Council of Microfinance Equity Funds

The Practice of Corporate Governance in Microfinance Institutions

Consensus Statement of the Council of Microfinance Equity Funds

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Preface to the Revised Edition

In 2005, the Council of Microfinance Equity Funds (CMEF) published "The Practice of Corporate Governance in Shareholder-Owned Microfinance Institutions." These "Governance Guidelines" were originally developed for two reasons:

- Lack of guidance tailored specifically for microfinance institutions (MFIs). While many of the principles of governance are the same for all types of institution, MFIs have special characteristics that bear directly on governance.
- To get beyond generalizations to the practical issues that boards actually face. While governance is an arduous process requiring diplomacy, insight, and even at times courage, it is easy for statements about governance to offer bland bromides.

The Governance Guidelines have since been widely used and highly regarded as an excellent source for governance information within the microfinance industry. Over the past seven years, much has changed in the field of microfinance, and good governance has become increasingly important. The Council has therefore updated this reference document to reflect new thinking and resources that have emerged in the microfinance industry around governance since the original version was published.

These updates were developed after consultation with fund investors and corporate governance experts, who shared the wisdom of their experiences. This document was drafted by Danielle Donza of the CMEF and Accion based upon this consultative process. The CMEF is particularly thankful for the time and feedback provided by Ira Lieberman of LIPAM International, Elisabeth Rhyne of the Center for Financial Inclusion (CFI) at Accion, the original authors of the guidelines, as well as Alex Silva of Omtrix Inc., Miguel Herrera of Accion's Frontier Investments Group (FIG), and David Dewez of Incofin.

While the original guidelines have not altered significantly, new or expanded guidance is provided in the areas of:

- Legal structures and formal documentation
- Social performance management
- Alignment of incentives
- Responsible exits
- Risk and crisis management

Many new publications related to MFI governance have now been added as references (see Annex 1). The CMEF hopes this statement will contribute to an active process of improving governance among the institutions CMEF members invest in, and in the microfinance industry as a whole.

1. Introduction to Governance

Microfinance institutions are playing an important role in the delivery of financial services to the poor. Increasingly, these MFIs are for-profit, limited liability companies, the ownership of which is in the hands of multiple shareholders. In most cases, shares are privately held (i.e., not publicly traded). Most such MFIs are licensed financial institutions – finance companies and banks. Many are deposit takers.

"Good governance is the ability of the board members to monitor the status of the organization, make good strategic decisions, and hold executives accountable for their execution. Ultimately, that comes down to the quality of the board members, the culture and practice of the board, and the power relationships among board members and executives."

Elisabeth Rhyne, the Center for Financial Inclusion

This statement on corporate governance of MFIs provides practical guidance for stakeholders in governance; investors, board members, and senior managers. Although these Guidelines are aimed primarily at shareholder-owned institutions, much of the material is also applicable to microfinance institutions with different ownership structures, such as nongovernmental organizations (NGOs) and cooperative credit unions.

1.1. What Is Sound Governance?

Governance, broadly defined, is the system of people and processes that keep an organization on track and through which it makes major decisions. In the broadest terms, the functions of governance are:

1. To uphold the organization's goals and mission and see that they are implemented
2. To guide the organization's major strategic directions
3. To maintain the organization's health over time and to mitigate risks
4. To ensure accountability throughout the organization
5. To ensure that the organization has the necessary human and financial resources to operate effectively

A broad range of actors have an active role in MFI governance. We can see these actors broadly as external or internal according to their roles in the governance process.

"External" actors:

- Entities that oversee the institutions' financial health: regulators and auditors
- Providers of financing: shareholders, lenders, and depositors

- Communities served by the institution
- Employees
- Clients

"Internal" actors:

- The board of directors
- Senior management
- Internal auditors, as they interact with the board

Although governance takes place in this broad context, the board of directors is the pivotal point through which all these players connect.

1.2. Role of the Board

The following major responsibilities of the board of directors reflect the broad purposes of governance:

- Define and uphold the social mission and purpose of the MFI
- Develop and approve strategic direction (with management); monitor achievement of strategic goals
- Foster effective organizational planning, including succession planning
- Ensure that the MFI manages risks effectively; assume fiduciary responsibility
- Oversee management performance, including selection, support, evaluation, and compensation of the chief executive officer (CEO)
- Ensure adequate resources to achieve the mission, including assistance in raising of equity and debt
- Represent the MFI to the community and the public; ensure that the organization fulfills its responsibilities to the larger community
- Ensure that the organization changes to meet emerging conditions; particularly in times of distress, temporarily assume management responsibilities

Events since the initial version of the Guidelines have dramatized the need for greater governance attention to social mission fulfillment and risk/crisis management.

Three further responsibilities address board and board member conduct:

- Uphold the ethical standards of the organization, with transparency and avoidance of conflicts of interest
- Represent the interests of the MFI as a whole and not those of one shareholder or group of shareholders
- Evaluate, or seek external evaluation of, the board's own performance and commit to improving that performance

Standards of Conduct for Board Members

Commitment to accountability, sometimes termed the fiduciary responsibility of board members, must infuse the performance of individual board members. Board members should:

- Know the mission, purpose, and goals of the MFI and its policies and programs
- Understand the organization's strengths and weaknesses (strategic role is to address these strengths and weaknesses)
- Prepare for, attend, and participate in board and committee meetings
- Ask substantive questions and resolve not to remain silent (a key role of board is to probe and to make policy decisions), particularly regarding areas of risk
- Review and understand the MFI's financial statements, key performance indicators (KPIs), and related information
- Avoid making an uninformed judgment/policy decision (if information is inadequate, work with management to get the information needed)
- Represent the interests of the MFI as a whole, not those of any individual investor
- Support the majority view once a decision is made
- Maintain confidentiality
- Maintain independence, objectivity, personal integrity, and ethical standards
- Avoid conflicts of interest, inter-related transactions, insider lending, and nepotism to meet personal disclosure requirements

2. Governance Implications of MFI Legal Structures

MFIs can take various legal forms such as a bank, nonbank financial institution, credit union, or NGO; each constituent form varies in its requirements in terms of governance structure, process, and level of regulation.

2.1. Regulation

The boards of licensed MFIs are subject to regulation by banking authorities and held responsible by those authorities. If an MFI is regulated, the board is the official point of contact between the regulators and the institution. Moreover, regulators often provide guidance on how governance is to be carried out. Board member selection is subject to approval by regulators, with candidates screened to be "fit and proper." Regulator guidance on board composition is intended to enhance governance quality. But, as with any regulation, inevitably the institution will perceive some regulatory directives as constraints.

Though day-to-day interaction between the MFI and bank supervisors may be with management, formal interaction is with the board, and the board must be prepared to respond to regulatory directives or inquiries properly and promptly. Basel III rules require a higher level of board involvement with management, and although its requirements are officially implemented only in OECD countries at present, they influence regulators in other countries.

