is it effective? |
| **A. Stability (Adjustment Factor)** Considers political tensions or other significant changes that affect the achievement of financial inclusion. | 1. General Political Stability *Weight: 33.3%* | To what extent are political institutions sufficiently stable to support the needs of businesses and investors? |
| | 2. Shocks and restrictive policies impacting financial inclusion *Weight: 66.7%* | To what extent have any shocks or restrictive policies affected market development? |

**For the purposes of this study, "insurance to low-income population", "micro-insurance" and "inclusive insurance" are considered to refer to the same concept.*

*Source: Global Microscope 2015.*

questions, which are scored according to thorough secondary research and expert interviews.

The scores for each question are aggregated to the sub-indicator level, where the individual weights are applied, and then the sub-indicators are aggregated to determine the final score.

For example, Financial Inclusion Indicator 1: Government support for financial inclusion is composed of two sub-indicators: sub-indicator 1.1 Existence and implementation of a strategy, and sub-indicator 1.2 Collection of data. Experts agreed that the Existence and implementation of a strategy (sub-indicator 1.1) is of greater importance to financial inclusion than Collection of data (sub-indicator 1.2), so sub-indicator 1.1 is weighted 66.67%, compared to 33.33% for sub-indicator 1.2.

Similar to previous years, the 2015 Microscope contains an adjustment factor, based on the stability score (the 13th indicator). After the country's total raw score is determined (through tallying and weighting of sub-indicator and indicator scores), the adjustment factor is applied, adjusting each country's total raw score downwards to account for any political instability and shocks/restrictive policies that may impact or challenge the environment for financial inclusion.

The adjustment factor is a percentage reduction applied to the raw country score, up to a maximum of 25% (that is, countries can lose up to 25% of their raw country score through this adjustment factor). The adjustment factor is calculated based on the country's stability indicator score, which, in turn, is a combination of two sub-indicators (general political stability, and restrictive policies or other shocks to the market) aggregated to generate a score of 0–100. The adjustment factor is calculated using the following formula:

Adjustment factor = (100 — stability score) × × 0.25,

where:

Stability score = 0.33 × (normalized political stability score) + 0.67 × (normalized restrictive policy score).

The country score follows this formula:

Country score = Raw country score × [ (100 – – adjustment factor)/100].

Example for a country "Y":

Raw country score = 40.8.

Stability score = 37.2.

Adjustment factor = (100 – 37.2) × 0.25 = 15.7.

Country score = 40.8 × [ (100 – 15.7)/100] = = 40.8 × 0.843 = 34.4.

*Moving in the right direction, though slowly*

*The 2015 Microscope Index* shows a number of improvements in the last year (see table 1), including an increase in the average score of the top ten in the study, from 67 in 2014 to 69 in 2015. One of the most positive developments is at the bottom of the rankings. In 2014, five countries received overall scores of 25 or less.

*Table 3*

**Microscope 2015 overall scores and rankings**

| Rank/55 | | | Score/100 | Δ |
|---|---|---|---|---|
| **Average** | | | 48 | +2 |
| 1 | ←→ | Peru | 90 | +3 |
| 2 | ←→ | Colombia | 86 | +1 |
| 3 | ←→ | Philippines | 81 | +2 |
| 4 | ▲1 | India | 71 | +10 |
| 5 | ▲2 | Pakistan | 64 | +6 |
| 6 | ▼2 | Chile | 62 | −4 |
| 6 | ▲3 | Tanzania | 62 | +6 |
| 8 | ▼1 | Bolivia | 60 | +2 |
| 8 | ▼3 | Mexico | 60 | −1 |
| 10 | ▲8 | Ghana | 58 | +7 |
| 11 | ←→ | Indonesia | 56 | +1 |
| 11 | ←→ | Kenya | 56 | +1 |
| 11 | ▲3 | Uruguay | 56 | +3 |
| 14 | ▼5 | Cambodia | 55 | −1 |
| 14 | ▲3 | Morocco | 55 | +3 |
| 16 | ▼5 | Rwanda | 54 | −1 |
| 17 | ▼3 | Brazil | 53 | 0 |
| 17 | ▲1 | Nicaragua | 53 | +2 |
| 19 | ▼5 | Paraguay | 52 | −1 |
| 20 | ▲3 | Bosnia and Herzegovina | 51 | +3 |
| 20 | ▲3 | Dominican Republic | 51 | +3 |
| 20 | ▲3 | Ecuador | 51 | +3 |
| 23 | ▲8 | Mozambique | 50 | +6 |
| 23 | ▲5 | Turkey | 50 | +4 |
| 23 | ▼3 | Uganda | 50 | 0 |
| 26 | ▼3 | El Salvador | 49 | +1 |
| 26 | ▼3 | Thailand | 49 | +1 |
| 28 | ▲1 | Mongolia | 48 | +3 |
| 28 | ▼8 | Nigeria | 48 | −2 |
| 30 | ▲3 | Kyrgyz Republic | 47 | +4 |
| 31 | ←→ | Panama | 46 | +2 |
| 31 | ←→ | South Africa | 46 | n/a |
| 33 | ←→ | Jamaica | 45 | +2 |

*Table 3 continued*

| Rank/55 | | | Score/100 | Δ |
|---|---|---|---|---|
| 33 | n/a | Russia | 45 | n/a |
| 35 | ▼2 | Senegal | 44 | +1 |
| 36 | ▲6 | China | 42 | +6 |
| 36 | ▲5 | Costa Rica | 42 | +5 |
| 36 | ▲8 | Honduras | 42 | +7 |
| 36 | ▲12 | Trinidad and Tobago | 42 | +9 |
| 40 | ▲2 | Argentina | 39 | +3 |
| 40 | ▼11 | Bangladesh | 39 | −6 |
| 40 | ▼4 | Guatemala | 39 | 0 |
| 40 | ▲7 | Nepal | 39 | +5 |
| 44 | ▼6 | Tajikistan | 38 | 0 |
| 45 | ▼1 | Cameroon | 35 | 0 |
| 46 | ▼10 | Vietnam | 34 | −5 |
| 47 | ▼3 | Sri Lanka | 33 | −2 |
| 48 | n/a | Ethiopia | 32 | n/a |
| 48 | n/a | Jordan | 32 | n/a |
| 50 | ▼1 | Venezuela | 31 | +3 |
| 51 | ▲2 | Egypt | 29 | +8 |
| 51 | ▼1 | Lebanon | 29 | +2 |
| 53 | ▼1 | Madagascar | 27 | +4 |
| 54 | ▼3 | Dem. Rep. of Congo | 26 | +1 |
| 55 | ←→ | Haiti | 24 | +8 |

*Normalised score 0–100, where 100 = best*
*"←→" No change in rank*
*"▲" denotes a change*
*Source: Global Microscope 2015.*

Four of these countries are covered again in this year's Index. Of these, three (Democratic Republic of Congo, Egypt and Madagascar) have moved above 25 points. The other, Haiti, nearly made it, with one of the biggest gains in the last year: it rose from 16 to 24 points. These improvements indicate that some basic elements of policy essential to promoting financial inclusion are now widespread, and that efforts to raise awareness and measure progress are more relevant with time.

Although less striking, progress is also visible in most other *Microscope* countries. Of the 51 that are covered in the 2014 and 2015 indices (country composition has changed in the last year), 37 saw an improvement in their overall scores from last year, while only nine experienced a decline.

**Bangladesh**, which slipped the most this year (six points), dropped mostly in the score for *Government Support for Financial Inclusion*, scoring poorly in the *Government's Collection of Customer*

*Data* from *Financial Institutions* sub-indicator, which was redefined in 2015. The declines also require a caveat. In some cases, they reflect deterioration in policy; a tightening of interest-rate caps, for example, contributes to **Vietnam's** decline of five points. In other cases, lower scores reflect reassessment in the light of our ongoing efforts to obtain more detailed information on how financial inclusion measures are working in practice. This affected **Vietnam**, for example, as a result of new information on regulation of agents.

In other words, one of the key takeaways from the *2015 Microscope* is that there is very little policy slippage around financial inclusion; new policies are being adopted and existing ones further implemented. The real concern in this year's report is how limited progress has been. Although most countries saw higher scores than in 2014, on average the increase was **only two points out of 100**. Moreover, the overall average is just **48** out of 100. Put another way, only 22 out of 55 *Microscope* countries are more than halfway towards a robust and functioning policy environment that fully promotes all aspects of financial inclusion, and just three are more than three-quarters of the way along that journey.

These figures have changed little since last year. Although, as discussed below, some countries are seeing important progress, worldwide financial inclusion is experiencing what could best be described as a *slight positive drift*.

*Looking at the big picture*

Given the diverse and complex elements that contribute to financial inclusion, it might be tempting for governments with limited resources to focus narrowly on specific areas. The Index results suggest that this is the wrong approach. The countries seeing the fastest increases in their scores, and those which are at the top of the Index, are more likely to be pursuing a comprehensive strategy, or at least programmes and laws that tackle simultaneously multiple, often interlinked, barriers to inclusion. High scores for *market-conduct rules* were mostly correlated with a high overall score and, although the correlation was not high, it was statistically significant.

The results of such an approach can be seen rapidly. **India** saw the biggest increase of any country in its score this year (10 points), which largely reflected a substantial drive to make banking more accessible to the entire population.

This included the issuing in July 2014 of guidelines for creating specialized *Payment Banks and Small Finance Banks* specifically aimed at the poor, and the in-principle approval of 11 of the former (as of August 2015) and 10 of the latter (as of September 2015). A month later, the Indian government, in conjunction with the banking industry, launched a programme to provide a basic bank account for every household, which included access to financial education, credit and insurance. By January 2015, nearly 100% of households had such a facility, although active use of the new accounts has been limited so far, with most accounts remaining dormant. Penetration of financial services in rural areas also remains low.

Two more of the top gainers over the past year — **Haiti** and **Egypt** (both up eight points) — took measures that covered an even wider range of financial inclusion issues. Haiti's new financial inclusion strategy, drawn up with the help of the World Bank and not yet fully implemented, has brought improvements across various areas of the Index. The most obvious was the *Government Support for Financial Inclusion* indicator.

Elsewhere, the knowledge obtained from the policy-creation process drove gains in *Regulatory and Supervision Capacity* and the creation of a Credit Bureau in October 2014 also led to improvements in the *Credit Reporting Systems* indicator. **Egypt**, meanwhile, improved its score in seven out of 12 Index indicators, largely because of *Law 141 of 2014* and its implementation. Although this does not represent a formal financial inclusion strategy, it is the country's first legislation that addresses microfinance.

In addition to gains over the short term, Index results also indicate that comprehensive, national financial inclusion *strategies* drive long-term results. Of the six countries that get top scores for implementing such a strategy (Colombia, India, Pakistan, Philippines, Rwanda, Tanzania), five finish in the top seven places overall in the Index (Rwanda being the exception). In other words, strength in this sub-indicator drives results across the board. **Peru** seems to be an anomaly, ranking first overall but scoring only 2 out of 3 for this indicator.

It may, however, be the exception that proves the rule. In July 2015, rather than continuing to rely on multiple, diverse initiatives, the country published its first *National Strategy of Financial Inclusion*. Full implementation of Peru's strategy would likely tip it into the top scoring range for this Index metric.

*Lessons from the top of the standings*

Three countries form a top group that scores far higher in the Index than all the others: **Peru** (90 points), **Colombia** (86 points) and the **Philippines** (81 points). Several commonalities among them are noteworthy, in that they suggest key approaches to improving financial inclusion.

I. **Commitment matters**: In all three countries, financial inclusion has been on the government's agenda for some time. The central banks of the Philippines and Peru, for example, were among the 17 original participants in the ***Maya Declaration*** in 2011 and, although Colombia took another year to join, its financial inclusion efforts date back to 2006.

II. **Consistency matters**: The most striking similarity in the scores of these three countries is the breadth of their activities. These countries perform well in the areas mentioned at the beginning: *policies and regulations* for a range of financial products and services offered; the *diversity of institutions* providing them; *regulation of delivery methods*; and the *institutional support* that ensures the safe provision of services to low-income populations. **Peru** gets top scores in seven of 12 indicators and scores 75 or above in all of them. **Colombia** earns 100 points for five indicators and also scores 75 or above everywhere, save *Regulatory and Supervisory Capacity for Financial Inclusion*, where it is let down by ongoing political interference with regulators. Similarly, the **Philippines** attains perfect scores in five indicators and falls below 75 only once, because of weaknesses in *Requirements for Non-Regulated Lenders*.

III. **Previous success does not exempt countries from the new challenge of adopting electronic-payment systems**: The one indicator where all three of the leading countries are relatively weak is the *Regulation of Electronic Payments*. Here, each country scores only 75, although this is much higher than the Index average of 55 for this indicator. The issue is not the details of the regulation — ability of the low-income population to use the electronic-payment infrastructure. In particular, electronic-payment systems tend to be expensive and fragmented, with only one of these countries, **Peru**, beginning to take advantage of mobile phones as payment management tools.

The three leaders are not alone in this. Given the wide distribution of mobile phones, the degree of media attention that the use of mobile payments in East Africa has received, and the clear potential of such systems for enhancing financial inclusion, it is surprising how few countries have been able to create reliable *electronic-payment systems* that address the needs of low-income individuals. This is relatively low-hanging fruit, however, which should draw the attention of those active in the field.

*Financial inclusion strategies and initiatives on the rise*

The 2015 Index has seen substantial progress in the launch of comprehensive financial inclusion strategies, as well as the implementation of existing ones. While Honduras is in the process of adopting a national financial inclusion strategy, Haiti, Indonesia, Peru and Paraguay have already launched such strategies.

In terms of ongoing commitments, in 2015, Bolivia, Colombia, Ecuador, Pakistan and Uruguay have all begun to implement previously adopted legislation and strategies, with the express purpose of increasing access to financial services. Bolivia has made financial inclusion a priority since its current constitution was inaugurated in 2009, and continues to move towards greater inclusion. Colombia's strategy is in the process of being fully implemented. Ecuador is implementing its strategy by initiating payments systems, electronic money, and credit facilities. In Pakistan, the government has a very well documented and articulated strategy, as well as a road map for priority actions and target indicators. The government has already taken steps towards further financial inclusion, having simplified the "Asaan Account", with no minimum balance and a required deposit of only PRs100 (around 95 US cents), although its degree of adoption will be a true test of success.

Implementation will also be the litmus test for the Credit Act, which has just been passed by the National Assembly. Although implementation of both of these initiatives is still in the early stages, the government has shown commitment and targets are expected to be implemented by 2020. The State Bank of Pakistan (SBP, the central bank) is addressing interoperability and money-transfer systems that will facilitate implementation of the requirement that all salaries be paid electronically. In Uruguay, the government passed Law 19 210, the Law on Financial Inclusion, in April 2014. The law details a number of specific steps. The first, which was reducing VAT on all transactions using electronic payments, has been taken.

Rounding out these positive developments, Argentina, Egypt and Nicaragua have shown great promise by adopting legislation that targets aspects of financial inclusion, despite lacking comprehensive national strategies. In April 2015, *Impulso Argentino* (a public-private partnership, or PPP, which promotes inclusive microfinance for small businesses and entrepreneurs), signed anagreement in which the government will provide Ps40m (around US$4.2m) to advance microfinance activities. In June 2015 the *Banco Central de la República Argentina* (BCRA, the Central Bank) and the Ministry of Education signed an institutional co-operation agreement to promote financial literacy nationally. Egypt has no specific strategy for financial inclusion. However, in July 2013, the Central Bank of Egypt joined the *Alliance for Financial Inclusion* (AFI) as a principal member of the AFI network. In November 2014, a presidential decree issued Law no. 141, which is the first law to regulate microfinance services. According to the Egyptian Financial Supervisory Authority (EFSA), a special unit will be established to supervise microfinance activities of civil associations and non-governmental organizations (NGOs).

Furthermore, the EFSA Board of Directors has been tasked with identifying priority areas within the microfinance segment, including licensing requirements, capital adequacy and rules of supervision and control. For Nicaragua, although there is no documented strategy, the country has passed and is implementing a microfinance law, and is honing the regulatory framework for the segment.

*Insurance for low-income populations needs far greater attention*

For those affected by financial exclusion, low asset levels not only make daily life more difficult, they also make it much harder to deal with economic shocks. Some form of insurance designed for the poor is, therefore, an essential part of full financial inclusion. The 2015 Index accordingly increased the number of sub-indicators covering this field in order to attain a more nuanced understanding of the state of play (see the Methodology in the appendix for full details).

Despite the importance of insurance for low-income populations, the Index shows that it is a very common weakness in national financial inclusion efforts. The average score for *Regulation of Insurance for Low-Income Populations* was just 34 out of 100, by far the lowest for any indicator. Just as striking, 29 of the 55 countries scored only 25 points or less —a markedly greater proportion than for any other indicator — and this was also the sole indicator for which no country scored 100.

The most common issue seems to be lack of focus. Too often, insurance for low-income populations is regulated as part of the mainstream insurance market, but its particular requirements, such as low levels of coverage, as well as a lack of simple policy conditions that can be explained by non-specialist agents and understood easily by purchasers, require more specific frameworks and oversight. Just six countries have implemented such targeted regulations in a comprehensive way. None of those six receive the top score for protecting consumers who buy policies, and 46 countries out of 55 score 50 points or below (out of 100).

Although the numbers are too small to allow definite conclusions to be drawn, the Index data suggest that the widespread failure to regulate adequately this type of insurance is holding back the market. For those countries scoring poorly, there is little statistical correlation between scores for this indicator and the number of people buying insurance. However, once a threshold is reached (around 60 out of 100) higher scores correlate in a statistically significant way with the percentage of people buying coverage. In other words, potential buyers may be put off until the market is deemed safe enough, after which effective regulation and protection makes offer-

ing insurance to low-income populations a viable business option.

*In too many countries, consumer protection remains a challenge*

India's 2010 microfinance crisis, which centered on the province of Andhra Pradesh, was a formative event in the history of financial inclusion, and it showed the central importance of effective consumer protection to the long-term success of the financial inclusion agenda.

Five years on, Index data point to some worrying gaps in such protection. To begin with, measures as a whole are often weak. As of 2015, only eight of the 55 countries, including just one outside of Latin America, provide a comprehensive framework and capacity to protect the financial consumer. There were some, but not many, improvements in this category from 2014 to 2015, with El Salvador, Colombia and the Dominican Republic improving their scores. Most countries stayed the same, with only Tajikistan seeing its score dropping. More worrying still, just eight countries have clear regulations aimed at preventing aggressive sales and unreasonable collection practices, while 20 countries score zero on this sub-indicator, indicating a complete absence of such protection. Four countries showed improvement in this area in 2015, and two saw a drop in their scores.

Concerns also exist around specific areas of activity relevant to financial inclusion. As noted above, no country gets top scores for legal protection for buyers of insurance targeting low-income populations. Similarly, only 14 countries have deposit-insurance schemes that cover, with the same conditions, all institutions allowed to receive funds from savers. Many states have such insurance for banks or other traditional financial institutions, but lower or no coverage at all for accounts at co-operatives or other deposit-taking institutions. Indeed, we downgraded the score of 12 countries for this indicator in this year's Index because a close examination of the regulations revealed such a disparity.

Finally, a danger that threatens both individual borrowers and the segment more widely is lack of attention to over-indebtedness. We changed the relevant indicators in the Index and found that 17 countries were doing this very well, and almost half improved year on year. In terms of regulations for risk management of consumer credit portfolios, only four countries improved and two dropped in score. Scores for the regulation of risk management of microcredit portfolios improved more broadly in 21 countries.

*Financial inclusion requires capable customers*

The qualitative country analyses included in this report are not only a means of providing important local details; they also help address a limitation inherent in any index such as this one. Indices can include only indicators for which data are available, which means that some factors of potentially great importance to understanding an issue may have to be left out.

For financial inclusion, one such issue is low financial literacy among the poor in many, if not most, developing countries. Measurement of the levels of such literacy is a major gap, although data from a new initiative, Standard & Poor's Ratings Services *Global FinLit Survey* (see: http://www.FinLit.MHFI.com), was being released as this report went to press. Even for developed countries, the OECD is only now undertaking a project to define the term and measure financial literacy.

The lack of hard data does not make the issue any less pressing. Although not asked to comment specifically on the question, the authors of roughly half the country assessments in this publication specifically mention poor financial literacy or the need for financial education as a leading inclusion challenge. This is no anomaly. In a global survey for the World Bank's 2014 *Global Financial Development Report*, 78% of financial-sector practitioners agreed that, "The lack of knowledge about basic financial products and services is a major barrier to financial access among the poor in my country." Nor is this a problem only for poor performers in the Index. The country reports of the top five finishers all note the need for improved financial literacy among the population targeted by financial inclusion efforts.

