EVALUATING MFIs' SOCIAL PERFORMANCE: A MEASUREMENT TOOL

microREPORT #35

FEBRUARY, 2006
This publication was produced for review by the United States Agency for International Development.
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EVALUATING MFIs' SOCIAL PERFORMANCE: A MEASUREMENT TOOL

Accelerated Microenterprise Advancement Project (AMAP) Financial Services

Contract: GEG-1-00-02-00013-00, Task Order #01

AMAP FS IQC, Knowledge Generation

ABBREVIATIONS AND ACRONYMS

ALS	Average Loan Size
AMAP	Accelerated Microenterprise Advancement Program
BanMicro	Banco de Microcrédito
CEO	Chief Executive Officer
CSR	Corporate Social Responsibility
FGD	Focus Group Discussion
FSS	Financial Self-Sufficiency
GNI	Gross National Income
LOE	Level of Effort
MFI	Microfinance Institution
MIX	Microfinance Information Exchange
OSS	Operational Self-Sufficiency
PAR	Portfolio-at-Risk
ROA	Return on Assets
ROE	Return on Equity
SPM	Social performance Measurement

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EXECUTIVE SUMMARY

INTRODUCTION

The microfinance industry has made significant progress developing and disseminating methods to measure financial return, while coalescing around the need for microfinance institutions (MFIs) to provide a transparent accounting of their financial performance. This progress stands in stark contrast to its lack of progress in measuring social return and promoting social transparency. This outcome reflects less the industry's lack of interest in social return than to the inherent difficulties of measuring social performance stemming from its inherent methodological difficulties and resources demands.

There is thus significant value to a simple and low cost yet credible social performance measurement (SPM) tool. This report presents such a tool. The SPM tool includes two components: (1) a social performance scorecard and (2) a social audit. The social performance scorecard assesses social performance using a set of simple indicators falling under one of seven dimensions of outreach. It assigns a social performance score in each of the seven dimensions as well as an overall score.

The social audit assesses an MFI's internal processes and the extent to which they align its performance with its social mission. The scorecard and audit results are combined to assign the MFI an overall social rating using a standardized rating scale. The standardized social rating states the likelihood that the MFI produces significant social impact both now and in the future. It can be used to compare social performance across MFIs and contexts.

Development of the SPM tool was driven by several criteria, of which feasibility and scalability were the most important. Feasibility means that SPM tool should be reasonably easy to implement without imposing a significant burden on the MFI's resources. Scalability refers to the likelihood that the SPM tool is adopted by a large numbers of MFIs.`

SOCIAL PERFORMANCE SCORECARD

SCORECARD FRAMEWORK

The social performance scorecard proposes that social performance is determined by net social benefit, which is determined by the sum of customer value, or the net private value customers derive from consumption, and social value, or the net benefit society derives from the production and consumption of microfinancial services. Customer value and social value in turn can be proxied by seven dimensions of outreach: (1) breadth, or the number of people reached, (2) depth, or the poverty status of people reached, (3) length, or institutional sustainability, (4) scope, or the number of distinct market offerings, (5) cost, or the sum of price, transaction, and opportunity costs, (6) worth, or the value of products and services consumed, and (7) outreach to the community, or the MFI's interactions and relationships internal and external stakeholders. Outreach to the community is synonymous with "corporate social responsibility."

Customer value is determined by scope, cost, and worth of outreach. Social value is determined by breadth, depth, length, and community outreach. Net social benefit is determined by the interaction of each of the seven dimensions of outreach. No single dimension or combination of dimensions can be considered in isolation from the others.

OUTREACH INDICATORS USED IN SCORECARD

A necessary condition of feasibility and scalability is that the scorecard does not require the MFI to collect additional information from clients. Any approach that requires additional data collection from clients was judged to have limited potential for scale. Also important to feasibility and scalability is that scorecard indicators already reside in or can easily be generated by the MFI's management information system.

The scorecard uses output and process indicators to measure social performance. Outputs are the direct and measurable products of MFI activity. Internal processes refer to operational processes within the MFI that transform inputs into outputs. Outcome indicators at the client or household level were not included in the scorecard because they require additional data gathering from clients, thereby violating the feasibility and scalability criteria.

The scorecard uses a number of traditional financial performance indicators as proxies for social performance. Within the outreach framework, financial indicators provide valuable information on social performance. For example, sustainable MFIs generate more social benefit over time than non-sustainable MFIs, all else equal, and institutional sustainability is measured using financial performance indicators. To take another example, financial indicators suggestive of customer satisfaction or customer loyalty are an effective way to measure worth of outreach.

Sole reliance on financial indicators, however, can produce an incomplete and possibly warped perspective of social performance, and it creates the risk of mission drift by displacing social values with financial values. Thus financial indicators should be combined with social performance indicators to give a more complete perspective of social performance.

PRESENTATION OF THE SOCIAL PERFORMANCE SCORECARD

The social performance scorecard has 40 indicators, including five indicators in each of six dimensions and ten indicators in outreach to the community. The indicators for breadth, depth, length, scope, cost, and worth are each scored on a scale of 0-2 points. Indicators for outreach to the community are scored either on a 0-1 scale or a 0-2 scale. Each dimension of outreach has a possible 10 points for a possible total of 70 points. The indicators falling under each dimension of outreach are as follows:

Breadth of Outreach

- Number of borrowers.
- Clients with non-enterprise loans as a percentage of borrowers.
- Voluntary savers as a percentage of borrowers.
- Clients with other financial services as a percentage of borrowers.
- Clients with non-financial services as a percentage of borrowers.

Depth of Outreach

- Average loan size as a percentage of GNI per capita for new loan clients.
- Percentage of loans less than (a) $300 in Asia, Africa, and the Middle East; (b) $400 in Latin America and the Caribbean; and (c) $1,000 in Europe and Central Asia.
- Percentage of female clients.
- Percentage of rural clients.
- Percentage of enterprise loan clients selected with direct poverty targeting tools.

Length of Outreach

- Profit margin.

- Return on equity.
- Return on assets.
- Portfolio at risk < 30 days.
- Operating expense relative to average loan portfolio.

Scope of Outreach

- Number of distinct enterprise loan products.
- Number of distinct other loan products.
- Number of other financial services.
- Type of savings offered.
- Percentage of clients with three or more products or services.

Cost of Outreach

- Real yield on average gross loan portfolio.
- Nominal yield on average gross portfolio relative to prime commercial lending rate in home country.
- Weighted average number of days to approve and disburse loans after completion of loan application.
- Percentage of loan clients providing non-traditional collateral.
- Percentage of enterprise loan clients whom loan officers visit for regular financial transactions.

Worth of Outreach

- Loan loss rate.
- Client retention rate.
- Share of two-year clients still with the program.
- Share of portfolio growth attributable to existing clients.
- Type of market research conducted.

Outreach to the Community

- Percentage of operating revenues reinvested back into the community.

- Percentage of employees that have left the firm not including pension leaves and deaths.

- Female-male employee ratio among professional-level staff.

- Percentage of employees receiving at least two days of training.

- If the MFI has a written, formal internal CSR policy.

- If the MFI has a written, formal code of conduct governing actions towards employees and clients.

- If the MFI provides clients formal access to management.

- If the MFI provides health insurance for full-time employees.

- If the MFI provides credit life insurance for borrowers.

- If the MFI discloses the effective interest rate on all loans.

THE SOCIAL AUDIT

SOCIAL AUDIT FRAMEWORK

The social audit provides an independent, external assessment of (1) the MFI's self-reported social performance information and (2) the quality of the MFI's internal processes, including their consistency with the MFI's social mission and their effectiveness at aligning performance with social mission. The social audit uses two general methodologies. One is a thorough review of internal and external documentation relevant to the organization's social mission. The second is a series of probing discussions with management, staff, board members, and clients, which may be individual interviews or group interviews (e.g., focus group discussions).

At the conclusion of the audit, the audit team issues a report that summarizes the audit findings. The report includes a completed social performance scorecard and a social performance rating based on (1) the MFIs social performance, as measured by the scorecard, and (2) the quality of the MFIs internal processes. The social performance rating uses a standard scale that rates the likelihood that the MFI produces significant social impact both now and in the future.

INTERNAL PROCESSES

Standardizing the social audit is necessary to facilitate comparisons across MFIs and contexts. This includes standardization of both the social rating scale and the internal processes to be audited. Five internal processes in particular appear to offer good potential for standardization. Each is common to all MFIs and contributes in a significant manner to social performance. They include (1) mission statement and communication and management leadership, (2) hiring and training, (3) incentive systems, (4) monitoring systems, and (5) strategic planning.

The mission statement is an explicit expression of the MFI's purposes and values. Organizations with a clear mission statement tend to be more effective in social mission fulfilment. The MFI's social mission needs to be communicated clearly and consistently reinforced down the hierarchical chain. This is the responsibility of management. Active, committed, and consistent management leadership is necessary to transform social mission from mere words into institutional action.

Hiring, promotion, and training offer the MFI excellent opportunities to communicate and reinforce social mission. Hiring and training are also an integral part of the socialization process necessary to create an organizational culture supportive of social mission fulfilment.

Hiring and promotion afford the MFI the opportunity to screen for candidates who possess the personal outlook and values consistent with the MFI's social mission and who are committed to social mission fulfilment.

Incentive systems do as much as anything to influence attitudes, values, and behavior within the MFI. An incentive system that rewards management and staff for behaviors consistent with social mission will prove powerful in promoting social mission.

In contrast, an incentive system that ignores social mission considerations is much less likely to produce behaviors and outcomes consistent with social mission. It may even produce behaviors and outcomes contrary to social mission.

Performance monitoring is necessary to align the MFI's activities with its social mission. Performance monitoring entails the routine collection of performance information. It a management tool that is used to inform management decision making and planning for the purpose of comparing organization performance to organizational goals and mission.

Strategic planning determines the objectives, activities, and values at the MFI. It involves establishing organizational priorities, setting performance goals, establishing action plans, and devising criteria to assess fulfilment of performance goals. The inclusion of social considerations into strategic planning signals the relative importance an MFI attaches to social mission.

SOCIAL AUDIT PROCESS

The social audit can be divided into three distinct phases: preparation phase, audit phase, and report phase. The preparation phase is the period prior to the social audit during which time the social audit team works with the relevant MFI to learn about the MFI, prepare a work plan, and arrange logistics for the audit. The social audit team should ideally consist of two members. Each member of the audit team should be capable of conducting independent research. The preparation phase includes the following tasks:

- Review all internal and external documents related to the MFI's social performance.

- Send a copy of the social performance scorecard for completion by the MFI prior to the audit.

- Create the audit work plan and submit it to the subject MFI for comment.

- Arrange the logistics of the work plan with the subject MFI.

The audit phase is the implementation of the social audit. The social audit consists principally of in-depth individual or group interviews with management, board members, staff, and clients. The interviews should focus on questions related to assessing the quality of the five critical internal processes. The audit team also reviews the social performance scorecard with management to verify the reliability of the responses.

At the conclusion of the audit, the audit team drafts a summary of its principal findings and presents it to senior management and Board members. Based on this meeting, the audit team will make necessary corrections and note areas of dispute. The outcome of this meeting will form the basis for the final report.

The final report will be completed within a month of the audit and sent to the MFI's management for review. Aside from pointing out factual errors, which the auditors are obligated to correct, the MFI can make additional comments or suggestions, although the auditors have no obligation to accept either.

The final report will include at least six sections: (1) executive summary, (2) in-depth narrative summary of the MFI's performance in each of the seven dimensions of outreach, (3) statement expressing the auditors' confidence in the validity of the information reported in the social performance scorecard, (4) in-depth narrative summary of the MFI's performance in each of the five critical internal processes, (5) completed social performance scorecard, and (6) copy of the social performance rating system showing the MFI's score along with all possible rating categories and corresponding definitions. The estimate LOE to complete the social audit ranges from 13-17 days.

PROJECTED MARKETS FOR SOCIAL AUDIT

Two primary markets are envisioned for the social audit: the market for social audits integrated with financial rating and the market for stand-alone social audits. Field-tests of the social audit tool are currently planned in conjunction with one or more of the financial rating agencies so as to determine how the social audit can be integrated at minimal incremental cost into the financial rating exercise.

The social audit will be offered to meet the demand (heretofore latent) demand for a simple, low-cost social performance measurement tool among MFIs, MFI networks, investors, and donor agencies. It is anticipated that the audit process will be adapted to meet the needs of the specific market/consumer. An important part of this approach will be to establish standard, or "best," social audit practices and to adapt the specific audit process on a case-by-case basis consistent with established best practice.

This process requires that training standards be established and enforced, along with adherence to best practice principles. One way to accomplish this is to create an accreditation process. Accreditation will not only help ensure the quality of the social audit process, but it will also serve as an important signaling device that will reduce the information asymmetries between consumers and providers of social auditing services.

SOCIAL PERFORMANCE RATING SCALE

At the conclusion of the social audit, the social auditors issue a report that includes a standardized social performance rating. The social rating is based on the MFI's outreach and the quality of its internal processes, defined as the extent to which internal processes serve to align behavior and outcomes to social mission. The social rating is the auditor's best, informed estimate of the likelihood that the MFI produces significant social impact both now and in the future.

The social performance rating includes ten rating categories ranging from AAA to D, as seen in the table below. The advantage of social performance rating is that it provides a standardized format for comparing social performance across MFIs and contexts. The social rating system employs simple proxies measuring the MFI's outreach and the quality of its internal processes. This process entails tradeoffs, but given the overarching objectives of feasibility and scalability, the tradeoffs are deemed worth it.

TABLE 1: SOCIAL PERFORMANCE SCORECARD

RATING SCORE	DEFINITION
AAA	Excellent internal processes aligning performance with social mission. Excellent outreach. Extremely likely to create significant social impact now and in the future.
AA	Very strong internal processes aligning performance with social mission. Very good outreach. Very likely to create significant social impact now and the future.
A	Strong internal processes aligning performance with social mission. Very good outreach. More likely to create significant social impact now and in the future.
BBB	Adequate internal processes aligning performance with social mission. Good outreach. Likely to create significant social impact now and in the future.
BB	Weak internal processes aligning performance with social mission. Good outreach. Likely to create significant social impact with threat to long-term social impact.
B	Weak internal processes aligning performance with social mission. Adequate outreach. Less likely to create significant social impact now and in the future.
CCC	Weak internal processes aligning performance with social mission. Weak outreach. Less likely to create significant social impact with threat to long-term social impact.
CC	Poor internal processes aligning performance with social mission. Adequate outreach. Less likely to create significant social impact with serious threat to long-term social impact.
C	Poor internal processes aligning performance with social mission. Weak outreach. Unlikely to create significant social impact both now and in the future.
D	Poor internal processes aligning performance with social mission. Poor outreach. Very unlikely to create significant social impact both now and in the future.

The rating score can be adjusted with a + or – sign indicating a positive or negative variation with respect to the score

CONCLUSION

The SPM tool proposed here recognizes the value of traditional impact assessments and monitoring household-level outcome indicators. These should be pursued wherever possible. However, there is also tremendous value to a simple, complementary approach that offers potential for scale and standardization. The proposed SPM tool was designed specifically for this purpose.

It is acknowledged that the proposed SPM tool is not a final product. It is fully expected that the tool will continue to evolve through experimentation and use. Yet, it is necessary to begin the process someplace. It is hoped that the proposed tool offers a productive beginning for this process.

INTRODUCTION

Microfinance stands out among development strategies for its potential to achieve financial sustainability and massive scale. Microfinance, moreover, offers a number of highly plausible links between the provision of financial services and a variety of socially desirable outcomes. These factors help account for the considerable world-wide attention microfinance has garnered over the last two decades, in addition to the large sums of public and private investment that have flowed into the industry over the same period.

The development of the microfinance industry has effectively settled the question as to whether the poor need, use, or benefit from financial services. Financial services are an important part of poor households' livelihood and coping strategies. A large body of empirical evidence also confirms that participation in microfinance programs yields significant benefits at the individual, household, and enterprise levels (although specific benefits vary by context). Although skeptics still exist, a general consensus appears to be forming that microfinance is an essential and permanent part of the development landscape.

As a result, debate among industry stakeholders is beginning to turn from questions of relevance to questions of return on investment; in other words, how to maximize the blended (financial and social) returns from investing in microfinance. The microfinance industry has made significant progress developing and disseminating methods and indicators to measure financial return. Years of emphasis on "best practice" have made concepts such as financial sustainability, return on assets, return on equity, portfolio-at-risk, or administrative efficiency part of the lingua franca of the industry. Meanwhile, industry stakeholders have coalesced around the need for microfinance institutions (MFIs) to provide a transparent accounting of their financial performance.

Industry progress in promoting financial transparency and measuring financial return stands in stark contrast to its lack of progress in promoting social transparency and measuring social return. Given the industry's social roots and ongoing commitment to social impact, this result might appear surprising. On further inspection, however, the result is less surprising. It reflects the inherent difficulties of measuring social performance, a difficulty microfinance shares with many other development strategies.

The difficulties measuring social performance in microfinance stem primarily from three factors: 1) the methodological difficulties that are inherent in any attempt to measure social phenomena; 2) the cost and other resource demands imposed by measurement methodologies; and 3) the large number and variety of social objectives sought by MFIs. In contrast, for-profit organizations share the common objective of making money, which is measured using well-known and widely-used processes and standards. In light these factors, it is of little surprise that measurement of social performance lags so far behind that of financial performance.

