Social Performance Task Force®

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Client Delinquency and Default: SPM Solutions

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No matter what the operational issue keeping you awake at night, if you're looking for a balanced and sustainable solution to a problem, the Universal Standards can help you. This note is part of a series of Guidance Notes called [SPM Solutions to Operational Challenges]—a series aimed at helping financial service providers (FSPs) use SPM to examine and solve critical operational problems. Each briefing will give you "client-centric questions" to support a more balanced diagnosis, as well as a list of the top resources you need to take action.

Client delinquency and default erodes your institutional sustainability, and is a serious warning sign about client vulnerability. This guidance note will help you use the [Universal Standards] to tackle this problem.

Bad news landed on your desk this morning. The latest management report shows an alarming rise in client default–with more trouble coming, given increasing portfolio at risk (PAR) figures. So, how can you safeguard your institutional sustainability and your social mission at the same time? And what does it mean to be the leader of a social business, when the business side of things is under so much pressure?

There are moments in the life of every financial service provider (FSP) when overall delinquency and default rates suddenly spike–in a branch, in a region, or even across a whole organization. Widespread client failure is sometimes due to a massive external event (economic, political, or environmental), but in most cases, it's an internal problem with some aspect of our business model. **The following guidance will take you through the most important questions for diagnosing the problem and working toward a resolution.**

Reality check: Ask the difficult questions about your strategy

Is this a landscape problem?

Five-year business plans are rarely agile enough to dynamically respond to major market shifts. If a national shock (political, economic, or environmental) is affecting your clients' livelihoods, take stock of your clients' savings, debt, and cross-borrowing levels. Keep an eye on whether your clients are liquidating their savings to cope, then consider rescheduling existing debts and extending emergency loan products where possible. When the dust settles, revisit your strategic plan and growth forecasts.

If your growth expectations have become too ambitious given recent changes in the competitive landscape, it's time to slow down and re-align, because pushing growth when it's no longer appropriate can lead to

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The Universal Standards for Social Performance Management ("the Universal Standards") is a comprehensive manual of best practices to help FSPs achieve their social goals. Find the Universal Standards manual [here](), and guidance on how to put the Universal Standards into practice in the [Universal Standards Implementation Guide]().

widespread client failure. Remember: extensive growth (offering different services to the same clients) can often be more effective, and more cost-effective, than intensive growth (offering the same services to different clients).

- **[Strategic Management Toolkit Handbook]()**
  Chapter 7 covers strategic analysis and introduces some of the basic approaches to determining an FSP's market position. Chapter 8 helps FSPs put this analysis into practice by looking at client needs analysis, determining the value proposition, and making this work within the marketplace.

- **[The Universal Standards Implementation Guide]()**
  The guidance for Essential Practice 6A.1 discusses how to set and monitor growth rates that promote both institutional sustainability and client well-being. The guidance discusses how to evaluate external factors such as local competition, as well as how to examine institutional capacity.

Is this a leadership problem?

Social businesses exist to create both social and financial value in the marketplace, and we can expect that these two aims will occasionally conflict. Sometimes decisions to create social value will create negative financial value. On the other hand, there will be instances where emphasizing social value will benefit the financial bottom line.

While your board should try to find and leverage these "sweet spots," it should also be on the lookout for warning signs that it is putting too much emphasis on profit at the expense of client well-being. A spike in PAR or default can be one such warning sign.

To successfully navigate these tensions, your board and management need to work in concert. Ensure you share the clarity, information, values, and skills needed to hold each other accountable for good decisions, and honestly examine your bad decisions. Every discussion, every decision, should begin and end with the well-being of your clients.

- **[Board implementation guide briefing]()** and **[Board SPM handbook]()**
  Make sure your board knows their roles and responsibilities vis-à-vis SPM.

- **[Strategic Management Toolkit Handbook]()**
  Chapter 8 contains a useful discussion of strategic choices to be considered when choosing a target market, including defining an FSP's value proposition, competitive advantage, growth, and competitive strategies. Chapter 9 looks in more detail at creating a strategy map to balance the needs of institutional stakeholders. Chapter 10 discusses lead and lag indicators from a Balanced Scorecard Perspective, and provides a template to develop year-on-year social performance targets.

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Head to Dimension 6 of the Universal Standards Implementation Guide to think through leadership and landscape issues in detail.

Have some SPM skeptics on your board? Tackle their concerns head-on using this SPTF Guidance Note

- **Defining responsible financial performance**
  Use this article to help put your growth targets into the larger context of your marketplace.

- **What happens to microfinance clients who default?**
  Use this Smart Campaign briefing to check your default processes. Annex 2 sets out the key questions you need to ask yourself to run a diagnosis, and Section 4 contains recommendations you can use in a discussion with your peers at a national level (perhaps through your network).