2.2. Privately Held Ownership

In most MFIs, the governance structure closely mirrors ownership. MFIs are typically owned by a small group of investors, often with no one investor in a controlling position, and with most board members directly representing specific shareholders. The close link between owners and governance creates characteristic strengths and weaknesses among MFI boards. The greatest strength is that investors take governance seriously. Investor representatives tend to show high attendance at board meetings, and they stay informed and engaged. Their own incentives to obtain returns on investment align with prudent risk management.

Directors have a duty of loyalty to the company. They must act in the interests of the company as a whole, not simply as appointed representatives of a particular shareholder. This duty may not be an issue when all shareholders have a long-term perspective, but it becomes difficult during times of ownership change, when shareholder interests differ. Departing shareholders want the best exit, while continuing shareholders want to retain value in the company. When shareholder representatives

begin fashioning their own deals, they may lose focus on the ongoing task of overseeing the institution. Differences among board members associated with ownership change can thus be disruptive for the institution.

When board representation is determined by share holding percentages, little room is left for independent directors (defined as directors who are neither direct shareholder representatives nor members of management) who can take an institution-wide perspective, or who bring the perspective of other stakeholders. The use of independent directors should be a priority for improving governance among MFIs. In a number of countries, governance reforms require that at least 25 percent of the board be independent appointees. This practice is particularly important for committees such as the compensation and audit committees. Often the decision to include or exclude independent directors comes down to the issue of compensating independent directors for their time and travel expenses. It is short-sighted for the shareholders to exclude a role for independent directors on this basis.

Finally, the close link between board and ownership structure suggests a need to ensure that the boards respect laws and agreements protecting minority rights, through safeguards such as requirements for super-majorities, for important company decisions.

2.3. Formal Documentation

Board members have a fiduciary duty, a duty of care, to the institution, to its shareholders, and to other stakeholders such as regulators. Normally, the company charter or the shareholders' agreement[1] outlines the duty and structure of a board: how many members, committees of the board, minimum number of members, frequency of meetings, permission for board or committees to meet telephonically, and board voting requirements, majority and super-majority votes. These documents are agreed to by the shareholders at company formation. The charter and/or the shareholders' agreement may well be modified at the time new shareholders enter the company, or when the company transforms from an NGO to a shareholder-owned institution. The documents may also change per regulatory requirements if the MFI becomes a regulated institution such as a bank or nonbank financial institution. Additionally, the organization's bylaws act as a governing document that establishes the day-to-day operating procedures for the institution; they are considered more of a living document because they can be more easily amended.

Voting requirements are normally defined in the company's charter or the shareholders' agreement and are discussed actively, debated, and agreed upon before the first

[1] In many countries, the legal status of the company charter, as recognized by courts, is stronger than the shareholders' agreement, so key provisions need to be included in the charter.

closing of investors entering the institution. Voting rights may be amended when new investors enter the company, based on a vote of the existing shareholders.

In addition to a company charter or shareholders' agreement, each board committee should have a charter that is revised annually. Each board meeting should have minutes prepared by the company secretary and approved at the subsequent meeting. The same is true for board committee minutes. In this way, policy decisions taken at the committee or board level, and approved by the board, are solidified and not left open to doubt.

A board member's fiduciary duty may have the force of law and, in some countries, directors may be sued or held criminally liable if they are deemed negligent. This can occur in the event of fraud, conflict of interest, failure (bankruptcy), or significant losses of the institution. Therefore, boards and board members are required to act prudently to protect the institution against undue risk. Directors bearing legal liability must be insured, through directors and officers (D&O) liability insurance, to avoid putting their personal assets at risk.

3. Unique Governance Issues for MFIs

MFIs combine certain characteristics that shape the requirements of their governance. No one feature is unique to microfinance, but taken together they give the governance of MFIs a distinctive character.

3.1. The Double Bottom Line

MFIs operate commercially while maintaining social aims. MFIs of all types pursue both social and financial goals, but shareholder-owned MFIs, especially regulated institutions, are required by law to maintain solvency and by structure to produce a return on investment. With these strong forces mandating attention to financial performance, it is often a significant challenge for MFIs to stay focused on social goals. It is therefore critical that the board play an active role in advancing and protecting the MFI's social mission. An MFI's mission should include clarity on who the target clients are and how the institution's work will make an impact.

"We don't think of social performance as a trade-off in any way. Social performance, when it's done well, makes good business sense, because you know your clients better."

David Dewez, Incofin

Even if they agree generally on social goals, MFI boards are continually called on to make specific decisions with social implications. In this process, what may at first seem like small differences among board members on social goals can generate difficult debates.

To strengthen oversight of social performance:

- Commitment to social goals should be a requirement for board membership and should be taken into account during member vetting and orientation.
- A board may wish to form a social performance committee, or to assign individual board members to act as "champions" for social performance, tasked with ensuring that mission fulfillment receives adequate weight and attention.
- Boards must invest time to develop a shared understanding about social goals and how to achieve them.
- Explicit social goals and targets should be set through the strategic planning process and approved by the board.
- MFIs should have, and the board should monitor (at each meeting), indicators demonstrating the achievement of social targets and goals.

- MFI boards should seek in-depth information about social performance from time to time, through market research, impact studies, and personal interaction with clients.
- Boards should advocate for the endorsement and implementation of client protection practices.[2]

Measurement of social goals poses a particular challenge, as reliable indicators are still in development.[3] "Social scorecards" or "balanced scorecards"[4] are often used, but there is frustration about the value, consistency, and reliability of available indicators. Nevertheless, social outreach indicators, benchmarks, or scorecards should be reported and discussed as part of a board's information package, just as financial statements are.

3.2. In Transition

Boards must become stronger as MFIs evolve from small operations to larger, more sophisticated institutions.

Whether they began as NGOs or as regulated financial institutions, and regardless of current form, many MFIs are in transition from social entrepreneur/founder-dominated institutions into more professional institutions with a wider array of checks, balances, and delegation of authority.

Such institutions may not have fully developed governance structures. They will need to chart a realistic path toward stronger governance. As institutions mature, their boards gradually formalize functions previously executed informally. Examples include creating committees of the board to undertake detailed work in support of board decisions, developing a board policy manual, or formalizing the CEO's annual review process. The board may need to add more technical expertise, e.g., legal,

> **The challenge of aligning stakeholder interests could be considered the "Achilles heel" of the transition process. The distinct interests and priorities of numerous stakeholders can cause difficult, awkward, or controversial conversations and potentially break down negotiations.**
>
> Stephanie Dolan, "Aligning Stakeholder Interests in NGO Transformations"

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[2] The Smart Campaign's Client Protection Principles are recognized as industry standards; implementation tools and resources can be found at: www.smartcampaign.org.

