Social and Environmental Field Guide

for Micro Finance Institutions

Working with Clients on the Social and Environmental Aspects of Microfinance

PART C: TRAINING GUIDE
Objectives and Program

“Social and Environmental aspects for MFIs”
9, 10 July, 2007
Phnom Penh, Cambodia

Objectives:
1. Create insight in the essentials of environmental and social risk management for MFIs
2. Adaptation of social and environmental risk recognition materials (Activity and Sector social and environmental fact sheets)
3. Definition of a pilot project to apply social and environmental aspects in providing microcredit
4. Development of a tentative action plan for subsequent implementation of social and environmental aspects in business operations
   a. Definition of a pilot project to apply social and environmental aspects in providing microcredit
   b. Further adaptation of social and environmental risk recognition materials (Activity and Sector social and environmental fact sheets)

Program

Part A       July 9, 2007
13.30 – 13.35 Opening
Anton van Elteren
13.35 – 14.00 Introductions and expectations
Anton van Elteren
14.00 – 14.45 Recognition of E&S risks
Geert Jan Schuie (Presentation A1)
14.45 – 15.00 Relevance of environmental and social issues for a MFI
Anton van Elteren (Presentation A2)
15.00 – 15.15 Explanation of what needs to be delivered by tomorrow evening Anton van Elteren (Presentation A3)
15.15 – 15.30 Tea break
<table>
<thead>
<tr>
<th>Time</th>
<th>Activity</th>
<th>Presenter/Content</th>
</tr>
</thead>
<tbody>
<tr>
<td>15.30 – 16.45</td>
<td>Fact sheets explanation &amp; application</td>
<td>Geert Jan Schuite (Field Guide)</td>
</tr>
<tr>
<td>16.45 – 17.15</td>
<td>Client and stakeholders explicit and implicit needs regarding E&amp;S and implications for the fact sheets</td>
<td>Geert Jan Schuite (Presentation A4)</td>
</tr>
<tr>
<td>17.15 – 17.30</td>
<td>Wrap up of today, description of assignment for tonight and outlook to tomorrow</td>
<td>Geert Jan Schuite</td>
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<tr>
<td>Evening</td>
<td>Assignment: Modification of activity fact sheet or sector fact sheet</td>
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</table>

**Part B**  
*July 10, 2007*

<table>
<thead>
<tr>
<th>Time</th>
<th>Activity</th>
<th>Presenter/Content</th>
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<tbody>
<tr>
<td>9.00 – 10.00</td>
<td>Presentations and discussion of modifications made to activity sector fact sheets by each MFI during assignment yesterday evening</td>
<td>Participants</td>
</tr>
<tr>
<td>10.00 – 10.30</td>
<td>Make a list of all activities / sectors in the field guide to be customized for “instant” application in the field</td>
<td>Participants (Format B1)</td>
</tr>
<tr>
<td>10.30 – 10.45</td>
<td>Break</td>
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<tr>
<td>10.45 – 11.15</td>
<td>Coupling E&amp;S aspects to the loan cycle in order to develop a pilot project</td>
<td>Geert Jan Schuite (Presentation B2)</td>
</tr>
<tr>
<td>11.15 – 12.00</td>
<td>Develop pilot project to integrate social and environmental aspects in credit process (for a particular sector or for a branch, timelines, evaluation criteria etc)</td>
<td>Participants (Format B3)</td>
</tr>
<tr>
<td>12.00 – 12.45</td>
<td>Short presentation per MFI about their pilot proposal</td>
<td>Participants</td>
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<tr>
<td>12.45 – 14.00</td>
<td>Lunch</td>
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</table>
Part C July 10, 2007

14.00 – 14.45 How to manage change in your organization? How to cope with resistance? How to build a successful action plan? How to roll out awareness? etc
Geert Jan Schuite (Presentation C1)

14.45 – 15.30 Develop action plan per MFI to integrate E&S topics into SOPs and to implement activities in the organization
Anton van Elteren (Format C2)

15.30 – 15.45 Tea break

15.45 – 16.15 Preparation of in-house training per MFI (agenda for meeting with management board, what to present to loan officers etc)
Participants and trainers in groups

16.15 – 16.45 Support from FMO, outlook to the in house sessions
Anton van Elteren

16.45 – 17.15 Evaluation of this (pilot) training

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Program for the in-house training

Presentation for and discussion with Management

- Benefits of environmental and social screening for clients and MFI
- Actions identified in MFI seminar to incorporate environmental and social screening in loan cycle and standard operating procedures
- Roles and responsibilities for implementing actions
- Reporting to FMO

Working session with (a number of) loan officers

- Identification of environmental and social issues using case studies and picture material and determination of actions needed on behalf of MFI using activity assessment tool and sector fact sheets
- Discussion about real cases brought forward by loan officers
- Customization of activity assessment tool and sector fact sheets to incorporate local circumstances
- Ways to interact with clients about environmental and social issues

The in-house training will be customized to reflect different needs of MFIs and MFI funds.
Recognizing Risks
Environmental and Social (E&S) issues for an MFI

Some Cases

Course ‘Social and environmental aspects for MFIs’
Phnom Penh, 9 – 10 July, 2007
In the next slides, you will meet Microfinance clients, from all over the world, and take a look at their activities.

The photographs do not show situations that are ‘bad’ or ‘good’, they just are how they appear to be, when viewed through a camera.

