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Beyond "Ethical" Financial Services: Developing a Seal of Excellence for Poverty Outreach and Transformation in Microfinance

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The idea of a Seal of Excellence in microfinance is to set a vision for the sector in terms that highlight the potential of microfinance to serve the poor and to contribute to a positive transformation in the lives of clients and their families and communities. A Seal would also provide a means of identifying and recognizing microfinance institutions (MFIs) that are implementing this vision using objective criteria based on a double-bottom-line ethos that underscores both the social and financial performance of MFIs. This idea is increasingly relevant today as recent developments—even crises—in some countries have demonstrated the risks of concentrating on the single bottom line of growth and financial performance alone.

All agree that poverty outreach and transformation (or contribution to poverty reduction) was the vision with which microfinance started. This ideal is well set out in the statement of the Asian Development Bank that defines microfinance and its potential (Box 1.1).[2]

This underlying philosophy of microfinance is repeated in hundreds of mission statements, websites, and case examples by MFIs and investors, and is the social basis for much of the funding that has gone into microfinance in the past two decades. For example, Box 1.2 quotes from two organizations that have played a key role in promoting the industry globally.

But while funding in microfinance has increased and the sector has grown, performance measures—and rankings of MFIs—have tended to focus on scale and financial indicators. Growth has been significant. Data reported by over 1,100 MFIs to the Microfinance Information Exchange (MIX Market) show

Box 1.1 Definition of Microfinance and Its Potential

Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their microenterprises.

Microfinance can be a critical element of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable the poor to smooth their consumption, manage their risks better, build their assets gradually, develop their microenterprises, enhance their income earning capacity, and enjoy an improved quality of life.

Microfinance can provide an effective way to assist and empower poor women, who make up a significant proportion of the poor and suffer disproportionately from poverty.

Asian Development Bank

Box 1.2 Microfinance Is About Serving Poor People

50 years: one mission. Since Accion's founding in 1961, our mission has always been to give people the opportunities they need to work their way out of poverty.

Accion's announcement of its 50th anniversary celebration 2011.[a]

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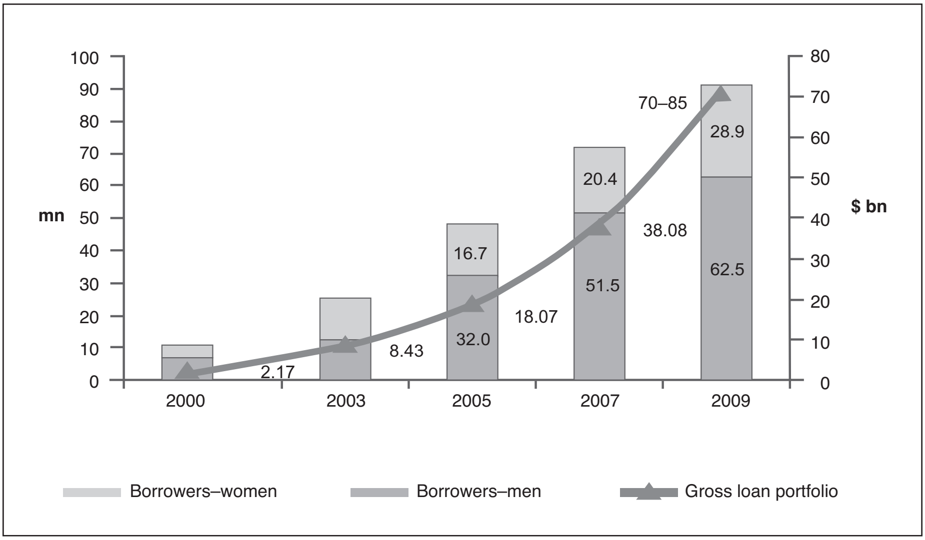
"Without firm commercial foundations, microfinance cannot become the profitable business that it needs to be in order to survive," said Elizabeth Littlefield, CGAP CEO. "But without firm ethical principles and a commitment to benefit poor people's lives first and foremost, it will no longer be microfinance. What Pocantico established is a common vision amongst microfinance leaders that a positive impact on the lives of the poor is at the essence of microfinance and that principles need to be established to clearly uphold that."

The "Pocantico declaration," 2008[b]

Notes: a. See http://www.accion.org/Page.aspx?pid=2197.
b. See http://www.bouldermicrofinance.org/POCANTICO/index.htm.

that by the end of 2009 there were globally 91 million borrowers, 68% of whom were women, and over 78 million depositors. The total gross loan portfolio (reported by 1,121 MFIs) was nearly $71 billion, and total deposits (reported by 619 MFIs) were $27 billion (see Figure 1.1).[3]

Figure 1.1 Growth in Microcredit (reported to the MIX)



Growth has led to transformation in the institutions delivering financial services, as many MFIs have adopted different legal structures. Many MFIs have transformed from NGOs and societies into banking and nonbanking finance companies, thus enabling them to raise capital for their growth, and provide a broader range of products and services—notably savings services that require a regulated status in many countries.

Given limited access in developing countries to formal financial services, the focus of the early years of microfinance was on creating this access. So growth—in microfinance clients and portfolio, along with on-time loan repayment—appeared to many stakeholders as a win-win. Growth was good for business—enhancing the profits of the MFI and the financial returns to promoters and investors, leading to further growth. It was also seen as a social good, since more loan accounts means more people with access to financial services—in other words, more financial inclusion, and all the other benefits that have the potential to follow. Investing in microfinance too became popular, safe, and profitable, with an accompanying halo effect since the sector was seen as contributing to development and poverty reduction through increasing access to financial services per se.

However, impressive growth in microfinance at the global level has been accompanied by signs of stress in a few countries in the past two years. A recent Consultative Group to Assist the Poor (CGAP) focus note analyzes the reasons for regional- or national-level delinquency crises in microfinance in four countries

(Nicaragua, Bosnia and Herzegovina, Morocco, and Pakistan), which have all experienced a repayment crisis after a period of high growth. The case studies indicate that although the global economic crisis was among various reasons affecting borrower capacity to repay in these countries, the primary cause of the problem lay in the institutional limits to growth, reflected in concentrated market competition with multiple borrowing by clients, overstretched MFI systems and controls, and an erosion of lending discipline.

India since 2010 has been facing a similar crisis, with rapid microfinance growth combined with increasing evidence of clients borrowing from more than one MFI, particularly in the two southern states of Andhra Pradesh and Karnataka. These two states account for around one-third of MFI loan accounts in India, and are home to the largest MFIs in the country, including SKS Microfinance Ltd., which had its IPO during 2010. Scale combined with apparent success on the capital markets in the name of the poor has attracted political attention and reaction. At the time of this writing, loan repayments are practically at a standstill in Andhra Pradesh. Negative publicity around allegations of suicides by overindebted clients, misbehavior by MFI staff, high interest rates charged to clients, and profiteering by MFI promoters has undermined the reputation of the sector as a whole, raising questions around governance, cost structure, strategic planning, mission drift, and regulation.

Lessons From India

One of the main lessons from India today is that scale and growth can go too far. It is possible to provide too much credit into too highly a concentrated market. And it is likely that the high levels of profitability contributed to the greater credit saturation. It makes us wonder whether the objectives of scale need to be revisited and similarly whether the lure of high profitability into a single product credit market is desirable. The evidence from Andhra Pradesh suggests we need to re-think or evolve what might qualify as "good" or "responsible" microfinance.

Greg Chen, CGAP

Beth Rhyne cautions now against the "hypnotic mantra of scale, scale, scale" with increasing evidence from some regions of the world that behind the overall numbers of microcredit accounts and million-dollar portfolios we may find, not growing numbers of happy, enterprising women and men working their way up out of poverty, but on the contrary, evidence for mission drift, irresponsible lending, and more obvious financial benefits to the MFI and its investors than to intended clients.[4] In 2008 Alex Counts paved the way for "Reimagining Microfinance,"[5] and last year, close to the events in India, Sanjay Sinha talked of the need to "Calm the Charging Bull."[6]

Rethinking is taking place across the sector, largely in terms of putting clients at the center of microfinance. This is an aspect that is beginning to be referred to as "fair trade microfinance."[7] It has implications for responsible and ethical microfinance, as well as social performance management; a move to fair trade microfinance also reflects a need to look more closely at the role of microfinance and related services in serving poor people effectively, enhancing opportunities for women, and including clients in governance structures. These issues apply both to MFIs as practitioners and to investors who are playing an increasing role in microfinance (the microfinance investment vehicles [MIVs]).

> **"Fair Trade Microfinance"**
>
> *It is high time for the launch of "Fair Trade Microfinance." The broader world, including international media, investors, and donors, will only have confidence in microfinance if the industry can in turn provide confidence that its members are genuinely working on behalf of their clients.*
>
> Beth Rhyne
> Center for Financial Inclusion

Drawing on these developments, the starting point for the design of a Seal of Excellence in microfinance is to ask: how can we think of "top performers" in a different way? Not in terms solely of the number of borrowers and the return on assets of a MFI, nor indeed the highest figures for these indicators, but also (and equally) with reference to social values and metrics—which needs to include indicators for responsible and ethical finance, as well as indicators that can be related to the contribution of microfinance to development. Being a top performer in microfinance means top performance in the double bottom line: balancing the financial goals of efficiency and profitability with social goals and values that relate to responsible and ethical practices, inclusion, and effectiveness. Financial sustainability and social values are both relevant and important.

How that balance works out can differ in perception and in practice, depending on the MFI's mission, legal structure, and governance. Different institutional models (banks to NGOs) reflect different orientations, systems, expertise, and liabilities. While the sector recognizes a double-bottom-line component, and the orientation to responsible and effective financial inclusion is reflected in mission statements and websites, whatever the model of microfinance, the balance of the double bottom line may tilt more one way or the other (financial or social). This initiative is in response to a perceived tilt more toward commercial goals in the sector, and a need to define social values and standards and their role in achieving a particular vision of the role microfinance can play for development.

Increasingly, we have the tools and metrics to define and measure social performance in microfinance, along with financial performance. These come from a variety of global initiatives that have included, since 2004, the development of social audits and social ratings, pilot reporting on social performance standards in the industry, the development by social investors of social scorecards (to match financial due diligence for investment), tools for poverty assessment and benchmarking, and an international campaign to define and implement client protection principles as part of responsible financial services. Regionally and at the country level, some networks of MFIs are beginning to put in place a code of conduct for the board and management of their members.

In all these initiatives, the focus is on practical tools—what can be measured, and what can be managed by an MFI to improve its social performance and to demonstrate social and development value, alongside the conventional indicators of growth and profitability. The range of initiatives related to the double bottom line in microfinance is discussed later in this chapter. The proposed Seal is intended to complement other ongoing initiatives related to responsible, ethical, and double-bottom-line finance (as promoted by the Smart Campaign and the Social Performance Task Force), which is discussed later in this chapter as well.

First we turn to a review of approaches to developing Seals of Excellence in other related fields.

DEVELOPING STANDARDS: EXPERIENCE IN OTHER SECTORS

What can we learn from the experience of developing certifications or Seals of Excellence in other sectors? This section aims to draw lessons that are relevant for the microfinance industry, and considers the draft design and implementation of a Seal of Excellence for microfinance later in this chapter.

There have been similar concerns and developments globally around strategic performance measuring nonfinancial elements, as well as the double/triple bottom line applied to businesses and nonprofits in different sectors. The main fields of certification and reporting that hold relevant lessons for microfinance include NGOs, management performance, impact investing, fair trade, environmentally sustainable forestry, fisheries, organic agriculture, health services, and education.

In the context of preparing this chapter, we looked at many examples and categorized them broadly according to purpose, as shown in Table 1.1. The purposes may overlap, and there may be more, but these seem most relevant to compare with or align to a proposed Seal of Excellence in microfinance. Common features of these examples include the following:

- All are *seeking to clarify or improve standards* in their sector, either to motivate companies/service providers to improve their performance so as to receive certification or a Seal of Excellence, or to demonstrate new standards that may set the direction of future development.

