

An investor initiative in partnership with UNEP FI and the UN Global Compact



Principles for Investors in Inclusive Finance case studies

February 2012





Disclaimer

The information contained in the report is meant for informational purposes only and is subject to change without notice. The content of the report is provided with the understanding that the authors and publishers are not herein engaged to render advice on legal, economic, investment or other professional issues and services. Subsequently, the PRI is also not responsible for the content of web sites and information resources that may be referenced in the report. The access provided to these sites does not constitute an endorsement by the PRI or the information contained therein. Unless expressly stated otherwise, the opinions, findings, interpretations and conclusions expressed in the report are those of the various contributors to the report and do not necessarily represent the views of the PRI or the member institutions of the PRI. While we have made every attempt to ensure that the information contained in the report has been obtained from reliable and

up-to-date sources, the changing nature of statistics, laws, rules and regulations may result in delays, omissions or inaccuracies in information contained in this report. As such, the PRI makes no representations as to the accuracy or any other aspect of information contained in this report. The PRI is not responsible for any errors or omissions, or for any decision made or action taken based on information contained in this report or for any consequential, special or similar damages, even if advised of the possibility of such damages. All information in this report is provided 'as is', with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, expressed or implied, including, but not limited to warranties of performance, merchantability and fitness for a particular purpose. The information and opinions contained in the report are provided without any warranty of any kind, either expressed or implied.

The Principles for Investors in Inclusive Finance were launched in The Hague in January 2011. Signatories to the seven Principles commit to adhering to and promoting the following principles:

- Range of services. We will actively support retail providers to innovate and expand the range of financial services available to low-income people in order to help them reduce their vulnerability, build assets, manage cash-flow and increase incomes.
- Client protection. We believe that client protection is crucial for low-income clients. Therefore we will integrate client protection in our investment policies and practices.
- **Fair treatment.** We will treat our investees fairly with appropriate financing that meets demand, clear and balanced contracts, and fair processes for resolving disputes.
- **Responsible investment.** We will include environmental, social and corporate governance (ESG) issues in our investment policies and reporting.
- **Transparency.** We will actively promote transparency in all aspects.
- **Balanced returns.** We will strive for a balanced long-term social and financial risk-adjusted return that recognises the interests of clients, retail providers and our investors.
- **Standards.** We will collaborate to set harmonised investor standards that support the further development of inclusive finance.

Contributions

The PRI Secretariat is grateful to the following people for their contributions to this compendium:

David Bartocha (Finance in Motion), Christophe Bochatay (Triple Jump), Rita de Boer (Triodos Investment Management), Ximena Escobar de Nogales (BlueOrchard), Christian Etzensperger (responsAbility), Marilou van Golstein Brouwers (Triodos Investment Management), Sascha Huijsman (SNS Impact Investing), Anna Kanze (Grassroots Capital Management), Ging Ledesma (Oikocredit International), Marieke de Leede (SNS Impact Investing), Holly O'Connell (Oikocredit International), Dina Pons (Incofin), Barbara Rademaker (Triple Jump), Nancy Sommer (responsAbility), S Viswanatha Prasad (Caspian Advisors) and Ellen Willems (Triodos Investment Management).

Contents 2

Introduction by James Gifford, Executive Director, PRI	3
Responsible investment in inclusive finance	3
Case studies	
Principle 1: Range of services responsAbility	4 5
Principle 2: Client protection Oikocredit International SNS Impact Investing	8 9 11
Principle 3: Fair treatment Grassroots Capital Management and Caspian Advisors	13 14
Principle 4: Responsible investment Finance in Motion	16 17
Principle 5: Transparency Incofin Triple Jump	20 21 25
Principle 6: Balanced returns BlueOrchard	27 28
Principle 7: Standards Triodos Investment Management	31 32
Further reading	34
Glossary	36
About the Principle for Investors in Inclusive Finance	37
Share your experience of implementing the Principles	37

Introduction

James Gifford, Executive Director, PRI



The following guide presents an introduction to each of the seven Principles for Investors in Inclusive Finance (PIIF), accompanied by nine case studies that demonstrate how investment manager signatories are implementing responsible investment-related policies and procedures in the field of inclusive finance.

The PRI is committed to encouraging responsible investment across asset classes

and themed investment areas, and is therefore delighted to have housed the PIIF since its launch in January 2011.

This compendium highlights how PIIF founding signatories that are directly investing in inclusive finance have approached the Principles in the first year. We encourage others to share their approach, as we will be publishing further case studies in the future.¹

Responsible investment in inclusive finance

An overview by Marilou van Golstein Brouwers, Managing Director of Triodos Investment Management BV and chair of the Principles for Investors in Inclusive Finance steering committee



Inclusive finance focuses on expanding access to financial services and products to poor and vulnerable populations, micro- and small-enterprises, and those otherwise excluded from affordable and responsible financial products and services. This encompasses a wide range of financial services including savings, credit, insurance, remittances and payments.

Investors approach investment in inclusive finance with different motivations. Some are engaged because they actively seek to alleviate poverty and see the provision of financial services as a tool to do so. Some seek to be a responsible investor because they recognise that issues such as over-indebtedness are material when assessing financial risks and returns. Whatever the motivation, there is a variety of approaches to being a responsible investor.

Microfinance investors are a diverse group. They have different business models, priorities and institutional capacities. This document offers some guidance regarding the interpretation of the Principles, and shares examples from founding signatories who are in the process of implementing the Principles, adherence to which will be monitored via the annual PRI Reporting Framework.² These case studies are shared in the spirit of facilitating mutual learning and co-development of responsible practices and standards in this nascent area over time.

- 1 Other case studies are available on the PRI signatory extranet, accessible to signatories only, at intranet.unpri.org
- 2. See www.unpri.org/reporting

 org for more information.

We will actively support retail providers to innovate and expand the range of financial services available to low-income people to help them reduce their vulnerability, build assets, manage cash-flow and increase incomes.

Competition creates market forces that reduce the cost of goods and services. But for microfinance investors and consumers, increasing liquidity and competition in recent years shows that competition can also pose risks. The predominance of microcredit relative to other financial products can create multiple lending and market saturation. This can lead to over-indebtedness which harms clients, and increasing default rates which reduce investor returns – damaging individual investors' reputations and the industry as a whole.

Microcredit is not the only service available to consumers. Other services include savings, loans, insurance, payment services, remittance facilities and pension plans. Investors are in a strong position to encourage a breadth of financial services provision to a greater proportion of the world's population – individuals as well as small- and medium-sized enterprises.

Retail providers³ serve approximately 200 million individuals, 137.5 million of whom were among the poorest of the world's population when they took their first loan.⁴ However, this serves only a fraction of the need: it is estimated that of the world's 7 billion population, 2.7 billion adults do not have access to financial services.⁵

Possible actions

- Develop and extend the range of financial services available to low-income populations. Extensions could include savings, loans, insurance, payment services, remittance facilities and pension plans;
- Encourage providers to develop innovative products tailored to the needs of low-income clients;
- Encourage retail providers to expand their service offerings to more remote areas and more vulnerable populations.
 - 3 See Glossary for a definition.
 - 4 Jan P. Maes and Larry R. Reed, State of the Microcredit Summit Campaign Report 2012.
 - 5 CGAP / World Bank, Financial Access 2009: Measuring Access to Financial Services around the World.

Country: Switzerland

Established: 2003

AUM: US\$ 1 billion

Type of investment: Debt and equity

Approximate percentage of AUM in inclusive finance: 100 per cent

Introduction

responsAbility uses a proprietary Development Effectiveness Rating (rADER) to measure and report on the social performance criteria of its investments. This case study outlines how responsAbility is implementing the first PIIF Principle by integrating rADER into the investment process.

Integrating 'range of services' into investment decisions

Integrating the PIIF Principles is a high priority for responsAbility. Like every other PIIF principle, Principle 1 was formally implemented into the investment decision process after cross-checking with the company's Guiding Principles. These are adhered to in all microfinance investments.⁶

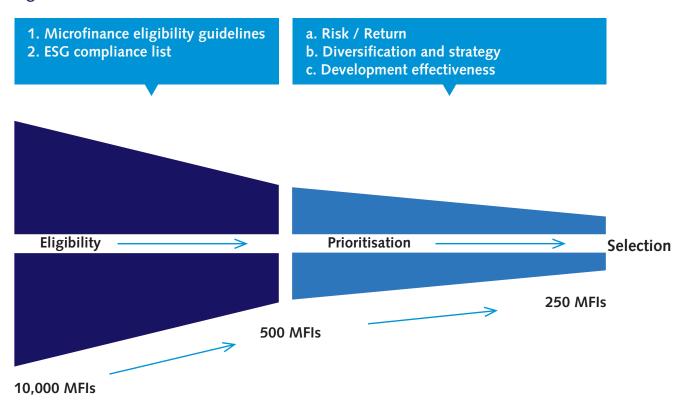
Having access to a range of financial services can reduce the vulnerability of households to economic, political and environmental threats. Therefore, responsAbility actively supports MFIs introducing new services to customers, specifically savings accounts. This also serves to reduce the vulnerability of MFIs, as savings enable them to refinance themselves locally.

