e-MFP BRIEF SERIES

Sharing innovative practices for responsible microfinance investment

Brief No.1

Driving Investment Decisions with Social Performance Information

prepared by the e-MFP Making Microfinance Investment Responsible (MIR) Action Group

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EUROPEAN MICROFINANCE PLATFORM

NETWORKING WITH THE SOUTH

EUROPEAN MICROFINANCE PLATFORM

The European Microfinance Platform [e-MFP] was founded formally in 2006. e-MFP is a growing network of over 130 organisations and individuals active in the area of microfinance. Its principal objective is to promote co-operation amongst European microfinance bodies working in developing countries, by facilitating communication and the exchange of information. It is a multi-stakeholder organisation representative of the European microfinance community. e-MFP members include banks, financial institutions, government agencies, NGOs, consultancy firms, researchers and universities.

e-MFP's vision is to become the microfinance focal point in Europe linking with the South through its members.

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DRIVING INVESTMENT DECISIONS WITH SOCIAL PERFORMANCE INFORMATION

The state of the practice of responsible microfinance has evolved considerably in recent years. MFI social performance assessment has gone mainstream. Investors are increasingly open to analyzing their own systems and strategies, and social performance data has become a core element in making investment decisions. The values of the microfinance sector have come into sharper focus: financial inclusion; appropriate, well-designed services; ethical behavior; client protection; decent working conditions and environmental protection.

Responsible finance has been a constant concern for socially responsible investors, who, by definition, approach investment with a social lens. What is new are the myriad of tools, frameworks and reporting formats trying to capture the essence of social performance through objectively verifiable indicators. These tools have filled a void, effectively balancing the scales that were long tipped in favor of financial performance. The question is no longer: "how do we get the data?", but "what do we do with it?" In a context where investors are increasingly awash with social performance information, how do fund managers integrate responsible finance into their day-to-day operations?

This brief offers a glimpse into the inner workings of some European fund managers. Drawing on in-depth interviews, it gives examples of the tools they rely on to make the most of the information they collect. It looks at their strategies for improving social performance among MFI partners. Finally, it looks at the ways investment funds are leveraging social performance data to increase our understanding of microfinance and push the sector forward.

INFORMATION IN THE SELECTION PROCESS: SOCIAL DUE DILIGENCE

"The time of assuming that microfinance automatically results in positive social benefits has passed. The achievement of social objectives cannot be taken for granted and cases of over-indebtedness, unethical collection practices and poor transparency call for a renewed emphasis on social performance. Social due diligence has to be done with the same professionalism and thoroughness which have accompanied our financial due diligence."
Ging Lesdma, Oikocredit

Due diligence is the bedrock of good investment. While financial due diligence is second nature for investment vehicles, investigating social performance is relatively new. In recent years, fund managers have developed scorecards and assessment formats to identify social risks and ensure the objectives of potential MFI partners match the fund's (Box 1). These tools assess "the likelihood that the services provided by an MFI will positively impact the lives of its clients," states Triple Jump.

Information is used to drive decision-making in investment committees. Some funds set a minimum scoring threshold, while others use results to identify technical assistance needs, or areas to monitor. For instance, as a general rule, Incofin screens out MFIs that score below 60%. In some cases, they will go ahead with the deal, but only after specifying expected improvements and required technical assistance in the contract. Triple Jump has a similar cut-off. Blue Orchard, Oikocredit and Grameen Crédit Agricole Microfinance Foundation (GCAMF) prefer not to set an exclusion threshold. One rationale for this is not to penalize new institutions.

BOX 1. SOCIAL DUE DILIGENCE TOOLS

Several funds have developed their own scorecards or rely on existing assessment formats to gather information on potential partners. Data is collected together with the MFI management throughout the due diligence visit (2 to 3 days). The following chart offers an overview of the different tools used by European investors.