Table 1.1 Purposes and Examples in Designing Standards in a Sector

Purpose	Examples
1 Respond to a recognized need for more information and transparency	Charity Navigator: NGOs
Support credibility of a sector accessing public funds, or looking for donations or social investment	GIIRS/B-Lab: companies seeking mission-aligned capital
2 Public accountability and improvement of services provided	Maryland Association of Nonprofits Public standards in health services, education
3 Minimum expected standards of quality for a specific product	ISO—manufactured products Food safety standards
4 Differentiate a service or product that represents development value in terms of, e.g., environmental sustainability or working conditions/benefits to producers	Many: in fisheries, forests, organic agricultural products, fair trade in various items
5 Support excellence in any field through public recognition and profiling of outstanding examples	Many: from organizational management (Baldrige) to handicrafts (UN)

- There is *stakeholder engagement* in setting standards (to build buy-in, recognize different concerns).
- There is *evolution of standards* to allow for modifications and improvements over time.
- In some cases, the approach involves setting *standards and actively supporting improvement in organizations* so that they are able to achieve those standards.
- *Standards may be linked to a public reporting mechanism* (for example, Charity Navigator is based on public accountability reporting to US Form 990); an agreed set of reporting indicators makes it easier to collect information, and standardized reporting can reinforce standards. The Global Reporting Initiative (GRI) is relevant here. It is not a certification or Seal of Excellence but a set of guidelines for public reporting that is applicable to and adapted to different sectors.
- The *content of the standards represents similar features*—in terms of governance and accountability, social responsibility, and development value.

- Where this is relevant (mainly related to purposes 1, 2, and 4 in Table 1.1), there is a common *challenge to define and measure end results*—in other words, the positive benefits or changes (impact) for local people and communities, beyond more readily available information on policies/systems and outputs in terms of numbers of participants.

In setting out the concept of a Seal of Excellence in microfinance, it is interesting to select a couple of the initiatives to map out their process of development and implementation, as a guide to what may be possible. For this we have selected three initiatives that seem close to this idea for microfinance, having a graded Seal (not just pass/fail certification) with related indicators. These three are the Maryland Association of Nonprofits, Charity Navigator, and B-Lab/Global Impact Investing Rating System (GIIRS). Their key features are summarized in Annex 1.1.

Considerable expertise has developed with some emerging lessons, which the International Social and Environmental Accreditation and Labelling Alliance (ISEAL) has brought together in a series of publications. ISEAL is "an international non-profit organization that codifies best practice for the design and implementation of social and environmental standards systems." ISEAL has created an international system of reference for setting social and environmental standards. The belief is that the credibility of social and environmental standards can be strengthened by the way the standards are set. ISEAL members are committed to improving the way they set their standards by complying with ISEAL's Code of Good Practice for Setting Social and Environmental Standards.[8] The code sets out systematic principles and guidelines for setting standards as well as setting up systems to implement. It draws on the ISO/IEC[9] Guides 2 and 59 code of good practice for standardization while adding practices that are relevant to social and environmental standard setting.

Two key elements of the code relate to building on what already exists and engaging with relevant stakeholders:

1. Determine the *need for the standards:* consider existing standards, how to complement these standards, and how to avoid duplications or contradictions. This step means understanding which standards already exist and the extent to which they overlap with the proposed initiative. (If the possibility exists to direct energy to further development of an existing standard, this should be carefully considered as an option.)

2. *Know your stakeholders* and communicate with them: stakeholders include all individuals and groups that are impacted by or have a potential

interest in the standard. Identify different interest groups, as well as key organizations that are representative of these interest groups. Better to err on the side of too much participation rather than too little.

The next section maps out key stakeholders in microfinance and reviews what standard-setting is already out there.

INITIATIVES THAT RELATE TO SETTING STANDARDS IN MICROFINANCE

The aim of this section is to review the initiatives that contribute to setting standards in microfinance. These initiatives provide the basis for engaging with key stakeholders to design a Seal of Excellence in such a way that it would build on and integrate with existing initiatives.

Microfinance stakeholders are listed in Table 1.2. The work of several groups of stakeholders and associated networks is relevant here. The initiatives reflect both financial performance (for which indicators and ratios are mostly well established) and social performance (which are more recent developments and largely works in progress). The following section focuses on the developments in social performance as an emerging field.

Table 1.2 Stakeholders in Microfinance

• Clients of MFIs
• MFIs—microfinance banks, nonbanking financial institutions, NGOs
• Associations/networks of MFIs—global, regional, national
• Regulators, policymakers
• Investors/MIVs—social, commercial
• Indirect investors (who fund MIVs)—institutional/private
• Banks—lending to MFIs
• Donors
• Aggregators (such as MIX)
• Rating agencies—specializing in microfinance
• Corporate researchers
• Media/public

Financial Performance

During the 1990s, initiatives in microfinance emphasized and promoted practices relevant to building strong financial systems with an emphasis on the growth and financial sustainability (efficiency, portfolio quality, profitability) of MFIs.

The specialist rating agencies, which first emerged in 1997–1998, developed a set of quantitative and qualitative indicators to measure governance, management, and financial performance as part of their performance assessments or credit ratings of MFIs. Ratings of larger MFIs are now also undertaken by the corporate rating agencies: Standard and Poor's, Moody's, Fitch, CRISIL.

The SEEP Network in 1995 published 16 ratios for financial analysis, with updates in 2002, 2005, and 2009 through the Financial Services Working Group.[10] These ratios provide a widely adopted basis for measuring financial performance and are reflected in the organizational and financial indicators that have been reported to the MIX Market website since the late 1990s. MIX data is publicly available online for all reporting MFIs.[11] Benchmarks are also created annually for key operational and financial indicators using peer groups for legal status, target market, age, region, country, scale, outreach, and other factors.

More than 1,000 MFIs globally in 2010 reported financial and operational data. The published data reflect the key indicators and ratios used to measure financial performance and efficiency, and show the variation by peer groups. This provides a reference point for potential financial benchmarks (the financial bottom line) as part of a Seal of Excellence for microfinance.

Social Performance

Sector initiatives to capture the second bottom line in microfinance started in the early half of the 2000s. These were brought together through the Social Performance Task Force (SPTF), an informal group of interested stakeholders who held their first meeting in 2005, with annual meetings since then. The SPTF expanded to more than 850 members in 2010, including all main stakeholder groups and quite active subcommittees.[12]

A core concern initially of the SPTF was to define social performance (Annex 1.2 provides the definition),[13] and to build consensus around a conceptual framework that presents the key elements of social performance for the industry. This consensus was built through an interactive process during 2006, drawing on the experience at that time and linked to the concurrent development of social ratings and audits.

Annex 1.3 sets out the conceptual framework or pathway for social performance. This framework represents substantial consensus in the sector around the organizational processes and systems at the MFI level as well as the outputs and results at the client level. "Impact"—within dotted lines, to the far right of the pathway—is used here in the technical (or academic) sense to mean "change that can be attributed to an intervention." The dotted lines denote the complexity and costs of assessing impact—as already noted for standard setting initiatives in other sectors. The pathway recognizes the relevance of impact, but initiatives around social performance stop short of trying to assess it, focusing instead on the preceding steps that are likely to contribute to positive change.

The social performance framework provides the reference point for understanding different initiatives. Different initiatives have focused on one or more steps in the pathway, as outlined in Annex 1.3. The following is a brief description about each initiative. These initiatives are at varying levels of development.

Initiatives With Overall Coverage of Social Performance Issues

Social performance standards (SPS) on the MIX. A set of indicators was developed and piloted through a consultative participatory process of the SPTF 2006–2008. The questions reflect the different components of the social performance (SP) pathway, both systems and results. They provide a taxonomy of questions and indicators that reflect the current state of practice in social performance reporting. The MIX market now aims to provide an "all-encompassing view of an MFI's performance by integrating social performance data into its online display: making social performance data more accessible to MIX Market users, underscoring the importance of social performance management, increasing the visibility of MFIs' social performance practices, and making it easier for users to analyze an institution's performance across both financial and social indicators. All social performance information is now featured directly alongside the financial information of individual MFIs on their profile page."[14]

***Imp-Act* consortium and integrating social performance into management.**[15] The consortium is a group of networks and technical assistance providers from around the world who pioneered the concept and practice of social performance management. This started with an action research program (2000–2003) with MFIs across different geographical regions, to monitor and improve impact (rather than proving impact)[16] in microfinance. The consortium currently promotes and documents good practice for double-bottom-line management to "serve the poor and excluded," including governance, strategic planning, human resource management, risk management, MIS, and reporting.[17]

Social audits (Cerise Social Performance Indicators—SPI),[18] ***Imp-Act* consortium/MFC SPM Quality Assessment Tool (QAT),**[19] **and social ratings (by**

the four specialist rating agencies: M-CRIL, Microfinanza Rating, Planet Rating, MicroRate). These cover the main steps of the social performance pathway, including mission, governance, strategy, products and services, and client protection, as well as gender approach and responsibility to staff, community, and environment. Social ratings may also include client-level profiling (poverty level at entry, vulnerable groups) as well as client awareness and client feedback on products and services. These assessment/rating tools have been piloted and developed since 2004–2005. The corporate raters (e.g., Moody's) are also beginning to show an interest in developing their own social rating tool. B-Lab is in 2011 piloting the rating of microfinance as part of the Global Impact Investing Rating System (included as an example in Annex 1.1).

Reporting by social investors in microfinance. Microfinance investment funds (also known as MIVs or microfinance investment vehicles) are developing a set of reporting indicators called Environmental, Social, Governance (ESG) indicators alongside existing indicators that cover financial risk assessment and organizational profiling of their MFI investees. Social investors are developing social scorecards that they use to screen potential investments as social due diligence alongside financial due diligence. The scorecards reflect social performance criteria that become part of the monitoring and reporting requirements to MFI investees.[20]

In 2010, as a subcommittee of the SPTF, a group of social investors has started to discuss the possibility of harmonizing their tools. The aim is to explore a consistent set of indicators and reporting requirements from MFIs, to align with the SPTF framework and MIX indicators as much as possible, and also to include the emerging concerns in MFI around governance and client protection.

Indicators are under development both for MIVs to assess their investments/MFIs and for potential funders (indirect investors) to assess MIVs.

Initiatives With Focus on Specific Aspects of Social Performance

Smart Campaign. Started in 2008 by the Center for Financial Inclusion at ACCION International,[21] the campaign has built consensus around six principles of client protection and is in the process of developing guidelines for good practice and assessments at the MFI level. The campaign is working with a technical subcommittee to establish specific indicators and is also exploring certification.

The principles of client protection are publicized and well received by MFIs and other stakeholders worldwide, and are increasingly recognized as non-negotiable across all models of microfinance. Over 1,000 signatories have endorsed the campaign—MFIs, investors, donors, networks, and support organizations as well as individuals. The campaign is actively working to document examples and guidelines of good practice in client protection covering all types of microfinance services, including the difficult area of what counts as "responsible costing" in microfinance.

Microfinance transparency. Also started in 2008, this initiative publicizes costs to clients of microcredit for different products of individual MFIs by country, relative to loan size and costs of delivery.[22] The idea is that clear, robust reporting, closely verified, helps to build evidence for what is "responsible" pricing. This point is important for understanding and analyzing a complex area, which otherwise MFIs can represent in different ways. Microfinance Transparency has been working in seven countries, with plans to expand into another 11 during 2011. The work and approach of Microfinance Transparency are publicized and accepted by stakeholders—including MFIs—worldwide.

Women's World Banking (WWB) and Women's Empowerment Mainstreaming and Networking (WEMAN). These groups are developing indicators for MFIs to report on gender equity, with training modules and case studies on integrating a gender focus into microfinance programs.[23] While women's empowerment through microfinance is a stated value for many involved in microfinance, and has been one of the core principles promoted by the Microcredit Summit Campaign, the topic lacks consensus, clear definition, and attention. Opposing views exist between those (especially male leaders in the sector) who see having women as microfinance clients as sufficient for gender equity, and others who point out that having women as clients because they accept small loans, pay on time, and are more humble is more opportunistic than empowering. The latter see having women as clients as just the starting point for gender equity, given the socioeconomic barriers that women face. Since those barriers differ in different contexts and regions, the elements of gender equity have proved difficult to define in a practical way and to implement. Clearly, having female clients involved in ownership and governance of MFIs is a step in the right direction, especially when management is largely male.

As these elements become more practically defined, they will serve an important part of the promise of microfinance. This is a work in progress.

