Microfinance India

The Social Performance Report 2011

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Acronymes

AIMS	Assessment of Impacts of Microenterprises Services
AP	Andhra Pradesh
APR	Annual Percentage Rate
ATM	Automatic Teller Machine
BOP	Bottom of Pyramid
BPL	Below Poverty Line
BRAC	Bangladesh Rehabilitation Assistance Committee
BRI	Bank Rakyat Indonesia
CCR	Customer Care Executives
CEO	Chief Executive Operators
CERISE	Comité d'Echanges de Réflexion et d'Information sur les Systèmes d'Epargne-crédit
CGAP	Consultative Group to Assist the Poor
CGT	Compulsory Group Training
COC	Code of Conduct
COCA	Code of Conduct Assessment
COMFI	Community Owned Microfinance Institutions
CPP	Client Protection Principles
CRS	Customer Relation Staff
ESAF	Evangelical Social Action Forum
ESG	Environmental, Social and Governance
FWWB	Friends of Women's World Banking
GIZ	German Society for International Cooperation
GK	Grameen Koota
GMSS	Gramin Mahila Swayamsidha Sangh
GNI	Gross National Income
GRT	Group Recognition Test
HR	Human Resources
IA	Impact Assessment
IDS	Institute of Development Studies
IFC	International Finance Corporation
IIMPS	Invest India Micro Pension Services
IMFP	India Microfinance Platform
IPO	Initial Public Offering
IRDA	Insurance Regulatory and Development Authority
JLG	Joint Liability Group
KGFS	Kshetriya Gramin Financial Services
KYC	Know Your Customer
MACS	Mutually Aided Cooperative Society
MBT	Mutual Benefit Trusts
MDG	Millennium Development Goals
MFI	Microfinance Institutions

MFIN	Microfinance Institutions Network
MIS	Management Information System
MIV	Microfinance Investment Vehicles
MIX	Microfinance Information Exchange
MSDF	Michael and Susan Dell Foundation
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non Banking Finance Company
NGO	Non Governmental Organisation
PAR	Portfolio at Risk
PAT	Poverty Assessment Tool
PE	Private Equity
PPI	Progress out of Poverty Index
PPP	Purchasing Power Parity
PSO	Pre-Service Orientation
RBI	Reserve Bank of India
ROE	Return on Equity
SDC	Swiss Agency for Development and Co-operation
SHG	Self Help Group
SIDBI	Small Industries Development Bank of India
SIFFS	South India Federation of Fishermen's Cooperatives, Tiruvananthapuram.
SME	Small and Medium Enterprise
SP	Social Performance
SPI	Social Performance Indicators
SPM	Social Performance Management
SPTF	Social Performance Task Force
Stanchart	Standard Chartered
USAID	United States Agency for International Development
UTI-AMC	Unit Trust of India Asset Management Company
UTI-RBPF	Unit Trust of India Retirement Benefit Pension Fund
VC	Venture Capitalists

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Foreword

ACCESS has been bringing out the Microfinance India State of the Sector (SoS) Report for six years now. We are highly encouraged with the credibility that the Report has gained over the years, as perhaps the most important reference document for the microfinance sector in India. As a corollary to the State of the Sector, to bridge the knowledge gaps in the Sector, ACCESS has also been bringing out a few other thematic reports / studies as a part of the Microfinance India initiative to build and contribute to sectoral knowledge. While, of the six SoS Reports released till now, four have featured separate chapters on Social Performance, in view of the recent emphasis on the subject and the turn of events since the AP Microfinance Ordinance in October 2010, ACCESS intends to make a more meaningful contribution towards advancing the idea of deeper and more committed integration of social performance into the practice of microfinance. While more broadly ACCESS has been contributing to instilling Responsible Finance as a sectoral ethic, an important initiative started this year is to bring out a separate Report on SPM in India. Although several stakeholders are already contributing to the SPM agenda, ACCESS is keen that more field based evidence on the good practices being followed by several institutions is shared within the Sector. I am happy that several key stakeholders saw merit in such and effort and willingly committed to supporting this new and important initiative of ACCESS at a time when the sector is at the ebb of its credibility.

Globally, in response to the increasing emphasis and obsession on financial sustainability and profitability over social mission, a few stakeholders in the sector attempted to work towards bringing the social mission back into the mainstream microfinance agenda. The Imp-Act action-research programme (2000-2004) helped move the industry's focus away from impact assessments to the need to understand and manage the process by which an MFI can achieve these impacts - a process known as social performance management. In 2005, the process was formalised by setting up of the Social Performance Task Force (SPTF) and a CGAP Donor Working Group on Social Performance. A strong body of knowledge and metrics has since been developed on the measurement, tracking and management of social performance of MFIs through these initiatives. Other initiatives that complement and reinforce SPM include The SMART Campaign promoted by ACCION and CGAP, which looks at minimum standards for ensuring client interests and the recent Microfinance Transparency initiative, aimed at enhancing transparency in pricing of MFIs globally. Over the past 4 years, emphasis of social investors on SPM has significantly increased and has helped to a certain extent, in integration of SPM in investee institutions. . In India, the SPM momentum picked up with development of Social rating by EDA/MCRIL in 2005, as an important tool for assessment of MFIs, along with the credit ratings (essentially financial assessment). This was supplemented by the MIX initiative which started to collate SPM data in addition to financial data. However, it was only after the 2010 Andhra Pradesh crisis that the sector realized the value of SPM; as a way of looking good when the whole sector was being painted as a bunch of unethical profiteering lot. The lenders, led by SIDBI, established the Lenders Forum, another Investors Forum was established by IFC; Sadhan rediscovered its code of Conduct, earlier adopted in the wake of the Krishna crisis in 2005, and MFIN started to look at ways in which it could ensure compliance and adherence to its own Code of Conduct. . SIDBI has begun to initiate a few Code of Conduct assessments. In its last Annual Conference, Sadhan released its association's SPM Report, however, mostly based on self reported data. In the last one year, under an IFC initiative, the Responsible Finance Forum has been set up with a cross section of sector stakeholders and its first important initiative has been the harmonisation of the two codes of Sadhan and MFIN into a unified industry code of conduct. MFT launched the India transparent pricing data early this year. The MIX with support from investors such as MSDF has played a significant role in SP reporting and analysis.

While the sector had been pursuing the agenda of embedding the social indicators within operations of MFIs and tracking the social performance indicators, the recent crisis initiated by the situation in AP and the critique from within and outside the sector regarding drifting from the mission has made it more critical for the sector to comprehensively document the efforts and progress in this area. The first Microfinance India Social Performance Report 2011 brought out by ACCESS presents a landscape of the role being played by various stakeholders in helping to internalise social performance in operations, document and showcase best practices through field based evidence and help to build and strengthen the drive towards responsible finance. We expect to produce this report annually alongside the SoS report in order to track the progress, highlight achievements and raise concerns in the area of SPM in microfinance in India. We hope that this effort will also help in reinforcing the credibility of the sector among external stakeholders by documenting the strong commitment and good initiatives of the sectoral players towards internalising SP and the willingness to introspect and learn. ACCESS is proud to have taken this initiative and privileged to receive overwhelming support from key stakeholders.

I take this opportunity to thank all the stakeholders who have supported this ACCESS initiative. Bob Annibale, Citi Bank's Global Director foir Microfinance was the first one to realize the value of this ACCESS SPM initiative. Over lunch with him in his New York Office, Bob was quick to realize the worth of the idea and agreed to Citi's support to the Report. With this, Citibank and Citi Foundation now support all the national microfinance initiatives of ACCESS. Bob's support encouraged us to start to plan and also to leverage other sources of support. Jennifer at IFC, already working on building an environment for Responsible Finance too found the SPM idea aligned to the IFC agenda and agreed to support the initiative. IFC has in fact agreed to support the SPM Report for the next three years. ACCESS was also fortunate to get a strong support from Standard Chartered Bank. Prashant, its Global Microfinance Head came on board right away and also welcomed the initiative. SIDBI which is leading the Responsible Finance initiative as the country's apex DFI too saw the ACCESS SPM initiative as contributing to its agenda and were quick to respond. I'd like to thank Mr P K Saha for his encouraging support for the Report. Similarly, I'm grateful to Maanaveeya and Ananya for their support to the Report. Finally, I'd like to thank Laura Foose, the Director of the Social Performance Task Force to agree to support the SPM India Report. We met Laura in Den Bosch, and she was glad that such an effort was being mounted by ACCESS to dig a bit deeper and document field evidence on social performance. So, thank you all for this incredible support, and my only worry at this stage is about meeting your expectations.

I would also like to thank a whole host of institutions which were visited for bringing together the Report. The institutions visited to collate data and good practices included Satin, Janalakshmi, Arohan, Equitas, Ujjivan, Cashpor, Grameen Koota, Shikhar and Chaitanya. The support they provided to the teams and authors has really helped in bringing together some good practices on the ground. I'd also like thank several institutions and individuals who spared their time for interviews and providing valuable data to the authors, including Bellwether, Lok Capital, Dia Vikas, Microvest, Grameen Foundation and senior sector experts Brij Mohan, Y C Nanda, Frances Sinha, Anton Simanowitz and Deborah Drake. Laura at SPTF has provided significant inputs to the content, besides being a comrade of ACCESS on this effort and beyond.

Finally, I would like to profusely thank the editors and contributors to this report. My sincere thanks are due to Girija Srinivasan for coming on board for editing the report with great proficiency and professionalism in limited timeframe available for completing the document. Girija, is one person,who I can always count on to bail us out of difficult situations. Her fixing the report has helped incredibly in enhancing the quality of analysis and narration. I'd like to also thank the the two contributing authors viz. Dr Radhika Desai and Ragini Bajaj for completing intensive field visits and literature review and contributing the draft chapters of the report, and also Niraj Kumar and Dr Rajeev Sharma for supporting the authors. Micol and the team at MIX have provided wonderful support and in contributing the detailed analysis of MIX data in the Chapter on State of Practice in Social Performance Management in India. I'm also grateful to N Srinivasan, our State of the Sector author for the last minute contribution to the chapter on Microfinance Funders and SPM. I'd like to profusely thank my own teams at ACCESS and ACCESS-ASSIST for coordinating this complex Report's completion. Everyone in the team pitched in. Sudipto, Deepak, Ashish and Srinivas helped immensely in participating in field visits, data collection, analysis and report writing. Finally it was Anna and Radhika who took up the challenge of bringing together this whole initiative. They were coordinating with the authors, tirelessly cleaning up and editing chapters and keeping all stakeholders in the loop. Being the first Report, required that extra effoirt. I'm proud that, irrespective of the devices, they were able to deliver a good outcome.

ACCESS proposes to bring out the SPM Report on an annual basis, and intends to make efforts to support all stakeholders that are contributing to the Responsible Finance agenda. I'm hoping that the SPM Report will be a small contribution in that direction.

Vipin Sharma

CEO, ACCESS Development Services

Introduction

WHAT IS SOCIAL PERFORMANCE MANAGEMENT?

Social Performance Management (SPM) is about the effective translation of an institution's mission into practice in line with accepted social values.[1] Accepted social values include outreach to poor and underserved populations, improving clients' overall financial security and access to financial services, ensuring quality and appropriate delivery of financial services and promoting socially responsible treatment of Microfinance Institutions (MFIs) towards their clients, employees and communities. Social Performance Management examines the strategies and operations of institutions and assists in monitoring whether the internal systems and activities produce the outputs and outcomes that have a positive social change for the clients.

WHY THIS STUDY?

There is a multiplicity of methodologies and indicators, which emphasize inclusion of social performance standards in concurrence with financial performance. There is also an emphasis from investors as well as lenders on incorporation of social performance metrics and adherence to codes of conduct. Against this backdrop, MFIs are undertaking objective steps to manage and enhance their social performance, which cover greater intentionality in targeting and outreach, changes in product features and delivery processes, clearer communication with clients, improved ethical treatment of staff and clients, increased attention to human resources management practices, internal audit and control mechanisms, Management Information System (MIS) and so forth.

As the sector experiences the ramifications of exponential growth and little accountability, the pertinence of showcasing noteworthy practices within the sector has become increasingly important. There is a need to collect evidence on the ground and report on these initiatives, their expected impacts as well as document learning on possible gaps and shortcomings. These findings will also support dissemination and further adoption of ongoing SPM efforts and best practices, as many MFIs are not aware of the possible impact of SPM and perceive the agenda as complicated and difficult to implement. In raising awareness of key findings, stakeholders can better inform day-to-day operations and incorporate necessary changes and procedures to effectively serve their clients.

OBJECTIVE

The objective of this study is twofold: (a) to paint a broad brush stroke of the emergence of Social Performance Management globally and in India and (b) to spotlight specific themes within SPM that bring to the surface good practices, challenges and opportunities for future growth within SPM in India. While the ideas of Social Performance Management have existed within the industry, the present emergence of global initiatives like the Social Performance Task Force, the SMART Campaign for client protection and most recently the Seal of Excellence for Poverty Outreach and Transformation in Microfinance have only formed in the last few years along side national codes of conduct. A myriad of stakeholders have played a part in these initiatives and therefore it is valuable to take stock of the current state of affairs of social performance. The first portion of the report provides a brief history and followed by social. The four thematic chapters - Targeting and Monitoring Social Performance, Responsibility in Product Design and Marketing, Human Resources for Social Performance and Responsible Finance, Client Protection abd Social Performance Management – The Road Ahead – delve into the on the ground realities of reaching poor segments of society with appropriate products and services in a transparent manner that respects the clients and staff of the MFI and enables the MFI to fulfill its mission.

METHODOLOGY

The background material for this report came from an intensive literature review, field visits, focus groups, interviews with clients and senior staff, review of policies and procedures of MFIs, inputs from investors and self-reported data on social performance from the Microfinance Information Exchange (MIX). A team of consultants and ACCESS-ASSIST staff visited twelve different microfinance institutions across India to collect examples of good practices for the thematic chapters. These institutions were chosen based on their performance and general recognition for outstanding practices within a particular theme. Interviews with twelve prominent social investors and lenders took place to glen from their perspectives on social performance and its implications for investment in the sector.

NOTES:

1 "What is Social Performance?" Social Performance Task Force website. Accessed on November 12, 2011 from http://sptf.info/what-is-social-performance.

Overview - Development of Social Performance Concepts

1

Chapter

EMERGENCE OF SOCIAL PERFORMANCE

Though informal microfinance has been operational for centuries, the two decades from 1970s to the 1990s are significant, which saw increased involvement of formal institutions in microfinance. This greater involvement stemmed from (i) the expansion of the scope of formal institutions into microfinance through downscaling and the establishment of linkage programs with semi-formal entities of different types; (ii) the emergence of new formal and semi-formal institutions focused on microfinance, such as the SEWA Bank in India, Grameen Bank of Bangladesh, Accion International, ASA Bangladesh etc.; (iii) reforms of state-owned financial institutions such as the Unit Desa of BRI, Indonesia; and (iv) the introduction of new microfinance programs by governments.

Though different types of formal institutions were developing their skills in delivering microfinance services, the microfinance movement was spearheaded by Microfinance Institutions (MFIs), which were comprised largely of NGOs and semi-formal institutions such as Grameen bank. They were funded by donors and experimental credit projects that found the involvement of specialized institutions to be important because their clients in general were poorer than those reached by many formal institutions and the services targeted in most countries aimed to serve poor women. The innovations of microfinance, notably group lending with joint responsibility, flexible approaches to collateral requirement, frequent installment payments, a focus on women and door step delivery of services[1] were developed by these institutions and defied conventional wisdom about financing the poor through subsidised credit. These institutions became increasingly professional and designed systems and processes to ensure high loan recovery rates. They considered microfinance as an essential service to enable the poor to deal with poverty. Empowering the poor and establishing long-term organic relationships with them was central to their concept of business.

The major concern about development minded MFIs, however, was that many of them did not attach importance to their financial soundness and sustainability within a reasonable period and became subsidy dependent. This made continued funding difficult for donors and funders. Thus in the nineties, the emphasis was on ensuring that MFIs were financially sound. Without self-sufficient financial institutions, there is little hope for reaching the large numbers of poor households. Financial viability is also considered important because only viable institutions can leverage funds in the market to serve a significant number of clients and contribute to broad-based development. Increasingly donors and funders to MFIs adopted the financial system development approach that was considered the key to achieving sustainable results and to maximizing development impact.

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This approach emphasized the development of financial intermediaries that are committed to achieving financial viability and sustainability within a reasonable period. Financial viability was seen as a critical requirement to reach larger numbers of the poor and in turn was considered to be essential to have a significant impact on poverty reduction[2]. Thus the beginnings of development oriented projects and institutions turning towards a financial systems approach for dealing with the poor were seen in the last decade of the last millennium.

Two main "approaches" emerged during this period regarding microfinance and poverty reduction: the financial systems/institutions approach and the poverty lending approach[3]. The financial systems approach views the overall goal of microfinance as the provision of sustainable financial services to low income people, but not necessarily to the poorest among them. If loans are demanded and paid back in time and the market has demonstrated that the services provided are valuable, then the relevance of the effort stands validated. The impact on borrowers and the community is not over emphasised, and success generally gauged by institutional movements toward achieving financial sustainability. Financial sustainability was stressed because sustainable MFIs implied continuing expansion of outreach in the future. Finally, among many of the proponents of the financial systems approach, credit is not seen as the most important tool for poverty reduction[4]; holistic financial services through competent formal institutions has been preferred as a key pro-poor strategy.

SPM not only helps to ensure a MFI meets its mission and manages its growing risks, but also improves its overall performance.

The poverty lending approach views that the overall goals of microfinance should be poverty reduction and empowerment. Financial sustainability matters little if the services provided do not have any impact on clients' poverty levels. Since the overall goal is poverty reduction, complementary services are often needed and integrated approaches are commonly applied. Some donor funding and subsidies may be needed because availability of funds is the most binding constraint in expanding the supply of financial services to the poor. Credit is perceived as an important and effective tool for poverty reduction[5]. The scaling up of efforts in financing poor and the desire for specialized the institutions that understood finance led to a discernible shift in preference towards the financial systems approach, with the poverty lending approach left to smaller efforts where financial service was not a core part of the projects and institutions.

Morduch[6] refers to these two approaches as the microfinance schism. Each differs in its views on how microfinance services should be delivered (NGO versus formal institutions), on the technology that should be used (financial services or a minimalist approach versus an integrated service approach), and on how their performance should be assessed (institutional sustainability or reaching customers). While the pros and cons of the two approaches were being debated, emphasis on financial soundness of the MFIs kept increasing. These institutions in order to be financially sustainable honed their techniques to ensure high repayment and charged cost-recovering interest rates, which permitted some MFIs to achieve sustainability and reach large numbers of clients. Public money was channelled into microfinance institutions worldwide[7]. But even with the good practices of microfinance, and the growing outreach, especially towards women, several stakeholders raised concerns on the depth and quality of the outreach. There was increasing skepticism that the MFI customers were not the poorest of the poor. The other critical concern was the lack of evidence on MFIs' long-term impact on poverty reduction in the lives of clients and their families. The microfinance industry had established best practices for measuring and reporting financial performance, but had not established comparable standards for performance in poverty outreach and socially relevant impact.

CHANGING FOCUS IN CLIENT TARGETING

Different MFIs describe their target clients differently - as vulnerable, poor, low income, disadvantaged, marginalised, poorest of the poor and the unreached; in income terms – earning per day of 1 dollar, 1.25 dollars, 2 dollars per capita (Purchasing Power Parity) etc. These terms, however, are seldom clearly defined, measured and monitored. Client profiles that many MFIs collect are not usually effectively used. Most MFIs assume that smaller the loan size, poorer is their target group. Many MFIs do not engage in any explicit targeting of clients since they feel that they are filling an important space in the financial sector by providing services to those who have no access to institutional financial services.

Those MFIs, that are more poverty focused have explicit targeting strategies to ensure that very poor people and vulnerable groups are being reached. They rely on different tools and methodologies, and have varied experiences with targeting. It is significant that when Microfinance Gateway was hosting a Client Targeting Resource Center, only 23 MFIs shared their targeting strategies and tools on the website where as the number of MFIs reporting to MIX and Microcredit Summit Campaign - two large data bases ran into a few thousands. Very few MFIs use check lists and other simple tools such as a housing index to measure the poverty level of clients, or to screen out potential clients above a certain a wealth level. CASHPOR for example uses housing index[8], which is a credible and cost effective tool to clearly target exclusively poor and very poor. However, these tools do not correlate their poverty indicators with the national and international poverty lines that are necessary to validate the assessment, facilitate comparison among MFIs and report to external stakeholders.

PPI[9] and PAT[10] are two examples of poverty scorecards that are gaining ground in the microfinance industry[11] since they help in quantifying microfinance clients' absolute poverty levels and benchmarking with national/ international poverty lines. Through client surveys, mostly during the initial acquisition process, information on key indicators are collected, which are the household-level variables that help predict the poverty status of the household (either poor or non poor). They help the MFI to answer the following general questions such as: *What percentage of my clients are poor? How does that percentage change over time?* Through the indicators that are selected and the weights assigned to each indicator, the tools capture underlying relationships between household characteristics and poverty. Because these relationships differ across countries, the tools are country specific.

Poverty focus of MFIs has been a concern for policy makers in India. Recently, the Reserve Bank of India (RBI), came out with guidelines for MFIs that define qualifying assets for priority sector lending. One of the criteria for meeting the conditions for qualifying asset is the income level of clients[12]. While statutory stipulation of the income level of clients is a welcome measure, the continuation of maturing clients within the MFI systems should not be ignored. Clients that have been acquired within the specified income limits might graduate into higher levels of income over a period of time. If such clients are to be dropped, it will be socially counter productive since these clients may still not be accepted by the formal banking system.

It is generally agreed that MFIs reach the "poor" and the "near poor" since they are more credit worthy[13]. The very poor have largely been left out of MFIs' client outreach. Most microfinance practitioners agree that financial services alone are not sufficient—in fact, they are often counterproductive—to lift very poor people out of poverty. They require more than financial services to build their equity, skills and confidence levels in order to be able to avail financial services. However, the body of knowledge on, what kind of complementary services should be offered to this target group in addition to financial services, is still emerging. In order to successfully serve the very poor they need to be explicitly targeted in most cases and assisted with products and services specifically tailored to their needs. Market research therefore needs to understand the requirements of microfinance clients and

In order to successfully serve the very poor, they need to be explicitly targeted in most cases and assisted with products and services specifically tailored to their needs.

On the whole, the evidence points in two directions: 1) there is much to be enthusiastic about; and 2) there is much to discover about the many ways in which microfinance works and does not work for different types of clients.…

relate these to their different poverty levels. Savings services respond better to the needs of the very poor and credit, if offered, should be made flexible enough to take into account their higher vulnerability. Building confidence and social capital among the very poor is as important as providing access to financial capital to take advantage of enterprise and market opportunities. Successfully targeting very poor clients requires persistence, visionary leadership, a strong shared commitment, staff incentives, performance measurement and a willingness to change and adapt.

The shift from poverty lending to financial systems approach has resulted in client targeting from the poorest to the higher strata of the poor. Ability to handle loans and generate demand for other financial services has become a key criterion in client selection and led MFIs towards the higher strata of the poor clients and sometimes the near-poor. Dealing with the ultra poor as mainstream clients may not be appropriate for commercial institutions to follow. Some of the ultra poor programmes carried out by BRAC, Bandhan etc., show that with initial capacity building and hand holding, the ultra poor can become mainstream customers of MFIs over a period of time. While targeting of the ultra poor as a policy has a legitimate place, it should not be used to force commercial institutions to take on very poor customers who might not be bankable. It should be left to the institutions to choose appropriate strata of poor as clients in accordance with their mission and business models. The shifts in client targeting have entailed a change in the development objectives of business – from socially relevant engagement with the poorest to providing responsible finance to the chosen customer segment.

IMPACT ASSESSMENT TO SOCIAL PERFORMANCE MANAGEMENT

Most of the microfinance programmes state poverty reduction of clients as their mission. Many investors in microfinance are interested in contributing to objectives such as reducing poverty and reaching the Millennium Development Goals (MDG). To date, progress towards these goals has been assessed primarily through one-off Impact Assessment studies led by external stakeholders. Several Impact studies were carried out from as early as 1988 to seek evidence that most of the people who access microfinance are able to improve their socio-economic well-being within a reasonable timeframe. Goldberg[14], who carried out a comprehensive review of the Impact Assessment studies in 2005 concludes :

> No study is perfect, and many suffer from serious methodological flaws. However, it would be hard to read through all of the many positive findings in these dozens of studies and not feel that microfinance is an effective tool for poverty eradication. Considering all the ways in which subtle differences between clients and comparison groups can affect the conclusions we draw, the evidence, as convincing as it is, is not quite good enough. It will be an enormous benefit to the entire industry when the first "incontrovertible" through randomized control trials is published.

Another question that is constantly debated is also whether such studies are aimed at "proving" that the impact has been there or at "improving" the services of institutions involved in offering financial services to the poor. The Impact studies are often of little use to MFIs themselves, as they tend to be too complex, time consuming, and expensive. In addition, these studies often do not generate information that is sufficiently timely, regular, reliable and cost effective to aid the MFIs' own performance. The emphasis on Impact Assessment, historically was on justification of external funding rather than helping MFIs improve their service to clients. Two major initiatives, namely, USAID supported Assessment of Impacts of Microenterprises Services [AIMS][15] and Action-Research programme_'Imp-Act' provided practitioners a low-cost way to measure impact and improve institutional performance.

Between 1995 and 2001, the AIMS programme carried out a number of research activities that were key to redefining the Impact Assessment (IA) agenda, and successfully developed a range of lower-cost, practitioner-friendly, methodologically rigorous and useful tools. The challenge that remained, however, was the integration of IA into MFI learning and development. In an attempt to address this challenge, the Institute of Development Studies (IDS) initiated a global action-research programme_'Imp-Act'[16] (2000-2004). The programme's primary objective was to improve and develop Impact Assessment systems that respond to the needs of the MFI, their clients and other stakeholders, and in doing so to improve the quality of microfinance services and their impact on poverty.[17] Thirty partner organisations developed internal systems for collecting information on clients that could be analysed by the staff and management to ascertain the MFIs progress towards their social as well as financial objectives. The MFIs used the learning to redefine their mission and social goals, and improve and align their systems and processes in a manner that would better their social performance. Instead of trying to demonstrate impact, efforts began to focus on how best can MFIs "serve their clients and improve the impacts of microfinance on poverty[18]". Im p-Act action-research showed that impact on clients is a result of design, delivery and management of the programme. The Imp-Act action-research programme helped shape the industry's focus on the need to understand and manage the process by which an MFI can achieve these impacts - a process known as Social Performance Management[19] (SPM).

Box 1

Significant Efforts towards Achieving Social Goals in Microfinance

In 2001 CERISE, in collaboration with North and South networks, developed the Social Performance Indicator tool - the first social performance assessment tool for microfinance[20]. In 2002, SEEP initiated a Poverty Outreach Working Group to focus on identifying promising programs for poverty alleviation and in 2003-4 a working group on consumer protection was initiated. In October 2004, SEEP members endorsed pro-client principles and members, such as ACCION International and Freedom from Hunger, adopted pro-client initiatives, resulting in their affiliates developing their own codes and policies to protect customers[21]. In 2005 the Imp-Act Consortium was formed with the objective to develop training and resources on Social Performance Management[22]. The formation of the Social Performance Task Force in 2005[23] has led to agreement on a common social performance framework[24] and development of an action plan to move social performance forward. The Social Performance Task Force consists of over one thousand professionals from all over the world from a variety of stakeholders. SPTF has been instrumental in developing several social performance tools – poverty assessment, audit, rating - for enabling MFIs and networks to improve social performance. SPTF in collaboration with MIX has developed in 2009 a set of standardized indicators to assess MFIs' social performance.

COMMERCIALISATION BROUGHT SCALE TO MICROFINANCE BUT …

The promoters of NGO - MFIs initiated microfinance for its development potential. They were genuinely double bottom line organisations. Many NGO-MFIs built their microfinance operations predominantly through donor funding which, were either grants or loans on soft terms. Though many were initially experimental projects to prove that the poor are bankable, they found it difficult to graduate the clients to the banking system and thus had to continue their financial services operations over longer periods of time. With the huge effort to formalise and professionalise MFIs, there was adequate demonstration that they could be profitable, and that it was possible to build sustainable institutions on the basis of microfinance. But their foot print was small as compared to the number of poor households that were financially excluded. With the experience and success gained on a smaller scale, the different stakeholders felt it necessary to scale up to reach the millions of poor. To provide credit on the scale that is necessary to deliver loans to all, poor people required huge resources in terms of equity and loan funds. This scale of financing was beyond even the larger donors and was only available in the mainstream financial system and capital markets. It was therefore inevitable to link MFIs to commercial providers of capital and loan funds[25]. Commercialisation of microfinance thus became an unavoidable development.

While some of the NGO-MFIs had modest plans for expansion, a few had grand visions of expanding to new geographies and out reach of millions of clients. They were seeking growth for pride and power of being the largest MFI. These grand plans had many interested buyers from the commercial investors who were keen to see increased efficiency contributing to higher profitability, which according to them only scale can provide.

NGO-MFIs were strapped for equity in their expansion plans. Mobilising equity from the community was an option, but an insufficient one to fully meet their equity need. They had to transform from a non-profit format to attract commercial gains. A for-profit company model was thought to be best suited for growth because it facilitated the raising of equity. While in some countries the NGOs could directly invest in the new for-profit institution, in India this was not possible. The transformation of Indian NGO-MFIs into Non Bank Financial Companies (NBFC) using the Mutual Benefit Trusts (MBT) of members clients' as shareholders became a route of choice to raise the initial equity and fund growth. This design lent itself to considerable abuse. The equity held in the name of MBTs was often available with the professional promoters that enabled them to take critical organisational decisions. In some cases the MBTs were bought out at low prices and the same equity shares sold at high premium to external investors. A new commercial institutional design brought in ostensibly to promote participation of customers as owners turned into a perverse instrument of profiteering.

There was a limit to the equity that could be brought in by the promoters and the clients. The MFIs had to turn to external sources of equity to achieve their expansion plans. The way an institution funds itself can drive very different behaviors, priorities, and business models. Strategic equity investors often expect to have a seat on the board, advising on the direction of the institution and, as such, have the potential to alter the behavior of management or the strategic priorities of the institution. If investors' goals are focused on their own short-term financial returns, it may drive decisions that conflict with an institution's ability to meet its social goals – in other words, to put clients first[26]. Equity funding does bring in its wake of undesirable influences in terms of growth requirements and pricing. MFIs in order to attract equity on an on going basis have to demonstrate consistent profitability to their investors. Only some MFIs mobilised equity from mission aligned investors, where as others mobilised equity from wherever it was available, disregarding the nature of investor.

The promise of microfinance as a business attracted venture capitalists (VCs) and private equity players (PEs) apart from social investors. As MicroSave observed, nascent businesses and markets necessarily attract high-risk, high-gain investors with a focus on quick profit. Investors in mainstream banks do not look for 30% per annum returns; but VC/PE investors do, since they perceive the risk of losing their investment as high[27].

The entry of VCs/PEs with their high expectations transformed not only the legal form of MFIs but the fundamental principles and social values of microfinance. The ownership and control structure changed in many of the MFIs. The governance structure could not cope with the increased skills required in understanding and steering the complexities of expanding business. The investors replaced the original socially oriented boards with those who would drive profit maximization. The promoters of the majority of the larger MFIs, apparently overwhelmed by the monetary benefits- high valuations for their equity, high executive pay and personal benefits, seemed to have lost sight of the fundamental principles on which they setup the MFIs.

The commitment to achieving numbers resulted in compromising the good practices in microfinance. Client acquisition processes were cut short and poaching of clients of other MFIs became a common practice to save costs on client acquisition. Staff performance and incentives were geared towards quantitative growth targets. Some MFIs cut back on social service programs, infrastructure, and staff training to reduce costs and increase profitability. Some MFIs levied additional charges other than interest and offered compulsory bundled products on additional fee basis to the clients, thus earning additional revenues but by increasing the burden on the customer. The progressive marginalisation of the community of clients as mere customers was very evident. Many MFIs either raised their interest rates or failed to lower them when reductions in costs achieved by scaling up allowed them to do so. Higher charges to borrowers in many MFIs correlate directly with higher profits desired by investors: there is a direct and obvious conflict between the welfare of the clients and the welfare of the investors. Majority of the MFIs became single bottom line organisations in spirit, even when maintaining their noble mission.

In 2007, Banco Compartamos (BC), a MFI that was launched in 1990 and originally funded by grants from various sources, completed a landmark initial public offering (IPO) of its stock. The IPO was 13 times oversubscribed and mainstream international fund managers and other commercial investors bought most of the shares. The IPO gave a significant boost to the credibility of microfinance in commercial capital markets and accelerated the mobilisation of private capital for the business of providing financial services to poor and low-income people[28]. However, serious concerns were raised on issues of where the original investments came from as well as the question of undue enrichment of people running the institution in comparison to the "poor clients" that had contributed to its overall profitability.

