KEY PERFORMANCE INDICATORS FOR DEVELOPMENT FINANCE INSTITUTIONS

A COMPLETE USER’S PACKAGE
What is ADFIAP?

ADFIAP is the focal point of all development banks and other financial institutions engaged in the financing of development in the Asia-Pacific region. Its mission is to advance sustainable development through its members. Founded in 1976, ADFIAP has currently 120 member-institutions in 43 countries and territories. The Asian Development Bank is a Special Member of the Association. ADFIAP is also a founding member and currently the Secretariat of the World Federation of Development Financing Institutions composed of regional associations in Africa, Asia-Pacific, Latin America and the Middle East. ADFIAP is an NGO in consultative status with the United Nations' Economic and Social Council. ADFIAP is headquartered in Manila, Philippines.

Statement of Mission

“To advance sustainable development by strengthening the development finance function and institutions, enhancing capacity of members, and advocating development finance innovations.”

Statement of Vision

“Through the provision of development finance services by its members, ADFIAP envisions a future of lasting economic development and growth in the region, with its people as the ultimate beneficiary.”

ADFIAP MEMBERS
(as of April 2011)

1. Agrobank
2. Al-Amnah Islamic Bank of the Philippines
3. Anmar Credit Union
4. AMZ Ventures Limited
5. Andhra Pradesh State Financial Corporation
6. Antigua and Barbuda Development Bank
7. Asia Bank (Uzbekistan)
8. Asian Development Bank
9. Bank for Development and Foreign Economic Affairs (Russia)
10. Bank for Investment and Development of Vietnam
11. Bank Jabar Banten
12. Bank Kedah (Malaysia)
13. Bank Nagari
14. Bank of Bhutan Limited
15. Bank of Industry and Mine
16. Bank of Khyber (The)
17. Bank of Maldives
18. Bank of the Cook Islands
20. Bank Perusahaan Kecil and Sederhana Malaysia Berhad (SME Bank)
22. Bhutan National Bank Ltd.
23. Brunei Economic Development Board (The)
24. Business Development Bank of Canada
25. Capital Bank of Mongolia
26. Centre for SME Growth & Development Finance (India)
27. China Development Bank
28. Coalition of Socially Responsible SMEs in Asia
29. Commonwealth Development Authority
30. Credit Guarantee Corporation Malaysia Berhad
32. Development Bank of Kazakhstan
33. Development Bank of the Philippines
34. Development Bank of the Philippines
35. Development Bank of Sri Lanka (The)
36. Development Bank of Turkmenistan
37. DFCC Bank
38. Eco-Frontier (Korea)
39. Entrepreneurship Development Institute of India
40. Export-Import Bank of China
41. Export-Import Bank of India
42. Export Credit Guarantee Agency of Oman SAOC
43. Export Credit Guarantee Corporation
44. Export-Import Bank of Thailand
45. Federated States of Micronesia Development Bank
46. Fiji Development Bank
47. Fiji National Provident Fund
48. First Credit and Investment Bank Limited (Pakistan)
49. Global Coalition for Efficient Logistics Asia (Malaysia)
50. Global Procurement Consultants, Ltd.
51. House Building Finance Corporation Ltd.
52. Housing Development Finance Corporation Bank of Sri Lanka (The)
53. IDBI Bank Ltd.*
54. IFIC Ltd.
55. India SME Technology Services Limited
56. Indonesia Ekonomi (formerly Bank Bispor)
57. International Bank for Reconstruction and Development
58. International Bank for Reconstruction and Development
59. International Bank for Reconstruction and Development
60. International Bank for Reconstruction and Development
61. International Bank for Reconstruction and Development
62. International Bank for Reconstruction and Development
63. IPDC of Bangladesh Limited
64. Japan Export-Import Bank
65. Japan Economic Research Institute, Inc.
66. Japan Finance Corporation, Micro Business and Individual Unit
67. John Co Corporation
68. Kamataa State Financial Corporation
69. Korea Development Bank
70. Land Bank of the Philippines
71. Lanka Oxin Leasing Company PLC (Sri Lanka)
72. Landmark Development Bank
73. Local Water Utilities Administration (Philippines)
74. Malaysian Industrial Development Finance Berhad
75. Microfinance Development Association of Mongolia
76. Micro Finance Development Fund (Mongolia)
77. Ministry of Finance Malaysia (Malaysia)
78. Mongolian National Chamber of Commerce and Industry
79. National Bank of Samoa
80. National Bank of Uzbekistan
81. National Development Bank of Palau
82. National Development Bank, The PNG
83. National Housing Bank
85. National Small Industries Corporation Ltd., (The)
86. Nepal Development Bank Limited
87. Nepal Industrial Development Corporation
88. NBL Bank Limited (Pakistan)*
89. Nue Development Bank
90. Oman Development Bank
91. Oman Housing Bank
92. Pacific Islands Development Bank (Guam)
93. Pak-Bunei Investment Company Ltd. (Pakistan)
94. Pakistan Joint Investment Company Ltd. (Pakistan)
95. Pak-Kuwait Investment Company Pvt. Ltd.
96. Pak-Oman Investment Company (Pvt), Ltd.
97. Palestine Mortgage & Housing Corporation
98. Parastan Farda Investment & Financial Counselors Institute
99. Philippine Export-Import Credit Agency
100. Philippine Postal Savings Bank
101. Planters Development Bank of Philippines
102. Public Development Bank Limited (Nepal)
103. Queen City Development Bank (Philippines)
104. Ratha Sereichan
105. Royal Insurance Corporation of Bhutan Ltd.
106. Rural Development Bank (Cambodia)
107. Royal Insurance Corporation of Bhutan Ltd.
108. Sabah Development Bank Berhad (Malaysia)
109. Samoa Housing Corporation
110. Saudi Pak Industrial & Agricultural Investment Company (Pvt), Limited
111. Seylan Bank (Sri Lanka)
112. SIDBI Venture Capital Ltd.
113. Small & Medium Enterprise Development Bank of Thailand
114. Small Industries Development Bank of India
115. SME Bank, Ltd. (Pakistan)
116. SME Development Bank of Thailand
117. Small Industries Development Bank of India
118. State Insurance Corporation for the Insurance of Export-Credit & Investment
119. Syndicate Bank
120. Tekun Nasional
121. BMB Bank Public Company, Ltd.* (Thailand)
122. Tonga Development Bank
123. Trade and Development Bank of Mongolia
124. Turkish Republic of Northern Cyprus Development Bank
125. Vanuatu Agriculture Development Bank
126. Vietnam Development Bank
127. Zain Tanzania Bank Ltd., (Pakistan)
KEY SERVICES

E-Library
The ADFIAP e-Library is a repository of valuable reference materials on development banking and related topics compiled over three decades of existence of ADFIAP. The collection documents the writings and presentations of ADFIAP members about their development work and achievements, their successes as well as their failures.

ADFIAP Awards
The ADFIAP Development Awards, honors members that have contributed significantly to the development of their nations. Given annually, the Awards consists of both institutional and individual awards.

Country Host Program
The ADFIAP Country Host Programme is ADFIAP’s way of assisting chief executive officers and senior officers of member-banks in their travel concerns in cooperation with the local host-member. This includes arranging business meetings or appointments and provision of a temporary office/message center while the CEO or senior officer is busy attending to his appointments.

ADFIAP Events
ADFIAP Events is the Association’s business unit that specializes in organizing and managing specific and demand-driven activities, in addition to the formal training and credentialing courses offered by the Institute of Development Finance (IDF). These activities include conferences, symposia, exhibits and expos, study tours, and on-the-job programs.

ADFIAP Inform
ADFIAP Information program consist of both print and electronic publications provided to members on complimentary basis.

Table of Contents

<table>
<thead>
<tr>
<th>Page</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>Foreword</td>
</tr>
<tr>
<td>5</td>
<td>Framework and Road Map</td>
</tr>
<tr>
<td>9</td>
<td>KPI User and Reference Manual</td>
</tr>
<tr>
<td>35</td>
<td>Code of Practice: Governance (Appendix)</td>
</tr>
<tr>
<td>59</td>
<td>DFI’s Performance Evaluation Sheet</td>
</tr>
<tr>
<td>73</td>
<td>Non-Disclosure Agreement</td>
</tr>
</tbody>
</table>
BUSINESS UNITS

ADFIAP Consulting: Consulting and advisory group.

ADFIAP Responsible Citizenship Institute: CSR and outreach unit.

Asia-Pacific Institute of Development Finance: Professional career development, training and credentialing center.

INITIATIVES

A knowledge forum and business network in support of small and medium enterprises.
Website: http://www.smefi.com

Policies, practices and programs on bank corporate governance.
Website: http://www.governance-asia.com

Environmental governance standards for internal management and project finance.
Website: http://www.egs-asia.com
This ADFIAP Key Performance Indicators for Development Finance Institutions Manual (The Manual) was prepared and developed by the Association with one key objective in mind – to use and adopt this performance management and measurement tool as a standard for development banks.

ADFIAP has since been working to develop a performance measurement system for DFIs, one that encompasses the main and critical aspects of their “balancing” mission and mandate – operational sustainability and development impact.

There were already many available indicators in terms of measuring a DFI’s financial and governance performance but none existed on quantifying its development impact, including economic, social and environmental aspects.

Through in-depth research and the mathematical savvy of Dr. Cesar Saldaña, ADFIAP’s Adviser on Corporate Governance and Risk Management, ADFIAP believes it has developed the “holy grail” of performance management and measurement system for DFIs that can be adapted and contextualized based on the conditions where a DFI operates.

Part I of the Manual starts with the mission and the adoption of good governance practice of a DFI. Part II tackles the impact of the DFI on society in general by quantifying, on one hand, the benefits of the DFI to the country (development investment) and on the other, the cost (subsidies and failure/longevity rates) of the DFI to the country. Part III covers the DFI’s operational efficiency and effectiveness by measuring profitability, portfolio quality, capital and liquidity and efficiency and productivity. It also covers benchmarking over three target sectors, namely, microfinance, SMEs and social enterprise. Finally, Part IV deals with the performance of a DFI on economic, social and environmental aspects.

The manual also comes with a model code of governance practice used by the Community Development Finance Association (CDFA) of the United Kingdom and a KPI performance evaluation sheet.
After a series of “tests”, using actual and factual data from member-banks, the next step of the development process of this Manual is to produce a software that can be integrated into the bank’s existing information technology system for a seamless and real time report generation of the DFI’s performance.

Members as well as interested non-members of ADFIAP that would like to use and adopt this Manual are requested to formally write the Association being its proprietary developer as well as sign a simple non-disclosure agreement which is also part of this Manual.

ADFIAP is indebted to the work of Dr. Saldaña in the development of this Manual and wish to acknowledge the use of the code of governance practice of the UK-based Community Development Finance Association.

