

## microNOTE #20

# Pilot Test of a New Social Rating Tool



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Branch visit with ANED loan officers, Santa Cruz, Bolivia

### Introduction

Two recent USAID publications—[microREPORT #35](#) and [microNOTE #12](#), both entitled “Proposal for a Social Performance Measurement Tool”—described a new social performance assessment (SPA) tool developed by USAID under AMAP Financial Services Knowledge Generation.

Two primary uses are envisioned for the SPA tool: social ratings integrated with financial ratings and stand-alone social audits. During March 23-29, 2006, Dr. Gary Woller (the lead researcher for the project) conducted a pilot test with a team from PlanetRating to integrate a social rating in the financial rating of the Asociación Ecuémica de Desarrollo (ANED), a microfinance institution (MFI) based in La Paz, Bolivia. This microNOTE summarizes the results and lessons learned from this pilot test. It also includes recommendations for further testing and refining of the SPA tool and for scaling up its use.

### The Pilot Test

#### *Objective*

The overriding objective driving the design of the USAID SPA tool is scalability, defined as the widespread adoption of the tool by microfinance stakeholders, including, most importantly, MFIs, social investors, donors, and rating agencies. Achieving significant scale in turn is considered a necessary condition to having significant impact on the microfinance industry and its development.

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The Social Performance Assessment tool included two components:

(1) **Social performance scorecard:** The social performance scorecard assesses social performance using a set of simple indicators falling under one of seven dimensions of outreach: breadth, depth, length, cost, scope, worth, and outreach to the community.

(2) **Social audit:** The social audit assesses five key internal processes and the extent to which they align its performance with its social mission: (1) mission statement and management leadership, (2) hiring and training, (3) monitoring systems, (4) incentive systems, and (5) strategic planning.

The scorecard and audit results are then combined to assign the MFI an overall **social rating score** using a standardized rating scale similar to those used by financial rating agencies. The social rating score 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.

To facilitate achievement of scale, both USAID and Planet Rating believe that social rating must be made commercially viable. The objective of the pilot test, therefore, was to determine how to integrate social rating into the financial rating process at the lowest possible cost. In this light, it was decided that the financial rating should proceed as normal, while simultaneously integrating tasks related to the social rating. Dr. Woller would play the role of advisor but otherwise leave the work to the members of the PlanetRating team. This process was followed, for the most part, during the rating exercise.

### **Integrating the Social Audit into the Financial Rating Process**

The financial rating process consists largely of three core tasks: (1) soliciting and analyzing financial and related institutional

performance data, (2) soliciting, finding, and analyzing supplementary institutional information (internal and external), and (3) conducting in-depth interviews with Board members, management, staff (main office and field), and clients. These three core tasks likewise make up the core tasks of the USAID SPA tool.

In addition, much of the information gathered during the financial rating process (both financial and non-financial) is the same type of information gathered during the social performance assessment process. This includes information related to each of the five key internal processes evaluated by the tool.

Given the considerable overlap between the three core tasks and the type of information gathered, the assumption prior to the pilot test was that grafting social performance assessment onto the financial rating process would not require the

rating team to make significant changes to its normal processes.

This assumption was confirmed during the pilot test. Integrating questions related to social performance, and the five key internal processes, proved to be reasonably easy. In some cases, relevant information was disclosed during the normal course of the interview without requiring separate questions. Other cases required separate questions related to social performance made within the context of the ongoing discussion. Still other cases required a completely separate line of inquiry related specifically to social performance issues.

On balance, however, adding these questions to the interview process did not materially change the way the process operated, nor did it materially increase the amount of time needed to complete the interviews. As commented by one member of the PlanetRating team, "During the on-site mission, I had the feeling that it was easy to integrate the two approaches, and we did not feel schizophrenic at any time in asking questions for the social part as well as the financial/institutional part. We can operate for this part as we usually do for the others . . ."

### **The Social Performance Scorecard**

Collecting information for the social performance scorecard did not on balance impose a significant increase in time.

