

Advancing Microfinance through
Association Leadership

**BUILDING STRONG
ASSOCIATIONS**



Product Costing and Performance Analysis: A Toolkit for Analyzing Associations' Service Offerings

2010

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Product Costing and Performance Analysis: A Toolkit for Analyzing Associations' Service Offerings

The SEEP Network

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Red Financiera Rural (RFR)

Russian Microfinance Center (RMC)

Sanabel – The Microfinance Network of Arab Countries

Introduction

Microfinance associations rely on multiple sources of income to finance their activities, including member dues, fees for services, donor funding, and endowments. For many associations, donations make up the bulk of their financing, at least during the early start up phase. This is particularly true in emerging microfinance markets where members have limited ability to pay for services and associations play a promotional role in the development of the industry. However, as associations grow and their markets mature, fees for services should start to replace donations as the primary source of revenue. This requires that associations have strategies in place to develop demand-driven, market-based products that are attractive to members and have the potential to become financially sustainable.

Function of the Guide

This Product Costing and Performance Analysis Guide provides guidance to associations to determine the cost structure of their products and services, and the implications of their current policies on the association's long-term financial sustainability. Tailored to reflect the unique business of associations, this tool has been designed to help institutions better understand 1) the full costs associated with their different service lines; 2) which products generate the most revenue for the association; and 3) the degree to which these products are, or can be, financially sustainable through membership dues, fees, and other charges. This exercise is a critical input in the business planning process and provides associations with important information needed to support realistic financial sustainability strategies and future fundraising efforts.¹

This tool uses a simple cost-allocation approach as a first step to understanding the costs and revenues associated with the association's products, recognizing that most associations do not have an activity-based accounting system nor business processes that are consistent across product lines. If association managers want a more in-depth analysis of the causes of costs and opportunities for increasing operational efficiencies, a more complex activity-based approach may be used.²

Preparation: Understanding the Methodological Approach

Product costing is the process of tracking and analyzing all of the costs incurred in the production and sale of a product or service, including **direct costs** and **overhead costs**. While it is generally clear where to assign direct costs of service delivery, overhead costs are often more challenging to allocate to different products and services, particularly personnel costs, when staff support the delivery of multiple products. Therefore, the main objective of this exercise is to help associations think through this allocation process to ensure that all institutional costs have been considered in pricing decisions and to help them organize their financial data in a way that allows for a basic analysis of their financial performance.

Box 1. Steps for Analyzing Cost and Performance

- Step 1: Identify products
- Step 2: Identify cost and income items for allocation
- Step 3: Decide and quantify allocation bases
- Step 4: Calculate full product cost and income
- Step 5: Analyze product performance

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1. For additional guidance on financial planning, see SEEP's *Strategic and Business Planning: A Guide for Microfinance Associations*. <http://networks.seepnetwork.org/en/resources>
 2. For a complete discussion of this approach, see B. Helms and L. Grace, 2004, *Microfinance Product Costing Tool for MFIs* (Washington, DC: CGAP), which can be used as a reference and adapted to meet the needs of networks. In addition, B. Helms, 1998, "Cost Allocation for Multi-Service Microfinance Institutions," Occasional Paper, no. 2 (Washington, DC: CGAP) provides an in-depth discussion on cost allocation for multi-service institutions and guidance for defining distinct cost centers for different products and services.

Step 1. Identify Products

A first step in this exercise is for the association to clearly identify individual product offerings. One useful way to do this is to classify products according to key service lines. A service line can be defined as a group of products that are closely related, usually because they share similar objectives or are delivered through the similar types of delivery channels. Service lines should represent the priorities of the association as reflected in its strategic and business plans. Some of the most common examples for associations are capacity building and information dissemination and exchange that are focused on the development of the sector, particularly member microfinance institutions (MFIs).

Once an association has defined its broader service areas, it is useful to then identify individual products. It is not uncommon for an association to offer multiple products within a service line, each with distinct sources of revenue and even possibly markets. For example, capacity-building services might include a training program, peer exchanges, technical assistance, or consultancies. These products could generate revenue from multiple sources, such as service fees from members and non-members, grants from donors, and other related service charges.

Product offerings will differ from association to association, depending on the market, its level of development, and the availability of alternative service providers. For example, training courses may be a top priority for members in a market where few other options exist, but may be much less important in a more mature market where there is a range of providers delivering high quality training courses at competitive rates. Similarly, industry benchmarking reports may start off as the sole product related to an association's transparency efforts, but may evolve over time to include a broader range of initiatives, such as standards development, interest rate reporting, or more comprehensive performance monitoring. Each association should assess the classification of their services according to their specific market context. Below is one example of an association's service lines and products.