The ADFIAP Secretariat
Manila, Philippines
July 2010
Framework and Road Map
to examine or make copies of any listings, files, or other information and content of the Manual which come into the Contracting Party’s possession or control. The Contracting Party further acknowledges that disclosure of any information regarding the Manual will give rise to irreparable injury to the Author, inadequately compensable in damages. Accordingly, the Contracting Party hereby consents to obtaining by the Author of injunctive relief against the breach or threatened breach of the undertakings of the Contracting Party contained herein.

3. CONFIDENTIALITY

At the conclusion of the use of the Manual, the Contracting Party shall, and hereby agrees to, return the provided copy of the Manual to the Author, erase any information generated therein, whether such be in electronic, magnetic, printed or other form, except for the printed forms identified by the Author that are deemed necessary for the supervision, monitoring and evaluation of the process conducted. The Contracting Party further agrees to take such steps as maybe necessary or appropriate to maintain the confidentiality of the Manual during such time as the Manual may be evident on the other person’s computer equipment or, otherwise in the control of its employees, in a manner at least secure as the Contracting Party maintains as its own most confidential information and data.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

AUTHOR

________________________
Authorized Signature

__________
Print Name and Title

CONTRACTING PARTY

________________________
Authorized Signature

__________
Print Name and Title
AUTHOR-CONTRACTING PARTY NON-DISCLOSURE AGREEMENT

This Non-Disclosure Agreement ("Agreement") is made and effective [date].

BETWEEN: The Association of Development Financing Institutions in Asia and the Pacific (ADFIAP), the focal point of all development banks and other financial institutions engaged in the financing of development in the Asia-Pacific region, whose headquarters is located at 2F Skyland Plaza, Sen. Gil Puyat Avenue, Makati City, Philippines, hereinafter referred to as "Author"

AND: [ORGANIZATION’S NAME] with its offices located at: [COMPLETE ADDRESS] hereinafter referred to as "Contracting Party"

WHEREAS the Author has developed a proprietary knowledge and performance measurement manual called, "KPIs for DFIs", hereinafter referred to as "Manual" which the Contracting Party desires to use for their institutional strengthening;

NOW, THEREFORE, in consideration of the mutual promises contained herein, the parties agree as follows:

1. COLLABORATION
In order to explore the possibility of a future collaboration between the Author and the Contracting Party in using the Manual, the Author shall allow the use of its Manual by the Contracting Party solely for their institutional strengthening. The Contracting Party acknowledges that the Manual will be used for this sole purpose only and that it acknowledges that the Manual is a proprietary product of the Author.

2. PROPRIETARY RIGHTS
All applicable rights to patents, copyrights, trademarks and trade secrets of the Manual are retained exclusively by the Author, and the Contracting Party shall acquire no rights or interests in the Manual by virtue of the use of this from and to, the specified duration of the Manual’s use. The Contracting Party acknowledges that the confidentiality of the Manual is essential to the organizational work and interest of the Author. The Contracting party hereby agrees not to disclose to any person or organization whatsoever at any time during or after the specified period under this agreement, or to permit any person or organization whatsoever...
Non-Disclosure Agreement
Part VI. Benchmarking: Key Performance Areas

Rating

Very Good                  Good         Average      Needs Improvement      Unsatisfactory

Brief Explanation for the rating _________________________________________________
______________________________________________________________________________
______________________________________________________________________________
______________________________________________________________________________

Overall Rating

Rating

Very Good                  Good         Average      Needs Improvement      Unsatisfactory

Brief Explanation for the rating _________________________________________________
______________________________________________________________________________
______________________________________________________________________________

<table>
<thead>
<tr>
<th>Part III. External Benefits of DFI: Development Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rating</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Brief Explanation for the rating</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part IV. Indirect Cost of DFI: Subsidies and Failures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rating</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Brief Explanation for the rating</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part V. Internal KPIs: The DFIs Efficiency &amp; Effectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rating</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Brief Explanation for the rating</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>
KEY PERFORMANCE INDICATORS FOR DEVELOPMENT FINANCE INSTITUTIONS

PERFORMANCE REPORT

DFI: __________________________ EVALUATOR: __________________________

Part I. Mission of the DFI - The Basis of KPI Systems

Rating

Very Good  Good  Average  Needs Improvement  Unsatisfactory

Brief Explanation for the rating _______________________________________________
____________________________________________________________________________
____________________________________________________________________________
____________________________________________________________________________

Part II. DFI Activities for Priorities Sectors

Rating

Very Good  Good  Average  Needs Improvement  Unsatisfactory

Brief Explanation for the rating _______________________________________________
____________________________________________________________________________
____________________________________________________________________________
____________________________________________________________________________

1 Modified and revised for use by DFI from Community Development Finance Association, Hatton Square Business Centre, 16/16a Baldwin Gardens, London EC1N 7RJ
### Pre-requisites for Adoption of KPIs

**Questions to Test whether the Requisite Systems are Functioning**

**Assessment of the Present Capacity of the DFI to Support a KPI System**

1. **Mission Statement**
   - Is there a clearly articulated Mission, reflecting sustainable financial services to target sectors as the role of the DFI?
   - **Clarity in Mission Statement reflects DFI's focus on providing financial services to target sectors**
   - **Some clarity in Mission Statement which includes reference to finance service provision but not priority sectors**
   - **Partial evidence of Mission Statement which includes role but not all services**
   - **No formal Mission Statement at this time**

2. **DFI-wide understanding if the mission & its implementation into programs for target sectors**
   - Is there evidence that the Mission is understood by board, senior management and staff?
   - **Clear evidence of knowledge and understanding of Mission at all levels**
   - **Some evidence of knowledge and understanding of Mission at various but not all levels**
   - **Partial evidence of knowledge and understanding of Mission at some but not all levels**
   - **Little or no evidence of knowledge and understanding of Mission among most staff of the DFI**

3. **An installed and operating system of reviewing performance against targets called KPI**
   - Are there clearly defined Key Performance Indicators against which progress toward achievement is measured and reviewed?
   - **Clearly described performance indicators and targets against which progress is measured and reviewed**
   - **Some indicators against which progress is measured, relatively clearly described and reviewed**
   - **Only a few indicators, but progress using those indicators are not clearly described and reviewed regularly**
   - **A few indicators, but not particularly clearly described and no clear way of measuring progress against them**

### PART VI: BENCHMARKING: KEY PERFORMANCE AREAS

<table>
<thead>
<tr>
<th>Micro Finance</th>
<th>Small Business</th>
<th>Social Enterprise</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Loan Fund Sufficient</td>
<td>35%</td>
<td></td>
</tr>
<tr>
<td>2. Gross Yield</td>
<td>16.50%</td>
<td></td>
</tr>
<tr>
<td>3. Annual Write Off</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>4. Loan Officer Productivity</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>5. Operating Expense</td>
<td>64%</td>
<td></td>
</tr>
<tr>
<td>6. Operating Self Sufficient</td>
<td>40%</td>
<td></td>
</tr>
</tbody>
</table>
### Pre-requisites for Adoption of KPIs

<table>
<thead>
<tr>
<th>Pre-requisites for Adoption of KPIs</th>
<th>Questions to Test whether the Requisite Systems are Functioning</th>
<th>Assessment of the Present Capacity of the DFI to Support a KPI System</th>
</tr>
</thead>
</table>
| 4. Internal KPI for Reviewing the Sustainability of the DFI | Does the organization monitor its own outputs and results using Internal KPI? | ✗ Clear, regular monitoring of results and reporting with internal documentation  
✗ Some reporting of performance of results and with internal documentation, but not conducted on a regular basis  
✗ Some reporting of results but selective, and not on a regular basis  
✗ Little or no reporting of results outside of mandatory reports like financial statements |
| 5. External KPI for Reviewing the Impact of DFI on the Target Sector/Country | Does the DFI define, monitor and evaluate its outcomes and beneficial impact to the people/society and country using External KPIs? | ✗ Clear, regular monitoring of impact and reporting external documentation submitted to the government  
✗ Some reporting of outcomes and reporting in external documentation submitted to the government, but on intermittent basis, e.g., for parliament budgeting process and not regular  
✗ Some reporting of impact, but not external and not on a regular basis  
✗ Little or no reporting of the DFI’s impact on society |

### B. Corporate Governance and the Code of Practice for DFIs

Another requirement for an effective KPI system is good governance practices, especially because DFIs can lose all of their capital due to weak corporate governance structures and practices. ADFIAP is aware of the importance of good governance and has supported its members through seminars on that subject. It is probably the best time, now that KPIs are to be installed, for ADFIAP members to formally adopt a Code of Practice.
ADFIAP encourages its member DFIs to adopt a Code of Practice of Good Governance. DFIs must take that step because the results of KPI might be related to weaknesses in governance practices. To resolve such conflict, a DFI must first state its governance practices in the form of a Code of Practice. Appendix 1 presents the CDFA Code of Practice that the DFI can adopt with or without amendment.

PART II: DFI ACTIVITIES FOR PRIORITY SECTORS

External KPIs measure the volume and quality of DI of the DFI. Eventually, these investments are expected to benefit the target sectors. Part II explores the scope of the DFI operation, its strengths and constraints. KPIs measure the volume and quality of investments. Special target sectors like SMEs, entrepreneurs and new technology are given their own KPIs.

A. The DFI offers the following services indicated with (9):

- Long-term loans
- Short-term loans
- Import-export facility and financing
- Consumer credit (automobile loans and personal loans)
- Guarantee for loans of clients (stand-by credit facility)
- Management of assets held in trust for clients
- Long-term loans
- Advisory services (no fee)
- Consulting services (for a fee)
- Equity financing participation for new projects
- Residential housing loans
- Consumer credit (automobile loans and personal loans)
- Guarantee for loans of clients (stand-by credit facility)
- Management of assets held in trust for clients
- Others (Please list)


<table>
<thead>
<tr>
<th>Code</th>
<th>Key Performance Indicator Ratio</th>
<th>KPI Definition and Formula</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>SD-1</td>
<td>1. Subsidy Dependence Ratio</td>
<td>Total value of subsidy to DFI / Total revenues from loans and equity investments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SD-2</td>
<td>2. Subsidy Dependence Index</td>
<td>Total subsidy to DFI / (Average loan portfolio (L) x yield on loans (i))</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SD-3</td>
<td>3. Subsidy-adjusted Return on Equity (SA-ROE)</td>
<td>Subsidy-Adjusted Profit = (Accounting Profits - Profit grants) / Average Equity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SD-4</td>
<td>4. Subsidy-adjusted Return on Asset (SA-ROA)</td>
<td>Subsidy-Adjusted Profit / Average Total Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SD-5</td>
<td>5. Investment Loans to New Business [3 years in business]</td>
<td>Total Loan to New Business / Total Loans</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SD-6</td>
<td>6. Failure Rates of DI Beneficiaries</td>
<td>Number of failures during the year / Average total number of DI beneficiaries</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Years from Start-up to Failure</th>
<th>Total No. of Failed Beneficiaries of DI</th>
<th>Percent of Total Failures</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2-4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5-7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8-10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Over 10 years</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total No. of Failed Business Survivors (1997)</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>
The following sectors or beneficiaries are the priority target for services by the DFI:

