

# The Board Rules

Founding an MFI Board

Kim Wilson





# The Board Rules: Founding an MFI Board

Kim Wilson

Published By  
Catholic Relief Services  
209 W. Fayette Street  
Baltimore, MD 21201

September 2001

8/20/03



Catholic Relief Services (CRS), founded in 1943, assists the poor and disadvantaged outside the United States. CRS works to alleviate human suffering, promote the development of people, and foster charity and justice in the world. CRS assists the poor solely on the basis of need, not creed, race or nationality, and maintains strict standards of efficiency and accountability. CRS currently operates in 88 countries and supports microfinance activities in 33 countries.

# Acknowledgements

*The Board Rules* draws on available literature in Board development and in microfinance institution (MFI) building. It also draws on the wisdom and experience of many individuals interviewed by the author who have sat on Boards of all kinds. Special thanks go to Till Bruett, Jenny Dempsey, Jennine Carmichael, Susan Hahn, Patrick McAllister, and Jim Hudock for their judicious edits and excellent suggestions. Also, thanks to Mary Houghton, Constance Dunham, and Jim Kaddaras—all who have had much experience with MFI Boards—for their many insights that have made this guide possible.

Kim Wilson  
CRS Senior Technical Advisor  
September 2001

**Catholic Relief Services** gratefully acknowledges the support of the USAID BHR/PVC in the publication and distribution of this guide under CRS/USAID Matching Grant FAO-A-00-99-00054-00. The views expressed in this document are those of the author and do not necessarily represent the views of USAID. This document may be reproduced without notification, but please give appropriate citation credit to the author and to Catholic Relief Services. Comments are welcome and may be addressed to CRS Microfinance or the author at <MU@CatholicRelief.org>.



# Foreword

Near Cape Cod about 40 miles from Boston, a museum memorializes the lives of the first settlers in Plymouth, Massachusetts. These settlers had only two goals: to survive and to practice their faith.

In Plymouth, when the townspeople needed to decide important community matters, a few leaders would gather in a meeting place, often someone's home. They seated themselves on long benches astride a table made from crude boards. In such humble circumstances, there was only one chair. The person presiding over the meeting sat in the chair, thus becoming the "Chair Man"; the table was the "Board".

How many communities around the world have had their own version of this story? It is likely that many readers could trace similar roots to community governance in their own cultures.

The real lesson here is focus. These settlers did not have time to spend endless hours quibbling about how to run the colony. Community leaders had to focus on the big picture so that villagers could go about the daily business of survival: staving off cruel winters and defending themselves against threats to family and farm.

The concept of focusing on the large issues is as important today for the Boards of big companies as it was many years ago for the Boards of earlier modest communities. Key overseers do not have the time to debate trivial matters. They must engage with their organization at its most strategic level.

Forming a Board to manage a microfinance institution (MFI) is a huge undertaking, but does not need to be daunting. Remember the humble beginnings of Plymouth. The key then was focus. Leaders focused on matters of greatest concern to their community, which included its survival. Similarly, the key now is focus. Board members of an MFI must focus on matters of greatest concern to the institution, which includes its survival and the fulfillment of a social mission. This guide, then, asks us to apply old wisdom to new challenges and in doing so, to achieve the same success enjoyed by leaders of long ago.



# Glossary of Key Terms

**CEO** - Chief Executive Officer. (Often called President in a Commercial MFI or Executive Director in a nonprofit MFI). The CEO, usually salaried, is the senior person in charge of the MFI. The CEO reports to the Board of Directors and is responsible for the performance of the MFI according to the approved strategic plan.

**Commercial MFI** - A microfinance institution owned by stockholders, often regulated. MFIs may have one stockholder (or owner) or many. Laws dictate the minimum and maximum number of shareholders a commercial MFI may have.

**Early Champion(s)** - Person or people interested in launching a new MFI or transforming an existing microfinance program into a new MFI. Not a technical term but useful for this guide.

**Equity** - The ownership, value or net worth of a commercial MFI.

**Founding Board** - First official Board members of the new MFI. Not a technical term but useful for this guide.

**MFI** - Microfinance Institution. A commercial or not-for-profit entity, specializing in bringing financial services to people underserved by conventional banks.

**NGO** - Non-governmental Organization. In this guide refers to any local nonprofit organization.

**Provisional Council** - Group of individuals interested in helping early champions launch the new MFI. Not a technical term but useful for this guide.

**Shareholder** - An individual or company owning shares (stock) in a commercial MFI. Also refers to shareholders of credit unions who own shares but whose value is not based on a percentage of equity in the MFI.

**Stakeholder** - An individual or organization interested in the success of the new MFI. May or may not be a shareholder.

**Stockholder** - An individual or company owning shares (stock) in a commercial MFI. Often interchangeably with shareholders, however shareholders is a broader term and includes shareholders of credit unions. Stockholder only includes owners of stock.



# Contents

Acknowledgements	iii
Foreword	v
Glossary of Key Terms	vii
Table of Contents	ix
<b>Section 1: Preparation</b>	<b>1</b>
Board Myths	3
Board Formation	7
Define Your Strategy	13
<b>Section 2: The MFI's Founding</b>	<b>23</b>
The Founding Board	25
Board Composition	29
Motivational Issues	35
Member Recruitment	37
Board Officers & Committees	43
Founding Documents	47
<b>Section 3: The Founding Years</b>	<b>53</b>
Managing the CEO	55
Board Meetings	63
Keeping Minutes	69
The First Year Plan	71
Financial Matters	77
Tips for the CEO	81
Transferring Powers	87
<b>Section 4: Conclusion</b>	<b>91</b>
Two Boards of Directors	93
Final Thoughts	97
<b>Selected Resources</b>	<b>99</b>

Cover Photograph:  
Jennine Carmichael—Regional Microfinance Coordinator for Europe



# Section One: Preparation

---



# Board Myths

This guide concerns itself with a new microfinance institution (MFI) and its first, or founding, Board of Directors. Many Board members of new MFIs have had years of experience as members of various Boards. Others come to the task for the very first time. Veteran Board members have much to offer newcomers, but even Board veterans may not be fully versed in the special nature of institutions that seek both a social good as well as a financial return. The following are two myths worth debunking.

## **The Myth That Ownership Equals Oversight**

In recent years, many debates have bloomed: Which types of individuals make the best Board members? Which kinds of organizations should be represented on the Board? Which stakeholders ought to participate in institutional oversight? The debate often narrows along the themes of ownership and accountability.

The notion of ownership has assumed great currency. We often presume that real owners, meaning holders of stock, should have more of a stake in the success of an institution than "virtual" owners, or "stakeholders"—those who do not hold stock but have a personal interest in the mission of the institution.

The myth is that stockholders demand a higher degree of accountability to optimize the value of their stock, while virtual owners—trustees, advisors, champions, and other stakeholders—have no monetary investment at stake and therefore do not demand accountability or success.

The reality is that an individual's sense of ownership and accountability has little to do with holding stock. Consider the legions of stockholders in the United States or elsewhere who do not bother exercising their voting rights, much less attending the annual shareholders assembly. They are owners but not participants in electing their Boards. Dig a little deeper and review the US banking industry prior to the depression in the 1930s or the savings and loan crisis of the 1980s. Shareholders

owned the banks, yet these institutions collapsed. Similarly, in 1999 most privately held, regulated banks in Uganda folded, taking the savings of many micro-savers with them.

### **Metemamem**

This Ethiopian organization is currently 100% funded by CRS, yet its Board of Directors, headed by Abba Tsegay, Secretary General of the Ethiopian Catholic Secretariat, takes their job to heart. They believe good stewardship of funds must be practiced from the outset. They plan to spend much of their first year putting good systems and controls in place.

Conversely, virtual owners may have great personal investment in the success of an institution. Many tax exempt or not-for-profit organizations operate professionally and offer clients outstanding quality. Think of National Public Radio, Harvard University, or the Metropolitan Museum of Art. Consider some of the outstanding nonprofits in the country in which you reside, perhaps a local advocacy organization, a literacy institution, or a hospital. Highly professional Boards of Directors oversee these organizations. They insist on quality, yet

own no stock. They demand from themselves maximum accountability, yet no shareholder insists they be accountable. They are stakeholders but not stockholders.

In addition to ownership structures, many microfinance institutions spend a great deal of time reviewing legal options to determine which might best foster a sense of real ownership. This is important work and part of good oversight. But institutions cannot legislate success by dint of a good legal structure. Nor can they ensure results by becoming regulated. Good oversight determines success and good oversight springs from commitment. We are speaking here of the kind of commitment that comes from passion, leadership, and dedication—qualities not found in, but at times protected by, regulation, legal frameworks and capital structures. This commitment takes root where individuals find the mission essential and worth the substantial effort to fulfill and preserve.

The Founding Board, the subject of this guide, can claim victory when each of its members is personally invested in the MFI's long-term success and agrees to set aside individual agendas for a greater good. This kind of commitment, which is as likely to appear among shareholders of a rural bank as among the Board of a nonprofit MFI, maintains the organization

through good years and bad and accounts for its survival and ultimate success.

## The Myth of the Double Bottom Line

Most microfinance organizations have two complementary objectives: to sustain growth through financial strength and to bring about a social good in the process. These dual tasks are enormously challenging. Most businesses struggle to maintain a positive bottom line (net profit) without the added pressures of a social objective.<sup>1</sup> Similarly, many nonprofit organizations struggle to maintain service quality without the added pressure of profitability.

One of the first decisions the new Board of an MFI must make is to agree on the priority of each objective. In good times, the organization may achieve both coincidentally, with neither compromised by the other. In difficult times, the MFI may find that these objectives conflict. A good Board needs to choose its priority objective well in advance of times of stress. For example, if your Board has decided that the MFI's social objective is of greater importance than its financial objective, the MFI may reduce its growth rate or prolong attainment of a financial objective—such as positive return on investment—to continue meeting its social objective. On the other hand, if your Board decides that growth is most important (perhaps for very good social reasons such as economic survival), then the MFI may find it necessary to decrease or prolong part of its social objective to stay competitive.

### Two Bottom Lines?

**E**nlace, CRS' microfinance program in El Salvador, offers financial services through a village banking model that incorporated a group savings component deemed important to Enlace's social mission. Because Enlace has the financial goal to access mainstream capital markets, regulations require Enlace to maintain certain profitability levels. The expense of the current savings strategy limits profitability and therefore its candidacy as a regulated institution. The social objectives in the savings program needed to be weighed against the objective of becoming a regulated commercial entity.

<sup>1</sup> Interestingly, most new businesses in the U.S. close within six years. "An Advocacy study of employer business starts from 1989 and 1992 finds that 66.0 percent of businesses remained open at least 2 years, 49.6 percent at least 4 years, and 39.5 percent at least 6 years." See: Richard J. Boden, Jr., "Analyses of Business Dissolution by Demographic Category of Business Ownership," Small Business Administration Website, 2001. <<http://www.sba.gov/ADVO/research/rs204tot.pdf>>

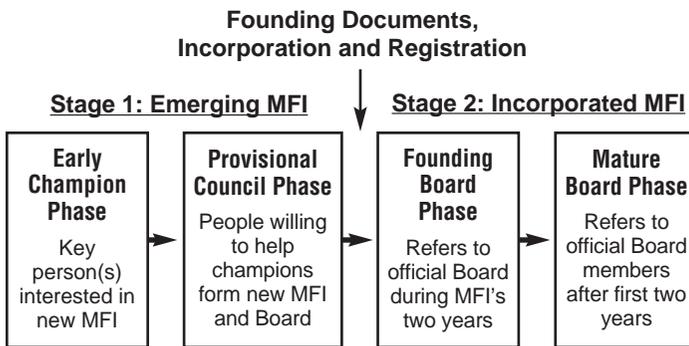
**This pivotal decision is not a hypothetical possibility. It is very real. By not addressing which objective, social or financial, has ultimate priority, one objective unintentionally gains primacy in times of stress without the benefit of the Board's thoughtful consideration.** By dealing with this trade-off up front, the Board can avoid unwittingly undermining its true priority. For example, the Board may choose to remain unregulated, as banking regulations often impose strict financial performance criteria.

# Board Formation

A new microfinance institution evolves from idea to reality by way of many small transitions, each marked by the input of new people, new information and new activities. As a microfinance institution evolves, so too does the concept of a Board of Directors. For purposes of this guide, we have labeled different stages and phases of an emerging Board. Such stages and phases are not technical terms, merely useful markers for the reader to locate the advice in this guide along the Board's developmental path.

## A Few Definitions

The schematic below charts the process by which an MFI may form. The brief definitions below are followed by more detailed descriptions of the four phases.



### First Stage: Emerging MFI

This stage includes the activities required in preparing the MFI for incorporation.

#### Phase 1: Early Champions

During the earliest activities in the MFI's development, we presume that one or several people are serving as the new MFI's champions, individuals who are committed to the

creation and success of the new institution. In this guide, we call these people "early champions."

### **Phase 2: Provisional Council**

It's quite likely that early champions will enlist the support of other key individuals in the creation of the new MFI, and a Provisional Board is formed. These individuals may or may not end up serving on the Founding Board.

### **Second Stage: Incorporated MFI**

This stage includes activities of early champions in finalizing the members of the Founding Board, the actual registration of the new MFI and the activities of the MFI during its first year or two.

### **Phase 3: Founding Board**

The Founding Board is the initial, official Board of Directors as delineated in the founding documents of the new MFI (articles of incorporation and bylaws).

### **Phase 4: Mature Board**

As the Board of Directors expands and matures over time, the Board increasingly delegates programming and operating decisions to the Chief Executive Officer (CEO) and manages only true Board business.

## **Phase 1: Early Champions**

---

The early champions are the MFI's originators. They have spearheaded the development of the new MFI and are committed to and passionate about its success. An early champion might be, for example: a social entrepreneur who sees a need for microfinance services in his area; a committed individual working for a larger, multi-purpose development organization that includes a specialized microfinance program; or, perhaps, a handful of local businesspeople who see the need for serving the self-employed sector.

It is possible that one of the early champions may serve as the CEO (salaried President or Executive Director) for the new MFI.

**Important Activities:**

Activities during the Early Champions Phase include:

- Development of the concept of the new MFI including its mission, goals and strategies. Concept development includes initial research of the market, competition and the legal and regulatory environment relevant to an MFI.
- Translation of the concept into a preliminary business plan (concise, under 10 pages) used to attract Provisional Council members and Founding Board members as well as funders.
- Activities related to attracting a Provisional Council as well as funding.

