

Board Governance Training for Microfinance Institutions Toolkit

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Version I

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This training manual needs comments from trainers to provide additional training tips, examples and ideas! Your thoughts and comments are anticipated and welcomed for the next version.

Board Governance for Microfinance Institutions

Trainer's Manual

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Board Governance Training for Microfinance Institutions

Section 1: Introduction to Board Governance

What is Governance?

The need for governance exists any time a group of people called stakeholders come together to accomplish an end result. It is the process through which this group of people make decisions that direct their collective efforts. Stakeholders are the people and groups with an interest, or ‘stake’, in the success of the institution.

Depending on the legal status of the institution, stakeholders may include:

- Donors
- Government
- Other financial institutions
- Regulatory bodies such as a country’s Central Supervisory Bank
- Other Stakeholders, including clients, employees, and shareholders

Stakeholders Involvement in Decision-making

Donors/Banks/Investors: want to see proper procedures to ensure repayment and/or proper use of funds. Donors may be less forgiving than banks and investors, who expect their investment to be returned.

Government/Regulating bodies: have reporting / oversight requirements that must be strictly adhered to. Efforts should be taken to understand these requirements and send appropriate information on time.

Clients: as end-users of MFI products and services, clients should be considered and/or have a voice in major decisions. Likewise, services & products should be designed to meet their needs and preferences.

Management: these are often the primary makers and implementers of policy. They are closer to and better understand operational realities. They need to be held accountable for proper implementation.

Shareholders: often have a seat on the Board, and thus voting rights on any major strategic decisions as well as executive management. They seek to advance financial or social aims (or both).

Network organisations: seek to leverage partnerships, to share best practices and to disseminate informal codes of conduct (e.g. Sa-Dhan).

Technical service providers: train and advise MFIs on policies and processes (but should not be the ones to decide them!)

Governance is a process by which a board of directors, through its management guides an institution in fulfilling its corporate mission and protects the institution’s assets over time. A board of directors is established to provide oversight and give direction to the managers of an institution. **One challenge many MFIs face is how to ensure that it can effectively balance its social and financial objectives.**

The term governing applied to a board of directors refers to its legal right to exercise authority over an institution, and its system or process for managing the board’s affairs.

What is the Relationship of Governance to the Board of Directors and to Management?

Fundamental to effective governance is the ability of individual directors to work together to accomplish a balance between strategic and operational responsibilities. Effective governance occurs when a board is able to provide guidance to management in strategic issues and is effective in overseeing management implement the strategic plan goals and initiatives.

Management assumes operational authority and ensures that the institution’s programme of activities responds to the direction jointly agreed upon with the board.

Both sets of priorities are required to successfully navigate an institution through its short and long term growth. The challenge of governance is to employ the perspectives and experiences of the board and management to maximize their overall contribution to the institution’s performance.

What is Good Governance?

Good Governance is about both achieving desired results and achieving them in the right way.

Since the “right way” is largely shaped by the cultural norms and values of the institution, there can be no universal template for good governance. Each institution must tailor its own definition of good governance to suit its needs and values.

There are, however, some universal norms and values that apply across cultural boundaries. Social performance norms are being disseminated among MFIs and their primary stakeholders throughout the world¹. The United Nations published a list of characteristics of good governance. Good Governance models include all of the principles.

Figure 1:1 - United Nations Five Good Governance Principles

Principles	
1. Legitimacy and Voice	Participation – all men and women should have a voice in decision-making, either directly or through legitimate intermediate institutions that represent their intention. Such broad participation is built on freedom of association and speech, as well as capacities to participate constructively Consensus orientation – good governance mediates differing interests to reach a broad consensus on what is in the best interest of the group and, where possible, on policies and procedures
2. Direction	Strategic vision – leaders and the public have a broad and long-term perspective on good governance and human development, along with a sense of what is needed for such development. There is also an understanding of the historical, cultural and social complexities in which that perspective is grounded.
3. Performance	Responsiveness – institutions and processes try to serve all stakeholders. Effectiveness and efficiency – processes and institutions produce results that meet needs while making the best use of resources.

¹ Social Performance Task Force. www.sptf.info

4. Accountability	Accountability – decision-makers in government, the private sector and civil society organizations are accountable to the public, as well as to institutional stakeholders. This accountability differs depending on the organizations and whether the decision is internal or external. Transparency – transparency is built on the free flow of information. Processes, institutions and information are directly accessible to those concerned with them, and enough information is provided to understand and monitor them.
5. Fairness	Equity – all men and women have opportunities to improve or maintain their well being Rule of Law – legal frameworks should be fair and enforced impartially, particularly the laws on human rights.

In the Microfinance Context

Legitimacy and Voice: Stakeholders (including clients, staff, funders, etc.) have a role to play in influencing decision-making of an MFI. Good governance involves using appropriate communication and feedback channels, whether formal or informal, to listen to/solicit their interests and concerns.

Direction: Dominance of a person – usually the CEO – is common in MFIs, unlike the corporate sector. There is a need to develop systems, processes and culture at MFIs to avoid being personality-driven and overly dependent on one key individual. Likewise, guiding an MFI requires an understanding of its “double-bottom line”.

Performance: The Board must continually monitor key performance indicators of an MFI (preferably against targets/benchmarks) and regularly review management’s performance. Furthermore, as many MFIs have a strong social mission, members are responsible to monitor both financial and social performance

Accountability: For MFIs, accountability means being responsive to the communities in which it operates as well as all its stakeholders (banker, shareholders, staff and clients, etc.) and being transparent in all areas, particularly in disclosing new policies, fees, and interest rates.

Fairness: Treating clients and staff fairly – regardless of caste, religion, race, sex, etc. – is also an important part of responsible and inclusive lending. This may also depend on a particular MFI’s target market.

Why is it Important to Focus on Good Governance?

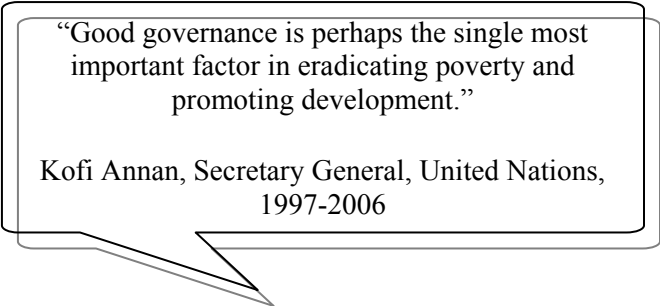
Governance has assumed increasing importance for several reasons.

- As microfinance institutions grow in their outreach, the size of their assets, as reflected in their portfolio, also grows to considerable size. Ensuring effective management of this growth requires added input and involvement from the board of directors.
- An unfocused Board raises the possibility of mission drift and reputation risks. Attention on social objectives will help to ensure achievement of mission and responsiveness to clients and stakeholders.
- The increasing numbers of MFI’s are becoming regulated and assuming the responsibilities and challenges of a regulated entity. Capturing deposits from savers and investors is an important challenge and requires the greatest oversight.
- MFI’s are operating in increasingly competitive markets, and maintaining or increasing market share has become an important component of their strategic objectives.

What are the Benefits of Good Governance?

Good governance leads to a number of positive consequences, including:

- Trust
- Clear vision, mission, and direction
- Relevant values
- Connection to the stakeholders
- Sustainable financial stability



“Good governance is perhaps the single most important factor in eradicating poverty and promoting development.”

Kofi Annan, Secretary General, United Nations,
1997-2006

Governance has become an important topic as evidence mounts on the critical role it plays in determining societal well-being. Not surprisingly, governance as a term has progressed from obscurity to widespread usage, particularly in the last decade.

(The remaining sections of this training course focus on governance. It is important to remember that governance models and policies are dependent upon a microfinance institution’s legal statutes.)

Section 2: Models of Governance

What are the Factors That Influence Board Governance?

Although boards carry similar responsibilities, there is great diversity in how they function in both theory and practice. Boards do not all look alike because the institutions they govern are extremely different

The role of the board should reflect the principles of good governance and the mission of the particular institution. Other factors that shape an institution and thereby affect the board’s governance role are:

- Institutional Needs
- Areas of interest and “business”
- Size and Complexity
- Key stakeholder relationships
- Cultural norms, values and accepted traditions
- Context and its place in the larger environment
- People, their personalities, their capabilities

What are Governance Models?

Let’s look at the different types of boards and their involvement in the governance of the institution. At one end is the Advisory board or it might be labeled a ‘rubber stamp’ board. At the other end of the spectrum is the ‘hands on’ board or “super micro managing” board. What are the characteristics of each type of governing board?

Advisory Board: Many times boards are appointed by donors, governments, etc. This type of board is typically reactive in its relationship with management. The appointing body leads in policy and strategy planning or management tends to present the strategic thinking plans and to recommend decisions for the board to adopt is a sign of an advisory board. Directors may be poorly prepared for meetings and may know little about the institution’s operations and activities. This board/management relationship negates the fundamental reason for a board’s existence and in the long term severely diminishes the institution’s overall effectiveness.

An Advisory Board is likely to create one of more of the following situations:

- The board brings little or no value added to the institution and is amenable to whatever strategy or programme is submitted for its approval.
- The institution is denied the benefit of varied thoughtful voices and experiences that are essential for its proper function and growth.
- Too much responsibility and power are placed in the hands of the CEO or one board member.
- Rubber Stamp boards do not provide the ‘checks and balances’ required to oversee the operations of the institution leaving it vulnerable to mismanagement and potential fraud.

Representational Board: These boards include well respected and influential directors who provide public visibility for the institution and give the board credibility it might not otherwise have earned. The board typically depends heavily on management to play a key role in developing the institution’s strategic direction and to make the critical operational decisions. Even though the board has deployed key responsibilities to management, the directors remain informed of the institution’s operations.

Members of this type of board accomplish the following:

- Open doors for the institution that would otherwise remain closed or hard to open, establish key linkages with the government, business, or banking sectors, allowing management to effectively achieve its institutional mission.
- Increase the institution’s access to information outside its direct area of operations and enhance its national and international exposure
- Maintain necessary oversight in part to ensure that their names and reputations are not damaged by their association with a poorly performing institution.

Hands On Board: The members of this board offer strong expertise and are actively involved in defining and monitoring the activities of the institution. Directors are kept informed of the ongoing operations and issues of the institution, and are well prepared for meetings and playing the proactive role in overseeing the management of the institution.

An effective board of directors that is well versed in the needs of the institution and able to utilize its collective experiences, skills, and contacts will consistently exhibit the following characteristics:

- Will raise issues that are at the core of the proper functioning of the institution and will not be distracted by concerns not relating to the goals of the institution.
- Will engage in more constructive and challenging discourse with management and provide the type of useful analysis that enables management to pursue increasingly higher levels of performance
- Accompanies good management and, if necessary, takes the lead in defining the overall strategy of the institution and works closely with management in overseeing its implementation
- Understands the difference between its strategic based role and the operational responsibilities of management
- Is more likely to identify quickly and effectively any shortcomings in the board’s functioning and seek to address them.

These same characteristics of the Hands On board can cause the directors to lose sight of its primary strategic function and may cross the line into micromanagement of the institution’s daily operations and may therefore become more harmful to the institution than the other board types!

Multi-type Board: What then is the answer to the ideal board type? A Multi-type board includes members who play a representational role and those who are well informed about the operations of the institution and have solid expertise thus extracting from each type of board the advantages for the overall functioning of the institution. This board would be able to make well-informed, timely, and efficient decisions because the board members have the skills and knowledge to do so. Moreover, this board type can evolve, balancing the types of members it incorporates into the board based on changing institutional needs and priorities.

Clearly, the above board governance model description serves as a continuum to guide boards in their own formation. A board needs to understand the advantages that arise from each of the board types and to tap these advantages as appropriate. However, regardless of the board that emerges in an institution, its functions as a governing body that does not vary.

Some boards take their charge of ultimate responsibility for an institution so much to heart that they also attempt to run it. Ultimate authority and responsibility does not mean ultimate control.

Board governance models tend to reflect the capacity of the institution’s management and the life cycle of the institution. Sometimes the board behaves like managers and at other times they act more like leaders. These institution cyclical model categories certain types of governance into several stages:

- Founding Stage – Where a board needs to manage the affairs of the institution because there is not staff
- Sustaining Stage – The board backs away from its governance responsibilities when it passes the torch to an executive
- Super managing Stage – the Board tends to micromanage

The value of this model lies in its diagnostic potential and its ability to recognize when the board is not governing or operating effectively.