- **Portfolio Analytics Toolkit**
  Look at the information you already have! The Portfolio Analytics toolkit provides the theoretical background on data analysis and basic statistical concepts as well as a step-by-step process for preparing for and conducting a basic and detailed portfolio analysis.

- **Understanding clients through in-depth interviews: *Imp-Act* Practice Note No. 2**
  Choose a key segment and get some rapid-fire qualitative feedback on key trends! Use this step-by-step guide to developing and conducting in-depth qualitative interviews with individual clients.

Data check

Where is the "fire"?

Find out where the problem is happening; where it is not happening will also help you find the right solution. Segment your data in as many directions, and at as many levels as possible, until the situation comes into focus. Look at your portfolio data for performance differentials as you segment by year, area, business type/size, loan type/size, gender, loan cycle, branch or loan officer. Also investigate whether failing clients have (or don't have) safety nets in the form of savings and insurance – and whether they cross-borrow from other institutions.

Use your existing data to identify trends, and use in-depth interviews (as well as your exit interviews) to investigate what lies behind those trends.

Is there definitely a fire? Check whether your monitoring system is sending the right signals. For instance, if you've recently introduced a soft collections policy (which might include loan rescheduling) – ask whether your MIS can cope with mid-cycle changes to loan terms.

Product check

Do we have a full picture of clients' needs?

What clients need isn't always the same as what they want. Clients might want bigger loans, faster loans – but it's up to you to deliver value without doing harm (which might lead to default). Typical market research tools can help you understand what clients want, but they might not be able to tell what they *need*. Instead, do serious homework on

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Trying to understand your clients' financial lives? Leave your assumptions at the door. Head to Dimension 3 of the Universal Standards Implementation Guide *to find out more.*

Flexible products rely on good design, as well as staff that are trained and supported to help their clients problem-solve mid-cycle.

Head to Section 3 of the Universal Standards Implementation Guide *to think through how smart product design can help keep clients on track.*

their lives. Find out how they earn a living – not just how much income they have, but *how many income sources* they have, and how they combine these throughout a typical year. Find out what the typical windfall points are, how often they face income shocks (and what kind), and how they typically manage risk and cope with emergencies (through formal and informal mechanisms).

- **[*MicroSave* toolkit: Market research for microfinance]**
  This toolkit provides Participatory Rapid Appraisal (PRA) tools, including: wealth ranking tools; seasonality, life cycle, and time series tools; and several original PRA tools developed to understand the financial service use, options, and opportunities within communities, including tools for assessing the gender issues and household control of resources.

- **Human-centred design toolkit**
  This open-source toolkit walks users through the human-centered design process and supports them in activities such as building listening skills, running workshops, and implementing ideas — all of which can generate insights into clients' lives that can be turned into effective product design.

How do we help with crunch points?

Hope for the best, but plan for bumps in the road. If you have a full picture of clients' needs, you'll know their lives and livelihoods are unpredictable. So build the security and flexibility they need into your products to cope with crunch points. Your products should help clients manage risk in terms of the timing, size, and delivery of both loan disbursal and repayment. This is especially important for agricultural clients – who for example, need longer loan terms to spread risk over more than one growing season. Also think through how to give clients access to lump sums in case of emergency (health, business); emergency loans and non-credit financial products can be useful here.

- **Avoidance of Over-indebtedness: Guidelines for Financial and Non-financial Evaluation**
  This Smart Campaign resource provides guidelines for determining a loan applicant's capacity and willingness to repay a loan.

- **Progress with flexible microfinance products**
  This study reviews, in both theory and practice, how flexible financial products can be combined to deal with risk as a complement to insurance.

Client check

Is this a group problem?

Well-functioning lending groups can be a useful space for clients to problem-solve when they run into repayment problems. However, this can also create data blind spots for the loan officer, who might not be aware that clients are helping each other out in times of difficulty. Do some

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Head to Section 4 of the Universal Standards Implementation Guide to think through issues around how you treat clients – both on sunny days and rainy days.

quick client listening exercises to find out what's happening at the group level.

- **Understanding clients through in-depth interviews: *Imp-Act* Practice Note No. 2**
  Choose a key segment and get some rapid-fire qualitative feedback on key trends. Use this step-by-step guide to developing and conducting in-depth qualitative interviews with individual clients.

Is this a targeting problem?

You may have designed great products, but that doesn't mean you are automatically getting them into the hands of your intended target clients. If the problem seems confined to one product, then check whether your targeting is working as it should. If not, revamp your communication, training, incentives, and auditing functions.

Is this a knowledge problem?

Debt means risk – so make sure your clients know their rights, their responsibilities, what late repayments affect them, and what to do when they hit a bump in the road.

- **Essential documents for new clients**
  Make sure your clients are in the know – adapt and use the sample loan summary and repayment schedule (p. 11), and the sample delinquency information (p. 18).

