MULTI DIMENSION IMPACT ACCOUNTING (MDIA)

Burgess Snippets

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Greece

The single biggest reason why there is economic dysfunction in modern times is the behavior of rich and powerful people. This applies everywhere in the world, including Greece. Very few governments are financially sound in large part because there is an imbalance between taxes and essential expenditures. Greece is notorious for its weak tax collection system which benefits the rich and powerful disproportionately. At the same time Greece has a social benefit system that is more generous than it should be and is unaffordable while rewarding quite youthful, healthy laziness. Correcting these structural issues is not austerity, it is simply good common sense. This can be done sensibly or it can be done stupidly. To start with please don't talk about increasing Greek exports of manufactured goods against German manufactured goods … no matter what exchange rate advantage there is in a post Grexit world, this is a non-starter. On the other hand tourism should be a real winner, but only possible if Greece is again a happy place. Media, politicians and pundits don't help especially when the underlying analysis is based of fatally flawed metrics.

Building on what Anna Diamantopoulou has written I would like to suggest that one of the best ways to enable Greece for a wonderful future is to make a huge investment in the restoration of its past. It is a crime against humanity … a cultural crime … to allow the disintegration of the ancient historic sites, but also important, it would rejuvenate the tourism sector which is arguably one of the most valuable parts of the Greek economy. Greece is one of the most beautiful parts of the planet and this should be driving its future. Sadly the metrics used by decision makers are fatally flawed … crude GDP growth is not the answer while initiatives that improve quality of life are, and European tourism / Greek history is one opportunity to pursue.

Barbara

Bravo … this is an excellent article, but more important it is about an immensely important issue. It is more than 50 years since I finished my formal education. I was responsible for an IBM computer installation in 1967 with 4K of memory … now my cellphone is a million times more powerful. So why is the world a mess? Why isn't society a million times better than it used to be? Damn it … it could be! We don't have to 'take' from the rich to give to the poor, but we do have to get the rich to invest in things that will really do some good for people and planet rather merely to make profit for owners and to hell with everything else. The world will value doing good as soon as we measure good as rigorously as we measure profit … it can be done, and sooner than you think, it will become mainstream.

Barbara … best wishes in your new environment. It sounds exciting … and with any luck something of a change-maker.

On Microfinance

Why are there continuing discussions on interest rates in microfinance? Read our latest article "Interest Rate Debate in Microfinance: Reflections on regulated caps" http://bit.ly/1l7ttme

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Comments
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Founder/CEO at TrueValueMetrics developing Multi Dimension Impact Accounting

This is a very good article covering the situation with interest rates in the world of microfinance. The fact that this discussion has been going on for 30 years or so suggests to me that there is a deeper issue that needs to be identified and addressed.

My first exposure to microfinance was in the 1970s in West Africa. At the time I was the CFO of a company operating in many developing countries and I wanted to know something of the social issues that people in these places were living with. I came across all sorts of systems that delivered some form of self help petty finance. Later I did consulting with with the World Bank, the UN system and others and was appalled at how much funding was delivering rather modest progress. As an accountant, it was fairly obvious that lack of money control was a huge part of the problem, but this was not something that was popular as an explanation of low project outcomes.

And then came microfinance ... or microcredit

By lending to small amounts to women it was discovered that they paid back ... something over 90% of the loans were being repaid. Compared to all the other projects where money was going out never to be seen again, this seemed like a real winner.

And in some ways it was. By borrowing a small amount of money, women were often able to incredible important things for their family ... like buying medicine to keep a child alive. The small amount borrowed plus even a big interest charge was a valueadd for the family, and women understood this.

Some microfinance initiatives made training an integral part of the lending process. When the loan was made, the loan resulted in a successful microbusiness, and the loan repayment plus interest was high but enabled the training and enabled the success. This, I argue is a good model.

When microfinance became a financial product, a very different set of issues emerged. Capital markets do their calculations around the money part of the business model but the social component disappears. (see note below)

The money dimension of microfinance is a help, and it makes extreme poverty a little bit less awful, but not very much. In too many cases the money of microfinance has helped people dig an even bigger (financial) hole for themselves. A microfinance organization that really helps not only with money but with learning really brings value to the client. OH BUT, this is a cost to the microfinance organization and this looks bad to funders who are looking at financials.