For the issues of health, safety, and the environment, the Netherlands Development Finance Company (FMO) has developed a set of guidelines and a training module for implementation by MFIs in relation to financed enterprises.[24] These are important issues, though MFIs find it difficult to address such questions along with everything else they are expected to do. There is, nevertheless, growing awareness of environmental risks in microfinanced enterprises that depend on the natural resource base (agriculture, fisheries) as well as larger-scale enterprises (small and medium enterprises [SMEs], larger than the typical micro-enterprises financed by microcredit). Also a work in progress, FMO guidelines probably have selective application.

The International Labour Organization (ILO). A survey of 16 MFIs globally identifies issues related to working conditions of MFI clients (including child labor and safety) and presents test strategies to address these issues.[25] The survey has not focused on wage employment specifically, but seems to have expanded to include general issues related to client awareness, appropriate products, and managing income fluctuations. The ILO is currently supporting program interventions (e.g., client training) along with Randomized Control Trials to assess the impact of the interventions. If the impact is positive, then MFIs are expected to continue them. The survey's findings seem particularly applicable for hired (nonfamily) workers in small and medium enterprises.

Poverty assessment of clients. There have been various types of tools developed to measure the poverty level of microfinance clients. These include, for example, FINCA's client assessment tool, Freedom From Hunger's food security index, CASHPOR's housing index, and CGAP's poverty audit. Most recent developments include the development of scorecards statistically derived from national survey data sets, and benchmarked to specific poverty lines.

Progress out of Poverty Index (PPI). A tool developed since 2006 by Mark Schreiner of Microfinance Risk Management and supported by the Ford Foundation, CGAP, and the Grameen Foundation (US), the PPI is now available for 34 countries worldwide.[26] It is a practical tool to assess the likelihood that a household is living below the poverty line. The tool comprises 10 easy-to-collect indicators, linked to a poverty benchmark, statistically derived from national survey data for different countries, where the data is relatively recent, robust, and available.

The tool enables collection of data on poverty levels of clients at entry to profile the depth of outreach. Poverty profiling of clients at entry provides a baseline with which to compare possible changes in poverty level over time. The Grameen Foundation has been driving the adoption of the PPI as an industry standard, recently introducing certification for basic, standard, and advanced use.

MFIs with a clear poverty focus in their mission (and similarly oriented social investors/funders) are motivated to try out and apply the PPI. The tool is also being applied as part of social rating.

Poverty Assessment Tool (PAT). Promoted by the US Agency for International Development (USAID), developed by the IRIS Center at the University of Maryland, and developed for 33 countries, so far,[27] the PAT has a similar purpose as the PPI—benchmarking poverty levels—and similar basis, statistical regression from national survey data sets. A difference is in the larger number of questions (up to 24). Used by recipients of aid from USAID, including some MFIs, the tool is specifically intended to enable reporting on outreach to clients living below $1 a day as part of assessment for the Millennium Development Goals.

STEP UP (Strengthening the Economic Potential of the Ultra Poor). Drawing on the experience of SEEP members and others with programs targeting the extreme poor, this is a very recent initiative (2011) of the Poverty Outreach Working Group (POWG) of the SEEP Network to generate, share, and replicate lessons learned to design a range of economic strengthening activities aimed at those living in extreme poverty.[28] This initiative emphasizes the synergies and linkages required between different types of programs—microfinance, social safety nets, enterprise development, value chain development, livelihoods promotion, and health. Over the next few years, it will promote learning and partnerships that bring together practitioners, donors, and researchers from these different specialties.

Associations/networks. At the national and regional levels, networks of MFIs are beginning to draw up codes of conduct for their members, with a focus on issues around client protection.[29] The national and regional microfinance networks in Latin America and the Caribbean (LAC) have joined together to support social performance in Latin America and are beginning to look at standards related to achievement of social goals—specifically poverty, rural development, and gender.[30]

* * *

The review in this section serves to highlight the substantial work and development of indicators and reporting systems related not only to financial performance but to an understanding of the elements of social performance and social value. Much of it is work in progress. Nevertheless, there is a solid depth of effort that can contribute to the development of agreed standards for excellence in microfinance.

SETTING STANDARDS IN MICROFINANCE

This proposal for a Seal of Excellence in microfinance aims to set out the elements that can distinguish what microfinance as a sector aspires to—reflecting the social value and potential of microfinance, while recognizing that microfinance also aims to be financially sustainable.

In different sectors, the experience of standard setting is that standards are not difficult to write. The difficult part is reaching agreement among a diverse group of stakeholders about what issues to cover and what to say about each issue. The ISEAL Code of Good Practice on standard setting starts from this statement to recommend a process that begins as follows:

- Bring together a critical mass of stakeholders: to determine common interest in developing the standard and to define the benefits. A core group will likely drive the process of developing the standards. The balance within this core group needs to represent potential interests in the standard—to establish legitimacy.
- Have clearly defined objectives: Define objectives in concrete terms as the change you would like to see. What change will be introduced through compliance with the standard? What are the desired outcomes? Clear objectives [from applying the standards] help to underpin the process of developing a standard. Requirements are included [in the standards] if they lead directly to achieving those objectives.

In terms of the first step in developing the concept of the Seal of Excellence, the core group driving the process has come from institutions with a vision for the field focused on "bringing the transformational dimension of microfinance back to its centre"[31]—that is, transformational for clients. The core group initially consisted of leaders of the Microcredit Summit Campaign, the Grameen Foundation, Freedom From Hunger, Microfinance Transparency, Kiva, and World Vision. This group expanded in January 2011 to widen representation from MFIs, other social investors, donors/networks, and other certification initiatives. Members of the interim steering committee are listed in the Appendix.

DEFINING WHAT WE WOULD LIKE TO SEE

Many recent public statements reflect on the social value of microfinance in terms of responsible and ethical principles and benefitting poor people. Box 1.3 draws on two examples: the declaration of principles by the Social Performance Task Force and the more recent Principles for Inclusive Finance for Investors.

Drawing on these public statements, and reflecting on recent discussions with sector leaders, stakeholders, and media reports, Table 1.3 sets out key elements of social value in microfinance. While there appears to be a broad consensus around these elements, different degrees of challenge arise in putting these elements into practice, defining them, and measuring them. The first five listed are generally accepted as part of good organizational practice and represent direct positive synergies between financial and social performance: what is good for clients—and for staff—is ultimately good for business. The further elements are more likely to represent a trade-off with financial performance, or are more challenging to measure and benchmark, particularly with variations between countries and context.

Box 1.3 Public Statements of Social Value in Microfinance

Members of the Social Performance Task Force:

Define social performance as the effective translation of an institution's social goals into practice in line with accepted social values such as:

- Serving increasing numbers of poor and excluded people sustainably (e.g., expanding and deepening outreach to poorer people).
- Improving the quality and appropriateness of financial services available to target clients through systematic assessment of their specific needs.
- Creating benefits for clients of microfinance, their families, and communities relating to social capital and social links, assets, reduction in vulnerability, increase of income, improved access to services, and fulfillment of basic needs.
- Improving the social responsibility of our own organizations and the partners we support. This includes consumer protection and gender equity, as well as responsibility to staff, environment, and the community.

Recognize that financial performance alone is insufficient to achieve our goal of serving and improving the lives of increasing numbers of poor and excluded people sustainably. Success in microfinance is driven by a double bottom line, strong financial and social performance, and these equally important aspects are mutually reinforcing in the long run.

Source: http://sptf.info/page/declaration-of-principles-1.

The **Principles for Investors in Inclusive Finance** were launched at a Responsible Finance Forum in January 2011 in the Netherlands, supported by Princess Máxima of the Netherlands, the UN Secretary-General's Special Advocate for Inclusive Finance for Development. The preamble states:

Inclusive finance, which includes but is not limited to microfinance, focuses on *expanding access of poor and vulnerable populations,* micro- and small-enterprises, and those otherwise excluded to *affordable and responsible financial products and services*. This encompasses a wide range of financial services including savings, credit, insurance, remittances, and payments. These services should be provided by a variety of sound and sustainable institutions. Inclusive finance carries with it the responsibility for all actors in the value chain—investors, retail financial service providers, and other relevant stakeholders—to understand, acknowledge, and *act in accordance with the interests of the ultimate client.*

Source: http://www.minbuza.nl/dsresource?type=pdf&objectid=buzabeheer:271118&ver (emphasis added).
Note: The full principles for investors and list of 41 signatories are at http://www.unpri.org/piif.

Table 1.3 Elements of Social Value in Microfinance

1.	Sound governance.
2.	Client protection—six principles (credit and all financial services).
3.	Strong HR systems—and social responsibility to staff.
4.	Design and provision of a range of financial products appropriate to the financial requirements of client markets—based on effective mechanism for market research and client feedback (client satisfaction).
5.	Financial services that support improvements in quality of life: education, health, housing, sanitation, clean water, renewable energy.
	[The following are more challenging—to implement or to define and measure]
6.	Financial sustainability but with optimal rather than maximum profits; *fair allocation* of profits.
7.	*Responsible* or *fair* pricing—on all microfinance services provided: credit, savings, insurance, remittances.
8.	Client *retention.*
9.	Targeting and outreach to underdeveloped regions.
10.	Outreach to the poor—not just growth in numbers but questioning who is being reached, are the poor included, defining *who is meant by poor* relative to poverty levels or indicators within a country.
11.	Gender equity—in terms of opportunities for women as clients, and as staff.
12.	Effective linkages (or direct provision) to optimize the potential of financial services through, for example, financial education/planning that supports household financial security, or through nonfinancial services that support client well-being and opportunities, e.g., livelihood support, health, education.
13.	Effective structures for client ownership and participation in governance (as part of the institutional model or otherwise).
14.	Contribution to poverty reduction.

ADDRESSING WHAT WE DO NOT WANT TO SEE

Negative experiences in microfinance—the "opposites of excellence"—have emerged most recently in the events in southern India during 2010 (and earlier) as well as in some other countries. Some of these are real, and others are exaggerations by opportunists in the media and politics—but all must be confronted and dealt with proactively. The experiences have demonstrated the reputation risk and potential political backlash that can arise.

Current and pressing concerns relate to evidence of the following events in some areas:

- An approach to growth that is fueled by standard vanilla products and has resulted in supply-driven competition between microfinance service providers: pushing multiple borrowing onto clients, leading to potential overindebtedness of clients and aggressive debt collection practices.
- Pursuit of high profits that are generated through high charges to clients; failing to reduce charges to clients when MFI business costs reduce.
- Shortcuts to growth that include less staff training and less client training/education; staff incentives that orient staff to scale and growth over portfolio quality and superior client service.
- Increases in efficiency (higher client/staff ratio) at the cost of opportunities for client interaction and building the client relationship.
- More emphasis on profits used for very high executive pay or very high dividends to outside investors, instead of making less profit but offering better services or plowing profits back into the institution to improve services to clients.
- Mission drift—moving up market, excluding those (the poor) who were the intended target population.
- Institutions that claim to be pro-poor but have no strategy to include the poor beyond having small loan size.

OTHER GLOBAL INITIATIVES: STANDARDS FOR CLIENT PROTECTION AND DOUBLE-BOTTOM-LINE COMMITMENT IN MICROFINANCE

The concept of this Seal has evolved over the past year and is continuing to evolve through a process that recognizes, and aims to reinforce, other initiatives that are contributing to setting standards in microfinance. At the time of writing, other works in progress relate to

- The Smart Campaign focusing on principles of client protection.
- The Social Performance Task Force (SPTF) focusing on "universal (minimum) standards for social performance."

An important practical issue is to consider how the different initiatives interrelate so that they can complement each other to promote social value. This section maps out the dimensions being covered and explored by the Smart Campaign and the SPTF.

The Smart Campaign is planning to introduce certification of compliance with the six client protection principles, and the SPTF is setting standards for social performance or double-bottom-line commitment.

The value framework is illustrated in the spectrum of microfinance diagram (see Figure 1.2) that was presented at the June 2010 annual meeting of the SPTF. This framework suggests a minimum bar to "do no harm" (interpreted in terms primarily of client protection), and higher-level bars related to "acting ethically" and committing to positive change for clients.

Six principles of client protection evolved through the Smart Campaign (see Table 1.4) are well publicized, though under further review during 2011. Guidelines for best practice and for certification are under development, along with work to relate these not only to microcredit but to other financial services (savings, insurance, etc.).