Given the inherent difficulties in measuring social performance, there is significant value to a tool that allows microfinance stakeholders to measure social performance in a credible yet reasonable (e.g., low cost) manner. This report proposes such a tool. The Social Performance Measurement (SPM) tool proposed in this report includes two components: a Social Performance Scorecard based on Mark Schreiner's Six Aspects of Outreach and a Social Audit component.[1]

The Social Performance Scorecard assesses social performance using a set of simple indicators falling under one of seven dimensions of outreach.[2] It assigns to MFIs a social performance score in each of the seven dimensions as well as an overall score.

The Social Audit component entails a series of in-depth discussions with MFI management, staff, board members, and clients. It serves two purposes: 1) to validate the information reported in the Social Performance Scorecard, and 2) to assess the MFI's internal processes and the extent to which they align the MFI's performance with its social mission.

The SPM tool assigns the MFI an overall social rating (similar to a financial rating) based on the results of the scorecard and the social audit. The social rating uses a standardized scale to rate the likelihood that the MFI produces significant social impact both now and in the future. The standardized rating scale can be used to compare social performance across MFIs and contexts.

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[1] For an in-depth description of the conceptual framework for the proposed SPM tool, see Gary Woller, (2004), "Proposal for a Social Accounting Framework in Microfinance: The Six Aspects of Outreach," AMAP-Financial Services Knowledge Generation, USAID, Washington, D.C., (http://www.microlinks.org/ev_en.php?ID=8574_201&ID2=DO_TOPIC).

[2] The seven dimensions of outreach include the six dimensions proposed by Schreiner (breadth, depth, length, scope, cost, and worth) plus a seventh dimension added for the purpose of this project (outreach to the community). The seven dimensions of outreach are described at length later in this document.

The remainder of this report describes the SPM tool, the conceptual basis underlying it, and how it works. Section 2 draws on lessons learned from other SPM initiatives to argue that social performance measurement is a core business function. Sections 3-6 of the report next describe the social performance scorecard. Section 3 presents the Six Aspects framework that forms the basis for the Social Performance Scorecard. It describes the origins and rationale for the Six Aspects framework. Section 4 describes the broad structure of the scorecard, including criteria for scorecard development, the types of indicators used in the scorecard, and a rationale for using financial indictors to measure social performance. Section 5 presents the indicators within each dimension of outreach and a short rationale for selecting each indicator. Section 6 presents the Social Performance Scorecard and demonstrates how it works using two hypothetical MFIs.

Sections 7-10 of the report present the social audit tool. Section 7 describes the basis for the social audit tool and how it operates. Section 8 describes operational details of the social audit and the criteria used to select the internal processes that are the focus of the social audit. Section 9 presents the social performance rating system. Finally, Section 10 presents a set of guidelines an estimated level of effort for conducting a social audit.

The report also includes two Annexes. Annex 1 presents a more detailed description of the criteria and considerations that influenced the selection and weighting of the indicators falling under the seven dimensions of outreach that form the Social Performance Scorecard. Annex 2 presents an example of what a social audit might look like. Included in Annex 2 is social audit report for a hypothetical MFI called Banco de Microcrédito.

SOCIAL PERFORMANCE MEASUREMENT AS A CORE BUSINESS FUNCTION

Fortunately, we do not need to develop an SPM tool from scratch. Microfinance is neither the only nor the first sector to worry about social performance or to attempt to measure it. A wealth of experience and numerous lessons can be gleaned from previous and ongoing initiatives in social performance measurement. Ironically, perhaps, much of the experience comes from the private sector, although the microfinance sector has important experience and lessons to offer as well.[3]

Perhaps the primary lesson coming from this experience is that measuring performance is a necessary condition for managing performance. This is true regardless of the performance objectives (see Box 1).[4] The ability to manage an organization toward specific ends, whether financial or social, requires some system of measurement to determine progress toward the desired ends. An important conclusion implied by this lesson is that performance measurement is a core

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[3] For more on various SPM initiatives, see Woller, 2004.

[4] Baldrige National Quality Program. (2004). *Criteria for Performance Excellence*, p. 9 (http://www.quality.nist.gov/Education_Criteria.htm).

business activity. Where the organization has a distinct social mission, it follows that social performance measurement is likewise a core business activity. Fulfilling an organization's social mission requires more deliberate strategies and more systematic ways of measuring and managing social performance.

BOX 1. THE BALDRIGE CRITERIA ON THE IMPORTANCE OF PERFORMANCE MEASUREMENT

Modern businesses depend upon measurement and analysis of performance. . . . A major consideration in performance improvement involves the creation and use of performance measures or indicators. . . . A comprehensive set of measures or indicators tied to customer and/or company performance requirements represents a clear basis for aligning all activities with company goals.

Another key point emphasized in these other initiatives is that organizations that claim social impact and who solicit funding and investment based on these claims have an ethical responsibility to account for their social performance in a reasonably transparent manner. In the case of microfinance, the same fiduciary/ethical principles requiring MFIs to account for their financial performance can be invoked to argue that MFIs should also provide a transparent accounting of their social performance.

Transparency about social performance in turn helps attract and diversify investment flows into microfinance. In the absence of widely accepted social performance measures, social investors often base funding decisions on financial performance alone. The result is private investment in microfinance tend to flow to a small number of high-profile MFIs with superior financial performance. In contrast, measuring social performance allows MFIs to demonstrate social value-added, arguably leading donors and investors to reallocate a portion of funding toward socially-oriented MFIs offering higher or competitive blended returns.[5]

The transparent measurement of social performance is also a necessary condition for social performance benchmarking. Social performance benchmarking permits industry stakeholders to compare social performance across institutions and contexts. Performance benchmarking in turn permits the establishment of social performance standards.

Yet one more key lesson learned from collective experience in social performance measurement is that social performance measurement is fully consistent with "best" business practice. Since 1995 hundreds of corporations have published an estimated 3,000 social performance reports, and since 2002 nearly one-half of the 250 largest global companies have produced corporate social responsibility reports in one form or another.[6]

A primary factor motivating social performance measurement in the private sector has been the dissatisfaction with the profit-centric values and practices of private business, including a recognition that financial

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[5] Blended returns refer to a combination of financial and social returns. It is possible that an MFI offering high blended returns is a preferable investment option to another MFI, even though the first MFI actually earns a lower financial return than the second MFI.

[6] Global Reporting Initiative. (2003). *Business Plan 2003-2005.* p. 5 (http://www.globalreporting.org/about/businessplan.asp).

performance measurement alone is not enough, that social performance matters, and that a system of accounting for social performance is necessary to integrate social concerns into strategic planning and action and to address the legitimate concerns of stakeholder groups.

In the end, measuring social performance is necessary to align policies and behavior to social mission. To the extent social performance measurement is integrated into an MFI's operations, it will create forces that serve to align performance with social mission. The process of defining, communicating, and measuring the MFI's social mission grants it legitimacy, embeds it into organizational activities, and keeps it in the forefront of staff's mind. Evaluating the organizational and staff performance using social criteria probably does more than anything else to transform social mission from an abstract principle into a concrete reality.

SIX ASPECTS OF OUTREACH

THE SIX DIMENSIONS OF OUTREACH

The Social Performance Scorecard is based on Mark Schreiner's Six Aspects of Outreach.[7] The Six Aspects of Outreach grew out of Schreiner's attempt to place the poverty outreach vs. sustainability debate within a scaled-down cost-benefit framework. The Six Aspects framework proposes that poverty outreach and sustainability are but two of six dimensions of "outreach," and that the relationship between the two can only be understood by considering their relationship with all other dimensions of outreach. The six dimensions of outreach include: breadth, depth, length, scope, cost, and worth. A brief description of each dimension follows.

- Breadth of outreach is equal to the size, or scale, of the microfinance institution.

- Depth of outreach is the value that society attaches to the net gain of a given client. All else equal, a unit of net gain for a poor person has greater social value than a unit of net gain for a less poor person.

- Length of outreach is the sustainability of the supply of microfinancial services. Length matters because society cares about supply both now and in the future.

- Scope of outreach is the number of distinct types of products and services offered. Greater scope implies greater probability of satisfying clients' needs and wants.

- Cost of outreach is equal to the sum of price costs and transaction costs. Transaction costs include non-cash

[7] Schreiner, Mark. (2002). "Aspects of Outreach: A Framework for Discussion of the Social Benefits of Microfinance." *Journal of International Development*, 14(5), 91-603.

opportunity costs (e.g., disbursal lag times, collateral) and indirect cash costs (e.g., transportation, documents).

- Worth of outreach is the value of products and services consumed and the client's willingness to pay. Value and willingness to pay are a function of the benefits derived from consumption.

According to the Six Aspects framework, net social benefit consists of customer value and social value. Customer value is the private value customers derive from consumption exceeding the private costs of consumption. Customer value is determined by scope, cost, and worth of outreach. Social value is the value society derives from the consumption of microfinancial services exceeding the private customer value. Social value is determined by the breadth, depth, and length of outreach.

Net social benefit is determined by the interaction of each of the six dimensions of outreach. No single dimension or combination of dimensions can be considered in isolation from the others.

OUTREACH TO THE COMMUNITY

To the six dimensions of outreach in Schreiner's framework, a seventh dimension is added to the Social Performance Scorecard: outreach to the community. Outreach to the community refers to the MFI's interactions and relationships with its various stakeholders, both internal and external. Although outreach to the community is not part of the original Six Aspects framework, it is nonetheless an important component of outreach that measures whether and the extent to which the MFI is contributing to the well-being of society at large.

Outreach to the community is more or less synonymous with "corporate social responsibility." Corporate social responsibility (CSR) refers generally to an organization's obligation to be accountable to all of its stakeholders in all its operations and activities with the aim of achieving sustainable development in the social and environmental dimensions, as well as financial.

A large number of organizations (including several Fortune 500 companies) have implemented internal CSR policies and have begun to report CSR performance to stakeholders. Interest in CSR is growing among microfinance stakeholders as well. It is presumed that certain stakeholders will find CSR information of value, not only of itself, but also because it helps give a more complete portrait of social performance.

USING A SCORECARD TO MEASURE SOCIAL PERFORMANCE

The objective of this project is to develop a useful tool to assess an MFI's social performance. A key underlying premise is that the outreach indicators are useful to the extent they yield information on different dimensions of social performance and are combined in a useful way.

The approach used here is to combine the indicators into a Social Performance Scorecard. The scorecard groups indicators under their relevant dimensions, assigns a point scale to each indicator and a point total to each dimension. The point totals across indicators and dimensions are then summed to arrive at an overall social performance score.

SCORECARD DEVELOPMENT CRITERIA

The development the Social Performance Scorecard was driven by a number of criteria and considerations. These are described in detail in Annex 1. Two of the selection criteria, however, particularly drove the development process: feasibility and scalability. Feasibility criterion means that scorecard should be reasonably easy to implement without imposing a significant burden on the MFI's human, physical, or financial resources.

Scalability refers to the likelihood that the scorecard is adopted by a large number and wide variety of MFIs. A condition of feasibility and scalability is that the scorecard does not require the MFI to collect additional information from clients. Any approach that requires additional data collection from clients was judged to have limited potential for scale.

OUTPUT AND INTERNAL PROCESS INDICATORS

The Social Performance Scorecard relies on output and process indicators to measure social performance. Outputs are the direct and measurable products of MFI activity, such as number of clients, portfolio size, client retention, or persons trained. Internal processes refer to operational processes within the MFI that transform inputs into outputs. Internal processes related to social performance include, targeting tools, market research methods, or loan disbursal.

Alternatives to output and process indicators are outcome and input indictors. Outcome indicators measure client outcomes at the individual, household, or enterprise levels. They are the indicators typically used to measure social performance. They include, for example, household income and expenditures, household asset ownership, enterprise profits, school attendance, housing conditions, access to utilities, access to health care, participation in the community, or intra-household decision-making. Inputs consist of the resources used to run the MFI, including money, people, time, physical facilities, and equipment.

Outcome indicators were not included in the Social Performance Scorecard, because they require additional data gathering from clients, thereby violating the selection criteria of feasibility and scalability. Inputs, on the other hand, are generally not regarded as a suitable proxy for social impacts, since the connection between inputs and social impacts is quite often very tenuous.

The connection between outputs and internal processes and social impacts can also be tenuous at times. Nonetheless, their link with social impacts is generally stronger. They have the virtue, moreover, of being relatively easy to measure and inexpensive to collect, often already residing in the MFI's management information system. Given the impracticality of outcome indictors for scorecard construction, they offer a reasonable second-best solution.

FINANCIAL INDICATORS AS PROXIES FOR SOCIAL PERFORMANCE

Implied by the Six Aspects framework is that information on social performance can be inferred from financial performance indicators. Net social benefit depends, for example, on breadth of outreach, which is measured by the number of persons reached, or institutional scale. Net social benefit is also higher the longer the timeframe of supply. Length of outreach implies financial sustainability, and financial sustainability is best measured using a variety of financial performance indicators. Greater customer value, or greater worth of outreach, likewise produces greater net social impact. Financial indicators suggestive of customer satisfaction or customer loyalty are a particularly effective way to capture worth of outreach.

Nonetheless, care should be exercised when using financial indicators to measure social performance. While financial information can yield useful information on social performance, sole reliance on financial indicators can also yield an incomplete and possibly warped perspective of social performance. Focus on financial indicators alone, moreover, risks creating an organizational culture in which financial objectives displace (or in extreme cases eliminate) social objectives among the MFI's hierarchy of values, creating in turn the risk of mission drift. A better approach is to combine a reasonable mixture of financial performance indicators with other social performance indicators so as to give a more complete perspective of social performance. This is the approach adopted here.

DESCRIPTION OF SCORECARD INDICATORS

This section presents a brief description of the outreach indicators selected. It is important to note that there is likely to be some cross-over among the indicators, meaning that some indicators might arguably belong to more than one dimension. In all cases, the decision to plane an indicator in a particular dimension was determined by where it appeared to the fit best given the structure of the scorecard.

BREADTH OF OUTREACH

Number of borrowers. This indicator measures the total number of borrowers at the MFI.

Clients with non-enterprise loans as a percentage of borrowers.[8] This indicator measures the extent to which the MFI extends outreach to meet the market demand for non-enterprise loans. None-enterprise loans include, for example, consumption-emergency loans, housing loans, education loans, medical loans, and so forth.

Voluntary savers as a percentage of borrowers. This indicator measures the extent to which the MFI extends outreach to meet the market demand for formal savings. MFIs can offer voluntary savings either directly as a deposit taker or indirectly by depositing client savings in local financial institutions.

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[8] Breadth of outreach in terms of non-enterprise loans, savings, and non-financial services is measured in relation to the total number of borrowers because of the difficulty establishing performance benchmarks for these indicators across MFI peer groups. Comparing them to the number of borrowers at the MFI is a method of normalizing the indicators and thereby permitting direct comparisons. In earlier forms of the scorecard, the scoring system was based on comparison to the relevant peer group as determined by The MIX. The current approach was adopted because it was deemed preferable to allow the user to determine the appropriate peer groups for comparison.

Clients with other financial services as a percentage of borrowers. This indicator measures the extent to which the MFI extends outreach to meet the market demand for diversified financial services. Other financial services include insurance (either directly or via linkages with formal insurance providers), housing loans, leasing, remittances, and money transfers. (This indicator does not include credit-life insurance.)

Clients with non-financial services as a percentage of borrowers. This indicator measures the extent to which the MFI extends outreach to meet the market demand for non-financial services either directly or via linkages with other service providers. Examples include education, training, or other capacity development related to business operations, health knowledge and practice, or gender equality and empowerment.

DEPTH OF OUTREACH

Average loan size as a percentage of gross national income (GNI) per capita for new loan clients. Average loan size (ALS) is the most widely used industry proxy for depth of outreach. Poorer clients are generally less able to absorb larger loans than better-off clients. The ALS is adjusted by GNI per capita so as to account for different income levels in different countries.[9]

Average loan size, however, has a number of deficiencies as a depth of outreach indicator. One of its most important deficiencies is that it penalizes MFIs that retain their clients and move them into progressively larger loans. In this case, an increase in the ALS/GNI does not necessarily reflect a drift away from its poor clients. It is entirely feasible that the ALS/GNI ratio increases over time at an MFI that maintains on ongoing commitment to its poor customers.

Taking the ALS/GNI per capita for new clients only is a simple adjustment to the standard ratio that does not penalize the MFI for retaining and growing its loan clients. If the MFI is drifting away from its poor clients, this will be more clearly reflected by an upward trend its average loan size among new clients who have not yet had the opportunity to take out more and bigger loans.

Percentage of loans less than $300 in Asia, Africa, and the Middle East; $400 in Latin America and the Caribbean; and $1,000 in Europe and Central Asia. This indictor measures the percentage of "poverty loans" in the MFI's loan portfolio. The $300, $400, and $1,000 values are the current poverty loan thresholds established by the US Congress for the respective regions.

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[9] USAID has funded research by the IRIS Center to develop simple and practical poverty measurement tools using indicators of household socio-economic welfare. These poverty indicators require additional data collection from client households, however, and for this reason are not included in the social performance measurement tool developed here.

Percentage of female clients. This indictor measures the extent to which the MFI has extended outreach to female clients. Poverty is disproportionately concentrated among women.

Percentage of rural clients. This indicator measures the extent to which the MFI has reached out to rural clients. Poverty is disproportionately concentrated in rural areas.

Percentage of enterprise loan clients selected with direct poverty targeting tools. This indictor measures the extent to which the MFI uses direct poverty targeting tools to reach poor clients. Direct targeting implies the use of a specific tool to measure or estimate a client's poverty status and includes tools such as participatory wealth ranking, housing indices, poverty scorecards, or estimates of household income or expenditures. Anecdotal experience suggests that MFIs that employ direct targeting tools tend to be reach poor clients more effectively than otherwise.