How to improve such literacy is an open question, with little, if any, good research to point to effective methods[13]. It is, however, an issue

[13] For a summary of what is available, see Margherita Calderone, "The Role of Financial Literacy and of Financial Education Interventions in Developing Countries," Deutsches Institut für Wirtschaftsforschung. Roundup Paper No. 34, 2014.

which those working for financial inclusion will need to address.

*Signs that policy is having the desired effect*

The *Microscope* Index is based on measures of policy, regulation, supervision, government capacity, infrastructure and stability — the elements that create the environment for financial inclusion — rather than measures of outcome. This can lead to incongruous results. For example, the three top Index countries — Peru, Colombia and the Philippines — score below others in their region and in their income group on most of the *Global Findex's* measures of inclusion. To look at just one metric, both Peru and Colombia are upper-middle-income countries, in which, on average, 71% of adults have bank accounts. They are also both in Latin America, where 51% of adults have such accounts. For Colombia, however, the equivalent figure is 39% and in Peru, the Index leader, just 29%.

The broad explanation for this apparent disconnect is that, just as it takes time for policy to change, it also takes time for policy, once enacted, to have an effect. Moreover, in some cases, as with insurance targeting low-income populations, as discussed above, a critical mass of regulation may need to exist before markets can grow in a meaningful way. And challenges posed by geography, history and cultural factors are unique in each country. Nevertheless, over time, one would expect that outcome measures of financial inclusion would begin to converge with policy-related ones.

The data suggest that this may be starting to happen, as a number of our Index scores correlate with several relevant Global Findex and IMF indicators. In particular:

1. A higher score on *Regulation and Supervision of Deposit-Taking Activities* is associated with a higher proportion of the adult population having bank accounts;

2. Better results on *Regulation of Electronic Payments* correspond with more of the population having mobile financial accounts;

and

3. The more points a country attain for *Credit Reporting Schemes* the greater the percentage of adults that have borrowed from a financial institution.

In each of these cases, the extent of the suggested effect, the correlation, is modest. However, the likelihood that there is no link at all (the p-value) is also small, indicating that the connections are statistically significant, if still weak. Correlation does not necessarily mean causation, but, in these cases, the posited explanations for the data seem reasonable. It will be worth taking a closer look when the Global Findex's revised figures appear in 2017 to see if advanced policies are having a measurable effect on financial inclusion.

***What about Russia?***

In 2014 the share of the adult population (15 or over) with an account at a financial institution was 67%, compared with 48% in 2011. Of these, women were slightly above the average, at 70%, while young adults (aged 15–24) were well below the average, at 54%. Of adults belonging to the poorest 40% and adults living in rural areas, 62% and 61%, respectively, had accounts at financial institutions. The landscape of providers consists of three main groups: banks and other credit organizations; non-financial organizations, such as microfinance institutions (MFIs) and credit co-operatives, which can lend, but cannot take deposits or give credit; and payment-service providers, such as money-transfer operators, e-money operators, mobile network operators (MNOs) and payment agents.

The government has been very active in relation to financial inclusion over the last few years, with legislation bringing MFIs and credit co-operatives into the regulatory framework, as well as laws on payment systems and payment agents. Formerly divided between the Central Bank of Russia, the Ministry of Finance and the Federal Service for Financial Markets, most categories are now regulated and supervised by the Central Bank.

This still leaves a large market for agricultural credit co-operatives (ACCs) that are regulated separately and overseen by the Ministry of Agriculture, as well as an unknown number of unregistered non-financial organizations (thought by some to outnumber the MFIs registered under the new law).

There have been several regulatory changes at the beginning of 2015 that have the potential to affect the environment negatively,

*Table 4*
**Russian scores overview**

| | Score/100 | | Rank/55 | |
|---|---|---|---|---|
| | **2015** | **Δ** | **2015** | **Δ** |
| Microscope 2015 overall score | 45 | n/a | =33 | n/a |
| 1) government support for financial inclusion | 61 | n/a | =13 | n/a |
| 2) regulatory and supervisory capacity for financial inclusion | 58 | n/a | =10 | n/a |
| 3) prudential regulation | 25 | n/a | =54 | n/a |
| 4) regulation and supervision of credit portfolios | 67 | n/a | =18 | n/a |
| 5) regulation and supervision of deposit-taking activities | 100 | n/a | =1 | n/a |
| 6) regulation of insurance for low-income populations | 53 | n/a | =16 | n/a |
| 7) regulation and supervision of branches and agents | 58 | n/a | =36 | n/a |
| 8) requirements for non-regulated lenders | 50 | n/a | =18 | n/a |
| 9) regulation of electronic payments | 25 | n/a | =41 | n/a |
| 10) credit reporting systems | 75 | n/a | =15 | n/a |
| 11) market conduct rules | 56 | n/a | =17 | n/a |
| 12) grievance redress and operation of dispute resolution mechanisms | 17 | n/a | =44 | n/a |
| A) adjustment factor (stability and policies) | 32 | n/a | =47 | n/a |

*Source: Global Microscope 2015.*

although their impact could be delayed and is likely to be more serious for smaller institutions. New interest-rate caps on consumer loans were temporarily suspended to allow banks and MFIs to reflect their full cost of lending and to secure their continued ability to provide funds. In addition, the minimum capital requirement was raised from 180m to 300m rubles (from around US$2.8m to around US$4.7m), which could lead to the closure of many regional banks. According to the Association of Regional Russian Banks, this would have a negative impact on the segment, as regional banks are often closer to their customers, better suited to regional specifics, and operate in areas where the larger banks do not have a presence.

While there has been significant progress in the regulatory framework for financial inclusion in recent years, there are still many areas for improvement. Not enough is known about demand for particular services among the financially underserved, and, while there has been plenty of innovation in the segment, most people still use traditional channels. This is partly due to infrastructure — with more remote areas and populations not being reached — and partly due to a lack of education and **trust** in financial services.

**Clearly, more work can be done!**

## References

1. ANNUAL REPORT 2014. Grameen Bank.
2. Calderone, Margherita. (2014). The Role of Financial Literacy and of Financial Education Interventions in Developing Countries. Deutsches Institut für Wirtschaftsforschung. *Roundup Paper,* No. 34.
3. Christen, Robert Peck; Rosenberg, Richard; Jayadeva, Veena. (2004). Financial institutions with a double-bottom line: implications for the future of microfinance. *CGAP Occasional Paper*.
4. Experiences of microfinance institutions serving very small to small enterprises in Latin America. International Finance Corporation in Partnership with Dutch Government, 2014.

5. Feigenberg, Benjamin; Field, Erica M.; Pande, Rohini. (2010). Building Social Capital Through MicroFinance». *National Bureau of Economic Research Working Paper,* No. 16 018.

6. Global Microscope 2015. The enabling environment for financial inclusion. The Economist Intelligence Unit.

7. Henry, Carla; Sharma, Manohar; Lapenu, Cecile; Zeller, Manfred. (2003). Microfinance Poverty Assessment Tool. Consultative Group to Assist the Poor. Technical Tools Series, No. 5.

8. Hermes, Niels. (2014). Does microfinance affect income inequality? *Applied Economics*, No. 46 (9), 1021–1034. Also: Yunus, Muhammad & Jolis, Alan (contributor). (2008). Banker to the Poor: Micro-Lending and the Battle Against World Poverty. Public Affairs.

9. ILO. (2014). Microfinance for Decent Work. Enhancing the impact of microfinance: Evidence from an action research programme. Social Finance Programme & Mannheim University.

10. "Local roots". Interview with Hans Dieter Seibel. D+C/E+Z, 2010 at: http://www.dandc.eu/en/article/why-microcredit-programmes-should-be-based-local-savings

11. McMillan, Margaret S. and Rodrik, Dani. (2011). Globalization, Structural Change, and Economic Growth. *National Bureau of Economic Research Working Paper,* No. 17143. National Bureau of Economic Research, Cambridge, MA.

12. Robinson, Marguerite. (2001).The Microfinance Revolution: Sustainable Finance for the Poor (Lessons from Indonesia. The Emerging Industry). The International Bank for Reconstruction and Development/The World Bank, Communications Development Incorporated, Washington, D. C. and San Francisco, California.

13. Rodrik, Dani. (2013). Unconditional Convergence in Manufacturing. *Quarterly Journal of Economics.*

14. ____. (2015). Premature De-industrialization. *National Bureau of Economic Research Working Paper,* No. 20935.

15. ___. (2015). Work and Human Development in a Deindustrializing World. UNDP Human Development Report Office.

16. ___. (2016). Is Liberal Democracy Feasible in Developing Countries? *Springer Science+Business Media*, New York. (Paper was prepared for the 50th Fiftieth Anniversary Conference of Studies in Comparative International Development, Brown University, 2015 October, No. 30).

17. Rutherford, Stuart; Arora, Sukhwinder. (2009). The poor and their money: micro finance from a twenty-first century consumer's perspective. Second edition. Warwickshire, UK: Practical Action Publishing.

# The effect of capital structure and legal status on financial sustainability of MFIs in developing countries

***Nguyen Bich Ngoc,***
*Banking Academy of Vietnam,*
*ngocnb@hvnh.edu.vn*

**Abstract.** Due to limitation of previous researches on sustainability of MFIs in general, and relationship between capital structure and MFIs' sustainability in developing countries after financial crisis, this study has been written to fill this gap by examining the effect of factors such as the effect of capital structure and legal status on MFIs' sustainability. A sample of 434 MFIs operating in developing countries from 2010 to 2014 was used. While multiple regression techniques was used to test relationship between dependent variables and predictors, one-way analysis of variance was used to find differences in mean value of sustainability of MFIs having different legal status. The results revealed that sustainability of MFIs in developing countries was significantly and negatively affected by capital structure. Besides, the effect of legal status on MFIs' sustainability is very small.

**Keywords:** sustainability, capital structure, legal status, MFIs.

# Влияние структуры капитала и юридического статуса на финансовую устойчивость микрофинансовых институтов в развивающихся странах

***Нгуен Бих Нгок,***
*Банковская Академия, Вьетнам,*
*ngocnb@hvnh.edu.vn*

**Аннотация**. Статья подготовлена с учетом неполноты прежних исследований, в особенности взаимосвязи между структурой капитала и устойчивостью микрофинансовых институтов в развивающихся странах после финансового кризиса, с целью проверки результатов влияния на устойчивость микрофинансовых институтов структуры их капитала и юридического статуса. Были использованы данные о 434 микрофинансовых институтах, действующих в развивающихся странах за период с 2010 по 2014 г. Для теста взаимозависимости зависимых параметров и предикторов использовалась техника многофакторной регрессии. Для оценки различий в значениях медианы устойчивости микрофинансовых институтов с разным юридическим статусом применялся однофакторный дисперсионный анализ. Результаты исследования показали, что устойчивость микрофинансовых институтов в развивающихся странах существенно и отрицательно зависит от структуры их капитала. Кроме того, юридический статус незначительно влияет на их устойчивость.

**Ключевые слова**: устойчивость, структура капитала, юридический статус, микрофинансовые институты.

# I. INTRODUCTION

MFIs are simply defined as organisations which are in charge of providing small scale financial services such as microcredits, savings or insurances for poor people (Asian Development Bank (ADB), 2000) to defeat against poverty (Armendariz & Morduch, 2010). By offering small, which is normally between $50 and $500 in short term, between three and twenty-four months with instalments are weekly or monthly (Strøm & Mersland, 2014), MFIs have increased income and consumption of poor households, leading to significant decrease in poverty (Boateng, Boateng & Bampoe, 2015); decrease in income inequality (Mahjabeen, 2008); and improvements in children's education and health (DeLoach & Lamanna, 2011). Therefore, microfinance model has been quickly replicated in many countries (Köhn, 2013) from its first application in Grameen Bank.

Happily, statistic shows that in 2010, 138 million poorest clients have been served by MFIs, and this number is expected to continuously increase to 175 million by 2015 (Reed, Gatti, Awimbo & Awimbo, 2013). Despite that, there are still many poor people, especially who living in developing countries, have had no chance to access basic financial services (Bogan, 2012). This fact leads to concern about by how MFIs can serve more customer in the future, and financial self-sufficiency is considered as a solution (Crabb, 2008; Daher & Le Saout, 2013; Quayes, 2015) because only when they are self-sufficient, they can help poor people become self-sufficient as well.

As a result, there are many researchers have studied factors affecting financial sustainability of MFIs such as Bogan, Johnson and Mhlanga (2007), Iezza (2010), Kinde (2012), Ngo (2012) and Tehulu (2013), in which most of them agree that capital structure is considered as one of key determinants of financial sustainability of MFIs. However, previous researches tended to be fairly limited because they have just been carried out in one economy or small region rather than all emerging economies as a sample. Therefore, this study wants to address this gap by conducting a research based on sample of MFIs in developing countries, and especially during 2010 to 2014 to examine the effect of capital structure on MFIs' sustainability in recent conditions. Besides, general trend in transforming from MFIs to banks or other legal status (Sekabira, 2013) in recent years is also controversial issue among researchers. There are many discussions related to whether these transformations are right or wrong, but the results are mixed. Therefore, in this paper the relationship between legal status and MFIs' sustainability is will be also studied.

The rest of this paper is structured as follows. Section 2 provides literature on the impact of capital structure as well as legal status on MFIs' financial sustainability. Section 3 looks at methods used to collect and analyse quantity data. Section 4 will report and discuss the results from analysis, models and findings. The last section will summarise main findings of this study, and gives some suggestions for future growth of MFIs in developing countries.

# II. LITERATURE REVIEW

## *2.1. Capital structure and MFIs' sustainability*

Tehulu (2013) tries to determine factors affecting MFIs' financial sustainability in East Africa. By using panel data collected from 23 MFIs during six-year period from 2004 to 2009, he examines the effect of leverage on MFIs' sustainability. In general, East African MFIs are found to follow pecking order theory that debts is preferred to equity when external financing is required, and for some reasons when debts become "infeasible", the use of equity is necessary to not reduce firm performance (Frank & Goyal, 2007). Particularly, the results obtained from binary prohibit and ordered prohibit regression models, which use outcome indicating MFI is financially sustainable or not as dependent variable, show that the relationship between debts to equity and MFIs' financial sustainability is negative and significant at the level of 5%. According to Tehulu, the main reason for inverse correlation between capital structure and sustainability of MFIs is many researched MFIs operating in developing countries attract investors by offering to make them loans rather than paying dividends to owners. As East African MFIs did not pay dividends to shareholders, equity is cheaper source of finance than debts; consequently, the great use of debts in total capital might reduce MFIs' chance to get sustainability.

Interestingly, also carrying research on sustainability of MFIs in East African countries like Tehulu (2013) does but in relatively smaller scale, differences in funding costs of equity and debts is also considered as main reason for inverse correlation between capital structure and MFIs' sustainability in studies conducted by Nyamsogoro (2010) and Kinde (2012). Particularly, Nyamsogoro (2010) surveys factors affecting financial sustainability of ninety-eight Tanzanian's MFIs in 2008. By running multiple regression, he concludes equity but not debts might significantly improve financial sustainability of MFIs at the level of 5%. Besides, Kinde's study, which is performed on fourteen Ethiopian MFIs during nine-year period from 2002–10, also concludes that the relationship between capital structure and sustainability of MFIs is negative. Clearly, as Tanzania and Ethiopia belong to East African countries, MFIs researched in Nyamsogoro' study and Kinde' study have the same characteristics with MFIs researched in Tehulu's study. Therefore, equity holders of MFIs in both Tanzania and Ethiopia also are not paid dividends by MFIs, and equity is relatively cheaper than debts and positively impact on MFIs' sustainability. These findings again confirm pecking order theory, noting there is no existence of target debt level, but when debts become "infeasible", the use of equity is necessary to not reduce firm's performance (Frank & Goyal, 2007).

However, while the negative relationship between capital structure and sustainability of MFIs in studies of Nyamsogoro (2010) and Tehulu (2013) is significant, Kinde's relationship is not significant. This might be explained by distinctive characteristic of Ethiopian MFIs. Particularly, most MFIs in Ethiopia are backed by government and large public financial institutions but not private investors are major owner of MFIs; therefore, capital market for MFIs is less developed and capital structure matters relatively little in this case (Deribie, Nigussie & Mitiku, 2013).

Sekabira (2013) analyses relationship between capital structure and sustainability of fourteen MFIs during 2004 to 2008 in Uganda — an East African country again. He finds that debts lower MFIs' chance to get sustainability or there is inverse relationship between debts and MFIs' sustainability, which is completely consistent with findings of Kinde (2012), Nyamsogoro (2010) and Tehulu (2013), who also undertake studies in East African countries. Moreover, the reason behind negative relationship between capital structure and MFIs' sustainability in Sekabira' study is also related to funding costs of MFI's financial resource. Particularly, Sekabira indicates that varied interest rate which MFIs have to pay for debt holders might threaten MFIs' performance or sustainability. Besides, debts used by MFIs perhaps come from non-regulated sources, which require high interest rate but have to be paid back in short term, might also contribute to increase financing cost and after that retard MFIs' financial sustainability (Sekabira, 2013). Thereby, limited access to debts for MFIs is what he recommends to Ugandan government.

Moreover, costs of funding is considered again as main reason for findings of Bogan et al. (2007) and Ngo (2012). Particularly, Bogan et al. (2007) complete the study for the effect of capital structure on MFIs' performance from the data of top 300 MFIs in Africa, East Asia, Eastern Europe, Latin America, the Middle East, and South Asia. They use two models, namely regression model and prohibit model, to examine relationship between MFI's sustainability and capital structure. Results obtained from both these models indicate the proportion of debts to total assets is negative and significantly related to operational sustainability. Based on a sample of cross-country MFIs from 1997 to 2010, Ngo (2012) also agrees with Bogan et al. (2007) that in general there is negative relationship between financial leverage and MFIs' sustainability. More importantly, both researchers use costs involved in using debts, such as transaction costs and interest paid to debt holders as main reason for placing financial burden on MFIs, reducing net income and lowering MFIs' chances to be sustainable.

By contrast, positive relationship between leverage and MFIs' sustainability is witnessed in study conducted by Kyereboah-Coleman (2007). Particularly, he reviews the impact of capital structure on financial sustainability of the 52 MFIs in Ghana during 1995 to 2004. In his study, two measures of outreach and default rate are used as proxy for MFIs' sustainability. According to Kyereboah-Coleman, higher leverage enables

MFIs to reach greater level of outreach or serve more customers, get higher income and profitability. Besides, he stresses that the increase in number of clients also helps MFIs to take advantage of economies of scale to reduce average operating costs. Moreover, the econometric result illustrates risk level of MFIs having high leverage is reduced because to cover funding expense of borrowing, managers are encouraged to generate higher income (Jensen, 1986) by diversifying their products, which after that help them to diversify and reduce risks (Kyereboah-Coleman, 2007). The negative relationship between leverage and default rates together with positive correlation between leverage and outreach lead Kyereboah-Coleman arrives at conclusion that highly leveraged MFIs have ability to get better performance and financial sustainability than other MFIs.

An additional confirmation of positive relationship between capital structure and MFIs' sustainability is witnessed in Iezza's study. Iezza (2010) tries to examine factors affecting financial sustainability of 687 MFIs in 63 countries worldwide in 2008. Results obtained by regression model reveal that capital structure keeps important role in improving sustainability of MFIs. Besides, findings of Iezza's study strongly support trade-off theory that MFIs would gain considerable tax advantage from using debts instead of equity; therefore, MFIs should be financed by debts to increase their profitability and sustainability level. However, he also notices that MFIs can take advantage of debts only when they do not step across the threshold of debt ratio.

Recently, Mwizarubi, Singh and Mnzave (2015) aim to explore how financial sustainability of a leading formal MFI in Tanzania responds to change in commercial borrowing. With the quarterly data from 1997 to 2014, their result is as the same as Kyereboah-Coleman and Iezza's findings, that the effect of commercial borrowing on sustainability is positive. However, the relationship between debts and MFIs' sustainability in study of Mwizarubi et al (2015) is insignificant, which might be explained by the changes in Tanzanian microfinance sector since 2003. Particularly, according to the official statistics on Tanzania's microfinance sector conducted by MFtransparency (2011), since 2003 there has been increase in the number of banks and financial institutions investing in MFIs, but unfortunately these investments have not achieved considerable success.

### *2.2. Legal status and MFIs' sustainability*

Mersland and Strøm (2008) in their research investigate whether governments are right about transforming MFIs from NGOs to private ones and find that there is slight difference in performance of NGOs and private owned MFIs. By analysing data collected from 200 MFIs in 54 countries during 2000 to 2006, Mersland and Strøm (2008) indicate NGOs and other MFIs use the same model in attracting and serving clients, and importantly are affected by the same economic rationality. Besides, authors confirm that NGOs can get sustainability by their own, because their ROA is higher than their counterpart' ones. As a result, undergoing transformation from NGOs to private owned MFIs or making changes in legal status might not be considered as a good idea for improving sustainability of MFIs.

