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Economic and Social Roles for Microfinance Institutions: Exposition, Approaches, and Suggestions

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Abstract

This paper is focused on the unique question of the nature, design, evaluation, and dynamics of the social role of a microfinance institution (MFI), as opposed to its economic role. The economic role is taken as the normal or traditional role for an MFI to generate profit or a surplus as a result of its operations, whereas the social role refers to the voluntary role of entertaining philanthropic objectives as a complement to the MFI's economic role. These roles will be defined in more details and contrasted later in the paper. It is hoped that the logic and analyses in the paper apply to all MFIs, including the savings and credit co-operative societies (SACCOs) in Uganda. To the best of the author's knowledge, no theory appears to exist on this subject of the social versus the economic roles of an MFI.

Keywords: Micro-financing, Economic and social roles, Uganda

Introduction

Microfinance institutions (MFIs) play a very important role in the development process of a country. For example, they complement the Formal Financial Institutions (FFIs) in the mobilization of savings, in directing savings and other resources to competing investment opportunities, in providing other financial services suitable especially to small-scale borrowers, and in the policy transmission mechanism. There is ample literature on MFIs. There are theories or arguments that MFIs exist just because of the inefficiencies of FFIs—implying that the MFIs would exit the financial markets if FFIs were at their maximum levels of efficiency. Other theories posit that the institutions have a raison d'etre of their own; just like microeconomic theory tells us that small firms will exist side by side with big firms due to economies of scale, leading to the small firms supplying a specified section of the market, MFIs exist to complement the big firms. The FFIs and MFIs offer highly differentiated financial services to specific segments of the market. In a game theoretic approach, the two categories of institutions participate in a win-win game in the act of providing the two differentiated products to the market. Technologies are such that, due to indivisibilities, if the big firm expanded, it would operate under capacity, i.e. with excess capacity. The MFI services are particularly tailored to specific clientele that FFIs are unable to serve adequately. These and other theories on MFIs or FFIs are, however, not the particular concern of this paper. This paper is, however, focused on the unique question of the nature, design, evaluation, and dynamics of the social role of a microfinance institution (MFI), as opposed to its economic role. The economic role is taken as the normal or traditional role for an MFI to generate profit or a surplus as a result of its operations, whereas the social role refers to the voluntary role of entertaining philanthropic objectives as a complement to the MFI's economic role. These roles will be defined in more details and contrasted later in the paper. It is hoped that the logic and analyses in the paper apply to all MFIs, including the savings and credit co-operative societies (SACCOs) in Uganda. To the best of my knowledge, no theory appears to exist on this subject of the social versus the economic roles of an MFI.

Despite the great investment opportunities which credit would offer to poor households in both rural and urban areas, formal financial institutions (FFIs)—dominated by commercial banks in most maskini (developing) countries—have paid minimal or inadequate attention to lending to the poor. The FFIs normally advance three main reasons for lending less to poor people. First, the institutions argue that the poor are unable to provide the necessary collateral security required for a borrower to qualify for various types of loans offered by the FFIs. Second, since the poor normally deal in small-size loans, it is very cumbersome and costly to deal with the poor. In other words, the FFIs are averse to lending to the poor (small borrowers) because of high transaction costs in terms of financial resources and time. Third, the incomes of the poor are very uncertain. For example, given the vagaries of weather in maskini countries, the incomes of the smallholder farmers in rural areas are not only uncertain but also very low. Consequently, one is not sure of the ability of the poor to repay the loans on time or at all.

The credit or lending modality of microfinance institutions (MFIs) is partly designed to circumvent some of the risks involved in lending to the poor. In literature, these risks are classified under three main headings: moral hazard, adverse selection and the agency problem. In economics, moral hazard occurs when one person (e.g. an MFI borrower) takes more risks because someone else (the lender) bears the cost of those risks. A moral hazard may occur where the actions of the borrower from the MFI in this case may change to the detriment of the MFI after a financial transaction has taken place. Therefore, in general, moral hazard is the risk that a party to a transaction has not entered into the contract in good faith, has provided misleading information about its assets, liabilities or credit capacity, or has an incentive to take unusual risks in a desperate attempt to earn a profit before the contract settles. The adverse selection problem is the issue or inability of screening out those potential borrowers who are likely to default. The agency problem occurs if the firm (MFI) is managed by persons other than the actual owners of the institution. The actions of the managers (management and/or the Board of Directors appointed by the owners) may deviate, sometimes substantially, from the policy guidelines or directives from the owners. As such, in practice, there are numerous cases where one finds management deviating, intentionally or otherwise, from the objectives and wishes of the owners of the MFIs, particularly at the policy implementation stage.