Research and analysis

After signing the PIIF, a working group with representatives from the Management Board, Credit Risk Management and Research was set up to put the Principles into practice. The working group re-examined the existing process of how social performance (SP) criteria were implemented in the investment process. The result was a redesigned investment process that takes social performance variables into account on two levels: eligibility and prioritisation (see Figure 1). The first level, a filter, assigns an increased importance to certain qualitative SP criteria and reduces the number of eligible MFIs from more than 10,000 worldwide to approximately 500. The second level, a prioritiser, ranks the MFIs for development effectiveness.



Figure 1: Selection of MFIs



Construction of a portfolio

As described in Figure 1, the selection of MFIs for investment is a two-stage procedure. In the first selection stage, for example, how far an MFI pursues formalisation (via the criterion 'sustainable legal / supervisory form') is qualitatively assessed. Formalisation is the transition that many MFIs are taking to being regulated. It is a necessary step to enable the provision of a wide range of services, in particular deposit accounts. Only formal, regulated institutions are allowed to take deposits. MFIs that do not or are not attempting to fulfil the nine criteria specified in Table 1 are not eligible for investment.

In the second selection stage ('prioritisation'), responsAbility uses quantitative measures e.g. the outreach to savings clients and resulting percentage of the portfolio of an MFI that is financed through savings, to measure the strength of product offerings. MFIs scoring higher in development effectiveness, as defined by the complete set of rADER criteria, are preferred to lower-performing MFIs.

Management and monitoring

responsAbility evaluates the social performance of its portfolio using 10 specific indicators. For example, the total amount of clients' savings under management and data regarding microfinance clients by gender and location, several of which are indicators of progress regarding the range of services offered by the MFI. This data are analysed against other data points, with summary results presented in the responsAbility annual Social Performance Report. By the end of 2011, responsAbility had used rADER to assess 100 per cent of the MFIs in its portfolio.

7 Regulated institutions meet an extensive set of requirements that allow them to offer financial services such as savings and insurance. Non-regulated MFIs are not monitored for compliance with these requirements, and are therefore legally unable to perform these functions.

Table 1: Eligibility criteria		
Sustainable business model	Has achieved or is in the process of achieving financial sustainability, and has a vision and a realistic chance to operate under commercial conditions.	
Sustainable legal / supervisory form	MFIs that seek formalisation.	
Targeted lending	The lending focus must be on microentrepreneurs.	
Adequate client analysis	To avoid client over-indebtedness, MFIs must have an adequate lending approach.	
Use of credit bureau	If a credit bureau is available and functioning effectively, MFIs must report to it and draw on it when lending.	
Fair client treatment	MFIs must implement appropriate client treatment and transparency principles such as the Client Protection Principles by the Smart Campaign.	
Reasonable owner and management compensation	Compensation must be sensible and in tune with local practice	
Owner and management integrity	Shareholders and management must pass integrity checks (e.g. no criminal track record, no illicit source of funds).	
Real financing need	responsAbility provides financial resources, it does not lend its name. MFIs must demonstrate a genuine financing need.	

Exiting

Assessing social criteria is important before exiting an investment. To encourage partners to deliver a range of financial services, the focus on the formalisation of MFIs should be an effective means to ensure an MFI's broad product offering even after exiting.

responsAbility's learning points

- The formalisation of MFIs is the only way to achieve a sustained, meaningful increase in product variety;
- Savings are an essential financial service for two reasons: 1) they reduce households' vulnerability while also strengthening MFIs' refinancing alternatives; and 2) savings can be measured not only qualitatively, but also quantitatively.

We believe that client protection is crucial for low-income clients. Therefore, we will integrate client protection in our investment policies and practices.

Client protection requires the protection of the ultimate client from unfair, non-transparent or unethical practices to ensure that clients do not borrow more than they can repay, or use products that they do not need. The aim is to protect clients, businesses and the industry as a whole.

There are various ways of implementing client protection, but industry consensus has emerged around a set of core principles, developed by a broad coalition of microfinance institutions, networks, funders and practitioners, known as the Client Protection Principles (CPPs). These were launched in 2008 by the Consultative Group to Assist the Poor (CGAP) and the Center for Financial Inclusion at ACCION International. The CPPs are an evolving set of minimum standards that clients should expect to receive when doing business with a retail provider.

The seven Client Protection Principles

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

Developments in the CPPs have been spurred on by the Smart Campaign,⁸ a global campaign committed to embedding client protection practices into the institutional culture and operations of the microfinance industry. The campaign has devised a number of toolkits and resources for retail providers, which are working on the frontline in this issue, but investors can support such implementation, as seen in the following case studies.

Possible actions

- Publicly endorse the Client Protection Principles;
- Incorporate the Client Protection Principles into investment policies, due diligence processes and financing or shareholder agreements where possible;
- Invest in retail providers that have endorsed the Client Protection Principles;
- Encourage retail providers to make the Client Protection Principles part of their operations;
- Check progress on implementation of the Client Protection Principles through mandatory reporting and regular monitoring and evaluation;
- Report on progress made in advancing the Client Protection Principles to investors and other stakeholders.

Country: The Netherlands

Established: 1975

AUM: € 476 million

Type of investment: Loans, credit lines, equity and guarantees

Approximate percentage of AUM in inclusive finance: 79 per cent

Introduction

Oikocredit believes microfinance is a valuable tool to empower people to create a better future, so long as clients' needs and wellbeing are the focus of its services. Microfinance investors play a special role in ensuring the protection and promotion of client benefit and welfare, and Oikocredit takes this responsibility seriously. To ensure its partners (the MFIs in which it invests) maintain client welfare as a priority, Oikocredit promotes the Smart Campaign's Client Protection Principles (CPPs).

Oikocredit endorsed the CPPs in September 2008 and circulated the principles to all local offices with the request they be shared with partners. Oikocredit has also collaborated with other investors to put the principles into practice and help MFIs ensure their operations become fully compliant.

Education and knowledge sharing

Endorsement and promotion are not enough: MFIs also need support with implementation. Oikocredit's staff are trained in the importance of the CPPs, and in India they are trained to become certified assessors. In 2011, Oikocredit was involved in more than 20 workshops, conferences and training courses aimed at educating investees on the CPPs, and they reached more than 100 microfinance partners around the world.

In October 2011, Oikocredit teamed up with the Costa Rican Microfinance Network (REDCOM) and Smart Campaign to deliver one such workshop, attracting 73 representatives from nine Latin American and Caribbean countries. Many of them were worried after seeing other countries struggle to manage the recent growth in the sector, and some felt that the region's clients and their existing loan portfolios would be at risk if client protection issues were not addressed.

Following the session, one participant noted the importance of discussing the CPPs with clients, particularly because when 'the poor cannot read or write, they are often not treated appropriately due to these limitations'. More than 14 participating organisations endorsed the CPPs following the workshop and pledged to use the tools in practice.

It is important to set targets on endorsement to make sure that MFIs work towards compliance. So far, more than 220 of Oikocredit's MFI partners (44 per cent) worldwide have endorsed the CPPs; the goal is 80 per cent by the end of 2012. Oikocredit has fully integrated the CPPs into its social due diligence tool and now includes compliance as a contractual obligation for MFI borrowers.



"Oikocredit approaches client protection with an active and comprehensive view to implementation; it has trained over one hundred microfinance partners."

It is also clear that end clients need more support to manage finances and avoid over-indebtedness. In Bosnia and Herzegovina, Oikocredit joined other funders in the establishment of a financial literacy centre. The project struggled to gain public trust because of the stigma that surrounds counselling of any kind, and a suspicion of services provided free of charge. In addition, some industry members were concerned the centre's staff would advise clients not to repay debts, or that the centre would be used by clients to stall their repayments. For many in the industry, the largest threat was that the centre would be 'competition' for debt collection departments.

As a result, only three MFIs were initially willing to work together and provide resources for the centre. However, with ongoing co-financing from Oikocredit and others, the centre has helped hundreds of people better manage their finances.