There were exceptions, however. A few of the indicators proved more difficult than others to collect. One difficulty that arose was determining workable definitions for the indicators given information found in ANED's MIS.

During the tool development phase, indicators were developed based on past experience and on what was assumed to exist in a "typical" MIS. During the pilot test, however, the rating team determined that certain scorecard definitions did not fit the information in ANED's MIS. This required the team to come up with alternative definitions that measured the same underlying factors and which could be measured using ANED's MIS. Examples of problematic scorecard definitions included "percentage of enterprise loan clients whom loan officers visit for regular financial transactions" and "share of portfolio growth attributable to existing clients over the most recent completed fiscal year." While the problems encountered were specific to ANED's MIS, they point to the need to develop generally relevant definitions (at perhaps some cost of precision) that apply to a wide range of information systems.

Another difficulty involved determining precisely how to generate reports on specific indicators in ANED's MIS. This required team members to spend time with the MIS Director during the last day of the rating exercise describing the

information that was needed and working out how to generate the corresponding reports.

Counting the additional time required to ask and follow up on social performance related questions and to complete the social performance scorecard, completing the social rating took no more than a few additional hours of management and staff time beyond what it would have spent otherwise.

### **The Final Presentation to Management**

During the final presentation, the rating team presents its findings and conclusions to management. It is the capstone of the rating exercise. The final presentation typically takes two hours but can last as long as four hours depending on the nature of the findings and the extent of management's questions and/or objections. Adding discussion of the social performance findings to the final presentation introduces the potential for significantly increasing the length of the presentation.

The rating team dealt with this issue by deciding to limit discussion of the social performance findings to one hour if possible. ANED management did not have substantive questions or objections related to the social assessment, so the team was able to complete this discussion in the allotted time. It may not always be possible, however, to limit the discussion of social performance. This will require future users of the tool to de-

velop strategies for balancing the length of the final management presentation with the breadth and scope of issues covered.

### **The Social Rating Report**

Rather than integrate the social rating report into its standard financial rating report, PlanetRating elected to create a separate social rating report. As is its normal practice, PlanetRating submitted the social rating report to ANED for review, comment, and clarification. On receiving comments back from ANED, PlanetRating revised the report and submitted it to its internal review committee for review and approval. Once approved, PlanetRating will make the report publicly available.

### **The Social Rating Score**

Going into the pilot test, the intention was to give ANED a social rating score. Based on the pilot test, however, the rating team decided not to assign and publish a social rating score.

As a result of the pilot test, the rating team determined that the SPA tool required further refinement. To the extent that the tool undergoes revision during the course of future field tests, it will make any social rating score assigned today non-comparable to a social rating score assigned later. Besides this, the rating team decided that it needs additional experience with the tool to acquire a sufficient baseline of information that would allow it to make informed judgments about rela-

tive social performance. The decision of when to begin to assign social rating scores has therefore been put off to an indeterminate date in the future.

One interim alternative currently under consideration is to assign but not publish a social rating score. In this case, the rating agency would present the rating score to management with an explanation of what it means within the context of the MFIs current operations, although making it clear that the rating score is tentative and cannot be used to compare the MFI's performance to that of other MFIs.

## **Lessons Learned and Recommendations**

### ***Days to Complete the Social Rating***

The consensus among the rating team was that several of the interviews did not go into sufficient depth on issues related to social performance. In hindsight, team members could identify topics that they would like to have addressed in greater depth. Examples include product descriptions, training programs and plans, loan officers' perceptions, community activities, and human resource policies.

PlanetRating estimates that it will require approximately five additional days to complete the social rating. Included in this amount is time required to:

- Read additional documentation internal and external to the MFI (e.g., impact or market studies, poverty assessments, and other background information)
- Conduct additional field visits and spend more time talking to loan officers
- Conduct additional interviews with home office management
- Verify MFI-generated social performance information
- Write the social rating report

In the standard financial rating mission, PlanetRating usually does not count the time for preparing the final management presentation and does this work on the team's own time during nights or weekends. Adding more tasks and time to the rating mission for the social rating, however, will make it necessary to take this time into explicit account.