The work of Microfinance Transparency in publicizing effective interest rates to clients of microfinance loans, through a systematic process of reporting by

Figure 1.2 SPTF: Spectrum of Social Performance in Microfinance, June 2010

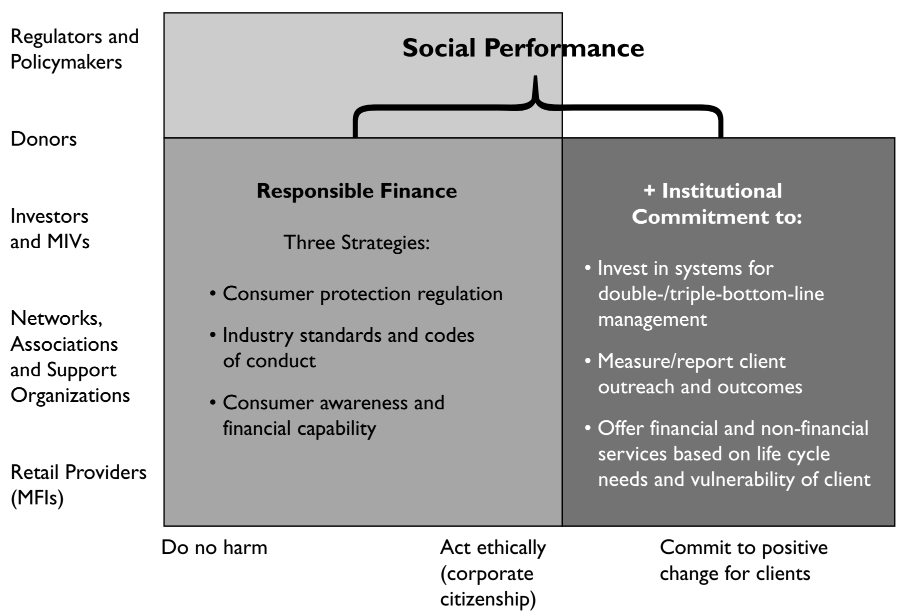


Table 1.4 Six Principles of Client Protection (under review during 2011)

1. Avoidance of overindebtedness
2. Transparent and responsible pricing
3. Appropriate collections practices
4. Ethical staff behavior
5. Mechanisms for redress of grievances
6. Privacy of client data

MFIs, contributes to understanding the range of product costs in different countries, and supports the second principle of client protection: transparent and responsible pricing.

The universal (minimum) standards for social performance for double-bottom-line institutions are currently under draft and consultation, and are likely to be finalized as part of the annual meeting of the SPTF in June 2011. The present draft adds to the six principles of client protection another six dimensions of social performance, as outlined in Table 1.5.

The SPTF's proposed standards aim to examine whether there is activity within the organization that backs up its social claims. The proposal states, "If you say you care about social goals, what is the evidence to show that that is reflected in your staff, governance, product/service offerings to clients, and systems to monitor/evaluate effects on clients?" The list of standards is intended as pointers to ways for MFIs to demonstrate a double bottom line. The draft list includes reference to "responsible" levels of profits, growth, and remuneration to the CEO—as suggested in earlier drafts of this concept note. The SPTF is coordinating with the Smart Campaign on the minimum indicators for client protection, and MFIs will be encouraged to look at the entire guidelines developed by the Smart Campaign, as well as to report to Microfinance Transparency.

A SEAL OF EXCELLENCE FOR POVERTY OUTREACH AND TRANSFORMATION

This Seal of Excellence would link into the initiatives of the Smart Campaign and the SPTF as providing the base for responsible and double-bottom-line microfinance. Looking back at the elements of social value outlined in Table 1.3, we can see that the Smart Campaign is covering in depth elements 2 and 7 (the latter—fair pricing—linked to Microfinance Transparency), and that SPTF aims to include these and other elements listed up to number 8, and may cover

Table 1.5 SPTF: Proposed "Universal (Minimum)" Standards for Social Performance

1. Responsible financial performance
2. Governance and staff commitment to social goals
3. Products and services that meet clients' needs
4. Client protection (minimum elements—from the Smart Campaign)
5. Social responsibility to staff
6. Client monitoring (retention, satisfaction, and monitoring stated social goals)

whether an MFI monitors the remaining elements if they are part of the MFI's stated social goals.

This Seal aims to include dimensions of responsibility (largely covered by the SPTF standards) as well as financial sustainability (including standard indicators of profitability, efficiency, and portfolio quality). Discussions on this aspect have indicated that the analysis of financial performance need not be directly part of this proposed Seal. Nevertheless, our suggestion is that qualification for the Seal would include a *responsible* approach to growth, and a *reasonable* balance and allocation of profits. The Seal would thereby incorporate a social/ethical perspective on financial indicators linking to the idea of optimal—rather than maximum—profitability and efficiency, as indicated in Box 1.4.

Guidelines for these indicators need to be worked out, and are now part of the discussion of draft indicators for double-bottom-line commitment being developed by the SPTF. At the minimum, the financial and organizational indicators listed in Table 1.6 would be a prerequisite for MFIs interested in receiving the Seal.

In addition to the double-bottom-line commitment represented by the SPTF standards, the Seal would add a focus on actual achievement of stated social goals. The Seal would recognize MFIs that achieve significant poverty outreach and who put effective strategies in place to achieve transformational change in the lives of the poor. Key dimensions proposed for the Seal are listed in Table 1.7.

The suggested scope of the Seal reflects recent research that has questioned old assumptions about the poverty-outreach and poverty-reducing effects of microfinance. The Seal would propose a set of practical indicators that support what microfinance can realistically achieve in poverty outreach and transformation.

Poverty outreach. This would include direct measurement of the poverty level of clients at entry to a microfinance program, applying a robust tool, such as the Progress out of Poverty Index (PPI). On this parameter, the Seal would link in with the Grameen Foundation Standards of Use of the PPI, which would

Box 1.4 The Overall Goal of the Proposed Seal

The overall goal of the proposed Seal is a microfinance sector that is responsible, genuinely inclusive (including the poor, the bottom 30% to 40% of the population) and contributing to positive change. Enabling MFIs to earn the Seal will support recognition of MFIs that combine financial sustainability and responsible practices with significant poverty outreach and a strategic approach to poverty reduction and transformation for clients.

Table 1.6 Financial/Organizational Indicators as a Prerequisite for the Seal

1. Two years' publicly available audited financial statements
2. Financially sustainable: Return on assets positive (or operational self-sufficiency > 95%) for two of three most recent years and within "reasonable" levels ("optimal" rather than maximum)
3. Rate of growth—"manageable" rather than maximum
4. CEO remuneration
5. APR in line with national competition and international standards on "fair pricing"
6. PAR—within "reasonable" range

certify MFIs according to their own monitoring of poverty outreach, as part of a strategic process of social performance management.

Transformation. The Seal would recognize effective strategies to add value for clients and to contribute to poverty reduction through additional nonfinancial services. It would not be assumed that such services are delivered by MFI staff, but that the MFI is responsible for their clients to have access to these services and the outcome and quality of the service. The concept of transformation may include nontangible effects (for example, increase in self-esteem, empowerment). Nevertheless, the Seal would focus on indicators that are practical and measurable. For this reason, impact in the technical sense (of attributing causation) is not an immediate part of the Seal.

When microfinance started—and of course up to the UN Year of Micro-Credit in 2005—it was more or less assumed to be serving poor people with small amounts of capital, and contributing directly to poverty reduction and other Millennium Development Goals. However, recent research, particularly since 2005, has begun to modify the expectations from microfinance. Findings come both from quantitative impact assessments (including randomized controlled

Table 1.7 Proposed Dimensions to Assess Poverty Outreach and Transformation

	Poverty Outreach
1.	Outreach to less developed/poorer regions within a country.
2.	Outreach to poor and excluded people (defined in local context, and relative to national poverty rates).
3.	Client retention (client exit < 20%) [link to MIX formula].
	Transformation
4.	Effective strategies to add value for clients (e.g., financial planning/security, enterprise/livelihoods, health, gender rights equity) through services that are directly provided or linked; robust evidence of value of services to clients—that is, not just existence of services, but significant access by clients (at least 20%, linked to identified need), responsible provision, and evidence of client feedback/response to the services.
5.	Gender diversity—in terms of opportunities for women as clients and as staff (at different levels of the institution).
6.	Effective structures for client ownership and participation in governance (as part of the institutional model, or otherwise).
Evidence of positive change occurring in the lives of clients over time—when practical to measure.	

trials [RCTs]) and from qualitative assessments (such as financial diaries, recently documented in the publication *Portfolios of the Poor*[32]). They emphasize the limitations of a focus on microcredit per se, the benefits of savings accounts for the poor, the challenge of responding to the diverse needs of poor households that use a range of mechanisms to manage their fluctuating cash flows, and the importance of nonfinancial services in supporting the needs of poor households.

The issue of "what it would mean for microfinance to work: how, for whom, where or when" was most clearly articulated in the article "In Microfinance, Clients Must Come First."[33] The article challenged the assumption of "institution-centered" microfinance: that building financial institutions that provide financial services to large numbers of people in and of itself enables poor clients to improve their businesses and in turn their socioeconomic standing. This seminal article advocates "client-centered microfinance" and a more realistic theory of change based on an understanding of the client situation, the factors that keep households in low income and poverty, and therefore the range of services that are relevant to poverty reduction.

"To make microfinance work . . . MFIs need to think clearly about how their practices will bring about the changes they seek [for clients]. This may mean making fewer microfinance loans and incurring more costs to support the loans they've already made. . . . The challenge is finding ways to provide these additional services efficiently."[34] And effectively.

The pointers from the research underline the following issues (both challenges and opportunities) if microfinance is to serve the poor effectively:

- Targeting less developed areas within countries (more remote rural areas, difficult urban slums).
- Providing more varied and flexible financial services to support the varied needs of different strata of poor and low-income households (poverty means not only low income but fluctuating income); adapting financial services to different livelihoods and levels of income; the importance of savings for the poor.
- Recognizing that the needs of poor people are not only about capital for microenterprises but also relate to consumption smoothing, managing available finances, meeting family/social obligations, maintaining the health of family members, and keeping children in school.
- Building successful enterprises, financial services per se are often not sufficient. MFIs need to look at other ways to support enterprises—for example, aggregating and linkages.
- Looking beyond microcredit and microfinance; microfinance provides an infrastructure in terms of access for poor and low-income people to other nonfinancial services to support client capacities and contribute to positive change, especially when serving poor people.
- Indirect outreach to poor people through more wage employment in SMEs (financed through SME lending).

SME lending (usually) involves a separate category of financial services. This is an important area of financial services supporting employment and market development that target the (nonpoor) owners of small businesses and benefit poor people indirectly through employment of (usually poorer) hired workers. This category of lending is outside the scope of this proposal at present, but a set of indicators can be developed that reflect the social value of SME lending related to employment (numbers employed), conditions of work, and health, safety, and environmental issues, since this is a sector where such issues are likely to be particularly relevant.

Another relevant and important dimension is the issue of governance structures that support member ownership. Cooperative structures can directly support intended values, through member participation in decision making and allocation of profits to member owners. Such participatory structures, if effective, can be both responsible and transformative. Including reference to effective member ownership—as well as representation of members in governance—is proposed to be within the scope of the Seal.

In considering the selection of indicators for the Seal, there are two caveats in measuring social performance results. These relate to the attraction of simplicity and of impact—and the ambiguities inherent in both.

First, there is a general tendency to assume "social" must be "simple" and easy to implement if the industry will accept. Certainly, the ideal is always to be practical—to be as simple and easy to implement as possible. But the simplest/easiest indicators are not necessarily useful.

One example of this is the measure of average loan outstanding, which has been quite widely used as a proxy for depth of outreach, when stated as a percentage of GNI per capita. Other proxies include percentage of rural clients and percentage of women clients. These are relatively straightforward indicators that all MFIs can routinely report (though there are issues with defining "rural"). The indicators do say something interesting, but should not be used to measure poverty outreach. Where direct data for the poverty level of clients at entry has been collected and compared with the proxies, the findings do not support a significant correlation. In other words, small average loan size is not directly associated with substantial poverty outreach when directly measured.[35] An indicator that reflects the entire portfolio at a moment in time is clearly limited when the question of interest is whether clients are improving over time. This question can only be addressed by examining differences between clients at different loan cycles or time periods with an MFI, rather than an overall average.[36]

With practical tools now available to benchmark poverty levels (such as the PPI and the PAT), it is proposed that the Seal will include a direct measure of poverty levels of entering clients as evidence for depth of outreach and changes in poverty status over time.

