PRISMS
Promoting Improved Sustainable MSME Financial Services
Contract No. 620-C-00-04-00037-00

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Trainer’s Guide

On Good Governance of Community Banks and Microfinance Institutions

September 2005

Prepared for the USAID Nigeria Promoting Improved Sustainable MSME Financial Services (PRISMS)
Eve Hamilton, Chemonics International
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Acknowledgements

A variety of sources were used in developing this course and guide. Particular thanks are due to Anita Campion, co-author of *Guidelines for the Effective Governance of Microfinance Institutions* and author of the original two day course of the same name. The Good Governance Workbook and other materials developed under the USAID/Jordan Achievement of Market-Friendly Initiatives and Results (AMIR) were also invaluable resources.
INTRODUCTION

Background: Community Banks, Microfinance Institutions, and Governance

Community banks (CBs) and microfinance institutions (MFIs) have the potential to dramatically expand access to financial services among the vast number of Nigerians with little or no access to commercial banks, particularly in rural areas. Their ability to realize that potential will depend, in part, on how they address governance issues.

Community Banks: Origins and Current Status. 1 With support from the Government of Nigeria (GON), community banks emerged in the early 1990s as a means to permit rural communities to own and management their own financial institutions, thereby increasing access to financial services. Initial licensing requirements for the banks reflected the development vision of these institutions and financial viability was not part of the screening process. Originally, CBs were regulated by the national Board for Community Banks (NBCB). Since 2000 responsibility for regulating these institutions has been shared with the Central Bank of Nigeria (CBN). Regulatory changes in recent years have stressed the importance of sound operational and financial management. Nonetheless, many community banks continue to operate more like development organizations than for-profit financial institutions.

There are currently approximately 775 community banks operating throughout Nigeria, of which 532 have obtained a license to operate from the Central Bank of Nigeria. These banks serve roughly one million clients and account for one sixth of all banking counters in Nigeria. They are an indispensable element of Nigeria’s strategy to accelerate growth in rural areas and to alleviate the widespread poverty that has reached about 70 percent of the total population. This is even more important as commercial banks have slowed down lending to rural areas since the liberalization of the financial markets, and as the state-owned agricultural development bank NACRDB is not yet in a position to fully serve farmers in Nigeria. The comparative advantage community banks have is their spatial proximity to their clients; their intimate knowledge of local cultures, habits, opportunities and constraints; and their focus on simple banking functions.

Yet the ability of community banks to sustainably expand outreach—or even survive—is undermined by pervasive governance problems. While well-governed community banks exist in Nigeria, in general, Board supervision is considered weak. Many Directors simply lack the skills needed to adequately supervise a financial institution. This helps to explain the poor financial management of many CBs, as well as persistent problems of fraud. According to a recent FAO report, 32 of 34 community banks visited had problems with overdue loans by members of the Board of Directors of the CB, or staff fraud and malpractice. Half of the community banks assessed fail to convene their Annual General Meeting (AGM)—required by law—and consequently are not fulfilling their legal and fiduciary responsibility to share financial information with shareholders. Not surprisingly, the FAO report found that those institutions that failed to hold their AGM, also tended to be the ones plagued by Director default on loans, fraud, and other forms of malpractice. In addition to insider lending and a lack of transparency, only 71 percent of

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1 This section is adapted from, “Federal Republic of Nigeria Assessment of Community Banks,” Food and Agriculture Organization of the United Nations – Rome Investment Centre Division, September 2004.
CBs regularly submit their quarterly financial reports to the CBN, which puts at risk their ability to obtain or maintain a license to operate.

**The Nigerian Microfinance Sector.** While smaller than the community bank sector, the Nigerian microfinance sector is growing, and a number of Nigerian MFIs are posed to reach significant scale. As their assets grow, and they engage in savings mobilization, either directly, or through the purchase of deposit-taking institutions—as is the case of the non-governmental organization, LAPO, which purchased a community bank—good governance becomes increasingly important to ensure the financial viability of the institutions and protect shareholder’s and clients interests.

Against this backdrop, this course is meant to introduce participants to the fundamentals of good governance and to provide them with the tools necessary to continually improve the governance of their institutions.

**Course Outline**

<table>
<thead>
<tr>
<th>Module</th>
<th>Purpose</th>
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</thead>
<tbody>
<tr>
<td>1. Introduction and Conceptual Framework: What is governance and why is it important to me?</td>
<td>Introduce yourself, the overall purpose of the training, and the course schedule to participants. Define governance and demonstrate to participants why this course will be of use to them.</td>
</tr>
<tr>
<td>2. Roles and Responsibilities of the Board</td>
<td>Introduce the key roles and responsibilities of the Board. Reflect on the level of commitment required of effective Board members, and provide participants with tools to promote that level of commitment. Define the relationship between the Board and management.</td>
</tr>
<tr>
<td>3. Board Membership: Guidelines for Creating an Effective Board, Part I</td>
<td>Discuss the technical and leaderships skills needed, and types of Directors generally found on Boards.</td>
</tr>
<tr>
<td>4. Board Structure and Procedures: Guidelines for Creating an Effective Board, Part II</td>
<td>Provide participants with the building blocks needed to construct effective Boards. Define the roles of key Board officers, Committees, and procedures.</td>
</tr>
<tr>
<td>5. Governance and the Legal and Regulatory Environment</td>
<td>To explore Boards’ obligations with respect to legal and regulatory compliance. To address issues of Director liability.</td>
</tr>
<tr>
<td>6. Board Oversight: Recommended Practices and Instruments</td>
<td>Explore the elements of an effective oversight strategy with a focus on action items and tools for strategy development and implementation. Special emphasis is placed on the process for establishing measurable objectives and selecting indicators.</td>
</tr>
<tr>
<td>7. Ownership and Governance: Who Does the Board Represent?</td>
<td>To explore the relationship between the ownership structure of distinct institution types and good governance.</td>
</tr>
<tr>
<td>8. Governing Change and Conflict</td>
<td>To discuss the Boards’ role in change and governing conflict. Participants will consider succession planning, conflicts of interest, and participate in a simulation on managing fraud.</td>
</tr>
<tr>
<td>9. Board Performance Evaluation and Board Development</td>
<td>To establish the importance of systematic Board evaluation. Participants will experiment with tools for conducting these evaluations and initiate a Board development plan.</td>
</tr>
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</table>
Trainer Preparation Guidelines

You should review each module carefully before initiating the training, ensuring that you are completely familiar with each concept. Each module follows the same layout:

**Purpose** – Every module begins with a brief purpose statement that informs the trainer why he or she is conducting the module. You should review this statement carefully and may wish to use this information when introducing the module to participants.

**Objectives** – This section describes what participants will achieve by the end of the module. You should keep these objectives in mind throughout the delivery of the module. Trainers should continually gauge participants’ grasp of the concepts and adjust the pace of the training as necessary to assure that the learning objectives are achieved.

**Preparation/Materials** – This section describes any materials you will need to conduct the training.

**Time** – Approximate times for each module (and in some cases specific steps or activities within modules) are provided as a general guide. However, the amount of time spent on any given module or activity may vary according to the number and/or experience level of participants.

**Delivery** – This section takes you step-by-step through the module. Although specific language for introducing or describing activities and concepts are provided, these are simply guidelines and you should feel free to use your own words.

The slide and handout numbers referenced in the text are for the module being discussed.

As written, this training is appropriate to both community bank and MFI representatives. However, you may want to shift the emphasis of the materials depending on the composition of the group receiving training. The specific target audience was assumed to be primarily CB and MFI Board members. The same materials can be used with Managing Directors. However, as noted in Module One, if the audience is comprised of mainly Managers, you should take some time at the outset of the course to ensure that the participants understand the value of having an effective Board before proceeding. An opportunity for you address this issue has been built into Module One, Step 4: Discuss Why Good Governance is Important.
MODULE ONE: WHAT IS GOVERNANCE AND WHY IS IT IMPORTANT TO ME?

Purpose:

To introduce yourself, the overall purpose of the training, and the course schedule to participants. While participants may have a general sense of why governance is important, some may not understand the value of sitting through a 3-day course on the subject. By the end of this module, participants should understand why this course will be of use to them.

Objectives

By the end of the Module participants will be able to:
  1. Identify each other by name and institutional affiliation
  2. Describe the course objectives
  3. Define governance and listed how good governance directly impacts their institutions

Preparation/Materials

Name tags or cards
Paper
Pens
Water
Flip Chart/markers
Power point slides
Handouts (copies):
  1. Detailed course agenda
  2. Board evolution

Time  1:30-2:00

DELIVERY

Step 1: Introduce yourself (5 minutes)

Display slide. Welcome participants to the course and introduce yourself briefly.

Slide

Good Governance of Community Banks and Microfinance Institutions

Presented by Nigeria PRISMS
Date:
**Step 2: Conduct Ice Breaker Activity: (20 minutes)**

Icebreaker activities are an effective tool for energizing the group, promoting participation and team building, and stimulating creative thinking. “Objectified” is a fun icebreaker that will help participants and the trainer feel more at ease with each other.

Tell the group that before getting started you would like to take a few minutes for everyone to get to know each other. Ask participants to pick up either an item from the table or one from their own purses, pockets, or wallets. Then ask one participant to introduce him or herself by name, institutional affiliation, and position and then to introduce the object he or she has chosen. When introducing the object, ask the participant to give the group one reason why he or she thinks he or she is similar to the object and one reason why he or she is unlike the object.

Example: Like the sharp point of this pencil I have a sharp analytical mind. Unlike this rigid pencil, I’m flexible and open to new ideas (or a very flexible dancer!).

Repeat the exercise until all participants have introduced themselves.

**Step 3: Review Course Objectives and Agenda: (15 minutes)**

Now that the group has gotten to know each other a little, ask participants what expectations they have for the course. Write answers down on a flip chart.

Display slide 1 with the course objectives and briefly discuss which of their expectations will be covered and which will not.

**Slide 1**

**Workshop Objectives**

By the end of this course, participants will be able to:

- Define effective governance practices
- Strengthen the corporate governance of their institutions using the knowledge and tools presented in this course

Display the Workshop agenda, slide 2, and briefly review the agenda for the 3-day course, noting the title of each module.
Distribute Handout 1 and review the day’s schedule, noting timing of each session and identify breaks and lunch. Begin each day with a quick review of the day’s agenda.

**Handout 1**

**Day 1**

<table>
<thead>
<tr>
<th>Time</th>
<th>Topic</th>
</tr>
</thead>
<tbody>
<tr>
<td>9:00-11:00</td>
<td>Module One. Introduction and Conceptual Framework: What is Governance and Why is it Important?</td>
</tr>
<tr>
<td>11:00-11:15</td>
<td>Coffee Break</td>
</tr>
<tr>
<td>11:15-12:15</td>
<td>Module Two. Roles and Responsibilities of the Board</td>
</tr>
<tr>
<td>12:15-1:45</td>
<td>Lunch</td>
</tr>
<tr>
<td>1:45-3:15</td>
<td>Module Three. Board Membership: Guidelines for Creating an Effective Board, Part I</td>
</tr>
<tr>
<td>3:15-3:30</td>
<td>Coffee Break</td>
</tr>
<tr>
<td>3:30-5:00</td>
<td>Module Four. Board Structure: Guidelines for Creating an Effective Board, Part II</td>
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</tbody>
</table>

**Day 2**

<table>
<thead>
<tr>
<th>Time</th>
<th>Topic</th>
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</thead>
<tbody>
<tr>
<td>9:00-10:30</td>
<td>Module Five. Governance and the Legal and Regulatory Environment</td>
</tr>
<tr>
<td>10:30-10:45</td>
<td>Coffee Break</td>
</tr>
<tr>
<td>10:45-12:45</td>
<td>Module Six. Board Oversight: Recommended Practices and Instruments</td>
</tr>
<tr>
<td>12:45-2:15</td>
<td>Lunch</td>
</tr>
<tr>
<td>2:15-4:15</td>
<td>Module Seven. Ownership and Governance: Who Does the Board Represent?</td>
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</table>

**Day 3**

<table>
<thead>
<tr>
<th>Time</th>
<th>Topic</th>
</tr>
</thead>
<tbody>
<tr>
<td>9:00-11:00</td>
<td>Module Eight. Governing Change and Conflict</td>
</tr>
<tr>
<td>11:00-11:15</td>
<td>Coffee Break</td>
</tr>
</tbody>
</table>
**Step 3: Define governance (20 minutes)**

Before showing the definition below, ask each participant to write down their definition of governance. Then, allow participants to volunteer their definition of governance and jot these down on a flipchart. Finally, establish the working definition for the purpose of this training using the slide 3 below.

**Note**: You should use this exercise to gauge individuals’ and the group’s understanding of and attitudes toward governance. You may wish to collect and quickly review the written definitions, visit the tables of participants during the exercise—casually reading their definitions—or simply ask as many people as possible to share their definitions with the group.

**Slide 3**

<table>
<thead>
<tr>
<th>What is governance?</th>
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</thead>
<tbody>
<tr>
<td><em>The process through which a board of directors guides an institution in fulfilling its corporate mission and protects that institution's assets over time.</em></td>
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Governance is a system of checks and balances, grounded in the transparent exchange of information, and accountability at all levels. At the core of the system the Board is created to both support and manage the institution’s managers. While management is accountable to the Board, the Board is accountable to the institution’s shareholders, or in the case of a non-profit MFI, to the institutions donors and other stakeholders.

In other words, it is the system that controls an organization, comprised of its written rules and the people charged with making sure they are followed.

**Step 4: Discuss why good governance is important (20 minutes)**

Ask participants why they think good governance is important. Write answers on a flip chart, then display slide 4, adding any reasons not already highlighted by the group. Make sure that you or someone in the group illustrates each reason with an example.
Why is Good Governance Important?

Good governance can help your institution:
- Prevent fraud and mismanagement
- Promote sound decision making
- Avoid costly fines and litigation
- Create/maintain a positive corporate image
- Attract and retain clients
- Attract and retain financing and investment (from commercial banks, etc.)

**Prevent fraud and mismanagement**: Ask if anyone has heard of a case in Nigeria or elsewhere where a Manager or Board has embezzled money from a financial institution, or simply made bad decisions, which led to significant financial losses or the closure of a financial institution. When you establish a system of checks and balances, and neither the Manager, nor the Board is operating without supervision, you minimize opportunities for fraud or mismanagement.

**Promote sound decision making**: Why does good governance promote sound decision making? Ask if anyone can think of an example from their own lives of when a group of people was able to make a better decision than an individual would have made on his or her own. When the Board and management work together, and a system of checks and balances at all levels is in place, more efficient and effective decision making is likely to follow. **Note**: If participants are primarily Managers, rather than Board members, you should use this exercise to establish why having a Board is useful to Managers. Some may come to this training thinking that Boards are at best a necessary evil.

**Avoid costly fines and litigation**: As we will discuss in Module Two, one of the Board’s key responsibilities is to ensure that the institution complies with all laws and regulations. As we will discuss in Module Five, failure to comply may result in fines of lawsuits.

**Create/maintain a positive corporate image**: In many countries people have lost faith in financial institutions because of corruption and mismanagement. A well-governed institution, with no major problems with fraud or mismanagement will be highly regarded, and will be better able to attract and retain clients.

**Attract and retain financing and investment**: Investors and donors want to know that the institution they are supporting is financially sound and that management is supervised effectively by a Board.

**Step 5: Conduct Board Evolution Exercise and Close Module One (10 minutes)**

Each participant will be asked to privately rate the current state of their board governance practices. Participants will revisit this exercise as part of the board development exercise at end of the course.

Distribute Handout 2. Ask participants to take 3-4 minutes to reflect on the state of board governance in their financial institutions and to fill out the Handout accordingly. Let them know that they do not have to share this information with the group, but that they should keep this form on hand to use in the final course exercise.
Handout 2

We estimate our Board to be at the following point of evolution in terms of Good Governance:

<table>
<thead>
<tr>
<th>Weak</th>
<th>Acceptable</th>
<th>Satisfactory</th>
<th>Good</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>50%</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

Participants may struggle with this exercise. Let participants know that:

*If you are not sure where your institution falls on the spectrum, or if you are concerned that your organization does not rate well, that is ok. We are going to spend the next three days discussing best practices for good governance and how to improve the governance of our institutions over time.*

Recommendation: Some participants may be overwhelmed by the gap between their current practices and the best practices discussed in this course. Therefore, it is important that you stress throughout the course that achieving and maintaining good governance is an ongoing process.
MODULE TWO: ROLES AND RESPONSIBILITIES OF THE BOARD

Purpose:

Introduce the key roles and responsibilities of the Board. Encourage reflection on the level of commitment required of effective individual Board members, and provide participants with tools to promote that level of commitment. Help participants clearly define the distinct roles and responsibilities of the Board and management.

Objectives:

At the end of this module participants will be able to:

1. Define the roles and responsibilities of the Board as a whole and of individual Board members
2. Identify policies and procedures to create an effective relationship between their Boards and Management

Preparation/Materials:

Flipchart
Powerpoint slides
Handouts:
1. Key Responsibilities of Directors
2. My Overall Responsibilities as a Board Member: Recommended Practice Example
3. My Board Member Undertaking: Recommended Practice Example
4. Constructing Effective Board-Management Relationships

Time

1:00

DELIVERY

Step 1: Define Key Responsibilities of the Board as a Whole

Display slide 1 and discuss each point: The Board has 5 key responsibilities: 1) fiduciary, 2) legal and regulatory compliance, 3) oversight, 4) policy making and strategic planning, 5) management oversight, and 6) performance evaluation.

Slide 1

<table>
<thead>
<tr>
<th>Key Board Responsibilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiduciary</td>
</tr>
<tr>
<td>Legal and Regulatory Compliance</td>
</tr>
<tr>
<td>Policy Making and Strategic Planning</td>
</tr>
<tr>
<td>Management Oversight</td>
</tr>
<tr>
<td>Performance Evaluation</td>
</tr>
</tbody>
</table>

13
A. Fiduciary responsibilities

There may be participants who are unfamiliar with the term fiduciary. To ensure that everyone understands this key concept, begin by asking the group to explain what a fiduciary is. Taking into account the responses, explain that *fiduciaries are the appointed to protect the interests of an institution’s owners, regardless of whether the owners are donors, shareholders, or members.*

Ask participants for examples of fiduciary responsibilities. These include:

1. Ensuring the sound financial management of the institution through regular monitoring of financial performance;
2. Securing the resources needed to achieve the institution’s goals; and
3. Ensuring timely, accurate reporting to shareholders and stakeholders on the institution’s financial performance

B. Ensure legal and regulatory compliance

The board ensures that the microfinance institution fulfills its legal obligations and protects it from unnecessary liability and legal action.

Ask: *What kinds of legal obligations does a CB or MFI have?*

These obligations include: compliance with the institution’s articles of incorporation, bylaws, internal policies and procedures, and government regulations.

C. Set policy and strategic direction

The board ensures that the institution’s mission is well defined, reviewed periodically, and respected over time. It also ensures effective planning, (ideally in collaboration with management), and works to enhance the image of the institution.

D. Ensure management accountability (oversight)

The board governs, not manages, the institution. It appoints and oversees the performance of the Managing Director, monitors operations and business performance, evaluates the institution’s performance in relation to other Community Banks or MFIs, assesses and responds to internal and external risks, and protects the institution in times of crisis.

E. Performance evaluation

The board should regularly assess its own performance to ensure that it is fulfilling its duties, identify any areas for improvement (whether at the individual Director or overall Board levels, and ensure that board development plans are developed and carried out.

Before moving on to Step 2, ask participants if they have heard of cases where a Board has not fulfilled one of these responsibilities.

*What were the consequences?*
They may think of examples close to home and may, therefore, be hesitant to share. If that seems to be the case, note that we can talk about the issues that arose without mentioning the name of the organization. Allow time for the group to discuss any examples for a few minutes, then conclude by saying that we will talk more about these Board responsibilities in upcoming modules.

**Step 2: Define Key Responsibilities of Directors**

Display slide 2 and Handout 1. Say: *Director’s have three key responsibilities.* Discuss each point.

