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Measuring Financial Performance: Practitioners Guide for Microfinance Associations

2010

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Measuring Financial Performance: Practitioners Guide for Microfinance Associations

The SEEP Network

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CONTENTS

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Introduction

Microfinance associations play a critical role in promoting financial access for poor and low-income people through direct support to microfinance institutions (MFIs) and policy advocacy that helps develop vibrant and inclusive financial sectors. While it is understood that a certain level of subsidy may be necessary to support the public goods that associations provide, it is increasingly accepted that associations need to pursue financial sustainability to ensure the continuity of services to their markets. Whether an association funds itself from grants, fees, donations, or a mix of revenue streams, it is important to regularly measure its financial health against a common industry standard. Standardized financial ratios provide those measurements as well the tools necessary to evaluate and improve operations through regular financial performance monitoring.

Table 1. Financial Performance Measures for Associations
Overhead ratio
Earned income ratio
Core Cost Recovery Ratio
Operating reserve ratio

The SEEP Network, in partnership with the Citi Foundation, engaged in a consultative dialogue and feedback process with microfinance associations from around the world. The goal was to identify a set of commonly agreed performance ratios that could be used to develop benchmarks for measuring financial performance. Through online conferences and direct consultations, over 20 associations contributed to the development of indicators presented in this Guide.[1] Although associations will not always meet the recommended targets, the application of these ratios will allow organizations to set financial performance goals and examine trends in their performance.

Core and Non-Core Services

In order to insulate associations from the impact of interruptions in donor funding and move towards financial sustainability, associations should consider the types of products and services that they offer, as well as their profitability, efficiency, and respective competitive advantages. The process of determining an association's core and non-core services includes identifying the products and services that an association considers essential to fulfilling its organizational mission—those which should be sustained even in the absence of outside funding and those that it considers non-essential.

There is still no industry consensus concerning the definition of core services for microfinance associations. The manner in which associations define this concept will largely depend on their business model and organizational mission. The costs associated with offering "core services" are considered **core costs**. Core costs are comprised of both overhead and direct costs associated with core activities. Core overhead is defined as all of the indirect costs that are required to run the association to fulfill its core activities. An association may define its core costs as only core overhead, or it may include both core overhead and direct expenses from product lines that it determines are integral to its success.

For services and/or products that are identified as "core," an association should aim to make their service provision fully sustainable by setting revenue targets that will cover 100 percent of all direct expenses and the overhead associated with these activities. Calculation of these costs should be defined in an association's accounting policy and tracked by its accounting system (e.g., salaries of core staff, such as the executive director, finance officer, membership services coordinator, performance analyst, together with any overhead costs associated with these staff, such as rent and utilities).

It may not be possible to achieve full cost recovery for services and/or products that an association identifies as "non-core," or non-essential. However, as associations grow and their members become more capable of paying full market rates for services, management can expand the range of core services offered.

1. The final ratios have been included in the *SEEP Network Capacity Assessment Tool for Microfinance Associations* (NCAT 5.0) as the current standard for_measuring the financial viability of associations. A subset of these ratios has also been included in the SEEP publication, *Success Indicators for Microfinance Associations,* which seeks to help associations measure their contribution to the development of the industries that they support.

Standard Definitions and Ratios

Financial performance ratios for associations cover three key performance areas: **operational efficiency, cost recovery,** and overall **financial sustainability.** Together, they help measure the financial health of an association in terms of its ability to utilize its assets efficiently, cover core costs with earned income, and accumulate the necessary reserves to ensure continuity of service delivery. While the set of ratios presented here was determined the most important by participating associations, it is by no means exhaustive and should not deter associations from conducting further analysis using additional indicators that they find relevant. Ratios are most meaningful when tracked over time to produce trend analysis and comparisons with industry benchmarks and association goals. The indicators should be calculated consistently using reliable and accurate financial reports (i.e., at least annually against audited financial statements) and utilized in the association's business planning.

R1: Overhead Ratio

The **overhead ratio** measures the percentage of total operating expenses used for overhead. It determines how efficiently an organization manages its resources. The ratio should be calculated using the following formula:

Overhead Costs / Total Operating Costs

Overhead costs (also known as indirect costs): Central administration costs paid by an association for successful program management (e.g., executive salaries, rent, and utilities) that are not directly related to the provision of any particular product or service.

Operating costs (also known as direct costs or program expenses): Costs that can be identified specifically with, or directly traced to, a specific product, service, or activity (e.g., salaries of trainers, consultants on a specific project, travel for a specific program).

Target: 15%–20%, with a decreasing trend

Keeping control of overhead costs is important to ensure that products and services are delivered in an efficient manner, as well as to attract donor funding. Although the ratio will fluctuate over time, increasing as associations add new products and services and decreasing as new economies of scale are reached, it should show a decreasing trend over time and stabilize at an acceptable level.

For example, an organization that currently has total overhead costs (e.g., salaries of non-program staff, rent, utilities, and marketing) of $355,000* and total direct operating program costs of $1.25 million, would have an overhead ratio equal to:

$355,000 / $1,250,000 = 28.4%

* All dollar amounts in U.S. dollars unless otherwise noted.

R2: Core Cost Recovery Ratio

The **core cost recovery ratio** measures the relative ability of an association to cover core costs (direct expenses related to core services and the associated overhead) from its earned revenues. The ratio should be calculated using the following formula:

Adjusted Earned Income / Core Costs

Adjusted earned income: All earned income, adjusted to account for the expenses associated with non-core services. Adjusted earned income represents the earned revenue truly **available** for covering core costs. It includes total gross revenue from core activities, including fees paid for membership services, sponsorships, foreign exchange gains and/or losses, interest, and other sources of self-generated income, plus net earned revenues from non-core activities.

Core costs: Represents the essential expenses that an association must cover in order to continue to offer the activities it has deemed integral to fulfilling its organizational mission and will continue to provide in the absence of outside funding. The calculation of these costs include: (i) core overhead, defined as the minimum administrative expenses required for the association to deliver its core services, and (ii) the costs of core activities, defined as the direct costs associated with core services.