	BlueOrchard SPIRIT	**GCAMF CERISE-SPI**	**Incofin ECHOS**	**Oikocredit/SNS Asset Management ESG Scorecard**	**Triple Jump SP**
Collecting social performance data since	2009	2010	2007	2008	2008
Number of MFIs assessed	75	25	88	130	168
Content (dimensions)	Intent and Outreach (25%) Client Protection (30%) Human Resources (20%) CSR and Corporate Governance (15%) Measurement of SP & Impact (10%)	Intent and Mission (for analysis) Outreach and Targeting (25%) Service Adaptation (25%) Benefits to Clients (25%) Social Responsibility (25%)	Social Mission Management/ Transparency (10%) Outreach and Access/Rural Outreach (25%) Customer Service Quality/ Responsible Pricing (30%) Human Resources (20%) Environment and CSR/Non Financial Services (15%)	Outreach and Targeting (20%) Client Benefit and Welfare (40%) Social Responsibility to Staff (10%) Environment (5%) Governance (25%)	Outreach (20%) Gender (10%) Client Protection (30%) Client Satisfaction (10%) Human Resources (10%) Social Performance Information (20%)

While all the tools cover more or less the same aspects, different investors emphasize different dimensions, and not all investors use the same indicators for the same dimensions, especially for broad areas like governance or human resources. Nonetheless, efforts to harmonize and standardize concepts and data collection methods are starting, as investors adopt sector-wide accepted indicators like the Smart Client Protection Principles, for example, and the MIX Social Performance reporting format.

An essential part of due diligence is to analyze the contextual elements that impact social performance-socio-economic context, regulation, institution size and maturity, and stated strategy-and compare with peer groups. Oikocredit and GCAMF rely on databases to compare potential partners with peers in terms of legal status, scale, rural or urban focus, country and region, etc.

One of the challenges of social due diligence is to avoid subjectivity. Investors have worked hard to identify objectively verifiable indicators, often relying on an iterative process of pilot testing and refinement, as well as new developments in the sector. In the previous version of Incofin's ECHOS, the question on protection against over-indebtedness had 3 possible answers: "Yes, completely", "Yes, partially" or "Not at all". In the current version, to answer yes, the analyst has to check a list of practices implemented by the MFI such as verification with a central credit bureau, analysis of cash flow, or calculation of repayment capacity. The work done by The Smart Campaign on client protection has helped identify key indicators, which now shape many assessment tools. BlueOrchard's SPIRIT was recalibrated to increase the weight given to client protection and human resource practices and to slightly reduce the social impact measurement, not yet very developed at the MFI level.

INFORMATION TO IMPROVE PRACTICES

Partner selection is only the beginning. Investors also capitalize on social performance information to encourage investees to manage their social performance. Whether this involves raising awareness, promoting compliance with the Client Protection Principles or using social due diligence findings to hone a technical assistance offer, fund managers make active use of data to push for better practices.

RAISING AWARENESS

The Principles for Investors in Inclusive Finance call for investors to understand, acknowledge and act in accordance with the interests of MFIs and the end client. To this end, many investors take advantage of the due diligence and investment process to encourage MFIs to take a more proactive approach to social performance. Sometimes, the information collected during due diligence is a first step towards a social audit or a social rating. According to the Rating Initiative, investors have been a major force behind the 200+ social ratings conducted worldwide. The Social Performance Task Force too recognizes investors' galvanizing role in the 500+ social audits that have been conducted in the last two years, and the 300 MFIs reporting on social performance to MIX.

BOX 2. CONDITIONING LOAN CONTRACTS TO SOCIAL PERFORMANCE

The **Luxembourg Microfinance and Development Fund** (LMDF) established a loan agreement with a relatively high interest rate with a young Cambodian MFI new to social performance. At the time of signature, the MFI did not have a clear social performance strategy but was given one year to prepare one, during which time the LDMF encouraged it to undergo a social rating. The MFI was rated by M-Cril, and obtained a beta score. In return, LMDF lowered the interest rate by a half percent and began monitoring the MFI's efforts to introduce more mechanisms to identify and measure outreach to their target population. During a recent field visit, LMDF noted significant improvements thanks to a retooled MIS. The institution is now able to get the breakdown of their clients by activities, and as a result is looking into launching a new value chain product intended for rice farmers.

LMDF now systematically conditions its loan agreements in order to develop a social rating culture and incentivize social performance management. It follows up all loan agreements. MFIs must undertake a social rating every 2 years if it does not want to be charged a penalty of one percent.