**Slide 2**

<table>
<thead>
<tr>
<th>The Three Key Responsibilities of Directors:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <strong>Be informed and participate in decision making in good faith</strong> (referred to as <em>Duty of Care</em>)</td>
</tr>
<tr>
<td>2. <strong>To put the interests of the institution above their own</strong> (referred to as <em>Duty of Loyalty</em>)</td>
</tr>
<tr>
<td>3. <strong>Be knowledgeable of and faithful to the institution’s mission</strong> (referred to as <em>Duty of Obedience</em>)</td>
</tr>
</tbody>
</table>
Handout 1

Key Responsibilities of Directors:

1. **Be informed and participate in decision making in good faith** (referred to as *Duty of Care*)

   *In practice this means that each Director:*
   - Must devote sufficient time to do the job, including meeting preparation and regular attendance at board and committee meetings.
   - Ask substantive questions and request more detailed information as required to understand what is happening within the institution.

2. **To put the interests of the institution above their own** (referred to as *Duty of Loyalty*)

   *Putting the interests of the institution first requires a Director to:*
   - Support the majority view of the board once an issue is decided or a policy adopted.
   - Maintain independence, objectivity, ethical standards and confidentiality.
   - Reveal any potential conflict of interest situation that could influence the member’s participation in a particular board decision.

3. **Be knowledgeable of and faithful to the institution’s mission** (referred to as *Duty of Obedience*)

Suggestion: Tell the group that we will talk more about both conflicts of interest and the mission of CB’s and MFIs tomorrow.
Distribute Handouts 2 and 3: *You may wish to emphasize the importance of these duties within your boards by asking each Director to sign a letter of commitment similar to the one provided in the second handout.*

**Handout 2**

<table>
<thead>
<tr>
<th>My overall responsibilities as a Board member</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RECOMMENDED PRACTICE EXAMPLE</strong></td>
</tr>
</tbody>
</table>

**My duty of Care**
I devote sufficient time to be a productive Board member.
I prepare for Board meetings by reading preparatory documentation
I participate actively in Board Committees.
I ask pertinent questions in order to understand more fully how the Company is operating.
I contribute in good faith.
I make decisions and participate in voting from an informed point of view.

**I use my relationship to bring in more business to the company.**

**My duty of Loyalty**
I avoid any conflict of interest. My loyalty as a Board member is to the Company, and I exercise my powers as a Board member exclusively in this interest.
Even when I vote in disagreement, I support majority Board votes without equivocation.
I maintain my independence, objectivity and absolute confidentiality.
I function according to the highest ethical standards.
I reveal any actual or potential conflict of interest that could have an influence on my participation in a Board decision.

**My duty of Obedience**
I am fully aware of the Company's Vision, Mission, Values and Goals. I am faithful to them, and they guide my contribution to every Board meeting.
I never behave in a manner that is not consistent with the Company's institutional Objectives.
Handout 3

My Board Member Undertaking

RECOMMENDED PRACTICE EXAMPLE

I, __________, understand, as a member of the Board of Directors of ____________, that I have a legal and moral responsibility to ensure that the Company does the best work possible in pursuit of its goals. I believe in the purpose and mission of the Company, and I will act responsibly and prudently as its steward.

As part of my responsibilities as a Board member:

1. I will communicate the Company’s work and values to the community, represent the Company, and act as a spokesperson and advocate.

2. I will attend at least 80% of Board meetings, committee meetings and special events.

3. I will actively participate in fundraising activities.

4. I will act in the best interests of the Company, and excuse myself from discussions and votes for which I have a conflict of interest.

5. I will stay informed about the Company’s program. I will ask questions and request information. I will participate in and take responsibility for making decisions on issues, policies and other Board matters.

6. I will work in good faith with staff and other Board members as partners toward achievement of our goals.

7. If I fail to fulfill these commitments, I will expect the Board Chair to discuss my responsibilities with me.

In turn, the Company will be responsible to me in several ways:

1. I will be sent in a timely manner, without request, quarterly financial reports and an update of Company activities that allow me to fulfill my obligations as per the Statutes.

2. Opportunities will be offered to me to discuss with the Chief Executive and Board Chair the Company’s goals, status, strategy and program. I may also request such opportunities.

3. The Company will help me perform my duties by keeping me informed about developments in the microfinance and related sectors, and by offering me opportunities for professional development as a Board member.

4. Board members and staff will respond in a straightforward fashion to questions I have that are necessary to carry out my fiscal, legal and moral responsibilities.

5. If the Company does not fulfill its commitments to me, I can call on the Board Chair and Chief Executive to discuss these responsibilities.

Signed:       Signed:
Date:        Date:
Member, Board of Directors    Chair, Board of Directors
Step 3: Discuss the Relationship between the Board and Management

The weakness of many institutions can be linked in part to a less than optimum relationship between the Board and the Managing Director. On one end of the spectrum the Managing Director is left alone to operate the institution with little or no guidance or oversight from the Board. In such cases, the possibility of fraud or mismanagement increases. At the other end of the spectrum, an overactive Board may make it impossible for a Manager to effectively manage.

The optimum division of labor between the Board and Managing Director and the complementarity of their roles are among the hardest concepts for Boards to understand, or embrace. The trainer should ensure that participants grasp these key concepts before moving on to the next module.

Ask the group: How would you describe the ideal relationship between the Board and the Managing Director?

Allow time for responses, then display slide 3, and relate participant’s comments to the three points.

The relationship between the Board and Managing Director, can be summarized as follows:

Slide 3

<table>
<thead>
<tr>
<th>Relationship between the Board and Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Board and management deal with the same issues, but at different levels</td>
</tr>
<tr>
<td>- broad policies vs. practical implementation</td>
</tr>
<tr>
<td>• Defined by partnership</td>
</tr>
<tr>
<td>- Particularly between the board chair and the managing director</td>
</tr>
<tr>
<td>- Based on mutual support, trust, and respect forged between them.</td>
</tr>
<tr>
<td>• The Board governs management</td>
</tr>
</tbody>
</table>

Ask the group for examples of how the board and management deal with the same issues, but at different levels. Examples could include:

1. Establishing institutional policies – The Board establishes the general policies regarding lending, branch openings, staff compensation, mergers and acquisitions, etc., while management determines how to apply these policies on a day-to-day basis.
   
   ✓ The Board defines the characteristics of communities where the institution will provide services, while management selects the actual communities.

2. Strategic planning – The Board defines key annual objectives for the institution. Management then develops the annual plan and 3-5 year strategic plan, both of
which are reviewed and approved by the board. We will talk more about Board-Management responsibilities and strategic planning in Module Six.

Display slide 4:

**Slide 4**

**Striking the Balance**

*Effective governance strikes the appropriate balance in the relationship between a board of directors and management in their combined efforts to move the institution forward. Each brings unique skills to this joint effort and views the institution from a different lens. Together they add value precisely because they are complementary.*


*As these examples demonstrate, the relationship between the Board and management is based on partnership. To be effective, that relationship must be rooted in mutual respect, with each party understanding its roles and responsibilities.*

*How do you establish and maintain that relationship?* Ask the group for suggestions. Write responses on flip chart. Make sure that their answers include the suggestions made in Handout 3, which you should distribute at the end of the discussion.

**Handout 3**

**Constructing Effective Board-Management Relationships**

Establish effective, systematic communications through:

- Regularly scheduled meetings
- Regular reporting

Respect the role of Managing Director:

- Avoid undermining the authority of the MD. Most communications between the Board and staff should pass through the Managing Director
- Don’t assume responsibilities beyond the scope of the Board (and vice versa)

Consider creating informal opportunities for discussion: social events, retreats, etc.

*Finally, it is important to remember that according to best practices, the Managing Director reports to the Board, and the Board is responsible for both supervising and guiding the Managing Director.*
MODULE THREE. BOARD MEMBERSHIP: GUIDELINES FOR CREATING AN EFFECTIVE BOARD, PART I

Purpose:

Provide participants with the building blocks needed to construct effective Boards. Discuss the technical and leaderships skills needed, and types of Directors generally found on Boards.

Objectives:

At the end of this Module participants will be able to:
1. Explain the key factors to consider when selecting Board members
2. Design effective recruitment and selection processes
3. List recommended terms of Board appointment.

Preparation/Materials:

PowerPoint slide
Handouts:
1. Types of Boards
2. Board Milestone Map
3. Recommended Board Member Skills
4. Our Board’s Composition: Recommended Practice Example
5. Board Member Tenure and Renewal: Recommended Practice Example
6. Removing Non-Performing Board Members: Recommended Practice Example

Time: 1:30

DELIVERY

Step 1: Present the issues to consider in determining board composition

A. Types of Boards (rubber stamp, hands-on, etc.)

The purpose of this discussion is to get participants thinking about the kind of board they want to construct.

Display slide 1: Boards may be grouped into four broad categories according to their level operating style and composition: rubber stamp, hands-on, representational, multi-type. Distribute handout and briefly discuss the attributes of each board type.

Slide 1

<table>
<thead>
<tr>
<th>Types of Boards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rubber Stamp</td>
</tr>
<tr>
<td>Hands-On</td>
</tr>
<tr>
<td>Representational</td>
</tr>
<tr>
<td>Multi-Type</td>
</tr>
</tbody>
</table>
What are the strengths and weaknesses of each type? Let the group brainstorm, then distribute Handout 1 and adding any issues that have not been covered.

Handout 1

Types of Boards

<table>
<thead>
<tr>
<th>Type</th>
<th>Rubber Stamp</th>
<th>Hands-On</th>
<th>Representational</th>
<th>Multi-Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Composition</td>
<td>Dominated by one or a couple Board member(s)—often the founder), or by the Managing Director</td>
<td>Brings diverse technical expertise to guide the institution</td>
<td>Comprised of well-connected, influential individuals</td>
<td>Combines best characteristics of each type</td>
</tr>
<tr>
<td>Strengths</td>
<td>May be led by a highly committed individual</td>
<td>Actively involved in decisionmaking Knowledgeable about the day-to-day challenges the institution faces</td>
<td>Able to attract financing and access information to support growth May provide effective oversight to protect their reputations</td>
<td>Strong commitment, diverse technical expertise, connections and influence Actively involved in decisionmaking, but avoid micromanagement</td>
</tr>
<tr>
<td>Weaknesses</td>
<td>Lacks diversity in skills and vision that can strengthen an institution If dominated by Board member, may drive away strong Managers Lack of checks and balances may lead to instances of fraud or mismanagement</td>
<td>Danger of micromanaging; can undermine the authority of the Manager and his or her ability to make rapid day-to-day management decisions</td>
<td>May have little time for board activities, and/or lack technical expertise</td>
<td></td>
</tr>
</tbody>
</table>

Where participants’ Board’s fall within this classification may depend in part on the stage of development of their institutions. Younger institutions are sometimes led by a strong visionary who takes an active role in all aspects of institutional management. During their early stages of development institutions may design and operate with a simple, centralized organizational structure and focus more on social than financial goals. As an institution grows and becomes more complex, a more decentralized and business-like approach to internal management and oversight becomes necessary to ensure sound management and sustainability and the achievement of both the social and financial
mission. While an effective Board is beneficial to an institution at all levels of development, it become particularly important as an institution matures.

Distribute handout 2: As handout 2 illustrates, it is not uncommon for the level of board involvement and development to evolve over time. The objective of this module and those that follow is to provide you with the information and tools you need to create or maintain the Board and overall governance structure that you want.

**Handout 2**

<table>
<thead>
<tr>
<th>Start up</th>
<th>ACTION</th>
<th>The future</th>
</tr>
</thead>
<tbody>
<tr>
<td>First phase leadership</td>
<td>Second phase leadership</td>
<td></td>
</tr>
<tr>
<td>Rubber stamp (Fan Club) Board</td>
<td>Board development plan implemented</td>
<td>Regular Board self-assessment</td>
</tr>
<tr>
<td>Unfocused recruitment of Board members</td>
<td>Focused Board member recruitment and renewal</td>
<td></td>
</tr>
<tr>
<td>CEO overly dominant</td>
<td>Chair overly dominant</td>
<td>Board begins to function as a team</td>
</tr>
<tr>
<td>Board &amp; CEO marginalize institutional sustainability in quest for operational &amp; financial sustainability</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>IMPACT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of transparency</td>
</tr>
<tr>
<td>No governance</td>
</tr>
<tr>
<td>Institutionally unsustainable</td>
</tr>
</tbody>
</table>

**B. Skills and characteristics of directors**

Display slide 2: To a significant degree the best mix of board skills (i.e. appropriate composition of a board) will depend upon three factors: the mission of the institution; the stage of the institution’s development; and the external context in which it operates.
The Optimal Board Composition Depends On:

- The mission of the institution
- The stage of the institution’s development
- The external context in which it operates: competitive or regulatory environment

Mission: An institution seeks to improve the lives of indigenous peoples would likely include representatives of indigenous groups; an institution that targets women may want a certain percentage of women on the board.

Stage of Development: An institution starting out may want influential, well respected Directors to help establish the reputation of the institution and attract funding, while an NGO MFI that decides to transform may need to bolster its banking knowledge.

External Context: Faced with increasing competition, an institution may need to strengthen its marketing and sales skills. An institution facing a new regulatory environment may need to recruit regulatory experts.

While the mix of skills may vary somewhat over time, in general, what basic skills should a community bank or MFI board possess? Make sure the group covers both technical and leadership skills, as well as skills specific to both CBs and MFIs.

After the discussion distribute the Handout 3.

Handout 3

Recommended Board Member Skills

<table>
<thead>
<tr>
<th>Leadership Skills</th>
<th>Technical Skills</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commitment to the MFI’s Mission</td>
<td>Banking and Finance</td>
</tr>
<tr>
<td>Integrity/Trustworthiness</td>
<td>Microfinance Industry Expertise</td>
</tr>
<tr>
<td>Demonstrated Leadership Success</td>
<td>Accounting</td>
</tr>
<tr>
<td>Communication Skills</td>
<td>Legal and Regulatory Skills</td>
</tr>
<tr>
<td>Common Sense/Sound Judgment</td>
<td>Public Relations</td>
</tr>
<tr>
<td>Willingness to Make Time Commitment</td>
<td>Marketing and Sales</td>
</tr>
<tr>
<td>Objectivity/Independent Thinking</td>
<td>Human Resources</td>
</tr>
<tr>
<td>Ability to Work with Other Board Members</td>
<td>Entrepreneurship/Business Success</td>
</tr>
<tr>
<td>Consensus Building Skills</td>
<td>Sociology/Community Development</td>
</tr>
<tr>
<td>Willingness to Participate</td>
<td>Information Technology</td>
</tr>
<tr>
<td>Awareness of Personal Contribution</td>
<td>Fundraising (for non-profits)</td>
</tr>
</tbody>
</table>
To summarize...

**Slide 3**

**Board Composition**

Effective board members possess:
- ✓ Diverse, complementary technical skills
- ✓ Proven leadership skills
- ✓ Understanding of and commitment to institutional mission
- ✓ Ability and willingness to fulfill duties
  - Beware of those with political motives
  - Beware of conflicts of interest

Close the discussion by distributing Handout 4. Suggest that participants take some time during a break, or in the evening, to use this simple and useful tool for rapidly assessing their Boards’ composition.

**Handout 4**

**Our Board’s Composition**

Our Board is currently composed of members with the following profiles:

<table>
<thead>
<tr>
<th>Profile 1:</th>
<th>Profile 2:</th>
<th>Profile 3:</th>
<th>Profile 4:</th>
<th>Profile 5:</th>
<th>Profile 6:</th>
<th>Profile 7:</th>
</tr>
</thead>
</table>

We are missing the following profiles:

<table>
<thead>
<tr>
<th>Profile 1:</th>
<th>Profile 2:</th>
<th>Profile 3:</th>
<th>Profile 4:</th>
<th>Profile 5:</th>
<th>Profile 6:</th>
<th>Profile 7:</th>
</tr>
</thead>
</table>

We intend to re-balance the Board, in order to ensure we have all the expertise that we need.

Priority recruitment for the next 6 months:

<table>
<thead>
<tr>
<th>Profile 1:</th>
<th>Profile 2:</th>
<th>Profile 3:</th>
</tr>
</thead>
</table>
C. Director Affiliation and Representation

Display slide 4. In addition to technical and leadership skills you also need to consider the relationship that Board Members have to your institution and to other institutions. There are three types of Directors:

**Slide 4**

**Director Affiliation and Representation**

*Types of Directors:*

- **Internal Directors:** Managers and staff
- **Affiliated Directors:** Investors, lenders, and legal representatives of the institution
- **External Directors:** Individuals, not reps of institutions, government, or donors

What advantages might there be to having Managing Directors (or other Managers) and staff on your Board?

Internal Directors can provide valuable inside information and a strong commitment to and understanding of the institution.

What about disadvantages?

Managers—and staff through Managers—are accountable to the Board. Therefore, in most instances it is preferred that these members have a voice but no vote on the Board. This facilitates the flow of information between the Board and staff without undermining the separation of powers between the two.

What advantages might affiliated Directors offer?

Affiliated Directors are the most common type of board member. They offer a strong commitment, fresh perspective, and broad information base. Best practice recommends that boards of for-profit MFIs consist primarily of affiliated directors because they have the strongest stake in the strong performance of the institution.

Why would a Board want external (or independent) Directors?

External Directors offer objectivity when the board is small and homogeneous. Recruiting external directors as individuals, rather than representatives of other institutions avoids conflicts of interest (split loyalties) and promotes continuity. An individual can switch jobs without resigning from the Board while a representative of an institution would have to be replaced.

Institutions with geographically dispersed outreach should consider appointing members from the different regions in which they work to ensure informed strategic planning, local contacts, etc.
Step 2: Define optimal board size

Distribute slide 5: In deciding on the size of your Boards, consider:

**Slide 5**

<table>
<thead>
<tr>
<th>Board Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Skill coverage</td>
</tr>
<tr>
<td>• 5-9 members</td>
</tr>
<tr>
<td>• Odd number</td>
</tr>
</tbody>
</table>

The Board should be big enough to encompass the diverse skills needed for effective governance, yet small enough to allow for adequate participation and facilitate decisionmaking. Typically, Boards have an odd number of members to avoid deadlocks. Worldwide, Boards generally have 5-9 members. The Council of Microfinance Equity Funds recommends that Boards be no smaller than 7 members because quorum becomes very small.

Step 3: Recruitment and Selection Policies and Procedures

Ask participants: who should select board members? If they say, “management,” respond that while the manager may recommend Directors, and even participant in the evaluation of candidates, to ensure the independence of the Board, in accordance with best practices, the existing board selects new members.

*And how do you ensure that you are selecting good board members?* Display slide 6 and discuss.

**Slide 6**

<table>
<thead>
<tr>
<th>Board Recruitment and Selection Process</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Evaluate current Board strengths and weaknesses and institutional performance objectives</td>
</tr>
<tr>
<td>• Develop a position description based on the skills and profile needed to complement existing board members and achieve objectives</td>
</tr>
<tr>
<td>➢ Remember to include commitment to the mission!</td>
</tr>
<tr>
<td>• Establish evaluation criteria and a rating system</td>
</tr>
<tr>
<td>• Use a nominating committee to ensure objectivity and avoid nepotism</td>
</tr>
</tbody>
</table>

Step 4: Discuss terms of appointment and director removal

*Clear terms of appointment and policies and procedures for the removal of Directors promote high quality board service and the right balance between continuity of*
leadership and the infusion of new ideas and skills. What are the key elements of effective terms of appointment? Display slide 7 and discuss each point.

**Slide 7**

**Terms of Appointment – Recommended Practices**

- Clearly communicate requirements and expectations
- Establish terms of service to the board
- Use renewable terms
- Stagger terms
- Establish a dismissal policy
- Consider compensation for Directors

Board members who are clear about their roles when they are hired are more likely to meet expectations. Moreover, it is easier to address Director performance problems when expectations are clear.

1. Develop a **written description** of board member responsibilities and the expected time commitment for the position.
2. **Create and approve a board manual** to share with potential board members before inviting them to their first board meeting.

The typical term for a Board Director ranges from 2 to 4 years. **Renewable terms** allow boards to retain their most dedicated and skilled directors. But you should weigh the benefits of limiting the number of consecutive terms (continuity vs. fresh perspectives). By **staggering the terms** an institution can avoid a situation in which an inexperienced majority governs the CB or MFI.