Calculation of these costs should be defined in an association's accounting policy and tracked by its accounting system (e.g., salaries of core staff, such as the executive director, finance officer, membership services coordinator, performance analyst; any overhead costs associated with these staff, such as rent and utilities; and, if applicable, direct expenditures incurred by core activities). For most associations this would include, at a minimum, costs associated with holding an annual conference, advocacy activities, information exchange activities, and other activities considered integral to achieving their missions. However, core costs may be limited to core overhead only.

Target: Positive trend toward 100% cost recovery

For example, the core cost recovery ratio for an organization that currently has booked gross earned revenue from its core activities of $1 million, core costs of $1.5 million, gross earned revenue from its non-core activities of $2 million, but non-core expenses equal to $3 million, would be:

$$\frac{\$1{,}000{,}000 + (\$2{,}000{,}000 - \$3{,}000{,}000)}{\$1{,}500{,}000} = \frac{\$1{,}000{,}000 + (0)}{\$1{,}500{,}000} = 67\%$$

Since the non-core services in this example do not fully cover their expenses, it would not be accurate to include the revenue derived from these activities in the core cost recovery calculation. In such cases, the adjusted earned income figure would equal the earned income from core activities only.

R3: Earned Income Ratio

The **earned income ratio** measures the contribution of earned income to the association's total revenue. The ratio should be calculated using the following formula:

Gross Earned Income / Total Income

Gross earned income: All revenue derived from fees paid for membership services, sponsorships, foreign exchange gains and/or losses, interest, and other activities for both core and non-core services. This sum includes all direct revenue generated by products and services.

Total income: All earned and contributed (i.e., donated) income generated by an association.

This ratio shows the portion of an association's revenues that it is internally generated from core and non-core services. An association can use the ratio to identify a need to increase earned revenues over time. It shows how willing members are to pay fees and dues for the association's services and measures the association's commitment to balancing donor income and earned revenue by taking a fee-for-service approach to service delivery.

Target: 40%, with an increasing trend

For example, the earned income ratio of an organization that currently has gross earned revenues from core and non-core activities of $3 million, and total donated income in the form of grants and program support of $3.2 million, would be:

$3,000,000 / ($3,000,000 + $3,200,000) = 48.4%

R4: Operating Reserve Ratio

The **operating reserve** ratio measures the adequacy of operating reserves for covering an association's core costs.

[Average Unrestricted Net Assets / Core Costs] x 12

Average unrestricted net assets: Unrestricted current net assets are the portion of current net assets (current assets minus liabilities) that are not restricted or tied to stipulations imposed by a donor or the board, nor temporarily restricted by donors for future program use. In most cases, the current net unrestricted asset amount will be a portion of total net assets. Average unrestricted net assets are calculated by averaging the opening and closing balances for a given period. An association may treat all or a portion of these monies as institutional reserves and therefore may choose to substitute average unrestricted net assets with a dedicated operating reserve account in which these monies are invested.

Core costs: Please refer to definition of core cost recovery ratio.

Target: 12 months

Consider the example of an association with total current net assets of $775,000 in 2005 and $850,000 in 2006. Since its current net assets are comprised of endowment funds, program funds, and other revenues and/or contributions, only the portion of these funds associated with unrestricted program funds, revenues, and contributions will be included in the available unrestricted net assets calculation. For 2005, endowment monies of $225,000 are permanently restricted by donors and excess program funds of $200,000 are temporarily restricted by donors. For 2006, $100,000 of endowment monies are permanently restricted by donors and $305,000 of excess program funds are temporarily restricted by donors. Total core costs for its programs in 2006 were $650,000. Therefore, the organization's operating reserve ratio would be:

	2005	2006
Total Current Net Assets	$775,000	$850,000
Less: Permanently Restricted Current Net Assets	225,000	100,000
Less: Temporarily Restricted Current Net Assets	200,000	305,000
Available Unrestricted Net Assets	**$350,000**	**$445,000**

$$\frac{[(\$350{,}000 + \$445{,}000) / 2]}{\$650{,}000} * 12 = 7.34 \text{ Months}$$

Financial Ratio Analysis

Financial ratios are most meaningful when assessed within the context of industry standards and the performance of peer organizations. It is also important to view these ratios in light of the history of a given association in order to understand how certain business developments (both internal and external) have affected past and may impact future performance. In addition, positive trends, even at levels inferior to industry benchmarks, indicate that effective business strategies and policies are in place.

When reviewing financial performance ratio calculations, associations should keep the following considerations in mind:

Overhead Ratio

- What is the basis for the increase or decrease in the overhead ratio? Is the association in the early start-up stages, with low operating costs due to low programming levels? Did the association make major changes in its staffing levels? Did it increase its office space?
- Did the association increase its programming in a given year due either to increased donor income or changes in its strategic plan, which may deflate its overhead ratio if staffing levels are not increased by the same proportion?
- Has the organization made any changes in its accounting procedures that may artificially lower its overhead costs?
- Does the organization currently allocate staff time for programs separately as a direct expense of each project? Or does it simply include all staff salaries as overhead? How does this allocation impact the overhead ratio?
- How well does the association measure up to the industry benchmark of 15–20 percent?
- Is the association's overhead ratio reasonable, given its age and maturity level?
- Is there a need for improvement in the operating ratio?
- What are the biggest cost contributors?
- Is there room to reduce costs or make efficiency gains?

Core Cost Recovery Ratio

- What is the basis for the increase or decrease in this ratio? Can the decrease in the association's core cost recovery ratio be explained by higher core costs (core overhead and direct expenses for core activities)?
- How does the association define core costs? Does it assume that all of its activities are "core" activities? Does it include all overhead costs or only a subset of overhead expenses needed to maintain basic services? Has the concept of core costs evolved over time?
- Given the association's current level of development, what should be the target for the core cost recovery ratio if it is not already 100 percent?
- Is the association charging member fees for core services such as training and conferences? If not, is there room to introduce fees for services? If these fees are not sufficient, is there room to increase fees?
- Are annual membership dues and fees sufficient to cover the core costs of the association? If not, is there room to increase the fees for membership by introducing membership tiers or categories with different dues and benefits?