The early Grameen Bank model had a huge social component, and I would argue that this was the foundation that made it successful. The money bit was part of a bigger view.

Over the years, I have looked at the performance of projects and organizations. I have also looked at the performance of places. It is disappointing to me how many places have failed to progress, though a company in a place may be very successful for a while and then move on ... in many cases leaving all sorts of detritus to be cleared up by others. The idea that a place should improve over time seems to me to be rather fundamental and quite simple. Better still, I can monitor progress over time quite easily because the place never moves. Using the place as the focus of development performance, including microfinance, I would argue that performance of the international development community and their initiatives has been quite appalling and for a very long time.

As I see it, interest rates are not the issue, the bigger issue is whether microfinance is, in the end, making for better places and better populations.

Note: The banking and finance system does not require high interest when it is in their own interest ... that is, their survival, to have something different. How else does one explain the zero interest transactions that saved the skins of everyone in this sector of the global economy in the recent great recession and near crash of the banking and finance sector.

The Multiplier Effect & Exponential Societal Results

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Charitable organizations and nonprofit networks pursue very ambitious, important and powerful missions that address societal challenges at local, national and global levels. The range of efforts and strategies is both impressive and daunting, such as ending homelessness, combatting hunger, solving diseases, accelerating student achievement, protecting the environment and assisting global development. Yet, realities continue to overwhelm individuals, families and communities everywhere given widening disparities in key areas that increasingly affect many segments of our society.

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As the “degree of difficulty” for these issues intensifies, so must our resolve – and our creativity – to drive progress that truly creates opportunity for all. No mission is more important. I believe organizations and networks can – and must – find the market-based multiplier in their model that exponentially increases the velocity of impact, growth and results.

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How?

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Given the urgency, we can no longer simply pursue additive strategies that affirm 1+1=2 … or even 10+10=20. We must now develop formulas that prove 10x10=100 or even 100-squared=10,000. Whether it’s through new or expanded markets, channels, services, donors or partners, these models should identify, aggregate, align and unleash the totality of resources, relationships and assets across one’s ecosystem to solve our greatest challenges.

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When these ecosystems – now smarter, faster and stronger – collide with other ecosystems on a similar trajectory, disruptive breakthroughs and innovations emerge. Big opportunities develop too. Together, these cross-sector efforts are more poised to ambitiously affect change in pervasive areas, such as income inequality and race relations in the U.S. or youth engagement and women’s rights around the world.

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Such a market-based approach will also generate significant value back to the charitable organizations or nonprofit networks whose leadership spearheads the change. Imagine more visible and valued brands, attractive and funded investment packages, and future programmatic or policy breakthroughs.

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Fundraisers – and strategists – value zeroes in big numbers because the multiplier effect can exponentially change models. Over time, the mutually-reinforcing nature of charitable missions and market-based partnerships will dramatically expand capabilities, unlock productivity and drive innovation, while closing the alarming disparities in society to ensure opportunity for all is truly possible.

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I was attracted to this post because of its title ... The Multiplier Effect and Exponential Societal Results

My training in economics in a Keynesian environment taught me about the multiplier effect in theory, bit it is hard to observe this in advanced economies as in Europe or North America. Some of my work over the years has been in extremely poor settings and in these environments, the immense value of the multiplier effect can be observed. The World Bank and other development projects have a huge multiplier effect as they ramp up their projects ... but sadly, they have the same effect in reverse as they close them down, Analytical rigor is important ... and these multiplier effect rarely get mentioned in the economic analysis.

The exponentials of social benefit should be possible, but sadly, social benefit cannot behave in quite the same way. There are system issues. The metrics for social benefit are poor, if they exist at all, and there is no mechanism for good to move through the economy in the same way that money moves through the economy. There are currencies and banks for the money part of the economy. There is nothing like this for the 'good' part of the economy.