Section 3: Board of Directors Roles and Responsibilities

What are the Board’s Primary Roles for Governance?

The board of directors’ responsibilities are to govern and to determine the ends for which the institution exists. It is to discern, to think, to exercise judgment, and to plan. Effective governance is achieved by clearly identifying the board of directors’ role to provide direction and oversight to the institution and its employees.

The board of directors’ role and responsibilities include:

1. Mission and Vision Development, Focus, and Preservation
 2. Board management and self governance
 3. Executive Oversight and Management
 4. Policy Development and Approval Process
 5. Financial and Operational oversight and fiduciary responsibilities
 6. Strategic Planning and Development
-

How is the Board Responsible for the Preservation and Management of the Institution’s Mission?

The first responsibility of a board of directors is to state clearly its **mission**. An institution’s mission is its reason for being. An effective institution has a clear mission –*what* the organization does, what it hopes to achieve, *who* it intends to serve, *how* an organization will conduct its business. The board of directors is responsible to communicate this message to its stakeholders, employees, and to the public at every possible opportunity. **It must also carefully balance (and manage!) the social and financial aspects of its mission.**

While each organization will have a unique mission statement, the following guidelines will help focus on the essentials of a mission driven institution:

- A good mission statement should be brief!
- The mission is more than a statement of good intentions; it must be operational.
- The mission should accurately state an institution’s business.
- Maximum participation in the process of formulating a mission statement helps to ensure ownership and commitment.
- When the institution continually adjusts its programmes because of changing environments, cultures or new client demands, or required changes in resources and organizational capacity to maintain the institution’s relevance and meet the goals of the organization, the mission statement should reflect a shift in direction.
- A focus on the mission in making decisions will cause a board of directors and executives to address issues relevant to the organization’s purpose and values.

The board of directors is responsible for evaluating the relevance of the mission statement. Effective oversight requires information. The following are some strategic, mission related questions that board members should be asking:

- What is the purpose of the institution’s programmes?
- What results are expected from the programmes?
- What problem areas not presently served by the programmes need attention?
- Who does the institution want to serve tomorrow?

- How do clients benefit from the institution’s services?
- What does the institution offer that others do not?
- Where is the institution succeeding? In which areas is it less than successful?
- If the organization ceased to exist, would it be missed?

As powerful as a good mission statement is, its predominance is a fragile commodity. It is easily transformed from a compelling authority into mere words and, ultimately, becomes hard to locate and impossible to remember! Leadership is responsible to keep the mission alive.

Dual Mission for Microfinance Institutions:

Although effective governance requires diverse people who complement one another by contributing a variety of skills and experience, such diversity must be achieved without sacrificing agreement on the dual mission of MFI’s. This dual mission is **to reach the unbanked with appropriate products and services *and* to achieve financial self-sufficiency**. *Although the mission of MFIs will differ, many emphasise reaching those typically excluded from formal financial services, the provision of products and services that meet clients’ unique needs and the importance of doing so in a responsible way*. Individual directors may emphasize one mission more than the other, but in a well-functioning board, differences of emphasis will foster productive and lively discussions that result in well-reasoned strategies and solutions for the institution.

It’s important to remember that social objectives are not charitable ‘asides’ but, if they are in the mission, should be an integral part of running an organisation. Deliberate management of social performance can actually bring significant benefits and even lead to enhanced financial performance.² For example:

- a better understanding of clients can help an MFI to define more appropriate products and services leading to improved client retention, stronger risk management and, ultimately, higher repayment.
- greater participation of clients in decision-making and operations may lower operational costs, enhance customer satisfaction and result in higher quality services and products.
- socially responsible behavior to protect clients engenders greater trust and loyalty, enhances an MFI’s reputation and limits the risks of over-indebtedness, fraud and abuse.
- a greater focus on staff satisfaction (clear policies, appropriate trainings, proper treatment and incentives, etc.) can help MFIs attract and keep staff that are more efficient, motivated and loyal.

What the “Code of Behaviour” for Board Directors?

Directors are expected to comply with the prescribed Code of Behaviour that encourages the development of a spirit of collective decision-making, shared objectives and shared ownership of and respect for board decisions. The Code of Behaviour should be a succinct statement of essential principles intended to govern the conduct of the Board and staff of the institution.

- **Duty of Care:** To discharge the Duty of Care, directors must attend meetings, exercise independent judgment, and ensure that they have an appropriate level of understanding of the issues critical to the institution.
- **Duty of Loyalty:** This requires the directors to exercise their powers in the interest of the institution and not in their own interest or in the interest of another entity or person. This primarily relates to conflicts of interest, corporate opportunity, and confidentiality.

² Bédécarrats et al. *Microbanking Bulletin* No 19. December 2009

This duty requires that a director be conscious of the potential for such conflicts and act with care in dealing with such situations. Conflicts of interest are neither inherently illegal nor are they to be regarded as a reflection on the integrity of the board or of the director. Once a director discloses a potential conflict of interest issue, it is the board’s interpretation of the issue that will determine if it is a proper or improper transaction.

- **Duty of Obedience:** This requires board members to be faithful to the institution’s mission, to be financially sound, and to maximize the institution’s positive impact on society and its needs. This duty grows out of the institution’s reliance on the public’s trust when soliciting donations and grants.

Why is the ‘Code of Behaviour’ so Important?

- Board members and the CEO must maintain a degree of distance. Loyalty to the CEO, rather than to the institution, will not allow directors to make independent, responsible decisions, particularly on issues such as management performance and compensation.
- Because microfinance involves many small loans, it has the potential to affect the lives of many people. Moreover, given that MFI clients are poor, it can be tempting for board members with political aspirations to use their positions in the MFI to enhance their political futures.
- Conflicts of interest occur when directors engage in related-party transactions, in nepotism, or in misappropriating property. The situation may be such that there are only a handful of qualified directors to sit on MFI boards. This may lead to reciprocal directorships, where friends render mutual favors by serving on each other’s boards. Here, too, board members must be mindful of their Duty to Loyalty and place the interests of the institution above other considerations.

What are the Board’s Responsibilities and Roles for Board Management and Self Governance?

A board’s ability to effectively shape policy and further the institution’s mission is either enhanced or constrained by the way its members relate to one another. The board’s organization and structure defines how members will interact.

Board Composition

Although board structures are relatively similar across institutional types and sectors, the individuals who make up the board memberships should display greater variation. The quality of board members is particularly important at two levels: to hold management accountable and to respond to external actors and issues of external accountability.

Investors, and increasingly donors, consider the character and involvement of the board as a assurance that their funds will be used properly.

Bank regulators and superintendents are keenly interested in the composition of the members’ composition, skills, and financial position of the board as part of the approval process for new regulated MFI’s and as part of the ongoing examination process. This level of interest is warranted because the directors will need to provide critical oversight of the operations and potential mobilization of replenishment capital if the institution becomes insolvent.

In examining board membership, one should consider the following factors:

- The skills and characteristics of the directors
- The directors’ understanding and commitment to the dual mission of financial security and social performance of the microfinance institution
- The directors’ ability and willingness to fulfill their Duties of Care and Loyalty;
- The development of the board.

Skills and Characteristics of Microfinance Board Directors:

Effective governance depends primarily on the skills and characteristics of the individual directors. Collectively, these attributes should represent a diverse set of experiences, backgrounds, areas of expertise, ethnicity, and gender.

Although, the main prerequisite for effective governance of a microfinance institution is a solid business sense, an MFI board can provide additional guidance to the institution if its members have expertise in microfinance. Of equal value is expertise in the following areas:

- **Business Sense:** A microfinance board must have solid business sense, with some financial expertise in two areas. The first area is financial analysis, which allows the board to understand and measure the performance of the institution in the key areas of capital adequacy, asset quality, profitability, and liquidity management. The second area is financial auditing, which provides the board with the capacity to adequately assess the strength of the institution’s internal controls.
- **Microfinance Experience:** Given the relative newness of the MFI sector, there are not many experts in this field. However, including individuals with some experience in these areas on the board can be very valuable to the institution.
- **Social Orientation:** As most MFIs have a social mission, some members should bring an understanding of clients. There does not need to be one social ‘expert’ on the Board, but those with a commitment to the mission and with appropriate social sensitivity/knowledge/expectations should be incorporated within the diverse expertise of the Board.
- **Financial Market Expertise:** Individuals who understand the local financial markets and know the players, as well as understand or have experience in international financial markets, can be important contributors as MFI board members.
- **Legal and regulatory expertise:** All MFI’s, but especially those that have entered the regulated financial sector or are considering such a change, will benefit from the individual directors who bring legal expertise to their boards.
- **Marketing Expertise:** With increasing competition, MFI’s are being required to move more aggressively “sell” their products to micro enterprise customers. Directors with expertise in this field and in product development can provide guidance to MFI’s.
- **Public Relations:** MFI’s must be concerned with the image they project to the client and to the public at large and must be able to conduct outreach campaigns.
- **Technology expertise:** Increasing competition, emphasis on cost reduction, and the increasingly complex nature of microfinance operations require that institutions enhance the information technology they use. Integrated and automated information technology systems enable the institution to better evaluate its performance at any given moment, as well as reduce operating costs. Boards will benefit from individuals with technological expertise.
- **Operations expertise:** Risk management and internal controls are a major concern with the regulators and donors. Directors with an understanding of the value of internal workflow, safety and soundness issues will be helpful to help the board understand the overall risk position of the MFI.

- **Fundraising:** For the non-profit MFI, board members are expected to play an active role in developing government, donor, agency contacts and the ability to facilitate fundraising campaigns.

In addition to the above skills, the characteristics described below should be considered in composing a board:

CEO and Staff Directors: The CEO is sometimes an ex-officio or non-voting member of the board. The CEO may also be a full voting director on the board, and other executive and staff members are sometimes included especially when a senior manager is being groomed to succeed the CEO. However, for effective oversight, the number of CEO’s serving on a board should be limited.

The inclusion of clients or employees as directors may give rise to the risk that their presence may become one of form rather than substance. They need to be active participants providing their perspective to the decision making function of the board. Also to be considered when clients are on the board is whether they are then precluded from borrowing, and how one might manage the risk or prevent related-party cases.

Demographics: MFI’s that operate nationally may select directors from different regions. Some MFI’s have found having directors who reside outside the country will provide the needed expertise not available locally. However, the challenge is to ensure that they have the time and resources to participate actively in the board meetings. To facilitate the participation of international directors, boards must avail innovative uses of technology and ease some of the restrictions on attending meetings by allowing alternative ways of casting votes remotely.

Additional considerations for developing a board of directors:

Size: of the board of directors should reflect the nature and mission of the institution. There is a strong correlation between size and effective functioning: Because MFIs have experienced rapid growth, the board has required frequent interaction with management to keep abreast of the institution’s performance. Monthly board meetings are not unusual. Most institutions have traditionally recruited boards of directors to fill board seats according to what committees need to be staffed. Most boards have at least 3 to 4 standing committees. Boards should consist of an odd number of members to avoid potential deadlocks when votes are taken. Boards with staggered terms may also want the number of directors to be a multiple of the term length so that the same number of seats are open each year.

Board Terms: Various ways exist to change the composition of a Board. One is through mandatory retirement, which although an effective strategy for older members, is not adequate to remove a younger member. Board membership therefore often is limited to specified terms. The board must strike a balance between a tenure that is long enough to allow directors to develop expertise that results in substantial contributions and to provide continuity of policy and practice, yet short enough to secure constant freshness of viewpoint.

The institution’s bylaws should specify terms of service. Two three year terms or three two- year terms are the most common terms of board service. Almost always, bylaws allow reelection to the board after one year’s absence. To avoid having all your board directors leave in the same year, stagger the years when terms expire.

How are the Members of the Board Developed to Maintain Overall Continuity of History, Institution Knowledge, and Good Governance?

New Director Orientation: To build a new director’s commitment to the institution and to ensure that he or she understands issues specific to the sector and the institution, it is necessary to orient new directors as it is to orient new staff. The following should be the minimal requirements for board member orientation:

- Institution’s Mission Statement
- Bylaws
- Description of board member responsibilities and expectations
- Board job descriptions
- Board minutes for at least the last several board meetings
- Financial audit or financial statement
- Names, Addresses, Email addresses, and phone numbers of the board members
- Organizational Plan
- Description of Programmes
- Calendar of Institution’s events and scheduled board meetings
- New clippings about the institution

Continuing Education: The education of board members needs to be ongoing. It is useful for directors to draw on the expertise of key staff members, individual directors, and outside experts in the field to inform and update the board. Additionally, directors should visit successful MFI models in the field to help cement a vision of where their institution is headed.