**Phase 2: The Provisional Council**

---

Imagine you are an early champion. You are committed to the success of a new MFI for which you and a colleague have developed a preliminary business plan. You face the challenge of transforming your ideas into an incorporated, legally registered entity, properly funded to bring quality financial services to the self-employed sector. To successfully begin the activities in developing the new MFI, consider creating a Provisional Council. The Provisional Council is a group of individuals who believe in the dream of the early champions and who will transform that dream into a reality. Collectively, Provisional Council members embody the commitment, skills, and contacts necessary to help early champions create a Founding Board.

**Who Should Sit on the Provisional Council?**

Policy-makers, legislators, lawyers, bankers, businessmen and women, people who understand microfinance, key members of the community, and representatives of the parent organization

**Taneakea Phum Cambodia**  
T<sup>PC</sup>, a CRS-inspired MFI in Cambodia, has a "Transformation Advisory Board" that functions as its Provisional Council. It includes a former Deputy Governor of the Central Bank, an attorney experienced in MFI transformation, the CRS Country Representative, the Regional Director and the Regional Technical Advisor in microfinance.

might all participate on the Provisional Council. The Provisional Council may even include consultants who are paid. Provisional Council members do not have to meet as a group, although they can. Their core purpose is to help early champions.

### **Who Makes Decisions During the Provisional Council Phase?**

The Provisional Council provides guidance and input. The early champions must make the final decisions concerning the new MFI, including who serves on the Founding Board.

### **How does this Provisional Council Transform into a Founding Board of Directors?**

It does not. The purpose of the Provisional Council is not to become the Founding Board of the new MFI. It is to help the early champions transform the program or idea into an institution. One task for the Provisional Council is to find appropriate Founding Board members, some of whom may be on the Provisional Council and some of whom may not.

### **Important Activities**

Activities during the Provisional Council Phase include the following:

- Understanding the critical issues in the new MFI's social and operating environment, such as important national and local power structures, pertinent social customs, regulatory issues, and ways to get things done.
- Attracting funders including local and international donors, wholesale financing institutions and banks.
- Identifying good legal counsel and a professional accountant or accounting service.
- Investigating appropriate legal options for the new MFI.
- Advising early champions on developing legal documents.
- Attracting Founding Board members.
- Assisting in identifying a CEO (if one has not been identified).

### **Phase 3: Founding Board**

---

For purposes of this guide, Founding Board members are the members of the new MFI Board of Directors who serve during the first year or two after incorporation. This text is primarily intended to provide guidance to MFIs, their early champions, the Provisional Council, and Founding Board members during the creation of the Founding Board and during its initial year of governance.

### **Phase 4: Mature Board**

---

It is not within the scope of this guide to describe the activities of the Mature Board of Directors. There already exists a considerable body of readily available literature that provides technical assistance and training opportunities for Mature Boards.<sup>2</sup>

---

<sup>2</sup> For example, for more information on Mature Boards, see **Selected Resources** (p. 99) for references to publications by John Carver, the National Center for Nonprofit Boards, and the CGAP Gateway site.



# Define Your Strategy

The activities of a Board, be they in the early or mature stages, are ongoing and usually routine. Their most important decisions, however, occur in the key stages of the organization's development, when an initial strategy is formulated and during key moments of transition. To define a good initial strategy and make transitional moments manageable, the early champions and Provisional Council must consider the following questions before making some of the early, crucial decisions.

## Initial Questions:

---

- Why do founding members want to form the MFI? Stock answers such as "there is a need" won't do. Honesty and research are essential to answering personal and organizational motives for starting the organization.
- Who else is doing similar work, and what do they have to offer the sector? This requires serious research. Each Provisional Council member should make it his or her homework to investigate the competition and complementary players.
- Where is funding likely to come from? The emerging MFI may already have identified funds. But it would be irresponsible not to know in advance the sources and likelihood for continued funding during the institution's first five years.

The answers to these initial questions inform the defining and structural decisions discussed in the next sections.

## The Defining Decisions

---

"What is the mission?" "Who is the customer?" "Which bottom line is most important?" These questions are closely connected and should be reviewed at the same time.

### What is the Mission?

Your MFI's mission statement articulates its core purpose and is closely tied to the question of "Who is the customer?" If

the core purpose is to effectively compete for self-employed customers requiring high quality financial services, then its mission statement might make mention of growth, market share and quality. If your MFI plans to correct economic injustices burdening the poorest, then its mission statement might focus on these customers and relief of their plight. It must be stressed, however, that even if poverty alleviation is the organization's mission, efficient service delivery and cost coverage are still essential, or the organization cannot serve its purpose effectively, nor survive as an MFI in the long-term.

### **Who Is the Customer?**

Who is the customer? This question is tricky. For microfinance programs becoming separate NGOs, the key issue is: Does our current client base offer a good focus? For brand new programs, the question involves a look at broad and narrow answers. To answer "who is the customer?" broadly, such as "the

poor self-employed," gives the MFI a wide berth to adapt as the organization grows, finding new markets and new ways to meet needs. But, a more narrow answer such as "the poorest economically active women in Sheepland province" assures focus and close adherence to your MFI's chosen social mission.

Most private businesses are concerned primarily with financial growth. They may change their target market as new opportunities for growth arise. Conversely, many social organizations focus on unjust conditions of a specific group of people and remain focused on

that group until their problem is solved. Your Provisional Council must articulate an initial market strategy and balance customer focus with flexibility.

### **Which Bottom Line is Most Important?**

As discussed in the prologue, perfect harmony of social and financial objectives is impossible in times of stress. From time to

#### **Recommendation**

**C**hoose a fairly narrow customer focus to start your MFI and agree to stick to this focus for at least three years. Build into the MFI's initial written plan a time to review the chosen customer focus in three years time at which point, the organization may wish to broaden the target in light of experience and changing social and economic conditions. In the written bylaws, leave the customer focus as broad as possible to allow flexibility over time.

time external pressures will force the MFI to prioritize one objective over the other. The Board must decide how it will guide the MFI to balance these agendas when they conflict.

Consider this scenario: your organization has chosen to provide quality services to the poorest of the economically active poor as one objective. Its other objective is financial self-sufficiency—that is, covering direct and indirect costs through income from customers within five years. After two years, you realize that the poorest customers actively borrow and gladly repay, but in smaller amounts than you projected. The smaller than expected loan portfolio is not generating enough revenue to cover costs of delivering the service.

The objective your MFI has decided to prioritize will lead to one of the following responses:

- The MFI stays focused on its target customer and postpones financial self-sufficiency beyond five years, requiring raising additional subsidized revenue or decreasing the cost of delivering the service.
- The MFI abandons the unprofitable customer base altogether in favor of meeting its financial self-sufficiency objective.
- The MFI broadens its mission to allow more profitable customers to cross-subsidize the poorest.

Obviously, there is no correct answer. The world economy has room for both market-based nonprofits as well as socially responsible businesses. The right decision results from reflection on the MFI's purpose as stated in its mission and consideration of external conditions such as regulations, availability of subsidies, competition or other factors. When choosing the most important "bottom line," choose the one that routes your MFI most directly to its hoped for ends.

In general, most MFIs do not operate at the extreme ends of the social-financial continuum—they are somewhere in the middle. Many consider full cost coverage as their financial goal and do not seek to offer shareholders large profits, nor do their

### Reality

**B**ecause many MFIs never grapple with this decision, it is made for them when external pressures arise, rather than as part of a conscious institutional strategy. Mission drift is often the result.

socially responsible stakeholders require it of them. Their Boards prefer to see profits plowed back into the MFI to either fuel growth or to reach a very poor constituency. In these instances, the Board must decide how much it can afford to subsidize its social objective while maintaining its financial objective.

For example, the Board may find that due to an increased cost of funds, the MFI requires a year or two extra to reach financial breakeven if it maintains its focus on very poor women. Alternatively, it may be able to achieve its financial objective by diversifying its client base to some extent.

If the Board has prioritized the social mission, it may move to keep its focus on the very poor and subsidize the MFI for the additional period until breakeven is reached.

## **Structural Decisions**

---

### **Who "Owns" The Institution?**

Your new MFI—probably conceived as a nonprofit organization by a few individuals—needs to broaden the Provisional Council and later the Founding Board to include other kinds of stakeholders or owners. We are speaking here of ownership in the broadest sense, not just stock ownership. These owners are individuals or institutions with a stake in the success of the MFI and who may be desirable Board members.

Your Provisional Council should choose the most important "owners," those whose stake is critical to the mission and performance of your institution. To stimulate your thinking, see the section on Board Composition for an analysis of the advantages and disadvantages of different types of Board members.

### **The Appropriate Legal Structure**

Should your MFI be a closely held shareholding company? A company backed by limited guarantee? A limited liability corporation? A cooperative? A commercial bank with multiple shareholders? A nonprofit organization? This decision depends on your MFI's mission, its operating activities, and the local socioeconomic and legal environment in which the MFI operates. Here are a few factors to consider in deciding the best legal structure.

<b>Decision Factor</b>	<b>Sample Implications</b>
<b>Existing legal options</b>	Laws may offer few options and require certain structures. There is no use debating possible structures without knowing available options.
<b>Possible legal options</b>	Laws and policies change. Check on advocacy activities or better yet, participate in them to facilitate the development of new legal options.
<b>Tax laws</b>	Some legal options may have more favorable tax implications to the MFI or to the owners. Employee taxes and taxes on interest revenue, profits, and dividends to owners may all weigh into your decision.
<b>Initial operating activities</b>	If your MFI intends to mobilize savings, you may have few legal options. Most likely your MFI either must become a cooperative or a regulated MFI with shareholders.
<b>Legal liabilities</b>	Different legal structures may have different implications for the obligations of both Board members and shareholders. Your Provisional Council needs to look at acceptable levels of liability in relation to available legal options.
<b>Mission and target customer</b>	If your mission is to serve very poor customers or a very poor locale, you may want to structure your MFI as a nonprofit. If your mission is to reach microentrepreneurs and has a high growth agenda, your MFI soon may need to use commercial capital. A stockholding structure would then seem most appropriate.
<b>Specific intent to include customers in ownership</b>	If your MFI is founded by customers and wants to include only customers (borrowers and savers) in the governance structure, specific laws of cooperatives may apply.
<b>Presence of competition</b>	Activities of other actors may influence available funds, both positively and negatively, and growth strategies. These, in turn, may dictate an optimum legal structure.
<b>Desired and available funding sources</b>	If subsidies are widely available in the form of grants, you might consider a structure to attract grants initially. If commercial funds are available, then a more commercial structure might be more attractive to this type of funder.
<b>Desired and available directors</b>	If your research shows that you can attract a higher caliber of Board member as a shareholder, then you may want your MFI structured as a shareholding corporation. Conversely, if you have quality voluntary individuals to choose from, you may wish to structure as a nonprofit.
<b>Desired and available key managers and their incentives</b>	Attracting the right management team may require special incentives. Sometimes a stock ownership plan can provide a competitive advantage in recruitment.

Seek the guidance of legal, financial and policy experts to evaluate these complex issues. Here are ideas to ensure that the emerging MFI Board makes the best decision concerning its legal options.

- Ask a representative of the appropriate government entity or entities—often a government ministry—to make a brief presentation to the Board on various legal options for MFIs in your country. Visit a key policy-maker and interview him or her.
- Often law and accounting firms give free talks on requirements of privately held, profit-oriented companies. If your MFI is a not-for-profit, attend a seminar on the creation of nonprofits.
- Research whether international donors have funded MFIs in your country. Often their local offices have staff who may be knowledgeable about required documentation.
- Interview at least three recommended attorneys on local laws governing microfinance institutions. Select the best one to assist your final choice of legal structures.

Ideally, your initial corporate structure keeps your MFI open to many legal and financial avenues as possible. The MFI needs the maneuverability to adjust its structure to match evolving strategies for growth. For example, in the United States, an MFI

Board may find that changing from a shareholding entity to a nonprofit entity is harder than the reverse action. The opposite may be true in other countries. Choose the founding structure that offers your MFI the greatest flexibility to innovate, adapt and grow. Management needs time to fully understand its customer base, refine

operations, decide if savings deposits are feasible, and thoroughly investigate the advantages and disadvantages of becoming a regulated institution. Ideally, the Board avoids shoehorning the MFI into a structure where adaptability is unnecessarily restricted.

#### **Recommendation**

Choose the structure with greatest flexibility and possibility for change in the future.

## The Wise Use of Subsidy

Self-sufficiency has become such an important idea in microfinance that practitioners often regard it as a goal. Self-sufficiency is not a goal in itself. It is a strategy for sustainability. The Provisional Council needs to balance different options for sustainability and find the appropriate role of 100% cost coverage within those options.

Obviously, no commercial or social entity is truly self-sufficient. New businesses particularly are frequent beneficiaries of subsidy from government or private foundations. The Provisional Council can help the CEO direct the MFI's wise use of subsidy. Some forms of subsidy expose the institution to more financial risks in the longer term and should be avoided where possible. The tables on the following pages are frameworks for looking at the risks of both **Sources of Subsidy** and **Uses of Subsidy**.

### Recommendation

A healthy MFI will always strive for at least 100percent cost coverage, including inflation, imputed cost of capital and the loan loss reserve. The discipline of cost coverage promotes efficiency and good financial management.