The **dismissal policy** should cover situations with cause and without cause.

Internationally, corporations tend give Board members financial **compensation**. MFIs—whether for-profit or non-profit—often do not. The decision is up to the institution. However, providing even minimal compensation can promote greater commitment from Directors. If the institution does not offer monetary compensation, the non-monetary benefits should be clear (the prestige of being affiliated with the institution, links to social mission, etc.)
Display slide 8: You may want to consider the following approaches to compensation:

**Slide 8**

<table>
<thead>
<tr>
<th><strong>Board Compensation Options</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay members for time spent in meetings based on the value of a senior professional’s time</td>
</tr>
<tr>
<td>BancoSol pays members a fee for time spent in board and committee meetings. It also provides a bonus—an additional 50 percent for meeting annual performance targets.</td>
</tr>
<tr>
<td>Council of Microfinance Equity Funds, 2005</td>
</tr>
</tbody>
</table>

Distribute Handouts 5 and 6: *Handout 5 provides an example of recommended practices for Board tenure and renewal, which illustrates the practices we’ve discussed. Handout 6 is an example of one approach to Director removal policy, which involves asking Directors to sign resignation letters when the join the Board, to be executed when necessary.*

**Handout 5**

<table>
<thead>
<tr>
<th><strong>Board Tenure and Renewal</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RECOMMENDED PRACTICE EXAMPLE</strong></td>
</tr>
<tr>
<td>Our Tenure and Renewal Policy is designed to balance governance continuity and institutional memory with dynamism and fresh ideas.</td>
</tr>
<tr>
<td>Our members stand for re-election every three years. They can only be re-elected once, which means that they can serve on the Board for a maximum of six years.</td>
</tr>
<tr>
<td>Even though our re-election period is every three years, we are also guided by our self-evaluation and peer evaluation policy. Every year, at our Board Retreat, we review our performance, and determine if we are still the right people, in the right place at the right time.</td>
</tr>
<tr>
<td>By staggering terms, a maximum of one third of the membership would leave or join the Board at one time.</td>
</tr>
<tr>
<td>We will attempt to ensure that no more than two Board members leave or join at the same time.</td>
</tr>
</tbody>
</table>
We remove non-performing Board members

RECOMMENDED PRACTICE EXAMPLE

As Board members, we commit to attend all Board meetings. This commitment is enshrined in the Board Member Undertaking.

When a new Board member is recruited, s/he signs an undated resignation letter. The letter is filed with the Board Secretary.

If the Member fails to attend more than two consecutive Board meetings, or if their behavior contravenes the statutes of the Company or the Board's Code of Conduct, the Chair may recommend that the resignation letter be dated and the resignation recorded at the next Board meeting.

Resignation letter

For the attention of the Chair

Dated: (to be completed with the full agreement of the Board)

Dear (name of the Chair)

I hereby submit my resignation from the Board of the Company.

Signature (Name of the resigning Board member)
MODULE FOUR. BOARD STRUCTURES AND PROCEDURES: GUIDELINES FOR CREATING AN EFFECTIVE BOARD, PART II

Purpose:

Provide participants with the building blocks needed to construct effective Boards. Explore the roles of key Board officers and Committees.

Objectives:

At the end of this Module participants will be able to:
1. Describe the roles of the Board Chair and other key Board officers
2. Evaluate the skills required of a Board Chair
3. Explain the function of Board Committees
4. Conduct a Board meeting following best practice Board procedures

Preparation/Materials:

PowerPoint slides
Slips of paper with Board member titles and roles for Board Procedures in Action
Exercise
Handouts:
1. Our Chair’s Role
2. Summary of Key Officer Duties
3. Specialized Committees

Time: 1:30

DELIVERY

Step 1: Establish the Role of Chair

A. Role of the Chair

Typically, what are the key positions on a Board?

Generally speaking a Board should consist of a Chair (sometimes called the President), Vice Chair, Treasurer and Secretary. The Chair is the principal officer of the institution and the heart and soul of the Board.

*What is the role of the Chair*?
Slide 1

Role of the Chair

Oversees the preparation of a board meeting, ensures that the meeting is effective, expends considerable effort building relationships (w/ management), oversees the long-term strategy of the institution (social vs. financial viability).

It is not uncommon for the Managing Director to serve as Chair. What advantages could this have?

The Managing Director knows the day-to-day details of the institution’s operations.

Why disadvantages might there be to having the Managing Director as Chair of the Board?

Ideally, the Chair should serve as the intermediary between the Board and Managing Director. As discussed in Module Two, the Managing Director is accountable to the Board. By keeping the positions distinct, you protect the separation of powers and the ability of the Board to hold the Managing Director accountable.

Display slide 2.

Slide 2

Recommendation: separate the positions of Chair and Managing Director

Divide participants into groups and give them 10 minutes to brainstorm on the characteristics of an effective Chair. Ask each group to present. If participants have left any of the following qualities out, suggest them to the group.

- Visionary who thinks ahead of management, anticipating situations, developments and needed changes
- Strong public relations skills, adds to the stature of the institution
- Strong coordination skills - sets meeting agendas (in cooperation with the managing director and/or other directors) and keeps meetings on track, ensures that the committees are active and well staffed
- Effective facilitator - creates a process for reaching consensus that is in line with the institution’s mission and ensures the active participation of all board members

B. Terms

Should the position of chair be renewable or not? As in the case of other Board member terms, each institution must weigh the advantages and disadvantages of allowing renewable terms for the Board Chair.
End the discussion of the role of the Chair by distributing Handouts 1 with more details on the role of the Chair.

**Handout 1**

<table>
<thead>
<tr>
<th>Our Chair's Role</th>
<th>RECOMMENDED PRACTICE EXAMPLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reports to: The Owners</td>
<td></td>
</tr>
<tr>
<td><strong>Our Chair serves as the principal officer of the Company</strong></td>
<td></td>
</tr>
<tr>
<td>Our Chair:</td>
<td></td>
</tr>
<tr>
<td>- provides leadership to the Board</td>
<td></td>
</tr>
<tr>
<td>- Chairs Board meetings after determining the agenda with the Board and the CEO</td>
<td></td>
</tr>
<tr>
<td>- Facilitates the Board's role in strategic planning</td>
<td></td>
</tr>
<tr>
<td>- In consultation with the CEO, appoints Chairs of Board Committees</td>
<td></td>
</tr>
<tr>
<td>- Serves as a Committee member and attends Committees</td>
<td></td>
</tr>
<tr>
<td>- Helps to guide the Board with respect to Company policies, priorities and concerns</td>
<td></td>
</tr>
<tr>
<td>- Reviews with the CEO issues of concern to the Board</td>
<td></td>
</tr>
<tr>
<td>- Monitors financial planning and financial reports</td>
<td></td>
</tr>
<tr>
<td>- Plays a leading role in promotional and Capital Resource Development activities</td>
<td></td>
</tr>
<tr>
<td>- With the Board, evaluates the performance of the CEO</td>
<td></td>
</tr>
<tr>
<td>- With the Board, evaluates Board performance in achieving its work</td>
<td></td>
</tr>
<tr>
<td>- Performs other duties as assigned by the Board</td>
<td></td>
</tr>
</tbody>
</table>
**Step 2: Role of Other Key Officers**

Distribute Handout 2 and briefly discuss the roles of other key officers.

*Handout 2*

<table>
<thead>
<tr>
<th>Summary of Key Officer Duties</th>
</tr>
</thead>
<tbody>
<tr>
<td>RECOMMENDED PRACTICE EXAMPLE</td>
</tr>
</tbody>
</table>

**Chair (or President)**
The Chair is the principal officer of the Company. The duties of the Chair are those customary to the position and include presiding at meetings of the Board, serving as an ex officio member on all Committees and performing other tasks as designated by the Board.

**Vice Chair**
The Vice Chair shall perform the duties of Chair in the event of the Chair's absence, and shall also perform other tasks as designated by the Board.

**Treasurer**
The Treasurer shall keep an account of all monies received and expended for the use of the Company. The Treasurer shall report at the Annual General Meeting (AGM), and at other Board meetings, as called upon by the Chair. The Treasurer heads the Internal Audit Committee. The funds, books and vouchers in the Treasurer's hands shall be open to inspection at all times by the Board.

**Secretary**
The Secretary shall ensure that notice of Board meetings is given as required by the Bylaws, and shall attend all Board meetings to keep a record of all proceedings (i.e. Minutes). The Secretary shall also perform other tasks as designated by the Board.

**Chief Executive Officer/Managing Director**
The CEO shall be appointed by the Board to serve at the pleasure of the Board. The CEO shall be salaried and shall be directly responsible to the Board. The CEO's performance shall be revised at least annually by the Board. The CEO shall serve as an ex-officio member of the Board without vote, and shall not be counted in determining the total number of authorized Directors.
**Step 3: Role of Committees**

Display slide 3 and discuss each point.

*Slide 3*

**Role of Board Committees**

Board committees focus on specific issues assigned by the board and develop thoughtful proposals to recommend to the full board.

Committees may include: Executive, audit and finance, nominating committee, credit committee, human resource committee, resource mobilization committee, and special/ad hoc committees.

In addition to the committees mentioned above, some MFIs choose to form an advisory board to expand access to a group of well-respected, high-stature, knowledgeable, and usually very busy, individuals.

*How can committees be useful to a Board?*

- They can be time saving. The full Board does not have to meet to discuss every topic.
- They can help improve the efficiency of board deliberations, help the board set priorities, and allow for more in-depth discussion of key issues than might be possible with the full board.
- They can include external specialists to provide greater insight into specific topics.
- Dividing the work among committees allows each Director to focus in-depth on a reduced number of issues, while staying adequately informed about all areas.

*Committees can reduce the amount of time full boards spend in deliberations. The absence of a committee structure can result in superficial decision making by the board.*

Warning: The time commitment required for committee work is an issue – you must have committed people.

In addition to the typical Board committees mentioned above, the Board may create special or ad hoc committees for a specific purpose and disband them when they have completed their task.

*Can anyone provide an example of an ad hoc committee that a CB or MFI might need to form?*

Distribute Handout 3: *Handout 3 provides guidelines regarding the appropriate role of committees within the Board.*
Suggestion: Read the two points highlighted under “Standing Board Committees, and a few committee mandates of your choosing.

Handout 3

<table>
<thead>
<tr>
<th>Specialized Committees</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RECOMMENDED PRACTICE EXAMPLE</strong></td>
</tr>
</tbody>
</table>

**Standing Board Committees**

Our Standing Board Committees provide specialist consultancy, gratis, to the entire Board.

Our Committees are mandated by the Board with a specific task to perform. They report and recommend to the whole Board.

No Committee makes policy or governance decisions on behalf of the Board.

**Special Board Committees**

We may set up special Committees to help the Board deal with a special issue, such as:

- Public relations policy and damage control after a damaging fraud case
- Major institutional restructuring
- Settling or adjudicating a major internal conflict

All our Committees have written mandates and are chaired by a Board member.

**Our Standing Committee Mandates**

- **Executive Committee**

  The Committee prepares key issues for resolution by the full Board. It is composed of the Chairs of all the Committees, and the Company Secretary, and is serviced by the CEO. It meets frequently.

  - Nomination Committee

  The Committee identifies candidates who may add significant value as Board Members. Its search for members is ongoing. The Committee is guided by the Board's Profile and Gender policy.

  - **Audit & Finance Committee**

    The Committee oversees the Company's risk assessment and monitors Company finances. It oversees the management of the internal audit.

    - Human Resource Committee

    The Committee oversees personnel policy.

    - Resource Mobilization Committee

    The Committee provides active support to the CEO in soliciting funds and financing.
Step 4: Review Board Procedures

Display slide 4: Now that we have discussed the role of Board members and committees, let’s talk about effective Board procedures.

**Slide 4**

<table>
<thead>
<tr>
<th>Board Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Most boards make decisions in full board meetings, however, other board procedures, such as Board retreats or task auctions can improve the effectiveness of the board.</td>
</tr>
</tbody>
</table>

Board retreats may last a day or more and can be useful for addressing complicated issues and for annual planning.

**Task auctions:** can be used to illicit volunteers to address specific tasks. When a new task or project arises the chair can send information regarding the task to Board members requesting that interested members reply. The chair then assigns the task to an interested member or forms a committee as necessary.

Divide participants into groups of 4-5 and ask them to pretend they are a CB or MFI Board. Ask them to spend 10-15 minutes defining the basic policies and procedures their Board will follow to ensure efficient and effective Board meetings and decisionmaking. For example, how frequently should meetings take place? Is unanimity required in decisionmaking? Have each group report what they decided and why.

Make sure the following guidelines are discussed with the full group:

1. **Frequency:** Boards generally meet monthly or quarterly, with committees meeting in between full Board meetings. More frequent meetings may be necessary as the institution becomes larger and more complex, or during times of significant change or growth.

2. **Duration:** Generally speaking a well-run Board meeting should not take more than 1.5-2 hours.

3. **Scheduling:** The Board secretary should work with the Executive Committee to schedule the program of meetings for the year.

4. **Quorum:** Typically, a quorum requirement of 50% plus one is sufficient. However, for important issues, such as amending the institution’s bylaws, a quorum requirement of 75% is recommended.

5. **Preparation:** Meeting materials should be prepared by the secretary and management and distributed at least a week in advance of the meeting. These materials include the agenda, financial statements (balance sheet, income statement, cash flow statement, and portfolio quality reports), and other reports.

6. **Agenda:** The agenda for each meeting is developed by the Board Secretary in conjunction with the Executive Committee.

7. **Minutes:** The Secretary prepares the minutes of each meeting and circulates the draft minutes to the full Board for review, preferably no later than two weeks after the meeting. The minutes should capture decisions made, pending items, and next steps.
Each Board meeting should begin with a review and approval—following any necessary amendments to the minutes—of the minutes.

After this discussion have participants return to their small groups for a Board Procedures in Action exercise. Give each table a stack of slips of paper with the title and role of Board members, including committees. Ask participants to select a slip of paper at random and assume the corresponding role.

Display slide 5 and ask each group to take 10-15 minutes to discuss 2-3 of the critical issues and come up with a course of action. Have each group report on their decisions and discuss.

**Slide 5**

<table>
<thead>
<tr>
<th>Board Procedures in Action Exercise</th>
</tr>
</thead>
<tbody>
<tr>
<td>Critical Issues for Discussion:</td>
</tr>
<tr>
<td>1. Conflict of interest</td>
</tr>
<tr>
<td>2. Death of the managing director</td>
</tr>
<tr>
<td>3. Rapid decline of portfolio quality</td>
</tr>
<tr>
<td>4. Theft</td>
</tr>
</tbody>
</table>
MODULE FIVE. GOVERNANCE AND THE LEGAL AND REGULATORY ENVIRONMENT

Purpose:

To explore with participants their obligations with respect to compliance with legal and regulatory requirements for CBs and MFIs in Nigeria. This module also introduces the issue of Director liability.

Objectives:

At the end of this Module participants will be able to:

1. Understand the content of bylaws
2. Understand some of the basic legal and regulatory requirements applicable to community banks
3. Understand the importance of compliance with these requirements

Preparation/Materials:

Powerpoint slides
Flipchart
Handout: Select Prudential Regulations for Nigerian Community Banks

Time: 1:00-1:30

DELIVERY

Step 1: Discuss the role of institutional bylaws

*What are bylaws?* After listening to the responses, display bullet point one of slide 1, below.

*What should be included in your bylaws?*

Bylaws include details on the roles and responsibilities of shareholders, board members, committees and officers; specifications on term lengths, board size and meeting frequency; and processes such as voting, nomination of directors and the execution of agreements.

After discussing the content of bylaws, conclude this session by displaying bullet points two and three of slide 1 and discussing each point briefly.

*Slide 1*

<table>
<thead>
<tr>
<th>Bylaws</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Bylaws establish the rules that govern an institution’s internal organization and management.</td>
</tr>
<tr>
<td>• They should be in simple, written form, and should be reviewed by the Board on an annual basis.</td>
</tr>
<tr>
<td>• The Board should have the power to amend the bylaws as needed.</td>
</tr>
</tbody>
</table>
The following guidelines are recommended for developing bylaws:

- Bylaws should be in simple, written form. An eloquent legal document with sophisticated language is less useful in assisting stakeholders in their effective governance than a straightforward statement.
- The board should always have the power to amend these bylaws according to a specified procedure.
- The board should review the bylaws on an annual basis to ensure that they continue to be relevant and provide adequate direction.

**Step 2:** Review basic regulatory requirements community bank

Begin this discussion by explaining that this will be a general overview of some of the regulatory requirements of community banks. It should not be considered an exhaustive review and will NOT constitute a legally binding interpretation of regulations. Urge participants to consult local lawyers and regulatory specialists. Note: the information in this section is drawn from the Comparative Database on Microfinance Regulation at [www.microfinancegateway.org/resource_centers/reg-sup](http://www.microfinancegateway.org/resource_centers/reg-sup); the Federal Republic of Nigeria Assessment of Community Banks; and Guidelines for the Operations of Community Banks in Nigeria, Central Bank of Nigeria, February 2000.

Display slide 2. As regulated institutions, community banks must comply with a wide range of regulations. These include regulations related to:

**Slide 2**

<table>
<thead>
<tr>
<th>Select Regulations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Board composition and directors</td>
</tr>
<tr>
<td>2. Prudential regulations</td>
</tr>
<tr>
<td>3. Reporting requirements</td>
</tr>
</tbody>
</table>

A. Board Composition and Directors

*What regulations exist regarding Directors or Board’s of Directors?* Answers include:

1. Boards must have a minimum of 3 members and a maximum of 7
2. The appointment of Directors—and management staff—must be approved by the CBN

*Can Directors be on the Board of more than one community bank?* No, (at least not without the approval of the CBN). *Why not?* To avoid conflicts of interest.

*Are there any other regulations related to conflicts of interest?* Yes. Directors and other community bank officers are required to disclose to the Board any personal interest they have directly or indirectly in an existing or proposed advance, loan, or credit facility of the institution on whose Board they sit. Similarly, they must disclose any affiliation they have, or property they own, which might create duties or interests in conflict with those they have with the community bank.
What happens if a Director fails to disclose a potential conflict of interest? He or she can be fined N100,000.00.

Are there any restrictions on lending to Directors? Yes. Unsecured loans and advances to insiders (Directors), are limited to an aggregate value of $50,000. Insider lending is a significant problem in many CBs, with many Directors loans in arrears. Ask the group to discuss why this limit exists.

We will talk more about conflicts of interest in Module Eight.

B. Prudential Regulations

Community banks and other regulated institutions must comply with a variety of prudential regulations. What are prudential regulations?

Allow time for participants to respond, then display slide 2.

Slide 3

Prudential Regulation Defined
Prudential regulations are requirements designed to ensure the financial soundness of an institution. They protect both depositors from losing their savings and the stability of the financial system.

What are some examples of prudential requirements? Discuss, then display slide 4

Slide 4

Examples of Prudential Regulations
1. Minimum capital requirement
2. Liquidity requirements
3. Capital adequacy requirements
4. Reserve requirements
5. Limit of lending to a single borrower
6. Provisioning requirements
7. Dividend payments requirements

Divide participants into two or more groups. Ask each group to specify the current requirement for each, i.e. CBs are required to maintain a minimum liquidity ratio of 30%; why it is important to observe these requirements, i.e. why should an institution limit lending to a single borrower?; and what, if any penalties exist for non-compliance. Give participants 20 minutes for this exercise, then ask for volunteers to provide the answers for each requirement. At the end of the discussion distribute Handout 1.
Handout 1

Minimum capital:
Minimum requirement: N5 million
Why important: To ensure that the institution has the resources necessary to cover infrastructure needs and operate profitably.
Penalties for non-compliance: Possible revocation of license.

Liquidity ratio:
Minimum requirement: 30%
Why important: Measures the ability of an institution to cover its short-term obligations.
Penalties for non-compliance: Possible revocation of license.

