The SEEP NETWORK

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Social Return on Investment and Its Relevance to Microfinance

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Social return on investment (SROI) is an emerging concept in economic development. The term SROI generally refers to a method of measuring social benefits. It is expressed as social performance as a ratio to an input, typically capital. SROI is likely to become increasingly relevant in microfinance as the industry transitions from donor capital to private investment. In this context, SROI is a tool by which MFIs can demonstrate their social value, which is presumed to be important to attract socially responsible investors to participate in microfinance as well as to allocate different levels of socially responsible investment to those MFIs offering varying risk and social/financial return.

It is important to note up front that SROI is not impact assessment. Although SROI and impact assessment utilize similar information and similar methods, the two are distinct. SROI is a broader concept that includes impact assessment within its framework, but which also includes other concepts, such as monetized outcomes and cost-benefit analysis.

The purpose of this Progress Note is to introduce key concepts of SROI to the SEEP Network and broader microfinance communities. In the following sections, this Progress Note discusses factors contributing to SROI emerging on the microfinance agenda, explores SROI's value to microfinance institutions, describes some SROI tools with examples, and suggests next steps for microfinance practitioners in developing/promoting SROI within the microfinance industry.

SROI FRAMEWORK

The SROI framework is depicted in Figures 1 and 2. As seen in Figure 1, below, an organization creates value over time (t on the z axis). Its foundation is capital (investment on the x axis). The organization is built up from capital by a mission led, but market driven, plan (the y axis).

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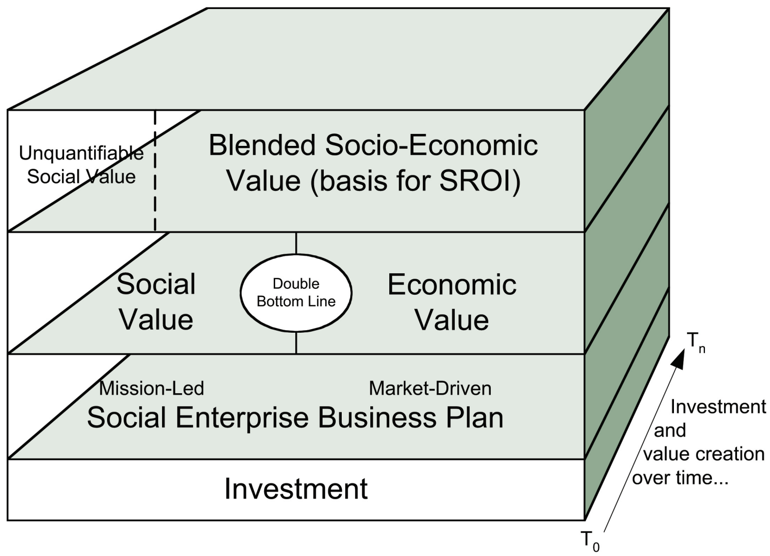
Figure 1: Understanding Value Creation

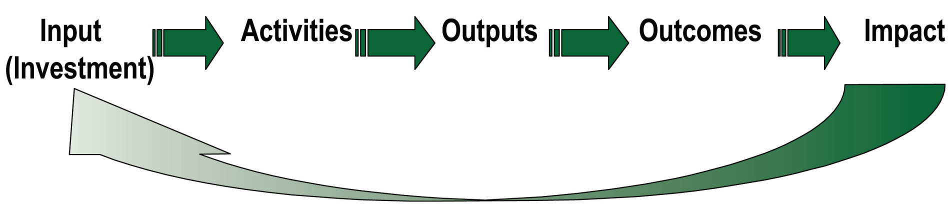


Source: Kim Alter, Virtue Ventures, SEEP Annual Meeting, October 2003

Implementing the plan creates social and economic value, measurable in quantifiable and unquantifiable ways.

In Figure 2, the SROI framework expresses the Y axis from Figure 1 above as a flow along a continuum. The input (investment) generates mission driven activities. These create outputs (a physical good, like a widget or a service, such as a loan). Outcomes are by-products of the outputs. Impacts are the results of outcomes. Impacts are in turn measured in relation to original output.[1]

Figure 2: SROI Framework Logic Model



Source: Drew Tulchin, Social Enterprise Associates paper, *Microfinance and the Double Bottom Line*

[1] The framework does not distinguish between direct or indirect results during the process of converting inputs to impacts. Proving the linkage between the input and the outcomes/impacts is common ground with impact assessment.