## **Potential Sources of Subsidy For Your MFI**

<b>Subsidy Sources</b> ( <i>less to more vulnerability</i> )	<b>Rationale</b>
<p><i>Local Provider:</i> Free or partially subsidized technical assistance to your MFI offered by local providers (for example, a local accounting firm).</p>	<p>If subsidy stops, your MFI still has a relationship with a local provider and perhaps can still negotiate a "good deal" that leaves your MFI with the possibility of future technical assistance.</p>
<p><i>International Organization:</i> Free or partially subsidized technical assistance (TA) offered by international providers.</p>	<p>International technical assistance is often subject to the whim of international funders, which are themselves subject to donor fatigue. Also, many technical assistance providers do not seek to build capacity in the MFI and instead create dependency. If TA is removed, the MFI is left unfamiliar with local sources, subsidized or not.</p>
<p><i>Grant-Making Institution (Short-term):</i> One-time special purpose grants from any source.</p>	<p>If subsidy vanishes, the MFI has not planned on its continuance and can keep operating. Not too risky.</p>
<p><i>Grant-Making Institution (Longer-term):</i> Multi-year grants from any source.</p>	<p>Multi-year grants are subject to the health of the institution providing them. If the funder collapses, and, if the MFI is counting on continued subsidy, the MFI may suffer. Moreover, the MFI may not meet performance benchmarks and risk losing the subsidy altogether.</p>
<p><i>Development Supporting Agencies (Longer-term):</i> Low interest loans to your MFI of less than a seven-year term.</p>	<p>There is some risk in that the MFI may depend on this source and not be able to replace this source. However, with good planning, the MFI may be able to create "equity" from profits and prepare the MFI for commercial funds.</p>
<p><i>Development Supporting Agencies (Short-term):</i> Low interest loans to your MFI of less than a two-year term.</p>	<p>The first rule of finance is "never fund long-term growth with short term funds." If subsidized rates disappear, the MFI may find it difficult to raise its interest rates to its own customers to cover the difference.</p>

## Potential Uses of Subsidy For Your MFI

<b>Subsidy <u>Uses</u></b> ( <i>less to more vulnerability</i> )	<b>Rationale</b>
<i>Special Research and Development:</i> For example, special impact assessment for MF or donor community.	If the subsidy is a planned single usage, the threat is minimal to the survival of the MFI.
<i>Fixed Assets for Non-Core Purpose:</i> For example, new electronic camera for brochures.	If use cannot be repeated, loss is minimal to survival of MFI.
<i>Marketing Subsidies:</i> For example, bus fare vouchers for first-time, poorest customers to attend an information meeting or for clients to transport goods.	If this practice is discontinued, the MFI may lose this "growth or social impact mechanism," but the loss impacts minimally on the survival of MFI. This assumes that it was the intention of the MFI that these customers would eventually pay the full amount.
<i>Operating Costs Up to Breakeven.</i>	Limited time of subsidy. Investments in operations until breakeven implies breakeven will happen. Subsidy is not too risky if the subsidy has already been secured. It is very risky if subsidy is planned but not secured, and MFI is operational, but not yet covering costs.
<i>Routine Research and Development:</i> For example, on-going market research.	There is some risk, but on-going research and innovation are part of the health of a market-oriented MFI.
<i>Fixed Assets for Core Purpose:</i> For example, new vehicle.	The MFI may not be able to continue accessing this subsidy. Dependence on subsidizing fixed assets might be risky.
<i>Operating Costs after Breakeven.</i>	Subsidizing operating costs endlessly to achieve continued growth may put the long-term survival of the MFI in jeopardy, unless the subsidy is assured.
<i>Loan Capital:</i> For example, subsidized interest rates to customers.	It's very difficult to raise interest rates to customers. Establishing subsidized interest rates as an initial practice is highly risky to the MFI, if and when the subsidy ends. However, it is possible to have subsidized loan capital, but not pass that subsidy on to the borrower.

## Model-Driven or Market-Driven?

Many MFIs form around a particular method of delivering services to the customer. Grameen replications, village banking, solidarity group lending, and self-help group structures are all models widely used in microfinance. While models may be a great way for a new MFI to quickly become operational, close adherence to a particular model over the long-term may undermine the institution's capacity to adapt to market behavior. Excessive concern about deviating from the original model may limit the opportunities for the MFI to modify its operations to satisfy customers and to compete in the marketplace—and even to survive as a financial institution.

The table below highlights the appropriate conditions for model-driven and market-driven MFIs.

	Model-Driven MFI	Market-Driven MFI
<b>CEO</b>	Potential CEO is a good manager, skilled in operations, not necessarily a "market thinker."	Potential to hire CEO with strong business sense and leadership qualities who can adapt the MFI to changing market conditions.
<b>Customs and Customers</b>	Model fits customer behavior patterns. Matches existing local practices. Local financial practices are strongly rooted in the culture.	Customers more concerned with quality financial services and less with adhering to cultural practices.
<b>Competition</b>	No serious competition, or competition is also model-driven.	Potential competition from market-driven MFIs that may lure your customers away.
<b>Mission</b>	Mission mandates social elements that are only found in a particular model.	Mission does not imply benefits associated with a particular model.

## Section Two: The MFI's Founding



# The Founding Board

The Founding Board of a new MFI has many important duties. Ultimately, this Board is responsible to either the stakeholders of a nonprofit MFI or to the stockholders of a commercial institution.

Generally, stakeholders—which include communities of donors, bankers, potential customers and social leaders—want to know the following:

- Is the MFI achieving its social mission?
- Is it viable, capable of covering its own costs and following disciplined financial practices?
- Is it complying with appropriate laws and regulations?

Generally, stockholders want to know:

- Is the MFI viable, capable of creating a financial return on shares? Even a modest return?
- Is it competing effectively in the marketplace, complying with regulations, and reducing, wherever possible, the potential liabilities to shareholders?
- Is it attaining its social agenda, if one is stated?

Stakeholders and stockholders entrust the Board of Directors to oversee the MFI and ensure that these questions are asked and answered favorably.

## Key Responsibilities of The Founding Board

---

### 1. Manage Itself

The Board is responsible for managing its own activities. It must establish a process to select future Board members, orient these members to their duties, elect officers, run Board meetings, document decisions, and create Board policy.

## **2. Ensure Legal and Financial Survival of the MFI**

The Board is responsible for the financial survival of the MFI and the institution's stewardship of resources. It is also responsible for ensuring that the MFI is compliant with local laws and exhibits fiscal integrity.

## **3. Create and Preserve the MFI's Mission**

The Board is responsible for determining the MFI's core purpose and core values. The Founding Board must articulate the mission in such a way that it identifies the results the successful MFI plans to achieve. The Board is responsible to its stakeholders for preserving its stated mission.

## **4. Create and Adjust the MFI's Bylaws and Key Policies**

The Board is responsible for creating, preserving and amending the MFI's bylaws—also called statutes and other names—in accordance with local law. It is also responsible for creating Board-level policies that complement these bylaws.

## **5. Hire and Manage the CEO**

The Board is responsible for hiring, managing and evaluating, and terminating, if necessary, the CEO. The Board ensures that the CEO operates the MFI in keeping with the MFI's mission and core values.

## **6. Assist the CEO in Managing the Operating Environment**

The Board has bottom line responsibility for the health of the MFI. For that reason, the Board may be required to assist the CEO in matters related to the growth and strength of the institution, such as, creating positive publicity, advocating for legal and policy changes, and raising funds.

## **7. Represent and Protect the Interests of the MFI's Shareholders**

Most commercial MFI's require that their Board members go beyond ensuring the financial survival of the organization. Shareholders usually demand a return on their investment. The

Board is entrusted with representing these interests. Stakeholders that are not shareholders also want a return on their time and commitment. Usually their return is in the form of a viable institution providing high-quality services.

## **Additional Responsibilities of the Founding Board**

The Founding Board of the MFI may find itself in the position of volunteering many hours to perform duties normally assigned to the CEO and her/his staff. Ideally, the Founding Board has a few members willing to roll up their sleeves and address the following tasks during the MFI's first year.

### **Create the Initial Strategic Plan or Concept Paper**

Developing the strategic plan is one of the chief tasks of the CEO. However, early champions and even the Founding Board should help create the first plan. In fact, it may be impossible to raise funds without an initial plan.

A Board must let go of this responsibility in the ensuing years of the MFI. At that time the Board should develop strategic guidelines for the CEO to follow and allow her/him to work with her/his staff in developing a strategic plan for the Board's approval. Only in this way can the CEO be truly accountable for the plan and is he/she fully empowered to do her/his job.

### **Intensively Seek Funds**

The Founding Board may find that it dedicates much time to securing funds for the new MFI, such as writing grant proposals, visiting donors, working with bankers, and so on.

While the Board always has an important role in securing funds, it fundraises most intensively during the first year or two. After these founding years, the CEO handles much of the interaction with donors, but she/he continues to encourage the Board to participate in fundraising according to the strategic plan. During the startup phase, however, the Board needs to shoulder

#### **Note of Caution**

Program operations, on-going strategic planning, and financial management are the tasks of the CEO. A Founding Board needs to assist the CEO in many areas and even handle these matters before the CEO is installed. The Board must never take on these responsibilities over the long term. Board involvement in programming and operations restricts the CEO from professionally managing the MFI. The Board must devise a plan to empower the CEO to take on these responsibilities over the first two years.

the bulk of fundraising activities.

### **Thoroughly Assess the Market and the Competition**

The early champions in particular perform a thorough analysis of the market and competition. Again, as the MFI grows, this activity becomes the responsibility of the CEO and her/his staff.

### **Help Create or Review the Initial Program Design**

While programming and operations are the responsibility of the CEO, the Founding Board may need to outline program elements in the initial strategic plan. Program elements might include the credit and savings methodology, staffing policy and recruitment, service delivery systems, and support in accounting and MIS. The Founding Board must fully hand over this activity to the CEO within the MFI's first year.

### **Assist the CEO in Hiring Key Personnel**

During the early stages of the MFI, the CEO generally requests help in recruiting and hiring key staff members, such as, a Chief Accountant, MIS Manager, Operations Manager, or Marketing Director. The CEO may want several Board members to assist as trusted colleagues in the interview processes.

However, a good Board should resist the temptation of directly overseeing the hiring of staff and simply offer to assist the CEO at her/his request.

### **Perform Treasury and Financial Functions**

The Founding Board may find itself investing funds for the MFI, creating budgets and assisting the CEO in other treasury functions. Again, while these activities may be good for a Founding Board to do during the very early stages of the MFI, the CEO must eventually take over full responsibility for these duties.

# Board Composition

Board composition issues include the criteria for a Board member, the number of members that constitute the Board, and specific qualifications of members. Good Board composition is more than the sum of its parts or the collection of experiences and skills its members bring to the table. Good composition requires a balance of expertise, attitudes and approaches. It requires thoughtful attention to synergy.

## How Many Members?

### The First Year: Founding Board Phase

Keep the Founding Board small to allow the Board to work as a real team. A Board of five members promotes thoughtful decision-making.

If your Founding Board would like to include other input and develop a pool of potential new members, consider creating a Board of Overseers. Overseers attend select Board meetings and are essentially in training to become full Board members. They may have regular Board assignments, such as organizing the annual meeting, assisting the Board and CEO with fundraising, and performing other Board-level work. Members of the Board of Overseers do not vote. If Overseers lack commitment in their service, the MFI would naturally not vote them in as new Board members.

### Thereafter: Mature Board Phase

The bylaws should provide the flexibility to grow your Board to seven members in the second year. A Board of five cannot sustain the organization. Not all members are able to attend every meeting, and having fewer than four members decide the fate of the organization is irresponsible. Plus, a slightly larger Board in the second and third years allows for more stakeholder representation. However, if the MFI is a commercial entity, it may attract new shareholders who might insist on sitting on and enlarging the Board.

#### Tip

Try to keep the Board to fewer than nine members for the first three years.

## For How Long?

---

To ensure continuity and for a Board to function well, a significant number of its members (optimally close to half of them) should at any time have at least one year of Board service. To institutionalize a pattern for Board continuity, consider staggering the elections for Board seats, as in the example below.

<b>Founding Board of Five Members</b>	
(A) Two Board Members	One-Year Terms ( <i>Transitions to two-year terms after first year.</i> )
(B) Three Board Members	Two-Year Terms

<b>Mature Board of Seven Members (can be a greater number)</b>	
(A) Two Board Members	One-Year Terms ( <i>Transitions to two-year terms after first year.</i> )
(B) Three Board Members	Two-Year Terms
(C) Two Board Members	Three-Year Terms

The Founding Board might consider limiting the number of consecutive terms any member can serve to two, with the provision that members may become candidates to rejoin the Board after not serving for at least one year. This provision gives the MFI the chance to bring in fresh ideas through new members as well as avoid problems associated with Board entrenchment.

## Who Should Serve?

---

### Qualifications

The qualifications of new Board members vary by organization. Early champions must consider their own skills and experience and how they wish to balance these with the skills and experience of others. They also want to consider who they might attract to best advance the new MFI's mission.

A good Founding Board consists of members who collectively embody these qualifications:

- An understanding of the operating environment, including knowledge of the key social, economic and strategic

issues faced by the new MFI. ( Several members).

- Experience with the duties associated with sitting on a Board of Directors—ideally, experience serving on other Boards—to guide the Founding Board in its first year of business. ( At least one member).
- An in-depth understanding of regulations surrounding microfinance or ready access to someone who can provide these insights when needed. ( At least one member).
- An in-depth understanding of either microfinance and its "best practices" or community banking, but not representing another MFI. ( At least one member).
- Connections to key services, such as legal, audit, or accounting services, to assist the CEO in opening doors to these services. ( Several members).
- Connections to funding sources. ( Several members).
- Belief in the social and/or financial mission of the new MFI and a commitment to its preservation. ( All members).
- Adequate time to meet regularly. ( All members).
- Knowledge of the issues articulated or implied in the mission and bylaws. ( All members).

During the Founding Board's first year, limit the number of stakeholders represented on the Board or decisions often slow to a crawl.

### Customers?

Save the decision of whether customers should serve on the Board until the MFI is stable. An exception is when your MFI is a cooperative or credit union, where regulations require that customers are represented on the Board. Also, consider that most customers are busy and may not have the time or the sophistication to serve on the Board of an ambitious MFI.

If Board members would like customers to serve on the Board, they must ask themselves: "What value would customers bring to Board business?" If the answer is: "Serving on the Board is empowering for customers," then the Board must ask whether "empowerment"

#### A Real Example

Working Capital, a U.S. microcredit institution, had two customers serve on a Board of nine members. One customer/member complained that she was too busy to sit on the Board and that the other Board members did not have to sit on their own bank boards to expect quality services. She resigned. The other customer/member remained, but complained of tokenism.

is written into the mission. If it is, then the MFI must directly manage this social agenda as part of operations, not necessarily as a Board function. If instead the answer is "to gain a customer perspective," this begs other questions: "Why is the MFI depending on understanding the customer perspective via the Board? Why isn't management routinely gathering market information as part of effective customer-oriented operations?" Alternately, if the answer is "customer representation," then the Board must understand that the MFI serves many different customer segments. A handful of customers cannot represent all customers. Proper feedback systems—such as customer focus groups, satisfaction surveys and thorough interviewing of customers who drop out—must be core operational activities, not Board functions.

### Tip

Invite customers to make presentations on specific subjects at Board meetings. These presentations should be related to the MFI's mission. Also, consider inviting customers to the annual meeting and other public events.

Customers serving on the Board may represent interests that run counter to the greater good of the MFI, such as lowered interest rates or special loans to them. Many new, idealistic MFI Boards would like customers to be shareholders and to have representation on the Board. The Founding Board's main concern is preserving the MFI's mission and its financial viability. There is enough to do without dealing with the added legal and organizational burden of organizing blocks of customers. Such activities can divert the Board from its primary responsibilities.

If the Board insists that customers serve on the MFI Board for whatever reason, it might consider selecting the most appropriate customers to serve first on a Board of Overseers, before serving on the Board of Directors.

### Staff?

The CEO might serve on the Board. On many such Boards, the CEO is not a voting member, but regularly attends each meeting. Occasionally, the Board might invite other staff to Board meetings to make special presentations.