1. **Economic Sectors**
   - Manufacturing
   - Forest products
   - Processing
   - Wholesale/Retail
   - Transport and Communication
   - Building and Construction
   - Real estate and lodging
   - Professional services
   - Social services
   - Agriculture (plantation)
   - Fishing
   - Others (list)

2. **Social Groups**
   - The poor (low income)
   - Women
   - SME
   - Small farmers, fishermen
   - Others (specify)

### PART III. EXTERNAL BENEFITS OF DFI: DEVELOPMENT INVESTMENT

<table>
<thead>
<tr>
<th>Code</th>
<th>Key Performance Indicators</th>
<th>KPI Definition and Formula</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>DI-1</td>
<td>Dl Ratio (Depth of DI)</td>
<td>Development Investment Loans / Average total assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DI-2</td>
<td>Dl Instrument (Breadth of DI)</td>
<td>Value of Dl by instrument / Total value of Dl</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DI-3</td>
<td>Dl Target Economic Sector (%)</td>
<td>Value of Dl for target economic sectors / Total value of Dl</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DI-4</td>
<td>Distribution of Dl by Sector (%)</td>
<td>No. of Dl per economic sector / Total number of Dl</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DI-5</td>
<td>Average Size of Dl ($)</td>
<td>Total value of Dl per sector / No. of Dl by economic sector</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DI-6</td>
<td>Share of Dl in Total Loans to each Economic Sector</td>
<td>Value of Dl per Sector / Total Value of Dl</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DI-7</td>
<td>Contribution to Entrepreneurial Development CED - Loans</td>
<td>Value of Dl committed for funding investment in new business / Total Amount of Dl</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DI-8</td>
<td>Contribution to Entrepreneurial Development CED - Advisory</td>
<td>Outreach: Number of new businesses / assisted by the DFI Number of clients assisted by the DFI to set up new business</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
concentrate its investments on non-DI assets, forego its priority sectors – and enjoy superior financial returns! Its weak performance over investing in priority sectors will be questioned. For a DFI’s performance to be sound and sustainable, it must perform well in its development investments and still be financially sustainable. Dual goals are a reality in development finance. A DFI is organized to take risks on behalf of the government to benefit the people.

DFIs are funds that DFIs commit to projects that benefit the target community/sector that commercial banks are unwilling to finance, being too risky. See Annex A for a list of different DI facilities that are accessed by DFIs. Included as DI are:

1. Debt or equity funds disbursed by DFIs and made available for investments with high development impact. Commercial banks do not finance projects with low short-term returns and high financial risk.
2. Funds provided by official development agencies (ODA) for relending to target sectors.
3. Funds that are committed for target sectors although not actually disbursed, e.g., “ear-marked” or guaranteed availability by a DFI.
4. Guarantees issued to commercial bank, underwriter, etc. in favor of a target beneficiary/sector to enable the latter to gain access to commercial bank funds or underwriter’s funds.
5. Infrastructure projects with very long term of cost recovery.
6. Residential housing loans.
7. New technologies.

The following loans are **not** DI.

1. Loans that would have been made by commercial banks to financially feasible development projects, e.g., structured financing for high risk, high profit development projects like bio-ethanol production.
2. All commercial short-term loans to established companies.
3. All consumption loans to individuals except residential loans, which are classified as DI.
4. Commercial real estate properties.
5. All capital expansion projects with proven markets.

An investment is classified as a DI or not based on adherence to the DFI’s mission and not to financial reporting rules like U.S. GAAP or IAS. The present accounting system reports assets and liabilities in terms of the nature of the instruments rather than whether DI or not. For this reason, referring to financial statements is not enough. A DFI must examine each loan, guarantee or equity investment and determine whether it is a DI or not. This will require the

---

**C. The DFI delivers the following types of Development Investments (DI) see Annex A for definition of DI.**

A. **Development Equity Investment**
   - Direct Equity Funding
   - Equity Funding of Projects through Subsidiaries
   - Equity Funding of Projects through Financial Consortia with banks

B. **Development Investment Loans**
   - Direct Lending to Beneficiaries
   - Financing of Projects through Apex Lending

C. **Innovative Financing of Development Investments**
   - Underwriting and Marketing of Securities on Behalf of a Particular Company
   - Guarantees Issued by the DFI over Development Loans of Company
   - Direct or Pass-Through Leasing Arranged by the DFI
   - Financing of Working Capital only for New and Innovative Industries
B. The following sectors or beneficiaries are the priority targets for services by the DFI. Identify and rank the top 3 target economic sectors of the DFI for the years 2007-2009

1) Economic Sectors
   Rank Top 3 only
   ___ Manufacturing (SMEs)
   ___ Forest products
   ___ Agriculture (Processing)
   ___ Wholesale/Retail
   ___ Transport and Communication
   ___ Building and Construction
   ___ Real estate and lodging
   ___ Professional services
   ___ Social services
   ___ Agriculture (plantation)
   ___ Fishing
   ___ Others (please list)

2) Social Groups. Identify and Tank Top 3 target social groups of the DFI from 2007-2009
   ___ The poor (low income)
   ___ Women
   ___ SME
   ___ Small farmers, fishermen
   ___ Others (please list)

Key Performance Indicators for the Development Investing Role of DFIs

The KPIs of DFIs are related to their two roles of making successful DI and maintaining profitable operations. The main focus of KPIs is to measure the achievement of development goals via the DI made by the DFI. KPIs measure the amount of benefits and development impact of the DFI’s investing activities.

1. Development Investments Ratio:

\[
\text{DI Ratio} = \frac{\text{DI}}{\text{TA}} = \frac{\text{Development Investments}}{\text{Average Total Assets}}
\]

Where: \[\text{Average Total Assets} = \frac{\text{Beginning} + \text{Ending Total Assets}}{2}\]

Interpretations:
- Measures the depth of a DFI with respect to its DI.
- The DI ratio’s denominator, average total assets, enables a comparison of the DI ratio across DFIs regardless of size of the DFI. A larger DFI could have a large DI but its DI ratio might be lower than a smaller DFI that used a higher percent of its assets for DI.
- Measures the intensity of a DFI’s development investment compared to non-DI assets.
- Can be benchmarked to other DFIs regardless of size.

2. Financial Instruments for Development Investment

\[
\text{DI Instrument} = \frac{\text{Value of DI by Instrument}}{\text{Total Value of DI}}
\]

Interpretations:
- Shows DI financial instruments (see Annex A for DI categories) used by the DFI in implementing its development mandate.
- Gives a breakdown of the investment funding used by the DFI, whether by traditional or by innovative means.
- Concentration of investments in a few types may show a need for the DFI to innovate to reach out to target sectors.
• Shows the limitations of DFIs over access to funds for development investments. Mandate of the DFI may need to be expanded.

3. Contribution of the DFI’s DIs in Target Economic Sectors:

   Target Economic Sectors DI (%) =
   \[ \frac{\text{Total Value of DI for All Target Economic Sectors}}{\text{Total Value of DI}} \]

4. Distribution of DIs by Sector (%) = \[ \frac{\text{No. of DIs per Economic Sector}}{\text{Total Number of DIs}} \]

5. Average Size of DI (per Sector) = \[ \frac{\text{Total Value of DI per sector}}{\text{No. of DIs by Economic Sector}} \]

Interpretations:
• Shows allocation of DI over the target vs non-target economic sectors. DFIs balance their constrained developmental roles vs making money on opportunistic commercial loans. This ratio shows how the DFI does its balancing act.
• Often, DFIs want to lend to priority sectors but the loan demand is in non-priority sectors. Stimulating growth of priority sectors is beyond the scope of DFI’s mandate. To avoid holding idle funds, DFIs face pressure to lend to non-target sectors.

6. Share of DFI in Each Economic Sector = \[ \frac{\text{Value of DI per Sector}}{\text{Total Value of DI + Com bank Loans}} \]

7. Share of Commercial Bank in Sector = \[ (1 - \text{Share of DFI in Each Economic Sector}) \]

Interpretations:
• Shows the distribution of DI by target sectors as to the average amount, number and size of DI.
• Benchmarking DFIs to Commercial Banks is possible. If data on loans by commercial banks are available, it is possible to calculate the share of DFI in the entire bank loans market and by industry sector.
• When loans data from commercial banks are available, one can determine the relative share of the DFI and commercial banks as well as the additionality of development investments. That is, following the essence of development banking, DI of DFIs are in addition to the loans market of commercial banks, e.g.,:

### Pre-requisites of KPIs

<table>
<thead>
<tr>
<th>Pre-requisites of KPIs</th>
<th>Questions to Test whether the Requisite Systems are Functioning</th>
<th>Assessment of the Present Capacity of the DFI to Support a KPI System</th>
</tr>
</thead>
<tbody>
<tr>
<td>5. External KPI for Reviewing the Impact of DFI on the Target Sector/Country</td>
<td>Does the DFI define, monitor and evaluate its outcomes and beneficial impact to the people/society and country using External KPIs?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>☐ Clear, regular monitoring of impact and reporting external documentation submitted to the government.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>☐ Some reporting of outcomes and reporting in external documentation submitted to the government, but on intermittent basis, e.g., for parliament budgeting process &amp; not regular.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>☐ Some reporting of impact, but not external &amp; not on a regular basis.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>☐ Little or no reporting of the DFI’s impact on society.</td>
<td></td>
</tr>
</tbody>
</table>

### PART II. DFI ACTIVITIES FOR PRIORITIES SECTORS

A. The DFI offers the following services indicated with (✓) and does not offer the ones indicated (✗).

- ✓ Accepting savings time and demand deposits from the public
- ✓ Long-term loans
- ✓ Advisory services (no fee)
- ✓ Advising services (for a fee)
- ✓ Equity financing participation for new projects
- ✓ Short-term loans
- ✓ Import-export facility and financing
- ✓ Residential housing loans
- ✓ Consumer credit (automobile loans and personal loans)
- ✓ Guarantee for loans of clients (standby credit facility)
- ✓ Management of assets held in trust for clients
- ✓ Others (please list)
  • ____________________________________________
  • ____________________________________________
  • ____________________________________________
### Pre-requisites of KPIs

<table>
<thead>
<tr>
<th>Pre-requisites of KPIs</th>
<th>Questions to Test whether the Requisite Systems are Functioning</th>
<th>Assessment of the Present Capacity of the DFI to Support a KPI System</th>
</tr>
</thead>
</table>
| 3. An installed & operating system of reviewing performance called KPI | Are there clearly defined Key Performance Indicators against which progress toward achievement is measured and reviewed? | ☐ Clearly described performance indicators & forward targets against which progress is measured & reviewed.  
☐ Some indicators against which progress is measured, relatively clearly described & reviewed.  
☐ Only a few indicators but progress using those indicators are not measured and reviewed regularly.  
☐ A few indicators, but not particularly clearly described & no clear way of measuring progress against them. |
| 4. Internal KPI for Reviewing the Sustainability of the DFI | Does the organization monitor its own outputs and results using Internal KPI? | ☐ Clear, regular monitoring of results & reporting with internal documentation.  
☐ Some reporting of performance of results & with internal documentation, but not conducted on a regular basis.  
☐ Some reporting of results but selective, & not on a regular basis.  
☐ Little or no reporting of results outside of mandatory reports like financial statements. |

- commercial banks deal with established SMEs while DFIs focus their DI on start-ups;  
- commercial banks lend to proven industries while DFIs give DI to pioneer industries;  
- commercial banks heavily rely on highly profitable consumer loans while DFIs do not have any in their portfolios; etc.

