Financing and Governance of Microfinance Institutions (MFIs)

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Abstract

The establishment of fictitious credits which is a sort of embezzlement of resources from the IMF by its leaders, for their own interests, creates problems of governance and has consequences to the profitability of MFIs. Under the hypothesis that the rate of fictitious credits outstanding credits of each MFI is private information, it may exist a problem of credit rationing on the donor's part when they are intended the funding MFIs that have rates of fictitious credits lowest (the most socially efficient). To resolve this problem, lenders may offer a financing contract incentive in which each MFI sustain a cost of funding equal to the cost of social inefficiency (transferred as bonus to its customers). This type of contract leads each MFI to reveal his true type and protects customers against any future social cost. The fictitious loans in the microfinance sector can have two consequences: the first is related to the questioning of the social responsibility of MFIs and the second is the undermining of the social objective of donors. We think that a contract incentive funding will enable the IMF to assume its social responsibility and to achieve the objective of his mission utility and social efficiency.

Keywords: MFI financing, Governance, Social Efficiency, Social Responsibility, Asymmetric Information.
Classification JEL: G21, G34, G14, M14, D82.

1. Introduction

Microfinance is an activity whose principal mission is to fund small activities that create incomes. It put in place microcredit in destination of financially vulnerable populations, and excluded from traditional bank financing channels, particularly because of this kind of population is unable to provide the necessary guarantees demanded by traditional commercial banks. This activity is highly developed in poor countries where a very large proportion of the population has no access to the credit of traditional bank in order to finance small business or agricultural activities that it can provide them modest incomes to respond at their basic needs. These structures generally referred to as a "microfinance institutions" (MFIs) are mostly of credit unions or NGOs, to fund their lending activities, solicit from funders (private or public). Financing is almost awarded as subvention or social funds repayable at low or zero interest rates. According Labie (2005a), these donors as opposed to shareholders of commercial organizations oriented profit maximization, are principally motivated by the social mission (granting microcredit to the largest number of poor) of MFIs that they support rather than performance of their funds. For Rock et al. (1998), microfinance has to objective, the pursuit of its social mission and the need for financial viability. Financial sustainability requires that MFIs must effectively use the funds at their disposal to achieve social goals while earning a minimum of profitability that can cover their management costs.

Indeed, behind the microfinance theme there are two approaches: the approach welfarist and the approach institutionalist. If these two approaches differ on funding mechanisms and the development of MFIs, the both consider that the mission of an MFI is to reduce poverty through the according of finance to the poor. For

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Gonzalez-Vega (1993), the institutionalist approach is the creation of MFIs able to sustain themselves financially on which depend their survival and their development. According Woller et *al*. (1999), the sustainability and development will be through a system of financial intermediation viable enabling MFIs to cover the cost of their operations with revenues earned. For the welfarist approach, the most important thing is to satisfy quickly as many of the poorest in the logic of social equity. That implies a large use of subsidies. According Tulchin (2003), microfinance must seek to mobilize financial resources necessary to fight against poverty, to achieve this goal; she must turn to investors (donors) search the same social aim (according funding for the poorest). A study by Christen et *al*. (1995) inspired by the analysis developed by Otero and Rhyne (1994) concluded that: if some observers have spoken in favor of targeting the poorest clients with an objective to fight against poverty, data we gathered and arguments for the use of financial leverage show that mixed programs, addressing to a greater customer base, can be very effective in reaching the poorest. It's the scale and not the exclusive focus, that determines the effective range to the poor. According Irlenbuch et *al*. (2006), Aghion and Morduch (2000), a means of improving the profitability of MFIs may be a better selection of funded projects and reduce the risk of non repayment of project, based on dynamic collective work in the villages or neighborhoods. For Morduch (2000), only 1% of MFIs are financially self-sustaining. Therefore, they need government subsidies and other donors to cover their costs. These institutions are therefore dependent on the goodwill of governments and private donors. Morduch (1999) talk about the questions of profitability and the financial balance of microfinance institutions, as well as assessments of social costs and benefits of subsidies received by the FMIs. The primary mission of the MFI is primarily social, the effectiveness of MFIs can be reduced to a simple analysis based on financial profitability.