[3] Industry organizations such as the Social Performance Task Force (www.sptf.info) and the Global Impact Investing Network (www.thegiin.org) are working to develop social performance indicators.

[4] Examples of Social Performance Management tools can be found on the Social Performance Resource Centre at: www.spmresourcecentre.net.

accounting, capital market, or human resources. It is difficult to generalize about what acceptable governance looks like at different stages, but organizations should look to their peers for guidance and make their own assessments.

For MFIs emerging from NGO origins, transition to a shareholder structure involves giving up control by the original board, which is always difficult. The original board members legitimately seek to maintain the mission and some level of control, even though they may have to share much of the control with new shareholders.

The question of founders' compensation arises in such situations, for both founding institutions and individuals. Since new shareholders benefit from the value created by the founders, it can be legitimate to provide some compensation to the founders. Appropriate mechanisms for compensation are complicated by the nonprofit structure of the originating NGOs and the presence on the balance sheet of donated funds.

The greatest vulnerability of MFIs created by one or two founders is management capture, when management dominates and the board serves as a rubber stamp for management. Among emerging MFIs, management capture occurs decidedly more frequently than its obverse, board capture, where boards get too involved in management. For example, an NGO may have been formed by a charismatic, strong-willed, social entrepreneur, with all board appointments initially made by the founder. In this case, the board may be led or dominated by management.

As the organization matures and shareholders place directors on the board and a few independent board members are added, the board should gain more balance between management and board. Sometimes management is perceived as weak, and the board, led by a strong chair, dominates governance, particularly in cases where founders are in the chair position. These boards may in fact try to manage and not govern. Achieving balance between the board's role in governance and management's role in managing is a fine line that may take time and significant effort. Organizations need to make their own assessments on how best to change their governance culture; add board members for skills, independence, or both; and define clearly the role of the board chair vis-à-vis the managing director or CEO. Maintaining the delicate equilibrium between management versus board capture is at the heart of good governance.

Succession planning becomes a particularly sensitive issue for emerging MFIs. It is important to ensure that the MFI is grooming future management and that there is a plan of succession. Management succession is a clear and important responsibility of the board.

3.3. Responsible Exits

Given the need to preserve the social mission that MFIs embrace, succession planning is not only important for management but also for shareholders. Some socially responsible investors may prefer to exit an investment by selling their shares to another socially responsible investor in order to continue the focus on the MFI's social mission at the board level, and ensure that the interests of shareholders remain aligned. In some cases, socially responsible investors will even accept a lower return in order to ensure this continuity of shareholders and select a buyer who is better aligned with the mission.

Responsible exits are increasingly an issue of concern among MFIs wishing to ensure the continuity of investors and to protect the social mission.

Another aspect of a responsible exit that socially responsible investors should have considered and discussed in advanced, and ideally even entered into the shareholders' agreement, is the ideal timing of the exit and the impact it will have on the MFI (which could be a potential conflict of interest between the shareholders and their fiduciary responsibility to the MFI). Some shareholders' agreements will include "ownership lock-ups" that prevent shareholders from exiting within a predetermined time, e.g., a minimum of five years. This type of clause helps to ensure that shareholders agree in advance to remain vested in the mission of the organization for a longer time horizon.

"While IPOs are possible in a few larger and more developed markets, most equity investors will exit through sales to current shareholders, new buyers, or occasionally management. This is the final point at which a social investor can influence the MFI's governance and direction. One fund manager described it as 'always a bit painful,' as they seek to find the right buyer(s) who will balance shareholder financial and social value with helping ensure the company's continued double bottom line success. These issues are getting more attention from both sellers and continuing owners." [5]

The role of the board in exits should be limited, as it is ultimately the role of the general assembly to devise a plan that ensures continuity. Responsible exits should be negotiated and determined early in the shareholders' agreement. Exit provisions help to protect minority shareholders and to maintain a continuity of like-minded ownership. Anticipating key exit issues early in the shareholders' agreement will help to ensure a smoother transition for the board.

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[5] McKee, Katharine. "Voting the Double Bottom Line: Active Governance by Microfinance Equity Investors." CGAP Focus Note No. 79. May 2012.

4. Structuring an Effective Board

While all investors become part of the general assembly, a larger governing body, shareholders owning a large enough percentage of shares are able to nominate a member to join the board of directors. Boards are nominated by the shareholders at the time the institution is created. Board composition and structure may change upon the addition of new investors or when the institution transforms from an NGO to a regulated financial institution. Bank regulators may set guidelines or standards for nomination of individual board members.

MFI by-laws should provide for flexibility in the number of board members to enable changes to occur as needed.

4.1. Board Size

Boards should be large enough to complete their work effectively (without over-burdening members), to provide continuity, and to ensure quorums for meetings. That said, boards should be small enough for the group to work together to make substantive decisions.

Seven to nine members appears both a common and ideal board size, though effective boards may have as few as five or as many as 11 or more.[6] Fewer than five is not generally advisable, as the quorum becomes very small, especially if management is on the board. Larger boards can help to facilitate more effective committees, as the committee work is more evenly distributed among board members.

4.2. Composition of the Board

Banking laws and regulations require a "fit and proper" test for financial institution board members, which generally requires that members be of good moral character, an appropriately senior level, and experienced in banking. Unregulated institutions and institutions in countries with weak supervision should certainly apply their own "fit and proper" test to ensure that members have these crucial characteristics. Boards should bring a range of skills useful to the MFI, including banking, accounting or finance, and legal knowledge, as well as community development or other social sector skills, including knowledge of the target market and social perspective.

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[6] According to a 2012 MIX Market study, "Measuring Governance in Microfinance," MFIs have a median of seven board members, with a minimum of three and a maximum of 15. The number of board members increases with MFI size. Read more at: www.themix.org/publications/microbanking-bulletin/2012/04/measuring-governance-microfinance.

Additional considerations include the following:

- Qualified members willing to make a personal commitment are highly prized. The ability and willingness of individual board members to devote time and talent to the MFI are essential. Candidates for board membership should reveal to the company all the other boards on which they sit, so that the company can determine whether the candidate has adequate time, or any conflict, in serving.
- Recognizing that shareholder claims generally dictate overall board composition in privately held organizations, MFIs should nevertheless aim to involve independent board members who can bring skills and objectivity.
- People with influence can assist with political issues, tap funding, and help project a positive public image. However, high-powered prestige counts for little if the person cannot or does not participate.
- Diversity of gender and ethnic or cultural background can ensure that the board has a broad perspective.

In order to ensure that board members will be ready to devote sufficient effort to serving on the board, it can be useful to present new members with a letter of appointment in which expected time commitments are outlined.