PROMOTING COMPLIANCE WITH CLIENT PROTECTION PRINCIPLES

The Smart Campaign promotes seven recently revised Client Protection Principles (CPPs). As of 10/2011, 131 investors and donors have endorsed the Principles, thus committing to funding institutions that adequately protect their clients. In practice, this means incorporating the Principles into the partner selection process, due diligence, funding agreements, monitoring, reporting, and governance.

Responsible pricing is one of the most sensitive issues, as there are yet no clear benchmarks for what constitutes "responsible" in a given context. The following are examples of how Triple Jump and Incofin have approached the slippery notion of reasonable interest rates.

BOX 3. CLIENT PROTECTION PRINCIPLES

1. Appropriate product design and delivery
2. Prevention of over-indebtedness
3. Transparency
4. Responsible pricing
5. Fair and respectful treatment of clients
6. Privacy of client data
7. Mechanisms for complaint resolution

BOX 4. TRIPLE JUMP'S INTEREST TRAFFIC LIGHT

Triple Jump strongly emphasizes client protection, including full calculation of the APR (Annual Percentage Rate) and EIR (Effective Interest Rate) using the Microfinance Transparency Effective Interest Calculator and a verification process. If effective interest rates are above a certain national or regional range, an additional assessment is conducted – the interest traffic light – to see whether rates are justified and the MFI warrants investment.

After comparing effective interest rates to national or regional averages, the Investment Officer will:

- Compare the rates with the rates of similar products from other MFIs in the country
- Look for evidence that clients get value from the products (impact study, satisfaction survey, cash-flow analysis),
- Analyze the specific factors in the operating environment potentially contributing to higher costs (salaries, rural outreach, administrative costs, infrastructure, regulatory requirements) or implying prudent MFI policies due to a riskier environment (inflation, currency fluctuation, political instability, natural disaster, etc.),
- Look at the MFI's profitability level and the way profits are used, and finally,
- Evaluate the MFI's past and current efforts to lower the interest rates. When available, input from MF Transparency is used for peer comparison.

The analysis results in a score, which corresponds to a red, yellow, or green light. A red light means the MFI will not be presented to the Investment Committee. A yellow light requires the investment to be conditioned to improvements in interest rate levels.

Recently a MFI in Sub-Saharan Africa which received a yellow interest traffic light was selected for a loan. The loan was conditioned to a commitment by management to lower interest rates by 10 percentage points and the loan tenor has been reduced to two years with an option to renew if the planned reduction in rates is met. Triple Jump monitors the MFI's performance against its business plan, which includes the gradual reduction of rates. The Traffic Light assessment identified several factors causing the high interest rates, mainly related to high cost levels in the country, but also low productivity in the MFI. It gave Triple Jump concrete issues to discuss with top management and made it possible to obtain a commitment from the MFI to actively improve productivity and decrease rates.

The Interest Traffic Light can be downloaded at http://www.interesttrafficlight.org

BOX 5. ANALYZING MARKET POSITIONING TO DETERMINE RESPONSIBLE PRICING – INCOFIN'S METHODOLOGY

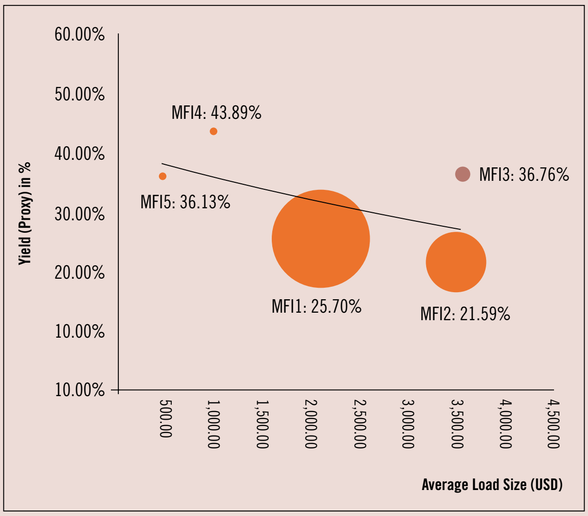
Incofin's due diligence tool ECHOS assesses interest rates with a specific question:

3.3.6. Does the MFI offer responsible pricing? (see graph)

- ☐ Yes, its EIR is in line with its competitors offering the same average loan size (the difference is < 5%) (5 points)
- ☐ The MFI's EIR is slightly higher than its competitors offering the same average loan size (the difference stands between 5-10%), but the institution is making concerted efforts to reduce its pricing (4-3 points)
- ☐ The MFI's EIR is higher than its competitors offering the same average loan size (10-20%), and the institution has no plan of price reduction (1 point)
- ☐ but the institution is making efforts to reduce its pricing (2 points)
- ☐ No, the MFI is much more expansive (>20%) (0 point)

This assessment is based on an analysis comparing EIR where available, or portfolio yield of the prospect with at least 4 other MFIs operating in the same market.