The poverty analysis would have to be country specific, linked to the appropriate poverty line for each country, and reflect the poverty rate in each country (the poverty rate is the proportion of households in a country below a specified poverty line). An MFI serving the poor will not be expected only to be serving the poor (or "very poor"), but the percentage (and number) of new clients at entry below the poverty line should be assessed relative to the average appropriate poverty rate for the country (so not 100%, nor even 50%, but for example, at least 20% to 25% in a country such as Cambodia, where the poverty rate is 26%, or 30% to 35% in Ethiopia, where the poverty rate is around 39%).[37] The standard can be in terms of the percentage of new clients at entry who are poor, as well as the number of poor clients at entry. The Seal will identify and recognize those MFIs with deep poverty outreach (i.e., serving at least a greater percentage of poor than the national poverty rate), or with outreach to significant numbers of poor people. It would not require outreach only to the poor (defined as the lower 30% to 40% of the population), nor would it necessarily require special programs targeting the ultra poor (the bottom 5% to 10% of a country's population), though such programs do in themselves have value.

The MFI should have robust evidence for poverty outreach. By "robust" evidence, we mean direct evidence of client poverty level (not the proxy—and misleading—indicator based on average loan outstanding). The evidence for poverty outreach can be collected using the Progress out of Poverty Index, the Poverty Assessment Tool, or other tools if they are well applied. The Grameen Foundation standards for use of the Progress out of Poverty Index (PPI) are also a useful reference for the Seal, and include tracking poverty level of clients over time, to assess change.

A second point is the attraction of impact. "Impact" has become a "weasel word" that sounds good but is often used ambiguously. Technically, "impact" is the change that can be attributed to an intervention. Its general use, by investors and some rating agencies, has been expanded when they talk about "impact investment" and "measuring impact." In this wider sense it includes, for example, serving (poor) people with quality products, working in less developed areas, and supporting the environment—in other words, activities that are likely to support positive change, but are not by themselves evidence for the end results, whether outcomes or technically impact.

Increasingly there is pressure to give evidence about the end results. ISEAL is starting to look at measuring impact in terms of the end results, and has recently published a Code of Good Practice for Assessing the Impacts of Social and Environmental Standards Systems. The code sets out the basic principles and methodologies well, which could be included in a future phase. Nevertheless, at present, impact assessment technically remains a difficult and complex task in practice.

For this reason, and until such time as it may be worked out, the Seal will not expect measurement of the impact of microfinance on client lives in the technical sense of attributing causation. Tracking outcomes with a high positive correlation—for example, application of the PPI/PAT to track change in poverty levels of client households over time—will be a valid way of estimating transformation for the purposes of the Seal.

Currently, the proposed Seal would recognize the combination of services (specifically linkages with nonfinancial services) that a theory of change indicates is most likely to support transformation—such as services for financial education, enterprise development, access to medical care, and education.[38] To qualify for the Seal of Excellence on this aspect, the MFI may directly provide nonfinancial services, or—and this is more likely—the MFI should have played a specific role in facilitating access to linked services and have a well-designed alliance with the providers of these services. In either case the MFI should have information on how many of their clients access such nonfinancial services, together with evidence of how clients use and value the services provided.

A draft of indicators related to the proposed Seal is given in Annex 1.4. There will need to be a process to develop consensus on the indicators and the benchmarks for each indicator, including identifying which indicators should be country-specific (likely for poverty outreach, and probably too for the gender indicators), with technical guidelines for assessing the standards as well as ensuring consistent definitions (for example, for client exit/retention).

The indicators are expected to leverage reporting and assessment systems, such as reporting to the MIX, as well as those applied for social rating and social auditing. As reflected in Table 1.3, the indicators in part represent a new set of data for MFIs to collect, or a new way of analyzing available data. Appropriate systems for data collection and reporting are already under development as part of integrating social performance indicators into microfinance management.

COMPLEMENTARITY BETWEEN STANDARDS

A Seal of Excellence in poverty outreach and transformation would require responsible and ethical practices at all levels of the institution, as well as a financially sustainable bottom line. The Seal would be for those who aspire to do more—and is intended to serve as an inspiration, and a recognition of what microfinance can achieve. The Seal would complement existing initiatives, adding recognition of what microfinance can achieve in terms of direct poverty outreach and transformation for clients.

This proposed Seal would be structured to complement the current initiatives for standard setting, and recognize the challenges to achieving excellence at each level. Client protection—or "Do no harm," which is the focus of the Smart Campaign—represents a basic standard for all financial service providers and is seen to be a pressing concern in the current context of microfinance. The SPTF standards for social performance add further elements of ethical/responsible finance and double-bottom-line commitment, which are expected to apply to financial service providers that have a double/triple bottom line. This Seal would incorporate the previous standards and add the poverty focus and transformational potential, which is applicable to MFIs and other stakeholders that aim for financial inclusion of the poor, and which have a mission that aims for poverty reduction.

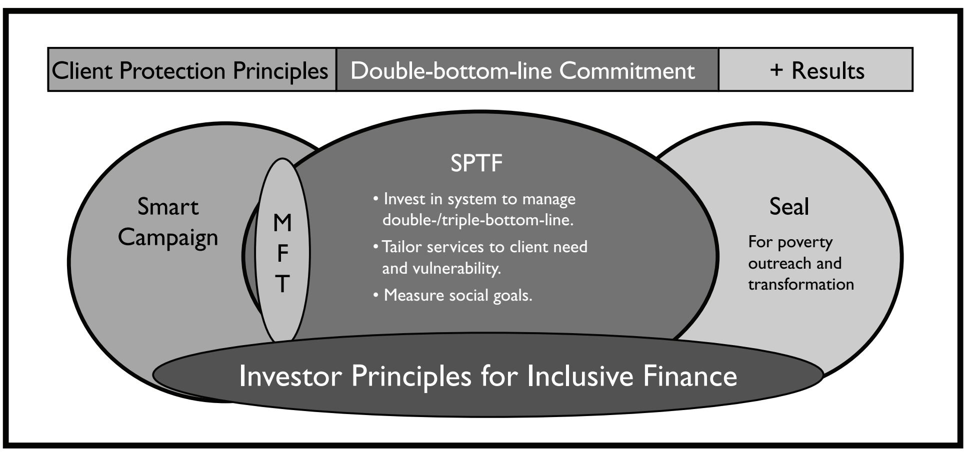
Figure 1.3 maps the interlinkages between the proposed standards. The figure also illustrates the relevance of these standards for application of the Investor Principles for Inclusive Finance.

Thus, it is intended that the Seal can link to and reinforce existing moves toward certification (SPTF, Smart Campaign) as well as current reporting and verification systems (MIX, specialist ratings, audits; more on this topic appears later in this chapter). Future development would also link in to ongoing initiatives by the LAC networks (referred to earlier). The aim would be to promote consistency and coordination across the sector.

DEFINING, APPLYING, AND IMPLEMENTING A SEAL OF EXCELLENCE IN MICROFINANCE

The previous section outlined the goals and the key elements that the proposed Seal of Excellence would cover. The standards for the Seal need to be finalized through a process of stakeholder consultation and testing. Subsequent application of the Seal raises questions of potential demand and the

Figure 1.3 Mapping the Linkages: Proposed Standards in Microfinance



Responsible Finance Deep and Effective Inclusion

Source: Figure adapted from the Social Performance Task Force (SPTF) presentation at SPTF Annual meeting in Den Bosch, the Netherlands, June 2011.

benefits of compliance, and implementation requires consideration of governance, reporting and verification, and costs.

Supporting a Process of Consultation

This chapter and the discussions being held about its topic are part of a process of stakeholder consultation designed to invite feedback, encourage different initiatives to become operational, and generate a consensus on the content and approach.

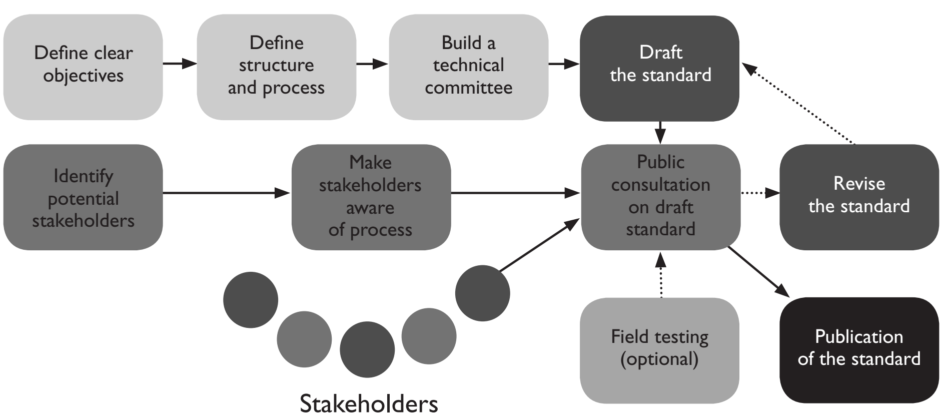
Ideally, voluntary standards are decided by consensus. Consensus is generally defined as the lack of sustained opposition to a decision and need not imply unanimity. However, consensus may be difficult to achieve if you have many stakeholders representing diverse interests. Decisions on the content of the standard are probably the most important decisions in the standard and certification development process; an appropriate decision-making process is essential.

The consultation process that is already under way broadly follows the steps recommended by ISEAL (shown in Figure 1.4). An expanded interim steering committee is now in place. The steering committee in turn is to appoint a technical subcommittee (from within its own members, and drawing on relevant external expertise). The role of the technical subcommittee will be to advise the steering committee on indicators, benchmarks, and findings from field testing.

In defining the standards, the steering committee for the Seal should also

- *Define the structures and procedures for the standards development process:* Stakeholder mapping, participation, and documented response; make

Figure 1.4 Steps in the Process to Set Standards (ISEAL)



it clear how stakeholders can provide input and how decisions are made; maintain records of activities to develop the standards such as the following: list of stakeholders contacted, their involvement at different stages, comments received, and a synopsis of how comments were taken into account.

- *Decide the end use of the standards.* Are they intended as voluntary guidance on good practice? Are they intended to be widely applicable across the industry? The steering committee should determine the end use as it relates to what issues should be included and how the standard is set (compliance, major and minor noncompliance, or a scoring approach).

Demand for a Seal of Excellence for Poverty Outreach and Transformation

The Seal represents a vision of microfinance: to serve the poor directly and to contribute to positive change. The concept of the Seal has so far been driven by microfinance network leaders and other stakeholders concerned to promote this vision. The following considerations will have to be addressed as part of building demand for the Seal:

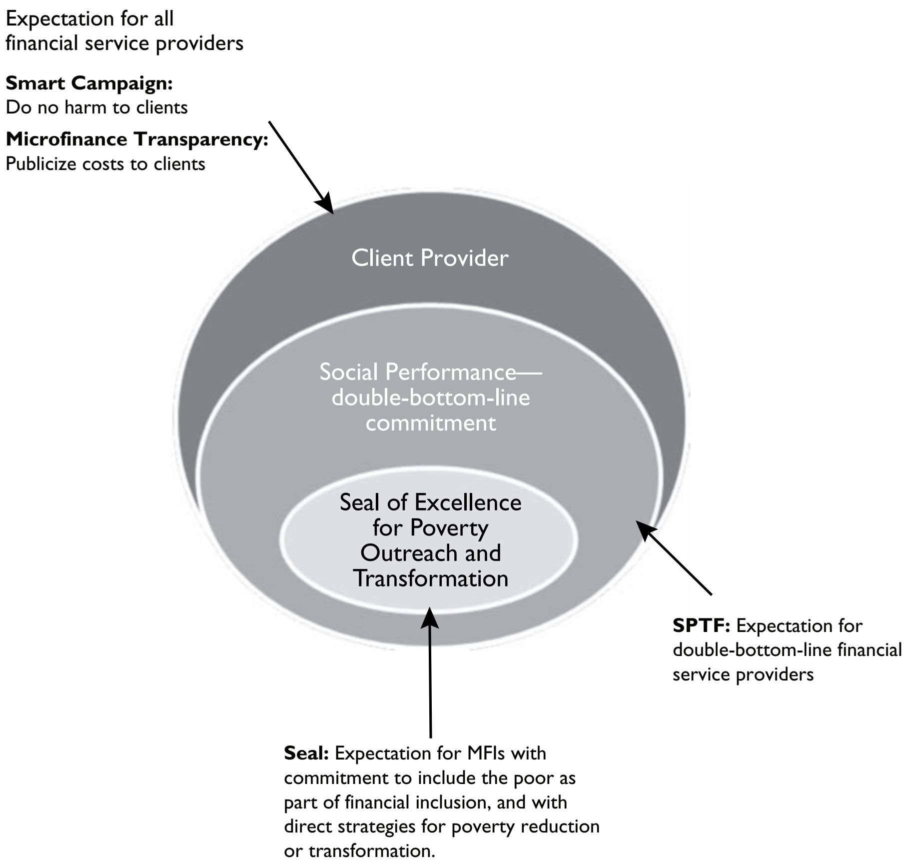
- What is the desired level of market uptake? A broad-based standard that applies to all MFIs? Or opportunities for top-performing MFIs?
- Who will support application of the standards?
- Is there a role for socially responsible investors to reference or support the standard?
- Is there a role for regulators to promote uptake at the country level?
- To what will compliance with the standards lead? What will be the benefits?