- **Internal Control Guidance Note**
  Make sure your internal audit is picking up warning signs before they turn into problems–do staff take the time to explain to clients their rights and responsibilities?

Is this a listening problem?

When used correctly, client exit and complaint data can provide good early warning signals on problems that are brewing. Some clients exit because they've outgrown your products. Others leave because your services created more problems than value – and chances are those clients aren't the only ones that feel this way.

- **Collecting and using client exit survey data**
  This Smart Campaign resource contains great basics. Also download the SPTF Guidance note on client exit interviews, and look at guidance/resources listed in the Universal Standards Implementation Guide (standard 3b and 4e).

- **How to Design a Complaints Mechanism**
  This Smart Campaign guide walks you through both design and use of a client complaints system.

Staff check

Is this a workload problem?

How much pressure does your business model put on your staff? Does your board expect to mitigate the trade-offs between social and financial value by pushing staff to be ever more productive and efficient? Of course, an organization can increase its

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profit margins by asking staff to increase their workload – but they'll have less time to give clients the attention and support they need when things go wrong. They'll also be less likely to spot problems as they develop. Consider:

- **Trends in loan officer caseload sizes:** Don't just look at averages, but segment by length of service, product type, client poverty level, etc. When staff get too busy – the temptation to cut corners on quality delivery is strong.

- **Balance between front and back office staff:** Are your frontline staff getting the support they need from branch and HQ?

- **Staff management systems:** Training and auditing gives staff the skills and guidelines they need to do excellent work – but if your internal audit or training department is overstretched, the quality of their work will start slipping. As your organization grows, the back office needs to grow as well.

Is this a knowledge problem?

If you've taken the time to build "social value centers" (like appropriate loan size appraisal, flexible terms, etc.) into your products – make sure the staff tasked with selling them to clients know what those points are, and (importantly) why they are crucial to clients' success. Reinforce this training with solid incentives and effective auditing.

- **Staff training guide: Microloan Foundation Malawi**
  Download and adapt this guide to train your staff to effectively collect social performance assessment data. It's based on the use of the PPI, but also can be adapted to other social data points.

- **Avoidance of Over-indebtedness: Guidelines for Financial and Non-financial Evaluation**
  This Smart Campaign resource provides guidelines for determining a loan applicant's capacity and willingness to repay a loan.

- **Internal Control Guidance Note**
  Make sure your internal audit is picking up warning signs before they turn into problems – multiple loans, renewal after early loan liquidation, etc.

- **Staff Incentives: *Imp-Act* Guidance Note**
  This briefing frames the key questions to consider when reviewing an FSP's staff incentive system. It then identifies some emerging practices that FSPs are finding helpful in ensuring that the staff incentive systems appropriately balance their social and financial performance objectives.

Is this a problem-solving problem?

When things go wrong for clients, staff need to work alongside them to solve the problem. To do this effectively, staff need to be surrounded by the right policies and training, so they know what to do, when to do it, and how.

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Section 5 of the [Universal Standards Implementation Guide] *will help shape your thinking around how you support, train, and encourage your staff to do excellent work for your clients.*

• **[How to Develop an Institutional Code of Ethics]**
Establishing high standards of ethical employee behavior is a two-part process; first, the institution defines standards of behavior, and second, those standards are brought to life throughout the institution. This guide focuses on the first part of the process—defining standards of behaviour through a formal Code of Ethics.

• **[Refinancing policy: FUBODE Bolivia]**
Download and adapt this sample refinancing and restructuring policy, to help staff to assist clients in distress.

• **[Best Practices in Collections Strategies]**
This fantastic guide explains the collections process used by ACCION International with partners in Latin America and India, and details the practices that a financial institution should consider for successful collections that also respect clients' rights.

Is this a feedback problem?

To what extent are staff encouraged to voice their concerns when things are *not* working? Cultural norms, organizational systems, data blind spots, and leadership signals can all act to put our better instincts about a problem on "mute".

• **[In Praise of Failure]:** We're great at praising success – but does your organization routinely talk about failure? Use this article to get the conversation going with your colleagues.

And finally…

There are myriad means of addressing an organizational crisis such as a spike in PAR or client default. A purely commercial response, of course, would be to come down hard on clients that are struggling to repay –thereby covering the institution's financial liabilities without considering the impact on clients and their relationship with the institution. An SPM approach, however, helps us to view high PAR as a symptom of a problem, rather than a problem in itself. Once we make this critical shift in perspective, a whole new interesting set of questions emerge – helping us to build organizational resilience by serving clients better. The Universal Standards for Social Performance Management offer a useful compass within this new landscape – helping us find a balanced and sustainable path around the bumps in the road.

"Guidance" is part of a series of short topic-specific bulletins produced by the Social Performance Task Force to inform its membership and other interested parties about key developments. Your comments are always welcome.

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