### 8. Contribution to Entrepreneurial Development -- Loans

CED -- Loans = \( \frac{\text{Value of DI committed for funding investment in new business}}{\text{Total Amount of DI}} \)

**Interpretations:**
- CED Loans shows the allocation of funds for DI to new business, budget vs actual. It can be compared to new businesses registered with the government (SEC, Ministry of Industry) to show how many were assisted by the DFI.  
- Assistance may be in a team effort with government ministry or Small Business Bureau to reduce risk. DFI is the last step in launching the business.

### 9. Contributions to Entrepreneurial Development -- Advisory

CED Advisory = \( \frac{\text{Number of new businesses advised/assisted by the DFI}}{\text{Number of clients assisted by the DFI to set up new business}} \)

**Interpretations:**
- CED -- Advisory shows the number and success rate of clients advised by the DFI to set up new business under DFI assistance.  
- Assistance other than lending enables the DFI to grow its services and outreach without increasing its risk.
PART IV. SUMMARY OF EXTERNAL BENEFITS OF DFI: DEVELOPMENT INVESTMENT

<table>
<thead>
<tr>
<th>Code</th>
<th>Key Performance Indicator</th>
<th>KPI Definition and Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>DI-1</td>
<td>1. DI Ratio (%)</td>
<td>Development Investments / Average Total Assets</td>
</tr>
<tr>
<td>DI-2</td>
<td>2. DI Instrument (%)</td>
<td>Value of DI by Instrument / Total Value of DI</td>
</tr>
<tr>
<td>DI-3</td>
<td>3. Target Economic Sector DI (%)</td>
<td>Value of DI for Target Economic Sectors / Total Value of DI</td>
</tr>
<tr>
<td>DI-4</td>
<td>4. Distribution of DI by Sector (%)</td>
<td>No. of DI per Economic Sector / Total Number of DI</td>
</tr>
<tr>
<td>DI-5</td>
<td>5. Average Size of DI ($) per sector</td>
<td>Total Value of DI per sector / No. of DI by Economic Sector</td>
</tr>
<tr>
<td>DI-6</td>
<td>6. Share of DI in Each Economic Sector (%)</td>
<td>Value of DI per Sector / Total Value of DI + Com Bank Loans</td>
</tr>
<tr>
<td>DI-7</td>
<td>7. Contribution to Entrepreneurial Development CED - Loans ($)</td>
<td>Value of DI committed for funding investment in new business / Total Amount of DI</td>
</tr>
<tr>
<td>DI-8</td>
<td>8. Contribution to Entrepreneurial Development CED - Advisory</td>
<td>Outreach: Number of new businesses/ assisted by the DFI Number of clients assisted by the DFI to set up new business</td>
</tr>
</tbody>
</table>

PART V. INDIRECT COST OF DFI: SUBSIDIES AND FAILURES

Because DFIs are set up by the government to be exposed to high credit and operational risk, subsidy from government to DFIs is a reality from the beginning. Many DFIs are organized with government providing most of their capital. One can now restate the objectives of DFIs to include the issue of subsidies, as follows: 1) to improve the socio-economic status of people by making the right DI and 2) to avoid subsidies and be financially and economically sustainable. Accounting rules might allow a DFI to show net income in its financial statements even if it is enjoying subsidies from the government. Financial reporting standards allow the subsidies to be treated as “Other Income”. This is one of the reasons why KPIs should distinguish financial from economic performance.

Annex B identifies different types of subsidies that may be enjoyed by a DFI. KPIs that measure subsidies by government and failures of beneficiaries of the DFI are likewise presented in Annex B. By combining the KPIs for DI and impact and those for subsidies and failures of beneficiaries, one gets a good picture of the external value and impact of the DFI to the country.
KPIs involving government subsidies are presented. All types of subsidies need to be identified in this ratio:

1. **Subsidy Dependence Index (SDI)**

   \[
   SDI = \frac{\text{Total Value of Subsidy to DFI}}{\text{Total Revenues from Loans and Equity Investments}}
   \]

   Where: Total Value of Subsidy = Equity grants + Revenue grants

   **Interpretations:**
   A DFI should aim for zero subsidy after the DFI has been set up. This happens when:
   - The government does not give any grant to the DFI and requires the initial capital of the DFI to be repaid.
   - The DFI entirely relies on its income and access to financial markets for sourcing funds.
   - The DFI takes the subsidy but pays back the government for the amount of subsidy plus social cost (social rate of return).

   The formula for SDI follows the definition of a subsidy. An alternative computational format is offered below for more precise interpretation:

2. **Subsidy Dependence Index (SDI)**

   \[
   SDI = \frac{\text{Total Subsidy to the DFI (S)}}{\text{Average Loan Portfolio (L) x Yield on Loans (i)}}
   \]

   + Income from Equity Investments (E)

   Or (for simplicity, ignore income from equity investments):

   \[
   SDI = \frac{S}{L \times i}
   \]

   with:
   - \( S \) = value of all types of subsidy received for the year
   - \( L \) = year-on-year average amount of loans portfolio
   - \( i \) = percent of gross income earned on loans for the year

   **Interpretation:**
   SDI is the ratio of subsidies given to the DFI to revenues from loans and equity investments. SDI>0 means there is some degree of dependence by the DFI on the government.

   SDI is the percentage increase in the yield of loans that will make the DFI subsidy-independent.
For example, a high subsidy DFI-1 whose SDI = 1.0 and yield is 8% would require yield to increase 100%, or double to 16%, before it could be free of subsidy. Another, DFI-2 with SDI = 0.20 and yield of 6% will require yield to increase by 20%, or 1.2% to 7.2% to be independent of subsidy. If DFI-2 has been subsidizing its interest charges to its clients, restoring yields to near market rates might do the job. Not likely for DFI-1. Its high subsidy probably indicates operating inefficiency and not just its rate subsidy to clients. Thus, there is a rule that DFIs should earn at least the social cost of capital (defined as the rate that the government earns if it moves its investment away from DFIs) and repay the government for the subsidy, if it wants to be subsidy-free.

Governments set up and capitalize a DFI, e.g., an SME Bank or an Export Guarantee institution, and then promise no further support in the future. The DFI is still subsidy-dependent. The DFI must earn the social cost of capital year after year to be subsidy-independent. If it does not, the DFI is subsidy-dependent even if it does not receive any grant from government after the DFI was set up.

It is often stated in the law creating the DFI that a minimum percentage of the DFI’s income must be remitted to the national government as dividend. Is this an example of “negative subsidy”, of DFI subsidizing government? The DFI needs to earn the social cost of capital each year and actually pay that to the government, not just dividends, to be considered subsidy-independent.

The summary measures of DFI performance like return on equity (ROE) and return on assets (ROA) will change if the government is granting subsidies. Their performance cannot be compared to DFIs that have been receiving subsidies.

To make them comparable, they must first be adjusted for subsidies as follows.

3. Subsidy-adjusted Return on Equity (SA-ROE)

\[
SA-ROE = \frac{Subsidy\ Adjusted\ Profit}{Average\ Equity} = \frac{(Financial\ Accounting\ Profits - Profit\ Grants)}{Average\ Equity}
\]

Where: Subsidy-Adjusted Profit = Financial Accounting Profit – (Discount on Public Debt + Revenue Grant + Discount on Expenses)

4. Subsidy-adjusted Return on Asset

\[
SA-ROA = \frac{Subsidy\ -\ Adjusted\ Profit}{Average\ Asset}
\]
Annex

DFI Business Principles

1. **Integrity**: A DFI will conduct its business honestly and in accordance with the standards of conduct agreed within the Sector for DFIs.

2. **Skill, Care & Diligence**: A DFI will also conduct its business with due skill, care and diligence.

3. **Management & Control**: A DFI will undertake to organize and control its affairs responsibility and effectively, with adequate risk management systems.

4. **Financial Prudence**: A DFI will maintain adequate financial resources at all times.

5. **Investors & Borrowers Interests**: A DFI will pay due regard to the interests of both investors and borrowers and treat them fairly.

6. **Rates of Interest**: A DFI will not charge rates of interest that are disproportionate to the level of risk involved. Interest rates will be fair in all the circumstances.

7. **Communications with Investors & Borrowers**: A DFI will undertake to communicate information to investors and borrowers in a way that is clear, fair and not misleading.

8. **Conflicts of Interest**: A DFI will manage any conflicts of interest arising out of its governance or business activities.

9. **Borrowers**: A DFI will take care to ensure the suitability of its advice and discretionary decisions relating to any borrower who is entitled to rely on its judgment.

10. **Complaints**: A DFI will deal honestly and efficiently with all complaints and if necessary will take part in conciliation or go to arbitration.

11. **Relations with Regulators**: A DFI will deal with their regulators in an open and co-operative way where appropriate.

12. **Social Impact**: A DFI will take steps to measure and report on its social impact.

5. Investment Loans to New Business (≤ 3 years in business)

\[
\text{Investment Loans to New Business} = \frac{\text{Total Loan to New Business}}{\text{Total Loan}}
\]

Where: new business are companies in commercial operations for maximum 3 years.

**Interpretations**:
- Shows share of new businesses in the loans portfolio of DFIs. Too high share might result in high failure rates, too low makes one question the DFI’s commitment to entrepreneurs.
- Benchmark the DFI to other DFIs because most commercial banks do not lend to new businesses.
- One should be aware of the risks involved and how the DFI is managing its risk of lending to new business.

6. Failure Rates of DI Beneficiaries

\[
\text{Failure Rates of DI Beneficiaries} = \frac{\text{Number of Failures during the year}}{\text{Total Number of DI Beneficiaries}}
\]

Where: average number of beneficiaries = sum of last 2 yearend balances/2

**Interpretation**:
- The ratio is a percentage of the total portfolio that failed each year.
- Definition of default: serious default in its loan repayment that called for loan restructuring or filing for bankruptcy.
- Compare with loans portfolio performance.