LENGTH OF OUTREACH

Profit margin. This indicator is a measure of profitability. It measures the extent to which operating income exceeds the MFI's operating.[10]

Up to this point, financial self-sufficiency (FSS) and operational self-sufficiency (OSS) have served as two of the primary financial performance indicators in microfinance. The former measures the extent to which operating revenues cover both operating and financing costs (actual and imputed) adjusted for inflation and subsidies received, while the later measures the extent to which operating revenues cover operating expenses.

Current trends in the industry suggest that indicators used to measure financial performance of MFIs will eventually converge with those in the mainstream banking sector. In this case, FSS and OSS are expected to fall out of usage in the industry. Already, for example, the MIX no longer reports FSS on its website, having replaced it with the profit margin. In recognition of these trends, FSS and OSS are omitted from the scorecard in favor of indicators one might more commonly find in the mainstream banking sector.

Return on equity. This indicator measures the effectiveness with which the MFI leverages its equity base to produce income.[11] Return on equity (ROE) is one of the most common indicators in the mainstream banking sector used by institutions and investors to measure financial performance.

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[10] The MBB defines profit margin as follows: Adjusted Net Operating Income / Adjusted Financial Revenue.

[11] The MBB defines ROE as follows: Adjusted Net Operating Income, Net of Taxes / Adjusted Average Total Equity.

Return on assets. This indicator measures the effectiveness with which the MFI utilizes its assets to produce income.[12] Return on assets (ROA) is one of the most common indicators in the mainstream banking sector used by institutions and investors to measure financial performance.

Portfolio at risk > 30 days. This indicator measures the risk to the loan portfolio in terms of loans past 30 days overdue.[13] The portfolio at risk (PAR > 30) is a leading indicator of portfolio quality and is thus generally considered a proxy for financial viability.

Operating expenses relative to average loan portfolio. This indicator measures the operational efficiency with which the MFI produces its loan portfolio.[14] A lower operating expense ratio is generally presumed to be a proxy for financial viability.

SCOPE OF OUTREACH

Number of distinct enterprise loan products. This indicator measures the scope of enterprise loan products offered by the MFI. A distinct product is one that is designed for a specific purpose to be marketed to a specific market segment. It does not include an existing product that is marketed unchanged or in a slightly altered form for a different use or to a different group of users.

Number of distinct other loan products. This indicator measures the number of non-enterprise loan products offered by the MFI.

Number of other financial services. This indicator measures the number of other financial services offered by the MFI not including loans and savings but including insurance (direct or via linkages), leasing, or money transfers.

Type of savings offered. This indicator measures the types of savings products the MFI offers to meet the market demand for formal savings. Voluntary savings with liberal access rules are preferred to compulsory savings with restricted access rules.

Percentage of clients with three or more products or services. This indicator measures the extent to which clients consume a diversified set of products and services from the MFI. This indicator includes both financial and non-financial products and services.

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[12] The MBB defines ROA as follows: Adjusted Net Operating Income, Net of Taxes / Adjusted Average Total Assets.

[13] The MBB defines PAR as follows: Outstanding Balance, Loan Overdue > 30 Days / Adjusted Gross Loan Portfolio.

[14] The MBB define the operating expense ratio as follows: Adjusted Operating Expense / Adjusted Average Gross Loan Portfolio.

COST OF OUTREACH

Real yield on average gross loan portfolio. This indicator is intended as a proxy for the average effective interest rate (interest plus fees) charged on loans.[15] Using the real portfolio yield adjusts the effective interest rate for the inflation rate in the relevant country, thereby making comparisons of effective yields more representative.[16]

Nominal yield on average gross loan portfolio relative to the lending rate in the country. This indicator measures the size of the average effective interest rate relative to the bank lending rate in the country. The bank lending rate is the rate reported by the MIX and is defined as "the bank rate that usually meets the short and medium term financing needs of the private sector. This rate is normally differentiated according to creditworthiness of borrowers and objectives of financing."

Weighted average number of days to approve and disburse enterprise loans after completion of loan application. This indicator is a proxy for the client's opportunity cost of time. The indicator is the weighted average of all enterprise loans, including initial and follow-on loans.

Percentage of enterprise loan clients whom loan officers visit for regular financial transactions. This indicator measures the extent to which the MFI reduces the client's transaction costs by reducing his/her travel and time costs to conduct financial transactions. The costs of travel to conduct financial transactions can be a significant component of clients' overall borrowing costs, particularly in areas with underdeveloped transportation infrastructures.

Percentage of loan clients providing non-traditional collateral. This indicator measures the extent to which the MFI enacts policies to reduce the opportunity costs imposed by collateral requirements. Non-traditional forms of collateral include social/group guarantees, third-person guarantees, movable property with significant personal value albeit perhaps minimal market value, or repayment history for clients taking follow-on loans.

WORTH OF OUTREACH

Loan loss rate. This indicator is intended as a proxy for how much clients value access to loans from the MFI. To the extent that clients value enterprise loans, they will seek to ensure access to future loans by repaying existing loans.

Client retention rate. This indicator is intended as a proxy for how much clients value enterprise loans from the MFI. If clients take out follow-

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[15] Accounting for the cost of outreach is particularly important when the overall goal is poverty alleviation or socio-economic improvement. It serves, among other things, to monitor whether MFIs are achieving their financial or institutional objectives by imposing excessive borrowing costs on low-income clients.

[16] The MBB define this indicator as follows: (Adjusted Yield on Gross Portfolio – Inflation Rate) / (1 + Inflation Rate).

on loans, it can reasonably be inferred that they value the loans and vice versa.[17] Repeat business is also a generally accepted indicator of customer loyalty.

Share of two-year enterprise loan clients still with the MFI. This indicator measures customer loyalty. It accounts for the length of time a client has been with the MFI by showing the percentage of clients who are still borrowing from the MFI after two years. It is measured by the percentage clients who were in their first loan cycle two years ago who are still clients of the MFI at a given point in time.

Share of portfolio growth attributable to existing clients over the most recently completed fiscal year. This indicator measures the extent to which the MFI's portfolio growth is driven through retention of existing clients or through client "churning."[18] A preferable way to grow the loan portfolio is through the retention of existing clients, who are presumably taking out bigger loans over time. This outcome is not only indicative of greater value creation but also bodes well for long-term financial viability.[19]

Type of market research conducted. This indicator measures the likelihood that the MFI's market offerings satisfy clients' needs and wants. Market research can be either informal (e.g., anecdotal) or formal, ad hoc or systematic. Formal market research includes, for example, surveys/questionnaires, focus group discussions, formal interviews, and analysis of MIS data. Systematic market research means that it is conducted on a routine basis are part of normal operations.

OUTREACH TO THE COMMUNITY

Percentage of operating revenues reinvested back into the community during most recently completed fiscal year. This indicator measures the extent to which the MFI supports community projects or social activities.

Percentage of employees that have left the MFI during two most recently completed fiscal years. This indicator is intended as a proxy for how the MF treats its employees. Presumably, employees who are treated well (e.g., paid

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[17] This will not be true in every case (e.g., clients may not take a follow-on loan because their businesses fail or they move from the area), but it will be true on average.

[18] Client churning is a phenomenon in which an MFI maintains high rates of portfolio growth by adding new clients at faster rate than it loses them. Client churning allows MFIs with high client desertion rates to maintain high rates of portfolio growth. Client churning, however, indicates generally low value creation, and it threatens long-term financial viability.

[19] There are exceptions to this general rule. For example, younger MFIs that are growing their loan portfolio by rapidly adding new clients will tend to have a lower share of portfolio growth through retention of existing clients, even if portfolio growth is accompanied by relatively high rates of client retention. On balance, however, a higher rate of portfolio growth achieved through retention of existing clients is expected to be positively associated with worth of outreach.

fairly, offered career and advancement opportunities, and provided a supportive work environment) quit at a lower rate than the converse.

Female-male employee ratio among professional-level staff. This indicator is a measure of gender equality at the MFI. The indicator measures female participation at the professional (salaried) level, which has been the level traditionally closed to women. It does not include lower-level administrative support positions (e.g., secretaries, receptionists, phone operators, drivers, etc.), which has been the level traditionally open to women, or custodial positions, drivers, etc., which tend to be traditionally be male

Percentage of employees receiving at least two days of training during the most recently completed fiscal year. The indicator is a measure of the professional development opportunities offered employees at the MFI. Organizations presumably have an ethical responsibility to provide employees with opportunities for professional development, which in turn contributes to improving employees' work effectiveness, increasing their career options, and creating a more fulfilling work environment. Training is a particularly important and effective tool of professional development.

Whether the MFI has a formal CSR policy. This indicator measures whether the MFI has formalized its commitment to the principles and practices of corporate social responsibility. Creating a formal CSR policy is a clear statement of an MFI's commitment to CSR, and it increases the likelihood that CSR principles actually inform and motivate products, services, policies, and practices within the organization.

Whether the MFI has a formal code of conduct governing actions towards employees and clients. This indicator is a proxy for the level of professional and ethical conduct at the MFI. Formal codes of conduct cover issues such as gender relationships/sexual harassment, disclosure and transparency, dress and language, employee or client rights, or respect for cultural and cultural traditions. Adopting a formal code of conduct is a clear statement of the MFI's commitment to high standards of professional and ethical behavior.

Whether the MFI provides clients formal access to management. This indicator measures whether the MFI has in place formal policies and processes that give clients a voice in MFI operations. Formal access to management is important for clients to be able to voice concerns, grievances, satisfactions, dissatisfactions, etc. Implied by this indicators is that the MFI grants clients reasonable access without undue bureaucratic barriers, stonewalling, or management indifference.

Whether the MFI provides health insurance for full-time employees. This indicator is a measure of the MFI's commitment to the well-being of its employees. The indicator measures health insurance for full-time employees only. It is not yet standard practice to offer health benefits to part-time employees.

Whether the MFI offers credit-life insurance to its commercial borrowers. This indicator is a measure of consumer protection. Credit-life insurance protects clients' families from the potentially destabilizing burden of debt in the case of the client's death.

Whether the MFI discloses its effective interest rate. This indicator is a measure of transparency. MFIs presumably have an ethical obligation to disclose the full costs of borrowing so that clients can make informed decisions.

SOCIAL PERFORMANCE SCORECARD

SOCIAL PERFORMANCE SCORECARD - DEFINITION

The Social Performance Scorecard is shown in Table 2. The first column lists the dimensions and indicators, while the second column shows the scoring system associated with each indictor. Each dimension has a possible 10 points for a possible total of 70 points. The scorecard has a total of 40 indicators, including 5 indicators in each of six dimensions of outreach and 10 indicators in the outreach to the community dimension. Thirteen of the 40 indicators in the scorecard are taken from the MIX or can be calculated using information found at the MIX.[20]

A benefit to this scorecard approach is that it allows users to assess an MFI's performance at three levels of analysis: the individual indicator level, the dimension level, and the overall level. It is assumed that different users will emphasize different levels of performance as well as different dimensions and indicators. The scorecard gives users the flexibility to use alternative weighting schemes but to do it using a standardized format, so that the same user can compare the social performance of one MFI to that of others.[21]

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[20] www.themix.org

[21] It is expected that the indicators, dimensions, and scoring system will be adapted, modified, and standardized over time by users, as was the case for financial performance indicators.

TABLE 2: SOCIAL PERFORMANCE SCORECARD - DEFINITION

BREADTH OF OUTREACH

INDICATOR	POINT SCALE
Number of borrowers	0. < 20,000 1. 20,000-50,000 2. > 50,000
Clients with non-enterprise loans as a percentage of borrowers (consumption-emergency loans, housing loans, education loans, etc.)	0. < 10 % 1. 10%-30% 2. > 30%
Voluntary savers as a percentage of borrowers	0. < 50 % 1. 50%-75% 2. > 75%
Clients with other financial services as a percentage of borrowers (insurance direct, insurance via linkages, leasing, and money transfers; does not include credit-life insurance)	0. < 10 % 1. 10%-30% 2. > 30%
Clients with non-financial services as a percentage of borrowers (directly or via linkages)	0. < 10 % 1. 10%-30% 2. > 30%

DEPTH OF OUTREACH

INDICATOR	POINT SCALE
Average loan size as a percentage of GNI per capita for new loan clients	0. > 100% 1. 60%-100% 2. < 60%
Percentage of loans less than (a) $300 in Asia, Africa, and the Middle East; (b) $400 in Latin America and the Caribbean; and (c) $1,000 in Europe and Central Asia	0. < 20% 1. 20%-50% 2. > 50%
Percentage of female clients	0. < 20% 1. 20%-50% 2. > 50%
Percentage of rural clients	0. < 15% 1. 15%-30% 2. > 30%
Percentage of enterprise loan clients selected with direct poverty targeting tools	0. < 20% 1. 20%-50% 2. > 50%

TABLE 2: SOCIAL PERFORMANCE SCORECARD – DEFINITION (CONTINUED)

LENGTH OF OUTREACH

INDICATOR	POINT SCALE
Profit margin	0. < 0% 1. 0%-10% 2. > 10%
Return on equity	0. < 0% 1. 0%-10% 2. > 10%
Return on assets	0. < 1% 1. 1%-2% 2. > 2%
Portfolio at risk < 30 days	0. > 6% 1. 4%-6% 2. < 4%
Operating expense relative to average loan portfolio	0. > 30% 1. 20%-30% 2. < 20%

SCOPE OF OUTREACH

INDICATOR	POINT SCALE
Number of distinct enterprise loan products	0. 1 1. 2 2. > 2
Number of distinct other loan products (consumption-emergency loans, housing loans, education loans, etc.)	0. 0 1. 1-2 2. > 2
Number of other financial services (direct insurance, insurance via linkages, leasing, money transfers; does not include credit-life insurance)	0. 0 1. 1-2 2. > 2
Type of savings offered	0. No savings or compulsory savings 1. Voluntary savings with limited access 2. Voluntary savings with full access
Percentage of clients with three or more products or services (does not include compulsory savings or credit-life insurance)	0. <15% 1. 15%-30% 2. >30%

TABLE 2: SOCIAL PERFORMANCE SCORECARD – DEFINITION (CONTINUED)

COST OF OUTREACH

INDICATOR	POINT SCALE
Real yield on average gross loan portfolio	0. > 40% 1. 20%-40% 2. < 20%
Nominal yield on average gross portfolio relative to prime commercial lending rate in home country	0. > 300% 1. 200%-300% 2. < 200%
Weighted average number of days to approve and disburse loans after completion of loan application (enterprise loans only)	0. > 10 1. 5-10 2. < 5
Percentage of loan clients providing non-traditional collateral (e.g., solidarity guarantees, third-person guarantees, movable property)	0. < 20% 1. 20%-50% 2. > 50%
Percentage of enterprise loan clients whom loan officers visit for regular financial transactions	0. < 20% 1. 20%-50% 2. > 50%

WORTH OF OUTREACH

INDICATOR	POINT SCALE
Loan loss rate	0. > 4% 1. 2%-4% 2. < 2%
Client retention rate (enterprise loans only)	0. < 60%; does not track 1. 60%-80% 2. > 80%
Share of two-year clients still with the program (enterprise loans only)	0. < 30% 1. 30%-60% 2. > 60%
Share of portfolio growth attributable to existing clients over most recently completed fiscal year	0. < 30% 1. 30%-60% 2. > 60%
Type of market research conducted	0. No market research 1. Informal or ad hoc market research 2. Formal and systematic market research

TABLE 2: SOCIAL PERFORMANCE SCORECARD – DEFINITION (CONTINUED)

OUTREACH TO THE COMMUNITY

INDICATOR	POINT SCALE
Percentage of operating revenues reinvested back into the community during most recently completed fiscal year	0. < 2% 1. 2%-5% 2. > 5%
Percentage of employees that have left during two most recently completed fiscal years (not including pension leaves and deaths)	0. > 30% 1. 15%-30% 2. < 15%
Female-male employee ratio among professional-level staff	0. < 40% 1. > 40%
Percentage of employees receiving at least two days of training during most recently completed fiscal year (does not include new hire training)	0. < 50% 1. > 50%
Whether the MFI has a written, formal internal CSR policy	0. No 1. Yes
Whether the MFI has a written, formal code of conduct governing actions towards employees and clients	0. No 1. Yes
Whether the MFI provides clients formal access to management	0. No 1. Yes
Whether the MFI provides health insurance for full-time employees (in addition to national health coverage system)	0. No 1. Yes
Whether the MFI provides credit life insurance for borrowers	0. No 1. Yes
Whether the MFI discloses the effective interest rate on all loans	0. No 1. Yes

TOTAL OUTREACH	70 Points Possible

HYPOTHETICAL EXAMPLE OF THE SOCIAL PERFORMANCE SCORECARD

To demonstrate how the proposed Social Performance Scorecard works, consider the following example of two hypothetical MFIs.

MFI #1 is a credit-plus NGO that has reached a moderate number of clients with enterprise loans and non-formal adult education through a combination of village banking and solidarity lending. It operates in both urban and rural areas targeting principally very poor and poor female entrepreneurs.

All loan transactions are completed at neighborhood locations nearby program members. The loan disbursal process, however, is cumbersome and inefficient causing significant delays between loan approval and loan disbursal. The MFI also offers clients health insurance through linkages with a local health insurer. To help it reach its target market, the MFI uses a simple housing index to qualify all borrowers into program. It is a well-run, fast growing, and efficient organization with good credit discipline, a high repayment rate, a good ROA, and reasonably high operational self-sufficiency.

