

Evaluating Access to Finance

The M-CRIL initiative for rating microfinance institutions

12 December 2007

Micro-Credit Ratings International Ltd

602 Pacific Square, 32nd milestone NH8, Gurgaon 122001 INDIA

www.m-cril.com Tel: +91 124 230 9707, 405 0739 Fax: +91 124 230 9520



The context – 1997

A **growing microfinance** sector in Asia

- **Vast network of microbanks** in Indonesia
- **Large, well known microfinance programmes** in Bangladesh
- **Increasingly important m-f sectors** in the Philippines, Cambodia, Nepal, Sri Lanka as well as India

The context...

- **Largely unsupervised** in most countries whether or not deposit taking institutions
- **Regulators had their hands full with the conventional banking system** – faced lack of skilled staff + motivation issues
- Lack of interest in supervision since **microfinance was seen mainly as poverty lending**

The result...

- **Appraisal systems** for microbanking used a mix of financial and development assessment tools to assess the performance of microfinance institutions
- Largely undertaken by individual consultants, academic institutions or consultancy companies with a wide range of interests
- Such techniques led to a variety of assessments – each of unique and not necessarily comparable with others – made **comparison of MFI performance a challenge**

The conclusion...

With increasing interest in microbanking, a **standardised tool** would enable investors – mainly lenders and donors – to

- **understand the risk profile** and credit-worthiness **of micro-banks** to estimate the appropriate volume of investments
- **identify their strengths and weaknesses** in order to determine their needs for institutional capacity building

The response

As a development consultancy organisation EDA set out to develop a standardised tool for this purpose since it had

- a **substantial research orientation**
- considerable **experience of monitoring** development finance programmes
- been engaged in **research on development appraisal** methodologies
- substantive **knowledge of microfinance**
- a **well-established reputation** for quality and integrity

Institutionalising the service...

M-CRIL – **a separate company** – was established to provide the rating service so as to

- develop a **team of professionals** with a combination of microfinance knowledge/experience and rating skills
- **facilitate transparency** in its operations and avoid conflict of interest

M-CRIL's transparency is ensured through the **vetting of reports by independent experts** who form a Rating Committee



M-CRIL's objectives

- **M-CRIL** was established to **facilitate the flow of commercial funds into microfinance**

The **aim of the rating service** is to

- **assess the creditworthiness of microbanks**, in terms of the quality of their operations and their capacity to absorb funds so as to provide an estimate of the risk associated with lending or investing in each institution
- determine their likelihood of achieving their social mission
- **social rating**

The Rating Instrument

The working hypothesis for credit rating is that

The risk profile and creditworthiness of an MFI depends critically on its financial performance, but is also affected by its managerial capabilities, governance & strategy

Social mission is achieved through good depth of outreach, appropriate systems and products responsive to client needs