They help us to learn and improve our abilities to support clients in making their enterprise a success.
Icons to quickly understand a given situation

Environment
- air pollution
- waste disposal
- water pollution
- clearcutting
- fish decline
- mining

Labour
- working conditions
- child labour

Health & Safety
- chemicals
- food
- animal husbandry
- machines
Relevance of Environmental and Social (E&S) issues for an MFI

Course ‘Social and environmental aspects for MFIs’
Phnom Penh, 9 – 10 July, 2007
A 15 second elevator pitch to summarize this presentation and this training

1. Especially in Latin America, many MFIs recognise the importance of social and environmental aspects for their (credit) operations.

2. However, it is considered difficult to implement a social and environmental management system.

3. For that reason FMO has organised a training and follow-up in-house session to help start integration of social and environmental aspects into the MFI credit process.
Especially in Latin America, many MFIs recognise the importance of social and environmental aspects for their (credit) operations

- It fits well with the developmental mission of MFIs
- During preparatory visits in LA with many MFIs confirmed this

However, it is considered difficult to implement a social and environmental management system

- Social and environmental risks in portfolio are typically limited
- MFIs are mostly focused on economic development
- Fear of weakening competitive position
- Fear that it may reduce transaction efficiency
- No tools are available

For that reason FMO has organized a training and follow-up in-house session to help start integration of social and environmental aspects into the MFI credit process

- A useful and useable set of tools that can be modified by individual MFIs
Some quotes from the preparatory work for this course

“Addressing social and environmental issues is a very important next step in our sector”

“Polluters don’t get a loan. We have no methods in place to improve the situation”

“Our credit officers support clients not only financially, but also with non-financial questions”
Environmental and social risks are typically quite small for MFIs

Environmental and social risks are small for MFIs because:

1. MFIs engage in relatively small loans

2. MFIs often finance activities and/or sectors where E&S risks are limited

3. Most MFI clients operate in the informal sector where environmental or social risks are either
   - *Not material* in comparison to other risks
   - *Small* since environmental and social legislation is not enforced
   - *Unlikely* to materialize due to short-term nature of many loans

4. MFIs take out limited collateral and the risk of collateral devaluing because of E&S problems is remote
MFI mission is typically oriented towards economic development preferably on short time scales

MFI mission is typically oriented towards economic development because it is seen as a prerequisite for environmental and social development

- “Let’s first lift these people out of poverty and then we’ll start worrying about other problems”

In addition the time scale of a typical loan is relatively short and E&S problems are not hampering (client) economic development

- “Everybody can see that environmental and social problems will hamper development in the longer run but what can I do about it without harming my clients prospects for tomorrow”
Some fear E&S aspects may hamper competitive position although at times the opposite may be true

<table>
<thead>
<tr>
<th>E&amp;S aspects may hamper competitive position …</th>
<th>But E&amp;S aspects may also be a source of competitive advantage</th>
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<tbody>
<tr>
<td>Microfinance has become an at time fiercely competitive business</td>
<td>Microfinance is basically information-based credit in stead of collateral-based credit</td>
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<tr>
<td>Borrowers are assumed to have a preference for the loans that come with the best conditions</td>
<td>The state of environmental and social management can be a valuable source of information about the lender</td>
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<tr>
<td>Therefore MFIs cannot be assumed to be “more catholic than the Pope”</td>
<td>Environmental pollution is often an indication of economic waste and clients are often willing to listen (and happy to take action)</td>
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It is easier to see the downside than the upside
And environmental and social problems may be a source of financing opportunities

Maqsood Sinha, an architect, and Iftekhar Enayetullah, a civil engineer, set up the 'Waste Concern' seven years ago in Dhaka to tackle the problem of garbage. Nobody was interested. A local Lions club gave them a plot of land to try it out for 3 months

Currently Waste Concern operates 38 plants around Dhaka and 30,000 people are benefiting directly
Waste Concern: Trash is cash in Bangladesh

A simple proposition:

Waste is a BIG problem in Dhaka so there is a BIG opportunity

A world of benefits

- Take the waste from the streets and compost it
- Reduction of 40 diseases related to waste build up
- Reduce need for fertilizer in Bangladesh
- Reduce the methane emissions from rotting waste

And real financial, environmental and social benefits

- Sell compost, earn money and create many jobs
- Improve productivity of society
- Improve soil texture and chemistry and thus food production
- Sell emission certificates to NL and Royal Dutch Shell

Example

3500 tons of waste produced every day in Dhaka

Dhaka City Corp has inadequate resources to collect and process waste
MFIs are very much oriented on transaction efficiency and eliminate as many steps as possible

Loan sizes are typically small and transaction costs are considerable

Therefore

Efficiency of the process is key in order to do as many deals as possible

Hence

Elements of a transaction that are not absolutely necessary are eliminated

Resulting in

Very limited or no time to look at environmental and social aspects
But inclusion of E&S aspects may add to financial sustainability of an MFI

An MFI is financially sustainable when it recovers all its costs

<table>
<thead>
<tr>
<th>Operational costs</th>
<th>Influence of E&amp;S aspects on the financial sustainability of an MFI</th>
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</thead>
<tbody>
<tr>
<td>Higher operational costs due to E&amp;S appraisal</td>
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<tr>
<td>Lower operational costs when E&amp;S appraisal reduces loan defaults and related work with that</td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Provisions</th>
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<tr>
<td>Lower provisions when E&amp;S appraisal reduces loan defaults</td>
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</table>