How are Boards Structured?

The relevant areas for discussion of board structure include the separation of the roles of board chair and CEO, the role of the chair, and board committees.

Selection of Board Offices:

The Board will elect its officers from the active board members. Typically officer terms are for two years. Board Officer terms and responsibilities are defined in the Institution’s bylaws.

Chairperson: Presides at board meetings, appoints committee chairperson, works closely with the CEO to guide the institution, and acts as public spokesperson for the institution along with the CEO.

For microfinance, the chair’s job is made more challenging by the likely presence of diverse viewpoints representing the dual mission of the institution. Ultimately, the chair must ensure that the board reaches consensus in a way that is congruent with the institution’s mission and that best allow full and free participation.

There are many reasons to separate the positions of the CEO and the Board Chairperson. First, it avoids concentrating power in one person, who, if playing both roles, would be responsible for the strategic and operational activities of the institution. The Chairperson should serve as an intermediary between the CEO and the outside directors. The Chairperson should maintain a degree of detachment that allows him or her to question basic assumptions about the institution. Separating these positions also facilitates a regular performance review of the CEO and avoids any risk that the CEO will preside over a discussion of his or her own future.

Vice Chairperson: Presides at board meetings in the Chairperson’s absence and may serve as a committee chairperson as appointed by the Chairman.

Secretary: Maintains the organization’s records, takes board-meeting minutes, and distributes minutes and announcements of upcoming meetings to board members.

Treasurer: A treasurer may be elected by the board to over see the financial aspects.

Board Committees:

Board committees should be formed to help the board of directors conduct its business rather than to augment the functions of the institution’s staff. The use of committees to accomplish certain tasks is based on the premise that smaller groups can conduct them selves more efficiently than the whole. Committees offer individuals an opportunity to contribute specific talents and expertise. Committees also serve as training grounds for board members to take on position of increasing responsibility, such as a board officer.

Board committees should be used to improve the quality and efficiency of the board by defining ways to address an issue that the board then considers in making a decision. Boards can assign considerable responsibility to committees; however, committees should never make a policy decision for the full board. For committees to be effective, their work, role, responsibilities, and mandates must be clearly outlined.

Committee Structure:

Executive Committee: Many boards have an Executive Committee made up of the board officers, chairs of the other committees, and/or other directors considered important to this committee. This committee, when functioning effectively, plays a key role in directing the activities, discussions, and decisions of the board. The Executive Committee:

- Discusses issues in preparation for a full board discussion
- Highlights agenda topics that the full board should discuss
- Establishes initial level of consensus on difficult issues that the board must address
- Makes decisions that the board has assigned to it, such as acting as the Human Resources committee, the investment committee
- Is designated as the leadership group to replace the CEO and/or senior management during a management crisis

Audit Committee: This is an important committee for a microfinance institution, as it empowers a board to fulfill its risk assessment responsibilities. Additionally, this committee provides oversight for safeguarding the institution’s financial operational resources. Both internal and external auditors should report directly to the audit and finance committee. Although it is the responsibility of management to design and implement an effective internal control system, the audit committee can have the role of overseeing the control policies.

Loan/Credit Committee: This committee has the responsibility of approving the institution’s credit policies. It has the authority to assign standards for credit officers loan authority, credit mix, and write off approval for bad loans. This committee may contract an external loan review process to verify the integrity of the loan portfolio and the adherence to the institution’s credit policies.

Other committees may include (if the responsibilities are not assigned to any of the above mentioned committees):

Human Resource or Compensation Committee: This committee is responsible for recommending to the board for approval personnel and compensation standards. The CEO and management is responsible

for developing and implementing the Human Resources Policy. This committee works closely with the CEO regarding any personnel issues, such as a lawsuit or grievance against the institution. This committee also supervises the orientation of new directors and seeks ongoing exposure of current directors to topics relevant to the institution and the microfinance field.

Social Performance Committee: As one way to ensure that social mission is incorporated into the governance process, the Board can designate an SPM Committee to regularly oversee and report on the process of integrating social aspects into its overall processes. Likewise, it can regularly report to the Board on whether the MFI is meeting its social objectives and fulfilling its mission.

Setting up an SPM Committee

AMK Cambodia set up a Social Performance Committee (SPC) in 2005 with responsibilities similar to an Audit/Finance committee, but more ‘social’. The SPC provides the board and key stakeholders with information related to achievement of mission.

Nominations Committee: The nominations committee is typically appointed by the Chairperson of the board. The committee nominates new board members who are independent of management and sufficiently skilled and brings these candidates for full board consideration and vote. Variations in the nomination process exist within the microfinance world. See *handout of different types of institutions, etc.*

Fundraising (or Resource Mobilization) Committee: Most nonprofit organizations have a fundraising or resource mobilization/development committee to oversee the solicitation of funds for the institution’s operations and special projects. Although the entire board is responsible for the institution’s performance, the fundraising committee is meant to actively engage in obtaining funds. In most nonprofit microfinance institutions, the CEO is responsible for soliciting funds and may call on board members to open doors or to carry out the fundraising activity themselves.

What are the Principles and Rules Governing Board Meetings?

The quality of its meetings is a measure of an institution’s effectiveness. Good institutions have good meetings. Good meetings, in turn, make an institution better.

From: Effective Meetings

Meetings are the primary method used by boards of directors to fulfill their governance responsibilities; they should thus be meaningful, thoughtfully planned, and well run in order for boards to be productive.

Principles of effective meetings:

In effective meetings, participants are encouraged to participate in discussion, ask clarifying questions, listen without judgment, share ideas and opinions freely and honestly, and help others from straying from the issue under discussion. Boards of directors can improve the quality of their meetings by applying the following principles:

- Ensure that members understand how their contributions affect both the group and the organization
- Emphasize the responsibility of each member to the group

- Establish realistic goals for the meeting
- Emphasize pride in belonging to the group
- Communicate ways to improve the group process

There are two main classes of meetings:

Public: These are meetings that members of the public are entitled to attend by virtue of their interest and by their payment of funds as outlined in the institution’s charter

- The annual meeting at which all interested people are invited to attend and consider past performance
- The election of officers; and
- The regular business of the association or institution.

Closed Session: These are meetings that relate to matters of private concern; members of the public are not entitled to attend unless they have been specifically requested to do so by the organization. Many are monthly meetings, with only officers and/or board members in attendance.

- A meeting is properly constituted and valid when the following conditions are satisfied:
- The person calling the meeting has the authority to do so
- Proper notice was given to every person entitled to attend the meeting
- A quorum is present, and
- The rules and regulations-or bylaws-of the institution are observed.

What are the key board meetings of the members?

Annual Meeting: During the annual meeting, the board, stakeholders, management, meet to fulfill the board’s functions:

- To consider and approve the minutes of the previous annual meeting and any special general meeting that may have been held since the last annual meeting;
- Receive and consider audited financial statements for the preceding fiscal year
- Receive and consider such other reports and statements as are required by law
- Elect the directors
- Board of directors appoint the institution’s officers.
- Appoint the auditors for the next fiscal year
- Transact any other business properly brought before the meeting.

Special General Meetings: The Secretary shall call a special general meeting of members at the request of the board. This meeting may be called for a specific purpose that should be discussed other than in a regular board meeting.

What are the “Rules of Order” for Board Meetings?

Notice: For a meeting to be valid, a notice of meeting must be sent to all persons entitled to attend. Apart from special provisions in the rules of the organization, even accidental omission to give notice will invalidate the proceedings.

The bylaws of the institution should state the preferred method of giving notice; if they are silent on this point, notice should be given by ordinary mail, fax, or electronic mail. Notices sent by post are deemed to be effected 24 hours after mailing, if properly addressed.

Send a notice of meeting well in advance of the date to allow the people concerned to plan ahead and allocate time. If the bylaws of the institution stipulate that a certain number of days’ notice must be given, the word ‘days’ is taken to mean clear days, i.e. including the day the notice is mailed and the day the meeting is to be held.

The notice must include the following details:

- Date
- Time; and
- Location of the meeting

Waiver of Notice: An individual may waive the right to receive notice of one particular meeting or of a series of meetings to be held in the future. Such a request must be precise and must be submitted in writing.

Notice to attend a meeting convened for the discharge of legal duties, either common law or statute cannot be waived.

The giving of notice may be waived by the meeting, if all entitled participants are present and agree that the failure to send the notice be waived and the meeting be held. If even one member dissents, the meeting is invalid.

Quorum: A board consists of a number of directors whom must be present at meetings if the decisions taken are to be recognized as valid and binding.

When the organization has no rule regarding the required number, a majority of members must be present. Observers and visitors do not count towards a quorum/

A quorum should be present at the start of a meeting and remain throughout the entire meeting in order to validate decisions made.

Points of Order: Unless your bylaws provide specific guidelines for managing meetings, the meetings should be conducted according to Robert’s Rules of Order. (*See Handout*)

Opening the Meeting: Meetings should begin on time. Officers, particularly the chair, should respect the starting time so that business can be conducted efficiently. After establishing that a quorum is present, the chairperson calls the meeting to order and it officially begins.

If a quorum is not present, the business meeting must be adjourned.

Voting: Most decisions on the meeting’s agenda are decided by majority vote. The usual methods of voting are:

- By a show of hands: This is the most common method of voting. The minutes reflect the number and/or those in favor of the motion and those against the motion.
- By Ballot: The secretary distributes slips of paper to record the vote of each member. The minutes reflect the votes for or against the motion.
- By Voice of Acclamation: This method is only suitable for small meetings. In large meetings it is impractical to decide the outcome of a vote from the sound of voices.
- If the vote ends in a tie, the Chairperson may cast one vote or the vote for the motion may fail.

Order of Business: The word, agenda, is derived from the Latin verb “agree” meaning “to do.” Following an agenda helps to avoid confusion and wasted time. Participants should receive the agenda before the meeting, along with copies of any reports or briefs to be presented.

Board Minutes: Board minutes provide a record of the issues considered by the board, the main points of its discussion, the motions made, and the resolutions the board approved. Board minutes must be kept and may be reviewed by bank regulators and auditors. All supporting documentation presented during the board meetings must also be retained. Minutes should reflect board attendance, guests, and speakers, the date and time of meeting, purpose of the meeting, for example: annual meeting, strategic planning meeting, regular board meeting. The minutes should be signed by the secretary or the person recording the minutes.

What is the Responsibility of the Board of Directors to Conduct a Self Appraisal of its Governance Performance?

Board Performance Evaluation: Just as important as setting terms and term limits is evaluating board performance, a practice that is relatively new to this field. In fact, often, little attention is given to the performance of the board or of individual directors until a crisis occurs. The success of board evaluations depends on setting the right criteria for evaluating board members, determining if the evaluation is done internally or externally, and having the structures within the board to carry out the recommendations from the board evaluation.

At a minimum, there should be an attendance requirement for board and relevant committee meetings.

Although effective governance requires diverse people who complement one another by contributing a variety of skills and experience, such diversity must be achieved without sacrificing agreement on the dual mission of MFI’s. This dual mission is to provide client coverage and to achieve financial self-sufficiency. Individual directors may emphasize one mission more than the other, but in a well-functioning board, differences of emphasis will foster productive and lively discussions that result in well-reasoned strategies and solutions for the institution.

Section 4: Executive Management and Oversight

What is the Relationship Between the Board of Directors and the Executive Officer?

It is often said that the most important task of a board is the hiring of the CEO. No single relationship in the institution is as important as that between the board and its CEO. Although this relationship between the board and the CEO is dynamic, it must be grounded in a clear understanding of the roles each serves. Effective governance strikes the appropriate balance in the relationship between a board of directors and management in their combined efforts to move the institution forward. Together they add value precisely because they are complementary.

Effective boards carry out their responsibilities by maintaining operational distance from the institution, drawing on the institutional memory of the directors, and making binding decisions as a group.

Management, in contrast, is intimately involved in daily operations, has an up-to-date and in-depth understanding of the immediate challenges and opportunities facing the institution, and the flexibility to react quickly. An institution’s executive will consult with senior management on key issues but is individually accountable to the board of directors.