Thus, beyond a financial performance, donors will seek to fund MFIs that establish credits that go to the real recipients that are the poorest (target population). It is admitted that the outstanding loans of microfinance institutions, there is usually a part of credit that do not go to the actual recipients (embezzlement of funds) but that serve the personal interests of leaders. These sorts of credit described in the literature of "fictitious credits" can be repaid in the short term by the introduction of new fictitious credits. Such, a practice raises the problem of governance of MFIs in terms of agency relationships between providers of funds and MFI managers. Providers of funds have difficulties to measure the performance of MFIs in terms of social impact in that they are conducting covert (introduction of fictitious credits) that are unobservable, this poses a moral hazard problem. The rate of fictitious credits in total outstanding credits established by each MFI is then she has private information (moral hazard).

However, the asymmetry of information between donors and microfinance institutions, conduce to the problem of the choice of the most socially efficient microfinance institutions (those rates lowest fictitious credits). This difficulty of choice of microfinance institutions (MFIs) can lead to credit rationing on the part of donors in so far as that they cannot distinguish the right kind of wrong type. The problem of credit rationing has been highlighted by Stiglitz and Weiss (1981) in corporate finance where they have shown to reduce the losses associated with bad debtors, lenders may have an interest in the volume of credit rationing rather than 'increasing interest rates. If the problem of credit rationing according to Stiglitz and Weiss (1981) arises because the lender has incomplete information on the profitability of a project submitted for funding by a borrower, in our approach, the rationing of credit by the lender (donor) arises from an asymmetry of information about social efficiency[1] of MFIs (debtor). In seeking social efficiency of microfinance institutions (MFIs), donors are pursuing their goal of granting external credit lines to MFIs with rates lowest fictitious credits. Thus, the credits will go to the target populations (the poorest). In short term, the existence of these fictitious credits makes that the rate of reimbursement is not a reliable indicator of selection. In fact,

[1] There is social efficiency when the credits established by the MFI are according to the real recipients that are the poorest. In other words, more the fictitious credits of an MFI are lower, more it is socially efficient.

in the absence of fictitious credits, financial profitability indicators (such as the repayment rate of loans granted by the MFIs) will be the best selection criteria for MFIs (the most socially efficient) to the extent that they are data observable accounting (common knowledge). In our research we show that the social efficiency measured from the rate of fictitious credits is the guarantee of a long-term financial return for MFIs and therefore that of sustainability. A study lead by Mersland and Strom (2009) on a sample of 278 MFIs in 60 countries has showed a positive correlation between governance quality and performance (in terms of return on lending activity). Clarkson and Deck (1997); Labie (2001) define governance of MFIs as all devices by which their funders ensure that their resources will be used to achieve the objectives previously defined.

However, the problem of governance of MFIs seeking funding from donors, is in the conflict of interest between the two contracting parties. According to Jensen and Meckling (1976), these conflicts can lead to agency costs whose minimization is the objective of governance mechanisms. Jensen (1993) explains that to improve the effectiveness of governance in a company, it must include the detention of a significant number of titles the company by the leaders and members of the board of directors. This could lead to a convergence of interests between different actors. For Doligez and Pierret (2005), the governance of microfinance institutions remains a strategic issue for all members involved in the construction and consolidation of such institutions. Therefore, the good governance requires a human dimension which falls under the social pact between the stakeholders, the acting and power issues. In the same point of view, Charreaux (1997) argues that trust between different stakeholders is a key mechanism in the heart of the governance system that determines the latitude of discretionary business leaders.

We believe social responsibility of MFIs is associated to a problem of governance because the primary purpose of MFIs is to allow the greatest number of poor access to financial services. The excesses of the microfinance sector in our context provides from bad governance. The governance tool then allows the MFI to design and implement mechanisms to ensure coherence between different aspects of its social mission and actions implemented. Thus, in the targeting strategy, for example, the MFI can check in the analysis of governance, the strengths or the weaknesses that reinforce its impact. The effectiveness in achieving the social performance of MFIs is thus based on a strong link between social policy and governance. According Chirlesan and Apostoaie (2012) the solid corporate governance is of a vital importance for the functioning of the financial system, these companies play a major role in the financial intermediation process.