The actual amount of time it takes to complete the social rating, however, will depend on the rating agency, on the MFI being rated, and on other circumstances, in addition to how quickly and how far the rating agency moves up the learning curve. It is expected that with greater experience implementing the tool, the rating agency will become significantly more efficient at implementing the tool and integrating it into the financial rating exercise. In this sense, five additional days beyond the standard financial rating is estimated to be the upper

bound to complete the social rating.

### ***Social Performance Scorecard***

PlanetRating identified a number of concerns related to the social performance scorecard.

A. There are too many indicators (40) in the scorecard. PlanetRating prefers to assess a smaller set of indicators. For its financial rating, PlanetRating rates only six core financial indicators: portfolio-at-risk, write-off ratio, return-on-assets, operating expense ratio, staff productivity, and financial self-sufficiency. The remaining financial indicators are used to provide context and depth to the analysis, but they do not figure in the final rating score. Likewise, PlanetRating recommends that the scorecard include fewer core indicators and that the social rating report uses the remaining indicators to provide context and depth to the social analysis. No specific target number of indicators is currently envisioned, although future iterations of the scorecard are expected to make significant reductions in the number of indicators.

B. PlanetRating tentatively concluded that numeric indicators are preferable to process indicators (indicators showing whether the MFI engages in certain behaviors, typically scored as "yes" vs. "no").

C. Under "breadth of outreach," PlanetRating would like to see whether it is possible to include an indicator measuring geographic breadth. (An indicator measuring geographic

breadth was included in earlier versions of the scorecard.)

D. PlanetRating would prefer to eliminate or consolidate some of the indicator (outreach) categories in the scorecard. In particular, it believes that the category “length of outreach” could be cut from the scorecard.

PlanetRating feels uncomfortable using financial indicators to measure social performance. Whereas it believes that financial performance is a necessary condition for social performance, it believes the two to be distinct concepts. Moreover, since PlanetRating already evaluates the length of outreach indicators in its financial rating, it feels it is redundant to include it in the social rating component. It prefers instead to use financial performance as background context to understanding social performance rather than as a direct measure of social performance.

In this context it is important to note that the USAID SPA tool was originally designed under the explicit premise that financial performance was an integral component of social performance. Pragmatic recognition of PlanetRating’s concerns, however, requires the tool designers to rethink, although not necessarily abandon, this premise. In any case, there is general agreement that financial performance is important in understanding social performance; financially un-viable MFIs are unlikely to produce much social impact over the long-term. The question raised by PlanetRating is how to account for it in doing the social rating, whether as an

explicit indicator of social performance or as background information to place social performance in context.

E. In addition to reducing the number of outreach categories and indicators, it may also be worthwhile to consider changing the scoring system for the indicators. One suggestion advanced by PlanetRating is to use a 5-point ordinal scale (e.g., 1-5) in place of the existing 3-point ordinal scale (0-2). The advantage of the larger scale is that it allows for finer distinctions. This of course assumes that such finer distinctions are meaningful.

F. For PlanetRating to transform the SPA tool into a rating methodology, it recommends that the indicator categories (dimensions of outreach) be combined with corresponding parts of the social audit into “evaluation domains.” such as the following:

#### *1. Integration of Social Mission*

- Decision making processes
- Strategic planning
- HR management
- Monitoring social performance

#### *2. Quality of services*

- Adaptation of services to client needs (scope and worth of outreach)
- Consumer protection policies

#### *3. Outreach*

- Breadth of outreach
- Depth of outreach

#### *4. Social responsibility*

- Responsibility toward staff
- Responsibility toward community
- Non-financial services offered to clients

Further work on defining, weighting, and using the evaluation domains remains pending.

G. Organizing the social performance assessment in terms of evaluation domains (and rating fewer social performance indicators) requires in turn a more thorough assessment of the context behind the indicators. The impact of the scorecard on the final social rating should not simply factor in the scorecard values but should also take into account the context behind the scorecard.