Earned Income Ratio

- What is the basis for the increase or decrease in this ratio? Has earned revenue from core and non-core activities increased in absolute terms, while the earned income ratio has decreased? If so, can a decrease in the earned income ratio be explained by an increase in the level of donated, or grant, income for the year? Conversely, does an increase in the earned income ratio actually reflect an increase in the level of earned revenues, or can it be explained by a decrease in donated income?
- Does the organization intend to readjust its earned income revenue target to offset possible increases or decreases in donated income?
- Has the organization met or exceeded the 40 percent target for earned revenues as a percentage of total revenues?
- If not, what targets will the association set that correspond with its current age and maturity level?
- What is the structure of earned revenue? Is there room to increase fees and dues to cover a greater portion of the association's costs?

Operating Reserve Ratio

- What is the basis for the increase or decrease in this ratio? How well does the association measure up against the minimum benchmark of 12 months?
- Does the association have reserve targets or a dedicated operating reserve account?
- Is the association's operating reserve ratio high because of a decrease in its core costs?
- Can an increase or decrease in the available unrestricted net program revenues be explained by increases or decreases in unrestricted donor grants for operations?
- If an association has a very high operating reserve ratio, is this level being maintained at the expense of programming? Or is it high due to other operating phenomena, such as high staff turnover or senior management change?

Setting Performance Targets

An important part of evaluating an association's financial performance is comparing its performance with established targets. The business planning process will vary from organization to organization, with the exact goals of each association greatly depending on its local context. ***However, all associations should have the long-term goal of achieving the basic performance benchmarks that are evolving for the sector***.

For more mature associations that have been offering their products on a fee-for-service basis for some time, it may be realistic to set a goal of 100 percent financial sustainability (full recovery of core costs from adjusted earned revenue) by the end of their business plan periods. However, for emerging associations in more nascent markets where the concept of cost recovery may not yet have taken root, more conservative annual growth targets (e.g., 20 percent per annum) may be in order. Similarly, associations that have been around for many years and have a solid funding base will likely find it easier to meet minimum reserve targets. Emerging associations, however, may not have robust reserves. More of their available resources may be used to cover program expenses in order to adequately serve their members. These emerging organizations may also rely on attracting outside funding to cover program expenditures in the near term.

Regardless of the stage of development of an association and/or the market it serves, performance targets should be realistic and accompanied by a clear strategy for achieving them, as reflected in an association's business planning documents. Ongoing financial performance analysis can contribute significantly to these efforts. Along with expense data generated from the *SEEP Product Costing Tool*,[2] associations can develop a sustainability strategy that leverages existing partnerships and explores new opportunities for generating the funding necessary to support growth. Some key issues to consider include:

- **Projected revenue.** How much revenue will be generated from the association's current products and services over the course of the business plan? What new sources of income can be considered?
- **Structure of income.** How will the sources of income change over the business plan period? How much income will be earned and how much contributed through donations and grants?
- **Funding strategy.** How does the association plan to grow its core and non-core activities over the business plan period? Is there a funding plan? Who is responsible for cultivating this support—the executive director, the director of development (if the position exists), or the board of directors?
- **Operating reserves.** Has the association set a target for minimum reserves? Is the target adequate or does it need to be revised?

2. The SEEP Network, *Product Costing and Performance Analysis: A Toolkit for Analyzing Associations' Service Offerings* (Washington, DC: SEEP Network, 2010), http://networks.seepnetwork.org/en/node/2185 (accessed October 14, 2010).

The Financial Performance Ratio Analysis Tool

The Financial Performance Ratio Analysis Tool is a free, easy-to-use Excel worksheet developed by the SEEP Network to help associations produce basic financial reports, as well as analyze and monitor their financial performance. Associations can choose to download the Financial Performance Ratio Analysis Tool, or a combined version of the Financial Performance/Product Costing Tool. The *SEEP Product Costing Tool,* helps associations determine the cost structure of their products and services and the implication of current pricing policies on their long-term financial sustainability. These tools can be used to develop a financial plan for long-term sustainability.

The Financial Performance Ratio Analysis Tool has seven main Excel worksheets, five of which are input worksheets and two of which display graphical results.[3] All manual data input areas are shown in blue font and all cells subject to formulas are highlighted in light gray. Next step buttons are also located at the bottom of every input sheet.