If staff are also shareholders, they may ask to serve on the Board. However, staff as Board members present a host of

problems. Consider the implications and the potential conflicts of including staff on the Board. For example, staff report to the CEO for operational duties. However, the CEO then is required to report to staff who are also Board members. This situation creates tension and could hold the CEO back from making good decisions. For instance, if the CEO believed it was in the best interest of the MFI to let certain staff go, and yet those staff either served on the Board or had close colleagues on the Board, the CEO might refrain from doing the best thing. As a matter of policy, avoid appointing staff to the Board.

### **Members of Other Local NGOs, Banks and MFIs?**

Early champions must evaluate each situation separately and ask whether new members represent potential competitors and whether they would face conflicts of interest in overseeing the MFI. Board or staff of local NGOs may seek funding from the same sources and would feel conflicted about advising the new MFI. A banker sitting on the Board may want to offer financial services to the same market and would also feel conflicted. That said, many bankers and NGO leaders make good Board members. They can also be very helpful on Provisional Councils.

### **Members of the International Financial Community?**

Chances are that people from international banking institutions—such as the IMF, regional development banks, or international development agencies—do not have the time required to serve on a Founding Board. Avoid inviting these people to serve as Board members. Encourage their interest by including them in key events. Ask for their assistance in providing insights, raising funds and in publicity. Include them in an advisory capacity.

#### **A Good Board**

**M**ikra, a localized partner MFI in Bosnia and Herzegovina, has five Founding Board members, including: the Deputy Minister of Finance (Muslim), a microfinance expert (Croatian), a representative of a reputable NGO (Serbian), a representative of the local Catholic Church (Croatian) and the Executive Director of Mikra. The Board plans to solicit new members once everyone is comfortable with the new Board structure.



# Motivational Issues

Boards face other issues in choosing and electing members. Early champions must look at the integrity of the Board and each member. Two specific issues that must be considered by Boards while recruiting new members are compensation and possible conflicts of interest.

## Compensation

Should your MFI Board compensate Board members? Should members receive money in exchange for services? Many commercial entities compensate professional Board members elected by shareholders. Many do not. Whether to pay Board members in a commercial MFI depends on how much the MFI requires the expertise of the Board members and the alternate availability of such expertise.

If your MFI is a nonprofit organization supplying a social good, your Board still has to consider the availability of expertise. If your MFI is operating in a country or region where expertise is in short supply and skilled leaders are over-committed, your Board may want to offer stipends to compensate Board members. While an ideal Founding Board comprises highly dedicated individuals devoted to the MFI's mission, they may still appreciate a stipend. Small payments show gratitude for long journeys and many hours of service, most of which are gratis.

### Real Example

The Uganda Microfinance Union pays Board members \$50 per meeting to defray travel expenses and show appreciation. Each member feels good about this formal recognition of their time and attention devoted to Board activities.

## Possible Conflicts of Interest

Board members may have different reasons for joining your Board. Ideally, members join because they are committed to the MFI's mission. There are other reasons for joining though, which can be beneficial in Board retention. These reasons might include gaining the recognition of peers, enhancing a resume, or widening a social circle.

Some reasons, however, are not good for the MFI and can produce conflicts among Board members and damage the integrity of the Board.

- Local leaders seeking political office and attempting to use the Board as a platform to solicit customers as voters.
- Bankers interested in issuing a line of credit or loan to the MFI.
- Government officials seeking to "help" with regulations, but ultimately seeking compensation for their efforts.
- Attorneys or accountants seeking more business.
- Staff or Board members of a competitor or similar organization seeking confidential information.
- Any person interested in obtaining a loan from the MFI.

Avoid these situations wherever possible. Consider creating a concise written document to be signed by each Board member that specifically defines "conflicts of interest." Conflicts of interest vary by culture and organization.<sup>3</sup>

That said, if your attorney or accountant shows wisdom and commitment, and the early champions really believe they would be outstanding Board members, include them. Consider incorporating the following ideas into board policy to mitigate potential conflicts of interest.

Ask members to abstain from any Board votes in which they may have something to gain. For example, if the Board is considering drawing up key legal contracts, the attorney should abstain, if she/he is also supplying services for a fee to the MFI.

Or, ask the CEO to come up with at least two competitive bids on the same work, if the cost of the contract is significant.

---

<sup>3</sup> See sample "Agreement for New Board Members" (pp. 40-41) in the next chapter on **Member Recruitment**.

# Member Recruitment

Finding the right Founding Board members is critical to the success of the MFI, but the work of recruiting and retaining new Board members never ends. Since the Board of Directors must continually renew itself, it is always engaged in the process of seeking, enlisting and orienting new members.

## Finding Members

---

Although Board members are primarily tasked with representing the MFI's stakeholders, new members should not necessarily hail from one of the MFI's key constituencies. Early champions, for example, may believe that during the MFI's first year, it is more important to attract Board members who have the political influence or a particular skill-set to advance the MFI along a professional track. Here are some tips for locating new members for the Provisional Council, the Founding Board, and the Mature Board.

### Ideas for the Provisional Council

Find the most influential or prestigious professional law and accounting firms and ask for appointments with decision-makers. Meet with them under the understanding that you are exploring consulting relationships for the future, when the MFI is in a position to afford such services.

- Engage the services of an attorney who may be able to point you to Provisional Council members.
- Visit important government and political events and forums that relate to your new MFI. You might meet individuals attending these events who can help.
- Enlist all your contacts—local bankers, religious leaders (who often know non-religious leaders), former classmates, and so on—to help you in your search.

## **Communication Tips**

Invite potential members to lunch. Breaking bread is always a good way to begin a dialogue.

- Be honest about the development of your MFI—such as its funding status.
- Let these potential candidates know you are looking for dedicated local leaders and professionals to help guide the MFI during its formative stages.
- Ask if she/he would like to serve on the Provisional Council.
- Leave behind a brief, preliminary business plan that describes the mission and key goals of the MFI.

## **For the Founding Board**

The Provisional Council's key role is to help early champions find members to serve on the Founding Board—that is, the official Board of Directors as of the MFI's founding. As the Provisional Council grows to better understand the mission and challenges of the new organization and the character and skills of early champions, it should assist in identifying potential Board members, some of whom may already be on the Provisional Council.

## **For the Mature Board**

One of the few committees of the Board is the Nominating Committee. This Committee may be comprised of one or two Board members or include the whole Board. The Nominating Committee reviews the status of the Board and helps fill gaps. This committee makes certain that new members, who are appropriate for Board positions, are recruited, nominated, approved, and trained. The following are recommended ways to recruit and train new members.

## **Recruitment Tips for the Nominating Committee**

Identify key areas where skills or experience are missing from the Board, such as a background in banking laws and regulations, team building skills, and/or auditing experience or contacts.

- Ask all Board members to identify individuals from their own contacts or networking opportunities who might be appropriate.
- Once you have identified individuals, take them to lunch and describe the MFI.
- Begin to engage them in the new MFI. Ask them to attend a customer meeting with you. Invite them to make a presentation on a topic with which they are familiar.
- If all is well, invite them to participate on the Board of Overseers for one year. The Board of Overseers is a group of individuals who may attend Board meetings, may assist the Board or the CEO in appropriate ways, but who do not vote as Board members.
- If all is well, invite them to become a Board member.

## **Orientation and Preparation of New Board Members**

---

Creating a Board of Overseers is a great way to gradually train Board members. But newly elected Board Members will need further orientation.

### **Materials**

Many institutions fall into the trap of creating comprehensive "Board Packets"—binders crammed with information. Usually these just collect dust. Be judicious about what a new member needs. The following are essential materials:

- Copy of current bylaws.
- Minutes of last Board meeting.
- Scheduled meeting times for the year.
- Most recent strategic plan.
- Organizational chart of Board and staff.
- Last few Hot Sheets.<sup>4</sup>
- Financial statements.
- Donor reports.
- Outstanding proposals or awarded contracts.
- External and internal audit reports, if any.

---

<sup>4</sup> A Hot Sheet is a brief, monthly sheet of key indicators that enable the Board and management to rapidly evaluate the health of the MFI. For more details about Hot Sheets, see "What to Track Monthly" (pp. 73-74) in the chapter on **The First Year Plan**.

Give out this packet only when the Board member has shown commitment to serving on the Board of Overseers or the Board of Directors.

### **Agreement**

The Nominating Committee may want to create a "Board Member Agreement" that spells out the MFI's expectation of the new Board member's duties. Often such commitment letters are signed without real knowledge of what the responsibilities involved. Someone from the Board—but not the CEO—must agree to take the time to:

- Review the information packet with the new Board member.
- Review the Board Member Agreement with the new member to be sure that she/he is comfortable with the duties involved and is willing to commit the necessary time.

Keep the Board Member Agreement simple and brief. Limit it to one to two clearly understandable pages, such as in the following example.

### **Sample Agreement for New Board Member**

#### ***Responsibilities to the Stakeholders***

On behalf of the Board of Directors and other stakeholders, including stockholders not represented on the Board, I agree to do all within my power to preserve the mission and ensure the survival and financial well-being of this MFI. I understand that I am a steward of the institution and am ultimately responsible to its stakeholders for its success or demise.

#### ***Responsibilities to the Board***

I will make every effort to attend all scheduled meetings.

I will participate in all key Board activities, including the creation or amendment of bylaws and the creation or amendment of policy.

I will be honest and transparent and commit to working with the Board as a whole, not only with a few individuals.

I will commit to preserving the integrity of the Board and avoid private interactions with individual members, unless sanctioned by the whole.

I will take great care to be a steward of the MFI's financial and human resources.

I will do my best to take the time to learn about the special challenges of this institution and to develop the requisite skills for overseeing those challenges.

I understand I have financial and legal responsibility for the MFI.

***Responsibilities to the CEO***

I agree not to involve myself in the operating decisions of the MFI, unless requested by the CEO.

I agree to faithfully review the performance of the CEO against the projected results stated in the approved strategic plan.

I agree to assist in the development of Restrictive CEO policies.<sup>5</sup>

***Agreement To Avoid Possible Conflicts Of Interest***

I understand I must refrain from voting on, or influencing in any way, matters where I, or others who I know, stand to gain, other than any person's rightful gain as a shareholder. These matters include instances where directly or indirectly, I, my business, my employer, members of my family, friends, or social and business colleagues have the possibility to:

- Take a loan from the organization.
- Enjoy increased assets, income or other financial benefit, other than what is agreed to in writing and approved as fair compensation for all Board members or stockholders.
- Gain increased political status or power.
- Gain increased opportunity for employment.
- Gain increased social recognition or social power.

***New Board Member***

Signature \_\_\_\_\_ Date \_\_\_\_\_

Printed Name \_\_\_\_\_

***Approved by full Provisional Council or Founding Board.***

Signature \_\_\_\_\_ Date \_\_\_\_\_

Printed Name \_\_\_\_\_

---

<sup>5</sup> For more information about restrictive CEO policies, see "Restrictive Policies" (pp. 59-61) in the **Managing the CEO** chapter.



# Board Officers & Committees

The Board manages itself by electing officers and sometimes by creating committees. Most likely your founding documents, by regulation, name the offices of the Board and the process by which people move into an office and leave an office. The founding documents may also cite "standing" or ongoing committees.

## The Offices

---

Local laws and banking regulations may name specific officers that are required for nonprofit and for-profit MFIs. Typically, the Board elects its own members to serve as its officers, but it is possible to do otherwise. In for-profit organizations, shareholders usually vote in officers as a slate—nominated by the Board itself—during annual stockholder meetings. Regardless of local regulations, each MFI should have the following officers at minimum.

### Board Chair

The Board Chairperson, or "Chair," is the Chief Officer of the Board. A good Chairperson excels at running meetings and mediating discussion and is a disciplined team player.

The Chair's responsibilities include:

- Calling Board meetings.
- Managing Board meetings.
- Ensuring the Secretary keeps meeting minutes.
- And, ensuring that the Board carries out the following duties:
  - ▶ Evaluating the CEO.
  - ▶ Establishing a strategic framework for the MFI.
  - ▶ Preserving the MFI's mission.
  - ▶ Assuring its financial health.
  - ▶ Signing key documents.

The Chair's term of office may vary. For the Founding Board, consider a term of office of two years for the Chair.

### **Secretary**

The Secretary is responsible for keeping the minutes of the Board meeting and ensuring that the MFI's key Board documents are compliant and in order.

### **Vice Chair**

For your Founding Board, consider naming the Vice Chair, the "Chair Elect"—the Board member designated to become the next Chair. The Vice Chair presides over meetings when the Chair is not available and assists the Chair in other Board activities.

### **Audit and Finance Officer**

This office goes by many names, including Treasurer. The primary functions of the Audit and Finance Officer are to ensure that:

- The Board reviews and approves annual budgets, reports from supervisory authorities, and monthly or quarterly financial statements.
- The Board creates an open line of communication between itself and the internal audit function. When the MFI becomes large enough to have internal auditors to protect the MFI against fraud, these internal employees should be able to report directly to the Board as a whole, rather than reporting only through the CEO.
- The Board interviews and retains the external audit firm and examines and signs off on external audits.

#### **Note**

It is not the Audit and Finance Officer's job to do the MFI's financial oversight, only to ensure that the Board as a whole performs these duties.

During the founding year, the Audit and Finance Officer may take on the special role of ensuring the Board is well trained in key financial indicators associated with overseeing an MFI. The CEO may also want to confer with this officer on a number of financial issues, such as:

- Preparing budgets and financial statements in formats agreed upon by the Board.
- Hiring a controller or Chief Financial Officer.

To accomplish these tasks effectively, it is critical that the Audit and Finance Officer has a background in banking, finance, financial management or accounting.

## **Committees**

---

During your MFI's founding year, keep committees to a minimum. Too many committees confuse responsibilities and dilute the integrity of the Board. Typically, committees consist of at least one Board member who chairs the committee and one or two other members who may or may not be on the Board. The committee does its work outside of Board meetings, but presents its findings at regular Board meetings.

The only essential committee is the Nominating Committee, which is responsible for ensuring that the Board reaches out to new members and recruits them according to Board policy. In a shareholding MFI, the Chair of the Nominating Committee works with the Board Chair to make certain that an appropriate slate of officers is developed for presentation to the shareholders. In a not-for-profit organization, the Chair of the Nominating Committee ensures that the Board appropriately fills Board seats and follows processes indicated in the organization's bylaws and policies.



# Founding Documents

The term "governance" refers to two closely connected elements: the body of principles, often called bylaws or statutes, which define the MFI's objectives; and the individuals, the Board of Directors, charged with the creation, amendment and execution of these principles. Early champions and the Provisional Council are responsible for creating good bylaws to be preserved and amended by the Founding Board.

## **Purpose of Bylaws or Similar Founding Statutes**

---

MFI's must develop several legal documents—bylaws, statutes, articles of incorporation, and others—as required by local law to constitute the new organization. These documents reflect the principles created by the Provisional Council and the Founding Board and draw on important decisions already described earlier in this guide.<sup>6</sup> The specific document requirements vary by corporate structure and from country to country, but in all situations, the rules of Board operations, that is, the bylaws, are of central importance.