<table>
<thead>
<tr>
<th>Capital cost</th>
<th></th>
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<tbody>
<tr>
<td>Lower capital costs through better access to MFIs through a function E&amp;S management system</td>
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</table>
Lack of MFI-specific tools makes it hard to start looking systematically at environmental and social aspects

Development banks like FMO have been demanding implementation of environmental and social management systems from their clients
  • Tools, support and training are often provided

The specific circumstances of MFIs however render existing tools and training useless

This course is one of the first attempts internationally to develop approaches that are tailored to micro finance
This is the second pilot training organized by FMO and we welcome your suggestions

A first training was held in India in March 2007
  • MFI setting in India is markedly different from Latin America
  • Learnings from that training have been incorporated

In order to assure that the training will be useful for a wide MFI audience we ask your feedback
  • Please tell us about things that are missing and things that should skipped (or de-emphasized)

Tomorrow afternoon we will do a formal evaluation
Explanation of what needs to be delivered by tomorrow evening

Course ‘Social and environmental aspects for MFIs’
Phnom Penh, 9 – 10 July, 2007
### The three deliverables for tomorrow evening

<table>
<thead>
<tr>
<th>Part A</th>
<th>Part B</th>
<th>Part C</th>
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</thead>
<tbody>
<tr>
<td>(this afternoon)</td>
<td>(tomorrow morning)</td>
<td>(tomorrow afternoon)</td>
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<tr>
<td>1. Adaptation of social and environmental risk recognition materials</td>
<td>Some modified fact sheets and a list of factsheets to be modified further</td>
<td>Action plan containing:</td>
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<tr>
<td></td>
<td>2. Definition of a pilot project to apply social and environmental aspects in providing microcredit</td>
<td>- Changes needed to SOPs</td>
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<td>- Obtaining board approval</td>
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<td>- Initial training and implementation</td>
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<td></td>
<td>3. Development of a tentative action plan for subsequent implementation in business operations</td>
<td>Action plan containing:</td>
</tr>
</tbody>
</table>

- Branch/sector selected
- Time period
- Responsibilities
- Evaluation criteria
- etc
In achieving the three objectives please keep a couple of things in your mind

Put the loan officer – client relationship central when modifying factsheets
  • Focuses on the big (and often obvious) issues
  • Ignores the details

Do not be overly ambitious in designing a pilot project
  • Think big, start small, evaluate critically and then scale up

Put the standard operating procedures of your MFI central when making a tentative action plan for implementing S&E aspects in your business operations
  • Add E&S aspects in the process where needed
  • Avoid E&S aspects taking away from efficiency of the process

This training is not put unreasonable demands on you but to help you improve your business
The generic loan cycle of a MFI is the starting point

- Application
- Appraisal
- Contracting & Disbursement
- Recovery & Monitoring
- Reporting
Standard Operating Procedures (SOPs) already define processes, deliverables and outputs for each step.
The goal of the ESMS is to add E&S specific input materials for each step in the loan cycle.
Today and part of tomorrow we will focus on application and modification of activity and sector fact sheets.
Explicit and implicit E&S needs of clients and stakeholders

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Phnom Penh, 9 – 10 July, 2007
Environmental and social concerns are held by many but it is hard to be turned into action by individuals

Many people are affected by deterioration of natural and social environments hit many people

- Climate change
- Deforestation and desertification
- Depletion of natural soil
- Exploitative working conditions

As a result many stakeholders (eg development banks, NGOs etc) ask for environmental and social aspects to be taken into account by businesses

Convincing individual business that action is required is harder if the pay off of these efforts is to be shared with many “free riders”

Many clients are unaware of their environmental and social effect and may be surprised if an MFI addresses these issues
Improving environmental and social performance may or may not enhance financial performance

<table>
<thead>
<tr>
<th>E&amp;S Performance</th>
<th>Financial Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improves</td>
<td>Hard to prevent (but undesirable)</td>
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<tr>
<td></td>
<td>No brainer (but often unidentified)</td>
</tr>
<tr>
<td>Worsens</td>
<td>Nobody would think of this (but it happens)</td>
</tr>
<tr>
<td></td>
<td>Hard to sell (and may be inefficient)</td>
</tr>
</tbody>
</table>

Effects of improving E&S performance on financial performance on longer term is often more favourable however.
Example of undiscovered needs that are good for financial and environmental & social performance

Cab drivers in La Paz, Bolivia typically drive low efficiency cars on expensive gasoline

A Swiss bank provided a credit line to improve energy efficiency

A micro finance institution provided loans to cab drivers to install a gas tank and switch to clean LNG as fuel
  • MFI was catalyst in uncovering this need

Pay back times were short and cab drivers substantially and sustainably improved their earnings

An MFI can play a catalyzing role in uncovering opportunities like these
When there is a trade of between financial and E&S performance things are more difficult: Carrot and Stick

Since MFIs have an interest in development of an area or a group of people they have an incentive to deter individuals from environmentally or socially unsound practices

- Exclusion list
- Loan clauses

Improvements of environmental and social performance at the cost of short term financial performance but with long-term pay off may need some sweeteners to make it happen

- Advice and education
- Favourable conditions
Outside stakeholders exert pressure to foster more favourable environmental and social conditions

Local and global NGOs are active in the field of
- Environment
- Social justice
- Labour conditions

In fact development banks are taking environmental and social factors into account partly due to pressure from their stakeholders.