The major debate around the public issue of Compartamos was three-fold:

a) If Compartamos' exceptional profits, and the high interest rates they are built on, were defensible in light of the social bottom line that the company identifies as part of its purpose, and consistent with the development objectives of its principal shareholders;

b) The use of grant money in the investment in Compartamos and the resultant enrichment of some of the promoters – particularly directors and managers and even the institutional investors like the Accion;

c) The appropriateness of offering for sale of the shares of existing share-holders while there was no expansion of the capital at the time of the initial public offering, which meant that the IPO was just an exercise in harvesting the enterprise valuation that does not benefit the customers in any way.

The above trends in microfinance and the IPO led to the surmise that microfinance was fast transforming from a development tool into a business instrument with a predominant goal of profit maximisation. There has been a sense that MFIs have added to their profits and enterprise value at the expense of the customers.

Similar trends and apprehensions were being held in India as well. MFIs in India, mainly in the NBFC category, were pursuing scale, high growth rates in the last ten years. The high growth rates raised several concerns, not without sufficient basis. Mission drift became a concern and in quite a few cases, the costs, loan terms, recovery practices and governance militated against customer-responsive financial intermediation. The products and processes that were to be aligned with the requirements of the customers no longer showed the intent that customers matter. The products, with their regimented weekly installments and very short duration loan terms more or less remained the same. Although cost-efficiencies were being achieved with increasing client loads, the benefits did not percolate to clients in the form of reduced interest rates. The urge to grow big has become compulsive and the pursuit of fancy valuations of equity and enterprise has become a competitive exercise[29].

Technical assistance providers, which were largely funded by donors, to aid smooth transformation[30] gave advice to MFIs to change their business models and products in order to maximize profits. Some of this advice resulted in considerable harm to the customers. Community-owned institutions were being routinely asked to change their legal form. MFIs adopting Self Help Group methodology, which offered members flexibility to accumulate their savings and to decide the loan terms, were advised to shift to Joint Liability Group methodology. Products that were long term with sensibly structured lumpy repayment installments to suit cash flows of client households were changed to weekly one year loans on advice from expert consultants[31].

SKS, the largest MFI in India went for an IPO in 2010 and mobilised USD 358 million with very high valuation of the shares – the offer price was 98 times that of face value. While the successful float bode well for MFI, several issues were raised, similar to those raised in the case of Compartamos. The promoter benefitting a windfall, especially at the cost of customer owned MBTs, raised a serious concern in the sector. Capitalists and promoters making money out of poor women's hard earned money was considered unpalatable.

MFIs are especially sensitive to issues of private benefit because of their overarching social objectives and reliance on philanthropy and soft aid. Microfinance executives who have received windfalls from public offerings are potentially undermining the public's positive perception of microfinance. The leaders of some MFIs anticipated these issues and adopted policies that limit how much employees and investors can benefit from their activities[32].

CONCERNS ABOUT RESPONSIBLE FINANCE[33]

As the visibility of microfinance increased, there was closer scrutiny of the promises held out by MFIs and the way they conducted their business. Globally, the high rates of returns on equity and assets registered by many MFIs raised concerns on the interest rates and other charges that were levied by MFIs and whether they were made transparent to the clients. Governments in Ecuador, Nicaragua, and India, cracked down on MFIs that allegedly charge exorbitant rates, collect payments unethically, and hide rates from clients[34]. Accusations of MFIs expressing their fees in misleading ways or using unscrupulous collection practices surfaced more often and undermine the public trust in microfinance[35]. Though Indian MFIs charge some of the lowest rates in the world, trailing only Bangladesh and Bolivia in the affordability of their loan products, they have been accused with not passing on the benefits of scaling up and increased efficiencies to clients.

Another global trend was the increasing competition among the MFIs in several countries. Multiple loans and impending over indebtedness of clients became a major concern. There was a concern that vulnerable clients may need protection from unscrupulous providers and unsuitable products. Branchless banking models, with new technologies and nonbank agents, raised further challenges of consumer protection.

In India, the southern states had a very high level of microfinance penetration. MFIs were competing among themselves as well as the state promoted SHG bank linkage programme in several states. Two major incidents in 2006 and 2009 when MFIs were charged with unethical practices of over lending, coercive collection methods and opaque pricing did not result in any major change in MFIs' sensitivity required in dealing with vulnerable people. In 2010, The Government of Andhra Pradesh passed an ordinance restricting MFI lending severely, citing client distress through multiple lending and over-indebtedness, usurious interest rates and coercive collection. Andhra

Pradesh, where all the large MFI players were active, also had the largest number of Self Help Groups, which were nurtured by the state run programme "Indira Kranthi Patham" under which low-cost credit through interest subsidy was offered to Self Help Groups. The number of loans of SHG members and MFI customers when put together were more than 10 times the number of poor households in the state[36]. In AP, therefore, any charge of excessive debt is believable, given the large number of loans and the fact that the average MFI loan per household in AP exceeded Rs 65,000 ($1400). [37]

Vijay Mahajan, pioneer of microfinance in the country summarises the AP crisis in a recent interview.[38]

> Leading to the IPO, SKS wanted to show high growth and high profitability. The way to maintain high growth and high profitability is by concentrating in the same geography and increasing the loan size to the same customers. Share and Spandana followed suit. This led to multiple lending, which in turn to over-indebtedness, which in turn led to all kinds of problems including allegedly coercive recovery practices, alleged suicides by borrowers.

However, overall in the state, while one-third of microfinance loans were given out by MFIs, the remaining two-thirds were given through the SHG Bank linkage programme and which loan was the last straw is not clear[39]. Since MFIs could not carry on their normal business of holding center meetings, loan applications had to be cleared by the government officials, propaganda against MFIs and the incidents that unfolded after the ordinance led to a major repayment crisis pushing all major MFI players to the brink. There are 9 million households in Andhra Pradesh who are appearing on the defaulters list of the National Credit Bureau[40]. The banks also suffered defaults in the SHG portfolio. This implies that continued access to financial services has been disrupted for millions of households.

This Indian experience shows that even well intended regulation when not appropriately designed can run counter to objectives of Social Performance Management. While the state has a role of securing socially relevant performance from microfinance sector, it has to ensure that the policy environment and regulation facilitate the sector. Public policy intervention such as subsidies and denial of level playing field distorted the market, damaged the financial institutions and shut out choices available to vulnerable people. Regulation by favouring certain types of institutions and select models of intermediation hindered financial inclusion efforts and provided monopolistic space to relatively inefficient programmes. The state should have ensured fair and even handed regulation to encourage competition and ensured that excluded people receive as many choices as possible. Clients should have been educated by the state on appropriate choices and avoidance of disadvantageous loan contracts.

SOCIAL PERFORMANCE MOVEMENT

The social performance movement has come alive globally to check some of the undesirable trends in microfinance due to commercialization and put the clients back in the core of business. Donors, investors, practitioners, support agencies and MFIs have been working on how to better balance MFI's social and financial objectives. MFIs have promoted and implemented strategies, practices and actions necessary to accomplish social performance, including revisiting the mission of the institution and aligning it with the objectives and activities of the institution to achieve the mission, adopting responsible lending, listening to clients, being sensitive to staff and training them to have behavior in line with responsible financing, ensuring systems and monitoring social indicators alongside financial ones for strategic decision-making.

Social Performance Task Force, Impact Consortium and SPM network, Microfinance Transparency and Smart Campaign have carried out pathbreaking work to improve social performance. These organisations have developed tools for adopting and improving social performance. Moreover, some investors and lenders are also developing internal systems for evaluating and monitoring MFIs' social performance.

...The way to maintain high growth and high profitability is by concentrating in the same geography and increasing loan size to the same customers.... This led to multiple lending, which in turn led to all kinds of problems...

SPTF has been defining what social performance is and enabling measurement and management of social performance through different sets of tools. The SPTF has begun a process to define Universal Standards for Social Performance Management for microfinance institutions. While 161 direct microfinance providers are members of the SPTF, many others might be using the tools developed.

'Imp_Act' engages with training agencies to review and adapt existing training materials in key technical areas.

MF Transparency works toward transparent and responsible pricing practices. Since borrowers are often charged a complicated combination of interest and fees, the Annual Percentage Rate (APR) is used as the means to combine all of the costs the client pays and convert it into simple, declining balance interest rate. This allows stakeholders to easily compare the prices of different loan products. The organisation is currently active on four continents in 28 countries including India, with pricing data collected for more than 1,000 different loan products sold to over 50 million clients[41].

The Smart Campaign is a global effort to help the microfinance industry to keep clients as the driving force. The campaign has been promoting client protection principles[42] and developing the tools and resources MFIs need, to adopt client protection principles and deliver responsible financial services to their clients[43]. Client education and financial literacy training for the clients was advocated and several initiatives were taken for development of training material with innovative methodology.

In India, EDA Rural Sytems and M-CRIL have been promoting Social Performance Management through social performance audit and ratings, providing technical assistance to MFIs to adopt SPM framework. Microfinance networks, Sa-Dhan and MFIN had developed codes of conduct[44] for the network members encompassing client protection and ethical behavior of staff incorporating the social values of microfinance. IFC and Michael and Susan Dell Foundation are leading an effort to harmonize the codes of conduct of two microfinance networks (Sa-Dhan and MFIN), which is expected to materialize shortly. SIDBI the major lender to the sector has carried out a code of conduct compliance assessment through M2i consulting. IFC, Indian Technical Service providers and industry associations collaborated with the global initiatives such as SPTF and Smart Campaign. Microfinance Transparency, in a major initiative, published the transparent interest prices paid by customers in the case of more than 80 MFIs. This was possible on account of the active cooperation of Indian MFIs, MFIN and donors.

ACCESS Development Services, under its Microfinance India initiative organises the Annual Microfinance India Summit that brings together stakeholders from across the country and globally to discuss and deliberate on issues and challenges in the sector. Issues of Impact of microfinance, mission drift, Social Performance Management, client protection, governance and responsible finance have featured as critical topics of deliberation over the past seven years in the Summit. ACCESS also annually publishes the State of the Sector report that has been highlighting social performance issues over the past 5 years, including separate chapters on SPM.

ADOPTING SPM

SPM focuses on an institution's own mission achievement. Thus, in theory, it should not require external reinforcement. In reality, however, SPM requires buy-in within MFIs and understanding from other stakeholders such as investors and bankers. According to the principles of SPM, an MFI needs to look at each area of its operations to assess whether and to what extent its systems and policies are aligned with its mission, goals and targets. Where there is strong buy-in at the board and management levels, SPM will thrive. There has been significant progress in measurement of client retention and staff appraisals and incentives, moderate progress in staff training on SPM, social responsibility to clients and staff and weak progress in monitoring advancement of clients out of poverty and market research on clients[45].

Just as good financials can support social outcomes such as increased outreach, dynamic products, lower costs and effective linkages, good social performance can enhance financial performance through client retention and stronger public reputation resulting in continued growth and investor interest[46]. However, at the macro level, tangible benefits for MFIs are not yet in sight. At the micro level, MFIs often face technical issues such as adapting the MIS, allocating staff and resources, developing appropriate skills to analyze new types of data and providing meaningful information to other stakeholders on SPM.

Some MFIs fear that an increased focus on social performance inevitably entails a revenue sacrifice or decline in financial returns. According to recent studies on the relationship between social and financial performance, the promotion of social performance factors (e.g. adequate service delivery, promoting client trust, etc.) can result in synergies that positively impact an institution's financial performance[47]. CERISE's study of 42 MFIs in Latin America found that while targeting the poorest may create additional costs, better tailoring products and services or reinforcing social capital, actually had a positive effect on financial results[48]. A recent study concludes that being responsible to employees and the community is correlated with lower PAR.[49]

Some argue that commercial MFIs can focus on social performance only when they reach financial sustainability, after building strong systems and secured sufficient equity and loan funds. Likewise, senior management of many Indian MFIs often view SPM as important, but costly and time-consuming. These beliefs have led to a limited unfunded uptake of social performance in India and elsewhere. As a result, SPM approaches are often donor or sometimes investor-led, focused primarily on indicators and lack practical application to the day-to-day problems or business context of MFIs. Furthermore, a top-down approach to SPM does not adequately involve clients or seek their opinions on what matters to them.

However, there is growing realization that SPM not only can help to ensure that an MFI meets its mission and manage growing risks, but also to improve overall performance. Ensuring that clients are not over-indebted and that they clearly understand prices and terms will not only assist an MFI's clients, but also help it maintain portfolio quality. Listening to clients and adapting products and services can likewise lead to improved client retention. Hiring and retaining the right staff, putting in place strong internal controls and even reaching out to the community are also ways to help mitigate risks. One can consider a market-led approach to Social Performance Management as one part truth in advertising, one part risk management and one part common business sense[50].

CONCLUSION

MFIs are at a stage where they have to prove to themselves that they create value to their clients through appropriate financial services and are responsible financiers. While MFIs have been able to adopt a code of conduct and client protection principles, they are yet to integrate Social Performance Management principles fully. The movement from code of conduct to responsible finance and further to Social Performance Management has been linear in many institutions. The AP crisis has shortened the learning curve and accelerated the pace of SPM initiatives across the sector.

MFIs' most important assets are not their loan portfolios, but their relationships with their clients. Social Performance Management thus has brought clients back into focus and reiterates that MFIs exist to serve the clients. Unless the customers are chosen with care, well-served and the relationship sustained over a long time, the MFI, whether commercial or developmental, cannot hope to survive. Growth over a long period of time and sustainability of institutions will critically depend not just on the numbers of clients and volume of business, but the quality of service and relevance of the services to the

Just as good financials can support social outcomes such as increased outreach, dynamic products, lower costs and effective linkages, good social performance can enhance financial performance through client retention and stronger public reputation resulting in continued growth and investor interest.

customer community. To ensure that MFIs remain relevant to their local context and are seen as important institutions, Social Performance Management in these institutions is a necessity. Weak SPM practices aggravate political risks and result in erosion of customer loyalty.

However, responsible finance and Social Performance Management are to be followed not only by the MFIs but other key stakeholders in the industry. Lenders to MFIs, investors, governments and regulators need to work in coordination to achieve the desired goal of responsible finance. MFIs are just the delivery edge of microfinance. Investors, funders, regulators and opinion makers are those who have a responsibility to ensure that the edge remains sharp and functional. Providing a facilitative policy environment, designing suitable mechanisms from which MFIs can access equity and funding resources, reducing political and policy risks, avoidance of distortion of microfinance markets and a sound regulatory framework are the responsibilities of other stakeholders.

NOTES:

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2. Asian Development Bank, Finance for the poor, Microfinance development strategy, http://www.adb.org/documents/policies/microfinance/financepolicy.pdf
3. Bhatt and Tang, 2001; Woller and Woodworth, 2001
4. As economists Adams and Von Pischke (1992) argue, "In our opinion, debt is not an effective tool for helping most people enhance their economic condition — be they operators of small farms or microenterprises, or poor women. In most cases lack of formal loans is not the most pressing problem faced by these individuals."
5. The director of Grameen Bank, Muhamad Yunus, states this view forcefully: "...credit is more than business. Just like food, credit is a human right" (Yunus in Microcredit Summit, 1997). "If we are looking for one single action which will enable the poor to overcome their poverty, I would go for credit" (Yunus, 1994).
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10. MIX social performance data 2009 shows that 22 MFIs reported having piloted or used PPI, and 15 provided their results to MIX. For PAT in 2009, 40 MFIs and enterprise development providers have reported their results to the USAID Microenterprise Results Reporting (MRR) system. Poverty targeting and measurement tools in Microfinance, October 2010.
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19. From the concept of performance management for achieving social purpose, Imp-Act Program coined the term “social performance management” to differentiate from financial performance management. http://www2.ids.ac.uk/impact/about/history.html
20. For more information on CERISE and its Social Performance Indicators (SPI) tool go to http://www.cerise-microfinance.org/spip.php?page=sommaire&id_rubrique=2 12/10/2011
21. This was the harbinger of the SMART Campaign launched by ACCION later in 2009
22. The members included the following: Institute of Development Studies, Sussex; EDA Rural Systems,India IDEAS, USA; CARD, Philippines; Microfinance Council of Phillippines; Microfinance Center, Poland; Freedom from Hunger, USA.
23. CGAP, the Argidius Foundation, and the Ford Foundation brought together leaders from various social performance initiatives in the microfinance industry, which led to the formation of SPTF.
24. SPTF defined the social performance management as “the effective translation of an institution’s social goals into practice in line with accepted social values,” which is widely accepted in the industry.
25. Manoj K. Sharma and Graham A.N. Wright, May 2010, Commercialization of Microfinance in India; is it all bad?, Micro Save India briefing note;43
26. http://microfinance.cgap.org/2011/10/12/commercialization-can-the-dual-social-and-financial-missions-of-microfinance-coexist/#more-2812
27. ibid
28. Rosenberg, Richard [2007]: CGAP Reflection on the Compartamos offering: A Case Study of Microfinance Interest Rates and Profits
29. N. Srinivasan, State of the sector report, 2010, Access Development Services
30. MFIs were not always free to choose the service provider; in several cases they had to use the services of those already identified by funders.
31. N. Srinivasan, in blog on the CGAP microfinance blog series on responsible finance – September 2011.
32. Equitas Microfinance for example has set limits on managerial remuneration by linking top pay to the pay of lowest rung in the organization; it also has a cap on return on assets and return on equity which are stated upfront to potential investors in equity.
33. CGAP in 2010 brought forth issues in responsible financing. It defines responsible finance as the delivery of retail financial services in a transparent and equitable fashion. The focus is on products, processes, and policies that avoid harmful or unfair treatment, appropriately balance customers’ interests with those of providers, and achieve the social mission of microfinance.
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41. Update on MF Transparency, SPTF Annual Meeting, June 2011 http://sptf.info/sp-task-force/annual-meetings
42. The campaign has developed client protection principles which have been widely accepted by the microfinance industry globally and in India. The adoption of these principles by Indian MFIs are discussed in a separate chapter.
43. The number of endorsers has doubled (from 1,000 to 2,000), representing MFIs in 130 countries, serving over 50 million clients worldwide. http://sptf.info/sp-task-force/annual-meetings
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45. MIX, 2011, State of the Practice of Social Performance Management

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State of Practice in Social Performance Management in India

2

Chapter

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The recent crisis in India has cast a shadow on the microfinance industry's ability to meet clients' demands through responsible lending. Data collected by the Microfinance Information Exchange (MIX) nonetheless portray a country increasingly committed to tracking and reporting social performance data, a trend perhaps spurred by the turmoil in Andhra Pradesh. While the regular assessment of social performance metrics is not yet common practice in the industry, data reported to MIX offer a first look at current social performance practices in India.

In this chapter, we will explore some aspects of Social Performance Management reported to MIX by Indian institutions in order to highlight key facts and trends as well as current challenges in social performance data collection and reporting.

TOP LEVEL FINDINGS OF THE REPORT:

- **Financial inclusion** is the most common development goal among Indian MFIs. These institutions offer a wide variety of loan products but most do not go beyond credit to offer other financial services that could promote financial inclusion. Indian MFIs have a relatively high level of outreach to rural clients, although the majority of poor people remain excluded from financial services. In fact, among those MFIs that measure the poverty level of their clients, only 13 percent fall below the national poverty line.
- **Poverty reduction** is cited as a development goal by a majority of Indian MFIs. In addition to the low levels of poverty outreach reported by Indian MFIs that do measure poverty, tracking client poverty levels is not common practice and most MFIs do not actively target the poor. Lack of concrete procedures to address poverty reduction helps explain the low percentage of Indian microfinance clients below the national poverty line.
- **Women's empowerment** is a key development area, as female clients represent the overwhelming majority of borrowers in India. One-third of MFIs offer women's rights education services or women's leadership services. Nevertheless, female economic empowerment has not been assured, as women are not always the final arbiter of loans extended in their names. At the institutional level, women represent the minority of staff for most (though not all) MFIs.
- **Social responsibility towards clients** is making progress. Client protection seems to have progressed farthest regarding over-indebtedness, but the recent crisis only reinforces that reporting on client protection is in desperate need of validation. Borrower retention rates have decreased, reflecting the recent turmoil in the Indian market.

64% of Indian MFIs identify financial inclusion as their top priority.

- **Social responsibility towards staff:** Staff rotation in India is as high as the most competitive countries in Latin America. Furthermore, many Indian MFIs lack progressive human resource policies regarding staff benefits and transparency on salary.

Note: MIX has conducted an analysis of MFI field staff compensation and incentive structure that offers important insights regarding social responsibility to staff. This analysis can be found in the chapter on human resources of this same volume.

BASELINE DATA

In 2009, MIX began the microfinance industry's first ever large-scale Social Performance data collection. It did so using the set of social performance indicators it developed in collaboration with the Social Performance Task Force (SPTF)[1] to assess the degree to which MFIs are aligning their operations with their stated goals and achieving outreach to their target markets.

Since then, over 500 MFIs spanning 80 countries have reported Social Performance data to MIX. In absolute terms, India is the country most active in reporting such information, with 54 MFIs submitting social performance data as of August 2011[2].

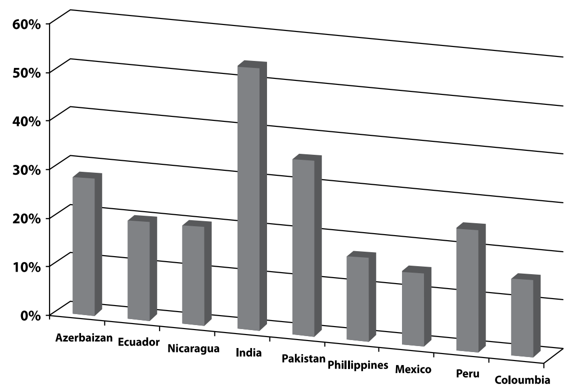
The typical Indian MFI reporting social performance information is a medium-sized NBFI[3], with a median of eight and a half years' worth of microfinance operations.

Table 1: Typical Profile of the Indian MFI

Age (median)	8.5 years
Size (median)	9 9,311 borrowers
MFI typology	1 bank, 6 credit union/ cooperatives, 28 NBFI, 19 NGOs

In terms of social performance reporting, Indian MFIs have by far the largest market coverage of all top-reporting countries, with over 20 million borrowers (70 percent of the total borrowers reached by the Indian MFIs currently registered on MIX Market) (Figure 1).

Figure 1: Markets with the Largest Number of MFIs Reporting SP Data and Associated Market Coverage (as percentage of borrowers served)

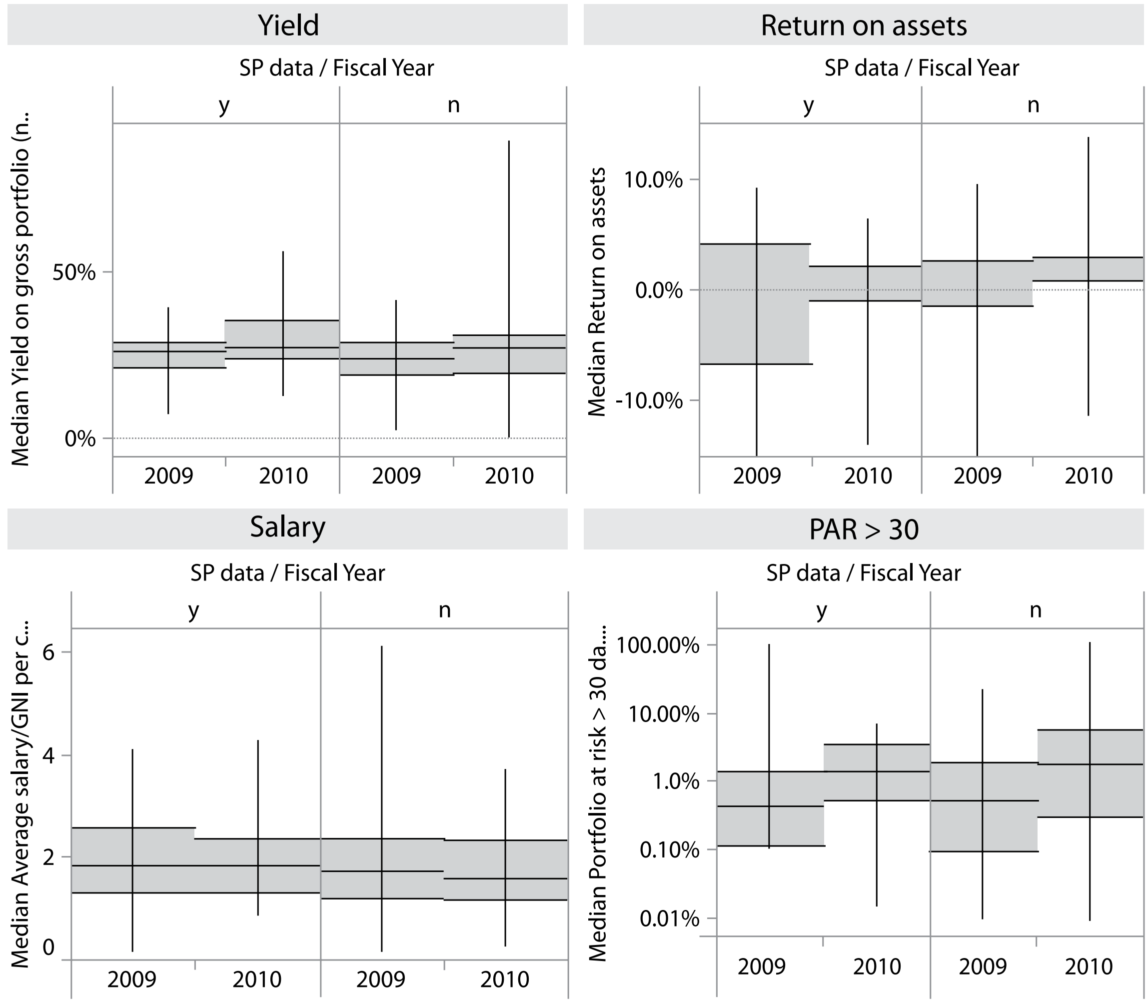


Source: MIX Market, 2010 data for outreach, 2008-10 data for social performance reporting. Numbers in columns represent the number of MFIs reporting social performance data.

Before launching into a detailed analysis of social performance data from India, it is worth asking whether the very act of reporting social performance information says anything about an MFI's performance. Since not all MFIs in India provide data on their social performance practices, it would be good to have a sense of any similarities and differences between these two groups. *What might these various relationships say about the social and/or financial performances of affiliated MFIs?*

First, MIX compared the values of four key indicators between MFIs that have provided social performance data to MIX and those that have not. It plotted the distribution of values for yields, returns on assets, average salary / GNI per capita and Portfolio-At-Risk (PAR) over 30 days for both 2009 (pre-crisis) and 2010 (after the start of the crisis). This plot yields little visible difference between costs, profits, compensation[4] and risk for MFIs that choose to provide social performance data compared to those that do not. Significance tests confirm that the group means are not significantly different (Figure 2).

Figure 2: Yield, ROA, Average Salary, and PAR>30 Distribution in Indian Institutions that do and do not Report Social Performance Data to MIX.



Source: MIX Market, 2009-10 data[5]

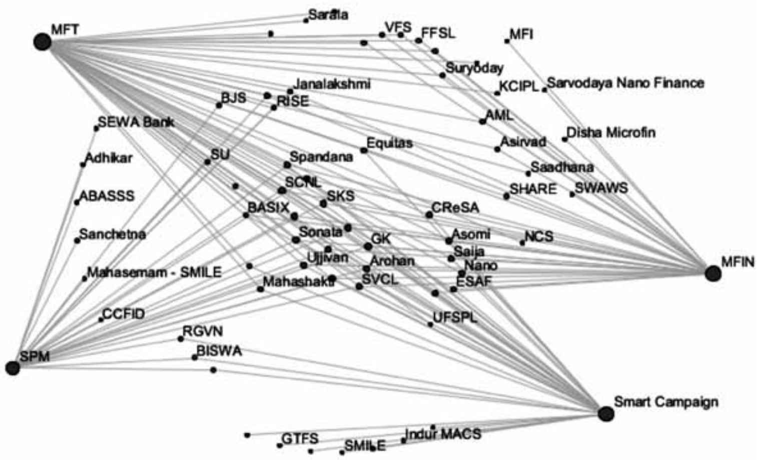
Thus, the act of providing social performance data to MIX does not say much about an institution's practices: transparency does not imply better or worse performance. However, there are other industry initiatives with which MFIs affiliate themselves to signal their interest or support of some issue. Using data on these types of relationships, it is possible to examine whether such affiliations create significant differences in performance results among MFIs. MIX's analysis tracks MFIs that have affiliated themselves with the following sub-groups:

- MFIs that are members of the MFIN network and have signed their Code of Conduct
- MFIs that have provided pricing data to MF Transparency
- MFIs that have endorsed the Smart Campaign Client Protection Principles[6].

In each case, there are slightly different expectations about how affiliation with the initiative may lead to improved results over time. For example, one would hope that adoption of client protection principles (especially those regarding over-indebtedness) leads to higher portfolio quality, as would adoption of other methods to prevent over-indebtedness by MFIN members.

The following chart maps the network of these relationships for all Indian MFIs that provided data (financial or social) to MIX Market (Figure3).

Figure 3: Distribution of Indian MFIs Participating in Social Performance Management Initiatives



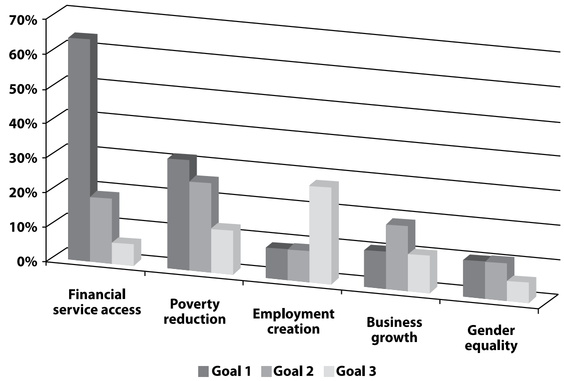
Those MFIs in the center of the graph participate in the most initiatives across this group; those on the periphery generally participate in only one or two. Using information on this network of relationships, MIX ran a similar set of tests to those in Figure 2 above to check if the performance of MFIs differs between those that do and do not participate in these initiatives[7].

These tests also resulted in little obvious difference between the groups in most cases. Tests for significance confirm that participants and non-participants achieve indistinguishable results in general[8]. There are a few interesting exceptions, although it is difficult to know how to interpret these given the effects of the crisis. MFIs that provided interest rate data to MF Transparency reported higher yields than those that did not (also true for MFIN members) – this could indicate either more accurate data on yields from MFIs that have shared pricing information or it could indicate that a cohort of lower-cost institutions was not captured in the survey. MFIs that endorse the Smart Campaign had lower risk levels in 2009, but this result dissolves in 2010 after the effects of the crisis. This is in keeping with recent MIX research establishing that conventional safeguards and best practices have less impact during the time of a crisis[9].

TRANSLATING SOCIAL MISSION INTO MEASURABLE OUTCOMES

When asked about their most important development goals, 64 percent of Indian MFIs identify financial inclusion as their top priority (Figure 4). Poverty reduction is a distant second, with 32 percent of Indian MFIs ranking it as the highest priority of their institution. MFIs' mission statements confirm this trend: the overwhelming majority are stated in terms of providing access to financial services. Nevertheless, poverty reduction remains an important goal, ranked among the top three development goals by 71 percent of Indian MFIs reporting social performance data to MIX. This ranking is similar to the one observed in other regions, thus confirming the prevalence of perceptions that microfinance is a tool to reduce poverty.

Figure 4: Top 5 Development Goals as Ranked by Indian MFIs

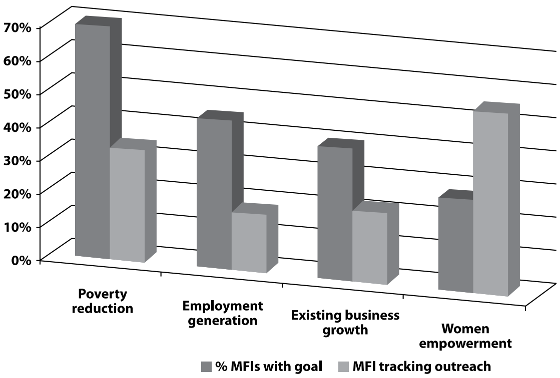


Source: MIX Market, 2010 data.

Each column represents the percentage of MFIs ranking each goal among the top three priorities for their institution. The columns do not add up to 100 percent because (a) there are thirteen goals to rank in total and (b) some institutions did not rank some goals pictured in their top three.

Stated goals are only part of the story, however. Just as important, if not more so, are the processes in place to track progress towards these goals. While inclusion of Social Performance Management in the policies and operations of Indian MFIs is on the rise, reporting on tangible results related to MFI missions is not common practice (Figure 5).

Figure 5: Development Goals and Outcomes Tracking in India



Source: MIX Market, 2010 data.

Poverty Reduction

The key example of this gap in monitoring is poverty reduction: only half of the MFIs citing this as an explicit goal report measuring the poverty levels of their clients (Figure 5). Of these MFIs, eleven[10] reported data using the Grameen Progress out of Poverty Index™ (PPI™) for both entering and current clients[11]. Data from the PPI estimates a median of 13 percent of these MFIs' clients to be below the Indian national poverty line[12], whereas 17 percent of Indian households in general are estimated to be below this line[13]. If we consider the US $2 a day poverty line, PPI estimates give 70 percent as the median number of MFIs' clients below this line. Meanwhile, 80 percent of the general Indian population is estimated to be below this line[14].