Moral hazard and adverse selection can alternatively be categorized into three main problems, namely, the problem with screening customers, the incentives problem, and the enforcement problem. The first deals with the issue and difficulty of determining the probability or likelihood of default by clients, a parameter or variable that determines the risk involved in extending credit to the clients. Since borrowers differ in the default likelihood, it becomes difficult to determine the level of risk for each borrower. The second problem deals with the type of economic or expenditure activity a client intends to engage in vis-à-vis repayment. Has the lender the ability to ensure that the activities engaged in by the borrower will definitely facilitate repayment of the loan? That is, will the borrower generate adequate revenue from the activities so as to be able to repay the loan and simultaneously make a surplus for himself/herself? Needless to point out, the probability of default on a credit facility depends on the probability that gross returns on the project for which the credit facility is being sought is less than the principal plus interest on the loan and related operating costs. The third problem focuses on the system set up to ensure that loans are repaid, and repaid on schedule. How does the lender effectively enforce repayment of loans?

In view of these problems, microfinance institutions have devised a microcredit modality, or methodology, that tries to solve the problems. The key elements of the modality are three: group lending (joint liability contracts), small, progressive loans, and targeting clientele with a high likelihood to repay loans.

Under this modality, lending is to groups of selected persons, rather than to individuals. Clients have to form groups (credit associations) so as to access credit from a microfinance institution (MFI). A typical credit association should consist of 25 to 40 members—members who are able and willing to work together for mutual benefit, on a win-win ideology. The association is organized along the lines of a co-operative society or a rotating savings and credit association (ROSCA), with an elected chairperson, secretary, treasurer and other officials. One of the principles of the group is that members are responsible not only for repayment of their personal loans but also for repayment of other members' loans in case of default; hence, the term joint liability contract. It is mutual trust amongst members of an MFI that sustains the MFI.

These joint liability contracts are used because:

- They provide a screening mechanism for borrowers, separating them into different risk types (Ghatak, 1997; van Tassel, 1999). It is the responsibility of each group to screen their members, since if any member defaults on loan repayment, the entire group have to make good the resulting liability. This generates pressure within each group to ensure that no member defaults.

- They utilize unique penalty mechanisms on members who willfully default (Besley and Coate, 1995; Conning, 1999). The penalty mechanisms are devised and enforced by the credit associations themselves. Socio-cultural and non-traditional as well as legal measures may come to bear on defaulters in this case. For example, it is reported that some 'muscle men' ('bouncers') may be used to deal (harshly) with defaulters in Malawi

- They induce endogenous peer monitoring to resolve the moral hazard problems in investment choices (Stiglitz, 1990). Members of a group counsel and help one another in order to attain the win-win situation.

- They reduce transaction costs for the MFI (Conlin, 1999). The MFI handles a relatively big loan to the credit association, rather than numerous small loans to each of the 25 to 40 individuals in the association.

- They provide insurance to other members in case their projects, for one reason or another, fail (Coleman, 1999).

- The groups guarantee acts as social collateral for each of the group members (Conning, 1999; Ghatak, 1999; Navajas et al., 2000). This mitigates the general lack of collateral security in terms of mortgageable, immovable assets as far as the poor are concerned.

As regards small progressive loans, the credit modality is such that lending goes through cycles. A client in a group starts with a small loan of a specified size—the size of the initial loan being determined by the credit association itself. For example, in the case of the defunct Foundation for Credit and Community Assistance (FOCCAS Uganda), the starting loan for an individual was set at just fifty thousand Uganda shillings. On successfully repaying the loan, the client qualifies for a bigger loan. This continues until the successful client eventually qualifies for a personal loan, outside the group. Personal loans are a special product of MFIs; they are available to those clients who prove through the cycles that they have business acumen and are trustworthy and deserve bigger loans on the recommendation of their credit associations.

Each MFI selects at the outset the type of customers it intends to deal with: men, women, men and women, the disabled, the rural poor, the urban poor, teachers, and so on. This is the targeting issue. For example, the defunct FOCCAS Uganda—that operated in Eastern Uganda between 1996-2008—chose rural women in Eastern Uganda as its target group. The choice of the targeted group is made with a view to assisting the poorest of the poor, taking into account the issues of moral hazard and adverse selection.

The MFIs' Economic and Social Roles Explained

It should be noted that, in practice, more often than not, microfinance institutions (MFIs) take on both economic and social roles. That is, they are in business not only to generate profits or surpluses in view of their economic roles, but also to carry out some defined social roles. The economic role demands that an MFI must at least break even in the medium term; the institution's total revenue must be equal or greater than its total expenditure. Short of this, the MFI will eventually collapse, for it will then be unsustainable in the long run. The social role is an outreach function based on philanthropic considerations, as will be explained in more detail below.