Many communities become increasingly aware that their long-term survival depends on their natural environment, resources and social systems.
- Harming these harms developments
Not to deny the many difficulties involved but: Healthy business happens when circumstances are good

- Improves (but undesirable)
- Worsens (but it happens)

- No brainer (but often unidentified)
- Hard to sell (and may be inefficient)

On longer time scales trade-offs between financial and E&S performance are less likely than on short time scales.

Financial performance

E&S Performance
But will I lose client when I am strict on E&S issues in a very competitive environment?

Competition is an issue

- Analogy: in project finance the world’s biggest banks have harmonized standards (called Equator Principles)

And you can thus not afford to be more catholic than the Pope

But FMO and other development banks try have similar E&S requirements for all MFIs in which they invest

- In order to try to create a level playing field

Involvement of loan officers is crucial in order to assure that treatment of E&S issues are useful and useable
Modification of activity assessment index and sector factsheets

Evening assignment

Course ‘Social and environmental aspects for MFIs’
Phnom Penh, 9 – 10 July, 2007
Customization of tools to your MFIs needs is important

Today we have used activity assessment index and sector factsheets to
  • Recognize social and environmental risks
  • Appraising these risks

Hopefully you have recognized that the fact sheets are a useful and systematic way of recognizing and appraising social and environmental risks

However, one size fits nobody and these fact sheets need to customized to your MFI’s needs
  • Possibly, not all important activities or sectors are included
  • Likely, not all important issues are included on the factsheets
  • Inevitably, the factsheets contain details that are not important for your situation
Customization does not happen overnight …
…so therefore we ask you to start tonight

Assignment:

Each participant customizes:

- The activity assessment index
- One or two sector factsheets

Keep in mind that the factsheets will only then be used when the loan officers consider the information useful and useable

- Add things where necessary
- Delete things where possible

Tomorrow morning we start the training with a short presentation by each participant about the proposed changes
Some guidelines for presenting your results shortly tomorrow

1. Introduce the main sectors / activities that your MFI is active in

2. Indicate using the activity assessment index which social and environmental risks you consider:
   • The most important three
   • The least important three
   • Any risks that you think are missing

3. Per sector factsheet(s) that you have modified
   • The things that are most useful for loan officers
   • The things that are least useful for loan officers
   • Any points that are missing given the context in which your MFI operates

Count on five minutes, including discussion
Modification of activity assessment index and sector factsheets

Evening assignment

Course ‘Social and environmental aspects for MFIs’
Phnom Penh, 9 – 10 July, 2007
Sector factsheets to be modified

<table>
<thead>
<tr>
<th>Factsheet</th>
<th>Importance for portfolio (high/low)</th>
<th>Significant change (yes/no)</th>
<th>Most important changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1</td>
<td>Crop growing</td>
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<tr>
<td>A2</td>
<td>Animal Husbandry</td>
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<td>A3</td>
<td>Fishery</td>
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<tr>
<td>S1</td>
<td>Shop/Retail/Market</td>
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<td>S2</td>
<td>Restaurant</td>
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<td>S3</td>
<td>Tourism</td>
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<td>S4</td>
<td>Healthcare</td>
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<td>S5</td>
<td>Transportation</td>
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</table>
## Sector factsheets to be modified

<table>
<thead>
<tr>
<th>Factsheet</th>
<th>Importance for portfolio (high/low)</th>
<th>Significant change (yes/no)</th>
<th>Most important changes</th>
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</thead>
<tbody>
<tr>
<td>S6 Wholesale trade</td>
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<tr>
<td>P1 Handycrafts</td>
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<tr>
<td>P2 Leather tanning</td>
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<td>P3 Brick/tile manuf.</td>
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<td>P4 Metal / Electro</td>
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<td>P5 Painting/Printing</td>
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<td>P6 Auto/Motor repair</td>
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<td>P7 Wood/metal proces.</td>
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<td>Factsheet</td>
<td>Importance for portfolio (high/low)</td>
<td>Significant change (yes/no)</td>
<td>Most important changes</td>
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<td>P8</td>
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<tr>
<td>Charcoal production</td>
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<td>P9</td>
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<tr>
<td>Garments prod.</td>
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<td>P10</td>
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<td>Textile dying</td>
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<td>P11</td>
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<tr>
<td>Ceramic/Pottery/Glass</td>
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<td>P12</td>
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<td>Glass manufacturing</td>
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<td>P13</td>
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<td>Mining</td>
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<td>P14</td>
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<tr>
<td>Forestry</td>
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<td>P15</td>
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<tr>
<td>Food processing</td>
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</table>
# Sector factsheets that need to be created

<table>
<thead>
<tr>
<th>Factsheet</th>
<th>Importance for portfolio (high/low)</th>
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Coupling Environmental & Social aspects to the loan cycle

Course ‘Social and environmental aspects for MFIs’
Phnom Penh, 9 – 10 July, 2007
We have already discussed a number of examples of environmental and social risks.