Hence, among those Indian MFIs that are serious about poverty measurement, the incidence of extreme poverty among their clients is underwhelming. The goal of poverty reduction and the act of measuring client poverty levels should imply that an MFI is also actively targeting the poor but too often this is not the case: only 15 percent of Indian MFIs citing poverty reduction as a goal also report the poor or very poor as their target market.

Indian MFIs are not alone in this trend. The majority of MFIs across all regions do not commonly track poverty outreach indicators and the poor are not usually their principal target market. In the end, more research is needed on the links between poverty measurement, poverty targeting and poverty reduction. MFIs that measure client poverty levels are better positioned to tailor products to the needs of clients and to improve their focus on this specific segment of the population but, until MFIs see the value of systematically tracking this indicator, it will be difficult to make concrete statements regarding the role of microfinance in bringing clients out of poverty.

Employment Generation

Half of Indian MFIs list employment creation as one of their top three development goals. However, employment outcomes are only tracked by 17 percent of these same MFIs, of which, five reported generating employment beyond the self-employment of their own microcredit clients. In addition, the 85 Indian MFIs providing enterprise data to MIX[15] reported financing about 65,000 start-up enterprises in 2010[16]. These 65,000 start-ups represent roughly 12 percent of all enterprises financed by Indian MFIs, suggesting that, while employment generation is commonly perceived as – and cited as – a goal of microfinance, MFIs in India tend more towards supporting existing enterprises.

Furthermore, the lack of employment tracking by Indian MFIs might be due to the fact that, when new employment opportunities are created, these tend to be for family members and not formal job opportunities as such. Such considerations make the definition of 'employment creation' murky, at best. Of all the Indian MFIs reporting any type of data to MIX, only five report lending to SMEs[17] but none of these reported employment data.

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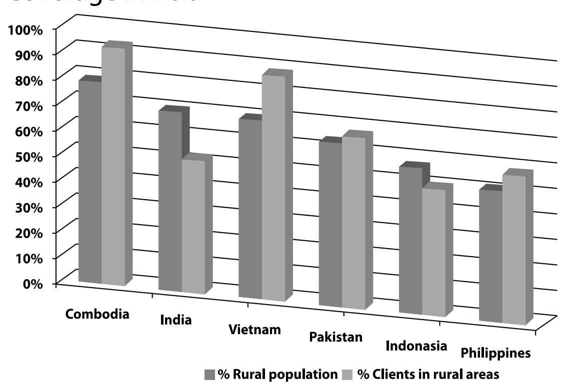
Rural Outreach

Contrary to employment creation and poverty reduction, Indian MFIs commonly track the geographic location of their clients and can readily report outreach to rural areas[18]. This is perhaps because Indian microfinance has its roots in rural areas. Outreach to rural areas is a stated goal for about 90 percent of Indian MFIs and, according to the data reported, half of these same MFIs' clients live in such areas. By way of comparison, Figure 6 represents select countries in Asia with half or more of the population living in rural areas and the percentage of rural clients served by the MFIs reporting to MIX in each of these countries. 60 percent of the aggregate gross loan portfolio in India is destined for clients in rural areas.

Figure 6: Rural Population and Market Coverage in Asia



Source: MIX Market, 2010 data. MFIs in the sample: India 54; Pakistan 21; Philippines 18; Indonesia 13; Cambodia 15; Vietnam 11. Data represent averages.

Women's Empowerment

Another area of relative, although qualified, success is that of female representation. 94 percent of the clients of Indian MFIs are women. Despite the fact that only 28 percent of MFIs rank women's empowerment/gender equality as a top development goal, over half of them MFIs reporting social performance data provide some sort of non-financial services targeted at women. The most common of these is women's leadership training. The vast majority of MFIs also report offering women's rights education training and one quarter offers counsel ling/ legal services for female victims of violence.

However, just because an MFI has a majority of female clients, one cannot assume that this translates to female economic empowerment. It is sometimes difficult to say whether "loans to women" means anything more than that the woman of the household signs for the loan but the money is then transferred to the man.

Box 1

Female Economic Empowerment: Evidence from Bandhan

Bandhan conducted an in-house impact study in 2007 that sheds light on the issue of female economic empowerment. Their study found that only 38 percent of its clients (all women) had used their first loan to invest in their own business. Furthermore, this number dropped as women progressed through the loan cycle: 33 percent of clients used their second loan for their own business, 29 percent for the third and only 25 percent for the fourth. Interestingly, this trend reversed when the business was jointly managed, from 15 percent for the first loan to 31 percent for the fourth.

These results are ambiguous for many reasons, but chief among which is the lack of corresponding data regarding how many of these same women owned their businesses in the first place. Nonetheless, an important element of female economic empowerment is autonomy: are women actually making decisions regarding the use of their loans or are they simply transferring this money to the man of the house? The fact that a little more than a third of women invested their first loan in their own business implies that a little less than two thirds were not the final arbiter of the uses to which that money was put. The similarly low numbers regarding joint businesses corroborate this implication. Thus, while the picture these statistics paint is in broad strokes, it is relatively safe to assume that there is no necessary correlation between loans in a woman's name and that same woman's economic autonomy.

Source: M-CRIL's 2010 social rating of Bandhan (http://www.mixmarket.org/sites/default/files/bandhan_social_rating_report_10.pdf) (Sep. 22, 2011).

A major caveat to the above discussion is that the high percentages associated with female clients in India are generally not reflected at the staff or board levels: 13 percent of loan officers, 12 percent of managers, and 29 percent of board members among reporting Indian institutions are women[19]. Such low female staff representation, especially at the management and board levels, leads one to question whether the majority of Indian MFIs have truly thought through the full implications of women's empowerment and gender equality.

Box 2

The Benefits of Female Staff: Testimony from ESAF

An exception to the trend of low female staff representation is ESAF, which has a greater percentage (71 percent) of female loan officers than the majority of MFIs reporting from India. According to ESAF, female loan officers are better able to relate to the social, economic, and emotional needs of clients, as they belong to the same socio-economic strata of the society. Daughters of the sangam (village bank) members who possess the relevant qualifications for a post are given priority during loan officer hiring. Like many other MFIs, ESAF uses sangam meetings as a platform for its (female) members to share concerns regarding their homes and communities, as well as to engage in loan operations, and thus provide a wellspring of experience from which to draw loan officers. Furthermore, ESAF asserts that female staff in general is better placed to envision new initiatives for the welfare and overall empowerment of its female clients.

Source: 2009 MIX interview with ESAF (http://www.spblog.org/2009/12/an-integral-approach-to-womens-empowerment-esaf-in-india-by-katherine-oglietti.html) (Sep. 22, 2011).

PRODUCTS AND SERVICES OFFERED

Financial Products and Services

Product and service diversification is often taken as a measure of financial inclusion, as greater product diversity usually means better adaptation to clients' demands. Indian MFIs score high on this indicator when it comes to loan products. Beyond microcredit loans for microenterprises and agricultural activities, almost 30 percent of the Indian MFIs reporting also offer education and consumption loans. This might seem at odds with the typical perception that India is a mono-product market offering only joint liability group lending products aimed at financing existing income-generating activities but, despite the different purposes of these loans, the terms still tend to be very similar[20].

As in the rest of the South Asian continent, most MFIs reporting to MIX (86 percent) require compulsory insurance. Voluntary insurance, on the other hand, is offered by less than half of the Indian MFIs reporting (47 percent). Other financial services, such as remittances, microleasing, or savings facilitation services are rarely offered on the South Asian continent. In juxtaposition to the nearby East Asia and Pacific region, where half of MFIs reporting social performance data to MIX offer remittances services, in South Asia, only 10 percent of MFIs offer such services and, in the Indian sample, only 4 MFIs do so.

Remittance services in particular represent an unrealized avenue of expansion for Indian MFIs. A 2010 study by GIZ, the German Society for International Cooperation[21], and NABARD, the Indian National Bank for Agriculture and Rural Development, estimated that India has in the neighborhood of 100 million domestic migrant workers who contribute as much as 10 percent to Indian gross domestic product. The same study found that remittances make up more than 80 percent of the cash income of sample households in Uttar Pradesh[22].

Another study by the same agencies found that, in some instances, informal remittance channels – mainly cash carried by the migrants themselves or by family and friends, make up 91 percent of total remittance flows[23]. This second study showed that most migrants actually trusted banks and saw them as the most efficient means of remitting money, but cited conditions such as lack of bank accounts in urban work destinations, time spent traveling to and waiting at banks, Know Your Customer principles and other banking requirements, and low financial literacy and capability as likely candidates for explaining the low use of banks as remittance channels among domestic migrants. The authors conclude that "most [financial] service providers have not made remittances a business proposition, but there is considerable potential for remittances to be linked to other financial services. Migrants need a secure place to deposit and remit small amounts of money[24]."

Apart from microcredit, savings accounts are perhaps the single most important product with which to facilitate financial inclusion. Although Indian financial legislation currently bars most Indian MFIs from taking savings deposits directly[25], MFIs can still facilitate client savings indirectly. Swadhaar[26] provides an example of such a program. Most of Swadhaar's clients do not have access to the formal banking system due to a lack of the documentation required to open a savings account. Furthermore, those who do have access are often hesitant to engage with formal banking institutions because of limited financial literacy. Such factors make it both difficult and intimidating to open a deposit account. According to Swadhaar, mainstream banks usually require a minimum balance of Rs 500 for a conventional savings account, while an account with a checkbook and ATM access requires Rs 1,000. However, the Reserve Bank of India (RBI) requires that banks also offer a no-frills account, with a minimum deposit of only Rs 50. To help clients overcome barriers to saving, Swadhaar connects them to such no-frills accounts, as well as to the zero-balance accounts they facilitate through a partnership with Citibank.

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Box 3

An Integrated Approach: Swadhaar and Non Financial Service Linkage

Swadhaar advocates combining financial education with savings facilitation and has linked the two in its own operations. It has found that simply offering a path to savings is often not enough – clients must be taught why savings is important, as well as how to make use of deposit products and services. Previously it had begun a savings partnership with ICICI in 2008 and, by 2009, their savings facilitation program had around 3,000 clients (roughly 10 percent of their total client base at that time). Anywhere from 75 to 93 percent of these clients had no money in their accounts, however, and around 63 percent had never made a single transaction. Furthermore, when questioned, ICICI asserted that these figures were fairly typical of the 40 such programs they offered in conjunction with NGOs.

To address this issue, Swadhaar has designed a new program in conjunction with Citibank combining financial education with savings facilitation. They designed the education component specifically for the needs of its female clients, covering several facets of household finance, from calculating income and budgeting to savings and credit management and linked to specific guidance on how to open an account with Citibank and make use of ATMs. Although the program holds much promise, challenges remain at the level of implementation: Swadhaar has found it difficult to interest clients in the concept of training on savings, as its clients tend not to see training as necessary to the act of saving.

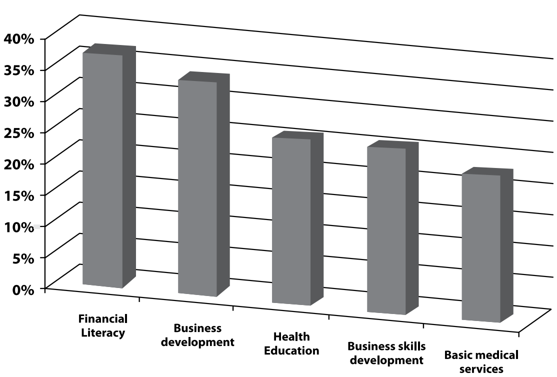
Source: 2010 MIX interview with Swadhaar (http://www.spblog.org/2010/02/innovation-meets-financial-education-swadhaar-in-india.html) (Sep. 22, 2011) and 2009 blog post by ACCION's Amitabh Saxena (http://centerforfinancialinclusionblog.wordpress.com/2009/03/31/some-unintended-benefits-of-improving-financial-inclusion/) (Sep. 22, 2011).

Non Financial Services

The majority of Indian MFIs reporting social performance data to MIX do not offer non-financial services in the areas identified by the MIX/SPTF social performance indicators (Figure 7)[27]. This trend is shared by MFIs in the rest of the world[28]. When an Indian MFI does provide non financial services, it often does so by way of a partner. For example, three MFIs with social ratings on MIX Market, Ujjivan, Bandhan and Mimo, have partnered with NGOs to create programs targeting the ultra poor. These services, usually involving business, health, and livelihood components, target individuals whose incomes are so low as to disqualify them from the bulk of MFI services. The aim of such programs is to increase the social, physical and economic well-being of ultra poor individuals in order to help them qualify to become MFI clients in the future.

The non financial services provided by Indian MFIs can be quite innovative, such as Mimo's pilot solar cooker project near Jim-Corbett Park in Uttaranchal, which aims to reduce inhabitants' dependence on firewood collected in the forest, or Bandhan's horticulture program, which targets one client in each branch to grow 50,000 saplings to sell locally. These programs can also be quite efficient: M-CRIL found Bandhan's ultra-poor program to be the most economical and low-cost program of its kind in a survey conducted in India and Haiti[29].

Figure 7: Non Financial Services in India and South Asia



Source: MIX Market, 2010 data.

SOCIAL RESPONSIBILITY TOWARDS CLIENTS

The problem of over-indebtedness and microfinance consumer prot ection generally has garnered a great deal of media attention since the crisis in Andhra Pradesh. This section examines MIX data on social responsibility to clients in order to shed light on india's current state of practice in this area.

Client Protection Principles

About half of all Indian MFIs reporting to MIX have endorsed the Smart Campaign and reported their effective interest rate data to MFTransparency. Around 60 percent of those reporting social performance data – a subset of all Indian MFIs on MIX Market – report implementing all six of the Smart Campaign's Client Protection Principles (CPPs)[30]. However, MIX data on consumer protection is currently self-reported, so it cannot be taken as authoritative. The Smart Campaign is working on a certification procedure for their principles which should significantly increase the reliability of this data in the future. Details on CPP implementation cited here come mostly from social ratings and audits.

As one might expect, given the stress on avoiding client over-indebtedness in recent years, CPP implementation seems to have progressed farthest in this area. In addition to self-reported MIX data, every Indian MFI submitting social performance information reports implementing the CPP aimed at avoiding over-indebtedness. All of the social ratings for Indian MFIs available on MIX Market attest to some form of repayment analysis, whether through onsite visits, loan utilization checks, cashflow, liability and household security analyses or, in most cases, a combination of these. Staff training on the dangers of over-indebtedness is also commonplace[31].

One over-indebtedness prevention policy shared by many socially rated Indian MFIs is that of not being the fourth lender to a client. This practice has even been made compulsory for Microfinance Institutions Network (MFIN) members, although variations do exist. For example, Trident Microfinance avoids being the fourth lender in rural areas but the fifth in urban ones. Grama Vidiyal, on the other hand, prefers to be the only lender to a given client[32].

MFIN members also follow the policy of never extending more than Rs 50,000 in combined credit to any one client[33]. In the absence of a credit bureau, however, policies regarding how many institutions a client may borrow from

Around 60% of those reporting social performance data…report implementing all six of the Smart Campaign's Client Protection Principles.

or capping a client's total combined debt are very difficult to pursue effectively: an M-CRIL survey of Ujjivan's clients, carried out as part of their social rating, indicated that only 8 percent of clients admitted to having loans from other MFIs. Such a low number seems unlikely, given the presence of four to five other major MFIs in the areas in which Ujjivan operates[34].

Some Indian MFIs pursue a less direct means of avoiding over indebtedness through the existence of policies forbidding expansion into areas where more than three other MFIs currently operate. Recent MIX research[35] has connected high levels of market saturation with decreased portfolio quality in many crisis areas, including India, and certain Indian MFIs appear cognizant of the risk such oversaturation entails. Ujjivan, perhaps the most famous practitioner of this policy, emerged from the Andhra Pradesh crisis relatively unscathed[36] in part, thanks to strict internal rules governing expansion. These rules prohibited Ujjivan from entering Andhra Pradesh due to the high number of MFIs already operating in the province. In addition to protecting an MFI's own health, such policies can combat client over indebtedness by lessening the need to aggressively recruit clients in order to meet growth targets.

The social audits and ratings available on MIX Market also corroborate that some Indian MFIs are taking the challenge of transparent and reasonable pricing seriously. Most of these have explicit policies regarding the clear explanation of fees, interest payments, and other costs associated with MFI products, and several print passbooks in local languages detailing these costs. A stress on explaining things in a language clients understand is evident. Ujjivan, for example, ensures that 50 percent of all field staff for each branch is recruited locally to ensure the presence of staff able to communicate effectively with clients. Conversely, the common Indian practice of compulsory insurance premiums complicates efforts at transparent pricing. MFIs can have difficulty explaining the idea of insurance to clients and, of course, the compulsory policies add to the cost of MFI services[37].

The median borrower retention rate in India in 2010 was 74% - 10 points lower than it was in 2009 – no doubt reflecting the recent turmoil in Indian markets.

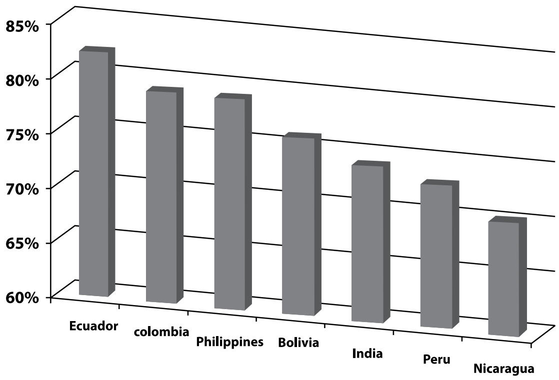
Overall, however, the above should not be taken as authoritative. Only six Indian MFIs have published social audits or ratings on MIX Market[38]. Moreover, while they count some of the largest institutions among their number, they do not constitute a significant sample of the Indian market. More than anything, the preceding discussion highlights the need for better data on CPP implementation at Indian MFIs. Simply endorsing the Smart Campaign does not signify application of its principles nor does reporting their application to MIX. Lack of reliable data on CPP implementation remains an obstacle to effective analysis of this aspect of the microfinance sector throughout the world, not just in India.

Borrower Retention Rates

An MFI's borrower retention rate[39] is a quantitative indicator frequently used to assess client satisfaction. It is often used as a benchmark because it is less subject to the vagaries of self-reporting than many other social performance indicators. The median borrower retention rate in India in 2010 was 74 percent (Figure 8) which was 10 points lower than what it was in 2009; no doubt reflecting the recent turmoil in Indian markets.

While this is a useful statistic, it is important to refrain from analyzing it in isolation. Borrower retention rates need context since by themselves, they do not shed light on the reasons for client exit. For example, an MFI could have lower than average borrower retention because of its success at reducing the poverty levels of its clients or because it services clients whose needs are more episodic: requiring loans one year, but other services the next year. In such cases, clients would be leaving not because they are dissatisfied but because they have "graduated" to more traditional forms of finance or because they are availing themselves of other microfinance products. Since borrower retention does not distinguish between "good" and "bad" reasons for client exit. One must exercise caution when using it as evidence for a particular explanation. Nonetheless, conventional wisdom holds that microcredit functions most often in extended series and therefore, if borrower retention is falling, it is because clients are leaving to have their loan needs met elsewhere.

Figure 8: Borrower Retention Rates in Select Countries[40]



Source: MIX Market, 2010 data.

SOCIAL RESPONSIBILITY TOWARDS STAFF

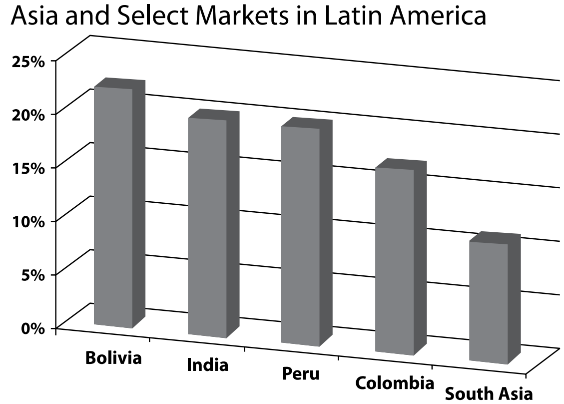
Social responsibility to staff is the other area of most direct relevance to the recent crisis in Andhra Pradesh. Media accounts of the event were as laden with reports of questionable staff behavior as they were with those of bad lending policies. While an investigation of the veracity of these reports is beyond the scope of this article, an examination of Indian MFIs' human resources policies can help shed light on the level of staff satisfaction within MFIs. A detailed MIX analysis of MFI field staff compensation and staff incentive structure is available in the chapter on human resources in this volume.

Staff Rotation Rates

Staff rotation rate, a measure of the frequency with which an MFI must hire new staff to replace existing staff, is often used as a shorthand for an MFI's overall human resource practices. As with borrower retention rates, context is important: the level of competition in a given market has a significant impact on aggregate levels of staff rotation. However, unlike borrower retention rates, there exists less ambiguity about what constitutes a "good" or "bad" staff rotation rate. While some degree of staff rotation can be beneficial to any organization, in general a high staff rotation rate represents a high cost for the MFIs in terms of resources spent on new hires and training. High staff rotation also has implications for client retention[41].

India has higher staff turnover rates than the rest of South Asia, with levels comparable to the most competitive markets in Latin America (Figure 9). Beyond competition, there are other factors that might explain the country's high staff turnover: for example, it is often argued that salary levels for Indian credit officers are particularly low and that this could represent an additional component in the Andhra Pradesh crisis. MIX examines this claim in detail elsewhere in this work.

Figure 9: Staff Rotation Rates in India, South Asia and Select Markets in Latin America

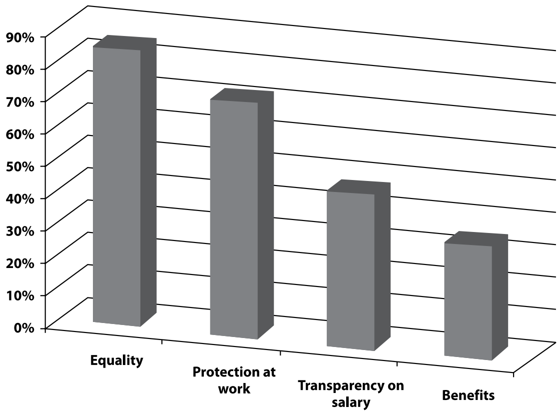


Source: MIX Market, 2010 data. Data for South Asia include Pakistan, Nepal, Bangladesh, Afghanistan and Sri Lanka.

Human Resources Policies

Apart from monetary compensation, the human resources (HR) policies of an MFI are an important determinant of staff satisfaction. An MFI may provide low levels of pay to its field staff and still represent an attractive work environment through progressive HR policies. Figure 10 represents the prevalence of different types of HR policies as reported by the 54 Indian MFIs submitting Social Performance data to MIX.

Figure 10: Human Resources Policies at Indian MFIs



Source: MIX Market, 2010 data

The most common HR policies across regions are those related to equality (anti-discrimination, equal pay for men and women with equivalent skill levels) and protection at work (safety, anti-harassment). India is no exception to this trend. Nevertheless, policies related to benefits (such as pension or medical insurance) are not common among Indian MFIs and less than half of the MFIs reported having a clear salary scale based on market salaries.

LOOKING FORWARD

Social Performance Management is a relatively new area of MFI performance assessment across regions. The degree of progress observed varies according to the indicator one examines. Generally speaking, the tracking of social indicators is on the rise in India and MFIs who do so already account for the majority of Indian borrowers on MIX Market. Monitoring social performance, however, is only a starting point: using it to improve microfinance practices is of even greater importance.

Annex 1

2011 MIX Social Performance Indicators

Indicator category	**What the indicators measure**
1. Mission and social goals	The MFI's stated commitment to its social mission, its target market and development objectives
2. Governance	Whether members of the Board of Directors have been trained in Social Performance Management and the presence of a formal Board committee that monitors SP
3. Range of products and services	Both financial and non financial products and services offered by the MFI
4. Social responsibility to clients	The number of Smart Campaign Client Protection Principles applied by the MFI
5. Transparency of cost of services to clients	How the MFI states its interest rates
6. Human resources and staff incentives	The MFI's policy regarding social responsibility to staff. This includes: HR policies in place, board and staff composition, staff turnover rate, and staff incentives linked to social performance goals
7. Social responsibility to the environment	Whether the MFI has policies and initiatives in place to mitigate the environmental impact of financed enterprises
8. Poverty outreach	Poverty levels of clients at entry and their movement out of poverty over time
9. Client outreach by lending methodology	The type of lending methodology (-ies) employed by the MFI
10. Enterprises financed and employment creation	The number of enterprises financed by the MFI and employment opportunities created by the enterprises financed
11. Client retention rate	The client retention rate of the MFI

MIX Market, 2011, www. http://www.themix.org/social-performance/Indicators.

NOTES:

1. The SPTF is an international group comprised of investors, donors, MFIs, microfinance networks, research agencies, and other stakeholders united in the goal of defining, measuring, and improving the social performance of MFIs. A more detailed history of MIX's efforts is available here: http://www.themix.org/social-performance/indicators/history (Sep. 26, 2011).
2. MIX data on social performance is divided into "results" data (e.g. enterprises financed and jobs created during the reporting period, number of female staff in various categories, etc.) and "profile" data (e.g. target market, development goals, human resource policies, etc.). Unless otherwise specified, throughout this report "MFIs reporting on social performance" and similar locutions signify MFIs who have reported the latter (social performance profile) data. At the time of the present analysis, 54 Indian MFIs had submitted social performance profile data to MIX over the course of fiscal years 2008-10. The number of MFIs who have reported social performance results data, on the other hand, varies by indicator. When this latter type of data is used for analysis, the sample size is noted in the text or in a footnote. A full description of the current suite of MIX/SPTF social performance indicators (including both profile and results indicators) is available at http://www.themix.org/social-performance/Indicators (Sep. 22, 2011).
3. Non-banking financial institution; sometimes called an NBFC in India.
4. "Average salary" is a statistical proxy for actual MFI salaries. It is derived by dividing an MFI's personnel expense by the average number of personnel at that institution. An empirical analysis of Indian MFI compensation levels is provided in the human resources chapter of this volume.
5. Also, available here: http://public.tableausoftware.com/views/India-baseline-SP-comparison/SPcomparison?:embed=yes&:toolbar=yes&:tabs=no (Sep. 22, 2011)
6. A list of MFIN members can be found here: http://www.mfinindia.org/mfin-member-profiles (Sep. 22, 2011). The list of Indian MFIs that have provided interest rate data to MFT is here: http://www.mftransparency.org/data/countries/in/ (Sep. 22, 2011). A list of MFIs endorsing the Smart Campaign is available here: http://www.mixmarket.org/service-providers/smart-campaign (Sep. 22, 2011).
7. Detailed results can be found at: http://public.tableausoftware.com/views/India-baseline-SP-comparison/MFTcomparison?:embed=yes&:toolbar=yes&:tabs=no (for MFT comparison); http://public.tableausoftware.com/views/India-baseline-SP-comparison/MFINcomparison?:embed=yes&:toolbar=yes&:tabs=no (for MFIN comparison); and http://public.tableausoftware.com/views/India-baseline-SP-comparison/Smartcomparison?:embed=yes&:toolbar=yes&:tabs=no (for Smart Campaign comparison).
8. MIX ran t-tests and Wilcox-on-Mann-Whitney tests on groups of affiliates for each initiative for the four variables listed in the graphs: return on assets, yield on gross loan portfolio, average salary / GNI per capita and PAR > 30 days, for both 2009 and 2010, yielding 64 results (4 variables x 2 years x 2 tests x 4 initiatives). Results had p-values < 0.05 in 19 of these cases, often for both tests for the same year.
9. Adrian Gonzalez and Emanuelle Javoy, Microfinance and the Role of Policies and Procedures in Saturated Markets and During Periods of Fast Growth, September 2011, http://www.themix.org/publications/microbanking-bulletin/2011/09/microfinance-policies-procedures.
10. Grameen Financial Services Pvt. Ltd., Ujjivan Financial Services Pvt. Ltd., Anjali Micro Finance, Chaitanya Fin Credit Pvt. Ltd., Janalakshmi Financial Services Pvt. Ltd., CASHPOR Micro Credit, ESAF Microfinance and Investments Pvt. Ltd., Arohan Financial Services Ltd, Basix, Bandhan and Sonata Microfinance Pvt. Ltd.
11. The PPI is specifically designed to facilitate the tracking of clients' poverty levels over time. This is a crucial and often overlooked aspect of outcome tracking – only by tracking poverty over time can one evaluate whether poverty reduction is actually taking place. It also one of the only poverty measurement tools available that is internationally benchmarked.
12. The official Indian national poverty line is Rs 14.25 a day, as defined by the Indian National Sample Survey Office in 2008. This data refers to nine MFIs in the sample.
13. This data refers to seven MFIs in the sample.
14. Non-PPI poverty data in this report is from Marc Schreiner, A Simple Poverty Scorecard for India, Microfinance Risk Management, L.L.C., http://www.microfinance.com/English/Papers/Scoring_Poverty_India.pdf (Sep. 5, 2011).

15. See footnote 2 above; the 17 percent reporting employment creation outside of self-employment is out of the 54 MFIs reporting social performance profile information to MIX.
16. Start-up enterprise creation is another way to measure employment creation.
17. SME lending is usually considered to have a greater impact on employment creation.
18. Rural areas are defined as settled places outside towns and cities, such as villages and hamlets, where most livelihoods are farm-based.
19. These figures are weighted averages derived from Indian MFIs for which total and female staff figures exist in each employment category. The sample sizes are: 60 MFIs for board member data, 64 MFIs for manager data, and 65 MFIs for loan officer data.
20. See the chapter on products and services in this volume for a more detailed discussion.
21. A newly incorporated German agency composed of DED (the German Development Service), GTZ (the German Society for Technical Cooperation), and Inwent (Capacity Building International).
22. Deshingkar et al. (2010) cited in Y. S. P. Thorat, Howard Jones, Remittance Needs and Opportunities in India, Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH – National Bank for Agriculture and Rural Development (NABARD), http://www.mikrofinanzwiki.de/file/1135/YSPThorat_HowardJones_remittance_needs_and_opportunities_in_india_2011.pdf (September 16, 2011).
23. Thorat, Jones, http://www.mikrofinanzwiki.de/file/1135/YSPThorat_HowardJones_remittance_needs_and_opportunities_in_india_2011.pdf (September 16, 2011). The 91 percent figure comes from the Rajasthan-Gujarat migration corridor. Other migration corridors vary from 90 percent (Maharastra) to 17 percent (Uttar Pradesh-Mumbai).
24. Ibid.
25. As of this writing, such is the case. A bill currently making its way through the Indian Parliament may have the effect of changing existing deposit legislation if the RBI becomes the sole authority over India's microfinance sector (http://www.microfinancegateway.org/p/site/m/template.rc/1.1.10908/).
26. Swadhaar FinServe Pvt. Ltd.
27. See footnote 1 above.
28. For a discussion of global trends in non-financial service offerings, see Chapter 4 of Micol Pistelli, Anton Simanowitz, Veronika Thiel, State of Practice in Social Performance Reporting and Management: A survey of 405 MFIs reporting to MIX in 2009-2010, MicroBanking Bulletin, http://www.themix.org/sites/default/files/MBB-%20SoPinSPReporting%20and%20Management_FINAL.pdf (Sep. 22, 2011).
29. Details of this survey are publicly unavailable as of this publication. The source for this statement is M-CRIL's 2010 social rating of Bandhan (http://www.mixmarket.org/sites/default/files/bandhan_social_rating_report_10.pdf) (Sep. 22, 2011).
30. For the list of questions related to consumer protection indicators, visit http://www.themix.org/social-performance/Indicators (Sep. 22, 2011).
31. Here a risk analysis of MFIs having one or more CPP in place versus those who do not would be ideal. However, while MIX data provide risk profiles for a large swath of Indian MFIs, such an analysis is problematic given the current state of CPP data. Every single Indian MFI reporting CPP data to MIX indicates having at least one CPP in place (invariably the principle tied to avoiding over-indebtedness), so it is reasonable to assume that every Indian MFI – even those that have not reported any social performance data to MIX at all – would do the same. Such considerations render analysis difficult as one cannot equate absence of MIX CPP data to absence of CPPs themselves.
32. By way of comparison, these voluntary standards are on the whole more lenient than those recommended in the January 2011 Malegam Committee Report, where the recommendation is that not more than two MFIs lend to a single borrower (http://www.sebi.gov.in/commreport/melagamreport.pdf) (Sep. 18, 2011).
33. Again, this is more lax than the recommendations of the Malegam Committee Report, which cites Rs 25,000 as the maximum credit to be extended to a single borrower. It also recommends that no client be part of more than one self help or joint liability group.
34. This is the opinion of M-CRIL in their 2010 social rating of Ujjivan (http://mixmarket.org/sites/default/files/ujjivan_social_rating_09_full.pdf) (Sep. 22, 2011).