Bylaws name and elaborate the mission of the organization and define a system that:

- Distributes powers among those who influence the organization's policy decisions, generally the Board and CEO.
- Restricts these powers and provides checks so that they are not abused.
- Motivates individuals to use these powers to the greatest good of the organization.

The central task of bylaws in a microfinance organization is to ensure that the MFI's core purpose is preserved and that the organization survives to achieve its mission.

---

<sup>6</sup> See the "The Defining Decisions" and "Structural Decisions" (pp. 13-18) sections in the **Define Your Strategy** chapter.

At times, these mandates are at odds. For example, in order for a microfinance institution to survive, it may need to charge high interest rates. These rates may run counter to the preferences of poorer customers and even to the social mission of the organization. Effective bylaws must clarify guidelines for making decisions when such inconsistent choices occur and offer ways of preserving the long-term purpose of the organization in the face of short-term pressures.

Good bylaws not only outline the central objectives of the organization, but also:

- Clearly distinguish roles and responsibilities of the various governing parties.
- Contain a clear system of checks and balances.
- Assign specific powers and responsibilities.

### **Whom and What Bylaws Regulate**

In an MFI, the bylaws bring to light the rights and responsibilities of at least three categories of actors:

- Owners or shareholders, if it is a commercial MFI, and the directors they elect. Voluntary Board members, if it is a nonprofit organization.
- CEOs—often with the title President or Executive Director—paid to carry out the directives of the Board.
- Customers, if their savings are at risk.

External forces also monitor or limit key players in their rights and roles. These external forces may include trade associations, government policymakers and regulators, wholesale financial institutions, and other institutions that operate outside the structure of the MFI, but yet may influence operations. Ceilings on interest rates, laws regarding the taking of deposits, government auditing requirements, and registration procedures comprise a few examples of external factors that have direct bearing on the governance of the organization.

Social norms and capacities weigh in as well. Examples include Muslim practices regarding interest, women's economic

roles, local savings practices, and literacy rates. A good set of bylaws clarifies how governing individuals on the Board are expected to comply with these external forces and entities and yet retain flexibility in decision-making.

### **Developing Bylaws**

Many countries have specific guidelines and requirements for developing bylaws or statutes. Working with a good attorney early in the MFI's development facilitates an in-depth understanding of local requirements upon which to develop your new bylaws.

Bylaws are best when they are "living documents," reviewed by the Board and amended when appropriate. That said, many countries require your MFI to file bylaws with a state authority or regulatory body, regardless of the legal structure of the MFI. In some instances, amending bylaws and other key documents requires many levels of approval, which can be time-consuming and expensive if an attorney is required.

To avoid these difficulties, ask your attorney to retain as much flexibility as possible within the bylaws. Flexible bylaws allow your Board members sufficient space to make changes while continuing to comply with regulatory constraints. Determine if it is legally feasible to maintain policy documents internally, which are separate from the officially submitted bylaws and therefore not registered with outside authorities.

#### **Tip**

If your MFI is constituted as a nonprofit, order a copy of *The Nonprofit Board's Guide to Bylaws: Creating a Framework for Effective Governance*, by Kim Zietlan and Susan Dorn. <http://www.ncnb.org/>.

## An Example of Transforming Rigid Bylaws into Flexible Ones

### **Rigid Bylaws:**

The Board shall be comprised of nine directors.  
At least one member must represent the banking sector.

### **Flexible Bylaws:**

The Board shall have no fewer than three directors and no more than fifteen.

The Board shall decide its own composition. At the time of deciding or reviewing its composition, the Board refers to policy statements already developed, one of which may concern Board composition.

### **Flexible Policy:**

The Board shall ensure that at least one of its members is from the banking sector or at minimum from a related sector and familiar with regulations and policy matters affecting financial institutions.

Your Board may be concerned that flexible bylaws might not preserve the intentions of the Founding Board. The Board may deal with this concern and still keep bylaws reasonably flexible by requiring that:

- Certain major changes in the **bylaws** are permissible only through the approval of all members of the Board. For example, "Board members must agree unanimously through an official Board vote to amend any language in this MFI's stated mission."
- Certain changes in **Board policy** also require a Board vote, but unanimity is not necessary. For example, "The policy on Board Composition requires approval by the majority of the Board."

## Topics Included in Many Bylaws

Topic	Explanation
<b>Board Voting</b>	Addresses which decisions require majority vote and which, if any, require a unanimous vote. The bylaws also describe which, if any, decisions are taken anonymously, as opposed to a raising of hands. Additional voting procedures are also described in detail.
<b>Quorum</b>	Enumerates the number of Board members required in attendance at a meeting for a Board vote to be valid.
<b>Board Members</b>	Discusses number of members, how they are appointed or elected, qualifications, length of terms, dues required, if any, process of filling vacancies, and compensation.
<b>Board Officers</b>	Describes duties, qualifications, terms and limits.
<b>Board Meetings</b>	Lists number and type required annually and explains how members are notified of meetings.
<b>Termination</b>	Itemizes causes and process for removing members.
<b>Audit Committee</b>	Specifies duties of the Audit Committee.

## Shareholders as Owners

---

Some MFIs have owners, who elect Board members, who in turn safeguard bylaws and other key documents. To maintain flexibility when there are shareholders, work with a good attorney to ensure that the bylaws contain the minimum of restrictions, especially if the MFI is regulated or intends to be. Instead, try to incorporate restrictions in the Shareholders Agreements between the shareholders and the MFI, which can be more easily amended.



## Section Three: The Founding Year



# Managing the CEO

This section draws heavily on the work of Mary Houghton<sup>7</sup> of the Shorebank Corporation and John Carver,<sup>8</sup> author and consultant on nonprofit Board issues. Both have similar thoughts on the role of a Board in relation to the role of the CEO. To assist organizations in better defining this relationship, John Carver has developed an outstanding method of creating policies to manage CEO activity. This method, while created for nonprofit institutions, has widespread application for commercial companies and MFIs.<sup>9</sup>

## Roles of CEO and Board

The following schematic describes the contrasting, yet complementary roles of CEO and Board.

Responsibility	Board	CEO
<b>Preservation of Mission</b>	Overall responsibility to preserve mission of organization, or if absolutely necessary, to amend mission as circumstances change (not recommended in early years).	Responsible for preserving mission in all aspects of executing organizational responsibilities.
<b>Financial Performance</b>	Responsible for financial survival of MFI and, if for-profit, for protecting shareholders' rights to enjoy a financial return. Responsible for evaluating CEO based on financial performance objectives as approved in strategic plan.	Responsible for MFI achieving financial performance objectives.

(Continued on following page)

<sup>7</sup> Mary Houghton is the Co-founder and President of the Shorebank Corporation, Chicago <[www.shorebankcorp.com](http://www.shorebankcorp.com)> The author's citations of Ms. Houghton's views on Boards are derived from personal conversations.

<sup>8</sup> See, for example: John Carver, *Boards That Make a Difference: A New Design for Leadership in Nonprofit and Public Organizations* (2nd ed.), San Francisco: Jossey-Bass, 1997.

<sup>9</sup> Though the author has never seen these techniques applied to an MFI, she has seen them successfully applied to commercial companies.

<b>Responsibility</b>	<b>Board</b>	<b>CEO</b>
<b>Social Performance</b>	Responsible for establishing social objectives in strategic plan and for evaluating CEO according to those objectives.	Responsible for MFI achieving social objectives agreed to in strategic plan.
<b>Staff Performance</b>	Only responsible for Board policies specifically limiting CEO in personnel issues.	Responsible for building a strong management and staff team.
<b>Strategic Planning</b>	Responsible for establishing general strategic framework (major goals and objectives) and for approving strategic plan prepared by CEO and staff. In the first year, the Board may be more involved in the actual planning.	Responsible for preparing an annual strategic plan (looking two to three years into the future) based on Board guidelines (strategic framework). Responsible for achieving results in the strategic plan.
<b>Organizational Policies</b>	Oversees Board policies. Establishes restrictive policies <sup>10</sup> for CEO. Board approves Board policies at Board meetings by voting.	Oversees all operating policies including marketing, financial management, and human resource.
<b>Liaison with Stakeholders</b>	Interacts with stakeholders and shareholders about Board matters. Involves stakeholders in key events. Includes stakeholder issues in strategic frameworks. Evaluates CEO performance in achieving goals set forth in the strategic plan.	Ensures that the interests of stakeholders and shareholders are represented, by achieving goals set forth in the strategic plan.
<b>Regulation</b>	Responsible for MFI issues of compliance and liability, but does not manage compliance activities. Oversees CEO's performance in areas of compliance and regulation through results-based monitoring.	Ensures MFI is compliant with regulators.
<b>Staff Oversight</b>	Oversees CEO and internal auditor.	Oversees all staff except internal auditor.
<b>Fundraising</b>	Since the Board is responsible for the health of MFI, it often engages in fundraising. This is best done in partnership with the CEO.	Responsible for raising funds for the MFI in partnership with the Board and according to approved strategic plan.

<sup>10</sup> For more details, see "Restrictive Policies" (pp.59-61).

## The Job of the CEO

---

The CEO is the senior person in charge of the MFI. This position is usually salaried. The CEO reports to the Board of Directors and is responsible for the performance of the MFI according to the approved strategic plan. This means the CEO oversees:

- Achieving growth objectives approved in the annual strategic plan.
- Identifying major market and strategic opportunities, and reporting these opportunities to the Board for their review, if such opportunities arise outside of the strategic plan.
- Alerting the Board about anticipated problems and possible solutions.
- Overseeing financial management of the MFI.
- Raising funds for the MFI in partnership with the Board.
- Presenting financial information to the Board including financial statements, audit reports and budgets.
- Analyzing financial trends in the MFI and reacting appropriately.
- Ensuring regulatory compliance.
- Developing human resource policy, maintaining oversight, and building a strong staff team.
- Achieving growth and performance objectives as set forth in the strategic plan.
- Preparing an annual strategic plan, including looking two to three years into the future. The strategic plan is built upon the Board's guidelines, which in this guide are referred to as the "strategic framework" and are based on an understanding of the market, social concerns and issues of competition and profitability.
- Fundraising, in close collaboration with the Board during the first year. Thereafter, asking for the assistance of the Board as needed.
- Networking with a broader constituency of government and political actors.
- Supporting the Board in its activities, including assistance in preparing for Board meetings and annual meetings, as well as Board orientation.

## Criteria for a Good CEO

---

A good CEO is competent at many things, but most important, she/he is able to lead. Leadership skills foster the respect of the Board, as well as the ability to manage the staff and build a strong team. The CEO needs to continually assess the market and adapt the MFI to important marketplace changes. Ideally, the CEO has experience in MFI management or in banking. If she/he does not, the Board must work closely with her/him to develop these important business management skills. To summarize, the skills and character required of a good CEO for your new MFI are:

- Trustworthy.
- Commitment, passion even, for the mission of the MFI.
- Dedication to achieving the MFI's social objectives.
- Problem solving ability and, even more importantly, problem anticipation.
- Team-building and human resource development skills.
- Efficient operational management and planning skills.
- Analytical skills of market and financial trends.
- Strategic insights and strategic planning skills.
- Presentation and public relations skills.
- Knowledge of banking, or easy access to this knowledge.

## Hiring the CEO

---

It's quite possible that the early champions can identify a CEO candidate for the founding year. In fact, one of the early champions may become the CEO. If this is the case, the Board must reassure itself that this candidate is the right person for the job and conduct a formal interview, comparing her/his credentials against an approved, written job description and set of qualifications.

If no candidate is obvious, the early champions and Provisional Council should not allow MFI operations to begin until the CEO is in place. Do not launch the MFI with a handful of staff who have no leadership skills.

Instead, write a detailed job description and begin an active search. Looking for candidates from the ranks of other MFIs may

### Tip

The best candidate may not come from the MFI sector. She/he may be a person switching careers. Ideally, she/he has leadership and business management skills and a total commitment to the MFI's mission.

not be your best strategy. In fact, a candidate who has grown up through the ranks of an MFI may be a great manager, but not a great leader. Choose your CEO carefully.

## Managing the CEO

---

The Board as a whole manages the CEO. Letting your CEO know ahead of time exactly how the Board plans to evaluate her/him is good practice. Consider evaluating the CEO based on her/his performance in achieving the results agreed upon in the approved strategic plan and her/his adherence to the written restrictive policy. This makes the performance review simple and fair.

### The Strategic Plan

To manage the CEO, John Carver<sup>11</sup> advises the Board to establish guidelines for developing an annual strategic plan that seeks to project two to three years in the future. The CEO prepares the plan according to these broad guidelines and presents the Board with a set of specific outcomes that she/he realistically expects the MFI to achieve. The Board approves the plan or advises the CEO on how to change the plan to meet the Board's requirements. Achieving the results stated in the plan is one measure of the CEO's performance.

### Restrictive Policies (Policies of Limitations)

John Carver has refined a concept for CEO management called "setting restrictive or limiting policies."<sup>12</sup> Carver concludes that strong Boards do not micromanage their CEO. Instead, they choose the right CEO and give her/him sufficient latitude to do her/his job—in other words to run the organization.

However, it's only fair that the CEO should have advance knowledge of which issues or types of issues might cause concerns for the

---

<sup>11</sup> John Carver, *Boards That Make a Difference: A New Design for Leadership in Nonprofit and Public Organizations* (2nd ed.), San Francisco: Jossey-Bass, 1997.

<sup>12</sup> *Ibid.*

#### Tip

Spend time during the Founding Year developing policies to limit the CEO in areas of concern. Each Board member may want to focus on one area and develop policies to present to the Board for its approval. Work in partnership with the CEO. The process should be one of good teamwork, not an adversarial one.

Board. Carver advises the Board to translate specific concerns or "worries into policy." These policies state **exceptions** to what the Board and CEO agree is normal business. If the CEO is able to conform to these stated exceptions to what is in the strategic plan or normal management, she/he should fare well in terms of policy compliance, the second measure of a CEO's performance.

Taking Carver's advice, let us see how an MFI's Board might translate worries into policy during the MFI's founding year. Here are a few examples that were suggested to Mikra, a CRS supported MFI in Bosnia and Herzegovina that successfully localized in early 2001.

**Example 1:**

**Area of CEO Limitation: Representing and promoting Mikra in public.**

The Board of Mikra agrees that the CEO may individually represent Mikra according to the approved strategic plan, except in the following situations:

- **Government meetings and other important official functions and ceremonies:** The CEO shall at all times invite a Board member to accompany her/him at government ceremonies.
- **The press:** the CEO may represent Mikra to the press; however, on all occasions, she/he must refer the press to at least one Board member for confirmation of information or to provide additional comments.