7. Longevity of Failed Businesses that Started-up with DI Support Over the Period 1994 – 2009

<table>
<thead>
<tr>
<th>Years from Start-up to Failure*</th>
<th>Total Number of Failed Beneficiaries of DI</th>
<th>Percent of Total Failures</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 – 1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 – 4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 – 7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8 – 10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>over 10 years</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total No. of Failures</td>
<td></td>
<td>100 %</td>
</tr>
<tr>
<td>Survivors</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Failure means either: a) permanent default on its obligations to the DFI under terms of the DI, b) bankruptcy of the business, or c) termination of operations of the beneficiary of the DFI.
Interpretations:

- Used mostly in rating survival rate of SMEs, it shows the contribution of DFI to increasing the sustainability of their client’s business.
- The benchmark is the average survival rate of DI beneficiaries in the country. Good DFIs have higher survival rates.
- Suitable for anticipating the risk – and support required – of start-up businesses.
- High rates of failure are expected in the initial years when start-ups do not have an assured market and resources are limited.
- May be classified further by economic sector as industry is a major survival risk factor.

PART VI. SUMMARY OF INDIRECT COST OF DFI: SUBSIDIES AND FAILURES

<table>
<thead>
<tr>
<th>Code</th>
<th>Key Performance Indicator Ratio</th>
<th>KPI Definition and Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>SD-1</td>
<td>1. Subsidy Dependence Ratio</td>
<td>Total Value of Subsidy to DFI / Total Revenues from Loans &amp; Equity Investments</td>
</tr>
<tr>
<td>SD-2</td>
<td>2. Subsidy Dependence Index</td>
<td>Total Subsidy to the DFI(s) / Average Loan Portfolio (L) x Yield on Loans (i)</td>
</tr>
<tr>
<td>SD-3</td>
<td>3. Subsidy-adjusted Return on Equity (SA-ROE)</td>
<td>Subsidy-Adjusted Profit = (Accounting Profits – Profit Grants) / Average Equity</td>
</tr>
<tr>
<td>SD-4</td>
<td>4. Subsidy-adjusted Return on Asset (SA-ROA)</td>
<td>Subsidy-Adjusted Profit / Average Total Assets</td>
</tr>
<tr>
<td>SD-5</td>
<td>5. Investment Loans to New Business (≤3 years in business)</td>
<td>Total Loan to New Business / Total Loan</td>
</tr>
<tr>
<td>SD-6</td>
<td>6. Failure Rates of DI Beneficiaries</td>
<td>Number of Failures During the Year / Average Total Number of DI Beneficiaries</td>
</tr>
<tr>
<td>SD-7</td>
<td>7. Longevity of Start up Businesses under DFI Support</td>
<td>Longevity of Start-up DFI-supported Businesses over a 10 year period or longer</td>
</tr>
</tbody>
</table>

PART VII. INTERNAL KPIs: THE DFI’S EFFICIENCY

Internal KPIs for DFIs are mainly financial ratios that are calculated to diagnose its condition and performance. The financial statements may be filled in using a customized electronic spreadsheet program (Excel) in order to generate the ratios that based on common definition (not yet available). Interpretations, by KPI, follow:

**Sustainability and Profitability (SP)**

1. **Loan Portfolio Self-sufficiency** - shows whether income from loans alone can cover the entire operating expenses of the DFI; and if sufficient, by how many times over coverage of annual expenses.

2.4.2 Procedures for dealing with complaints

DFIs should have in place speedy, responsive, and accessible and user friendly procedures for dealing with complaints from individuals and businesses lending or borrowing money from the CDFI. These must be publicized by DFIs at point of sale and/or in their contractual material at an appropriate point in the sales process. Information to consumers should also give information about the Financial Ombudsman Service and provide contact details.

2.4.3 Co-operation with local consumer advisors and intermediaries

Subject to holding the client’s written authority, DFIs should offer maximum co-operation with local consumer advisers or any other intermediary consulted by the individual or business making a complaint.

2.4.4 Conciliation

DFIs must offer complainants access to a conciliation service.

2.5 Publicizing the Code

**2.5.1 Customer Awareness**

DFIs must ensure that their customers are aware of this Code, make clear their adherence, to it, and any areas in which there is variation from the Code, and ensure that it is readily available without charge.
2.3.2 Clear repayment, default and cancellation arrangements

Arrangements for repayment should be clearly set out, as should arrangements/penalties relating to cancellation or payment.

2.3.3 Provisions of Advice/guidance to borrowers

The DFI should make clear what advice and support is available to borrowers once the loan has been taken out.

2.3.4 Compliance with consumer protection legislation

Where borrowers are individuals, the DFI must take care to comply with the Consumer Credit Act (where DFIs are entering into regulated agreements they will need to obtain a license from the Office of Fair Trading). In relation to borrowers who are individuals, the DFI must also comply with the Unfair Terms In Contracts Regulations.

2.3.5 Compliance with Advertising codes

DFIs must ensure that any advertisements must comply with any relevant code and/or legislation (e.g. The British Code of Advertising, Sales Promotion and Direct Marketing). DFIs should (take legal advice on) establish whether its products are ones which fall within the scope of the Financial Services Act.

2.3.6 The objective of DFIs is to provide access to finance where the mainstream financial services market is failing to deliver. DFIs should ensure that customers are aware of mainstream providers (prior to offering customers their own products), for example in the letter of offer or on their website.

2.4 Consumer Satisfaction/Complaints

2.4.1 Consumer (Satisfaction) Service

DFI should establish and monitor performance standards for key areas of their operations.

DFIs should assess consumer satisfaction on an ongoing basis.

2. Operational Self-sufficiency – same as (1) except that income is expanded to all sources of income.
3. Yield on Gross Loans Portfolio – earnings (in percent) from the gross loan portfolio
4. Average Cost of Deposits – percent of interest cost paid to depositors (in percent)
5. Average Cost of Borrowings – interest cost paid to DFI’s lenders (in percent)
6. Net Income/Capital – return on equity based on accounting rules (US GAAP or UK IAS). It will require adjustment if the DFI draws subsidies from the government.
7. Net Income/Total Assets – return on assets based on accounting and requires adjustment for subsidies that may be enjoyed by the DFI.

Portfolio Quality (PQ)

1. Rescheduled Portfolio at Risk – the percentage of the gross loans portfolio that has been restructured and still at risk
2. Annual Write-off Rate – the percentage of the gross portfolio value that was written off this year
3. Loan Loss Coverage (Times) – capacity of earnings to cover current year’s loan provision/expense. Ratio should be greater than 1, in which case, there is a margin of safety or excess income coverage.
4. Loan Loss Provision/Total Loans – this ratio specifies the value of the loss provision into a ratio of average loans. The resulting ratio is called provisioning rate. This is the balance sheet effect of loan loss provisioning.
5. Provision for Loss/Net Interest Earnings – the same value of loss provision is compared to net interest spread that will be used to pay for the loss. This is the income statement effect of provisioning.

Capital / Liquidity (CL)

1. Current Ratio – the simplest way to measure liquidity. Standards depend on the industry (non-financial or financial) and the sub-industry level (deposit-taking or not).
2. Capital to Risk Assets – the Basel capital adequacy reference of 8% for banks. The benchmark for non-deposit-taking banks may not be the same.
3. Capital to Loans – referencing capital to loans makes sense because credit risk is the most significant risk asset of most banks
4. Borrowed Funds to Risk Assets – shows the margin of safety to the creditors of the DFI in terms of the excess assets over its borrowings. Because those assets are at risk, this ratio should be less than 1 at all times.
**Efficiency and Productivity (EP)**

1. **Loan officer productivity** – the ratio implies that loan officers with a higher number of active borrowers are more productive under this ratio. This may be true for standardized credits like housing loans. In commercial loans, companies have complex loan packaging requirements and loan amounts are larger. Quality and creditworthiness of the borrower becomes the key productivity indicator. Both aspects of performance must be reviewed.

2. **Average disbursed loan size** – the average loan size is an important reference for assessing the average lending risk to clients and for knowing what loan officers will do when a client is way off normal risk.

3. **Cost per active loan outstanding** – this is a cost allocation to the most important activity of the bank – loans – but can be misleading because banks do a lot more than lending.

4. **Operating expense ratio** – this is another cost allocation exercise of distributing operating expense over to the average loan portfolio. This ratio can be matched to the yield of the gross loans portfolio in SP-3.

**PART VIII. SUMMARY OF INTERNAL KPIs: THE DFI’s EFFICIENCY**

<table>
<thead>
<tr>
<th>Key Performance Area</th>
<th>Code</th>
<th>Key Performance Indicator Ratio</th>
<th>KPI Definition and Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sustainability and Profitability (SP)</td>
<td>SP-1</td>
<td>1. Loan Portfolio Self-sufficiency</td>
<td>Revenue from loan portfolio / Total expenses</td>
</tr>
<tr>
<td></td>
<td>SP-2</td>
<td>2. Operational Self-sufficiency</td>
<td>Revenue from all earned income / Total expenses</td>
</tr>
<tr>
<td></td>
<td>SP-3</td>
<td>3. Yield on Gross Loans Portfolio</td>
<td>Interest expense on deposits / average deposits</td>
</tr>
<tr>
<td></td>
<td>SP-4</td>
<td>4. Average Cost of Deposits</td>
<td>Interest expense on borrowings / average borrowings</td>
</tr>
<tr>
<td></td>
<td>SP-5</td>
<td>5. Average Cost of Borrowings</td>
<td>Net income / Average capital</td>
</tr>
<tr>
<td></td>
<td>SP-6</td>
<td>6. Net Income / Capital</td>
<td>Net income / Average assets</td>
</tr>
<tr>
<td></td>
<td>SP-7</td>
<td>7. Net Income / Total Assets</td>
<td></td>
</tr>
</tbody>
</table>

**2.2.1 Responsibility not to mislead**

DFIs must be careful not to mislead investors, especially into thinking that their financial promotions are subject to regulation by a statutory agency (e.g. in the case of I&P Societies, by the FSA via the Financial Services & Markets Act 2000) when it is not the case. The Board must ensure that the wording of any share issues or invitations to invest in the DFI have first been approved by a suitable qualified person.

**2.2.2 Transparency about Risk**

Investors must be given enough information to make an informed decision and the element of risk should be made explicit (e.g. that loan undertaken by DFIs may be unsecured). Accounts and reports to investors should be clear and transparent and not mislead investors about the financial health of the DFI.

**2.2.3 Targeting Investors**

DFIs should endeavor to target prospective investors who are equipped to understand the risk (or have access to external, professional advice, attached to their investment). Exceptions to this will be membership organizations offering fixed, low cost shares as a form of membership of the DFI.

The Board must ensure that prospective investors understand that investments in DFIs are risk capital, and not equivalent to deposits. (With the exception of DFIs that are banks)

**2.2.4 Identification of Investors**

Especially in the case of prospective retail inventors, DFIs should take reasonable steps to verify their identity with a view to preventing money laundering.