In contrast, Tchakoute-Tchuigoua (2010) indicates there is significant difference in sustainability between MFIs related to legal status. Tchakoute-Tchuigoua' study is based on worldwide sample of 202 MFIs from 2001 to 2006, and documents dissimilarity in form of ownership might lead to difference in organizational structure, which might result in difference in financial performance and sustainability among MFIs. Specifically, he indicates in terms of OSS, private MFIs do perform better than NGOs because NGOs run higher risk in lending money and their board members might pay less attention to monitor management and sustainability (Christen & Rosenberg, 2000).

Similar to Tchakoute-Tchuigoua (2010), Barry and Tacneng (2011) also observe different level of sustainability among different types of MFIs. They examine 281 MFIs in Africa from 1996 to 2008 to find out whether or not sustainability in terms of OSS is affected by organizational structure or legal status of MFIs. Their study's findings reveal under the effect of competition for clients and grants, the behaviour of different types of MFIs is not the same; therefore, the differences in financial performance and level of sustainability among MFIs related to legal sta-

tus is undeniable. Specifically, in terms of OSS, credit unions do perform better than NGOs and in turn, NGOs perform better than Non-Banks.

## III. METHODOLOGY

The central topic of this paper is sustainability of MFIs in developing countries, where many poor customers have still found difficult to access financial services (Ghalib, Malki & Imai, 2015); therefore, the sample frame of this study consists of all MFIs operating in less developed countries and disclosing their annually financial information in MIX market. The reason for choosing all MFIs operating in developing countries, which are listed on MIX market as a sampling frame, is because they are assumed to be most accountable and transparent MFIs (Cull, Demirgüç-Kunt & Morduch, 2007).

As data used in this study is numerical data, of which value can be measured numerically (Saunders, Lewis & Thornhill, 2007), quantitative approach was applied. Particularly, quantitative approach was used to measure sustainable level of MFIs, capital structure, revenue, efficiency, risk and liquidity, and development and growth factors of MFIs. Moreover, quantitative analysis was also used to look for connections and spot relationships between dependent variable (Operational self-sustainability) and independent variables, especially capital structure (debt to equity ratio). Particularly, before deciding which statistical tests are appropriate to answer specific research questions, it is important to describe characteristics of all variables used in this study and check assumptions to make sure that study's findings are accurate.

*Firstly*, as data in this study is continuous variables, descriptives was used to explore basic statistics such as mean, maximum, minimum, standard deviation of dependent variable and predictors. Besides, SPSS graph builder was also used to describe changes in mean value of OSS and DER through years.

*Secondly*, to access normality of the distribution, which is one of important assumptions should be satisfied to use parametric tests, this paper used the Kolomogorov-Smirnov test on SPSS (Appendix 1). As sig. value of K-S test is less than 0.05; therefore, assumption of normality in this study is violated. Data transformation in general and log transformation in particular was applied to all variables to deal with this problem as comment of Field (2009) and many researchers in microfinance sector such as Nyamsogoro (2010), Ngo (2012) and Nwachukwu (2014).

*Thirdly*, not only normal distribution, but autocorrelation, outliers, and multicollinearity were also tested to make sure results of further tests are accurate (Field, 2009; Pallant, 2013). Particularly, in terms of cross section data is used like this study, there might be autocorrelation or "correlation between members of series of observations ordered in time" (Kendall, Buckland & International Statistical Institute, 1971, p. 8). But the important thing is the presence of autocorrelation might lead to many problems such as estimators are biased and inefficient, results of t and F-tests and $R^2$ are not reliable (Gujarati, 1999). In this study, Durbin Watson d statistic, one of the most celebrated tests used for testing autocorrelation, was used. Fortunately, Durbin-Watson value is approximately 2 (Appendix 2); therefore, autocorrelation might not be problem in this paper.

*Fourthly*, in regression context, the presence of an outliers, which is defined as cases of which values are quite higher or lower than majority of other cases' ones (Pallant, 2013), might make researchers miss important information and receive confusing results; therefore, it is essential to recognise outlier (Dielman, 2001). Tails of distribution presented in graph named histogram was used to find out there is potential outliers in this study or not. There are some observations are out at the outlier labelling rule, but difference between trimmed mean and mean value is extremely small (0.003 — Appendix 3); therefore outlier problem might not be serious.

Finally, the existence of multicollinearity or explanatory variables are correlated might lead to estimates of parameter values are not reliable, and it is difficult for researchers to access the contributions of each independent variable to overall $R^2$ (Gujarati, 1999). Therefore, this study used results obtained from correlation matrix, which presents not only correlation between dependent variable and predictors, but also between independent variables to test for multicollinearity. Particularly, Pearson product moment correlation coefficient used, and fortunately the highest absolute value of correlation coefficient

between each of independent variable in this study was 0.543, which was less than 0.7 (Appendix 4); therefore, multicollinearity does not happen in this study.

After checking and correcting problems related to data, the next step is to run appropriate tests to answer specific research questions.

Firstly, to answer whether or not capital structure affect MFIs' sustainability, this paper used multiple linear regression model in which LOSS is dependent variable, LDER is main explanatory variable, LGLTA, LNEA, LDP, LALGNI, LYGL, LCPB, LPAR 30 and LFB are other independent variables.

$$LOSS = \beta_0 + \beta_1 \times LDER + \beta_2 \times LGLTA + \beta_3 \times LNEA + \beta_4 \times LDP + \beta_5 \times LALGNI + \beta_6 \times LYGL + \beta_7 \times LCPB + \beta_8 \times LPAR30 + \beta_9 \times LFB + \varepsilon,$$

where:

LOSS: natural logarithm of operational self-sufficiency.

$\beta_0$: constant.

$\beta_{1-9}$: slopes of independent variables.

LDER: natural logarithm of debt to equity ratio.

LGLTA: natural logarithm of gross loan portfolio to total assets.

LNEA: natural logarithm of non-earning liquid assets to total assets.

LDP: natural logarithm of deposits to total assets.

LALGNI: natural logarithm of average loan portfolio balance per borrower gross national income per capital.

LYGL: natural logarithm of yield on gross loan.

LCPB: natural logarithm of cost per borrower.

LPAR30: natural logarithm of portfolio at risk of default after 30 days due date.

LFB: natural logarithm of female borrower to total borrowers.

$\varepsilon$: random error.

To estimate parameters ($\beta_0$–$\beta_9$), this study used ordinary least square (OLS) estimator because firstly even in some estimating problems, OLS estimator still succeed on some of other criteria, and secondly it is easy to compute (Kennedy, 2008). Besides, when comparing with other method "it is intuitively appealing and mathematically much simpler" (Gujarati, 2003, p. 58).

Secondly, to analyse whether MFIs having different legal status have different sustainability level or not, one-way analysis of variance, which enabled me to compare mean score on sustainability for five groups (NGOs, NBFIs, credit unions, microfinance banks and others) was used.

## IV. FINDINGS AND DISCUSSIONS

### *4.1. The effect of capital structure (DER) on financial sustainability*

The econometric result of model supports the argument in literature that capital structure in terms of debt to equity ratio is significantly and negatively related to financial sustainability of MFIs (appendix 5). This finding is consistent with results in studies conducted by Bogan et al (2007), Ngo (2012), Nyamsogoro (2010), and Tehulu (2013).

Similar to this study, all researchers mentioned above use panel data collected from cross country MFIs, and choose operational self-sufficient and debts relative to equity as proxy for financial sustainability and capital structure respectively. For example, by using data collected from over 20 MFIs in East Africa, where many countries are developing ones, regression's result of Tehulu's study (2013) reveals that capital structure is significant and negatively related to financial sustainability of MFIs. According to Tehulu, the reason behind this finding is because there are many researched MFIs attracting investors by offering to make them loans rather than paying dividends. As a result, equity is relatively cheaper than loans, and more importantly equity but not debts can improve financial sustainability of MFIs. Moreover, not only being supported by results of cross-country studies, findings of this research are also backed by findings of Nyamsogoro (2010), who uses a sample of Tanzania's MFIs, which also has common characteristics like East Africa's MFIs.

The negative relationship between debt and financial sustainability is also reflected in study made by Kinde (2012), but not significant. The inconsistency in results obtained by this study and Kinde's study can be explained by differences in characteristics of studied MFIs. Particularly, while Kinde does research only in Ethiopia's MFIs, this study aims at analysing MFIs operating in developing countries. More importantly,

most MFIs in Ethiopia are backed by government, or large public financial institutions still dominate financial sector (Deribie, Nigussie & Mitiku, 2013); therefore, the involvement of private investors in MFIs is not big. That might be the reason why Ethiopia's MFIs investors did not find attractive to MFIs, and capital structure did not significantly affect financial sustainability of MFIs. Another important factor is that the period of time that Kinde's study covers is from 2002 to 2010, when global financial crisis happened. This may also affect financial performance or financial sustainability of MFIs during this time because Ethiopia is one of the countries that are significantly affected by crisis (Te Velde, 2008).

This study's finding is also differ from Kyereboah-Coleman (2007), who indicates that the increase in proportion of debt in capital structure will enhance greater outreach, profit and finally sustainability. However, instead of studying MFIs operating in many countries as this study did, Kyereboah-Coleman only concentrates on analysing the relationship between financing decision and sustainability of MFIs in Ghana. More importantly, Kyereboah-Coleman also does not use operational self-sufficiency as proxy for sustainability of MFIs like this research did, but outreach and default rate are used as variables to evaluate sustainability of Ghana's MFIs. These differences might help to explain why this result is true in case of Ghana's MFIs but not similar to results obtained by this research.

Interestingly, also using data of Tanzania's MFIs like Nyamsogoro (2010) does, but only focusing on leading formal MFI over the period of 18 years from 1997 to 2014, Mwizarubi, Singh and Mnzava (2015) find that debts or commercial borrowings have positive and insignificant impact on financial sustainability of MFIs, which is contradict with this research findings. This inconsistence might be firstly explained by differences in sample size. Particularly, while this study conducts research on MFIs in developing countries, Mwizarubi, Singh and Mnzava study just one MFI in Tanzania. Therefore, their result might be not universally appropriate or does not reflect relationship between capital structure and sustainability in other MFIs. Secondly, during researched period of Mwizarubi, Singh and Mnzava's study, changes in the development of microfinance industry in this country in general, and studied MFI in particular have occurred and might have impact on performance of MFIs. For example, since 2003 Tanzania has been witnessing an increase in the number of funds provided by banks and financial institutions to improve MFI's performance (MFtransparency, 2011). All together perhaps explain why result obtained from Mwizarubi, Singh and Mnzava's study is quite dissimilar to this study's one.

### *4.2. The effect of legal status on MFIs' sustainability*

The significant value for Levene's test, which tests whether variance in financial sustainability for each of five groups is the same or not, was less than 0.5 (0.000) (Appendix 6); therefore, assumption in this study is violated. As a result, I looked at Welch test, which verifies the robustness of ANOVA's results (Field, 2009) and is considered as a major alternative to the ANOVA F test (Jan & Shieh, 2014). Sig. value of Welch test is less than 0.05 (0.000) (Appendix 6), but eta squared value is quite small (0.014 — Appendix 7). This result indicates although there is significant difference among mean scores on OSS for five groups, the actual difference was very small, which is similar to conclusion of Mersland and Strøm (2008). Particularly, Mersland and Strøm (2008) indicate because of small differences in performance of MFIs having different legal status, the transformation from NGOs to private MFIs might not be a good option to encourage financial sustainability of MFIs. To explain for the reason behind this finding, Mersland & Strøm show NGOs and shareholder-owned MFIs might apply nearly the same model in attracting and serving clients. More importantly, Mersland and Strøm notice that a large portion of private MFIs' equity holders are still NGOs, grantors or investors with social orientation.

This study's finding, however, is contrast with results obtained by Tchakoute-Tchuigoua (2010), who documents in terms of OSS, private MFIs do perform much better than NGOs. He explains that NGOs run higher risk in lending their money (Tchakoute-Tchuigoua, 2010), and board members of NGOs pay less attention to monitor their management and sustainability (Christen & Rosenberg, 2000). However, based on legal status Tchakoute-Tchuigoua only classifies MFIs into three

groups (NGOs, cooperatives and private MFIs) but not five groups as this study did, and sample size of his study (202 MFIs) is relatively smaller than this study's one; therefore, there might be an inconsistency in results of two studies.

In addition, this study is also not in line with the conclusions of Barry and Tacneng (2011), who find that credit unions totally dominates NGOs in terms of OSS. However, unlike this study, which analyses data collected from many developing countries in the world, Barry and Tacneng's study is only based on a sample of 281 MFIs operating in African region. Another important point is that not only using OSS as proxy for MFI's financial sustainability as what this research did, but Barry and Tacneng also use return on assets and financial revenue ratio to measure sustainability of MFIs. Therefore, Barry and Tacneng's result might be different with this study's finding.

## V. CONCLUSIONS

There are two main results were found in this paper. *Firstly*, it is found that this paper's finding is in line with pecking order theory, which shows that in comparison with equity, debts are favoured among MFIs in developing countries, and the increase in debt to equity ratio led to decrease in MFI's sustainability level. This negative relationship between capital structure and financial sustainability of MFIs in this study might be explained by the lack of accessing full costs associated with financing sources in general, and debts in particular. This reason is also emphasized by a survey conducted by CGAP (2007), which indicates based on price debts are primarily chosen by MFIs' managers but few of them thoroughly understand monetary and non-monetary costs of debts as well as factors affecting on these costs.

*Secondly*, small difference in financial sustainability among MFIs related to legal status was found and might be explained by great similarities in objectives (Hartarska, 2005) and business model of MFIs having different legal status (Mersland & Strøm, 2008). Besides, as public funders hold up to two thirds of MFIs' share (Köhn, 2013); therefore, they but not commercial investors occupy a crucial role in equity funding for shareholder-owned MFIs (MicroRate, 2013) might also contribute to give a reason for small effect of legal status on MFIs' sustainability.

## References


1. Armendariz, B., & Morduch, J. (2010). The economics of microfinance. Cambridge, Mass; London: MIT Press.
2. Asian Development Bank (ADB). (2000). Finance for the poor: Microfinance Development Strategy. Retrieved from: http://www.syngentafoundation.org/__temp/Finance_for_the_poor_ADB_2000.pdf
3. Barry, T. A., & Tacneng, R. (2011). Governance and performance: evidence from African microfinance institutions. *Laboratoire d'Analyze et Prospective Économiques (LAPE) Working paper.*
4. Boateng, G. O., Boateng, A. A., & Bampoe, H. S. (2015). Microfinance and Poverty Reduction in Ghana: Evidence from Policy Beneficiaries. *Review of Business & Finance Studies*, 6 (1), 99–108.
5. Bogan, V. L. (2012). Capital structure and sustainability: An empirical study of microfinance institutions. *Review of Economics and Statistics*, 94 (4), 1045–1058.
6. Bogan, V. L., Johnson, W., & Mhlanga, N. (2007). Does Capital Structure affect the financial sustainability of Microfinance Institutions. Retrieved from: http://www.researchgate.net/profile/Vicki_Bogan/publication/238621802_Does_Capital_Structure_Aect_the_Financial_Sustainability_of_Microfinance_Institutions/links/004635399e807e6069000000.pdf
7. CGAP. (2007). MFI Capital Structure Decision Making: A Call for Greater Awareness. Retrieved from: http://www.cgap.org/sites/default/files/CGAP-Brief-MFI–Capital-Structure-Decision-Making-A-Call-for-Greater-Awareness-Aug-2007.pdf
8. Christen, R. P., & Rosenberg, R. (2000). The Rush to Regulate: Legal Frameworks for Microfinance. *Occasional Paper*, (4).
9. Crabb, P. (2008). Economic freedom and the success of microfinance institutions. *Journal of Developmental Entrepreneurship*, 13 (02), 205–219.
10. Cull, R., Demirgüç-Kunt, A., & Morduch, J. (2007). Financial performance and outreach: A global analysis of leading microbanks. *The Economic Journal,* 117 (517), F107-F133.

11. Daher, L., & Le Saout, E. (2013). Microfinance and financial performance. *Strategic Change*, 22 (1–2), 31–45.

12. DeLoach, S. B., & Lamanna, E. (2011). Measuring the impact of microfinance on child health outcomes in Indonesia. *World Development*, 39 (10), 1808–1819.

13. Deribie, E., Nigussie, G., & Mitiku, F. (2013). Filling the breach: Microfinance. *Journal of Business and Economic Management*, 1 (1), 10–17.

14. Dielman, T. E. (2001). Applied regression analysis for business and economics (3rd ed.). Pacific Grove, CA: Duxbury/Thomson Learning.

15. Field, A. P. (2009). Discovering statistics using SPSS: And sex and drugs and rock 'n' roll (3rd ed.). Los Angeles, [Calif.]; London: SAGE.

16. Frank, M. Z., & Goyal, V. K. (2007). Trade-off and pecking order theories of debt. Retrieved from: www.tc.umn.edu/~murra280/WorkingPapers/Survey.pdf

17. Ghalib, A. K., Malki, I., & Imai, K. S. (2015). Microfinance and Household Poverty Reduction: Empirical Evidence from Rural Pakistan. *Oxford Development Studies,* 43 (1), 84–104.

18. Gujarati, D. (1999). Essentials of econometrics. (2nd ed.). London: McGraw-Hill.

19. Gujarati, D. (2003). Basic econometrics (4th, international ed.). Boston, [Mass.]; London: McGraw-Hill.

20. Hartarska, V. (2005). Governance and performance of microfinance institutions in Central and Eastern Europe and the newly independent states. *World development*, 33 (10), 1627–1643.

21. Iezza, P. (2010). Financial Sustainability of Microfinance Institutions: An Empirical Analysis (Master's Thesis). Retrieved from: http://studenttheses.cbs.dk/handle/10 417/1560.

22. Jan, S., & Shieh, G. (2014). Sample size determinations for Welch's test in one–way heteroscedastic ANOVA. *British Journal of Mathematical and Statistical Psychology,* 67 (1), 72–93. doi: 10.1111/bmsp.12 006.

23. Jensen, M. C. (1986). Agency cost of free cash flow, corporate finance, and takeovers. *Corporate Finance, and Takeovers. American Economic Review*, 76 (2).

24. Kendall, M., Sir, Buckland, W. R., & International Statistical Institute. (1971). A dictionary of statistical terms: Prepared for the international statistical institute. (3rd revised and enlarged ed.). Edinburgh: Published for the International Statistical Institute by Oliver and Boyd.

25. Kennedy, P. (2008). A guide to econometrics. (6th ed.). Malden, Mass; Oxford: Blackwell.

26. Kinde, B. A. (2012). Financial sustainability of microfinance institutions (MFIs) in Ethiopia. *European Journal of Business and Management*, 4 (15), 1–10.

27. Köhn, D. (Ed.) (2013). Microfinance 3.0: Reconciling Sustainability with Social Outreach and Responsible Delivery. Heidelberg [u. a.]: Springer Berlin Heidelberg.

28. Kyereboah-Coleman, A. (2007). The impact of capital structure on the performance of microfinance institutions. *The Journal of Risk Finance,* 8 (1), 56–71.

29. Mahjabeen, R. (2008). Microfinancing in Bangladesh: Impact on households, consumption and welfare. *Journal of Policy modeling*, 30 (6), 1083–1092.

30. Mersland, R., & Strøm, R. Ø. (2008). Performance and trade-offs in microfinance organisations: Does ownership matter? *Journal of International Development,* 20 (5), 598–612.

31. MFTransparency. (2011). Country Survey: TANZANIA. Retrieved from: http://www.mftransparency.org/wp-content/uploads/2012/05/MFT-RPT-106-EN-Country-Survey-Tanzania.pdf

32. MicroRate. (2013). The State of Microfinance Investment 2013: Survey and Analysis of MI Vs — 8th Edition. Retrieved from: http://www.microrate.com/media/downloads/2013/11/MicroRate-The-State-of-Microfinance-Investment-2013.pdf

33. Mwizarubi, M., Singh, H., & Mnzava, B. (2015). Emerging Paradigms of Financing Tanzanian Microfinance Institutions and their Impact on Financial Sustainability — Part I. In: 11th International Business and Social Science Research Conference, Dubai, Retrieved from: http://www.wbiworldconpro.com/uploads/dubai-conference-2015-january/finance/1420797589_338-Mosses. pdf

34. Ngo, T. V. (2012). Capital structure and microfinance performance: A cross country analysis and case study of Vietnam (PhD Thesis). Retreived from: http://etheses.bham.ac.uk/4428/1/Ngo13PhD.pdf

35. Nwachukwu, J. (2014). Interest rates, target markets and sustainability in microfinance. *Oxford Development Studies,* 42 (1), 86–110.