Table 1. Product Identification

Service line	Products	Market	Sources of Income
Capacity Building	Trainings: MFIs (loan officers, middle management, senior executives), training of trainers, specialized courses	Members, regulators, auditing companies, non-member MFIs	Grants, program service fees, membership dues
Information Dissemination and Exchange	Conferences: National and regional	Members, non-members, donors, government, investors	Grants, fees, sponsorships, membership dues
	Advocacy: Representation, research, monitoring	Members, researchers	Grants, membership dues
Transparency, Research, and Publications	Transparency: Industry survey, benchmarking	Members, investors, donors	Grants, membership dues
	Research and publications: Market demand studies, technical papers		Grants, fees, and membership dues
	Social performance initiatives: Consumer protection, financial education, code of ethics		

Product classification allows an association to begin the process of assessing a product's potential for financial viability. Optimally, associations should aim to deliver products on a cost-recovery basis. This requires pricing services to reflect their full cost. It may be the case, however, that income earned from membership dues and fees is insufficient to cover costs at present levels, yet the association continues to offer products because they have value for members and the sector. In this instance, it is necessary to assess the level of cost recovery, and thus the amount of subsidy required, either through grants or cross subsidies from other products for their ongoing provision.

Step 2. Identify Cost and Income Items for Allocation

The next step is to identify the cost and income items for allocation. In order to do this, the association will need to identify all costs associated with each of its individual products including **direct costs** and **overhead costs**. Direct costs include all costs associated with the delivery of the product, including **variable costs** to the association—which are directly related to the delivery of services, such as venue rental, fees for external consultants or experts, travel cost, etc.—as well as **fixed costs**—which will not change regardless of output volume, such as the salary of a full time program manager. These differ from overhead costs that are essential for successful program management, but are not directly related to service provision. These include costs, such as rent, utilities, communications, and executive salaries that are shared among multiple products or services.

Direct costs include all costs directly related to product service delivery, for example, program manager salaries, program supplies, venue rentals, etc.

Overhead costs are central administration costs that are not directly related to a specific product or program activity, but are essential for successful program management, for example, key staff positions (managing director, finance manager), rent utilities, etc.

Ideally, associations should already track their costs and income by products. For those that do not, this exercise should help lay the foundation for the institutionalization of a cost-center approach to accounting from this point forward.

Below is an example of how one association organized its various products into five main product or program lines (training, conference, advocacy, transparency, and social performance), in order to track direct costs. The example uses basic cost categories characteristic of most associations. It is possible to use aggregate figures if more detailed data is not available. Given the lack of detail in many associations’ chart of accounts, it may be necessary to approximate based on what data is available.

Example 1. Identification of Direct Costs

	Training	Conference	Advocacy	Transparency, Research, Publications	Social Performance
COSTS					
<i>Direct</i>	135,486.52	293,941.00	74,200.00	66,221.00	272,952.48
Salaries, wages, benefits	11,886.58	-	26,969.00	38,355.00	20,134.42
Staff development	-	-	-	-	-
Training expenses	122,600.61	-	-	5,837.00	226,903.39
Conference expenses	-	290,023.00	-	-	-
Office expenses	35.51	2,301.00	45.00	3,385.00	2,487.49
Professional services	573.53	585.00	47,152.00	7,500.00	23,008.47
Travel	217.00	726.00	-	11,144.00	-
Depreciation	-	-	-	-	-
Other	173.29	306.00	34.00	-	418.71
Total Costs	135,486.52	293,941.00	74,200.00	66,221.00	272,952.48

Once this is done, the association can do the same for its key income streams. When assessing income streams, it is important to distinguish between *earned income*—member dues and user fees paid directly to the association for the provision of specific services—and *contributed income*—grants received from donors to support the provision of specific services, as well as the association as a whole. This will be useful when working on the association’s financing strategy. It is important to note that, in addition to coming directly from users of services, income may also come from governments or donors paying for services on their behalf, for example, through conference sponsorships or training scholarships, and still be considered earned income.

While many associations work toward maximizing their earned income to lower their dependency on donor funding, most will end up with blended income streams, where a mix of fees for services and grants are needed to sustain the full functioning of the association.

Table 2. Example of Blended Income Streams

Income Types	Description	Example
Earned Income	<ul style="list-style-type: none"> • Member fees • Advertising revenue, sponsorship • Transaction fees • Licensing fees • Fees for intellectual property • Overhead charged to donors for project administration 	<ul style="list-style-type: none"> • Annual dues • Sale of advertising space in journals and newsletters • Training courses • Training of trainers certification • Sale of publications • Scholarships, conference sponsorship, peer exchange sponsorships
Contributed Income	<ul style="list-style-type: none"> • Grants • In-kind contributions 	<ul style="list-style-type: none"> • Operating grants to support the association as a whole or direct support to specific product development and implementation • Staff time, equipment, conference space

Regardless of whether the income is earned or contributed, it should be assigned to a respective product in the association’s tracking system. In the case below, the association has categorized *direct income* to include all *earned* and *contributed income* generated from the association’s key products.

For *earned income*, this would include training and conference fees, as well as conference sponsorships. For *contributed income*, this would include earmarked or restricted grants covering salaries and other related costs of project implementation of a specific product.

Direct income is all earned and contributed income generated from the association’s products and services. It does *not* include grant income for overhead, membership fees, or investment income.