Simply put, we ought to be able to have exponential progress in the social dimension of the global economy ... but the metrics to encourage this are missing ... and the system infrastructure to enable it are missing as well.

In my world view, there ought to be a continuum through all organizations that engage in economic activity ... whether charities or for profit businesses or government agencies. In the end they all use resources and they all have impacts. I want to see a uniform system of metrics that works for all types of organization. Those with the power to allocate resources should have meaningful data about the performance of all organizations on a uniform basis so that in the end everything that is worthwhile can get funded. Every organization does some form of money accounting, they all ought to do some form of impact accounting on a uniform basis as well.

Talking about this is relatively easy. Designing a system to do this is not. I am trying. This essay describes some of my thinking:
http://www.truevaluemetrics.org/DBpdfs/MDIA/TVM-Short-Introduction-to-7D-Capitalism-and-MDIA-141212a.pdf

MISC MATERIAL

But worse, money itself has been corrupted in very important and dangerous ways.

Money is one of the most important parts of our modern world, and yet it is also one of the least understood. Whether or not this is by design on the part of the leaders in the system is a matter for consideration, but not, perhaps at this time and in this article.

What is the 'Purpose' of Money

When I was a student of economics some 50 years ago, I remember being taught that money was 'a medium of exchange' and a 'store of value'. I argued as a student that this was only partially true and is far less true today.

> *I see banking and financial services as being very much like a lubricant in an automobile. The lubricant is essential to keep the vehicle running, but it is the motor and the gas that gives the vehicle the power it needs. Financial innovations move wealth around but they do not create additional real wealth.*

In the modern enviro-socio-economic system money is now not only the essential lubricant, but is also used as a measure that purports to give an indication of value. Perhaps more than anything money has become a device for the creation of apparent value where no real value has been created.

> *In 1948 my parents bought the house we were living in as sitting tenants for 700 pounds (then about $2,000). Recently this house sold for 480,000 pounds. Same house. Same location. But the pound (money measure) is different.*

And another case of money and value making no sense:

> *I bought a house in 1976 for $59,000. Two years ago this same house sold for $850,000. Same house, same place … but different money.*

Money as a Measurement is a Failure

Money has neither substance nor reality. It has become a fiction that sustains itself on top of a massive amount of ignorance and misinformation. It has none of the characteristics of a sound unit of measure.

> *The unit of measure for length is clearly defined by the International Standards Organization (ISO) and though length may be called different things, they all refer to the same physical entity. A kilometer and a mile have a fixed relationship to each other … and the physical distance does not change when these two measures are switched.*

The International Standards Organization (ISO) does not have a definition for money. Money as the unit of measure for wealth or value does not have any of the rigor used by the ISO for a physical measure. The relationships between the moneys of different countries changes all the time. As we have already seen, the relationship between a physical item and its value measured in money terms changes over time and very significantly

For most of history there were efforts to ensure that the value of money was not debased over time. This is one of the reasons for the so called 'gold standard' where the value of money was defined by reference to an ounce of gold. In that era, paper currency could be exchanged for physical gold held by the issuing organization as 'backing' for the currency. The last vestiges of that system were swept away when Richard Nixon was President of the United States more than 40 years ago.

Market Price and Value are not the Same

There are significant myths surrounding the idea of a market. For many items supply and demand and a market will result in a price for the buy-sell transaction. In my experience this system works better than when an organization like a government tries to set prices. The Soviet Government could not make an economy work on top of this type of price control, and when it was used in the USA after the 'oil shock' of 1973 it did not work either.

But market price only works when there is no asymmetry between buyers and sellers, and recent years it seems that every possible market is now subject to gaming where people with more knowledge are able to make transactions at prices that favor themselves. Managing misinformation in the modern economy has become big business.

There is a view that a market price of something is the same as the value of something. This is rarely the case. A human life has a value, but the ideas that this value can be determined by some sort of market mechanism is obscene.

Value, however, does have an impact on price. Buyers do not buy when a product or service has a price that exceeds the perceived value (in money terms) of the item. One of the reasons why healthcare is such a profitable sector in the United States is that sick people perceive that the value of medical interventions are very valuable, and healthcare suppliers are therefore able to price their services at a level that usually is extremely profitable. This business model ends up being bad for society … rich people can afford the high prices and poor people die.