36. Nyamsogoro, G. D. (2010). Financial sustainability of rural microfinance institutions (MFIs) in Tanzania (Doctoral thesis). Retrieved from: http://gala.gre.ac.uk/6366/1/Ganka_Daniel_Nyamsogoro_2010.pdf

37. Pallant, J. (2013). SPSS survival manual: A step by step guide to data analysis using IBM SPSS. (5th ed.). Maidenhead: McGraw-Hill.

38. Quayes, S. (2015). Outreach and performance of microfinance institutions: A panel analysis. *Applied Economics,* 47 (18), 1909–1925.

39. Reed, L. R., Gatti, L. L., Awimbo, A., & Awimbo, A. (2013). Vulnerability: the state of the microcredit summit campaign report, 2013. *Microcredit summit campaign*.

40. Saunders, M., Lewis, P., & Thornhill, A. (2007). Research methods for business students. (4th ed.). Harlow: Financial Times Prentice Hall.

41. Sekabira, H. (2013). Capital Structure and Its Role on Performance of Microfinance Institutions: The Ugandan Case. *Sustainable Agriculture Research*, 2 (3), p. 86.

42. Strøm, R. O., & Mersland, R. (2014). Microfinance institutions: Financial and social performance. GB: Palgrave Macmillan Ltd.

43. Tchakoute-Tchuigoua, H. (2010). Is there a difference in performance by the legal status of microfinance institutions? *The Quarterly Review of Economics and Finance,* 50 (4), 436–442.

44. Te Velde, D. W. (2008). The global financial crisis and developing countries. *ODI Background Note. London: Overseas Development Institute*.

45. Tehulu, T. A. (2013). Determinants of financial sustainability of microfinance institutions in East Africa. *European Journal of Business and Management*, 5 (17), 152–158.

## APPENDIX

*Appendix 1*

| | Kolmogorov-Smirnov | | |
|---|---|---|---|
| | **Statistic** | **df** | **Sig** |
| OSS | .158 | 2060 | .000 |

*Appendix 2*

| Model | R square | Adjusted R square | Durbin-Watson |
|---|---|---|---|
| 1 | .425 | .419 | 1.971 |

Predictors: LDER, LGLTA, LPAR30, LYGL, LNEA, LCPB, LALGNI, LFB, LDP.

Dependent variables: LOSS

LOSS = natural logarithm of operational self-sustainability; LDER = natural logarithm of debt to equity ratio; LPAR 30 = natural logarithm of portfolio at risk over 30 days due dates; LCPB = natural logarithm of cost per borrower; LYGL = natural logarithm of yield on gross loan portfolios; LGLTA = = natural logarithm of gross loans to total assets; LNEA = natural logarithm of non-earning assets to total assets; LDP = natural logarithm of deposits to total assets; LALGNI = natural logarithm of average loans to gross national income; LFB = natural logarithm of female borrowers to total clients.

*Appendix 3*

*Descriptives*

| | | Statistic | Std. Error |
|---|---|---|---|
| LOSS | Mean | 4.71 617 493 | .004 613 246 |
| | 5% Trimmed Mean | 4.71 935 278 | |

*Appendix 4*

| | LOSS | LDER | LNEA | LGLTA | LDP | LALG N1 | LYGL | LCPB | LPAR30 | LFB |
|---|---|---|---|---|---|---|---|---|---|---|
| LOSS | 1 | –.471** | –.360** | .188** | .075** | .044* | .174** | –.035 | –.227** | –.046 |
| LDER | –.471** | 1 | .188** | –.038 | .021 | .184** | –.197** | .042 | .004 | –.005 |
| LNEA | –.360** | .188** | 1 | –.248** | –.048 | .072** | –.044 | .056* | .111** | .028 |
| LGLTA | .1S8** | –.038 | –.248** | 1 | .059* | –.087** | –.074** | –.171** | –.103** | .105** |
| LDP | .075** | .021 | –.048 | .059** | 1 | .082** | –.084** | .013 | –.030 | –.018 |
| L ALGNI | .044* | 184** | .072** | –.087** | .082** | 1 | –.303** | .543** | .115** | –.462** |
| LYGL | .174** | –.197** | –.044 | –.074** | –.084** | –.303** | 1 | .081** | –.040 | .086** |
| LCPB | –.035 | .042 | .056* | –.171** | .013 | .543** | .081** | 1 | .320** | –.540** |
| LPAR30 | –.227** | .004 | .111** | –.103** | –.030 | .115** | –.040 | .320** | 1 | –.204** |
| LFB | –.046 | –.005 | .028 | .105** | –.018 | –.462** | .086** | –.540** | –.204** | 1 |

*** Correlation is significant at the 0.01 level (2-tailed)*

** Correlation is significant at the 0.05 level (1-tailed)*

OSS = operational self-sustainability; DER = Debt to equity ratio; PAR 30 = portfolio at risk over 30 days due dates; CPB = cost per borrower; YGL = yield on gross loan portfolios; GLTA = gross loans to total assets; NEA = non-earning assets to total assets; DP = deposits to total assets; ALGNI = average loans to gross national income; FB = female borrowers to total clients.

*Appendix 5*

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| 1 (Constant) | 4.854 | .176 | | 27.596 | .000 |
| LDER | –.114 | .007 | –.457 | –16.803 | .000 |
| LGLTA | .154 | .031 | .136 | 4.886 | .000 |
| LNEA | –.081 | .009 | –.242 | –8.732 | .000 |
| LDP | .013 | .007 | .051 | 1.963 | .050 |
| LALGNI | .074 | .009 | .291 | 7.887 | .000 |
| LYGL | .116 | .020 | .186 | 5.827 | .000 |
| LCPB | –.042 | .009 | –.165 | –4.544 | .000 |
| LPAR30 | –.027 | .006 | –.135 | –4.898 | .000 |
| LFB | –.033 | .017 | –.057 | –1.867 | .062 |

Dependent Variable: LOSS.

Predictors: LDER, LGLTA, LNEA, LDP, LALGNI, LYGL, LCPB, LPAR30, LFB.

LOSS = natural logarithm of operational self-sustainability; LDER = natural logarithm of debt to equity ratio: LPAR 30 = natural logarithm of portfolio at risk over 30 days due dates; LCPB = = natural logarithm of cost per borrower; LYGL = natural logarithm of yield on gross loan portfolios; LGLTA = natural logarithm of gross loans to total assets; LNEA = natural logarithm of non-earning assets to total assets; LDP = natural logarithm of deposits to total assets; LALGNI = = natural logarithm of average loans to gross national income; LFB = natural logarithm of female borrowers to total clients

*Appendix 6*

*Levene's test and Welch's test*

| | **Levene test** | | **Welch test** | |
|---|---|---|---|---|
| LOSS | Statistics | Sig. | Statistics | Sig. |
| | 13.134 | .000 | 6.998 | .000 |

*Appendix 7*

*Eta squared value*

| | **Sum of squares** |
|---|---|
| Between groups | 4.609 |
| Within groups | 321.300 |
| Total | 325.909 |
| $Eta\ squared = \frac{Sum\ squared\ groups}{Total\ sum\ of\ squared}$ | 0.014 |

Dependent variable: LOSS.

# Acquisition premiums and subsequent impairment of goodwill in 2010–2015 in oil and gas sector

***Irina Zemskova,***
*irisze@mail.ru*

**Abstract**. Since 2014 oil price has decreased from above 100US$ to sinking below 28US$, which is the lowest price since 2003. Analysts expect M&A (mergers and acquisitions) activity in oil and gas sector to increase in 2016. That is why, two empirical researches are conducted to investigated factors influencing premiums paid and impairment of goodwill. The results showed that the increase in P/NAV and P/2P variable and taking logarithm from them lead to increase in the premium paid, while the increase in EV/BOED and in Oil price leads to decrease in the premium paid. According to the model of goodwill: goodwill on acquisition's increase impacts positively, deal value increase shows negative impact, increase of % of gas in target company also shows positive impact, oil price increase affect positively.

**Keywords:** market capitalization, merger premiums, goodwill impairment, deal value, acquisition premiums.

# Премии по сделкам и последующее списание гудвилла в 2010–2015 годах в нефтегазовом секторе

***Ирина Земскова,***
*irisze@mail.ru*

**Аннотация**. С 2014 г. цена на нефть снизилась от 100 долл. США до порога в 28 долл. США, что является самым сильным падением с 2003 г. Аналитики ожидают, что в 2016 г. увеличатся сделки M&A (слияния и поглощения) в нефтегазовом секторе. Поэтому были проведены два эмпирических исследования: влияние факторов на премии по сделкам и влияние факторов на последующее списание гудвилла. Результаты исследования показали, что увеличение мультипликаторов P/NAV и P/2P приведет к увеличению уплаченной премии, в то время как увеличение мультипликатора EV/BOED и рост цены на нефть приводит к снижению уплаченной премии. В соответствии с моделью гудвилла: гудвилл, учтенный при поглощении, влияет положительно, увеличение стоимости сделки показывает негативное влияние; рост доли газа в компании-цели до поглощения также показывает положительное влияние, рост цен на нефть влияет положительно.

**Ключевые слова:** рыночная капитализация, премия при слиянии, списание гудвила, цена сделки, премия при поглощении.

## METHODOLOGY OF SURVEY

As the cost of completing a merger, the premium paid on mergers has received much attention. Most of these characteristics are peculiar to the bidder, the target, or the deal itself. After the transaction goodwill can be created as the dif-

ference between Deal value (Payment consideration) and Net Asset Value of the target. The main assumption is that by investigating whether goodwill is impaired after the deal, it can be assumed whether the transaction was overpaid or not and which factors influenced overpayment for the deal. Goodwill write downs have wreaked havoc on income statements and balance sheets across many sectors in multiple markets.

The purpose of the following two research studies is to shed light on overpayment for the deals and future goodwill impairment by examining premiums paid and whether many goodwill impairment losses arise from overpayment for the target at the time of the acquisition, rather than from a subsequent deterioration of goodwill values.

Numerous studies offer insight on characteristics that can cause the premiums paid by bidders for targets to vary among mergers as stated in the paper of J. Hagendoff et al. (2012). In general, the studies find that bidder, target, or deal characteristics that represent greater expected synergies or that increase the potential competition for the target will result in higher merger premiums. Since the synergy characteristics only contribute to the target's value if a merger has been consummated, they are not factored into the market stock price until the firm becomes the target of a merger. To the extent that the potential benefits of mergers vary among bidders, they influence the premium that the bidder is willing to offer.

For example, for banking industry, high growth of the target firm and its market and a low capital-to-assets ratio are particularly attractive to bank managers, for which they are willing to pay a premium[1].

The market capitalization has a positive effect on the formation of the value of the premium; operating income of the target company and the number of outstanding shares — negative[2]. Preemptive bidding and target resistance were investigated by T. Dimopoulos (2014). Simulation experiments showed that initial bidders have, on average, a higher valuation for the target than rival bidders, so that a relatively low initial bid is sufficient to deter a rival from entry[3]. However, no evidence was found that high merger premiums paid are unlikely to be responsible for acquirers' long-run post-merger underperformance[4]. In Russian practice statistical resources are used for computing premiums for M&A deals[5].

The defensive acquirers experience significant negative abnormal returns on the announcement day, and that smaller competitors have positive abnormal returns on the announcements of defensive acquisitions. In contrast, larger competitors do not react to the announcements, which is consistent with takeover premium hypothesis[6].

In addition, goodwill impairment has been found to be positively associated with the that the payment of higher takeover premiums and the amount initially recorded as goodwill.

## SAMPLE

We obtain sample of oil and gas mergers from the Bloomberg and from Zephyr of Buro Van Dijk databases. The target or the acquirer are restricted to being from the Oil and Gas sector. The deals from all subsectors are considered: Upstream, Midstream, Downstream and Oil Financial Services companies and Integrated Majors.

The period is limited to January 1, 2010 to December 31, 2015. The total amount of deals in Bloomberg for oil and gas industry for the given period is 3474 global deals, not including Russia and 130 deal in Russia. Zephyr database include 50 656 deals for oil and gas sector.

A filter is used to focus on the deals with the premium known. In addition, only completed and pending deals are tested. Withdrawn deals are not taken into account. Moreover, only deal with known multiples are taken into account.

[1] Rhoades, S. A. (1987). Determinants of premium paid in ban acquisitions. *Atlantic Economic Journal*, 15, pp. 20–30.

[2] Nazarova V. V., Shevyakina O. R. (2015). Determining the optimal premium in mergers and acquisitions in the oil and gas sector. *Corporate Finance*, 4(36), pp. 5–30.

[3] Dimopopoulos, T., Sacchetto, S. (2014). Preemptive bidding, target resistance, and takeover premiums. *Journal of Financial Economics*, 114, pp. 444–470.

[4] Antoniou, A., Arbour, P., Zhao, H. (2008), How Much Is Too Much: Are Merger Premiums Too High? European Financial Management, 14/2, pp. 268–287.

[5] Fedotova, M. A. (2008) The prize for the control and reduction of the size of the package: the practical application of national statistics. *Valuation activity*, № 1, pp. 67–81.

[6] Baradwaj, B. G., Dubofsky, D. A., Fraser, D. R. (1996). Defensive acquisitions in the banking industry: The takeover premium hypothesis. *Journal of Economics and Finance*, pp. 119–141.

In order for a transaction to be included the acquirer purchases at least 1% of the target's equity in the transaction and the acquirer finishes our sample period with at least 10% ownership, since otherwise it would be treated as minority stake and requires a discount. We thus narrowed the sample to 182 deals from Bloomberg and 70 deals from Zephyr database.

If the acquirer proposes stocks as a valuable means of payment, it requests that a large transparent market exists for the bidder's stock to be accepted.

Only 48 deals were investigated for the goodwill impairment, with many multiples.

The above arguments lead to the following hypotheses:

1. The premium depends on the method of payment;
2. The premium paid depends on multiples;
3. Goodwill impairment shows that the deal is unsuccessful.

For the first part — Premiums paid for M&A in oil and gas industry, the variables mentioned below will be tested, using also suggested variables in the paper of T. Dimopoulos, S. Sacchetto (2014)[7]:

- Cash offer Dummy variable equal to one for contests in which the final bid is a pure cash offer.
- Stock offer Dummy
- Deal value — Value of cash and all securities offered by the bidder to the target shareholders in Euro
- Merger premiums as the purchase price paid for by the acquirer scaled by the pre-merger book value of the target. We define the percentage book value premium as:

$$\text{BVPREM}(\%) = \left( \frac{\text{deal value}}{s \times \text{BV}(\text{equity})} - 1 \right) \times 100,$$

- Friendly Dummy variable equal to one for contests in which the management declares a friendly attitude toward the initial bidder.
- Premiums for target price
- Target share increase — how much target share price has increased from announcement date till the competed date.
- Tender offer Dummy variable equal to one for contests in which the initial bid is a tender offer. Source: SDC Platinum.

For each deal in the unrestricted full sample, information was collected on the terms of the transaction and bidder managers' projections of merger-related cash flows from press releases and news stories and from annual reports. The analysis focuses on successful deals to minimize the impact of the implicit probability of completion embedded in the merging firms' stock prices.

It will be done in 3 steps:

1. Analysis of the impact cash or stock consideration on premiums paid
2. Analysis of impact of multiples and descriptive characteristics
3. Analysis of impact of certain Upstream sector multiples on Upstream sector deals.

The second part is connected with impairment of goodwill. The FASB 1999 Exposure Draft distinguished four acquisition characteristics that may indicate impairment of the goodwill acquired in a business combination: (1) payment of a significant premium relative to the purchase price paid; (2) an auction-like situation or the presence of multiple bidders that are competing for the target; (3) use of the acquirer's stocks as the primary form of consideration; (4) a considerable amount of goodwill relative to the acquisition price.

Consistently, Hayn and Hughes (2006)[8] found that goodwill acquired in stock deals is more likely to be impaired over the years following the acquisition, suggesting that those targets were probably overpaid. Tested factors for goodwill impairment:

- Bid premium — Announced date %.
- Goodwill on acquisition m.
- Deal value in EUR.
- P/CF.
- P/NAV.
- EV/ BOED.
- P/2P MMBOE1.
- EV/EBITDA.
- %gas.
- Oil price.
- US Henry hub.

[7] Dimopoulos, T., Sacchetto, S. (2014). Preemptive bidding, target resistance, and takeover premiums. *Journal of Financial Economics*, 114, pp. 444–470.

[8] Hayn, C., Hughes, P. (2006). Leading indicators of goodwill impairment. *Journal of Accounting, Auditing and Finance*, 21, pp. 223–265.

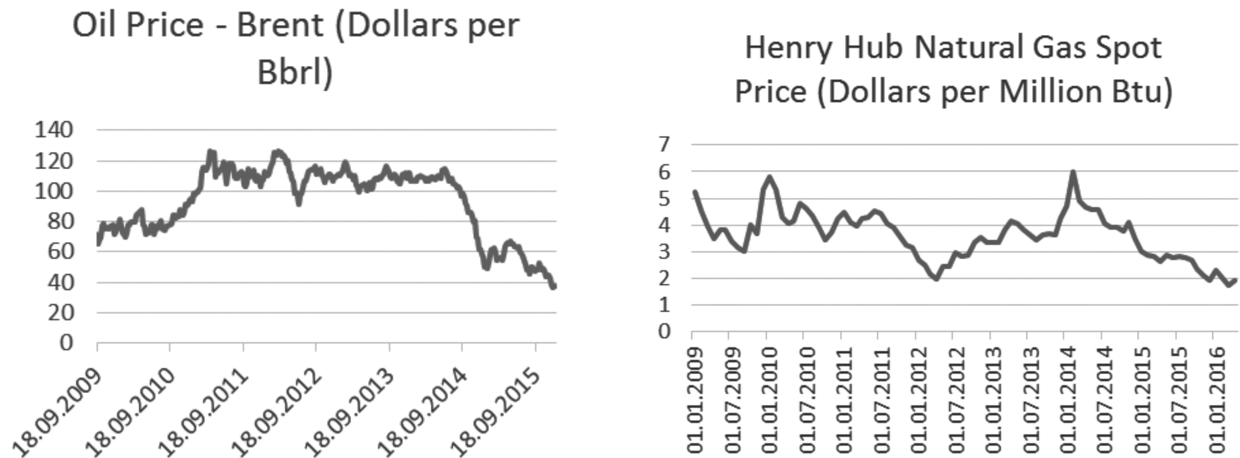



*Figure 1.* **Oil and gas price**

- Target share increase.
- Control.
- Cross border.
- Losses of the target.

On the graph the fluctuation of oil and gas are evident. That is why it is assumed that in times of high oil, premium paid is higher.

## ACQUISITION PREMIUMS PAID IN 2010–15 (in Russia and abroad)

An Acquisition premium is the difference between the estimated real value of a company and the actual price paid to obtain it. Acquisition premium represents the increased cost of buying a target company during a merger and acquisition. There is no requirement that a company pay a premium for acquiring another company; depending on the situation, they may even get a discount.

The premium in a merger or acquisition is defined as the difference between the offer price and the market price of the target before the announcement of the transaction. A substantial body of evidence indicates that M&A premiums average 20 to 30 percent above a target's pre-acquisition share price. For example, Kengelbach and Roos (2012)[9] found that the average premium was 36 percent during the period 1990–2010. As conventional wisdom suggests, acquirers perform better when they pay a premium that is below average rather than above average. As mentioned earlier, a high premium is a sure path to overpaying and reducing the likelihood of making the acquisition a success.

M&A premiums are sometimes referred to as control premiums. In general, the target's shareholders demand them as compensation for transferring controlling interest in the target to the acquirer. Majority control in a company conveys many valuable rights and benefits, including control over all operating policies and decisions, the selection of management and the board of directors, and the distribution of cash to shareholders.

M&A premiums can also represent compensation for other economic benefits, such as the expected synergies associated with the transaction. They can reflect capital market pricing inefficiencies as well, wherein a target is undervalued because the company or its industry is out of favor with investors.

In essence, in about every other transaction, the acquirer's management commits some type of critical error — in the due diligence investigation, in the bidding process, or in the post-acquisition integration of the target. How to avoid each of these pitfalls is beyond the scope of this book; instead, we focus on the process of assessing the target's value — namely, the specific accounting, finance, and taxation issues that the analyst must successfully deal with to estimate the value associated with a merger or acquisition.

In 2012 premium for the deals were the highest. Buyers typically pay a premium to acquire all the shares of a company. But this year that premium has been larger. According to deal tracker

[9] Kengelbach, Jens, Klemmer, Dominic C., Roos, Alexander. (2012). How M&A Can Grow Portfolio Value. The 2012 M&A Report.

Dealogic, on average, acquirers of publicly trading companies have paid 25% more than where those companies' shares had traded. That's up from 23% in the first seven months of 2011, and it's the highest average premium paid since 2001.