Example 2. Identification of Direct Income

	Training	Conference	Advocacy	Transparency, Research, Publications	Social Performance
INCOME					
Contributed Income: Grants					
<i>Direct</i>	131,871.00	242,990.00	82,585.00	22,643.00	302,491.00
Donor A					
Donor B	-	-	82,585.00	-	-
Donor C	-	-	-	-	-
Donor E	50,000.00	-	-	-	-
Donor F	-	-	-	22,643.00	-
Donor G	22,845.00	-	-	-	-
Donor H	59,026.00	-	-	-	-
Donor I	-	-	-	-	-
Donor J	-	-	-	-	302,491.00
Donor K	-	-	-	-	-
Donor L	-	242,990.00	-	-	-
Total Contributed Income	131,871.00	242,990.00	82,585.00	22,643.00	302,491.00
Earned Income					
<i>Direct</i>	34,825.23	128,384.00	-	-	10,729.77
Membership fees	-	-	-	-	-
Program fees	34,825.23	-	-	-	10,729.77
Conference fees	-	128,384.00	-	-	-
Conference sponsorship fees	-	-	-	-	-
Other: interest, miscellaneous	-	-	-	-	-
Total Earned Income	34,825.23	128,384.00	-	-	10,729.77
Total Income	166,696.23	371,374.00	82,585.00	22,643.00	313,220.77

Step 3. Decide and Quantify Allocation Bases

Once *direct costs* and *income* have been assigned to their specific products, *overhead costs* should be allocated across the association's product lines, based on certain logical criteria that are known as *allocation bases*. Table 3 below describes the most common approaches to allocate overhead costs.

Table 3. Allocation Bases

Staff time estimates	Assigns overhead costs in proportion to relative estimates of staff time.	May require the use of a time-keeping system to make accurate estimates.
Relative contribution to direct income	Assigns overhead costs in proportion to the product's relative contribution to direct income.	Can overestimate costs of a product. Higher earning products do not necessarily consume more general overhead costs.
Relative consumption of direct costs	Assigns overhead costs in proportion to the product's relative consumption of direct costs.	Assumes direct costs and general overhead costs are consumed in the same proportion.

1. Staff Time Estimates

The allocation method assigns overhead costs according to estimates of staff time. This may include salaries of the executive director, financial manager, and other positions that support the general administration of the association, but are not directly responsible for the delivery of products and services. These salaries are usually the largest category of overhead costs. Likewise, it may include the estimates of time that program managers dedicate to general administrative tasks. In the example below, salary costs of the advocacy, training, and transparency managers have already been fully assigned to products as direct costs; thus, only salaries of management (i.e., the executive director and finance manager) and the administrative staff need to be allocated. General administrative costs, such as rent and utilities, are then assigned in the same proportion. Staff time estimates may be derived from a system of time keeping in which personnel are required to track their time by product with the use of timesheets.

Allocation Base	Total	Training	Conference	Advocacy	Transparency, Research, Publications	Social Performance
1) Staff time	100%	30%	20%	20%	10%	20%
Costs						
Overhead	178,417.00	53,525.10	35,683.40	35,683.40	17,841.70	35,683.40

2. Relative Contribution to Direct Income

This method uses an allocation based on the pro-rata distribution of costs, proportionate to the contribution of each product to direct income. Where training accounts for 25 percent of all income, it receives 25 percent of all overhead costs, and so on. While this is a straightforward method for allocating costs, it should be noted that higher earning products do not necessarily consume more costs. Therefore, this method may overestimate the share of administrative costs for certain products and underestimate on others.

Allocation Base	Total	Training	Conference	Advocacy	Transparency, Research, Publications	Social Performance
2) % Contribution to Direct Income	100%	17%	39%	9%	2%	33%
Costs						
Overhead	178,417.00	31,093.41	69,271.43	15,404.37	4,223.54	58,424.26

3. Relative Consumption of Direct Costs

This method uses yet another allocation based on the pro-rata distribution of costs, proportionate to the use of direct costs by each product. Here we can see that “conferences,” the top earning product and highest recipient of administrative costs in allocation base 2 (above), in fact, is allocated a smaller portion of administrative costs, based on its relative cost structure.

Allocation Base	Total	Training	Conference	Advocacy	Transparency, Research, Publications	Social Performance
3) % Contribution to Direct Costs	100%	16%	35%	9%	8%	32%
Costs						
Overhead	178,417.00	28,681.86	62,225.92	15,707.79	14,018.67	57,782.75

As these examples illustrate, the choice of allocation method can make a considerable difference in the proportion of overhead costs allocated. Therefore, the key for the association is to understand the costs and revenues of its products and not to arrive at a “correct” answer. It is useful to compare different bases before choosing one to determine which calculation makes the most sense for its operations and on the availability of information. It is recommended that associations reevaluate their allocation methods on an annual basis to ensure their continued appropriateness. With experience estimates may be adjusted to more accurately reflect known costs.

Step 4: Calculate Full Product Cost and Income

Once an allocation method is selected and used to estimate the relative proportion of overhead costs for each product, the total product cost can be calculated. **Full product cost** is the sum of direct costs and overhead costs associated with each product. The figure below uses an allocation based on the relative contribution of the product to direct income illustrated in allocation base 2 (contribution to direct income). Applying full costs, there is a clear increase in the costs of service delivery, as each product now shares a portion of the association's overhead, e.g. rent, utilities, communication, translation, director's salary, accountant's salary, etc.