Raising the bar for best practice

Under its commitment to ensuring that protection and promotion of clients' welfare remains central to partners' operations, in 2011 Oikocredit participated in its first in-house assessment of an MFI specifically focusing on the CPPs. Janalaksmi Financial Services Private Ltd (JFSPL) is a tech-savvy, efficient and successful Indian partner. The rigorous assessment of JFSPL included interviews at all levels of the organisation and in-depth cross-checks to develop

an overall picture of JFSPL's commitment to its clients. Oikocredit was pleased to find good practices in both debt collections and product design, and is discussing with JFSPL how best to promote these with other MFIs.¹⁰

Improving client service and governance

If things go wrong, MFIs often apply a zerotolerance policy on delinquency. Clients' rights can be jeopardised for the sake of collections. The chief executive of Tanzanian MFI Belita, Helena Lutege, changed her approach to clients in default after she received training in social performance management facilitated by Oikocredit. A client's business had burnt down, and Belita chose to allow her to reschedule her loan and re-capitalise, instead of selling her land and impoverishing her family. The client has been able to keep up the rescheduled repayments, her business is successful and she speaks highly of Belita. This case study has been recorded as a video and used by other initiatives such as the Social Performance Management Network¹¹ to provide guidance to other practitioners.

Oikocredit encourages partner MFIs to conduct client satisfaction surveys so they can serve clients better and with more tailored products. Support is also offered in training staff, developing codes of ethics, and reviewing human resource regulations and incentive systems.

Oikocredit's learning points

- Promote education and information sharing between MFIs to develop best practice endorsement is not enough;
- Stress the importance of CPPs from the outset by building them into formal agreements with investees;
- Encourage MFIs to deliver client satisfaction surveys to check practice on the ground;
- Train your staff to be able to help partners, highlighting good practice where you see it and sharing this among MFI partners.

¹⁰ See Oikocredit's blog, Microfinance in the Field, for more information. www.oikocredit.org/en/microfinance-in-the-field

☐

¹¹ The SPM Network connects individuals and organisations that are committed to managing and achieving social performance in microfinance. www.spmnetwork.net

Country: The Netherlands

Established: 2006

AUM: US\$ 435 million

Type of investment: Debt and equity

Approximate percentage of AUM in inclusive finance: 100 per cent

Introduction

SNS Impact Investing is the development investment entity of SNS Asset Management and a founding signatory to the PIIF. It manages two institutional microfinance funds. To ensure responsible investments, it has a Responsibility and Impact Framework for all funds under management. With respect to Principle 2, SNS perceives client protection to be central to the funds' performance because it reduces the financial and social risks of client non-repayment.

Making client protection operational

Based on its Responsibility and Impact Framework¹², SNS Impact Investing developed a non-financial scorecard.¹³ The scorecard was designed to enable SNS to review the social, environmental and governance performance of MFIs in a consistent manner. The tool consists of five sections: outreach and targeting; client benefit and welfare; governance; environment; and responsibility to staff and community. It includes, for example, questions on poverty screening, the client retention rate, non-financial products and the measures the MFI takes to avoid client over-indebtedness. Through this scorecard, part of the due diligence process, the actual level of transparency and client protection practices of the MFI are evaluated.

The scorecard enables a systematic assessment of an MFI's non-financial aspects. The findings are discussed at the Investment Committee and used in the investment decision process. In addition, the scorecard provides a structured basis for investment officers to start a dialogue with the MFI on client protection as it raises awareness of areas which require improvement. MFIs with substandard performance on the vital social performance elements, such as client benefit and welfare, will be requested to draw up a plan with measures to implement within a certain timeframe. Commitment to this plan and results are deemed necessary for continuing the borrower/lender relation between the MFI and the fund.



¹² The Framework was developed in 2010 and further refined during 2011.

¹³ The scorecard was developed in close cooperation with Oikocredit (see previous case study) and Developing World Markets.

An important step for SNS in protecting clients from becoming over-indebted is the requirement for investees to endorse the Client Protection Principles (CPPs). This was formalised during 2010 and 2011, when additional clauses were introduced to the loan agreement requesting MFIs to:

- Maintain their status / become a signatory to the Client Protection Principles in Microfinance and operate in accordance with these Principles, adopting the following practices:
 - i. in order to provide full transparency (a) adopt policies and procedures to disclose to its clients the total cost (including all fees, commissions, insurance premiums and other costs) and (b) report this information to MFTransparency, if requested by investors;¹⁴
 - ii. in order to promote prevention of overindebtedness, make use of client information from relevant credit bureaus before lending and report client data to relevant credit bureaus, where it is commercially reasonable to do so.¹⁵

Clause (1) was introduced in 2010. Some 70 per cent of investees had endorsed the CPPs before signing the loan agreement. Those who had not are being encouraged by the investment manager to do so. Although most non-signatory MFIs have in place policies and practices regarding client protection, endorsing the CPPs demonstrates a firm commitment, particularly in cases where management or ownership changes. Clauses (i) and (ii) were introduced more recently so statistics

on compliance are not yet available. Information from the scorecard shows that 91 per cent of the MFIs in the portfolio actively disclose loan conditions and terms to their clients, indicating room for improvement. Compliance is checked by the investment manager during the due diligence process, when end clients are visited and the MFI's disclosure policies and marketing documentation are checked.

Working with MFIs

SNS Impact Investing also supports MFIs in implementing the required action for CPPs compliance. For instance, a Nepalese MFI seeking help in managing its social performance and analysis data was put in contact with consultants and academics who specialise in the topic.

Once the loan agreement has been signed, SNS Impact Investing starts the process of monitoring the MFI concerned. This may result in a process of engagement with the MFI to set clear objectives. Responsibility for eventual compliance remains with the management of the MFI. Non-compliance puts at stake a possible renewal of the loan agreement.

In summary, client protection is taken into account in the entire investment process. It is part of the due diligence process, discussed during the approval and renewal process, integrated in the loan agreement and the MFI's commitment to client protection is assessed on a regular basis during the monitoring process.

SNS's learning points

- Include key client protection covenants in all loan agreements and monitor these regularly;
- Integrate client protection in the entire investment process.

¹⁴ This is applicable only in countries where MFTransparency is active. See Principle 5 for more information on MFTransparency.

¹⁵ The final requirement only is relevant in countries where there is a credit bureau or a data sharing service.

We will treat our investees fairly with appropriate financing that meets demand, clear and balanced contracts, and fair processes for resolving disputes.

Principle 3 encourages investors to protect their own investees, an extension from the commitment in Principle 2 to protect the end client.

It also overlaps with Principle 5, as a key step for investors committing to the fair treatment of their investees is to ensure transparency in their own policies, procedures, terms and conditions. Fair treatment applies at every stage of the investment cycle: in the design of the products and services offered by the investor; portfolio construction; due diligence and selection of partners; monitoring and reporting; and exit.

Possible actions

- Provide financing in an appropriate currency;
- Provide financing with an adequate tenor;
- Negotiate terms and conditions that are transparent and reasonable, including fair break-up clauses;
- Actively support the building of a diversified funding base;
- Focus on ultimate clients' interests when dealing with defaults, forced exit or restructuring situations.

Grassroots Capital Management and Caspian Advisors

Country: US/India Established: 2005

AUM: US\$ 200 million

Type of investment: Equity

Approximate percentage of AUM in inclusive finance: 100 per cent

Introduction

Grassroots Capital Management and Caspian Advisors, an India-focused asset manager promoting financial inclusion, have co-launched five social investment funds since 2003.

A joint approach to responsible investment

The funds are designed to meet a gap in the market, both from the perspective of investees and the ultimate clients whose livelihoods should be improved through the investments. To be eligible for an investment from any of the funds, a company must be involved in bringing about financial inclusion as well as provide the potential for capital appreciation for the funds.

Integrating fair treatment of clients in the investment process

The central tenet of the funds is to make investments in companies that are either directly or indirectly engaged in bringing about financial inclusion of the poor, the under-served or disenfranchised into the formal financial system. Reporting requirements are updated to incorporate and support industry initiatives such as the Smart Campaign's Client Protection Principles and the Social Performance Task Force/MIX Market¹⁶ social performance indicators and poverty indices.





These requirements have been included in term sheets, shareholders agreements and/or side letters of new investments. The funds share a dedicated Social Performance Manager who works with individual investment managers to track and optimize social performance from pre-investment through to exit.

The funds play an active role in partnership with the MFIs, generally taking majority or significant minority positions in portfolio companies. Investment managers take seats on boards and often participate in sub-committees, contributing to the improvement of governance practices. The funds also assist with management, operational and capital-raising support, helping social entrepreneurs negotiate better deals or providing guidance on fundraising strategies. Investment managers provide training, give presentations on key topics and will intervene at a portfolio company when necessary to assist in correcting an issue such as portfolio quality.