Poorly defined division between the roles and responsibilities of the CEO and the board is a recipe for institutional chaos. Lines become blurred to the point where it is not clear who is responsible for successes and failures.

Also, it allows CEO’s and board members to interfere in areas where they should have no role. Board members may begin to interfere in the day-to-day operations of the institution. Micro-managing by board members undermines the work of the CEO and sends conflicting messages to other senior managers, staff and the public.

From another perspective, CEO’s can intrude on the responsibilities of the board and make board members feel their ideas and participation are not wanted. The board’s role might be marginalized to the point where the board members become disengaged and apathetic, and serve only to “rubber stamp” management decisions.

Separate and defined roles with clear lines of responsibility are essential for the organizational health. New board members must be made aware of their role and what classifies as appropriate behaviour.

Figure 4.1 - Contrasting Frames of Reference

Executive	Board of Directors
Executives are individuals	Boards are legal entities and a group
Executives deploy professional skills exclusively to one organization	Each board member has many additional commitments
Executives are compensated	Board members typically serve voluntarily or receive insubstantial compensation
Executives can make decisions alone	A board makes binding decisions as a group
Executives rely on staff	Boards operate without staff
Executives serve at the pleasure of the board	Boards as entities are permanent, despite director rotation
Executives are professionals in the Institution’s area of activity	Directors most likely are not experts in the institution’s area of activity

Based on Duca, 1996

How does the Board of Directors Provide Executive Management and Oversight?

To ensure that management is held accountable for the activities of the organization, a board must:

1. Focus on the process and mechanisms it uses to identify a competent executive.
2. The Board must set clear and measurable goals.
3. A board must monitor the performance of the executive.
4. **Guide the executive team and help to prevent mission drift in the organisation**
5. The Board must be able to identify managerial weaknesses and confront them when these adversely affect the institution. If necessary, the board must be prepared to remove the CEO it appoints, and therefore it must consider this a core responsibility.

Why is it Important for the Board to Hire Qualified Competent Executive Managers?

Hiring a strong, competent CEO is one of the primary functions of a board of directors. This individual, as the operational leader for the institution and the representative of the entire staff to the board, plays a key role in the long-term success of the institution and in the realization of effective governance. A board can only be as effective as the CEO it appoints.

What Goals Should the Board Establish for the CEO?

The Board’s role is to monitor the performance and progress of the institution through its oversight of the CEO. Well-functioning boards spend time working with management to define goals and set targets for the institution. They then monitor the institution’s attainment of these goals and targets by assessing the executive’s performance. The key areas in which an executive should perform effectively are:

- **Vision:** Vision refers to management’s capacity to define a long-term view of the institution’s future, **linked to its mission**, to ensure the institution’s sustainability over time. Vision is a Big Audacious Goal, which can be qualitative or quantitative. Management’s vision should be clearly defined and the steps to its achievement well conceived.

The vision is articulated in the strategic plan which should outline the institution’s programmes, products, and expected results.

- **Management:** The CEO’s ability to manage and lead the institution’s human resources is addressed in productivity, performance, development **and satisfaction levels** of staff. The organizational chart should ensure staffing adequacy for deployment of its operations.
- **Financial Performance:** The CEO is responsible for maintaining an institution’s financial solvency. Asset quality and the ability to mobilize financial resources are also key in obtaining good financial results. Key benchmarks for a microfinance institution to measure management performance includes targets of: scale of operations, market penetration, level of self-sufficiency of the institution, legal structure required to reach targets, level of efficiency of the operations and the quality of the assets.
- **Social Performance:** The CEO must also manage the social performance of an MFI to help ensure achievement of its mission. The goals may vary, but generally include maintaining client and staff satisfaction (and retention!), understanding client preferences/needs, having positive changes in lives of clients/families, and taking measures to avoid risks (over-indebtedness, etc.).
- **Relationship to the Board:** The CEO is responsible for ensuring an effective board-staff relationship. This relationship is a product of the official board meetings and the numerous interchanges that occur between individual board directors and the staff. Among the factors that contribute to this relationship are the extent to which the board is well informed and prepared for meetings, the strength of the working relationships between the board of directors and staff, and the degree to which individual directors are knowledgeable of the institutional mission.

The directors do have access to the staff but must use judgment in their interactions to avoid being a distraction to the institution’s operations or to undermine the CEO. Senior managers are often invited to attend the board meetings to provide the directors with additional insight into areas under discussion, and it allows board members to have exposure to staff with future potential for more senior positions.

What are the Components of a CEO’s Job Description?

The CEO’s job description is a statement of what the board of directors has delegated to the executive manager of the institution. The CEO is responsible for all of the institution’s activities, personnel, board relations, and the institution’s reputation.

The job description is a short document that clearly presents the institution’s expectations regarding every position in the institution.

The Job Description lists:

- The knowledge and skills required to accomplish the objectives of a position;
- The responsibilities for which the position is accountable
- The working conditions under which a job must be performed

The development of a CEO’s job description is the joint responsibility between the board and the CEO. The job description is updated as often as necessary.

Key Point: The job description is a written description of the position, not the person holding that position.

Job Description Components:

- **Job Title:** The name given to the position. The job description indicates who the position reports to. In the case of the CEO, the job description would state that the position reports to the Board of Directors.
- **Goal or overall summary or purpose:** The purpose of the position is summarized.
- **Major Responsibilities:** A list of the job categories of responsibility should explain the critical responsibilities. Job descriptions generally conclude with: “Perform any other duties as required...”
- **Primary relationships (managerial responsibilities):** The CEO is responsible for the overall management of the employees.
- **Decision Making authority:** A list of the extent and limits of any major area of responsibility and authority invested in the position.
- **Knowledge and skills, behaviour, qualification required; or preferred:** The job description should list those major skills, knowledge areas, and qualifications needed or desired in order to successfully carry out the job.
- **Working conditions:** A list reflecting any special or unique working conditions of the job.

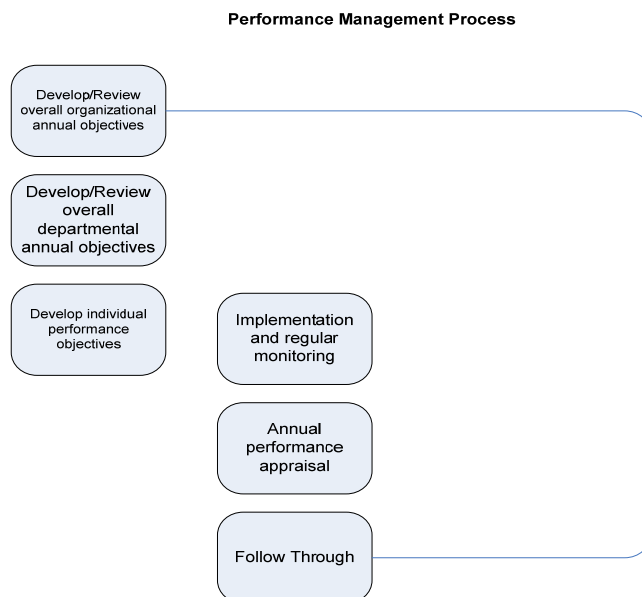
How Does the Board Monitor and Evaluate the CEO’s Performance?

There is only one way to ensure the mission and goals of the institution are more than words on some paper in some file. That one way is to systematically follow the planning process through from the strategic level to the individual staff level. Strategy becomes reality once the initiatives and goals have been delegated to the CEO to be implemented. The task for the board is to develop a plan to monitor and assess the CEO’s performance.

“Performance Management” is the method by which the board of directors delegate responsibility to achieve specific results, and the effort they make to ensure the success of the executive management.

- It is providing consistent and systematic supervision to all staff in the institution
- It is ensuring the mission, goals, objectives, and action plans of the institution are actually accomplished
- It is focusing the growth and development of the CEO, not just reprimanding poor performance
- It is taking the time to build trust between the board and the executive manager, developing strong communication skills, listening, clarifying, giving and receiving feedback
- It is creating the balance between the board of directors and the executive manager to participate in strategic planning and in monitoring his or her own work as the CEO.

Figure 4.2 - Staff Performance Management Process



Performance Objectives

Without annual performance plans...the CEO has no basis for:

- Knowing specifically what is expected of her/him
- Making informed decisions and taking creative initiative
- Monitoring his or her own performance and generating feedback
- Identifying performance improvement areas

Without annual performance plans...the board has no basis for:

- Specifically communicating performance expectations to the CEO
- Providing feedback that compares performance with an objective standard
- Identifying performance that should be rewarded
- Effectively making and supporting decisions regarding resources, plans, policies, schedules, and organization structures
- Identifying performance gaps that need attention

CEO Performance Plans and Objectives should be:

- Developed annually
- Focus on specific objectives to be achieved for the fiscal year, rather than on the general tasks or expectations of the ongoing job
- Aligned and linked to the institution’s objectives for the fiscal year
- Limited but significant objectives
- Specific, measurable, achievable, relevant and time fixed (SMART)
- Clearly worded

The board and its CEO benefit when they both are involved in the performance planning process:

- They may have different ideas about what is expected and the importance of the responsibilities. Expectations need to be documented and the definitions agreed upon by the board and the CEO.
- Planning is linked to the strategic initiatives and goals.
- Plan development provides the ability for the CEO to work with the board, committee, or the Chair of the board to create the opportunity for:
 - Mutual goal setting
 - Sharing of ideas
 - Discussion of problems and concerns
 - Planning for growth and development

The Annual performance appraisal tool often includes the following sections:

- Section 1 – Performance objectives
- Section 2 – General Standards of Performance

This is a general section, which applies to all employees, regardless of position. It assesses qualities, interpersonal skills, and standards of performance that should be common to all employees within the institution. It describes “how the job was done”.

- Section 3 – Development Plans and Career Plans

Actions are formulated to address areas of weakness identified in the evaluation process. Action plans may include training programmes, executive coaching, courses, etc.

This is also an opportunity to identify additional strengths and areas of further development for the CEO, to discuss career interests and to identify action plans.

Remember: the overall purpose of the year-end performance appraisal is to agree on a development plan for a CEO. It is a forward-looking process which is action-oriented. It is also the time to set the compensation for the next fiscal year based on the institution’s achievement of the financial and operational goals and targets.

Figure 4.3 - The Most Common Appraisal Errors
1. Inadequately defined standards of performance
2. Over-emphasis on recent performance
3. Reliance on feelings not facts.
4. Mis-comprehension of performance standards by the CEO
5. Insufficient or unclear performance documentation
6. Inadequate time allotment for the annual appraisal discussion
7. Too much talking by the board director or committee responsible for the appraisal
8. Lack of a follow up plan

No Surprises! There should be no major surprises in the annual review discussion, and won’t be any if:

- Performance expectations have been clear, and clearly communicated
- Performance monitoring has taken place regularly throughout the year.
- The executive manager feedback and coaching has been open, honest, and consistent

The annual appraisal discussion should be a “wrap-up” session, a summary, a conclusion to a year long process of review. (Source: How to do a Superior Performance Appraisal, Swan and Marguiles)

Effective board monitoring of the executive performance requires the following:

- **Availability of information.** The board must have timely access to the appropriate information.
- **Clarity of objectives.** Strategic goals and objectives against which the performance of a particular period is measured must be clearly articulated. This is a prerequisite to receiving the right information.
- **Candor.** The executive must report to the board with candor and the level of detail and analysis necessary for effective board deliberations. An executive can not withhold information from the board about a situation or crisis that may seriously affect the institution, even if that member thinks it will be resolved soon.
- **Analytical rigor.** Board members must have the analytical skills to pose the right questions and to be incisive in their discussions of the institutional performance.

The board must be willing to confront the institutional and management weaknesses of the CEO and to address them. It is incumbent upon the board to identify those areas in which the institution displays poor performance because of weak management practices. Examples might include poor financial controls, low staff morale, or weak information systems. A board’s responsibility is to demand and support management in strengthening these areas and to monitor the process of improvement.

Institutional and management weaknesses fall on a spectrum of severity. On one end are procedural matters that may result from management inexperience and require a practical solution. On the other end are actions that may include fraud. In either case, incompetent performance or fraudulent actions, boards must be willing to confront and, in the worst case, fire the CEO.

This can be quite challenging and uncomfortable for a board to do. Individual directors may hesitate to act because they are unsure that they have seen the full picture or no one director is willing to step forward and challenge the CEO. A board’s ability and willingness to make the hard decisions and confront weakness in the executive, and therefore the institution, is a function of the following:

- Degree of board member independence from management
- Leadership skills of individual directors
- Climate that allows for dissension
- Mechanisms or opportunities for the board as a group or individually to voice their concerns; and
- Effective ownership stake in the institution or strong identification with the objectives of the organization.