Example 3. Full Product Costs Using Relative Contribution to Direct Income

	Training	Conference	Advocacy	Transparency, Research, Publications	Social Performance
COSTS					
<i>Direct</i>	135,486.52	293,941.00	74,200.00	66,221.00	272,952.48
Salaries, wages, benefits	11,886.58	-	26,969.00	38,355.00	20,134.42
Staff development	-	-	-	-	-
Training expenses	122,600.61	-	-	5,837.00	226,903.39
Conference expenses	-	290,023.00	-	-	-
Office expenses	35.51	2,301.00	45.00	3,385.00	2,487.49
Professional services	573.53	585.00	47,152.00	7,500.00	23,008.47
Travel	217.00	726.00	-	11,144.00	-
Depreciation	-	-	-	-	-
Other	173.29	306.00	34.00	-	418.71
<i>Indirect</i>	31,093.41	69,271.43	15,404.37	4,223.54	58,424.26
Indirect	31,093.41	69,271.43	15,404.37	4,223.54	58,424.26
Total Expenses	166,579.93	363,212.43	89,604.37	70,444.54	331,376.74

After calculating total costs for each product, the same needs to be done for calculating total income. **Total income** is the sum of direct income and indirect income. **Indirect income** includes revenue not directly associated with any particular product, such as investment income, grants to cover general expenses, and membership dues. Some associations distribute evenly across all service lines because overhead contributions and member dues are paid for the functioning of the association as a whole, in other words, for all of the products and service delivery, although others may argue that a weighted allocation basis for indirect income is more appropriate. As with overhead costs, the allocation base will be a management decision.

In the following example, the association has used an equal allocation bases for all unrestricted funds.

Example 4. Total Income: Mixed Allocation Basis

	Training	Conference	Advocacy	Transparency, Research, Publications	Social Performance
INCOME					
Contributed Income: Grants					
<i>Direct</i>	131,871.00	242,990.00	82,585.00	22,643.00	302,491.00
Donor A	-	-	-	-	-
Donor B	-	-	82,585.00	-	-
Donor C	-	-	-	-	-
Donor E	50,000.00	-	-	-	-
Donor F	-	-	-	22,643.00	-
Donor G	22,845.00	-	-	-	-
Donor H	59,026.00	-	-	-	-
Donor I	-	-	-	-	-
Donor J	-	-	-	-	302,491.00
Donor K	-	-	-	-	-
Donor L	-	242,990.00	-	-	-
<i>Indirect</i>	16,038.60	16,038.60	16,038.60	16,038.60	16,038.60
Indirect	16,038.60	16,038.60	16,038.60	16,038.60	16,038.60
Total Contributed Income	147,909.60	259,028.60	98,623.60	38,681.60	318,529.60
Earned Income					
<i>Direct</i>	34,825.23	128,384.00	-	-	10,729.77
Membership fees	-	-	-	-	-
Program fees	34,825.23	-	-	-	10,729.77
Conference fees	-	128,384.00	-	-	-
Conference sponsorship fees	-	-	-	-	-
Other: interest, miscellaneous	-	-	-	-	-
<i>Indirect</i>	16,813.00	16,813.00	16,813.00	16,813.00	16,813.00
Indirect	16,813.00	16,813.00	16,813.00	16,813.00	16,813.00
Total Earned Income	51,638.23	145,197.00	16,813.00	16,813.00	27,542.77
Total Income	199,547.83	404,225.60	115,436.60	55,494.60	346,072.37

Step 5: Analyze Product Performance

Once full product costs and income are accounted for, an association can begin to analyze individual product performance. There are several methods of analysis that can inform an association's pricing policies and service delivery processes, as well as overall financial sustainability strategies.

Box 2. Examples of Product Performance Analysis

Cost Analysis

- Trends in overhead costs
- Cost structure by product
- Trends in direct costs by product
- Cost determinants

Income Analysis

- Trends in earned income
- Income structure by product
- Product contribution to net income
- Product contribution to total earned income
- Trends in earned income by product

Product Viability Analysis

- Product cost recovery
- Unit performance
- Unit cost

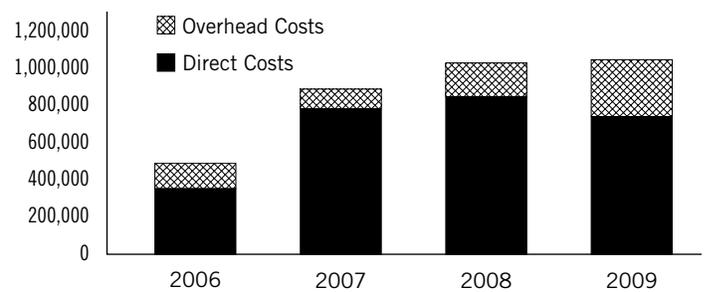
Cost Analysis

Cost analysis is a useful first step in analyzing product performance. Costs are often the most significant barrier to achieving viability of a particular product. Understanding the most important contributors to product cost and how these costs have behaved over time allows managers to make more informed decisions about designing and delivering products. When undertaking a cost analysis, there are a number of questions to keep in mind:

- What is the relative importance of overhead costs?
- Which products are the most costly to deliver?
- What is the cost breakdown of products in terms of direct and overhead costs?
- What have been the trends in costs over time?
- Are there opportunities to reduce costs?