This paper discusses the two roles of MFIs, their interaction as well as issues on how to manage the roles in the process of ensuring the sustainability of an MFI. In this regard, some of the questions that need attention include the following:

- What are the basic or primary functions of a micro-finance institution?

- Should a micro-finance institution take on a social role, that is, activities that do not perfunctorily flow from its economic role as a credit provider to a poor community?

- If it indeed decides to take on a social role, how should the social role be 'managed' such that it does not unnecessarily compromise or adversely compete with the economic role of credit provision to a maskini (poor) society?

- Further, if it embraces a social role, should the MFI, therefore, offer two products (one product based on its social role and the other arising out of its economic role as a credit provider), or one composite product?

- What is the point of integration of the two roles or products, if both are accepted? Should there also be a differentiation in the roles in terms of fund raising, budgeting, accounting, staffing, reporting, and so on?

The crux of the matter is that, to be able to continue serving the concerned poor community as a credit provider, the microfinance institution must be sustainable—that is, in street parlance, it must survive in the long run by all means.

This question of 'survival of the fittest' in the financial superstructure has been of great concern in Uganda because of the nasty experiences of the near-collapse of the formal financial sector during the late 1970s to the early 1990s. The item "bad and doubtful loans (debts)" at financial intermediaries like the defunct Uganda Commercial Bank (UCB), the defunct Co-operative Bank (Co-op Bank), the ailing Uganda Development Bank (UDB), and many other government-owned institutions was so huge that it threatened the very survival of the institutions concerned. All studies of the operations of the institutions showed unequivocally that that item was as a result of the social roles played by the institutions. For example, the expansion of the branch network, and many investment (loan extension) activities, of the UCB were based on its social role. For instance, it was argued that the "people's own bank" (the UCB, as it was known) had to have a wide branch network and extend loans to the people, not necessarily on sound economic principles. As a result, loans were many a time given on socio-political considerations. Consequently, by the beginning of the 1990s, the UCB and many other public financial intermediaries were virtually insolvent, at the brink of utter collapse; and, indeed, some did eventually collapse.

Apart from unsecured lending arising mainly from the social role, institutions can also sink into oblivion as a result of uncontrolled internal lending, that is, unchecked and unwarranted lending to the managers and shareholders (owners) of the institutions, normally at zero or token rates of interest. Loans to management and owners (internal loans) are normally based on social roles and, therefore, are quite difficult to recover. In fact, by 1992, the average recovery rate in many public financial intermediaries in Uganda like the UDB was just around 36 per cent. The unsecured external lending together with unchecked internal lending (at near-zero or very low rates of interest) made the institutions virtually insolvent. In fact, such a situation was a big contributor to the eventual collapse of the UCB, Greenland Bank, the Co-operative Bank, Teefe Bank, the International Credit Bank (ICB) and other banks in Uganda since the 1990s.

The bitter memories of an unstable financial intermediation system in Uganda during the 1970s and early 1980a are today still so fresh in the minds of policy-makers and many other Ugandans. Many account-holders at various banks in the country still remember the long queues they used to be part of whenever they wanted to withdraw any amount of money from their accounts. It is then not surprising that both the new laws on formal financial institutions and microfinance institutions in the country put considerable stress on solvency of institutions, in an attempt to hedge the institutions and the public from past mistakes. Consequently, the Ugandan public is generally jittery about the entire idea or notion of financial institutions (including microfinance institutions) playing a social role. As the sayings go, 'history is the best teacher' and 'once beaten, twice shy'. In fact, even the Bretton Woods institutions (the World Bank and the International Monetary Fund, IMF) and the 'advocates of the profit motive being the best guarantor of motivation, efficiency, and sustainability' are not amused when they are informed that a financial institution is designed to play a social role in addition to its 'normal' economic role.

It is with this background in mind that the question of the nature, design, and evaluation of any MFI's social role should be scrutinized.

Financial Sustainability and Exposition of the Two Roles

Any business enterprise must ensure that it attains financial sustainability at least in the long run. It can afford to make year-in-year-out losses only during its infancy stage, not in the medium and long runs. Before looking at the definitions of the economic and social roles in detail, the concept of financial sustainability is presented below.

Microfinance Institutions and the Question of Sustainability

It is by now quite evident that microfinance (or microcredit) plays an important part in poverty alleviation in particular and development in general. However, for the microfinance sector to play its rightful role in development, the sector must sustain itself. That is, the sector must generate adequate revenues to cover its operations plus a surplus for re-investment and growth. This means that each MFI to be sustainable over a wide space in time must operate at such a level of output that its total cost (TC) must be less than, or at worst equal to, its total revenue (TR). If the MFI is unable to generate a surplus (TR > TC), it must at worst break even (TR = TC). As consumer theory specifies, to maximize profit, the firm must operate at the point of operation where the firm's marginal cost (MC) is equal to its marginal revenue (MR). Hence, the (average) price of the firm's product or output must be set such that this technical condition is fulfilled. This is the business/economic principle of every firm—a condition that must be sustained over time if the firm has to attain long-run sustainability.