**2.3 Marketing Financial Products**

**2.3.1 Clarity in respect of loan interest rates**

There should be clarity in respect of the interest rates that will be charged and any additional fees that may be incurred in borrowing money.
DFIs should take out appropriate insurances to cover the organization against losses arising from fraud. This should include Fidelity Insurance and/or Officers and Directors Insurance.

### 2.1.12 Money Laundering & Proceeds of Crime Act

Clarity when this is necessary and then appoint or designate a suitably trained Money Laundering Reporting Officer (MLRO). This may be internal or external appointment. In smaller DFIs, the role of MLRO may form part of a staff member’s responsibilities.

The function of the MLRO will be:
- To establish and maintain procedures to prevent money laundering
- To establish and maintain awareness among the DFI’s staff of the procedures to prevent money laundering, including the provision of training
- Receiving internal money laundering reports on suspicious activity
- Making external reports to the Serious Organized Crime Agency (SOCA) if it is considered that the suspicion is justified. This must include full co-operation with SOCA, and the identification of individual borrowers and information about their accounts if required, irrespective of duties and confidentiality

DFIs must be satisfied about the validity of the identity of all borrowers.

### 2.1.13 Conflicts of Interest

Members of staff are required to declare any conflict of interest arising in connection with the DFIs activities, whether financial or other, which might influence their decisions or lead to personal gain.

### 2.1.14 Staff Training & Appraisal

Systems should be in place to ensure that staffs are offered appropriate induction and training to enable them to carry out their duties and those appraisals are carried out to assess levels of professional competence. This should include training in the operation of this Code of Practice.

### 2.2 Raising Investment/Financial Promotions

When raising funds by means of a prospectus, advertising or website, a DFI should observe the following:

---

### PART IX. BENCHMARKING: KEY PERFORMANCE AREAS

Benchmarks are useful for DFIs that are seeking acceptable target performance levels and good/best practice standards. There is an association of Community Development Institutions (CDFI)\(^2\) that has published benchmarks representing current good practice amongst UK CDFIs. They are intended to act as goals or targets, particularly for younger organizations. DFIs are very close to CDFIs in terms of orientation to development and their focus on the disadvantaged sectors. They can be

---

\(^2\) Community Development Finance Association, Hatton Square Business Centre, 16/16a Baldwin Gardens, London EC1N 7RJ  For info, email to this address: info@cdfa.org.uk
used as initial benchmarks and possibly replaced by peer groups of DFIs. The benchmarking is done using a three-step technique as follows:

1. Determine KPIs for main market(s) served – Core markets of the CDFI determine the benchmarks to be used. Clients of the DFI shape the way DFIs operate. Benchmarks are usually the average values of KPIs of peer DFIs operating in their respective main markets. If the DFI is operating at several markets, its KPI must be measured separately for each market. The core markets served by CDFIs are:
   - Individuals for housing and consumer loans
   - Microfinance
   - Small business
   - Social enterprise

2. The KPIs selected for benchmarking should be reviewed and adjusted as follows:
   - Adjust for the age and maturity of DFI because the CDFI benchmarks are based on mature organizations. The benchmarks broadly apply to organizations with a minimum of five years of lending experience.
   - Adjust for differences in DFI size and delivery models. Peer comparisons are most effective for DFIs that have the same delivery models. Two obvious different delivery models – wholesale or retail lending and deposit-taking and non-deposit-taking DFIs – should have different benchmarks for each type of financial service delivery. One should not attempt to critique the superiority of one over the other when interpreting the benchmarks.

3. Review interlinked factors together to draw a complete picture. According to CDFI, strong performance on one benchmark may directly impact (sometimes negatively) performance over another. Some of these key relationships applied to DFIs include:
   - Good self-sufficiency vs outreach/impact and vice versa – Some DFIs might target the very hardest to reach, riskiest customers in their chosen market. As a result, these DFIs will show significant social and economic impacts. However, this concentration can affect overall organizational self-sufficiency because it is costly.
   - Low efficiency vs successful handling of local cultural and environmental practices – Some DFIs operate in adverse environments which can affect efficiency measures (such as self-sustainability ratios or loan officer productivity). DFIs might be prevented from delivering services in rural contexts.

2.1.6 Key Performance indicators

The DFI will operate within the DFI performance Framework and use the framework’s performance indicators as a basis for reporting to the Board alongside statutory/management accounts.

2.1.7 Portfolio Management

Effective systems should be implemented to facilitate due diligence in advance of lending and also post-lending portfolio management.

2.1.8 Internal controls

A set of procedures designed to protect against financial mismanagement and fraud. These will include:
   - Separation of duties, in such a way that more than one person has to be involved in important decisions/processes
   - Checklists and signing-off, signifying that specific checks or procedures have been followed
   - Restricting authority with the help of third parties, for example bank mandates and standing instructions to solicitors

2.1.9 External Audit

All DFIs should ensure that:
   - External Auditors are independent and effective
   - There is a proper procedure for their selection
   - A periodic review of their appointment takes place

2.1.10 Internal Audit

Larger DFIs may separate out an internal audit function (perhaps by setting up an audit committee) that should have an overview of:
   - Finance Reporting
   - Internal Controls
   - External Controls

2.1.11 Insurance
• Some DFIs have charitable objectives and are also registered as charities with the Charity Commission.

As a result, there is no one regulatory body, but several: Companies House, the FSA and the Charity Commission. Although there is no one set of regulations to which all DFIs have to conform, there are clearly a range of issues where ‘best practice’ is essential (see below).

2.1 Systems & Control

The Board needs to satisfy itself that there are adequate systems and controls in place to ensure that the DFI is well managed, is financially sound and that all risks are mitigated. These should include:

2.1.1 Business Planning

The DFI should produce a business plan that is updated and reviewed on a regular basis, at least annually.

2.1.2 Budget & Cash Flow

The DFI must produce and work to an annual budget and regular cash flow analyses, against which performance should be reviewed on a regular basis throughout the financial year. This would normally be carried out on a monthly basis and should be done at least quarterly.

2.1.3 Accounts

The DFI must maintain a system of management accounting leading to year-end audited accounts, undertaken by a suitably qualified external auditor.

2.1.4 Solvency/Liquidity

The DFI must maintain adequate capital resources and liquid assets commensurate with the nature and scale of its business and the risks inherent in its business.

2.1.5 Reserves

The DFI should aim to build up appropriate reserves to underpin their operations, based on policies and projections commensurate with the scale of their operations and risk profiles.

• High annual write off vs. “high” loan officer productivity – There is a trade-off between high loan officer productivity and reducing or lower annual write offs. For many DFIs, striking a balance between efficiency and quality is an on-going strategic and management challenge. Overloaded loan officers may look efficient but the lack of intensity in supervision of the account results in higher write-offs.

Table 1: Example of Benchmarks – UK’s CDFI

<table>
<thead>
<tr>
<th>DFI Target Sectors</th>
<th>Loan Fund Self-sufficiency</th>
<th>Gross Yield</th>
<th>Annual Write/Off</th>
<th>Loan Officer Productivity</th>
<th>Operating Expense</th>
<th>Operational Self-sufficiency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microfinance</td>
<td>35%</td>
<td>16.50%</td>
<td>9%</td>
<td>100</td>
<td>64%</td>
<td>40%</td>
</tr>
<tr>
<td>Small Business</td>
<td>50%</td>
<td>14.50%</td>
<td>12%</td>
<td>82</td>
<td>48%</td>
<td>55%</td>
</tr>
<tr>
<td>Social Enterprise</td>
<td>48%</td>
<td>5.50%</td>
<td>3%</td>
<td>20</td>
<td>18%</td>
<td>75%</td>
</tr>
</tbody>
</table>

PART X. SUMMARY OF KEY ECONOMIC AND FINANCIAL PERFORMANCE INDICATORS FOR SUCCESSFUL AND EFFICIENT DFIs

Key economic and financial Performance Indicators will show that a DFI, being an instrument of Public Policy, is a successful and sustainable institution when:
• it meets its primary mission and achieves its development goals
• its business activities are focused on Priority Target Sectors
• it continues to invest for development projects with growing outreach in both number and geographic distribution of projects. In this way, more entrepreneurs open their small businesses
• it meets its social goals of developing SMEs and nurturing entrepreneurs and promoting new technologies
• it is independent of subsidy in whatever form after its initial set-up
• it is economically efficient and financially self-sustaining at a scale comparable to performance ratings of benchmark DFIs
PART XI: ECONOMIC, ENVIRONMENT AND SOCIAL PERFORMANCE INDICATORS

**ECONOMIC CODE**

<table>
<thead>
<tr>
<th>Description of Performance Indicator (GRI Code)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EC2 Financial implications and other risks and opportunities for the organization’s activities due to climate change (EC2)</td>
</tr>
<tr>
<td>EC4 Significant financial assistance received from government (EC4)</td>
</tr>
</tbody>
</table>

**Market Presence**

<table>
<thead>
<tr>
<th>Description of Performance Indicator (GRI Code)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EC7 Procedures for local hiring and proportion of senior management hired from the local community at significant locations of operation (EC7)</td>
</tr>
</tbody>
</table>

**Indirect Economic Impacts**

<table>
<thead>
<tr>
<th>Description of Performance Indicator (GRI Code)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EC8 Development and impact of infrastructure investments and services provided primarily for public benefit through commercial, in-kind, or pro bono engagement (EC8)</td>
</tr>
</tbody>
</table>

**ENVIRONMENT CODE**

<table>
<thead>
<tr>
<th>Description of Performance Indicator (GRI Code)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EN1 Materials used by weight or volume (EN1)</td>
</tr>
<tr>
<td>EN2 Percentage of materials used that are recycled input materials (EN2)</td>
</tr>
<tr>
<td>EN4 Indirect energy consumption by primary source (EN4)</td>
</tr>
<tr>
<td>EN51 Energy saved due to conservation and efficiency improvements (EN51)</td>
</tr>
<tr>
<td>EN8 Total water withdrawal by source (EN8)</td>
</tr>
<tr>
<td>EN11 Location and size of land owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas (EN11)</td>
</tr>
<tr>
<td>EN19 Emissions of ozone-depleting substances by weight (EN19)</td>
</tr>
<tr>
<td>EN26 Initiatives to mitigate environmental impacts or products and services, and extent of impact mitigation (EN26)</td>
</tr>
</tbody>
</table>

**SOCIAL CODE**

<table>
<thead>
<tr>
<th>Description of Performance Indicator (GRI Code)</th>
</tr>
</thead>
<tbody>
<tr>
<td>LA1 Total workforce by employment type, employment contract, and region (LA1)</td>
</tr>
<tr>
<td>LA4 Percentage of employees covered by collective bargaining agreements (LA4)</td>
</tr>
<tr>
<td>LA6 Percentage of total workforce represented in formal joint management-worker health and safety committees that help monitor and advise on occupational health and safety programs (LA6)</td>
</tr>
<tr>
<td>LA10 Average hours of training per year per employee by employee category (LA10)</td>
</tr>
<tr>
<td>LA14 Ratio of basic salary of men to women by employee category (LA14)</td>
</tr>
</tbody>
</table>

1.7.6 Whistle blowing

The Board should have a whistle blowing policy and procedures to allow confidential reporting of matters of concern, such as misconduct, misuse of funds, mismanagement, and risk to the DFI or to people connected with it.