Consolidation is expected across the energy sector as companies struggle with low oil prices and a pullback in drilling activity. The deal comes months after Schlumberger's two biggest competitors, Halliburton Co. and Baker Hughes Inc., agreed to combine.

The price tag values Houston-based Cameron — which makes drilling equipment and supplies maintenance equipment to pipelines, refineries and oil-and-gas wells — at $66.36 a share, a 56.3% premium to closing price. Cameron's shares have fallen 42% in the past 12 months as the price of oil plunged. But stock in Cameron surged 41% to $59.81 midday in 2015. Shares of Schlumberger fell 4.7% to $69.11.[10]

Stock and cash consideration are important for the deal premium. For example, in Shlumberger — Cameron deal, Cash and stock deal represents 56% premium for Cameron shareholders. Although it is paying a high premium based on Cameron's current price, the bid represents a 10% discount to where the company's shares traded a year ago.

When the prices for crude oil was high, premium was also high, but in 2014–2015 many deals were cancelled. Santos Ltd. rejected an offer worth $11.3 billion including debt from Scepter Partners, calling it "opportunistic." Canadian Oil Sands Ltd. snubbed a C$6.6 billion ($4.96 billion) bid from Suncor Energy Inc. saying it "substantially" undervalued the company.

"Many names among the E&Ps require a much higher oil price than $60 a barrel to justify their valuation and you won't have a transaction if you don't pay a premium to the share price"[11].

The investigation of the impact of factors on the share price is done in 3 steps.

**1. Impact of cash and stock consideration and other characteristics (database from Bloomberg).**

a) We assume that premium in stock deals are less than in stock deals. Intuition behind this: in cash transactions, acquiring shareholders take on the entire risk that the expected synergy value embedded in the acquisition premium will not materialize.

b) Friendly deal: Intuition behind this: For friendly deal the premium is less than for hostile, as in hostile deals the buyer need to overpay to overcame the resistance. In fact, bidders often pay a premium to the target firm, which introduces problems in financing the deal[12].

c) Losses of the target: No premiums should exist.

d) Diversification: For 1995–05, however, a significant premium emerges, shedding further light on the notion that the diversification discount or premium may be a factor of the time period being analyzed. However, for the premiums it is insignificant[13].

**2. Impact of multiples on deals from all subsectors (database from Zephyr).**

a) P/E: The price-earnings ratio (P/E Ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings.

b) P/CF: Target value to cash flow. The ratio takes into consideration a stock's operating cash flow, which adds non-cash earnings such as depreciation and amortization to net income. Source: annual reports.

c) P/ NAV: Target value to net asset value based on net asset value of the acquired company after the acquisition based on annual statement. Source: annual reports.

d) P/ Assets: Target value to assets.

e) EV/ EBITDA.

f) Oil price $/bbrl.

g) US Henry hub $/mln btu/

h) Target share acquisition: share acquisition between announcement and completed date.

i) Cross border (Dummy).

[10] Schlumberger to Buy Cameron International for $12.7 Billion. *The Wall Street Journal*, 26.08.2015. At: http://www.wsj.com/articles/schlumberger-to-buy-cameron-international-for-12-7-billion-1440584852.

[11] Rascouet, A. Oil Dealmakers Find Slim Pickings among Premium-Priced Explorers. *Bloomberg*, 16.11.2015. At: http://www.bloomberg.com/news/articles/2015-11-16/oil-dealmakers-find-slim-pickings-among-premium-priced-explorers-ih16r3oh.

[12] Geppert, M., Dorrenbacher, C., Gammelgaard, J., Taplin, I. (2013). Managerial risk-taking in international acquisitions in the brewery industry: institutional and ownership influences compared. *British Journal of Management*, 24 (3), pp. 316–332.

[13] Bunnim, D. (2005). Diversification Discount or Premium? Evidence from Merger Announcements., *NSSB*, 205.

**3. Impact of special multiples on E&P companies (Upstream sector; database from Zephyr).**

a) P/CF.

b) P/ NAV.

c) EV/ BOED: Also referred to as price per flowing barrel, this is a key metric used by many oil and gas analysts. This takes the enterprise value (market cap + debt — cash) and divides it by barrels of oil equivalent per day (BOE/D). All oil and gas companies report production in BOE. If the multiple is high compared to the firm's peers, it is trading at a premium, and if the multiple is low amongst its peers it is trading at a discount. Source: annual reports.

d) P/2P: Target value divided by the proven and probable (2P) reserves shows what multiples the company is trading at. Proven and probable (2P) refers to geologic reserves, such as oil, that are more likely than not able to be recovered.

e) EV/ EBITDA.

f) %gas.

g) Oil price.

h) US Henry hub.

i) Target share acquisition.

j) Control.

k) Cross border.

l) Losses of the target.

m) Year.

It should be noted that we assume that the dependence between premium and variables could not be linear, that is why we construct both linear and non-linear models.

We apply three tests to check the adequacy of the model for the significance level of 20%:

- R2 — explain how much of the variance of the model is due to explanatory variables.
- F statistics — if F statistics of the model if higher than F critical, the model is significant.
- P-value — if it is lower than 20%, then coefficients are significant and can be included in the model.

**In the first part** we have investigated the impact of cash or stock consideration on the amount of the premium.

Among 182 deals 66% used cash consideration and 49% used stock consideration. Only 54% used only cash consideration.

The average premium among 182 deals is 179%, calculated as:

$$Premium\ paid = \frac{(Cash\ per\ share + Stock\ offered\ per\ share \times Acquirer\ price)}{Tar\ get\ Share}.$$

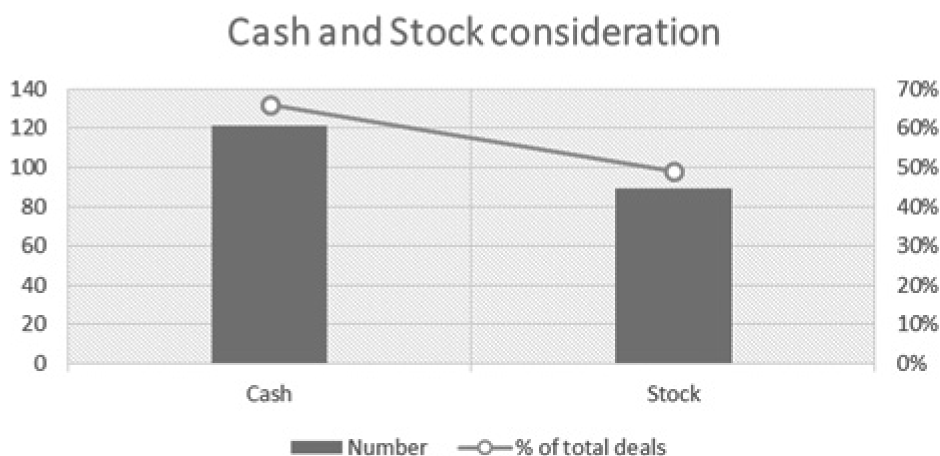



*Figure 2.* **Cash and Stock consideration**

*Table 1*
**Average premiums and total value**

| | Premium paid | Announced Premium | Announced Total Value (mln. Eur) |
|---|---|---|---|
| Mean | 179% | 33% | 139 989 |
| Mediana | 27% | 29% | 15 368 |
| 1st q | 8% | 10% | 5502 |
| 3rd q | 65% | 50% | 71 387 |
| Max | 11473% | 176% | 7 330 483 |
| Min | −100% | −45% | 1022 |

Announced average premium is 33% computed by Bloomberg on the day of the announcement. Average announced Total Value is 139 989 mln Euros.

The first model is presented below. It analyzes the impact of several coefficients on the premium paid.

The distribution of the sample is evident from the Figure 3. Most deals are friendly (166) and about 37.91% of the deals include buying company with losses (69). The distribution per year is approximately the same. In 49 transactions the buyer was from the industry other than oil and gas.

The first model is presented below. It is the first attempt to investigate the impact of variables on the model. Tested variables are presented in the Table 2 and are considered to be significant depending on the P-value test.

R2 of the model is 0.1283, meaning that this model describes only 12.8% of the variance in the premiums paid. F-test shows that the model is significant. P-value test shows that only few coefficients are significant at 20% confidence level:

$$PP = 0.186 \times Cash - 0.023 \times 2011Y + 0.154 \times 2015Y,$$

where: $PP$ — premium paid.

But this model is not significant, since most variables are Dummy variables. However, we may assume, that if Cash is used then premium is 0.186 higher, if the deal occurred in 2011 than it decreased the premium by 0.023 (the reason may be stabilized high oil prices), if the deal has occurred in 2015 it increases the premium by 0,154. However, the premium here defined as %.

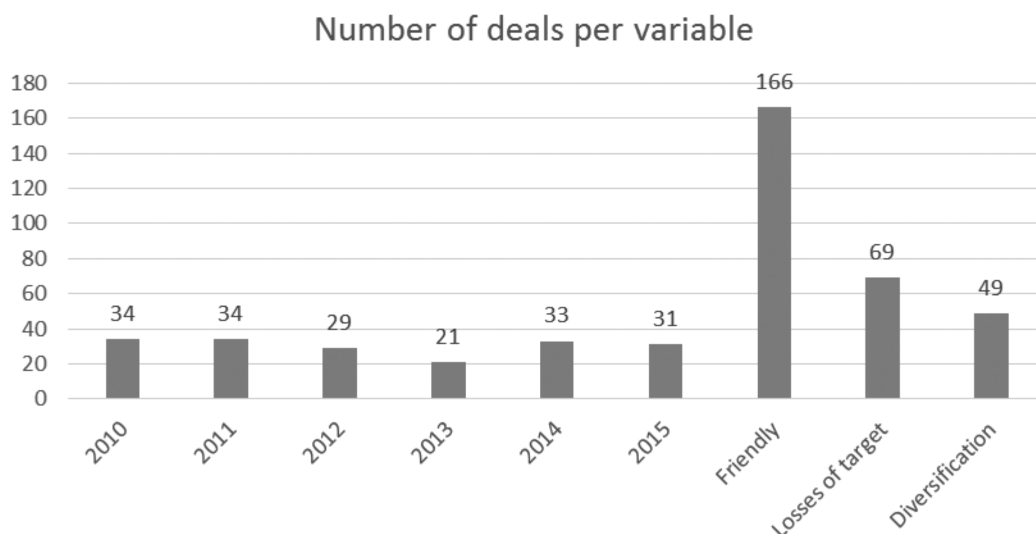



*Figure 3.* **Number of deals per variable**

*Table 2*

**Model 1. Premiums paid calculated in %**

| SUMMARY OUTPUT Model 1 | | | |
|---|---|---|---|
| R Square | 0.128 349 | | |
| Observations | 182 | | |
| | *Coefficients* | *P-value* | *P value 20%* |
| Intercept | 0.175 049 | 0.197241 | Not |
| Announced Total Value (mil,) | 2.71E-06 | 0.528768 | Not |
| **Cash (Dummy)** | 0.186607 | 0.071355 | Significant |
| Stock (Dummy) | −0.02141 | 0.782372 | Not |
| Cash/ Stock per share % | −0.04862 | 0.559052 | Not |
| **2010 (Dummy)** | 0 | 0.071355 | Significant |
| **2011 (Dummy)** | −0.02263 | 0.071355 | Significant |
| 2012 (Dummy) | −0.00289 | 0.974132 | Not |
| 2013 (Dummy) | 0.047684 | 0.628225 | Not |
| 2014 (Dummy) | 0.103983 | 0.236526 | Not |
| **2015 (Dummy)** | 0.154379 | 0.092059 | Significant |
| Friendly (Dummy) | 0.09888 | 0.260376 | Not |
| Losses of target (Dummy) | 0.020544 | 0.558125 | Not |
| Diversification (Dummy) | −0.16603 | 0.008465 | Significant |
| New product (Dummy) | −0.13494 | 0.015585 | Significant |

Model 2 is regression for global deals based on announced premium as Y, and the variables mentioned below as explanatory variables. In this model we evaluate the impact of ROA and market premiums for the stated period before the deal. We also use Stock, 2011 as variables, since in previous model they are significant.

R2 of the model is 0.2553, meaning that this model describes only 25.53% of the variance in the premiums paid. F-test shows that the model is significant. P-value test shows that only few coefficients are significant at 5% confidence level:

$$PP = 0.28 - 0{,}0101 \times \left(\Pr\, to\, 1Day\ Avg\ Px(\%)\right) \times 0.011 \times \left(\Pr\, to\, 1Month\ Avg\ Px(\%)\right) - 0.00421 \times \left(\Pr\, to\, 90Day\ Avg\ Px(\%)\right),$$

where: $PP$ — premium paid.

So, premiums to the Target price for 1 day, 1 month, 90 days affect the premium paid. It is interesting, that according to the regression, 1-day premium and 90-day premium affect negatively, while 1-month premium affect positively. In addition, Stock and 2011 variables appear to be insignificant for this model.

In Model 3 we investigate whether the model is nonlinear and whether the data distrusted normally.

First, we apply Normal Probability Plot Test for Model 1 and Model 2. Normal Test Plots (also called Normal Probability Plots) are used to investigate whether process data exhibit the standard normal "bell curve" or Gaussian distribution. A normal probability plot can be used to determine if small sets of data come from a normal distribution. This involves using the probability properties of

*Table 3*
**Model 2. Announced premium**

| SUMMARY OUTPUT | | | |
|---|---|---|---|
| R Square | 0.25 539 501 | | |
| Observations | 113 | | |
| | **Coefficients** | **P-value** | **P value** |
| **Intercept** | 0.28086722 | 0.00134064 | Significant |
| Stock (Dummy) | −0.00601692 | 0.93810448 | Not |
| Cash/ Stock per share (%) | 0.03478109 | 0.58082506 | Not |
| 2010 (Dummy) | −0.06422034 | 0.42513167 | Not |
| 2011 (Dummy) | −0.02998174 | 0.71331419 | Not |
| ROA Acquirer/Target | 6.184E-05 | 0.38292882 | Not |
| Premium to 1-Day Avg Px (%) | −0.01010687 | 0.00036599 | Significant |
| Premium to 1-Week Avg Px (%) | 0.00356482 | 0.45501279 | Not |
| Premium to 1-Month Avg Px (%) | 0.01109722 | 0.00929312 | Significant |
| Premium to 90-Day Avg Px (%) | −0.00421683 | 0.02524256 | Significant |
| Deal price (th. euros) | 8.5703E-05 | 0.41745793 | Not |

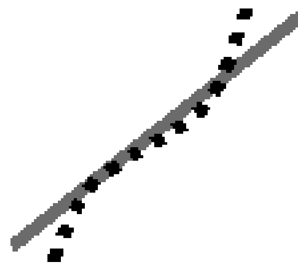


*Figure 4.* **Long tails of normal probability plot***

* *Normal Test Plot, Scymark.com. At: http://www.skymark.com/resources/tools/normal_test_plot.asp*

the normal distribution. We will eventually make a plot that we hope is linear.

The resulting plot is shown on the graphs in Figure 5 and trend line is also presented. If the data do not fall in a straight line, then we cannot assume that the data follows a normal distribution. The normal probability plot for the non-normal histogram is shown below in Figure 4. It should be noted that it tails like an S at one side or both side as in Figure 4. This is often typical of distributions that are not normal.

Figure 4 represents Long Tails — A curve which starts below the normal line, bends to follow it, and ends above it indicates long tails. That is, more variance is seen than one would expect in a normal distribution. Normal Probabity Plots of data of models is presented in Figure 5 and it is seen that the distribution is nonlinear and has long tails.

The result of the projected linear trend line is not acceptable since it does not explain tails. The trends can be similar to moving average. We can make the following conclusions from the above plot.

1. The normal probability plot shows a non-linear pattern.

2. The normal distribution is not a good model for these data.

Linear relationships that are not evident using an untransformed form of 'Lifetime Giving' may be rendered detectable after transformation. So, in short, we transform variables in hopes of improving the overall model, which after all is a linear model.

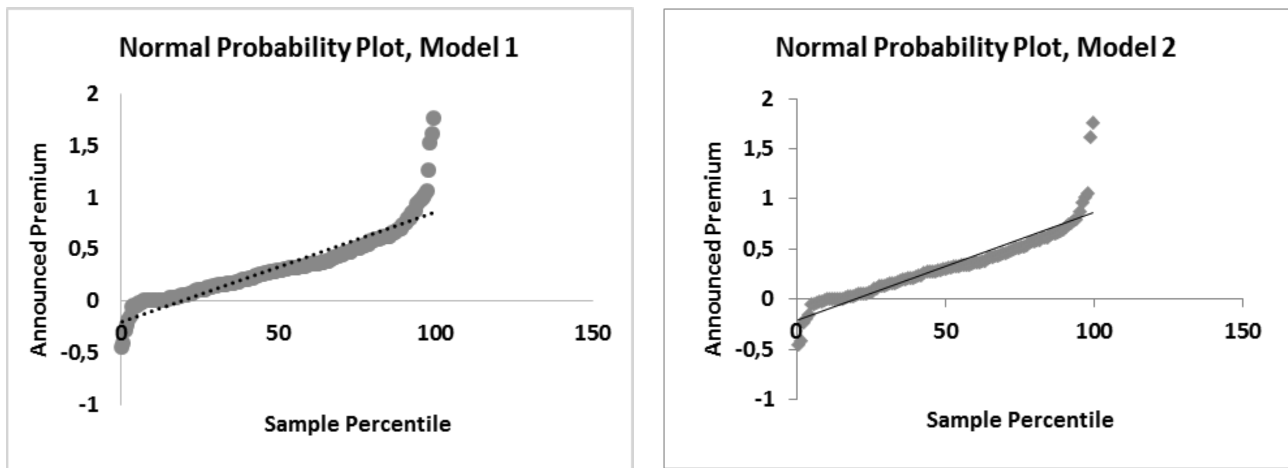



*Figure 5.* **Normal Probability Plot of Model 1 and Model 2**

One of the options could be to use logarithm model. Our goal in transforming variables is not to make them more pretty and symmetrical, but to make the relationship between variables more linear. Ultimately we want to produce a regression equation which both characterizes the data and meets the conditions required for accurate statistical inference.

Logarithmic Model 3 is used:

$$\mathrm{Ln}\left(\frac{\mathrm{TV}}{(1+\mathrm{PP})}\times \mathrm{PP}\right)=\mathrm{Ln}(\mathrm{Targ\ EBITDA})+\mathrm{Ln}\left(\frac{\mathrm{Ln\ Prem\ Cash}}{\mathrm{CAR}}\right)+Cash+Friendly,$$

where: $PP$ — premium paid.

This is logarithm model. The variables of the model are presented in Table 4.

R2 of the model is 0.2649, meaning that this model describes only 26.49% of the variance in the premiums paid. F-test shows that the model is significant. P-value test shows that only few coefficients are significant at 15% confidence level:

- Intercept.
- Ln Target EBITDA is significant.

According to the regression, the coefficient for target EBITDA is elasticity coefficient and the increase in Target EBITDA by 1% lead to 0,484% increase in Premium paid.

*Table 4.*
**Model 3. Logarithm model (Log-Log)**

| **Regression Statistics** | | | |
|---|---|---|---|
| R Square | 0.26496105 | | |
| Adjusted R Square | 0.24407927 | | |
| | *Coefficients* | *P-value* | *P-value* |
| Intercept | 2.10663033 | 0.00017 019 | Significant at 15% |
| LN (Target EBITDA mln euros) | 0.48407662 | 3.4737E-12 | Significant at 15% |
| Ln (Premium cash/offer price) | −0.00625855 | 0.88141013 | Not |
| Cash (Dummy) | 0.18446566 | 0.54499487 | Not |
| Friendly (Dummy) | −0.35171654 | 0.47412195 | Not |
| 2010 | 0.17025218 | 0.6369686 | Not |

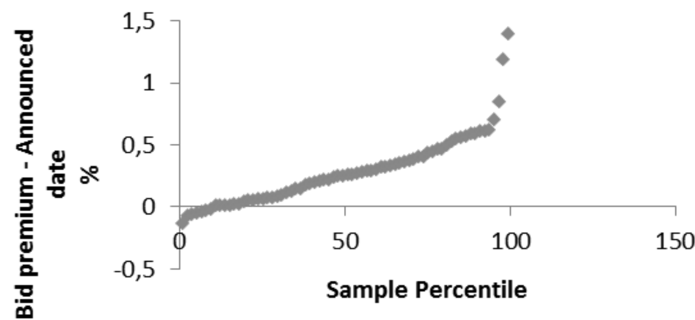



*Figure 6.* **Normal Probability Plot, Model 3**

*Table 4*
**Payment type in Russian deals**

| Method of Payment | Number of deals in the sample |
|---|---|
| Undisclosed | 64 |
| Cash consideration | 64 |
| Stock consideration | 1 |

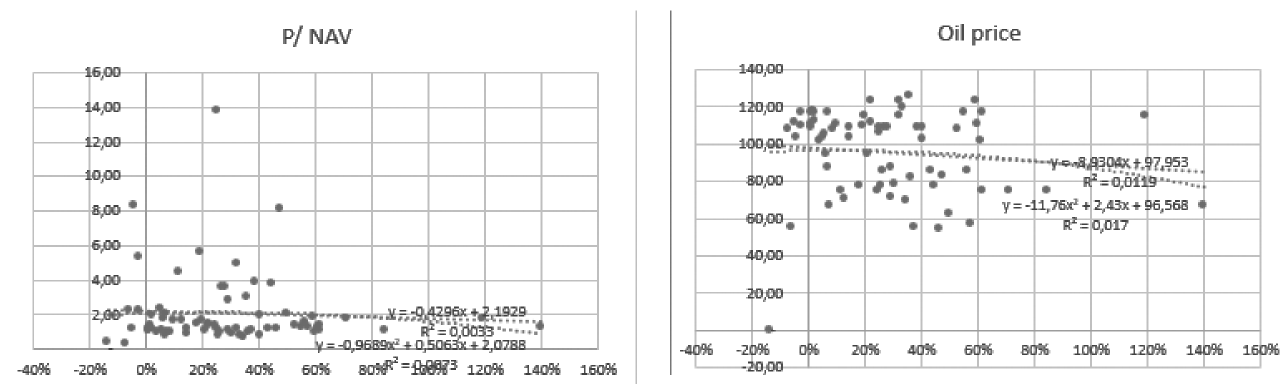



*Figure 7.* **Distribution of P/NaV and Oil price for premium paid**

In the logarithm model the distribution becomes more linear, which is more preferable. It is seen in Figure 6.