Many times boards are tempted to assist an under-performing CEO by assuming the management of certain tasks or projects. This approach is extremely damaging because it both obscures the accountability of the CEO and it delays addressing that individual’s underlying incompetence. The board should only assume management duties after it has decided on a permanent solution to the deficiency and only as a temporary solution in the absence of any other alternative.

In summary, it is the board’s role and responsibility to establish clear goals for the CEO to have something tangible that can be measured. Each year the board should be working with the CEO to build his or her development plan. The board must also plan for future interruptions in the leadership and management of their institution. A CEO succession policy should be written and reviewed every year by the board of directors and the CEO to avoid a lapse in competent leadership of the institution.

Section 5: Policy Development and Oversight

What are the Board of Directors Responsibilities for Development, Approval, and Oversight of the Institution’s Policies?

John Carver’s work in developing models of board governance spans two decades. His theories of board governance are studied by many boards today. His belief is that the board’s concern for developing policy is a means for the members to stay close to the center of the institution’s meaning or what it values.

Carver believes that when a board exercises its leadership by setting explicit policies, it governs more effectively for several reasons:

- A policy focus brings efficiency and leverage to a board of directors. The more time a board spends on resolving specific problems, the less time it has to devote to the larger issues. Focusing on policies as a core element of an organization uses a board’s time more effectively. Instead of devoting a block of precious meeting time to discuss the pros and cons of, and options for, expanding hours of operation, discussion should focus on what policy is driving the move toward expanded service.
- Budgets, long-range plans, and programme evaluations brought to the board for deliberation and action are materials. A board that addresses the policies underlying these materials, rather than the material’s content, deals directly with organizational fundamentals that are more enduring by nature.
- Boards need members who are unafraid to ask questions about the value of one alternative over the another. They should not become preoccupied with seeking new members whose expertise matches the administrative or functional areas of an organization. This approach to board composition is wasted effort from the Carver model perspective, because a board governing through policy does not need to focus on that kind of expertise.

According to the governance-theory perspective, policy-making should be guided by questions about governance and not administrative details. An institution’s governing board should envision the future; its leaders should feel free to dream.

What is a Policy?

An institution is guided and defined by its plans and policies. A policy is a broad interest, direction, or philosophy, an expression of the institution’s principles and objectives; guides to thinking and action; general standards not subject to frequent change; and procedures and practices.” (George Steiner, *Top Management Planning* (New York: Macmillan Publishing, 1969), 176.

Sometimes it is difficult to distinguish a policy from a plan. A policy has the following characteristics:

- Focus on critical issues
- Guide to action
- Broad statement of intent
- Expression of values or perspectives
- Presentation of the philosophy of an organization
- Establishment of limits

- Resolution of questions about how an institution generally conducts its business in the present and future
- Long-term applicability at the higher levels of an organization’s operations
- Inclusion of different levels of operation

What are Board Driven Policies?

The board of directors is responsible for developing its own governance policies. Some of the major policies developed and maintained by the board of directors include:

Constitution/Articles of Incorporation and Bylaws:

These policies may be combined into one document. The Constitution is a statement that provides basic authorization for the institution’s existence. The bylaws define the rights and obligations of various officers or groups with the corporate structure and set rules for routine matters such as calling meeting. They also include directives that define the structure and procedures of the board. The articles of incorporation is authorization to raise funds. As an institution evolves, its bylaws will require revisions including changes in the area of governance. It is important to keep the bylaws up to date.

What are the guidelines for developing the institution’s bylaws?

- **Length:** Bylaws are best kept lean. Include only those items that establish the basic structure and empowerment of the board and its members. Whatever can legitimately be put into policy should be omitted in the bylaws.
- **Membership:** Not-for-profit statutes call for a ‘corporate membership’ to which the board is accountable. The members are the nonprofit equivalent of stockholders.
- **Board Size:** Board member size should be clearly defined in the bylaws.
- **Quorum:** Set the quorum no lower than 51 percent.
- **Attendance:** Require that board members attend a certain percentage or number of the board’s regular meetings, and required attendance for special meetings such as annual meetings or annual strategic planning meetings.
- **Officers:** Keep the number of officers minimum and describe their jobs.
- **Committees:** Committee assignments may be defined in the bylaws unless otherwise defined in a board policy outlining the committees responsibilities.
- **Staff:** Bylaws are not for staff. Bylaws do define succession plans in case of a management emergency.
- **Legal Review:** The bylaws is a legal document. It should be reviewed by legal council. Approval to make changes to the bylaws must be defined in the document.

Statement of Policies (or Board Policy Manual): Policies related to conduct, strategy, and operation that guide the activities of an institution require board approval and should be recorded in the board minutes that are distributed to board directors, the CEO, and management as appropriate. Policies should be explicit, current, literal, and available. Examples:

- Board Committee governance policies
- Audit Policy
- Financial Stewardship
- Conflict of Interest
- Disposition of complaints and disputes involving directors
- Board Succession Policy
- CEO Succession Policy

Code of Conduct and Confidentiality:

Respect for confidentiality is the corner stone of trust and confidence as well as a legislated obligation. Board members must at all times respect the confidentiality of any client names and/or circumstances that might identify clients. Similarly, all matters dealt with by the Board during meeting and matters related to personnel and/or collective bargaining must be held in strictest confidence. Confidentiality means Directors may not relate such matters to anyone including immediate family members. The duty of confidentiality continues indefinitely after a Director has left the Board.

What are Management Driven Policies?

Policy making requires an understanding of where the line between the board and management lies. The board is responsible for policies regarding board governance. Management is responsible for recommending the board adoption of policies establishing procedures and direction for the implementation of operational and financial standards set by the board.

Management is best qualified to identify the institution’s specific policy needs because they have the most knowledge of the day to day operations of the institution. These policies are developed to direct the efforts of the staff in their daily operations of the institution or to establish compliance with government laws and regulations. Some of these policies are:

- Risk Management Policy
- Asset Liability Management Policy
- Compliance Policy
- Human Resource Policy
- Loan/Credit Policy
- Information Technology and Communication Policy
- Marketing Policy
- Customer Complaint Policy
- Internal Controls Policy
- Internal Audit Policy

Section 6: Corporate Oversight and Fiduciary Responsibilities

What are the Board of Directors’ Financial and Operational Fiduciary Responsibilities?

The fiduciary responsibility of the board of any financial institution is considered greater than that required for many other types of commercial businesses. Protecting financial institutions is a high priority for governments. Without solvent financial institutions, business, commerce, and the economy would become dysfunctional. Liquidity is essential for the deployment of a financial institution’s product: money. Moreover, because of their high leverage ratio and impact on the payments system, financial institutions require more stringent internal controls, and more prudent external supervision and regulation, than do non-financial entities.

Due to the lack of availability of deposit insurance in many developing countries, the fiduciary responsibility of the boards to savers increases even more. In addition to needing to maintain a solvency of a financial institution, the boards of MFI’s whether or not they oversee regulated institutions, have additional issues to consider in executing their fiduciary responsibility. These issues are:

- **Access to Financial Services:** An insolvent MFI likely means an end to a client’s access to capital until they find another source of loan funds. As micro enterprise grows, more individuals will come to rely on its success, and unlike middle-income individuals with access to multiple forms of financing, low income micro entrepreneurs’ growing circle of jobs and income will greatly suffer if the institution providing their financing falters. Similarly, micro entrepreneurs as savers are also at greater risk in the event of loss than are other sectors of the populations.
- **Fiduciary Responsibility to Lenders:** microfinance boards incur a fiduciary responsibility when the institution obtains funds from donors. The fiduciary responsibility increases when the institution borrows funds from a local bank, mobilizing deposits, or floating an instrument in the local securities exchange.
- **The Microfinance Sector.** In the case of large scale microfinance institutions, insolvency would affect both the domestic and the international sector. The number of individuals suffering losses would be significant. Additionally, insolvency of any of these large MFI’s would set the microfinance field back many years. It is likely that lenders and investors to these institutions would become concerned about the viability of this sector in general and possibly react by withdrawing or curtailing financial resources to microfinance.
- **Responsibility to Clients:** MFIs, particularly those with a social mission, have additional ethical duties, particularly those that mobilise public funds, among which is *responsibility to its clients*. This refers to: being watchful for over-indebtedness and multiple loans, putting in place systems to avoid of fraud/abuse by staff or group leaders, safeguarding client data, and implementing transparency (e.g. interest rates) and feedback mechanisms for client complaints.

What is a Board’s Legal Responsibility?

As a fiduciary, the board of directors has several legal obligations.

- Ensure compliance with its bylaws/articles of incorporation and internal policies and procedures.
- Ensures that the institution maintains its legal status
- Ensures compliance with government rules and regulations

- Ensure a level of personal liability of the individual directors for the institution’s activities. This liability varies by country, but the board members must be keenly aware of the degree of responsibility and immunity provided for them by local law.

In representing the interests of the stakeholders and fulfilling their legal obligations, boards delegate responsibility to management and hold management internally accountable to a set of objectives and performance standards that the board has defined.

What is the Board’s Role in the Institution’s Risk Management Programme?

Risk management is a process, affected by an institution’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the institution, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of institutional objectives.

COSO

Few areas of the board’s oversight responsibilities are more important than the evaluation of the institution’s ability to manage risk. Risk management is dependent upon the integrity of the operational internal controls implemented by management.

A risk management programme establishes a process of identifying and assessing the major risks covering all areas of the institution’s activities. This includes all activities geared toward meeting its strategic, operational, reporting, and compliance objectives. Management then develops ways to manage and mitigate these risks by implementing a very strong system of internal controls. Management is accountable to the board of directors for the state of the institution’s risk management and is responsible for reporting to the board of directors its assessment of the institution’s risk and its efforts to manage and reduce this risk.

The board of directors is responsible to ensure that management has implemented a risk management programme, that resources are allocated for risk management and internal controls, and that there is adequate oversight of the audit function as one of the board of director’s responsibilities. **Ensuring that the MFI’s management understands its market and clients, designs appropriate products and monitors client retention and satisfaction levels can also help to prevent risks to an MFI’s portfolio.**

What are the Fundamentals of Board Monitoring Performance?

Among the many responsibilities of a board of directors is monitoring performance. The role of the board of directors is to ensure that the financial **and social** affairs of the institution are being well managed by management; NOT to actually manage these affairs themselves. The board hired a competent executive to do that job.

A good board member asks questions—including financial questions.

Trustee Tips Summer 1992

To be more precise, a good board member must ask relevant and timely financial **and social** questions that assist the board in making decisions. For many board members of MFI’s, especially those who have limited experience in microfinance or are new to the board, it is not always easy to know what questions to ask or when to ask them. Board members do know who to ask; management answers the board’s questions. However, if questions are asked too late, or do not address crucial issues, important information might never be shared – not necessarily out of lack of transparency, but out of lack of preparedness of board members.

In order to ask relevant and timely questions, board members of MFI’s need to be familiar with performance monitoring techniques – **both financial and social**. This requires that the board have a basic understanding of the key quantitative and qualitative information needed to govern an MFI.

As with monitoring financial performance, it is important for the board to design a management review system such that management is held to clear objectives. This may be facilitated by developing a format for annual performance plans for the CEO with regular and standardized review of management’s progress in fulfilling its plans.

Financial Reports

For most institutions, the CEO provides the link between staff and board. Depending on the size of the institution, the governance structure, and the complexity of the operations, the chief financial officer may present the financial reporting to the board of directors at their regular board meetings.

The staff has several responsibilities related to performance monitoring, including the following:

- To prepare accurate financial data
- To analyze the financial data
- To submit financial reports to the board in a timely and organized manner
- To make appropriate financial decisions
- To be responsive to the board’s questions or directives

The board of directors should review at least quarterly the following financial reports:

- Balance sheet – The balance sheet is a snapshot of the institution’s financial position at a specific point in time. All amounts are cumulative since the institution began. The statement reads “As at.....”
- Income Statement – The Income Statement (also called Profit and Loss Statement) portrays the events that have occurred between the dates of two consecutive balance sheets. The statement reads, “For the period...”
- Loan Portfolio Information – The portfolio usually is generated by pulling information from the loan tracking information system, the operational reports, and the general ledger system tracking the loan loss reserve (LLR). The information must include:
 - o Portfolio Activity (loans disbursed, active clients, new clients, geographic data, loan fund use)
 - o A portfolio aging schedule of delinquent loans, Loans write off recommendations for board approval, and the loan loss reserve activity
- Actual to Budget Comparison of the approved budget – This report provides an analysis of management’s accountability to the board approved budget.
- Financial narrative discussing unusual financial transactions, large actual to budget variances, project financial updates, market analysis
- Performance ratios benchmarks – Ratios captures a relationship among financial data and monitoring ratios over time provide financial trends for board and management discussion.