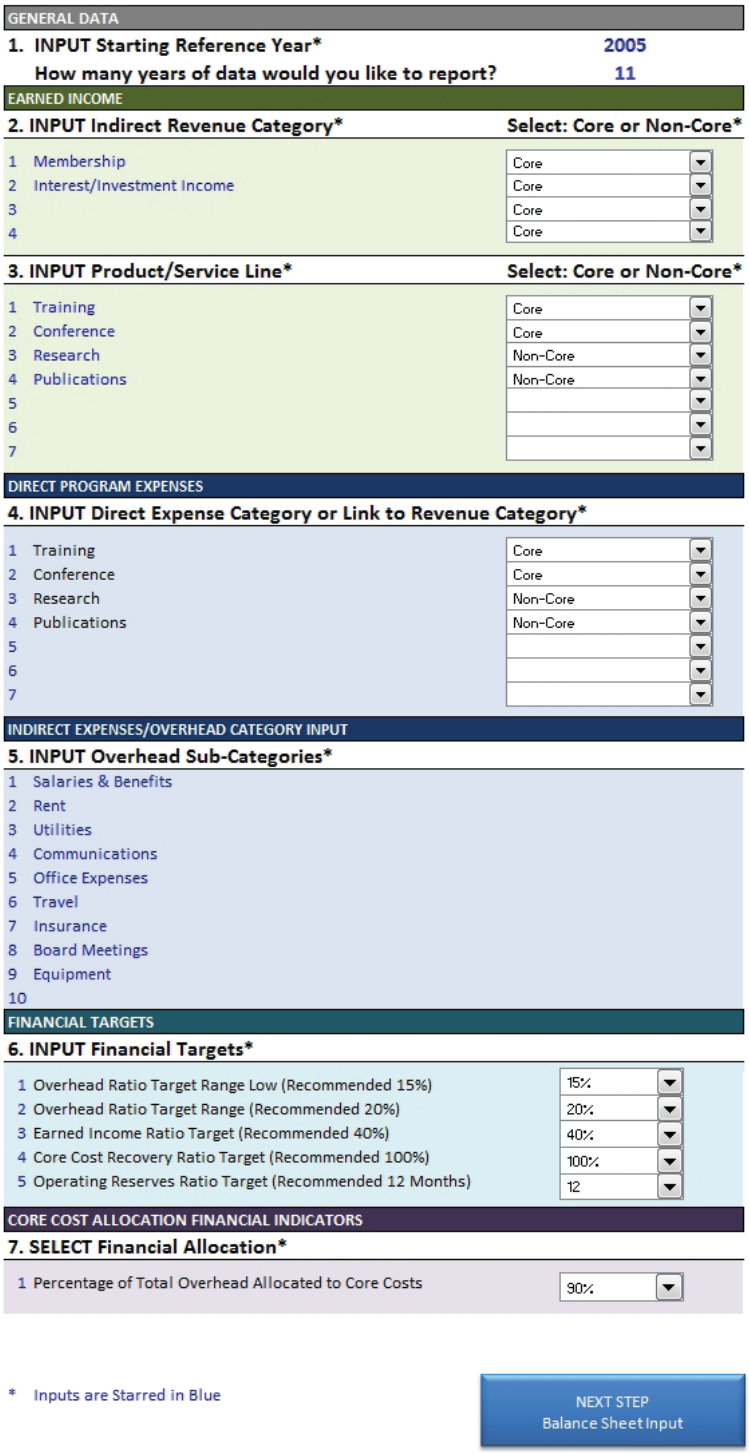
Worksheet 1: Setup Data

The first worksheet is for inputting general information regarding financial data (by year), product/service line categories, and association targets for ratio analysis. Users will categorize revenue and expenditure categories as core and non-core, and select financial ratio targets by selecting from the drop down menus. Users will also have the option of selecting the percentage of the total overhead costs to allocate to core costs.

Worksheet 2: Balance Sheet Data

As shown on page 8, the second worksheet is for inputting data on available unrestricted current net assets for the operating reserve ratio. An association determines internally the portion of its current net assets that are neither restricted nor temporarily

Figure 1. SEEP Financial Analysis Tool: Setup Worksheet



GENERAL DATA

1. INPUT Starting Reference Year* 2005
How many years of data would you like to report? 11

EARNED INCOME

2. INPUT Indirect Revenue Category* — Select: Core or Non-Core*

1	Membership	Core
2	Interest/Investment Income	Core
3		Core
4		Core

3. INPUT Product/Service Line* — Select: Core or Non-Core*

1	Training	Core
2	Conference	Core
3	Research	Non-Core
4	Publications	Non-Core
5		
6		
7		

DIRECT PROGRAM EXPENSES

4. INPUT Direct Expense Category or Link to Revenue Category*

1	Training	Core
2	Conference	Core
3	Research	Non-Core
4	Publications	Non-Core
5		
6		
7		

INDIRECT EXPENSES/OVERHEAD CATEGORY INPUT

5. INPUT Overhead Sub-Categories*

1 Salaries & Benefits
2 Rent
3 Utilities
4 Communications
5 Office Expenses
6 Travel
7 Insurance
8 Board Meetings
9 Equipment
10

FINANCIAL TARGETS

6. INPUT Financial Targets*

1	Overhead Ratio Target Range Low (Recommended 15%)	15%
2	Overhead Ratio Target Range (Recommended 20%)	20%
3	Earned Income Ratio Target (Recommended 40%)	40%
4	Core Cost Recovery Ratio Target (Recommended 100%)	100%
5	Operating Reserves Ratio Target (Recommended 12 Months)	12

CORE COST ALLOCATION FINANCIAL INDICATORS

7. SELECT Financial Allocation*

1 Percentage of Total Overhead Allocated to Core Costs 90%

* Inputs are Starred in Blue

NEXT STEP
Balance Sheet Input

3. Descriptions and instructions in this document pertain ONLY to the use of the Financial Ratio Analysis Tool and not the merged Product Costing Performance Tool. This guide does not include instructions for the seventh input sheet for financial projections. For more information on this functional tab, please refer to the instructions tab located in the excel tool.

restricted by donor or board policies. Associations may choose to change the input categories if they have established a dedicated operating reserve. Users can also input more balance sheet information if they plan to undertake additional analyses.

Figure 2. SEEP Financial Analysis Tool: Balance Sheet Data Worksheet

CURRENT ASSETS	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total Net Current Assets (Check Against Balance Sheet)	775,000	-	-	-	-	-	-	-	-	-	-
Total Net Current Assets	775,000										
Less: Portion of Total Net Current Assets that are Permanently Restricted	225,000										
Less: Portion of Total Net Current Assets that are Temporarily Restricted	200,000										
AVAILABLE CURRENT NET UNRESTRICTED ASSETS	350,000	-	-	-	-	-	-	-	-	-	-
UNAVAILABLE CURRENT NET RESTRICTED ASSETS	425,000	-	-	-	-	-	-	-	-	-	-

Inputs are in White Cells
Cells with Formulas are Highlighted in Light Gray

NEXT STEP
Core Cost Data Input

Worksheet 3: Core Cost Data

This worksheet is for inputting core cost data, as defined by each association. Categories of core and non-core earned revenues and expenses will be directly pulled from the setup worksheet. Core costs are input manually into this worksheet and will automatically update the Income and Expenditure worksheet. Users also have a choice to select the percentage of total overhead on the setup worksheet to calculate how much of total overhead is allocated to core overhead in this section. Alternatively, users will manually input the core overhead costs directly into the worksheet.