Russia. As far as Russian deals are concerned, about 49% are cash deals, 49% are undisclosed and only 6 deals have enough data among 130 deals, as premium is calculated based on target price.

In addition, most all Russian deals lack data. Many buyers are individuals and targets are private companies, which make it impossible to gather all the necessary data for the models.

Second step is investigating the impact of multiples on the premium. The distribution of the multiples is presented below:

Model 4 is connected with variables: P/E, P/CF, P/NAV, P/Assets.

R2 of the model is 0.3553 meaning that this model describes only 35.53% of the variance in the premiums paid. F-test shows that the model is significant. P-value test shows that only few coefficients are significant at 20% confidence level. The offer price in local currency and Target stock price prior to announcement are significant and together with Oil price and Gas price from Henry Hub explain 14,9% of the variance of the model.

**The third step** is connected with investigating the impact of multiples on the Upstream companies, Exploration and production companies. The data is obtained from the Zephyr and it is the partial sample of companies from Second step. The model has been built to find the best to describe the variance of the premium paid.

*Table 5*

**Model 4. Multiples, announced premium in %**

| SUMMARY OUTPUT | | | |
|---|---|---|---|
| R Square | 0.355221 | | |
| Observations | 70 | | |
| | *Coefficients* | *P-value* | *P-value* |
| Intercept | 17065716 | 0.178959 | Significant |
| P/E | 973550 | 0.146568 | Significant |
| P/CF | −866,783 | 0.000222 | Significant |
| P/ NAV | 539923,8 | 0.331657 | Not |
| P/ Assets | −457 106 | 0.788 822 | Not |
| EV/ EBITDA | −63473,1 | 0.343604 | Not |
| Oil price $/bbrl | −124913 | 0.199143 | Significant |
| US Henry hub | 35257,01 | 0.98133 | Not |
| Target share acquisition $/ mln btu | −195341 | 0.955274 | Not |
| Cross border (Dummy) | −3547904 | 0.302873 | Not |
| 2010 (Dummy) | −4901280 | 0.20822 | Significant |
| 2011 (Dummy) | 2817086 | 0.331967 | Not |
| 2015 (Dummy) | 63172,32 | 0.990859 | Not |

The sample includes 48 upstream oil and gas company. To test against multiples and coefficients in the previous step two models was tested: linear model and logarithm. Since logarithm can be taken only from positive numbers, only 24 deals satisfy this condition.

Model 5 uses the data for premium as value in thousands euros. Here we also apply logarithm model, as the distribution of data is non-linear.

The results of the regression are presented in table 9. It is seen that simple model explains 51% ($R^2$ = 0.51), logarithm model explains 56% ($R^2$ = 0.56) variance of the model. F statistics is significant at 10% significance level.

The interesting feature of these two models is that in linear model P/CF and % of gas are significant, while they are not significant in the linear model.

So, the model is:

$$\text{Ln PP} = 41{,}17 + 3\ \text{Ln}\frac{\text{P}}{\text{NAV}} - 1{,}2\ \text{Ln}\frac{\text{EV}}{\text{BOED}} + 1{,}5\ \text{Ln}\frac{\text{P}}{\text{2P}} - 5{,}37\ \text{Ln Oil price},$$

where: *PP* — premium paid.

It is double logarithmic model (log-log): $LnY = \beta + \beta_1 \times LnX$, where $\beta_1 \approx$ % growth with an Y by an increase in X by 1%. This formula is a point elasticity of *Y* with respect to *X*.

The elasticity of P/NAV is 3 and if P/NAV increases by 1%, Premium increases by 3%, the increase of EV/BOED by 1% lead to decrease of Premium by 1.2% and increase of P/2P lead to increase by 1.5% in premium, while oil price lead to decrease by 5.37%.

This model explains 56% of the impact of the premium paid. It should be noted that multiples P/NAV, EV/BOED, P/2P are important for oil and gas sector.

*Table 6*
**Model 5&6**

| Bid Bid premium — Announced date Euro mln | | | | Ln Bid premium — Announced date Euro mln | | | |
|---|---|---|---|---|---|---|---|
| | | | | | | | |
| Regression Statistics | | | | Regression Statistics | | | |
| Multiple R | 0.718965 | | | Multiple R | 0.748391 | | |
| R Square | 0.51691 | | | R Square | 0.560088 | | |
| Adjusted R Square | 0.3322 | | | Adjusted R Square | 0.325469 | | |
| Standard Error | 3964331 | | | Standard Error | 2.922959 | | |
| Observations | 48 | | | Observations | 24 | | |
| | | | | | | | |
| | | | | | | | |
| | Coefficients | Standard Error | | | Coefficients | P-value | |
| Intercept | 1 400 601 | 5 586 548 | Not | Intercept | 41.16 563 | 0.029305 | Significant at 20% |
| P/CF | −431,591 | 115,0805 | Significant at 20% | Ln P/ NAV | 3.006 967 | 0.020058 | Significant at 20% |
| P/ NAV | 119 266,9 | 276 472,4 | Not | Ln EV/ BOED | −1.20 917 | 0.107161 | Significant at 20% |
| EV/ BOED | −0,4181 | 0,778 722 | Not | Ln P/CF | 0.11 065 | 0.734601 | Not |
| P/ 2P | 1669,573 | 2793,629 | Not | Ln P/ 2P | 1.522 472 | 0.036487 | Significant at 20% |
| EV/ EBITDA | −16 805,7 | 33 385,48 | Not | Ln EV/ EBITDA | 0.639 749 | 0.306967 | Not |
| %gas | 5 015 916 | 2 209 792 | Significant at 20% | Ln %gas | −0.49 053 | 0.539981 | Not |
| Oil price | 12 943,27 | 36 002,7 | Not | Ln Oil price | −5.36 853 | 0.114878 | Significant at 20% |
| US Henry hub | −482 606 | 867 683,1 | Not | Ln US Henry hub | −0.77 289 | 0.788621 | Not |
| Target share acquisition | 708 471,6 | 2 928 505 | Not | | | | |
| Control | 2 051 065 | 2 172 837 | Not | | | | |
| Cross border | −2 355 883 | 2 131 108 | Not | | | | |
| Losses of the target | 1 037 357 | 1 689 419 | Not | | | | |
| Year | 93 372,68 | 405 883,6 | Not | | | | |

## IMPAIRMENT OF GOODWILL IN 2010–15 (IN RUSSIA AND ABROAD)

Impairment expenses occur in the oil and gas industry when the current carrying value of a company's oil and gas properties, for any given technical or economic reason, can no longer be recovered under present conditions. The dollar amount of goodwill impairment recorded by U. S. companies rose 18% to $26 billion in 2014, with impairments in the oil and gas industry increasing dramatically, according to a report from Duff & Phelps[14].

In addition to modifying operational and growth strategies, the decline in oil prices has ramifications for companies' financial statements and tax planning. An important consideration for companies is potential impairment of assets, including goodwill. Upon the occurrence of a business combination, goodwill is typically recorded on the balance sheet. Goodwill represents the excess of the purchase price of a business combination over the Fair Value of the net assets acquired. For publicly traded companies and private companies, goodwill is an indefinite and long-lived asset and is not amortized. Rather, goodwill is tested for impairment, at least annually. Goodwill impairment testing standards are governed by ASC Topic 350-20-35, Goodwill — Subsequent Measurement, and ASC 820, Fair Value Measurement.

[14] Heller, M. Oil & Gas Sees Steep Rise in Goodwill Impairments, CFO.com, November 18, 2015. At: http://ww2.cfo.com/accounting/2015/11/oil-gas-sees-steep-rise-goodwill-impairments/ (data: 21.05.2016)

Indeed, large impairments rocked many U. S. companies' income statements at year-end 2014 and in 2015. The major cause of most of these impairments was the fall in global commodity prices in the final quarter of the year. This is the conclusion of a study looking into asset impairments using the annual data of 72 U. S. oil and gas companies[15].

The data for the research was the same as in the third step of empirical study. The sample includes 48 deals from E&P sector.

As evident from the Figure 8 and from the Table 7, the goodwill has been impaired by many companies. Among 48 deals 47 deals have recorded impairments. And after that the 15 acquirers have impaired the goodwill partially or fully. The impairment of goodwill is higher in 2012–15, which goes in line with industry trends and with the fall in oil prices.

Model 6 Goodwill investigates the impact of various factors on the impairment of goodwill. The goodwill is regressed across some factors. The deals from the sample that had impairment of goodwill are presented in Appendix 1.

We assume that the model is reliable since the model has passed $R^2$ test and F-test. $R^2$ for Model of goodwill equals to 39.36% and it explains 39.36% of the variance, which is quite low, however we did not take into account inner company factors after the acquisition and overall

[15] Young, M. Low Oil & Gas Prices Result in Major Asset Impairments Across the U.S. 24.03.2015. At: http://blog.evaluateenergy.com/low_oil_gas_prices_result_major_impairments_in_us.

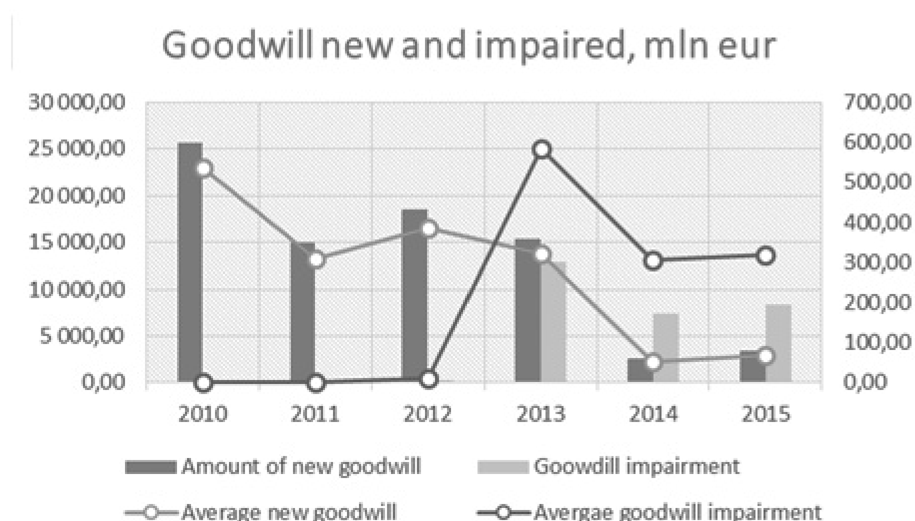



*Figure 8.* **Goodwill new and impaired, mln euros**

*Table 7*
**Goodwill. Sample**

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| Amount of new goodwill mln euro | 25708,86 | 14895,00 | 18576,80 | 15395,00 | 2599,00 | 3363,98 |
| Average new goodwill mln euro | 535,60 | 310,31 | 387,02 | 320,73 | 54,15 | 70,08 |
| Number of deals | 9 | 10 | 5 | 6 | 8 | 9 |
| **Goowdill impairment** mln euro | 0,00 | 0,00 | 235,40 | 12840,41 | 7364,00 | 8317,65 |
| Average goodwill impairment mln euro | 0,00 | 0,00 | 12,39 | 583,66 | 306,83 | 319,91 |
| Number of deals impaired | 0 | 0 | 1 | 2 | 5 | 7 |

*Table 8*
**Model 6. Goodwill impairment**

| SUMMARY OUTPUT. Goodwill impairment | | | |
|---|---|---|---|
| R Square | 0.393 619 | | |
| Observations | 48 | | |
| | | | |
| | *Coefficients* | *P-value* | *P value* |
| Intercept | −4742,94 | 0.039044 | Significant |
| Bid premium — Announced date % | 6,305 914 | 0.746786 | Not |
| Goodwill on acquisition m | 0,116 051 | 0.137537 | Significant |
| Deal value th EUR | −5,7E-05 | 0.099331 | Significant |
| P/CF | −0,06 466 | 0.276664 | Not |
| P/ NAV | −64,5788 | 0.589575 | Not |
| EV/ BOED | −0,00 013 | 0.686979 | Not |
| P/ 2P MMBOE | −0,03 833 | 0.974436 | Not |
| EV/ EBITDA | 14,61 603 | 0.319198 | Not |
| %gas | 1690,48 | 0.104533 | Significant |
| Oil price | 23,70 111 | 0.128385 | Significant |
| US Henry hub | 329,1193 | 0.364473 | Not |
| Target share acquisition | 2389,593 | 0.230145 | Not |
| Control | −927,473 | 0.33597 | Not |
| Cross border | 399,4124 | 0.722791 | Not |
| Losses of the target | 653,2435 | 0.36967 | Not |

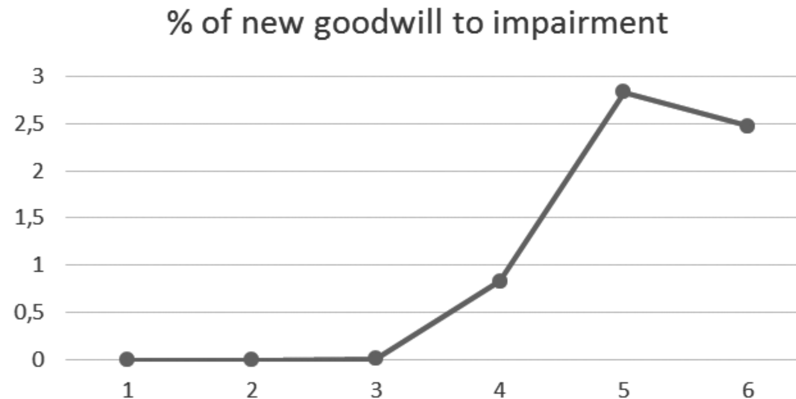



*Figure 9.* **% of new goodwill to impairment**

economic factors in oil and gas industry. Only few variables have passed P-value test, meaning that some variables should be excluded from the model. The final model is presented below:

$$GI = -4742{,}94 + 0{,}116051 \times \text{Goodwill on acquisition mln} - 0{,}0000575 \times \text{Deal value th EUR} + 1690{,}48 \times \%\text{gas} + 23{,}70111 \times \text{Oil price},$$

where: GI — goodwill impairment.

According to the model goodwill on acquisition's increase shows impact positively, deal value increase shows negative impact, % of gas increase also shows positive impact, oil price increase affect positively. The reason behind negative impact of deal value is that in large deals there is high probability of overpayment which leads to overstated goodwill and later impairments.

The energy sector was particularly hard hit, with the amount of goodwill impairment nearly tripling in 2014 to $5.8 billion, primarily due to charges taken in the exploration and production sector.

## CONCLUSIONS

Investigating the impact of deal characteristics on the premium paid and on the goodwill impairment. The period is limited from January 1, 2010 to December 31, 2015. Another important filter is share of the acquirer after the deal — it should be more than 10%, since otherwise it would be treated as minority purchase. Using only completed deals we thus narrowed the sample to 182 deals from Bloomberg and 90 deals from Zephyr database. The deals are from all subsectors of oil and gas sector. Only 48 deals were investigated for the goodwill impairment, with many multiples.

The significant model for premium paid was created for the Upstream sector for sample of 24 deals, since it is logarithm model. The model explains 56% of the impact of the premium paid. It should be noted that all three multiples are important for oil and gas sector.

$$Ln\ Premium = 41{,}17 + 3\ Ln\frac{P}{NAV} - 1{,}2\frac{EV}{BOED} + 1{,}5 Ln\frac{P}{2P} - 5{,}37\frac{P}{NAV} Ln\ Oil\ price.$$

Among 48 deals 47 deals have recorded impairments. And after that the 15 acquirers have impaired the goodwill partially or fully. The impairment of goodwill is higher in 2012–2015, which goes in line with industry trends and with the fall in oil prices.

*Appendix 1.*

**Impairment of goodwill**

| Acquiror name | Target name | Acquiror country code | Target country code | Announced date premium | Completed date | Bid premium – Announced date % | Deal value mln EUR | Goodwill impairment mlnEUR | Goodwill on acquisition mlnEUR |
|---|---|---|---|---|---|---|---|---|---|
| Statoil asa | Brigham exploration company | NO | US | 14.10.2011 | 08.12.2011 | 20,22% | 3503,53 | 8400 | 6687,00 |
| Avenir diversified income trust | Great plains exploration Inc. | CA | CA | 21.09.2010 | 05.11.2010 | 30,39% | 58,93 | 5179 | 23424 |
| Freeport-mcmoran copper & gold Inc. | Plains exploration & production company Lp | US | US | 04.12.2012 | 31.05.2013 | 38,70% | 12533,07 | 1700 | 1916,00 |
| Denbury resources inc. | Encore acquisition company | US | US | 30.10.2009 | 10.03.2010 | 34,88% | 3308,30 | 1000 | 1061,00 |
| Apache corporation | Mariner energy Inc. | US | US | 14.04.2010 | 10.11.2010 | 44,93% | 3101,05 | 862 | 863 |
| North america holdings ii Inc. + bhp billington | Petrohawk energy corporation | US | US | 13.07.2011 | 26.08.2011 | 61,93% | 10506,75 | 994 | 3 591,00 |
| Whiting petroleum corporation | Kodiak oil & gas corporation | US | CA | 11.07.2014 | 08.12.2014 | – 2,31% | 4883,22 | 874 | 875,00 |
| Noble energy Inc. | Rosetta resources Inc. | US | US | 08.05.2015 | 20.07.2015 | 37,77% | 3598,10 | 779 | 163,00 |
| Sandridge energy Inc. | Arena resources Inc. | US | US | 01.06.2010 | 16.07.2010 | 7,31% | 1026,12 | 235 | 234,46 |
| Pacific rubiales energy corporation | Petrominerales Ltd. | CA | BS | 27.09.2013 | 28.11.2013 | 52,99% | 1 112,31 | 116 | 50,00 |

## References

1. Antoniou, Antonios, Arbour, Philippe, Zhao, Huainan. (2008). How Much Is Too Much: Are Merger Premiums Too High? *European Financial Management*, 2008, No. 14/2, pp. 268–287.

2. Rascouet, Angelina. (2015). Oil Dealmakers Find Slim Pickings Among Premium-Priced Explorers. Bloomberg. At: http://www.bloomberg.com/news/articles/2015-11-16/oil-dealmakers-find-slim-pickings-among-premium-priced-explorers-ih16r3oh

3. Baradwaj, B. G., Dubofsky, D. A., Fraser, D. R. (1996). Defensive acquisitions in the banking industry: The takeover premium hypothesis. Journal of Economics and Finance, pp. 119–141.

4. Bunnim, D. (2005). Diversification Discount or Premium? Evidence from Merger Announcements. *NSSB*, No. 205.

5. Fedotova, M. A. (2008). The prize for the control and reduction of the size of the package: the practical application of national statistics. *Valuation activity*, No. 1, pp. 67–81.

6. Hayn, C., Hughes, P. (2006). Leading indicators of goodwill impairment. *Journal of Accounting, Auditing and Finance*, No. 21, pp. 223–265.

7. Kengelbach, Jens, Klemmer, Dominic C., Roos, Alexander. (2012). How M&A Can Grow Portfolio Value. The 2012 M&A Report. At: https://www.bcgperspectives.com/content/articles/mergers_acquisitions_divestitures_plant_and_prune_m_and_a_2012

8. Geppert M., Dorrenbacher C., Gammelgaard J., Taplin, I. (2013). Managerial risk-taking in international acquisitions in the brewery industry: institutional and ownership influences compared. British Journal of Management, No. 24 (3), pp. 316–332.