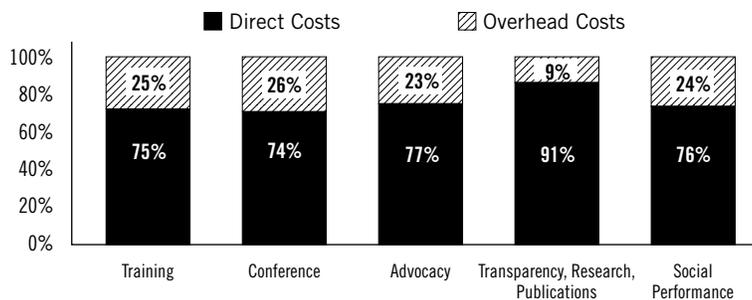
An analysis of the historical cost structure of this association shows a significant growth in direct costs since its inception in 2006. This is to be expected from a young association as it grows and defines its products and services. As the association matures and introduces new product lines, one can expect to see a steady increase in the corresponding costs associated with service delivery. It is important for an association to keep an eye on the growth of overhead costs to ensure these stay within acceptable limits and do not impede the potential profitability of individual products. In this case, the association's overhead costs grew considerably more, relative to direct costs, from 2006 to 2009—something to keep an eye on.

Figure 1. Trends in Overhead Costs



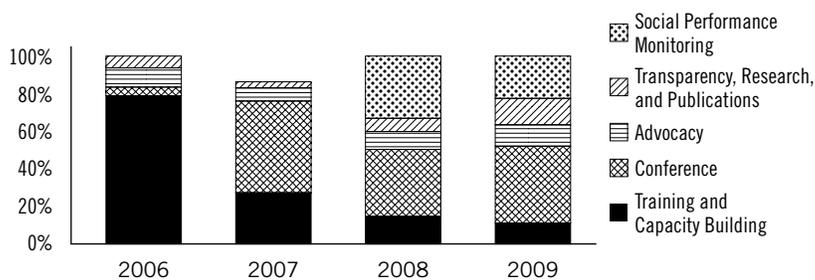
An analysis of the relative importance of direct and overhead costs by product allows managers to better understand the impacts of overhead costs on individual product costs. It may also help in assessing the appropriateness of certain cost allocation methods in the case that a particular product may not be sharing a reasonable proportion of the overhead burden. In the example above, “Transparency” bears a much smaller portion of overhead costs, relative to the other product lines, which is consistent with its relative contribution to earned income. If, however, this service line contributes to a large portion of the association’s overhead, in spite of its limited revenue potential, the allocation basis should be changed to more accurately apportion cost sharing.

Figure 2. Cost Structure by Product



An analysis of the historical trends in direct costs illustrates the relative contribution of individual products to direct costs. In figure 3, “Training and Capacity Building” accounted for the vast majority of direct costs for the association at its inception. However, as new products were introduced and the role of training diminished, there has been a more even distribution of direct costs, with “Conferences” and “Social Performance Monitoring) consuming the majority of the association’s resources by 2009.

Figure 3. Trends in Direct Costs by Product



Minimizing Costs

One important aspect of cost analysis is to identify key factors that affect the costs of a particular product. Some examples of the key factors that are typical for association product lines have been identified below. Associations should try to minimize costs wherever possible and use effective and efficient models for service delivery that can leverage the resource base and comparative advantage of the association.

Table 4. Cost Determinants

Product/Service	Factors Affecting Costs	Opportunities for Cost Control
1. Training: Courses for MFIs, regulators, and training of trainers (TOT); social audits; e-learning; peer exchanges	<ul style="list-style-type: none"> • Use of external trainers and their rates • Location and venue for events—hotel, venue rental, meal/coffee break costs • Number of events • Number of participants • Demand for translation services • Additional equipment/materials needed • Countries visited • Number of visits made • Number of participants 	<ul style="list-style-type: none"> • Establish a minimum number of participants per training unit or course to be sustainable • Balance quality of trainer and rate • Use association staff • Manage trainer travel costs
2. Conferences	<ul style="list-style-type: none"> • Country/venue of event • Use of consultants, use of event management company, honorariums, etc. • Printing: quantity and quality • Interpreters for conference, translation of materials 	<ul style="list-style-type: none"> • Manage number of “tracks” on agenda requiring multiple interpreters • Watch number of meals/coffee breaks offered
3. Transparency, Research, Publications: MIX Market participation, development and tracking of social indicators, regional MFI industry survey, quarterly reports, newsletter, case studies	<ul style="list-style-type: none"> • Quality and timeliness of raw data • Responsiveness of MFIs • Number of publications created and translated • Use of external consultants • Local and/or regional travel required 	<ul style="list-style-type: none"> • Establish pay grades for staff • Use existing sources versus association collecting its own data
4. Advocacy: Document review, translation, maintenance of database/library (e.g., legal documents)	<ul style="list-style-type: none"> • Number of publications translated 	<ul style="list-style-type: none"> • Keep computerized library • Cooperate with other companies to avoid duplication of translation, etc.
5. Social Performance Initiatives: Consumer protection, code of ethics, financial education	<ul style="list-style-type: none"> • Number of events • Number of participants • Venue • Use of external experts 	<ul style="list-style-type: none"> • Manage travel costs • Use association staff

