Identification of Intangibles in the Value of Microfinance Institutions

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ABSTRACT

This paper examines the relevant qualitative aspects of a microfinance company’s strength. The inclusion of these aspects in accounting reports through what may be called “invisible balances” (coming from intangible assets) would be a complement to “visible balances” in which the tangible assets of the company are reflected. The methodology that the authors propose is based on the application of the theory of fuzzy subsets. The authors’ approach makes use of logical outlines, which are flexible enough to attempt more realistic assessments and is indispensable in a context clearly defined by complexity and uncertainty.

Keywords: Fuzzy Logic, Invisible Balances, Microfinance Institutions, Qualitative Indicators, Visible Balances

INTRODUCTION

Microfinance Industry Rating began at the end of last decade and it has experienced its own evolution. Many have been the debates, studies and opinions trying to find the best assessment indicators of financial situation, risk and yield of rated companies. The task is not simple, if one keeps in mind the wide variety of tasks carried out by such companies, of task contexts, size differences and differences in accounting practices, which make it difficult to establish comparisons between companies and may distort the net worth view. All this has resulted in the absence of universal indicators in Microfinancing.

In 2003, a round table discussion involving the Inter-American Development Bank (IDB), the Consultative Group to Assist the Poor (CGAP), the United States Agency for International Development (USAID) and rating agencies MicroRate and PlaNet Rating, concluded in the publication of a list of twenty performance indicators, their definitions, applications and weaknesses.

These indicators basically referred to four main categories: quality of the portfolio, efficiency and productivity, financial management and profitability. Their aim is to offer an image of the risk and financial situation of the microfinance companies analysed.

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One of the analysis areas that have suffered from the lack of indicators (due to its difficult quantification) involves the qualitative aspects that consider and influence the strength of microfinance companies. Management quality, market opportunities, research and development of new products, knowledge about the market, measurements of organizational performance, clients' satisfaction… would be some of them. Most of the analysts agree that these aspects should be treated as a complement to reports involving more quantifiable aspects. Interviews at on-site visits to companies by rating agents could be a way of summarizing information, although no method is able to handle such information and incorporate it in reports with the importance that it should be given. Let us keep in mind that a microfinance company may be carrying out important work in a depressed area with a high index of poverty and low capital ratios, infrastructure or turnover, and however receive a bad rating that makes it difficult to find financing for its objectives.

This paper attempts to better understand the relevant qualitative aspects of a microfinance company’s strength. The inclusion of these aspects in accounting reports through what may be called “invisible balances” (coming from intangible assets) would be a complement to “visible balances” in which the tangible assets of the company are reflected. According to this proposal, comparisons among microfinance companies should be carried out based on total balances (visible and invisible). The arguments used may become sound enough to eliminate founders’ apprehensions and convince them that no trace of danger of disloyal management exists as regards investors’ interests, particularly if one takes into account that a more transparent image of strengths and weaknesses would be achieved for each company rated.

Anumber of different types of rating scales or scale formats are available to measure the intensity of concepts or attitudes (e.g., semantic differential, Stapel scale, Likert scale, Thurstone scale, and the direct rating scale). They generate numbers that represent a rough ordinal level of the attribute at the most, while data processes involve indices and parameters implying that the resulting scores are real numbers. In fact, there are many approaches to measure the direction and strength of an attitude.

The Likert scale poses, in fact, many problems. The presence/absence of the neutral point denoted by syntags (a sequence of words in a particular syntactic relationship to one another, a construction of sentences in nature languages) such as «same as now», «right amount», «I don’t mind» is a debated issue. It is often eliminated to press respondents to choose a sharp alternative instead of allowing refuge in a middle position, assuming that (1) it attracts people who have no opinion or prefer a noncommittal position rather than saying «I don’t know», (2) respondents tend toward one or the other polar alternative, (3) people who really are neutral, randomly choose one of the two nearest alternatives (Schuman & Presser, 1996). A scale without a middle position has no position equal to “zero” and the alternative options are no longer equidistant, but its inclusion does not solve the difficulties of using option values as real numbers.

The methodology we propose is based on the application of the theory of fuzzy subsets. Our approach makes use of logical outlines, with are flexible enough to attempt more realistic assessments - which is indispensable in a context clearly defined by complexity and uncertainty. Fuzzy Logic was first developed in 1965 by Lotfi A. Zadeh, professor of computer science at the University of California of Berkeley. Basically, Fuzzy Logic (FL) is a multivalued logic that allows intermediate values to be defined between conventional evaluations like true/false, yes/no, high/low, etc. Notions like rather tall or very fast can be formulated mathematically and processed by computers, in order to apply a more human–like way of thinking in the programming of computers.

Fuzzy logic perfectly adapts to the non linear requirements resulting from the presence of qualitative variables. It also suits the manner in which such requirements’ rules are expressed, facilitating the identification of strengths and weaknesses, previous to a comparison among...
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