Thus, for Servet (2009) the social responsibility is defined in microfinance by contributing to financial inclusion populations. These is understood as an offer of financial services answer effectively and efficiently meet the needs of different population groups, remaining at a cost compatible with their ability to cover. The social responsibility can empower women in poverty, to target the sustainability of the MFI. And social responsibility of an MFI is its ability to respond to social concerns of its members in terms of supply of products and prospects (opportunities). Directors' responsibility vis-a-vis customers: satisfaction, improved living conditions, risk minimization and cost of credit, adaptation of customer credit. In the same context, Pasquero (2004) shows that each period possesses its own requirements of social responsibility, but all are based on the achievements of the periods that preceded them. For Dunford (2006) MFIs must observe the ethical standards in its decisions: equity in the provision of microcredit, in order to avoid creating dependency and on indebtedness, to the prudent management. Lapenu and *al*. (2009) explain that the social mission of an MFI is to improve the quality and appropriateness of financial services, to create economic and social benefits for customers and improve the social responsibility of an MFI. They demonstrated the importance of strengthening institutions (MFIs) intermediates, clarifying the roles of funders, ethics and innovation, to lead to an inclusive financial sector and is a vehicle for change for its beneficiaries. Argandona (2006) states that when the concept of moral responsibility is applied to organizations, it is possible to specify the obligations of their actions and must be addressed to the managers of these organizations.

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Argandona and Priorand (2009) show that the social responsibility of business is the consideration of his social duty to be effective. This corporate social responsibility will be the generic moral and social content, the specific content that flows from its social function: the satisfaction of market needs, value creation, employment creation, human development, etc. Foote and *al*. (2010) explain that social responsibility is an important factor in achieving better performance. We show in this article that the incentive funding contract requires the MFI to assume its social responsibility by giving loans without risk to its customers; it must facilitate access to a larger number of poor to the credit. This type of contract encourages the good governance and provides a gradual decrease of fictitious credits in the microfinance sector. We think that the MFI is not intended to transfer the risk of bad governance to its customers.

Finally, to solve the problem of choice of microfinance institutions (MFIs) the most socially efficient, we suggest that donors to MFIs offer an incentive contract in which they request each MFI interest rates on financing equal to social cost of inefficiency. The interest earned on a unit of account of the funding for each MFI is then transferred as a bonus to each customer receiving a unit of account credit in the latter. Such an approach saves the client of any future social costs inherent inefficiency of an MFI any social and forces it to assume its social responsibility. In the rest of this article, we explain how such a contract and the different results generated by it.

2 - The Model

In order to simplify our analysis, we consider two MFIs seeking external credit lines from the same donor. Both MFI (players) are risk neutral and are denoted by $i = 1;2$. The donor has the financial resources necessary to satisfy any request for funding market. However, it wants to fund MFIs that socially efficient. This assumes that if the two MFIs are at the same level of social efficiency, they are both funded by the donor.

We specify that: - The lender provides credit lines to MFIs outside.

-MFIs lend money to customers in the form of credits.

Each *IMF i* has a market rate of fictitious credits θ_i which is private information.

Suppose that there exist on the market two types of MFIs:

- The socially efficient MFIs that have a low rate of fictitious credits $\underline{\theta}$.

- Socially inefficient MFIs that have a high rate of fictitious credits $\overline{\theta}$.

Suppose p the probability that an MFI i is to type $\underline{\theta}$ and therefore $(1-p)$ the probability of being type $\overline{\theta}$.

We start with the case where the objective of the funding is not to provide funding to an MFI i, if it is of type $\underline{\theta}$ (socially efficient). Credit management entails medium-term market inefficiencies costs (social costs) associated with the establishment of contracts fictitious credits to satisfy the specific interests of MFI managers. These loans are risky embezzlement that increase the term loan portfolios insolvent. Such costs will be passed on to customers later today. Indeed, a client is member of the IMF remains a long time customer of it and therefore must incorporate into its borrowing costs, costs related to employee future inefficiencies caused by the management of the MFI.