Capital adequacy:
Minimum requirement: 10%
Why important: Shows how much of a safety cushion (in the form of equity), an institution has to absorb losses.
Penalties for non-compliance: May not grant credits or make further investments or pay dividends to shareholders; and possible revocation of license.

Reserve requirement:
Minimum requirement: 25% (where reserve fund is less than the paid-up share capital); 12.5% (where the fund is greater than paid-up share capital).
Why important: Ensures that the institution is able to absorb losses.
Penalties for non-compliance: NA

Limit of lending to a single borrower
Maximum: 10%
Why important: Avoid concentration of risk.
Penalties for non-compliance: Possible revocation of license.

Provisioning requirements
Requirements:
90-180 days: 10%
180-360 days: 50%
> 360: 100%
Loans should be reviewed quarterly
Why important: Ensure that loan losses can be covered. Serves as a check on adequacy of credit policies and procedures.
Penalties for non-compliance: Possible revocation of license.

NOTE: Because of the unique risk structure of microfinance loans, it is generally accepted that provisioning requirements for MFIs should be more stringent than those for standard commercial banks. At a minimum, it is recommended that MFIs adopt the following provisioning guidelines:

<table>
<thead>
<tr>
<th>Days Past Due</th>
<th>% Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current loans</td>
<td>0%</td>
</tr>
<tr>
<td>1-30</td>
<td>10%</td>
</tr>
<tr>
<td>31-90</td>
<td>25%</td>
</tr>
<tr>
<td>91-180</td>
<td>50%</td>
</tr>
</tbody>
</table>
Dividend payments
Terms of payment: Must first –
1. Write off all expenses not represented by tangible assets
2. Ensure adequate provisioning
3. Comply with the capital adequacy ratio
Penalties for non-compliance: Any Director, Manager, or Officer implicated is subject to a fine of 5% of the dividend paid or imprisonment up to 3 years, or both.

Before closing this discussion, make sure that someone makes the point that individual Directors who fail to ensure compliance with prudential regulations may be subject to sanctions, including being black listed from ever again serving on the Board of any financial institution.

C. Reporting Requirements

*What reporting requirements do community banks have? Why are these important?*

CBs must submit a quarterly financial report to the CBN. They must also submit to the CBN and publish the results of an annual external audit. Failure to comply with reporting requirements or ensure the availability of accurate information can result in fines for the community bank of individual Directors or Managers. Fines range from $1,000N per day for lateness in submitting reports, to $50,000N for a Director or Officer who willfully fails to ensure that proper books of accounts are kept. Persistent failure to submit reports in the designated formats can also result in the revocation of the CB’s license.

*What are some other regulations that community banks and their Boards should have in mind?*

1. Must appoint an outside auditor,
2. Annual General Meeting should be held within 6 months of the end of the CBs fiscal year,
3. Others?
MODULE SIX. BOARD OVERSIGHT: RECOMMENDED PRACTICES AND INSTRUMENTS

Purpose:

Explore the elements of an effective oversight strategy with a focus on action items and tools for strategy development and implementation. Special emphasis is placed on the process for establishing measurable objectives and selecting indicators.

Objectives:

At the end of this Module participants will be able to:
1. Describe the steps for creating an effective oversight strategy
2. Identify the instruments they have at their disposal to fulfill their oversight function

Preparation/Materials:

Powerpoint slides
Handouts:
1. Strategic Plan Overview: Recommended Practice Example
2. 12-Month Business Plan Outline: Recommended Practice Example
3. Common MFI Performance Indicators
4. Indicators and Recommended Frequency of Reporting
5. Monitoring Managerial and Financial Performance
6. Checklist for Operational Danger Signs

Time: 2:00

DELIVERY

Step 1: Establish the Importance of Efficient Board Oversight

Oversight refers to the methods by which the Board and Management attempt to establish accountability, control risks, prevent losses, and achieve institutional objectives.

Ask participants: When financial institutions get into financial trouble, whose fault is it usually? If they respond that it is Management, ask them to whom management is accountable. Answer: the Board. So, who is really at fault? (the Board). Conclude by displaying slide 1 and stressing that:

Slide 1

The Oversight Challenge
Oversight is perhaps the most important responsibility of the Board and yet it is also the responsibility that Boards are most likely to fall short on.
Step 2: Discuss the steps involved in developing an oversight strategy

What are the steps involved in developing an oversight strategy? Display slide 2:

Slide 2

Steps for Developing an Oversight Strategy

1. Define Measurable Performance Objectives, Policies, and Procedures
2. Select Performance Targets and Indicators
3. Collect and Analyze Performance Data
4. Implement Corrective Measures as Necessary

We will discuss these steps in more detail in a moment, but first, what are the factors that affect the quality of Board oversight? Display slide 3.

Slide 3

Factors that Affect the Quality of Oversight

- Profile and composition of Board members
- Capacity of management information systems (MIS)
- Diversity and quality of tools used to collect and evaluate information (staff surveys, client suggestion boxes, reports, audits, board committees)
- Enforcement of policies - clear accountability and decisive action

Why is quality dependent on these four factors? Ask participants to provide specific examples. This is an opportunity to test their grasp or acceptance of the Board composition discussion, (as well as their grasp of the MIS module in the Strategic Management Training for Community Banks, if the participants are the same). Examples might include:

Profile: If no one on the Board has financial management skills, the Board probably will not recognize financial warning signs before it is too late.

MIS: Without effective MIS, management may have difficulty providing timely and/or accurate reports.

Diversity of tools: If you rely solely on management reports and client feedback is not considered, you may not realize that you are out of touch with your clients, and you may lose them to the competition that does listen to them. Similarly, if you only have the Managing Director’s perspective you may or may not discover any staff problems that exist.

Enforcement: If policies are not enforced, they serve no purpose.
A. Defining Performance Objectives: the Role of Strategic and Business Plans

Returning to the steps for developing your oversight strategy, how does the Board go about defining performance objectives? What instruments does it use?

Give participants an opportunity to answer. Make sure that you or someone else covers the following points:

In addition to setting policies, as we mentioned in Module Two, one of the Board’s key responsibilities is working with Management to set the strategic direction of the institution. A critical component of setting the strategic direction is establishing clear, measurable objectives. This is usually done during a strategic planning process.

What is strategic planning? An in-depth discussion of strategic planning is beyond the scope of this course. Simply put, strategic planning is the process of determining where an organization is going, how it is going to get there, and how it will know it has gotten there. While many variations on strategic planning exist, in general strategic planning involves four basic elements:

1. Defining or reviewing the institution’s mission statement: this is the statement that describes the institution’s purpose, its target market and the services it offers

2. Establishing goals or objectives: these are the results the institution expects to achieve

3. Selecting strategies: how the institution plans to reach those goals

4. Developing action plans: these are the specific activities the institution will carry out within each strategy

Typically,

1. The Board establishes key objectives for the coming year, in collaboration with Management.

2. Management prepares a three to five year strategic plan (or revises this plan if it already exists) and an annual business plan. The business plan includes measurable objectives and a detailed work plan for the year, and projected financial statements for the year. **Both plans—or instruments—should include targets and performance indicators that both Board and Management can use to measure performance and progress.**

3. The Board reviews and approves these plans.

Distribute Handouts 1 and 2. *While an in-depth discussion of strategic planning is beyond the scope of this course, these handouts provide more detail on the types of objectives and information you might include in strategic and business plans.*
Strategic Plan Overview (next 5 years)

RECOMMENDED PRACTICE EXAMPLE

<table>
<thead>
<tr>
<th>Year 1:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Ownership issues resolved</td>
</tr>
<tr>
<td>- Strategy for scaling up completed</td>
</tr>
<tr>
<td>- Succession plan for CEO and Board Chair</td>
</tr>
<tr>
<td>- Joint MFI lobbying strategy defined to</td>
</tr>
<tr>
<td>advocate for legislative reform</td>
</tr>
<tr>
<td>- Good governance strategy designed</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year 2:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Merger/takeover plans finalized</td>
</tr>
<tr>
<td>- External evaluation of scaling up strategy</td>
</tr>
<tr>
<td>10% organic growth achieved</td>
</tr>
<tr>
<td>- Lobbying for legislative reform</td>
</tr>
<tr>
<td>- Good governance strategy operational</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year 3:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Merger completed</td>
</tr>
<tr>
<td>- 10% organic growth achieved</td>
</tr>
<tr>
<td>- Legislative reform achieved</td>
</tr>
<tr>
<td>- Access to commercial financial markets</td>
</tr>
<tr>
<td>- External governance capacity evaluation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year 4:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 10% organic growth achieved</td>
</tr>
<tr>
<td>- Dependence on external grants &amp; subsidies</td>
</tr>
<tr>
<td>ended</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year 5:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 10% organic growth achieved</td>
</tr>
<tr>
<td>- Company ranked among top 3 national MFIs, by market share</td>
</tr>
</tbody>
</table>
B. Selecting Performance Indicators

What is a performance indicator?

A performance indicator is a measurement of an institution’s progress toward meeting its objectives. For example, an institution with the goal of being the largest MFI in Nigeria would use total number of clients as a performance indicator. However, to be useful, the indicator must also be tied to a target. In our example, that target might be a 10 percent annual increase in the total number of clients.

What exactly does the Board oversee? What aspects of institutional performance?

Answer: All aspects. The Board oversees both the financial and managerial performance of the institution.

Ask participants: What indicators do you currently review? Write answers on flipchart. How often do you review them?

Distribute Handouts 3 and 4. This is a list of indicators commonly used by MFIs to measure institutional performance.
<table>
<thead>
<tr>
<th>Category</th>
<th>Indicator</th>
<th>Formula</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy</td>
<td>Minimum required capital</td>
<td>Institutional capital/required minimum capital</td>
<td>Ensures that the institution has the resources necessary to cover infrastructure needs and operate profitably.</td>
</tr>
<tr>
<td></td>
<td>Risk weighted assets</td>
<td>See central bank guidelines</td>
<td>Risk-weighted assets factor in the risk of loans turning irrecoverable and serve as the denominator for calculating banks' capital ratios. Risk weights are applied to loans according to their categories.</td>
</tr>
<tr>
<td></td>
<td>Debt/Equity ratio</td>
<td>Total liabilities/total equity</td>
<td>Shows how much of a safety cushion (in the form of equity) an institution has to absorb losses.</td>
</tr>
<tr>
<td></td>
<td>% current earnings retained</td>
<td>See financial statements</td>
<td>Profits not distributed to shareholders, which are available for reinvestment in the business</td>
</tr>
<tr>
<td>Liquidity</td>
<td>Short-term liquidity</td>
<td>(Cash + deposits + short-term investments)/(deposits/borrowings)</td>
<td>Measures an institution's ability to cover short-term obligations.</td>
</tr>
<tr>
<td></td>
<td>Changes in cash flow, liquidity trends</td>
<td>NA</td>
<td>Identify and avoid potential shortfalls.</td>
</tr>
<tr>
<td></td>
<td>Sources of funds</td>
<td>NA</td>
<td>Review risk diversification, costs, etc.</td>
</tr>
<tr>
<td></td>
<td>Concentration risk</td>
<td>10 largest depositors/funders as % of total deposits/funds</td>
<td>Measures exposure to changes in depositor or funder behavior.</td>
</tr>
<tr>
<td>Profitability/Financial Self-Sufficiency</td>
<td>Budgeted vs. actual revenues and expenses</td>
<td>NA</td>
<td>Identify potential budgetary shortfalls, institutional performance problems.</td>
</tr>
<tr>
<td></td>
<td>Net income</td>
<td>Total revenue – Total expenses</td>
<td>The institution’ &quot;bottom line&quot;—total earnings after adjust revenue for costs of doing business, depreciation, interest, taxes and other expenses.</td>
</tr>
<tr>
<td></td>
<td>Return on Assets</td>
<td>Net income/Average Equity</td>
<td>Overall measure of profitability reflecting both the profit margin and the efficiency of the institution.</td>
</tr>
<tr>
<td></td>
<td>Return on Equity</td>
<td>Net income/Average assets</td>
<td>Measures return on investment in an institution.</td>
</tr>
<tr>
<td></td>
<td>Financial self-sufficiency</td>
<td>Financial income/(Financial expenses + loan loss provisions + operational costs expense)</td>
<td>Measures the ability of the institution to generate sufficient income to cover all operational and financial expenses, cover loan losses, and maintain the value of institutional capital.</td>
</tr>
<tr>
<td>Portfolio Quality</td>
<td>Portfolio at risk</td>
<td>(Outstanding balance on arrears over 30 days + total gross outstanding refinanced Portfolio)/Total outstanding gross portfolio</td>
<td>Measures the actual financial risk to the institution due to loan arrears.</td>
</tr>
<tr>
<td>------------------</td>
<td>------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------</td>
</tr>
<tr>
<td>Loan loss provision expense ratio</td>
<td>Loan loss provisioning expenses/Average gross portfolio</td>
<td>Provides an indication of the expense incurred by the institution to anticipate future loan losses.</td>
<td></td>
</tr>
<tr>
<td>Risk coverage ratio</td>
<td>Loan loss reserves/(Outstanding balance on arrears over 30 days + Refinanced loans)</td>
<td>Shows the percentage of the portfolio at risk that is covered by loan loss reserves.</td>
<td></td>
</tr>
<tr>
<td>Write off ratio</td>
<td>Value of loans written off/Average Gross Portfolio</td>
<td>Represents the loans the institution has removed from its books.</td>
<td></td>
</tr>
<tr>
<td>Reserve ratio</td>
<td>Loan loss reserves/Outstanding portfolio</td>
<td>Shows weather or not the level of reserves is sufficient for the portfolio.</td>
<td></td>
</tr>
<tr>
<td>Operational Efficiency</td>
<td>Personnel productivity</td>
<td>Loans/Total staff</td>
<td>The higher the ratio the more productive the institution.</td>
</tr>
<tr>
<td>Loan officer productivity</td>
<td>Loans/Loan officers</td>
<td>The higher the ratio the more productive the institution. Low productivity may indicate excessive paperwork and procedures for loan approval.</td>
<td></td>
</tr>
<tr>
<td>Operating cost ratio</td>
<td>Operating costs/average outstanding loan portfolio</td>
<td>Measures the institutional cost of delivering loan services.</td>
<td></td>
</tr>
<tr>
<td>Staff turnover</td>
<td>NA</td>
<td>High staff turnover can undermine productivity</td>
<td></td>
</tr>
<tr>
<td>Growth/Expansion</td>
<td>Size of portfolio</td>
<td>NA</td>
<td></td>
</tr>
<tr>
<td>No. loans disbursed</td>
<td>NA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No. clients, branches, staff</td>
<td>NA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market share</td>
<td>% of estimated target market</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Client Satisfaction</td>
<td>% Repeat loans</td>
<td>NA</td>
<td></td>
</tr>
<tr>
<td>Client desertion rate</td>
<td>NA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reach/Social Impact</td>
<td>Loan size distribution</td>
<td>NA</td>
<td></td>
</tr>
<tr>
<td>Analysis of impact data (increase in sales, assets, employment, profits, savings)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Resources:**


### Handout 4

<table>
<thead>
<tr>
<th>Category</th>
<th>Indicators and Frequency of Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Monthly</td>
</tr>
<tr>
<td>Capital Adequacy</td>
<td>• Minimum required capital</td>
</tr>
<tr>
<td></td>
<td>• Risk weighted assets</td>
</tr>
<tr>
<td></td>
<td>• Debt/Equity ratio</td>
</tr>
<tr>
<td></td>
<td>• % current earnings retained</td>
</tr>
<tr>
<td></td>
<td>• Short-term liquidity</td>
</tr>
<tr>
<td></td>
<td>• Changes in cash flow, liquidity trends</td>
</tr>
<tr>
<td></td>
<td>• Sources of funds</td>
</tr>
<tr>
<td></td>
<td>• Risk concentration (funders and/or depositors)</td>
</tr>
<tr>
<td>Liquidity</td>
<td>• Portfolio at risk</td>
</tr>
<tr>
<td></td>
<td>• Loan loss provision expense ratio</td>
</tr>
<tr>
<td></td>
<td>• Write-off ratio</td>
</tr>
<tr>
<td>Profitability/Financial Self-Sufficiency</td>
<td>• Budgeted versus actual revenues and expenses</td>
</tr>
<tr>
<td></td>
<td>• Net income</td>
</tr>
<tr>
<td></td>
<td>• Return on assets</td>
</tr>
<tr>
<td></td>
<td>• Return on equity</td>
</tr>
<tr>
<td></td>
<td>• Financial self-sufficiency</td>
</tr>
<tr>
<td>Portfolio Quality</td>
<td>• Personnel productivity</td>
</tr>
<tr>
<td></td>
<td>• Loan officer productivity</td>
</tr>
<tr>
<td></td>
<td>• Operating cost ratio</td>
</tr>
<tr>
<td></td>
<td>• Staff turnover</td>
</tr>
<tr>
<td>Client Satisfaction</td>
<td>• Percentage of repeat loans</td>
</tr>
<tr>
<td></td>
<td>• Client desertion rate</td>
</tr>
<tr>
<td></td>
<td>• Portfolio quality by branch</td>
</tr>
<tr>
<td>Operational Efficiency</td>
<td>• By branch: productivity of field staff and loan officers, operating costs</td>
</tr>
<tr>
<td></td>
<td>• Monthly trends in:</td>
</tr>
<tr>
<td></td>
<td>• Size of portfolio</td>
</tr>
<tr>
<td></td>
<td>• Loan disbursement</td>
</tr>
<tr>
<td></td>
<td>• Number of clients, branches and staff</td>
</tr>
<tr>
<td></td>
<td>• Market share (as percentage of estimated target market)</td>
</tr>
<tr>
<td></td>
<td>• Review progress towards objectives, adjust as necessary</td>
</tr>
<tr>
<td>Reach/Social Impact</td>
<td>• Monthly: Loan size distribution</td>
</tr>
<tr>
<td></td>
<td>• Annually: Analysis of impact data collected at the time of loan disbursement such as increase in sales, assets, employment, profits, savings</td>
</tr>
</tbody>
</table>

**What criteria do you use when selecting indicators for your institutions?** Allow for discussion, then display slide 4.

**Slide 4**

**Criteria for Selecting Performance Indicators**
Performance indicators should be:
- clearly linked to performance objectives
- both qualitative and quantitative
- both static (historic) and dynamic (predictive) indicators
- (relatively) few in number, but **monitored frequently**
How would you assess managerial performance?

Divide participants into groups of 3-5 and distribute sheets of paper.

Ask participants to spend approximately 15 minutes, depending on the time available, on the tasks outlined in slide 5:

**Slide 5**

<table>
<thead>
<tr>
<th>Instructions for Performance Indicators Exercise</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Develop lists of critical indicators for monitoring managerial performance</td>
</tr>
<tr>
<td>• Be prepared to explain why your group chose these indicators</td>
</tr>
<tr>
<td>• With what frequency should they be monitored?</td>
</tr>
</tbody>
</table>

Have each group present its suggestions, while you write them on a flip chart (no duplicates), and discuss.

Possible indicators:

- Human Resource Management: Staff incentives are commensurate with the competition (yes/no); Staff turnover below industry standard
- Processes, Controls, and Auditing: External audit carried out in last 12 months (yes/no); Are you getting independent external auditor reports? Are control issues being addressed in a timely and effective manner?
- Strategic Planning and Budgeting: Staff are involved in strategic planning (participatory strategic planning)

Suggestion: Review the Managerial Performance questions in Handout 5 and come up with some indicators of your own in preparation for this session.