35. Adrian Gonzalez, Defining responsible financial performance: how to think about growth, MicroBanking Bulletin May 2011, http://www.themix.org/publications/microbanking-bulletin/2011/05/excessive-microfinance-growth (Sep. 5, 2011).
36. Between March 2010 and March 2011, Ujjivan's gross loan portfolio almost doubled (from $82M US to $133M US), real yield on that portfolio hovered around 17 percent, operational self-sufficiency remained stable at above 100 percent, PAR>30 only rose by about half of a percentage point (from 0.46 percent to 1.03 percent) and write-off ratio actually decreased by a similar amount (from 0.51 percent to 0.14 percent).
37. As documented in M-CRIL's social rating of Bandhan (http://www.mixmarket.org/sites/default/files/bandhan_social_rating_report_10.pdf) (Sep. 22, 2011).
38. Ujjivan Financial Services Pvt. Ltd., Bandhan Financial Services Pvt. Ltd., Mimoza Enterprises Finance Pvt. Ltd., Sonata Finance Pvt. Ltd., Trident Microfin Private Ltd., and Grama Vidiyal Microfinance Ltd.
39. MIX's formula for calculating client retention rates is the following: end of period active borrowers / (beginning of period active borrowers + new borrowers during the period).
40. The countries listed here are among those ranking highest in the Economist Intelligence Unit's Global Microscope on the Microfinance Business Environment 2009, which ranked countries according to (1) the institutional and regulatory framework, (2) the general investment climate, and (3) the level of institutional development. This graph considers only countries with the highest number of reports submitted to MIX in 2010 (15 or more).
41. For a full discussion of staff rotation, see section 5.2 in Pistelli, Simanowitz, and Thiel, State of Practice, http://www.themix.org/sites/default/files/MBB-%20SoPinSPReporting%20and%20Management_FINAL.pdf (Sep. 5, 2011)

Microfinance Funders and Social Performance Management

3

Chapter

MFIs, while attracting commercial capital, are required to achieve their social mission too. While financial performance was adequately demonstrated to attract and retain commercial capital, the achievement on the social performance side has lagged behind. In recent times, though, there has been a resurgence in the social aspects of MFI business. While governance, human resources, products and proceses have a significant influence on the social orientations of MFIs, funding stakeholders have the potential to direct the energies of MFIs. Funders, especially the equity investors, play a key role in the governance of the institutions. In the past fifteen months, MFIs have attracted a lot of negative attention from the government, media and regulators on account of their commercial orientation. The commercial outlook of MFIs is mostly attributed to the nature of investments and bulk loans that they had received. It is important therefore to examine the role of funding stakeholders viz investors and lenders in the governance of MFIs and their social orientation.

Investors, regardless of their pedigree, influence the business decisions and return expectations of investee institutions. The promoters play a key role in 'expectation formation' in the minds of the investors. High growth plans accompanied by high enterprise value as the basis for fixing the price of equity raise expectations in the investor of high returns. The investor seeking normal market-equivalent returns would cause MFIs to produce high returns, if the equity was priced at a high premium. The investors' returns are based on the amount invested (including the premium) and not the number of shares acquired. The high valuation of equity (which in India had been above the above global average) has thus been a siginificant factor driving the sector towards higher yields and competitive behaviour. Many investors, including those with strong social orinetations did not refrain from making such high premium investments, knowing fully well that the impact on the customers of MFIs will not be positive in a social sense.

Most funders financed MFIs as it counted towards their priority sector lending obligations. The MFIs provided a facile route for deploying their funds with lower risks. But the social aspect of MFIs business did not influence the pricing of bulk loans from funders. The interest rates were market based and calibrated to the relative risks of financing different MFIs. A reduction price of loans to enable the MFIs to deliver credit at a lower cost to customers was not considered. The vulnerable nature of grassroot customers was not a consideration in the pricing of loans or in fixing the loan terms. A few funders did impose interest rate caps on what the MFIs can charge to their customers and to that extent made their social concerns manifest.

The high valuation of equity, which in India had been above the global average, has thus been a significant factor driving the sector towards higher yields and competitive behavior.

SOCIAL DEFINITION

Microfinance is widely recognised as a social enterprise and is expected to adhere to double[1] bottom line performance standards. A degree of consensus on financial parameters have emerged over a decade of work around defining and benchmarking indicators, which has been carried out by various stakeholders such as CGAP, SEEP Network, rating agencies and capacity building providers, but a consensus on social performance standards is still evolving. From an investor's point of view social relevance of microfinance seems limited to customer centricity. Some investors also require MFIs to focus on underdeveloped geographies, impact on quality of life and development of staff. Nine investors were polled on their views on social performance in microfinance. The responses from the investors[2] (Table 1) show that MFIs "having customer focus" or "being client centric" is one of the key requirements. Investors also have a geographic focus. Some investors like MSDF are clearly focused towards urban programmes and some like Incofin have a rural focus. In addition "under-served regions" also comes up as an aspect of social focus. Promoting innovations for improved access is also a focus of some investors. Few investors define their focus in terms of reaching the poor or defining poverty levels. Gender focus or targeting only women is also not a key requirement from the investors.

Social Definition for Lenders

The understanding of the social content of microfinance among lenders is about creating benefits for MFI, clients and the bank. Corporate social responsibility, lending to economically disadvantaged low income women, a rural focus and financial inclusion are some of the aspects considered to be socially relevant by lenders. While the bankers lend to MFIs for commercial reasons on commercial terms, they do acknowledge this as an opportunity for socially beneficial lending. There is no clear articulation of these social benefits that should emanate from such lending.

Efforts for Social Performance and Responsible Microfinance

Social Performance Management has become an integral strategy of Microfinance focused funds as reflected in the efforts made by different funds (See Table 1)[3]. Some notable efforts[4] are as under:

Table 1: Social Performance and Responsible Finance Intitatives

Funder	Social Performance Management and Responsible Finance Initiatives
Lok Capital	Social performance assessments, defining social indicators for internal reporting, research work on human resources management practices and financial inclusion
MSDF	Supporting sectoral initiatives on SP reporting through Sa-dhan, SPM implementation projects for some partners, supported financial literacy projects for some partners and now one of the stakeholders in unified code of conduct for Indian MFIs
IFC	Unified code of conduct for Indian MFIs and select technical assistance for implementing Social Performance Management among partners
DiaVikas Capital	SPM implementation project with investees in a phased manner (Details in box 1)
Citi Foundation	Financial literacy key theme in Indian efforts
Standard Chartered	Supporting SPM at sectoral level
SIDBI	SIDBI's recent efforts have been around having common lending covenants across lenders (Annex 1), unified code of conduct, code of conduct Audits (details in box2), working with MFI industry bodies to implement a validation of code of conduct.

FWWB	Piloted social ratings and assessments
Maanveey[5]	Social assessments, assessment on ESG score card, training on SPM and its parent body Oikocredit is member of most of the global initiatives in SPM

Investors and Lenders have been actively supporting various SPM initiatives and social assessments are gaining acceptance. Though the desire to assess, measure and report on social returns has been long-held, reporting systems have been put in practice only recently. The presence of a number of reporting and assessment tools has made it difficult for the investors and lenders to choose the one with the best features. The quest for finding simple and easy to administer tools for social performance is continuing.

RETURN OF EXPECTATIONS

Expectations of Investors

In the survey, minimum return expectations on equity varied from 10% to 25% with majority of funds in the range of 20-25%. The key response in the light of Andhra Pradesh crisis is that these expectations should be reset. The average Return On Equity (ROE) for top 5 Indian MFIs was 31%[6] in 2009; that of commercial banks 19% and that of mainstream NBFCs was 18%.MFIs outperformed other financial sector players in growth and profitability and hence the return expectations that the investors had were much higher whether articulated or not. The returns were higher in the microfinance sector because of early growth stage of the sector, which usually stabilises as the sector matures.

Expectations of Lenders

Lenders have been lending in the range of 9.5% to 14%[7]. This corresponds with the range of cost of funds for the MF sector in 2010 which was around 10-15%[8]. The return expectations from microfinance sector are similar to those expected from any other sector. In fact due to their continued excellent financial performance, these expectations have only increased.

SOCIAL RETURNS

Regarding social returns, the key area for most investors is outreach to the underserved, which is in line with their definition of social as "rural," "underserved" and "urban". This is followed by "impact" or the change in quality of life that most of them want to see among clients. Most investors desire to make an impact on low income families. However, specific benchmarks for outreach to poor, women and low income are not articulated by many. Innovation is seen as another socially relevant outcome. There seems to be a realization that not much has been done in the sector towards product design and delivery.

Social Performance Indicators

Social Performance Indicators for Investors : The Social Performance Indicators (SPI) used by investors as a part of their monitoring is largely based on outreach and dropouts. This is largely in line with social returns they are looking for in terms of outreach. Mix Social Performance (SP) reporting is now gaining prominence among investors for reporting on Social Performance. For their internal reporting, funds have selected some of the indicators which are critical for them and encourage their investees to report to Mix for both social and financial performance. Environmental, Social and Governance (ESG)[9] reporting is required by CGAP[10] annually for their Microfinance Investment Vehicle surveys since 2008.

Social Performance Indicators for Lenders: Lenders have had the initial assumption that microfinance is aimed at the poor and hence do not seem to articulate clear social reporting requirements. Some lenders require the MFIs to report on outreach to women and underserved. While there is recognition that social returns are desirable, funding stakeholders find it difficult to articulate and measure them.

Lenders have had the assumption that microfinance is aimed at the poor and hence do not seem to articulate clear social reporting requirements.

DIFFERENTIATING FACTORS

Differentiating Factors for Investors

It is important to understand the key differentiators that define microfinance focussed funds or those loosely termed as "social investors". The key quality that emerged during the interviews was patience or long-term commitment. This was substantiated by their investment horizons, which were from 5 to 10 years. Other factors included providing hands on technical support and high risk appetite.The key nonnegotiable for investors that could cause disengagement was vision alignment with the promoter. However, it is important to recognise that there is limited enforceability once the investment is made, unless there is a buyer or promoter buy back clause that can be enforced.

Differentiating Factors for Lenders

For lenders, the key differentiation came from their willingness to reach out to a diversity of MFIs subscribing to different models, geographies and legal forms. For Maanaveeya the key differentiator is working with community-based models, having a rural focus and clearly articulated social returns. To the credit of lenders, all MFIs across the country could access loan funds with initial support from SIDBI and Friends of World Women Banking (FWWB).The nonnegotiables for lenders are loan covenants, governance and diversion of funds. Since lenders have short-term contracts with MFIs, renewal and increase in limits are key decision points based on their past relationship.

Governance is the process by which stakeholders guide the MFI to define and protect the mission and protect the institution's assets.

GOVERNANCE

Governance in microfinance has been defined as *"the process by which stakeholders guide the MFI to define and protect the mission and protect the institution's assets."*[11] The stakeholders of MFIs include the board, management, staff, investors, donors and clients. The guiding principles[12] of stakeholder involvement are accountability, responsibility, fairness and transparency. The key areas which constitute governance of an institution are board composition, board contribution, strategy and risk management. It is important to recognize the role of funding stakeholders in an institution. Their contribution is critical as they are likely to enjoy a considerable influence on account of their ability to provide the most critical raw material for MFIs to exist i.e., funds. The influence that funding stakeholder in practice can exercise depends on many factors.

Fund Strategy

The investment strategies of the funds were explored to understand their risk appetite. Most of the funds have made investments at the early stage as well as at the mature stage. This highlights their commitment to microfinance institutions at all stages of growth. Many of these funds provide funds at the early stage of entry and also provide growth capital by participating in next rounds of equity raising. All early stage funding are perceived to be more risky than growth stage funding. Microfinance focussed funds display a high risk appetite while balancing their portfolio among start-ups, growth phase and mature institutions.

Extent of Ownership

To understand the degree of influence the investors can have, it is important to evaluate their approach to investing in terms of the extent of their ownership of company's equity. Most of the investors interviewed take either a significant minority or majority position. Minority position is favoured by only a few. The ability to influence governance towards social performance declines with lower stake in ownership. The other funders that have invested in the company could at times overrule the attempts towards a social agenda. Hence those with a clear vision of social performance in investee companies need to have a significant stake and ensure that like-minded investors are on board.

Time Horizon

Microfinance focussed funds have a relatively long time horizon that ranges between 5-10 years. This reflects their commitment to stay invested for a longertime and focus on short-term gain versus long-term gains. Setting a social agenda and getting it implemented are not easy tasks that can be accomplished within a short time. MFIs with a SPM agenda are most likely to take longer to produce returns to the shareholders and hence patient investors are required. Investors with shorter horizons may not fit in well with SPM considerations.

Selection Criteria for Funding

All investors and lenders carry out due diligence exercises prior to investment decisions. The intensity varies on various factors such as size of the institution, existing investors and lenders and external rating information available. The due diligence is done in house. All the investors/lenders have in house capacity, which is augmented by external support in terms of credit rating/social rating reports. While the key parameters such as governance, management and finance remain common across the due diligence, relative importance of such parameters varies across funds and across potential partners. However, one common factor that is of highest importance is the trust and confidence that the promoter or promoter group enjoys among the stakeholders. The due diligence exercises do not adequately focus on SPM, and SPM practice is not a key investment decision criterion for most investors. Due diligence should cover both social and financial parameters. The capacity for assessing an MFI on its social orientation/performance is still under development as indicated in the MIV rating report. Incofin a Belgium based global fund working in 35 countries with 90 MFIs, has recognized that investing in microfinance is not sufficient proof of social motivation[13]. Hence David Dewez, the Investment Manager with the fund, developed a social score card[14] for its due diligence process. Incofin has fixed a minimum score of 50% for any MFI to qualify for investments. If social orientation is not assessed before the due diligence, the likelihood of implanting it later is remote[15].

Maanaveeya also uses the ESG scorecard for the due diligence of its investees. The comparison of social score cards used by Incofin and Maanaveeya in Annex 1 reveal that they broadly cover similar dimensions viz governance, outreach, and responsibility to clients, staff and the environment. However, they give different weightages to different aspects and the degree of detail varies in measurement of these dimensions. For e.g. Maanaveeya gives 5% weightage to environmental responsibility and Incofin 10%. Similarly, Incofin gives 25% weightage to client responsibility and Maanveeya 40%. The weightages may reflect focus of the funds. Low weightages could be on account of relative ease and reliability of collecting data around some indicators rather than others. Most of the respondents highlighted the difficultly of verifying and validating environmental exclusion lists and hence avoid too much weightage on this indicator.

Investment Covenants

All investors require a board seat in their investee partners. This helps them to take part in governance. This could change if their stake reduces significantly[16]. The other notable covenants are that the MFIs should go through a social assessment and report on select social indicators. The covenants reflect the investor's commitment to social returns. Some of the investors cite inability to choose an appropriate indicator as one of the issues in defining covenants and others cite inability to validate the covenants as one of the issues for not having stricter SPM related conditions. Some funds like Incofin and Aavishkar Goodwell have an exclusion list for lending purposes (based on their commitment to report on ESG reporting for MIV by CGAP since 2008). However, in practice these exclusion lists are difficult to validate and report on.

Social performance indicators are largely based on outreach and dropouts.

Lenders largely have financial covenants built in. Manveeya defines its social covenants clearly as assessment on ESG score card, rural focus and reporting on social indicators Notable among the financial covenants is Portfolio At

Risk (PAR) for both lenders and investors[17]. Thankfully none of the covenants define their PAR limits at zero percentage. PAR between 2-4% is largely accepted. A reasonable level of PAR provides MFIs space to deal patiently with defaults that are beyond the control of the customers and thus ensure that field practice is responsible.

Post Investment Involvement

Involvement of Investors: In the post-investment stage, investors have a greater involvement in terms of a board seat and access to regular monitoring reports compared to lenders. Most of the investors have a very high degree of engagement with their investees irrespective of the size of stakes. The investors are very active in boards and many of them are part of various committees such as audit.

Some MIVs actively mentored their investee with the help of their own teams and have also helped them raise funds. Two of the funds interviewed have very active involvement in identifying key people for their core operations. They also play a role in identifying independent directors for the company. DiaVikas provides technical assistance for improving efficiency and social performance. In addition it introduces different product and services ideas[18] through periodic meetings of its investee partners.

INVOLVEMENT OF LENDERS

Lenders have relatively short term, renewable-at-will association with MFIs. Except SIDBI the lenders do not have a board seat and hence do not have any formal role in governance. They exercise their influence through lending covenants and loan agreements. The lending covenants largely constitute of financial parameters of capital adequacy, debt servicing capacity, profitability and portfolio at risk. Ananya and SIDBI have additional covenants about outreach to women and underserved areas. Post Kolar crisisa need was felt to exercise more influence on MFIs.The lender's forum was convened by SIDBI to coordinate the lenders' policies towards MFIs. It is now working towards creating common lending covenants (Annex 1) which will signal the need for focus on client protection. However, they do provide substantial post funding support in terms of technical assistance and capacity building grants. Many banks such as Citi bank and Standard Chartered bank are involved in Meso level work to improve the social performance content of MFIs.

[Lenders] exercise their influence through lending covenants and loan agreements.

Successful interventions of investors and funders in SPM:

Box 1

Caspian's Promotion Model

Promotion Model: Caspian efforts in promoting social performance in MFI operations[19]

- Caspian investees have invested in the first microfinance credit bureau High Mark.
- Caspian investees have also taken lead in submitting the portfolio information to Highmark to deal with the problem of multiple lending and borrowing.
- Caspian encourages and facilitates the submission of MFI-level financial and social data to the Mix Market.
- Caspian has not only encouraged its investees to discuss and endorse the CPPs, but has also assisted them to implement the principles through workshops and training. As of the end of 2010, all MFI investees had endorsed the CPP.
- All MFI investees contributed data to MFTransparency's India study.
- Caspian also commissioned social assessments for some of its investee partners during 2009-10. The findings from the assessments have been discussed in the boards.

Box 2

DiaVikas SPM Implementation Programme

DiaVikas's SPM Implementation Programme[20]

DiaVikas, a social microfinance investor, is committed to measuring and reporting on the social impact of its microfinance investments, which is reflected in Dia's innovative Social Performance Management (SPM) program. DiaVikas works with 16 partners in 19 states in India.

DiaVikas' strategy for SPM is based on a) targeting of poor for client selection through the use of Progress out of Poverty Index (PPI), a poverty assessment tool and b) enshrining client protection principles in governance and management of investees. PPI along with additional indicators[21] suited to the local context is being used to assess outreach to the poor, and will be used to measure change in poverty status of clients over time. Implementation of this strategy is aimed at building capability within the MFI to measure and report on social performance.

DiaVikas' implementation partner EDA Rural System Private Limited provides technical support and training to each MFI partner during implementation, assessing client protection and recommending improvements, guiding the partners through an initial pilot of the Progress out of Poverty Index (PPI) Scorecard, assisting in reviewing results and planning future roll-out of SPM.

The DiaVikas SPM project is now in its third year and many valuable lessons have already been learned. Challenges are:

- building buy in with partners – this requires a tough stance on the social covenants.
- building sufficient capacity in the partner to enable them to continue SPM without external support.
- It is critical that there is a project lead (or SPM Champion) within the MFI who has sufficient influence at senior management level, and capacity to manage the project.
- A stable Management Information System (MIS) with the capability to record, and provide reports on, social data is essential, but this has proven to be a significant challenge for many partners.

The PPI Scorecard has been successfully piloted and shown to be an effective tool for monitoring and reporting on client profile. In 2011, 10 of DiaVikas' partners participated in the SPM program in some form, whether ensuring strong implementation of client protection principles, piloting PPI surveys, or rolling out PPI across branches. Further, two partners have developed SPM systems[22]. DiaVikas will continue to develop this strategy, encourage adoption of SPM and share lessons learned from this program with other MFIs and social investors both in India and beyond.

CODE OF CONDUCT ASSESSMENT

Investors and funders have in the recent past been interested in ensuring the field practices of MFIs are fair and responsible. While most MFIs have adopted a code of conduct, the compliance with the code has not been assessed. For appropriate delivery of microfinance services to the low-income clients, fair practice codes and principles are prescribed by different agencies. Some important norms include, Fair Practice Codes for NBFC by Reserve Banks of India, Client Protection Principles (Smart Campaign), Sa-dhan's Code of Conduct and MFIN's code of conduct. Since the compliance to code of conduct principles is largely voluntary, need for external assessment was expressed during a stakeholder meeting called by SIDBI in December-2009. Since then SIDBI is actively involved in the development of a Code of Conduct Assessment Tool. The first tool was designed and piloted with 8 MFIs by M2i Consulting Pvt. Ltd. This framework includes assessing the key issues at the governance and management level as well as the client level using client feedback and observance of field practices. Out of these eight MFIs, five (BFSPL, EMIPL, BSFL, AIIMPL and UFSPL) received "very high level of adherence", two MFIs (CMC and AFSL) received "Reasonably high level of adherence" and one MFI received "reasonable level of adherence" rating.

Box 3

Aspects Examined in the Code of Conduct Compliance Assessment Tool by M2i

Six dimensions of the Code of Conduct

1. Client origination and targeting
2. Loan pricing
3. Loan appraisal

4. Client data security
5. Staff conduct
6. Relationship management and feedback mechanism

ADDO Assessment Framework:

A: Approval at the policy level from the board

D: Documentation of the guidelines and procedures that emerge from the policy

D: Dissemination of the guidelines and procedures across the organization

O: Observance in practice of these guidelines and procedures

Microfinance Investment Vehicles Ratings[23]

CGAP since 2006 has worked on developing MIV disclosure guidelines on both financial and outreach parameters. Swiss Agency for Development and Co-operation (SDC) recently piloted financial and social ratings for MIVs, conducted by M-CRIL. The rating was piloted with 3 holding companies viz Blue Orchard, Incofin and Oikocredit. The key findings are as under:

- Commitment to mission and values –not yet defined or demonstrated. Varying degree of engagement with global efforts on responsible finance.
- Staff capacity and orientation geared towards financial analysis, capacity for social performance is beginning to grow with specified responsibilities for SP within the investment teams.
- MIVs moving towards integrating social score card in their due diligence.
- Investments in tier 2 and 3 MFIs are suggestive of socially oriented approach in terms of supporting smaller institutions to grow and develop their potential.
- Outreach to the countries with low score on human development index are considered to be more socially oriented.
- Responsible investment in terms of aiming for reasonable growth rates is now being reflected in due diligence process.
- Client Protection Principles (CPP) are a global focus and the rating scores each fund on their engagement, capacity and monitoring. This is a work in progress for MIVs and too early to come out with conclusive findings.
- Reporting social returns – outreach to women and rural areas reflects significant efforts towards financial inclusion; however, data on poverty outreach and effectiveness of services to the clients is not available and not monitored.

The study identified three key challenges to MIVs:

- Absence of information on SP systems and end clients at the investee levels
- Consolidating and tracking investee information at MIV level
- Adjusting indicators according to "peer groups" of MIV categories.

The findings and challenges from MIV ratings are quite similar to those found at the investee level. The key weaknesses which emerged in the 5 Social assessments undertaken by Caspian of its investees reveal :

- Social goals and key terms from mission statement are not defined in measurable terms
- There is absence of recording, reporting and analysing information on social performance indicators
- Other systems such as human resources and internal audit not aligned with social performance goals.

Hence the challenges need to be addressed at the MIV level for clarity to emerge at the investee level.

CRISIS AND BEYOND

A detailed discussion with all funding stake holders around the on-going crisis fuelled by the AP Ordinance was held since the ordinance and lack of liquidity in the sector has led to shrinking portfolios[24], stunted growth[25] and deteriorating portfolio quality.

The discussions with all investors and lenders sought to explore the reasons for the crisis and the SPM aspects related to the same.

Unbridled Growth

Unbridled growth was the first response of most of the stakeholders regarding the reasons for the current crisis. Most investors claim to have been uncomfortable with overly optimistic growth projection and the claim that the board never put any pressure on the investees to grow faster than they could manage. The promoters and senior management genuinely felt that they could grow at that pace though they did not have the capacity. Most of the MFIs were expanding due to readily available liquidity, which is good as it avoids portfolio concentration risk. However, the problem was that they were all expanding in the same areas – in effect, a concentrated expansion.

The growth was too fast and institutions were not ready to absorb this growth. In the quest to grow it was forgotten that it was a credit business. The institutions did not have any conditions in place to reject a loan application which is fundamental to any financial services business. The unrealistic targets and aligned incentives promoted unhealthy practices of assigning agents, poaching clients and staff and reckless lending. In the context of absence of supply constraints and a push for growth, the fundamental weakness in appraisal was magnified. Competition for the same client by different MFIs led to over-indebtedness at the client level.

The key question which arises is the role of governance in decisions about rate of growth and where to grow. The pursuit of unsustainably aggressive growth, the shift away from responsible finance practice and unhealthy competition that eroded customer protection levels are issues that should have been dealt with at the board, investor and funder levels.

Promoter's Aspirations

SKS definitely led the way by setting benchmarks for growth, investments and IPO. Most of the MFI promoters aspired for similar success stories and growth became the means to that end. The funding decisions of the stakeholders rely strongly on their comfort with promoters and trust in their abilities. The promoters were confident and investors seemed to have accepted their word without demur. However, it is important to explore the role of governance in providing strategic inputs to promoters and senior management. The investors were very engaged with their investees providing them key inputs in fund raising and mentoring for operations. The key role of investors in restraining the unrealistic aspirations of the promoters should be emphasised for the future.

Valuations

As per Global Microfinance Survey conducted in 2009-10 by J.P. Morgan[26], Indian equity deals had a median price to book value multiple of 6 that was 3 times the global median of 2.1. The report also expressed concern on the Indian microfinance being over valued in the light of risky expansion and deteriorating portfolio quality. However, the MFIs in India sought higher valuations with delusions of institutional grandeur overshadowing concern for the customers who would have to pay a price to protect the revenues of overvalued MFIs.

Wrong Positioning

It also seems that MFIs through their external communications projected themselves as good Samaritans working towards the cause of poverty eradication, whereas they were merely in the business of providing financial services (largely credit) to the low income segment. This is not to argue that being pro poor means to make losses or charge subsidized rates of interest. However, it is about "truth in advertising". If the systems are not in place to measure and report on the claims of mission statement, then it is time to relook at the mission statement.

The public debate on CEO compensations[27] also added to the negative image of the sector. Some of the CEO's were drawing higher salaries than mainstream private sector banks in India. Managing percpetions and a positive image is a key aspect of SPM. The ability to make a credible promise and deliver on the same is an essential part of SPM practice.

EMERGING ISSUES FOR INVESTORS AND LENDERS

The key issues which the sector needs to grapple with are:

- **Reasonable growth:** The levels of growth which the sector has attained in the past have not proven to be sustainable. Fast paced growth in competitive markets do not serve the interests of vulnerable customers.
- **Reasonable valuation:** Enterprise valuations should be moderate and should not seek high premiums that are dificult to service. A voluntary limit on returns will impose effective safeguards against high equity prices and thereby avoid the undesirable investors that seek make a quick profit at the cost of poor customers.
- **Image of MFIs:** Some of the negative publicity for the sector has also been around high levels of compensation drawn by promoters and senior management. High interest rates and bundling of products have also tarnished the image of MFIs. Investors should focus on image management through appropriate policies that have high visibility in the public domain.
- **Positioning of funds:** The MIVs also need to clarify their position vis-a–vis other investors. What characteristics define a social investor? Is it social intention or just financing microfinance or expecting lower returns than market or providing incentives to reach out to more difficult areas or more poorer sections? It may be some or all of these characteristics but it is important to understand the perils of wrong positioning for investors and investees both.
- **Priority sector and beyond:** It is important for lenders to clarify their stake in microfinance in terms of: is it only about priority sector lending? is it about corporate social responsibility or pure lending to MFIs? If they are committed to the cause of financial inclusion, it is important for them to see MFIs as partners. As one of the bank representative articulated - "banks have failed in reaching the poor" and work towards strengthening the sector. Banks today have proved to be fair weather friends of the sector; they need to develop a vision, invest in due diligence and have a long-term strategy[28].

In conclusion, the role of investors and funders in microfinance seems to have been largely in providing equity and liquidity. While some investors have social performance considerations and have sought to drive the SPM agenda, most have not really prioritised the social relevance of MFIs' business. The mission of the MFIs was assumed to be a proxy for delivery of SPM and the MFIs were left unquestioned. On the funders side, with some notable exceptions such as SIDBI and FWWB, the role was more of lending money to a profitable low-risk sector. Social considerations were very weak and the engagement with the borrowing MFIs was too short for significant influence over social agenda. While the investors and lenders enabled fast paced expansion, they have not helped the orderly development of the sector as a socially responsible one. In the recent past the investors and funders seem to have learned the lessons from a painful AP crisis and are seeking to put in place, safeguards that would protect the customers, focus business on social aspects and ensure that lending practices are responsible and sensitive. No doubt some of these initiatives had commenced well before the AP crisis, but the vigour behind such initiatives was weak and did not bring the social agenda to the centre. The future of funding for MFIs does not look too positive. But whatever funding that flows in either as equity or loans will come with a social agenda and ask the relevant questions of promoters, boards and staff. This is what will define the future direction of growth of microfinance in India; a balanced outlook towards financial and social sustainability.

Annex 1
List of Covenants Agreed Upon by the Lenders' Forum

The borrower shall agree:

1. To furnish financial and operational data in the specified format to IMFP within reasonable timelines and with accuracy.
2. To undergo a third party COCA with a view to assessing the degree of adherence to the voluntary microfinance Code of Conduct through accredited agencies for the purpose.
3. To undergo a Systems and Portfolio Audit involving detailed examination of operational systems and procedures, funds utilization, assessment of loan portfolio in respect of the risk parameters, finance as well as planning and control etc. by an external agency.
4. To ensure transparency and uniformity in calculating and reporting to clients and in the public domain the effective cost on reducing balance basis being charged to the ultimate beneficiaries.
5. To prepare a board approved note on recovery practices that would be displayed in local language at each branch and to give an undertaking to take steps to ensure responsible and non-coercive loan recovery practices at the field level.
6. To develop a board approved strategy to check multiple-lending and over-indebtedness amongst clients and implement it thereafter and also obtain annual affirmation of the strategy by its board.
7. To put in place an effective grievance redressal mechanism on the MFI's website and displayed in the branch offices.
8. To take steps to ensure that some acceptable form of electronic, written or printed acknowledgement of financial transactions is left with the individual borrower or group represented.
9. To furnish regularly, accurate and comprehensive data on beneficiaries to the Credit Bureaus.

NOTES:

1. The triple bottom line is used as well by investors and lenders, which encompasses financial performance, social relevance and environmental sensitivity
2. See table 1 for the list of investors who participated in the survey
3. Views expressed by Ms. Deborah Drake, Representative Council for Microfinance Equity Funds
4. Key current concerns addressed by different funding stakeholders are listed not all
5. Maanveeya is the Indian arm of global MIV Oikocredit
6. Inverting the Pyramid edition 3 by Intellicap
7. This does not include upfront processing fees charged by some banks.
8. M-Cril Review 2010
9. ESG indicators include Environment – exclusion list for lending purposes, Social – outreach, women, rural, average loan size, product range, client protection , ,Governance- reporting to funders, staff training, board representation and anti-corruption policies
10. CGAP is the global platform dedicated to "advancing financial access for the world's poor". http://www.cgap.org
11. Definition adapted from Campion, A. and Linder, C., with K. Knotts (2008) Putting the 'Social' into Performance Management: A Practice-Based Guide for Microfinance, Brighton: Imp-Act Consortium, Institute of Development Studies
12. Drawn from Integrating social performance management (SPM) into microfinance capacity building: governance- Frances Sinha and Ragini Bajaj Chaudhary EDA Rural Systems; Chris Linder and Matt Leonard, MicroSave; RashmiEkka,,Anita Campion from AZMJ; Cécile Lapenu from CERISE; contributions from Anton Simanowitz (Imp-Act/IDS), and VeronikaThiel
13. http://www.microfinanceforum.org/cm_data/David_Dewez.pdf
14. The scorecard includes most of the SP dimensions viz mission, customer service and responsible finance, outreach and scale, human resources , environmental risks and support to community. This score card was drawn from CERISE tool and Accion Social

15. With inputs from Deborah Drake, CMEF Representative
16. As per company law shareholders with less than 10% stake may not get a board seat, however this depends on the inter se arrangements among shareholders.
17. Some investors do not have financial covenants built into equity agreement.
18. DiaVikas has introduced its partners to Pension scheme of PFRDA, health mutuals, community health leader's programme in the last two partner's meet.
19. With inputs from Caspian team
20. With inputs from Calum Scot, Social Impact Director, Opportunity International
21. PPI has 10 indicators that assign poverty likelihoods, certain additional indicators are suggested and to measure, progress towards social goals of institutions which are optional for different MFIs. The additional indicators include school enrollment of client's children, availability of water and sanitation facilities, engagement of clients in financed enterprises, employment generated by financed enterprise etc.
22. ESAF/EMFIL discussed in MiX chapter and Shikhar discussed in Client Protection and MIS chapter are DiaVikas Partners
23. Adapted from p romoting accountability and transparency on social performance of microfinance investment vehicles – France Sinha, M-cril India 2010
24. 16 DiaVikas partners reported a reduction in number of clients by 1.25 lakhs in July 2011 compared to September 2010, portfolio shrunk by 16 crores during the same time
25. M-CRIL 2011 indices reports that growth in 2010-11 was just 7.5% in terms of borrowers reduced greatly from 43% last year.
26. CGAP, JP Morgan, Occasional paper: Microfinance Global Valuation Survey 2010
27. http://articles.economictimes.indiatimes.com/2011-02-01
28. Adapted from Give a new deal to microfinance -Economic Times Article by K.C. Ranjani , MD DiaVikas Capital

Targeting and Monitoring Social Performance

4

Chapter

Social performance management has often been considered synonymous with targeting of clients. This is understandable since the social performance framework enables MFIs to be strongly client focused in defining its mission and social objectives and aligning the internal systems to achieve these objectives. At the output level, the MFI has to know the poverty level of their clients. Does the institution serve poor and very poor people? Furthermore, do MFIs need to measure the outcomes i.e. social and economic improvements in their clients due to institutional activities?