Figure 3. SEEP Financial Analysis Tool: Core Cost Data Worksheet

DIRECT PROGRAM CORE COSTS	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Training	100,000	-	-	-	-	-	-	-	-	-	-
Direct Labor	65,000										
Supplies	20,000										
Expenses	8,500										
Travel	6,500										
Conference	110,000	-	-	-	-	-	-	-	-	-	-
Direct Labor	60,000										
Supplies	25,000										
Conference Grants	10,000										
Consultants	15,000										
INDIRECT CORE OVERHEAD	91,350	-	-	-	-	-	-	-	-	-	-
Salaries & Benefits	58,500	-	-	-	-	-	-	-	-	-	-
Rent	9,180	-	-	-	-	-	-	-	-	-	-
Utilities	3,960	-	-	-	-	-	-	-	-	-	-
Communications	4,500	-	-	-	-	-	-	-	-	-	-
Office Expenses	2,970	-	-	-	-	-	-	-	-	-	-
Travel	3,308	-	-	-	-	-	-	-	-	-	-
Insurance	6,503	-	-	-	-	-	-	-	-	-	-
Board Meetings	1,350	-	-	-	-	-	-	-	-	-	-
Equipment	1,080	-	-	-	-	-	-	-	-	-	-
TOTAL CORE COSTS	301,350	-	-	-	-	-	-	-	-	-	-

Inputs are in White Cells
Cells with Formulas are Highlighted in Light Gray

NEXT STEP
Income & Expenditure Data Input

Core costs will vary from association to association, depending on what they have defined as the minimum services that they seek to provide their members, regardless of the availability of donor funding. (Refer to the earlier definition of core costs in section III.) For most associations, this would include, at a minimum, costs associated with holding an annual conference, advocacy activities, and the collection and reporting of performance data. Overhead in the core cost data input worksheet will be a subset of total overhead expenses that are entered in the Income and Expenditure Data worksheet.

Worksheet 4: Income and Expenditure Data

Income and expenditure data may be input manually into the fourth worksheet from product costing exercises performed by the association. Income should be entered according to ***earned income*** from dues and fees and ***contributed/donated income*** from grants and project funds. Earned income is separated into the two categories—core and non-core activities. Based on the aforementioned discussion of core and non-core activities, associations will individually classify their services under each category.

The Financial Performance Ratio Analysis Tool allows users to customize the names of their main earned income categories (highlighted in yellow) by product or type of service in the setup worksheet (worksheet 1). Some of the categories commonly used for earned income are membership dues, training, conference and/or regional events, publications, and interest income. The setup worksheet also separates these services into core and non-core groupings. Organizations can modify individual subcategory items for service lines under each category of earned income in worksheet 4. The examples provided in figure 4a. illustrate some of the sub-entries commonly provided under each product line. For example, rent for training facilities is included as earned income under the broader category of "Training."

Contributed income includes donations, direct grant monies, and subsidies provided by donors. However, certain subcategories of donor funding, such as sponsorships for association members to attend conferences or trainings, may be considered earned income. This category does not include in-kind donations.

Figure 4a. SEEP Financial Analysis Tool: Revenues in the Income and Expenditure Data Worksheet

REVENUES	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Earned Income	236,750	-	-	-	-	-	-	-	-	-	-
Core Activities	231,250	-	-	-	-	-	-	-	-	-	-
Membership	117,000	-	-	-	-	-	-	-	-	-	-
Dues	102,500										
Sponsorships	14,500										
Interest/Investment Income	11,500	-	-	-	-	-	-	-	-	-	-
Interest Income	6,500										
Dividends	5,000										
Conference	87,000	-	-	-	-	-	-	-	-	-	-
Fees	75,000										
Sponsorships	12,000										
Training	15,750	-	-	-	-	-	-	-	-	-	-
Fees	15,000										
Rent	750										
Non-Core Activities	5,500	-	-	-	-	-	-	-	-	-	-
Publications	1,500	-	-	-	-	-	-	-	-	-	-
Subscriptions	1,000										
Royalties	500										
Other Income	4,000	-	-	-	-	-	-	-	-	-	-
Fees	4,000										
CONTRIBUTED INCOME	375,500	-	-	-	-	-	-	-	-	-	-
Donations/Program Grants	375,500	-	-	-	-	-	-	-	-	-	-
Program Grants	350,000										
Donations	15,000										
Unrestricted Donations	10,500										
TOTAL REVENUES	612,250	-	-	-	-	-	-	-	-	-	-

Expenditures in this worksheet are divided into two major categories: ***operating/program*** and ***overhead/administrative*** expenditures. As in the earned income section, operating/program expenditures are also classified into core and non-core expenses. Only the cells for non-core expenses and total overhead should be inputted in this worksheet. All of the expenses for core services are linked to the prior worksheet for core costs. The input worksheet has been designed based on a cost center approach; therefore, all direct program-related expenses should be entered under the appropriate service line or product. All central administrative costs paid by the association for program management (e.g., executive salaries, rent, utilities) that are not directly related to the provision of any particular product or service should be entered under overhead.

Figure 4b. SEEP Financial Analysis Tool: Expenses in the Income and Expenditure Data Worksheet

EXPENDITURES	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
OPERATING EXPENSES	331,500	-	-	-	-	-	-	-	-	-	-
Core	210,000	-	-	-	-	-	-	-	-	-	-
Training	100,000	-	-	-	-	-	-	-	-	-	-
Direct Labor	65,000										
Supplies	20,000										
Expenses	8,500										
Travel	6,500										
Conference	110,000	-	-	-	-	-	-	-	-	-	-
Direct Labor	60,000										
Supplies	25,000										
Conference Grants	10,000										
Consultants	15,000										
Non-Core	121,500	-	-	-	-	-	-	-	-	-	-
Research	71,500	-	-	-	-	-	-	-	-	-	-
Direct Labor	60,000										
Supplies	3,000										
Expenses	7,500										
Other	1,000										
Publications	50,000	-	-	-	-	-	-	-	-	-	-
Direct Labor	43,000										
Supplies	4,500										
Expenses	2,500										
TOTAL OVERHEAD	101,500	-	-	-	-	-	-	-	-	-	-
Salaries & Benefits	65,000										
Rent	10,200										
Utilities	4,400										
Communications	5,000										
Office Expenses	3,300										
Travel	3,675										
Insurance	7,225										
Board Meetings	1,500										
Equipment	1,200										
TOTAL EXPENDITURES	433,000	-	-	-	-	-	-	-	-	-	-
NET Income from Non - Core Activities	-	-	-	-	-	-	-	-	-	-	-
Adjusted Earned Income	231,250	-	-	-	-	-	-	-	-	-	-
NET REVENUES	179,250	-	-	-	-	-	-	-	-	-	-