Amazing improvements in the cost effectiveness of modern medicine is obscured because price is more correlated with perceived value than a reflection of cost.

> *It was almost 30 years ago that I first wrote something to the effect that the biggest cost in the modern US economy was profit. The cost to a consumer, is what a consumer pays … that is the price, and the price is cost plus profit.*

Alternatives to National (and Regional) Currencies

The money centric establishment does not want to see significant changes to the status quo. National currencies like the US dollar and regional currencies like the EURO are in the mainstream and Central Banks like the Federal Reserve Bank together with law-makers and the established banking system want this to continue.

In spite the impediments, alternative currency systems do exist and they compliment the established national level currencies very well. In Switzerland there is a unit of currency called the WIR that has been in circulation since the 1930s in parallel with the Swizz Franc. It represents maybe as much as 20% of Swiss GDP. The WIR seems to help the economy by being somewhat counter-cyclical. There are several hundred very small alternative currency initiatives in the United States … such as Berkshares in Massachusetts. Typically these initiatives encourage local purchases at local businesses. It may be argued that many of the big business incentive programs like Frequent Flyer Miles are an embryonic form of alternative currency.

Alternative Metrics

We cannot make sense of the modern enviro-socio-economic system until we have ways to measure not only tangible 'stuff' that we buy and profit flows that we anticipate, but also those very important things that go into producing quality of life and impact on the environment that we have taken for granted until very recently.

The good news is that there is a rapidly growing body of research into what goes into quality of life and how the environment and the global eco-system works. The bad news is that most of this is complicated and not easy to understand and up to now there is no way for quality of life and the state of the planet to be accounted for and reported on in an easily understandable manner.

Corporate profits, prices on the capital markets and GDP growth are metrics that are easy to talk about. No easy metrics are available for what is happening to quality of life, and no easy metrics are available for the state of the planet. Financial analysts look at the future prospects for a company and convert that to a present value that justifies the price of the company's shares.

There is no easy methodology to compute the present value of environmental disaster that might possibly have massive impact in the future.

The genius of conventional money profit double entry accounting is that it is amazingly simple and immensely powerful. It is at the center of even the most sophisticated corporate management information system. A key characteristic of money profit accounting is that there is a common language that enables big complex organizations to summarize their performance very succinctly and also to drill down to very specific elements in the complexity. There is, however, nothing like it to account for what is going on with quality of life and what is going on with the condition of the planet. This has to change.

There is a lot of initiatives trying to work out how this can be done. My view of these initiatives is that they are all incremental improvements on the status quo, and accordingly will not make much of a difference. In particular, they assume that better corporate performance will result in better impact on people and planet … and assumption that may have been valid through much of the last century, but has not been valid for perhaps the last 40 years. What I want to see is a data architecture that will enable accounting and accountability for every component of the complex enviro-socio-economic system … the profits of organizations, the quality of life of people, the impact on the planet … and the state of place … and the role of product and process in this system .. and the role of knowledge, governance, institutions, organizations, infrastructure, society and culture on all of this.

Effective metrics … scorekeeping … has to be easy to understand. The game may be complex and sophisticated, but keeping score has to be simple.

Dinosaurs are extinct. Are people next?

What is Money and What is a Security?

There used to be (in the United States) paper 'Bank Notes' which were issued by a bank to facilitate trade. They were more convenient than metal coin, which would have been the alternative. There was backing for these notes in the form of metal coin in the vaults of the bank. The banks realized early on that since the notes were required for commercial transactions, they could issue more paper bank notes than the metal currency or coin backing them because there would never be a case when holders of bank notes would call for repayment of the note in coin.

The banks also applied the same logic to money deposited in the bank by depositors. The money deposited could be used by the bank for income generation through investment and loans. Again the assumption was that depositors would not call for their money and a proportion of that money could be safely used without any problem.

From time to time these assumptions were wrong. People wanted their bank notes to be redeemed in coin or depositors wanted to withdraw their money from their accounts … and in some cases the bank could not meet these demands. This was called a 'run on the bank' and in the past both bank, bank not holders and depositors were ruined.