The policy and procedures will need to be commensurate with the size of the DFI, but should:
- Be accessible and open to staff, Board members and partners of the DFI
- Provide for those who are not confident about raising a concern with their line manager or a senior manager to have direct access to a Board member, an independent person or a regulatory body
- Ensure people who raise such concerns in good faith that they need have no fear of reprisals or other adverse consequences
- Ensure that all such concerns will be properly assessed and investigated in a way that is fair to the whistleblower and others involved
- Provide for appropriate action to be taken where a concern is shown to be well founded

1.8 Group Structures

In some instances, DFIs operate a group structure involving two or more legal entities operating together, to deliver different services. Where this is the case, it is essential that the Board of each organization operates discretely, always strictly within the terms of reference of each organization and in accordance with the requirements of the organization responsible for regulation (e.g., FSA, Companies House & the Charity Commission).

2. Practical Issues

There are various legal forms currently used by DFIs including:
- Companies Limited by Guarantee
- Companies Limited by Share
- Industrial & Provident Societies
- Banks
- Limited Liability Partnerships
- Community Interest Companies
1.7 The Board and Risk

The Board must act prudently to protect the assets and property of the DFI, and ensure that they are used to deliver the DFI’s objectives and mission. The Board must regularly review the risks to which the DFI is subject, and take action to mitigate risks identified.

1.7.1 Avoidance of risk

The Board must avoid undertaking activities which might place at undue risk the DFI’s clients, shareholders, investors, staff, property, assets or reputation, or that might risk damaging the DFI sector or the DFI.

1.7.2 Investment and borrowing risk

The Board must exercise special care if investing the DFI’s funds, or borrowing funds for it to use, and must comply with its governing documents or standing orders and any other legal requirements in so doing.

1.7.3 Risk Assessment

Board members should understand the risks facing the DFI, and how these are managed and minimized. The Board should undertake a full risk assessment (either periodically or on a rolling basis) and take appropriate steps to manage the DFI’s exposure to significant risks.

1.7.4 Professional Advice

The Board should obtain advice from professional advisers or others on all matters where there may be material risk to the DFI, or where Board members may be in breach of their duties.

1.7.5 Dealing with conflict

The Board should take ultimate responsibility for ensuring that conflicts that may arise within the DFI are effectively dealt with and managed. This includes conflicts arising between Board members, staff, the Chief Executive, members (where applicable) and clients.

---

### ANNEX A: DEFINITION AND MEASUREMENT OF “DEVELOPMENT INVESTMENT”

Development Investments are funds that commercial banks would not have made available for investment, e.g., because of these projects’ low short-term returns and high risk, regardless of high development impact. The following are examples of development investments:

#### A. DEVELOPMENT EQUITY INVESTMENTS

1. **Direct Equity Funding**
   
   The DFI contributes equity to establish a company. The equity funds were taken from its own funds and will earn dividends or be lost depending on the success of the company.

2. **Equity Funding Through Subsidiaries**
   
   The DFI may set up subsidiaries that will make the DFI. This is a way of controlling the risk that failures of DFI might affect the DFI. The DFI may invest in a subsidiary that will undertake the investment itself. The DFI aims to establish a presence in a growth sector with the intention of privatizing it after sometime.

3. **Equity Funding Through Financial Consortia**
   
   The establishment of a large company can be financed by a consortium of private investors, private financing institutions, and DFI. The idea behind this scheme is to engage the private sector in financing development projects.

#### B. DEVELOPMENT INVESTMENT LOANS

1. **Direct Lending**
   
   Direct lending is when the DFI gives long-term loans directly to the investor.
2. Financing Through Apex Lending

Apex Lending is when the DFI gives loans to commercial banks for re-lending to the real investor. DFIs call it “wholesale” lending or relending funds. The DFI specifies the purpose of the loan. Apex lending offers the following advantages to DFIs:

a. it is able to expand its operation and reach more clients with better volume and profits
b. the clients will be gradually trained to deal with commercial banks and gradually absorb market interest rates
c. it can reduce its administrative costs because credit risk is absorbed by the retail banks

C. INNOVATIVE FINANCING OF DEVELOPMENT INVESTMENTS

1. Underwriting or Marketing of Securities on Behalf of a Particular Company Underwritten by the DFI

In addition to applying its own funds DFIs can raise capital for a company in the target sector or pioneering a new industry. An example is when the DFI underwrites the equity or bond issue for a particular company, with or without its guarantee, and re-sells the security to the public. A significant contribution by DFIs for increasing investment in development projects, it is included as a DI for the amount underwritten and re-sold by the DFI. By underwriting and marketing these securities, the DFI gets the public to invest in growth industries that the DFI endorses to the public.

2. Guarantee Issued by the DFI Over Development Loans by a Company

Loans to pioneer companies that are covered by guarantees issued by DFIs should be included in the calculation of DI if the following assumptions hold:

a. the investor is not able to get those loans from a commercial bank without the guarantee of the DFI
b. the proceeds of the loan will be used for industries or sectors targeted by the DFI

This is a common practice in funding small and medium enterprises whose investors have not yet proven their creditworthiness to the commercial banks. Issuing guarantees instead of direct funding or lending gives significant leverage to the DFI.

3. Direct or Pass-Through Leasing Arranged by the DFI

Direct or pass through leasing arranged by the DFI are considered DI since it was able to support an investor whose strained finances make it unable to buy the equipment. In direct lease the DFI buys the equipment and leases it to the investor, thereby relieving it of

Amongst DFI the most common of these subcommittees are those dealing with lending/loans, investment, risk management and finance/audit.

1.6.1 Terms of Reference

Each subcommittee should have clear terms of reference approved by the Board and should report regularly to the Board.

1.6.2 Membership of Subcommittees, and delegation of decision making

Dependent on the governing document or standing orders, of any subcommittee, whether it has delegated authority or not. The Board must therefore agree and set out in writing any delegation of authority or not. The Board must therefore agree and set out in writing any delegation of authority in the terms of reference of each subcommittee. The powers delegated must be set out in detail, and make clear any limits to the decision making powers of the subcommittee, and at what point decisions should be referred to the main Board.

A subcommittee with delegated powers of decision making should be:

- Chaired by a Board member, and ideally, should have a majority of Board members
- Where non Board members are members of a subcommittee they must have the necessary skills and experience in the work area of the subcommittee, and have been asked to evidence these
- Any subcommittee with delegated powers must be attended and advised by a member of the DFI staff having professional expertise in the work area of the subcommittee
- Minutes must be kept at all subcommittees. Even where the subcommittee has delegated powers of decision making, the minutes must form a standing agenda item for full Board meetings, and be presented to the Board for information

1.6.3 Disputes

In the event of a dispute, the Board’s decisions must override those of any subcommittee.
• The operating environment and risk that exist for the organization

1.5.4 Co-options to the Board

Individuals may be co-opted to serve on the Board where the governing instrument allows. Co-option may be used to recruit individuals with particular skills and expertise or independence, as required, but the number of co-optees should never exceed one third of the total number of Board members.

1.5.5 Diversity of Board Membership

In determining a policy for recruitment of new Board members, some priority should be given to ensuring diversity of Board membership, within the context of ensuring that Board members have the skills required for the role. Policies aiming to ensure that the Board is balanced with regard to race and gender, and that people with disabilities have representation, will increase the abilities of the Board to promote an inclusive society in line with the mission of DFIs.

1.5.6 Staff of the DFI as Board members

Staff of the DFI may only become Board members where this is permitted by law and by the governing document. It should also be agreed by the Board as being demonstrably in the interests of the DFI, and as not creating unacceptable conflicts of interest. A staff Board member should not be eligible to become chair of the DFI, and staff Board members must never form a majority on the Board.\(^{11}\)

1.5.7 Representation of clients & The Local Community

Where it is felt that there needs to be representation of clients and/or the local community and these cannot be otherwise accommodated on the Board, consideration should be given to the use of advisory groups or focus groups.

1.6 Committees of the Board

The Board may delegate work to subcommittees if this is allowed within the DFI’s governing document or standing orders. It is vital that Board of a DFI does not operate any system of delegation to subcommittees unless given the powers to do so in its governing document or standing orders.

---

\(^{11}\) Paraphrased from Good Governance, ibid
REFERENCES


“Concepts and Methods for Evaluating the Performance of a Development Bank”, Pena, Alberto D. Illinois State University (Internet source)
1.4.12 Receipt of gifts or hospitality

The Board should establish a policy on the receipt of hospitality and gifts by Board members and staff. Board members and staff should declare all personal gifts received and hospitality accepted while on the DFI’s business, or from people or organizations connected with the DFI. Such declarations should be recorded in the Board in the Board’s minutes or in a register kept for that purpose.

Board members and staffs should not accept gifts with a significant monetary value or lavish hospitality. Where this may be a frequent issue, the DFI should set a policy to define what is and is not acceptable.9

1.4.13 Board expenses and remuneration

The Board should set a policy on payment of expenses and/or remuneration for services to Board members. Board members may be only be remunerated on terms and conditions set out in the governing document or standing orders of the DFI.

1.4.14 The prevention of receipt of financial services from the DFI

The Board must ensure robust policies and procedures to prevent declare a conflict of interest Board members and staff, or their immediate families, receiving loans, investments or other financial products from the DFI. This will always represent an unacceptable conflict of interest, and policies must make it clear that any such transaction would lead to the resignation of, or the taking of disciplinary action against, any parties involved.

1.5 Renewal and Composition of the Board

1.5.1 Board members standing down

Board members should stand down on a systematic basis, to allow an open and transparent process for new individuals to stand for Board membership. To avoid upheavals in business continuity, Board members should not all stand down at the same time, but in proportions of the whole Board (e.g. one third or one half each year) as set out in the governing document or standing orders.

9 Good Governance, ibid
1.4.7 Separation of strategic and operational roles

The Chief Executive has responsibility for maintaining a clear division of responsibilities between the Board and the staff team. S/he should provide an effective link between the Board and staff, informing and implementing strategic decisions of the Board. Board members should not seek to become directly involved in decisions which have been properly delegated to staff. Where necessary the Board should raise any such issues through the Chief Executive.7

1.4.8 Urgent decisions

Urgent decisions should be taken in accordance with predetermined arrangements set out in standing orders.