Inputs are in White Cells
Cells with Formulas are Highlighted in Light Gray

NEXT STEP
Financial Indicator Output

Worksheet 5: Key Financial Ratios (Output Worksheet)

The Financial Ratios worksheet is automatically generated, based on the data input into the first four worksheets. The chart at the top of the worksheet displays the four key financial performance ratios, along with the industry benchmarks reflected in the *SEEP Network Capacity Assessment Tool (NCAT).* Associations can override these benchmarks and set their own targets, based on their business plans, if they differ significantly from industry figures.

Figure 5. SEEP Financial Analysis Tool: Financial Ratios Worksheet

Ratios	Description	Indicator		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Overhead Ratio	Overhead cost / Operating Expenses	%	Actual	30.6%										
			Target	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
				20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
			Status	●										
Earned Income Ratio	Earned Income / Total Revenue	%	Actual	38.7%										
			Target	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
			Status	●										
Core Cost Recovery Ratio	Adjusted Earned Income / Core Costs	%	Actual	77%										
			Target	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
			Status	●										
Operating Reserve Ratio	Average Unrestricted Net Assets / Core Costs	# of months	Actual	7.0										
			Target	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0
			Status	●										

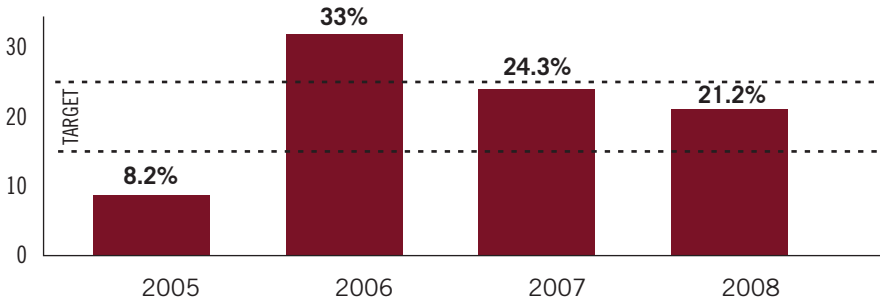
Red and Green dots indicate whether association's financial performance satisfies target level for indicator.

The following examples show the type of graphs that are automatically generated by the Financial Performance Tool. These graphs show trends in performance for the four key ratios. These charts are for illustrative purposes only and do not correspond to the previous worksheet input and output representations.

Overhead Ratio

Figure 6 shows an association that is making major advances towards bringing its performance into line with industry norms. The initial low overhead ratio in 2005 reflects low operating costs during the association's early startup days, when programming was less active. The major jump in 2007 reflects an increase in staffing costs, as the nascent association built up its human resource base before realizing increased efficiencies in subsequent years. Based on these figures, there continues to be room for the association's management to set targets for increased efficiency as part of the business planning process.

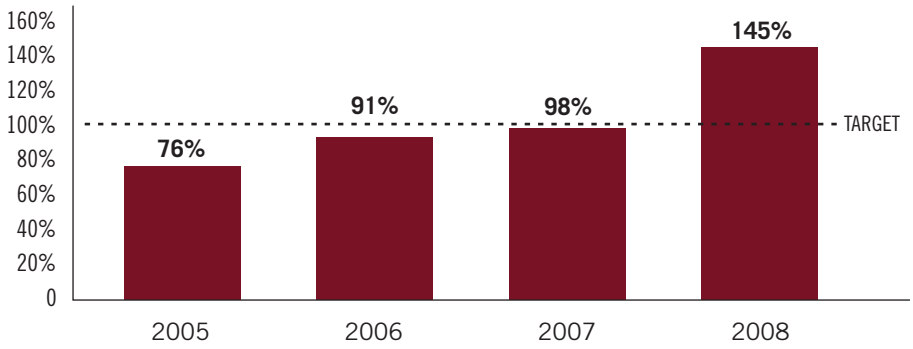
Figure 6. Sample R1 (Overhead Ratio) Graph



Cost Recovery Ratio

Figure 7 shows an association that has done very well covering core costs with adjusted earned income since the beginning of its operations. As expected, the association began with a cost recovery rate below 100 percent, when it tested out market demand and the willingness of its members to pay dues and fees to cover the core costs of basic services. Over time, it has far exceeded the benchmark for the sector, reaching 145 percent cost recovery.

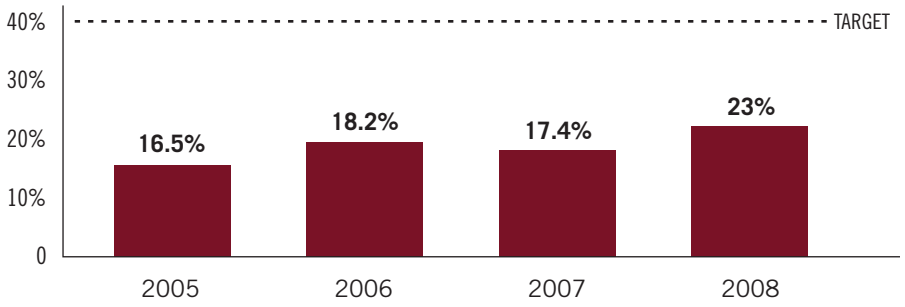
Figure 7. Sample R2 (Core Cost Recovery Ratio) Graph



Earned Income Ratio

Figure 8 shows an association that is gradually achieving an earned income ratio of 40 percent, which is considered an acceptable norm for the industry. While 40 percent is the minimum target, associations with little access to donor funding and/or associations that seek to fund themselves primarily with member dues and fees should target a much higher ratio.