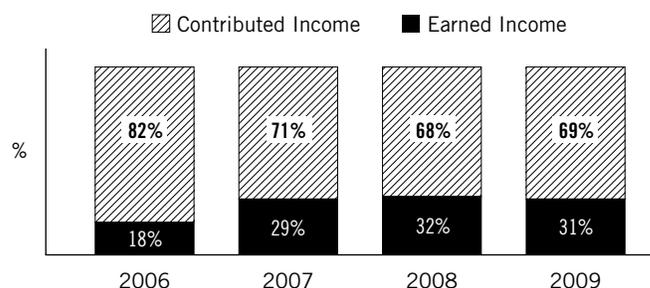
Income Analysis

Income analysis is an important element of product performance analysis. It provides useful information to managers concerning the relative importance of individual products, the impact of earned income, and trends in income generation overtime. Some of the most important questions to consider are:

- What are the key income-earning products and services for the association?
- Which products generate the most income from fees?
- Which products are most dependent on donor funding?
- Which products are the main income generators for the association in terms of earned income?
- Is there room to expand on certain products?

An analysis of the association’s income stream over the first four years of its operations shows a steady increase in both earned and contributed income. Earned income has slowly started to account for a larger portion of the association’s total income growing from 18% of all income in 2006 to 31% in

Figure 4. Trends in Earned Income



2009, reflecting a growing independence from donor funding. Ideally, an association should strive to earn the bulk of key services from earned income, to ensure that its programming can be maintained in spite of changes in donor funding priorities.

Analyzing the importance of earned income relative to the total income generated for each individual product provides useful information to managers about members' willingness or ability to pay for these services through fees and dues. In figure 5, it is apparent that the association has yet to find a clear market among its members for social performance monitoring, advocacy or its transparency initiatives, which at present are donor-sponsored initiatives. While these activities may add clear value to the sector in terms of their development impact, if the association does not develop a strategy for to ensure greater cost recovery, either through member fees or ongoing donor support, it will be unable to ensure the sustainability of these products.

In terms of individual product contribution to total earned income for the association, it is obvious that conferences are the biggest contributor, accounting for (61 percent) of all earned income, followed by trainings (19 percent); these two elements are the biggest revenue earners for the association at this point.

If contributed income is taken into account, as well as earned income from fees, dues, and other service charges, it is easy to see which of the association's products are net income earners and which ones are net income losers, even with donor funding. In figure 7, the association is actually subsidizing the costs of its transparency-research-publications activities with income derived from its other products.

Looking at trends over time is a useful way to detect changes in the performance of individual products. The relative increase in conferences as the primary income earner for the association has occurred gradually over time. And, while it is positive to have a product with such high demand, the association should explore why the other products have decreased in their contribution to earned income and whether other products should be developed to add value to both members and the association.

Figure 5. Income Structure by Product

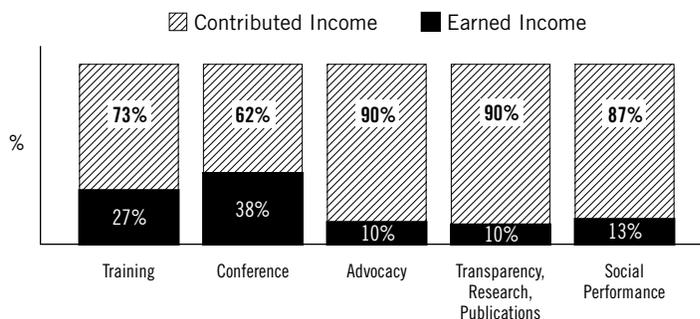


Figure 6. Product Contribution to Total Earned Income

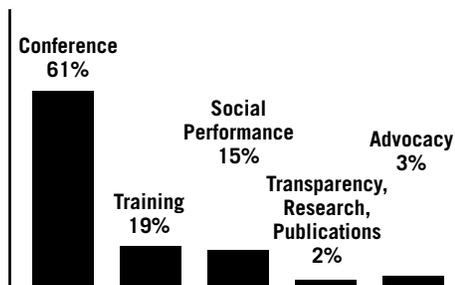


Figure 7. Product Contribution to Net Income

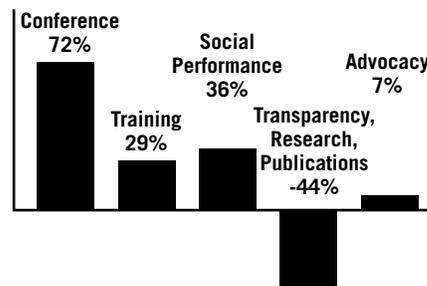
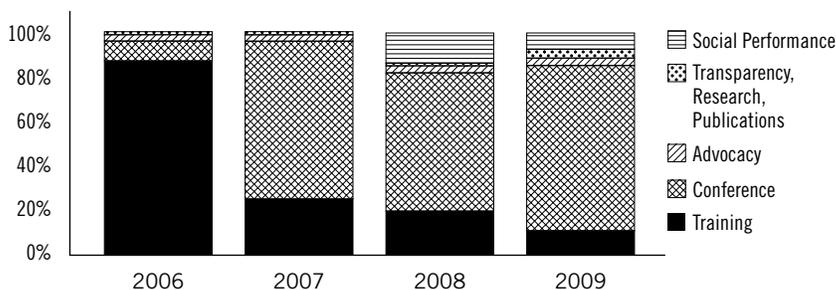


