Microfinance

Rating Market Review 2010

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ADA is a non-profit organization specialized in microfinance. For over 15 years, ADA has shared its expertise with partners from the North and the South in order to create a series of innovative tools that facilitate poor people's access to responsible financial services across the globe. With their knowledge and competence, ADA's experts contribute to the improvement of the microfinance sector.

The paper can be downloaded from www.ratinginitiative.org or www.microfinance.lu
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ISBN
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Glossary

Acronym	Definition
ADA	Appui au Développement Autonome a.s.b.l.
AECID	Agencia española de Cooperación Internacional para el Desarrollo
AFD	Agence Française de Développement
AKAM	Aga Khan Agency for Microfinance
AMFI	Association of Mutual Funds in India
AMT	African Microfinance Transparency forum
Asia	East Asia, Pacific and South Asia region
BCEAO	Banque Centrale des Etats de l'Afrique de l'Ouest
CEMAC	Communauté Economique et Monétaire de l'Afrique Centrale
CGAP	Consultative Group to Assist the Poor
CIDR	Centre for Independent Development Research
DANIDA	Danish Development Assistance
DWM	Developing World Markets (LLC)
EECA	Eastern Europe and Central Asia region
EU	European Union
FED	Fundación Ecuatoriana de Desarrollo
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit

Acronym	Definition
HIVOS	Humanistisch Instituut voor Ontwikkelingssamenwerking
IADB	Inter-American Development Bank
IFC	International Finance Corporation
KfW	Kreditanstalt für Wiederaufbau Entwicklungsbank
LAC	Latin America and the Caribbean region
MENA	Middle East and North Africa region
MFI	Microfinance Institution
MITAF	Microfinance Investment and Technical Assistance Facility
MIX	Microfinance Information eXchange, Inc.
NGO	Non-Governmental Organisation
PRESEM	Programme de Renforcement du Secteur de la Microfinance (Nations-Unies)
RF	Rating Fund
RI	Rating Initiative
SSA	Sub-Saharian Africa
UEMOA	Union Economique et Monétaire Ouest Africaine
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme

Terminology

Financial rating

<u>Performance rating</u>

These products correspond to the product that is commonly called a “performance rating”. Such ratings include the analysis of institutional risks, including credit risk, and the financial performance of MFIs. Microfinance ratings do not only measure the MFI’s creditworthiness, but also its trustworthiness and excellence in microfinance. They indicate how well an MFI is performing compared to its peers, i.e. whether the MFI reaches micro-entrepreneurs efficiently and with high quality loans. Performance ratings can be used by investors, especially, donors, technical assistance partners and the MFI’s management and administrators.

<u>Sub-products</u>

Sub-products (of Performance ratings) include mini-ratings, diagnostics and Investment Advisory Reports (IARs).
These rating products are specific to the microfinance rating sector and are invariably applied to young and/or small institutions. They emphasize the analysis of institutional features considered necessary to grow and prepare MFIs to undertake a microfinance rating.

<u>Credit rating</u>

Credit ratings are the product of conventional rating agencies and have a narrower focus than Performance ratings. Credit ratings predict the likelihood that an MFI will not be able to meet its debt obligations. Credit ratings do not focus on how effective or efficient an MFI is at extending loans to micro-entrepreneurs. They are conducted under a standard methodology, applied to any kind of financial institution, be it a commercial bank or an MFI. Their purpose is to formulate an opinion on the MFI’s risk of default during a given period of time. They focus on credit risk and are used by investors and supervisory authorities as part of the compulsory requirements to comply with national regulation.

Terminology

Social ratings

A social rating is an “independent assessment of an organization’s social performance using a standardized rating scale”. Social ratings assess both social risk (the risk of not achieving a given social purpose) and social performance. Achievement of social impact is the ultimate goal of social performance. However, proving that a given intervention has caused a certain social outcome is a complex econometric exercise impossible to accomplish within the quicker processes of a social rating. Nevertheless, what a social rating can achieve is an analysis of the measures taken by an MFI towards the realization of its desired social goals, and the results in terms of outreach and quality of services provided.
Source : « Social Performance Map», SEEP.

Voluntary / Mandatory rating

In addition to the products mentioned above, a distinction should be made between voluntary and mandatory ratings. In some countries in Asia and the LAC regions for example, regulatory authorities require that MFIs obtain a rating which allows them to practise.

Subsidised rating

A subsidised rating is a rating whose costs charged to the MFI are totally funded or partially co-funded by a partner.

Table of contents

Main figures

NB: Compared to previous years, the number of rating agencies participating in the quantitative data collection has decreased. This impacts the representativeness and relevance of results presented in this report, which must thus be interpreted with some caution.