The process of giving small loans to the poor is fraught with fundamental problems and costs. The problems and costs arise from the issue of market imperfections and high costs of operations partly attributable to lack of both exploitation of economies of scale and a big enough market for the concerned product. Hence, to forestall the collapse of an MFI or the entire microfinance sector, and, therefore, to guarantee continuity of access to microcredit and other financial services by the poor, the sector must be able to sustain its operations from internally generated revenues. It is clear from the literature that a viable and economically sustainable institution is one that has been able to deal in a substantial way with the hazards of providing small loans to the poor. The MFI and the sector must continuously find solutions to the twin problems of moral hazard and adverse selection. In the final analysis, long-run sustainability (LS) of an MFI or the entire microfinance sector is a function of a number of variables, including capitalization (K), financial self-sufficiency or sustainability (FS), outreach (OU), corporate governance (CG), the social role (SR) of the institution/sector, and a number of other seasonal, temporary, or persistent factors (υ). That is,

$$LS = f(K, FS, OU, CG, SR, \upsilon)$$

An MFI with high capitalization (K), sound financial self-sustainability (FS), optimal or substantial outreach (OU), sound corporate governance (CG) and an optimal balance between the economic and social roles of the institution (SR) will be sustainable even in the long run. The converse is true. The other factors (υ) include the prevailing socio-political environment, natural calamities (earthquakes, floods, severe droughts, frost, tsunamis, and the like) and man-made calamities (civil strife, wars, bad governance, severe economic shocks or business cycles, and so on). The impact of the υ on the LS will depend on the elements dominating the υ over time.

Capitalisation is a very important variable to any firm, for without a solid capital base the firm will continuously experience severe financial problems that will eventually lead to its demise. In a deposit-taking financial institution, adequate capitalization ensures safety of deposits. Like any other financial institution, an MFI to be sustainable must be able to absorb all losses that may occur without encroaching on depositors' funds. Inadequate capitalization is sub-optimal in that, from time to time, it results in shortages of working capital and illiquidity. It is for this reason that governments the world over have found it expedient to enact laws requiring deposit-taking institutions, including MFIs, to be adequately capitalized. The capital requirement also acts as an incentive to the owners of the institutions to prudently manage depositors' funds and other resources they

might be entrusted with.
Financial self-sustainability is achieved when the return on equity, net of any subsidies received, is not less than the opportunity cost of funds. In this respect, a positive on-lending interest rate—a rate which is able to cover administrative or overhead costs and simultaneously maintain the value of equity in real terms—is advocated for. It should be noted that financial self-sufficiency depends on various factors, including the following:

- Loan collection or recovery rates: Frequent collections, peer monitoring and efficient collection systems will assist in reducing arrears, and, therefore, in achieving high loan recovery rates. High recovery rates lead to financial self-sufficiency, other things being equal.

- Rates of interest on deposits: Deposit interest rates in real terms should be high enough to attract deposits for those MFIs which are deposit-taking. Availability of deposits reduces the institution's dependence on equity and donor and other borrowed funds.

- Management of administrative/overhead costs: Administrative and other overhead costs must be held to a minimum—possibly in the region of 15 to 20 percent of total costs or revenue of the firm. The MFI must avoid high overhead costs arising from high wage bills, high fuel and other transport costs, high entertainment expenses, mere extravagance by management as well as other administrative costs. In any case, for every, say, $100 available or borrowed, at least $80 should go into productive operations (on-lending and related investments). This is likely to ensure that the return on the initial investment of $100 will be far in excess of the $100.

- The effective real interest rate charged on loans: There is a dilemma here. Whereas the interest rate charged on loans must be high enough to cover rates on deposits, rates on loans to the MFI, overhead costs and other operating costs, the rate must not be so high as to scare away customers. This is one of the main criticisms labelled against MFIs: that they charge very high interest rates. In some cases, the effective real interest rate, in Uganda for instance, is anywhere from 40 to 100 per cent per year. For all intents and purposes, this rate is too high for the poor.

- Availability of voluntary savings facilities: For a deposit-taking MFI, it must provide a variety of savings facilities so as to attract savings from its clientele. A narrow variety of facilities will constrain savings mobilization and, hence, impact adversely on financial sustainability.