Stakeholder participation: staff and clients. There are a variety of philosophies regarding board structure and staff representation on boards. The Anglo-American governance structure generally incorporates at least the CEO, and sometimes other members of senior management, on the board. Conversely, Continental Europe normally has a dual board structure – a management board made up of senior members of management, and a supervisory board made up of independently appointed directors (no management included, though the CEO, the chief financial officer (CFO), and others often attend the supervisory board meetings ex-officio). Some European countries also mandate worker participation on the supervisory board. Employee stock option plans (ESOPs) can provide a framework for staff to participate (this refers to staff, not senior management), but may be impractical if the organization is small and the market for its shares illiquid.

The customer perspective is important for effective governance, but having clients on the board has not proved to ensure that voice. Clients generally lack the requisite financial skills, and their participation is often little more than window dressing. The board should, however, make it a priority to get ongoing input from clients through client visits, market research, and other means. Visits by board members to meet clients may be a good way for the board member to understand how the MFI and its management are perceived by its clients.

Relationship to CEO. The temptation is great in young institutions dominated by founding entrepreneurs for the founder to select board members on the basis of friendship or previous relationship. While this practice may provide support and counsel to the founder and a ready-made group of backers for a new venture, it leads to management-dominated organizations lacking important checks and balances. Board members whose primary loyalty is to the CEO may hesitate to challenge him or her or demand accountability, particularly if such members lack technical qualifications. As the institution transforms, such boards are often reluctant to cede control to a different group of people, particularly if the long-time members identify strongly with the shared experience of building the institution. This factor has prevented some NGOs from becoming licensed financial institutions with investors as owners. Evolution into a robust professional organization requires that board members with such ties yield over time to more independent board members.

4.3. Recruitment, Appointment Period, Rotation

A committee of the board, the nominating committee, usually handles recruitment of board members. Boards should develop an orientation program for new board members that provides them with the opportunity to meet with management, review previous board meeting packages and current operating and financial data as appropriate, and meet with the board chair. A good orientation process and package of information allow a newly appointed board member to assume their role on the board quickly.

Given that the boards of most MFIs are tied directly to ownership, term limits and rotation are often ignored, but this is not good practice. At a minimum, boards should regularly examine the performance of individual members, the size of the board, the skills on the board, and potential needs for adding to the board or rotating existing members. This responsibility is normally that of the chair, in consultation with the CEO.

Among publicly listed companies, board members may be re-elected every year (a common practice) or for a defined period, e.g., three years, with renewals possible. Members who do not participate in most of the meetings during a specified period – such as one year – should be dropped from the board.

4.4. Board Member Compensation

Compensation is important to help attract skilled people to the board and to ensure that board members take their responsibilities seriously.[7] Board compensation should be high enough to bring about that result, without attracting members who wish to make compensation the objective of their board service.

One approach is to pay board members for the time they spend in board and committee meetings at a rate commensurate with what senior-level professionals would earn during a similar amount of time. Compensation can be benchmarked against fees paid by similar organizations in the same country. Board chairs and committee chairs are usually paid an extra amount in recognition of the additional time they are expected to devote to the organization.

The high travel expenses of international directors are a particular issue. Many MFIs, especially larger, licensed institutions, cover such expenses. For directors who are representatives of institutional shareholders, board fees are generally paid to the institution rather than the individual.

MFIs with a strong sense of mission may choose not to pay compensation if they feel that voluntary service by directors aligns with the institution's social commitment.

If MFIs are expecting high-caliber, highly qualified senior people to commit a significant amount of time to their governance duties, sometimes with personal liability, often with extensive travel, then they need to be willing to compensate directors for their time and efforts. The role of a board director needs to be seen as a responsibility, not an honor, and remuneration underscores the importance of the role.

Compensation may include an annual retainer plus a fee for each board and committee meeting attended, as well as extra stipends for serving as the board chair or a committee chair. Board members of publicly quoted companies, not in microfinance, are normally awarded stock options or restricted stock grants. It is unclear whether or not this is the case in MFIs, but there is some evidence that in a few cases

[7] CMEF and the Microfinance Network (MFN) conducted a board remuneration survey and found that 40 and 25 percent of boards, respectively, don't pay their board directors. Of those that do, the average amount was US$500 per meeting, for a total annual compensation of US$2,000, since board meetings are generally held quarterly. Less than 20 percent reported paying an additional annual retainer fee, but almost 60 percent reported covering travel expenses. More information about the board remuneration survey results can be found at: http://cfi-blog.org/2012/05/22/what-are-board-members-being-paid-in-the-microfinance-industry/.

board members received bonuses. As the microfinance industry matures, practices are becoming more commercial. The industry needs to engage in open dialogue about board compensation in order to develop clearer standards.

4.5. Conflict of Interest Policy

Hidden or inappropriate relationships between board members (and their friends, relations, and business partners) and the institutions they are responsible for may be the single largest cause of financial institution demise. Although the small size of MFI loans makes them less vulnerable to related party or insider lending than larger institutions, they are not immune. Even less serious conflicts can damage an institution's public standing or internal trust. Although views on what constitutes an unacceptable conflict of interest vary around the world, the key guidelines for resolving common conflicts are presented on the following page (see Table 1).

When joining the board, each new director should sign a code of conduct agreeing to a primary commitment to the MFI in all board dealings. New directors should also complete a conflict of interest form, which lists all potential conflicts and overlapping affiliations. Members with an acknowledged conflict of interest on a given issue should excuse themselves from voting on that issue. If a board member has not been transparent about a conflict of interest that has caused harm to the MFI, the board should ask the member to resign. Some boards even have a conflict committee to review and address potential conflicts of interest.

4.6. Structures to Balance Governance and Management

One of the most important and delicate tasks in creating good governance is to achieve the proper balance of functions between the board and management, avoiding either board or management capture. The guiding concept is that a supervisory body holds an executive body accountable for performance. This two-tier system of accountability functions poorly if either management or the board is strongly dominant.

Governance traditions around the world use different structures, but all traditions embody the core accountability principle. In some institutions, management executives hold board positions – less so in regulated MFIs. But increasingly the trend is to limit management participation to the CEO and one to two other senior members of management, depending on the size of the board. If management is not officially represented on the board, the CEO and the CFO usually attend board meetings in an ex-officio capacity. Other members of management may also attend meetings, or part of a meeting, especially if the subjects being addressed require specific management knowledge.

