



Surplus distribution and characteristics of social enterprises: Evidence from microfinance



Marek Hudon^{a,*}, Anaïs Périlleux^b

^a CEB (SBS-EM), Université Libre de Bruxelles (U.L.B.), CERMI, 42 Avenue Roosevelt, 1050 Bruxelles, Belgium

^b Université Catholique de Louvain (UCL), IRES, CIRTES, and CERMI, AXA Fellowship, 3 Place Montesquieu, 1348 Louvain-la-Neuve, Belgium

ARTICLE INFO

Article history:

Received 10 February 2012

Received in revised form

19 September 2013

Accepted 1 October 2013

Available online 4 November 2013

JEL classification:

O16

O50

G21

Keywords:

Microfinance

Social enterprise

Surplus

Governance

Size

Subsidies

Cooperatives

ABSTRACT

The issue of surplus distribution has hardly been analyzed in the context of the social economy. This paper highlights the main drivers of distribution between various stakeholders of microfinance institutions (MFIs), which are an example of social enterprises. We focus on three major variables: size, governance structure and subsidies. Our results show that the size of the institution is the main indicator of the surplus that the organization keeps as a self-financial margin. Moreover, MFIs with a cooperative ownership structure allocate a larger part of their surplus to their employees, whereas non-profit organizations and shareholder-firm MFIs do not allocate their surplus in a significantly different way among their main stakeholders. Finally, we do not find any clear-cut effect of subsidies on the surplus allocation process.

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1. Introduction

Which actors or stakeholders benefit from the value created by an institution? Do clients get cheaper products, staff higher salaries, or shareholders more dividends? The distribution of the value or surplus created by a company is a key issue in governance, revealing the balance of power among the people having an interest in the organization (Labie & Mersland, 2011). The objective of this paper is to validate the main drivers of surplus distribution inside microfinance institutions (MFIs).

Distribution of the surplus is especially crucial for hybrid financial institutions that have multiple goals, e.g. social or developmental and financial objectives (Battilana & Dorado, 2010; Gutiérrez-Nieto, Serrano-Cinca, & Mar Molinero, 2009). It is even a major element of the identity of social enterprises, according to the UK Department of Trade and Industry (DTI). A social enterprise

is defined as “a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners” (DTI, 2002). MFIs are good cases for analyzing the distribution of social enterprises’ surpluses. They combine social goals, poverty alleviation and financial objectives (Armendáriz & Szafarz, 2011; Copestake, 2007; Dorfleitner et al., 2012). Moreover, surplus distribution is a key concern in microfinance as Muhammad Yunus, the founder of Grameen Bank, insists that the surplus of social business in general, and microfinance in particular, should always be reinvested in them (Yunus, 2010).

Over the last twenty years, microfinance has spread rapidly in many countries, and on average MFIs have become more efficient over time (Caudill, Gropper, & Hartarska, 2009). Calling for more management research in microfinance, Khavul (2010, p. 65) argues that “to understand the opportunities for research, one approach could be to follow the money from its source, through its distribution, and to its use”. While the average MFI produces a low level of profit and surplus, it is unclear who will reap the benefits when it starts to be more profitable or generate a surplus. We will use

* Corresponding author. Tel.: +32 26504247.

E-mail addresses: mhudon@ulb.ac.be (M. Hudon), anaïs.périlleux@uclouvain.be (A. Périlleux).

the global productivity surplus (GPS) method to analyze the distribution of surpluses among different stakeholders. There is a large literature discussing the determinants of the profitability of MFIs, but it gives no indication about the characteristics of MFIs that earn large surpluses. We also question what kind of institutions use their surplus to favor their clients, increase staff salaries or keep the surplus in reserve for future investment or distribute it as dividends to shareholders.

This article analyses specifically whether the size of the institution, its ownership structure and the level of subsidy can explain this distribution process. It will thus expand on what was done by Périlleux, Hudon, and Bloy (2012) because it does not confine itself to the status of MFIs but tests several other potential indicators of surplus distribution in microfinance. Contrary to Périlleux et al. (2012), who conduct a simple difference of mean analysis, this study is based on panel estimations using a database of 761 observations of 225 MFIs to investigate the main determinants of the surplus distributed to an MFI's principal stakeholders: its clients, staff, funds providers (lending institutions or savers), providers of all material inputs (e.g. office furniture, papers, vehicles) and the residual owners of "private value", which accounts for the dividends and reserve for future investments.

Our empirical analysis reveals that larger institutions keep a larger part of their surplus inside the organization as self-financial margin to strengthen the organization, finance further growth or remunerate shareholders, if any. The ownership structure influences the surplus allocation process since cooperatives give a significantly bigger portion of their surplus to employees. However, non-profit organizations (NPOs) and the comparatively more profit-minded shareholder firms (SHFs) do not significantly differ in the way they allocate their surplus among their main stakeholders. Finally, we do not find any clear-cut effect of subsidies on the surplus allocation process.