This was very much the banking model in the 19th century, but something very similar but on a grander scale and much more sophisticated took place with the banking crisis of 2007/8. During the 20th century many important safeguards were introduced including a lot of regulation of the banking system, the introduction of the Federal Reserve Bank as the issuer of bank notes, now called 'Federal Reserve Notes', the introduction of a system of deposit insurance, and other measures.

Banks Love Leverage

Where Does Wealth Come From?

I think it is fair to say that most wealthy bankers think that they have earned their wealth by their work as bankers. I argue that the wealth of bankers was earned in some other sector of the economy and merely transferred from that sector into the banking sector by the machinations of the banking institutions and the money system.

This is not obvious … in fact it is downright confusing … when money is both the measure of the wealth, the substance of the wealth and a part of the mechanism that is the system representing wealth.

To a great extent money wealth is a mirage.

Wealth and how it is represented in a balance sheet.

A business balance sheet has three components: the assets, the liabilities and the owner's equity. Assets less liabilities equals the owner's equity. The owner's equity is a manifestation of the owner's wealth. In a big company, the owner's equity may be split into many shares (stocks) which are owned by many rather than a single person, and these shares may be traded on a stock market. Better yet, they may be traded at a price that is higher than the book value of the shares according to the balance sheet.

About 30 years ago the value of shares traded on stock exchanges was some 30% higher than the book value of these shares according to the balance sheets. In recent years this has increased so that the market price has become something like 75% higher than the book value according to the balance sheet.

The reason for this is that real assets that are on the balance sheet have become parts of processes that are extremely profitable. Technology has enable productivity, and this has resulted in higher production for less labor, better quality for less labor and in the end higher profits for a lower payroll. In turn higher profits means more optimistic investors and high stock prices and in turn again more wealth for owners.

There is no wealth for workers on the balance sheet … rather there is less wealth for workers because higher productivity leads to lower payroll and a society increasingly stressed by the continuous growth of income inequality.

The wealth of the world's wealthiest is based on ownership of something, rather than the work they have done and the income generated from the work. Investors drive stock prices in anticipation of the future, and assign value based on a multiplier of future performance. The ownership wealth at a moment in time may be many times what the real economy has produced in real wealth. This is one of many manifestations of growing wealth for owners and reduced wealth for everyone else.

> *The story of Mo Ibrahim in Africa is interesting. He was able to build out a mobile phone network (Celtel) in Africa that represented a considerable real physical investment. It was profitable and the future looked good. Ibrahim sold out to a bigger company at a price that made Ibrahim a billionaire and very much more than the book value of the company. The problem with this is that the new investor has to raise prices substantially in order to get the same return on investment than Celtel was getting on its smaller balance sheet. Net net this is a win for Ibrahim and a huge loss for the people who are the customers of the network.*

Another way of looking at this is to consider this from the perspective of various capitals. If we think of financial capital as being the owner's equity in a company, then this is the same as the net assets (assets less liabilities of the company) plus of minus the difference between the book value and the market value. As Centel invested to build out a cellular telephone network, there was both an increase in the financial capital as the earning potential of the network grew, but also increases in physical capital that benefited both the company and the society, and social capital as people now had access to an important tool for communications. In turn human capital also was increased as lives improves and communication resulted in more knowledge capital.

Markets and Money

The idea that a market enables the discovery of something's true value is widely held, but, in my view is entirely wrong and a very dangerous idea. There are assumptions that the market is perfectly efficient which it never is, and that all the parties have complete and valid information, which never happens. But it is even worse than this.

The value of money itself is also a function of a market situation. Markets respond to supply and demand … but the money system itself allows for creation of supply in all sorts of ways that are convenient without much of a basis in anything that touches tangible reality.

The balance sheets of the world's central banks, which includes the Federal Reserve Bank of the United States, expanded by about three times in the aftermath of the financial system meltdown of 2007/8. In other words, a supply of money was conjured out of thin air to ensure that the wealth of the owners of the banking and financial institutions would not vanish.

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