RESPONSIBLE USE OF PROFITS

SPM ESSENTIALS: Practical strategies for today's management challenges

*SPTF has spent the past year updating the **Universal Standards for Social and Environmental Performance Management ("Universal Standards")** to reflect evolving industry best practices. The revised manual will be released in February 2022. To support implementation, SPTF is hosting a **webinar series** focused on new or updated concepts in the Universal Standards.*

SPEAKERS:

- **Amelia GREENBERG**; *Deputy Director*, SPTF (moderator)
- **Mitch GOMEZ**; *President,* GM Bank (Philippines) *(unable to join live; provided remarks in advance)*
- **KEA Borann**, *Chief Executive Officer,* AMK (Cambodia)
- **Padma RAJPAL**, *Social Performance Manager,* Dia Vikas, (India)

This webinar examined how financial service providers' (FSPs) can use profits in a way that benefits clients. As part of the update to the Universal Standards, Dimension 6 -- Responsible Growth and Returns – has been revised to strengthen and clarify management practices connected with a responsible use of profits. On the call, AMK and GM Bank shared examples of such management practices, including the specific ways they integrate client-centric decisions into their budget and business plans, as well as how they engage with socially committed investors. On the investor side, Dia Vikas shared how it promotes social performance through its investments.

GOALS FOR FSPS:

- Understand how to integrate client-centricity and social goals in use of profits

WHERE IS THIS IN THE UNIVERSAL STANDARDS?

- **STANDARD 6A:** The provider manages growth in a way that promotes its social goals and mitigates risks to clients.
  - **EP 6A1:** The provider's strategic and/or business plan establishes responsible growth targets.
  - **EP 6A2:** During times of high growth, the provider monitors more frequently data related to responsible growth.
- **STANDARD 6B:** The provider sets prices responsibly.
  - **EP 6B1:** The provider charges fair prices.
  - **EP 6B2:** The provider charges reasonable fees.
  - **EP 6B3:** The provider does not transfer unnecessary costs to clients.
- **STANDARD 6C:** The provider uses profits responsibly.
  - **EP 6C1:** The provider engages with equity investors whose investment strategy is aligned with the provider's social goals.
  - **EP 6C2:** The provider uses its profits for expenditures that benefit clients.
  - **EP 6C3:** The provider has a transparent financial and social structure.

UPDATES TO DIMENSION 6

Amelia Greenberg outlined the changes and clarifications to this dimension as part of the broader updates the Universal Standards. Specifically, the updated dimension:

- Focuses on elements of FSP growth specific to social performance, namely how an FSP should preserve their commitment to the social mission and mitigate risk to clients during times of growth.
- Revises the model used to define acceptable pricing ranges – notably the operating expense ratio – based on pricing data.
- More clearly defines "fair price" and "reasonable fees."
- Focuses on what an FSP realistically has control over in terms of relationships with its investors; while FSPs can't always choose the investors they want, they can position themselves to attract likeminded investors.

IMPLEMENTING DIMENSION 6: FSPS

Mitch Gomez of GM Bank and Kea Borann of AMK discussed how their organizations integrate client centricity and social goals into budget and operational decisions.

- **Begin by benchmarking your practices.** GM Bank conducts a social performance audit every three years to establish a baseline of management practices, which is vital in working toward its mission of improving outcomes for clients. "If you're trying to do good, you need to go beyond the regulation," Gomez said. " With an assessment…you really get a better sense of how you're doing and how you could be doing." He stressed the importance of using the audit's results to improve practices and to embed the concept of continually improving SPM throughout their organizations.
- **Investing in client-centric product design.** AMK invests in a research team that regularly studies clients' needs and preferences, as well as market changes. Every five years, it also studies how its products directly impact the customer. From this research, AMK has developed several products and services that have proven popular with clients. For example, approximately 80% of AMK's loan clients own a microinsurance policy for themselves or their spouse. Additionally, based on clients' needs, it introduced death benefits, such as free life insurance for small loan clients and uses its own profits to write off loans when a client dies. Such an investment in client centricity has helped AMK be sustainable despite a competitive Cambodian market.

Similarly, Gomez noted that when GM has not incorporated clients' needs during product design, it didn't work out well for the bank or for the customers. "Investments in a client-centric product design take time, money, and effort, but if it meets the clients' needs and their cash flow patterns, it's a win-win," Gomez said.

- **Aligning with likeminded investors.** AMK and GM highlighted the importance of finding investors who share similar social goals as your organization. "Alignment with our board has helped us invest in understanding our customer," Gomez said.
- **Balancing profit with flexibility.** Both organizations stressed how COVID demonstrated the importance of sacrificing short-term profits to help clients weather crises. If a customer tested positive for COVID, AMK waived two months of interest and penalty fees, and anyone in a lockdown had a three-month moratorium without penalties. GM Bank offered similar adjustments, and its clients are now able to start rebuilding businesses. "Calamities highlight the need for flexibility," Gomez said.

IMPLEMENTING DIMENSION 6: INVESTORS

Padma Rajpal shared how Dia Vikas embeds social performance throughout its investment process.

- **Assessing mission alignment of investees.** Mission alignment is the first step in Dia's due diligence and is a prerequisite for investment. Given that it makes early-stage investments, many of its investees are starting operations and do not yet have defined frameworks for meeting social goals. For these FSPs, Dia meets with senior management to assesses its intentions to improve SPM. It also examines employee practices, as well as client feedback mechanisms, which helps demonstrate that the potential investee is seeking out and incorporating the voice of the client in its decisions.
- **Requiring social audits and impact assessments.** Dia requires investees to conduct quarterly or annual SPI reporting and benchmarking, as well as other disclosures pertaining to governance and transparency. Dia also provides funding to help investees measure outcomes so that investees can see the benefit of collecting social data. "We expect them to institutionalize social performance within the organization and encourage partners to see value in using social data in their decision making," Rajpal said.
- **Defining responsible use of profits.** FSPs and investors should clarify expectations regarding responsible use of profits at the start of the investment process. Dia does not specify a rate of return against other commercial funders in the industry. However, it believes its requirement of social performance audits leads to partners increasingly use SPM in its decisions. For example, one of its partners reduced its interest rates to among the lowest in the industry after reporting growth and profit of around 140%. Additionally, another investee gives loyalty bonuses to clients who pay installments on time.