Due to the marginal areas where it works, MFI #1 has a high operating cost structure and a low average loan size, which have negatively affected its profit margin and ROE. To compensate for its high operating cost, it offers a single, highly standardized enterprise loan product and charges a high effective interest rate including a number of hidden fees. It is prohibited by law from mobilizing savings, although it does collect forced savings from its loan clients. MFI #1 suffers from a high client desertion rate. It conducts exit interviews on a sporadic basis so as to understand why clients leave the program.

MFI #2 is a commercial bank operating in urban neighborhoods of large cities and has achieved significant scale in both lending and savings. The MFI collects information on household income and expenditures as part of its normal loan application. It uses this information to help it target its basic working capital loan to smaller and lower income enterprises.

MFI #2 offers only individual loans, requires traditional forms of collateral, tends to cater to larger, more established business, and has relatively few female clients. Clients taking out smaller working capital loans conduct loan transactions with loan officers at branch offices, while loan officers make frequent visits to larger loan customers, particularly those taking out loans for fixed capital investments. The MFI offers a variety of enterprise loans, including working capital and fixed asset loans. It recently introduced a consumer loan product. It has streamlined its loan approval process in recent years and offers a quick turnaround time by industry standards. Intense competition in the microfinance sector has forced the MFI to charge a competitive interest rate for loans and to be transparent about loan costs.

MFI #2 is a well-run, efficient organization with good credit discipline and high repayment rates, and it has managed to achieve a relatively high profit margin along with an ROE this is high by industry standards, although achieving only a moderately high ROA. The MFI suffers from moderate client desertion, although not high enough yet to cause management to worry. It carries out routine client satisfaction surveys and regularly mines its MIS for information on client and market trends.

Neither MFI #1 nor MFI #2 has adopted a formal CSR policy, although each has codified a code of conduct for employees. Each MFI makes token contributions to the local community, principally in the cities where the headquarters are located. MFI #1 has struggled with high staff turnover recently due to low pay, long work hours, the lack of employee benefits, and little opportunity for professional development or advancement. It has, however, made a conscious effort to hire women and members of the local indigenous population. In contrast, MFI #2 enjoys generally good relationship with employees, as reflected in a relatively low staff turnover rate, good benefits, and opportunities for professional development. Its record of hiring women and minorities is less admirable.

Because empowerment of its target market is a primary institutional goal of MFI #1, it has created formal channels for clients to participate in the organization and to voice their concerns. It also provides compulsory credit life insurance for all loan clients. MFI #2 does not provide clients any formal access to management, aside from a suggestion box placed in all branch offices. It does not offer credit life insurance.

The scores of the MFI #1 and MFI #2 on the different dimensions of outreach are shown in Table 3.

TABLE 3: SOCIAL PERFORMANCE SCORECARD - HYPOTHETICAL		
BREADTH OF OUTREACH		
INDICATOR	**MFI #1**	**MFI #2**
Number of borrowers	1	2
Clients with non-enterprise loans as a percentage of borrowers (consumption-emergency loans, housing loans, education loans, etc.)	0	1
Voluntary savers as a percentage of borrowers	0	2
Clients with other financial services as a percentage of borrowers (insurance direct, insurance via linkages, leasing, and money transfers; does not include credit-life insurance)	2	1
Clients with non-financial services as a percentage of borrowers (directly or via linkages)	2	1
Total Breadth of Outreach	5	7

DEPTH OF OUTREACH		
INDICATOR	**MFI #1**	**MFI #2**
Average loan size as a percentage of GNI per capita for new loan clients	2	1
Percentage of loans less than (a) $400 in Latin America and the Caribbean; (b) $300 in Asia and the Middle East; and (c) $1,000 in Europe and Central Asia	2	1
Percentage of female clients	2	1
Percentage of rural clients	2	0
Percentage of enterprise loan clients selected with direct poverty targeting tools	2	1
Total Depth of Outreach	10	4

LENGTH OF OUTREACH		
INDICATOR	**MFI #1**	**MFI #2**
Profit margin	1	2
Return on equity	1	2
Return on assets	2	1
Portfolio at risk < 30 days	1	2
Operating expense relative to average loan portfolio	0	1
Total Depth of Outreach	5	8

TABLE 3: SOCIAL PERFORMANCE SCORECARD (CONTINUED)

SCOPE OF OUTREACH

INDICATOR	MFI #1	MFI #2
Number of distinct enterprise loan products	0	2
Number of distinct other loan products (consumption-emergency loans, housing loans, education loans, etc.)	1	1
Number of other financial services (direct insurance, insurance via linkages, leasing, money transfers; does not include credit-life insurance)	1	0
Type of savings offered	0	2
Percentage of clients with three or more products or services (does not include compulsory savings or credit-life insurance)	2	0
Total Scope of Outreach	4	5

COST OF OUTREACH

INDICATOR	MFI #1	MFI #2
Real yield on average gross loan portfolio relative	0	1
Nominal yield on average gross portfolio relative to prime commercial lending rate in home country	0	2
Weighted average number of days to approve and disburse loans after completion of loan application (enterprise loans only)	1	2
Percentage of loan clients providing non-traditional collateral (e.g., solidarity guarantees, third-person guarantees, movable property)	2	0
Percentage of enterprise loan clients whom loan officers visit for regular financial transactions	2	1
Total Cost of Outreach	5	6

WORTH OF OUTREACH

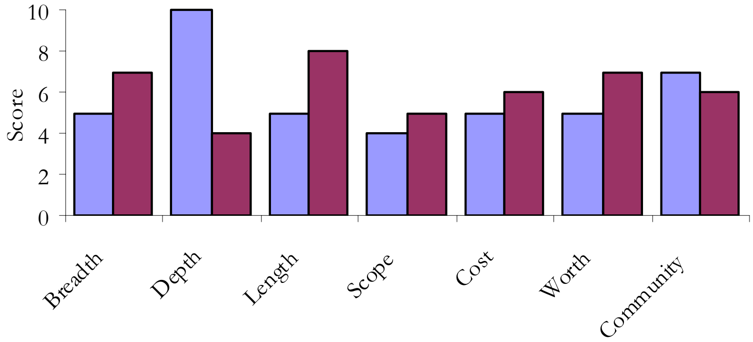
INDICATOR	MFI #1	MFI #2
Loan loss rate	2	2
Client retention rate (enterprise loans only)	0	1
Share of two-year clients still with the program (enterprise loans only)	1	1
Share of portfolio growth attributable to existing clients over most recently completed fiscal year	0	1
Whether the MFI conducts market research over the most recently completed fiscal year	2	2
Total Worth of Outreach	5	7

TABLE 3: SOCIAL PERFORMANCE SCORECARD (CONTINUED)		
OUTREACH TO COMMUNITY		
INDICATOR	**MFI #1**	**MFI #2**
Contribution to community causes and social activities	1	1
Percentage of employees that have left during two most recently completed fiscal years (not including pension leaves and deaths)	2	1
Female-male employee ratio among professional-level staff	1	0
Percentage of employees receiving at least two days of training during most recently completed fiscal year (does not include new hire training)	0	1
Whether the MFI has a written, formal internal CSR policy	0	0
Whether the MFI has a written, formal code of conduct governing actions towards employees and clients	1	1
Whether the MFI provides clients formal access to management	1	0
Whether the MFI provides health insurance for full-time employees (in addition to national health coverage system)	0	1
Whether the MFI provides credit life insurance for borrowers	1	0
Whether the MFI discloses the effective interest rate on all loans	0	1
Total Outreach to the Community	7	6

	MFI #1	**MFI #2**
TOTAL OUTREACH	41	43

Figures 1-3 present alternative methods for graphically presenting the results found in Table 3. As can be seen in Figure 3, MFI #2 has overall slightly greater outreach than MFI #1. MFI #1 performs relatively well in depth of outreach and outreach to the community, while MFI #2 performs relatively well in the remaining five dimensions.

Figure 1: Comparison of MFIs #1 and #2 along the Seven Dimensions of Outreach



Considering alternative measures along multiple dimensions of outreach shows the two MFIs to have similar outreach overall. The example demonstrates how a profit-oriented commercial bank can achieve similar, or higher, levels of social performance than a poverty-focused MFI. It further demonstrates that a small, poverty-focused lender can achieve comparable, or perhaps higher, overall social performance than a large, commercial bank.

This level of understanding regarding social performance may not have been possible were we to focus narrowly on a single dimension of social performance, on limited subset of dimensions, or on a limited set of indicators. This conclusion emerged only after assessing the two hypothetical MFIs using multiple indicators and multiple dimensions of social performance. The example drives home the point that social performance is a complex construct that can best be understood along multiple dimensions.

Figure 2: Outreach of MFI #1

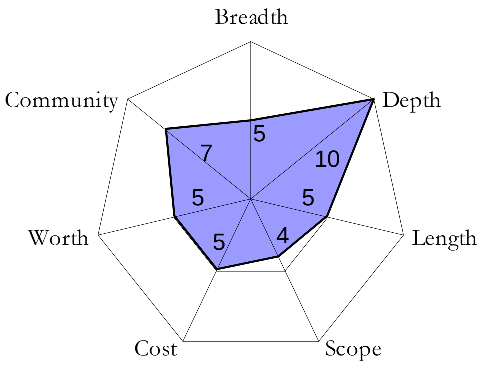
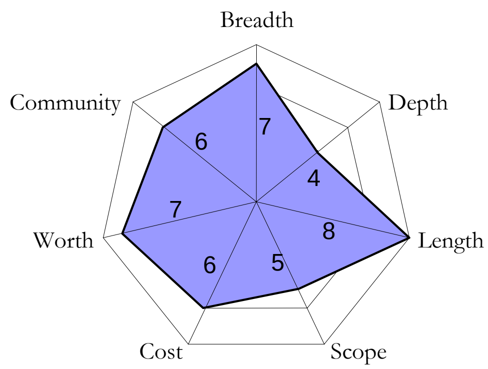


Figure 3: Outreach of MFI #2



A final lesson learned from this example is that indicators traditionally associated with financial performance are useful proxies for social performance, particularly when combined with other social performance indicators. The number of clients reached, the sustainability of the MFI, the number and variety of financial needs met, the costs borne by clients, and the level of value creation all contribute to social performance. Social performance is much more than simply reaching poor people with loans.

SOCIAL AUDIT

Social auditing includes elements of financial auditing and financial rating. Financial auditing entails an external, independent review of self-reported financial information. At the conclusion of the financial audit, the auditor issues a statement as to how accurately the financial statements reflect the organization's true financial position.

A financial rating entails an independent and in-depth external review of the organization for the purpose of assessing risk. It involves a more holistic assessment of factors that affect risk in the organization, including its finances, operations, management, policies, internal processes, and the external environment. At the conclusion of the financial rating, the rating agency issues a judgment as to the relative riskiness of the organization using a standardized rating scale.

The social audit proposed here combines elements of the financial audit and the financial rating. It provides an independent, external validation for the social performance information reported by the MFI, and it provides an independent, in-depth, and more holistic external review of the organization. The purpose of the in-depth review in this case is to assess MFI's internal processes, their consistency with the MFI's social mission, and their effectiveness at aligning performance with social mission. This is accomplished in two ways. The first way is thorough review of internal and external documentation relevant to the organization's social mission. The second way is through a series of probing discussions with management, staff, board members, and clients, which may be individual interviews or group interviews (e.g., focus group discussions).

At the conclusion of the audit, the social auditor issues a report that summarizes the audit findings. The report includes a completed Social Performance Scorecard and a social performance rating based on (1) the MFIs social performance, as measured by the Social Performance Scorecard, and (2) the quality of the MFIs internal processes. Like the financial rating, the social performance rating uses a standard scale, only this one rates the likelihood that the MFI produces significant social impact both now and in the future.

SOCIAL AUDIT AND INTERNAL PROCESSES

Standardizing the social audit to the extent possible is necessary to facilitate comparisons across MFIs and contexts. In addition to the standardized social rating scale, the internal processes to be audited can also be standardized. Five internal processes were identified that appeared to offer good potential for standardization. Each is also an internal process common to all MFIs and contributes in a significant manner to social performance. They include (1) mission statement and communication and management leadership, (2) hiring and training, (3) incentive systems, (4) monitoring systems, and (5) strategic planning. A description of each follows.

Mission statement, communication, management leadership. The mission statement is an explicit expression of the MFI's purposes and values. Presumably, organizations with an explicit and clear mission statement tend to be more effective in social mission fulfilment. Not only should the MFI's mission be stated explicitly and clearly, it needs to be communicated clearly and consistently reinforced down the hierarchical chain of the MFI. A mission statement that is not communicated or reinforced will exert little to no influence organizational performance.

Management is primarily responsible for the clear articulation, communication, and reinforcement of the MFI's social mission. Active, committed, and consistent management leadership is necessary to transform social mission from mere words into institutional action.

Hiring, promotion, and training. Hiring, promotion, and training (including new hire training and on-going training) offer the MFI excellent opportunities to communicate and reinforce social mission to management and staff. Hiring and training are also an integral part of the socialization process (e.g., the transmission of shared values) that must take place in order to create an organizational culture supportive of social mission fulfilment.

Hiring and promotion afford the MFI the opportunity to screen for candidates who possess the personal outlook and values consistent with the MFI's social mission and who are committed to social mission fulfilment. Hiring or promoting the "wrong" persons (e.g., weak or non-existent commitment to social mission) can prove detrimental to creating an organizational culture supportive of social mission. It can prove disastrous if the wrong person is promoted to senior management. Conversely, hiring or promoting the "right" persons (e.g., strong commitment to social mission) can be instrumental to creating a supportive culture of successful mission fulfilment.

Incentive systems. Incentive systems do as much or more than anything to influence attitudes, behavior and, subsequently, values within the MFI. It is axiomatic that people respond to material incentives (e.g., performance bonus system). An incentive system that rewards management and staff for behaviors and outcomes consistent with social mission will prove powerful in promoting social mission.

In contrast, an incentive system that ignores social mission considerations is much less likely to produce behaviors and outcomes consistent with social mission. It may even produce behaviors and outcomes contrary to social mission. For example, an incentive system that disproportionately rewards portfolio growth may encourage loan officers to abandon poorer borrowers to move up-market where they can make bigger loans.

Monitoring systems. Performance measurement is necessary to align the MFI's activities with its goals and mission. In this context, performance measurement does not mean a one-off activity, but it implies an ongoing process. In other words, it implies performance monitoring. Performance monitoring entails the routine collection of performance information for the purpose of comparing performance to organizational goals and mission. Performance monitoring is a management tool that is used to inform management decision making and planning.

The value of performance monitoring is clearly seen and understood in the context of financial performance. Quarterly financial statements, for example, are an ubiquitous tool of financial performance monitoring. The rationale behind financial performance monitoring—assessing financial performance in relation to financial performance goals—is non-controversial. The rational behind social performance monitoring is the same. The context is different, but no less valid.

Strategic planning. Strategic planning is a process that includes, among other things, establishing organizational priorities, setting performance goals, establishing action plans, and devising criteria to assess fulfilment of performance goals. Notwithstanding an MFI's rhetorical commitment to social mission, the inclusion, or non-inclusion, of social considerations into strategic planning is perhaps the clearest signal of the relative importance an MFI attaches to social mission.

SOCIAL PERFORMANCE RATING SYSTEM

At the conclusion of the social audit, the social auditors issue a report that includes a standardized social performance rating. The social rating system is shown in Table 4. The social rating is based on the MFI's outreach and the quality of its internal processes, defined as the extent to which internal processes serve to align behavior and outcomes to social mission. The social rating is the auditor's best, informed estimate of the likelihood that the MFI produces significant social impact both now and in the future.

The social performance rating includes 10 rating categories ranging from AAA at the top, or "extremely likely to create social impact now and in the future," to D at the bottom, or "extremely unlikely to create significant social impact both now and in the future." In between AAA and D, the rating scores, from high to low, are as follows: AA, A, BBB, B, B, CCC, CC, C, and D. A social rating of BBB or above is considered "investment grade."

The advantage of the social performance rating is that it provides a standardized format for comparing social performance across MFIs and contexts, much in the same fashion that financial rating allows comparisons of financial performance and financial risk across multiple MFIs and contexts. Rather than attempt the difficult task of measuring outcomes or impacts (an undertaking that would severely diminish any chance of achieving scale), the social rating system proposed here employs simple and feasible proxies measuring the extent of the MFI's outreach and the quality of its internal processes. This process entails tradeoffs, but given the overarching objective of scalability, the tradeoffs are deemed worth it.

To demonstrate how the social rating works, a set of social audit guidelines are included in Annex 1 of this report and a prototype social audit is provided in Annex 2. The prototype social report is done for a hypothetical Peruvian MFI called Banco de Microcredito. It shows what a final social audit report might look like given its current state of development. It is expected that as the industry gains experience with utilizing the tool, the report, and its contents, will come to take on different forms over time.

