

An Equity Investor Takes Stock

Integrating Social Performance Measurement
and Microfinance Investment

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Many socially-minded investors believe that integrating social performance into the investment process can help preserve the character of double-bottom line institutions. For Grassroots Capital, social and financial performance, rather than distinct or conflicting goals, are intertwined into the company's day-to-day activities. In fact, they have created their own framework for evaluating the social impact of current and potential investee MFIs.

At Grassroots Capital, we believe that more often than not, microfinance institutions (MFIs) that excel at creating social value for clients will also be those with the best knowledge of their clients' needs, and will, therefore, be best-positioned to adapt and innovate in response to changing market conditions, competition and technological change. Because social performance is integral to successful microfinance from financial, moral and capital markets standpoints, integrating social performance into the investment process from the start is paramount. There are multiple ways to do so: performance measurement at both the intermediary and client levels, linking to the broader social investment community, and exploring structural elements that can help preserve the character of double bottom line institutions.

For several years, Grassroots has used an in-house social return metric to help bring a consistent approach to its evaluation of MFIs. Like most such frameworks in use, the focus had originally been on the intermediary MFI rather than end-clients, and relied on indicators that provide mostly indirect evidence, such as loan size and mission statement, to determine its success in reaching and benefiting the target population. With the launch of the Global Microfinance Equity Fund in 2008, Grassroots updated and enhanced its social impact tool, and has been testing the revised version on its portfolios. The changes in the tool incorporated the results of important work underway in the industry that has recently become available.

Building the Framework

| Grassroots Social Impact Indicator Descriptions | | | |
|---|------------------------------------|--|--------|
| Category | Indicator | Description | Weight |
| Outreach | New Market | Entered a rural, urban, or overall new market over previous 12 months | 5% |
| | Depth of Outreach ¹ | Under development; Poverty Index Score of Clients indicates > 80% of clients in bottom two quintiles of income distribution. | 5% |
| | Initial Loan/GDP per Capita | Size of the initial loan as a percentage of GDP per capita | 5% |
| | Rural/Agricultural | Distribution of portfolio in rural or agricultural loans | 5% |
| | Coordinated Services | Non financial services projects - education, market linkages, etc. | 5% |
| Scale | Absolute Size | Top 20% of MFIs in microfinance industry based on the number of clients | 8% |
| | Market Share | Top 20% of MFIs in region based on the number of clients | 8% |
| | Mainstream Collaboration | Financial collaboration with insurance co., service company model, etc. | 8% |
| Consumer Protection | Truth in lending | Transparency in loan rates, tenure, collection procedures | 4% |
| | Monitor Collection Practices | Collection procedures clearly defined and well-supervised | 4% |
| | Monitor Over-indebtedness | Procedures to screen out over-indebtedness are in place and periodically tested | 4% |
| | Reasonable Pricing | Under development; loan rates are within defined range of regional average and/or base rates | 4% |
| | Grievance Procedure | Well-publicized client ombudsman or equivalent system in place to collect and investigate complaints. | 4% |
| | Protection of Privacy ² | Safeguards in place to protect confidentiality of client data | 4% |
| Innovation | New Products | Introduction of new products over previous 24 months | 5% |
| | Non-credit Products | Offers non-credit FS- savings, insurance, remittances | 5% |
| | Market Research | Systematically conducts market research on client needs, satisfaction | 5% |
| Financing | Employee Equity Ownership | Employee stock ownership plan | 3% |
| | Local Ownership | Equity ownership structure includes domestic participants | 3% |
| | Public Deposits ³ | Voluntary savings are source of funding | 3% |

Notes:

(1) Score currently indicates whether Progress Out of Poverty Index (POPI) or similar tool is being implemented to measure poverty rates of clients. In future, will track where MFI clients are with respect to the poverty lines.

(2) Currently not incorporated into MFI scores but is in testing

(3) Is not incorporated in scores for MFIs where the collection of public savings is not an option, e.g., India

First, consistent with increased emphasis by many participants in the microfinance industry, Grassroots has incorporated indicators of a robust consumer protection process in MFIs developed as part of the Campaign for Client Protection being promoted under the auspices of the Center for Financial Inclusion and CGAP (www.campaignforclientprotection.org). These indicators include the existence of truth in lending policies, grievance procedures and monitoring of collection practices, among other features.

Second, Grassroots has incorporated client-level impact data generated by poverty scorecards such as the Progress Out of Poverty Index (PPI) into its framework. Poverty scorecards, which emerged from work by the Grameen Foundation, Ford Foundation and CGAP, and tools developed by Prizma (Bosnia), Microfinance Centre (Warsaw), ASA (Bangladesh) and others, support meaningful targeting, product development, market research and peer group comparisons. This in turn can help MFIs to identify opportunities to develop their financial offerings, and measure changes in poverty status over time relative to the general population. They are designed to add negligible cost and little burden to the MFIs' processes.

Since the redesign, Grassroots has been testing the tool on its portfolio, and is gradually rolling it out to include all portfolio companies and new investments. Overall, the MFIs tested to date are found to be transparent, employ truth-in-lending strategies, and have begun to utilize tools like the PPI to better understand their clients. Some of them also conduct market research to inform the development of new products, offer innovative products to promote clients' financial inclusion, and collaborate with other non-financial initiatives to further enhance social impact.

Social Capital Markets

While improving metrics specific to microfinance remains a priority, Grassroots also sees the need to incorporate these into a more general framework for social performance evaluation, since many social investors have multisectoral interests that may, for example, encompass the environment or gender issues, in addition to the eradication of poverty. In this regard, Grassroots is working with B Corp (www.bcorporation.net) to help develop transparent, comparable and comprehensive social and environmental impact standards across sectors. Grassroots is participating in a working group to develop specific ratings to measure the social impact of financial services businesses - lenders, private equity/venture capital fund managers and investment advisors - a singular challenge because it requires data regarding who is being served by the financial services product and how effectively they are being served. The goal is to promote the flow of institutional and high net worth capital into the impact-investing marketplace by creating comparable impact-reporting standards for financial services intermediaries.

Institutional Character

Finally, Grassroots also hopes to be able to draw on the work of B Corp and others in the US to devise features that can be incorporated into the charters or by-laws of MFIs to enable them to preserve their double-bottom line character even as they grow and access capital markets. Such features could enable MFIs to consider the interests of stakeholders, in addition to that of shareholders, in managing the company and generating liquidity for investors. While they are not appropriate to all MFIs and investors, Grassroots believes that the development of such features will give different types of investors a clearer understanding of what they are investing in, and reduce conflicts as MFIs develop and grow.

Grassroots Social Impact Indicator Descriptions

The challenges of developing and incorporating meaningful sector-specific social impact metrics into investment analysis and reporting remain daunting; and generalizing them to apply across sectors is even more so. Grassroots, however, believes that over the past twelve months the many years of dogged effort by several industry participants is starting to bear usable fruit, and the momentum towards moving social reporting from an aspiration to a requirement has grown. Grassroots hopes that its commitment to using and developing social metrics will contribute to the emergence of broadly recognized industry conventions, in the belief that these will be an important step towards substantially increasing and facilitating the flow of capital into the social investment space.