In the context of other initiatives, it is expected that the SPTF standards represent a broad-based standard that applies to all MFIs with a double-bottom-line commitment. The SPTF standards would be a prerequisite for the Seal, which would apply to a subset of MFIs that have social goals reflected in the Seal, and the achievements of which would be recognized by application of the Seal (Figure 1.5).

The Seal of Excellence is intended to be a voluntary standard for MFIs that apply for it, to demonstrate and recognize the potential and achievement for poverty outreach and transformation of clients for those MFIs (and their investors) that have direct poverty outreach and poverty reduction as their social goals.

Having the guidelines and parameters clearly set out by the Seal would support a "brand" for such MFIs. As the examples are documented, they

Figure 1.5 Standards in Microfinance: Expectation of Demand



would provide a demonstration effect of what is possible and sustainable for microfinance that aspires to this Seal. In the longer term, this could broaden the Seal's applicability.

The proposal for this Seal recognizes that different types of institutions are providing microfinance services, with diverse social goals or different approaches to supporting development, employment, and poverty reduction. For example, in the Balkans and the former Soviet Union, financing self-employment for inclusive economic development is a key objective of microfinance. Or SME lending can contribute indirectly to poverty reduction, particularly through wage employment of poorer people in financed enterprises. These issues are important but separate categories of microfinance, which might be covered by a different Seal.

Investors (microfinance investment vehicles [MIVs]) are already making the business case for client protection in terms of risk mitigation. Some are also beginning to make the longer-term business case for ethical double-bottom-line standards. In other words, there are signs of change in the investor calculus, mainly as a result of the difficulties in the microfinance sector in South India and elsewhere, as well as the questions around what microfinance is actually achieving in practice. There may be a less obvious business case for the Seal. Nevertheless it would have relevance for investors depending on how they "sell" microfinance as an investment and how they define and measure social returns. There is likely to be interest from a subset of indirect investors (those who invest in MIVs) and social investors, or impact investors who are looking for a social return that they define with reference to poverty outreach and poverty reduction. There is a role for such investors (direct and indirect) to support application of the Seal and to reference it as part of their own investment strategy.

National regulators and central banks have a primary mandate to support monetary and financial stability. Usually this mandate is linked to policies and incentives for responsible financial services. Regulators are most directly concerned with issues of responsibility and governance, although in developing countries the mandate can extend to supporting strategies for financial inclusion and effective participation in financial services across all market segments. Regulators might therefore support uptake of the Seal. It is unlikely to be a part of regulation, but it would be of interest since it represents the core of why microfinance is allowed to function in the first place.

The Seal would be an opportunity for financial service providers that are genuinely committed to poverty alleviation and development to position themselves as such. It is expected that MFIs' compliance with the standards would have the benefits for different stakeholders shown in Table 1.8.

REPORTING AND VERIFICATION OPTIONS

Tables 1.9 and 1.10 map existing information sources relevant to indicators for standards of excellence and the proposed Seal. Table 1.9 lists some of the main sources of reported data on financial and social performance of MFIs, self-reported or verified, with the number of MFIs covered in 2010. Table 1.10 is an overview of the scope and reliability of data for different parameters of performance, covered by the different sources.

Microfinance reporting is beginning to involve a combination of financial and social indicators. From 2011, reporting to the MIX combines organizational and social performance data. Specialist rating and the different social performance

Table 1.8 Benefits From Compliance With the Seal

Stakeholders	Benefits
Public, media, regulators, social investors, funders (those who fund investment funds)	More and better information on poverty outreach and approaches to poverty reduction Evidence of MFIs that are not only financially sustainable and responsible but are achieving significant poverty outreach and strategically contributing to transformation Increasing evidence of microfinance that is client centered and directly contributing to poverty reduction
MFIs, cooperatives, financial service providers that receive the Seal	Recognition of their development focus and strategic approach Greater confidence of stakeholders such as board members about where their institutions stand among their peers in terms of achieving the double bottom line Helping to regain civil society support for double-bottom-line microfinance Interest from social investors—and potentially reductions in cost of funds, improved terms of investment Interest and support from local banks and regulators Potentially, a competitive edge with clients and prospective clients
Poor people (in the bottom 40% of the population)	More access to appropriate and affordable financial services, and to linked services that contribute to their financial security and an improved quality of life A share of the profits from financial services delivery

audit approaches (such as the Cerise—SPI) are also aligned with the MIX reporting standards.

Monitoring compliance and verification. There are three options to monitor compliance with any proposed standards:

Table 1.9 Current and Potential Sources of Data for the Microfinance Sector and Coverage

Potential Sources	Coverage (no. of MFIs, 2010/yr)	Observation
MIX—financial/ operational	> 1,200	Voluntary reporting, data may be verified against third-party sources (audits, ratings)
MIX—social performance standards (SPS)	~ 350+	As above SPS indicators streamlined for 2011
Ratings, financial	> 350	Verified data—scored
Ratings, social	~ 100	Verified data—different scope between rating agencies; scored
Cerise—SPI Audit	> 150	Mostly verified by third parties—TA providers, professional associations, investors
B-Lab/GIIRS	—	About to apply to (75) MFIs—different from specialist rating agencies since no visit to the MFI is involved
Smart Campaign assessments	< 10	Planning to increase: may link certification to rating agencies
Microfinance Transparency	MFIs in 8 countries (+20 countries, 2011)	Detailed and streamlined reporting format and analysis
Grameen Foundation	> 100	Planning certification of application of the PPI

1. Self-reporting
2. Third-party verification
3. Self-reporting with third-party verification

These options reflect a trade-off between cost and credibility. A very clear lesson from all standard-setting initiatives is that verification of standards is required for credibility. Verification involves a cost. The first option of self-reporting by the MFI without verification is lowest cost, but has the least credibility. The second

Table 1.10 Current Sources for Different Parameters—Scope and Reliability

Parameters (selected)	**Availability and Reliability**						
	MIX—Financial	**MIX—Social**	**Rating Financial**	**Rating Social**	**Cerise SPI**	**Smart Campaign**	**Microfinance Transparency**
Financial sustainability	■		●				
Governance		**X**	**X**	■			
Client protection		**X**	**X**	●	(■)	●	
Responsible pricing	■		■	(●)			■
HR		**X**	**X**	●	**X**		
Product design		■	**X**	■(**X**)	**X**		
Depth of outreach		■		(●)	(■)		
Nonfinancial services/linkages		■		(■)	■		
Gender analysis	**X**	■		■	**X**		
Member ownership/participation				**X**(**X**)	**X**		
Environment		**X**		**X**	**X**		

Key: **X** available though not fully covered or not verified; ■ available, quite well covered; ● available, fully covered, and verified
( ) Parentheses refer to differences in methodology with variation in coverage.

is higher cost, with the highest credibility (depending on reputation and accreditation of the entity that carries out the verification).

The second option is ideal in terms of credibility, but the third is also possible, in which self-reporting by the MFI is verified, with or without on-site visits. For example, under the GIIRS approach, B-Lab reviews 50% of the data in reports for all companies, and does on-site checks (that take less than a day) for 10% of the reports. Interestingly, so far B-Lab states that the on-site checks do not result in substantial variation. Random audits on a specified proportion of self-reported data can encourage accuracy. An additional option would be to link verification with the internal audit processes of MFIs.

Off-site verification may be an option but only where the reporting indicators and guidelines are clear and unambiguous, there is adequate public reporting (including audited financial statements, annual reports, and government compliance documents), there is no qualitative assessment involved, and other certification may also have been applied. This approach would probably not be appropriate for first-time application of a standard, but could be used for subsequent applications.

What are the options for third-party verification? There are generally two models for verification:

1. *Verification is conducted by the certifying authority,* which hires staff to verify data and provide direct certification. Fees are paid directly to the certifying authority.
2. *Verification is outsourced.* The certifying authority outsources verification to third-party firm(s) or individual(s) in particular countries who have the relevant skills, or whom the certifying authority may train for the purpose. Usually there would be a prescribed format for data and for validating. Fees can be paid to the certifying authority or to the third-party firm(s).

Microfinance is a unique sector in that it has specialist rating agencies that have the relevant expertise for the Seal, both for financial sustainability assessment and social performance assessment. In addition, other eligible firms would include consultancies and research agencies with relevant experience. The certifying authority might engage with networks or associations of MFIs in different countries to consider options that may differ between countries.

The Seal would link in with related reporting and certification—as with the SPTF standards and with application of the PPI. The SPTF is likely to adopt a process that draws on the MFI self-reported data to the MIX, verified through random audits by a third party. The specialist rating agencies are piloting a rating product that enhances the scope of financial performance ratings by adding selected core social values to the main rating product, which is also expected to reflect the SPTF's double-bottom-line commitment. The Grameen Foundation has developed a system for certification of use of the PPI, which would be a resource for verification. The Seal could also be available for MFIs that choose to apply directly, and that may not be reporting to the MIX.

Tenure. Microfinance performance ratings are usually valid for one year, reflecting the changes that can take place particularly in financial performance; social ratings and assessments or audits may be renewed every other year. For this Seal, the tenure could be for two or three years, in terms of certification or verification, but with annual self-reporting.

What would the Seal consist of? The entity awarding the Seal would list all approved organizations in the public domain, through, for example, a website, and integrating announcements with ongoing conferences. For MFIs, a certification or approval letter is something that they can show as proof to potential investors, for example, and as part of their annual report. In addition, an MFI could show a logo for the Seal in market interactions—with regulators and with clients—to underline the type of outreach and services to expect, along with responsible delivery.

Application. There would be an application process by which organizations interested in the Seal can signal their interest and be provided a clear set of guidelines to move forward with the certification. Supporting organizations—networks, the MIX, investors, raters, auditors/evaluators—would also be able to recommend MFIs to apply.

COSTS

Costs relate to MFI time in reporting, as well as changes in operations and systems to achieve the standards. Costs would also be incurred in external assessment or verification of reported indicators and complying with the necessary oversight and governance.

For the MFI, the expectation is that the reporting indicators would match those already in place for financial and social performance reporting, as reported to the MIX for example, so there would be no additional costs over and above the systems that are under development for full reporting.

Similarly, when on-site verification is linked to a rating or an audit, the costs of verification would be covered as part of the cost of the rating/audit. A rating/audit report would be expected to cover the indicators necessary to comply with the Seal, and can be the basis for certification by the entity that grants the Seal.

The advantage of linking to ratings would be to ensure credibility based on on-site visits with a holistic perspective that covers financial performance and responsible finance (particularly as covered in the proposed double-bottom-line ratings). At a lower cost, and as experience develops, there could be self-reporting (linked to Grameen Foundation certification) with a process of off-site verification that could be done by trained staff of the certifying entity, or by a third party (rating agency, social auditor, network, evaluator, etc.).

The certifying entity would require funding for oversight of third-party agencies, including random checks of products; for collation of the data for certification; and for ensuring transparent reporting.