- o Ratios are guidelines only.
- o One ratio cannot give you an accurate picture; you need other indicators and to monitor the ratio over a period of time (such as a year)
- o Ratios are summaries of past performance – they do not predict the future.

Industry standard financial and social performance and measurement ratios used to compare the industry include:

- CAMEL – (Ratio assessment tools – Capital Adequacy, Asset quality, Management capacity, efficiency ratio, and liquidity ratios)
- PEARLS – (WOCCU ratio assessment tools; Efficiency, Assets, etc)
- Banking Ratios (Many banks use CAMEL rankings)
- Microfinance SEEP, donor and practitioner’s new Industry Framework and Standards – the SEEP 18)
- MIX – online peer comparison of the microfinance industry

Social Reports³

To ensure that social performance concerns are adequately addressed through the governance process, the Board should be actively engaged in monitoring progress toward the MFI’s social mission. Just as they review financial information, the Board should review, analyse and discuss information related to relevant social performance indicators (client drop out, poverty level, staff satisfaction, etc.). For this to occur, appropriate systems to collect and analyse data need to be in place and reports should be delivered to members before for board meetings. At board meetings, social performance should be a recurring topic on the agenda and appropriate decisions taken when and as needed. The Board should also review any impact studies, social audits, social ratings or balanced scorecards with social indicators. This can also be done with an social performance committee (SPC) that can track the progress of social indicators and then report this to the Board on a regular basis. The SPC should also take the responsibility of verifying that the data is of a high quality and should proactively analyze the data, hold the management accountable to its social objectives and provide recommendations on further action, as needed.

Tracking Social Indicators

CRECER, a leading MFI in Bolivia, balances its social and financial priorities with a ‘performance management system’ to track and report on social indicators like:

- Outreach to target clients
- Quality of products and services
- Financial capability of clients
- Changes in clients’ behaviour
- Life conditions of clients/families.

Board members can also have their MFI conduct (them selves or with an outside agency) periodic social ratings, audits or impact assessments (see below). However, a more integrated approach would be to supplement such audits/ratings with an ongoing balanced scorecard or management dashboard reporting framework. This would include social and financial indicators that could be reported on a monthly, quarterly or annual basis.

1. Social Audits/Assessments

These tools help institutions evaluate their intentions, systems and actions to determine whether they have the capacity and have addressed the internal processes adequately to attain their social objectives. These tools are often used for internal purposes only, for the MFI to improve their systems and processes. These tools focus on the “Intent and Design,” “Internal Systems,” and “Outputs” stages of the social performance framework. Examples include: CERISE Social Performance Indicators initiative, MFC Quality Audit Tool (QAT), ACCION’s SOCIAL diagnostic tool and USAID’s Social Performance Audit.

³ Campion, A et al. *Integrating SPM into Microfinance Capacity Building: Governance*. AZMJ. 2010

2. Social Ratings

Social Ratings are generally used by MFIs for external purposes to be shared with donors, lenders or investors and focus on the same three areas as Social Audits but also include outcomes. Several rating agencies have developed tools to complement their financial ratings to fill the expectations of social investors. These include: M-CRIL, Microfinanza, Planet Rating and MicroRate.

3. Social Performance Management

Social Performance Management (SPM) concerns setting clear social objectives, aligning systems, understanding clients and monitoring and reporting on key items of relevance to a particular MFI like client/staff satisfaction and retention. Rather than a one-off social assessment or audit, SPM focuses on integrating social performance into the day-to-day management practices of an MFI. It should be market-driven in the sense that MFIs see the value and need to better achieve their double bottom-line. Example: *MicroSave’s SPM for MFIs Toolkit*.

4. Poverty Assessment Tools

Poverty assessment tools typically consist of those tools used by MFIs (particularly those with a focus on poverty) to understand if it is reaching its target market and/or predict the likelihood of poverty. They include: Grameen Foundation’s Progress out of Poverty Index, USAID’s Poverty Assessment Tool, and FINCA’s Client Assessment Tool as well as the Food Security Survey (Freedom from Hunger), Housing Index (Cashpor) and CGAP Poverty Assessment

5. Impact Assessments

The purpose of an “impact” measurement is to provide an in-depth understanding of changes occurring in microfinance clients, and to further assess whether they can be attributed to (or are caused by) the MFI itself. It involves conducting research with the objective of attributing observed outcomes to organisational activity. Impact is determined by the counterfactual, which requires comparing a treatment group to a valid control group. SEEP has a set of tools (AIMS) to measure impact.

Industry standard social performance and measurement ratios used to compare the industry include:

- MIX – online peer comparison of the microfinance industry (now includes social indicators)
- Social Performance Task Force – has developed indicators to monitor social performance

What are the Performance Monitoring Challenges for the Board of Directors?

Institutions and their boards that have been struggling to monitor performance effectively have learned valuable lessons. There is a high degree of similarity among the monitoring systems for the microfinance sector.

As competition increases for clients, staff, and funding, monitoring performance at the management and board levels becomes even more critical. It follows logically that as benchmarks become more widely accepted and comparative data are disseminated, the top performers will be rewarded with a better reputation in the marketplace, and the best clients, the best staff, and the best funding sources will be available to them.

The experience of microfinance boards mirrors the progress made by management in performance monitoring. As staff members understand the importance of relevant and timely information, boards will be able to review the reports more regularly and thereby increase the effectiveness of their input.

Remember that the financial and social reporting presented to the board as part of the monitoring process is not an end to itself, but a means for the board to make more informed decisions. The data reviewed during this process should be used for other purposes as well, including a review of the institution’s

interest-rate policy, or decisions regarding product design, service quality or even institution structure. Strategic policies and decisions must reflect the reality in which the institution operates, and by comparing the institution’s indicators with those of its peers and with industry standards, the board can ask informed questions and make wiser recommendations.

What are the Key Areas to Monitor?

Figure 6.1 - Key Areas to Monitor: SEEP’s Financial Ratios	
Profitability and Sustainability (3 Ratios)	Will the MFI have financial resources to continue serving clients tomorrow as well as today?
Asset/Liability Management (5 Ratios)	Does the MFI have adequate resources to meet its obligations and is it using funds as effectively as possible?
Portfolio Quality (3 Ratios)	Is the MFI managing its most important asset responsibly?
Efficiency and Productivity (7 Ratios)	Is the MFI serving as many clients as possible for the lowest possible cost?

What are the Microfinance Industry Standards?

Operating and financial self sufficiency	> 100%
Portfolio at Risk	< 5%
Loan Loss Write Offs	< 2%
Operating Cost Ratio ranges from	20 to 40%

Figure 6.2 - Key Areas to Monitor: Examples of Social Indicators	
Depth of Outreach	Measuring client poverty level or average size of starting loan can be means to show depth of outreach
Client Retention Rate	Can indicate client’s level of satisfaction and is one predictor of stronger financial performance
Staff Retention Rate	May indicate level staff satisfaction levels, but is one predictor of sustainability and higher financial performance
Effective Annual Interest Rate	Shows the real cost of borrowing from an institution (and can be benchmarked against competitors)
Client Satisfaction	Measures the level of client satisfaction directly based on survey ⁴
Staff Satisfaction	Measures the level of staff satisfaction directly based on survey ⁵

⁴ Examples of client satisfaction surveys, including SerQual-based systems, can be found in MicroSave’s Customer Service Toolkit: <http://www.microsave.org/toolkit/customer-service-toolkit>

⁵ Examples of staff satisfaction surveys including climate surveys can be found in MicroSave’s Human Resource Management Toolkit: <http://www.microsave.org/toolkit/human-resource-management-toolkit>

Section 7: Strategic Planning Process

What is the Strategic Planning Process?

Strategic planning is the process by which an institution critically reviews its past performance, where it is today, and determines where it wants to be in the future. It is an opportunity for the board of directors and management to reflect on the larger picture, to think more globally, and to reflect on the institution’s mission, vision, and desired results – to dream.

The strategic planning process becomes a working document called the business plan. A business plan defines the specific targets and goals for the next 3 to 5 years. Management creates master project plans to implement the business strategies and initiatives, financial projections are included in the budget. Management reports back to the board of directors the status of the operations and financial projections outlined in the business plan and institution’s budget.

Strategic planning is not “wishful thinking”, it is a commitment to action, answering a call to purposeful service.

There are many ways to develop a strategic plan. The approach here consists of several steps, all of which keep the clients and the institution’s mission and vision in the forefront during the planning process:

- Articulating the institution’s mission and goals which express its aspirations and intentions
- Defining the institution’s markets and clients (and researching client needs/market demand, if possible) to clarify whom it seeks to serve.
- Undertaking an environmental analysis to examine key factors in the broader context in which the institution operates
- Performing an institutional assessment to explore key strengths and weaknesses of the institution
- Based on the results of these analyses, developing a strategy that builds on the institution’s strengths and develops key areas needing improvement, enabling the institution to better serve its clients and achieve profitability.

Mission Statement

An institution’s mission articulates its guiding principles and overall direction. It is an expression of the vision that led to the founding of the institution, a “declaration of organisational purpose.” Goals reflect how the institution intends to pursue its mission. A statement of mission and goals generally addresses several key questions:

- Why do we exist? What issues are being addressed by the institution?
- How does the institution respond to these issues?
- Who do we serve? Who are the intended clients?
- Where do we work?
- What are the institution’s core values?
- What is the institution’s promise and responsibilities to the staff?
- What is the institution’s responsibility to financial management?

A microfinance institution’s mission and goals underlie and inform all the activities that it undertakes and serves as a source of motivation for the institution’s board and staff. The strategy chosen should reflect the institution’s mission and further its goals.

What are Strategic Issues?

Strategic issues are conditions, obstacles, weaknesses, etc which an institution will need to deal with in order to successfully live out its mission and achieve its key results. Strategic issues can also include goals to strengthen under-utilized strengths, resources, and opportunities.

What makes an issue a strategic one is that it cannot be easily dealt with in the normal course of operations. Rather, it will take a special effort by the institution to ensure that the issues do not persist.

Strategic issues impact the entire institution and therefore require decision making by more than one person.

How do you Choose Strategies?

A strategy is a series or combination of activities which on its own, helps accomplish the institution’s goals. Some results or objectives can be achieved fully by using only one strategy. In other cases it may be necessary or desirable to employ several.

It is important when deciding upon a strategy, that the board and management look at various alternatives and select those which will enable the institution to be most effective in serving its clients.

Specific criteria to help determine which strategies have the highest priority for implementing in the institution:

- Which best fits our overall purpose and values?
- Which most adequately achieves our intended result?
- Which represents the greatest return on the institution’s investment? (personnel, financial, **social**, resources, assets, etc)
- Which is most realistic to be implemented and successful based on time and institution resources?
- Which represents the least risk to the institution?

What are the Key Programme Results of Strategic Planning?

Mission and vision describe the fundamental mandate, the reason for an institution’s being, and how it sees itself in the future, the Key Programme Results describe what the board of directors and management are trying to accomplish and how they are positioning the institution for the future.

Key programme results are:

SMART Objectives and results should be:

Specific...	not	general
Measurable		in terms of quantity, quality, time or cost
Achievable		in terms of capacity, feasibility, and available resources
Relevant		in that they fit with the mission and vision of the institution
Time Bound		meaning they have a beginning and an end

A microfinance institution assesses the content in which it operates through an environmental analysis to gauge how foreseeable external challenges will affect its capacity to achieve its goals. External factors

can prove to be either opportunities or threats. Opportunities if the institution can position it self to take advantage of changes in the environment, threats if the changes jeopardize its ability to pursue its goals in the way it had planned. By anticipating the effects of external factors, the institution can better position itself to take advantage of its environment.