MFIs need to clarify three key questions at the outset of SPM: Who are your target clients? How will you ensure that you meet your clients' needs? What changes and impact are your services designed to reach?[1] Thus social performance management largely focuses on clients.

MISSION OF MFIS AND TARGET GROUP

Social goals can be derived from the mission of the MFI to define its strategic direction: where (target areas/sectors) and who (target markets) it aims to serve, and how (with what services). The mission may also define the intended outcomes that the MFI aims to achieve for its clients. However, in practice mission statements vary in content, clarity and follow-up commitment. Often as MFIs gain experience they revisit their mission and reset their focus and development objectives.

Target clientele of MFIs are largely determined by whom the institutions are expected to serve as expressed in their mission. While some MFIs explicitly set their mission to serve specific target clientele (excluded, very poor, poor women, etc.), others focus on specific development objectives such as reduction of poverty, empowerment of women and provision of holistic services that reduce vulnerability in the clientele served.

Indian MFIs define their client base not only on the basis of poverty levels but also on the basis of gender, marginalised, minorities, exclusion from financial services, type of enterprise owners (farmers, fishers, micro enterprises) etc., Most MFIs do not target the poor exclusively, but endeavor to include a mix of non-poor and poor in their provision of appropriate financial services. Differences in poverty targeting strategies appear to depend on how much pressure there is on the MFI to be financially self-sufficient. Very few MFIs exclusively target the poor and very poor because this requires substantial time and resources for reaching financial self-sufficiency and these institutions are also conscious of the pricing of their services.

Most MFIs do not target the poor exclusively, but endeavor to include a mix of non poor and poor in their provision of appropriate financial services.

MFIs use a variety of strategies and techniques to target clients. Non measurement techniques include (1) use of selection criteria such as geographic area, gender, or participation in other programs (with competition being an issue faced by MFIs and in order to prevent over indebtedness of clients some of the MFIs do not open branches where three other MFIs are already operational); (2) use of loan size as a targeting tool; and (3) peer group self-selection is common in MFIs using self-help group methodology. The first two are based on MFI procedures, while the third incorporates actual clients' decisions in the new client selection process. These methods are extremely low cost and are implemented as part of the MFI's regular operational tasks. Unfortunately, these methods do not provide information about the poverty level of those who actually enter the program or those who choose not to participate, nor do they provide information for fitting financial services or for subsequent client monitoring.

Rapid assessment methods include visual indicators of poverty, such as housing quality or a means test to provide low-cost and relatively effective method of targeting households by poverty level. Such methods assess the relative poverty of the households. Cashpor working in the states of Bihar and Uttar Pradesh with high incidence of poverty has been a pioneer in developing the Cashpor housing index, which has been a very effective tool for targeting.

Many of the Grameen replicators in their initial years were stringent on poverty targeting and adopted tools such as the housing index and means test to target poor and exclude non poor. Similarly other NGO-MFIs adopted participatory wealth ranking to select poorer households to join SHGs. However, with goals set for rapid scaling-up and focus on financial numbers and efforts needed in adapting tools for different geographical regions, training staff etc., they now adopt More non measurement techniques for targeting. Several MFIs continue to collect demographic and socio-economic data on clients but not specifically for targeting purposes. Very often MFIs collect such information to know the characteristics of their clients for designing appropriate services rather than for purposive inclusion of poor. The data is not often converted to useful information for tracking the clients' progress.

One of the challenges that has been faced by the poverty focused MFIs who had been using poverty targeting tools has been to relate and authenticate the poverty level of clients to the well accepted national and international poverty lines. MFIs also need reliable tools to track the progress of their clients. With the initiative of the Grameen Foundation in India, the Progress out of Poverty Index (PPI) has been implemented by 12 MFIs who are in different stages of adopting this tool. PPI can be used for targeting, internal learning and external reporting. PPI holds promise since it provides a reliable measure on the poverty outreach of the MFI as per the chosen poverty line but it can also measure the changes in the poverty status of clients provided it is applied on the same set of clients over a period of time.

Box 1

PAT and PPI

The Poverty Assessment Tool (PAT)[2] and Progress out of Poverty Index (PPI)[3] hold promise of being cost-effective ways to track outreach of MFIs[4]. The primary objective of both PPI and PAT is to measure the poverty rates of a clearly defined subset (or the entire population) of MFI clients at a given point in time. PPI developers have identified targeting as an additional potential use by MFIs. PAT developers, in contrast, do not view their tool as an instrument for targeting, because targeting accuracy tends to be significantly lower than accuracy of poverty incidence of a group of MFI clients. The PPI scorecard contains ten observable, non-financial indicators that are weighted and scored on a 0-100 point scale. The number on the scorecard represents the likelihood of the household's poverty level along standard poverty lines. The household scores are aggregated to determine the probability of poverty outreach for the MFI. While absolute poverty measurements allow more accurate aggregated analysis, the indicators may not always properly reflect the poverty level of the household due to government handouts and subsidies. Additionally, issues of staff interpretation, governance buy-in and incorporation of data collection into operational practices raise challenges to implementation and accuracy of PPI[5].

SOCIAL PERFORMANCE ASSESSMENT AND RATINGS

Comprehensive Social performance ratings (9), assessments(1), audit (1) of 11 MFIs have been carried out by M-CRIL, MicroSave and EDA Rural Systems respectively in 2010 and 2011, but predominantly in 2010. The MFIs include Arohan, Ashirwad, Bandhan, Cashpor, Sahayata, Sonata, Shikar, Satin, Ujjivan, Mimo and Trident. The sample consists of MFIs operating exclusively in urban areas or in rural as well as urban areas. Some of them like Bandhan have achieved considerable outreach of more than 2 million where others like Shikar have about 12000 active clients. The findings of these assessments have been analysed for three aspects – (i) mission and clarity in client definition; (ii) poverty outreach; and (iii) internal systems to report on key social performance indicators especially client retention, client oriented products and client improvement.

Mission clarity in social goals and client definition

The assessments found that 7 of the MFIs had very clear mission and social goals; however, only three MFIs have well defined, measurable social goals. Reaching poor clients and reaching socially excluded or disadvantaged communities are two important social targets expressed in their mission. Therefore, to be aligned with the social mission, they have to reach poor and low-income households i.e. the clients their mission states they intend to serve.

Client definition and targeting

Each of the MFIs set target clients and targeting methods, which is summarized in the table below:

Table 1: Non Measurable and Measurable Parameters in Social Performance

Name of MFI	Target group	Non measurable parameters	Measurable client level targeting parameters
Asirwad	Not very clearly defined and targeted though mission talks of poor women; Excluded are covered		
Bandhan	Poor asset-less women who have an income generating activity		Asset-less, landless client with income level between Rs.2,500-3,500 mentioned in the operations manual but not strictly followed
Cashpor	Poor and very poor women from marginalised community	Outreach to poorest states- poorest districts; selection of SC/ST hamlets	Housing index and exclusion list based on certain asset ownership
Arohan	Socioeconomic backward women	Urban slums	6 conditions to become group member and 6 set of indicators regarding housing, assets, income, occupation, education, banking services
Sahayata	Women		Income Rs.2,000 to Rs.7,000 per month but not strictly followed
Sonata	Economically active poor women from marginalised communities	Areas with concentration of poor especially SC/ST	Housing index

The assessment found that 7 of the MFIs have very clear mission and social goals; however, only three MFIs have well defined, measurable social goals.

Name of MFI	Target group	Non measurable parameters	Measurable client level targeting parameters
Ujjivan	Economically active poor		Per capita income falls between Rs.1,000 to Rs.1,500 per month. Not strictly followed.
MIMO	Women; not enough clarity on the target clients in terms of their poverty status.		Monthly household income falls between Rs.3,000 to Rs.8,000 per month. Actual is between
Shikar	Women in the age group of 18-55 years, who have been living in the area for more than 2 years	Area based targeting in slums	
Satin	Low income households earning less than Rs.50000 (USD 1.25 poverty line) not clearly defined and followed	Self selection of clients and centre leaders;	
Trident	Financially Excluded		

Table 2: Arohan's Client Profile for its Saral product

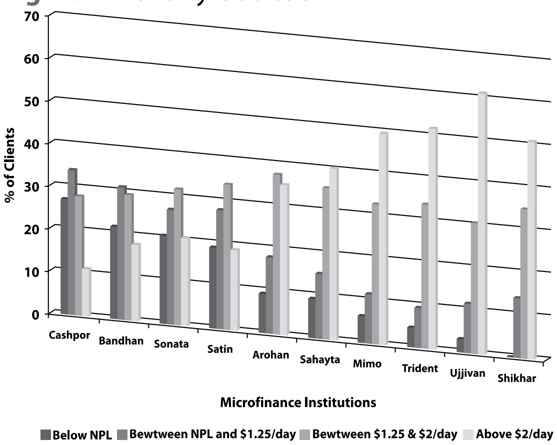
Housing	Typically the customer would reside in a slum, with a 1-2 room dwelling, of less than 200 sq. ft., with non concrete roof, no tap water, no self-owned sanitary toilet and no separate cooking space.
Occupation	Involved in small trading and micro enterprises, with daily or weekly cash flows.
Income	Rs. 2,000-5,000 per month
Lifestyle Attributes	Asset holding would be very limited (no landline phone, two/four wheeler, dining table and medium of cooking kerosene of coal/firewood).
Education	An average Arohan customer would not have studied beyond Class 8 and would not be fluent in English
Banking services	Neither she nor any family member would have received a bank loan.

Cashpor, Sonata and Arohan have developed methods and tools to monitor the type of clients entering their programmes. Both Cashpor and Sonata are strictly poverty focused; selection of area, target groups and selection of poor clients through tools indicate their intent. Some of the MFIs who have a mission of reaching the poor have not followed it up through defining target groups and ways of including them.

Poverty outreach through PPI

As part of the social performance ratings and audit of the 10 MFIs, a survey of the poverty level of entry and existing clients using PPI was carried out. Though the sample size is small for 9 MFIs (varying between 103 to 150 clients), it gives an indication of the poverty outreach. Cashpor has been using PPI and hence the sample size is higher at 37,000. For Asirwad no such data is available. The figure below gives a graphical representation of PPI scores[6] for a sample of the 10MFIs:

Figure 1: Poverty Outreach



The PPI data clearly shows that for most of the MFIs, outreach to those below National Poverty Line is not significant[7]. Cashpor has the maximum outreach to those under NPL, 27%, and Ujjivan has the least, 3.1%. Only three MFIs-Cashpor, Bandhan and Sonata have an outreach below NPL that is greater than the proportion of the population. 31.47% of the Cashpor clients and 20.6% of Sonata's clients live below the poverty line. Only 20.4% of the population of UP where both the MFIs are working is under the poverty line. Out of the total number of clients served, 21.6% of Bandhan clients live below the poverty line, which is higher than the benchmark of 18.9% for rural West Bengal. Thus, Cashpor, Sonata and Bandhan are reaching substantial number of households below the poverty line.

Six MFIs out of the eleven have outreach to the segment below $1.25/day/PPP greater than the proportion of the population under poverty. Of these, two are rural -Cashpor and Sonata. Of the Cashpor clients served, 61% live on an average income of less than $1.25/day; in comparison only 44.9% of the UP population lives below the income of $1.25/day. Sonata with an outreach of 47.6% of persons below the $1.25/day has a greater outreach to this segment compared to the proportion in UP state. Arohan and Shikhar, two urban MFIs, have a good outreach to the poor who live on incomes below $1.25/day. Arohan has an outreach of 27.2% below the $1.25/day poverty line (compared to the benchmark of 19.2% for urban West Bengal); Shikhar has an outreach of 14% (compared to the NCR average of 5.8%). Clearly in this sample outreach to poorer segments below $1.25/day/PPP is significantly better for MFIs that operate in the urban areas than those that operate in the rural areas.

Five MFIs out of the ten have outreach to the segment below $1.25/day/PPP greater than the proportion of population under poverty. Of these, two are rural, Cashpor and Sonata. Of the Cashpor clients served, 61% live on an average income of less than $1.25/day; in comparison only 44.9% of the UP population lives below the income of $1.25/day. Sonata too, with an outreach of 47.6% to persons below the $1.25/day has greater outreach to this segment compared to the proportion in UP state. Arohan, Shikhar, and Mimo are the three urban MFIs who have a good outreach to the poor who live on incomes below $1.25/day. Arohan has an outreach of 27.2% (compared to the benchmark of 19.2% for urban West Bengal); Shikharhas an outreach of 14% (compared to the NCR average of 5.8%) and Mimo has an outreach of 17.8 %(compared to the Uttarakhandbenchmark of 13.4%).

Thus poverty outreach of some of MFIs are very high where as others are covering more of near poor and not so poor as well. These performances have to be compared against how other Indian MFIs fare.

The MIX data[8] for 54 Indian MFIs that report on the social performance management shows that 70% of the MFIs have an explicit goal of poverty reduction; however, only half of them actually track their poverty outreach. Of these MFIs, eleven[9] reported data using the PPI for both entering and current clients[10]. Data from the PPI estimates a median of 13% of these MFIs' clients to be below the Indian national poverty line[11], whereas 17% of Indian households in general are estimated to be below this line. If the US $2 a day poverty line is considered, PPI estimates give 70% as the median number of

MFIs' clients below this line[12]. Meanwhile, 80% of the general Indian population is estimated to be below this line[13].

Poverty targeting - Cashpor Micro Credit case study

Established in 1997, Cashpor Micro Credit's mission is to identify and motivate below poverty line (BPL) women in rural India and to deliver financial and other vital credit plus services to them in an honest, timely and efficient manner. Their methodology to reach their target clients consists of three steps: first, to identify geographical areas with high poverty density; second, to use housing conditions, such as the quality of walls or roof, as an indicator to eliminate the non-poor; and third, to conduct a detailed household interview or net-worth test to further determine the eligibility of a client. The PPI has been added to this assessment to identify the likelihood of clients below the national poverty line.

Cashpor has chosen to work in one of the most poverty-stricken regions of India - Eastern Uttar Pradesh and Bihar. In the Human Development Index in 2006, eastern Uttar Pradesh and Bihar ranked 34 and 35 respectively out of the 35 states and union territories in India as the least developed and had 31% and 42% respectively of their population living below the national poverty line[1]. All the districts where Cashpor works have a lesser banking network compared to all India position. Likewise penetration of MFIs and SHGs is also very low. Cashpor has 71% of the branches in rural areas and 83% are rural clients.

To ensure effective targeting Cashpor uses the Cashpor Housing Index[1] and the Progress out of Poverty (PPI) tools during its client acquisition process.Cashpor has created the Casphor Housing Index (CHI), a poverty-targeting tool, based on one parameter – the external condition of a dwelling unit, which is used as a proxy for the poverty level of a household. The index is based on a point system - a score of 2 or less is very poor, three moderately poor and 4 and above non-poor.

In addition, the net-worth assessment of client is also done along with administering CHI to validate the score. A short interview of applicant that focuses on the value of their key assets is also undertaken; this includes agricultural land owned and/ or leased, farm equipments and machinery, livestock, transport vehicles, etc. Households owning a motor vehicle, like car, jeep, van, tractor, hand tractor, motorbike, etc. are also excluded from being a client of Cashpor. Eligible clients must meet the following criteria: Score < 4 on the Cashpor Housing Index, own $\leq$ 1 hectare of irrigated land or $\leq$ 2 hectares of non-irrigated land, own livestock worth < 8000/- INR and not possess a colour television, motorcycle, water pump or auto-rickshaw[1].

Cashpor can make a provision of appeal for an applicant if she claims to be poor despite a CHI score of four or more. The branch managers are given the discretion of overriding CHI score (>3) in appeal cases, when they feel that other economic parameters (household income and assets) of appellants do not match with the CHI score.Though Cashpor does not keep track of appeal cases in its MIS, but its own estimate is about 5%. The number of appeal cases is greater, especially in urban or semi-urban areas where the housing index does not accurately portray the the client due to the type of housing material used.Neither the CHI tool nor its cut-off marks have been revised since its introduction.

Some MFIs indicate that PPI is a tool in progress[14] and since the conditions differ from state to state or region to region, it is imperative that the tool is dovetailed to local conditions. For example, in the state of Tamil Nadu successive state Governments have distributed household assets such as consumer goods, housing, livestock etc., free of cost to poor households. Out of the ten indicators of PPI as many as 6 indicators can be distorted since a poor household may "own" these assets and hence may be considered as non poor. Thus it is necessary to adapt the tool state wise, considering state policies and practices. Keeping PPI indicators up to date presents a real challenge for tool developers. Some indicators can quickly become inappropriate, particularly those based on ownership of an asset.

However, the overall mismatch between the mission intension and actual performance as shown by the Social Performance Assessments and ratings as well as PPI scores has to be taken into account by the MFIs who want to be poverty focused. Sa-Dhan's report on code of conduct and social performance management of Indian MFIs throws light on the gap that exists in the industry in poverty targeting and reporting.

Sa-Dhan on the basis of analysis of data of 63 MFIs on Social Performance Management observes that 67% of them have poverty outreach and 50% have poverty reduction as their mission and 20% intend to reach poor and very poor clients. The majority of MFIs report that they are measuring information related to poverty status of clients at entry. However, MFIs do not usually collate, or report it nor do they benchmark it to a poverty line. Without systematic monitoring of poverty related data, under half of MFIs are able to provide only a rough estimate of the poverty profile of their clients.MFIs do not have systems in place to assess whether they have indeed reached the target clients[15].

Information systemfor social performance

Three MFIs (Arohan, Sahayata and Ujjivan) have centralised data management systems. The greater monitoring in data entry and specialised HR expertise in managing the data greatly improves the quality of data. This in turn makes further analysis of the data more reliable and useful for decision-making.

Client retention and drop out rates

Client dropout rates indicate possible client dissatisfaction with MFI's products or services and will have a negative impact on the organisation's financial bottom line. "Client vote with their feet" when they dropout-is a common utterance in SPM. Dropouts are a cost to an MFI as replacing old clients with new is more expensive. At the client level, dropouts lead to a loss of access to valued credit and other services. Clients that dropout are less likely to experience a long-term positive impact on their lives. Dropout analysis serves as a warning to the MFI of potential client dissatisfaction and lead to corrective action. Segmentation of dropouts will further reveal patterns of correlation if any between different groups of clients and high dropout rates.

Eight MFIs in the sample reported capturing data on dropouts. The major reason for the inability of others is the software constraints and lack of unique ID for a client, which enables sound tracking. While some of the MFIs treat the clients without a loan as a dropout, others have a waiting period between loans before client is considered as a dropout where as a few treat clients as dropouts only when the clients resign their membership. The different definitions make the data on client dropout not a comparable one. Most of the MFIs do not collect information on reasons for dropout. Two MFIs collect data on a sporadic basis but systematic analysis on drop out is not made. Ujjivan conducts exit interviews and analyses the reasons for corrective action.

Box 2

Tracking Client Dropout

Aarohan maintains dropout data for different brackets of dropout clients (60days, 90days, 180 days and so on) to track resting time of its clients.

Ujjivan has appointed Customer Care Representatives in select branches. They conduct exit interviews of the dropout clients and send the information to the head office for further analysis. In addition, the CCR address any issues the existing clients may have with the customer service at the branch and tries his/her utmost to retain credit-worthy clients.

Client feedback mechanisms

Many MFIs have not as yet instituted an organisational process of client feedback mechanisms on the products and processes to ensure that the institution's services meet the client needs. However,there are cases of good practices:

- Arohan carries out a yearly client satisfaction survey and the results are used for product and process improvements.
- The product development process in Bandhan is customer driven; new products are introduced as per the demands of the clients.
- Ujjivan uses client feedback mechanisms to explore opportunities for new product development and to check for the receptivity of clients to changes in the products and services that the management thinks may be the way forward. For example, Ujjivan's study of distressed clients in higher loan cycles revealed that group liability creates problems within the group and sometimes causes defaulting members to drop out or even take drastic measures such as suicides. Based on this feedback from this segment of clients, Ujjivan is piloting the new loan product, Mera Loans, which includes only limited groups liability, in 12 branches around the country. The customer response has been very positive and Ujjivan plans to roll out this product on a larger scale in the near future.

Tracking client progress

All the MFIs captured client information but the parameters varied. Demographic features, occupation, household assets, income etc., Only very few collected information on level of indebtedness. In the case of four MFIs the data are not inputted into the MIS and collated.

Use of the data for tracking client progress has been limited. Most of the MFIs collected data at the time of joining thus creating a baseline data and some of them continued to collect the details in each loan cycle. Systematic verification and validation of data processes is a critical gap that inhibits establishing of a sound baseline. Only three MFIs have a centralised data management system with due verification processes.

Systematic verification and validation of data processes is a critical gap that inhibits establishing of a sound base line.

Designing and customizing the MIS and software is very critical in getting useful information. In two MFIs, the present software does not support detailed analysis of client information. Lack of unique identity for a client is another major impediment in tracking clients over loan cycles and monitoring the changes. Five MFIs face this issue. Aarohan and Bandhan have plans to migrate to new a technology and software platform that would allow the tracking of individual clients over time and reporting on social performance. In three MFIs the client data gets over written in each loan cycle thus making comparison over different periods impossible. Thus the majority of the MFIs have difficulty in tracking client progress.

However, Indian MFIs are not faring badly as compared to global trends. While Social Performance Management is on the rise globally, reporting on tangible results related to an MFI's mission is more challenging and very few MFIs can actually state whether their goals are being met. An emblematic example is that of poverty reduction. This was defined as a goal by 84 percent of MFIs but, when it came to reporting client progress out of poverty, only 10 percent of MFIs could provide this information[16].

Impact Assessments

MFIs have carried out Impact Assessment studies to measure the changes in the status of the clients. BFSPL has a six member research team that works exclusively on customer satisfaction studies and other Impact Assessment studies. A large sample Impact Assessment study was carried out in 2007. Sahayata carries out Impact Assessment study on mature clients through external experts. Since 2004, Cashpor actively measures, on a periodic basis, poverty status of clients and impact on poverty in terms of the progress out of poverty by mature clients, through external studies. Ujjivan conducted an Impact Assessment study through Delphi Market Research in 2009. Ujjivan has started collection of PPI data for 3000 first cycle clients across the four regions. It plans to measure the PPI of the same clients after a period of three years to assess improvement in client lives. Sonata conducted an Impact Assessment and client satisfaction study in association with Microfinance Connect in 2009.

The above analysis shows that most MFIs do not have several features and data in their MIS that would enable the organization to assess their social performance. For some the limiting condition is the technology and the software. A few among these have plans to upgrade their technology in order to be better able to cope with the requirements of a MIS for Social Performance Management. Others with technological capacity to track social performance seem not to have yet given it sufficient thought or are yet to take action. A lot needs to be done ahead in this critical domain of operation systems of MIS.

Monitoring Social Performance

Seven of the 11 MFIs do not track their social performance in their MIS. While a few like Bandhan face issues with their software, most have not decided on the social indicators and are yet to decide on how to convert the data that they collect to useful information. Two MFIs, Trident and Ujjivan, conducted analysis of its social parameters on an "as required" basis. Ujjivan does such analysis as part of the market research process for product development, for external reporting and in response to the queries from the Board. Ujjivan reports to their board on limited aspects of social performance. Arohan has a low reporting capacity on social parameters in its current MIS software but plans to improve reporting on social performance after it updates its software.

Alignment of the information system to track expected outcomes in order to track achievement of the mission is largely a work in progress for most of the MFIs. The example of Grameen Koota presented below showcase some innovations in social performance monitoring.

Box 3

Case of Grameen Koota

Grameen Koota is an MFI operating in the urban and rural areas of Karnataka, Maharashtra, Tamil Nadu and Madhya Pradesh. As of June 2011 it had an outstanding portfolio of Rs. 2,071 million and 293,974 active borrowers. The mission of Grameen Koota is "to transform and uplift the lives of poor and low income families with micro finance services and other developmental services."

Box 4

MIS for Social Performance – Use of PPI

Poverty level of clients is a critical criterion in the client acquisition process of Grameen Koota. The Member's Basic Data Form of Grameen Koota includes information on several indicators including income, access to basic services, number and types of asset owned, score on the Cashpor Housing Index (CHI), etc. Together these serve as guides to poverty assessment of clients. Based on the values and scores of these various indictors, the field officer arrives at a composite poverty index ranging from very poor to non-poor. Clients who fall within the category of non-poor are not included as clients. A substantial part of the client data is not captured in the MIS. However, since 2009, Grameen Koota has started using the PPI at the time of entry of clients and the data is entered in the MIS at the branch level, which can act as a baseline for measuring progress.

PPI is administered on repeat clients as well as dropouts. The MIS generates weekly automated reports on the number of new clients vs. PPIs done; number of repeat clients vs. PPIs done; and dropouts vs. PPIs done. The SPM department presents an analysis of PPI poverty outreach data to the senior management team for monthly review, which covers these areas:

- Current poverty portfolio
- Current portfolio across rural/urban; states as well as regional offices
- Comparison of current portfolio with historical figures
- Poverty portfolio of new clients inducted for the month across rural/urban geographies and across regional offices
- Dropout portfolio
- Poverty portfolio of clients who abandoned for the month
- Number of new clients vs. PPIs done; number of repeat clients vs. PPIs done

The PPI dashboard is used to present PPI data to the board every quarter. The PPI dashboard gives a comprehensive picture of the poverty profile of the clients for the overall portfolio, for various segmentations

Lack of unique identity for a client is a major impediment in tracking and monitoring clients over multiple loan cycles.

such as urban and rural, new and existing clients, defaulting and creditworthy clients; across products and services, loan cycles, regions and years.

Grameen Koota has made an innovative use of the PPI for assessing client needs. The information on the question relating to type of fuel used for household cooking revealed that there were specific geographical areas and social segments that used kerosene/firewood/chips/charcoal as fuel for cooking. Well aware of the health hazards and environmental consequences of these sources of cooking fuel, the MFI finances purchase of cook stoves as a special product.

SOCIAL PERFORMANCE MONITORING: BEYOND PPI

Grameen Koota has established a Business Analytics Department that does analysis and reporting on a monthly basis. The monthly analysis presented by the Business Analytics team in the Monthly Review Meetings includes analysis of Branch Performance and Efficiency Indicators. Dropout analysis is included in monitoring and review of Branch Performance.

In addition, the Business Analytics team does analysis of specific problems that emerge from the data. Such analysis can potentially benefit the clients by identifying the problems at the field level that are too dispersed to be observed by the operations team. To specifically monitor the progress of its heterogeneous client base, Grameen Koota does profiling of clients based on different social indicators on a regular basis; this analysisis presented in the monthly review meeting. The client and business data is segmented along specific dimensions to track the progress of distinct client segments. The table below (Table 2) provides information on some of the segmentation analysis done by Grameen Koota for senior management.

Grameen Koota has effectively used the PPI for tracking client progress out of poverty and report it to the Board and management in a simple yet comprehensive manner for policy direction setting.Grameen Koota finds that its social performance analysis is constrained by the limitations of its technology. Grameen Koota is in the process of acquiring a new cloud computing technology. It plans to improve to explore the synergies between its financial and social information even more fully once this is done.

To specifically monitor the progress of its heterogeneous client base, Grameen Koota does profiling of clients based on different social indicators on a regular basis;

Table 3 : Segmentation Analysis by GK

	MEMBERS				PORTFOLIO
	Outreach	Active Borrowers	Member Joining	Member Dropout	
Geography	Urban/Rural				
Religion	Branch/Kendra	Branch/Kendra	X	X	Branch/Kendra
Caste	Kendra-wise	Kendra-wise	X	X	Kendra-wise
Poverty	District/PPI				
Activity-wise	Kendra/district	X			X

External Reporting on Social Performance

Seven MFIs report to MIX Market on the social indicators; this mirrors the observation by MIX[17] that a high percentage of MFIs from India are reporting to MIX. The analysis of the 11 MFIs shows how difficult it has been for some of the leading MFIs to track and report on social performance internally. Hence external reporting though on limited parameters will not be easy for many MFIs.

While the exemplary efforts of MIX – SPTF effort in developing the indicators, encouraging

MFIs to report and carrying out analysis to arrive at key findings are encouraging more MFIs to review and improve their internal reporting mechanism, the reporting has to be further refined. Some of the indicators on Governance, non financial services, adoption of client protection principles have to be expanded further. Given the proven track record of MIX in standardizing - in depth financial reporting, it is expected that social performance reporting will also get further refined.

SUMMARY

The main intention of targeting is to increase the usage of the institution's services by those the MFI intends to reach to achieve its mission and objectives. Though poverty reduction and poor outreach are stated as developmental goals and objectives of a majority of MFIs, only some of them have aligned their systems and invested in tools and methods to reach the poor and measure the progress of clients. However, the question of poverty outreach achieves greater significance since the RBI has specified that loans of MFIs to households earning annual income of below Rs. 60,000/-in rural areas and Rs. 1.20 lakhs in urban areas will only qualify as Micro finance. The targeting decision has been taken away from the MFIs by the regulator. The MFIs will need to develop suitable systems and tools to ensure compliance with regulation.

PPI as a targeting and progress, measuring tool holds promise. However, the tool has to reflect field realities of the different states and regions especially where state policy has distributed assets free of cost.

Tracking the progress of clients has not been possible for most of the MFIs. Technology selection, software customisation would require investment. Many MFIs will need technical assistance in designing the monitoring aspects to be monitored and indicators to be selected that would allow for the desired analysis for management decision making. Investors and donors should invest in enabling MFIs to develop core competence in social performance monitoring and reporting as they had done for capacity development of MFIs for financial reporting.

Annex 1
PPI Scorecard for India

Indicator	Value	Points	Score
1. Is the residence all pucca?	A. No	0	
	B. Yes	4	
2a. How many rooms are there?	Number: ________________		
2b. How many electric fans are there?	A. None	0	
	B. One	5	
	C. Two or more	9	
3. How many people aged 0 to 17 are in the household?	A. Five or more	0	
	B. Four	4	
	C. Three	8	
	D. Two	13	
	E. One	20	
	F. None	27	
4. What is the household's main source of income?	A. Casual wage labour	0	
	B. Salaried	14	
	C. Other	8	
5. Does the household own a two-wheeler (bicycle, scooter or motor cycle)?	A. No	0	
	B. Yes	5	
6. Does the household own a television?	A. No	0	
	B. Yes	6	
7. Does the household own an almirah/dressing table?	A. No	0	
	B. Yes	3	
8. Does the household own a sewing machine?	A. No	0	
	B. Yes	6	
9. What is the household's main energy source for cooking?	________________		
	A. Firewood/charcoal	0	
	B. Kerosene, other	5	
	C. LPG	17	
10. How many pressure cookers/ pressure pans does the household own?	A. None	0	
	B. One	6	
	C. Two or more	9	
		Total Score	

Annex 2
Distribution of Poverty Level Likelihood by PPI Score

Score	< National	< $1/day (at PPP)	< $2/day (at PPP)
0-4	77.0	93.8	100.0
5-9	58.3	78.5	98.9
10-14	51.2	68.4	97.6
15-19	35.5	58.1	99.0
20-24	28.7	53.3	98.0
25-29	21.3	37.6	95.0
30-34	18.9	29.8	93.8
35-39	14.9	23.1	84.7
40-44	10.0	14.8	77.8
45-49	4.5	5.8	79.0
50-54	5.1	5.1	64.1
55-59	5.6	5.6	69.9
60-64	6.1	6.1	55.2
65-69	3.6	3.6	50.0
70-74	1.5	1.5	43.0
75-79	1.6	1.6	27.2
80-84	0.7	0.7	15.4
85-89	1.2	1.2	12.9
90-94	0.0	0.0	8.3
95-100	0.0	0.0	4.3
Poverty rate – All India	**17.0**	**25.4**	**74.9**

Indicators and probability score based on Schedule 1.0, Round 62 of the National Sample Survey Organisation (NSSO) Government of India, 2006. Scores have been also been constructed for other 'levels of poverty': – in bottom half below the national poverty line, below $1.50 and below $1.75 at purchasing power parity.