SROI AND MICROFINANCE

A combination of several factors has resulted in SROI being placed on the microfinance agenda. The following factors are both broad in origin and specific to microfinance.

Broad Factors

- Increased accountability for non-profits: Institutional and individual donors are increasingly demanding greater accountability and transparency from the non-profits they support. The charity model of doing "good works" is no longer sufficient justification for funding. Like their for-profit counterparts, non-profit institutions are expected to demonstrate their value added.

- United Nations' Millennium Development Goals (MDGs): The UN established the MDGs to eradicate extreme poverty and halve the number of poor people by 2015. This ambitious goal focuses on outcomes rather than inputs and draws attention to the social performance of development institutions and their ability to measure and demonstrate results.

- Growth in socially responsible investing (SRI): The SRI sector has sustained growth of 15% a year for more than a decade. SRI investments in 2003 totaled more than $2.2 trillion. Nearly one in nine professionally managed dollars in the US is invested with at least a social screen. Efforts to define and measure social benefits presumably increase the attractiveness of investment alternatives for socially responsible investors.

Microfinance Specific Factors

- Insufficient donor funds to address market demand: Demand for microfinance far exceeds donor supply of funds. Donors provide an estimated $500 million a year to microfinance. MFI growth requires billions of dollars. MFIs need to access new sources of private capital to meet global demand for microfinancial services.

- Need to define and differentiate MFI performance: Competition for capital between MFIs requires institutions to seek new ways to attract investor attention. Measuring social return offers MFIs an opportunity to differentiate themselves in the marketplace, especially when financial performance is similar, and raise attractively priced funds.

- Legislative mandate to demonstrate poverty outreach: Legislation requiring USAID-funded MFIs to demonstrate poverty outreach has propelled poverty assessment, and more generally social return measurement, to the top echelon of industry priorities.

In addition to the above factors, the rise of SROI on the microfinance agenda is attributed to the benefits it offers MFIs and other stakeholders. To MFIs, SROI offers:

- Promotes customer-centered service delivery.

- Makes measurement of social performance possible, providing management a mechanism to manage toward a double bottom-line.

- Provides information, enabling management to make more informed decisions.

- Improves financial and social bottom lines.

To external stakeholders, SROI offers the following potential benefits:

- Establishes transparency in documenting social performance.

- Permits comparisons between organizations in social performance.

- Links MFI performance to the UN MGDs.

- Connects a social return to the investment inputs.

- Increases investment flows into microfinance and improves efficiency of investment allocations.

SROI MEASUREMENT TOOLS

SROI measurement tools can be grouped into two categories. One group emphasizes process validation for performance-based indicators while the other focuses on outcomes and monetization.

Group 1: Process Validation

A fundamental driver of social return is taking a specified mission, consider the activities generated to accomplish it, and measure the outputs of those activities. The tools in this group emphasize how this is done by measuring business processes. Broadly, these tools tend to be descriptive and qualitative. Their primary use is tracking change over time and progression towards a goal in relation to the underlying mission. Tools in this group include (1) the Balanced Scorecard, (2) Global Reporting Initiative, (3) AccountAbility 1000, and (4) Calvert Foundation's SROI Calculator.

Balanced Scorecard. The Balanced Scorecard (BSC) expands beyond financial activity by establishing a link between and tracking of the mission, goals, and performance. BSC tracks organizational behavior in four areas: financial, customer, internal business processes, and learning/growth. In each of the four areas, management chooses goals, develops key indicators to represent core activities, and then compares performance with stated objectives.[2] The BSC is a practitioner-centered device that empowers management. It translates mission into concrete behavior and enables outcome tracking.