TABLE 4. SOCIAL PERFORMANCE RATING SYSTEM

RATING SCORE	DEFINITION
AAA	Excellent internal processes aligning performance with social mission. Excellent outreach. Extremely likely to create significant social impact now and in the future.
AA	Very strong internal processes aligning performance with social mission. Very good outreach. Very likely to create significant social impact now and the future.
A	Strong internal processes aligning performance with social mission. Very good outreach. More likely to create significant social impact now and in the future.
BBB	Adequate internal processes aligning performance with social mission. Good outreach. Likely to create significant social impact now and in the future.
BB	Weak internal processes aligning performance with social mission. Good outreach. Likely to create significant social impact with threat to long-term social impact.
B	Weak internal processes aligning performance with social mission. Adequate outreach. Less likely to create significant social impact now and in the future.
CCC	Weak internal processes aligning performance with social mission. Weak outreach. Less likely to create significant social impact with threat to long-term social impact.
CC	Poor internal processes aligning performance with social mission. Adequate outreach. Less likely to create significant social impact with serious threat to long-term social impact.
C	Poor internal processes aligning performance with social mission. Weak outreach. Unlikely to create significant social impact both now and in the future.
D	Poor internal processes aligning performance with social mission. Poor outreach. Extremely unlikely to create significant social impact both now and in the future.

The rating score can be adjusted with a + or – sign indicating a positive or negative variation with respect to the score.

SOCIAL AUDIT GUIDELINES

The social audit can be divided into three distinct phases each with a distinctive set of tasks. The three phases are: the preparation phase, the audit phase, and the report phase. The three phases and their tasks are summarized in this section.

PREPARATION PHASE

The preparation phase is the period prior to the social audit during which time the social audit team works with the relevant MFI to learn about the MFI, prepare a work plan, and arrange logistics for the audit. The social audit team should ideally consist of two members.   Each member of the audit team should be capable of conducting independent research. Designate a team leader who will be responsible for all communication with the subject MFI during the preparation and report phases. Designation of a team leader is intended to avoid any possibility for miscommunication stemming from confusion of messages and intent that are common when clear lines and sources of communication are not established.

During the preparation phase, the team leader will carry out the following tasks.

1. Request the subject MFI to submit a list of internal and external documents in its possession related to the MFI and relevant to its social performance. Review the list and request specific documents that appear the most relevant. Follow-up as necessary.

2. Conduct an Internet search for all public access documents on the subject MFI. Identify and download all documents that are relevant or contain passages relevant to the MFI's social performance.

3. Request copies of internal documents from the subject MFI. Internal documents requested should include descriptions of items a-m below. Read the selected documents and make notes of items relevant to the social audit and those that require follow-up during the social audit. It is important to be judicious in the amount of time spent

searching the Internet and in the volume of reading material downloaded or requested. Preparation phase should ideally only take a couple of days, and time needs to be allocated efficiently. Priority should be put on securing and reading the internal documents describing items a-m above. It will probably be necessary to divide the responsibility for reading documents among the audit team. Prior to beginning work, however, the audit team needs to compare reading notes and incorporate the information into its work plan.

- The MFI's financial performance over the last three completed fiscal years and up to the most recent accounting period for which information exists.

- All products and services offered by the MFI along with related terms, conditions, and policies.

- The breakdown of financial performance by (and to the extent possible) product and service lines, gender, operating units, and geographical location.

- The MIS and other monitoring systems.

- The performance incentive system.

- Hiring practices and new hire training.

- Existing staff and management training.

- Employee benefits.

- Other human resource policies.

- Strategic planning, including strategic planning reports and meeting minutes.

- Mission statement, vision, strategic objectives and related policies, plans, actions, etc.

- CSR policy.

- Formal codes of conduct.

Much of the information sought in items 1-m can be found in a few internal documents, such as the Operations Manual, Human Resource Manual, or MIS Manual.

4. Request information from the subject MFI on the composition of the MFI, including geographic location of headquarters and field offices, staffing at head quarters and field offices, travel times between

headquarters and field offices, and client composition at field offices. This information is required to create the work plan for the audit.

5. Send a copy of the Social Performance Scorecard to the subject MFI and ask it to complete and return it preferably within a week's time prior to the audit team's arrival.

6. Create the audit work plan and submit it to the subject MFI for comment. The work plan should include a description of the information sought by the audit team (including any questionnaire or focus group guides) and the proposed methodology to gather the information. The team leader should negotiate the terms and logistics of the work plan with the MFI. It is essential that the work plan be arranged ahead of time so as to ensure that the time for the audit is allocated efficiently. In creating the work plan, is recommended that the members of the audit team divide up as necessary so as to achieve greater geographic coverage in the audit. It is important that the audit extent beyond the MFI's headquarters and environs so as to achieve a more representative assessment of the MFI. It is acknowledged that full representativeness may not be achievable depending on the size and geographic scope of the MFI and time and resource limitations.

7. Arrange the logistics of the work plan with the subject MFI. Logistical arrangements should consider (a) transportation to and from the airports, (b) lodging, (c) in-country transportation, (d) interpretation, as needed, and (e) access to management, board members, staff, and clients.

AUDIT PHASE

The audit phase is the implementation of the social audit. Given the key criteria of feasibility and scalability, it is essential to keep the number of audit days to a minimum. It is recommended that the audit be of no more than 3-5 working days in length. This presumes that the audit team can devise an efficient work plan and secure the close logistical cooperation of the subject MFI. It will also require the members of the audit team to work independently and possibly in different regions of the country.

Although working independently, members of the audit team should remain in close communication during the audit, to the extent the communication and transportation infrastructure make this possible. The audit may want to consider purchasing pre-paid mobile phone cards so that they may communicate via mobile phone during the audit.

The work in the social audit consists principally of in-depth individual or group interviews with management, board members, staff, and clients. The interviews should focus on questions related assessing the quality of the five critical internal processes. Questions should focus on those issues that the interviewees are capable of addressing

Interviews should be planned to last approximately one hour. Each audit team can decide what combination of individual and group interviews is best for the situation, although it will want to consider a few general guidelines.

1. Conduct individual interviews with members of the senior management team. Interviews should be conducted with the following members of the senior management team (or their equivalents): Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Chief Information Officer, Human Resource Director, and Marketing Director. During interviews with senior management, auditors should review the responses to the Social Performance Scorecard relevant to the manager's position and verify the process used to complete the scorecard.

2. Conduct individual interviews with board members. Board members may or may not be familiar with day-to-day operational issues; therefore, interviews with Board members should focus on the level of operational and/or strategic issues with which they are most familiar.

3. Conduct interviews with a combination of field managers at each hierarchical level, including, for example, regional managers and branch managers. Either individual or group interviews are appropriate depending on time and logistical considerations. Field managers should only participate in group interviews with managers at the same hierarchical level. Under no condition should someone be interviewed in the presence of a hierarchical superior.

4. Conduct interviews with loan officers. Either individual or group interviews are appropriate, although group interviews are preferred for logistical reasons. To save on time and simplify logistics, field managers and loan officers should, to the extent possible, be brought to a central location to participate in interviews. The number of field managers and loan officers interviewed will be determined by the competing criteria of representativeness and feasibility. It will be up to the social audit team in each case to determine how to balance the tradeoff.

5. Conduct group interviews with clients. The group interviews may be conducted in a number of manners, such as a traditional focus group discussion of approximately 6-8 clients or by using PRA tools and methodologies.[22] Client interviews should focus on experience, attitudes, and perceptions of clients regarding issues such as customer service, quality and usefulness of products and services offered, treatment by field and office staff, and sources of satisfaction and dissatisfaction. Each member of the social audit team should plan on conducting between 2-4 group interviews, preferably in diverse locations. Participants in client interviews should be drawn from homogenous client groups. It is up to the audit team to determine which client groups to interview. If the MFI offers products targeted

[22] An example of PRA tools (Participatory Rapid Assessment) are the MicroSave market research tools. Information on the MicroSave tools can be found at www.microsave.org.

specifically to the poor or disadvantaged, it will be particularly relevant to interview members of this group.

6. Conduct interviews with support staff at headquarters and field offices. Individual and groups interviews are appropriate. Interviews with support staff are the lowest priority and should only be performed if slack time exists or if it does not conflict with other work.

7. Members of the social audit team should take detailed notes during all interviews. If possible, the auditors should arrange for a reliable staff member to take notes during group interviews. Each day as time permits, members of the audit team should write up their interview notes and, if possible, share them with each other. If the audit team is working in different locations, the team may consider sending their transcribed notes to each other via email. Notes from the previous work days should be used to update the questionnaire guidelines for remaining work days.

The audit team should draft a summary of its principal findings and present it to senior management and Board members on the final day of the audit. The summary of findings and presentation serves two purposes. First, it requires the audit team to organize and summarize its findings prior to the completion of the audit, which will facilitate the timely writing and completion of the final report during the report phase. Second, it gives management and Board members the opportunity to review the principal findings of the audit and to comment on them, correct factual errors, clear up misunderstandings, and dispute differences of opinion. The audit team will make any necessary corrections to its findings and note areas of dispute. The outcome of the final meeting will form the basis for the final report.

REPORT PHASE

The team leader should take the lead in writing the final report. It is important to begin writing the final audit report immediately on returning home, otherwise the audit team's recollection of events and statements during the audit will recede thereby diminishing the quality of the final report.

The team leader should complete the draft of the final report within two working days at which point he/she will share it with other team members for review and comment. Based on comments received, the team leader will take one more day to complete the final audit report. On completion of the final audit report, the team leader will submit it to the subject MFI to review and check accuracy. Aside from pointing out factual errors, which the auditors are obligated to correct, the MFI can make additional comments or suggestions, although the auditors have no obligation to accept either.

The auditors need exercise care not to allow the MFI to influence their assessment. To be credible, the audit must be independent and objective. It is acknowledged that the audit report contains elements of subjectivity. This cannot be helped. What is essential is that the process and the report are perceived as objective, fair, and transparent. It is also important that the auditors themselves are credible and competent.

On receiving comments from the MFI, the team leader will make relevant changes and complete the audit report. The team leader will then submit the final audit report to the MFI and to other relevant stakeholders (e.g., an investor or donor who has paid for the audit).

The audit report should contain, at a minimum, the following:

1. An Executive Summary that includes the following:

    - The MFI's social rating score with a description of what the score means.
    - A brief description of the MFI and its history.
    - The MFI's mission statement, plus its formal vision statement and strategic objectives as relevant.
    - A tabular and graphic summary of scores obtained in the Social Performance Scorecard.
    - A brief written summary of the MFI's performance in each of the seven dimensions of outreach.
    - A brief written summary of the MFI's performance in each of the five critical internal processes.
    - A tabular summary of financial and institutional performance indicators.

2. An in-depth narrative summary of the MFI's performance in each of the seven dimensions of outreach. The narrative summary should be supplemented by appropriate tables, graphs, and figures.

3. A statement expressing the auditors' confidence in the validity of the information reported in the Social Performance Scorecard.

4. An in-depth narrative summary of the MFI's performance in each of the five critical internal processes. The narrative summary should be supplemented by appropriate tables, graphs, and figures. Quotes taken from the interviews can also be used to highlight key points or conclusions described in the narrative summary.

5. A completed Social Performance Scorecard for the MFI. This may be presented in the body of the report or in an appendix as deemed appropriate.

6. A copy of the Social Performance Rating System showing all the possible rating categories along with corresponding definitions. This may be presented in the body of the report or in an appendix as deemed appropriate.

ESTIMATED LEVEL OF EFFORT

It is estimated that it will require between 13-17 person days to complete the entire social audit (see Table 4). The low estimate includes three person days during the preparation phase, six person days to complete the social audit, and four person days to complete the final report. The high estimate includes three person days during the preparation phase, ten person days to complete the audit, and four person days to complete the final report. This is a preliminary estimate based on a single field test. It is expected that the actual level of effort (LOE) to complete the audit may vary up or down, depending on a number of factors.

It may also be the case that different stakeholders will require more or less in-depth evaluations, which will affect the upward or downward, respectively. Although it is desirable to push the time required down as far as possible, there are limits to how far down it can be pushed without unduly compromising reliability. This point is likely to be determined only through use.

The estimated LOE in Table 4, therefore, should be considered only a rough estimate of the actual time necessary to complete the social audit.

TABLE 4. SOCIAL PERFORMANCE RATING SYSTEM

	NUMBER OF DAYS – LOW ESTIMATE	NUMBER OF DAYS – HIGH ESTIMATE
PREPARATION PHASE		
Team Leader	2	2
Audit Team Members	1	1
AUDIT PHASE		
Team Leader	3	5
Audit Team Members	3	5
REPORT PHASE		
Team Leader	3	3
Audit Team Members	1	1
TOTAL	**13**	**17**

MARKETS FOR SOCIAL AUDITS

Two primary markets are envisioned for the social audit. The first is the market for social audits integrated with financial ratings. Field-tests of the social audit tool are currently planned in conjunction with one or more of the financial rating agencies. The purpose of these field-tests will be to determine how the social audit can be integrated at minimal incremental cost into the financial rating exercise. Preliminary investigations reveal several areas of overlap between the social audit and financial rating suggesting significant potential for low-cost integration. The eventual objective is to offer the social audit as a low-cost complement to the financial rating to MFIs that need or want this information for internal or external audiences.

The second market is the market for stand-alone social audits. There is believed to exist a latent demand for a simple, low-cost social performance measurement tool among MFIs, MFI networks, investors, and donor agencies. The social audit will be offered to meet this demand. It is envisioned, for example, that microfinance networks may adopt the social audit as a simple, low-cost, and easily replicable method to assess the social performance of its network members or to enable network members to assess and/or monitor their own social performance.

The social audit process will be adapted to meet the needs of the specific market/consumer as pertains to, for example, cost or breadth and depth of information. An important part of this approach will be to establish standard, or “best,” social audit practices and to adapt the specific audit process on a case-by-case basis consistent with established best practice.

The simplicity of the social audit tool is such that requisite skill in implementation of the tool can be acquired at a reasonable level of difficulty and cost. Continuing the example of the microfinance network from above, it would be feasible to train network members in implementation of the social audit who could in turn train other members of the network or even provide training services to non-member MFIs or other microfinance networks. The point is that the technical skills necessary to implement the social audit are not overly demanding and can be acquired at relatively low cost, a necessary condition for scaling up adoption and implementation of the tool.

This process requires that training standards be established and enforced, along with adherence to best practice principles. One way to accomplish this is to create an accreditation process. Accreditation will not only help ensure the quality of the social audit process, but it will also serve as an important signaling device that will reduce the information asymmetries between consumers and providers of social auditing services. It is anticipated that, to the extent the social audit approach grows in popularity and practice, an accreditation process will be established along with a cohort of accredited social auditors and trainers.

ANNEX 1: CRITERIA FOR SELECTING INDICATORS

Operationalizing the Six Aspects framework entails selection of indicators falling under each of the seven dimensions of outreach. This section describes the criteria and other considerations that went into selecting the indicators.

SELECTION CRITERIA

Indicator selection was based on eight selection criteria:

- feasibility
- familiarity
- intuitive appeal
- inclusivity
- familiarity
- standardizability
- verifiability
- scalability

Feasibility. The feasibility criterion means that indicator should be reasonably easy to collect and report without imposing a significant burden on the MFI's human, physical, or financial resources. A condition of feasibility is that the indicator does not require the MFI to collect additional information from clients.

Availability. The availability criterion means that, to the extent possible, the indicator should be one that already resides in the MFI's MIS or can be computed from information in the MIS.

Intuitive Appeal. The intuitive appeal criterion means that the indicator should have a reasonably clear intuitive link to the underlying dimension it is measuring.

Inclusivity. The inclusivity criterion means that the indicator should apply to all MFIs. In other words, the indicator should not rule out any particular institutional type, although it is not required to apply equally to each institutional type. For example, the indicator measuring outreach to rural clients applies to all MFIs, regardless of institutional type. While an MFI may choose not to target rural areas, there is nothing inherently prohibiting it from doing so.

Likewise, an NGO may be legally prohibited from intermediating savings, but there is typically nothing legally or inherently prohibiting NGOs from collecting voluntary savings from program participants. Indeed, most NGOs already require involuntary savings and most could offer voluntary savings too. That an MFI chooses not to do something, for whatever reason, does not invalidate the inclusivity criterion.

Familiarity. The familiarity criterion means that the indicator is, to the extent possible, familiar to users of the information. One means to satisfy this criterion was to try to identify and use performance indicators currently reported by the Microfinance Information Exchange (the MIX). Where not possible to use indicators reported by the MIX, indicators selected were judged to be reasonably familiar within the industry or to possess strong intuitive appeal.

Standardizability. The standardizability criterion means that the indicator can reasonably be standardized across MFIs, countries, regions, and socio-economic contexts.

Verifiability. The verifiability criterion means that the indicator can reasonably be verified by external sources. Verification by external sources is considered essential to create long-term credibility and legitimacy of self-reported social performance information.

Scalability. The scalability criterion means that the indicator should have reasonable likelihood to be adopted by a large number and wide variety of MFIs. Scalability is the most important selection criterion and is itself a function of the other seven criteria.

DETERMINING THE NUMBER OF INDICATORS

Determining the appropriate number of indicators to assess social performance involves tradeoffs. Selecting too few indicators may present a shallow or unrepresentative picture of social performance, while selecting too many indicators may impose unreasonable burdens on MFIs, thereby reducing the likelihood of achieving scale. The burdens of collecting too many indicators can be mitigated to a degree depending on the ease of collection. The approach to managing the tradeoffs here is to focus on collection feasibility, which permits collection of a larger number of indicators that provide a more complete view of social performance.

Another consideration is that the number of indicators in any dimension of outreach necessarily affects the weighting of that dimension relative to the other dimensions. Given the decision to weight each dimension equally (see below), it was necessary to factor in weighting considerations when selecting the number of indicators falling under each dimension.

DETERMINING WEIGHTS FOR OUTREACH DIMENSIONS

Weighting of dimensions refers to the relative importance of dimensions. Some weighting scheme, whether implicit or explicit, is unavoidable.