When the time is right, an important part of the process is exit management and selling to the right buyer with minimum disruption to the organisation and its mission. In playing these roles, Grassroots and Caspian are sensitive to the fact that with the market segment that they are most engaged with, the balance of expertise, information and negotiating leverage are often very much in the investor's favour. But the long-term prospects of the industry – and its ability to appropriately serve its end clients – depends on MFIs being treated fairly as long-term partners.

Grassroots and Caspian see their role as contributing to the development of what is still a nascent industry by promoting strong entrepreneurs and providing them with the incentives and support to succeed. Essential to this is flexible financing that balances the shorter-term financial goals of investors with the longer-term requirements for value creation for all stakeholders.

Fair treatment of investees in practice: Bellwether Microfinance Fund

An example of the application of this principle is the Bellwether Microfinance Fund in India. In 2005, microfinance in India was poised for commercialisation. Several MFIs planned to transform into regulated entities, but scaling up and transformation was difficult due to lack of risk capital and of investible MFIs with shareholder-accessible structures or the expertise to create them.

Bellwether was designed to fill this gap with the strategy of coupling financial support in the critical first few years of the MFIs' operations with close operational support, oversight and assistance in accessing domestic financial markets. As the first on-shore microfinance investment fund offering equity, debt and hybrid products as well as a wide range of advisory and facilitation services, Bellwether was designed to address the shortage of domestic capital.

The fund provides a variety of financing options in local currency, important to enable portfolio companies to grow microfinance in poorly served parts of the country. Bellwether assembled the necessary expertise by reaching out into the community of microfinance professionals to find those with the entrepreneurial capacity to lead sustainable MFIs.

A significant portion of Bellwether's initial portfolio consisted of such start-ups. The selected entrepreneurs were typically provided with equity in recognition of their efforts, with the goal of building relationships that would be viewed as both fair to the individuals involved and supportive of broader developments by setting standards of collaboration between entrepreneurs and investors.

Originally, a main focus for Bellwether was investing in NGOs and assisting in their transformation to commercial institutions. But the microfinance landscape in India has changed dramatically, leading to new challenges. Bellwether found that having clear-cut social goals from the beginning and working in concert with like-minded investors made it easier to identify and partner with those entrepreneurs and institutions that had aligned interests, which has protected the fund's investments to some extent. One key learning point has been the risks posed by rapid growth: the speed with which the commercial sector developed has subsequently been questioned because some institutions failed to exercise the necessary restraints. The fund is therefore now focused on differentiating its portfolio companies from less customer-focused institutions and more actively participating in industry initiatives as a means to help influence the behaviour of the sector overall.

Grassroots and Caspian's learning points

- Investors sharing risks and rewards with MFI management creates institutions with strong foundations that promote sustainability;
- Although microfinance offers ample opportunities for investors to dictate terms to investees, ultimately investors and the industry benefit from more equal and respectful partnerships;
- Be sensitive to the risks posed by rapid growth, and the behaviour of other market players.

We will include environmental, social and corporate governance (ESG) issues in our investment policies and reporting.

Many inclusive finance investors and microfinance institutions have social goals, and undertake social performance management to measure the progress made in their implementation. Principle 4 encourages all investors in inclusive finance to look at social performance management and to also consider environmental and corporate governance issues.

The PIIF are housed within the Principles for Responsible Investment (PRI) Initiative. The PRI Initiative has a broader set of principles devised by the investment community that reflect the importance of ESG issues to investment portfolios, and therefore must be given appropriate consideration by investors to fulfil their fiduciary (or equivalent) duty.

The six Principles for Responsible Investment

- 1. We will incorporate ESG issues into investment analysis and decision-making processes.
- 2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
- 3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- 4. We will promote acceptance and implementation of the Principles within the investment industry.
- 5. We will work together to enhance our effectiveness in implementing the Principles.
- 6. We will each report on our activities and progress towards implementing the Principles.

Possible actions

- Sign the PRI Initiative's six Principles and commit to their adoption and implementation;
- Adhere to CGAP MIV Disclosure Guidelines and report annually;
- Use the Social Performance Task Force standards and tools to measure and report on social performance;
- Assist in developing appropriate references for environmental and corporate governance issues;
- Promote implementation of anti-corruption practices.

Country: Germany
Established: 2009

AUM: € 939 million

Type of investment: Debt and equity

Approximate percentage of AUM in inclusive finance: 84 per cent

Mapping the different initiatives

As a consequence of signing the Principles for Responsible Investment in July 2010 and the PIIF in January 2011, Finance in Motion decided to review and broaden its existing social performance approach.¹⁷ Finance in Motion provides investment for microfinance but also other areas with development impact such as small- and mediumsized enterprises (SMEs), housing, renewable energies and energy efficiency, educational and water finance. Consequently, there was a gap between the information required by the investors in the funds managed and advised, and the information required from the investees of these funds: commercial banks, microfinance banks and non-bank microfinance institutions in emerging markets and developing countries.

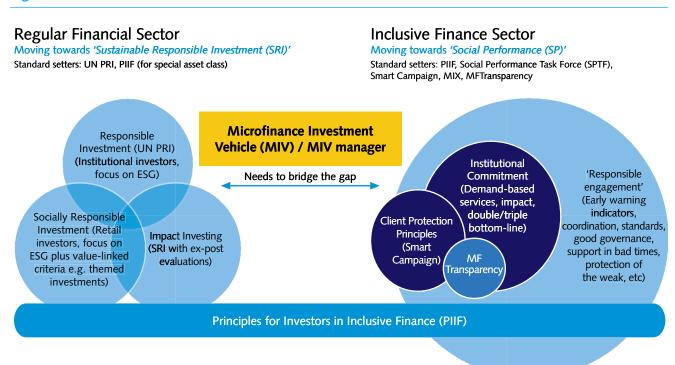
This gap needed bridging. Finance in Motion therefore decided first to map the different initiatives to see how they interrelated and where to position itself as a themed investor (see Figure 2). This analysis revealed that:

■ The mainstream financial sector focuses on responsible investments (RI), which include aspects of responsible investment, socially responsible investment and impact investing. ESG issues and impact investing are important cornerstones in this market.

- The inclusive finance sector focuses more on social performance, including client protection, institutional commitment and 'responsible engagement', such as early warning indicators on over-indebtedness or the development and coordination of standards. However, environmental issues are hardly discussed and governance discussions focus on social aspects of governance rather than on good governance, such as those promoted by the Organisation for Economic Co-operation and Development (OECD) and other international bodies.
- The gap between the mainstream and the inclusive finance sectors needs to be bridged by themed investment funds, including Microfinance Investment Vehicles (MIVs). There is also a 'language gap' as the two sides talk about similar aspects using different language.
- The overlapping of initiatives creates some confusion. This is particularly true within the inclusive finance sector, which is in the process of defining its social performance standards.
- The PIIF provide a framework that 'bridges' both sectors and can be developed to communicate to both investors and investees of the funds managed and advised by Finance in Motion.



Figure 2: Interrelation of initiatives



Going beyond social performance

Finance in Motion therefore decided to go beyond social performance and developed dimensions and elements based on the PRI and the PIIF. ESG issues, responsibility and impact for development became the building blocks of this new framework.

Impact for development has two elements for Finance in Motion: the primacy of impact on the final client along with Finance in Motion's engagement in building sustainable financial institutions. Engagement activities include specific complementary technical assistance for the partner institutions of the funds managed and advised, in order to enable the sustainable development of investees and the financial sectors in which they operate.

Finance in Motion therefore developed an operational framework for responsible investments, ESGRID¹⁹, which combines initiatives such as the PRI, the PIIF and social performance and reflects Finance in Motion's focus on development finance.

^{19 © 2011} Finance in Motion GmbH. Finance in Motion is an alternative asset management firm exclusively focused on development finance and among the first signatories of the PIIF. It is incorporated with limited liability under the Laws of Germany and has its head office in Frankfurt/Main, Germany.

Dimensions	Elements	
Environment	Protection of the environment	
	 Active promotion of the environment 	
	 Compensation for environmental damages 	
Social	Client protection	
	 Outreach to the disadvantaged / excluded 	
	 Corporate Social Responsibility 	
Governance	Strategic guidance and effective monitoring	
	of management and accountability by the board	
	Timely and accurate disclosure and transparency	
	Effective internal controls	
Responsibility	 Fair treatment of clients, peers and staff / stakeholders 	
,	Responsible financial performance	
	Long-term commitment and engagement	
1 (5)		
Impact for Development	Socio-economic effects on the ultimate clients	
	 Impact on financial institutions and the financial sector 	

ESGRID is currently in development and is undergoing field testing to refine its elements and indicators and to find a balance between practicality on the one hand and detailed information on the other. The next step will include discussions about ESGRID with the investors and investees of the funds advised and managed by Finance in Motion, with a view to create a common language between the investors' and investees' goals and activities.