Source: Mark Schreiner, 2008: "A Simple Poverty Scorecard for India"

Annex 3
Prices in Rupees for National Poverty Line (NPL) and for the $/day/PPP benchmarks 2010

		Per person/day				Per household*/month**				Per household/year			
		National	$1.25/ day	$1.5/ day	$2/ day	National	$1.25/ day	$1.5/ day	$2/day	National	$1.25/ day	$1.5/ day	$2/day
Rural	India	19	29	35	46	3,193	4,793	5,752	7,669	38,311	57,513	69,027	92,026
Urban	India	28	31	37	49	4566	5042	6050	8067	54,786	60,499	72,599	96,799
Poverty Lines at 2005-6 prices (per person/per day)													
Rural	India	12	19	22	30	2047.65	3073.95	3689.4	4918.65	24571.8	36887.4	44272.8	59023.8
Urban	India	19	21	25	33	3085.5	3407.25	4088.7	5451.6	37026	40887	49064.4	65419.2

*Household Size - 5.5

**No. of days - 30

Annex 4
Cashpor Housing Index (CHI)

a.	**Height of the Walls and Materials used**	**Score**
i.	More Than 5 feet and made of brick.	4
ii.	More than 8 feet and made of mud.	2
iii.	Between 4 and 8 feet and made of mud.	1
b.	**Materials of Roof**	
i.	Concrete/Pucca/Patia/New Tiles/GI Sheet	2
ii.	Old Tiles /GI Sheet	1
iii.	Thatch/Straw/Plastic/Leaves	0
	Maximum Score	6
	Poverty Status	
i.	Non Poor	4 or more
ii.	Moderately Poor (MP)	3
iii.	Very Poor (VP)	2 or less

If the house index score is =<4 and for the occupants of government allotted houses,household assets verification is to be conducted.

Following households are not eligible as client of CMC:

- Households, where any member has any type of motor vehicle, like a motor bike, car, jeep, van, tractor, hand tractor, etc.
- The house is built with brick walls and a reinforced concrete roof (excluding the Government allotted houses).

Annex 5
Grameen Koota PPI Dashboard- June2011

Grameen Financial Services Private Limited
GrameenKoota
Management Dashboard
PPI Scores analysed for the quarter ending June 2011

Poverty Lines

	$PPP a day	Corresponds to roughly, Rs.	Defined as,
National poverty line (NPL)	0.93	3,300 per household per month	Very Poor (<NPL)
Absolute poverty line	1.25	4,300 per household per month	Poor (<$1.25/day)
Relative povery line	2.00	6,800 per household per month	Low Income (>1.25, <$2/day)

This report is based on the most recent PPI scores available on MIFOS for the customers. The data used for analysis is as on 30th June 2011. A total of 290,433 number of active customers' most recent PPI data have been used for the analysis.

A. Overall Portfolio

Portfolio	Base (Nos.)	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
GK Clients	290,433	12.7%	35.3%	73.4%
National Rates (All India)	_	17.0%	42.6%	74.9%

B. By types of client

Portfolio	Base (Nos.)	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
Existing	289,456	12.7%	35.3%	73.4%
New Clients	977	9.4%	26.7%	66.6%

C. Rural Vs. Urban Clients

Portfolio	Base (Nos.)	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
Rural Clients	158,318	13.9%	38.6%	76.5%
Urban Clients	132,115	11.3%	31.3%	69.7%

C. Default vs. Non-defaults clients

Portfolio	Base (Nos.)	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
Default Clients	7,994	11.1%	33.6%	75.9%
Non-default Clients	282,439	12.8%	35.3%	73.3%

Poverty levels of non-defaults clients are slightly higher than that of defaults'.

E. Product-wise Analysis

Portfolio	Base (Nos.)	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
General	282,716	12.7%	35.2%	73.3%
WatSan	4,563	11.2%	32.4%	72.3%
Cook Stove	3,154	17.3%	48.1%	84.0%

F. Customer Cycle Analysis

Portfolio	Base (Nos.)	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
Cycle 1&2	173,066	13.7%	37.9%	75.9%
Cycle 3	60,509	13.3%	36.3%	73.6%
Cycle 4	14,838	9.4%	27.2%	66.4%
Cycle 5 & above	42,020	8.9%	25.8%	65.2%

G. Portfolio comparison of New Clients over the last 3 years

Portfolio	Base (Nos.)	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
FY 2008-09	62,678	13.4%	36.2%	73.5%
FY 2009-10	133,401	14.1%	38.5%	76.1%
FY 2010-11	55,908	13.9%	38.4%	76.4%
FY 2011-12				
Quarter1	977	9.4%	26.7%	66.6%
Rural	370	12.6%	37.0%	76.0%
Urban	607	7.4%	20.4%	60.9%

H. Regional Analysis

Portfolio	Base (Nos.)	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
South Karnataka	78,229	12.3%	34.9%	72.8%
Central Karnataka	119,093	13.4%	36.5%	73.9%
North Karnataka	39,885	16.4%	43.2%	79.1%
Maharastra-Pune	31,264	7.5%	22.0%	63.8%
Maharastra-Aurangabad	21,962	11.6%	34.6%	76.1%

I. Drop-out Analysis

Portfolio	Base (Nos.)	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
FY 2010-11	65,988	14.3%	38.2%	75.2%
FY 2011-12				
Quarter 1	90,926	14.1%	37.9%	74.9%
Active Clients				
Quarter1	290,433	12.7%	35.3%	73.4%

Drop-outs have higher poverty incidence as compared to current set of active clients.

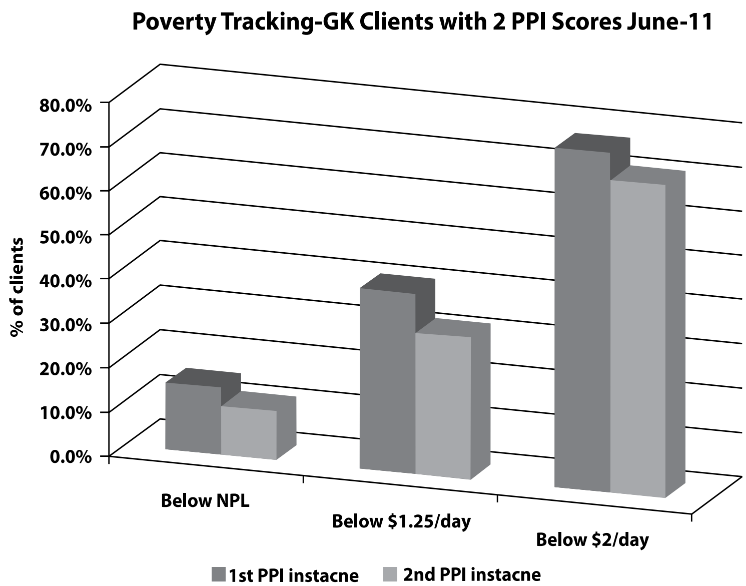
J. Poverty Portfolio comparison over the last three fiscals

Portfolio	Base (Nos.)	Below NPL	Below $1.25/day/PPP	Below $1.5/day/PPP	Below $2/day/PPP
FY 2008-09	120,425	11.3%	31.5%	46.9%	69.7%
FY 2009-10	253,826	12.8%	35.2%	50.9%	73.1%
FY 2010-11	309,734	13.0%	35.8%		73.7%
FY 2011-12					
Quarter1	290,433	12.7%	35.3%	51.1%	73.4%
Rural	158,318	13.9%	38.6%	54.8%	76.5%
Urban	132,115	11.3%	31.3%	46.6%	69.7%

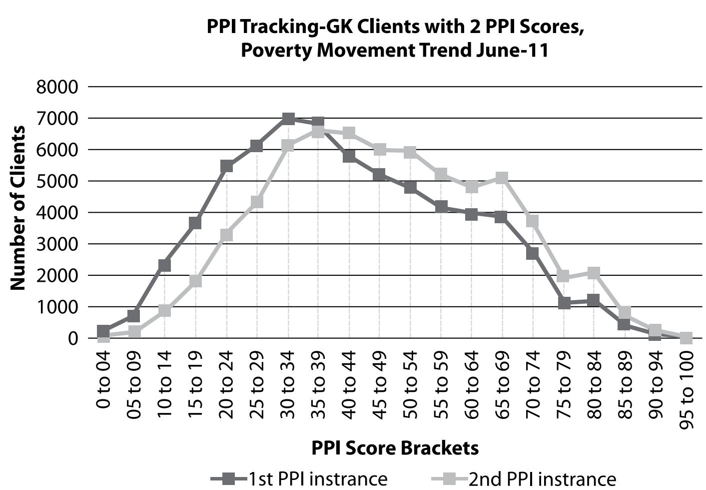
The numbers red circled above are to refer RBI compliance figures with respect to income levels. Loans close to 55% of the current set of rural clients comply as per RBI guidelines for income definition and all the urban clients comply mostly.

K. Poverty Movement tracking

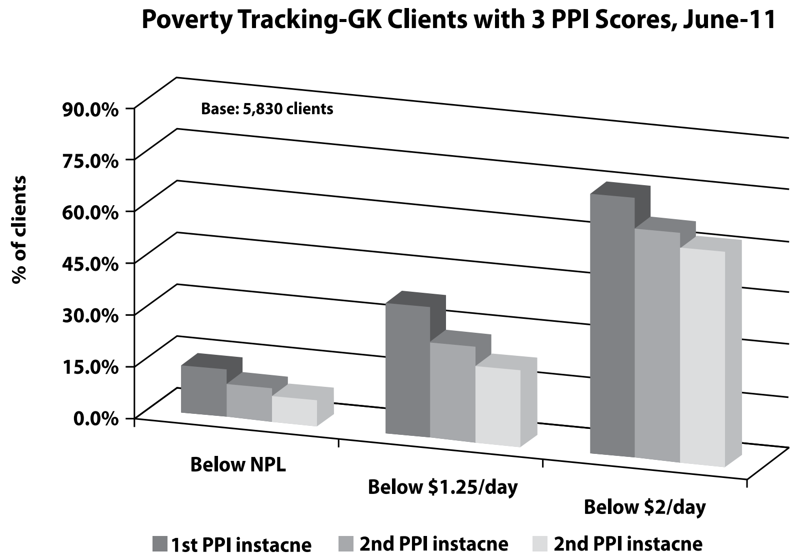
a. Clients with two PPI Scores



Poverty Movement Trend



b. Clients with 3 PPI Scores



NOTES:

1. Frances Sinha and Ragini Chaudhary, May 2009, Social performance Management in practice, Micro finance insights, Volume 12 may – June 2009
2. Developed for USAID-funded projects by the IRIS Center at the University of Maryland, College Park.
3. An initiative of the Grameen Foundation
4. Currently, there are PPIs for 34 countries and PATs for 30 countries. At the MFI level it is not possible to know how many MFIs are currently using these tools. However, MIX social performance data gives an indication: 22 MFIs reported having piloted or used PPI, and 15 provided their results to MIX. For PAT in 2009, 40 MFIs and enterprise development providers have reported their results to the USAID Microenterprise Results Reporting (MRR) system. Ford foundation and CGAP, October 2010, Poverty Targeting And Measurement Tools In Microfinance,
5. Awais, M. "Top Ten PPI Challenges: Barriers faced by MFIs"(2011). Progress out of Poverty website. Accessed November 2, 2011 from http://progressoutofpoverty.org/blog/top-ten-ppi-challenges-barriers-faced-mfis.
6. For the PPI tool see Annexure I.
7. All comparisions are to the respective State urban or rural benchmarks and not to the all-India benchmark; thus the all-India benchmarks are not shown in the graph.
8. See chapter on state of social performance management of Indian MFIs
9. Grameen Financial Services Pvt. Ltd., Ujjivan Financial Services Pvt. Ltd., Anjali Micro Finance, Chaitanya Fin Credit Pvt. Ltd., Janalakshmi Financial Services Pvt. Ltd., CASHPOR Micro Credit, ESAF Microfinance and Investments Pvt. Ltd., Arohan Financial Services Ltd, Basix, Bandhan and Sonata Microfinance Pvt. Ltd.
10. The PPI is specifically designed to facilitate the tracking of clients' poverty levels over time. This is a crucial and often overlooked aspect of outcome tracking – only by tracking poverty over time can one evaluate whether poverty reduction is actually taking place. It also one of the only poverty measurement tools available that is internationally benchmarked.
11. The official Indian national poverty line is Rs 14.25 a day, as defined by the Indian National Sample Survey Office in 2008. This data refers to nine MFIs in the sample.
12. This data refers to seven MFIs in the sample.
13. Non-PPI poverty data in this report is from Marc Schreiner, A Simple Poverty Scorecard for India, Microfinance Risk Management, L.L.C., http://www.microfinance.com/English/Papers/Scoring_Poverty_India.pdf (Sep. 5, 2011).
14. Grameen Foundation has initiated the process of updating PPI as per the National Sample Survey Organisation (NSSO) 2009-10 data.
15. Sa-Dhan 2010. Client Protection and Social Performance of Indian MFI-An Empirical Report.
16. MBB MIX
17. See chapter 2 Section

Responsibility in Product Design and Marketing

5

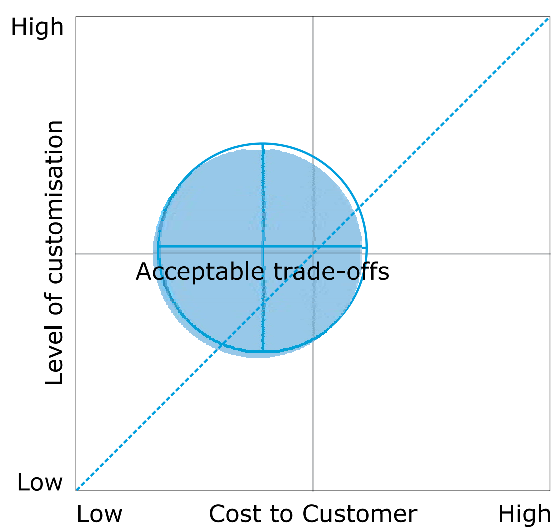
Chapter

Microfinance institutions deal with vulnerable people. Mission, client targeting, governance and processes are normally seen as the major aspects of social performance in microfinance, but products play a critical role as the customer interface and customer experience of the MFI is through the products. Typically vulnerable clients require small volumes of financial services whether it is in savings or credit. While volumes of savings are small, the need to put away savings may be frequent. Products for vulnerable clients can be socially relevant only when the customers' needs are fulfilled to a significant extent. The degree to which these products are customised and aligned closely to the needs of the customers will determine the extent to which microfinance institutions perform in a responsible and socially relevant manner.

The commercialisation of microfinance enabled fast expansion of outreach across several states in India covering a large number of customers. This expansion was possible on account of microfinance institutions adopting a simple and rapidly scalable product, which was easy for MFIs to work with. The most common product being offered even today is that of a loan to a member of a Joint Liability Group (JLG) that is repayable in weekly installments over a period of 6 months to one year. These loans are easy to understand and the weekly equated installments are determined in advance and made known to the customer. However, the question is whether these small sums of money that are disbursed in this manner and recovered in weekly installments are the best way that the customers' needs can be satisfied. For households in which income generation is uncertain and inconsistent, weekly installments do not seem to be well suited.

There is a trade-off between the level of customisation and the price. The higher the degree of customisation, the higher will be the associated costs and greater will be the reluctance of borrowers and the MFI to use the same. When the customisation is at a low level, the cost to the customer will be low, but the customer discomfort will be high. The customers will be prepared to pay a higher cost for a degree of customisation that makes it comfortable for them to use the products and services.

Figure 1: Trade-off Between Customisation and Costs



The degree to which these products are customized and aligned closely to the needs of the customers will determine the extent to which the microfinance institutions perform in a responsible and socially relevant manner.

Figure 1 depicts the relationship between the level of customisation and the relative cost to the customer. The curve represented by the dashed line indicates the cost relative to each level of customisation. (The higher degree of customisation to meet individual customer's requirements will entail high costs). The exceptions to this would be product innovations and introduction to new technology. A very sophisticated product that fully meets the customers' needs might be service intensive and expensive. The vulnerable customers may not be able to afford the same. On the contrary, poorly designed products that are easy for the MFIs to service may not carry high costs, but customers might not find such products friendly and will reject them the same over time. Customers are willing to pay reasonable costs for acceptable quality products and services. The circle in the figure represents the typical range in which the trade-offs betweeen customisation and price are feasible, given the fact that customers are poor and vulnerable.

MFIs need to be conscious of the trade-offs in designing products.The returns to the MFI on the product line should be sufficient enough to permit a degree of customisation. As one part of social performance is appropriate pricing, the MFIs will have to determine the limits of customisation while factoring in affordable costs. Loan size and business volumes also play a part in determining the limits of customisation. Initial costs of product customisation can be absorbed through higher loan size per customer and overall business volumes. But if the customisation involves intensive processes at individual customer levels, cost recovery could be a problem, more so with margin and interest caps in place.

Recent developments in the sector show that MFIs are moving away from enforcement of joint liability.

PRODUCT DESIGN

In product design, the purpose, size, duration, price, loan instalment, risk and loan penalties associated are the key issues. A cash flow based analysis of the customer prior to financing is an essential ingredient of a good product. In the past, MFIs were not always in a position to invest time and money in carrying out any analysis of the customer's cash flows and designed the product terms accordingly. A deeper examination of the products in vogue showed that the design of the product is more towards institutional comfort. People borrow for different purposes ranging from emergent consumption and medical treatment to investments in their small enterprises and working capital. A number of MFI loans have been given for undertaking agriculture related activities. On almost none of these purposes is a steady income generated in weekly intervals. Consumption loans have to be repaid from other cash flows. Loans taken for enterprises, cropping and even dairying may not produce steady incomes every week that would be required to service the loans. When the borrowers are unable to generate these weekly incomes, how do they manage to repay? Increasingly MFIs have taken to reengineering their product portfolios and offering better aligned products to the customer, as explained in the later part of this chapter. Weekly installments are giving way to fortnightly and monthly repayments at the choice of the customers. However, the MFIs are understandably reluctant to offer balloon repayment loans for customers on account of the liquidity management issues on their part.

MFIs have traditionally assumed negligible default risk in such loans on account of group liability. The repayment burden in most cases where cash flows do not permit the same, causes acute distress and misery to the borrower. MFIs, nevertheless, are able to post high recovery rates, as non-defaulting customers pay on behalf of others. Group liability thus acts as a risk transfer mechanism by which MFIs shift risks to vulnerable customers who do not have the ability to cope with the same. How can then the MFIs claim that they are socially responsible? The weekly repayment loan product and the joint liability mechanism have inherent flaws and need to be reset.

Box 1

Joint Liability Products and the Burden on Customers

A small study[1] covering 339 clients found that 279 had been maintaining their repayment schedules while 60 were defaulters. The ratio of defaulters to total clients was 2.2:10. However, in the books of the MFI, there had been zero default on account of the joint liability mechanism working efficiently. The defaults placed a huge burden on the remaining members in the group. The analysis showed that 9 clients had to bear an extra Rs.1210 to repay 48 remaining installments of a borrower. This amounted to almost 20% of the loan that each of them had taken from the MFI. Apart from the normal interest rates, which are in the range of 30%, a capital charge of 20% is too big a burden for the poor to bear. The MFI cannot claim ignorance of the underlying stress among the customers. But still it persisted with the product and continued to have unrealistic installments and unrealistic loan service expectations.

Even after the defaulters' remaining liabilities to the MFI had been met by the group members, the MFI closed down the centres where these problems occurred. It looks unfair that the joint liability mechanism works one way. When the members show responsible repayment behaviour despite considerable odds and personal deprivation, the MFI shuts down the centre at the end of loan cycle to the detriment of good repaying members.

Recent developments in the sector show that MFIs are moving away from enforcement of joint liability. Many MFIs do not insist on the group to make good the shortfall in repayment by members. Some MFIs offer a repayment holiday and extend the loan the period. Others have a loan rescheduling mechanism to deal with long-term problems of the customer in repayment.

Table 1: MFI Responses to Client Default

Name of MFI	Response to default in repayment
Cashpor	A grace period of four weeks is available, which can be used by customers during difficulties. A emeregency loan is also extended to customers having severe short-term cashflow problems. In case of genuine difficulty, customers can have their loan rescheduled.
Samruddhi	In case of member default, other group members are not asked to make good the shortfall. If the defaulted installment is paid before the end of the calendar month, it is treated as repayed on time.
Ujjivan	In case of a default by a group member, group members' liability is limited to a maximum of three months. Loans can be rescheduled in case of genuine difficulties of the customer.
ASA	Three repayment holidays are available to customers in case of cash flow problems to repay their loan. If a member defaults, the group is not asked to pay on behalf of the defaulter. A scheme for rescheduling the loans of needy borrowers is available.
Bandhan	A repayment holiday is available if the customer is unable to meet the installment. If the default is on account of migration or business failure or long-term problem, groups are not asked to make good the shortfall. Groups are asked to contribute, voluntarily, only if the default is on account of some temporary cashflow problems.
Equitas	In case of long-term problems faced by the customer, the loan is rescheduled and sometimes even a partial waiver is possible. No interest is levied on delay of payment installments.
Arohan	No penalties are levied for delay in repayment.

The purpose of the loan should have a lot to do with the design of the product. Typically MFIs do not offer loans that have a lump sum repayment at the end of the loan period, thus failing to recognise the inconsistent nature of cash flows involved in certain types of livelihood activities. The size of loans again have been too small for making investments in income generating activities. Further, small loans underfinance requirements of livelihood investments and compel the borrower to borrow from multiple sources. Overall, very small loans run counter to social performance principles and increase their stress levels and possibly affect future repayment rates. The period of loans permit only very short-term activities and are ill suited for investment in business assets. The pricing of these loans also seem to be extracting almost the entire surplus that most rural and vulnerable livelihoods generate. The risks in carrying out the small activities by vulnerable people have not been adequately examined in the product design. The products assume that 100% of the money lent will be repaid on time week after week and year after year. The issues arising from this kind of product design result in borrower resistance and also fatigue, which eventually leads to voluntary defaults. Over the last few years, the loan size has tended to increase. Individual loans of Rs 50,000 have also been introduced making livelihood investments possible. Some MFIs have started piloting balloon repayment products especially for crop production. The funding structure on the liabilities side limits their capacity to design long-term loans and loans with bi-annual or annual repayment installments. With the focus on livelihood loans as directed by the regulator, the bulk funders of MFIs should re-examine their loan terms.

A fair price is not the same as a low price, but one in which the customer is not overcharged and the MFI does not lose.

PRICING AND TRANSPARENCY

Loan pricing has come to centre stage in recent months, especially after the AP crisis. Not only the price should be fair, but should be made transparent to the customer. A fair price is not the same as a low price, but one in which the cutomer is not overcharged and the MFI does not lose. A fair price will cover reasonable costs of the MFI, but will not cover costs of inefficiency, costs of greed, cost of infrastructure for future growth and costs of poor risk management on the part of the MFIs. A fair price is what covers costs of a MFI that is efficiently run with reasonable returns for the investors. Transparency in price is communicating the actual price that customers pay in a manner that they understand. Indian MFIs (85 of them) took an important step last year to publish the price that a customer pays on their loans after factoring in all charges and fees on the Microfinance Transparency[2] website. While transparency does not automatically mean affordable prices, it sets the ground for comparison in a competitive market and will lead to competitive pricing over time. The opaque pricing practices, charging of different fees and high interest rates led RBI to issue regulations on the subject of pricing. While the price of a microfinance loan is to remain limited to 26% (with a service charge of 1%), RBI has also stipulated that the financial margin should be capped at 12%. With the interest and margin caps coming into existence and also the mandate that at least 75% of loans should be given for income generating purposes, MFIs will find it extremely difficult to operate. The cost of doing business will increase if loans have to be given to the extent of 75% of portfolio for income generating activities and MFIs have been advised that loans of more than Rs.15,000 should have a longer repayment period.

In the field there are institutions that have priced loans at lower rates to make the loans affordable. There are also institutions that have set voluntary caps on the rates of return on assets and return on equity[3] consistent with their mission. Even with low interest rates, a small loan size makes the overall costs high. The members have to spend time periodically for the loan transactions and this cost is proportionately high for smaller loans. The ability of the MFIs to price loans at reasonable rates is impaired if the average loan size is low. Adequacy of loan, timeliness of service and appropriate staff behaviour for a virtuous bundle promotes social performance features of a loan product. MFIN affirms that all its members are compliant with the RBI interest and margin caps, despite the profitability coming under pressure.

Another feature of the product design is the delivery and service process that requires the small vulnerable people to assemble in a common place week after week even when their time spent on such meetings has an opportunity cost. The assumptions behind product design are belied when the alignment of the products to the customers is poor and the monitoring of performance of the product and the client experience are nonexistent. The problems across the sector are not just that of poor product design that is ill suited to the needs of several clients. There have been several cases where MFIs have tried to bundle several products along with the loans in order to maximise their own revenues. The product bundle comprises certain products that the customers do not actually need but nevertheless buy. Some institutions have bundled insurance products of types that are not suitable to the clientele. In others physical goods such as mobile phones, water filters, stoves, solar lanterns, refrigerators and the like have been made available to customers along with a loan for the purchase. This kind of bundling introduces avoidable consumption to the consumer and makes clients indebted just so that the MFIs gain a revenue stream. MFIs after intial experimentation have started unbundling the products on account of negative feedback from customers. Barring credit life insurance, no other financial product is bundled with credit. On the other products such as water and sanitation and solar energy, most MFIs have been advocating adoption of products only if the customer is offered benefits of a lower price or improved livelihoods.

Since MFIs by and large do not seem to focus on suitability of products to the customers, the regulators have stepped in. RBI's regulations announced in May 2011 stipulate the period of the loan, the purpose of the loan as well as the pricing of the loan to MFI clients. Product designed is part of business strategies and internal to organisations. MFIs have come to realise the criticality of products design to their business strategies and have been working hard to introduce a range of products that meet regulatory standards as well as improve customer comfort.

Box 2

Uplift's Community Health Mutual Scheme

Uplift assists urban slum dwellers and clients in rural areas who are mostly daily wage earners and generally do not have access to social protection schemes. With a daily income of 2-6 USD for an average family of four, health is not their primary concern until a destabilizing event happens. Insurance products in the market are out of their bounds because of high premiums, yet government schemes by their very design (the unpopular BPL measure) exclude them. Mutuals funds are created and governed by communities; the product design, fund rules, health service network and exclusions are all validated by the community. Communities themselves settle claims in a democratic and transparent way. Upon availing hospitalization, the members file claims that are first medically validated and then come to the claim committee's final decision-making meetings. This has brought not just a sense of ownership to members but has also helped to make decisions that are fair and sound for the client and the fund respectively.

COMMUNITY OWNED INSTITUTIONS AND RESPONSIBLE PRODUCT DESIGN

There have been a number of institutions that have tried to experiment with different types of products in order to see that the customer is better served. During a study of the community-owned microfinance institutions[4], it was found that member-owned institutions tried their best to customise products for their clients in a relevant and responsible manner. These institutions had introduced long duration loans, loans with flexible installments, saving schemes, pension schemes and a variety of niche products to take care of the emergent requirements that crop up in customers' lives. There are schemes that provide for accumulation of savings[5] over a long-term so as to create a vesting corpus that can be useful for annuity payouts in old age. The community run MFIs seem to have prioritized savings, as per the needs of the members. The products were custom designed to meet the members' needs through daily savings schemes offered by two institutions i.e. SEWA Bank and Bagnan Mahila Cooperative Society), where staff of MFIs collected the savings every day. There were also goal oriented long-term savings products. A combination of compulsory and voluntary savings schemes was in place in most of the studied MFIs. While SIFFS[6] has an Old Age Savings Scheme, SEWA offered a pension savings scheme in partnership with Unit Trust of India Asset Management Company (UTI-AMC).

For customer risk management, these MFIs tried to either bring in the best fitting off-the-shelf insurance products or where feasible, custom designed a product to closely fit members' needs. The insurance products cover life, assets, health and accidents. Uplift India Association (Uplift)[7] runs community-owned and managed funds where members pool their resources together to provide coverage for post-treatment claims. Gramin Mahila Swayam sidha Sangh (GMSS)[8] provides access to life, accident and health insurance services in partnership with registered insurance companies. Indur Intideepam MACS Federation ran a life scheme on mutual contribution basis. Crop loss protection through rainfall indexed insurance (for Kalanjium Development Financial Services members), crew insurance in the case of fishers (SIFFS) and pregnancy insurance for expectant mothers (Sarvodaya Nano Finance Limited) are some of the innovative products offered to customers in response to their needs. In distribution of the mainstream products, the COMFIs have chosen those that provide maximum benefits to their members. Each of these innovative products closely aligns to the customers needs and hence enhances their well being.

In the case of loans, the customer specificity was clearly discernible. The products differed in features based on the purpose and the expected cash flow. The term of loans varied from a few months to ten years. Five MFIs in the study had short-term, medium and long term loans. The repayment installments ranged from daily to six months. Some loans had lump sum repayments within the period of the loan depending on the cash flow. Most loans had a defined purpose, with the repayment period and interest rate aligned to the purpose to the extent permitted by the MFI's cost of funds. Loans to vegetable and fruit vendors that were given in the morning and repaid by nightfall (SEWA Bank) are one of the most innovative products; these were coupled with daily deposit scheme for the same clients. Some MFIs offered loans for redemption of old loans taken elsewhere and loans for redemption of mortgaged land or pledged jewels. The seasonal factors and uncertainties in the livelihoods of members formed the basis of repayment schedules. For example, a loan repayable in 36 monthly installments had a repayment period of 42 months to provide flexibility to the member to adjust to lean cash flows during the off-season (SIFFS).

Member based institutions are better placed to offer a range of products and services; while this is on account of the pressure of member demands, the substitution of profit-targeting with customer comfort is what enables the operation of product lines that might not initially be profitable. The studied institutions have been able to compete with others in the market, which did not come from financial strength. The extra effort that had gone into developing and customising products to make them suit the client's needs by the factor that ensured customer loyalty. The institutions studied had developed a portfolio of products after studying the requirements of the customers and their livelihoods.

In the case of other institutions, special mention should be made of Kshetriya Gramin Financial Services (KGFS), which had introduced a suite of products of different types in credit, savings, insurance and investment. KGFS has both long and short term duration loans. It had savings and investment products and in fact KGFS helped the customers to plan their finances based on their future goals and life cycle needs. It adopted a wealth mapping approach for each of the customer households and then set about advising the households on how to manage their money. This level of customisation was found feasible by KGFS as it was able to offer a range of products to the families. The offering is a complete suite of products such as short term money market mutual fund, personal accident insurance, group term life insurance, livestock insurance, and National Pension Scheme. KGFS offers a variety of loans to suit the requirements of the customer. JLG, livestock, gold, retail, salary and education loans are offered with different features and maturities. The rate of interest is 18% on a declining loan balance.

Box 3

Basix's Suite of Products

Basix has been a pioneer in offering a mix of diverse products from which the customers are able to choose what best fits them. It has a suite of 21 loan products that fall into 6 financial services: agriculture and farm-based activities, business, clean energy, water and sanitation facilities, education, home repairs and construction. It has developed systemic capabilities to enable cash flow based repayments. This is with the understanding that cash flows in the households differ on account of consumption needs (life cycle of families, number of family members, and number of dependents) and livelihoods. This results in different target segments based on surplus cash flows. The loan installments vary across clients, including partial payments and pre-payments. While the normal repayment interval is monthly, Basix offers weekly and fortnightly options as well to clients. Moratorium of a minimum of 60 days is built in all the products, which is higher for agricultural loans and education loans.

Equitas Microfinance from the beginning had long-term loan products repayable in 24 months. Equitas also did not remain wedded to the weekly installment concept. It introduced a fortnightly installment concept and a debt restructuring scheme for customers with high debt stress for reasons beyond their control. Like **Basix** (See Box 3) Bandhan and Ujjivan offer a range of loan products to their customers. Ujjijvan has a product development team that designs region specific and purpose specific products. Ujjivan product range includes business and housing loans. Bandhan also provides livelihood, enterprise and emergency loans including individual loans. It offers grace periods and repayment holidays connected to major festivals and client health.

Box 4

Social Dimensions of Rickshaw Loans[9]

A significant intervention had been made by a few institutions (notably Rickshaw Bank and Bharatiya Micro Credit[10]) in Assam, Tamil Nadu, Gujarat, Tripura, Bihar, Rajasthan and Uttar Pradesh in financing rickshaw pullers. Rickshaw loans have a positive impact on all aspects of the triple bottom line. First, it has enabled pullers to own a rickshaw in a reasonable timeframe. Through this effort they are able to work towards owning a rickshaw within 18 months. Second, pullers have been able to increase their income levels because their daily costs are lower than other alternative financing options. The newly designed rickshaws have enabled them to handle more clients during the day, which has increased their earning power. Third, pullers have also economically benefited because they now have access to a sound financial resource in case they need to borrow money for other ventures. The Rickshaw Bank has a positive impact on the social conditions for rickshaw pullers as well. The program has offered pullers, life and health insurance as well as benefits for their families. It has also made the rickshaw pulling business a more respectable profession. The program has instilled a sense of pride among pullers regarding their line of work through the use of uniforms along with the establishment of monthly discussion forums and peer groups. As a result of the comprehensive interventions, the Rickshaw Bank enables pullers to increase their standard of living and achieve a greater degree of financial independence.

WHAT DO CLIENTS WANT IN PRODUCTS[11]?

