Facilitating fund flows to MFIs:
How financial and social ratings help

Micro-Credit Ratings International Ltd
602 Pacific Square, 32nd Milestone NH8, Gurgaon 122001  INDIA
sanjaysinha@m-cril.com  Tel: +91 124 230 9497, 230 9707  Fax: +91 124 230 9520
What we will talk about

• M-CRIL as a microfinance rating agency
• What microfinance performance rating is about
• Why social ratings were introduced
• How these services facilitate the flow of funds
What is M-CRIL

- **World’s leading mf rating agency** – 700 ratings in 30 countries – spread across Asia and into Europe and Africa

- **A decade of pioneering** experience in mf rating services

- **Professionally qualified team** of 12 analysts.

- **Independent rating review committee** with microfinance experts

- Range of **clients/partners** - Multilateral, Bilateral and other Development Organisations, Not-for-profit Organisations, Govt. Organisations, FIs, MFIs and others

- Record of **pioneering products** in microfinance analysis
M-CRIL has…

• Record of **pioneering products** in poverty-focused programmes
  – One of the first to introduce **financial rating of MFIs**, 1998
  – First to introduce **social rating of MFIs**, 2005

• **Rating of chit funds** [formal RoSCAs], 2008

• Pipeline, 2009

• **Low cost private schools** in developing countries

• **Value chain initiatives** for microenterprise promotion

• **Community led slum redevelopment initiatives**
What is rating?

A standardised tool to enable investors – mainly lenders and donors – to

- understand the risk profile and credit-worthiness of microbanks/MFIs – both in absolute terms and in relation to other similar institutions
- estimate the absorptive capacity of MFIs and estimate the risk associated with lending to each institution
- via a Social Rating provide feedback on the MFI’s ability to achieve the impact it seeks

M-CRIL’s ratings were launched specifically to facilitate the flow of socially responsible funds into microfinance
Microfinance rating is the **rating of MFIs (mainly) by specialist institutions**

Started about 11-12 years ago with ratings in Latin America and by M-CRIL in South Asia

The standard **performance rating** consists of making a systematic assessment and benchmarking of the performance of an MFI from the perspectives of:

- Governance, product delivery & competitive strategy
- Management systems – portfolio tracking, MIS, internal controls, human resources
- Financial performance including portfolio quality

It needs a specialist knowledge of microfinance since it is a diagnostic assessment of performance not just of risk
M-CRIL financial/credit rating..

“..provides an objective assessment of the performance of institutions providing financial services to low income families – MFIs, NBFIs, rural and cooperative banks as well as commercial banks with a focus on mf”.

• Evaluates the MFI or bank’s creditworthiness as well as its strengths and weaknesses.

• **Assesses the risks** associated with lending to the organisation (incl. external risk, credit risk, market risk and the risk of fraud)

• It covers – the quality of the governing board, the depth of management systems and financial health
Rating Instrument – areas of assessment

1 Governance & strategy (20%) – determines continuity, transparency, ability to grow & work within cost parameters, minimise risk

2 Management (40%) – assesses HR policies, MIS, internal controls, tracking and follow up of overdues – overall risk management

3 Financial performance (40%) – comments on the portfolio quality and current and historical profitability/sustainability of the MFI – includes PAR, RoA as the key factors
Governance & strategy

Indicators on experience and strategy:

⇒ professional experience of the board members
⇒ degree of focus on micro-finance
⇒ degree of concentration of operations
⇒ development strategy and services provided
⇒ involvement in mf
Management

Indicators on:

- quality of management and field staff members
- quality of accounts and MIS
- financial control systems and cash flow management
- strength and capability of borrower groups
- level and adequacy of infrastructure
Financial performance

Indicators like:

- age statement of overdues and portfolio quality (>60 days)
- financial management
- liquidity and coverage
- capital adequacy
- operational efficiency
- return on assets and sustainability
Rating process

at M-CRIL

**Scheduling**

at the MFI

**Start-up**
- discussion with head of operations
- head office data collection

**Field visit**
- branch visits & data collection
  - MIS verification
  - client interaction

**Follow up & de-briefing**
- discussion of preliminary analysis
- filling data gaps
Rating process ...continued

at M-CRIL

Data analysis & report writing

Draft report to MFI
- for feedback
- report revision based on feedback

Review by Rating Committee
- MFI views presented alongside
- final decision on grade & recommendation

Report finalised
and submitted to client
# M-CRIL’s rating grades

<table>
<thead>
<tr>
<th>Grade</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>α++</td>
<td>Highest safety, very good systems&lt;br&gt;most highly recommended</td>
</tr>
<tr>
<td>α+</td>
<td>Very high safety, good systems&lt;br&gt;highly recommended</td>
</tr>
<tr>
<td>α</td>
<td>High safety, good systems&lt;br&gt;highly recommended</td>
</tr>
<tr>
<td>α-</td>
<td>Reasonable safety, good systems&lt;br&gt;recommended</td>
</tr>
<tr>
<td>β+</td>
<td>Reasonable safety, reasonable systems&lt;br&gt;recommended, needs monitoring</td>
</tr>
<tr>
<td>β</td>
<td>Moderate safety, moderate systems&lt;br&gt;acceptable&lt;br&gt;needs improvement to handle large volumes</td>
</tr>
</tbody>
</table>
### M-CRIL’s rating grades ...

<table>
<thead>
<tr>
<th>Grade</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>β−</td>
<td>Significant risk, poor to moderate systems acceptable only after improvement</td>
</tr>
<tr>
<td>γ+</td>
<td>Substantial risk, poor systems needs considerable improvement</td>
</tr>
<tr>
<td>γ</td>
<td>Highest risk, poor systems not worth considering</td>
</tr>
</tbody>
</table>
...the performance of MFIs

Latest rating grades of 145 MFIs

![Bar chart showing different rating grades for MFIs]
Why social ratings were introduced

Within the past few years, the performance rating has been complemented by a social rating.

Concerns have emerged about MFI commitment to the social values on which they are predicated.

Social rating was developed to assess the translation of **mission into practice**

- Outreach to target clientele – poor/women or m-e’s
- Commitment to social values – client protection, employment generation, staff working conditions
- Design of products/delivery systems to meet the needs of clients
Social rating

• Key areas of assessment
  – *clarity of mission* and alignment of systems
  – *social responsibility* and transparency of operations (clients, staff, society)
  – *depth of outreach*
  – *suitability of products* to serve the needs of clients

• **Output** = a good understanding of the MFI’s ability to generate social value

• **Demand** for social ratings is increasing but not yet as widespread as for credit rating – about 50 undertaken
Impact of rating on the growth of mf

• Availability of a standard assessment system has drawn in commercial banks as well as development banks and donors
• Most private investment and international debt funds are able to function because due diligence is predominantly addressed by microfinance ratings
• A couple of years ago there was estimated to be some $2 billion invested in microfinance and another $5 billion available for such investment
• In India alone the coverage of microfinance clients by MFIs has jumped from around 0.5 million clients 12 years ago to around 20 million clients now
• Much of this is attributable to the availability of financial resources
M-CRIL’s ratings were launched…

…specifically to facilitate

the flow of commercial funds into microfinance

this may now be reinterpreted as

the flow of socially responsible funds into double/triple bottom line programmes