Finance in Motion's learning points

- Investors and investees require a common language understandable to both sides. Inclusive finance typically focuses on social performance, whereas the mainstream financial sector focuses on ESG issues. Themed investors in inclusive finance should combine the different aspects. The PIIF provide a good framework that 'bridges' both sectors, which investors in inclusive finance can use to fine-tune their operations;
- Finance in Motion has nonetheless had to develop its own internal operational framework, ESGRID, that integrates different principles and puts these principles into practice, to ensure the best fit with its investors and investees.

We will actively promote transparency in all aspects.

There is a lack of transparency and information on the processes and practices throughout the inclusive finance investment chain. Transparency requires a top-down and bottom-up commitment from investors: investors at the top of the chain need to demonstrate their commitment to open policies and procedures; and a bottom-up commitment involves investors encouraging retail providers to be transparent when engaging with clients.

Pricing is important when discussing transparency in microfinance, as the true cost of products can be unclear. This can lead to over-consumption and harm clients, creating credit and reputational risks for investors.

There are various tools for investors to determine the true annual percentage rate (APR) and effective interest rate (EIR)²⁰ being charged by retail providers, including MFTransparency's Calculating Transparent Interest tool (see Further reading, page 34).

Pricing is not the only area that requires greater transparency: communication of social and financial goals is important to help retail providers understand their respective missions and encourage alignment. As more social performance data are collected, some investors are choosing to publicly share this data in an annual report or separate social performance publication. This information can be useful not just for individual investment decisions, but for the industry as a whole by aggregating data and comparing trends, trade-offs and synergies (see Principle 6).

Possible actions

- Ensure that investees adequately disclose the pricing, terms and conditions of financial products and services offered, and that the pricing, terms and conditions are understood by clients;
- Fully disclose policies, criteria and related conditions of products and services to investees and other relevant stakeholders;
- Fully disclose investment objectives, both financial and social, to investors;
- Endorse MFTransparency, a global initiative for fair and transparent pricing in the microfinance industry.

20 The effective interest rate (EIR) is the rate that converts all the borrower's financial costs for a loan into a single declining balance interest calculation. It includes the effects of interest rates, whether they are calculated on a flat or declining basis, payment schedules, commissions, fees, discounting and compensating balances. It is the rate that a client actually pays based on the amount of loan proceeds the client receives.

Incofin 21

Country: Belgium

Established: 2009

AUM: € 310 million

Type of investment: Debt and equity

Approximate percentage of AUM in inclusive finance: 100 per cent

Introduction

Incofin is committed to delivering innovative practices to ensure awareness and understanding of its financial products, for investors, investees and their end clients. Many end clients have a low level of literacy, so simply publishing terms and conditions is insufficient to ensure transparency.

To serve such clients, who include impoverished women, unbanked populations, micro-entrepreneurs and rural farmers, Incofin demands that its MFI partners adopt transparent and clear lending channels. In return, Incofin actively promotes transparency in its own practices.

Transparency in the investment process

Incofin's Communications Manager recently revised its marketing brochures and website content to ensure that its investment procedures and line of products are clearly detailed and understandable for all partners. The website, application form and term sheet templates are available in three languages.

During the due diligence process for the selection of new MFIs, Incofin uses an in-house Social Performance Management (SPM) evaluation tool, ECHOS©. This puts significant emphasis on and rewards an MFI's level of transparency, accounting for 25% of the overall social mission management score. This category looks at annual reporting on social indicators to the MIX Market, the undertaking of social audits and / or social ratings, i.e.:

Does the MFI report social indicators to the MIX Market on a regular basis?

- Yes (5 points)
- No (0 point)

Has the MFI conducted a social rating or social audit within the past two years?

- No (0 point)
- Yes, but it was a self-evaluation (1 point)
- Yes, and it was an audit conducted by an external party but the MFI did not publish it (2 points)
- Yes, and it was an audit conducted by an external party but the MFI published it (3 points)
- Yes, it was a rating conducted by an external party, the MFI published it, but the result showed a negative trend (4 points)
- Yes, it was a rating conducted by an external party, the MFI published it, the results showed a positive trend (5 points)



ECHOS also looks at the implementation of the seven Client Protection Principles, with a special emphasis on transparent pricing:²¹

Did the MFI endorse the CPP / Smart Campaign?

- Yes (5 points)
- No (0 points)

Is the pricing information provided to clients transparent?

- Yes, loan contracts include EIR and detail all loan conditions, all loan/savings conditions have been explained to the client, contracts' language is simple and in the vernacular (5 points)
- The interest rate is stated but not the EIR, explanations by field staff are not fully adapted to clients' literacy level (2.5 points)
- No (0 points)

In 2011, Incofin revised its investment memo to include a specific section on transparent and responsible pricing. Investment managers are now expected to answer the following question, using data collected during the due diligence process:

Does the MFI offer responsible pricing?

- Yes, the EIR is below 20% (5 points)
- The EIR is between 21% and 30% (4 points)
- The EIR is between 31% and 40% (3 points)
- The EIR is between 41% and 50% (2 points)
- The EIR is between 51% and 60% (1 point)
- The EIR is above 60% (0 points)

Of course, the responses need to take into account the pricing offered by competitors in the market where the MFI operates. Investment managers conduct a comparative assessment of the MFI's pricing, by collecting and comparing EIRs where available using MFTransparency data. Alternatively they use the portfolio yield (as a proxy for EIR) of the MFI in question and compare it with the pricing of at least four other MFIs operating in the same market (see Figure 3).

Evaluating transparent and responsible pricing is an integral part of Incofin's overall social performance analysis. A score of 0 would raise a red flag but is not necessarily a deal-breaker. In such cases, the investment committee looks at the yield margin (portfolio yield minus costs). A high yield margin puts the MFI at a disadvantage, but a pricing committee at the MFI's Board level would mitigate this as it indicates the MFI's intent to review and ultimately reduce the interest rates it offers to clients.

Incofin's own term sheets and legal agreements have been revised to ensure they are consistent. Legal documents clearly state annual interest rates and all other additional fees. Debt partners are provided with a clearly detailed repayment schedule so that they know exactly how much they receive and how much they need to pay, including the calculation behind it.

²¹ See Principle 2 for more on the Client Protection Principles and Smart Campaign.

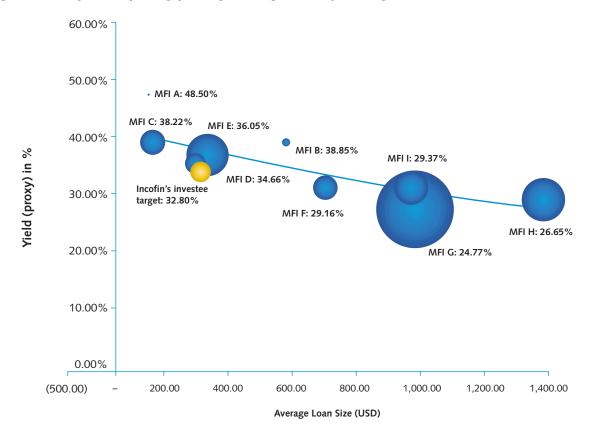


Figure 3: Graph comparing pricing among MFIs operating in the same market

Finally, MFIs have direct contact with Incofin's accountant and finance director as well as their investment manager should they need it. Since the beginning of 2011, an independent legal department has been in charge of answering any questions investees might have regarding the loan or shareholder agreements they are about to sign.

Promoting transparency, beyond investment management activities

Within the community of investors focused on microfinance, Incofin is leading or participating in a number of initiatives of working groups promoting transparency:

Incofin subscribes to the online services of three specialised microfinance rating agencies in recognition of the need for the production of objective and public information in the microfinance market. In 2010, Incofin was one of three MIVs to agree to a public financial and social rating (a report is available on the company website). ²² Additionally, Incofin reports to the MIV Disclosure Guidelines. ²³ The disclosure and standardisation of MIV performance data should provide investors with a greater level of confidence in the integrity, comparability and completeness of MIV reporting. By improving transparency on MIV financial performance and ESG disclosures, the Guidelines are intended to define and benchmark the performance of microfinance investments. ²⁴ Incofin won an award in recognition of the quality of its social performance reporting to these Guidelines.