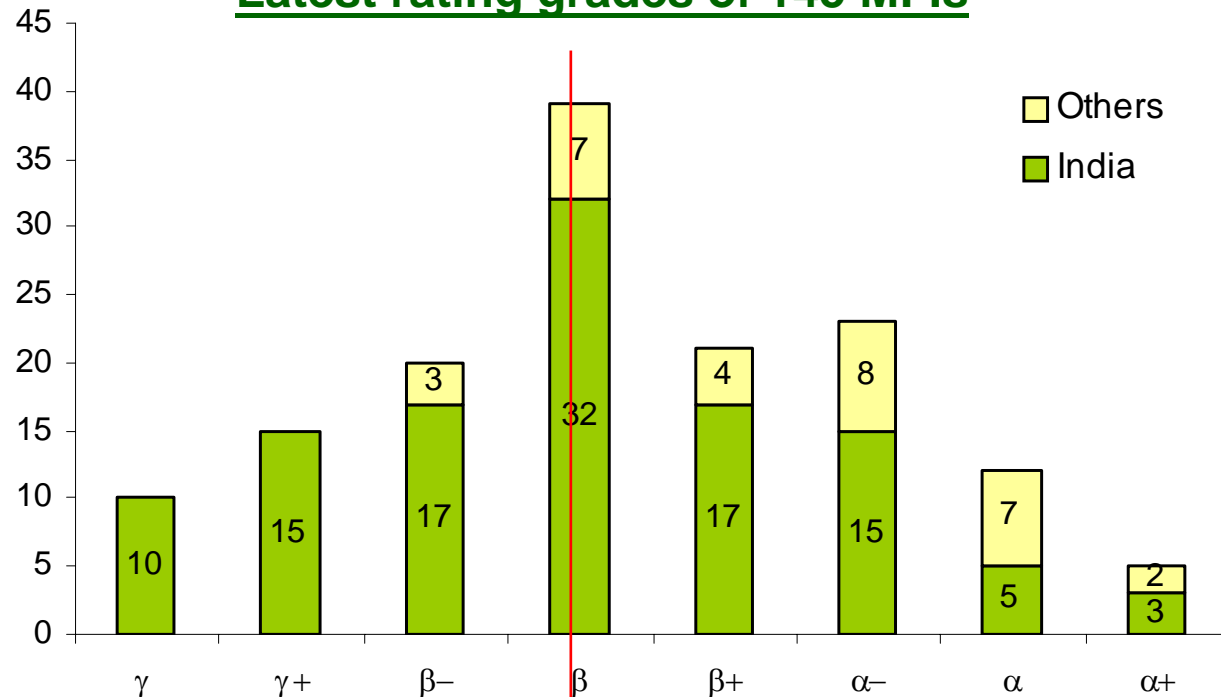
Progress

- A total of **465 ratings done so far** – covers **280 MFIs** in Asia, NIS and Africa with 185 rating updates – some 20 social ratings
- Ratings have been in 25 countries of **South Asia, SE Asia, NIS and a few in Africa**
- There is a predominance of India in this profile which is a reflection of the **advances made by Indian microfinance**

Ratings have enabled

The **identification** of MFIs that are credit-worthy or have the potential to become sustainable in the near future

Latest rating grades of 145 MFIs



Stimulating access to finance

A **professional assessment** by a dedicated team is

- **Standardised:** Enables comparison across institutions, regions and over time
- **Verified:** Uses validated information that would be very time consuming and resource intensive for lenders/donors to obtain themselves
- **Diagnostic:** Undertaken by a specialised team with experience and knowledge of issues specific to m-f
- **Predictive:** Based on incisive analysis of both subjective and objective indicators

Promoting transparency

Achievement 1 – helping to overcome information asymmetry

Has made lenders/donors aware of issues affecting creditworthiness
– emphasises for the sceptics that MFIs

- provide financial services to those the formal banks don't reach
 - a substantial outreach to low income families
- have a prudent approach to client savings
- are responsible in ensuring the repayment of borrowed funds

most importantly,

- a significant number are at or near sustainability, therefore,
good investments for either loans or equity

Promoting transparency...

Key weaknesses found amongst the many MFIs

- lack of a business orientation which limits sustainability – most MFIs in the region emerge from NGOs with a social agenda
- do not adequately relate good microfinance practice to social objectives resulting in disenchanting clients, high cost services
- some are leader dominated institutions with centralised decision making, which
- affects receptivity to ideas, limits response to market opportunities

Promoting transparency...

Typical **systemic weaknesses** found in Asian MFIs

- incomplete understanding of client needs/product design
- poor loan tracking and follow up
- lack of incentives for staff
- accounting deficiencies
- occasional rescheduling/refinancing of client loans
- (minor) cases of fraud undetected by management on account of poor MIS/internal audit processes

Promoting transparency...

- o Rating has enabled such **issues** to be highlighted and **discussed between lenders/donors** and **MFIs**
- o **Transparency** has also become established as many MFIs now make their rating reports public – having a standard assessment facilitates comparison
- o Rating Fund & investors have **imposed public disclosure** of rating reports as a condition for its support

Strengthening links with investors

Achievement 2: Providing an assessment of the risk profile of MFIs has facilitated substantive links with investors

- Lending of the order of \$100 million by SIDBI to some 100 MFIs in India and other banks now regularly expect to see ratings as part of due diligence
- Social investors too use ratings as an essential part of decision making – used by all leading social investors – Bellwether, Lok Capital, IFC, ADB, Hivos, DFID, SDC, UNDP, Dexia Micro-Fund – used in Bangladesh, Nepal to assess access to finance



Establishing internal accountability

Achievement 3: identifying strengths and weaknesses

- prioritises capacity building needs
- specific recommendations facilitate capacity building support
 - financial/yield analysis and delinquency management
 - loan tracking systems and MIS
 - financial control – budgeting, cash planning & internal audit
 - staff skill improvements through better recruitment and training
 - product development focussed on client needs
 - better governance + focus on microfinance as specialised financial intermediation

Enabling improved provision of services

Achievement 4: Research and advisory services are serving to improve understanding of the sector

- M-CRIL Review: an analysis of aggregated rating data provides overview of performance of MFIs in the Asian region
- Best practices documentation has resulted in dissemination of systems and techniques used by the best MFIs to the sector as a whole
- Studies of RRBs and DCCBs – undertaken and planned – to strengthen the contribution of the banking sector to the provision of financial services to low income clients

Conclusion

M-CRIL's experience is that institutional assessments based on accepted standards and incisive research can be **a very powerful tool** in

- **enabling capitalisation** of MFIs, as well as in
- **promoting institutional capacity building** through the systematic identification of operational strengths and weaknesses
- **improving understanding** of the means to promote the delivery of appropriate financial services to low income families

Conclusion...continued

- but to be effective, the service must be provided by a professional team
- **dedicated to microfinance**, having the knowledge and experience that goes with that specialisation
- **committed to** the long term establishment of access to financial services – insurance as well as credit and deposit services



Conclusion...ends



...and this requires focussed agencies such as

M-CRIL

Thank you