- Availability of incentives to repay loans: Training in book-keeping, simple business skills and marketing, peer mentoring and availability of well-laid-out procedures as to how to qualify for various loan facilities (differentiated products of the concerned MFI) are some of the means of enhancing repayment of loans.

A firm can afford to make losses in its initial stages (the period of infancy), provided that firm will at least break even in the medium term and makes a sizeable profit or surplus in the long run. This is the main challenge to the microfinance institutions; they have to generate adequate surpluses to avoid extinction and to grow over time.

Outreach refers to financial widening in terms of geographical coverage as well as branch network. The elements in the outreach set can also include the nature, type and variety of clients an MFI chooses to serve. Should the MFI cover the entire country or only selected regions of the country? Should it deal with the urban or rural poor only, or women only, or the poor plus a selected small set of not-so-poor men and women? In this case, the not-so-poor men and women will be charged relatively higher interest rates so as to subsidise the poor borrowers.

An MFI should examine the variable outreach in relationship to sustainability. An optimal level of outreach should be decided upon. There is need to decidedly resist the temptation to rapidly expand, without adequate analysis and justification, its branch network. That is, the MFI must not overstretch itself in terms of branch network and commitments so as to lose sight of its long-term objective of attaining and maintaining sustainability.
In general, corporate governance refers to the role of the shareholders and other decision makers (volunteer and other members of the relevant Board of Directors) in the running of the MFI concerned. To be specific, governance is a process through which a Board of Directors, through management, guides an institution in

fulfilling its corporate mission and vision and protects the institution's assets. Fundamental to good governance is the ability of individual directors to work in partnership so as to balance strategic and operational responsibilities. Effective governance occurs when a Board provides proper guidance to management regarding the strategic direction for the institution and oversees management's efforts to move in this direction. In exercising their governance responsibilities, Board members must consider the perspectives of numerous external actors: providers of capital, such as donors, governments, depositors or other financial institutions; regulatory bodies, such as the central bank and the Treasury; and other stakeholders, including shareholders, clients and employees. The Board is definitely responsible and accountable to all these groups of stakeholders.

The running of the institution must be entrusted to a Board of Directors and management consisting of respectable individuals and professionals in the field. All Board members must follow basic codes of conduct in carrying out their governance roles and responsibilities. For example, interference in the professional running of the MFI as well as unsecured internal lending (lending to the owners of the institution or to top management) are two of the issues the MFI must steer clear of. First, Board members must place the interest of the MFI above their own and other interests. This is dubbed the duty of loyalty. Second, the members must be well versed with the vision and mission of the MFI and must participate in decision making prudently (duty of care). Lastly, the members must be faithful to the mission of the institution (duty of obedience). Sound corporate governance will go a long way in ensuring sustainability in the long run, because a badly governed or managed institution will sooner than later sink into utter oblivion.

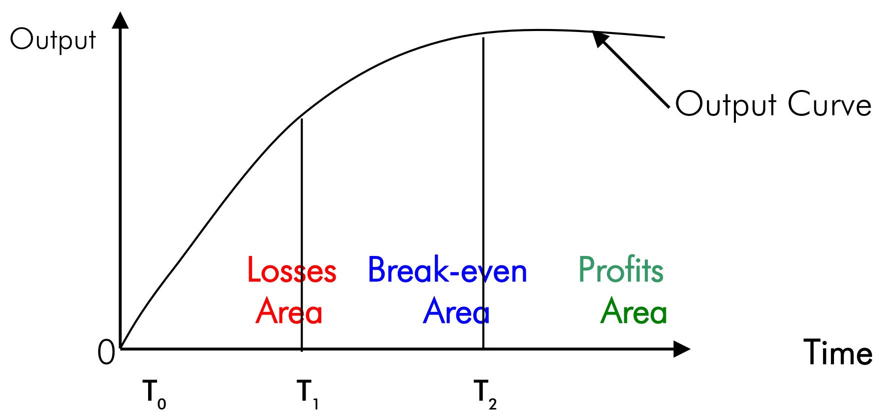
Corporate governance is inextricably intertwined with the social role of financial institutions in many cases in Africa. In the extreme, the social role involves offering a product on purely philanthropic or charitable grounds, with little regard to economic or business considerations (profit or surplus maximization). By an economic role, one refers to justification of the existence of an institution on purely its economic (business) activities. However, the institution plays an indirect social role in its provision of the differentiated product, for without that product society would be worse off. But, it should be re-emphasized that it can play this indirect role if and only if it can at least break-even in the long run.

The Economic and Social Roles Explained

As pointed out above, by an economic role, one refers to justification of the existence and operation of an institution on purely its economic (business) activities. In the final analysis, this boils down to the institution making a profit as a result of its operations, or, at worst breaking-even. For a young institution, a time horizon is spelled out at its conception, inception, or initiation. An example of a time horizon is shown in Figure 1 below.