Note that there are different ways to calculate many of the financial indicators discussed during this module and that the exact mix of indicators will depend on institutional objectives and regulatory requirements. Refer participants to the resources included in handout 3a, where participants can access to learn more about financial performance indicators:

Distribute Handout 5. Whichever specific indicators they choose, it is recommended that Boards ask themselves these questions as part of their oversight strategy.
<table>
<thead>
<tr>
<th>Capital Adequacy</th>
<th>Earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Risk Weighted Assets vs. Equity</strong></td>
<td><strong>Adjusted Return on Equity:</strong></td>
</tr>
<tr>
<td>• Is the balance right?</td>
<td>• Is the Company’s net worth increasing through earnings? Even after adjustments, such as for inflation and subsidies?</td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td><strong>Operational Efficiency</strong></td>
</tr>
<tr>
<td>• Are we in a good position to replenish equity?</td>
<td>• How similar are our cost structures to formal financial institutions?</td>
</tr>
<tr>
<td><strong>Reserves</strong></td>
<td>• How can we improve our efficiency?</td>
</tr>
<tr>
<td>• Can we absorb potential loan losses?</td>
<td><strong>Adjusted Return On Assets</strong></td>
</tr>
<tr>
<td><strong>Asset Quality</strong></td>
<td>• Are we using our assets to generate optimum earnings?</td>
</tr>
<tr>
<td><strong>Portfolio Quality</strong></td>
<td><strong>Interest Rate Policy</strong> (Re: profitability targets, cost of funds, and macroeconomic environment)</td>
</tr>
<tr>
<td>• What's the total value of the outstanding loans?</td>
<td>• Do our current rates (lending and deposit rates if applicable) make sense in the current circumstances?</td>
</tr>
<tr>
<td>• What percentage of loans was late last month?</td>
<td>• Should our rates be adjusted?</td>
</tr>
<tr>
<td>• Are there certain branches, geographic regions or sectors with higher delinquencies?</td>
<td><strong>Liquidity Management</strong></td>
</tr>
<tr>
<td><strong>Write-Offs</strong></td>
<td><strong>Liability Structure</strong></td>
</tr>
<tr>
<td>• How many loans were written off last month?</td>
<td>• Are our liabilities a danger to the Company?</td>
</tr>
<tr>
<td>• What's the total value of the write-offs?</td>
<td><strong>Creditors</strong></td>
</tr>
<tr>
<td><strong>Fixed Assets</strong></td>
<td>• Do we have sufficient funds to meet the demands of our creditors?</td>
</tr>
<tr>
<td>• Are our long-term assets productive?</td>
<td><strong>Cash Flow Projections</strong></td>
</tr>
<tr>
<td>• Do our branches and offices meet the needs of clients and staff?</td>
<td>• How effective have we been at projecting our cash flow requirements?</td>
</tr>
<tr>
<td><strong>Productivity Of Other Assets</strong></td>
<td>• How can we improve our projections?</td>
</tr>
</tbody>
</table>

Are we getting the best possible return from our cash, investments and bank accounts?
<table>
<thead>
<tr>
<th>Governance</th>
<th>Processes, Controls, and Auditing</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Is the Board functioning optimally?</td>
<td>• Risk management: Do we have a high quality, ongoing, internal audit process? Are we effectively minimizing risks of error and fraud?</td>
</tr>
<tr>
<td><strong>Human Resources</strong></td>
<td>• Are we learning from the lessons of the last external audit?</td>
</tr>
<tr>
<td>• Does our organization provide clear guidance to staff?</td>
<td><strong>Information Technology</strong></td>
</tr>
<tr>
<td>• Is staff recruitment policy appropriate?</td>
<td>• Are our computerized information systems operating effectively and efficiently?</td>
</tr>
<tr>
<td>• Does the organization provide appropriate staff incentives?</td>
<td>• Is our Management Information System providing analytical data?</td>
</tr>
<tr>
<td>• Is staff evaluated on the basis of performance to objectives?</td>
<td><strong>Strategic Planning</strong></td>
</tr>
<tr>
<td>• Is staff turnover low?</td>
<td>• Are we involving our staff sufficiently in the strategic planning process?</td>
</tr>
<tr>
<td></td>
<td>• Are we re-planning regularly as circumstances change?</td>
</tr>
</tbody>
</table>

To conclude, it is the responsibility of the Board to establish objectives and to communicate to management which indicators they should report on and with what frequency. It is also the Board’s responsibility to work with management to develop a standard reporting format.

C. Ensuring Accuracy and Reliability of Reports: the role of internal controls and internal and external audits

According to the recent FAO Assessment of Community Banks, many CBs have weaknesses when it comes to reporting, yet effective reports are one of the key requirements of an effective oversight strategy.

As we discussed, it is recommended that you use a variety of tools to collect performance information. Since reports are one of the most important tools, let’s discuss these in more depth.

*What are the characteristics of effective reports?* After they respond, present slide 6:
Reports should compare current month ratios and statistics to those of previous months and to the same month for previous years. They should also present an analysis of actual versus budgeted figures.

*What do we mean by “incorporates market intelligence”?* (It allows for comparison with competition or industry standards.

*How do we ensure that the information we are collecting is accurate?* Display slide 7.

**Slide 7**

**Ensuring Accuracy and Reliability of Reports – Supervisory Tools**

Institutions have 3 supervisory tools for ensuring the accuracy and reliability of the information collected:

1. Internal controls
2. Internal audits
3. External audits

*What are some common internal controls?* Discuss, then display slide 8.

**Slide 8**

**Types of Internal Controls**

- Segregation of duties
- Limits
- Physical controls
- Crosschecks
- Dual controls
Ask group to provide examples of these controls, then display next slide 9.

**Slide 9**

**Examples of Internal Controls**

- Segregation of duties: Separate expense authorization from check disbursal duties
- Limits: Having a maximum amount of cash allowed at a branch
- Physical controls: Daily cash box reconciliation
- Crosschecks: Manager or internal auditor visits clients to verify balances
- Dual controls: Two signatures required on all checks

*Has anyone heard of a case where a loan officer invented clients and stole money from a financial institution? Unfortunately, that is not uncommon worldwide. Crosschecks or spot checking a loan officer’s work by visiting clients periodically to verify their existence and balances can prevent fraud and errors.*

*What is the purpose of these and other internal controls? Display slide 10.*

**Slide 10**

**The primary objectives of internal control are:**
1. To verify the efficiency and effectiveness of operations
2. To assure the reliability and completeness of financial and management information
3. To comply with applicable laws and regulations

*What is the purpose of an internal audit? Wait for responses then display slide 11.*

**Slide 11**

**The purpose of an internal audit is to:**
- Identify irregularities in compliance with internal controls
- Identify new or previously uncontrolled risks or inefficiencies
- Propose new or revised internal control procedures

*How often should the internal auditor report to the board? The internal auditor should report to the Board at least quarterly.*
What are some characteristics of an effective internal audit? Discuss and display slide 12.

**Slide 12**

**Effective Internal Audits:**
- Objective and independent
- Auditor understands norms and intricacies of MFIs
- Auditor has unrestricted access to information
- Monitors adherence to pre-established policies and procedures
- Includes branch level analysis
- Auditor reports directly to the board
- Incorporates client visits as part of process

What is the difference between internal control and internal audit? Discuss, then display slide 13.

**Slide 13**

**The Difference between Internal Control and Internal Audit is that:**

Internal controls are the policies and procedures a CB or MFI puts in place to monitor risks before and after operations.

Whereas, internal audit is the systematic “ex-post” appraisal of an institution’s operations and financial reports.

After showing header of slide below, ask: What are external audits good for? Discuss then display slide 14.

**Slide 14**

**External Audit**
- Provides the board with an objective, third-party opinion on the adequacy of the internal control system.

Warning! However, institutions can not rely on them to identify risk exposure, fraud or needed control activities.

How is an internal audit different from an external audit? Make sure you or someone else responds correctly: External audit focuses solely on the financial audit

How often should you carry out an external audit? At least annually.
**Step 3:** Conduct operational danger signs round robin exercise

This will test participants practical understanding of the concepts discussed in the last two modules.

*During the last two modules we have talked about the importance of monitoring financial and managerial performance. Taking into account your experience and the lessons learned, if you had to come up with an operational danger signs checklist, what would you put on it?*

If necessary, give an example to get the exercise started. Go one-by-one through participants—allowing people to pass if they cannot think of anything—until no new ideas come up. Write answers on flipchart. Then distribute Handout 6 saying the following checklist can be adapted and used by your organization for rapid appraisals of institutional performance during Board meetings or at any time.

**Handout 6**

**Checklist for Operational Danger Signs**

<table>
<thead>
<tr>
<th>Danger signs</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>At Risk Portfolio has increased every month for the last three months</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rescheduled loans have increased every month for the last three months</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The CEO keeps trying to grow the portfolio by more than 50% per year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The last three reports were incomplete, incorrect or non existent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The spread keeps narrowing between the effective annual interest rate and the weighted average cost of funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No forecasts or projections of portfolio, income or expenses for the last three months</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans are getting progressively larger, and the repayment period is getting longer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit quality is slipping. New clients are increasingly marginal</td>
<td></td>
<td></td>
</tr>
<tr>
<td>High staff turnover in the past six months, especially at the branch level</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incidents of fraud are on the rise</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All the risk is being concentrated in one type of product, client or type of business</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff consistently fail to extend repeat loans to existing clients in a timely manner</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ongoing liquidity crisis (more than 3 months)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Over reliance on consultants after the third year of operation</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note: Items checked YES are potentially serious matters that require attention.*
MODULE SEVEN. OWNERSHIP AND GOVERNANCE: WHO DOES THE BOARD REPRESENT?

Purpose:
• To explore the relationship between the ownership structure of distinct institution types and good governance.

Objectives:
• At the end of the module participants will be able to identify the strengths and governance challenges associated with different ownership structures.

Preparation/Materials

Powerpoint slides
Handouts:
1. Community Bank Governance Game
2. For-Profit MFIs
3. Corposol/Finansol Case Study

Time: 2:00

DELIVERY

Display slide 1: In this module, we will discuss three institutional types: for-profits; non-profit, non-governmental organizations (NGOs); and credit unions.

Slide 1

Ownership and Governance
• For-profits: Banks, Finance Companies
• Non-profits: NGOs
• Credit unions/cooperatives

Step 1: Conduct afternoon icebreaker

Community Bank Governance Game

The following exercise is designed to wake participants up as their energy is ebbing in the afternoon, while it tests their knowledge of governance. Some of the governance practices highlighted in this exercise have not been covered yet, which is fine. When these new topics arise, briefly explain the practices and mention in which Module you will discuss them in more detail.

Instructions
Break the group into teams and tell participants that we are going to play a quick game to test our knowledge of good governance and wake ourselves up.
Tell them that in a moment you will be distributing a short profile of a fictitious community bank.

Inform participants that they will have three minutes to identify as many good (better) practices, bad (questionable) practices, and warning signs as they can and that they should appoint a note taker to capture their answers.

Handout profile. After three minutes, ask each group to read their list, briefly explaining why each item is considered good, bad, or a warning sign. The exercise is designed to highlight the fact that what constitutes a good or bad practice is not always cut and dried and that it is the job of the Board to keep an eye out for potential governance issues and to investigate warning signs to determine if they are, in fact, problems. Make sure that you, or someone in the group, makes this observation before concluding the exercise.

Distribute candy to the group with the most right answers.

**Handout 1**

The Community Bank ABC was founded in 1997. The CB was capitalized quickly by selling shares through the parish and currently has NGN 4.75 million in share capital. Fifty-eight percent of shares are owned by individuals—up from fifty six percent in 2004—thirty one percent are owned by a Community Development Association, and eleven percent are owned by mutual associations.

The Board of ABC is comprised of six Directors, who were elected at the last General Assembly meeting 9 months ago: a chief, a retired banker, director of a local women’s guild, a chairman, representative of the CDA, and leading business person. Five of the six Board members have been customers of the CB since it was formed. All five have outstanding loans and two have savings accounts with NAME. Of those with loans, three are delinquent.

The Managing Director, the brother-in-law of a Board member, used to run a CB in another state, and recently returned to TOWN to be closer to his family. He is well liked and known for his fairness and consensus building skills.

**Trainer Answer Sheet** (Note: You are the group may identify additional practices not mentioned in the list below)

**Good practices:**
- General Assembly meeting within last year
- Banking and finance experience on the Board
- Managing Director is an experienced community banker with strong consensus building skills

**Bad practices**
- Even number of Directors
- Under the required minimum share capital
- Board members with delinquent loans (Note: Could also arise under warning signs – GON places restrictions on the size of loans given to Directors without CBN approval.)

Warning signs
- Potential conflict of interest between Managing Director and a Board Member (was he the best person for the job? Did the MD meet the technical and leadership requirements? Was the CB he used to manage successful? Is his brother-in-law the Board Chair?)
- 42% of shares are held by CDA and mutual associations (potential over emphasis on social mission to detriment of sound financial management, and/or “overly democratic” voting—one person, one vote.
- Board composition. Might be heavy on figure head Directors, i.e. individuals with many useful contacts, but little time or few of the other skills needed for effective oversight of a financial institution. In general, the Board composition could be considered good, bad, or neutral, depending on the mission of the financial institution, level of development, external operating environment, and the specific mix of technical and leadership skills of each director.
- Since most Directors are customers of the CB, but for credit only, they may be inclined to set policies that favor borrowers and that undermine long-term financial security and profitability.

Step 2: Define the ownership structure of a bank

What is the typical ownership of a for-profit bank? Discuss, then display slide 2.

Slide 2

For-Profit Ownership
- Governance structure
  - ownership typically driven primarily by profit motive
  - board members are shareholders & have financial stake in the financial institution
  - those with more shares have more votes for making decisions

What does it mean for effective governance that those with more shares have more votes?

Let the group discuss this then note that individuals with a greater financial investment in the institution have a greater stake in ensuring sound financial management and governance.

Are there any potential problems or concerns with this governance structure?

Community banks and MFIs have a dual mission. They seek to improve the lives of low income people through the provision of financial services (the social mission). At the same time, as financial institutions they have a responsibility to maximize
(and protect) financial returns in the case of a for-profit institution, or ensure sound management of institutional and/or donor funds in the case of a non-profit.

MFIs considering transformation to a regulated institution, or that observe banks moving into the microfinance sector, may be concerned about mission drift, i.e. that the institution will stop serving lower income clients, or will raise interest rates for poor or sell off assets of MFIs, won’t be committed to the social mission of providing access to financial services to the poor. Also, remember that many CBs have moved away from their original low-income target market, even if they haven’t fully embraced sound, for-profit management principals.

If no one raises this point, ask: *What about balancing a social and a financial mission? Is it possible to successfully pursue both?* Encourage both CBs and MFI representatives to responds.

*Can anyone think of an example of an institution that is successfully meeting both objectives?*

Allow time for responses then note that worldwide there are an increasing number of formal MFIs that effectively balance both social and financial objectives, among them: Banco Solidario Ecuatoriano, Financiera Calpia (Banco ProCredit), and K-Rep.

Distribute Handout 2 and briefly describe these institutions.

**Handout 2**

**Banco ProCredit**

El Salvador

In July 1995 the microfinance NGO Fundacion Calpia successfully transformed into a regulated finance company, Financiera Calpia, SA. At the end of 2003, Financiera Calpia had 54,000 outstanding loans worth over US$66 million and US$35 million in savings captured. In June 2004, after nine years of successful operations providing credit and savings products to urban and rural micro, small and medium enterprises (MSMEs), Financiera Calpia was converted into the full-service commercial bank Banco ProCredit. With loans starting at US$25, Banco ProCredit maintains the MSME target market of its predecessor, Financiera Calpia.

**K-REP Bank**

Kenya

K-Rep Bank in Kenya has been licensed as a commercial bank since 1999, serving MSMEs. Currently, the bank has 7 branches serving over 45,000 active borrowers and 17,000 savers with a diverse range of savings and credit products. The average loan size of only US$443 suggests that the bank maintains a strong focus on the smaller enterprises within its client base.
**Banco Solidario**

Ecuador

The commercial bank, Banco Solidario, was created through the merger of two finance companies in 1995. The bank serves urban and rural microentrepreneurs, small businesses, and other low-income individuals marginalized from the traditional banking sector. Among the products and services offered are group and individual credit, housing loans, and savings accounts. As of June 2004, the bank had over 91,500 clients and a loan portfolio of US$85.5 million.

Display slide 3: Social and financial missions may be mutually reinforcing and consistent with both sound business practices and social philosophy.

**Slide 3**

**For-profits Balancing Dual Objectives**

“Social mission, expressed in conventional business terms, is an MFI’s orientation toward a specialized market niche, where actors must be innovative to serve the market efficiently and profitably. The profit objective, expressed in social terms is an institution’s search for permanence.”

Perceived duality is nothing more than the usual tradeoff between short- and long-term goals (profitability supports long-term fulfillment of social mission)

*Guidelines for the Effective Governance of Microfinance Institutions*

*In other words, a profitable institution can fulfill its social mission over time if it is profitable, and therefore sustainable.*

For-profits often serve both high and low-income clients (an effective risk diversification strategy). That doesn’t necessarily mean moving away from a social mission, since for-profits are generally able to reach larger scale, thereby serving MORE low-income clients than their non-profit counterparts.

**Step 3:** Discuss the ownership structure of microfinance NGOs

*What is the governance structure of a microfinance NGO?* Allow time for a few answers then show bullet point 1 of slide 4 below.

*What happens to an institution if the managing director is no longer willing or able to fulfill duties?* It may lose direction, encounter financial and/or operational management problems because no one else has the skills and knowledge to lead.

*What are the typical concerns with this governance structure?* Allow time for a few answers then show bullet point 2.

If participants have not explicitly described the risks associated with having Directors with no financial stake, ask:
Why is this a potential governance problem? Since they have no money of their own invested and there is no personal risk of loss, they may be less stringent in financial management of the institution.

Finally, show bullet point 3 and ask: What about multi-service NGOs?

**Slide 4**

<table>
<thead>
<tr>
<th>Governance of NGOs</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Most NGOs are staff driven</td>
</tr>
<tr>
<td>- Boards often not very active and possibly selected by management.</td>
</tr>
<tr>
<td>- Often dependent on strong managing director</td>
</tr>
<tr>
<td>• Board representatives are not owners/investors - have no financial stake in the MFI</td>
</tr>
<tr>
<td>• Multiservice NGOs – multiple objectives adds to complexity and hinders transparency</td>
</tr>
</tbody>
</table>

Does anyone know the case of Corposol/Finansol in Colombia? Distribute Handout 3, Corposol/Finansol Case Study.

The case of Corposol highlights these governance challenges. The NGO MFI Corposol transformed from an NGO into a formal financial institution, but the NGO retained 71% ownership. As an NGO, they were unfamiliar with the financial management requirements of a for-profit entity. Their Board representatives lacked a financial stake in the new institution, and provided insufficient oversight. Corposol became insolvent and had to be liquidated. The MFI was restructured with new owners and is now the successful for profit MFI, FINAMERICA.

Give participants time to read the study. Once they have read the case study, ask the group to discuss the following:

- How did Corposol’s governance structure contribute to the NGOs ultimate liquidation?
- How did the governance structure of Finansol undermine the institution’s financial viability?

**Handout 3**

**Corposol/Finansol Case Study**


Corposol began operations in Colombia in 1988 as a nongovernmental organization (NGO) whose mission was to provide microfinance services to poor small business
owners. Through its 1993 acquisition of Finansol – a regulated, commercial finance company (CFC) – Corposol became the second microfinance institution (MFI) in Latin America to enter the commercial arena. In its heyday, Corposol was internationally celebrated for its rapid growth and success in meeting the needs of a vast number of Colombian microentrepreneurs in need of credit. But in 1996, Corposol collapsed under the weight of its rapid growth, flawed institutional relationship with Finansol, and inadequate governance structure.

BACKGROUND

Finansol emerged from Actuar Bogota (hereafter referred to as Corposol), an NGO founded by influential local business persons with ACCION’s support to provide services to microentrepreneurs in Colombia’s informal sector. From its start in 1987, Corposol was noteworthy. It grew at an unprecedented rate, providing integrated training and access to credit to more than 3,000 clients in 1989, and escalating to nearly 25,000 active borrowers at the end of 1992. Corposol was also one of the first microlending institutions to begin its lending activities by obtaining lines of credit from commercial banks, initially through the personal guarantees of the founders, and afterwards through guarantees from ACCION's Bridge Fund and FUNDES. However, these sources of capital were insufficient to sustain the institution’s rapid growth. By 1992, Corposol began to explore ways to tap directly into financial markets by forming a regulated financial intermediary.