The repayment rate of credits r (considered by the client) set up by each MFI i at a given rate is then calculated ex ante future that integrates the current interest rate and cost inefficiencies associated with future policy credit the MFI.

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This rate is then an increasing function from the amount of credit risk θ_i (at the instant t) of each MFI's outstanding loans total either: $r : [0;1] \to [0;1]$

$$\theta_i \mapsto r(\theta_i)$$

We suppose that both MFIs seeking as credit line with the external funding agency, the same amount M ($M > 0$) refundable without interest. The external lines of credit requested by MFIs are fully placed as credits to their customers. We assume that customers are homogeneous in the sense that they yield the same function and therefore for a unit of account and invested borrowed, every customer expects a rate of return on investment equal to α.

We assume hypothetically that $r(\underline{\theta}) \le \alpha \le r(\bar{\theta})$.

For a loan ω of any client, its expected net return on investment is given by:

$$t(\underline{\theta},\bar{\theta}) = p\left[\alpha\omega - \omega r(\underline{\theta})\right] + (1-p)\left[\alpha\omega - \omega r(\bar{\theta})\right],$$

$$t(\underline{\theta},\bar{\theta}) = \omega\left(\left[\alpha - r(\bar{\theta})\right] + p\left[r(\bar{\theta}) - r(\underline{\theta})\right]\right). \qquad (1)$$

With, $(r(\bar{\theta}) - r(\underline{\theta}))$, equals the rate of cost inefficiency (supported with an MFI-type inefficient). This expression reflects the relationship between the gain in efficiency $(\alpha - r(\bar{\theta}))$ and cost inefficiency $r(\bar{\theta}) - r(\underline{\theta})$: She must be, regardless of the loan amount, positive or zero it means that each unit of cost inefficiency requires a certain amount of efficiency gain to cancel. The decision of donors is given in the following proposition:

Proposition 1: The donors refuse to fund MFIs, when the proportion $(1-p)$ of MFI-type inefficient $(\bar{\theta})$ on the market, is greater than or equal to the gain in efficiency induced by a unit of account of cost inefficiency $\left(\frac{\alpha - r(\underline{\theta})}{r(\bar{\theta}) - r(\underline{\theta})}\right)$. This result shows that the application for funding of MFIs (with donors) depends on the proportion of inefficient MFIs in the market and the relative gain $\left(\frac{\alpha - r(\underline{\theta})}{r(\bar{\theta}) - r(\underline{\theta})}\right)$ made by a client of an MFI-type efficient.

Indeed, when the proportion of ineffective MFI market is greater than the relative gain, the credit given to a client is such that the charges on loans are higher than the profitability of client activity. This situation will lead to credit rationing on the part of donors (donors want to provide financing only socially efficient MFIs). MFIs will find themselves unable to meet credit demand in the market. Thus, customers will turn to informal mechanisms (traditional) funding that are often sources of conflict and economic distortions.

Proof of Proposition 1: A loan on the market is profitable for the client if and only if:

$$t(\underline{\theta},\bar{\theta}) = \omega\left(\left[\alpha - r(\bar{\theta})\right] + p\left[r(\bar{\theta}) - r(\underline{\theta})\right]\right) \ge 0. \qquad (2)$$

Which is also equal,

$$\left[\alpha - r(\bar{\theta})\right] + p\left[r(\bar{\theta}) - r(\underline{\theta})\right] \ge 0, \qquad \forall\omega$$

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$$p \geq \frac{\bar{r(\theta)} - \alpha}{\bar{r(\theta)} - \underline{r(\theta)}}.$$

Thus, we can write

$$1 - p \geq 1 - \left(\frac{\bar{r(\theta)} - \alpha}{\bar{r(\theta)} - \underline{r(\theta)}} \right)$$

This implies,

$$1 - p > \frac{\alpha - \underline{r(\theta)}}{\bar{r(\theta)} - \underline{r(\theta)}}. \quad (3)$$

This result leads to a situation of credit rationing. Donors refuse to fund MFIs socially inefficient.