It is recognized that different people will attach different weights to different dimensions of outreach. Some people may attach the greatest weight to depth, while breadth or length may be more important to others. Alternatively, some may not consider cost as important, while others may de-emphasize depth or scope.

Short of undertaking the task of trying of anticipating or mediating disagreements that will inevitably arise over the relative weight of dimensions, a more pragmatic approach is simply to assign equal weights to each dimension. This approach acknowledges the diversity of opinion on this matter by not seeking to impose a particular value set on the process. Users are free (and expected) to assign their own subjective weighting scheme to the dimensions.

ANNEX 2: BANCO DE MICROCRÉDITO (BANMICRO) – SOCIAL AUDIT MARCH 2005

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BANMICRO SOCIAL AUDIT - EXECUTIVE SUMMARY

FINAL RATING: BBB
Adequate internal processes aligning performance with social mission. Good outreach. Likely to create significant social impact now and in the future.

Mission Statement. To reduce poverty and promote socio-economic development in Peru by providing sustainable and innovative financial services tailored to the unique needs of microenterprises and low-income households.

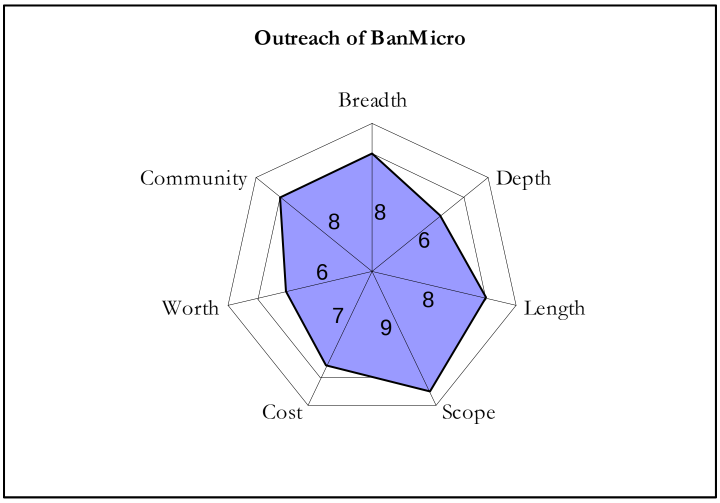
Target Market. Targets micro and small enterprises and low-income households in urban and rural areas of Peru.

History. Founded as an indigenous Peruvian NGO in 1989 to provide training and technical assistance to microenterprises. BanMicro started lending to micro and small enterprises in 1993 using solidarity group lending method. In 1996 it stopped offering business development services and solidarity lending and started offering individual loans. BanMicro transformed into a supervised, deposit-taking commercial bank in 2000.

OPERATING PERFORMANCE TREND

LOANS			
	2004	**2003**	**2002**
Borrowers	173,298	156,124	121,408
Portfolio ($000)	260,466	202,493	117,101
ALS ($)	1,795	1,539	1,243
New ALS ($)	1,503	1,297	969
ALS/GNI (%)	83.6	76.2	63.1
New ALS/GNI (%)	70.0	64.2	49.2
Female Clients (%)	22.9	24.8	29.4
Rural Clients (%)	15.1	19.1	20.5
SAVINGS			
	2004	**2003**	**2002**
Savers	85,347	64,376	42,345
Savings ($000)	189,044	121,864	67,413
OPERATIONS			
	2004	**2003**	**2002**
Op. Expenses (%)	19.3	28.1	32.7
ROA (%)	4.1	3.4	2.6
ROE (%)	28.1	24.5	20.9
Portfolio Yield (%)	38.4	33.9	39.3
Real Port. Yield (%)	36.1	30.2	36.3
Loan Loss Rate (%)	1.9	2.4	2.8
PAR > 30 (%)	3.1	3.4	7.3
Profit Margin (%)	14.7	10.1	8.3
OSS (%)	132.2	117.0	111.3
FSS (%)	128.8	110.2	98.7
Client Retention (%)	70.6	75.2	80.4

BANMICRO OUTREACH		
DIMENSION OF OUTREACH	**POSSIBLE SCORE**	**SCORE**
Breadth	10	8
Depth	10	6
Length	10	8
Scope	10	9
Cost	10	7
Worth	10	6
Community	10	8
Overall Score	70	52



OUTREACH SUMMARY	
OUTREACH DIMENSION	**COMMENTS**
Breadth of Outreach	Among one of largest MFIs in Peru and Latin America. High percentage of clients with non-enterprise loans combined with moderate percentage of clients with savings and other financial services. Does not offer non-financial services.
Depth of Outreach	Moderate average loan size/GNI per capita, although average loan size shows sustained upward trend. Nearly one-third of loans below $400. Percentage of female and rural clients on sustained downward trend and less than 30% in both cases. Does not use explicit poverty targeting tools and relies on product attributes to attract poor microentrepreneurs.
Length of Outreach	FSS, OSS, ROA, PAR > 30, and operating expense ratio all favorable and show strong positive three-year trends.
Scope of Outreach	Moderately diversified set of loan and savings products, including working capital loan, fixed asset loan, consumer loan, housing loan, and money transfers. Savings include passbook savings with unlimited access and fixed-term savings. Nearly one-fifth of clients use three or more financial products.
Cost of Outreach	Charges high effective interest rate in absolute terms and relative to the commercial lending rate in country. Non-prices costs moderate in terms of loan disbursal times and the percentage of clients offering non-traditional collateral. Loan officers visit borrowers premise for the large majority of loan transactions.
Worth of Outreach	Low loan loss rate combined with moderate client retention rate. Some evidence of client churning as measured by the percentage of two-year clients remaining with the bank and the share of portfolio growth accounted for by existing clients. Conducts formal market research on a systematic basis.
Outreach to Community	Actively involved in supporting community causes and events. Moderate employee turnover combined with high female/male employee ratio. Offers multiple training opportunities to professional staff with a high percentage participating actively in ongoing training. No internal policy on corporate social responsibility and no code of ethical or professional conduct. Offers health insurance to all employees but and credit-life insurance to borrowers. Discloses effective interest rate on all loans but has no formal policy to grant clients access to management.
Overall Outreach	Overall good outreach. Very strong in length of outreach; strong in outreach to the community; moderately strong in breadth, scope, and worth of outreach; and in depth of outreach.
Validity of Outreach Indicators	BanMicro's MIS permits a detailed breakdown of its loan portfolio and savings accounts by client, product, size of transaction, operating unit, region, gender, and time frame. The MIS also tracks the number of money transfer made by each operating unit. All indicators based on MIS information are judged to be accurate. Indicators related to the percentage of rural clients and average loan disbursal times contain element of subjectivity and error, although judged to be reasonably accurate. Overall, information reported in the Social Performance Scorecard can be considered reasonably to highly accurate.

INTERNAL PROCESSES SUMMARY	
PROCESS	**COMMENTS**
Mission Communication & Leadership	Weak processes to communicate social mission within organization. Focus within organization overwhelming on financial performance. Management and Board have not demonstrated leadership on social mission. Weak social mission culture. Management has recently taken greater leadership in this area and has launched initiatives to address deficiencies in social performance.
Incentives	Performance bonus system creates moderate incentives for field personnel to target poor microentrepreneurs. At the same time, bonus system creates strong incentives for field personnel to target larger businesses and more well-off borrowers. Although current share of poor borrowers appears reasonably large, forces exist to push field personnel further up-market over time.
Hiring and Training	Social mission issues raised but not emphasized during hiring and training process. Social mission addressed indirectly in training sessions on customer service but not explicitly. New hires and staff know little about BanMicro's social roots or mission. Overall socialization process is weak.
Monitoring	Client retention and changes in client profiles routinely monitored in MIS. Recent downturns in client retention led to analysis of MIS finding that (1) dropout concentrated among smaller businesses and (2) enterprise loan clients becoming larger and richer over time. MIS analysis followed-up with focus group discussions to determine the causes and profile of client dropout.
Strategic Planning	Social mission issues traditionally not raised during strategic planning. Deterioration in client retention and research findings led to focus on social mission during 2003 strategic planning retreat. Decision made to investigate policy, product, and process reforms to align performance with social mission. Uncertain whether this marks new era of integrating social mission into strategic planning or is anomaly to traditional practice.
Overall Processes	Overall adequate internal processes aligning performance with social mission. Nonetheless, management is taking purposive action to reemphasize social mission, implement sound internal processes, and create a stronger customer-oriented culture.

HISTORY OF BANCO DE MICROCRÉDITO

Banco de Microcrédito began operations in 1989 as Promover, an NGO with the mission to promote the development of microenterprises in Peru through training and technical assistance. During 1990 and 1991 Promover provided training and technical assistance to microenterprises in Trujillo and surrounding communities.

After two years of operation, Promover had reached only around 100 clients. Unhappy with its limited outreach and slow growth, in 1992 Promover's Board of Directors approved a plan to extend operations into lending. In 1993 Promover began offering small working capital loans to microentrepreneurs using the solidarity group lending methodology, in addition to training and technical assistance.

From 1993-1995, the scale of Promover's operations grew rapidly, reaching 20,274 borrowers with an outstanding loan portfolio of $4.6 million and an average loan size of $269. Despite rapid client and portfolio growth, improvement in Promover's financial self-sufficiency lagged behind reaching a high of only 73% by year end 1995. In December 1995, Promover held a strategic planning retreat to assess its performance to date and establish a five-year operational plan. The consensus emerging from this exercise was that Promover's narrow market focus, its low average loan size, and its non-financial market offerings were slowing its progress toward financial sustainability. In light of this consensus, Promover established a new direction for the organization that included the following four strategic objectives:

- Focus on lending and stop offering training and technical assistance,
- Switch from solidarity group lending to individual lending,
- Expand the target market to include micro and small enterprises, and
- Offer a full range of financial services, including deposit services, so as to meet the diverse financial needs of micro and small enterprises.

In line with its five-year timetable, Promover successfully transformed into a commercial bank during the later half of 2000 at which time it changed its name to Banco de Microcrédito (BanMicro for short).

Figure 3 Map of Peru

Today BanMicro operates out of its headquarters in Trujillo with 91 retail branches in thirteen of Peru's 26 regions: Ancash, Arequipa, Ayacucho, Cajamarca, Cusco, Huanuco, Junín, La Libertad, Lambayeque, Lima, Lima City, and Puno. The thirteen regions cover 75% of Peru's population. BanMicro has 706 full-time employees, including five members of the senior management team, 13 regional managers, 91 branch managers, 455 loan officers, and 142 support staff.

BANCO DE MICROCREDITO'S PERFORMANCE ON SEVEN DIMENSIONS OF OUTREACH

BREADTH OF OUTREACH

As of December 31, 2004, BanMicro had 173,298 loan clients and an outstanding loan portfolio of $260 million. These figures represent an 11.0% and 28.6%, increase over year-end 2002. During 2002 and 2003, the average annual growth in loan clients averaged 14.4%.

At the end of 2004, BanMicro had 85,347 voluntary savings accounts worth $189 million and an average account balance of $2,215. These figures represent a 32.6%, 55.1%, and 17.0% increase over year-end 2003. The number of voluntary savers is equal to just over two-thirds of total borrowers.

Slightly less than one-fifth—or 34,487—of BanMicro's loan clients hold consumer or housing loans. During 2004, BanMicro processed 23,049 money transfers, which is equal to 13.3% of its borrowers at year end.

BANMICRO BREADTH OF OUTREACH (DECEMBER 31, 2004)		
BREADTH INDICATOR	**BANMICRO**	**BREADTH SCORE**
Number of borrowers	173,298	2
Clients with non-enterprise loans as a percentage of borrowers	19.9	2
Voluntary savers as a percentage of borrowers	68.5	1
Clients with other financial services as a percentage of borrowers	13.3	1
Clients with non-financial services as a percentage of borrowers	0.0	0
Total Breadth Score	**-**	**6**

DEPTH OF OUTREACH

The average loan size at BanMicro among new clients has increased significantly over the last few years climbing from $969 in 2002 to $1,503 in 2004, equal to a 55.1% increase, although the rate of growth did slow from 2003 to 2004 to 15.9%. The average loan size relative to GNI per capita among new clients has climbed commensurately over the same period from 49.2% to 70.0% with 37.2% of all loans below $400.

The increase in the average loan size follows close on the heels of the introduction in 2002 of the fixed asset loan, which is targeted to larger enterprises that demand more financing than the working capital loan. The average loan size among fixed asset borrowers is $2,791 compared to $507 for working capital borrowers.

The share of female and rural clients at BanMicro has also shrunk over the last three years. At year-end 2002 the share of female and rural clients stood at 29.4% and 20.5%, respectively, compared to 22.9% and 15.1% at year-end 2004. These outcomes are explained by two aspects in the expansion pattern at BanMicro. First, BanMicro has increasingly been locating its retail branches in urban centers of large to medium-sized cities. Second, with the introduction of the fixed asset loan, BanMicro has been increasingly targeting small and some medium (as opposed to micro) enterprises, which tend to be male-owned.

BanMicro does not use any targeting tool to reach poor microentrepreneurs or poor households beyond structuring its product attributes to appeal to this market segment. Initially, it pursued a geographical targeting strategy by establishing branches in rural communities linked through adequate infrastructure to urban centers. It has since, however, abandoned this targeting strategy and begun focusing almost exclusively on urban areas. Of BanMicro's 91 retail branches, only 27 (29.7%) are located in rural areas, and of these all but six (6.6%) were established prior to 2002.

BanMicro's current targeting strategy is to locate new branches in business districts of urban areas and rely on mass media, referrals, and walk-ins to generate new business. This strategy has worked well in terms of generating new business (as seen by program growth), but increasingly new business is larger, urban, and male.

BANMICRO DEPTH OF OUTREACH (DECEMBER 31, 2004)

DEPTH INDICATOR	BANMICRO	DEPTH SCORE
Average loan size as a percentage of GNI per capita	70.0	1
Percentage of loans less than $400	32.7	1
Percentage of female clients	29.4	1
Percentage of rural clients	20.5	1
Percentage of enterprise loan clients selected with direct poverty targeting tools	0.0	0
Total Depth Score	-	4

LENGTH OF OUTREACH

BanMicro has shown steady improvement in all length of outreach indicators. Its profit margin has increased steadily over the last several years to 14.7% by year-end 2004 from 8.3% in 2002. The improvement in its profit margin is reflected in similar improvements in ROE, ROA, portfolio-at-risk 30 days (PAR > 30) and the operating expense ratio. ROE and ROA increased from 20.9% and 3.4% in 2002, respectively, to 28.1% and 4.1% in 2004, while PAR > 30 and the operating expense ratio fell from 3.4% and 28.1% to, respectively, 3.1% and 19.3%.

BANMICRO LENGTH OF OUTREACH (DECEMBER 31, 2004)		
SOCIAL PERFORMANCE DIMENSION	**BANMICRO**	**SCORE**
Profit margin	14.7	2
Return on equity	28.1	2
Return on assets (%)	4.1	2
Portfolio at risk > 30 (%)	3.1	2
Operational expense ratio (%)	19.3	2
Total Length Score	**-**	**10**

SCOPE OF OUTREACH

BanMicro offers four loan products and two savings products. Loan products include the working capital loan, fixed asset loan, consumer loan, and housing loan. Saving products include passbook savings and time deposits. In addition, BanMicro offers money transfers.

The working capital loan is the primary loan product offered by BanMicro. It accounts for 53.2% of loans made and 17.9% of the outstanding loan portfolio. The working capital loan is a modified version of the original working capital loan offered by Promover.

The working capital loan is targeted to microenterprises. It carries a four or six month term with bi-weekly payments and is priced on a declining balance with an interest rate of 30% and an origination fee of 3%. It ranges in size from $300 to $1,500 with an average loan size of $507. Mature clients with stellar repayment records are eligible for a stepped reduction in the interest rate of up to three percentage points.

The fixed asset loan was introduced in 2002 and is targeted primarily to small and medium enterprises that require fixed asset investment, particularly small-scale manufacturing enterprises. It ranges in size from $1,000 to $10,000, with an average size of $2,791. It carries a loan term of 1-2 years with monthly payments and is priced at 22% on a declining balance with a 3% origination fee. The fixed asset loan accounts for 26.9% of loans made and 50.0% of the loan portfolio.

The consumer loan was introduced in 2002 and is targeted to households that need short-term cash for consumption purposes. BanMicro uses an industry credit scoring tool to screen borrowers. The consumer loan is a revolving loan with no fixed due date. The loan ranges in size from $200 to $3,000 with an average loan size of $552. It is priced at single interest rate of 35% applied on a declining balance with a $15 origination fee. Working capital and fixed asset borrowers with stellar repayment records can qualify for up to a three percentage point interest rate reduction. The consumer loan accounts for 12.6% of loans made and 4.6% of loans outstanding.

The housing loan was introduced in January of 2003. It is targeted to low-income households that need extra money to repair/remodel their homes or to purchase new homes. The primary market for the housing loan is BanMicro's commercial borrowers, although it is marketed to the broader population as well. The housing loan is a long-term loan with maturities of five, 10, and 15 years with corresponding interest rates of 13%, 15%, and 18% and an origination fee of $50. The minimum loan size is $500 with no maximum. During 2003 the average housing loan was $5,653, while all housing loans accounted for 7.3% of loans made and 27.5% of loans outstanding.

The working capital, fixed asset, and consumer loans each require collateral in the form of land, buildings, business assets, secured wages, a second party guarantee, or, in the case of the working capital loan, movable personal property. The housing loan is secured with the property being financed.