Intuitively, one can allow an institution to incur losses for some time, provided that the losses decrease over time. After some specified time (T1 in the figure), the institution should break-even (i.e. its revenue should cover its expenses). This should also be a transitional time, for, thereafter (after time T2 in the figure), the institution ought to generate profits or surpluses on a continuous basis. This is the only way the institution will be sustainable in the long run, or else it will remain in its infancy perpetually (relying on benevolent handouts from well-wishers). This perpetual infancy is not only undesirable but also unsustainable in the long run, for the 'manna from Heaven' will soon or later dry up, thus leading to the 'timely' death of the infant.

Figure 1: Time Horizon for an Institution in Its Infancy



Note that the institution cannot either break-even or make a profit or surplus unless it offers a service or sells a product demanded by consumers. As elucidated before, the institution plays an indirect social role in its provision of the differentiated product, for without that product society would be worse off. It should, however, be re-emphasized that it can play this indirect role if and only if it can at least break-even in the long run. Applied to say, any savings and credit co-operative society (SACCO) in Uganda, this means that the institution must strive to break-even within a specified time horizon, or else soon or later, unfortunately, it will be forced to kiss good-bye to the light of this world. To the owners of MFIs, directors, and management, this point cannot be overemphasized.

Making a profit and maximizing profit are two different things. The latter involves operating at such a level (in terms of the quantity and price of the product being marketed) that maximum profit is earned, while the former just refers to operating at the level that earns the institution a profit, not necessarily maximum profit. To maximize profit, one may need to put out in the market as small a quantity at as high a price as possible, which is exactly what a monopolist does. Applied to a microfinance institution, the question of maximizing profit is out, yet it must generate profits for it to grow over time. There is latitude for playing a social role to a limited extent once the goal of profit-making (or generating a surplus), rather than profit-maximization, is adopted by any business firm. In fact, MFIs should aim at this goal. That way, they can, for instance, offer some free services or goods to their customers as part of their operations.

Operating at such a level that profit is generated, or maximized, is essentially what the economic role is all about. Stated in a different way, the objective is to offer a product to consumers such that both the firm offering the product and the consumers of the product are better off than before on a sustainable basis, that is, even in the long run. By making a profit, backed by good investment plans and activities, the firm ensures its continued existence in the business of its choice, and the consumers of the relevant product (the clients) are assured of the availability of the product on a sustainable basis. This is a win-win situation for the firm and its clients.

Next, attention is focused on the social role of an MFI or any other business firm. In the extreme, the social role involves offering a product on purely philanthropic or charitable considerations, with little regard to economic considerations. Examples of decisions that have, over time, been based on socio-political aspects are given in Table 1 below.

Although many of the 'problems' given in Table 1 have occurred in various African countries (including Uganda), they are highlighted in the table with a light touch. In fact, in many cases the 'bad and doubtful debts' referred to earlier actually resulted from activities such as those caricatured in Table 1. But the point is mad

T**able 1**: Socio-political Problems and Related Socio-political Solutions

	Stereo-type Problems	Stereo-type Solutions
1	Colonial banks in their lending policies discriminated against Africans and small-scale businesses in favour of whites and Indians and large-scale businesses	Banks in independent Africa must favour Africans and small-scale enterprises in their lending activities
2	Financial institutions' outreach in remote villages, where the majority of our people live, is very poor	Increase the branch network of the institutions up to sub-county level
3	'Our people' are too poor to have the type of collateral security or mortgages demanded by banks	Banks must be patriotic enough to lend without emphasizing collateral security
4	There is need for a change in attitudes and behaviour for the country to be 'liberated' from malaria, the six killer diseases for children, HIV/AIDS, and similar epidemics	Given the extensive outreach of micro-finance institutions, all MFIs must have programmes directed at attitude and behaviour change
5	There is need to assist our political party supporters to develop themselves through various businesses	Banks and MFIs must lend to these 'patriotic citizens' for the country to develop
6	There is need to assist employees to develop themselves	Lend to employees on soft terms (interest rates and maturity)

It is good and recommendable that all firms (private or public) pay attention to the social role. However, priorities must be very clear: down the line, the firm must 'survive'. The social role must not be left to 'strangle to death' the economic role. The impact of the social role must always be carefully justified and assessed, using unbiased, scientific measures. Efforts must be made to quantify the social role, so that, among other things, it can be weighed against the economic role. In many institutions, this is a difficult task to undertake, since many aspects of the social role are capable of generating or arousing, considerable emotions—emotions that will drive rational approaches and even common sense to the brink of a bottomless pit of oblivion, never to resurface again. The social role, it must be remembered, will thrive if and only if the firm 'survives' and prospers over time. It, therefore, goes without saying that all business firms (including microfinance institutions) should pay attention to the social role, but not at the expense of the economic role.