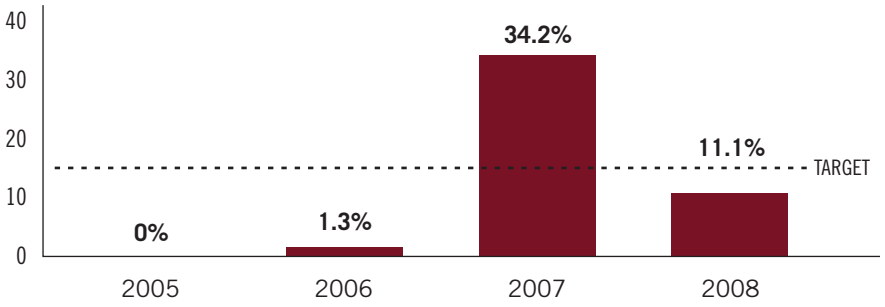
Figure 8. Sample R3 (Earned Income Ratio) Graph



Operating Reserve Ratio

Figure 9 shows an association's excessive operating reserve levels for 2007, which indicates that this high reserve level was being maintained at the expense of program investments. In this particular case, the association was undergoing a period of high staff turnover and senior management change. Therefore, the large reserve was understandable, considering the internal state of the association. Under normal circumstances, however, such a high level of reserves would indicate a need to review the association's reserve policy and other existing requirements on restricted funding that may have contributed to the size of the reserves.

Figure 9. Sample R4 (Operating Reserves Ratio) Graph

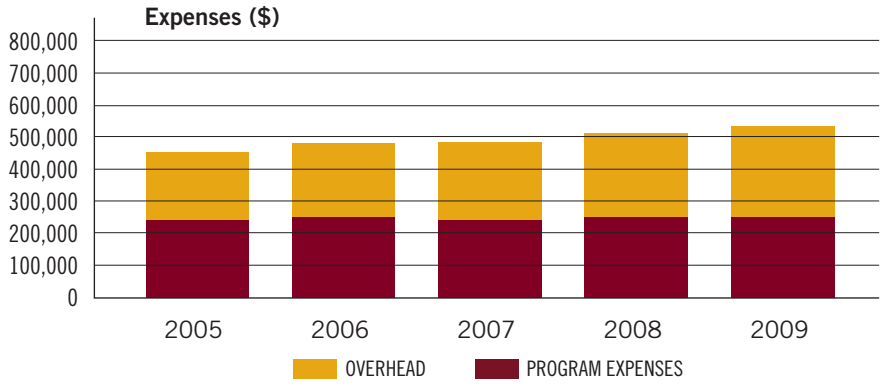


Worksheet 6: Additional Analysis (Output Worksheet)

This worksheet generates additional analysis that associations may find useful. It can also be used to create customized reports that meet an association's specific needs. Setting targets for stable, planned growth will help ensure that the association can deliver consistent levels of products and services to the market from year to year.

Figure 10. SEEP Financial Analysis Tool: Worksheet 6—Additional Expense Analysis

Area	Indicator	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Program Expenses	Expenses ($)	331,500										
	%Total Expenses	77%										
Overhead	Expenses ($)	101,500										
	%Total Expenses	23%										
Total Expenses	**Expenses ($)**	**433,000**	-	-	-	-	-	-	-	-	-	-



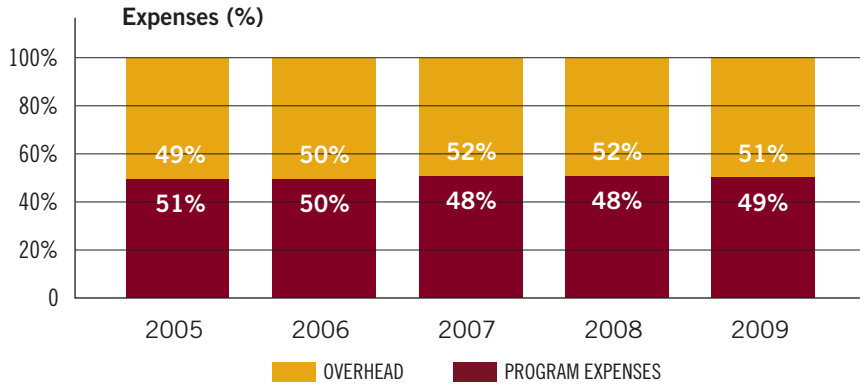
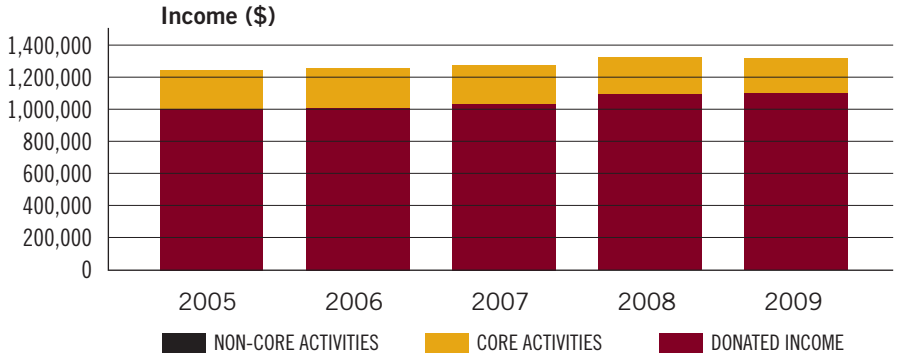


Figure 11. SEEP Financial Analysis Tool: Worksheet 6–Additional Total Income Analysis

Area	Indicator	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Non-Core Activities	Income ($)	5,500										
	%Total Income	1%										
Core Activities	Income ($)	231,250										
	%Total Income	38%										
Donated Income	Income ($)	375,500										
	%Total Income	61%										
Total Income	**Income ($)**	**612,250**	-	-	-	-	-	-	-	-	-	-