MFI	Average loan balance (USD)	Loan portfolio (USD)	Portfolio yield (Mix Market)	PAR (Mix Market)	Write off (Mix Market)	Proxy of yield (Incofin calculation)	Difference from average	Loan portfolio (USD)
MFI 1	2,072.00	25,335.52	18.96%	6.49%	0.25%	25.70%	1.00%	641,888,803
MFI 2	3,480.00	16,235.60	19.87%	1.64%	0.08%	21.59%	-3.11%	263,594,653
MFI 3	3,543.00	2,970.89	35.96%	0.80%	0.00%	36.76%	12.06%	8,826,208
MFI 4	978.00	1,495.07	41.03%	2.86%	0.00%	43.89%	19.19%	2,235,249
MFI 5	461.00	1,489.11	35.95%	0.03%	0.15%	36.13%	11.43%	2,217,446
Market average						24.7%		



Investee EIR is also analyzed on a standalone basis, in relation to the quality of customer services and the level of client protection within the MFI.

Evaluating pricing is an integral part of Incofin's overall social performance analysis. A score of 0 on the indicator will raise red flags, but is not necessarily a deal-breaker. In such a case, the Investment Committee looks at the yield margin (portfolio yield – costs). A high yield margin puts the MFI at a disadvantage.

Other investors use different criteria. BlueOrchard's SPIRIT looks at whether the total effective interest rate is clearly stated on loan documentation and/or read out loud to clients. They also benchmark the MFI's EIRs against the market average. Oikocredit's ESG checks whether the effective interest rate is within range of other institutions in the country. Investors that use the SPI for social due diligence look at the EIR compared to the cost of MFI funding, as well as trends in interest rates, and the level of transparency in communicating costs to clients. While the parameters of such comparisons are still being refined, investors are clearly working to operationalize the concept of responsible pricing. It is still rare for a MFI to be rejected purely on the basis of interest rates, but investors do not hesitate to add conditions to loan agreements that require the MFI to lower its rates.

Over-indebtedness, a rising concern in many markets, has also garnered the attention of investors. While operational tools for monitoring over-indebtedness are still in the works (see "Strengthening Governance for Responsible Finance: Examples from European Investment Funds" e-MFP Brief 2, 2011), Box 6 shows how one investor is trying to better understand the issue by gathering information and sharing practices from a range of sector stakeholders.

BOX 6. SOCIAL PERFORMANCE INFORMATION AND POTENTIAL ACTIONS ON OVER-INDEBTEDNESS

In early 2011, **Oikocredit** conducted a survey on over-indebtedness. It invited partner MFIs, microfinance investors and microfinance networks to share what they were doing and seeing in the field. The survey also asked for recommendations on how the issue might be addressed by not only MFIs and networks, but also investors. Over 250 responses came in, including 236 from MFIs in 39 countries, suggesting that over-indebtedness is a concern for many.

Respondents cited the most effective measures for preventing over-indebtedness were improved credit analysis, adaptation of loan products and the introduction of non-credit products such as insurance and savings. The establishment of industry codes of conduct and information sharing through credit bureaus (or informal information sharing) were highly regarded and desired by the respondents. Building good client relationships based on regular contact and feedback mechanisms were also identified as sound strategies to minimize over-indebtedness. MFIs warned funds against flooding markets with too much debt, which increases competition levels and fuels irresponsible lending.

This example shows how investors can be involved with other industry players in order to exchange information when it relates to a shared concern that must be dealt with collectively.