Approaches to the Two Roles

Unless there is separate, autonomous funding for the social role, and such funds for this role are not fungible, a firm's priority must be the economic role. In times of inadequate funds for the economic role, all activities under the social role ought to be frozen, except those activities that directly complement or are inextricably intertwined with the economic role. In the case of an MFI or SACCO, knowledge of book-keeping, marketing and entrepreneurship is so linked to the economic motive that stopping dissemination of such knowledge to customers would be suicidal. One needs an extremely sober mind and a sober atmosphere to disentangle the activities under the social role that can be labelled as directly complementary to the economic role from those which are basically complimentary. The line of demarcation is thin, and yet drawn it must be.

In any case, it is highly advisable that separate fundraising, budgeting, accounting, and marketing be undertaken in instances where, like in the case of the defunct FOCCAS Uganda, the firm has/had willingly opted to play both roles.

It should be stressed that what is being advocated here is not that no firm should entertain both an economic and a social role. In a world of competition, all choices should be available to all individuals and other legal persons or entities. The gist of the underlying philosophy is rather that the two roles must be defined and distinguished from each other carefully, the impact of the social role on the economic role must be determined and evaluated from time to time, and the ideology and philosophy for each of the roles must be based on firm considerations, devoid of emotions or socio-political considerations. If the two roles are to be integrated into a composite product (as was the case with the defunct FOCCAS Uganda's Credit with Education, rather than Credit and Education), the point of integration must be discussed and determined rationally. That is, the point of intersection (the common set or area) between the two roles must be clearly defined and emphasized in writings directed at the 'uninitiated' or the inquisitive general public.

To highlight the point further, take the defunct FOCCAS Uganda as an example. In the case of this institution, it had been decided by the founders that the product would be the composite Credit with Education. Therefore, there was no separate fundraising, budgeting, accounting, or marketing for the two roles, namely, the economic role (credit provision to the poor) and the social role (education). However, a few questions still remained to be answered. These questions included the following:

- Was the product Credit with Education superior to the products Credit and Education? Or was it merely a purely semantic difference?

- What was the point of integration? Was that the optimal point of integration?

- If a composite product was being offered, where was the emphasis. Did the staffing reflect that emphasis? Did the fact that staffing was heavily weighted against education reflect the existing or desired (optimal) composition or 'chemical content' of the composite product?

- Were there adequate efforts and resources devoted to mobilizing operating resources for the education component? One needs to spend resources so as to generate more resources; that is what investment is all about. What plans and strategies were in place to attract funding of the education component both in the medium and long runs?

- What was the impact of the education component on the credit component? Had a meaningful, unbiased, scientific assessment of this impact been made?

It should be noted that that in view of the virtually insatiable demand for credit in Uganda, like in many other maskini countries, the peasants (including FOCCAS Uganda's customers) were/are reasonably sensitized about the credit component in the Credit with Education product. It appears that the peasants were not adequately sensitized about the education component. They, therefore, did 'consume' the education component just because it was tied to credit—that is, just because they saw it as a necessary evil. Two fundamental questions here are: If these peasants had been reasonably sensitized about education, would they have turned up for education sessions, just in case the sessions were held separately from credit sessions? If they were not adequately sensitized, what were the short-term, medium-term, and long-term plans to sensitize them so that they would 'consume' the component out of their own volition or conviction? I believe that hardly any attention was focused on these basic questions. The question now is: Are the SACCOs paying adequate attention to these questions? Further, are the problems faced by SACCOs partly explained by lack of adequate focus on these and related fundamental issues?

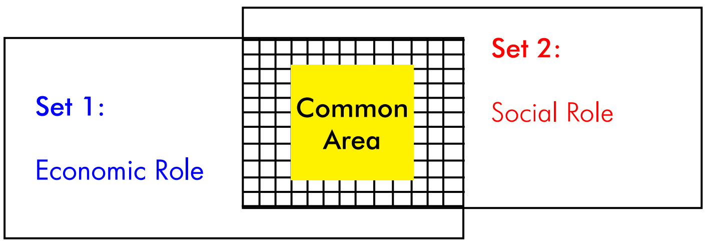
Those were some of the questions that the owners and directors of FOCCAS Uganda, with the expected expert assistance of the institution's management, were expected to grapple with in an attempt to find suitable answers thereof. Unfortunately, the MFI—backed by its main financier, Freedom from Hunger, an NGO based in the United States—appears to have been not entirely capable of dealing with, or rather unwilling to decisively tackle, the issues raised in the above questions. It is my considered view that the MFI's stakeholders appear to have been too emotional and infatuated, particularly with the ill-conceived education component, that the MFI failed to get the required Pareto-optimal balance between the two roles; consequently, the microfinance institution had to sink into oblivion around 2006.