Managing these risks improves the quality of your loan book and risk profile.
Environmental and social issues can impact the risk level of a microfinance institution

**Credit Risk**
- defaults
- payment rescheduling

**Systemic Risk**
- sector-wide practices
- market devaluation

**Security Risk**
- defunct / devalued collateral

**Legal Risk**
- potential transfer of liability from borrower to lender

**Funding Risk**
- access to capital (eg FMO)
- cost of funds

**Reputational Risk**
- national
- international
Environmental and social risks are bigger in developing markets

<table>
<thead>
<tr>
<th>Developed markets</th>
<th>Developing markets</th>
</tr>
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<tbody>
<tr>
<td>Advanced regulatory system</td>
<td>Less advanced regulatory system</td>
</tr>
<tr>
<td>Sector has a formal regulatory system</td>
<td>Sector has an “informal” regulatory system</td>
</tr>
<tr>
<td>The probability of risks are often known</td>
<td>Probability of risks are typically unknown</td>
</tr>
<tr>
<td>Costs associated with risks are typically known</td>
<td>Costs associated with risks are typically unknown</td>
</tr>
<tr>
<td>The role of the Financial Institution is limited to due diligence of the collateral</td>
<td>The role of the Financial Institution is critical for long-term success of the company or the project</td>
</tr>
</tbody>
</table>
Your MFI will not be the first one to develop an E&S Management System: Example ACLEDA Bank

<table>
<thead>
<tr>
<th>ACLEDA Bank in Cambodia</th>
</tr>
</thead>
<tbody>
<tr>
<td>In May 2006 ACLEDA Bank presented its first sustainability report, in which the bank presents detailed information about working standards, paper usage, energy consumption and CO2 emission, etc.</td>
</tr>
<tr>
<td>It also includes the results of a survey among 1,200 clients, focused on the question whether the services of ACLEDA Bank really improved their living standards. It has announced a dedicated plan, aiming at improving services to dissatisfied clients.</td>
</tr>
<tr>
<td>ACLEDA has an exclusion list in place</td>
</tr>
</tbody>
</table>

Other good examples are Banco Solidario in Bolivia en Findesa in Nicaragua
We will discuss all below topics high-level and you can find more details in the E&S Field Guide.
E&S actions in the loan application
An exclusion list defines what activities may not be financed

An exclusion list includes:

- Activities which are regulated or prohibited under international agreements and by national laws

- Activities which may give rise to significant environmental/social problems, or that lead to significantly adverse public reaction

- In your contract with FMO is agreed that you can not finance activities that are on the FMO exclusion list
FMO Exclusions list excludes specific sectors and specific actions

FMO Exclusion list:

- Production or activities involving forced labour or child labour
- Production of or trade in any product or activity deemed illegal under host country legislation or regulations or international conventions and agreements
- Production of or trade in weapons and munitions
- Trade in wildlife or wildlife products regulated under CITES
- Production or use of or trade in hazardous materials such as radioactive materials, unbounded asbestos fibres, products containing PCBs and chemicals subject to international phase-outs or bans
- Commercial logging operations or the purchase of logging equipment for use in any primary forest or forest areas with a high biodiversity value, or any other activities that lead to substantial clear cutting of such forests
- Production of or trade in pharmaceuticals subject to international phase-outs or bans.
- Production of or trade in pesticides/herbicides subject to international phase-outs or bans.
- Production of or trade in ozone depleting substances subject to international phase-out
- Drift net fishing in the marine environment using nets in excess of 2.5 km in length
E&S actions in the loan appraisal
Three generic possibilities how to treat a loan are based on the E&S risk level and the size of the loan.

- **Large Loan Size**
  - Low E&S Risk Level: Raise E&S awareness
  - High E&S Risk Level: Explain and educate E&S improvements

- **Small Loan Size**
  - Low E&S Risk Level: Explain and educate E&S improvements
  - High E&S Risk Level: Insert E&S clause in loan contract
Classification of E&S risk and loan size depend on individual choices made by MFIs

<table>
<thead>
<tr>
<th>E&amp;S risk level</th>
<th>Loan size</th>
</tr>
</thead>
</table>
| The E&S field guide contains sector fact sheets for 24 sectors that provide  
  • Overview of the main E&S risks  
  • Solutions for clients  
  
  Based on these risks loan officers can make a quick-scan risk analysis  
  
  Depending on the local circumstances an MFI may decide to add or delete individual items on the sector fact sheets | Each MFI has a classification of what constitutes a small and what a large loan  
  
  In order to minimise E&S-related transaction costs we suggest to only agree specific actions with clients for the larger loans |

Together these two indicators determine what E&S action to take towards a client
An activity assessment tool helps loan officers in determining what the main E&S risks are.