Microsave has conducted market research with microfinance clients to understand their financial needs and capture feedback on customer service from MFIs. The following findings voice some of the key client concerns and preferences that have emerged specifically from two studies[12] as well as Microsave's experience of over a decade of conducting market research:

1. **Transparent pricing:** Clients attach more importance to product features than price. This means, given the right product and good service, they will be ready to pay the appropriate price. They want complete disclosure of all the charges to enable them to take informed decisions.
2. **Individual responsibility vs. group liability:** Increasingly clients desire to move away from the group. Most clients would prefer to take an individual loan on the basis of their business, reputation and financial strength rather than relying on a group guarantee.
3. **Cash flow based installments:** Some clients prefer monthly and others weekly repayment schedules depending on the nature of their business and cash flows; however, most seem to prefer monthly repayment schedules.
4. **Flexibility in repayments:** Clients want flexibility in repayment installments to reduce the financial pressure when they are facing emergencies or contingencies. Some note that a grace period at the beginning of the loan is important to allow them invest the money and start generating income with which to repay the loan.
5. Convenience: One attribute that is rated very highly and most liked by clients is convenience, especially that of offering services at the doorstep. In addition to this, two other important related factors are quick processing time and simple documentation.

A socially responsible product design involves respecting customer needs, adopting transparency and flexibility, aligning cash flows and creating convenient processes.

A socially responsible product design involves respecting customer needs, adopting transparency, flexibility and alignment to cash flows and implementing convenient processes as part of the design characteristics. Are the MFIs willing to spend the time and money on developing good products that serve both customers and MFIs in the long run? MFIs should engage themselves in product design after market research on what customers actually need.

The RBI regulations and proposed Microfinance Bill focus on product design to ensure that reasonable terms are offered that actually help the customer. Nevertheless, the price controls introduced fail to recognise that the MFIs are operating in a market for their liabilities while the asset is tightly controlled. Unless the funding of MFIs takes place in reasonable conditions, they will find it difficult to introduce friendlier products to the customers and adopt more facilitative delivery processes. Products are also a function of the market competition. The competition from banks with low priced loans where the total price is not transparent will tempt the MFIs to introduce complexity in product design to hide the true costs and revenue therefrom. The playing field should be leveled and fair prices and transparency demanded of all players, whether they are banks or MFIs.

Box 5

Pensions for the Poor

Dia Vikas Capital, a leading social investor in the microfinance space has provided the platform of its 16 investee partners to roll out a pension product 'NPS lite'. This will ensure outreach of this product to 1.5 million families serviced by 16 MFIs in 19 States. Some MFIs such as Basix and

Janalakshmi (See Annex 1) have also worked with UTI to provide micro-pension facility to their clients. Janalakshmi has enrolled over 80,000 clients in the micro-pension product out of their 250,000 clients who avail of credit services.

There are several challenges in expanding pension products. Pensions require a long-term commitment from the client and MFI. The lower quartile within the BOP segment with unstable incomes are less likely to be concerned with future planning than with their current survival and stability issues. Janalakshmi's experience reflects this, because people from more stable income streams among the BOP prefer this product. Improving outreach will require a capacity building of staff and counselling of clients along with transparent reporting to the clients. The staff will require a mind-set shift from selling demand-led products to a product whose demand needs to be created. The creation of financial literacy in clients is a key to marketing of pension products. Thus pension marketing should figure among list of top socially relevant activities of MFIs.

INSURANCE

On insurance products, many MFIs were distributing products of mainline insurers without examining the suitability thereof to customers. Some MFIs nevertheless had collaborated with insurers to customise the insurance product to the needs of their clients. Bandhan, Basix, Sewa Bank, Arohan and others have customised insurance products covering life, accidents and in some cases, health. While credit life insurance is a compulsory requirement in all MFIs, some of them have negotiated more customer friendly features such as paying the difference between insured amount and the loan outstanding to families and covering the life of the spouse in addition to the borrower. A few MFIs have encouraged mutual insurance schemes among customers. However, insurance products have the potential of turning out to be socially counter productive. A leading MFI was fined recently by IRDA for deviant practices in insuring the lives of customers. Bundling of insurance with the loan without notifying customers regarding the benefits, change of insurer year after year without justification, choice of expensive products with an eye on commission incomes and charging administrative fees for handling the insurance premium are some practices that have eroded the value of insurance products to customers. Recent RBI regulation has prohibited MFIs from charging administration charges for handling insurance products. MFIs should exercise care in the choice of insurance products for distribution among the customers and make the customers' benefit as the sole criteria if they are to conform to social performance principles.

MFIs are limited in offering savings and insurance products on their own account today in the light of regulatory restrictions. But MFIs such as KGFS have found a way of offering regulated savings cum investment services. On insurance, pension and remittance too, new products have been introduced, but the mainstreaming of such products to all needy people is likely to be a time consuming exercise unless significant external support is forthcoming.

To summarise, there is evidence that MFIs pay increasing attention to product design and improving customer relevance in the recent past. While MFIs look to be socially relevant through interventions in education, health and livelihoods, the best manner of becoming relevant to the customers is to ensure that their business interface through products and processes are well designed. Good product and process features make for satisfied customers and engender customer loyalty. Avoidance of long term costs of customer attrition and fatigue with ill designed products provides the economic basis for the investments in product design. Sustainability of MFIs will critically depend on their ability to continue to offer well engineered products at affordable prices. Product improvements thus make strategic and economic sense, not only for meeting social performance benchmarks.

Annex 1
Janalakshmi Micro-Pensions

Micro-Pensions at Janalakshmi Financial Services (P) Limited

JFS launched the pension scheme in 2009. Under this pension scheme, the customer needs to open an account with Invest India Micro Pension Services (IIMPS) and an account with UTI-RBPF (Retirement Benefit Pension Fund), a Central Government notified fund. As Janalakshmi customers, they can save into the account by handing over savings to Janalakshmi which will then deposit the money in UTI through IIMPS.

The Micro-Pensions product is designed for the customer to contribute on a monthly basis. The monthly contribution of the Janalakshmi customer is channelized to UTI AMC for investment into RBPF. The fund is managed for a period of time and the benefits are given to the customer upon withdrawal.

Annex 1.Table 1: Micro-Pensions

Eligibility	18-55 years, pay outs through savings bank account
Frequency	Monthly
Amount of savings	Rs 100, 200 or 500, can be changed annually
Investment	Mutual funds with more investment in debt funds
Returns	Vary according to market conditions, indicative rate of 9-10% based on 17year historical record of the fund
Withdrawal option	No partial withdrawal, premature withdrawal in lump sum, on maturity Lump sum or monthly pension for next 20 years
Charges	No exit load on withdrawal at maturity
Death before maturity	Nominee eligible to withdraw the corpus or transfer the same into his/ her own account

NOTES:

1. The study was carried out by Ms Mani Nandhi of Delhi University. Findings were presented in the CMF - MRAP researchers workshop in Chennai in August 2010 and cited in the State of the Sector Report – Microfinance India 2010 – brought out by Access Development Services.
2. Microfinance Transparency is an international non-profit that seeks to improve transparency in the sector, especially in pricing. After a six month data collection effort, MFT published data of more than 85 Indian MFIs in its website www.MFTransparency .org.
3. Equitas Microfinance for example has capped its return on equity in a range between 20 and 25%.
4. This section borrows heavily from 'Community Owned Microfinance Institutions – Meeting the Challenge of the Double Bottomline – Girija Srinivasan and N.Srinivasan – published by Rabobank and Access Development Services'.
5. Typical MFIs do not operate savings schemes both on account of the regulatory restrictions on mobilizing savings and the risks involved.
6. South India Federation of Fishermens Cooperatives, Tiruvananthapuram.
7. A registered trust that is a member of Chaitanya's SHG federations
8. Modified from the website of www.rickshawbank.org of the Centre for Rural Development, NOIDA, UP.
9. BMC is based in Lucknow, U.P.
10. With inputs from Veena Yamini, Senior Analyst, Microsave
11. Full report on www.microsave.org
12. With inputs from Jaya Rupanagunta, Product & Marketing Department Janalakshmi Financial Services

Human Resources for Social Performance and Responsible Finance

6
Chapter

Social Performance Management is a feasible exercise only when the staff of the institution have the necessary skills and orientations to do business responsibly. Institutions that want to deliver value in a social sense to their customers and convince the stakeholders that their business is an ethical and sensitive one, need to build a sound base of human resources. One of the tests of an organisations' preparedness and intent to deliver social performance would be to see whether the profile of its human resources match the mission and objectives of the organisation. Very often organisations have missions that are noble and mean much to the vulnerable customer segments, but the staff hired by the institutions are not always oriented towards the mission. The staff might target high returns and business expansion rather than looking at the social parts of the mission. The HR policies of the MFIs have a lot to contribute to staff performance and orientations.

Recruitment of staff and the initial induction are critical stages in orienting staff. A number of MFIs recruit staff from the local areas in which they have chosen to operate so that they are able to respond to local people with social and cultural sensitivity. Others while recruiting staff from other areas provide the field officers orientation to the local area in which they are to work, thus sensitising them to the local socio-cultural aspects. While there are positives and negatives in both approaches, the manner in which the recruitment and induction is carried out holds the key to the orientation that staff exhibit on the job. While the staff could be hired for their business skills and entrepreneurial inclinations, there is a need to ensure that they absorb the organisational values and become sensitive to the customers' requirements. The role of training in microfinance institutions cannot be over-emphasised. While institutions spend large amounts of money on training the staff on technical skills and improving their process efficiencies adequate time is not spent in training them on aspects of responsible finance and quality customer service. Some MFIs have been investing time in providing skills to staff on responsible finance concepts. Others use the code of conduct in the field to drive home lessons to staff on acceptable behaviour and processes. In many institutions the code of conduct is not consciously apprised to staff. The code of conduct is only something the staff certify as having 'read and understood' at the time of appointment, without in fact having an opportunity of being able to do so.

> ***Box 1***
>
> **Reasons for Staff not Adhering to Good Conduct Code[1]**
>
> Details of staff behaviour are not adequately emphasised in the operations or policy manuals. Generic description of good behavior is indicated such as 'Behaving politely with the clients' without defining what is considered polite behavior.

While institutions spend large amounts of money on training the staff on technical skills and improving efficiencies, adequate time is not spent in training them on aspects of responsible finance and quality customer service.

The rules of staff conduct are contained in the operational manual of the organisation, which most of the staff do not refer to as it had become outdated. Operations are guided by a series of administrative circulars, which are issued regularly.

Almost total focus of most of the induction training is on operational processes and ensuring 'strict credit discipline'. Nuances of staff behaviour towards clients are not adequately emphasised.

Operational monitoring and internal audit do not require staff behaviour to be specifically checked and reported.

Evidence from the field indicates that the staff are not trained well enough to be sensitive to the behavioural cues emanating from the clients whenever there are signs of problems. The inability to be sensitive to the clients' requirement and also the lack of skills to respond in a manner that is appropriate have led to full blown crises for institutions. It is also a matter of concern that good quality mainstream training programmes on issues in social performance and skills in responsible finance are not available to the extent necessary. With more than a 100,000 staff the MFIs have very few options in social performance training even for a small percentage of the staff. In internal training of staff, aspects of customer comfort and responsible finance must form a strong part of the curriculum. When business expansion and revenue maximisation are discussed, the need for balancing the same with customers' requirements and ensuring their comfort should be an integral part.

Box 2

How Equitas Secures Good Conduct from Staff[2]

One of the important aspects of staff's induction training is conduct towards clients. There is a formal process of certification for the field staff, which involves trainings and examinations. Unless a staff is certified he is not allowed to interact with the clients. All the interviewed staff members know the rules of conduct and adhere to these in all the situations.

The incentive systems in microfinance institutions have come under criticism for a long time. Incentives mostly reward commercial aspects of business, ignoring the social aspects. The HR rewards and incentive systems in MFIs should include responsible finance practices and social performance indicators too. For example, while rewarding accelerated customer acquisition the rewards could also include the extent to which vulnerable clients have been brought in. Incentives for 100% on-time repayment are perverse. Targeting such high recovery rates breeds ground for recovery practices that make borrowers miserable or the staff dishonest in reporting. Disincentives in some institutions that deducted the shortfall in recoveries from staff salaries cause more distress to both staff and customers. The basic assumptions must include the possibility of some customers failing to repay on time and consider the same as permissible staff performance.

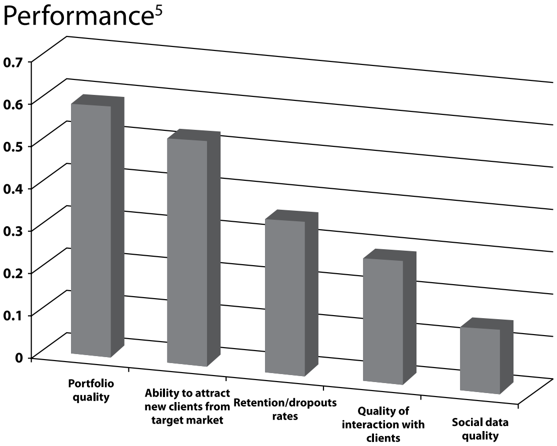
Box 3

Navigating Staff Incentives, Examples from the Field[3]

Given the risk of exacerbating client over-indebtedness that can arise from an ill-balanced staff incentive scheme, Bandhan has avoided the use of target-based incentives altogether. Bandhan feels that such incentives encourage aggressive client canvassing, which can lead to deterioration in portfolio quality, as well as increasing the prospect of unqualified candidates being allowed into loan programs. Instead, the MFI relies on bonuses and strong internal promotion practices. Recruitment is generally undertaken at the credit officer level, with higher positions filled from this initial pool. However, Bandhan does recruit laterally to fill positions requiring specific skill sets. Other MFIs use less extreme methods to address the same danger. For example, Trident Microfinance sets a cap on incentives for field staff and Ujjivan, in addition to capping supervisors' incentives, does not allow staff to collect incentives at all for their first year. These measures are explicitly aimed at thwarting indiscriminate and aggressive extension of credit to meet incentive targets. Ujjivan does increase the fixed component of probationary staff salaries to compensate for the decreased pay.

Bandhan avoids the problems relating to in appropriate incentives and penalties for staff. It provides for no incentives for client origination or loan disbursements. Staff, therefore, have no motivation for engaging unauthorized agents for enrolment of clients or for encouraging clients to take large loans. Staff are not penalised in case there is loan delinquency. Staff are, therefore, less likely to put undue stress on the clients for repayment of installments. According to MIX[4], MFIs tend to reward staff on the basis of portfolio quality and the ability to attract new clients, but indicators of high client retention, such as 'quality of interaction with staff' and 'quality of social data,' are not commonly linked to staff incentives (Graph 1). MFIs that are more proactive in offering staff incentives exhibit higher staff productivity and better portfolio quality.

Figure 1: Staff Incentives for Social Performance[5]



The performance appraisal systems in many MFIs are rudimentary. They do not take into account several important aspects necessary for the growth not only of the individual but also of the organisation as a whole. Short-term objectives of meeting targets have conventionally been prioritised over long-term objectives of investing in sound customer friendly practices. There is a need for MFIs to look very closely into whether the staff appraisal systems include social performance aspects. Issues such as whether the staff members have had an unusually large number of complaints from the customers, the ability to deal with grievances of the customers, the speed and competence with which customer sensitivities were handled etc. should be a part of the performance appraisal parameters. Without this it would be difficult to make the staff realise that social performance and responsible finance matter to the organisation. The performance appraisal system should also be made the basis of building the training courses for staff so that where specific skills are deficient the institution can design suitable programmes.

Box 4

Are Staff Clients?

The SPTF recognizes the responsibility of the MFIs to their staff as internal clients and the importance of staff satisfaction for achievement of the social goals of the MFI. The framework developed by the Social Performance Task Force (SPTF) includes a dimension of MFI's social responsibility to its staff as a process indicator. Similarly, the MIX requires MFIs to report on social responsibility to the employee. The social responsibility dimension includes stable and quality employment; fair and transparent remuneration, provision of benefits to the staff; equality, safety, and protection from harassment at workplace. In addition, to assess whether the MFI has aligned its HR systems in line with the Social Performance Management motto of integration of social and financial values, the MIX also examines the composition of the incentive system and training within MFIs.

In the staff profile, there is a need to achieve a balance across different sections of society as also gender. Staff, who can operate in local areas in a manner that the customers understand are a necessity. Disadvantaged sections of society would like to see an empathetic staff member; similarly certain religious groups look to deal with women belonging to that group. These sensitivities have to be taken into account while recruiting and placing staff in different parts of the MFIs business. Achieving this balance even if it entails a higher cost would go a long way in promoting social performance aspects of business. In Kolar one of the contributing reasons for the fatwa was that male field staff of MFIs transacted directly with women and visited homes when men of the household were away. This was found unacceptable on account of religious and cultural mores of the community, which could have been avoidable with an adequate number of female staff.

The pressure on staff to perform and provide the organisation with 'good stories' is often a cause of MFIs failing to notice failures in communication with the customers and customer discomfort. Field staff underplay bad news on account of the negative fall out it might have on them and routinely exaggerate the information relating to positive aspects of their work. The reporting structures do not actively seek negative information and problems. In Kolar it was seen that the problem of multiple loans and excessive debt was rampant, but was not reported to the highest levels of management of MFIs. The HR culture is in many ways to blame for the breakdown in organisational communication. Facilitating an open culture, seeking positive as well as negative information from the field and developing an appropriate communication protocol are important aspects of ensuring that information necessary for social performance is available to the MFIs.

In Kolar it was seen that the problem of multiple loans and excessive debt was rampant, but was not reported to the highest levels of management of MFIs.

Box 5

How ASA Leverages Staff for Responsible Finance :

The expected behavior from staff members towards staff members is also inculcated through compulsory Pre-Service Orientation (PSO) training provided to all the staff members. All the staff members interviewed had participated in PSO trainings. In addition to the PSO training, refresher trainings are conducted to reinforce sound operational management and client relationship practices. Some design aspects of the organization ensure that the loan officers do not have excessive workload and are able to devote sufficient time in order to build sustainable relationships with clients. The organization does not provide monetary incentives to the loan officers for ensuring 100% on-time repayment and achieving high client enrolments.

An area that is often neglected is that of participation of customers in business. While groups are the predominant tool used for financing customers, the groups are used more as a passive congregation that has to listen to what the MFIs have to communicate. The participation of groups in terms of active discussions, contribution of ideas and ongoing feedback for redesign of products and processes rarely happens. This is on account of high workloads in the field staff who do not have adequate time to make the groups come forward with views. The MFIs on the otherhand do not have flexibility to receive feedback and act on the same. This situation must change. An involved clientele that feels itself to be a part of the organisations' processes and business ideas will be more loyal and supportive to the institutions in terms of crisis. Groups participating can help in better credit decisions and avoid risky customers; but, the workload on staff and the guidance on work processes to field staff must permit them to ensure people's participation.

There have been surveys carried out on the best places to work. Staff rate institutions based on whether they enjoy working there. Satisfaction in workplace does not come merely from high salaries and high targets. It also comes from the staff feeling that they have been a useful part of the development of the local area and have been a meaningful tool to the customers that they serve. Organisations that have meaningful outreach programmes aimed at customers are more likely to be places where the staff enjoy working. In a recent survey of "Great Places to Work in India", two microfinance institutions were part of the list of top 25 institutions (Ujjivan Micro Finance was placed at 14th and Equitas Micro Finance at 21st in the list). An examination of the work done by these two institutions reveals that both have significant outreach activities beyond business. Their processes ensure that the customer is treated fairly and transparently. They have instituted practices that ensure that customers are not unduly troubled on account of their inability to pay on time. Training of staff, pricing, staff case loads and the organisational processes have all been designed in such a way as to introduce comfort both to the customers and the staff members.

Staff satisfaction and happiness in the work situation cannot be the final proof of the organisation performing socially. There are several organisations where an staff are not asked to stretch and walk the extra mile in serving the customer. In such cases, the staff have a reason to be happy as their work burden is significantly less and organisations where staff have to walk the extra mile and work hard at providing quality customer service in a responsible manner have reasons not to be happy because of the extra work burden. Hence, mere happiness of staff in the work situation should not be taken as a proxy towards social performance. A combination of customer and staff satisfaction should measure the degree to which resonsible finance and social performance agenda drive business.

Cost-cutting experiments in some MFIs have tried to outsource services instead of employing staff. While in non-core areas this might be functional and deliver cost savings, when adopted in core areas of business, especially in the customer interface, it will result in undesirable consequences and have the potential to significantly reduce customer comfort. The emergence of centre leaders that facilitated customer acquisition in different parts of the country helped some MFIs to reduce their costs. However, customers acquired through these informal arrangements turned out to be qualitatively inferior in terms of repayment performance. Social performance and responsible finance practices require that the customers are directly approached by the staff of the institutions and not indirectly, especially through informal arrangements that can extract rents from customers. The lessons learned by several MFIs is that adequate staffing to deal with customers in the frontline is an imperative and the costs thereof should not be avoided. Further, the field staff should be trained to avoid depending on centre leaders for performing their tasks. MFIs should carefully identify areas of work for outsourcing and eschew social performance risks through understaffing.

MIX and Impact consortium in a survey[6] of 405 MFIs across the world came to the following conclusions on HR related aspects of SPM practice.

- The majority of MFIs offer staff training on SPM, but there is relatively low-board and management involvement in these trainings.
- Operating systems are in the process of realignment, with SPM increasingly integrated into staff incentive structures. However, questions remain regarding implementation and monitoring of compliance.
- Overall, MFIs show progressive human resource policies.
- Staff employment scores low on gender equality.

The Indian situation is by and large similar to global findings, but the urge to implement SPM practice is greater in recent times in India on account of the regulatory and policy developments over the last year.

The lessons learnt by several MFIs is that adequate staffing to deal with customers in the frontline is an imperative and the costs thereof should not be avoided.

To summarise, social performance in an MFI depends on the mission and objectives that it has set for itself. The human resources of the organisation should share the mission and vision of the organisation if they have to contribute meaningfully. This sharing is possible only when the organisation has taken the pains to disseminate the mission among the staff members and make them understand the nature of the organisation in which they work for. The internal work processes and the design of products should be such that the human resources have easy ways of adopting and succeeding in responsible finance practices. The staff training and skill building should continue to look at skill issues and keep filling the gaps. The incentives and disincentives systems built in the organisation for staff should ensure that responsible finance practices and social performance are an integral part thereof. The performance appraisal systems and career planning for staff must prioritise social performance issues as a critical factor. Without this, staff might feel that social performance is an optional extra and as long as they do, they will do well on the commercial aspects of business so their career will grow. An important area is that of handling of grievances from customers. Banks should invest in specialist staff with competencies of dealing satisfactorily with customers' complaints and grievances. This should not be left as an optional extra responsibility on an already busy operational field staff. Unless customer complaints are taken very seriously and resolved expediently, organisations cannot claim to be responsible towards the customers. Governance has a major role to play in instilling SPM orientation and monitoring performance at periodic intervals. The question is whether the sector is providing the right kind of sensitisation to board directors so that they provide appropriate direction to the organisation.

NOTES:

1. Cited from a Code of Conduct Compliance Assessment carried out by M2i consulting
2. Cited from the Code of Conduct Compliance Assessment of Equitas Microfinance, conducted by M2i consulting – from SIDBI website www.sidbi.in
3. Source: M-CRIL's 2010 social rating of Bandhan (http://www.mixmarket.org/sites/default/files/bandhan_social_rating_report_10.pdf), as well as their 2010 ratings of Ujjivan (http://mixmarket.org/sites/default/files/ujjivan_social_rating_09_full.pdf) and Trident Microfinance (http://mixmarket.org/sites/default/files/trident_social_rating_09.pdf).
4. Defining financial performance – how to think about social performance – Microbanking Bulletin June 2011, by Micol Pistelli, MIX Market.
5. Graph reproduced from the same source as above.
6. State of Practice in Social Performance Reporting and Management – Microbanking Bulletin 2011 – by Micol Pistelli, Anton Simanowitz and Veronika Thiel.

Client Protection

7

Chapter

SOCIAL VALUE IN MICROFINANCE – CLIENT RESPONSIBILITY

Client protection emphasises on product and delivery quality, from ensuring that microcredit products will not result in further impoverishment of already poor clients to providing reliable channels for addressing client complaints. Adoption of client protection measures by MFIs ensures that the clients are treated with transparency, respect, and prudence. This is especially important because MFIs operate within limited government regulations and the clients that are served by MFIs are vulnerable.

Client protection principles have been adopted widely by MFIs under the umbrella of Social Performance Management. The codes of conduct of MFI networks Sa-Dhan and Microfinance Institutions Network (MFIN) embody a set of core principles for the fair treatment of microfinance clients while transacting with a microfinance institution that incorporate client protection principles. Microfinance codes of conduct in India adopt the Smart Campaign's[1] client protection principles. Sa-Dhan brought out the code of conduct for adoption by member MFIs in 2007 and in 2010 invested greater energy into having its members adopt the code of conduct and implement these principles in their operations and practices. By 2010, 109 members reported on Sa-Dhan's Code of Conduct. MFIN has developed its own code of conduct, which has been adopted by its members. A comparison between the different codes and Smart Campaign Principles are given in **annexure 1.**

The code of conduct of MFIN includes information sharing with credit bureaus and among network members whereas Sa-dhan's code of conduct does not actively promote information sharing. Sa-Dhan's code of conduct specifies responsible and transparent pricing and also promotes investment in client education and financial literacy whereas MFIN's code advocates transparency in sharing all the costs with the clients. Dell Foundation and IFC have brought together key stakeholders to form a responsible finance forum to harmonise the different codes of conduct in use in the industry.

PRINCIPLES 1 & 2: APPROPRIATE PRODUCT DESIGN & DELIVERY PREVENTION OF OVER-INDEBTEDNESS

MFIs need to design products and delivery channels in such a way that they take client characteristics into account. The chapter on products has more details on the efforts of MFIs in designing appropriate products. MFIs need to ensure in all phases of their loan process to determine that the clients have the capacity to repay without becoming over-indebted. MFIs need to implement internal systems to prevent over-indebtedness of clients and share adequate information with other MFIs to enable market level credit risk management[2].

Adoption of client protection measures by MFIs ensures that the clients are treated with transparency, respect and prudence.

The current issue being faced by Indian MFIs is to ensure that the multiple lending by MFIs is kept to a minimal so that clients are not over-indebted.

Selection of area and clients for lending

MFIs especially NBFCs adopt the Know Your Customer (KYC) norms specified by RBI[3] to ensure identification of clients. These documents if captured in a centralised MIS can provide a first level check for every client to ensure that a defaulter in one branch does not become a client in another branch. This also provides information about the number of clients from the same household who are applying for loans using the same KYC document. This is a first level of check for household indebtedness within an institution, but does not address loans from multiple institutions.

With an inflow of capital into the microfinance sector, many local players have become multi-state operators with the top 10 MFIs spread out across India. This had the advantage of avoiding portfolio concentration risk[4] and achieving economies of scale. However, even the multi-state MFIs continued to have a larger portfolio concentration in certain states and regions. On account of growth pressures, it became easier to approach existing clients of other MFIs than branch out and find new clients in uncharted territories. This caused a significant overlap[5] of clients leading to multiple lending and cases of over-indebtedness. In addition, practices of using agents to source clients gained prominence, which resulted in quick client acquisition with MFIs having little check on multiple membership.

While some MFIs like Equitas have incorporated clear norms to avoid over indebtedness, a few like Sonata decided not to open a branch in an area where two or more MFI where already operational.

While some MFIs like Equit as have incorporated clear norms to avoid over indebtedness, a few like Sonata decided not to open a branch in an area where two or more MFIs were already operational. MFIN's code of conduct for its members specifies that their members cannot be a fourth lender to any microfinance clients and the total debt from MFIs to a household should not be more than Rs 50,000. SIDBI commissioned Code of Conduct Audits (COCA)[6] of 8 MFIs around October 2010[7] to validate the adherence with the code of conducts accepted by the MFI sector, which included the client protection principles. One of the dimensions of this audit was Client Origination and adherence to MFIN code, targeting strategies and practices of ensuring identity of the clients. The audit finds that MFIs are seriously working towards curbing the overlap to avoid institutions like Kolar and AP.

There are apparent challenges of enforcing the same in the field since at present the disclosure on the number of loans depends on the borrower and MFIs have to rely on their personal disclosures. Since MFIs rely on information that the credit officer brings from clients. There could be convenient oversights in information gathering from both sides. Clients have strong incentive to not disclose to their other lenders, and staff under the pressure of targets have strong incentive to ignore obvious signals in the field. Many MFIs at the field level operate out of the same area as other MFIs and their field staff interact with each other. There is enough informal local intelligence which does not get factored in information systems of MFIs. The only credible way to triangulate this information is through a credit bureau.

Two credit bureaus have made their presence in the microfinance space in recent times: Highmark and Equifax[8]. The acceptance and use of credit bureaus is slowly increasing. The MFIs are making the enquiries either at the pre-screening stage or at the pre-disbursement stage based on decentralised or centralised system of using the bureau chosen by them. Some MFIs have made the credit bureau screening mandatory for processing all their loan applications.

The High Mark credit information service is one of the first credit bureaus to operate in the microfinance space in India. It has 50 MFI members (including 45 NBFCs) till date. It has received 60 million records and around 13 lakh inquiries. It plans to add an equivalent number of MFIs (both NBFC and non-profit) in the next few months.

In the aftermath of the crisis, the industry has seen value in the services of the credit bureau and therefore has given a positive response to High

Mark. As a measure of responsible finance, banks are also likely to insist that the MFIs use the credit bureau. Despite severe limitations in data quality, it has consistently uncovered a multiple lending rate of about 25% in aggregate. The real rates are expected to be higher (based on extrapolation) because as of now only about 40-55% of MFIs are members of the bureau. In the case of Karnataka, overlap was found to be about 43%.

Equifax Inc. is a global credit information services company with 110 years of experience in delivering consumer and business credit intelligence. It has been working in the MFI domain for more than a decade. Equifax has signed up 25 MFIs and has data of more than 35 million clients. The usage on the MFI bureau has recently commenced.

Information sharing among MFIs through the credit bureaus have faced numerous challenges:

- **Reluctance to share data:** Most MFIs see the relevance of the credit bureau in light of the recent crisis in microfinance, but they have had reluctance in sharing data on account of concerns about security and legitimate use. MFIN has played an important role in ensuring that its members enrol with High Mark and share data.
- **Data quality:** The integrity and completeness of MFI records have posed challenges. Different spellings of the same name, different names for the same place, different use of surnames, different KYC documents accepted by MFIs are other issues. MFIs have to make dedicated effort to ensure data quality.
- **Lack of Self Help Group (SHG) data:** SHG data is captured by many MFIs but not individual member data. The household level indebtedness cannot be reasonably estimated without this data.
- **Enrolling for membership does not guarantee usage:** The membership requires one time fees but every enquiry has a charge. Enrolling as members is just the first step. The next step is to share records and third is to use it for credit decision. So far the success largely has been around the first step.

The use of the credit bureau is likely to gain an impetus with support from lenders and investors. The usage will increase once all the top MFIs who serve the majority of the microfinance clients share their loan records and make the credit inquiry mandatory for every loan approval. This will make it easier to enforce the code of conduct which will ensure that the multiple lending is reduced considerably. From the client perspective, they will be cautious to take loans from many MFIs. The down side is that their borrowings from informal sources could increase. In any case research[9] has shown that they are more likely to have multiple loans from informal sources than formal sources.

Apart from ensuring through internal and external systems to check multiple MFI lending, the industry has to invest in client education and increase their awareness of the perils of multiple loans and overindetedness.

Deciding debt thresholds

Over indebtedness is difficult to define[10]. The clients find it difficult to define at what levels of debt they will have repayment stress. The MFI debt thresholds are based on cycle wise limits. These limits were set according to the comfort of exposure which MFI desired and to incentivise the clients to repay on time to graduate to higher loan levels. The debt thresholds are usually not based on the loan purpose or house hold debt service limits.

The recent RBI guidelines has recommended debt thresholds for rural and urban poor households. This will now become mandatory for MFIs to follow. The effect of household level debt thresholds which prescribed by RBI was analysed in a recent study[11] which concludes that the loan size limit of Rs.35,000 in the first cycle enables all clients with incomes less than $2 a day to borrow. However, critically, it leaves all those with less than $1.5 per day open to over-indebtedness (because the loan size limit may be too high) and it may not be high enough for those close to the $2 a day threshold (who can repay more and probably need more for productive investment). Not catering to the needs of the upper income segments amongst microcredit clients that are the major client goups for most MFIs creates an incentive for multiple borrowing. MFIs need to develop suitable products for different client segments.

Cash flow based loan appraisal process

The loan application form of most of the MFIs usually contains details of the household cash flows. This process is not followed with the rigour required especially for group loans which come with group guarantee. Barring a few MFIs such as Bandhan and ASA, peer pressure is the norm for most of Grameen replicators. Hence, appraisal is replaced by insistence on group guarantee as a precondition for the loan. Some of the MFIs are asking deeper questions, including the maximum share of client disposable income allowed to count toward repayment coverage and the number of existing loans held by clients. In the COC reports[12] also, this emerged as a major area of improvement for MFIs. This was also reiterated in the Smart campaign[13] work with Indian MFIs which found that while the commitment to the principle of avoiding over-indebtedness is high, the capacity to assess the debt repayment levels is low.

A stringent loan appraisal process requires staff capacity building for estimating cash flows from diverse sources. The MFIs will need to strengthen their loan appraisal processes, reorient staff and improve the internal controls to ensure process adherence.