**Example 2:**

**Area of CEO Limitation: Establishing rates of interest.**

The Board of Mikra agrees that the CEO may set interest rates on loans to customers of Mikra, **except** in the following situations:

- If the interest rate at any time is to exceed three percent per month.
- Raising the interest ceiling higher than three percent requires Board approval.

***Example 3:***

**Area of CEO Limitation: Financial management and oversight.**

The Board of Mikra agrees that the CEO may manage Mikra's financial decisions according to the approved strategic plan or the routine requirements of managing the MFI, **except** in the following situations:

- Investments in assets or general expenditures greater than US\$5,000.
- Investment of unused loan capital in financial instruments other than Treasury bills, government-backed bonds, or Certificates of Deposit.
- Any situation that jeopardizes the financial and ethical integrity of Mikra.

***Example 4:***

**Area of CEO Limitation: Developing personnel policies.**

The Board of Mikra agrees that the CEO may set Mikra's personnel policies, except in the following situations:

- The CEO may not set his own salary and benefits. CEO salary and benefits are always established and approved by the Board.
- The CEO may not set staff salary and other forms of compensation, including health benefits, significantly higher—that is, 10 percent or greater—than that of similar positions in the microfinance sector in Bosnia and Herzegovina.
- The CEO may not set salary and other forms of compensation, including health benefits, significantly lower than that for similar positions in the microfinance sector in Bosnia and Herzegovina.



# Board Meetings

During the founding year of your new MFI, the Board may meet many times informally to help create the new organization. While unstructured effort and enthusiasm surely pays off in years to come, meetings where Board-level decisions are made must be documented.

Mature organizations often host Board gatherings quarterly or twice per year. A new MFI, however, undoubtedly has many Board-level issues to debate during the first 18-24 months. You may want to divide meetings between special meetings, where your Board learns about key issues, and regular Board meetings, where Board members agree to vote on key strategic issues.

## Special Board Meetings

---

During your MFI's founding year, your Board probably needs to hold several special meetings. There are big decisions to make. These decisions require discussion, reflection and information. A special meeting is a good way to create the time needed to pursue specific topics more deeply.

Run special meetings the way you would run a regular meeting. The Chair should call the meeting to order, the Secretary should keep records, and an agenda and timeframe should be agreed upon before the meeting begins. You may wish to include outside specialists in these meetings to help clarify specific issues. However, refrain from making key decisions with outsiders present.

**Tip**  
It is always a good idea to have light snacks and drinks on hand to keep people's energy high.

## Board Retreats

---

Managing an MFI is different from managing either a business or a nonprofit. An MFI has elements of both a bank and a social enterprise. A good Board consists of a mix of individuals who address both business and social issues. Once your MFI has identified its Founding Board members, think about scheduling a full two-day Board retreat within the first quarter of your new MFI's operations. The goals of the retreat are:

- Build a Board team that works as a whole. Use various team-building exercises to strengthen understanding and communication among members.
- Understand the special considerations of an MFI. You may want to invite an internal or external expert to review key financial information.
- Make the big decisions. Many key organizational decisions may have already been made before the retreat takes place. The retreat is a good time to review these decisions and to complete or refine those decisions not yet made.
- Create policy. The retreat provides a quiet, thoughtful venue to identify which policies the Board wants to tackle in the first year and to develop a plan to systematically deal with other policy issues.
- Develop a Board Learning Agenda. Over the course of the first year, Board members need to learn many things to make them better at their jobs. During the retreat, take the time to develop two things: A meeting schedule for regular and special Board meetings for the year and a Learning Agenda.<sup>13</sup>

If members of your Board are skilled in managing long sessions, invite one or two of them to head the facilitation. If no one on the Board has these skills, investigate retaining an outside facilitator.

#### Tip

To build recognition and goodwill, hold a brief meeting of just the Board members first to conduct Board business. Adjourn to a larger meeting where other stakeholders and even the press are included. Invite customers and offer food and music.

## Annual Meetings

---

### Of a Nonprofit Board

The bylaws of most nonprofit organizations stipulate that the Board must hold an annual meeting. Check local laws to determine the requirements for the essential business items that must be included at an annual meeting. Usually, at least the Board must convene. Often, MFIs use this as an opportunity to include other stakeholders and have some fun. If there is Board business to

---

<sup>13</sup> For more details on the Learning Agenda, refer to "The Founding Board's Learning Agenda" (p. 75) in **The First Year Plan** chapter.

conduct, typically it includes approving a budget for the coming year, electing new Board members, and electing new officers of the Board.

### **Of Organizations with Shareholders**

Most legal environments require an annual meeting of shareholders. If the MFI has shareholders, the CEO or Board Chair or both address shareholders about the past year's performance of the MFI and prospects for the coming year. The shareholders then vote on the new slate of Board members.

#### **Tip**

To learn about presentations and discussions of an annual shareholders meeting, download a transcript from a publicly traded company such as Kodak ([www.Kodak.com](http://www.Kodak.com)) or Citigroup ([www.citigroup.com](http://www.citigroup.com)). They cover the same topics as small companies, including MFIs.

## **Regular Board Meetings**

---

### **How Often?**

Agree to meet at least monthly during the first year for regular Board meetings. At the end of the founding year, vote on the Board meeting schedule for the next year.

### **Who Runs the Meetings?**

The Chair runs the meeting, unless the Chair cannot be present, in which case the Vice Chair runs the meeting. The Secretary makes sure that meeting minutes are kept and approved by the entire Board.

### **How Long?**

Keep meetings to two hours, no longer. The limited time period helps to focus the discussion and decisions. If the MFI is facing a crisis or a special opportunity, discuss these issues in advance of the actual meeting.

### **What Is Discussed?**

Board meetings should deal exclusively with the Board's responsibilities, not staff responsibilities. Meetings should stay at the most strategic level. The Chair, in creating an agenda, should make every attempt to limit discussion about operating and staff issues. These issues are the purview of the CEO. Here are

examples of appropriate matters to be discussed at the Board meeting:

- Bylaws—creating, preserving and amending them—and Board documents.
- Big initial decisions.
- New Board members.
- Board logistics: next meetings, annual meeting, gatherings, etc.
- Strategic issues brought to the Board's attention by the MFI's stakeholders.
- Audit reports, internal and external.
- Issues regarding the organization's mission.
- Funding issues and opportunities at the most strategic level.
- The performance and pay of the CEO.
- A framework and basic directions for an annually produced strategic plan.
- Approval of the strategic plan.
- Development and amendment of Board-level policies.
- Issues of organizational liability.

### **Meeting Agenda**

The Board Chair is responsible for establishing a meeting agenda, with the participation of all Board members. Call or write the Board Chair in advance of the meeting if you have issues to discuss that require Board consideration. This helps the Chair create a reasonable timetable for the meeting.

The Chair might consider the following in establishing an agenda:

- Indicate which items require a Board decision (vote), which require discussion or advice, and which are for information purposes only.
- Set a time limit for each item, and move discussion along to ensure important items are discussed.
- Place critical items at the beginning of the agenda.

Here is a sample agenda for an MFI not facing any pressing or critical situations.

**Sample Board Meeting Agenda, September 22, 2001, 6:00 pm**

Item	Member	Decision	Time
1. Roll call and bring meeting to order. Chair takes note of who is present and who is missing. Secretary records this in minutes.	Nina, Board Chair	No	
2. Review meeting agenda. Make adjustments.	Nina, Chair	Yes	10 minutes
3. Review and approve previous meeting minutes.	Tia, Board Secretary	Yes	5 minutes
4. Treasurer's report.	Alfonso, CEO (Treasurer is absent)	No	10 minutes
5. CEO's report.	CEO	No	15 minutes
6. Approval of new budget for this quarter based on increased expenses.	CEO	Yes	15 minutes
7. Strategic opportunity! New funding available from EU, but strings are attached.	Nina, Chair	Yes	45 minutes
8. Report of internal audit (Executive Session).	Sam, Internal Audit Director	Yes	10 minutes
9. Confirm dates, times and places for next regular meeting.	Nina, Chair	Yes	5 minutes
10. Review and approve "Key Decisions."	Tia, Secretary	Yes	5 Minutes
11. Adjourn Board meeting.	Nina, Chair	No	

### **Executive Session**

Executive Session, common among both nonprofit and shareholding institutions, refers to time the Board spends meeting without the CEO. Topics of the Executive Session include:

- Evaluation of the CEO, such as the CEO's performance, his pay, audit reports or other strategic matters.
- Evaluation of the Board meeting: What can be improved for next time?
- Evaluation of the Board's performance.

#### **Tip**

**A**s a matter of practice, include an Executive Session in each meeting so that neither the CEO nor the Board finds such sessions unusual.

# Keeping Minutes

It is the responsibility of the Secretary to ensure that records of each Board meeting are kept. However, the Secretary is not required to take the minutes. The Secretary may appoint another Board member to do so.

Boards often find their members too busy to type and distribute minutes after each meeting. Some MFI Boards have gone without minutes altogether or use minutes that are distributed months late. Minutes must be kept. They are the only proof that a Board has met and is fulfilling its obligations. Moreover, local law may require your filing minutes. Delegating the taking of minutes to MFI staff is not a good practice. Staff may not know what is important and, consequently, omit critical information or include too much.

As a remedy, consider using a "Key Decisions" form. Any Board member may volunteer to complete this form by hand; it includes important decisions agreed to by the Board and indicates who raised which issues and whether any members disagreed. The Key Decision form may be completed during the meeting and then verified and signed by officers present at the meeting. The Secretary keeps one copy and gives one copy to the CEO to keep at the MFI office. These handwritten documents are valid records and are made tidy by the use of a printed form. Below is a sample form that records a hypothetical Board meeting:

## Minutes of MicroCapital Board of Directors Key Decisions

**Date of Meeting:** August 4, 2001

**Time/Place of Meeting:** 3:00 pm, MicroCapital HQ

**Board Members Present:** 7 of 7 voting members present.

W. Wanda (Chair), R. Kim (Treasurer), S. Pond, R. Srina, J. Paul (Secretary—Arrived late, with prior notification, but missed first two decisions), L. Piro, G. Sam, and Tom Tingo (CEO and non-voting member)

**Comments:** Agenda attached, but Board only made it through point 10, with 2 points remaining for the next meeting.

**Time Adjourned:** 5:30 pm

**Next Meeting Date, Time and Place:** September 15, 3:00 pm at MicroCapital HQ.

<b>Key Decisions Made</b>	<b>Moved and Seconded By</b>	<b>In Favor/ Opposed</b>
1. Reviewed and approved minutes of previous meeting.	G. Sam, R. Srina	All in favor.
2. Approved this quarter's budget, presented by CEO and reviewed by Treasurer.	R. Kim, W. Wanda	All in favor.
3. Made key revision in draft of strategic plan: Revised plan now calls for researching the viability of offering individual loans.	S. Pond, J. Paul	All in favor.
4. Approved date and place of annual meeting: January 20, 2002, at MicroCapital.	G. Sam, S. Pond	All in favor.
5. Nominated and approved Tina Moro as new Board member at next meeting. Tina replaces Lana Brag who moved to the U.S. last month.	L. Piro, R. Kim	All in favor.
6. Approved location of new branch in South Riceland (45 Hull Street).	J. Paul, S. Pond	All in favor.
7. Agreed to add "Attrition" as a key indicator on the Hot List and drop "Arrears" (as we have other delinquency indicators).	L. Piro, W. Wanda	All in favor.
8. Held Executive Session and agreed to give CEO Tom Tingo a five percent raise. (CEO not present during this discussion).	R. Srina, G. Sam	All in favor.
9. Approved Personnel Policy of MicroCapital's three senior staff.	S. Pond, R. Kim	All in favor.

These notes were taken by: S. Pond, August 4, 2001.

Approved by (*signature*):

W. Wanda R. Kim R. Srina J. Paul G. Sam L. Piro

A Board member can also take more detailed notes or full meeting minutes. If minutes are taken by hand, the CEO should offer to have them typed, approved and distributed.

# The First Year Plan

The founding year of the Board requires hard work for the launch of the MFI and associated Board-level activities. Here are some approaches to managing the Board's initial decisions, actions and need for information.

## **Developing an Annual Agenda and Time Table**

---

After Founding Board members have agreed to join the Board, they must manage as a group the multiple Board activities in the MFI's first year.

Below is an example of the kinds of decisions and activities that might constitute the Board's first year. Note that most are dedicated to the Board itself, not to the microfinance program. Operations and programming are the responsibility of the CEO. Do not use this table as a guide, but as a starting point to generate ideas.

## Types of Activities Common for Founding Boards

Activity	Pre-Founding Period	Quarter One	Quarter Two	Quarter Three	Quarter Four
<b>Research</b>	Legal options, attorney, accountant, future funding.	Changing legal environment.		Two new Board members for next year.	
<b>Key Decisions</b>	Choose best legal option. Select attorney and accountant.			Approve location of second branch based on performance.	
<b>Mission Statement</b>	Early champions develop initial mission statement. Founding Board refines it.	Board reviews MFI performance against mission.	Same	Same	Same
<b>Strategic Planning and Reporting</b>	Early champions develop 10-page plan with summary projections. Use plan to attract other founding members.	Strategic framework discussed at Board retreat. Board chooses initial Hot Sheet indicators.	CEO prepares strategic plan for two years. Board approves/ rejects/ or recommends.	CEO begins reporting each month how MFI is tracking with Strategic Plan and Hot Sheet indicators.	
<b>Board Members</b>	Confirm final slate of Founding Board members.	Vote in officers.	Establish nominating committee.	Develop orientation program for new members.	Present two new members to Board for consideration (not election).
<b>Funding</b>	Secure at least two years of funding for new MFI.		Make links at request of CEO.	Same and begin developing an event to assist CEO in showcasing MFI.	Same
<b>Bylaws</b>	Finalize bylaws and articles of incorporation. Register MFI.				Review and make suggestions for endment.
<b>Policy</b>	Begin developing Board-level policies.	Begin developing Board-level policies for CEO.		Complete developing Board-level policies.	Complete Board-level policies for CEO.
<b>Meetings</b>	Establish monthly meeting agenda and process.	Board retreat.	Two special meetings to advance Board Learning Agenda.		Plan annual meeting.
<b>CEO</b>	Identify CEO and develop CEO contract and compensation plan.	Request and approve a standard budget format for Board and meetings.	Establish process for evaluating CEO. Request a loan loss reserve write-off policy.	Request from CEO, an investment plan for unused funds.	
<b>Audit</b>			Recruit several external audit candidates.	Select and approve external auditing firm.	
<b>Board Learning Agenda</b>		Develop Learning Agenda at Board retreat.	Begin implementing Learning Agenda.		Review Learning Agenda. Plan for next year.