<table>
<thead>
<tr>
<th>*' ' indicates when a risk is possible, but not probable,</th>
<th>'X ' indicates when in a sector there is a relevant risk possibility...</th>
</tr>
</thead>
<tbody>
<tr>
<td>... when the Client is ...  downfall</td>
<td>(a) A1 A2 A3 S1 S2 S3 S4 P1 P2 P3 P4 P5 P6 P7 P8 P9 P10 P11 P12 P13 P14 P15</td>
</tr>
<tr>
<td>... using (a) machine(s) [E] [H&amp;S]</td>
<td>X</td>
</tr>
<tr>
<td>... using chemicals/paint/solvents/ lubricants/pesticides/fertilizers [H&amp;S]</td>
<td>X X X X X X X X X X X X X X X X X X</td>
</tr>
<tr>
<td>... employing children [L]</td>
<td>X X X X X X X X X</td>
</tr>
<tr>
<td>... working in bad conditions [H&amp;S]</td>
<td>X X X X X X X X X X X X X X X X X X</td>
</tr>
<tr>
<td>... disposing of organic / production / chemical waste [E] [H&amp;S]</td>
<td>X X X X X X X X X X X X X X X X X X</td>
</tr>
<tr>
<td>... causing emissions to air [E] [H&amp;S]</td>
<td>X X X X X X X X X X X X X X X X X X</td>
</tr>
<tr>
<td>... polluting water [E] [H&amp;S]</td>
<td>X X X X X X X X X X X X X X X X X X</td>
</tr>
<tr>
<td>... processing food [H&amp;S]</td>
<td>X X X X X X X X X X X X X X X X X X</td>
</tr>
<tr>
<td>... clearing forest for land cultivation [E]</td>
<td>X X X X X X X X X X X X X X X X X X</td>
</tr>
<tr>
<td>... extracting clay or minerals [E]</td>
<td>X X X X X X X X X X X X X X X X X X</td>
</tr>
<tr>
<td>... catching fish [E]</td>
<td>X X X X X X X X X X X X X X X X X X</td>
</tr>
<tr>
<td>... keeping animals [H&amp;S]</td>
<td>X X X X X X X X X X X X X X X X X X</td>
</tr>
</tbody>
</table>

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**Environment**

- Crop growing
- Animal husbandry
- Fishery
- Shop / Retail / Tea Stall
- Tourism
- Healthcare
- Transportation
- Wholesale Trade
- Handicrafts
- Brick / tile manufacturing
- Metalworking & Electroplating
- Painting & Printing
- Auto / Motor repair
- Wood / metal Processing & Finishing
- Charcoal Production
- Garments production
- Textile dyeing
- Ceramics, Pottery, Glazing
- Glass Manufacturing
- Mining
- Forestry
- Food Processing

---

**Health and Safety**

- Environment
- Health and Safety
- Labour

---

**Labour**

- Textile production
- Textile dying
- Brick / tile manufacturing
- Metalworking & Electroplating
- Painting & Printing
- Auto / Motor repair
- Wood / metal Processing & Finishing
- Charcoal Production
- Garments production
- Textile dyeing
- Ceramics, Pottery, Glazing
- Glass Manufacturing
- Mining
- Forestry
- Food Processing

---

**Health and Safety**

- Environment
- Health and Safety
- Labour
Sector fact sheets have been developed to help the loan officer make fast E&S assessments.

**A1 Agriculture – Crop Growing**

<table>
<thead>
<tr>
<th>Observe</th>
<th>Analyse</th>
<th>Explain</th>
<th>Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>The client is ...</td>
<td>There is a risk if ...</td>
<td>What is important ...</td>
<td>Suggest the client to ...</td>
</tr>
<tr>
<td>... using (a) machine(s)</td>
<td>[H&amp;S] Machines look unsafe, ill maintained, have dangerous parts</td>
<td>Well maintained machines are safe, not dangerous and cheaper in use</td>
<td>• Take up maintenance routine, follow strict maintenance and lubrication practices for the moving parts of equipment</td>
</tr>
<tr>
<td></td>
<td>[H&amp;S] No safeguards are available and/or used when necessary</td>
<td>• Operating a machine with proper safeguards prevents accidents</td>
<td>• Keep machines in good shape and clean</td>
</tr>
<tr>
<td></td>
<td>[E] Leaksages, disposals, liquid waste or wastewater drains to stream/river/pond/soil</td>
<td>• Machines can leak oil/handcarts and that will spoil drinking water</td>
<td>• Experience operators only</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Malfunctioning Electricity is dangerous and create fallout</td>
<td>• Provide and use safeguards (goggles, gloves, mask)</td>
</tr>
<tr>
<td>... using chemicals/ lubricants/pesticides/fertilizers</td>
<td>[H&amp;S] No safeguards are used when necessary</td>
<td>Applying/handling toxic substances with proper safeguards prevents illness</td>
<td>• Re-use scrap / disposals</td>
</tr>
<tr>
<td></td>
<td>[H&amp;S] No relevant Material Safety Data Sheets (or other safety leaflet) are available</td>
<td>• Safe storage prevents from chemical reactions, explosions, fire, leakages and intoxication</td>
<td>• Stop leakages</td>
</tr>
<tr>
<td></td>
<td>[H&amp;S] Storage is unsafe, since unlocked, near sleeping area</td>
<td></td>
<td>• Stop draining liquid waste</td>
</tr>
<tr>
<td>... clearing forest for land cultivation</td>
<td>[E] Forest is managed unsustainable (illegal and/or without reforestation plan)</td>
<td>Deforestation, if not performed carefully and in a sustainable way causes land erosion and degradation, and eventually mud streams and water floods</td>
<td>• Establish contingency plans for accidents</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• A separate storage is created, locked away from children and living/heating rooms</td>
</tr>
<tr>
<td>... employing children</td>
<td>[L] Children are being employed</td>
<td>Children should receive education, proper nutrition and health care. They should be protected from abuse and discrimination, able to play and enjoy their childhood</td>
<td>• Establish contingency plans for accidents</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Have fire fighting equipment available</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Agree only on permitted and sustainable forms of use of pristine land</td>
</tr>
</tbody>
</table>

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**Background, relevant legislation, minimal requirements**

- Waste/water disposal without permit (e.g. Prevention and Control of Pollution Act, 1974)
- Don’t install diesel generator sets without approval certificate
- Have MSDS available when working with chemicals