Table 1. Key Board Conflicts and Guidelines for Resolution

Conflict	Definition	Guidelines for Resolution
Related-party transactions	Engaging in activities to the detriment of an organization on whose board one serves in order to benefit another related organization or individual.	Some institutions prohibit any business transactions between an institution and its directors (including relatives and related businesses). However, business transactions that are carried out on an arms-length basis, with competition and at market prices, can be acceptable within limits or special approval requirements. In certain cases, it can be useful to allow board members to provide consulting services to the institution because they have in-depth knowledge about the institution.
Insider or related lending	Providing loans to board members, their relatives, and/or businesses in which they have a stake.	Prohibit related lending or apply strict limits for maximum loan amounts and transparent documentation and approval procedures. (Exception: lending to executives under a broadly applicable and formal staff loan program such as a car loan program.)
Nepotism	Hiring family members to fulfill a function within the institution.	A best practice is to prohibit the hiring of family members. If family members are considered for employment, they should be hired only if the candidate passes objective hiring criteria determined by non-family members. Set policies, such as “no reporting to a family member,” to provide checks and balances on such relationships.
Springboard	Using a board position to advance political aspirations or run for political office.	The board member should resign before pursuing such goals or be asked to leave the board.
Competition	Institutions that have common board members begin to compete.	The overlapping board member(s) must resign from one of the boards.
Multiple relationship	International shareholders are also providers of technical assistance or financial services.	Involve different individuals on the technical assistance team(s) and the board. Set policies for dealing with possible conflicts of interest and include these in the shareholder agreement.

Some boards create executive committees of the board that occupy a middle ground between board and management. The executive committee usually meets between board meetings, especially if the board meets relatively infrequently, e.g., quarterly.

The test for any arrangement is whether there is a body not dominated by management that actively holds management accountable. Danger signals that have been observed in the microfinance industry (as well as in many other industries) include:

- Boards fail to meet regularly or meet in a pro-forma fashion, a signal of management capture.
- CEO and chair are the same person.[8] This has been a frequent practice in U.S. corporate governance, though current views on corporate governance are trending away from this practice.
- Management occupies a major share of the seats on a board, either because the board is small or because several members of management participate.
- Board is largely composed of friends of CEO, often a problem for young organizations and NGOs.
- Board meets more often than once a month. This is a signal of board capture.
- Executive committees in effect substitute for the board. Executive committees empowered to make interim decisions should promptly seek full board ratification.
- Boards must frequently resort to recorded votes with split decisions. This signals that the board is in disarray. In well-functioning boards, most decisions are reached through consensus, then formalized through a vote.

4.7. Responsibilities of the Board Chair

The chair is expected to play a more active role than other board members. The board chair should interact regularly with the CEO, have an active role in recruiting board members, be responsible for succession oversight, and be an ex-officio member of all committees. The chair is the primary representative of the MFI to the external community and should confer prestige to the institution. Some of the most important governance roles of the chair are as follows:

- Represent the organization publicly as the chief nonexecutive officer.
- Partner with the CEO to achieve the MFI's mission.
- Provide leadership to the board to set policy and to oversee the MFI.
- Chair meetings of the board after developing the agenda with the CEO.

[8] According to a 2012 MIX Market study, "Measuring Governance in Microfinance," more than 80 percent of MFIs separate the CEO role from the chair of the board role. Read more at: www.themix.org/publications/microbanking-bulletin/2012/04/measuring-governance-microfinance.

- Appoint committee chairs.
- Serve ex-officio as member of committees and attend their meetings whenever possible.
- Discuss key issues confronting the MFI with the CEO.
- Help guide and mediate key board actions such as those on organizational priorities and governance.
- Evaluate the effectiveness of board members.
- Ensure that the board carries out its mandate.

4.8. CEO's Role and Governance Responsibilities

The CEO's role in governance is to guide and support the board's activities, and to represent the interests of shareholders, as expressed by the board, in managing the company and executing strategy. The CEO has the advantage of knowing the MFI intimately and being aware of what is occurring at any moment. Therefore, the CEO needs to guide the board in framing key policy decisions. The CEO also should ensure that the board has adequate financial and operating information in hand with adequate time to review before board meetings, so that it can provide oversight. In addition, the CEO has to make sure that the board has adequate information with respect to decisions the CEO, in tandem with the chair, has presented for the board's consideration. The following are the key responsibilities the CEO has toward the board.

- Help the board to govern more and to manage less (avoid board capture).
- Articulate the MFI's strategy and work with the board, whose role is to review, modify as necessary, and approve the strategy.
- Structure materials for the board meetings to focus on policy and strategy issues (frame significant questions and complex problems in ways that facilitate board action).
- Deliver to the board, and to its committees as appropriate, standard financial and operational reports to monitor institutional performance and progress.
- Develop with the board a set of institutional performance indicators, including social performance. Assist the board in managing the double bottom line.
- Get material to the board in a timely fashion.
- Be available to answer questions of individual board members before and during committee and board meetings.
- Maintain ongoing contact with the board chair to keep the chair informed of, and to consult about, major developments.
- Assist in orienting new board members.

Table 2. Division of Responsibility between Board and CEO

Responsibility	Board	CEO
Fulfillment of Mission	Guard and promote mission; establish social objectives; evaluate CEO according to those objectives.	Mission fulfillment through organization's operations. Recommend strategies for achieving social objectives; propose objectives; execute and achieve agreed-upon social objectives.
Financial Performance	Ensure financial survival and solvency; protect shareholders' rights; set key financial targets; evaluate CEO on financial objectives.	Achieve financial performance objectives; ensure accurate and timely reporting on financial status.
Responsible Performance	Approve code of ethics for organization and for own operations; receive and act on reports from internal audit.	Put systems and culture in place to ensure that clients are protected, fraud is prevented, and organization behaves in accordance with code of ethics.
Staff Performance	Select and evaluate CEO; ensure organization has succession plan; oversee internal auditor.	Build and maintain a strong management and staff team; set and uphold human resources policies; oversee staff performance.
Strategic Planning	Establish strategic framework and approve strategic plan.	Prepare and propose strategic plan based on board guidelines. Prepare and propose annual operating and financial plans; execute plans and achieve results.
Organizational Policies	Oversee board policies and procedures.	Develop and implement operating policies.
Liaison with Stakeholders	Uphold the interests of shareholders; represent the organization in public when appropriate.	Ensure that the interests of shareholders, clients, employees, and other stakeholders are represented.
Regulation	Liaise officially with regulators regarding compliance and liability; respond to directives by regulators.	Ensure that MFI is compliant with regulations; report regularly to regulators and facilitate supervision.

5. Effective Board Processes

In addition to the time commitments outlined in this section for board and committee meetings, best practices suggest that board members should regularly schedule time to meet in-person with the MFI's other stakeholders (e.g., regulators, clients).

5.1. Board Meetings

Full board meetings are to exchange information and to make key decisions. The majority of board work takes place between meetings, both through committees and during informal exchanges, especially between the chair and CEO. At meetings, routine reporting should not crowd out treatment of important open-ended and strategic issues. Therefore, board meetings should be structured to deal quickly with routine financial and operating reports and leave adequate discussion time for strategic issues.

Boards should regularly meet in executive session without management present to discuss matters that may be particularly sensitive regarding management. The standard board agenda should designate a time for an executive session in order to create consistency around this practice. Executive sessions are an important part of preventing management capture.

A board secretary should be appointed to keep detailed minutes of the board and its committees and to keep other detailed company records as required.