Not catering to the needs of the upper income segments amongst microcredit clients, which are the major client groups for most MFIs creates an incentive for multiple burrowing.

Incentives

The incentives and disincentives in place drive the staff behaviour and thereby process adherence. Till recently many MFIs have based staff incentives on a number of clients and disbursement targets to achieve ambitious MFI growth targets. This appears to be one of the main reasons for many process short cuts and unhealthy practices of using unauthorised agents to source the clients. The incentives need to include both quality and quantitative parameters such as weightage on client retention and portfolio quality which can drive balanced growth. In wake of Andhra crisis, many MFIs have discontinued client acquisition targets and related incentives. They have replaced the variable compensation package with a fixed slab- based system.

Box 1

Avoiding over-indebtedness, the Equitas way

Equitas has been very conscious of the multiple lending issues in the microfinance. It has put policies in place to minimize the possibility of over-indebtedness. Some of its efforts are as below:

- Equitas has a policy of not funding a client in an urban location if she has already more than 2 loans and in rural area if she has already more than 1 loan. This policy was in place since its inception.
- Equitas has 'No ration card – no loan' policy. The ration card number is entered into their system and all new applicants for loans go through the de-duplication process on this data base of ration card, thus ensuring that one household has only one loan from Equitas.
- The loan term of two years and fortnightly payments reduces the instalment size and resultant burden on household cash flows.
- One of the prime movers for establishing the credit bureau in the microfinance sector through MFIN (Association of NBFC MFIs); it was one of the first MFIs to provide branch level access to credit bureau reports.
- The success of the credit bureau depends on the data available with it and hence Equitas has canvassed extensively to ensure that other large MF players also submit their client data to the credit bureau. These efforts have ensured that now all of its branches perform the first level credit bureau check before sending the loan application forms to the centralised data processing unit.

Some emerging good practices as observed during the MFI visits and COC audits are:

- Enrolling with the credit bureau and using the information for credit decision
- Abolishing staff incentives on client origination
- Modifying loan application forms to collect more detailed information
- Enforcing the number of MFI per client norm

Deciding on growth strategies, debt thresholds and enrolling with credit bureaus are strategic decisions driven by boards, which in the short run have an impact on operating costs and profitability of smaller MFIs especially with the interest rate caps by RBI. The restricted liquidity for the past year has enabled enforcement of multiple lending norms. It remains to be seen whether these will remain in practice once the funding flows improve. Here the role of investors, lenders, regulators and the industry associations is likely to be paramount in ensuring its consistent application across MFIs.

While MFIs bear large responsibility for avoiding over-indebtedness, clients also have a responsibility to borrow prudently. Unfortunately, not all borrowers have the understanding and caution to avoid falling into risky situations that can lead to over-indebtedness. From the perspective of clients, multiple loans is a way of life for poor household and this has been substantiated in numerous studies[14]. It may prevent multiple loans from MFIs but may not prevent the same from informal sources[15]. The government and RBI have to take suitable measures in financial education to raise awareness of the dangers of over-indebtedness.

PRINCIPLES 3 & 4: TRANSPARENCY AND RESPONSIBLE PRICING

MFIs should communicate clear, sufficient and timely information in a manner and language clients can understand so that clients can make informed decisions. The core component of transparency is pricing disclosure, including how clearly and understandably a MFI presents interest rates, fees, and commissions; compulsory bundled products (such as insurance), caution deposits and other factors that affect the price of a loan.

Pricing, terms and conditions will be set in a way that is affordable to clients while allowing for financial institutions to be sustainable.

Communication with clients

MFIs need to communicate to the client complete information about:

- Interest rates – nominal and declining both
- Fees percentage and amount
- Penalties
- Prepayment conditions
- Foreclosure conditions
- Repayment frequency
- Instalment amount
- Repayment schedule which clearly separate interest and principle repayments
- Insurance and breakup charges into premium and administration charges.
- Insurance coverage
- Insurance claim processing mechanism
- Cost of any other bundled service
- Overall annual percentage rate, which includes all costs[16]

MFIs use different channels to convey the product terms to the clients at different stages. Grameen replicators who have the largest client base, test the knowledge of the clients on product related information at various stages. At the pre-screening stage, MFI field staff explains the terms to the clients in the Compulsory Group Training (CGT). The CGT required 7 days during the early days of microfinance. This is usually for 3 days in most MFIs now. CGT is followed by Group Recognition Test (GRT), where an official conducts a check on client awareness levels, the group which passes this test becomes eligible for loan. The rules are again repeated at the time of disbursement of loan which usually happens at the branch level. The clients are provided with a pass book that captures some of the information listed above.

Simialr processes are followed by MFIs following other methodologies as well. For

While MFIs bear large responsibility for avoiding over-indebtedness, clients also have a responsibility to borrow prudently.

example, SHG lenders explain terms and pricing of credit at each stage – pre-loan, loan verification, and disbursement. The pass books contain information as well.

> *Box 2*
>
> **Arohan's Passbook**
>
> - Complete insurance policy details along with claim procedure
> - A brief of its operation's policy – eligibility criteria for loan, JLG rules, loan approval process, document required, repayment process, insurance details, prepayment conditions, staff service assurance, rights and duties of Arohan and its clients.
> - Contact details including address and phone number of local branch office and head office and toll free number
> - It provides for preprinted repayment schedule

However, not all information is given on the passbook for e.g. only 54% of MFIs[17] disclose fees paid on the repayment schedule. MFIs have been reluctant to put in all the information on their pass books particularly with regards to interest rates since they do not want to attract unnecessary attention and negative publicity by printing. In addition there is reluctance in disclosing declining rate which is higher than the flat nominal rate communicated by most of the MFIs[18]. Nevertheless the disclosures are increasing on account of regulation, industry networks and work of MF Transparency amongst larger MFIs[19].

Client Awareness

There are two elements in transparency – clear communication with clients by the MFI and actual client awareness.

There are two elements in transparency – clear communication with clients by the MFI and actual awareness of clients. There have been concerns about the level of awareness among microfinance clients and the actual charges that they are paying MFIs. This has been on account of their high vulnerability to overcharging and mislaying on account of low literacy levels and little experience of dealing with formal financial institutions. These concerns have largely not been misplaced. In the Social Performance Assessments conducted by Microsave, two areas in need of improvement that are common across institutions are as follows:

- Communication with Clients: lack of structured, regular communication channels with members to ensure they are aware of any policy changes and
- Client awareness levels: Clients seem to be not fully aware of the total cost of the loan.

This was substantiated through the data collected from the field visits. The awareness levels were found to be as under:

Table 1: Client Awareness

Awareness parameters	Awareness levels based on field visits[20]
Loan amount	100%
Instalment size	100%
Repayment Frequency	100%
Interest rate	50%
Processing fees	80%
Insurance charges	50%
Insurance coverage	40%
Group guarantee	100%
Ability to make comparison with any other informal source	100%

Interest Rate - Clients' awareness levels about interest rates is fairly low. The interest cost is communicated in various ways – stated or nominal interest rate, total interest amount, declining equivalent or flat, monthly rate.

Processing fees - The clients were able to recall processing fees in most of the cases. However, there was some confusion between insurance charges and processing fees.

Insurance - Insurance related information was found to be low among clients. In some cases even centre leaders did not remember the details of the insurance. Regarding claim processing the key response was that they will contact their centre leader and field officer.

Thus the SPM assessments and ratings show that overall client awareness levels on the costs are low[21]. The MFIs need to intensify their efforts in improving client awareness about their products.

MFIs need to ensure more frequent interaction with clients on products.The information is provided during CGT/GRT and disbursement. However during their year long interaction, they are only required to repay a fixed amount at agreed frequency in quickly concluded collection meetings. Hence they are not able to retain most of the information provided to them. Lack of awareness often means low recall not low understanding.

Lack of financial literacy is another factor that can come in the way of making rational decisions. This was also substantiated in the recent study[22], which concluded that clients with low financial literacy are more likely to experience repayment distress. MFIs need to ensure that they provide complete information in the local language using local context of the loans that they are offering, however for improving financial literacy a deeper engagement and higher investment is required.

Responsible pricing

Microfinance clients are known to have valued the continuous availability of loans over price associated with it. MFI loans were perceived to be costlier than bank loans on account of higher operational costs due to door step delivery to the clients. This was a very strong justification for pricing of the loans.

The responsible pricing debate started intensifying when the industry indices[23] revealed widening the gap between MFI yields (income from loans) and operating costs (cost of servicing loans) and increasing return on assets. While the industry did demonstrate high median returns of assets, it was much lower than rest of the world[24]. This implied that benefits of increased efficiency and scale were not being passed on to the clients in terms of reduced interest rates.

Equitas has set new standards for the industry in terms of transparency and responsible prices in long-term pricing strategy. Its unique pricing philosophy was based on the following:

- Cost of expansion should be borne by investors and only steady state cost to be borne by borrowers.
- The company puts in place a self-imposed condition that it would aim at a Return on Equity(ROE) of around 20% (in line with RoE of nationalised banks in India) but would never exceed RoE of 25% under any circumstance. This means that all benefits of higher efficiencies would necessarily be passed on to borrowers by way of lower rates.
- These philosophies translated to Equitas charging an all-inclusive reducing balance interest rate of 25.5% on its first loan in Dec 2007 and stating the same in the client pass books, while the other MFIs were still stating flat rate in the loan cards.
- The client communication clearly explained the difference between declining and flat interest rates.
- The COC audit also revealed a very high level of transparency demonstrated by ASA International Cashpor. The pricing debate has however been settled by RBI. The interest rate cap and margin cap are in place.

PRINCIPLE 5: FAIR AND RESPECTFUL TREATMENT OF CLIENTS

MFIs need to treat their clients fairly and respectfully. MFIs also need to ensure that adequate safeguards are in place to detect and correct corruption as well as aggressive or abusive treatment by their staff and agents during the loan sales and debt collection processes[25]. This principle advocates treating clients with dignity even when they are unable to make the repayments as per schedule.

The success of microfinance in India has been anchored on credit discipline, which was enforced through peer pressure and enforcement by field staff. Common practices of ensuring

The success of microfinance in India has been anchored on credit discipline, which was enforced through peer pressure and enforcement of credit discipline by field staff.

peer pressure are insisting on other group members to pay up and if group members were not able to pay up, the centre members had to pay up. This led to a series of negotiations while the whole centre was held up in the meeting. The field officer would not leave the centre till the repayments were received, and this would mean extended meetings and pressure on centre leader to ensure full repayment.

Staff behaviour and unethical practices in client acquisition and ensuring repayment have been cited as one of the reasons for mass default crisis in Karnataka in 2009[26] and also in the events leading up to Andhra Crisis. MFIs have received a huge media backlash on the practices employed for ensuring collection leading to huge reputational setback.

There are some MFIs who as a policy do not enforce group guarantee even though they follow group methodology. Bandhan and ASA[27] International are such examples.

Bandhan and ASA have operationalized the pro-client loan collection practices right from the inception. They have tried to eliminate the stressful peer pressure that originates due to group members being liable to repay for the defaulting group member. While the women are organised in groups, the group just acts as a control mechanism to ensure that members do not make wilful defaults. In case a member is unable to make her payment, the other group members are NOT required to make up for the short fall.

Bandhan allows a grace period of up to four weeks for repayment in case of a mishap in the family or illness of the client. ASA's client can avail up to three repayment holidays in case she faces difficulties. As a result stress levels of clients and the group are considerably reduced.

Collection at the field level is fraught with challenges. On one hand, MFIs need to reinforce discipline while differentiating between the clients in real difficulty from those who are defaulting wilfully. Any behaviour in the field has a huge dominos effect as MFIs work in concentrated pockets. If one exception is made, the same is expected by all. Hence these policies need to be implemented with objectivity and communicated clearly to staff as well as clients. The commitment towards appropriate collection practices is now evident in acceptance and implementation among MFIs[28].

Box 3

Appropriate Collection Practices - Equitas

After the Andhra crisis, recognizing the fragility of group guarantee and the need to be more empathetic towards its clients, Equitas introduced a Customer Friendly Repayment Policy. This policy has been in effect from November 2010. This policy has ensured that all delays in repayment are not treated in the same manner. The wilful defaults and genuine difficulties are differentiated. The genuine repayment issues are further divided into long term and short term problems. The short term problems are dealt with group guarantees and long term issues are dealt with in combination of repayment holidays, and principle waivers. Additionally all the field staff of the Equitas have undergone a soft skill training which explicitly covers the accepted and unaccepted behaviour during collection and the staff are taught the difference between persuasion and coercion. Field risk audit checks the adherence of the same.

Ethical Staff Behaviour

MFI clients are vulnerable to malpractices on account of their low awareness levels. The systems need to be in place for preventing such practices. MFIs need to frame clearly articulate and practice codes of values and ethics. Incentives and disincentives need to be put in place to encourage ethical behaviour.

Some of the MFIs conduct specific soft skills training for their staff. Shikhar, an emerging MFI based out of national capital region conducts Ethics training for its staff. The ethics training covers the core values of the company through a mix of interactive activities.

The presence of agents who are not staff of the MFI have led to several unethical practices. Karnataka repayment crisis in 2009 brought to light the widespread corruptive paractices around selection of clients and disbursement. The MFI field staff were found to be using commission agents for sourcing clients to keep up with their enrolment targets due to growth pressures. In some instances, centre leaders doubled up as agents and they were serving multiple MFIs and charging commision and other fees from clients. This led to widespread proxy lending and later resulted into a full blown repayment crisis[29]. The COC audit reports also confirm the existence of these agents in the operational areas of some MFIs. However, this issue is being dealt with by all the MFIs visited during the field visit:

- Clients have been educated about not making any extra payments to anyone and to ask for acknowledgments for all their payments.
- Staff code of conduct is in place.
- Internal audit checklist requires a close checking of all the field level processes
- Zero tolerance policy for any staff misconduct is in place.
- Insistence on centre leader to hold only one MFI meeting in place.

One of the critical dimensions of ethical behaviour with clients is ensuring that they are protected from frauds by MFI staff. This would include ensuring that staff do not charge any bribes or commissions for sanctioning loans or misappropriates their repayments. MFIs are investing in robust processes and strong systems for supervision and monitoring including internal audit.

Overall, the standards of transparency, disclosure and ethical behaviour will need to be set by the board and senior management and ensure the adherence through internal control. Risk management systems are driven by governance and hence the ethics to be translated into practice will require demonstration from the top.

PRINCIPLE 6: PRIVACY OF CLIENT DATA

MFIs need to take measures for preventing unauthorised use of client data and maintaining confidentiality about their dealings with the MFI. This is about ensuring that there are policies in place which govern collection, storing, using and sharing of client information. The clients' information should not be shared with anyone without prior permission from clients. There are a few good practices in valuing privacy of client data. The KGFS model values confidentiality of the client information. All the wealth managers are required to collect the information at the client's place and they are taught to be non-judgmental and discreet about the collected information.

In India this principle is yet to gain buy-in. Privacy as a principle is not a priority for Indian MFIs as of now[30]. However, MFIs will need to provide client information to the credit bureaus for their effective functioning, which should be informed to the clients. Ujjivan shows a film to their clients that explains the concept and importance of a credit bureau, emphasizing the importance of building a positive credit history.

Overall, there is need for greater understanding of this principle and defining guidelines for what is authorised and unauthorised use of information.

PRINCIPLE 7: MECHANISMS FOR COMPLAINT RESOLUTION

MFIs need to have in place, timely and responsive mechanisms for complaints and problem resolution for their clients and should use the mechanisms both to resolve individual problems and to improve their product and services[31].

MFIs need to handle client complaints in a responsive manner. The most commonly used mechanisms by MFIs are printed telephone numbers on the client pass books, and having client suggestion boxes in the branch offices. However, in practice there is no systematic recording of complaints and working on them. Despite this there are some emerging good practices in the area of grievance redressal:

- Many MFIs now have a toll free number for clients that is handled by separate staff.
- There is a separate cell which is responding to client complaints

- Internal audit checklist covers the complaint resolution process.

The key issues around the mechanisms are that the toll free number at the head office level is manned by executives who need to have intricate details about the operations. With multi-state operations, it is important for the staff handling the toll free number to know multiple languages for them to understand the communication. Recording of the complaint is also important for follow ups. The system of follow-up should be put in place. The MFIs need to create awareness among the clients about this mechanism in place for its effective use.

Box 4

Ujjivan Service Quality Promise :

Ujjivan's service quality vertical is designed around the principles of client protection originated with a primary focus on the customer grievance redressal. Ujjivan has appointed Customer Care Executives (CCRs) in all mature branches (with more than 4000 customers with Regional Help Desks for grievance redressal. CCR details & Helpdesk numbers are being given to clients. CCRs have the following role in the branches:

- Making centre visits to inform them about the helpdesk and other credit plus initiatives of Ujjivan.
- Making note of all the complaints with all details. CCR also talks to Customer Relation Staff to ensure that fake complaints or complaints by defaulters are eliminated.
- Taking relevant action to ensure proper solution to customer's problem.
- Discuss the incidents of customer complaints in weekly staff meeting without naming CRS so as to ensure other CRS do not repeat the same.
- Following up with customers to ensure that the problem is solved.
- Escalating the complaint in case the complaint is not resolved in 2-3 days

In addition to the above responsibilities CCR is also responsible for monitoring the Centre leader Meetings which are organised to connect with clients.

CCRs are also responsible for improving client retention in their branches; they conduct the exit interviews of the dropout clients. CCRs record the concerns of the idle clients and the clients who do not wish to continue and enable the MFI to address their issues. Ujjivan is generally able to retain about 15-25% of idle customers. The core operations staff appreciate that service quality staff are helping them to improve their service to clients contributing towards improving the business performance. The service quality vertical of Ujjivan while catering to the mechanism for grievance redress principle also ensures adherence of other principles such as ethical treatment of clients and transparency while systematically recording and addressing client concerns.

Grievance redressal mechanism has a buy in from MFIs through policy and implementation. However, instituting an operating system that is functionally useful is still a challenge[32].

CONCLUSION

Indian MFIs have largely incorporated client protection principles. RBI has adopted customer protection principles in framing regulatory guidelines for MFIs. The regulatory requirements are making it mandatory for MFIs to integrate these principles in their functioning. There has been significant progress on implementation of some of the client protection principles such as avoiding over-indebtedness, ethical client behaviour and appropriate collection practices because of the current crisis. Other principles such as transparency and mechanism for grievances redressed are also gaining ground albeit more slowly. Privacy of client data is still not on the radar of Indian MFIs.

Investment in client awareness needs to be increased, and grievances redressal mechanisms needs to be systematically operationalised. Loan appraisal mechanisms have to be systemized to ensure an assessment of household cash flows and appropriate loan sizes to avoid overindebtedness. The criticality of group liability as a collateral substitute needs to be re-examined and alternatives considered.

Finally, the role of centre leaders in the outreach and delivery processes is a cause of immense concern and needs to be addressed. The insights from the field clearly point out the prominence of centre leaders and the asymmetry of information and social capital between them and the rest of the members which lead to unethical practices. A widespread negative consequence of this asymmetry is the coercion and harassment clients face from centre leaders. This raises a key question: how can the clients be protected from their own centre leaders? The sector needs to take corrective action on an urgent basis to address this issue.

Annex 1
Comparison of the Smart Campaign's Client Protection Principles and Codes of Conduct in India

Smart Campaign's Client Protection Principles	**Banking Code of Conduct**	**Sa-Dhan Code of Conduct**	**MFIN Code of Conduct**
Appropriate product design and delivery/ prevention of over-Indebtedness	• Customers will be contacted in their place of choice. • To help clients understand how the banks financial products and services work	• Raise the client's awareness of the options, choices and responsibilities in the financial relations. • Adequately inform clients about policies and procedures in order to enable them to make informed choices and decisions. • Avoiding over indebtedness and making efforts towards client education and financial literacy	• Check on multiple lending • Data sharing and incident sharing • Cap on lending
Transparency/ responsible pricing	• To maintain information transparency clear information of the services and products	• Clearly disclose all terms and conditions for finanical services. • Provide clear documentation on all rates and terms of payment. • Provide periodical statements of client accounts	• Clear communication of interest rates and other charges in writing and in a medium understood by the borrower.

Smart Campaign's Client Protection Principles	Banking Code of Conduct	Sa-Dhan Code of Conduct	MFIN Code of Conduct
Fair and respectful treatment of clients	• Collection policy is built on courtesy, fair treatment and persuasion • To act fairly and reasonably in all dealings with the clients. • To help clients understand how the banks' financial products and services work.	• Educate the clients on the code of conduct and their rights. • Design appropriate policies and operating guidelines to treat clients and employees with dignity	• Recovery mechanism: MFI shall not use any abusive, violent, or unethical methods of collection and recovery. • Efforts should be in line with guidelines issued from RBI from time to time.
Privacy of client data	Privacy and confidentiality of personal information	Privacy of client information	
Mechanisms for complaint resolution	• Complaints, grievances and feedback mechanism • Banking Ombudsman Scheme, information transparency and clear information of the services and products	• Feedback/ grievance mechanism. • Appointment of dedicated persons for resolving the complaints & ensuring transparency on all the terms and conditions in the language understood by the client.	• Ombudsperson Mechanism Consumer help-lines are in pipeline. • Clear communication of interest rates and other charges, in writing, in a medium understood by the borrower.

NOTES:

1. The SMART Campaign, launched in 2009 by a group of international donors, investors, providers and enabling instituions, assists the industry in ensuring clients receive fair and transparent services. As per Sa-dhan's report on social performance management, In India at least 82 microfinance institutions and resource institutions, including six of the largest MFIs, have joined the campaign and endorse the principles of client protection.
2. Rozas, D., 2011
3. Know Your Customers norms specified by RBI require photo identity proof and address proof of every client. There are various options for photo identity proof that can be provided such as ration card, BPL Card, voter ID card and recently introduced unique identification number.
4. Gaul in his 2011 article Defining Responsible Financial Performance: the role of growth argues that extensive growth is better than intensive growth as MFIs are likely to run out of good borrowers faster while increasing client base in the same area.

5. M-CRIL India Indices of Microfinance 2011 estimates the overlap to be 50%. The credit bureau transaction overlaps estimates it at 25% overall. In Karnataka it was found to be 43%. Highmark doesn't have data of all MFIs yet so overlap estimates are likely to be low.
6. Code of Conduct Audits were conducted by M2I a leading microfinance resource agency. Details of COC are provided in the Investor chapter.
7. October 2010 – March 2011
8. Credit Bureaus in India are monitored by RBI and governed by Credit Information Companies Regulation Act (CICRA), 2005. This law prevents the use of information submitted by members for marketing purposes. In addition onus of making legitimate enquiries lies with the members.
9. Source: Centre for Micro Finance, IFMR Research. "Access to Finance in Rural Andhra Pradesh 2010."
10. Source: 2011 CGAP EDA Rural Systems Study Microfinance in Kolar Karnataka revisited- new client survey data.
11. Source: 2011 M-CRIL EDA study "Of interest rates, margin caps and poverty lending How the RBI policy will affect access to microcredit by low income clients "
12. SIDBI commissioned Code of Conduct assessments for 8 MFIs during the last year. These assessments were conducted by M2i a resource agency for microfinance sector.
13. In conversation with India Representative of SMART Campaign
14. Portfolios of the poor, CMF study on Financial Access
15. Similar thoughts were expressed in a recent article on "Rethinking of Multiple Lending" By Daniel Rozas In Microfinance Focus published on 15th September, 2011
16. For full disclosure the annual percentage rate should include all costs including cost of any bundled service such as insurance or business development services. From the perspective of the client these are the costs that he/she needs to incur to receive loan. This is however debated by MFIs as these services are for the benefit of the clients and hence feel that they should not treat as costs for calculating APR.
17. MF Transparency India report
18. This was also discussed in MF Transparency India report
19. In discussion with India Representative SMART Campaign
20. Access team member along with the author visited 5 MFIs and conducted focused group discussions across 450 clients. This assessment is based on the discussions with the clients during the FGDs. The responses are averaged across clients. The sample has urban bias as 98% of FGDs were conducted in urban and peri-urban areas
21. This was also found in client protection assessments of 9 Dia Vikas Investees by EDA Rural Systems Pvt Ltd
22. MCIL Kolar Study
23. Source: M-CRIL Microfinance Review 2010
24. Source: 2011 Gaul Scott Defining Responsible Financial Performance: the role of profits
25. Rozas, D., 2011
26. Source: 2010 EDA Rural System Pvt Ltd Study on Competition and role of external agents – The 2009 Delinquency Crisis in Karnataka
27. Source Code of Conduct Audit reports of Bandhan and Asa International
28. In discussion with
29. 2010 EDA Rural System Pvt Ltd Study on Competition and role of external agents – The 2009 Delinquency Crisis in Karnataka
30. In discussion with India Representative SMART Campaign
31. Rozas, D., 2011
32. In discussion with India Representative SMART Campaign

Social Performance Management – The Road Ahead

8 *Chapter*

Social performance in the microfinance sector has come a long way over the last decade from being an optional extra to a core part of the deliverables. A transforming microfinance sector that had essential features of social performance as part of its mission and mandate had its attention diverted elsewhere. The pursuit of commercial funds led to large scale expansion that went astray in some places and institutions. Profit orientation and expansion as superordinate objectives led to customer distress and inappropriate models of business coming into existence. Country after country has seen problems arising from the unbridled and sometimes unregulated growth of the microfinance sector, which has not satisfied the customer. More than the customers, the other stake holders and those watching the sector from outside have felt that microfinance, far from being a service to vulnerable people was fast becoming the source of their problems.

Over the last three years, much greater attention on the social performance aspects has been in evidence. The commercialisation using market-based capital funds that started with good intentions led to significant concerns being raised on the role of funders and lenders. The corrections to the sector entailed a movement towards responsible finance and socially relevant actions in client targeting, product design, process design and governance. Reporting structures and rating mechanisms have evolved to ensure that the sector performs well. While other stakeholders tried to drive the social performance agenda on the MFIs from the outside, the MFIs themselves through their industry associations went in for implementing codes of conduct that reinforced responsible finance practices. Today there are terminological debates in the social performance domain; the distinction between quality customer service, responsible finance practice and Social Performance Management is blurred.

While MFIs have their mission to fulfil, they should ensure that the quality of customer service is of a high standard and its financing practices reflect a sense of responsibility towards customers. Social performance calls upon them to make significant changes in the way they acquire clients, the way they set business targets as also ensure a sensitive and empathetic handling of customers. Governance is a key aspect of the entire set of actions in social performance. The quality of boards and the level of information available to the boards on social performance still fall short of what is desirable. A good board with sound governance structures would ensure that there is sufficient internal focus on delivering value to customers in a social sense. If governance is not designed well, the focus could shift to demonstrating to the external world that the institution is socially performing even when the customers do not get the benefits thereof.

While MFIs have their mission to fulfill, they should ensure that the quality of customer services is of a high standard and its financing practices reflect a sense of responsibility towards customers.

Whether MFIs by themselves can deliver social performance is a complex question. The expectations from those outside the sector and stakeholders other than MFIs is that the MFIs are the prime if not the sole drivers that should deliver on social performance. However, it has to be remembered that MFIs do not operate in a vaccuum. There are owners, customers, regulators, donors and researchers who have their expectations of what an ideal MFI should do and deliver. These expectations from the outside are not premised on business concerns and these stakeholders often do not have primary considerations of institutional sustainability. An MFI in order to be able to deliver sustainable services in a socially relevant manner requires support from all around.

Regulation should provide an environment in which institutions can exercise the freedom of choice and compete fairly with others in the market. The policy environment should provide a level playing field and reasonable entry and exit norms so that entrepreneurs can take decisions. The investors should have mature moderate expectations of returns and should not drive the MFIs into producing high returns to service commercial equity. The lenders should ensure that the MFIs have cost effective borrowing lines so that the ultimate cost to the customer is reasonable. Unless all the stakeholders get together towards one objective that is of serving the vulnerable customers in a manner that is socially relevant at the same time protecting the institutions' financial interest, it would be difficult for the MFIs alone to perform. The risks of dealing with the political and social uncertainties should not be left to the MFIs. The other stakeholders cannot remain isolated from the risks of the MFIs. Over a period the risks will escalate and will eventually impact all stakeholders at the higher levels of the sector. This is what happened in Andhra Pradesh and it will repeat itself unless the other stakeholders realise their responsibilities and enable the MFIs to do their task effectively.

Contextualising the operations of MFIs to the local areas in which it does business and ensuring that the potential vulnerable people are included as customers with quality services is probably the best way an institution can deliver social performance.

In the Indian context, regulation has taken a firm hold on customer service as also responsible finance. The Malegam committee recommendations moved the emphasis from the harsh and stringent norms of behaviour and business models imposed by the Andhra Pradesh regulations. The RBI regulations for MFIs issued a few months back had clear directions on targeting of services, client acquisition, processes, extent of borrower indebtedness, avoidance of multiple loans, staff conduct towards customers, setting up of grievance redressal mechanism as also pricing of loans. Certain issues relating to product design were also part of RBI's regulations.

The ongoing effort to create a separate class of institutions as NBFC MFIs has to be looked at carefully. An institution defined as an MFI will have to adopt the responsible finance and social performance frameworks. An institution that merely wants to offer quality service but not wanting to be burdened with social performance aspects might choose to be outside the definition of MFI and carry on with any business model as it sees fit. The arbitraging based on a mere classification would introduce two different types of services and approaches as far as the customers are concerned. Regulations should apply across the board to any type of institutions that serves the same class of customer. The object of regulation should be that vulnerable customers are similarly serviced. The short point is that institutions should not have the option to avoid social performance by remaining outside the regulatory definition of what constitutes microfinance.

While the regulatory expectations are the minimum, the MFIs themselves can deliver much better quality of customer protection and responsible finance. The code of conduct designed by the two industry associations go much further than what the regulator has imposed except in the case of interest pricing.

However, the move from responsible finance to social performance is likely to be tough and entail costs. Targeting the poorer persons in every location, delivering a variety of financial products closely aligned to the customers' requirements, keeping the prices of loans at low effective rates and ensuring good systems of loan service and grievance redressal are bound to impact profitability of MFIs heavily. Given the very low average loans and the large numbers to be covered, the cost of operations would certainly be high. When seen in the context of the interest and margin caps imposed alongwith an accompanying hardening of interest rates on borrowed funds, it would be very difficult for MFIs to deliver responsible finance at the capped rates of interest for a long period of time. Regulation has to review its stance in relation to MFIs. High quality service and Social Performance Management do entail high costs. The freedom for pricing should be available to MFIs in order to ensure that they continue to serve the customers. If public policy dictates that the rate of interest to the customers should be low so that it is highly affordable to them, then the cost of low priced loans should be borne by the state; commercial institutions would be hard put to incur high cost and negative returns. This effectively means that institutions would either scale down or close operations, which will limit the choices available to the excluded people. Instead of making social performance a compulsion, incentives should be built in to make institutions voluntarily adopt SPM. These institutions could be in the form of funding infrastructure cost, dedicated refinance facilities at low effective rates, capacity building of institutions and institutional strengthening in areas related to social performance. These incentives will go a long way in ensuring that MFIs adopt responsible finance and social performance practices without concerns relating to their own sustainability.

Contextualising the operations of MFIs to the local areas in which it does business and ensuring that all potential vulnerable people are included as customers with quality services is probably the best way of social performance that an institution can deliver. The reporting, measurement and the assessments do not add much to actual delivery. They merely provide an external view of what the institution does to its members. The more concentrated efforts are made on making institutions internalise responsible finance and social performance principles and enable the staff to gain the competence to deliver on social performance, the better it is for the sector. Stakeholders looking from the outside into the MFIs do serve a good purpose. But then this should not become the major task in social performance. Making MFIs to perform to the requirements of customers is the more legitimate and critical task. This requires more investments in the institutions that deliver.

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For a longtime as a value added idea, pushed by a few donors and social investors, Social Performance Management in microfinance was seen more as a distraction and the focus largely remained on financial performance. Of late, the criticality of Social Performance has assumed serious significance and is increasingly being seen as central to the operations of MFIs. Several stakeholders have been investing in efforts to embed Social Performance indicators into institutional practices and promote management and staff to adopt them. Efforts of a few stakeholders such as social investors, the Smart Campaign, the Social Performance Task Force, MIX and MF Transparency at the global level have helped to push the idea and agenda of Social Performance and its adoption by MFIs. Within India, particularly after the Andhra Pradesh crisis, the need and significance of SPM to be adopted and internalized into MFI operations came to be realized. While EDA initiated the idea of social ratings a few years back, there was not enough response to the idea from MFIs. However, soon after the crisis, the SIDBI - led Lenders Forum and the more recently established Responsible Finance Forum have helped in better integration of SPM within the practice of the microfinance sector, which has been enabled by the Codes of Conduct instituted by the two industry associations, code of conduct assessments of MFIs and SPM reporting in MIX. Given the critique from within and outside the sector regarding drifting from the mission, the need for promoting Social Performance Management and documenting and disseminating the progress in this area, SPM has become more critical. The Social Performance Report 2011 is the first report brought out by ACCESS Development Services to present a landscape of the role being played by various stakeholders in helping to internalise Social Performance in operations, document and showcase best practices through field-based evidence and help to build and strengthen the drive towards responsible finance.

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