For any MFIs that apply for the Seal, a single, composite rating or audit for Seal certification that is drawn mostly from existing data could actually save MFIs' time and money.

GOVERNANCE AND IMPLEMENTATION

Governance would involve the following responsibilities:

- Specification of the Seal and link with other standards.
- Reviewing and updating as necessary the standards covered by the Seal.
- Oversight of implementation.
- Final arbitration of any disputes.

The current mechanism covering these responsibilities is the interim steering committee. To some extent there may be overlap with the existing steering committees of the Smart Campaign and the SPTF, which consist of respected industry leaders representing different constituencies and models of microfinance. The focus of this Seal is different, however, from both initiatives and therefore at this stage justifies a separate committee. In the longer term it would be worthwhile if all three initiatives (or at least two of them—SPTF and this Seal) were under the umbrella of one body supervising the standards implementation efforts.

Implementation would involve the following responsibilities:

- Building buy-in from the field—through, for example, interaction with country networks/associations.
- Developing reporting guidelines and formats (linking with the MIX).
- Coordinating and accrediting third parties—for verification.
- Coordinating with related initiatives—Smart Campaign, Grameen Foundation (PPI certification).

- Awarding the Seal.
- Oversight (quality control, consistency of application) and transparency.
- Arbitration.
- Funding of own activities.

These tasks would require a specific entity to carry them out. It should be possible to house the Seal within an existing institution rather than create a new one. The criteria for assigning implementation responsibilities would include alignment of interest, capacity, and credibility within the microfinance sector. Different options considered so far are as follows:

- The SPTF secretariat, so as to combine the certifications within one entity.
- The Microcredit Summit Campaign, given its specific orientation to poverty reduction linked to high-visibility conferences and annual reports.

NEXT STEPS

First, a broad-based consultation process is needed to reach consensus on the indicators and to develop benchmarks for each indicator:

- Continue ongoing rounds of consultation and feedback.
- Establish a technical committee.
- Engage with the SPTF standards committee to provide inputs for the development of universal standards of social performance.
- Review the terminology to be used for this Seal.
- Conduct alpha tests drawing on social ratings/audit reports completed in the past year in different global regions for selected MFIs that are likely to qualify for the Seal.

Then, once a consensus is reached, implementation would involve:

- Deciding on administration of the Seal.
- Deciding on the indicators for the Seal, and developing definitions and guidelines for each indicator—with advice from the technical committee.
- Reviewing indicator values, including specific benchmarks by country, as appropriate.

- Piloting with beta tests.
- Engaging with the MIX to ensure linkage with SPS reporting.
- Engaging with networks, specialist rating agencies, and social auditors/ evaluators to review the verification process related to the indicators to be covered by the Seal.
- Defining the certification process.
- Developing accreditation procedures and standards for accreditation.
- Developing a business model.

This chapter has set out the rationale for a Seal of Excellence in microfinance. The process for its development and future application is under way through wide consultation across the microfinance industry, and engagement with other initiatives. The process will take time and is likely to evolve as part of new solutions to the current questions around microfinance.

APPENDIX: SEAL OF EXCELLENCE FOR POVERTY OUTREACH AND TRANSFORMATION IN MICROFINANCE, INTERIM STEERING COMMITTEE

Susy Cheston, World Vision
Alex Counts (Steve Wright), Grameen Foundation
Sam Daley-Harris, Microcredit Summit Campaign
Susan Davis, BRAC USA
*Frank DeGiovanni, Ford Foundation
*John de Wit, Small Enterprise Foundation
Chris Dunford, Freedom From Hunger
*Laura Foose, Social Performance Task Force
*David Gibbons, CASHPOR Financial and Technical Services
Tim Hassett (J. D. Bergeron), Kiva
*Antonique Koning, CGAP
Larry Reed, Consultant
*Ben Simmes, Oikocredit
*Carmen Velasco, Pro Mujer
Chuck Waterfield, MicroFinance Transparency
Steve Wright, Grameen Foundation
*Special Technical Advisors: Scott Gaul, MIX; Elizabeth Rhyne, Centre for Financial Inclusion

Joined the Interim Steering Committee in January 2011

Annex 1.1 Comparing Features of Initiatives to Apply Standards in Related Sectors

	Maryland Association of Nonprofits	Charity Navigator	B-Lab/GIIRS
Date started	1998	1998	2007–2008
Sector	Nonprofits	Nonprofits	Development sectors (education, health, agriculture, SME . . .) Microfinance—in pipeline
Purpose	Build standards for excellence; aim that every applicant will ultimately be successful	Transparency and financial accountability as a basis for informed donation; helping donors choose their charities	Identify investments that "actively create positive social and environmental impact"
Who can use	NGOs Public	NGOs Public	Investors/fund managers: to raise/apply capital aligned with values of social impact Companies: seeking mission-aligned growth capital and liquidity
Product(s)	Seal	Star grading	Current: Company "impact rating" report and analytical tool (allows downloading of data to use for own due diligence) To pilot: Fund overall rating report (weighted roll-up of company GIIRS reports in portfolio)—will pilot with 25 funds
Coverage #	?		> 4,000 companies
Defining framework	Ethics code for the nonprofit sector	Organizational efficiency and capacity from financial audit data; different sectors	IRIS taxonomy/reporting standard; different sectors

continues

Annex 1.1 Cont.

	Maryland Association of Nonprofits	Charity Navigator	B-Lab/GIIRS
Governance		Advisory panel of experts	Standards Advisory Councils—separately for emerging and developed markets; 14–18 individuals with deep sector/stakeholder expertise GIIRS Advisory Council: 14 reps. of leading investors, advisors, raters, investor associations
Content	55 standards i. Mission and program ii. Governing board iii. Conflict of interest iv. Human resources v. Financial and legal (Form 990) vi. Openness vii. Fundraising viii. Public affairs and policy	Administrative cost ratios (program allocation, fund-raising costs, administrative costs) Annual growth in revenue and program expenses past three to five years; working capital ratio to net available assets Plans in next three years to add accountability and transparency (board, management capacity, CEO salary, etc.), as well as research into "impact on the ground"	A company's "impact on each of its stakeholders over time" 170 questions/5 dimensions i. Accountability/governance/reporting ii. Employees iii. Consumers iv. Community v. Environment Overall
Standards approach	Standards for Excellence logo certification	Awards one to four stars	Certification as a B corporation with score of > 80 out of maximum 200 points Scored on each dimension as percentage of points available Area of excellence = > 60% on any dimension
Reports	?	Based on public documents (so far)	Company rating and peer comparisons in sector
Frequency	Certified for three years Annual updates	Annual	Annual Funds: fund target (start-up), initial, updated, track record

continues

Annex 1.1 Cont.

	Maryland Association of Nonprofits	Charity Navigator	B-Lab/GIIRS
Process to obtain data	Application, including policies and descriptions of organization's procedures/practices. Some policies must be approved by board of directors, with date of approval	Public access to available documents	Online questionnaire
Process to verify	Initial staff review Completed applications forwarded to trained peer reviewers; make recommendation to Ethics Standards Committee On-site visit, or personal discussion may be requested	Off-site assessment and scoring	Third-party assurance provider to verify 50% of the questions in the survey (over the phone) "Rigorous audit and assurance process"—10% on-site verification—visits are less than one day to complete (Note that off-site verification cannot by its nature be rigorous)
Promotion/ influence strategies	Public announcement	Public listing; including a "donor advisory" in case of misconduct	Exclusive partnerships for use of rating system—with investor networks, trading systems, banks, and private equity funds Partnerships—with investors, rating agencies Database—available through subscription
Costs			Trying to keep cost low, so focusing on "assurance," not on "verification"
Payments	Annual participation fee	Free for public use	Institutional investors/advisors will subscribe to data platform Purchase by an institutional investor
Issues/follow-up	What are the benefits for participating NGOs? Check basis for awarding the Seal	Basis for scoring/star system Future developments: "transparency and accountability," impact evaluation	Claims "beyond SRI to impact"—that is, not only socially responsible investment, but also achieving impact Level of engagement of councils—payment Costs—and who pays Process of verification Low cut-offs for the rating?

Annex 1.2 Definition of Social Performance

http://sptf.info/page/sign-on-letter

Promoting Social Performance in Microfinance

> *"Microfinance works best when it measures—and discloses—its performance; accurate, standardized performance information is imperative, both financial information and social information."*
>
> from the G8-endorsed CGAP "Key Principles of Microfinance"

As organizations involved in the field of microfinance, members of the SPTF:

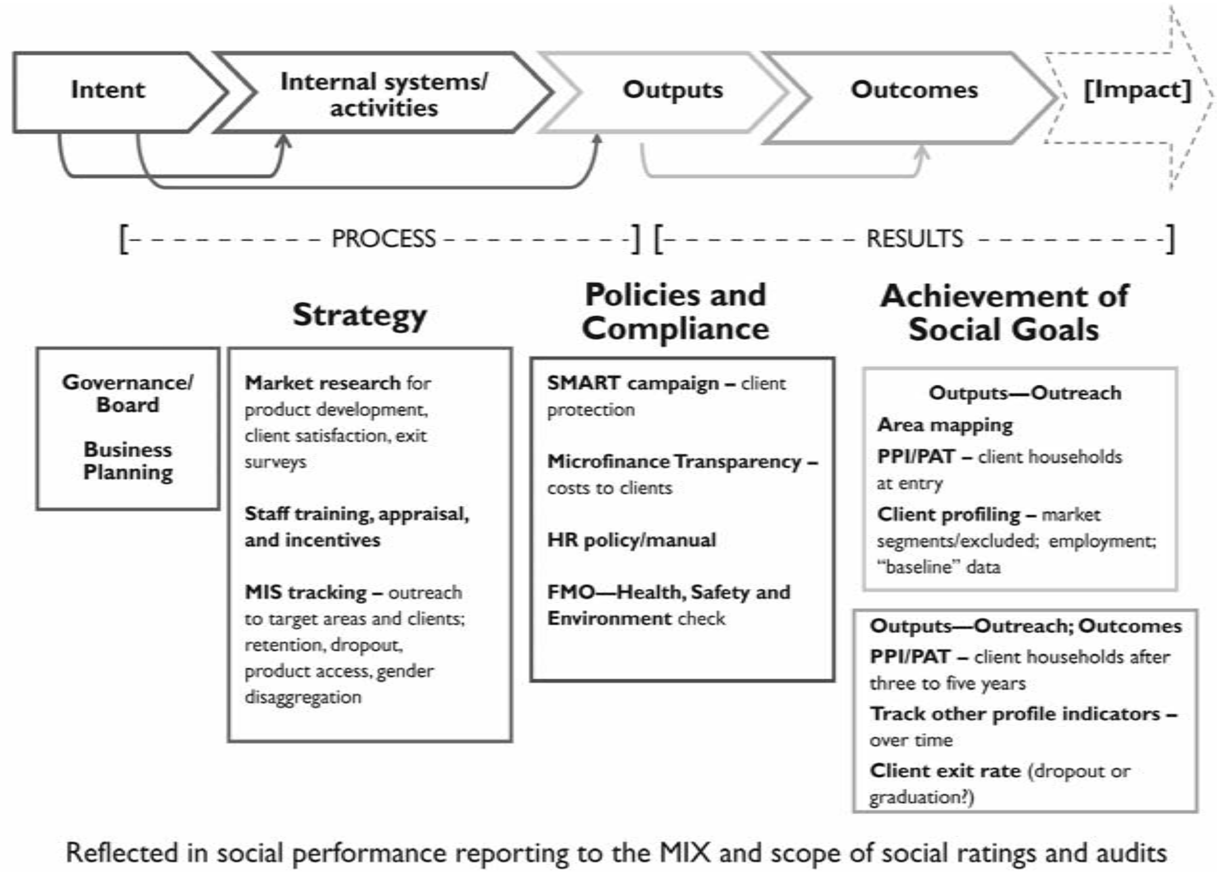
1. **Define** social performance as the effective translation of an institution's social goals into practice in line with accepted social values that relate to:
   - Serving increasing numbers of poor and excluded people sustainably (i.e., expanding and deepening outreach to poorer people).
   - Improving the quality and appropriateness of financial services available to target clients through systematic assessment of their specific needs.
   - Creating benefits for clients of microfinance, their families, and communities relating to social capital and social links, assets, reduction in vulnerability, income, access to services, and fulfillment of basic needs.
   - Improving the social responsibility of our own organizations and the partners we support. This includes consumer protection and gender equity, as well as responsibility to staff, environment, and the community.

