



microNOTE #12

Evaluating MFIs' Social Performance: A Measurement Tool

A. Introduction

Begun as a social movement, microfinance has evolved into a global industry dedicated to commercial principles of operation. Included among these commercial principles is the need for financial transparency. Over the years, the microfinance industry has made significant progress developing methods to measure and report financial performance. In contrast, the industry has made little progress developing methods to measure and report social performance consistent with its social roots. The lack of progress in this area owes largely to the difficulties and high costs inherent in measuring social performance.

Thus, there appears to be significant value in developing a simple, low cost, and credible social performance measurement (SPM) tool. This microNOTE briefly presents such a tool. As seen in the tool includes three components administered in successive steps: (1) **a social performance scorecard**, (2) **a social (or process) audit**, and (3) **a standardized social rating**. 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 **standardized social rating** states the likelihood that the MFI produces significant social impact both now and in the future. It, along with the scorecard, can be used to compare social performance across MFIs and contexts.

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B. Social Performance Scorecard

B1. Conceptual 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.

B2. Scorecard Criteria

Development of the scorecard was driven primarily by two criteria (among others): feasibility and scalability. Feasibility means that scorecard should be reasonably easy to implement without imposing a significant burden on the MFI's resources. Scalability refers to the likelihood that the scorecard is adopted by a large numbers of MFIs.

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.

B3. Scorecard Indicators

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.

B4. Financial Indicators

Within the outreach framework, financial indicators can provide valuable information on social performance. For example, financial indicators suggestive of institutional sustainability, 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.

B5. The 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:

1. Breadth of Outreach

1. Number of borrowers.
2. Clients with non-enterprise loans as a percentage of borrowers.
3. Voluntary savers as a percentage of borrowers.
4. Clients with other financial services as a percentage of borrowers.
5. Clients with non-financial services as a percentage of borrowers.

2. Depth of Outreach

1. Average loan size as a percentage of GNI per capita for new loan clients.
2. 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.
3. Percentage of female clients.
4. Percentage of rural clients.
5. Percentage of enterprise loan clients selected with direct poverty targeting tools.

3. Length of Outreach

1. Profit margin.
2. Return on equity.
3. Return on assets.
4. Portfolio at risk < 30 days.
5. Operating expense relative to average loan portfolio.

4. Scope of Outreach

1. Number of distinct enterprise loan products.
2. Number of distinct other loan products.
3. Number of other financial services.
4. Type of savings offered.
5. Percentage of clients with three or more products or services.

5. Cost of Outreach

1. Real yield on average gross loan portfolio.
2. Nominal yield on average gross portfolio relative to prime commercial lending rate in home country.
3. Weighted average number of days to approve and disburse

loans after completion of loan application.

4. Percentage of loan clients providing non-traditional collateral.
5. Percentage of enterprise loan clients whom loan officers visit for regular financial transactions.

6. Worth of Outreach

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

7. Outreach to the Community

1. Percentage of operating revenues reinvested back into the community.
2. Percentage of employees that have left the firm not including pension leaves and deaths.
3. Female-male employee ratio among professional-level staff.
4. Percentage of employees receiving at least two days of training.
5. If the MFI has a written, formal internal CSR policy.
6. If the MFI has a written, formal code of conduct governing actions towards employees and clients.
7. If the MFI provides clients formal access to management.
8. If the MFI provides health insurance for full-time employees.
9. If the MFI provides credit life insurance for borrowers.

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

C. The Social Audit

CI. Social Audit

The social (or process) 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 individual or group interviews with management, staff, board members, and clients.

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.

C2. 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.

1. 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 fulfillment. 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.

2. 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 fulfillment.

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 fulfillment.

3. 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 considera-

tions is much less likely to produce behaviors and outcomes consistent with social mission. It may even produce behaviors and outcomes contrary to social mission.

4. Performance monitoring is necessary to align the MFI's activities with its social mission.

Performance monitoring entails the routine collection of performance information. It is 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.

5. 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 fulfillment of performance goals. The inclusion of social considerations into strategic planning signals the relative importance an MFI attaches to social mission.

C3. Social Audit Process

The social audit can be divided into three distinct phases: preparation phase, audit phase, and report phase.

1. 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:

1. Review all internal and external documents related to the MFI's social performance.
2. Send a copy of the social performance scorecard for completion by the MFI prior to the audit.
3. Create the audit work plan and submit it to the subject MFI for comment.
4. Arrange the logistics of the work plan with the subject MFI.

2. The audit phase is the implementation of the social 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 to the quality of the five critical internal processes. The audit team will also review the social performance scorecard with management and verify the reliability of the responses.

At the conclusion of the audit, the audit team will draft a summary of its principal findings and present 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.

3. The report phase pulls all the information together. 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.
6. Copy of the social performance rating system showing the MFI's score along with all the possible rating categories and corresponding definitions.

C4. Estimated Level of Effort (LOE)

The estimate LOE to complete the social audit ranges from 13-17 days, as seen below.

Phase	Number of Days Low Estimate	Number of Days High Estimate
Preparation Phase		
Team Leader	2	2
Audit Team Member	1	1
Audit Phase		
Team Leader	3	5
Audit Team Member	3	5
Report Phase		
Team Leader	3	3
Audit Team Member	1	1
Total	13	17

C4. Markets for Social Audits

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 also 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. 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 through 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.

D. Social Performance Rating

D1. 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 as follows:

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.

D2. Advantages of Social Performance Rating

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.

E. Concluding Remarks

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 also be offered to meet the demand (heretofore

latent) for a simple, low-cost social performance measurement tool among MFIs, MFI networks, investors, and donor agencies. An important part of this approach will be to establish standard, or "best," process audit practices.

This requires that training standards be established and enforced through an accreditation process. Accreditation will not only help ensure the quality of the process audit, but it will also serve as an important signaling device that will reduce the information asymmetries between consumers and providers of social auditing services.

During the field-tests, the social performance scorecard will also undergo revision, including the indicators used in the scorecard and the scoring system.

A unique value of this social audit is that its component pieces (scorecard, process audit, and social rating) can be used separately or in different combinations, depending on the needs of the user. Each offers insight into different dimensions of social performance, and each can be standardized across MFIs and contexts.

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 prod-

uct. 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.

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