LOAN PORTFOLIO MIX AT BANMICRO (DECEMBER 31, 2004)

LOAN PRODUCT	NUMBER	%	PORTFOLIO	%	AVERAGE LOAN SIZE
Working capital loan	92,195	53.2	46,742,630	17.9	507
Fixed asset loan	46,617	26.9	130,108,499	50.0	2,791
Consumer loan	21,836	12.6	12,053,222	4.6	552
Housing loan	12,651	7.3	71,514,712	27.5	5,653
Total	173,298	100.0	260,466,894	100.0	1,503

BanMicro introduced its passbook savings when it transformed into a commercial bank in 2000. The passbook savings is an open-ended savings account allowing unlimited deposits and withdrawals and paying an annual interest rate of 6.2%. The passbook savings initially required a minimum deposit of $100, but this was later reduced to $50 to facilitate greater outreach to poor savers. At year-end 2003, nearly 70% of all passbook savings accounts at BanMicro were less than $100.

BanMicro introduced the time deposit in 2002. Time deposits offer higher returns of 7%, 7.8%, and 8.8% for locking up savings for, respectively, three, six, or 12 months. BanMicro charges a penalty of 8% for early withdrawals. The minimum time savings deposit is $200.

COMPOSITION OF SAVINGS AT BANMICRO (DECEMBER 31, 2004)

LOAN PRODUCT	NUMBER OF SAVINGS ACCOUNTS	%	VALUE OF SAVINGS	%	AVERAGE SAVINGS ACCOUNT SIZE
Passbook savings	70,923	83.1	34,327	18.2	484
Time savings	14,424	16.9	154,717	81.8	10,726
Total	85,347	100.0	189,044	100.0	2,215

Passbook savings comprise 83.1% of all savings accounts at BanMicro but only 18.2% of savings volume. Time deposits make up the balance. The average account size for passbook savings is $484 compared to $10,726 for time deposits.

Overall, 39,512, or 22.8%, of BanMicro's clients consume three or more products simultaneously.

COST OF OUTREACH

During 2004, BanMicro earned a 38.4% nominal yield and a 36.1% real yield on its average loan portfolio. The former was equal to 2.7 times the lending rate in Peru. The nominal and portfolio yield in 2004 represents a nearly 5 percentage point increase from 2003, although it is down slightly from 2002.

BanMicro takes on average six business days to evaluate, approve, and disburse loans. BanMicro's lending methodology requires loan officers to make routine visits to clients' business premises, including even the smallest working capital loans. Just over one-quarter of enterprise loans made by BanMicro accept movable personal property as collateral. The use of movable property collateral is heavily concentrated among smaller working capital borrowers. Over 90% of loan transactions are concluded at the client's place of business.

BANMICRO COST OF OUTREACH (DECEMBER 31, 2004)

COST INDICATOR	BANMICRO	SCORE
Real yield on average gross loan portfolio	36.1	1
Nominal yield on average gross portfolio relative to prime commercial lending rate in home country (%)	270.0	1
Weighted average number of days to approve and disburse loans after completion of loan application	6.0	1
Percentage of loan clients providing non-traditional collateral	26.2	1
Percentage of enterprise loan clients whom loan officers visit for regular financial transactions	95.7	2
Total Cost Score	-	6

WORTH OF OUTREACH

BanMicro has created its different loan and savings products based on perceived market demands and targeted to specific market segments. Nonetheless, BanMicro continued a pronounced negative trend in 2004 when it recorded a 70.6% client retention rate, down from 80.4% in 2002 and 75.2% in 2003.

BanMicro's retention rate masks a significant attrition of mature clients from the program. Of 14,786 working capital and 3,093 fixed asset loan clients who were on their first loan cycle as of December 31, 2002, only 4,746 (32.1%) and 1,695 (54.8%), respectively, were still loan clients of the bank as of December 31, 2004. Overall 36.0% of new enterprise loan clients from December 2002 were still clients of the bank in December 2004.

The exodus of mature clients from the program also shows up when portfolio growth is broken down by new and existing clients. During 2004, new clients accounted for 61.8% of loan portfolio growth compared to only 38.2% by existing clients. This outcome is also explained in part by the rapid program growth during 2004.

Despite a deteriorating retention rate, clients continue to repay loans at a high rate, both in absolute terms and relative to the average of BanMicro's peer institutions. The loan loss rate in 2004 continued a sustained downward trend finishing at 2.1% down from 2.8% in 2002 and 2.4% in 2003.

BanMicro collects information on clients' household income and business performance (sales, expenses, and profits) on its loan application form. BanMicro closely monitors this information, in addition to client retention information. An internal analysis of BanMicro's MIS conducted by the Business Development Department in early 2004 revealed that the large majority of client dropouts were coming from working capital borrowers and were concentrated among lower income clients with smaller enterprises. The same analysis also uncovered an upward drift in the socio-economic profile of working capital clients.

These findings have become a major concern to senior management. During October 2004 management launched market research using focus group discussions (FGDs) with ex-clients to discover more about the causes and composition of client desertion. Researchers found general satisfaction with BanMicro's market offerings together but a wide-spread dissatisfaction with service quality and a perception that BanMicro did not care about poor borrowers. This perception was based on interactions with field personnel and on mass media marketing messages.[23] Many ex-clients took their business to other financial institutions, despite being generally satisfied with BanMicro's market offerings.

Client FGDs performed by the social audit team largely confirmed these conclusions.[24] The overall impression of the focus group participants was that BanMicro offered high quality products but that loan officers and branch office staff provided mediocre to poor service.

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[23] Field personnel include Regional Managers, Branch Managers, and loan officers. BanMicro has two types of loan officers: enterprise loan officers and consumer loan officers. Enterprise loan officers work solely with business clients. They work out of a branch office but spend most of their time visiting clients. Consumer loan officers work solely with consumer and housing loans. They spend all their time in branch offices. This audit report refers solely to enterprise loan officers.

[24] Auditors conducted four FGDs with 8-10 working capital clients each. To ensure participation by poor clients, only working capital clients that reported a household income less than $500 per month were invited to participate.

FDG participants expressed general satisfaction with the working capital loan. They liked its flexibility and felt it was well-suited to their business needs. On the other hand, several participants cited examples of shoddy treatment by loan officers and branch office staff, such as long queues, inattention by branch office staff and loan officers, and preferential treatment given to larger borrowers (e.g., allowing them to cut into the queue).

There was general agreement among FDG participants that the loan application and approval process takes too long and is too complicated, particularly relative to the small loan size. Clients also complained about the collateral requirements, which many clients felt were excessive. Several clients cited friends and associates who could not qualify for loans from BanMicro because they lacked approved collateral despite operating, presumably, viable businesses.

A number of FGD participants also held passbook savings at BanMicro. They appreciated the flexibility of the savings and the safe, positive return offered by passbook savings. Several, however, complained about the minimum savings requirement. Many FGD participants could cite friends or colleagues who would probably save at BanMicro were it not for the minimum deposit requirements. Virtually all FGD participants continued to save via informal methods, for a variety of reasons, including the minimum savings deposit, long lines at branch officers, the distance to branch offices, or impersonal treatment by bank office staff.

On balance, FGD participants were satisfied with BanMicro, but several were considering taking their business elsewhere, particularly if they could find market offerings of similar quality. The general consensus was that they would recommend BanMicro to their friends, although they might hesitate if the friend were obviously poor or had a very small business. When asked what BanMicro could do better, participants cited improvement in service quality, in particular showing greater interest in clients' lives, more rapid and conscientious service at branch offices, relaxing collateral constraints, possibly accepting other forms of collateral, lowering the minimum savings deposit, and streamlining the loan application and approval process.

With the exception of ongoing monitoring of its MIS, BanMicro generally carries out market research only on an ad hoc basis as it perceives the need, typically using FGDs, with the recent research on client desertion being a prominent example.

BANMICRO WORTH OF OUTREACH (DECEMBER 31, 2004)		
WORTH INDICATOR	**BANMICRO**	**SCORE**
Loan loss rate	2.1	2
Client retention rate	70.6	1
Share of two-year clients still with the program	36.0	1
Share of portfolio growth attributable to existing clients over most recently completed fiscal year	53.9	1
Type of market research conducted	Formal, Systematic	2
Total Worth Score	**-**	**7**

OUTREACH TO THE COMMUNITY

Human Resources

BanMicro has achieved reasonably good gender diversity in its hiring and promotion practices. Two of five members of the senior management team are women, including the Chief Financial Officer and Operations Manager. Six of the 13 (46.2%) regional managers are women, as are 40 of 91 (44.0%) branch managers and 213 of 411 (51.8%) of loan officers. Overall, 46.3% of BanMicro's professional employees (not including administrative support staff) are women.

BanMicro has managed to create a cohesive and functional internal culture. Management and staff express high levels of satisfaction with their jobs at BanMicro and with the overall work environment. Employee turnover is low, totaling only 20.2% over the last two fiscal years.

Management and staff interviewed attributed three factors to this outcome: (1) a supportive work environment, (2) relatively good pay (including bonuses), and (3) opportunities for promotion.

BanMicro provides comprehensive health insurance for all of professional-level employees. Administrative staff support can also get health insurance through BanMicro, albeit at a higher cost and with fewer benefits than professional staff.

Training

BanMicro offers multiple training opportunities for management and staff. Trainings are either compulsory or voluntary. Compulsory trainings are typically offered when BanMicro introduces a new product, and it wants to instruct staff on the features of the product. BanMicro may also hold compulsory trainings on other topics, such as business development, loan appraisal, and customer service.

BanMicro offers a number of voluntary trainings each year for management and staff. Typically, field staff has to apply to participate and receive an endorsement from the Regional Manager. Headquarters staff requires an endorsement from the Operations Manager to participate in voluntary trainings. Voluntary trainings are in areas such as leadership, management skills, customer relations, marketing, or time management. Each year BanMicro also sponsors a small number of staff or management to attend a regional or international conference or workshop, such as the Microcredit Summit or conferences hosted by COPEME or FOROLAC.

During 2004 BanMicro offered a total of 11 training courses, including four for management and seven for staff, and supported attendance at three conferences. A total of 1,226 management and staff attended the trainings (several attended multiple) accounting for 7,700 person hours. Overall, 63% of BanMicro's professional-level staff received two days or more of training during 2004.

TRAINING COURSES OFFERED BY BANMICRO IN 2004				
MANAGEMENT TRAINING				
TYPE OF TRAINING	**NUMBER OF SESSIONS**	**NUMBER OF ATTENDEES**	**HOURS PER SESSION**	**PERSON HOURS PER TRAINING**
Loan Appraisal	7	91	6	546
Marketing	1	18	8	144
Leadership	2	36	8	288
Conference/Workshop Attendance	3	6	24	144
Customer Relations	6	104	8	832
Sub-Total	19	255	30	1,954
STAFF TRAINING				
TYPE OF TRAINING	**NUMBER OF SESSIONS**	**NUMBER OF ATTENDEES**	**HOURS PER SESSION**	**PERSON HOURS PER TRAINING**
Loan Appraisal	7	236	8	1,888
Business Development	4	110	4	440
Client Consulting	2	56	4	108
Customer Relations	10	411	6	2,466
Credit Scoring	5	91	4	364
Focus Group Facilitation	1	8	8	64
Housing Loan Documentation	2	50	4	200
Conference/Workshop Attendance	3	15	24	360
Sub-Total	34	977	62	5,890
TOTAL	53	1,232	116	7,844

Corporate Social Responsibility

BanMicro does not have a formal corporate social responsibility (CSR) policy. It is a regular contributor (both cash and in-kind) to community causes and events, but this is not part of an official CSR policy. At the corporate level, BanMicro contributes annually to local NGOs working to support the microenterprise sector in the communities where it works. It also encourages its branches to regularly sponsor community events. Each branch is permitted to donate 3% of its operating expenses from the previous year to community causes or events. During 2004 60 of BanMicro's 91 branches sponsored and contributed to a local community cause or event.

BanMicro does not have a formal, written code of conduct governing employees' interactions with other employees or clients.

Consumer Protection

In 2001, BanMicro introduced credit-life insurance that pays off loans when borrowers die. The insurance fund is self-funded with a nominal contribution of $1 from each loan disbursed. So far, the insurance fund is running a large surplus, and management is considering a proposal to reduce the contribution amount.

BanMicro adheres to a policy of full transparency about pricing. Loan officers disclose the effective interest rate in writing to all loan applicants prior to approving any loan. BanMicro is less accommodating, however, when it comes to giving client a voice in operations. Aside from suggestion boxes left at all branch offices, there is no formal policy that grants clients access to management to voice concerns and complaints. Loan officers typically fail to follow up aggressively on customer concerns and complaints. There is no formal channel at BanMicro to push the complaints up the management chain. Plus, loan officers have no incentive to pass complaints along, particularly when the complaints may reflect poorly on them.

BANMICRO OUTREACH TO THE COMMUNITY (DECEMBER 31, 2004)		
OUTREACH TO COMMUNITY INDICATORS	**BANMICRO**	**SCORE**
Percentage of operating revenues reinvested back into the community during most recently completed fiscal year		1
Percentage of employees that have left during two most recently completed fiscal years		1
Female-male employee ratio among professional-level staff		1
Percentage of employees receiving at least two days of training during most recently completed fiscal year		1
Whether the MFI has a written, formal internal CSR policy		0
Whether the MFI has a written, formal code of conduct governing actions towards employees and clients		0
Whether the MFI provides clients formal access to management		0
Whether the MFI provides health insurance for full-time employees		1
Whether the MFI provides credit life insurance for borrowers		1
Whether the MFI discloses the effective interest rate on all loans		1
Total Outreach to Community Score	-	**7**

VALIDATION OF OUTREACH INDICATORS

BanMicro adheres to generally accepted accounting principles in all its financial reporting. It has submitted its financial data to the MIX since 2001. The MIX awarded BanMicro's 2003 data a three-star quality rating. All outreach indicators utilizing MIX indicators are therefore judged to be of sound quality.

BanMicro relies heavily on its MIS to provide management with timely performance information. Consequently, it has made substantive investments upgrading the MIS over the last few years. The MIS tracks each of the products offered by BanMicro separately. Each unique client is given a client ID, which is used for any product the client purchases. BanMicro's MIS thus permits a detailed breakdown of its loan portfolio and savings accounts by client, product, size of transaction, operating unit, region, gender, and time frame. The MIS also tracks the number of money transfer made by each operating unit.

The MIS also tracks client retention of enterprise loans. BanMicro calculates the retention rates every each quarter using the following: RR = (FL/LP), where RR equals the retention rate, FL equals the number of follow-on loans made during the period, and LP equals the number of loans paid off during the period. The relevant time period used in the formula is three months. BanMicro defines a dropout as an enterprise loan client who has not taken a follow-on loan within three months of paying off the previous loan.

In the audit team's opinion, the MIS is a reliable source of information, and all indicators based on MIS information can be considered accurate.

BanMicro does not, however, track activity by urban or rural locations. Since it targets primarily urban areas, this has not been considered a priority. The percentage of rural clients was based on management's best estimate using the definition of rural and urban areas provided by the Peruvian census bureau. There is thus expected to be minor to moderate error in this estimate.

BanMicro's estimate of the average enterprise loan disbursal time is also based on management's best estimate. Management asked branch managers to estimate the average disbursal time for each enterprise loan product, including initial and follow-on loans, from which it calculated an average disbursal time using the percentage of new loans and follow-on loans for each loan product. It finally calculated a weighed average disbursal time by adjusting the average disbursal time for each loan product by its percentage share in the loan portfolio. Although the process used was reasonably sound, it did incorporate subjective assessments at different stages, which means that the indicator can be considered broadly accurate, although not precisely accurate.

Overall, it is the auditors' judgment that the information reported in the Social Performance Scorecard can be considered reasonably to highly accurate.

INTERNAL PROCESSES AT BANMICRO

BanMicro began operations as an NGO motivated by a social mission to assist microenterprises in and around Trujillo. The decision to begin enterprise lending and later to transform into a commercial bank was motivated largely by social considerations. Specifically, BanMicro's Board and management concluded that the best way to fulfill its social mission was through three strategic objectives: (1) offer a broad range of financial services suited to the needs of micro and small enterprises and low-income households, (2) achieve financial self-sufficiency, and (3) achieve significant scale. Eleven years after its founding and two years after transforming into a commercial bank, BanMicro successfully met all three strategic objectives.

By other measures as well, BanMicro appears to have fulfilled its social mission. It has reached hundreds of thousands of micro and small businesses and low-income households with loans and savings, it offers a diversified portfolio of financial services tailored to different market segments, it has established the foundation to continue delivering financial services to these markets on a sustainable basis, and it has a low average loan size relative to its peer group average with nearly one-third of loans below $400.

Despite its outward successes, BanMicro suffers from generally weak to adequate internal processes aimed at aligning policies and actions with social mission. Auditors assessed BanMicro's internal processes in five areas and found deficiencies in four of the five. Auditors found deficiencies in terms of mission communication and leadership, hiring and training, incentive systems, and strategic planning. In contrast, auditors found BanMicro's monitoring system to do a reasonably good job of aligning policies and behavior to social mission.

MISSION COMMUNICATION AND LEADERSHIP

BanMicro management repeatedly emphasized BanMicro's commitment to social mission to the social audit team, as did home office staff. Outside of the home office, however, references to social mission were less frequent. Field personnel generally conceded the importance of social mission, but several field managers and field staff were unable to recite BanMicro's mission statement. Nearly all field personnel interview cited financial imperatives (e.g., FSS, client retention, portfolio quality) as the driving force behind operations.