Global Reporting Initiative. The Global Reporting Initiative (GRI) establishes and publishes voluntary performance guidelines. It uses an oversight board, like the Financial Accounting Standards Board, to recommend procedures and enact changes to guidelines. Standardized reporting guidelines establish the variables to measure, indicate how to measure them, and provide data presentation formats. Indicators are divided into the following five areas: economic, environmental, social, human rights, and workplace. GRI's inclusive framework defines a role for all stakeholders. It emphasizes transparency, trend analysis, and incremental improvement.[3]

AccountAbility 1000. AccountAbility 1000 (AA1000) is "a foundation standard," which comprises principles and a set of process standards. A set of key principles aim to stimulate innovation above an agreed quality floor, rather than encouraging the development of a more rigid compliance-oriented culture. AA1000 focuses on engagement with stakeholders, seeking to link the defining and embedding of an organization's values to the development of performance targets, in order to tie social and ethical issues into the organization's strategic management. Organizational learning and improvement is seen as central to the approach, as is the link between organizational accountability and developing trust with stakeholders. As a process standard, rather than performance standard, AA1000 specifies the processes that an organization should follow to account for its performance, not the levels of performance the organization should achieve.[4]

Calvert Foundation's SROI Calculator. Calvert Foundation has developed its own SROI calculator using self-reported data from organizations in its portfolio. The web-based tool computes social outcomes based on a given investment amount in the Calvert portfolio. It provides a specific, readily understood, estimate of the social good produced by a specific monetary investment.[5]

Group 2: Social Outcomes and Monetization

Tools falling in this group seek to quantify social benefits. This is accomplished by monetizing social returns in relation to investment. A number of formulas have been developed to quantify the blended value of social and financial returns. The equations concentrate on net financial return and net social value divided by the investment costs for a given period. The precise measurement depends on the indica-

[2] For more information and details, see www.balancedscorecard.org.
[3] All materials are free to download, see www.globalreporting.org.
[4] Definitions are elaborated, see www.accountability.org.uk/aa1000/default.asp
[5] The tool can be used online, see www.calvertfoundation.org/individual/investment/index.html?source=

tors used, with a typical calculation estimating value creation through direct (e.g., increased incomes) and indirect (e.g., public expenditures saved) outcomes.

Freedom from Hunger's approach to measuring the SROI of its Credit with Education service delivery model is a good example of this type of tool. The mission statement (or value proposition) of Freedom from Hunger is to reduce malnutrition in children less than five years old. Consequently, its SROI tool estimates social return in four areas:

1. Lives saved due to information from health education.

2. Money saved by members due to the lower cost of financial services.

3. Net income earned by the organization offering Credit with Education services.

4. Subsidy invested to create and/or expand Credit with Education services.

The computation they use for their specific SROI is as follows:

1. Value of lives saved (number of lives saved * GNP per capita * life expectancy).

2. Net gain to the user (cost of borrowing from moneylender – cost of borrowing from organization offering Credit with Education).

3. Financial income to the MFI [income – (administrative costs + loan loss reserve + cost of funds)].

4. Investment costs (grants + subsidies).

Much work remains to refine existing tools and develop new ones to measure SROI. The field is young, but growing rapidly. There exists ample opportunity for microfinance researchers and practitioners to contribute to the discussion, test existing approaches or develop new ones, and disseminate lessons learned and other information.

NEXT STEPS

This Progress Note hopes to encourage practitioner activity in developing and adapting SROI for microfinance. The following actions are proposed.

- Add the topic of SROI to more microfinance conferences. Social return can readily be promoted in industry conferences, publications, and trainings. Given the mainstream growth of the concept, it is a good connector for microfinance to the greater SRI and investing public.

- SEEP working groups: This effort will utilize SEEP's established channels for supporting practitioner interest on the emerging subjects in the field and has begun to be incorporated in other areas of SEEP, including Social Performance.

- Involve social investors and donors: Encourage the Mix Market to work with the SRI community to identify their priorities and interests in social return and social return measurement.

- *MicroBanking Bulletin* issue: Once there is a critical mass of interest in SROI in the industry, devote a *MicroBanking Bulletin* issue to this topic.

The end goals of these proposed actions are to:

- Increase attention on MFI social performance.

- Develop standards for social return in microfinance.

- Incorporate new tools to inform management and investor decision-making.

- Increase socially responsible investment in microfinance.

It is hoped that practitioners will take the opportunity to participate in the process of building collective knowledge in this important topic and demonstrate the unique value-added of microfinance.

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