9. Heller, M. (2015). Oil & Gas Sees Steep Rise in Goodwill Impairments. At: http://www.cfo.com/accounting/2015/11/oil-gas-sees-steep-rise-goodwill-impairments

10. Young, M. (2015). Low Oil & Gas Prices Result in Major Asset Impairments Across the U. S. At: http://blog.evaluateenergy.com/low_oil_gas_prices_result_major_impairments_in_us

11. Nazarova, V. V., Shevyakina, O. R. (2015). Determining the optimal premium in mergers and acquisitions in the oil and gas sector. *Corporate Finance*, No. 4 (36), pp. 5–30.

12. Normal Test Plot. At: http://www.skymark.com/resources/tools/normal_test_plot.asp

13. Rhoades, S. A. (1987). Determinanats of premium paid in ban acquisitions. *Atlantic Economic Journal*, No. 15, pp. 20–30.

14. Schlumberger to Buy Cameron International for $12.7 Billion. *The Wall Street Journal*, 26.08.2015. At: http://www.wsj.com/articles/schlumberger-to-buy-cameron-international-for-12–7-billion-1440584852

15. T. Dimopopoulos, S. Sacchetto (2014). Preemptive bidding, target resistance, and takeover premiums, *Journal of Financial Economics,* No. 114, pp. 444–470.

# What is not CSR: extremes of CSR perception in the world of business and strategic view on it in the era of conscious capitalism

***Anastasia Okorochkova,***
*graduate student, faculty of public administration, Lomonosov Moscow State University,*
*aokorochkova@yahoo.com*

**Abstract.** Extremes of Corporate Social Responsibility (CSR) perception are evident in the business world today. Business leaders and other stakeholders can't understand what in particular, how and for what purpose they should practice CSR and they often narrow it down to different business activities that do not have any connection with sustainable development of business. By opposing it to philanthropy and charity; to practice of social investments; to marketing activities and PR; to the concept of shared value, one would find out that CSR is not something evident; it is more about sustainable business model creation. Even if the company is following the rules and requirements, paying taxes on time and demonstrating an annual social report, it doesn't necessarily mean that this company is a socially responsible one. This paper tests the hypothesis that in the era of conscious capitalism CSR is to be more complex and strategic. The evidence collected from real business stories supported this hypothesis. This suggests that there is a managerial, complex and strategic definition of CSR that does ensure business to become more sustainable in the era of conscious capitalism.

**Keywords:** sustainable development, corporate social responsibility, conscious capitalism.

# К чему не следует сводить корпоративную социальную ответственность: экстремумы корпоративной социальной ответственности и стратегическое видение бизнеса в эпоху «сознательного капитализма»

***Анастасия Окорочкова,***
*аспирантка факультета государственного управления,*
*Московский государственный университет им. М.В. Ломоносова,*
*aokorochkova@yahoo.com*

**Аннотация.** Очевидно, что корпоративную социальную ответственность (КСО) в настоящее время сводят к разного рода практикам, совершенно не относящимся к процессу создания устойчивой бизнес-модели. Руководители компаний и представители заинтересованных сторон не могут понять, что, в частности, каким образом и с какой целью они должны предлагать в контексте реализации КСО. Многие сводят КСО к благотворительности, практике социального инвестирования, маркетинговой деятельности, к взаимодействию с общественностью и к концепции общих ценностей. Однако даже если компания соблюдает законодательство, своевременно платит налоги, демонстрирует ежегодный социальный отчет, это не всегда означает, что она является социально ответственной. Автор статьи ставит под сомнение существующие практики в области КСО, приводя актуальные примеры; предлагает авторское определение КСО

и подводит к тому, что КСО является особенно важной частью стратегии развития бизнеса в эпоху «сознательного капитализма».

**Keywords:** устойчивый рост, корпоративная социальная ответственность, «сознательный капитализм».

## 1. INTRODUCTION

In different times and different countries, under different economic systems, and from the perspective of different industries, corporate social responsibility (henceforth, CSR) is being understood in different ways. Even today, there is no widespread agreement about the practice of CSR.

In order to understand what we are going to think about, let's regard an approximate definition of CSR. CSR, from the point of the author, in its broad theoretical meaning, is a complex responsibility (form of action) of business (subject) towards society (object) for the sustainable development of both business organization and socio-economic and ecological system (matter of the relationships between subject and object), where business organization is functioning.

Of course, in the last decade the representatives of the business elite have started thinking more about sustainability and have become more aware of social and environmental issues such as global population growth, poverty and climate change. There are many reasons for this. Some business leaders have understood the importance of global problems and chosen to become more involved in the global socio-economic and environmental drift; they recognized that they are the agents of change and CSR practices might influence not only the capitalization of the company, but also on the level of the quality of people's lives (those companies are, for instance, General Electric, Whole Foods Market, Patagonia, Walt Disney Company, The Body Shop, Ben & Jerry's, Unilever etc.). Other companies have decided to become socially responsible because of increased pressure from NGOs as well as social, government or financial institutions (Shell in Nigeria, BP etc.). Third, some business leaders decided themselves to become socially responsible because they wanted to be legitimate by the community and other stakeholders (local authorities, suppliers, potential employees etc.).

Consequently, now more and more businessmen try to show their engagement in global trends: they practice charity and give donations, they conduct and publish social annual, sustainability or integrated reports, sponsor sports or cultural events and contribute to local communities where their companies operate actively discussing the concept of shared value.

However, most of these companies simply narrowly interpret CSR to include only loud, bright and demonstrative actions that amount to an irregular set of socio-economic and ecological initiatives. So, it's really very easy to be confused nowadays with socially responsible corporate practices, because most of them look very impressive from a distance.

Many definitions of CSR have been proposed (see literature review), but all are too vague and theoretical. The findings and the definition given in this article are different from the previous ones with a distinctive contribution to the theory of CSR evolution. The project is to propose more clear and practical-oriented definition of CSR that captures the complexity of the concept and does ensure business to become more sustainable in the era of conscious capitalism.

In this article we will start from the examination of some historical definitions of CSR and then we will paint the picture of it through negative description; by considering what CSR is not before we regard what CSR is to be in the era of conscious capitalism.

## 2. LITERATURE REVIEW

M. Porter and M. Kramer raised the question of bright and loud actions of companies in the field of CSR in their article "Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility". They said that "the most common corporate response has been neither strategic nor operational but cosmetic: public relations and media campaigns, the centerpieces of which are often glossy CSR reports that showcase companies' social and environmental good deeds" (Porter & Kramer, 2006). So, sometimes we can see that a company has a very nice annual social report and it expresses concern for people on paper, but then in real life we may find

that employees of that company who work more than they are supposed to work and who are paid less than they are supposed to be paid.

In the literature, CSR is being regarded from a variety of different perspectives and there are plenty of opinions. Scientists started thinking about CSR in the 1950s and they first approached it in a normative way, when the main questions were: what is CSR? and what are the sources of CSR? (Bowen, 1953; Selekman, 1958; Eells, 1956) They tried to understand the essence of CSR, to find out whether its' beginning was external or internal. One group of scientists insisted on the external nature of CSR, arguing that social contract played the key role (Davis, 1973). The other group of scientists claimed that CSR was internally generated and corporations had their own right to choose whether or not to be socially responsible and, moreover, to formulate the meaning of CSR themselves (Ladd, 1984).

Today, the essence of CSR is still discussed in the literature, but CSR is regarded as neither a strictly internal or external phenomenon; rather, there is understood to be "inside-out" or "outside-in" linkages, that are "corporate activities" of business or "social conditions", where a business unit operates. So, CSR today is generally considered an interdependent system of business and society cooperation, and it is regarded strategically. M. Porter and M. Kramer explain it this way: "not only does corporate activity affect society, but external social conditions also influence corporations, for better and for worse" (Porter & Kramer, 2006).

H. Bowen was the first to venture a definition of CSR, suggesting that it is composed of the obligations of businessmen to pursue policies, make decisions, or pursue lines of action which are desirable in terms of the objectives and values of their society (Bowen, 1953). Many people call Bowen the "Father of CSR" because he wanted to integrate business into the context of social life and to regard the CSR practices of businesses as a part of a social system.

A. Carroll invented a very popular pyramid of social responsibility of business that consisted of different types of responsibility: economic, social, ethical and discretionary (Carroll, 1979).

In the 1970s, scientists were thinking more in a positivistic way; they were more concerned about practical issues. Pragmatism and instrumentalism became the organizing principles of thinking about CSR.

CSR started being understood more as a business instrument the use of which may help the company not just to make money, but also to help the society develop. The "Corporate Social Responsiveness" concept started being more popular than "corporate social responsibility" and the focus shifted from determinations to actions, from the question "what CSR is" to the question "how CSR is possible to use" (Ackerman, 1973; Sethi, 1978; Bauer & Ackermnan, 1976; Frederick, 1960).

W. Frederick was the first to pay attention to the same abbreviations of "corporate social responsibility" and "corporate social responsiveness", and he named them CSR-1 and CSR-2 accordingly. Concerning CSR-1 (corporate social responsibility), he defined this as "a public posture toward society's economic and human resources and a willingness to see that those resources are used for broad social ends and not simply for the narrowly circumscribed interests of private persons and firms" (Frederick, 1960). As to CSR-2 (corporate social responsiveness), he defined this as a "capacity of a corporation to respond to social pressures" (Frederick, 1978). Frederick's argument was that none of these concepts was dominant, and that it was incorrect to mix them together. Both of them deserved attention, he said, and they both had a significant meaning. He stressed that CSR-2 was the continuation of CSR-1.

R. Ackerman, for example, explained that CSR-2 is critically important for the company. Companies must meet social demands and deal with social problems at some point, because otherwise there so many social and environmental problems might accumulate that it would be very difficult for the companies to exist. Also, he wrote about "organizational involvement", and he said that the company was responsible just then when all the members of the organization were responsible (Ackerman, 1973). And just through the organizational involvement according to his thoughts it was possible for the company to become more socially responsive.

S. Sethi touched upon corporate legitimacy. He explained that companies were to narrow "legitimacy gap", because if you, as a company, want to be understood and accepted by people

with whom you cooperate, you must meet their expectations (Sethi, 1978).

Since the 1990s, the scholarly community has started thinking more about how to measure responsibility, and what results can possibly be achieved through CSR practices. The "Corporate Social Performance" (CSP) concept has steadily become more popular (Wartick and Cochran, 1985; Wood, 1991; Swanson, 1995).

What is also very interesting, nowadays scholars more and more work on CSR. And the main issues are: CSR and stakeholder theory (Freeman, 1984; Freeman, Harrison, & Wicks, 2007; Freeman et al., 2010), CSR and financial performance (e. g. McWilliams & Siegel, 2000; Rowley & Berman, 2000; Hillman & Keim, 2001; Margolis & Walsh, 2003; Orlitzky, Schmidt, & Rynes, 2003; Barnett & Salomon, 2006), environmental and financial performance (Winston & Esty, 2006; Sharma & Starik, 2002; Etzion, 2007; Ambec & Lanoie, 2008; Dixon-Fowler, Slater, Johnson et al., 2013), philantropy and CSR (Lubin & Esty, 2010; Kiron, Kruschwitz, Haanaes et al., 2012).

Let's have a look at the line chart demonstrating the quantity of CSR publications (journal and magazine articles, books, reports, newsletters etc.) since 1950s until 2015 that are available at Yale university library site.

So, the evolution of understanding of CSR has been rather long, and the limitation is that there was no clear and practical-oriented definition. Today, most businesses do recognize the importance of CSR, but at the same time they continue looking at value and sustainable business model creation narrowly. Business representatives still do not really know what "CSR" means and how to handle it strategically. Economic, social, environmental and governance issues are still at the periphery and not at the core of most business strategies.

This research is different from previous ones because it provides the comparative analysis of CSR and other business practices that were not observed before systematically: CSR was not compared with the concept of shared value, PR and philanthropy at the same time. Moreover, this research gives clear and practical-oriented definition of CSR that ensures business to become more sustainable in the era of conscious capitalism.

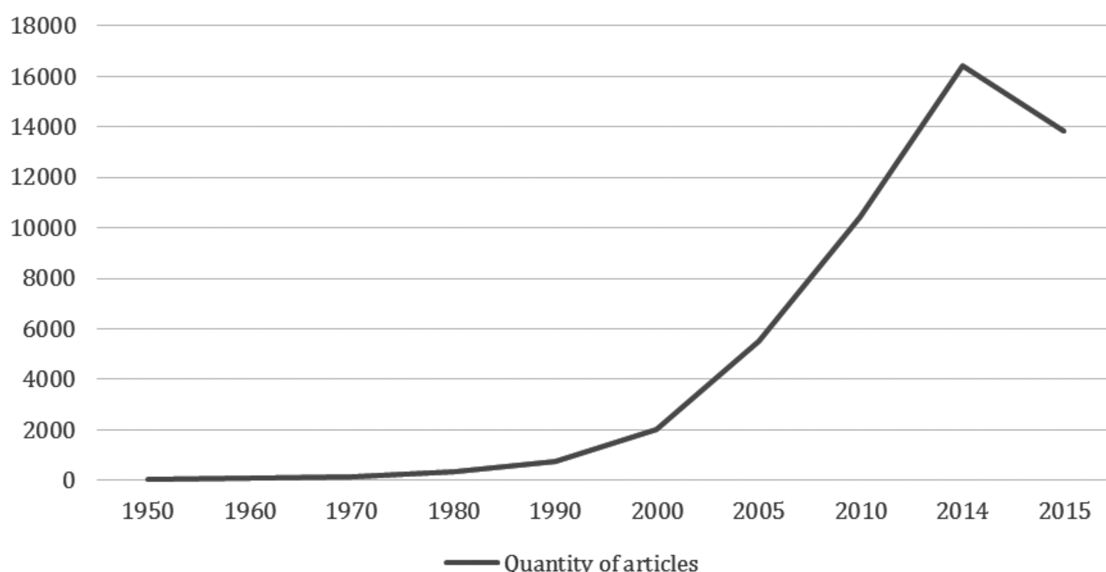
## 3. METHODOLOGY

The author of this paper analyzed different articles, books, researches, social polls and statistical data.

The methods employed in this article are as follows:

Analysis of the words "corporate", "social" and "responsibility" so that we fully understand the meaning of the term CSR;

Synthesizing our definition with observed practices of CSR in different companies to generate the idea of CSR complexity;



Generalizing from the analyzed and synthesized information to arrive at a better definition of the term CSR;

Imitating modeling (the process of modeling the reality; for example, modeling of the implementation of CSR policy in a company that is not socially responsible).

As we have already mentioned, CSR–from the perspective of businessmen–often looks like something evident that simply lies on the surface of business. However, we will put several practices of business under scrutiny and try to prove that none of them is in fact an example of a company practicing CSR.

Methodology proposed in this article is author's innovation.

## 4. CSR IS NOT PHILANTHROPY OR CHARITY

Today, lots of companies narrow their CSR activities down to one of the most obvious kinds of goodwill activities, such as charity. We understand that it is very important to help the poor as possible. However, truly helping the poor is rarely best served by an extremely public and self-congratulatory annual corporate practice, and is better served by regular and quieter assistance. Furthermore, charity alone is not an adequate CSR policy. Charity should be an addition to something more, to the responsible decision making process, for example, and, secondly, it should be an honest, systematic and sustainable corporate action.

Let's draw our attention to some contradictions in this context that may somehow push us towards deep thoughts about corporate philanthropy and charity.

We all know that charity is a voluntary act of giving, so the interests of the company that gives someone money are not obvious. What are the motives of the business to practice charity? Does charity today imply that a company will be rewarded tomorrow?

It is helpful to draw into these discussion Andrew Carnegie's two principles from "The Gospel of Wealth" and the tradition of noblesse oblige. Carnegie's first principle is the principle of charity that requires the most prosperous members of society to help the less prosperous, and the second one is the stewardship principle, when businesses and wealthy individuals suppose themselves as stewards of their property and use their money for the purposes of the society. Regarding these two principles, we may say that to share wealth is not an easy task for anyone, especially for a businessman, whose main interest is profit maximization.

Then what kind of motives and goals should businessmen have in order to practice charity and donation? Let's clarify. When you give money without any wish to get something from it you should have very strong beliefs, religious ones, for example, and in this case we can say that it's a kind of charity. Whereas, when you donate and hope to get something from it, community or stakeholder loyalty, for example, you rather practice something like quasi-charity. Feed first, and then ask people for their support. Charity becomes nothing more than a business tool here, a hook that will attract people's attention to the business and help the company to become legitimated, increase its intangible assets, and enhance its corporate reputation and brand image. Making money becomes easier when your business image is good.

Paul Godfrey, who has studied self-interested corporate charity, has argued that (a) corporate philanthropy can generate positive moral capital among stakeholders and communities, (b) this moral capital can provide business owners with insurance-like protection for a firm's relationship-based intangible assets, and (c) this protection contributes to shareholder wealth. So, from his point of view, corporate philanthropy is an asset to both the company and the recipients. But does it qualify as CSR behavior?

Observing the possible motives and goals of businessmen who practice charity, we also should pay attention to one suspect current trend: companies generally help the needy internationally shortly before they expect to expand into those communities abroad.

Although there are plenty of reasons the rich help the poor, it is really very difficult to believe that businessmen have strong beliefs and want to help society without any self-interest. Nonetheless, there are some examples of altruistic businessmen who became philanthropists, past and present.

Andrew Mellon, for example, donated enough art to start the National Gallery of Art; Henry Ford created the Henry Health System and then his son formed the Ford Foundation of wellbe-

ing, a society that is now the third biggest charity in the United States of America.

Even now, corporate philantopy is widespread and there is a Committee Encouraging Corporate Philanthropy (CECP) that conducts surveys. According to the Corporate Giving Standard (CGS) survey for 2012, for example, the sum of all the contributions across 240 companies participating was more than $20.3 billion in total giving. And this is more than the sum of all the contributions in 2011 ($19.9 billion in cash and product giving).

The top five foundations of 2013, by total giving, are: Bill & Melinda Gates Foundation, AbbVie Patient Assistance Foundation, Pfizer Patient Assistance Foundation, Inc., GlaxoSmithKline Patient Access Programs Foundation, and Genentech Access to Care Foundation.

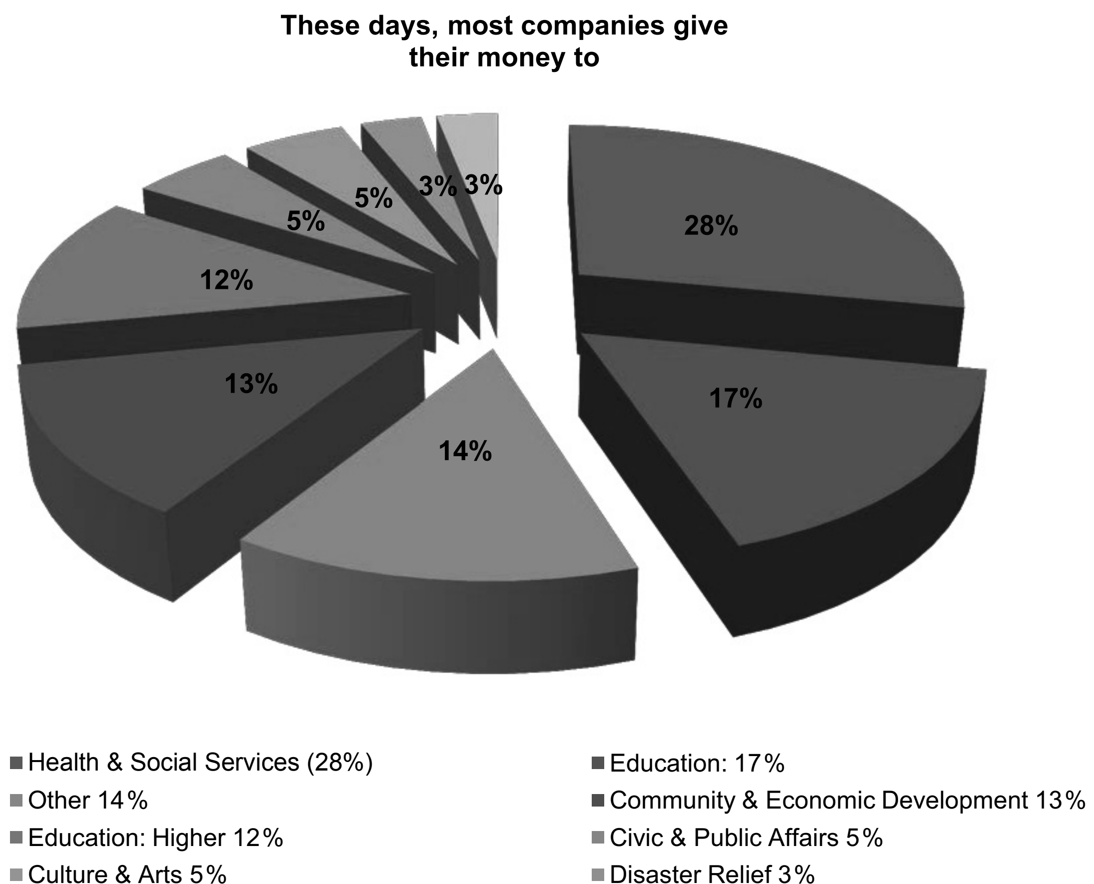
So, corporate philanthropy is becoming very important in the age of conscious capitalism, globalization and information technologies. It is a very positive trend that corporate charity is becoming more widespread. However we shouldn't forget that charity is real when it is being practiced not for the business reward, but for changing the life of those who need it. Charity is really honorable when it is an honest and willing action of a business, when it is something more than just a show to boost the company's reputation.