Note :

We distinguish two special cases for this proposal:

1) If $\alpha = \underline{r(\theta)}$ then, the gain of efficiency induced by a unit of account of cost inefficiency $\frac{\alpha - \underline{r(\theta)}}{\bar{r(\theta)} - \underline{r(\theta)}}$ is zero. In this case, the donors fund MFIs in the market because they are socially efficient $p = 1$.

2) When $\alpha = \bar{r(\theta)}$, the gain of efficiency induced by a unit of account of cost inefficiency $\frac{\alpha - \underline{r(\theta)}}{\bar{r(\theta)} - \underline{r(\theta)}}$ is to unity and donors should not fund MFIs because they are all socially inefficient $p = 0$.

In the case of asymmetric information on the type of MFIs through fictitious credit market, the consequences from such a situation are credit rationing or denial of funding by donors. That explain that MFIs have inefficient types of fictitious credits the highest on the market are numerous.

We are thus dealing with the problem of credit rationing when $1 - p > \frac{\alpha - \underline{r(\theta)}}{\bar{r(\theta)} - \underline{r(\theta)}}$, and opening the way for funding of MFIs, we suggest that donors offer a contract in which:

- They ask about an interest rate equal to financing $(r(\theta_i) - \underline{r(\theta)})$. In doing so, lenders are charging each MFI's cost inefficiency ($r(\theta_i) - \underline{r(\theta)}$).

- Donors will transfer to each customer (with a credit rating equal to in an MFI any, equal to a bonus $\omega(r(\theta_i) - \underline{r(\theta)})$. Each client of an MFI is then any solvent because of the bonus $\omega(r(\theta_i) - \underline{r(\theta)})$ to compensate fully the loss potential profitability in the long run.

- Donors offer to the MFI-type inefficient practice a current interest rate and equal to $\bar{R}$ the MFI-type effective interest rate equal to $\underline{R}$ current such that $0 \leq \underline{R} < \bar{R}$, either $\Delta R = \underline{R} - \bar{R} \leq 0$. We recall that the current interest rate does not seek to maximize the benefit of the microfinance institution and as well as customer behavior is relatively inelastic to interest rates.

We assume that the transfer of the bonus to the client is done without cost. The usefulness of an MFI-type inefficient on a loan ω (nominal value) sought from donors is:

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$$u(\bar{\theta},\bar{\theta}) = \omega\left[\bar{R} - (r(\bar{\theta}) - r(\bar{\theta}))\right]. \quad (4)$$

We will as a result, the utility of MFI-type inefficient when seeking funding with the real type with the donor. This value corresponds to the ω loan amount times the current interest rate $\bar{R}$ less the cost of inefficiency.

The utility of the MFI-type efficient on a loan (nominal value) from donors is as follows:

$$u(\underline{\theta},\underline{\theta}) = \omega\left[\underline{R} - (r(\underline{\theta})) - r(\underline{\theta}))\right],$$

$$u(\underline{\theta}) = \omega \underline{R}. \quad (5)$$

We obtain the value of an MFI-type efficient when seeking funding with the real type with donors. This value corresponds to the loan amount (ω) multiplied the current interest rate ($\underline{R}$) of the MFI efficient. So we announce the strategy of donors in the following proposition:

Proposition 2: When donors are supporting each MFI's potential market inefficiency MFI type ineffective has no incentive to set a nominal interest rate lower, by choosing one of an MFI efficient type.