Figure 8. Trends in Earned Income by Product



Product Viability Analysis

While it is understood that a certain level of subsidy may be needed to help associations carry out certain functions, there is a basic assumption that key member services should be provided on a cost-recovery basis and have the potential, at least in the long run, to generate some measure of surplus for the association. While the timeline for full cost recovery for certain products may be different in different markets, based on the level of development and existence of other service providers, associations should be working toward this goal. There are several important questions to consider:

- Does the association have a pricing policy in place, including the use of subsidies for certain products?
- Is it clear where the responsibility for pricing decisions lies?
- Is the pricing policy implemented consistently across the organization?
- Are the products and services segmented to take into account different consumer groups and their willingness to pay?
- Are there cost or sales objectives in place to guide current pricing policies (i.e., cost-plus, competitive, or value-driven pricing mechanisms)?
- What is the market price of comparable services?
- Are subsidies needed for any of the products? Is there a strategy in place to raise these subsidies?
- Are income-earning opportunities currently being optimized?
- Are the fees generated from these products covering the full cost of service delivery?
- If not, is there room to increase fees or dues, or create classes of members with different fee structures and benefits, for example, membership grades, sliding fee scales, etc., to achieve higher levels of financial sustainability. Is it possible to negotiate service arrangements with strategic partners to ensure cost recovery on key public goods important for the further development of the sector?

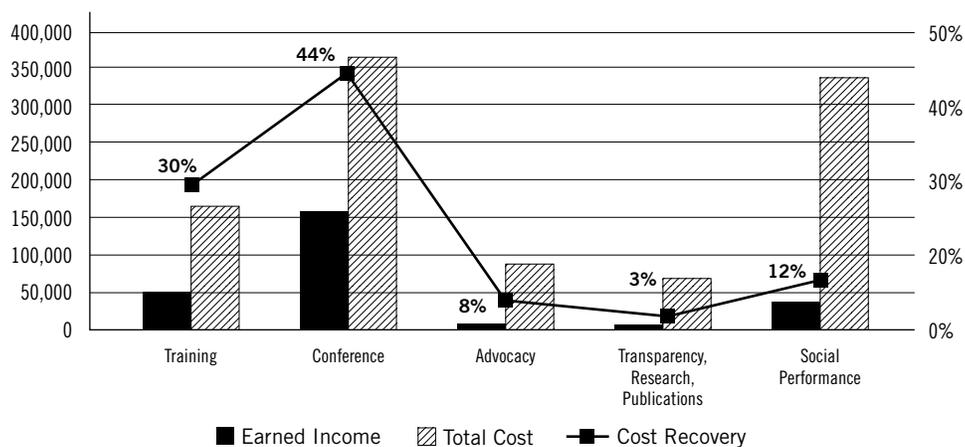
Cost plus pricing is a method of pricing where the base per-unit cost of a product is calculated, taking into account all direct and overhead costs, with a percentage added on top for a profit margin.

Competitive pricing is where prices are set based on the price of comparable competitive products in the market.

Value-driven pricing is when prices are set based on the perceived value to the customer, rather than on the actual cost of the product, the market price, or competitor prices.

One of the most basic and essential types of analysis is measuring the level of cost recovery of individual products—how much the cost of service delivery (direct and overhead costs) is being covered from earned income. In figure 9, conferences earn the greatest income for the association, but it still only covers 44 percent of its total costs. The same goes for training, which achieves only 30 percent cost recovery. For every product, there is likely an opportunity to increase earned income through pricing adjustments and service improvements that increase use.

Figure 9. Product Cost Recovery



Establishing Unit Costs

Establishing unit costs is a necessary step to assess an association’s pricing policy. Total cost can be misleading as it provides little insight into actual cost recovery of services. By looking at costs per individual units, managers can more adequately assess fee structures for individual users of service as well as the need for subsidies. Different products will have different units of measure. Associations need to determine the most appropriate unit of measure for their particular product and market. The example includes some common measures.

When we look at each product in terms of unit cost, it becomes clear that there is considerable room for the association to adjust its current pricing to improve its cost recovery. Currently none of the association’s products are set at full cost recovery and two of the most expensive products per unit are provided at no additional cost to members.