After examining the feasibility of a number of options, Corposol decided that a commercial finance company (CFC) was the preferred type of regulated financial institution. Not only would Corposol avoid raising the large minimum capital requirement (US$13.7 million at that time) to create a bank like BancoSol, but it could buy an existing CFC license and begin operations immediately. In October 1993, with 71% of the shares, Corposol became the controlling owner of a CFC, which was renamed Finansol. Joining Corposol as minority shareholders were ACCION International, Calmeadow, FUNDES, a local development bank and private individuals.

THE INSTITUTIONAL RELATIONSHIP BETWEEN CORPOSOL AND FINANSOL

Much of the institutional dysfunction between Corposol and Finansol can be attributed to ambiguity of authority and of responsibility within the credit process.

Mismatched Responsibilities and Uncontrolled Growth

Within Corposol and Finansol, staff responsibilities were inconsistent with ultimate accountability. Loan officers, as the primary liaisons between the clients and Corposol’s many services, remained part of Corposol’s staff until 1996. Their responsibilities went beyond evaluation of clients’ creditworthiness and repayment capacity. They also advised clients on training options, and reviewed with them possibilities for additional credit lines offered by Construsol or Mercasol, described below.

Buoyed by the success of establishing a regulated financial institution, the management of Corposol set out to provide completely new services and expand quickly at the same time. During 1995, the microfinance portfolio grew from US$11M to US$35M. This huge portfolio increase was delivered in part by large numbers of new credit officers who had not endured a well-structured induction and training system. Due to their entangled
relationship, Finansol was dragged along as Corposol launched three new untested microfinance projects: Mercasol, a chain of retail outlets for microentrepreneurs to purchase supplies with credit lines; Agrosol, a rural credit program with borrower groups of twenty or thirty clients and different repayment schedules than the urban program; and Construsol, a home improvement loan scheme. Although the establishment of these programs, collectively called Gruposol, was consistent with the overall mission of Corposol – to provide the poor with tools to increase their income-generating capacity and quality of life – they were initiated with insufficient market research. In some cases, Corposol approved two or three concurrent loans per client.

Because all of Corposol’s income was generated through mandatory training fees, there was an inherent conflict of interest: Priority was placed on the one-time training fee that clients brought in, not the long-term relationship, or even the probability that clients would repay their loans. The results were dismal. The new products were largely unsuccessful; the management information system could not keep up with the product diversification; and the institution lacked appropriate staff training for the new products.

Finansol, as the regulated institution within Corposol, was ultimately responsible for the quality of the portfolio, yet had little or no control over the loan officers who were in the position to follow up on client repayment. Finansol’s role was limited to the financing, including tapping the financial markets to fund Gruposol’s operations, loan disbursement and reporting to the Superintendency. When loan officers were finally incorporated into Finansol’s organizational structure in 1996, it was far too late to ameliorate the problems caused by the weak institutional relationship.

Cultural Differences
Differences between the nonprofit culture of Corposol and the banking culture of Finansol caused tension between the employees of the two organizations. Finansol’s survival was dependent on solid financial performance and a high-quality portfolio. These concerns were not as important to Corposol as an NGO.

Informal vs. Formal Cultures. In an industry that traditionally represents a hybrid of financial and social mentalities, Corposol staff felt that Finansol bankers did not understand the idiosyncrasies of the microentrepreneurs or Corposol’s methodology. They also felt that Finansol staff was excessively bureaucratic and their higher budget and salary expectations were not in keeping with the overall mission of helping the poor.

The attitude of informality that had driven Corposol's operations throughout its history conflicted with Finansol’s need to be accountable to its shareholders and the Superintendency. By the time Finansol was established, the “growth at all costs” mentality and consequent methodological shortcuts were firmly entrenched in the lending operation, as was the practice of refinancing to sweep bad loans under the rug.

Additionally, an unwritten code of flexibility permeated clients' repayment culture, further damaging portfolio quality. Clients were accustomed to Corposol overlooking late payments, as long as they eventually paid. By August 1995, there was a significant deterioration in Finansol’s credit portfolio because Corposol consistently failed to collect in a timely manner. The stricter collection culture of Finansol confused clients and fostered a negative perception when they began incurring penalties and interest on payments in arrears. As a result, some clients resisted repaying their loans at all.
For Corposol, the price of these sloppy lending procedures had been inconsequential. However, once Finansol was required to make provisions for portfolio at risk (in accordance with the Superintendency regulations), the burden was overwhelming for the new financial institution struggling to break even.

**Differences in Lending Methodology.** As Corposol and Finansol continued to grow, a distortion of the lending methodology emerged. Under pressure from Corposol to bolster the number of clients (so they could receive the mandatory training fee), the loan officers allowed larger loans for longer terms, without following traditional, more stringent lending criteria.

As noted above, due to rapid growth and product diversification goals, by 1995 Gruposol programs often made parallel loans to the same client without proper lending analysis. To stop the monthly deterioration of the profit and loss statement caused by provisioning for the increasing number of delinquent loans, management launched a massive refinancing of the portfolio. This response provided brief cosmetic relief at the huge cost of hiding and worsening Finansol’s asset quality.

As it turned out, there were other serious problems that would contribute to the Corposol and Finansol crisis. Finansol was in the practice of financing long-term assets with short-term capital, paid little attention to the systemization of financial data, and was vulnerable to fraud due to a lack of checks and balances. For example, as early as 1992, loan officers were fired because they had made loans to “ghost groups” that did not exist. At that time, such indiscretions were still the exception. By 1995, fraud was increasingly prevalent. In a diagnostic undertaken by Tobón in 1995, he discovered ghost groups and self-lending (funds disbursed to loan officers themselves) totaling US$200,000 in several branches.

**Ability to Hide Problems.** By working through a non-regulated entity, Finansol was able to avoid government regulations when they were inconsistent with the institution’s strategy or needs. For example, when the Superintendency imposed blanket limitations on the lending growth of financial institutions in 1994, Finansol issued loans through Corposol, thus avoiding interruption or limitation of client service. This opportunistic swapping of loan portfolios was one of the most detrimental practices undertaken by the two institutions.

The Corposol crutch made it possible to mask the true performance of Finansol. When Finansol’s portfolio began to deteriorate, the worst loans were restructured and sold to Corposol, whose portfolio was not subject to provisioning requirements or review by the Superintendency.

Such maneuvers were, at best, temporary fixes and allowed Finansol to hide behind an NGO to avoid Superintendency scrutiny. This tactic exempted Finansol from developing operational standards with the required rigor of a regulated entity. At the same time, Finansol did not have to bear its own full operational cost (as loan officers were supported by Corposol until 1996), helping to camouflage its true financial condition.
FLAWED GOVERNANCE STRUCTURE

The Management
In addition to mismatched responsibilities on an operational level, Finansol’s management lacked autonomy because Corposol had ultimate oversight and management control over the CFC. Strategic decisions – such as rapidly diversifying lending products with little market research to back it up – were imposed upon Finansol by Corposol’s management.

Corposol’s strategic direction, operational details and organizational culture were influenced by the strong ambition and personalities of its president, Oscar Giraldo and the president of its board of directors, Alvaro Arango. Their emphasis on the growth of the organization propelled it to the levels it achieved in 1995, but their insatiable appetite for that growth led them to pursue ill-advised strategies.

The Board of Directors
The inability of Finansol’s board of directors to prevent the Corposol crisis was due to the weak structural relationship between the Corposol and Finansol boards. Finansol’s statutes mandated that majority control of its board must always remain with Corposol, the primary shareholder. This governance structure was fundamentally flawed as it placed the decisionmaking power of a for-profit institution in the hands of an NGO. Their differing missions and responsibilities were inherently at odds.

With five Finansol board seats occupied by close friends and staff of Corposol, the Finansol board played only a nominal role in governance of its own institution. Furthermore, with no rotation of the presidency of Finansol’s board – Alvaro Arango always held the position – there was a lack of new opinions to challenge the status quo. Given his daily meetings with Giraldo and his dual position as president of Corposol’s board, Arango was unable to truly consider Finansol’s best interests at all times. Especially in key events leading to the Corposol crisis, Finansol board members did not exercise their power to override the decisions of management as they should have. When the Finansol board finally took action and demanded that the recovery of doubtful loans become a priority in October 1995, it was too late to save Corposol.

THE TURN-AROUND

In 1996 and 1997 changes in leadership resulted in some dramatic changes including a complete separation of Corposol and Finansol. Buckling under outstanding loans from 17 financial institutions and debts equaling US$15 million, Corposol was unable to restructure its debt with any of its creditors. Corposol – along with Agrosol, Construsol and Mercasol – was completely dissolved in September 1996. Finansol remained as the only surviving entity within Gruposol, continuing to offer individual and group loans. To break its association with its tumultuous past, Finansol was re-named FINAMERICA and hired a new president.

Now that we have explored the serious problems that may arise when governance challenges are not addressed, how can the governance challenges of NGOs be addressed? Display slide 5 and discuss.
Slide 5

General Recommendations for NGO Governance

- During board Selection:
  - Avoid polarization of dual objectives issue: try to recruit Directors committed to both missions
  - Select members with time, capacity, and commitment to learn microfinance
- Encourage Board Involvement through Board Development:
  - Provide education and training opportunities to Directors on both technical and governance issues

With multi-service NGOs...Display slide 6 and discuss.

Slide 6

Multiservice NGOs

To minimize governance issues:

- If starting new MFI, recommend creating:
  - MFI specialized in microfinance
  - Separate legal entity
- In general:
  - Hire specialized staff, management, board
  - Hold to industry performance standards
  - Ensure higher levels of transparency

Step 4: Describe the ownership structure of cooperatives

Finally, what is the governance structure of a cooperative? Give participants a moment to respond, then reveal bullet point 1 of slide 7 below.

What are the typical concerns with this governance structure? Discuss, then reveal bullet points 2-4 and ensure that participants have fully described the associated risks as outlined below.

Board qualifications inadequate: Since Directors are elected from within the client base and don’t necessarily have the skills needed to guide a financial institution.

Net borrowers’ interests pervade: Borrowers tend to have a shorter term outlook. They often advocate for low interest rates and other policies, which may undermine the profitability and sustainability of the institution. Promoting a loose lending policy can lead to insider lending, favoritism, and inadequate review of creditworthiness, further undermining institutional sustainability.

Diffuse ownership: Generally, no one owner holds significant shares. Therefore, unlike for-profit institutions, no one has a significant enough stake in efficient oversight. Even if shareholder holdings weren’t limited, the one-person, one-vote approach to
decisionmaking would prevent that individual from exerting more influence on oversight than anyone else.

Note: Even though they don’t have a cooperative ownership structure, CBs are employing this approach in practice, so make sure this point is drawn out.

**Slide 7**

**Governance of Credit Unions/Cooperatives**

*Governance structure:*
- members are owners and clients

*Governance issues:*
- Board qualifications often inadequate
- Net borrowers’ interests pervade
- Diffuse ownership/One person-one vote decisionmaking structure

How can these issues be addressed? Display slide 8 and discuss.

**Slide 8**

**Addressing Credit Unions’ and Cooperatives’ Governance Challenges**

*Board qualifications often inadequate*
- Specify minimum qualifications for Directors in by-laws
- Provide training to board members

**Slide 9**

**Addressing Credit Unions’ and Cooperatives’ Governance Challenges**

*Net Borrowers’ Interests Pervade*
- Prohibit insider lending or limit board loan sizes
- Encourage savings, attract net savers to board
- Support adequate regulation and supervision

*Diffuse Ownership*
- Attract net savers, natural oversight incentives
- Encourage shareholder participation by ensuring adequate flow & transparency of information
- Internal/external controls, operational audits
Ask participants to form groups of 3-5 people by institutional type, i.e. groups of community bankers and groups of MFI representatives. Provide flip charts and markers and ask groups to answer the questions on slide 10:

**Slide 10**

<table>
<thead>
<tr>
<th>Instructions for Governance Structure Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. What is the ownership structure of your institutional type?</td>
</tr>
<tr>
<td>2. What are the most common governance issues Nigerian CBs or MFIs face?</td>
</tr>
<tr>
<td>3. Do any of the challenges we’ve discussed apply to your type of institution—even if they were attributed to another institutional type?</td>
</tr>
</tbody>
</table>
MODULE EIGHT. GOVERNING CHANGE AND CONFLICT

Purpose:

To discuss the Boards’ role in change—with a spotlight on management succession planning—and governing conflict. Participants will consider conflicts of interest and participate in a simulation on managing fraud.

Objectives:

At the end of this module participants will be able to:

- Describe the steps needed to minimize disruptions due to management changes
- Identify and minimize conflicts of interest

Preparation/Materials:

Powerpoint slides
Handouts:
1. Managing Conflict of Interest
2. Simulation handouts – Managing Director, Chairperson, Members, Observers
Candy for prizes

Time: 2:00

DELIVERY

Step 1: Discuss the Board’s Role in Change

Financial institutions such as community banks and MFIs may face a wide range of changes over time, including management changes, changes in the regulatory environment, rapid growth, NGO transformation, and mergers and acquisitions.

In cases such as these, what is the Board’s role? Discuss then display slide 1.

Slide 1

The Board’s Role in Change

The board’s advisory role is particularly critical during a major transformation because of the number of fundamental changes involved, such as setting new policies, offering new products, complying with regulators, and managing the expectations and concerns of staff and clients.
**Step 2:** Establish the importance of management succession planning

Do any of you know of a case when a bank or MFI managing director died unexpectedly? Was their a succession plan in place? What happened?

What steps can be taken to facilitate a smooth transition? Discuss, then display slide 2 ensuring that someone else or you has covered each point.

**Slide 2**

<table>
<thead>
<tr>
<th>Steps to Facilitate a Smooth Management Succession</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Prepare a written succession plan (update annually)</td>
</tr>
<tr>
<td>• Groom senior managers as potential successors</td>
</tr>
<tr>
<td>• Develop contingencies in case of certain potential happenings, i.e. mass staff exodus</td>
</tr>
</tbody>
</table>

Management should draft the succession plan, which should include job descriptions and criteria for the replacement of all senior staff, and a plan for addressing staffing should several senior staffers leave at the same time. The Board reviews and approves the plan. It should be updated annually.

By including the current Managing Director in selecting and training his or her predecessor you avoid concerns about being replaced. This also creates a more capable management team independent of succession.

*In summary, maintaining and up-to-date succession plan is critical for good governance. Even if operations are running smoothly, unforeseen events can occur.*

**Step 3:** Present common forms of conflict of interest and their associated risks

What is a conflict of interest, could someone give an example they have seen on Boards before? How was that problem addressed? Or how do you think it could have been addressed?

After discussing the example briefly, display slide 3 and emphasize that Boards inherently have conflicts of interest. Conflicts of interest are not inherently illegal, nor do they necessarily infer a lack of integrity on the part of the board member involved. (Read example from slide).

**Slide 3**

<table>
<thead>
<tr>
<th>Identifying and Minimizing Conflicts of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>• <strong>Boards inherently have conflicts of interest.</strong> e.g. Individuals frequently serve on a board because of their institutional affiliation. As a result, board members often end up representing two institutions—their employer and the MFI—and this can lead to conflict.</td>
</tr>
</tbody>
</table>
While it is unrealistic to expect an MFI to have no conflicts of interest within the Board, by demanding transparency, their potential negative impacts can be minimized.

Display slide 4: *This is a list of common conflicts of interest.*

**Slide 4**

<table>
<thead>
<tr>
<th>Common Conflicts of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Related-party transactions</td>
</tr>
<tr>
<td>Nepotism</td>
</tr>
<tr>
<td>Insider lending</td>
</tr>
<tr>
<td>Springboard</td>
</tr>
<tr>
<td>Competition</td>
</tr>
<tr>
<td>Multiple relationships</td>
</tr>
<tr>
<td>NGO dominance</td>
</tr>
</tbody>
</table>

*Ask participants to define any of the conflicts of interest that haven’t already been defined.*

**Related party transactions.** Engaging in activities to the detriment of an organization on whose board one serves in order to benefit another related organization or individual. **Nepotism:** Hiring family members to fulfill a function within the institution. **Insider lending:** Providing loans to board members. **Springboard:** Using a board position to advance political aspirations or run for political office. **Competition:** Institutions begin to compete that have common board members.

**Step 4:** Define policies for minimizing and manage COI

To conclude the discussion of COI, divide the group into 2-3 teams. Pass out pieces of paper with policy categories. Keep slide with the list of conflicts of interest visible.

Read the policies from the right-hand column of Handout 1 below in random order. Have each person or team raise the number over their head for which the policy corresponds. The fastest person gets 5 points, others that get it right get one point. Go through until all policies are read.

Total points, announce winner and hand out candy, along with Handout 1.
### Managing Conflicts of Interest

<table>
<thead>
<tr>
<th>Conflict</th>
<th>Guidelines for Resolution</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Related-party transactions</strong>: Engaging in activities to the detriment of an organization on whose board one serves in order to benefit another related organization or individual</td>
<td>When joining the board, each new director should sign a Code of Conduct agreeing to a primary commitment to the MFI in all board dealings. New directors should complete a “conflict of interest form,” which lists all potential conflicts and overlapping affiliations. Members with an acknowledged conflict of interest on a given issue should excuse themselves from voting on that issue. If a board member has not been transparent about a conflict of interest that has caused harm to the MFI, the board should ask the member to resign.</td>
</tr>
<tr>
<td><strong>Nepotism</strong>: Hiring family members to fulfill a function within the institution</td>
<td>Allow hiring to take place only if the candidate passes objective hiring criteria determined by non-family members. Set policies, such as “no sole reporting to a family member,” to provide checks and balances on such relationships.</td>
</tr>
<tr>
<td><strong>Insider lending</strong>: Providing loans to board members</td>
<td>Do not allow or apply strict limits for maximum loan amounts and transparent documentation and approval procedures.</td>
</tr>
<tr>
<td><strong>Springboard</strong>: Using a board position to advance political aspirations or run for political office</td>
<td>The board member should resign before pursuing such goals or be asked to leave the board.</td>
</tr>
<tr>
<td><strong>Competition</strong>: Institutions begin to compete that have common board members.</td>
<td>The overlapping board members must resign from one of the boards.</td>
</tr>
<tr>
<td><strong>Multiple relationships</strong>: International shareholders are also providers of technical assistance or financial services</td>
<td>Consider technical assistance from shareholders only after the consolidation of a transforming MFI, and then on a case by case basis. Involve different individuals on the technical assistance teams and the board. Set policies for dealing with possible conflicts of interest and include these in the shareholder agreement.</td>
</tr>
<tr>
<td><strong>NGO dominance</strong>: Majority NGO shareholder advancing the agenda of its institution</td>
<td>Limit power through principles set in bylaws or shareholders agreement.</td>
</tr>
</tbody>
</table>

**Step 5**: Conduct the “Who Pays the Price for Fraud” simulation (Adapted from AMIR)

The purpose of this simulation is to give participants the opportunity to strengthen their conflict management skills through horizontal learning, while at the same time highlighting many of the good and bad governance practices discussed throughout the course.
1. Distribute the general guide and explain that participants will now participate in a simulation that illustrates the role of the Board in managing difficult situations and personalities.

2. Ask for 4 volunteers.

3. Assign each a role (Managing Director/Executive Director, Chairperson, 2 Members) and distribute the corresponding guide.

4. Distribute the “Observer” guides (along with copies of everyone else’s guide to remaining participants (Do not let Managing Director, Chairperson, or Members know the Observers have their guides too.))

5. Give 15 minutes to review guides and prepare arguments, and 30 minutes for the role playing.

6. At the end of the 30 minute role play, ask the observers to comment on what they just witnessed.

Display slide 5.

Slide 5

**Instructions for Governance Simulation Exercise**

What were the strengths and weaknesses of each character’s argument?

Who was most convincing, and why?

What lessons learned can be drawn about:

a. Managing difficult situations

b. Good governance?

Simulation Handouts 2: Governance Simulation Exercise

Handout 2a – For General Distribution

The Prosperity Fund. Who pays the price of fraud?

Background

For the past three years the Prosperity Fund has seen exponential growth in its loan portfolio. The organization is now approaching financial sustainability, and its default rate is among the lowest in the industry. It is one of the top three MFIs in the country, and has expanded very rapidly (competitors say recklessly) into new markets.