Frequency and time commitment:

- Board meetings may be quarterly or monthly (may be mandated by banking law, central bank, or supervisory agency).
- Typically, in addition to the actual board meeting, board members spend at least one day reading board material and preparing for the board meeting, and one or two days at committee meetings.
- Committees meet as necessary and as determined by the board and committee chairs.
- Special-purpose meetings may take place to discuss a specific issue that needs timely attention. These may take place via email or a call as long as a quorum exists.
- Email and telephone can be used to ratify or bring final closure to issues discussed previously.
- For every full meeting, a board member can expect to triple the time commitment between meetings. If the MFI is experiencing problems, the board member can expect time to increase substantially as the board provides more detailed, prudential oversight, or even steps in to temporarily manage.

An Effective Board Meeting

- The CEO sends the board package five working days before the meeting.
- All the members review the package before arriving at the meeting.
- Most of the members join an informal board dinner the night before, allowing them to discuss important issues.
- All board members are present because the meeting date was fixed well in advance.
- The agenda is clear. It balances routine oversight and treatment of special issues, and schedules time for an executive session.
- Committee chairs give succinct, substantive reports.
- The chair, though conscious of time management, seeks to air all views, and assists the group in reaching a consensus on decision issues. One board member raises an issue about a risk she observed. This is briefly discussed and follow-on steps are determined.
- The CEO supplies information as needed to advance the discussion.
- Discussions are candid, and almost all the members speak.

An open board culture is critical to effectiveness. The chair should carefully guide the board through the agenda and try to adhere to the timetable for the meeting, but also allow adequate time for questioning by individual board members and robust discussion of the issues. Chairs and CEOs who dominate the agenda do a disservice to the board and MFI.

Decisions should if possible be made by consensus; boards that need to decide issues by voting are generally in trouble.

5.2. Committees

Committees are the workhorses of the board. Committees should meet before formal board meetings and report their progress and findings to the board in an oral report at board meetings, supported by minutes of the committee meetings. If a committee is seeking a decision from the board, the committee chair should arrange adequate time on the agenda through the board chair and have the necessary information circulated to the board in advance. Committee chairs should generally discuss the issues for consideration with the board chair and the CEO before taking them to the full board.

Common board committees include:

Audit/Finance Committee. This committee must have strongly qualified members. It meets with external auditors independent of management to understand whether there are problems of control, accounting, or financial statements. The practice of obtaining management letters from external auditors is important, and the committee must meet with the internal auditor regularly, especially if the internal auditor reports to CEO (which is not recommended).

Executive Committee. This committee normally meets between formal board meetings. Its mandate should be clear: not to take authority away from the board but to assist the board in carrying out its role. If the board meets frequently, e.g., monthly, there may be no need for an executive committee. The danger with executive committees is that they sometimes supplant the board. This should be carefully guarded against.

Compensation/Personnel Committee. This committee determines compensation for the CEO and other senior management, and provides guidance on overall compensation increases and incentives. It deals with the adequacy of human resources in the MFI and the sensitive issue of management succession.

Risk Management/Investment Committee. This committee examines issues such as portfolio risks, maturity and foreign exchange mismatches, and the need for financial resources in the form of long-term loans, equity investment, and the like. It is responsible for monitoring the overall risk strategy and parameters set for the MFI by the board.

Information, Communications, and Technology (ICT) Committee. This committee develops and executes a strategy for information and communications technology in furtherance of the MFI's aims and objectives. It will ensure a coherent and coordinated approach to the development, deployment, and support of the ICT services and makes recommendations regarding priorities and resource requirements.

Temporary Committees. Ad hoc committees are formed for a limited time period to oversee specific issues (e.g., nominating committee to nominate new board members or a transformation committee to oversee the transformation process of an NGO to a bank).

Committee charters. Most permanent committees have charters, which are generally updated annually. The charters outline the responsibility of the committee, its membership, and its goals. The board as a whole normally approves the charter, even if drafted by the committee, and any amendments thereto.

Board minutes. It is good practice for a committee to submit formal minutes to the board secretary for inclusion in the board package for each board meeting. Normally, the committee chair will supplement the minutes with a brief report to

the board at each board meeting. This is especially required if the committee seeks board approval on a specific matter, such as annual raises and the award of bonuses agreed upon in principle by the compensation committee and the CEO.

5.3. Information and Disclosure

The quality of board oversight, decision making, and strategy development is closely tied to the quality of information that management provides. In turn, this is tied to the quality of accounting, management information systems, and the system of internal controls.

- The board will normally receive monthly or quarterly reports on financial and operating performance.
- At each meeting, the board should track a carefully chosen set of indicators aligned with financial goals and social mission – a "scorecard" or "dashboard." These indicators should give a complete and focused picture of the institution, and the presentation should show trends over time. Such a scorecard is an essential tool for the board in fulfilling its mandate to guide strategy.
- A complete board package will include: a) meeting agenda, b) minutes of previous meeting, c) reports/minutes of board committees, d) management report, e) standard financial and operating reports, including key financial and social performance indicators, and f) additional information related to issues for discussion during the meeting.
- Independently audited annual financial statements and the auditor's management letter, outlining any weaknesses in controls and other problems found during the audit, will generally be presented by the auditors in draft to the audit committee without the presence of the CEO or the CFO. The audit committee may want to confer with the CEO and CFO if any problems arise during discussions with the auditors. After discussion of any salient issues, the annual financial statements will be presented to the board as a whole for approval.

Management should disclose to board members any unusual or adverse events as soon as possible after becoming aware of such an incident; these could include fraud, litigation, or an unforeseen financial event. External disclosure to shareholders, bankers, regulators, etc., if needed, would generally occur thereafter, with the agreement of the chair as to the tone and substance of the wording. This kind of issue illustrates the importance of regular communication between the CEO and chair.

6. Key Board Responsibilities and Decisions

The topics covered in this section represent the "heavy lifting" of governance. They are the hard issues, difficult decisions, and major challenges that board members will face and must be prepared to address.

6.1. Major Strategic Directions

The board has a major responsibility to set the strategic direction of the organization. This direction is carried out through strategic planning and oversight of performance vis-à-vis the strategic plan. Management normally prepares the strategic plan, but the board should have significant input into strategic direction and any commitment of resources required by the plan. Board retreats every year or two are important vehicles for strategy development. Board members need to stay alert to the overall competitive environment in which the MFI operates. One hallmark of an excellent board is that it is instrumental in identifying the need for innovation and change in strategic direction, and that it assists the organization in making such changes.

6.2. Risk Strategy and Management

Good governance for financial institutions, especially deposit-takers, requires constant vigilance regarding risk. It is well recognized that MFIs face financial risks, and most risk management frameworks focus on credit, liquidity, and refinancing risks and capital adequacy. As microfinance matures and the market environment includes greater competition, these financial risks tend to become more complex, requiring a higher degree of expertise and attention. In addition, the importance of risks not directly reflected in financial statements, such as political, operational, and reputational risks, has increased dramatically.