TARGETING TECHNICAL ASSISTANCE

Social due diligence tools are particularly helpful for identifying opportunities for improvement. For funds that propose technical assistance, the resulting data is valuable for orienting capacity building activities. Whether provided directly by the fund, through a TA provider, or via a strategic alliance with a partner organization, social performance-targeted technical assistance is on the rise.

Investor-backed TA offers a concrete way to push MFIs to improve their practices Nonetheless, it is essential to clearly separate the roles and responsibilities of the funders and TA providers, so each stays fully focused on their job.

BOX 7. CAPACITY DEVELOPMENT FOR MFIs INVESTEES

Incofin Investment Management provides Incofin cvso, Rural Impulse Fund I and II with technical assistance services originated at due diligence and monitoring levels of the investment process. The TA project flow is generated through several channels including:

- Incofin IM's professional investment team located in Belgium, Columbia, India and soon in Kenya through their operational involvement in the field with regular missions in developing countries to monitor the Fund's existing investments, generate new investments and identify TA needs.
- Incofin IM's partner MFIs located worldwide that may identify specific TA needs and may ask for TA support.
- Incofin IM's technical assistance department monitoring the overall TA facilities and ensuring the completion of their objectives according to specific timelines.

TA is supported in particular by FMO and the European Investment Bank.

In India, Rural Impulse II provides support to the MFI Fusion to help it set clear social objectives such as increasing sustainable outreach to poor and excluded people; improving the quality of the financial services available to target clients through the systematic assessment of their needs; creating benefits for microfinance clients, their families and communities; and improving the MFI's social responsibility towards its employees, clients and the community it serves. The TA aims to systematize data collection related to these goals and integrate it into operations, decision-making and reporting. External consultants with a proven track record in designing and implementing SPM systems have been selected in close consultation with the MFI. A SPM tool customized to Fusion's needs was developed. A training program has been organized to inform staff members about SPM, its importance and utility. After completing the training, the SPM tool will be implemented under guidance for one month and reviewed at the end of the period.

In Guatemala, RIF I investee Fundea receives TA for social performance assessment, monitoring and management, but also in improving key practices, like market focusing, product development (through the assessment, design and adaptation of products and services with high social value with regard to client target group needs and of non-financial services aiming at enhancing entrepreneurship development with regard to client target group needs), CSR and environmental policies.

In Tanzania, Pride Tanzania receives TA to facilitate its transformation process into a regulated entity. The Frankfurt School of Finance is providing the assistance on-site.

<u>Two organizations under the same umbrella</u>, the case of Triple Jump: **Triple Jump Investment Management** works side by side with Triple Jump Advisory Services Foundation (TJAS), a NGO under the Triple Jump umbrella that offers capacity-building services and cost-sharing grants to microfinance institutions for strengthening governance, introducing and improving the use of technology (mobile banking/management information systems), developing client-focused financial products and incorporating social performance management (SPM) into operations. Since inception in 2006, TJAS has supported 30 MFI partners

<u>An in-house capacity-building fund</u>: Through its capacity building fund, **Oikocredit** helps project partners develop skills and expertise in the following areas: social performance management, risk management, product development, market coverage and strategic positioning. Capacity building is done in collaboration with partners such as ICCO, Terrafina, Rabobank, Social Microfinance Foundation and Church of Sweden. Oikocredit uses the results of the ESG Scorecards and SPI audits to identify key areas of individual or collective weaknesses of the partners to provide focus support aimed at reinforcing both social and financial performance In 2009, Oikocredit allocated €2 million in capacity building support to its project partners.

<u>Partnership between LMDF and ADA</u>: **LMDF** is an investment fund open to retail distribution in Luxembourg. Given its regulated structure and access to public and private sources of capital, the fund acts a vehicle channeling resources and financial expertise to tier 2 and tier 3 microfinance institutions. The development vision behind the Fund comes from the experience and expertise of the NGO **Appui au Développement Autonome** (ADA) which acts as investment advisor to the Fund. ADA is in charge of the due diligence and monitoring of the MFIs and may provide additional technical support in the domain of transparency and capacity building.

INFORMATION TO COMMUNICATE BETTER

Fund managers affirm that collecting information has proven to be a good way to initiate dialogue with partners on issues related to social performance management. It helps structure and focus the discussion; it stimulates MFIs to think about what they can do to fulfill their own mission and increase their impact. It also creates a common language, between the MFI, the fund and the fund's investors.