22 www.incofin.be

- 23 See Further reading (page 34) for more information.
- 24 The recommended disclosures include key information on MIVs' profiles, including legal information and investment strategy, as well as selected indicators to assess financial performance and environmental, social and governance (ESG) policies. Certain indicators have been incorporated into the PIIF Reporting Framework.

The challenge of keeping abreast of industry developments

One of the challenges is having to change, adjust and enhance internal processes and policies in order to meet evolving best practices and benchmarks. For example, when the Smart Campaign updated its list from six to seven Client Protection Principles in 2011, Incofin had to review its social performance management due diligence tool and retrain all its staff. Loan contracts have also been updated to include endorsement of the principles on social representation and to educate MFI partners on their duty.

It requires time and effort to keep up with and help shape the debate on transparency. When Incofin underwent its first Microfinance Investment Vehicle (MIV) rating, the rating agent had never conducted such an exercise before, so the company had to dedicate significant resources and time to make possible the most complete and objective picture of Incofin. Belonging to industry networks such as the Social Performance Task Force helped make this process easier. Building transparency has to be a proactive process; it does not happen by chance.

Incofin's learning points

- Ensure your own legal documents are consistent and clear, and provide MFIs with access to individuals other than the main investment manager should they have any concerns or problems;
- Some of the PIIF principles, such as a commitment to transparency, cut across many aspects of both Incofin and its investees' work. This makes keeping up with best practice a constant challenge. It helps, therefore, to be 'on the front foot' by taking your own experiences and using them to shape industry debate;
- Transparency is a highly sensitive topic. Promoting transparency of pricing at the MFI level will only be truly accepted if it is coupled with advocacy to national regulators and technical assistance focusing on financial literacy to support MFIs' clients.

Country: The Netherlands

Established: 2006

AUM: US\$ 350 million

Type of investment: Debt and equity

Approximate percentage of AUM in inclusive finance: 100 per cent

Introduction

Triple Jump currently manages investments in more than 165 MFIs in Latin America, Eastern Europe, Africa, the Middle East and Asia. Interest rates charged by MFIs to their clients vary greatly between regions, products and institutions, and have a significant impact on the end clients' financial health and ability to repay. To assess if an MFI will provide an appropriate balance between social and financial returns, social investors should determine if the MFI is practising responsible pricing. Triple Jump believes responsible pricing to be pricing, terms and conditions that are both affordable to clients and sustainable for financial institutions.²⁵

Assessing what is responsible when it comes to pricing

A simple and quick way to assess if an MFI's pricing is fair is to compare it with other institutions in the market. There are, however, many limitations to this approach. While pricing transparency is improving, there are still countries where no reliable sector information is available. In certain cases, there are no relevant peers to enable comparison with MFIs serving a particular client segment.

To tackle this challenge, Triple Jump developed its own approach in 2010. The Interest Traffic Light was designed to assess, in a systematic way, whether the interest rates charged by microfinance institutions are justified and warrant investment from Triple Jump. The tool proposes a framework to assess a balanced return from the perspective of the end client, the operator (MFI) and the investor. It considers absolute rates as well as a set of underlying factors that determine what institutions need to charge their clients in order to provide sustainable financial services. For example, after comparing the effective interest rates of the microfinance institutions to national and regional averages, the officer will:

- compare rates with those of similar products (methodology, loan size);
- look for evidence that clients get value from the products (impact study, satisfaction survey, cash-flow analysis);
- analyse the specific factors in the operating environment that can potentially contribute to higher costs (salaries, rural outreach, administrative costs, infrastructure, regulatory requirements) or indicate a riskier environment requiring prudent policies (inflation, currency fluctuation, political instability, natural disaster, etc.);
- look at the institution's profitability level and the way profits are used;
- evaluate its past and current efforts to lower the interest rates.



During the due diligence process, investment officers assess and rate each of these. Wherever possible, benchmarks provided by external parties such as MFTransparency are used to compare the microfinance institution's rates with relevant peer groups. The complete analysis results in a final score and yields a recommendation to assist in Triple Jump's investment decision. A green light means the investment can be approved without further conditions on interest rates. A yellow light would require the MFI to make a commitment to reduce its interest rates levels within a specified timeframe. In case of a red light, the investment will not be proposed to the investment committee. The results of the Interest Traffic Light are discussed at investment committee level and form an integral part of the investment decisions alongside other factors of social and financial performance.

Because Triple Jump felt that its approach was an innovative way to address interest rates in microfinance, it was eager to share it with peers and receive their feedback. The tool was made available for download at www.interesttrafficlight.org This attracted a valuable response that is helping improve the methodology. Triple Jump hopes that sharing its approach will encourage other investors to use the Interest Traffic Light or further develop their own methodology.

Triple Jump's learning points

- If you develop an individual approach to responsible investment because existing tools or products are insufficient, being transparent about your approach can help harmonisation;
- This can help improve your tool and may also encourage others to develop their practice.

We will strive for a balanced long-term social and financial risk-adjusted return that recognises the interests of clients, retail providers and our investors.

Investors need to be satisfied that investing in inclusive finance appropriately contributes to their returns and creates value. But this is rarely the only reason investors are attracted to inclusive finance; other, more social, outcomes are of importance. Microfinance is frequently associated with improving the lives of the poor, by providing formal financial services either for consumer purposes (day-to-day household needs) or to improve income-generating microentrepreneurial activities that can help lift families out of poverty. Microfinance has also been associated specifically with empowering women and improving access to healthcare and education.

In practice, how investors balance social and financial objectives and returns varies greatly. The first step is to have a clear mission and set of objectives. It is also important to establish appropriate key performance indicators and data collection processes to enable accurate measurement, monitoring and reporting processes. Unless there is a clear objective with monitoring and governance mechanisms, organisations (both investors and their clients) can get mired in inappropriate data collection.

The second step is to gather data: the Microfinance Information Exchange (MIX), with SPTF, has established 11 indicators to measure the social performance data of MFIs – indicators which are clearly and directly linked to results. The indicators can also be tested and benchmarked and can be easily validated by third parties: www.themix.org/social-performance/Indicators

Investors can encourage their investees to report to the MIX. They can also use the data for their own internal purposes. This leads to the third step, that of aggregating and analysing data to look at trends and developments. Emerging evidence would suggest that there is not a straightforward trade-off between financial and social returns (i.e. invest in social performance, and financial returns reduce). Rather, there is a complex interplay of factors which evolve over time, and indications of a positive relationship between the two. Whatever the focus and intended outcome of the investor. returns need to be balanced with whether the products and services on offer provide value to the client; as the value proposition to the client is a key determinant of long-term sustainability.

Possible actions

- Exercise voting rights when available;
- When investing in equity, engage with investees to achieve a reasonable and fair alignment between the social impact and the financial return requirements of shareholders, focusing on the long-term.

BlueOrchard 28

Country: Switzerland

Established: 2001

AUM: US\$ 1 billion

Type of investment: Debt and equity

Approximate percentage of AUM in inclusive finance: 100 per cent

Asking the right questions

BlueOrchard has investments in 150 MFIs in 44 countries. This universe is diverse: MFIs differ in legal status (they can be NGOs, cooperatives, banks and non-banking financial institutions); they differ in size (some have a portfolio of more than US\$ 500 million, while others are young start-ups with a small portfolio); they differ in focus (some primarily target rural clients, while others lend mostly to urban, scarcely banked populations). These are just three of many differences.

BlueOrchard's social performance scorecard SPIRIT (Social Performance, Impact Reporting and Intelligence Tool) attempts to assess an MFI's social performance across these differences. Assessing social performance is an integral part of BlueOrchard's due diligence process. SPIRIT is applied in annual visits to MFIs, throughout the investment period. It measures an MFI's social performance across five dimensions, as indicated in Table 3. At the end of 2011, SPIRIT had been applied to 101 MFIs, 67 per cent of BlueOrchard's outstanding portfolio.²⁶

SPIRIT was designed in a highly participatory manner, with numerous iterations and workshops with investment analysts and managers. In developing the tool, BlueOrchard also benefited from valuable advice from industry experts. The questions addressed throughout development were, how do we make sure we capture the essential, account for differences and do not penalise MFIs unfairly?

A recent example from a BlueOrchard equity investment illustrates the pitfalls of assuming in social performance measurement that one size fits all. For example, percentage of rural clients is one of the usual questions the microfinance industry examines and scores positively. But the MFI in this case offers financial services to low-income female slum dwellers in an Indian metropolis. No one would disagree that integrating these clients has a high social value. A more relevant indicator would be the percentage of previously unbanked clients. Complexity plays against standardisation; it is easier to estimate percentages of rural versus urban than banked versus non-banked. BlueOrchard's response to this challenge has been to examine the coherence between social goals and actual outreach. If you do not know what an MFI's claimed social goals are, how can you score it?