**Solutions, tips, further information**

- Farmers should use pesticides that are permitted
- Farmers should consider to carry out integrated pest management (biological – physical – chemical)
- Fix leaks promptly. Dripping joints can waste over 76 liters of water a day
- In case there is no waste disposal facility. Contact (alone or in collaboration with other entrepreneurs) local council and ask for improved public service
E&S actions in the loan contracting and disbursement
For larger loans with a relatively E&S risk it is recommended that E&S clauses are added to contract

For small loans where E&S risks is small the loan officer can raise awareness about the (longer-term) importance of environmental and social aspects
  - As eg Grameen bank banks does as one of their 16 decisions

For small loans with E&S risks or for larger loans with small E&S risks you can train and educate the client about somewhat more specific aspects
  - For example leave a copy of the relevant sector factsheet with the client

For larger loans with E&S risks it is recommended to specify some E&S specific clauses in order to mitigate the risks
  - Limit the amount of clauses to a maximum of three in order to focus on the big issues
  - Although a clause may be hard to enforce it does make action less voluntary
Examples of standard E&S contract clauses

I, …, undertake to carry out my business in a way that avoids, reduces, and compensates for damage to nature, public services, or the well-being of the individuals who work with me and who live in the vicinity, by continuing with or taking the following actions:

- Operate and maintain machines and equipment professional and with proper (safety) measures
- Don’t employ children
- Use (toxic) chemicals with proper safeguards and store them properly
- Comply with accepted standards and regulations regarding land cultivation
- Reduce the amount of waste by improving the process or recycling
- Prevent land erosion or degradation
- Take precautions in waste disposal, not dump liquid or solid waste in public places
- Avoid, reduce, control processes that pollute the air
- Take steps to protect my own health and that of my employees / clients / neighbours
- Comply with municipal regulations on environmental protection, health and safety, hygiene, labour
- Comply with government regulations

I have been informed that entity granting me the loan may take a visit to evaluate my activities from the environmental, health and safety, and labour standpoints and that I may only obtain a new loan if, in addition to complying with the financial conditions, I also comply with my environmental, health and safety, and/or labour commitments.
E&S actions in the loan recovery and monitoring
Logging the client and/or loan specific E&S issues in the MIS facilitates monitoring until the loan matures

The current Management Information System (MIS) can most likely be adapted without too much effort to include:

- Whether an E&S appraisal has been performed
- What the most important E&S aspects of a client or a loan are
- What clauses have been added to the contract
- If a client has made the necessary improvements this can be logged in the MIS as well

Loan officers can use information from MIS to monitor progress and compliance

In case loan officers change information is not lost

Status and progress information can be used during subsequent loans to the same client

How to integrate E&S information depends entirely on MIS in place
Logging the basic E&S info related to a client or to a loan can also deliver cross loan-book insights

Logging the basic E&S info related to a client or to a loan is important to

- Develop a cross loan-book view on what are the main E&S risks
- Learn what works and what does not

Based on knowledge of the E&S aspects of the portfolios MFIs can

- Customize activity and sector fact sheets to reflect the local circumstances
- Customize the loan appraisal process

With this information cross loan-book overviews can be generated about nature and magnitude of the E&S risks

- This can be used for reporting to investors and other capital providers
E&S actions in reporting
Internal and external reporting (e.g. towards FMO/other investors) must cover process and portfolio overviews

Information FMO wants to see regarding E&S management system

- Overview of the entire loan process
- Exclusion list in use
- Checklists and other sector or activity assessment tools
- Board approval of the E&S management system

Information FMO wants to see regarding the E&S performance of the loan book

- Number of loans screened on E&S issues (absolute and relative to portfolio)
- Outcome of the E&S appraisal process (% disproved, % approved with contract clauses etc)
- Overview of sectors with most identified E&S issues
- Overview of most frequent E&S issues
Format B3

Development of a pilot project to integrate social and environmental aspects in the credit cycle

Course ‘Social and environmental aspects for MFIs’
Phnom Penh, 9 – 10 July, 2007
What will be the scope of the pilot project

In what region will the pilot project be held and why?
_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________

Will the pilot be limited to specific sectors? If yes, what sectors
_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________

Which branches / offices will be involved and why? Will all the loan officers participate?
_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________

When will the pilot start and when will it end?
_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________
What tools and materials will be needed

Sector fact sheets and activity assessment index?

_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________

What existing loan application, loan appraisal and loan contract materials need to be modified?

_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________

What modification needs to be made to the management information system?

_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________

Who will be responsible for making (managing) the necessary modifications?

_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________
When will the pilot be a success?
Evaluation criteria

What client-related evaluation criteria and methods will be used?
_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________

What loan officer-related evaluation criteria and methods will be used?
_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________

What organisation-related evaluation criteria and methods will be used?
_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________

Are there any other dimensions to be considered in evaluation the success of the pilot?
_____________________________________________________________________________
_____________________________________________________________________________
_____________________________________________________________________________
What training and management support will be needed?

What training materials will be needed for the loan officers participating?

Who will develop the training materials?

What management support will be needed for the pilot?

What other conditions must be met to allow the pilot to proceed uninterrupted?
Any other important aspects of the pilot?
## Time planning for the pilot project

<table>
<thead>
<tr>
<th>April</th>
<th>May</th>
<th>June</th>
<th>July</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>

1. Decision on scope / period

2. Modification of loan-related materials
   - Loan application
   - Loan appraisal
   - Loan contracting
   - Mgt info system

3. Develop evaluation criteria

4. Develop training materials

5. Ensure management support

6. Start pilot

Weeks after training
How to manage change in your organization?