Table 5. Unit Costs

Product	Unit of Measure
Training	No. of paid participants
Conference	No. of paid participants
Advocacy	No. of members
Transparency, Research, Publications	No. of publications
Social Performance Monitoring	No. of members participating

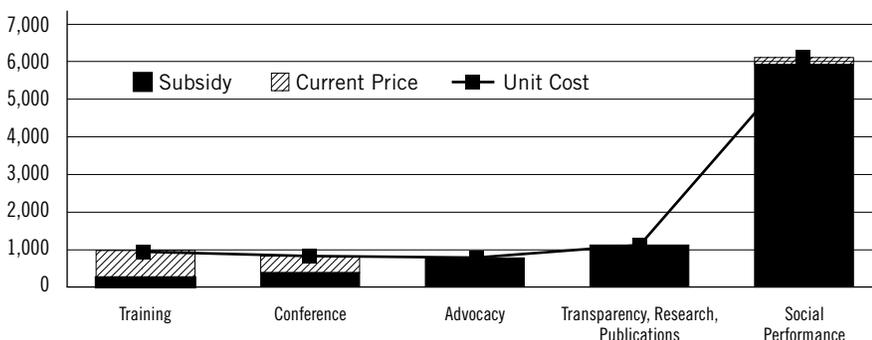
Ideally, members should demonstrate their demand for products and services through a willingness to pay fees, which ought to be one of the key income streams for the association. It may be that fees are not enough to cover the costs of all these services, yet the association continues to provide them because of their value to its members. In this instance, it is important for associations to know exactly how much of their costs are being covered and how much subsidy will be needed to continue to provide these services.

Exactly what balance the association strikes between market-oriented and more industry-supportive products and services will greatly depend on the state of the industry and level of maturity of the association’s members. However, understanding what products can be financially sustainable and which will need continued subsidy will be crucial in this decision making process.

Table 6. Unit Performance

Per Unit Analysis	Training	Conference	Advocacy	Transparency, Research, Publications	Social Performance
Units	180	460	150	64	54
Unit cost	925.44	789.59	597.36	1,100.70	6,134.61
Current price	194.00	350.00	-	-	194.00
Cost recovery	(731.44)	(439.59)	(597.36)	(1,100.70)	(5,942.61)

Figure 10. Unit Performance



Assess Pricing Policy

The last step in income analysis is to evaluate the association's current pricing policy in relation to the unit cost calculated. Given the public goods nature of many association products, the objective of this exercise will not necessarily be profit maximization, but rather cost contribution, particularly when it comes to member services.

Many associations set their fees at rates meant to ensure the greatest degree of participation by its members or to reflect the market situation—competitors' pricing, for example, which is often at price points far below cost recovery. Although increasing access to services for its members is an important objective, this policy should be balanced with the larger goal of cost recovery to ensure the long-term viability of the association. Therefore, a pricing structure that takes into account the full cost of service delivery, industry averages, and perceived value of products among different user groups, as well as its own cost recovery goals, should be used. A more value-driven approach that segments the market into different customer groups—e.g., member MFIs, non-member MFIs, donors, investors, etc.—will increase sales opportunities by identifying variations in ability and willingness to pay. By understanding the value of its products to different customer groups, associations can set different prices for different market segments, thereby increasing revenue from fees and reducing reliance on donor grants for core member services.

Conclusion

Product costing is a crucial exercise for associations, as they try to better understand their product offerings and how they position themselves in the market. By helping identify key service lines, managers can begin looking at their association's unique products and allocating all associated costs (direct and overhead) to better understand the financial viability of the current pricing structure. Through an analysis of product costs and sales, associations can begin to think about which products contribute the most to their bottom line and where additional subsidies may be needed to support services that may not be financially viable at least in the short term, but are still a priority for the association and its members. Finally, by better understanding the dynamics behind expense and revenue streams, associations will be better placed to develop financial projections that will form the basis of their financial sustainability strategy.

Glossary of Costing Terms³

Activity-based costing (ABC)

Costing method that traces costs through significant activities to products or other cost objects.

Allocation basis

The method used to assign overhead costs to individual products.

Contributed income

All revenue from grants, in-kind contributions, donation, etc.

Cost accounting

Managerial accounting activity designed to help managers identify, measure, and control costs.

Cost determinant

Event or action that triggers an activity and allows for calculation of a unit cost.

Direct costs

Costs that can be identified specifically with, or directly traced to, a specific product or service.

Direct income

Earned and contributed income generated from the association's main products and services, i.e., fees, sponsorships, advertising.

Earned income

All revenue derived from fees paid for membership services, sponsorship, foreign exchange gains/losses, interest, etc. Includes direct revenue generated by products and services.

Fixed costs

Costs that remain constant, regardless of activity or output levels.

Full product costs

Sum of direct costs and overhead costs allocated to each product.

Indirect income

Revenue derived from sources not directly attributable to a single service, such as interest income, foreign exchange gains/losses, grants to cover core expenses.

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3. Adapted from Helms and Grace, *Microfinance Costing Tool for MFIs*.

Net income

Net income is equal to an organization's income after subtracting all direct and overhead costs from the total revenue.

Overhead costs

Central administration costs that are essential for successful program management, e.g., executive salaries, rent, utilities, etc., and shared among cost objects.

Processes

Several activities directed toward a common outcome or objective.

Total income

All earned and contributed income generated by the association.

Total operating costs

Direct costs and overhead costs.

Total product income

Sum of direct revenue earned from a product and indirect revenue.

Unit cost

Cost per unit produced or per transaction.

Unrestricted net assets

All unrestricted net assets calculated by averaging the opening and closing balances for the period.

Variable costs

Costs that change in proportion to levels of activity or output.

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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