An environmental analysis looks at four factors:

- Competition
- Collaborators
- Regulatory Factors
- Macro-economic context and other external forces

Areas of operations are reviewed, generally assessing internal strengths and weaknesses:

- Credit and savings programmes
- Board and management issues
- Human Resource management
- Administrative programmes
- Financial management

The purpose of the environmental analysis and the institutional assessment is to provide a microfinance institution with a clear idea of where it needs to focus its attention in order to meet its clients’ needs and enhance its profitability. By systematically developing the information needed to assess past trends and current performance, the analyses lay the groundwork for determining what kind of strategy will enable the institution to achieve its goals.

What is the Process to Develop or Update the Strategic Plan?

A microfinance institution chooses its strategy for expansion on the basis of the information and perspectives developed in the first four steps of the strategic planning process. Having articulated its mission and goals, defined which markets and clients to target, forecasted what favorable and unfavorable external conditions it is likely to face, and gauged its strengths and weaknesses, the institution is ready to decide on a strategy for providing the right products in the appropriate markets in a cost-effective manner.

The process of identifying a strategy has three parts:

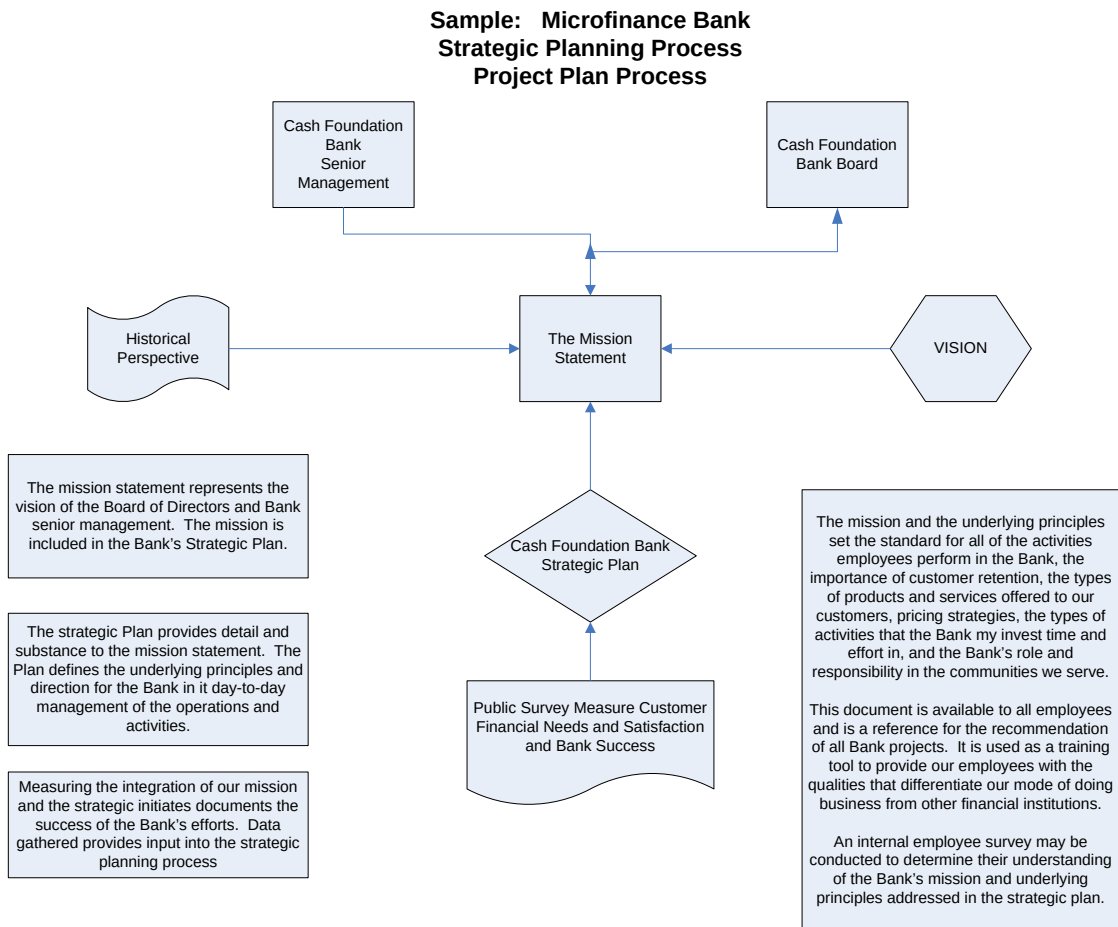
1. Choosing what products to offer in which markets
2. Deciding which areas of the institution need to be strengthened to ensure that it can provide the chosen products in the selected goals.
3. Determining clear objectives and activities for implementing the product, market, and institutional development goals.

A strategic plan is a long term plan – 5 to 10 years. It is generally not prepared in great detail. Business plans detailing project plans, operational plans and budgets are prepared by the staff for recommendation for approval and adoption by the board of directors. The strategic plan should be reviewed annually by management and the board of directors to keep it relevant and current.

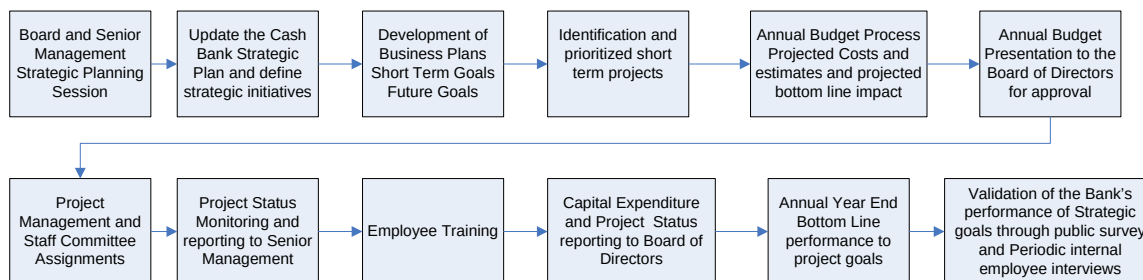
Strategic Plans should address the institution’s market area, its market approach, its products and product mix targets, the institution’s technology plans.

How is the Strategic Plan Implemented?

Figure 7.1 – Project Plan Process Sample



IMPLEMENTATION OF STRATEGIC INITIATIVES PROCESS



What are Some Future Strategic Decisions a Well-Managed and Profitable MFI Board May Consider?

What does transformation mean for microfinance institutions?⁶

“The difference between transformation by accident and transformation by a system is like the difference between lightening and a lamp. Both give illumination, but one is dangerous and unreliable, while the other is relatively safe, directed, available.

-Ferguson and Naisbitt 1987, p85

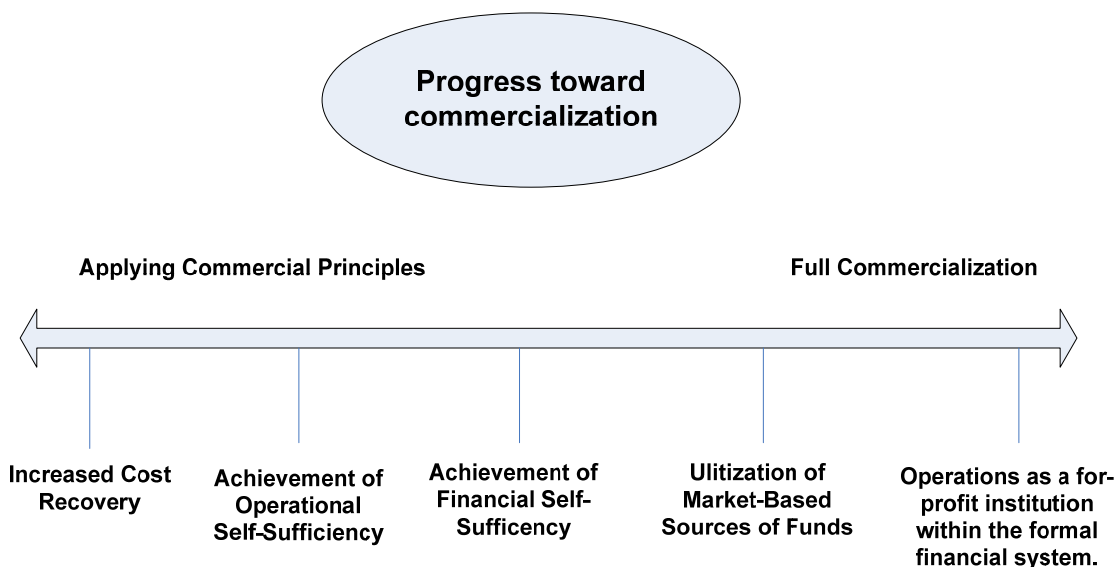
Well over a decade ago, Promotion and Development of Microenterprises (PRODEM) created the first regulated financial institution dedicated to microfinance, BancoSol. This single event changed the way in which microfinance was viewed, revealing new possibilities for other microfinance nongovernmental organizations (NGOs) and sparking great debate within the microfinance community. “Transformation” and “commercialization” are today part of the microfinance lexicon, reflecting a shift in the industry’s focus from microfinance as a social movement to the integration of microfinance into the formal financial sector.

The terms commercialization and transformation are frequently used interchangeably; however, transformation is only one of the ways an MFI can commercialize.

Commercialization: Commercialization of microfinance generally refers to the application of market-based principles and to the “movement out of the heavily donor-dependent arena of subsidized operations into one in which microfinance institutions ‘manage on a business basis’ as part of a regulated financial system” (Christen and Drake 2002, p. 4). “In commercialization lies the potential for truly exponential growth and ultimately, vastly improved financial services to the poor. Competition for microenterprise clients will improve product design, delivery systems, and perhaps even outreach” (Christen and Drake 200, p. 19) Commercialization also includes linking MFIs with commercial sources of funds, both debt and equity. This “linking” is driven by the belief that massive outreach will only be achieved when the sector can access truly commercial financial markets.

⁶ Ledgerwood, Joanna; White, Victoria. Transforming Microfinance Institutions Providing Full Financial Services to the Poor. The World Bank. 2006 Various sections

Path toward Commercialization



Transformation in the microfinance industry generally refers to the institutional process whereby an NGO microfinance provider or a microfinance project creates or converts into a share-capital company and becomes licensed as a regulated financial institution. Transforming from an NGO or project to a regulated financial institution may involve becoming licensed to be a deposit-taking institution or only as a credit institution.

Transformation is defined as the process of a credit-focused MFI becoming a regulated deposit-taking financial intermediary. An intermediary is an institution that mobilizes deposit and then on-lends the se deposits to its borrowing clients.

Two crucial aspects of financial intermediation are:

- The need for a sound and reasonable regulatory environment and capable supervision by the central bank or relevant regulatory authority.
- The institutional capacity and culture required to be a true financial intermediary taking deposits from the public, on-lending these deposits, and in doing so, complying with regulations and being supervised by a regulatory body.

Why Transform?

From an institutional perspective, the primary reasons MFI's choose to transform are to offer additional products and services (particularly savings) to their clients and to gain access to capital, and in so doing, expand their outreach. Transformation to a regulated deposit-taking financial intermediary generally results in an improved governance and ownership structure.

Is Transformation a good idea?

In addition to facilitating the mobilization of savings, expanding the funding base, and increasing the numbers of clients reached, institutions through transformation have also diversified their ownership and governance structures; increase the professionalism of their staff, improved management information systems, and improved overall internal controls. All of these changes, combined with a strategic shift to focus on customer service and provide demand-driven services, as well as the requisite need to satisfy investors and regulators and increase transparency, have resulted in overall improved performance and efficiencies that have benefited their clients. Proponents of the transformation model would argue that for the most part, transformed MFI’s have met their objectives in becoming regulated institutions.

However, despite the increase in the number of transformed institutions and evidence that regulated institutions are better able to meet client demand and thus increase outreach, many skeptics believe that the commercialization of microfinance will inevitably result in the profit motive replacing the social mission – e.g. ‘mission drift’. They cite as well the high costs associated with transformation and argue that these funds could be better spent elsewhere.

A recent example involves the IPO of Compartamos, a leading MFI in Mexico, in 2007. The successful and high valuation of Compartamos brought a lot of excitement to the microfinance community. At the same time, it provoked much debate on fundamental issues concerning interest rates, the use of profits, what it means to work in the interest of clients, and ownership and governance of regulated MFIs⁷. Compartamos, however, did not wish to significantly disrupt its governance structure or deviate from its mission. Thus, instead of selling significant parts of its capital to a single investor, Compartamos chose the IPO route to ensure a diversified ownership base and then set a limit of 30% on the amount of shares available. Some NGOs - such as Promujer and Crecer in Bolivia, or Fondo de Desarrollo Local (FDL) in Nicaragua - may chose not to be transformed because the regulation would limit their possibilities to lend without collateral (group lending) or to lend to rural areas (provision associated with rural lending).