The Prosperity Fund has been under pressure to expand rapidly in order to capture market share ahead of its competitors. The Board knew there would be risks involved in such rapid growth, but decided that the benefits outweighed the disbenefits. Indeed, six months ago the Chairperson argued successfully that the organization's future might be endangered if it did not maintain and strengthen its position as a leader in Microfinance,
given the growth of aggressive competition in the market. This view tipped the balance in favor of expanding to three new regions of the country. Thus in the last six months the Prosperity Fund has opened three sub-offices, hired 3 new Regional Managers and 40 more credit agents.

Staffing the expansion has been a major problem in recent months, because it has been hard to recruit and train enough agents to keep up with demand for the organization's loan products. Staff and portfolio quality may have slipped a bit, and there has been a slight rise in defaults and late payments, but in general, according to the Managing Director, everything seems to be on track.

The Managing Director has been with the organization since start-up and is well connected at the Ministry of Social Affairs. He is also well connected less formally, through his relatives in very high positions in society. He has used his connections to promote the Prosperity Fund with some success.

**Board members include:**
- Banker
- Entrepreneur
- Advertising executive
- Media executive
- CPO
- Ex government minister at the MoF, now leading a management consultancy (Chairs the Board)
- Social development expert
- Legal expert

The Board usually meets monthly. Officially the Chairperson chairs meetings, but in practice it is the Managing Director who leads the meetings. After all, s/he is better informed than anyone else about the Prosperity Fund and its situation, and it has worked fine this way so far.

**Today’s meeting**

The Chairperson has called today’s emergency meeting in order to discuss an urgent problem. The very future of the Prosperity Fund is at stake.
Handout 2b – The Managing Director – (for Your Eyes Only)

Do not allow anyone to see this document. It is for your eyes only. Use its content to guide your behavior and attitudes throughout the simulation.

Your role as Managing Director
You are a dominant leader. Team work is a nice idea, but it doesn't work.

You have been in post for three years. All the Board members came to the organization after you. You even proposed most of them yourself because you knew they admired and respected you. But you didn't choose the Chairperson. S/he was imposed on you. It's a difficult relationship.

You have led the organization to success for three years, and nobody seems to understand just what a challenge it has been, or how spectacularly well you have done, against all the odds.

Your attitude to governance
These people on the Board are well meaning, but are basically not aware of the realities of Microfinance. Even the bankers don't really understand the unique methodology of MFIs. But they seem to get more and more troublesome these days. They ask questions that are none of their business, and they seem to want to exert too much influence over the organization. Are they going to become a group of micromanagers, or let you lead and get out of the way?

So governance is a time-consuming and pointless charade. Board meetings are basically a waste of time, where people who don't really know what they're talking about, like to listen to the sound of their own voices. Most of them are on this Board because it's good for their image. They get to tell people at cocktail parties in Abuja how they are involved in helping the poor. Unfortunately the donors have insisted on this supervision structure, and the organization has been obligated to comply. You do your best to play the game, and to show respect, but let's face it; you are the only expert around here. You are the only one who has done the advanced training in Boulder, the only one who really knows the methodology. And after all, where would this organization be without you?

The expansion to three new regions
You led this expansion. You pushed for it. The Chairperson finally agreed with your proposal for rapid expansion because you convinced her/him that you could deliver the recruitment and maintain portfolio quality. Then you managed to get the Chairperson to sell the idea to the rest of the Board.
You hired the three new Regional Managers yourself, without the participation of any of the Board members. Then the expansion got out of hand, and too many credit agents were hired too fast. Now it's turned out to be a disaster, and you realize that you were unprepared for the challenges you would face. It's going to be very hard to get out of this with your reputation intact.

The fraud
In the past two weeks, a major fraud has come to light. You alerted the Chairperson about the fraud three days ago. For the first week you tried to find out if the
problem could be contained, and decided not to mention it to the Board until you were fully aware of the extent of the fraud. At that time your finance people calculated a probable loss, due to fraud, of $75,000. Unfortunately it now seems probable that at least $200,000 is missing. You are going to have to announce this revised figure at the emergency Board meeting today.

Over the past five months 12 new credit agents, working together, have created at least 150 bogus clients, and pocketed the 'loans'. The repayment reporting has indicated that 'repayments' have been made on time, but finally the negative cash flow has revealed the fraud. The full extent has yet to be revealed.

You have discovered that the credit agents have manipulated portfolio-monitoring visits. For weeks the Managers have met with numerous bogus 'borrowers', and have not realized that these were not clients at all. They were people who had been bribed by the Credit Agents. And the credit agents have been pocketing the funds.

No staff members have been fired yet. Four have resigned and are unreachable. If you fire anyone, the problem will be exposed, and the entire organization will surely suffer the consequences. And what about your reputation?

There is no evidence that any of the three new Regional Managers have participated in any fraud. Indeed it was one of the Managers who reported the fraud to you last week. But there is considerable evidence to indicate their lack of capacity, experience and lack of sufficient training.

The PR implications are appalling. The survival of the organization and is at stake. You are vulnerable to accusations of incompetence.

Who is at fault here? What are you going to do? If you fire the staff, the story may reach the media, and the organization may go under.

**Your objectives at this meeting**

1. Announce the full extent of the fraud and all its implications for the program.
2. Pass the problem to the Board. Try to get the blame for the expansion decision moved from your shoulders to the Chairperson. He sold the idea to the Board, not you. After all, you are just the servant of the organization.
3. Get the Board to absolve you from blame, and reiterate its confidence in your leadership.
4. Sell a rescue strategy to the Board that shows you have the capacity to get on top of the problem. Regain their confidence.
Handout 2c – The Chairperson - (for Your Eyes Only)

*Do not let anyone see this document. It is for your eyes only. Use its contents to guide your behavior and attitudes throughout the simulation.*

**Your role as Chairperson**

You joined the Board two years ago. You are the only Board member who was not nominated by the Managing Director, and you are aware that this may be the cause of some chronic difficulties between you.

The Managing Director has been in post for three years. S/he is undoubtedly a talented person, but there are problems that are increasingly disturbing to you:

1. The Managing Director seems to be on a personal ego trip and treats the Board like a fan club. S/he doesn't seem to understand that you and the Board are her/his employer.
2. In reality, some Board members behave as if they are in a fan club, and don't seem to understand their supervision, support and governance role. This just reinforces the problem.
3. Recently, your own lack of availability has meant that you have been less and less available to keep an eye on the business.
4. Against your better judgment, you have allowed yourself to be swayed by the Managing Director on a number of important issues recently, the most important of which was the decision to expand into three new regions of the country. This effectively doubled the size of the organization's portfolio in six months. You allowed yourself to be persuaded, and even recommended that the Board accept the expansion as part of the revision to the Business Plan. You bitterly regret your weakness.

**Your attitude to governance**

Governors employ the Executive. It's that simple. The sooner the Board understands that, the better for everyone.

The Board needs reform. New members need to come in who are not friends of the Managing Director. And the fans need to be removed. Elegantly removed.

Board members need to face up to their responsibilities as governors. They simply must stop behaving in such a sycophantic manner toward the Managing Director. This may have been acceptable at the early stage in the life of the organization, but not any more. This is business with a social conscience, not a personality cult. The rot must stop.

**The fraud**

In the past three days, a significant fraud has come to light. Three days ago the Managing Director contacted you confidentially with the bad news. According to the Managing Director, it is probable that $75,000 is missing. The PR implications are not good. The reputation of the organization is at stake. As Chairperson, you are vulnerable to accusations of incompetence.
Apparently over the past five months 12 new credit agents, working together, have created at least 100 bogus clients, and pocketed the ‘loans’. The repayment reporting has indicated that ‘repayments’ have been made on time, but finally the negative cash flow has revealed the fraud. According to the Managing Director full extent of the fraud has now been fully exposed.

The rest of the Board is not aware of the fraud problem. It will be your unpleasant duty to explain the gravity of the situation to them today at the extraordinary meeting.

No staff members have been fired yet.

According to your Managing Director, there is no evidence that any of the three new Regional Managers have participated in any fraud. Indeed it was one of the Managers who reported the fraud to the Managing Director last week. But there is considerable evidence to indicate their lack of capacity, experience and lack of sufficient training.

It's just appalling. This is the very last thing you need now.

You have chaired the organization successfully for two years, and it has been quite a sacrifice of time and effort. You knew that the expansion plan was misconceived, but in a weak moment you allowed yourself to be influenced.

Whose fault is it? The Regional Managers? The Managing Director? The other Board members for not understanding their role as governors? You?

Should you resign? The loss of face will be intolerable. Should the Managing Director be made to resign?

Your objectives at this meeting

1. Pass the problem to the Board. This may be an opportunity to move them from fan club mode to a real governance mode. It won't be easy to get friends of the Managing Director to behave like employers. But it's high time they understood their responsibilities.

2. Devise a rescue plan with the Board. Make sure that everyone takes responsibility for the problem and its resolution. Don't let yourself be pushed around by the Managing Director. After all, look what happened last time. Make sure that all issues are covered.

3. Make sure all stakeholders in the organization (especially the funders) will be reassured that everything is under control.

4. Advise the Board on whether this issue should provoke sackings or resignations.
Handout 2d – Members – (for Your Eyes Only)

Do not let anyone see this document. It is for your eyes only. Use its contents to guide your behavior and attitudes throughout the simulation.

Your role as a Board member
You have been on friendly terms with the Managing Director for some time. S/he suggested your name be put forward as a member, and you were flattered to be asked to join. The Managing Director is a talented professional, and you have every confidence in her/his abilities to lead the organization to success.

You are aware that funding partners place a high priority on good governance, and that a certain game must be played with them to keep them sweet. But let's face it, this is our country and we'll do things the way we see fit.

Anyway, what is good governance? You go to the meetings regularly, you try to read all the reports they send you, and things seem to be on track. What more can anyone ask of a volunteer?

Your objectives at this meeting
Once you are aware of the reason for the meeting, you may need to seriously rethink your relationship with the Managing Director and the Chairperson. The situation is deeply embarrassing, and may reflect very badly on you. Put the interests of the organization first. Put your personal relationship of trust and friendship with the Managing Director to one side.
Handout 2e- Observers – (for Your Eyes Only)

Your role
You have access to all the information about the other participants in this meeting. Be aware that other participants may not have all the information. Do not show your information to participants in the meeting. Your information is only for Observers.

You are the fly on the wall. You are invisible. You are an objective outsider. Observe the meeting.

Do not comment or react outwardly during the simulation, no matter how much you may want to. Allow the participants to conduct the meeting in their own way.

Your task
Because you are not directly involved in the problem or in its resolution, you will have a unique perspective. Make mental or written notes about key events, key statements, good governance behavior, governance or leadership errors, or other noteworthy information that emerges during the simulation.

When the simulation ends, you will be asked to give feedback to all the participants.

Your objective
To offer constructive criticism of the governance process during the extraordinary meeting of the Board of the Prosperity Fund.
MODULE NINE. BOARD PERFORMANCE EVALUATION AND BOARD DEVELOPMENT

Purpose: To discuss the importance of regular Board performance evaluations. Participants will experiment with tools for conducting these evaluations and initiate a Board development plan.

Objectives:

At the end of this Module participants will be able to:
1. Describe the purpose and focus of Board evaluations
2. Identify tools for Board evaluation
3. Initiate a Board development plan

Preparation/Materials:

Powerpoint slides
Handouts:
1. 12-Month Board Development Plan: Recommended Practice Example
2. Self Evaluation and Individual Board Member Development Plan
3. Checklist for Governance Danger Signs
4. Board Evaluation and Development Plan Worksheet
5. 12-Month Board Development Plan Form

Time: 2:00

DELIVERY

Step 1: Discuss objectives of and provide tools for board performance evaluations

Performance appraisal is one of the most powerful board development tools. Constructively utilized, it can improve the performance of individual directors, of the board as a whole, and ultimately, of the institution by essentially creating an additional level of accountability.

A. Objectives

What is the purpose of board performance evaluation? Discuss then show slide 1.
**Slide 1**

<table>
<thead>
<tr>
<th>Objectives of Board Performance Evaluation:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Clarify individual and collective roles and responsibilities of Board Directors;</td>
</tr>
<tr>
<td>• Help the Board identify areas of weakness and stimulate ideas about how it might improve in those areas;</td>
</tr>
<tr>
<td>• Enhance the working relationship between Board and management by encouraging greater candor in dealing with each other;</td>
</tr>
<tr>
<td>• Provide a mechanism for regularly reviewing the performance of individual Directors, thus making it possible to assess Board member strengths and weaknesses, and apply a performance-based policy for replacing Directors who are not providing the leadership that the institution requires.</td>
</tr>
</tbody>
</table>

**Do you see any value in this? How do you know if you are doing a good job? Surely some of you have had the experience of working with a Board member who you would have liked to replace?**

**B. Board evaluation**

**Who should lead the evaluation?** Discuss, then display slide 2.

**Slide 2**

<table>
<thead>
<tr>
<th>Who Leads the Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Evaluations may be internal or external. Internal evaluations should be conducted annually. While optional, some institutions also like to conduct evaluations with external consultants every three years to get an outside perspective.</td>
</tr>
</tbody>
</table>
Display slide 3: *What should you evaluate?*

**Slide 3**

**The Focus of Full Board Evaluations:**
- Review board skills and experience in comparison with the institution’s strategic direction to determine whether training and/or changes to the board’s composition are needed;
- Compare board accomplishments with the work plan;
- Ensure the MFI has internal control, information and audit systems in place, which can adequately convey to the board whether the institution is achieving its objectives;
- Examine the sources of the data used by the board ensuring the use of information from both internal and external sources;
- Assess the effectiveness of meetings in terms of frequency, time efficiency, and ability to reach important decisions;
- Consider whether board members are receiving, in a timely manner, the type and quality of information they need to prepare for meetings;
- Evaluate the institution’s strategic planning process: does one exist, is it being used, is it yielding strategic initiatives that are on schedule, within budget, and producing the desired results?

Display slide 4: *The following four steps are recommended to launch a performance evaluation process:*

**Slide 4**

**The Performance Evaluation Process**
- Set performance targets
- Prepare a report on resource use and activities
- Survey Directors on achievement of performance targets
- Draft a comprehensive report on findings and recommendations, discuss, **set new performance targets as necessary.**

1. The Board establishes objectives for each area of responsibility against which to measure performance. These should be set annually at beginning of fiscal year. Boards should ensure that all major areas of responsibility are covered periodically, but not every responsibility needs to be evaluated each year.
2. The Board Secretary, or another officer prepares a report on resources and activities in the past year, including an analysis of how the Board spent its time and energy. The report should include external information from market analysts, industry networks, and rating agencies, if available.
3. Assign a Director to survey members regarding the Board’s performance relative to the objectives. This can be done by distributing surveys or conducting interviews. The survey can include open ended questions and scoring.
4. The information collected through the survey and activities and resources report should be synthesized and compiled into a single report that identifies in which areas the board met its objectives and where it needs improvement. The author of this report should consider the tone, confidentiality, and balance of the report. The Board should receive a summary of the report, discuss the findings, and set new performance objectives accordingly.

Distribute Handout 1, which provides an example of a Board Development Plan a community bank or MFI might draft. Read the three objectives to the group, as well as a couple Action items of your choosing before moving to the next topic.
Handout 1

12 month Board development plan

RECOMMENDED PRACTICE EXAMPLE

Aim: Measurably improved governance in 12 months

Possible Objectives for the coming 12 months:

1. Enlarge our Board by two people to include a broader skill and capacity base
2. Strengthen our Board Committees to ensure quality monitoring and governance efficiency
3. Measurably upgrade our Board decision making process

Objective 1: Enlarge our Board to include a broader skill and capacity base

<table>
<thead>
<tr>
<th>Action</th>
<th>Responsible person</th>
<th>Target date</th>
<th>Resources Needed</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establish permanent Nomination Committee</td>
<td>Chair</td>
<td>Feb 28</td>
<td>Consultant specialist</td>
<td>Nomination Committee voted into being</td>
</tr>
<tr>
<td>Assess required Board profile &amp; composition</td>
<td>Committee Chair</td>
<td>March 31</td>
<td>Updated market study from CEO</td>
<td>Conclusions &amp; Recommendations to the Board</td>
</tr>
<tr>
<td>Determine appropriateness of current Board member profiles &amp; capacity gaps</td>
<td>Committee Chair</td>
<td>April 30</td>
<td>Updated market study from CEO</td>
<td>Recommendations to the Board</td>
</tr>
<tr>
<td>Produce an orientation pack for new Board members</td>
<td>Committee Chair</td>
<td>May 31</td>
<td>Admin support through CEO</td>
<td>Orientation Pack</td>
</tr>
<tr>
<td>Revise Board Workbook to accommodate the change</td>
<td>Board Chair</td>
<td>June 30</td>
<td>Committee Chair</td>
<td>Revised Workbook</td>
</tr>
<tr>
<td>Propose recruitment of one new member</td>
<td>Committee Chair</td>
<td>Aug 31</td>
<td></td>
<td>Named individual</td>
</tr>
<tr>
<td>Recruitment of new member</td>
<td>Board</td>
<td>Sept 30</td>
<td></td>
<td>First new member joins Board</td>
</tr>
<tr>
<td>Propose recruitment of second new member</td>
<td>Committee Chair</td>
<td>Oct 31</td>
<td></td>
<td>Named individual</td>
</tr>
</tbody>
</table>

Recruitment of second new Member

Objective 2: Strengthen our Board Committees to ensure quality monitoring and governance efficiency

<table>
<thead>
<tr>
<th>Action</th>
<th>Responsible person</th>
<th>Target date</th>
<th>Resources Needed</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Review Committee capacity and</td>
<td>Board Chair</td>
<td>March 31</td>
<td>Consultant specialist</td>
<td>Consultant recommendations</td>
</tr>
<tr>
<td>Effectiveness</td>
<td>Design revised Task Descriptions for each Committee</td>
<td>Committee Chairs</td>
<td>May 31</td>
<td>Revised Task Descriptions</td>
</tr>
<tr>
<td>-------------</td>
<td>---------------------------------------------------</td>
<td>-----------------</td>
<td>-------</td>
<td>-------------------------</td>
</tr>
<tr>
<td>Review Committee membership</td>
<td>Board Chair</td>
<td>June 30</td>
<td>Committee Chair CEO Consultant specialist</td>
<td>Membership review &amp; recommendations for changes</td>
</tr>
<tr>
<td>Upgrade Committee skills</td>
<td>Board Chair</td>
<td>Sept 30 – Dec 31st</td>
<td>Consultant specialist</td>
<td>Committee skills upgraded</td>
</tr>
<tr>
<td>External evaluation of Board capacity and performance</td>
<td>Board Chair</td>
<td>Nov 30</td>
<td></td>
<td>Evaluation report &amp; recommendations for further investment in capacity development</td>
</tr>
</tbody>
</table>

**Objective 3: Measurably upgrade our Board decision-making process**

<table>
<thead>
<tr>
<th>Action</th>
<th>Responsible person</th>
<th>Target date</th>
<th>Resources Needed</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distribute proposed agenda 7 working days before every Board meeting</td>
<td>Board Secretary</td>
<td>12 times this year</td>
<td>Board Chair CEO</td>
<td>Board aware of proposed agenda</td>
</tr>
<tr>
<td>Solicit additions/changes to agenda from Board members</td>
<td>Board secretary</td>
<td>12 times this year</td>
<td>Board Chair CEO</td>
<td>Board buy-in to &amp; ownership of agenda</td>
</tr>
<tr>
<td>Record all Board decisions</td>
<td>Board Secretary</td>
<td>12 times this year</td>
<td></td>
<td>Draft Minutes</td>
</tr>
<tr>
<td>Strengthen Board Committees</td>
<td>Chair</td>
<td></td>
<td>Consultant specialist CEO</td>
<td>External evaluation report</td>
</tr>
<tr>
<td>Draft Committee reports submitted to Board meetings</td>
<td>Committee Chairs</td>
<td>7 days before Board meeting</td>
<td></td>
<td>Draft Committee reports</td>
</tr>
<tr>
<td>Update member Workbooks with last six Minutes</td>
<td>Board Secretary</td>
<td>At every Board meeting</td>
<td></td>
<td>Updated Workbooks</td>
</tr>
<tr>
<td>Clarify role of Chair</td>
<td>Board Chair</td>
<td>Feb 28</td>
<td>Board Consultant specialist</td>
<td>Chair Task Description</td>
</tr>
<tr>
<td>Clarify division of discretionary powers and responsibilities of the CEO relative to the Board</td>
<td>Board</td>
<td>June 30</td>
<td>CEO Consultant specialist</td>
<td>Revised CEO Job Description Revised</td>
</tr>
</tbody>
</table>
C. Individual Director Evaluation

Display slide 5: We’ve already discussed the value of evaluating individual board members, in addition to the board as a whole. But it’s important to recognize that there is a risk of offending Directors, creating tension among Directors, or even scaring good candidates away. The three approaches here can help minimize these risks.