REPORTING BACK TO INVESTEES

Fund managers are well aware that collecting social information is time-consuming; gathering data during the social due diligence process and monitoring phase takes up time not only of the managers themselves, but of MFI staff. Managers consider it their responsibility to share findings with the institution in a format that makes the process just as valuable for the MFI, so that they can be used for strategic reflection or external communication.

Oikocredit develops a social performance report for each MFI it assesses. Results are first discussed with top management, to explain scoring and compare points of view. Once finalized, investment managers write up a two-page summary the MFI can use for internal or external communication, and Oikocredit can send to its investors. The summary comes with a confidential letter that formulates recommendations for improvement.

Fundación Mujer

Oikocredit

CERISE

SOCIAL PERFORMANCE OF FUNDACIÓN MUJER
Costa Rica (March, 2009)

This social audit of Fundación Mujer (FM) uses the Social Performance Indicators (SPI) tool developed by Cerise and its network of partners. An assessment is made of the extent to which an MFI dedicates the means to fulfill its social mission in the light of four fundamental dimensions of social performance: Who are the clients and how are they targeted? To what extent are the programs and services adapted to clients' needs? How are clients' capacities reinforced and what is the social responsibility of the institution?

Fundación Mujer (FM) key data:

Starting year: 1988
Active borrowers: 1,973
Active savers: not applicable
Staff: 18
Regulated: no
Main lending methodology: individual
Legal status: non-profit institution
Main zone of intervention: urban

Legal form: NGO (not permitted to attract savings)
Branches: none
Gross loan portfolio: US$ 884,810
Total assets: US$ 1,259,660
Return on assets: 0.4%
Financial expense ratio: 1.9%
Operating expense ratio: 37.3%
Operational self-sufficiency: 101.3%

Social mission and strategy of Fundación Mujer:

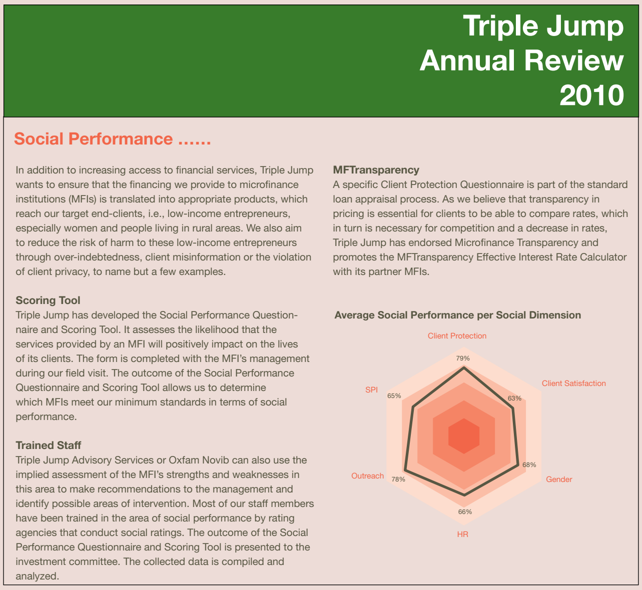
Fundación Mujer (FM) works for women's development and empowerment. It provides support in social, organizational and productive activities as a means of improving the quality of life for women and their families. FM focuses purely on female clients, offering them individual or group loans through women's banking groups known as "Banmujeres". The provision of credit is accompanied by a variety of training seminars and courses focusing on issues and concerns of female clients.

The following figures graphically represent FM's scores in the dimensions evaluated. The graphs reflect FM's focus on providing quality products and services and on improving clients' social and economic benefits. Within these dimensions, client representation is a prominent strength in the institution's operations.

REPORTING BACK TO INVESTORS

The highly publicized shortcomings of the microfinance sector have made it more important than ever for microfinance investment funds to "prove their social worth". The increasing abundance of social performance data has made it easier for funds to show their progress in annual reports.

BOX 8. EXAMPLES OF ANNUAL REPORTS: SHARING KEY MESSAGES WITH EXTERNAL PARTNERS



Triple Jump
Annual Review
2010

Social Performance ......