> **In the past, risk in financial institutions mostly meant bad debts or operational problems such as fraud, systems breakdown, and security. These continue to be important, but the range of risks has broadened enormously to include exposure to markets, to new technology, to regulatory compliance, and now to public opinion.**
>
> David Lascelles, "Running with Risk: Microfinance – A Risky Business"

The board must be continually alert to potential risks and should expect to devote much of its time to identifying and managing risks, and determining the risk appetite of the MFI. Boards should conduct regular risk assessments and ensure that risk management plans are in place (e.g., scenario, contingency, and/or continuity

of business plans). The board should operate with an active risk management committee that regularly reports key risks to the board.

It is especially important to create a board culture that encourages board members to speak up early when they are experiencing unease about a given issue, so that risks can be caught and mitigated while they are still manageable.

Financial risks. Since financial institutions manage other people's money, their boards carry special fiduciary responsibility to maintain the value of financial resources. The paramount responsibility of the board, often enshrined in law, is to ensure that the organization protects those resources. The board monitors solvency, liquidity, and profitability while keeping the organization on mission.

In terms of board composition, some fundamental components are needed to ensure proper financial risk management capabilities.

- Some members of a board must be deeply experienced in banking and finance, and able to make sound business judgments about financial institutions.
- All members must develop a working capacity for financial statement analysis and understanding of banking; each board member bears fiduciary responsibility individually.
- Extra attention may be needed to educate board members on credit risk in microfinance: how MFIs monitor and control credit risk, and how they respond to credit risk problems.

All boards should have an audit committee, which communicates with both external and internal auditors.[9] The audit committee should be independent and not include membership from management. At least once a year, the audit committee should meet with the external auditors, without any management representative present, to discuss concerns of the auditors with respect to the system of internal controls or other matters the auditors may care to raise. Expertise in accounting and financial analysis is particularly critical for members of the audit committee.[10] Internal auditors should also have a direct reporting line to the audit committee.[11]

Nonfinancial risks. As MFIs grow more sophisticated and offer a wider array of products using new technologies, new internal and operational risks emerge. Similarly, as microfinance becomes a more visible industry and touches significant

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[9] According to a 2012 MIX Market study, "Measuring Governance in Microfinance," 40 percent of MFIs don't have a risk committee and 25 percent don't have an audit committee. Read more at: www.themix.org/publications/microbanking-bulletin/2012/04/measuring-governance-microfinance.

[10] In the United States, the Sarbanes Oxley Act requires members of the audit committees of publicly listed companies to have accredited financial expertise and also to be independent directors.

[11] More information, resources, and tools related to internal auditors can be found on The SEEP Network's website at: www.seepnetwork.org/resources-pages-4.php.

portions of the population, new external risks appear. Recent experience suggests that many risks begin as nonfinancial but ultimately appear on the financial side, as their consequences are felt throughout the organization.[12] Nonfinancial risks may not lend themselves to quantitative indicators and are therefore difficult to monitor. Board members must draw upon their own knowledge and judgment, seeking to continually stay alert. Since they are outside the organization and familiar with the market/political environment, board members may in some cases be better positioned than management to identify such risks, especially local board members.

Among the most important categories of nonfinancial risks are these:

Political risk. Sudden changes in the political environment can occur, from political disturbances that affect MFI clients' businesses to direct interference by politicians in the microfinance sector. Board members should be aware of deterioration in attitudes among government and political leaders; experience has shown that actions can occur with little warning.

Reputation risk. The press and public, and hence other stakeholders, are sensitive to any suggestion that microfinance institutions treat their clients unfairly, charge too much, or push clients into debt traps. Active adherence to the Client Protection Principles can help here, as well as a range of public relations and relationship-building efforts.

Operational risk. As MFIs become operationally more complex, there are new risks that a significant aspect of operations will malfunction as a result of weaknesses in people, processes, or systems. Organizations may be especially prone to such risks when growing rapidly.

Fraud and other staff risks. If internal controls are not functioning properly or if a high proportion of staff are new, especially during rapid growth, outright fraud and other staff lapses can harm the organization.

Some warning signs that boards should watch for include:

- Incomplete, incorrect, or nonexistent board reports or financial information; management reluctance to provide information
- Inadequate forecasts or projections of portfolio, income, or expenses
- Portfolio concentration in one type of product, target market, region, or type of business
- Ongoing liquidity crisis

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[12] In "Weathering the Storm," by Daniel Rozas, the case of FuegoNord, an MFI in Nigeria, demonstrated how rapid growth and methodological design flaws can ultimately lead to a financial crisis. Read more at: http://centerforfinancialinclusionblog.files.wordpress.com/2011/07/weathering-the-storm-case-studies_110712_final.pdf.

- Overleveraged capital
- Increasing portfolio at risk (PAR) and/or rescheduled loans
- Extremely rapid growth, particularly if it stresses internal systems or occurs in highly competitive markets
- Evidence that the relevant market is becoming saturated
- Quickly growing loan sizes and/or longer repayment periods
- Staff incentive systems that overemphasize profitability
- High staff turnover, especially at the branch level
- Incidents of fraud, especially if the resolutions are inadequate and systems/ processes are not put in place to prevent future instances

The board has the unique opportunity to effect institutional change at many levels – strategically, financially, organizationally, and operationally – all of which hold risks to the MFI. However, these risks can be managed through the appropriate risk management practices.

6.3. Oversight and Compensation of CEO; Succession Planning

The board has a critical role in overseeing and evaluating the performance of the management team, especially the CEO. That role is reflected in questions raised to management at board meetings and in evaluating management performance and compensation, at least annually. Preferably, the board and management will have agreed on benchmarks as a driver of management compensation, particularly if incentives such as bonuses or profit sharing are involved. A variety of forms of compensation can be devised to align the incentives of the CEO with those of the shareholders and with the overall achievement of the MFI's strategic aims. These incentives can include performance bonuses in the form of shares or options to buy shares. It can be easier to structure incentives that focus on short-term financial returns, and so care should be taken to ensure that the CEO's compensation encourages focus on social performance and long-term institutional health.[13]

Succession planning is another key responsibility of the board. This is an important aspect of evolution from founder-based beginnings, but can be sensitive. The board should develop a pool of prospective replacements. Plans for succession should consider a variety of scenarios, such as a CEO's retirement at an appropriate age, a CEO's decision to leave without notice, medical or other emergency (illness or temporary absence of CEO), or untimely death. A leadership development plan aimed at employees with strong growth potential can be an important element

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[13] For more information on aligning incentives, please reference the CMEF's "Aligning Stakeholder Interests in NGO Transformations - Emerging Good Practices." January 2011.

in the overall approach to succession. With its succession plan the board should convey the message that the MFI is bigger than any single person.