1.4.9 Conflicts of interest

The DFI must have procedures for Board members to declare actual or potential conflicts of interest to the Board; such declarations should be made at the earliest opportunity. They should be recorded in Board minutes or in a register kept for the purpose. Where a conflict of interest arises at a Board meeting, the Board member concerned should not vote on the matter or participate in the discussions. S/he should also offer to withdraw from the meeting, and the Board should decide if this is required. Where a Board member has a major or ongoing conflict of interest, s/he should offer to resign from the Board.8

1.4.10 Periodic review

At agreed intervals, the Board should set aside time for full discussion about the effectiveness with which it is conducting its business.

1.4.11 Exit interviews

All departing Board members should be interviewed by the Chair and be given the chance to record their views on the operations of the Board and the organization. This should then be reported back to the wider Board. In some cases, the Chair may delegate this interview to another Board member, if required by the person departing.

7 Paraphrased from Good Governance, ibid
8 Good Governance, ibid
1.4.2 Frequency and Board meetings

The Board should meet as frequently as needed to ensure fulfillment of its duties and responsibilities, but as a minimum four times per year.

1.4.3 Quorum

DFI boards should aim to conduct their business with as high a proportion of members present as possible. However, there may be circumstances when this will not be possible and for that reason a quorum must be agreed and recorded. This will generally be set within the governing document or standing orders, but should require as a minimum one third of Board members (not including co-optees) to be present.

1.4.4 Non attendance at Board meetings

If a Board member fails to attend three consecutive Board meetings without setting out an appropriate reason in writing to the Board, the Board should be entitled to remove that person as a Board member. This will need to form part of the governing document or be set into the standing orders of the DFI.

1.4.5 Induction & Board development

All Board members should be offered an induction programme and subsequent opportunities to develop their knowledge and skills in ways which will enable them to carry out effectively their responsibilities as Board members.

1.4.6 Decision making

Board decisions should be, wherever possible, based on full agendas and documents circulated to members in advance of meetings. Points for decision should be clearly identified and decisions clearly recorded in the minutes.

The Board should ensure it receives the information and advice needed to make good decisions.

Board papers should be well presented, circulated in advance of board meetings, and make clear recommendations to the board in situations where a decision is required.

APPENDIX 1: CODE OF PRACTICE AT COMMUNITY DEVELOPMENT FINANCE ASSOCIATION, UK

Code of Practice

Contents

Introduction

1. Governance Issues
2. Practice Issues
3. Further Information

Annex

DFI Business Principles

The DFI is an institution that provides capital and support to enable individuals or organizations to develop and create wealth in disadvantaged communities or under-served markets.

The DFI’s mission is to support the development of a thriving and sustainable development finance sector that provides finance for disadvantaged and underserved communities and, as a consequence, contributes to the increasing prosperity of these communities.

Introduction

This Code sets out a series of key commitments and principles in accordance with which DFIs should operate and which underpin good practice across the sector.

DFIs use a number of different legal frameworks and therefore, the Code sets out to distil the commonalities between these different legal forms. Due to these different legal structures, it is recognized that not all DFIs will be able to comply fully with this Code on its introduction. However, all DFI members will be expected to work towards full compliance.

The importance of good practice

For the DFI sector to grow and mature, it needs to demonstrate to its stakeholders its commitments to the highest standards of governance and best practice. To facilitate this, each member of the DFI must ensure that their own organization adequately addresses the issues set out in this Code.
What is governance?

Governance is “the systems and processes concerned with ensuring the overall direction, effectiveness, supervision and accountability of an organization”.1

Terminology

Throughout, this code uses the term Chief Executive as meaning a DFI’s most senior member of staff, although we recognize that there are other titles used to describe that role. Similarly we refer to “the Board” and ‘Board Members”, although other terms may be used in some DFIs.

The role of the Board and staff

The Board is the overall governing body of the DFI. As such, it must be able to balance a commitment and willingness to achieve the DFI’s mission and aims with the ability to ensure that the DFI has the organizational strength and capacity to achieve that mission. The Board is responsible for developing and monitoring systems and controls. In so doing, it must make itself accountable to its stakeholders and act in a manner that is open and transparent.

Day-to-day management of the DFI should be delegated to the Chief Executive and staff. Their responsibility is to manage the affairs of the organization in accordance with the policies and decisions of the Board; to ensure that appropriate systems of control are in place; and to ensure that the Board receives the information necessary for it to monitor performance and determine policy.

Compliance

All DFIs within the DFI’s membership, and any applicants for membership, must adopt the Code of Practice and will be expected to work towards full compliance. Such compliance will be monitored by the DFI via annual statements of compliance and explanation, filled as part of the DFI annual member’s survey returns. Where a DFI does not comply with specific parts of the Code, the statement should explain the reasons for non compliance and set out when full compliance can be expected.

If a DFI’s governing document does not allow the organization to comply, then the governing document must take precedence until such time as it can be amended.

1 The Governance of Voluntary Organizations’, Comforth, 2003

1.3.3 Relationship with the Chief Executive

Establish a constructive working relationship with, and provide support to, the Chief Executive.

1.3.4 Delegation of authority

Ensure that the Board delegates sufficient authority to its subcommittees (where such subcommittees exists), Chief Executive and Chair, to enable the business of the DFI to be carried on effectively between meetings.

1.3.5 Compliance with this Code

The Chair should ensure that the DFI complies with this Code of Practice.5

1.3.6 Professional advice

Ensure the Board receives professional advice where necessary or where requested by other Board members.

1.3.7 Appraisal of the Chief Executive

Appraise the performance of the Chief Executive and ensure the recruitment and employment of the Chief Executive complies with employment legislation and good practice.6

1.3.8 Review of the Board

Ensure that the composition of the Board and the skills of its individual members are periodically reviewed in line with this Code, and that action is taken to remedy any gaps identified.

1.3.9 Representation

Represent the DFI as required.

1.4 The Operation of the Board

1.4.1 Size

DFI boards have at least five members (excluding co-optees) to enable them to conduct their business properly and efficiently.

5 Good Governance, ibid
6 Good Governance, ibid
1.2.4 Confidentiality

Board members must respect the confidentiality of information provided to the Board.

1.2.5 Conflicts of Interest

Board members should always declare any conflicts of interest that may arise as a result of having an involvement or connection with any person or organization with which the DFI (of its formal partners) has dealings (see clause 1.4.9 of this Code).

1.2.6 Prepare & attend

Board members should prepare for meetings commensurate with their duties and attend them as required.

1.2.7 Contribute outside of Board meetings

Board members should attend additional meetings within the DFI or with external agencies, as appropriate, and whenever possible, attend any training organized for Board members.

1.2.8 Uphold the DFI’s Code of Practice

Board members must support and uphold this Code of Practice.

1.3 Responsibilities of the Chair

The Chair of the DFI has particular and specific duties and responsibilities. The Board should define these in writing. As a minimum, these will include the following duties:

1.3.1 Efficient conduct of business

Ensure the efficient conduct of the Board’s business and the DFI’s general meetings.

1.3.2 Decision making

Ensure that all Board members are given the opportunity to express their views as appropriate before any important decisions are taken.

Any DFI that cannot comply with parts of the Code should review their governing document, standing orders and other documentation, and aim to amend them to enable full compliance.

In order to ensure that the whole of the DFI sector benefits from the common standards of good practice ensured by this Code, DFI members that are unwilling to work towards full compliance will be considered by the DFI Board, under clause 1.6.4 of the Articles of Association.

The DFI Performance Framework

The Code of Practice is an integral part of the Performance Framework, and is cross referenced throughout. As such, compliance checks will be carried out on a three year basis.

1. Governance Issues

1.1 Responsibilities of the Board

The Board should lead and set the strategic direction of the business of the DFI. The Board has and must accept, both collectively and as individual directors, ultimate responsibility for directing the affairs of the DFI, ensuring it is solvent, well run, and delivering the outcomes for which it has been set up.2 The Board retains ultimate responsibility, even where it may have properly delegated its powers to a subcommittee or staff.

However, Board members should avoid becoming involved in day to day operational decisions and matters. The Chief Executive has responsibility for maintaining a clear division of roles between the Board and the staff team.

The essential functions of the Board should be formally recorded in the DFI’s governing document by standing orders. As a minimum, these essential functions should include clauses 1.1.1 to 1.1.5 below.

1.1.1 Legal duties

The Board must satisfy itself that the DFI complies with all relevant laws, regulations and the requirements of its regulators, including the timely submission of accounts and returns.

---

2 Paraphrased from “Good Governance: A Code for the Voluntary Sector”; published July 2005 by NCVO on behalf of the National Hub of Expertise in Governance
1.1.2 Strategic development & policy making

The Board must define and ensure compliance with the objectives and values of the DFI and of this Code and establish appropriate policies to achieve these objectives.

1.1.3 Monitoring performance

The Board must agree processes and procedures to enable monitoring of the DFI’s policies, procedures and finances.

1.1.4 Financial responsibility

The Board must ensure that the organization is financially healthy and secure by monitoring financial indicators at least quarterly, setting annual budgets and approving annual accounts. Clear financial standing orders should set out in detail financial approval and decision making processes, and how the Board will monitor the finances of the DFI.

1.1.5 Delegation

The Board must establish and oversee a framework of delegation and systems of control, set out in standing orders and procedural documents. This must include clear terms of reference for any subcommittees, where the governing document or standing orders allows such delegation.

1.1.6 Risk management

The Board must establish or ratify policies and decisions on all matters that might create significant risk to the DFI, financial or otherwise. Such policies should aim to control these risks appropriately.

1.1.7 Staffing & employment

The Board must appoint, induct and support the Chief Executive, and motivate management to achieve best practice in all areas of its work. The Board must also, if necessary, implement disciplinary procedures (up to and including dismissal) against the Chief Executive. The Board should also determine the appropriate level of remuneration for this post.

1.1.8 Advocacy

The Board must be an advocate and champion of the DFI.

1.1.9 Representation and accountability

The Board must always act in the best interests of the DFI. It must represent the interests of the DFI’s shareholders and/or members (in the case of membership organizations) and ensure that there are procedures in place for reporting back to them.

1.1.10 Equal Opportunities

The Board must ensure that clear policies are developed, implemented and monitored in relation to equal opportunities as they affect clients, staff, volunteers and the Board itself.

1.2 The responsibilities of individual Board members

Each Board member should be given written notification of their responsibilities as a Board member, and should sign a copy to indicate their acceptance. This should include the following obligations:

1.2.1 Contribute & share responsibility

Board members should use their skills and experience to help the Board make appropriate decisions. They should share responsibility for and uphold all decisions made by the Board. All Board members are equally responsible in law for the Board’s actions and decisions, and have equal status as Boards members.3

1.2.2 Support objectives & policies

Board members must support the DFI’s objectives and policies, as agreed.

1.2.3 Maintain independence as a Board member

Each and every Board member must act as an individual, and not as the representative of any group or organization. This applies regardless of how that person was nominated, elected or selected to become a Board member. Board members must ensure that they remain independent, and do not come under the control or influence of any external organization or individual.4 Board members must always act in the best interests of the DFI.

3 Good Governance, ibid
4 Good Governance, ibid