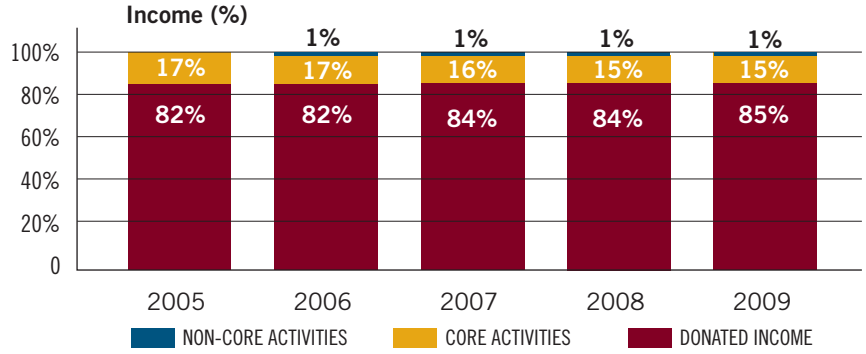
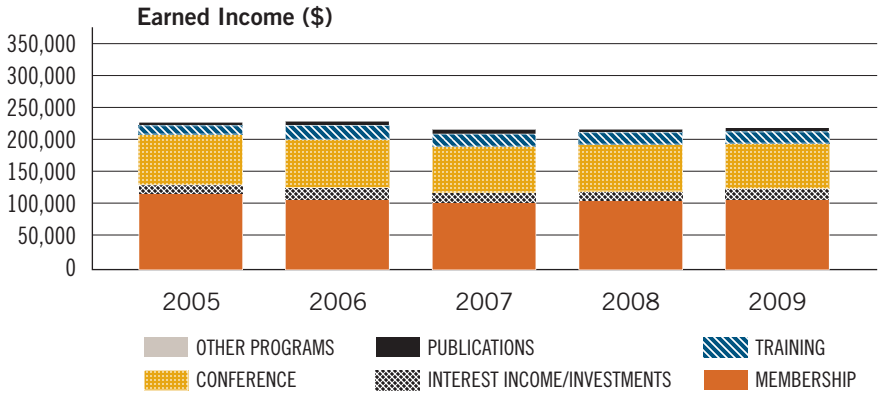
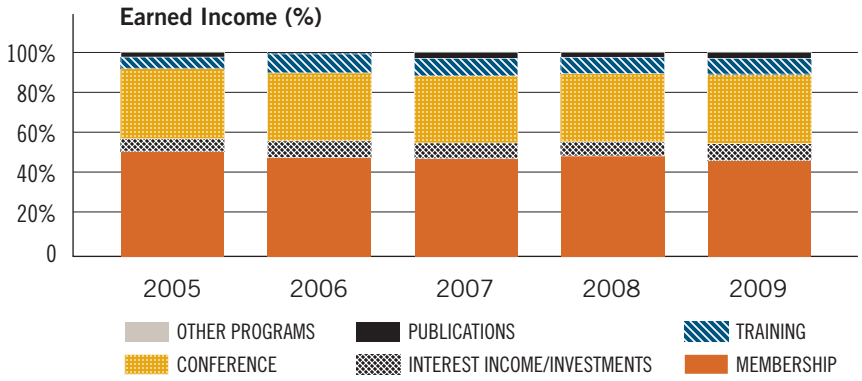


Figure 12. SEEP Financial Performance Tool: Worksheet 6—Additional Earned Income Analysis

Area	Indicator	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Membership	Income ($)	117,000	-	-	-	-	-	-	-	-	-	-
	% Earned Income	49%	-	-	-	-	-	-	-	-	-	-
Interest/Investment Income	Income ($)	11,500	-	-	-	-	-	-	-	-	-	-
	% Earned Income	5%	-	-	-	-	-	-	-	-	-	-
Training	Income ($)	15,750	-	-	-	-	-	-	-	-	-	-
	% Earned Income	7%	-	-	-	-	-	-	-	-	-	-
Conference	Income ($)	87,000	-	-	-	-	-	-	-	-	-	-
	% Earned Income	37%	-	-	-	-	-	-	-	-	-	-
Research	Income ($)	4,000	-	-	-	-	-	-	-	-	-	-
	% Earned Income	2%	-	-	-	-	-	-	-	-	-	-
Publications	Income ($)	1,500	-	-	-	-	-	-	-	-	-	-
	% Earned Income	1%	-	-	-	-	-	-	-	-	-	-
Total Earned Income	Income ($)	236,750	-	-	-	-	-	-	-	-	-	-





Conclusion

This tool has offered four ratios that can be used to measure the financial performance of microfinance associations: overhead, earned income, core cost recovery, and operating reserve ratios. A consensus on the importance of these ratios was reached by the 20 associations that took part in the development of the tool. Identifying the products and services that an association considers essential to fulfilling its organizational mission (i.e., "core" products that it seeks to deliver even in the absence of outside funding) is a crucial part of using this tool and, more generally, evaluating financial performance.

As noted earlier, the financial ratios presented here are most meaningful when assessed within the context of industry standards and the performance of peer organizations. The ratios can also be used by associations to understand how business developments (both internal and external) have affected past and may impact future performance. Although organizations will not always meet the recommended targets for each ratio, using this tool will enable them to set financial performance goals, monitor their performance over time, and examine specific operational trends.

About SEEP

The SEEP Network is a global network of microenterprise development practitioners. Its 80+ institutional members are active in 180 countries and reach over 35 million microentrepreneurs and their families. SEEP's mission is to connect these practitioners in a global learning environment so that they may reduce poverty through the power of enterprise. For 25 years, SEEP has engaged with practitioners from all over the globe to discuss challenges and innovative approaches to microenterprise development. As a member-driven organization, our members drive our agenda while SEEP provides the neutral platform to share their experiences and engage in new learning on innovative practices. The SEEP Network helps strengthen our members collective global efforts to improve the lives of the world's most vulnerable people.

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