In addition to increasing access to financial services, Triple Jump wants to ensure that the financing we provide to microfinance institutions (MFIs) is translated into appropriate products, which reach our target end-clients, i.e., low-income entrepreneurs, especially women and people living in rural areas. We also aim to reduce the risk of harm to these low-income entrepreneurs through over-indebtedness, client misinformation or the violation of client privacy, to name but a few examples.

Scoring Tool
Triple Jump has developed the Social Performance Questionnaire and Scoring Tool. It assesses the likelihood that the services provided by an MFI will positively impact on the lives of its clients. The form is completed with the MFI's management during our field visit. The outcome of the Social Performance Questionnaire and Scoring Tool allows us to determine which MFIs meet our minimum standards in terms of social performance.

Trained Staff
Triple Jump Advisory Services or Oxfam Novib can also use the implied assessment of the MFI's strengths and weaknesses in this area to make recommendations to the management and identify possible areas of intervention. Most of our staff members have been trained in the area of social performance by rating agencies that conduct social ratings. The outcome of the Social Performance Questionnaire and Scoring Tool is presented to the investment committee. The collected data is compiled and analyzed.

MFTransparency
A specific Client Protection Questionnaire is part of the standard loan appraisal process. As we believe that transparency in pricing is essential for clients to be able to compare rates, which in turn is necessary for competition and a decrease in rates, Triple Jump has endorsed Microfinance Transparency and promotes the MFTransparency Effective Interest Rate Calculator with its partner MFIs.

Average Social Performance per Social Dimension

10 YEARS BlueOrchard
Microfinance Investment Managers

INFORMATION TO BETTER UNDERSTAND THE DYNAMICS OF MICROFINANCE

Now that they are starting to have a critical mass of social performance information, some investors are beginning to analyze aggregated data to draw conclusions about their portfolio, specific groups of institutions and even general trends in microfinance.

BOX 9. CONSOLIDATING FINDINGS FROM INVESTOR ANALYSIS ON SOCIAL AND FINANCIAL PERFORMANCE OF MFIs

Based on reliable information collected during the due diligence processes, several investors are using different types of data to analyze the links between social and financial performance: some select individual variables, others build compound indexes. In terms of methodology, some use descriptive statistics to reveal trends by country, type of MFIs, funding instruments, etc, while others rely on simple correlation, to highlight to what extent two variables are statistically linked. Moreover, there is now a sufficient quantity of data to run more sophisticated analysis (regressions) to demonstrate the causality between these dimensions and reveal complex interactions.

Incofin has pioneered this type of research among investors. In 2009, the fund built a linear regression model to cross the results of its ECHOS due diligence scorecard with financial performance data from 64 MFIs. They found a positive and significant relationship between these two bottom lines. Moreover, they identified factors that improve both financial and social outcomes, such as good customer service, easier access, financial literacy, sound HR management policies and the fact of having implemented social audits or ratings. In 2011, Incofin updated this analysis with a study on results from 88 MFIs. It confirmed the positive and significant correlation between financial and social performances. It showed also that a stronger outreach to poor and female borrowers is associated with lower profitability and lower cost efficiency while it is not necessarily associated with lower repayment risk.

From January 2009 to June 2010, **Triple Jump** conducted 81 Social Performance Assessments. The data from these 81 assessments was combined in a database together with financial information on the MFIs. They found that institutions classified as tier 3 and tier 4 generally have a deeper outreach, with a higher share of female and rural borrowers and smaller average loan sizes. Organizations with a wider outreach (compound index including number of borrowers, women, rural or excluded clients) demonstrate lower operating expense ratio and higher productivity. The research also identified a positive correlation between the proportion of women in management and higher productivity, repayment rates and profitability. Finally, better HR policies and lower staff turnover coincide with less write-offs.

Using social performance data collected from 131 **Oikocredit** MFI partners with the CERISE SPI and a dataset with social and financial information from 295 MFIs, CERISE conducted multiple linear regressions and found that individual targeting of the poor (i.e., direct selection of clients according to their socioeconomic profile) implies higher costs for MFIs. Similar losses in efficiency are induced by innovative and non-financial services, as well as client protection. Nevertheless, other aspects of social performance are positively correlated with good financial performance: geographic targeting, participation and empowerment favor staff productivity. Quality of services, reasonable interest rates and socially responsible HR policies improve portfolio quality. A characteristic of more efficient MFIs is that they offer high quality products.