Any MFI, needless to stress, must adequately address the issues raised in the above questions. Currently, some SACCOs in Uganda have collapsed due to failure to handle these very factors.

The Ultimate Choice

Ever since the days of Adam and Hawa (Eve), goods and services have been scarce, in the face of insatiable wants and rational consumers. For instance, the couple in heaven was desirous of even consuming the 'forbidden fruit'—and yet the fruit was not part of the feasible set of consumption goods and services at their disposal in the 'Garden of Eden'. In a world of scarcity, the key word is choice. With reference to the subject under discussion, Figure 2 below diagrammatically portrays the choice sets available.

Figure 2: The Intersection between the Economic Role and the Social Role



As noted before, this common area (Figure 2) encompasses those aspects of the social role that are complementary (rather than complimentary) to the economic role. The choice alternatives are, therefore, as follows:

- The Economic Role alone: => the pure profit maximization option
- The Economic Role + the Common area => the conventional option
- The Economic & Social Roles together: => the unconventional option
- The Social Role alone: => the economically unfeasible option
- Neither the Economic nor the Social Role: => the option to get extinct.

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The choice for a business firm organized on sound business principles is the economic role, in view of its alleged rationality. In a way, the famous Grameen Bank in Bangladesh adopted this approach, right from its inception, with the social role being complementary. Thus, education—on book-keeping, accountancy, accountability, marketing, simple economic and business principles and ethics, legal interpretations, and so on—comes in to 'improve' the effective implementation of the economic role; and the institution is concerned with the indirect social role of serving the poor (rather than directly aiming at attitude and behaviour change in relation to aspects of the social role that are merely complimentary to the economic role).

This is the bottom line. And, it is in view of this traditional approach that planners, policy makers, and many financiers of microfinance (and banks and other financial) institutions are jittery when the institutions take on complimentary aspects of the social role. It is often times stated that a financial institution is best at providing financial services. If it does anything else, it is bound to be less efficient than the optimum demands. MFIs, including SACCOs in Uganda, must recognize this so-called traditional, or rational, approach, for it is set in a competitive environment, an environment that also demands that the main stay of all financial institutions (including microfinance institutions) must be commercial credit from national and international organizations. This is the in-thing.

In the final analysis, this means that any MFI must market its product comprehensively in the face of this bias in the traditional or conventional viewpoint or the sphere of influence, and in the face of severe and growing competition from other microfinance institutions and related business enterprises in the country. The onus is on the relevant institution to justify why it plays a (complimentary) social role. For example, a close scrutiny of the new law on deposit-taking microfinance institutions in Uganda clearly shows that the law was formulated and promulgated with this conventional viewpoint (and bias) in mind. Depositors' resources and interests must be protected at all costs.

Concluding Remarks and Suggestions

MFIs' owners, directors, and management have no alternative but to find time and resources to address various issues raised in this paper, if the institutions are to be efficient and sustainable over time. Issues must be examined with an open mind, a mind able and willing to accept and take into account opposing views, and an optimistic mind, searching relentlessly but meticulously for optimal answers to various questions, with the principal goal of achieving the ultimate optimal solution(s) at least in the medium to long runs.

This is the challenge confronting business enterprises head-on, a challenge even MFIs must face squarely, bearing in mind that Darwin's law of natural selection or 'Survival of the Fittest" is a universal law in a world of competition. Any MFI must be amongst the "fittest". And it is the owners, the directors, and management of each institution to ensure that this objective is attained as quickly as possible. Government and other MFI supervisory bodies must also emphasize and ascertain that the institutions use the best practices available in the world. As the late Mwalimu Julius Kambarage Nyerere of the United Republic of Tanzania put it, 'we must run while others walk'.

Available empirical evidence shows that many small-scale businesses (including MFIs) in Uganda and in various other countries in Eastern Africa and beyond do not live long enough to celebrate their fourth or fifth birthday anniversaries; they perish in their infancy. This is because they do not pay adequate attention to the factors—mentioned in an equation stated above—that would ensure their long-term sustainability. Many also, for one reason or another, fail to differentiate economic from social roles; or complementary aspects of the social role from the complimentary ones.

This calls for a fresh start, or at least significant improvements and changes, in the management of MFIs (including SACCOs) and other small-scale enterprises in the region. All stakeholders have to put their heads together so as to come up with optimal positions and solutions to the seemingly gigantic, multifaceted problem confronting the institutions.

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