6.4. Board Disputes

Board disputes or a schism over an issue or series of issues may well develop. Some of the most common "hot button" issues on boards include:[14]

- How fast to grow and where
- Which products to offer
- Which client segments to prioritize
- How to price products
- How to ensure that clients are treated responsibly
- What profit targets/allocation are appropriate
- What level of executive remuneration is appropriate
- How to finance the company, including which new creditors and owners to let in
- How to handle crisis
- How to exit

It is the role of the chair to try to mediate and resolve differences, preferably through discussion that ultimately results in consensus.

> **Good governance is the ultimate backstop for crisis prevention and management.**
>
> Daniel Rozas, "Weathering the Storm"

If consensus is not found, the board must resort to more formal processes. It may need to vote with one vote per director, unless a shareholders' agreement and the company charter clearly delineate other voting rights. Board members normally have equal votes, but if an issue reverts to a regular or special shareholders' meeting, then the shareholders will vote per the number of common shares (unless agreements or the company charter set out other voting rights).

6.5. Board Role in Crisis

Recent studies have highlighted the importance of governance during times of crisis.[15] The board should be prepared to identify times when major changes are needed and help the institution prepare for change.

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[14] McKee, Katharine. "Voting the Double Bottom Line: Active Governance by Microfinance Equity Investors." CGAP Focus Note No. 79. May 2012.

[15] "Weathering the Storm: Lessons in Microfinance Crisis Survival from Those Who Have Been There," Center for Financial Inclusion at Accion. July 2011, and "Failures in Microfinance: Lessons Learned." Calmeadow. June 2010.

> **The clearest and strongest conclusion derived from this study is that an institution's governance structure proved to be the primary differentiating factor between those entities that overcame a crisis and those that did not.**
>
> Beatriz Marulanda, "Failures in Microfinance: Lessons Learned"

The board's role as a force for change may become particularly important during a crisis, which could arise from any aspect of the institution's work: management, operations, finance, or external shocks. If the board loses confidence in management, it effectively takes management control. The board then has the responsibility to steer the MFI through the crisis, including and until a new CEO is recruited. This is often when an executive committee plays an important role. It will meet frequently during a crisis, possibly appoint one board member, e.g., the chair of the board or a member of management, as acting CEO, and report back regularly to the full board.

6.6. Executive Session

The board should reserve certain discussions and decisions for itself. Though made in consultation with management, these decisions should not be delegated to management. Examples include:

- Management performance, and a decision to fire senior management
- Executive selection and compensation
- Raising of additional capital
- Borrowing decisions (beyond existing interbank arrangements to bridge temporary liquidity needs)
- Appointment of external auditors and external legal counsel
- Payment of dividends; distribution of profits
- Transformation and intention to bring on new investors
- Major investments such as a new software/MIS system
- Mergers and acquisitions

The issues noted above involve 1) essential prerogatives needed for the board to hold management accountable for performance, and 2) decisions directly affecting the financial interests of shareholders. Time should be allocated regularly for the board to discuss these topics openly and frankly without management present.

7. Evolving Good Governance

Good governance is not automatic. It must be developed over time. Among the processes that boards can and should follow to improve their own functioning are:

Board training and exchange. Training sessions to ensure that the board understands how microfinance works and how to evaluate MFI performance. These can involve presentations by experts and members of MFI staff, or peer-to-peer exchanges with board members from other institutions.

Board retreats. Annual (or biennial) retreats of the board are especially helpful in building consensus among board members regarding the balance of social and financial objectives and in considering major advances in strategy. They also enhance the ability of board members to work with each other.

Opportunities to observe the business and talk with clients. Board members should participate in some field-based activities so they can gain a better understanding of the business operations on the ground.

Board evaluations. Boards should evaluate their structure, procedures, and performance at one- to two-year intervals. Ultimately, boards should strive to have an external board evaluation conducted to receive independent feedback. However, many boards opt to conduct peer and/or self-evaluations internally.[16] Regular assessments help boards gauge how close they are to good practice, identify areas of weakness, and make plans to address the weaknesses. Boards often neglect this important function.

Boards should engage in all of these activities in order to assure that they grow in their ability to take responsibility for their MFIs and lead them into the future.

"Board evaluations help to increase transparency, improve information on board roles, prepare the board for changes and new members, and increase the accountability of the board to shareholders."

David Dewez, Incofin

[16] A board self-evaluation template can be found at: http://www.cmef.com/document.doc?id=1023.

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Annex 2. Endorsement of the CMEF Governance Guidelines

The MicroFinance Network (MFN) is an international association of leading microfinance institutions. Through the MFN, 32 members from 27 countries share ideas, experiences, and innovative solutions to the challenges they face in search of continuous growth and progress. MFN members, whether commercial banks or NGOs, share the common belief that a MFI can serve more clients by establishing a sustainable and profitable institution. MFN members also believe that an MFI can maximize both financial and social performance by establishing innovative business models that can satisfy both financial and social goals of the institution. MFN members seek to be models of what is possible in the industry.

The MFN endorses the "Consensus Statement of the Council of Microfinance Equity Funds" on "The Practice of Corporate Governance in Microfinance Institutions" as a useful tool for the boards and management of microfinance institutions in establishing corporate governance policies and practices for their institutions.

For more information, please visit: www.mfnetwork.org

About the Statement

This statement on corporate governance for MFIs provides practical guidance for stakeholders in governance – investors, board members, and senior managers – to use in assessing the governance of their own MFIs. Since it was first published in 2005, microfinance institutions around the world have used this statement to guide their governance practices. Now updated to reflect new challenges in the microfinance sector, this revised version will contribute to an active process of improving governance among CMEF members and the microfinance industry as a whole.

About the Council

Since 2003, the Council of Microfinance Equity Funds (CMEF) has been the first membership organization to bring together the leading private entities that make equity investments in MFIs. The Council's members seek both social and financial returns from their investments in these institutions, all of which provide a range of financial services to poor households in developing countries. As an industry association, the CMEF convenes its members semiannually for in-person meetings and networking. Equity investors in microfinance face tremendous opportunities and challenges; at the same time they bear great responsibility for the health of the microfinance institutions they support. Issues of concern to equity investors range from pipeline development to governance to valuation. By offering a forum where investors can share their experiences and challenges, CMEF helps investors collaborate to address shared difficulties and improve the practice of investing in microfinance. In addition, the Council, through its secretariat at the Center for Financial Inclusion, represents the voice of equity investors through a range of ongoing industry initiatives.

For more information, please visit: www.cmef.com

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Equator Capital Partners
FINCA International
Grassroots Capital Partners
Grupo ACP
Incofin Investment Management
Lok Advisory Services
MicroVentures Investment
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Opportunity International
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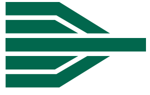
Triple Jump



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