According to field personnel, management has taken only half-hearted steps to communicate BanMicro's social mission. While management makes frequent references to social mission in written or oral communications, it has not implemented any visible program to integrate social mission into operations. As a result, field personnel appear not to have internalized messages related to social mission.

BanMicro management has recently assumed a greater leadership role in addressing social mission issues in response to negative findings from analysis of BanMicro's MIS and subsequent focus group discussions. Management insists that it has turned a new leaf and that social mission will assume a more prominent place in operations. Field personnel, however, remain skeptical and have adopted a "wait and see" attitude.

Board members interviewed tended to downplay the relevance of social mission as a driving force for operations, instead arguing that social impact would be best achieved through achieving scale and financial sustainability.[25] They were also less inclined than senior management to attach significance to recent trends in terms of client retention and clients' socio-economic profiles. While conceding that each was important, especially client retention, the Board felt that these issues were best dealt with through tweaking normal operating procedures and did not require more drastic interventions. While the Board did agree to management's request to investigate possible organizational responses to the aforementioned trends, Board members remain hesitant to undertake too radical of a response.

So far, senior management at BanMicro has not created an effective system for communicating the message and values related to social mission to other members of the organization. The Board has also declined to take a leadership role in this area. A result is the absence of anything akin to a "social mission culture" at BanMicro. The recent initiative launched by management to address deficiencies in social performance suggests that management has assumed a more pro-active leadership role in this area, although it is still too early to tell.

INCENTIVE SYSTEM

Field personnel at BanMicro are paid a combination of salary and bonus. The bonus is determined by the HR Manager in consultation with senior management and based on the following four performance criteria: number of loan clients, outstanding loan portfolio, PAR > 15 days, and client retention. The bonus for loan clients, loan portfolio, and PAR are paid on a monthly basis, while the bonus for client retention is paid on a quarterly basis. For the outstanding portfolio bonus, all loans exceeding 15 days past due are subtracted from the portfolio in determining the bonus.

A bonus is awarded when field personnel exceed certain performance thresholds. With the exception of the client retention bonus, BanMicro has established three performance thresholds for each performance criterion. The size of the bonus increases for each performance threshold achieved, and no bonus is awarded for performance below the lowest performance threshold. Thresholds for loan officers are aggregated to create the thresholds for branch managers, which are in turn aggregated to create thresholds for regional managers.

The client retention bonus uses a single performance threshold and is awarded to all branch management and staff if the branch meets or

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[25] Eight of BanMicro's nine Board members come from the managerial ranks of the private sector. The lone exception is a professor of economics from the National University of Trujillo.

exceeds the performance threshold. Regional managers receive the client retention bonus if all branches in its region meet or exceed the performance threshold.

When asked to identify the component of the bonus system that influenced behavior the most, field personnel tended to cite the outstanding loan portfolio and PAR > 15. The dollar bonus for outstanding portfolio is the largest of the four, and it is also the easiest to earn. Field personnel also noted that the policy of subtracting past due loans from the portfolio bonus created strong incentives to maintain portfolio quality. In contrast, loan officers felt that the client retention bonus was to a large extent out of their control, which created less incentive for them to focus on this performance criterion.

Loan officers have discovered that they can maximize their bonus by reallocating more of their time to marketing and servicing the fixed asset loan, for two reasons. First, fixed asset loans are on average much larger than the working capital loan. Second, fixed asset loans tend to have a lower PAR and a higher client retention rate. Nonetheless, they also concede that there are diminishing returns to allocating time to the fixed asset loan. The market for working capital loans is larger and clients are easier to find. Moreover, the loan application and approval process for the working capital loan is less time consuming, which means that loan officers can do more working capital loans for the same level of effort as fixed asset loans.

Loan officers prefer working with larger working capital borrowers and, where possible, generally try to focus the bulk of their attention there. Competition in this market segment, however, is more intense relative to smaller working capital borrowers. Some loan officers have found it easier to focus their attention on smaller borrowers because it is easier and they can disburse large numbers of loans in relatively little time.

As currently structured, the performance bonus system creates moderate incentives for field personnel to target poor microentrepreneurs. This is evident in the relatively large share of loans outstanding less than $400. On the other hand, the performance bonus system also creates strong incentives for field personnel to move up-market either by focusing on fixed asset lending or by targeting larger working capital borrowers. Thus while the share of loans to poorer microentrepreneurs is relatively large at the moment, there are forces at play that threaten to diminish this share and push BanMicro further up-market.

HIRING AND TRAINING

BanMicro hires recent university graduates as loan officers. It aggressively recruits loan officers from the economics and business departments of local universities. Its preference is to hire local graduates who were born or raised in the area so as to ensure familiarity with local conditions and culture. Although the base pay for loan officers is not high by industry standards, the potential to earn significantly more via bonuses and abundant opportunities for internal promotion make BanMicro an attractive employer.

Prior to assuming loan officer duties, new hires undergo an intensive four-week training period, including two weeks of classroom training and two weeks of field training. BanMicro's social mission receives little attention during hiring or training. According to loan officers, the issue is raised during the hiring phase but not emphasized. Instead, the hiring process focuses almost entirely on the education and technical competency of applicants.

Social mission receives limited attention during new hire training. The topic is raised in introductory speeches by the Chief Executive Officer (CEO) during the first day of training and reinforced occasionally during the two-week classroom training. It is almost never raised, however, during the two-week field training.

BanMicro offers multiple training opportunities for management and staff. Aside from training sessions on customer service, however, none of the trainings are related to social mission or include social mission messages.

In summary, BanMicro makes only a limited effort to integrate social mission related issues into the hiring and training process, normally an excellent opportunity to select, transmit, and reinforce values related to social mission.

STRATEGIC PLANNING

BanMicro holds an annual strategic planning retreat in December to plan for the following year. Attendees at the retreat include Board members, senior management and regional managers. Issues commonly discussed at the strategic planning retreat include product innovation, operational and policy issues, financial performance goals, staff training, competition, and perceived opportunities or threats. The decisions reached at the strategic planning retreat establish the priorities for the coming year. BanMicro has established a good record of following through with strategic priorities established during the retreat.

Up to 2004, issues related to social mission have not been addressed during the strategic retreat. The last time the topic of social mission was discussed at any length was during the 1995 strategic retreat when BanMicro changed its mission statement to reflect its new strategic direction.

At the 2004 strategic retreat, discussion of social mission took center stage in light of the findings from the MIS analysis and focus group discussions. Participants at the retreat debated two broad strategic options: (1) continue as is; that is continue to expand breadth of outreach while catching a share of poor clients in the product net or (2) embark on a new strategic direction by implementing product/policy changes and reforming internal processes aimed at increasing outreach to and retention among poor clients.

Participants at the strategic retreat elected to pursue the second option. Rather than radically change its operations, however, BanMicro decided to implement common-sense, measured changes to increase its outreach to the poor and create a more customer-centered culture.

In January 2005, senior management at BanMicro held a one-day workshop to draft a broad strategy for implementing the proposed changes. Workshop participants identified the following as areas for potential reform: customer service, minimum savings deposit, collateral requirements, loan terms, performance bonus system, hiring and new hire training, and on-going training. The CEO assigned members of the management team responsibility for drafting reform proposals falling under their jurisdiction. All reform proposals are to be completed by June 2005 in time for the annual mid-year management meeting.

The discussion of social mission at the 2004 strategic retreat marked an important deviation from past practice. Early indications are that the decisions taken at the strategic retreat will lead to important reforms in policy, products, and processes, although it is still too early to determine whether this will be the case. Based on experience at the 2004 retreat, BanMicro's Board and senior management have expressed a commitment to integrate social mission into future strategic planning activities, although they cannot specify yet what form this will take and what importance it will assume.

While there is reason for optimism that BanMicro will do a better job in future integrating social mission into strategic planning, its history in this area gives reason for caution. BanMicro has yet to demonstrate whether 2004 was merely an anomaly to a tradition of downplaying social mission during strategic planning or the beginning of a new tradition.

MONITORING SYSTEMS

BanMicro collects information on clients' household income and business performance (sales, expenses, and profits) on its loan application form. This information is entered into BanMicro's MIS and used by the credit committee to determine whether to grant the loan and the accompanying loan terms.

The Business Development Department at BanMicro conducts routine analysis of client information in the MIS. It produces a quarterly report of its analysis that shows, among other things, trends in clients' demographic profile controlled for factors such as number of loans, gender, repayment, or drop-out. The primary purpose for the analysis and report is to identify market trends that suggest threats or opportunities for BanMicro.

The information can also be used to monitor outcomes related to social mission, though it is not traditionally used for this purpose. However, BanMicro's deteriorating client retention rate led management to request a more in-depth analysis so as to determine a client desertion profile. During this analysis, researchers determined that desertion was concentrated among poorer working capital clients with smaller or less successful businesses. The same analysis also found that fixed asset clients tend to be drawn from a higher socio-economic class than working capital clients. Average monthly sales and profits among the former equal $2,395 and $1,442 for compared to $1,036 and $814 among the latter. Similarly, the average monthly household income for fixed asset clients totals $1,273 compared to $661 for working capital clients.[26]

These findings led in turn to further market research via FGDs with ex-working capital clients. The combined findings of these market research activities convinced management of the need to undertake a strategic intervention.

On balance, BanMicro maintains a reasonably effective monitoring system. While the monitoring system was created for other purposes, it has proven useful to monitor compliance with social mission. It presumably, however, could be made more useful were it adapted and used more systematically for this purpose.

[26] BanMicro does not collect information on household size, so it was not possible to compare the household income per capita of the two borrower groups.

APPENDIX I – BANMICRO'S SOCIAL PERFORMANCE RATING

BANMICRO SOCIAL PERFORMANCE RATING	
RATING SCORE	**DEFINITION**
AAA	Excellent internal processes aligning performance with social mission. Excellent outreach. Extremely likely to create significant social impact now and in the future.
AA	Very strong internal processes aligning performance with social mission. Very good outreach. Very likely to create significant social impact now and the future.
A	Strong internal processes aligning performance with social mission. Very good outreach. More likely to create significant social impact now and in the future.
BBB	**Adequate internal processes aligning performance with social mission. Good outreach. Likely to create significant social impact now and in the future.**
BB	Weak internal processes aligning performance with social mission. Good outreach. Likely to create significant social impact with threat to long-term social impact.
B	Weak internal processes aligning performance with social mission. Adequate outreach. Less likely to create significant social impact now and in the future.
CCC	Weak internal processes aligning performance with social mission. Weak outreach. Less likely to create significant social impact with threat to long-term social impact.
CC	Poor internal processes aligning performance with social mission. Adequate outreach. Less likely to create significant social impact with serious threat to long-term social impact.
C	Poor internal processes aligning performance with social mission. Weak outreach. Unlikely to create significant social impact both now and in the future.
D	Poor internal processes aligning performance with social mission. Poor outreach. Very unlikely to create significant social impact both now and in the future.

The rating score can be adjusted with a + or – sign indicating a positive or negative variation with respect to the score.

APPENDIX II – BANMICRO'S SOCIAL PERFORMANCE SCORECARD

The Social Performance Scorecard rates MFI performance on the following seven dimensions of outreach/social performance:

- Breadth of Outreach: The number of persons reached with loans, savings, and non-financial services.
- Depth of Outreach: How far down the socio-economic ladder the MFI reaches with financial and non-financial services.
- Length of Outreach: The timeframe of supply of financial and non-financial services; institutional sustainability.
- Scope of Outreach: The number of distinct types of financial and non-financial products and services supplied.
- Cost of Outreach: Price costs and transaction costs borne by clients.
- Worth of Outreach: The value clients derive from consumption of products and services.
- Outreach to the Community: Socially responsible behaviors toward MFI staff and local community.

BANMICRO SOCIAL PERFORMANCE SCORECARD		
BREADTH OF OUTREACH		
INDICATOR	**POINT SCALE**	**BANMICRO SCORE**
Number of borrowers	0. < 20,000 1. 20,000-50,000 2. > 50,000	2
Clients with non-enterprise loans as a percentage of borrowers (consumption-emergency loans, housing loans, education loans, etc.)	0. < 10 % 1. 10%-30% 2. > 30%	2
Voluntary savers as a percentage of borrowers	0. < 50 % 1. 50%-75% 2. > 75%	1
Clients with other financial services as a percentage of borrowers (insurance direct, insurance via linkages, leasing, and money transfers; does not include credit-life insurance)	0. < 10 % 1. 10%-30% 2. > 30%	1
Clients with non-financial services as a percentage of borrowers (directly or via linkages)	0. < 10 % 1. 10%-30% 2. > 30%	0
Total Breadth of Outreach		6

DEPTH OF OUTREACH		
INDICATOR	**POINT SCALE**	**BANMICRO SCORE**
Average loan size as a percentage of GNI per capita for new loan clients	0. > 100% 1. 60%-100% 2. < 60%	1
Percentage of loans less than (a) $300 in Asia, Africa, and the Middle East; (b) $400 in Latin America and the Caribbean; and (c) $1,000 in Europe and Central Asia	0. < 20% 1. 20%-50% 2. > 50%	1
Percentage of female clients	0. < 20% 1. 20%-50% 2. > 50%	1
Percentage of rural clients	0. < 15% 1. 15%-30% 2. > 30%	1
Percentage of enterprise loan clients selected with direct poverty targeting tools	0. < 20% 1. 20%-50% 2. > 50%	0
Total Breadth of Outreach		4

LENGTH OF OUTREACH		
INDICATOR	**POINT SCALE**	**BANMICRO SCORE**
Profit margin	0. < 0% 1. 0%-10% 2. > 10%	2
Return on equity	0. < 0% 1. 0%-10% 2. > 10%	2
Return on assets	0. < 1% 1. 1%-2% 2. > 2%	2
Portfolio at risk < 30 days	0. > 6% 1. 4%-6% 2. < 4%	2
Operating expense relative to average loan portfolio	0. > 30% 1. 20%-30% 2. < 20%	2
Total Length of Outreach		10

SCOPE OF OUTREACH		
INDICATOR	**POINT SCALE**	**BANMICRO SCORE**
Number of distinct enterprise loan products	0. 1 1. 2 2. > 2	1
Number of distinct other loan products (consumption-emergency loans, housing loans, education loans, etc.)	0. 0 1. 1-2 2. > 2	1
Number of other financial services (direct insurance, insurance via linkages, leasing, money transfers; does not include credit-life insurance)	0. 0 1. 1-2 2. > 2	1
Type of savings offered	0. No savings or compulsory savings 1. Voluntary savings with limited access 2. Voluntary savings with full access	2
Percentage of clients with three or more products or services (does not include compulsory savings or credit-life insurance)	0. <15% 1. 15%-30% 2. >30%	1
Total Scope of Outreach		6

COST OF OUTREACH		
INDICATOR	**POINT SCALE**	**BANMICRO SCORE**
Real yield on average gross loan portfolio	0. > 40% 1. 20%-40% 2. < 20%	1
Nominal yield on average gross portfolio relative to prime commercial lending rate in home country	0. > 300% 1. 200%-300% 2. < 200%	1
Weighted average number of days to approve and disburse loans after completion of loan application (enterprise loans only)	0. > 10 1. 5-10 2. < 5	1
Percentage of loan clients providing non-traditional collateral (e.g., solidarity guarantees, third-person guarantees, movable property)	0. < 20% 1. 20%-50% 2. > 50%	1
Percentage of enterprise loan clients whom loan officers visit for regular financial transactions	0. < 20% 1. 20%-50% 2. > 50%	2
Total Cost of Outreach		6

WORTH OF OUTREACH		
INDICATOR	**POINT SCALE**	**BANMICRO SCORE**
Loan loss rate	0. > 4% 1. 2%-4% 2. < 2%	2
Client retention rate (enterprise loans only)	0. < 60%; does not track 1. 60%-80% 2. > 80%	1
Share of two-year clients still with the program (enterprise loans only)	0. < 30% 1. 30%-60% 2. > 60%	1
Share of portfolio growth attributable to existing clients over most recently completed fiscal year	0. < 30% 30%-60% > 60%	1
Type of market research conducted	0. No market research 1. Informal or ad hoc market research 2. Formal and systematic market research	2
Total Worth of Outreach		7

OUTREACH TO THE COMMUNITY		
INDICATOR	**POINT SCALE**	**BANMICRO SCORE**
Percentage of operating revenues reinvested back into the community during most recently completed fiscal year	0. < 2% 1. 2%-5% 2. > 5%	1
Percentage of employees that have left during two most recently completed fiscal years (not including pension leaves and deaths)	0. > 30% 1. 15%-30% 2. < 15%	1
Female-male employee ratio among professional-level staff	0. < 40% 1. > 40%	1
Percentage of employees receiving at least two days of training during most recently completed fiscal year (does not include new hire training)	0. < 50% 1. > 50%	1
Whether the MFI has a written, formal internal CSR policy	0. No 1. Yes	0
Whether the MFI has a written, formal code of conduct governing actions towards employees and clients	0. No 1. Yes	0
Whether the MFI provides clients formal access to management	0. No 1. Yes	0
Whether the MFI provides health insurance for full-time employees (in addition to national health coverage system)	0. No 1. Yes	1
Whether the MFI provides credit life insurance for borrowers	0. No 1. Yes	1
Whether the MFI discloses the effective interest rate on all loans	0. No 1. Yes	1
Total Outreach to Community		7

TOTAL OUTREACH	
POSSIBLE POINTS	**70**
BANMICRO SCORE	**46**

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