Regardless, if an MFI decides to transform from a non-profit organization into a formal, for-profit institution or with the entry of new investors, it is especially important to ensure that mission drift does not occur and that the selection of investors (who will become future Board members) includes those that will be committed to the social mission. In addition, these MFIs should assess the investor’s exit strategy to determine whether the social and financial performance expectations and time horizon are realistic.

For microfinance institutions that have their leadership, vision, and skills to change their institutions fundamentally, transformation to a regulated deposit-taking institution can be a route to viable long-term commercial microfinance-and to large-scale outreach to the poor. But transforming to a regulated financial intermediary is not for the vast majority of financial nongovernmental organizations or other microfinance institutions. Even for a strong MFI, the process of building a large-scale financial intermediary is considerably more difficult than is generally realized.

The single most important point that transforming MFI’s must understand is that successful mobilization of savings from the public, including from large numbers of low-income people, changes the institution (but not the mission) profoundly and irreversibly. No one says that transforming microfinance institutions to a regulated financial institution is simple-or that mobilizing and intermediating savings from the public is easy. These are not activities for the faint of heart. So an institution must first ask if it is worth all that trouble. What difference does it make if large-scale financial intermediaries fund loans with savings collected from the public, and serve low- and lower-middle-income households? The short answer is that commercial microfinance does make a difference-and that it benefits virtually everyone involved.

⁷ Rhyne, E and Guimon, A. *The Banco Compartamos Initial Public Offering*. Insight No 23. ACCION. June 2007

Section 8: Board Governance Tips

What are Some Practical Tips and Advice for Good Governance?

1. One size Does Not Fit All

There is no one-size-fits-all governance model or framework that can be imported from elsewhere and applied successfully to your institution. A more useful approach is to build your governance framework around your mission, and to make sure it is well-suited to your organization’s size, culture, people, traditions and history.

2. Have a Clear, Up-To-Date Mission Statement

MFIs should build a governance framework that is driven by their mission. That means that the first job is often to put together a brief, inspiring, distinctive statement that is neither too broad nor too specific, one that explains why the organization exists. It can be tricky for board members to agree on a clear statement, but this is vital in putting together a strong governance framework. If you already have a mission statement, make sure that it is up-to-date. Some organizations have taken on significant new responsibilities or functions without renewing their mission statements.

3. Can you answer “where do you want your organization to be in 5 years”?

While a mission statement explains why the organization exists, a vision statement outlines where the organization wants to be. This can help guide the board as it selects new members and considers budgetary implications.

4. Get the Right People Around the board table.

Boards are only as good as the people who sit on them. Identifying and attracting members interested in serving as potential directors of the board is an ongoing process, one that will certainly involve much of the Chair’s time, and the interest and support of other board members as well, including a Nominations Committee. Incumbent board members should be actively involved in selecting new board members – this not only creates an incentive for sitting board members to integrate new members into the group but also avoid exclusionary feeling that can create tension. It is important to look for new directors with strategically relevant experience. A good place to start is by tying the priorities in your strategic plan to the discussion of what traits and skills you will need on your board. Also, new board members’ knowledge and skills should complement those of the CEO and top management, as well as those of existing board members, to provide a richer consideration and resolution of strategic issues. Other things to look for in new directors include their communications style, their personality and whether they actually have time to serve.

5. Have a Fair, Transparent and Appropriate Nominations Process

Is your nomination's process fair, transparent and appropriate to your institution? Using a calendar that lists the key dates and responsibilities can help you keep on track with your nominations process. For example, if your Annual General Meeting where board members are elected is held every summer, your Nominations Committee may want to begin putting together a slate of nominees in the late fall so that the board can review the list in the winter. This leaves the Nominations Committee time to follow up with potential candidates to secure their interest and availability, and also allows sufficient time for voting members to receive the information prior to the annual meeting.

6. Don’t Leave New Board Members Out in the Cold!

An important task for any organization is to educate new members and equip them to become productive, knowledgeable contributors within a short time of joining the organization. Many directors say that when they were starting out on their boards, they could have benefited from more help from standing directors.

A thoughtful, deliberate orientation process creates a good impression, and signals the professionalism and seriousness with which the organization approaches its work. The creation of such a process ultimately saves time and avoids frustration for all concerned. Responsibility for the details and strategy of recruitment and orientation will normally reside with those board members charged with nomination responsibilities. It is important that whoever handles these tasks assumes responsibility for ensuring that any printed materials used in the process are regularly updated. There are a variety of ways to undertake orientation and training including, but not limited to, printed documents.

7. Build Teamwork

One of the keys to making boards work better rests in board process and the nature of the interactions among board members. The ability of a board of directors to do all the things they need to do depends largely on the quality of the individuals who become directors and their ability to work together as a group. Group processes related to conflict and teamwork are critical determinants of board effectiveness. It is important, for example, for boards to make the most of the time they have together in order to develop team norms and to avoid having a small number of dominant directors take over deliberations.

Constructive conflict tends to improve decision-making in a board, because such exchanges can help the board to understand related issues, and to synthesize multiple points of view into a decision that goes beyond the individual perspective. Constructive conflict on boards can be fostered by preparing board members for meetings and scheduling meetings to provide an opportunity for debate. It is important for board members to be as inquiring as they feel is necessary on key issues, but here is a balance to be struck between not ever challenging management and micromanaging every decision the CEO makes. Finally, building good board process also means avoiding destructive conflict – personal friction and tension – which can degrade group decision-making and interfere with the board’s ability to perform its key roles.

8. A Good Chair is important to have.

The Chair of the board occupies a pivotal role and it is important that this role be performed effectively. The Chair plays a key role in: setting the tone and direction for the board; the nominations process; the setting of the board agenda; and many other responsibilities. A Chair should be a good leader who understands the issues, help the board use its strengths to the fullest, and assists others in leadership roles. The Chair also needs to work closely with the CEO and others in the organization. Often, a Chair plays a representative role in the community and can serve as a spokesperson for the organization. It is important for the Chair to have good judgment, particularly when it comes to conflict of interest and ethical issues, and to know how to run a meeting well, in terms of making room for all to be heard, fostering constructive conflict, avoiding destructive conflict, and building teamwork.

9. Have Clearly Defined Roles and Responsibilities...

It’s important to have clarity around what everyone’s job is and what expectations are. Clear position descriptions for your CEO, Chair vice Chair and board members can help. Make sure to include information about term, selection and key responsibilities.

10. Particularly with the Board and CEO

A potential thorny issue is where the board’s work stops and that of the CEO begins. This is why it is important to clearly define the roles of the board, the CEO.

11. Know your duties...And Your Liabilities as Board Members

Board members of non-profit corporations have a variety of duties and liabilities and it is important for directors to understand them. Directors are required to exercise their power with competence and diligence in the best interests of the organization. They owe what is called a “fiduciary duty” to the

organization. It is “fiduciary ” because the obligation to act in the best interests of the non-profit, at its core, is an obligation of loyalty, honesty and good faith.

As a general rule, directors are not personally liable for the contracts of, or the action or omissions of the organization they serve because a corporation is considered to be a separate legal person at law. But there are exceptions and many instances of directors’ liability. Legal advice is available.

12. What about board-staff relations?

The roles of the CEO and his/her staff and board members are interdependent. Each party has something the other needs, and boards have both a legal and moral responsibility for their institution’s well being. A board has the authority to select the CEO and monitor management. The CEO is dependent on the board for authority to function and manage the institution, and should view the board as more than a legal requirement. He or she also needs the collective wisdom that board members can bring to decisions about institutional mission, direction and values. Boards depend on their CEOs to exercise leadership by building a successful team of staff by helping board members use their time most efficiently. Boards depend on CEOs for information and reports, as well as for valuable input in decisions and, often, for day-to-day management of the institution.

The way board members and CEO treat each other’s respective powers does more to affect the quality of leadership and governance than any agreement on proper boundaries. A good starting point for strong board-staff relations is to have clear boundaries between the role of the CEO and the role of board members, particularly that of the Chair. Clear communication is also important, and this includes making the time to meet and discuss issues of importance. It is important to remember that board-staff relations are not static and there is no “one right way”. They can change at various points in an organization’s lifespan and depend on a variety of factors, such as how much of the operational work resides with the board versus the staff.

13. Make sure the Board is Getting the Right Information in the Right Format

When board members are well prepared for board meetings, this sets the stage for stronger interactions and often, better decisions. Directors’ busy schedules can get in the way of finding the time to prepare, but it is particularly frustrating for them to receive discussion materials just prior to the meeting. This is why it is important to give board members enough time to prepare for meetings. Time is one thing, but quality of materials is another. The information and reports directors receive should include enough detail to make them useful and board members should speak up to ensure that the materials are meaningful and complete.

14. Have a Code of Ethics or, at least a Policy on Conflict of Interest

It can be helpful to have a written document to help govern the conduct of members of the Board to ensure that business is conducted with honesty and integrity. A Director’s Code of Ethics or Behaviour can help define accepted/acceptable behaviours and promote high standards of practice. A Code of Ethics can also provide a mechanism for disclosure leading to informed decisions on matters involving the ethics of the board. One of the most important elements of a Code of Ethics is a policy specifically about conflict of interest. Board members are likely to be affiliated with many organizations and businesses, both on a professional and a personal basis, so it is not unusual for actual or potential conflict(s) of interest to arise. Such conflicts, whether real or perceived, can serve to undermine public trust and may constitute a breach of board members’ fiduciary duties. It is therefore important for the board to discuss and then set out on paper (a) what conflict of interest means and (b) what board members should do if they perceive a potential conflict of interest. Beyond having a written policy, it is also necessary to periodically refresh board members on the policy through discussion.

15. Accountability Counts: Maintain Strong Relationships with Your Stakeholders

It is important to account to members and stakeholders on programmes, activities, accomplishments, financial management and the state of key relationship. This involves strong communications and vehicles for messages to be sent out to stakeholders as well as ways to allow those with significant relationships to the institution to communicate back. Maintaining strong relationships with stakeholders strengthens the legitimacy of your institution and enhances its reputation. It also builds a sense of trust, and this can help bring additional resources, such as funding and grants.

16. Be As Prepared as Possible for a Crisis

Having a sound governance framework always helps institution weather crises. Clear roles and responsibilities and strong financial and organizational stewardship can make a huge difference. Many organizations find it helpful to have an emergency communications plan or strategy, and to identify spokespeople and key messages long before they are required.

17. Know if You’re On Track: Consider Measuring Your Board Performance

Both individual and boards as a whole struggle with how to answer the question: “how do we know if we are doing a good job?” It can be useful for boards to regularly evaluate their performance as this process can help board members to better understand their role, and can provide valuable information on the board’s weaknesses and strengths. For example, a performance assessment can help shed light on whether a board has the right talent around the table.

Before you start measuring your board, however, it is important to think about what kind of board exists now. Do you already know that you need different board members? Are there problems with micro-managing, or understanding of financial information? Should you train your board members better or change the documentation attached to your agenda? Should your priority really be on performance measurement? If so, should you use performance measurement to support another process or change?

Something else to consider is what your board sees as “good” performance. You need clarity on this to build a framework for evaluation of the board. All boards differ in terms of their levels of engagement, their board-staff relations, and their roles and responsibilities.

Once you’ve decided to proceed, there are different options for performance measurement. You can choose to evaluate individual board members, in order to help give participants the opportunity to improve their own effectiveness and better put their talents to use. You can also evaluate the board as a whole – something the Nominating committee may have charge of as part of their mandate. There are a variety of options and approaches to use, including surveys, interviews and discussion. Sometimes outside consultants are used to ensure that the hard questions are raised, the sensitive issues are addressed and confidentiality is maintained.

18. Don’t Try to Do Everything At Once

Remember that board governance is a journey, not a destination. Decide on what you want to accomplish this year, and set priorities for the next few years. There is no need to try to tackle everything at once. Despite the hot glare of the spotlight on good governance these days, it is still important to remember that doing governance for governance’s sake is not the best way to proceed. Rather, the goal is to build and maintain a robust and appropriate governance framework in your institution. Getting there requires time, persistence, patience and strong leadership.

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