M2i Consulting
Microfinance Management and Investment Advisory

Why is Financial Self Sufficiency not the best measure of commercial sustainability of institutions?

An MFI that has achieved a Financial Self Sufficiency of 100% is often assumed to have reached the epitome of sustainability. However, Financial Self Sufficiency may not necessarily mean commercial sustainability. The reason, I say this is because while calculating FSS, the cost put to equity is just the inflation rate, which we know is not true. The cost of equity depends on the risky-ness of the business the equity is invested in and will always exceed the inflation rate by an amount equal to atleast the risk-free rate. In effect FSS puts no real cost to equity. In this light Subsidy Dependence Index (SDI) which puts the cost of equity as market rate of debt would seem to be a better indicator. However there are two main limitations with SDI:

1. Cost of equity is not the same as cost of debt and

2. It's a dependence index and hence it is not suitable for measurement of sustainability. To measure sustainability using SDI one would need to interpret negative values of SDI.

The sector needs a sustainability measure that puts a commercial cost to equity, which is adjusted for the risk profile of a Microfinance Institution. However, the rating methodologies in use today may not be appropriate to arrive at a risk-return relationship to arrive at a cost of equity.

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