2. **Recognize** that financial performance alone is insufficient to achieve our goal of serving increasing numbers of poor and excluded people sustainably. Success in microfinance is driven by a double bottom line—strong financial and social performance—and the concept that these twin measures are mutually reinforcing in the long run.

3. **Further recognize** a growing interest from donors, networks, practitioners, rating agencies, funders, and other stakeholders in testing, applying, and improving new tools for social performance management, assessment, monitoring, and reporting.

4. **Commit** to improving the social performance of microfinance by:
   - Setting clear and specific social objectives for our own organizations and expectations for the organizations we support.
   - Designing, introducing, and using systems to manage, assess, monitor, and report on social performance inside our own organizations and the organizations we support.
   - Using information on social performance to improve our own operations.
   - Verifying our social results with external assessments, audits, and ratings where appropriate and available.
   - Being transparent about our social performance and promoting transparency of the partners we support through regular reporting to the MIX on its indicators of social performance standards (SPS).
   - Promoting and exchanging ideas, resources, good practices, and other information on social performance.
   - Endorsing the Social Performance Management Principles, http://www.spmresourcecentre.net/iprc/index.cfm/spm-principles/.

Annex 1.3 Social Performance Framework/Pathway: ELEMENTS AND TOOLS



Annex 1.4 Draft List of Indicators for the Seal

This is the draft list of indicators prepared in April 2011 as a starting point for consultation and technical review to select indicators and develop benchmarks for the Seal. The list is divided into three parts. The first section, Part A, lists expected minimum conditions of financial sustainability (the single bottom line). The second section, Part B, lists expected standards of social performance. Part B indicators are under consideration by the Social Performance Task Force, to include in their proposed "Universal (Minimum) Standards for Social Performance." Part C lists the indicators to represent poverty outreach and transformation.

A Single Bottom Line
Financial Sustainability: Performance, Systems, and Transparency

Indicator	Suggested Guidelines for Defining the Indicator
1 Microfinance	*Average loan size within norms for microfinance with reference to country GNI per capita (note—data available is for average loan balance)—usually not more than 100%*
2 Audited financial accounts	At least two years
3 Transparency	Public reporting—may be to a local network, or to the MIX (note MIX from 2011 will include both financial and social indicators)
4 Number of clients	A minimum scale of operation—say, 500 for individual model; 2,000 for other/mixed model
5 Profitability	Positive—or on the path to be positive; OSS > 100% in two of previous three years
6 PAR (30 days)	Able to track and at a *manageable level*
7 Loan write-off	Include as a check on the measurement of PAR
8 Yield on portfolio	*Comparable to the national average, taking into account operating and financial costs*

B Standards for Double-Bottom-Line Finance

Indicator	Suggested Guidelines for Defining the Indicator
Governance/responsible financial guidelines	
1 Board composition and activity	The board includes at least two independent directors with relevant qualifications (list of board members, current employment, and qualifications). There is evidence of active board engagement (regular meetings, attendance, minutes).

continues

Annex 1.4 Cont.

Indicator	Suggested Guidelines for Defining the Indicator
2 Reasonable level of profit	RoA slightly above the equivalent for the banking sector, to allow for additional risk—may differ by country; if high, then clear rationale and evidence of allocation that benefits clients
3 Reasonable rate of growth	< 50% for Tier 3 MFIs, 40% Tier 2, and 25% Tier 1
4 Reasonable remuneration of the CEO	Remuneration to CEO is transparently reported and is not more than the equivalent level in the country's private banking sector
	Ratio of remuneration to CEO to remuneration to lowest-paid field officer
Appropriate products – *in context of legal options*	
1 Range of products	Description of products: credit, savings, insurance, remittance, pension
2 Appropriate product design	Evidence that product design has been based on appropriate market intelligence, relevant to the target clients/markets
Conditions of staff employment (social responsibility to staff)	
1	HR practices conform with country's legal requirements
2	Percentage of professional staff who are permanent
3	Working expenses of staff are fully reimbursed
4	The MFI has adequate policies for staff safety (including accident coverage, dealing with possible assault).
Client protection	
1	Selected key indicators as agreed with the Smart Campaign
2	Application of the principles of client protection to savings and insurance, for MFIs that offer these services

C Poverty Outreach and Transformation

Indicator	Suggested Guidelines for Defining the Indicator
POVERTY OUTREACH	
Outreach to less developed areas	
1	At least x% of clients are in less developed regions of the country (as locally defined) (may include urban slum areas).
2	The MFI tracks this information and uses for strategic planning.

continues

Annex 1.4 Cont.

Indicator	Suggested Guidelines for Defining the Indicator
Outreach to poor households	
1	% and number of clients at entry below the country poverty line (related to average poverty rate for the country)
2	% and number of clients from recognized marginal communities (related to country data)
3	The MFI tracks this information and uses for strategic planning.
Client retention	
1	The MFI tracks the client exit rate—and reasons for exit.
2	The client retention rate is more than 80% (MIX formula).
3	The MFI tracks this information and uses it for strategic planning.
TRANSFORMATION	
Nonfinancial services to support clients for financial security, livelihoods, or other improvements in quality of life *(e.g., financial education, skills development, market linkages, health education, access to appropriate medical care)*	
1	MFI directly provides such services or arranges linkages to related programs/organizations.
2	At least 20% of clients have access to such services.
3	There is robust evidence of the value of such services to clients—for example, through client feedback and analysis or other adequate evidence for positive change.
4	The MFI tracks this information and uses it for strategic planning.
Gender equity—opportunities for women	
1 For women clients	At least x% of clients are women.
	If there are both women and men clients, the MFI disaggregates portfolio information by gender.
	Evidence for products and services that specifically enhance women's skills and opportunities.
	The MFI tracks this information and uses for strategic planning.
2 For women as staff	At least x% of staff are women (may vary by region); report at different levels (senior management, middle, field, technical, support). At least two board members are women.

continues

Annex 1.4 Cont.

Indicator	Suggested Guidelines for Defining the Indicator
Client representation in governance/member ownership (for member-owned institutions, and possibly for others)	
1	Effective mechanisms for client ownership and representation in decision-making
2	Effective mechanism for client member share in profits
Future option as measures develop	
Evidence for contribution to poverty reduction	
1	The MFI periodically tracks outcomes for its clients, analyzes the data for clients who have been at least three years with the MFI, and uses the findings to improve its services.
2	The MFI applies a robust method to track poverty over time—for example, the PPI or PAT if available for the country and is GF certified for use for tracking over time.
3	x% of clients (who were below the poverty line at entry) have moved above the poverty line after three years.

Notes

1. I would like to acknowledge the guidance and inputs I have received from all the members of the Interim Steering Committee (listed in the Appendix) who commissioned the concept paper, and from many others working in microfinance, and outside the sector, who took the time to read through different drafts and have contributed to refining the ideas and the approach. Thanks also to my colleague Rupal Patel in EDA Rural Systems, who assisted in identifying and reviewing different initiatives for setting standards outside microfinance.
2. See http://www.adb.org/documents/policies/microfinance/microfinance0100.asp?p=policies.
3. See http://www.mixmarket.org/mfi/trends/. These figures do not include microfinance by banks and the 80 million or so women in self-help groups in India.
4. Elisabeth Rhyne, "Microfinance, Scale and Financial Inclusion: The End of the Scale Mantra," *Microfinance Insights* (Mar/April 2010), http://www.microfinanceinsights.com/story-details.php?sid=308&iid=16.
5. See http://www.ssireview.org/articles/entry/reimagining_microfinance/.
6. See http://www.microfinancegateway.org/p/site/m/template.rc/1.1.5515/.
7. See http://blogs.cgdev.org/open_book/2010/12/recalibrating-microfinance-a-six-point-program.php#comment-5275.
8. See www.isealalliance.org. The ISEAL alliance has nine full members setting standards for fair trade, sustainable natural resources, and socially accountable businesses. There are also two associate and five affiliate members that subscribe to the ISEAL Code of Good Practice and are in the process of meeting requirements for good practice in international standard setting. The members participate to share information and raise awareness. ISEAL has invited the entity that may set up a seal of excellence in microfinance to join the alliance.
9. The International Organization for Standardization is widely known as ISO. Established in 1946 as a nongovernmental organization, ISO headquarters are in Geneva with representatives from country standards organizations, working through 2,700 technical committees, subcommittees, and working groups. The ISO produces international standards that are widely accepted for their application to commercial manufacturing and trade.
10. See http://www.seepnetwork.org/resources/Measuring%20Performance%20of%20MFIs%20Framework.pdf.
11. See http://www.mixmarket.org/mfi/indicators.
12. See http://sptf.info/.
13. See http://sptf.info/page/sign-on-letter.
14. See http://www.mixmarket.org/social-performance-data.
15. See http://www.imp-act.org.
16. See more on the question of impact later in this chapter.
17. Publications include James Copestake et al., *Money with a Mission 1: Microfinance and Poverty Reduction* and Alyson Brody et al., *Money with a Mission 2: Managing the Social Performance of Microfinance* (UK: Institute of Development Studies, 2005); Anita Campion et al., *"Putting the 'Social' Into Performance Management: A Practice-Based Guide for Microfinance* (UK: Institute of Development Studies, 2008). The consortium also publishes a series of technical guideline notes and other resources that are available at http://www.spmresourcecentre.net.
18. See http://www.cerise-microfinance.org/-impact-and-social-perfomance.
19. See http://www.mfc.org.pl/publication.html.
20. The latest developments are reported in the latest European dialogue (Number 3), "Making Microfinance Investment Responsible—State of the Practice in Europe," European Microfinance Platform, 2010, http://www.e-mfp.eu/resources/european-dialogue.

21. See http://www.smartcampaign.org/.
22. See http://www.mftransparency.org/.
23. See http://www.swwb.org/.
24. See http://www.fmo.nl/smartsite.dws?id=1670.
25. See http://www.ilo.org/asia/whatwedo/projects/lang-en/WCMS_114241/index.htm.
26. See http://www.progressoutofpoverty.org/.
27. See http://www.povertytools.org/.
28. The Poverty Outreach Working Group (POWG) defines extreme or absolute poverty as absence of enough resources to secure basic life necessities, with reference to the estimated 1.3 billion people living below the international poverty line of $1.25 at 2005 purchasing-power parity (PPP).
29. See, for example, in India, http://www.sa-dhan.net/Resources/Sa-Dhan%20Code%20of%20Conduct%20final.pdf. http://www.mfinindia.org/mfin-code-conduct.
30. The designated coordinating institutions are REDCAMIF, FOROLAC, and Project Mission.
31. Speech by the Microcredit Summit campaign director Sam Daley-Harris in Spain, April 2010, looking forward to the Global Summit 2011.
32. Morduch Collins et al., *Portfolios of the Poor: How the World's Poor Live on $2 a Day* (Princeton, NJ: Princeton University Press, 2009).
33. S. Datar, M. Epstein, and K. Yuthas, "In Microfinance, Clients Must Come First," *Stanford Social Innovation Review* (Winter 2008), http://www.ssireview.org/articles/entry/in_microfinance_clients_must_come_first/.
34. Ibid.
35. Data for nine MFIs across the world are presented in the review report, "Promoting the Development of Social Ratings of Microfinance Institutions" by M-CRIL and Microfinanza Rating, 2009, http://www.m-cril.com/BackEnd/ModulesFiles/Publication/TheDevelopmentOfSocialRating.pdf. See also the similar findings in IRIS Center, University of Maryland–College Park, "Developing and Testing Poverty Assessment Tools: Results from Accuracy Tests in Bangladesh," USAID, 2005.
36. Information on loan disbursed by cycle would be a more dynamic indicator. See similar arguments in C. Dunford, "What's Wrong with Loan Size," http://www.microfinancegateway.org/p/site/m/template.rc/1.9.26357/.
37. These are the rates below $1.25 or the national poverty line, as reported in the UN Human Development Report, 2010, http://hdrstats.undp.org/en/indicators/38906.html. Mapping of the relevant poverty lines and poverty rates by country has to be done systematically as part of applying this standard. This will help to define the context in a way that is relevant to assessing the depth of financial inclusion.
38. See n. 26.