In the presence of asymmetric information, lenders are able to offer a credit agreement may lead the MFI to reveal their private information. In our approach the socially inefficient MFIs has no interest to lie about its type, that is to say, pretending to be the socially efficient MFIs. If the MFI-type inefficient wants to lie on its type will be required initially to pay lenders an interest rate higher than that of the class of risk, in a second time, it may make losses important and put into bankruptcy. We note that the increased rate of fictitious credit can contribute to long-term disappearance of the IMF and thus the deviation of its social mission. The explosion of fictitious credit challenges the social responsibility of the MFI because of its social objective is incompatible with the personal enrichment of its leaders, which is clearly a problem of conflict of interest in the management of MFIs. However, the social efficiency of an MFI can have a positive impact on financial results through customer retention, reduced credit costs and administrative costs. We can therefore say with regard to Proposition 2 is that the contract offered by lenders that guarantees the announcement or disclosure of the truth of the true type of the MFI. The MFI obtained at the end of his choice a utility greater than or equal to his reservation utility, that is to say that it could get better out of his contract with the funder, s it did not require funding. Our contribution is to explain that as part of a financing contract that will make more sense for donors to provide funding to MFIs when they have higher rates of fictitious credits lowest (meaning in As part of our model indicates a willingness or good governance) and they reveal themselves socially efficient. In doing so, donors can secure financing for MFIs by minimizing credit risk and protecting customers against opportunistic behavior of MFIs.

Proof of Proposition 2: When the MFI-type inefficient wants to pose as an MFI-type effective, its usefulness is

$$u(\underline{\theta},\bar{\theta}) = \omega\left[\underline{R} - (r(\bar{\theta}) - r(\underline{\theta}))\right], \quad (6)$$

So, $$u(\underline{\theta},\bar{\theta}) - u(\bar{\theta},\bar{\theta}) = \omega\left[\underline{R} - (r(\bar{\theta}) - r(\underline{\theta}))\right] - \omega\left[\bar{R} - (r(\bar{\theta}) - r(\underline{\theta}))\right].$$

from which, $$u(\underline{\theta},\bar{\theta}) - u(\bar{\theta},\bar{\theta}) = \omega\left[\underline{R} - \bar{R}\right] < 0, \text{ since } \underline{R} < \bar{R}.$$

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which implies that, $u(\theta,\bar{\theta}) < u(\bar{\theta},\bar{\theta})$.

This result shows that the MFI type ineffective is obliged to choose the nominal interest rate higher than that of the MFI-type effective. Thus, by choosing this option it reveals its type. The nominal interest rate is then used to signal the market to distinguish the type of MFI any where donors are transferred on each MFI's social cost possible.

Such a result allows us to deduce the following propositions.

Proposition 3: When customers receive a loan ω from each MFI, a bonus equal to the cost of Social inefficacy ($\omega(r(\theta_i) - r(\bar{\theta})$) thereof, they have the same value regardless of the type of MFI. MFI clients are able to borrow on the credit market without worrying about the potential risks of fluctuations in future interest rate resulting from poor management of MFI portfolios. For the simple reason that they would not support future social costs.

Proof of Proposition 3: The utility of a customer who applies for a loan from a MFI is ineffective:

$$u_c(\bar{\theta}) = \omega + \alpha\omega - (\omega + \omega r(\bar{\theta})) + \omega(r(\bar{\theta}) - r(\bar{\theta})),$$

$$u_c(\bar{\theta}) = \omega\left[\alpha - r(\bar{\theta})\right]. \quad (7)$$

The utility of a customer who applies for a loan from a MFI is efficient:

$$u_c(\bar{\theta}) = \omega + \alpha\omega - (\omega + \omega r(\bar{\theta})) + \omega(r(\bar{\theta}) - r(\bar{\theta})),$$

$$u_c(\bar{\theta}) = \omega\left[\alpha - r(\bar{\theta})\right]. \quad (8)$$

this implies, $u_c(\bar{\theta}) = u_c(\bar{\theta})$

This result shows that borrowers are indifferent to current interest rates charged by MFIs in the market. This indifference due to which borrowers will receive bonuses, facilitates access to credit. Thus, our approach shows that the value of a customer who applies for a loan from a MFI inefficient type is equal to the value of a customer who applies for a loan from a MFI-type effective. Allowing us to announce the following proposition.

Proposition 4: When each MFI bear the cost of inefficiency in the market, the expected utility ($u_c = \omega\left[\alpha - r(\bar{\theta})\right]$) from a customer who applies for a loan ω (nominal) with it, is independent of the proportion $1-p$ of inefficient MFIs on the market. MFI clients are not at risk on the credit market because the probability of inefficient IMF does not affect their expected utility. This would explain in terms other than the bonus offered by donors protects clients of MFIs to bear any risk associated with the social inefficiency of the latter.