"Analysing the interplay between financial and social performance is complex and time-consuming. But it is fundamental for the impact investing industry."

SPIRIT	Issues examined (not exhaustive)	Weight	Number of questions
Intent and outreach	 MFI's financial and non-financial product offer MFI's social objectives and its commitment towards their achievement Alignment of staff incentives with social objectives 	25 per cent	9
Client protection	 Endorsement and practice of client protection principles including: Over-indebtedness Collection practices Transparency Responsible pricing Complaints mechanism Protection of client data Client retention 	30 per cent	14
Human resources	 Number of staff and gender representation Remuneration ratio (CEO to loan officer) Compensation Training Career progression 	15 per cent	6
Corporate social responsibility and governance	 Exclusion list Internal environmental policy Board composition and adequacy of representation regarding social goals Documentation of board decisions 	15 per cent	4
Measurement of social performance and impact	 Impact indicators (data is requested on number of enterprises financed by the MFI and jobs created) MFI's poverty focus MFI's social performance reporting 	15 per cent	6

Analysing the data gathered

The data collected through the scorecard give an insight into the non-financial performance of the organisation. The MFI's social performance score is part of the document that is submitted to the credit committee and influences BlueOrchard's investment decisions. Social and financial performances are therefore considered jointly.

To explore the relationship between social and financial performance further, with the data collected through SPIRIT, BlueOrchard conducted some basic econometric analysis. The sample was diverse in factors such as size, age, legal status of MFIs and geographic location, factors which affect both social and financial performance. Partial correlations were conducted and controlling for these differences revealed some interesting synergies and trade-offs between the five distinct dimensions and indicators of social performance:²⁷

- MFIs with a good score for measurement of social performance and impact tend to have a portfolio with lower financial risk and better productivity.
- Corporate social responsibility and governance is correlated with the portfolio quality. A better score in this dimension is associated with a lower write-off ratio.

Other microfinance investment managers and microfinance players²⁸ have conducted similar exercises. BlueOrchard believes more market research is necessary in order to understand the interplay between social and financial performance.

BlueOrchard's learning points

- Flexibility is required in devising a social performance scorecard which can cover the diversity of MFIs found in a well-balanced portfolio;
- It is critical to ask the right questions and invest resources in understanding the answers provided;
- More research is needed into the trade-offs and synergies between financial and social performance.

²⁷ For the complete analysis see BlueOrchard's 2011 Social Performance Report.

www.blueorchard.com/jahia/webdav/site/blueorchard/share d/Publications%20and%20Resources/Social%20Performance%20Report/SPReport2011.pdf

²⁸ See MIX Research Adrian Gonzalez (2010) New Research Results on Trade-offs and Synergies between Social and Financial Performance, David Dewez and Sandra Neisa (2009) MFI's Social Performance Mapping and the Relationship Between Financial and Social Performance as well as research by Florent Bédécarrats of CERISE.

We will collaborate to set harmonised investor standards that support the further development of inclusive finance.

Across each PIIF principle there are examples of investors working together to establish standards in the inclusive finance industry. Growing the inclusive finance industry relies on developing a common language and reporting standards. This creates efficiencies by avoiding similar data being collected in many different forms to satisfy multiple stakeholders. Setting harmonised standards can also improve competition and performance: by enabling clients to make comparisons when choosing products and services; helping investors during portfolio selection; and guiding asset owners when selecting investment managers.

Investors will develop their own performance management systems, but can use various industry standard indicators as a basis for doing so. The PIIF are themselves intended to provide a framework for responsible investment in inclusive finance. They act as an umbrella for various different market initiatives, several of which have been referred to in this publication.

Possible actions

- Participate in networks to share tools, information and resources;
- Develop and support appropriate collaborative initiatives;
- Contribute to advancing benchmarking, as an incentive for improvement;
- Contribute to and encourage use of the Impact Reporting and Investment Standards (IRIS) for measuring and reporting social and environmental performance;
- Collectively address relevant emerging issues, particularly on regulation and policy.

Country: The Netherlands

Established: 1994
AUM: € 1.7 billion

Type of investment: Equity, subordinated debt and senior debt

Approximate percentage of AUM in inclusive finance: 19 per cent

Introduction

Triodos Investment Management is a 100 per cent subsidiary of Triodos Bank, one of the world's leading sustainable banks. Triodos Investment Management manages direct investments ranging from sustainable energy infrastructure to microfinance institutions, and is currently managing 20 funds investing in both Europe and emerging markets with different risk-return profiles and financial instruments, four of which are specialised microfinance funds.

Triodos Investment Management's vision is to develop microfinance – ranging from credit facilities and savings accounts to payment services and microinsurance – into a fully-fledged, integral part of the financial sector in developing countries.

Harmonised investor standards

In line with this overall vision, Triodos Investment Management believes that harmonised investor standards are necessary to enable a high degree of comparability between different organisations active in inclusive finance, and to ensure the effectiveness of impact investing.

Reporting non-financial data is still a relatively new phenomenon among investors and even though the sector is moving towards more standardisation, some challenges remain.

Triodos @Investment Management

There are different opinions about which indicators to use, inconsistencies in definitions and differences in the way indicators are reported. Many of the indicators look at qualitative information, leaving room for interpretation. Data cannot tell the full story and caution is required when aggregating information and drawing conclusions.

A proprietary tool based on standardised indicators

In 2009, Triodos Investment Management developed a Sustainable Banking Assessment tool to meet the growing need for standardised reporting and evaluation in the microfinance sector. This tool assesses an organisation's mission, vision and intentions, along with its products, services, processes and systems. Rather than introducing a new set of indicators, the tool brings together 38 indicators aligned with sector initiatives such as the Social Performance Task Force, the Smart Campaign, MIX Market and MFTransparency.

Sustainability reporting in microfinance

Triodos Investment Management has sought to apply this standardisation to its investments in microfinance. Every year it organises a workshop that brings together the senior management and board members of its equity investees. During the 2004 workshop, Triodos Bank and the Global Reporting Initiative (GRI) launched the Transparency and Sustainability in Finance (TSF) project in cooperation with six leading retail providers (from Cambodia, Bolivia, Nicaragua, Ecuador, Uganda, and Kenya).²⁹

"Focusing on leaders in the field of microfinance contributes to the development of best practices that can be followed by other organisations in the same countries and regions."

The ultimate goal of this project was to introduce the same sustainability reporting guidelines to investees and to implement financial, social and environmental management and reporting tools using the GRI Guidelines. Participating retail providers are required to contribute to the costs in an effort to ensure their commitment to the project.

Focusing on leaders in the field of microfinance contributes to the development of best practices that can be followed by other organisations in the same countries and regions. Having developed its own integrated sustainability management system, one of the participants, ACLEDA Bank (Cambodia)³⁰, used the experience to replicate the system in ACLEDA Bank Lao (Laos).³¹

Later, the TSF project formed a basis for the SMARTRAC initiative (2008). Through this EU/ACP Microfinance Programme, Triodos Investment Management enhanced risk management and sustainability management and reporting with eight African retail providers.

Using mainstream banking guidelines (e.g. Basel II) and the GRI, practical tools were developed and adapted to the needs of smaller unregulated institutions that want to become fully licensed banks. The project resulted in a sustainability toolkit (2009).³²

In an effort to include indirect retail investors in this process, they were invited to special side events at Annual Workshops hosted by Triodos Bank in 2008 and 2010, facilitating round-table discussions between indirect retail investors, senior representatives of the retail providers and investment officers and senior management of Triodos Investment Management. Giving indirect investors the opportunity to interact directly with retail providers helps to create awareness and ensures that the development of investor standards happens in a way that is understood and supported by all stakeholders.

Triodos's learning points

- Setting harmonised investor standards is necessary to enable a high degree of comparability between different organisations, but data cannot tell the full story and caution is required when aggregating information and drawing conclusions;
- Developing qualitative harmonised reporting standards can only be successful with the commitment of all stakeholders in the value chain. This requires retail providers, direct and indirect investors, funders and consultants to work together and take into account each other's concerns. Investors can play a role in bringing these stakeholders together;
- To successfully participate and contribute to the process of setting harmonized investor standards, it is essential that both retail providers and (in)direct investors dedicate specific time and resources to this process.