Course ‘Social and environmental aspects for MFIs’
Phnom Penh, 9 – 10 July, 2007
Implementing E&S aspects in SOPs faces difficulties always found in change management

Initiating change within an organization is difficult

This is true for “change management from within” as will be the case for MFIs who are implementing E&S procedures

It is equally true for MFI funds who want to initiate change in their investee partners

• Although position as supplier of (equity) capital may increase leverage

So a couple of words here about change management and how to proceed
Why change is so difficult

“*Why do we need to change?*”

- Change is difficult because many see it as a rejection of how they have done their work before

“*What do we need to change?*”

- Change is difficult because it is unlikely that everybody agrees with what to change

“*How do we change?*”

- Change is difficult because every change implies uncertainty which people tend to avoid
- Change is difficult because organisational structures encourage other objectives
- Change is difficult because many lack the required knowledge and skills
Change hurdles lead to self sufficient organisations … … also with respect to E&S risks and impacts

- No visible crisis
- Status quo considered OK
- Incentives stimulate other behaviour
- Lack of sufficient external reactions
- Lack of change leaders
- Uncertainty avoidance
- Lack of knowledge and skills

Self-sufficiency

Organizational barriers Individual barriers
Start with activating the change levers that are within reach.
## Potential complications and some tips on how to resolve them

<table>
<thead>
<tr>
<th>Potential complications</th>
<th>Tips on how to resolve them</th>
</tr>
</thead>
<tbody>
<tr>
<td>Action plan is still a draft</td>
<td>Gather input from colleagues</td>
</tr>
<tr>
<td>No commitment of Management Board</td>
<td>Propose to Mgt Board with help FMO</td>
</tr>
<tr>
<td>Loan officers and other key people may have limited knowledge</td>
<td>Focus on training many people (<em>Reach</em> is more important than <em>rich</em> content)</td>
</tr>
<tr>
<td>Loan officers may be sceptical</td>
<td>Gather a coalition of the willing</td>
</tr>
<tr>
<td>Lack of success stories</td>
<td>Share best practices as soon as they come about</td>
</tr>
</tbody>
</table>
## Anticipate on critical question with counter arguments

<table>
<thead>
<tr>
<th>Critical question</th>
<th>Counter arguments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Majority of loans/clients do not imply environmental or social risk</td>
<td>Fine, focus on the ones that do</td>
</tr>
<tr>
<td>There is no environmental/social risk or government does not regulate or check</td>
<td>No risk if the government would control. Problem is “privatisation of regulation”</td>
</tr>
<tr>
<td>No time to manage E&amp;S issues</td>
<td>Loans with E&amp;S issues may take more time</td>
</tr>
<tr>
<td>We do not have the skills</td>
<td>Access to some excellent external experts</td>
</tr>
<tr>
<td>We will lose customers</td>
<td>When a project is OK, the client has no objections. And you do not want bad clients</td>
</tr>
<tr>
<td>There were never problems before</td>
<td>The problem is about to emerge. Costs have not been measured yet</td>
</tr>
<tr>
<td>It is no common MFI practice</td>
<td>Risk management is a key theme for MFIs</td>
</tr>
</tbody>
</table>
MFI Funds can make efficient inclusion of E&S aspects part of their investment decisions

As part of the investment decision, MFI Funds can stipulate that an efficient environmental and social management system should be developed by the investee

- In case the MFI Fund has received finance from FMO this is expected

MFI Funds can leverage their expertise with other MFIs to help implement an environmental and social management system

- Part of the reason why MFI Funds are here
Development of an action plan to integrate E&S topics into standard operating procedures

Course ‘Social and environmental aspects for MFIs’
Phnom Penh, 9 – 10 July, 2007
## General actions

<table>
<thead>
<tr>
<th>What</th>
<th>When</th>
<th>Who</th>
<th>How</th>
<th>Approval by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Evaluate of the pilot</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formulate ambition level regarding integration of E&amp;S aspects</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Communicate ambition level to organisation</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

*Note: The table continues with more rows, but they are not shown in this transcription.*
# Actions relating to loan application phase

<table>
<thead>
<tr>
<th>What</th>
<th>When</th>
<th>Who</th>
<th>How</th>
<th>Approval by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Modify / adopt exclusion list</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Modify loan application sheet to include E&amp;S aspects</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Actions relating to loan application phase

<table>
<thead>
<tr>
<th>What</th>
<th>When</th>
<th>Who</th>
<th>How</th>
<th>Approval by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Modify factsheets (as determined already: B1)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Develop appraisal criteria for risk officers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Modify loan appraisal sheets</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>
### Actions relating to loan contracting and disbursement phase

<table>
<thead>
<tr>
<th>What</th>
<th>When</th>
<th>Who</th>
<th>How</th>
<th>Approval by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Develop general contract clauses for situations often encountered</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Determine E&amp;S risk level and loan size for which to use clauses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Actions relating to recovery and monitoring phase

<table>
<thead>
<tr>
<th>What</th>
<th>When</th>
<th>Who</th>
<th>How</th>
<th>Approval by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Determine changes needed in MIS to document E&amp;S aspects of loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Determine how to document changes in E&amp;S aspects during loan</td>
<td></td>
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