Based on its own social performance assessment tool (SPIRIT), **BlueOrchard** also built a database with information from 75 MFIs. Like Triple Jump and Oikocredit, they find that a deeper and wider outreach is correlated with higher staff productivity. This may reflect the fact that group lending has higher staff productivity, according to BlueOrchard. Like its peers, BlueOrchard found that targeting the very poor in rural areas increases operating costs. When controlling for institutional type, return on assets for banks is correlated with more responsible HR policy. Corporate social responsibility and governance appear to be correlated with a better portfolio quality (lower write-off). Such results are in line with findings from the MIX, analyzing the SP reports of 208 MFIs, and showing that rural institutions are more productive, as well as MFIs with more responsible HR and staff training policies.

These analyses concur in several conclusions. In particular, though proactive targeting implies higher expenses, it often allows a better staff productivity, in particular when linked to higher client participation. Such costs can also be compensated for by combining the outreach to the poor and excluded with high quality of services, empowerment and responsible HR policies. The analysis of data collected by investors shows that despite some trade-offs, social performance and financial performance are compatible and tend to mutually strengthen each other. Ongoing studies, like the one implemented by **Microfinanza Rating**, suggest that the relationship between social and financial outcomes can evolve over time. In particular, in the short run, they find a negative effect of client protection policies, financial self-sufficiency, and profitability. But in the longer term, this relationship is reversed and becomes a synergy.

INTERNAL TRAINING AND COMMUNICATION

While social performance data is critical to partner selection, improving practices and understanding sector dynamics, it can also be overwhelming without the proper training to implement them. Investors are increasingly investing in staff capacity to ensure analysts are equipped to collect, interpret and manage information.

BOX 10. STAFF TRAINING FOR FUNDS MANAGERS

Some investors offer in-house training. Incofin delivers a one day training program for investment managers during its annual meeting to train new hires. It focuses on the definition of SPM, international initiatives, and Incofin's internal tools (new version of ECHOS, case study for the use of ECHOS). **BlueOrchard** also organizes trainings for its SPIRIT social scorecard (collection of data and interpretation of results).

Training can also be provided by an external partner. **MicroFinanza Rating** has developed specific training modules on social performance and client protection assessment for fund managers. Concepts such as social governance best practices, interaction between social-financial performance, responsible finance and client over-indebtedness are analyzed in-depth, in line with the recent sector initiatives. MicroFinanza Rating combines extensive experience of independent social ratings (1-2 weeks on the field) with practical cases and exercises that draw on more than 100 social ratings. The data from social ratings with client surveys represents a comprehensive base for benchmarking client protection practices, poverty and financial inclusion. Training programs aim to strengthen investment officers' knowledge and analytical skills. High quality social analysis in the due diligence enhances investor social accountability and reduces its exposure to reputation risk. BlueOrchard, Triple Jump, Oikocredit, Cordaid and ICCO, among others, have participated in MicroFinanza trainings.

Staff feedback indicates that trainings, despite being too short and somewhat subjective, help structure conversations on social performance. Client protection principles offer a road map to fund managers. Reporting, ratings and labels promote transparency and external accountability. Social audit tools give clear guidance on what to look for and which activities/documents to verify. And ultimately, well-trained investment managers send a strong signal to MFIs that social performance is a genuine priority.

Microfinance investment funds are collecting more social performance data than ever before and actively exploiting it in their day-to-day operations. But the new generation of tools, reporting formats and management approaches has left many actors overwhelmed. A number of investors are nonetheless taking these sector developments in stride, adapting their decision-making processes, information systems, evaluation frameworks and human resources to a new set of standards. Their efforts are pushing the sector forward. Still, there is cause for caution, as the investors well know. Over-emphasis on data collection can cause MFI-investor relationships to become mired in technical aspects and divert energy from a more strategic approach to social performance. This is why solid technical management must be combined with strong governance mechanisms at both the sector and MFI level, to ensure microfinance grows while staying true to its double mission.

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www.mftransparency.org

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Smart Campaign
www.smartcampaign.org

Social Performance Task Force
www.sptf.info

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