In this context, let us remember the CSR pyramid of A. Keroll. Charity, according to Karoll's CSR pyramid, is the most voluntary component of CSR. Beside a company's economic, legal and ethical responsibilities there is one more kind of responsibility — the discretional or philanthropic one. This last is the top level of CSR and is definitely a voluntary kind of responsibility. If we perceive charity as a part of CSR, we should better recognize that it is an extra responsibility of business and it is the most voluntary element of CSR. So, charity is important in terms of CSR, but not sufficient.

CSR is no longer code for philanthropy, says Stephen Howard, the chief executive of BITC. "We know from working with hundreds of business of all sizes that the role of CSR is an increasingly integral element of how business operates," he says (The Independent, 2014).

## 5. CSR IS NOT THE SAME AS SOCIAL INVESTMENTS

Social investments may sometimes also resemble charity; however the most important differ-



ence between these two practices is the goal and motivation. When we think about companies' investments we have thoughts about financial returns. To sponsor important social projects or to invest money in socially or environmentally relevant problems and derive benefit from them is the essence of social investment practice. However, this is not the same as CSR. Social investment practice is just the part of CSR with the help of which a company may solve some problems of the society or environment in which it operates. But before resolving these problems, company has to determine them. CSR is something more than a social investment strategy.

For example, Norilsk Nickel, Russia's largest mining company by market capitalization, and its new social program called World of New Opportunities aimed to promote regional public initiatives and form favorable conditions for social and economic development of the Polar regions (Norilsk Nickel Press Release, 2014). World of New Opportunities is a good example of social investment program, however when we read about it we shouldn't think the company is socially responsible. We should consider company's profile. Do we know what the scale of negative impact of company's operations on the environment is? Do we remember the case when Norilsk Nickel suspended mining at its Lake Johnston operations, in Western Australia, laying off employees, and not compensating them fairly (The Western Australia, 2014)? So, before saying that Norilsk Nickel is a socially responsible company because it has a new program of social investments we should learn its business story.

## 6. CSR IS NOT AN ENUMERATION OF PR ACTIONS AND MARKETING ACTIVITIES

As we all understand today Public Relations (PR) and marketing activities play a very important role in the world of business. The results of these activities are the most evident and tangible. Companies try to broaden their influence through sponsorship of different events. And it is a great business tool in terms of company promotion. By football match sponsorship, for example, you may enhance the pull of your customers who will definitely mention the name of your company on the stadium billboards and will become more loyal towards your brand, however it doesn't mean that you practice CSR. By showing everyone your prosperity you won't be able to create a new business model.

When we look at Chobani, maker of America's No. 1-selling Greek Yogurt brand, the proud sponsor of Team USA athletes competing in Sochi, we think that Chobani is a socially responsible company. However when we start thinking critically about its label that is "Greek Yogurt", misleading to consumers who believe that it's a product from Greece instead of Chenango County, NY (Morran, 2014); when we start examining the ingredients contained in Chobani yogurt and remembering the claims the company uses milk consisted of genetically modified items (Morran, 2014); when we start analyzing why the export of Chobani yogurts to Russia was forbidden (My Fox New York, 2014), then we will recognize that sponsoring sport events or doing other PR activities doesn't necessary mean that a company does care about CSR.

Concerning Nestlé, the world's largest food company, with more than 450 manufacturing facilities in over 80 countries spread over six continents, that used to call itself the "world's leading nutrition, health and wellness company" Is also one of the world's most controversial corporations. For more than two decades the Nestlé name was widely associated with a longstanding boycott, over its marketing of infant formula in poor countries. More recently, the company has been one of the primary targets of the global movement against the bottled water industry. The company's hardline labor relations practices in poor countries have made it a villain in the eyes of the international union movement.

We should say that PR is nothing when there is no sustainable and outstanding business behind it. The goal of PR and marketing activities is to enhance the influence of the company and to promote business, while the goal of CSR is to make the business that is to be promoted a more responsible member of society.

## 7. CSR IS NOT JUST GR, IR AND HR

It's logical to continue, by saying that we shouldn't narrow CSR to GR, IR or HR as well. All these spheres of business are important and equal in terms of their position to CSR. All these practices are about relationships with stakeholders, that are really very important in the context

of CSR ( (Freeman, 1984; Freeman, Harrison, & Wicks, 2007; Freeman et al., 2010)), however we shouldn't narrow CSR to one of these parts of business. Of course, CSR practices may attract socially conscious consumers (Hillman & Keim, 2001), attract financial means from socially responsive investors (Kapstein, 2001), enhance access to finance (Ioannou & Serafeim, 2013) or help poorly performing firms to recover from disadvantageous positions more quickly (Choi & Wang, 2009). CSR touches GR, IR and HR issues. But CSR is not just about interaction with government officials, investors, employees, suppliers, customers and other stakeholders. CSR is more about the way of managing these relationships and influencing positively on society by making money.

Of course, we should remember here the case of Nestlé Waters that was drawing water from multiple reserves in California to make its bottled water during record-breaking drought. Of course, that was terrible in terms of social and environmental risks perspective. The company should have thought carefully before extracting water in that period of time. Poor stakeholder engagement and risk management lead Nestlé Waters to face a number of legal battles with local governments in areas designated for water extraction and its requests to extract water in Florida, Wisconsin, and Michigan were denied.

## 8. CSR IS NOT JUST THE EXISTENCE AND PRESENTATION OF AN ANNUAL SOCIAL REPORT

Here is something you should think about. Most of the companies have annual social reports and even integrated reports; however does it really mean that they are socially responsible. Do we always write something on paper that is not done? Do we show everything to those who evaluate?

Do we remember Bangladesh Factory Collapse when over 1100 workers were killed because of unsafety working conditions? Bangladesh's biggest buyers, biggest brands that produce merchandise in Bangladesh — H&M, Walmart, J.C. Penny, Benetton, Gap, Zara — were in a difficult situation, because they were all responsible and honest on paper, however not responsible and transparent in real life. They ignored opportunity to increase transparency of supply chain risk and that is why received negative press and discontent from consumers on social media. Moreover, as a result there was $3B in total damages and repair and 900,000 signatures of upset customers.

It is very important to be open and transparent to the society and constantly lead the discussion about the process of work for the company. Leading the discussion does not mean a company has to be executing perfectly. 85% of respondents say it's okay if a company is not perfect, as long as it's honest about its efforts.

The company TOMS is a good example of being transparent and leading the discussion with customers. One-for-One business model has revolutionized the way customers and companies think about corporate responsibility. Launching the conversation on giving back has paid back significantly, and TOMS has seen significant growth for its philanthropy efforts. Launching the discussion on Giving Back has caused a shift in the retail industry and raised consumer expectations of major clothing companies.

Alternatively, another good example is the company Patagonia. Through the Common Threads Initiative and the Sustainable Apparel Collective, Patagonia has led the discussion on Sustainability, from encouraging customers to stop buying their products in order to focus on reuse to uniting 30 apparel companies, including Nike and Walmart, in sustainable practices.

Today, most companies have social annual, sustainability, integrated reports or some other kind of papers that show the process of value creation; however, it does not mean that those companies are socially responsible. The existence of an annual social report may sometimes be a pretension of a socially irresponsible company. We should critically evaluate these reports, because often they do not reflect the real state of affairs of the company. The content of socially annual report and factual realization of CSR strategy — this is more important.

## 9. CSR IS NOT JUST FOLLOWING THE RULES OR REQUIREMENTS AND PAYING TAXES TIMELY

Most of the businessmen still think that their main social responsibility is to follow the rules and pay taxes timely. As Milton Friedman said that "there is one and only one social responsi-

bility of business — to use it resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud." (book *Capitalism and Freedom*) It's the responsibility of the government to distribute finance and to care about citizens, most of the businessmen say. However, no one even thinks that when you make your business you have much more possibilities to help people and, even if it's a burden for business it's also the strategy of a winner nowadays. In case you are helpful and fair, you can influence not only on the community and the local government, you can develop your own business much faster and broader. Win-win-win is the strategy of the future. There should be a mutually favorable exchange between company, society, government and other stakeholders. Therefore, CSR is not just to follow the rules and to pay taxes timely.

## 10. CSR IS NOT THE CONCEPT OF SHARED VALUE

Often we hear that CSR is something similar to the concept of shared value. However, the essence of this concept is not about the process of how to do business, it's more about the premises of doing this particular business in a socially responsible manner or about the results business aims to achieve. "Shared value is a benefit for both society and its own competitiveness", as M. Porter and M. Kramer, say (Porter & Kramer, 2006). It is about creation of an important benefit for society that at the same time helps a company make a profit and remain competitive. The concept of shared value is very nice in terms of understanding that CSR is a profitable business activity. However doing business in a responsible manner is not just contributing to society and deriving some benefit from it, there are much more CSR nuances about how you should make your business, as risk management, global/local requirements and business ethics, for instance.

The quality of your CSR largely depends on risk management. Every business persons should know that non-financial risks omitted in the concept of shared value might cause operational disruptions and impact company stock price. Companies with disruptions have 30% lower shareholder returns than peers and share prices do not return even two years post-announcement. Then negative exposures can cause long-term brand damage.

For example, the company Mattel Toys recalled over 1 million children toys after it was discovered the paint contained lead. The breakdown occurred because a supplier used an unapproved vendor to overcome a temporary shortage. In addition to significant costs, Mattel suffered significant brand damage.

Work on risks connected with value chain of a company can drive competitive advantages. In a market study, sales of fair-trade label coffee remained steady even as prices were increased by up to 8%.

Starbucks, for instance, launched the C.A. F. E program to ensure ethical sourcing practices and product quality. Suppliers were evaluated across social, economic, and environmental standards. In 2012, 98% of Starbucks' sourcing contracts included economic transparency clauses.

Also, in the context of shared value concept, globalization is very important. We all understand that emerging markets represent a significant amount of untapped revenue and we see many western companies started operating there. However, in order to make profit there, the company is to think about local community needs.

For example, Newmont Mining halted work at Yanacocha (Peru), one of Latin America's largest gold mines, after protesters torched earth-moving equipment. Yanacocha officials said protesters were "trying to pressure the mine to sign a community relations pact" that would give local communities US$72 million.

## 11. WHAT CSR IS: A GESTURE TOWARD A MORE COMPLETE DEFINITION

We have looked at different extreme views of CSR and shown why each does not capture the essence of what CSR is about. But we aimed to find out the core components of CSR that increase business awareness of how to do business and influence the capitalization of the company through sustainable development practices.

In this regard, CSR is a complex managerial responsibility of shareholders of big/medium/small businesses to affected stakeholders for the results of business activity that is expressed

in economic effectiveness and value creation of business thanks to its obligatory:

• Compliance with global/local and corporate requirements (legal responsibility);

• Governance and regular work on prevention, mitigation and liquidation of non-financial risks (economic, social and environmental responsibility);

• Governance and regular work on managing social investments, if and where needed, that are aimed to facilitate the sustainable development of both business organization and the community where this organization operates (economic, social and environmental responsibility; the concept of shared value can be regarded here);

• Governance and regular work with all affected stakeholders (social responsibility);

• Compliance with an ethical code of conduct (ethical responsibility).

And also thanks to possible and voluntary contributions as charity or donations (called discretionary responsibility which is an extra responsibility taken by business in order to improve the image of the company).

Exceeding social expectations connected with the contribution to the social welfare does not mean that a business has already governed all non-financial risks, worked out social investments, met all the expectations of the stakeholders (investors, suppliers, customers, media, government structure representatives, local community and others) — all of which comprise the basis for a sustainable development of business.

CSR is to be an obligatory kind of responsibility of business, because doing business today implies making decisions in competitive circumstances. And to be irresponsible while making decisions in competitive circumstances may lead to fail.

Also it is very important to pay attention to the fact that all "must" do practices are connected with sustainable development of business. When we work on non-financial risk prevention on a territory of operation we guarantee ourselves that the process of production we have will be finished on time, we will get planned profit and we will be able to continue our business without any extra costs.

Today in the era of conscious capitalism we have to think about higher purpose of business, conscious leadership, stakeholder orientation and conscious culture (Mackey & Sisodia, 2013). We should recognize that money is just a means of doing business that good corporate governance happens when "we" is much more important than "me" to business leaders. Stakeholders are those on whom business is dependent and their knowledge of values, principles and patterns of conscious behavior, their understanding of the common business goal is of paramount importance. Thus, CSR is a great strategic approach for doing business that will meet all the obvious requirements of conscious capitalism. In this era, CSR is to be taken into account strategically (Mackey & Sisodia, 2013).

Concluding, the hypothesis that CSR is a complex and strategic concept that allows business to become more sustainable in the era of conscious capitalism is true. The findings that were given above contradict anti-capitalism statement that the only social responsibility of business is to make profits (Friedman, 1970), and support the view that CSR is about conscious capitalism, about a company's commitment to make money by operating in an economically, socially and environmentally sustainable manner.

## References

1. Ackerman, R. & Bauer, R. (1976). Corporate social responsiveness: The modern dilemma. Reston, VA: Reston.
2. Ackerman, R. (1973). How companies respond to social demands. *Harvard Business Review*, No. 51 (4).
3. Ambec S., Lanoie P. (2008). Does It Pay to Be Green? A Systematic Overview. *Academy of Management Perspectives,* No. 22 (4), pp. 45–62.
4. Barnett M.L., Salomon R.M. (2006). Beyond dichotomy: the curvilinear relationship between social responsibility and financial performance. *Strategic Management Journal,* No. 27 (11), pp. 1101–1122.
5. Bowen, H. (1953). Social Responsibilities of the Businessman, New York: Harper and Row.
6. Carnegie A. (1889). The Gospel of Wealth, *North American Review*, No. 148 (391), pp. 653–665.
7. Carroll A. (1991). The pyramid of corporate social responsibility: toward the moral management of organizational stakeholders. *Business Horizons,* No. 34 (4).

8. Carroll, A., 1979. A three-dimensional conceptual model of corporate performance. *Academy of Management Review,* No. 4 (4), pp. 497–505.

9. CECP in association with The Conference Board. (2013). Giving in Numbers: 2013 Edition. CEPS. Available at: http://cecp.co/measurement/benchmarking-reports/giving-in-numbers. html [accessed 28 February 2014].

10. Davis, K. (1973). The case for and against business assumption of social responsibilities. *Academy of Management Journal*, No. 16 (2), pp. 312–322.

11. Dixon-Fowler, H. R., Slater D.J., Johnson J.L., Ellstrand A.E., Romi A.M. (2013). Beyond "Does it Pay to be Green?" A Meta-Analysis of Moderators of the CEP — CFP Relationship. *Journal of business ethics,* No. 112 (2), pp. 353–366.

12. Eells, R. (1956). Corporate giving in a free society. New York.

13. Frederick, W. (1960). The growing concern over business responsibility. *California Management Review*, No. 2, pp. 54–61.

14. Frederick, W. (1978/1994). From CSR sub 1 to CSR sub 2: the maturing of business and society thought. *Business and Society*, No. 33 (2), pp. 150–166.

15. Friedman, M. (1970). The Social Responsibility of Business is to Increase its Profits. *The New York Times Magazine*, September No. 13, 1970.

16. Freeman R. (1984). Strategic Management: A stakeholder perspective. Boston, MA: Piman, United States.

17. Freeman R., Harrison J., Wicks A., Parmar B., De Colle S. (2010). Stakeholder theory: The state of the art. New York: Cambridge University Press.

18. Godfrey P. (2005). The relationship Between Corporate Philanthropy and Shareholder Wealth: A Risk Management Perspective. *Academy of Management Review,* No. 30 (4), pp. 777–798.

19. Hillman A., Keim G. (2001). Shareholder Value, Stakeholder Management, and Social Issues: What's the Bottom Line? *Strategic Management Journal*, No. 22 (2), pp. 125–139.

20. Kiron D., Kruschwitz N., Haanaes K. (2012). Sustainability nears a tipping point. *MIT Sloan Management Review,* No. 53 (2), pp. 69–74.

21. Lightfoot, L. (2014). Work together and tackle global issues. *The Independent*. Available at: http://global.factiva.com/ga/default.aspx?imt=2 [accessed 28 February 2014].

22. Lubin D., Esty D. (2010). The sustainability imperative. *Harvard Business Review,* No. 88 (5), pp. 42–50.

23. Mackey J., Sisodia R. (2013). Conscious Capitalism: Liberating the Heroic Spirit of Business. Boston: Harvard Business Review Press.

24. Margolis J., Walsh J. (2003). Misery Loves Companies: Rethinking Social Initiatives by Business. *Administrative Science Quarterly,* No. 48 (2), pp. 268–305.

25. McWilliams A., Siegel D. (2000). Corporate Social Responsibility and Financial Performance: Correlation or Misspecification? *Strategic Management Journal*, No. 21 (5), pp. 603–609.

26. Morran, C. (2014). Is Greek Yogurt still Greek if It's Made in America? *Consumerist*. Available at: http://consumerist.com/2014/01/29/is-greek-yogurt-still-greek-if-its-made-in-america [accessed 28 February 2014].

27. Morran, C. (2014). Whole Foods Reportedly Ditching Chobani Over GMO Concerns. *Consumerist.* Available at: http://consumerist.com/2013/12/18/whole-foods-reportedly-ditching-chobani-over-gmo-concerns [accessed 28 February 2014].

28. My Fox New York. (2014). Chobani yogurt not allowed into Russia. *MyFoxNY*. Available at: http://www.myfoxny.com/story/24650355/chobani-yogurt-not-allowed-into-russia [accessed 28 February 2014].

29. Norilsk Nickel Press Release. (2014). Norilsk Nickel opens a world of new opportunities. *Norilsk Nickel Press Release*. Available at: http://www.nornik.ru/en/newsroom/news-and-press-releases/news/norilsk-nickel-opens-a-world-of-new-opportunities [accessed 28 February 2014].

30. Porter, M., Kramer, M. (2006). Strategy and Society: The Link between Competitive Advantage and Corporate Social Responsibility. *Harvard Business Review*, No. 84 (12).

31. Selekman, B. (1958). A Moral Philosophy for Management. New York: McGraw-Hill.

32. Sethi, S. (1978). Advocacy advertising — the American experience. *California Management Review*, Fall, pp. 58–64.

33. Sharma S., Starik M. (2002). Research in corporate sustainability: the evolving theory and practice of organizations in the natural environment. Edward Elgar Publishing.

34. Swanson, D. (1995). Addressing a Theoretical Problem by Reorienting the Corporate Social Performance Model. *ACAD MANAGE REV*, No. 20 (1), pp. 43–64.

35. The West Australian (2013). Norilsk to close Lake Johnstone. *The West Australian,* Available from: http://au.news.yahoo.com/thewest/business/wa/a/16205832/norilsk-to-close-lake-johnston [accessed 28 February 2014].

36. The West Australian, 2013. "Norilsk workers in Pay Threat". *The West Australian*, Available from: http://au.news.yahoo.com/thewest/business/wa/a/16862812/norilsk-workers-in-pay-threat [accessed 28 February 2014].

37. Erin Brodwin, 2015. People are furious that Nestle is still bottling and selling California's water in the middle of the drought. *Business Insider*. Available at: http://www.businessinsider.com/nestle-is-bottling-water-from-california-2015–4.

38. Engel, Pamela. (2013). Here Are Some of The Biggest Brands that Make Clothes in Bangladesh. *Business Insider*. Available at: http://www.businessinsider.com/big-brands-in-bangladesh-factories-2013–5

39. Mattera, Philip. (2013). "Nestlé: Corporate Rap Sheet", *Corporate Research Project*. Available at: http://www.corp-research.org/nestle

40. Watrick S., Cochran P. (1985). The evolution of corporate social performance model. *Academy of Management Review*, No. 10 (4).

41. Winston A., Esty D. (2006). Green to gold: how smart companies use environmental strategy to innovate, create value, and build competitive advantage. New Haven: Yale University Press.