In deciding which indicators to cut, keep, modify, or add to the scorecard, special attention should be paid to identifying ways in which indicators can lead to misleading conclusions. For example, the rating team determined that the indicator measuring “the percentage of enterprise loan clients whom loan officers visit for regular financial transactions” has high potential for creating misleading perceptions about the true cost of outreach. Consequently, this indicator has already been earmarked for removal from the scorecard.

### **Recommendations for Further Tool Refinement and Achieving Scale**

## Recommendations for Social Rating Tool

The current USAID SPA tool is but a starting point. It is assumed that the tool will undergo a process of refinement through field testing and use. If the objective of scale is to be achieved, it will be necessary to adapt the tool to the needs of its users, which includes not only the rating agencies but also social investors, donors, and practitioners.

It is not certain *ex ante* how many field tests are required to complete this process. The answer depends on the number of rating agencies involved, on the complexity/diversity of their needs, and on how quickly those needs can be discerned and addressed. The process is inherently iterative. In the end, each rating agency will create its own version of the social rating tool. Nonetheless, the goal of the project is not only to develop a social rating tool but also to develop and establish social rating standards. It will work with the rating agencies and other industry stakeholders to help ensure that tool adaptations conform to established standards.

## Recommendations for Stand-Alone Social Audit

In addition to the social rating component, it will also be necessary in the near future to commence pilot tests of the stand alone social audit component, which is targeted to MFIs and MFI networks as an internal assessment tool. It is expected that a similar iterative process will be required to adapt the

tool to the needs of the practitioner organizations.

Depending on how the social audit is implemented, the results of the social audit can also be disseminated to external audiences as evidence of social performance, or as evidence that the MFI is doing what it says it is doing. In this case, it will be important to standardize the tool, or more precisely the process for implementing the tool, to the extent possible so that the social audit findings are considered credible by external audiences. This will require, over time, the establishment of something akin to an accreditation process that creates a cadre of trained and certified social auditors.

## Objectives of Future Field Tests

As stated, one purpose of the pilot tests is to refine the tool and adapt it to the needs of its users. This is considered a necessary condition for achieving scale and significant impact. Another purpose of the pilot tests is to create legitimacy of the tool, and social performance assessment in general via use and dissemination. The more the tool is implemented, the greater its visibility and legitimacy and greater the likelihood that others will decide to use it. Increasing usage enhances the probability of the tool to be accepted as the industry standard, consequently helping it achieve scale and establishing social performance assessment as a legitimate and core function of microfinance.

There are expected to be strong first-mover advantages

to the SPA tool that enters the market and achieves both legitimacy and scale. The strategy for pilot testing and dissemination of the USAID SPA tool should bear this point in mind.

## Social Performance Scorecard

Taking the preceding into account, the following sequencing of actions is recommended.

Social Rating:

- Revise SPA tool taking into account recommendations made by PlanetRating.
- Conduct further field tests and tool refinements with PlanetRating beginning in Mali (where PlanetRating is scheduled to conduct social ratings of several MFIs during July and August 2006) and elsewhere as appropriate.
- Solicit interest from other microfinance rating agencies and perform field tests corresponding to the level of interest.
- Solicit interest in supporting and funding field implementation from other microfinance stakeholders, including investors, donors, USAID missions, and relevant program/project administrators.
- Refine the tool to meet the needs of the marketplace through field tests, while identifying opportunities to standardize the tool.
- Demonstrate the usefulness and commercial viability of the social rating tool thereby helping to create an effective demand for social ratings.

### Stand-Alone Social Audit:

- Recruit a core of North American PVOs to field test the social audit tool with their microfinance partner organizations.
- Recruit indigenous microfinance networks from different regions of the world to field test the social audit tool with their member organizations.
- Revise the social audit based on the experience of field tests so as to meet the needs of the users, while looking for opportunities to standardize the tool.
- Develop guidelines for conducting the social audit and create a certification program to train social auditors using the guidelines.
- Conduct “training of trainers” workshops for microfinance practitioners and consultants in the use of the social audit tool. Create a cadre of certified social auditors.
- Demonstrate the usefulness and cost-effectiveness of the social audit thereby helping to create effective demand for social audits.

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