## What to Track Monthly?

---

Each month, Board members should review important information to ensure the MFI is tracking toward its goals.

During the first quarter of the new MFI, the Board might consider working closely with the CEO to create a Hot Sheet.

The Hot Sheet should flag problems, show important achievements, and anticipate challenges. The CEO should supply the Hot Sheet a few days after the close of each month and provide more detailed information for full Board meetings or if the MFI is experiencing difficulties. The Chair and other officers may want detailed information regularly, as well as the Hot Sheet.

Allow time at one of the first Board meetings to discuss and decide what information to include in the monthly Hot Sheet. Choose no more than 15 indicators and be sure every member understands each one selected. Indicators vary from MFI to MFI to reflect the organization's specific social mission as well as the Board's obligation to its financial goals. Hot Sheet indicators may change as the organization evolves and as the Board becomes more sophisticated in executing its duties.

Typically, the Hot Sheet reflects both social and financial indicators, such as those in the example below:

## Sample Hot Sheet

<b>Financial Indicators</b>	<b>Explanation for Indicator</b>	<b>Current Period</b>	<b>Previous Period</b>	<b>Change</b>	<b>Comments</b>
<b>Loan Portfolio:</b>	Shows balance of outstanding loans	\$1,200,000	\$1,100,000	9%	Will hold back growth for the next two months
<b>Portfolio at Risk:</b>	Shows value of balances with late payments	14%	10%	40%	Flooding causing payment problems
<b>Earned Income:</b>	Revenue from interest and fees	\$24,000	\$22,000	9%	
<b>Profit Margin:</b>	Net Profit as a % of earned income	-2%	1%	3 point swing	More expenses due to flooding
<b>Cash Position:</b>	Shows cash balance	\$80,000	\$90,000	-11%	We need to discuss
<b>Social Indicators</b>					
<b>Active Customers</b>	With loans and/or savings	13,000	11,500	13%	
<b>% Women</b>	Target is 75%	70%	68%	3%	
<b>% New customers at poverty level one</b>	Lowest income level Target is 50%	60%	60%	0%	
<b>Average 'customer life' in months</b>	Shows retention. Important for profits also	38	50	-24%	Many drop-outs due to flooding
<p><b>Other Key Information:</b></p> <ul style="list-style-type: none"> <li>• Approved for \$200,000 Line of Credit from National Farm Bank.</li> <li>• Addressing loan rescheduling for flood victims.</li> <li>• Began market research in Northeast Province for new branch.</li> </ul>					

The Board may ask to track certain indicators for just a few months. For example, if the CEO alerts the Board that liquidity has been a problem, the Board may ask to show more cash indicators for a specified time to assist its planning for future funding.

As the MFI becomes increasingly sophisticated, the Board works closely with the CEO to understand more complex data, such as liquidity indicators, capital adequacy ratios or the latest findings in impact assessment. While the Hot Sheet is limited to a few indicators, the Board must make a point to learn the many important financial ratios and markers of organizational impact.

## The Founding Board's Learning Agenda

During the retreat or even sooner, the Board may want to develop a plan to address its own learning needs. Each learning topic must be justified by its connection to the Board's responsibility to preserve the mission of the MFI.

A good way to develop the Learning Agenda is to hold a 45-minute brainstorming session at the first Board retreat or at a special meeting. Manage the session this way:

- Ask members individually what skills they must learn to advance the mission. Write ideas down on a flip chart. Prioritize the suggestions by how closely the mission depends on the Board understanding these ideas.
- Develop a Learning Agenda and a proposed timeline for learning.
- Share the responsibilities for ensuring that the learning occurs.

### Sample Founding Board Learning Agenda, 2001

Learning Topic	Approach	Dates	Responsibility
<b>Financial Indicators</b>	Invite experts from an MFI consortium to give training. Allow four hours for Part One and four hours for Part Two. Hold sessions in the context of a special meeting. The training should be at the most strategic level; avoid technicalities and focus on key indicators and their meaning.	January	Tia, Chair
<b>Social Impact of MFI</b>	Talk to customers. Arrange for full Board to visit four village banks and individually talk to members. Allow one full day and dinner.	March	Tom, CEO
<b>Auditing Procedures: Roles of internal and external audit and the duties of the Board</b>	Invite internal auditor and external auditor to be present. Tie presentations to Board responsibilities. Allow for two sessions in the context of a special meeting.	April	Tom, CEO
<b>Regulations on Savings</b>	Invite expert from Ministry of Finance to discuss requirements for taking savings.	November	Jan, Treasurer



# Financial Matters

The word "finance" is embedded in the word microfinance. The Board, in fact, is charged with overseeing a financial institution. Does the Founding Board need to know every aspect of managing a microfinance institution on a day-to-day basis? No, it does not.

That is the CEO's job. Search the web sites of major banks and research what kind of individuals sit on their Boards. Bankers rarely sit on these Boards—but influential members of the business community do. These Board members do not concern themselves with the details of banking. However, as powerful shareholders they do understand basic finance and good business practices and know what kind of returns to expect. This is the same degree of know-how required of a Founding Board for a microfinance institution. Here are a few guidelines.

## Projections

---

Financial projections assist both the CEO and the Board in predicting profitability, in understanding sensitivity analysis—that is, the impact of various financial decisions, such as setting interest rates—and in estimating cash needs.

### Early Champion Phase

To attract funding, early champions may prepare a preliminary strategic plan, including a business plan with some basic projections. These projections should indicate at a minimum:

- Projected number of customers for three years.
- Projected individual loan balances (amount of unpaid principal).
- Projected portfolio (the sum of all individual balances).
- Interest income.
- Staffing expenses.
- All other expenses.

- Profit or loss.
- Required loan funds.
- Required operating funds until breakeven.

During these early stages, projections do not mean much. Unless the MFI is the outgrowth of an existing microfinance program, the projections may point to a general direction in growth, but little more. Savvy donors or investors do not put a great deal of stock in start-up projections. However, they are still necessary.

### **Founding Year Phase**

The CEO does far more with these projections. She/he uses projections as a tool for tracking liquidity (cash available), to optimize efficiency, to project growth and to anticipate profits.

The CEO prepares projections for her/his own use in internal planning and to present to the Board for its review and understanding. These projections should include the same information cited in Early Champions phase plus the following:

- Portfolio at risk.
- Loan loss reserve.
- Cost of capital.
- Efficiency ratios.
- Liquidity ratios.
- Return on assets ratios.
- Return on equity ratios.
- Debt to equity ratios.
- Capital adequacy ratios.

#### **Tip**

This information is not intended to replace the Hot Sheet, but to complement it when requested and as appropriate.

Within the first quarter of the founding, the CEO should prepare an annual budget for the Board's review and approval. The budget includes anticipated income and expenses for the year by individual month and is actually part of the strategic and business plans. The Board reviews the monthly income and

expenses and other key indicators based on the projected budget and looks at variances.

Elements of the budget appear in the monthly financial statements and vice versa. The budget, which varies in form according to the preference of the Board, is a good tool for financial oversight; it synthesizes key elements of the financial statements for the purposes of planning and analysis. Here is a sample of a one-month budget, contrasted to actual results:

**MicroCapital Budget Comparison for January 2001**

	Projected	Actual	Variance	Variance %
Loan Portfolio	\$100,000	\$95,000	(5,000)	-5%
Loan Funds Available	\$20,000	\$25,000	\$5,000	25%
Cash Income from Interest and Fees	\$3,000	\$2,500	(\$500)	-17%
Cash Income from Investments	\$750	\$700	(\$50)	-7%
Total Cash Income	\$3,750	\$3,200	(\$550)	-15%
Salaries	\$2,500	\$2,000	(\$500)	-20%
Other Programming Expenses	\$1,000	\$1,100	\$100	10%
Overhead Expenses	\$1,000	\$1,000	0	0
Total Cash Expenses	\$4,500	\$4,100	\$400	-9%
Surplus/Deficit	(\$750)	(\$900)	(\$150)	-20%

**Financial Statements**

During the Founding Year phase, the Board should expect the CEO to produce timely, monthly financial statements within ten days of the close of the month. Statements include:

- Income statement.
- Balance sheet.
- Cash flow or statement of changes.

The Board may also want more details on the quality of the loan portfolio, such as reviewing the aging of past due accounts and an update on the status of the loan loss reserve.

**Policies**

During the founding year, the Board should ask the CEO to develop a loan write-off policy and a loan loss reserve policy. The CEO should recommend a policy for Board approval.

The Board should also expect the CEO to provide insightful financial analysis. This means the CEO should analyze financial statements and other financial indicators each month and point out important trends to the Board in addition to providing monthly Hot Sheet reports to the Board.

## **Audit and Control**

---

Microfinance involves the handling of many small sums of cash. This cash is subject to fraud and mismanagement, either through inappropriate handling or inappropriate record keeping. The Board must ensure sound financial practice without micromanaging the CEO. The Board can best exercise this responsibility by working with the CEO on a number of policies and by taking its role seriously in:

- Retaining an excellent external auditor.
- Supervising the internal auditor.
- Supporting the CEO in hiring a controller.
- Supporting the CEO in financial management, management information system development, managerial accounting, and developing a risk management framework for ensuring adequate internal controls.

# Tips for the CEO

The CEO has much to do in working with a Board. Her/his role is key to forming and preserving a healthy directive body. Here are some tips for the CEO to maximize Board effectiveness.

## The CEO's Main Tasks

---

The CEO is responsible for the operational, financial and social success of the MFI. The Board is responsible for itself and for the CEO. It bears ultimate accountability to its stakeholders.

Your main tasks as CEO are:

- Support the Board in all activities, but do not do the Board's work.
- Apprise the Board of important legal, financial, and strategic issues.
- Manage the MFI according to Board policy and its approved strategic plan.
- Go the extra mile: motivate staff, please customers, and create a positive public image for the MFI. Promote goodwill, learning and creativity among all stakeholders.

## Who Is Your Boss?

---

Your boss is the entire Board of Directors. For practical reasons, you may work most closely with the Chair, who then communicates information to the rest of the Board. But the Chair is not your boss. The full Board membership is your boss, which means the whole Board hires you, evaluates you, gives you raises, creates policy for you, or fires you. You are accountable to the Board as a whole, not to one person or to a committee.

## Define Expectations

---

Leave nothing to chance. As you are hired, be sure you have a clear job description and a contract that references this job description. Understand exactly how and when the Board reviews

your performance and how you might be rewarded for good performance. Take the time to interview each Board member—over a meal is best—to understand what each member expects from you and your staff.

## **Build Trust**

---

The Board must trust the CEO. If there is little trust, the Board tends to micromanage the CEO with restrictive policies. To gain the Board's trust, remember to make time for the following common sense approaches to interaction with Board members.

### **Be Honest**

Always tell the Board the truth, even when the news may be unpleasant, or even when full disclosure of information means, as CEO, you may not get your way, or even when important information seems too complex for the Board to grasp. This advice may seem trite, but Board members appreciate prompt communication of important news.

### **Anticipate Problems and Consider Opportunities**

The CEO's main job is to anticipate problems and find new opportunities for the MFI. The Board trusts a CEO who informs members of problems far in advance of their turning into crises. Even with fair warning, the organization may find it difficult to avert a crisis altogether, but advance notice at least gives the Board a chance to solve the problem.

Each year, the MFI develops an operating plan. However, during the course of the year, many unpredicted opportunities may arise. A great location for a new branch may suddenly become available. A new donor may show interest in investing substantial funds. A local MFI

may wish to merge with another MFI. Bringing strategic opportunities to the Board early on is part of the CEO's job. First,

### **Downsizing**

In 1996, Working Capital, a Boston-based MFI, had to cut one-third of its staff because of funding issues. The CEO alerted the Board as soon as it became clear the organization would need to let go some of its newly hired staff, all of whom were minorities (posing a potential legal problem for the MFI). The Board was able to assist the CEO in planning to downsize while avoiding negative legal and public relations issues.

screen these opportunities based on your own experience and research. Then present details about opportunities that make it through your filter to the Board for further discussion.

### **Communicate Regularly**

If Board meetings are quarterly, communicate in writing or by phone in the intervening months. Let Board members know of new branch openings, about a visit to your office by a politician, an award you may be receiving, or other newsworthy events. Board members appreciate your reaching out.

### **Spend Time Orienting New Board Members**

This critical task cannot be overemphasized. Many CEOs think that sending a big package of materials to new members is sufficient to orient them. Typically, it is a waste of paper. Members new to the Board need to understand the nature of the MFI, the environment in which it operates and their own responsibilities. Here are some tips as CEO:

- Work closely with the Board on developing an orientation program.
- Include site visits to customers or branches to inform and engage new members.
- Ensure training is available on key social and financial issues. Frequently the CEO helps orient a Founding Board on these matters. But when a new member joins the Board, the CEO often puts off training for just one person. It seems time consuming and inefficient. Work with the whole Board to address the need for timely Board orientation for individual new members.

### **Engage All Board Members**

To preserve trust, the best CEOs work with the whole Board, not a few members. That said, find opportunities that encourage individual Board members to shine and be appreciated. It increases their commitment and serves the CEO in the long run. How to engage them?

- If you are asked to speak on a radio show, ask a Board member to join you.
- If your MFI is awarded a prize, enlist all Board members to attend the reception.
- If you are interviewed by a local paper, insist that the reporter also talk to several Board members to give their perspectives.
- If you are invited to make a presentation to a local university, ask a Board member to do the presentation on the MFI's behalf.
- If pending legislation affects your MFI, ask your Board members to attend hearings with you.
- If your MFI is asked to present at an international summit, ask the Board Chair to make the summit an agenda item at the next meeting. See if other Board members would like to attend or present, particularly on topics that address the governance, but not operations, of your MFI.

### **No Surprises**

Never surprise your Board with news, good or bad. Members begin to mistrust or resent you. Do not bring up important news

for the first time at a Board meeting. Call members individually or meet with each and give a private briefing. Members appreciate the opportunity to reflect on new information and prepare their thoughts before discussion at the Board meeting.

A briefing to all, not just a few, Board members ahead of time, informs you where each stands and how each may vote during the meeting. Knowing who stands where on which issue enables you to disengage from debate and let members who represent your own point of view speak out at the meeting. Letting Board members take your position allows you, the CEO,

to remain a neutral presenter—someone on hand to frame the problem or opportunity, and to responsibly answer questions.

#### **CEO Finesse**

In 1995, the CEO of the Dorchester Bay, Massachusetts, Economic Development Council wanted his Board to approve diverting significant funds to a new microloan facility, an idea that had not been discussed in the strategic plan. The CEO met with each member individually, and when he understood that the majority was in favor of the new facility, he knew he needed to only present the plan at the meeting, not engage in the debate. The Board voted in favor of the new loan facility.