The rest of the article is structured as follows. The next section explains the application of the *global productivity surplus* theory to the microfinance sector and reviews the literature on the surplus generated by financial intermediaries such as MFIs. Section 3 presents the potential variables which explain the surplus distribution process and our hypotheses. Section 4 details the methodology and the database. Section 5 discusses the empirical results, and the last section concludes.

2. Efficiency and surplus of financial intermediaries

High interest rates and the commercialization of the microfinance sector have revitalized the debate on the distribution of MFIs' revenues among their various stakeholders. This issue is not restricted to microfinance since there is also a lively debate about the association between the financial and social performance of all socially responsible actors (Drut, 2010) and more traditional companies. Distribution of the surplus, as profit, added value or net output, generated by an institution is part of this debate.¹

One way of calculating the surplus generated by an institution and the way it is distributed is the "global productivity surplus (GPS)" methodology. This makes it possible to decompose the change in operating profit into a "quantity effect" and a "price effect" (Appendix A). The methodology was developed by the Centre d'Etude des Revenus et des Coûts (CERC, 1969, 1987) to

evaluate surplus distribution in public companies. At that time, studies based on this method were conducted in particular by Courbis and Templé (1975), Vincent (1971) and Burlaud and Dahan (1987). More recently, authors such as Grifell-Tatjé and Lovell (2008), Estache and Grifell-Tatjé (2010) and Arocena, Blázquez, and Grifell-Tatjé (2011) have rediscovered this method and used it in different sectors.

The GPS is defined as the variation of output quantities at constant prices minus the variation of input quantities at constant cost. As suggested by Périlleux et al. (2012), it corresponds to the "net output" generated by an MFI. It can also be called the "quantity effect" (Estache & Grifell-Tatjé, 2010; Grifell-Tatjé, 2011). As demonstrated in Appendix A, this "quantity effect" is equal to a "price effect", which corresponds to the surplus distribution. If we apply this equality to microfinance, we obtain:

$$GPS_t = \underbrace{[\Delta OL_t \times i_{t-1} - \Delta OL_t \times pr_{t-1}]}_{\text{Output(O)}} - \underbrace{[\Delta DE_t \times i''_{t-1} + \Delta D_t \times i'_{t-1} + \Delta N_t \times w_{t-1}]}_{\text{Input(I)}} = S_t^1 + S_t^2 + S_t^3 \quad (1)$$

The first term is the global surplus (GPS_t), where the output variation (O) represents the variation in the MFI's outstanding loan portfolio ΔOL_t at the previous year's interest rate charged to clients (i_{t-1}). We must also take into account the bad debt (i.e. clients who are behind on repayments) and should therefore reduce the output. This is done by subtracting $\Delta OL_t \times pr_{t-1}$ from O, where pr_{t-1} is the provision rate for clients who are suspected of repayment default.

The input (I) is composed of the suppliers of MFIs (the different parties bringing inputs): funds providers, workforce providers (staff) and other providers. There are two types of funds providers: savers and lending institutions (LIs). Regarding savers, MFIs' expenses engendered by deposit collection are expressed as follows: $\Delta DE_t \times i''_{t-1}$, the change in the deposit amount at the previous year's deposit interest rate (i''_{t-1}). Regarding LIs, MFIs' expenses for acquiring funding are defined as follows: $\Delta D_t \times i'_{t-1}$, the change in the funding amount at the previous year's external lending rate (i'_{t-1}). Regarding workforce, the MFIs' expenses generated by employees can be noted as follows: $\Delta N_t \times w_{t-1}$, the variation in the number of employees multiplied by the previous year's average salary. Finally, concerning other suppliers (providers according to the accounting definition), it is impossible to differentiate between price and quantity variations. For this reason, when analyzing surplus distribution, these suppliers are not included in the calculation of global surplus formation but are considered only in terms of value variation.

The second term shows the allocation of the GPS among the MFI's different stakeholders. The three surpluses (S_t^1, S_t^2, S_t^3) can be divided into more subcategories.

S_t^1 is the surplus allocated to the clients (borrowers) of the MFI:

$$S_t^1 = -[(\Delta i_t \times OL_t) - (\Delta pr_t \times OL_t)] \quad (2)$$

This surplus is estimated by the interest rate variation multiplied by the portfolio. A negative sign means that an interest rate decrease ($\Delta i < 0$) generates a gain for clients. This surplus must be corrected by the surplus gained or lost through bad debts: $\Delta pr_t \times OL_t$, where Δpr represents the variation in the provision rate. This means that an increase in the provision rate generates a gain for borrowers, since they have the potential to reduce their repayments.

¹ The difference between these three concepts is not always straightforward. A firm's profit can be defined as the excess of revenues over costs for distribution to the owners. Its added value is the sum of wages and salaries, interest payments, rent and profits. Net output is the difference between the change in output quantities at constant prices and the change in input quantities at constant cost.

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