Proof of Proposition 4: The utility of a customer who applies for a loan from a MFI is ineffective:

$$u_c(\bar{\theta}) = \omega + \alpha\omega - (\omega + \omega r(\bar{\theta})) + \omega(r(\bar{\theta}) - r(\bar{\theta})),$$

$$u_c(\bar{\theta}) = \omega\left[\alpha - r(\bar{\theta})\right]. \quad (9)$$

The utility of a customer who applies for a loan from a MFI is efficient:

$$u_c(\bar{\theta}) = \omega + \alpha\omega - (\omega + \omega r(\bar{\theta})) + \omega(r(\bar{\theta}) - r(\bar{\theta})),$$

$$u_c(\underline{\theta}) = \omega\left[\alpha - r(\underline{\theta})\right]. \quad (10)$$

The expected utility of a customer who applies for a loan from a MFI is:

$$u_c = p\omega\left[\alpha - r(\underline{\theta})\right] + (1-p)\omega\left[\alpha - r(\underline{\theta})\right],$$

$$u_c = \omega\left[\alpha - r(\underline{\theta})\right]$$

Therefore,

$$u_c(\underline{\theta}) = u_c = \omega\left[\alpha - r(\underline{\theta})\right] \quad (11)$$

Assume ω equal to one unit of account ($\omega = 1$). We have:

$$u_c = \left[\alpha - r(\underline{\theta})\right] > 0, \text{ then } r(\underline{\theta}) < \alpha.$$

or even $\forall \omega > 0$, $u_c = \left[\alpha - r(\underline{\theta})\right] > 0$, because $r(\underline{\theta}) < \alpha$.

This result shows that the proposed contract to MFIs by the funders protects customers against the risk of default and thus guarantees their solvency and profitability of their investments over the long term through the bonuses $(r(\theta_i) - r(\underline{\theta}))$ they receive a unit of account loan sought from any MFI.

3 – Conclusion

Our analysis is developed in the short and long term. Indeed, we have proposed an approach that not to support the borrowers of MFIs social costs related to their future bad governance. In the current literature, it is recognized that the financial structures that take more risk practice of current interest rates on higher borrowing. In our analysis when we ask MFIs to pay for this risk to their customers today, they can be an incentive to have interest rates lower. The mechanism that we develop permit to dissuade the MFI type ineffective, to cheat on her type by pretending efficient type (see Proposition 2). An interesting result of our approach is that customers are indifferent to current interest rates charged by MFIs in the market. This indifference due to bonuses enjoyed by borrowers easier access to credit in the sense that they are protected from future consequences of possible ineffectiveness of microfinance institutions (MFIs).

Our results show that the incentive funding contract allows the donor to achieve their social objectives by protecting borrowers in financing MFIs. Intuition and the conclusion of our results show encouraging MFIs to practice good governance by contracting credit without risk to their client, to receive funding from donors. We also explained in this paper that social responsibility was related to an MFI governance. To fulfill its social responsibility or social mission, the MFI of the obligation to provide social utility contracts to its customers, this social contract need good governance of MFIs by reducing the fictitious loans in the market for microcredit to be socially efficient. In this context Mercier (2004) explains that social responsibility is the obligation for managers to pursue policies and make decisions that are consistent with the values of society. For Labie (2005b), Governance Social Performance for MFIs includes all the mechanisms and processes that determine the strategic decision making (investments, customer relationships, etc..) And operational (management activities) through which the actors continue social mission and implement its social policy. The effectiveness in achieving the social performance of MFIs is thus based on a strong link between social policy and governance. The integration of the social mission of an MFI in its principles and governance process then allows the organization to facilitate and promote its social performance management, she can manage daily the subtle balance of economic and office taking into account a balanced way the interests of stakeholders: the owners and managers, managers and employees, but also service users (customers or members), donors and government, community and environment. The contract provides incentive funding to MFIs to practice sound governance, vital to their survival and laying the foundation for effective

management of social performance. An interesting extension of our model, would be to assume that the transfer bonus to customers is socially costly.

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