**Slide 5**

<table>
<thead>
<tr>
<th>Evaluating Individual Board Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>- More controversial, may undermine teamwork, cause top-notch candidates to shy away</td>
</tr>
<tr>
<td>- Options: self evaluation, committee assessment, anonymous evaluations by fellow members</td>
</tr>
</tbody>
</table>

Distribute Handout 2 below on Self Evaluation of Individual Board Members

Confidential Self Evaluations: Can encourage members to reflect on their performance, but they is no real accountability. Encouraging Directors to set performance targets for themselves, by using tools such as Handout #, may increase their commitment to improving.

Committee Assessments: The Nominating Committee—or another—assesses individual Directors, sharing results only with the evaluated director (Who evaluates the Committee members?)

Anonymous Evaluation by Fellow Members: Can be either distributed in-house or collected and summarized by an outsider.
**Handout 2**

**Self Evaluation and Individual Board Member Development Plan**

**How am I doing as a Board member?**

<table>
<thead>
<tr>
<th>Key Question</th>
<th>Yes</th>
<th>No</th>
<th>What am I going to do in the next 12 months? (These statements will serve as indicators of my future performance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Am I fulfilling my responsibilities as a Board member?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Do I comply with our Code of Conduct?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Am I sufficiently aware of the Company’s business?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Am I sufficiently aware of the Company’s challenges and opportunities?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Am I reactive or proactive?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Am I a Committee member?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Am I making a useful contribution as a Committee member?</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Step 2: Conduct governance danger signs exercise**

*By now you are well versed in what constitutes good and bad governance practices. Round robin brainstorming activity. Let’s put that knowledge to the test.*

Go one-by-one through the group asking each person to provide a danger sign. If someone draws a blank, let them pass. Go once or more through the group—until ideas run out—writing them on a flip chart. Distribute Handout 3 below, noting that they may want to customize this checklist using the group’s ideas.
### Handout 3

#### Checklist for Governance Danger Signs

<table>
<thead>
<tr>
<th>Danger signs</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>I did not attend the last three Board meetings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>I consistently fail to read the CEO’s report to the Board</td>
<td></td>
<td></td>
</tr>
<tr>
<td>I am a passenger. I consistently sit passively and quietly in Board meetings. In all honesty, I add no value</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Chair dominates the Board to the point that my participation is irrelevant</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The CEO dominates the Board meetings to the point that my participation is irrelevant</td>
<td></td>
<td></td>
</tr>
<tr>
<td>I consistently feel that I don’t understand Company business</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Chair micromanages the Company, and treats the CEO like a servant or a junior family member. I don’t like this, but I do nothing to stop it.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board meetings consistently last more than an hour and a half</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board meetings are usually arranged by telephone</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board has not agreed to a Board meeting schedule, one year in advance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>There is no proper nomination process for new Board members. New members are brought in informally by the Chair</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Essential skills, capacities and profiles are not represented on the Board or the CEO</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board member turnover is high</td>
<td></td>
<td></td>
</tr>
<tr>
<td>For the last three years there has been no member turnover</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Any box checked YES potentially is a serious problem and requires further attention

### Step 3: Conduct Board Development Plan Exercise

Ask participants to take out the Board Evolution exercise they completed in Module 1 and tell them that for their last exercise they are going to begin to prepare a board development plan that they can review and complete with their colleagues when they return to their respective institutions.

Assure them that they will not be required to share their plans with anyone, though there will be some time at the end of the session should they wish to share or seek input from the group on addressing a particular challenge they have identified. Participants can work individually, or in groups.

Distribute Handout 4, which restates the elements of a board review in the form of a worksheet and Handout 5 to help them get started. Also remind them of the Board Profile worksheet they received during Module Three and suggest they look at that, as well. Give participants 30-45 minutes to work on this exercise.
**Handout 4**

Board Evaluation and Development Plan Worksheet

*How are we doing as a Board?*

<table>
<thead>
<tr>
<th>Key Question</th>
<th>Yes</th>
<th>No</th>
<th>What are we going to do in the next 12 months? (These statements will serve as indicators of our future performance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is the Board's profile and composition appropriate for the Mission and strategic direction of the Company?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Did we deliver on the performance targets we set ourselves last year?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does our Company have adequate internal controls and audit systems in place, so that we are able to judge if the Company is achieving its objectives?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Are we receiving the quality and quantity of internal and externally sourced data that we need to make well-informed decisions?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Are our Board meetings well managed and efficiently run?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Are we making an adequate contribution to the strategic planning process?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is Board performance strong overall?</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Handout 5**

12 month Board development plan

*In summary, our 12-month Board development is as follows (General and Specific Objectives):*
4. Workshop Closure

Approximately 15 minutes before the end of the session ask the group if anyone has anything they would like to discuss with the group about the Board Development Exercise. If not, ask if after participating in the workshop their self evaluation of their board’s development had changed at all. Ask if there were any issues that were discussed that surprised them. *What aspects of the course were most helpful?* Listen to responses, thank participants.

Recommended: Handout course evaluation form and give participants time to fill it out before they leave.
Good Governance of Community Banks and Microfinance Institutions

USAID Nigeria Promoting Improved Sustainable MSME Financial Services (PRISMS) project
MODULE ONE:

INTRODUCTION & CONCEPTUAL FRAMEWORK:
WHY IS GOOD GOVERNANCE IMPORTANT TO ME?
Workshop Objectives

By the end of this course participants will enable you to:

- Define effective governance practices; and
- Strengthen the corporate governance of their institutions using the knowledge and tools presented in this course.
Workshop Agenda

Day 1:
- Introduction and Conceptual Framework: What is Governance and Why is it Important to Me?
- Roles and Responsibilities of the Board
- Board Membership: Creating an Effective Board, Part I
- Board Structure: Creating an Effective Board, Part II

Day 2:
- Governance and the Legal and Regulatory Environment
- Board Oversight: Recommended Practices and Instruments
- Ownership and Governance: Who Does the Board Represent?

Day 3:
- Governance and Conflict of Interest
- Board Performance Evaluation and Board Development
What is Governance?

- The process through which a Board of Directors guides an institution in fulfilling its corporate mission and protects that institution’s assets over time.

*Guidelines for the Effective Governance of Microfinance Institutions, Anita Campion and Cheryl Frankiewicz, 1999.*
Why is Governance Important?

Good governance can help your institution:

- Prevent fraud and mismanagement
- Promote sound decisionmaking
- Avoid costly fines and litigation
- Create/maintain a positive corporate image
- Attract and retain clients
- Attract and retain financing and investment (from commercial banks)
MODULE TWO:

ROLES AND RESPONSIBILITIES OF THE BOARD
Key Board Responsibilities

- Fiduciary
- Legal & Regulatory Compliance
- Policy Making & Strategic Planning
- Management Oversight
- Self-assessment
Key Responsibilities of Directors

1. Be informed and participate in decisionmaking in good faith (referred to as *Duty of Care*)

2. Put the interests of the institution above their own (referred to as *Duty of Loyalty*)

3. Be knowledgeable of and faithful to the institution’s mission (referred to as *Duty of Obedience*)
Relationship Between the Board and Management

- Board and management deal with the same issues, but at different levels
  - Broad policies vs. practical implementation

- Defined by partnership
  - Particularly between the board chair and managing director
  - Based on mutual support, trust, and respect forged between them

- The Board governs management
Striking the Balance

Effective governance strikes the appropriate balance in the relationship between a board of directors and management in their combined efforts to move the institution forward. Each brings unique skills to this joint effort and views the institution from a different lens. Together they add value precisely because they are complementary.

MODULE THREE:

BOARD MEMBERSHIP:
GUIDELINES FOR
CREATING AN EFFECTIVE
BOARD, PART I
Types of Boards

- Rubber Stamp
- Hands-On
- Representational
- Multi-Type
The Optimal Board Composition Depends On:

- The mission of the institution
- The stage of the institution’s development
- The external context in which it operates: competitive or regulatory environment
Board Composition

Effective board members possess:
✓ Diverse, complementary technical skills
✓ Proven leadership skills
✓ Understanding of and commitment to institutional mission
✓ Ability and willingness to fulfill duties
  - Beware of those with political motives
  - Beware of conflicts of interest
Director Affiliation and Representation

Types of Directors:

Internal Directors: Managers and Staff

Affiliated Directors: Investors, lenders, and legal representatives of the institution

External Directors: Individuals, not reps of institutions, government, or donors
Board Size

- Skill coverage
- 5-9 members
- Odd number
Board Recruitment & Selection Process

- Evaluate current Board strengths and weaknesses and institutional profile
- Develop a position description based on the skills and profile needed to complement existing Board members and achieve objectives
  - Remember to include commitment to the mission!
- Establish evaluation criteria and a rating system
- Use a nominating committee to ensure objectivity and avoid nepotism
Terms of Appointment: Recommended Practices

- Clearly communicate requirements and expectations.
- Establish terms of service to the board
- Use renewable terms
- Stagger terms
- Establish a dismissal policy
- Compensate board directors
Board Compensation Options

- Pay members for time spent in meetings based on the value of a senior professional’s time
- BancoSol pays members a fee for time spent in board and committee meetings

Council of Microfinance Equity Funds, 2005
MODULE FOUR:

BOARD STRUCTURES:
GUIDELINES FOR CREATING AN EFFECTIVE BOARD, PART II
Role of the Chair

Oversees the preparation of a board meeting, ensures that the meeting is effective, expends considerable effort building relationships (w/ management), oversees the long-term strategy of the institution (social vs. financial viability).
RECOMMENDATION:

- Separate the positions of Chair and Managing Director
Role of Board Committees

Board committees focus on specific issues assigned by the board and develop thoughtful proposals to recommend to the full board.

Committees may include: Executive, audit and finance, nominating committee, credit committee, human resource committee, resource mobilization committee, and special/ad hoc committees.
Board Procedures

- Most boards make decisions in full board meetings, however, other board procedures, such as board retreats or task auctions, can improve the effectiveness of the board.
Board Procedures in Action Exercise

Critical Issues for Discussion:

1. Conflict of interest
2. Death of the managing director
3. Rapid decline of portfolio quality
4. Theft
SESSION FIVE:

GOVERNANCE AND THE LEGAL AND REGULATORY ENVIRONMENT
Bylaws

- Bylaws establish the rules that govern an institution’s internal organization and management.
- They should be in simple, written form, and should be reviewed by the Board on an annual basis.
- The Board should have the power to amend the bylaws as needed.
Select Regulations

1. Board composition and directors
2. Prudential regulations
3. Reporting requirements
Prudential Regulation Defined

Prudential regulations are requirements designed to ensure the financial soundness of an institution. They protect both depositors from losing their savings and the stability of the financial system.
Examples of Prudential Regulations

1. Minimum capital requirements
2. Liquidity requirements
3. Capital adequacy requirements
4. Reserve requirements
5. Limit of lending to a single borrower
6. Provisioning requirements
7. Dividend payment requirements
MODULE SIX:

Board Oversight: Recommended Practices and Instruments
The Oversight Challenge

Oversight is perhaps the most important responsibility of the Board and yet it is also the responsibility that Boards are most likely to fall short on.
Steps for Developing an Oversight Strategy

- Define Measurable Performance Objectives, Policies, and Procedures
- Select Performance Targets and Indicators
- Collect and Analyze Performance Data
- Implement Corrective Measures as Necessary
Factors that Effect the Quality of Oversight

- Profile and composition of Board members
- Capacity of management information systems (MIS)
- Diversity and quality of tools used to collect and evaluate information (staff surveys, client suggestion boxes, reports, audits, Board committees)
- Enforcement of policies – clear accountability and decisive action
Criteria for Selecting Performance Indicators

- clearly linked to performance objectives
- both qualitative and quantitative
- both static (historic) and dynamic (predictive) indicators
- (relatively) few in number, but monitored frequently
Instructions for Performance Indicators Exercise

- Develop lists of critical indicators for monitoring managerial performance
- Be prepared to explain why your group chose these indicators
- With what frequency should they be monitored?
Effective Reports Are:

- Relevant
- Timely
- Accurate
- Easy to read
- Show trends

- Balanced - include qualitative and quantitative data
- Contextual - incorporate market intelligence
Ensuring Accuracy and Reliability of Reports – Supervisory Tools

Institutions have 3 supervisory tools for ensuring the accuracy and reliability of the information collected:

1) internal controls
2) internal audits
3) external audits
Types of Internal Controls

- Segregation of duties
- Limits
- Physical controls
- Crosschecks
- Dual controls
Examples of Internal Controls

- **Segregation of duties**: Separate expense authorization from check disbursal duties
- **Limits**: Having a maximum amount of cash allowed at a branch
- **Physical controls**: Daily cash box reconciliation
- **Crosschecks**: Manager or internal auditor visits clients to verify balances
- **Dual controls**: Two signatures required on all checks
The Primary Objectives of Internal Control Are:

1. To verify the efficiency and effectiveness of operations

2. To assure the reliability and completeness of financial and management information

3. To comply with applicable laws and regulations
The Purpose of an Internal Audit is to:

- Identify irregularities in compliance with internal controls
- Identify new or previously uncontrolled risks or inefficiencies
- Propose new or revised internal control procedures
Effective Internal Audits

- Objective and independent
- Auditor understands norms and intricacies of MFIs
- Auditor has unrestricted access to information
- Monitors adherence to pre-established policies and procedures
- Includes branch level analysis
- Auditor reports directly to the board
- Incorporates client visits as part of process!
The Difference Between Internal Control and Internal Audit is that:

- Internal controls are the policies and procedures a CB or MFI puts in place to monitor risks before and after operations.

- Whereas internal audit is the systematic “ex-post” appraisal of an institution’s operations and financial reports.
External Audit

- Provides the board with an objective, third-party opinion on the adequacy of the internal control system.

⚠️ Warning! However, institutions cannot rely on them to identify risk exposure, fraud or needed control activities.
SESSION SEVEN:

OWNERSHIP AND GOVERNANCE: WHO DOES THE BOARD REPRESENT?
Ownership and Governance

- For-profits: Banks, Finance Companies
- Non-profits: NGOs
- Credit unions/cooperatives
For-profit ownership

- Governance structure
  - Ownership typically driven primarily by profit motive
  - Board members have financial stake in the financial institution
  - Those with more shares have more votes for making decisions
For-profits: Balancing Dual Objectives

Social mission, expressed in conventional business terms, is an MFI’s orientation toward a specialized market niche, where actors must be innovative to serve the market efficiently and profitably. The profit objective, expressed in social terms is an institution’s search for permanence.

Perceived duality is nothing more than the usual tradeoff between short- and long-term goals (profitability supports long-term fulfillment of social mission).
Governance of NGOs

- Most NGOs are staff driven
  - Boards often not very active and possibly selected by management.
  - Often dependent on strong managing director
- Board representatives are not owners/investors - have no financial stake in the MFI
- Multiservice NGOs - adds to complexity and hinders transparency
General Recommendations for NGO Governance

- During Board Selection:
  - Avoid polarization of dual objectives issue
  - Select members with time, capacity, and commitment to learn microfinance

- Encourage Board Involvement in Board Development
  - Provide education and training opportunities to Directors on both technical and governance issues
Multi-Service NGOs

- To minimize governance issues:
  - If starting new MFI, recommend creating:
    - MFI specialized in microfinance
    - Separate legal entity

- In general:
  - Hire specialization of staff, management, board
  - Hold to industry performance standards
  - Ensure higher levels of transparency
Governance of Credit Unions/Cooperatives

Governance structure:
- members are owners and clients

Governance issues:
- Board qualifications often inadequate
- Net borrowers’ interests pervade
- Diffuse ownership/One person-one vote decisionmaking structure
Addressing Credit Unions’ and Cooperatives’ Governance Challenges

Board qualifications often inadequate

- Specify minimum qualifications specified in by-laws

- Provide training to board members
Addressing Credit Union’s and Cooperatives Governance Challenges, cont.

Net Borrower’s Interests Pervade
- Prohibit insider lending or limit Board loan sizes
- Encourage savings, attract net savers to Board
- Support adequate regulation and supervision

Diffuse Ownership
- Attract net savers, natural oversight incentive
- Encourage shareholder participation by ensuring adequate flow & transparency of information
- Internal/external controls, operation audits
Instructions for Governance Structure Activity

1. What is the ownership structure of your institutional type?
2. What are the most common governance issues Nigerian CBs or MFIs face?
3. Do any of the challenges we’ve discussed apply to your type of institution—even if they were attributed to another institutional type?
Board’s Role in Change

- The board’s advisory role is particularly critical during a major transformation because of the number of fundamental changes involved, such as setting new policies, offering new products, complying with regulators, and managing the expectations and concerns of staff and clients.
Steps to Facilitate a Smooth Management Succession

- Prepare a written succession plan (update annually)
- Groom senior managers as potential successors
- Develop contingencies in case of certain potential happenings, i.e. mass staff exodus
Identifying and Minimizing Conflicts of Interest

- Boards inherently have conflicts of interest. E.g., individuals frequently serve on a board because of their institutional affiliation. As a result, board members often end up representing two institutions—their employer and the MFI—and this can lead to conflict.
Common Conflicts of Interest

- Related-party transactions
- Nepotism
- Insider lending
- Springboard
- Competition
- Multiple relationships
- NGO dominance
Instructions for Governance Simulation Exercise

What were the strengths and weaknesses of each character’s argument?

Who was most convincing?

What lessons can be drawn about:

a. Managing difficult situations
b. Good governance?
MODULE NINE:

BOARD PERFORMANCE EVALUATION AND BOARD DEVELOPMENT
Objectives of Board Performance Evaluation

- Clarify individual and collective roles and responsibilities of Board Directors;
- Help the Board identify areas of weakness and stimulate ideas about how it might improve in those areas;
- Enhance the working relationship between Board and management by encouraging greater candor in dealing with each other;
- Provide a mechanism for regularly reviewing the performance of individual Directors, thus making it possible to assess Board member strengths and weaknesses, and apply a performance-based policy for replacing Directors who are not providing the leadership that the institution requires.

✓ Performance appraisals should evaluate both the Board as a whole and individual members
Who Leads the Evaluation

Evaluations may be internal or external. Internal evaluations should be conducted annually. While optional, some institutions also like to conduct evaluations with external consultants every three years to get an outside perspective.
The Focus of Full Board Evaluations

- Review board skills and experience in comparison with the institution’s strategic direction to determine whether training and/or changes to the board’s composition are needed;
- Compare board accomplishments with the work plan;
- Ensure the MFI has internal control, information and audit systems in place, which can adequately convey to the board whether the institution is achieving its objectives;
- Examine the sources of the data used by the board ensuring the use of information from both internal and external sources;
- Assess the effectiveness of meetings in terms of frequency, time efficiency, and ability to reach important decisions;
- Consider whether board members are receiving, in a timely manner, the type and quality of information they need to prepare for meetings;
- Evaluate the institution’s strategic planning process: does one exist, is it being used, is it yielding strategic initiatives that are on schedule, within budget, and producing the desired results?
The Performance Evaluation Process

- Set performance targets
- Prepare a report on resource use and activities
- Survey Directors on achievement of performance targets
- Draft a comprehensive report on findings and recommendations, discuss, set **new performance targets** as necessary
Evaluating Individual Board Members

- More controversial, may undermine teamwork, cause top-notch candidates to shy away
- Options: self evaluation, committee assessment, anonymous evaluations by fellow members
Thank you!