29 www.microfinancegateway.org/p/site/m/template.rc/1.9.35214

- 31 www.acledabank.com.la/la/eng/bp_sustainabilityreport.php
 Other examples of retail providers that report according to the GRI Guidelines are Mibanco (Peru), Visión Banco (Paraguay), Banco FIE (Bolivia), Akiba Commercial Bank (Tanzania), K-REP Bank (Kenya) and Centenary Bank (Uganda).
- 32 www.triodosfacet.nl/images/stories/smartrac/a%20handbook% 20for%20microfinance%20practioners%202009%20(smartrac).pdf

Principle 1

Over-indebtedness

- An investor survey found the most effective measures for preventing over-indebtedness were improved credit analysis, adaptation of loan products and the introduction of non-credit products, such as insurance and savings: Oikocredit (2011) Over-indebtedness www.oikocredit.org/socialperformance/en/qa/over-indebtedness/oikocredits-over-indebtedness-report
- An academic study looking at the significance of various indicators in developing a country early-warning index for over-indebtedness: Kappel, Krauss and Lontzek (2010) Over-indebtedness and Microfinance: Constructing an Early Warning Index www.microfinancegateway.org/p/site/m/template.rc/1.1.9421 🗗

Developing a range of services

- Five case studies of insurance companies engaging in microinsurance to explore the circumstances insurance companies can generate profits from microinsurance: Microinsurance Innovation Facility (2011) A business case for microinsurance www.ilo.org/public/english/employment/mifacility/download/brnote9_en.pdf ☑
- The Microinsurance Network website contains publications and resources for investors considering or actively engaging in the development of insurance products for low-income persons: www.microinsurancenetwork.org

Principle 2

■ The Smart Campaign has produced a summary of current practice on client protection and implementation guidance specific to investors. Investors can also endorse the Smart Campaign: www.smartcampaign.org

Principle 3

■ A working group on responsible covenants was established at the Social Performance Task Force meeting in June 2011. The group aims to increase the transparency of microfinance investors' positions when defining the nature and level of covenants in loan contracts to avoid irresponsible covenants:

http://sptf.info/sp-task-force/working-groups

Principle 4

- Mainstream industry standards on corporate governance include the OECD Principles of Corporate Governance and ICGN Principles of Corporate Governance: www.oecd.org www.icgn.org
- This e-MFP Making Microfinance Investment Responsible action group publication contains case studies regarding governance at the MFI level and the role of investors: Strengthening Governance for Responsible Finance: Examples from Examples from European Investment Funds www.e-mfp.eu/node/513 🗗
- The World Microfinance Forum has a working group on institutional governance: www.microfinanceforum.org

Environment

■ FMO has developed practical environmental and social risk management tools for MFIs. The management support tools are consist of office, field and training guides in English, Spanish, French and Khmer: www.fmo.nl 🗗

Industry reporting for Microfinance Investment Vehicles (MIVs)

- The MIV Disclosure Guidelines, developed by CGAP, recommend disclosure includes information on MIVs' profiles, including legal information, investment strategy, selected indicators to assess financial performance and ESG policies: www.cgap.org/gm/document-1.9.47636/CG_MIV_Rev.pdf
- Some of the CGAP indicators have been incorporated into the PIIF Reporting Framework as a proxy for responsible investment processes.

Principle 5

■ MFTransparency encourages the microfinance industry to be open and transparent regarding the true price of loan products and to provide the information clearly and consistently. It collects and publishes data on loan pricing to help investors and other industry stakeholders to make comparisons. Investors can endorse MFTransparency and download resources, including the Calculating Transparent Interest tool: www.mftransparency.org

Principle 6

Tools for measuring non-financial performance

- The Social Performance Task Force (SPTF) provides a map of existing social performance resources specifically for investors: inthiseconomy.org/SPTF/investors-map.html 🗗
- The SPTF has begun a process to define Universal Standards for Social Performance Management for MFIs pursuing financial, social and environmental objectives: sptf.info/sp-standards

Poverty alleviation

- The Progress out of Poverty IndexTM (PPITM) helps financial services providers measure the poverty levels of groups and individuals and to track changes in poverty levels over time. The Index contains ten country-specific, non-financial indicators such as family size, the number of children attending school and the type of housing they live in: progressoutofpoverty.org/understanding-the-progress-out-poverty-index ■
- A Seal of Excellence for Poverty Outreach and Transformation in Microfinance is being developed to recognise institutions doing the most to help families lift themselves out of poverty:

 www.globalmicrocreditsummit2011.org/plenary-papers
- FOROLACFR, the Latin American and Caribbean Forum on Rural Finance, is developing certification for three different seals: one for MFIs combatting poverty, one for those tackling gender inequalities and another for rural financial services: www.forolacfr.org

Balancing social and financial returns

- This publication of the e-MFP Making Microfinance Investment Responsible action group provides case studies on the interplay between social and financial returns: Sharing innovative practices for responsible microfinance investment: Driving Investment Decisions with Social Performance Information: www.e-mfp.eu/node/513 🗹
- The MIX has used its self-reported data from MFIs to analyse the trade-offs and synergies between financial and social performance outcomes: Data brief no.7 www.mixmarket.org

Principle 7

- The Global Impact Investing Network hosts the Impact Reporting & Investment Standards (IRIS), an initiative to develop a common language for describing the social and environmental performance of organisations, including retail providers of financial services. The aim is to establish an independent and credible set of metrics for organisations to use when reporting their impact: iris.thegiin.org
- Other industry networks include the Council of Microfinance Equity Funds (CMEF) and the International Association of Microfinance Investors (IAMFI), both member bodies representing investors in microfinance: www.cmef.com www.iamfi.com

Glossary 36

Credit bureau: An agency that contains information on the credit history of consumers for creditors to make decisions when granting loans.

End client/ultimate client: The recipient of financial services; typically poor and low-income people. The client group for a given financial organisation depends on the organisation's mission and goals.

Global Impact Investing Network (GIIN):

A not-for-profit organisation dedicated to increasing the scale and effectiveness of impact investing. The GIIN supports collaboration, develops industry infrastructure and undertakes research and advocacy to foster a coherent impact investing industry.

Inclusive finance: Financial services that target working age adults, including those currently excluded by the financial system, to ensure that all have effective access to financial services. Effective access involves convenient and responsible service delivery, and at a cost affordable to the customer and sustainable for the provider.³³

Microcredit: The provision of credit services to low-income entrepreneurs. Microcredit can also refer to the actual microloan.

Microentrepreneur: People who own small-scale businesses, known as microenterprises.

Microfinance: The provision of diverse financial services to poor and low-income clients.

Microfinance Information Exchange (MIX): MIX is a non-profit that delivers data services, analysis, research and business information on the institutions that provide financial services to the world's poor. MIX Market collects financial and social performance data from over 2,000 MFIs worldwide.

Microfinance institution (MFI)/retail providers:

Financial institutions that specialise in microfinance. MFIs aim to reach low-income households with an increasing variety of financial services, including but not limited to financing for their microenterprises. MFIs include banks, regulated nonbank financial institutions (NBFI), savings and loan cooperatives and not-for-profit organisations.

Microfinance Investment Vehicle (MIV): MIVs are independent investment entities specialising in microfinance, with more than 50 per cent of their non-cash assets invested in microfinance. They are either self-managed or managed by an investment management firm and are open to multiple investors.

Retail providers: See Microfinance institution, above.

Smart Campaign: A global campaign committed to embedding client protection practices into the institutional culture and operations of the microfinance industry.

Social performance management: A process that involves setting clear social objectives, monitoring and assessing progress, and using this information to improve overall performance.

Social Performance Task Force (SPTF): A global, industry-wide task force focused on developing ways to measure social performance in microfinance.

About the Principle for Investors in Inclusive Finance

The PIIF were developed in response to growing interest in inclusive finance and demand for investor guidance. They are an initiative of investors and Her Royal Highness Princess Máxima of the Netherlands, the UN Secretary-General's Special Advocate for Inclusive Finance for Development. The group developed the PIIF together with the PRI Initiative, the Consultative Group to Assist the Poor (CGAP) and key industry players. They were launched on 27 January 2011 at the Responsible Finance Forum hosted by the Dutch Ministry of Foreign Affairs. More information, including the list of signatories, can be found at www.unpri.org/piif

Share your experience of implementing the Principles

The PRI will continue to collect and publish case studies on how PIIF signatories are implementing the Principles and plans to both update this publication and offer further examples within the relevant section of the PRI signatory extranet.

For more information, or if you would like to contribute a case study, please contact emilie.goodall@unpri.org



An investor initiative in partnership with UNEP FI and the UN Global Compact

www.unpri.org/piif