## Do The Nitty Gritty Work

Your Board members will quite likely be volunteers. Even if your MFI pays them a stipend or they earn a return on their shares, a significant amount of their time is probably contributed free of charge. Constantly seek ways to ensure that their time is used to its best advantage. Wherever possible, ask your staff to assist Board members in the Board's work. First, ask the Board how it would like its work supported, and then find ways to provide the assistance.

- If key issues are to be discussed at a meeting, do some research and write a very short briefing paper to advise the Board. Mail it to members ahead of the meeting.
- If the Board Secretary takes handwritten minutes, and does not have administrative support, ask an administrative person working for the MFI to type them. Let the Board Secretary approve the typed minutes.
- If you need a Board member to call on a donor or investor, offer to make all the meeting arrangements.

Your goal is for the Board to actively participate in the strategic issues that affect your MFI. Make sure that they optimize their time by engaging them in critical matters and deflecting nonessential activities.

## Celebrate

Did your MFI have a great quarter, a great six months, a great first year? Celebrate! Hold a dinner for the Board and staff. To keep the budget intact, work with the Board Chair to develop economical alternatives: see if one member would like to host an informal supper or if all members would like to bring something to a common feast. Invite key donors, investors and other important stakeholders.

Did your MFI endure a crisis, but you pulled through as a team? Celebrate! Help the Board act as a team. At appropriate times, let the Board get to know staff and let staff get to know the

### MDF-Kamurj

In Armenia, Save the Children and CRS decided to celebrate the merger of their two microfinance operations and christen Kamurj, the new MFI. The CEO saw to it that a big party was arranged. Representatives of each parent organization, new Board members and staff ate and danced till the wee hours of the morning.

Board. Celebrate small victories and large. Celebration builds awareness, a sense of connection between staff and Board members and fosters a team spirit. The good energy that springs from a celebration helps remind stakeholders of why they invest so much time in the new MFI.

# Transferring Powers

Many MFIs are the product of international development organizations, international agencies or local multi-purpose NGOs. Often such MFIs begin as programs operated from the office of the agency. As the program grows, the agency frequently finds it necessary to create a separate MFI for many of the following reasons:

- Promoting specialization of services: the opportunity for a new organization to develop focus, discipline and excellence in service quality.
- Attracting funding specifically geared to the needs of an MFI.
- Offering staff a solid career path based on their performance and the growth of the new institution.
- Attracting a local Board with particular commitment to the work of an MFI.
- Ensuring growth and sustainability after the above items are accomplished.
- Reducing constraints on the international agency resulting from regulations specific to a local MFI, including legal, tax and accounting issues.

## What to Consider

---

In these cases, the international agency may find itself deciding what its role might be in forming and overseeing the new entity. Its potential role as a Board member depends on:

- **The policies of the agency concerning staff or other representatives serving on Boards of Directors.** For example, some agencies, such as FINCA International, assume seats on an MFI board where the MFI is part of its network. The agency believes it is a better steward of funds if it can directly oversee the MFI's performance. Conversely, other agencies, such as CR, do not take a Board seat unless necessary. The agency believes that

building local Board capacity and control is essential for long-term viability.

- **The capacity of an agency’s international staff to serve on an MFI Board.** The agency may or may not have staff with the skills and the requisite time to provide good oversight. If staff members are not local, but live in another country, the transportation expense may be too great to justify their Board service.
- **The availability of qualified local Board members.** In some instances, such as in post-conflict situations, skilled overseers may be scarce in a country or region. If no qualified Board members are available, the agency may have no choice but to assume one or more Board seats.
- **The requirements for local organizational structures.** Laws and regulations may require the agency to assume key responsibilities that warrant a seat on the new Board. Laws may also prevent the agency from serving in any Board capacity.
- **The requirements of donors and investors (shareholders).** International donors and investors may require the agency to represent their financial interests on the new Board. Local investors and donors may desire just the opposite—that is, that they not share the Board function with members of the international community.

### Reassure at Every Opportunity!

Many staff work at an MFI because they feel secure that it is part of an international agency. Many funders grant, invest, or loan monies because they feel secure for the same reason. The same thinking applies to regulators. Transferring powers to a local Board requires the early champions and Provisional Committee to spend great chunks of time reassuring all parties that the international agency is committed to the MFI’s success and will continue to support it in years to come.

## Transferring Control

---

Agencies with policies that encourage or require eventual ceding of control and oversight to local representatives—where such cession is possible—must find ways to make the transition from microfinance program to MFI as smoothly as possible. Ways to achieve an effective transfer of Board powers include:

- **Develop a phase-out plan** before the new MFI is formed. All parties, including government regulatory bodies, stockholders, Provisional Board members and Founding Board members, should

know of and fully support your agency's plan to transfer its Board powers to others. Remember, your phasing out can be threatening. It may appear as though your agency is not committed to the MFI's success. Develop the plan in concert with the Provisional Council. Fully brief the Founding Board members about the plan and ensure their support.

- **Identify early champions** beyond members of the agency as soon as possible. Early champions may be program staff that exhibit strong leadership qualities, local contacts, or even contacts of local contacts. Let these early champions know your agency's role will decrease as local capacity and commitment increase.
- **Serve on the Provisional Council**, but also ensure that others outside the agency serve as well. Seek influential local members to serve on the Provisional Council. Ensure their full understanding and support for your agency's plan to eventually reduce its participation and remove itself from the Board.
- **Serve as a non-voting member on the Founding Board or phase your voting rights out over time.** Assess the capacity of the Founding Board. If the Board includes competent individuals with the right philosophy and leadership skills, consider taking a seat on the Board without a vote. If the Board's abilities are uncertain at the beginning, create benchmarks that trigger your changes in role and voting rights from Board decision-maker to advisor to supporter.



## Section Four: Conclusion



# Two Boards of Directors

Imagine you are a Board consultant not yet expert on governance. You are asked to walk into two different rooms, each with a Board meeting in session. You are to listen to discussions and observe members for 15 minutes. After visiting both sessions, you are asked to draw conclusions as to which Board is more effective and why.

## Scene One

---

You enter the room and take a seat to the side. You notice the CEO is sitting at the head of the table. He looks anxious. He is doing all the talking. The nine Board members around the table are staring at him.

One finally says: "I do not understand what you mean? What does portfolio at risk mean? I am not sure why its increasing to 30 percent is a problem."

The CEO begins to answer and another member says: "I think we should put this aside and go back to the discussion on group formation. I think it would be good idea to include a few checklists that the credit agent completes and signs off on."

The CEO says: "Thank you for the advice, but we are already doing this."

A staff member is sitting in the corner busily taking notes. You assume she is taking the minutes as no Board member appears to be writing anything down.

Another member says: "I must excuse myself. I have to leave early."

Yet another member says: "But you are the Chair, and this is the third meeting where you have left early."

The CEO attempts to break into the discussion and explain portfolio at risk: "Not only is this ratio important," he says, "but its increase means we may lose some loans."

The Chair, as he is leaving, says: "Losing some loans is not the end of the world. Do we have enough cash in the till to cover any losses?" And then he exits.

The other members thank the CEO and pack their things to leave.

"We need to vote on a strategy to reschedule loans during this flooding emergency," says the CEO.

"Just put down what you think is best," answers one member over her shoulder.

You leave the room with the rest of the Board.

## **Scene Two**

---

You enter the room and take a seat to the side. You notice the Chair is sitting at the head of the table. She looks calm and seems to be listening intently to the Treasurer, who is standing beside the CEO. Both are pointing to some financial information projected onto the wall.

The Treasurer says: "Because of the recent floods in the Southern province, our portfolio at risk has increased to 30 percent. We are concerned and tracking this closely, but I'd like to ask Nina, our CEO, to brief you on a few measures we are taking." He takes a seat.

The CEO stands and says: "As soon as the floods rose to emergency levels, we knew we should prepare to minimize damage to our portfolio and preserve client relations. Our staff has met with every client affected. We have let each know that we are there to help and would like to stay as their banker throughout these tough times. Because we know our clients so well, they trust us and have fully explained their present situations to our credit agents. Nearly every client believes she can become current on her loan within two months, or four payment periods. I do not think we need to consider rescheduling at this point."

The Chair thanks the CEO and the Treasurer. She faces the Board and says: "I would like you to note on the agenda that we have placed the option to reschedule loans in this emergency up for a Board vote. Our Board policies call for this vote, as you can note in 'Policy 29: Emergency Rescheduling'. If our CEO, Nina, needs to act quickly based on new information, we would not want to hold her back. Then she could check with us if she would

like advice, but she would already have official approval to respond rapidly."

One member says: "I move that we allow the CEO to make rescheduling decisions in this emergency until the next regular Board meeting, when we review the situation." The Secretary notes the motion.

"I second the motion," says another. The Secretary notes the second.

"All in favor?" says the Chair. All raise their hands. The Secretary notes the unanimous vote.

The Chair says: "Nina, are there ways as a Board we can help you during these difficult times?"

"Yes," says Nina. "I am getting many calls from international donors who would like to meet with me about funding. I would appreciate it if some of you could meet with them first, and, based on the emergency funding plan we approved at this meeting, determine if they are good funding candidates. That would save me some time."

You have seen enough and leave the room.

## Your Assessment

---

You write your notes and present them.

**Scene One Notes:** Not atypical. The CEO is managing the meeting. Staff take notes. Board members have not been trained on critical indicators. Nor do they show commitment. The Chair does not understand his role, nor do any of the Board members. They are "operational," preferring to focus on issues such as group formation, rather than strategic issues, dealing with the implications of Board policy in times of emergency. The CEO appears to find the Board more of a hindrance than a help. There is no meeting agenda and no method of conducting the meeting. This Board does not operate as a team. Moreover, this Board is a "rubber stamp" Board, one that approves whatever the CEO suggests. It does not operate from plans or policy. This MFI is in trouble.

**Scene Two Notes:** The Board seems to understand the importance of the portfolio at risk ratio. Clearly, they have been trained. The meeting focuses on Board issues, specifically the

issue of limiting or expanding the powers of the CEO. The Board has developed policies on this issue and can look to the policy to help them respond. The meeting is well run and follows clear voting procedures. The CEO seems to have a good working relationship with the Board. And the Board seems willing to help the CEO during these difficult times. The CEO is careful not to engage members in operations, but asks them to become involved in donor relations—something the CEO usually handles, but the Board can easily help with. This MFI is not in trouble.

## **The Difference**

---

Why does one Board succeed and the other fail? Why does one MFI survive and the other founder? The answer is simple: Everyone involved in the Board's evolution did their homework. The CEO trained members on technical matters, and the Board set up clear guidelines and procedures for its own activities. Above all, the Board is the right Board. Members are competent and committed. They have chosen the right CEO. They keep her/him motivated by establishing clear guidelines and showing confidence in her/his abilities to manage the MFI.

# Final Thoughts

How the Board conducts itself as a Board at its earliest stages affects the MFI in fundamental ways. The energy, commitment and clarity offered by a good Board trickles down to staff levels. It influences the image of the MFI in the wider community. It even impacts clients who may never attend a Board meeting, but who appreciate a professionally run institution, clearly the result of a competent Board.

May all new MFI Boards find themselves, if ever in difficult times, operating as in Scene Two and never like Scene One. Scene Two is hard to come by. Scene Two requires preparation and long hours of effective planning. Scene Two requires a commitment to learning, to remaining strategic, to supporting the CEO. Scene Two is worth the effort. Scene Two Boards know they are the DNA of a microfinance institution, the essential matter from which future actions spring, shaping the traits, strategies and operations of their organization for years to come. Scene Two Boards are few and far between, but with some effort, they can span the globe, determining the fate of hundreds, maybe thousands of microfinance institutions. Let Scene Two Boards become the norm, not the exception.



## Selected Resources

Boden, Jr., Richard J. *Analyses of Business Dissolution by Demographic Category of Business Ownership*, Small Business Administration Website, 2001.

<<http://www.sba.gov/ADVO/research/rs204tot.pdf>>

Campion, Anita and Victoria White. *Institutional Metamorphosis: Transformation of Microfinance NGOs into Regulated Financial Institutions*, Microfinance Network, 1999.

Available through PACT Publications [www.pactpub.com](http://www.pactpub.com).

Carver, John. *Boards That Make a Difference: A Design for New Leadership in Nonprofit and Public Organizations*, San Francisco: Jossey-Bass, 1997.

Carver, John and Miriam Mayhew Carver. *Reinventing Your Board: A Step-by-Step Guide to Implementing Policy Governance*, San Francisco: Jossey-Bass, 1997

Churchill, Craig. *Establishing a Microfinance Industry: Governance; Best Practices; Access to Capital Markets*, Microfinance Network, 1997. Available through PACT Publications [www.pactpub.com](http://www.pactpub.com).

National Center for Nonprofit Boards [www.ncnb.org](http://www.ncnb.org) (Network for information, resources, and workshops about nonprofit boards of directors.)

Otero, Maria (Editor), Elizabeth H. Rhyne (Editor), and Mary Houghton. *The New World of Microenterprise Finance: Building Healthy Financial Institutions for the Poor*, West Hartford, CN: Kumarian Press, 1994.

The SEEP Network. *Financial Performance Monitoring: A Guide for Board Members of Microfinance Institutions*, Washington DC: The SEEP Network, August, 2001. <[www.seepnetwork.org](http://www.seepnetwork.org)>



**Catholic Relief Services**, founded in 1943, assists the poor and disadvantaged outside the United States. CRS works in solidarity with all people of good will and similar vision to promote human dignity, alleviate human suffering, promote the development of people, and foster charity, justice, and peace in the world. CRS assists the poor solely on the basis of need, not creed, race, or nationality, and maintains strict standards of efficiency and accountability. CRS currently operates in 88 countries and supports microfinance activities in 33 countries.

### **CRS Microfinance**

#### **West Africa**

Benin  
Burkina Faso  
Ghana  
Niger  
Senegal

#### **Eastern Africa**

Ethiopia  
Kenya  
Rwanda  
Uganda

#### **Southern Africa**

Madagascar  
Zimbabwe

#### **Middle East and North**

**Africa**  
Egypt  
Jerusalem, West Bank, and  
Gaza

#### **South Asia**

India—Eastern  
India—Hyderabad  
Pakistan

#### **South East Asia**

Cambodia  
Indonesia  
Philippines  
Thailand  
Vietnam

#### **Europe**

Armenia  
Bosnia-Herzegovina  
Bulgaria  
Croatia  
Macedonia

#### **Latin America and the Caribbean**

Bolivia  
Dominican Republic  
Ecuador  
El Salvador  
Guatemala  
Haiti  
Nicaragua  
Peru



Catholic Relief Services  
209 W. Fayette Street  
Baltimore, MD 21201