Rating process

There is a negligible decrease in the number of MFIs that initiated the rating process - from 266 MFIs in 2008 to 264 MFIs in 2009 (only the number of MFIs asking for a rating renewal decreased significantly - by 12%).

Rating renewal

A little over a third of MFIs enter the rating renewal process within three years following their first rating.

Sampling

411 MFIs are included in the sample related to FY 2009 (434 in 2008).

Transparency

Approximately 92% of MFIs voluntarily conducted a financial rating, which shows that MFIs (or their donors) actively seek information from an external source.

Social rating

Social ratings made significant progress in 2009. Compared with financial ratings, social ratings are the only rating product which increased in terms of number of first ratings (+51%, from 47 ratings in 2008 to 71 ratings in 2009), renewed ratings (+25%, from 4 to 5 ratings) and subsidised ratings (+306%, from 16 to 65 ratings).
The SSA and LAC regions show the highest growth rates in terms of social ratings (+150% for the SSA region and +58% for the LAC region).

Correlation between subsidies and rating process

Relatively speaking, if we double the number of co-funded ratings (+100%), the number of first ratings would increase by 42%. Even though this result should be qualified, it still shows the positive impact of co-funding on helping MFIs enter the rating process.

Africa

We observe a significant increase in co-funded ratings (+66%), even though the total number of ratings have decreased due to the fall in financial ratings (-26%). Social ratings, on the other hand, have increased by a factor of 1.5; there is therefore a switch (confusing term – see Africa section for more detail) between the two types of rating. This situation confirms the idea that MFIs seek a social rating after they have obtained a financial rating.

Observations

Based on the results derived from the sample used in this study, the following five key findings can be presented:

- The multitude of rating products and sub-products offered by rating agencies results in a lack of clarity in the definition of (sub)products and their related methodologies. There is still a lack of communication on the various products offered by those agencies. As a result, the wide variety of products does not help MFIs understand the services offered. Additional activities such as consulting services only add to the lack of understanding.
  A possible solution could be the creation of an integrated financial rating product, which would include a selection of key social indicators. This product would be positioned to gradually replace financial ratings in the long run. It is conceivable that such a product could be of use to both investors and MFIs. The former could use the new product as an assessment tool that combines financial and social information, while the latter would view it as a more affordable alternative to obtaining two separate ratings.

- The level to which MFIs integrate ratings in their operational costs is globally relatively low, except in the LAC region. This can be explained, amongst other things, by the increasing number of funding sources that are no longer limited to donors, national initiatives and programmes but also to investors. This trend points to a shift in the rating outlook (duality between the assessment for the MFI and the service for the investor).

- Subsidies have had a very positive impact on the demand for social ratings. This is a recent product and the enthusiasm it has created is linked primarily to an increased awareness on behalf of investors regarding the social mission of the MFIs in which they would like to invest. The demand for social ratings is strongly influenced by the demand for financial ratings.

- As far as Africa is concerned, new ratings and rating renewals have been steadily decreasing despite the strong increase in the number of co-funded ratings. This situation may point to a discrepancy between the support given and actual needs. These needs differ from those relating to other regions for several reasons specific to Africa including culture (ambiguous...), distribution of poverty (mainly located in a rural environment, far away from urban areas), level of legislation, specific features of microfinance actors, etc. These specific features require an appropriate answer.

  …

Observations (cont'd)

…

- It has been observed that rating agencies evaluate certain MFIs more than once. Consequently, a certain "repeat business" trend has been identified. Indeed, rating renewals have increased, and the availability of tailor-made products has been expanded. The emphasis placed by MFIs on the professional and interpersonal history they have developed with the rating agencies (which means that they are familiar with the MFI's processes and organisation), is also worth questioning.

  This loyalty may jeopardise the rating agencies' neutrality when they conduct their analyses. Furthermore, this position is strengthened by the fact that MFIs mainly change agencies because they are concerned by a heightened need for transparency and would like or are required to have someone take a new look at their activities. Rating agencies, on the other hand, believe these changes are made as a result of shortcomings in the services they provide (awarding a bad grade, high costs etc.).

Table of contents

Considerations

This report has been prepared on the basis of data provided mainly by rating agencies and MFIs. The purpose of the report is to provide an overview of the microfinance rating market based on a predefined sample of rating agencies. Consequently, this report does not purport to be exhaustive, as its findings may not be extended to all rating agencies operating in the microfinance industry. However, this report provides a relevant analysis of the current state of the industry.

The results presented in this report are solely based on the data collected as part of this study and only cover the **2008-2009 period**.

Comparisons between the two years are based on a **year-on-year sample**; in other words, the same list of rating agencies is used for both years. This prevents the bias which could be caused by taking into consideration new data issued from additional rating agencies for either year under review. This ensures that the data and comparative analysis are relevant.

The latter consideration is the very reason why the data collection period has been restricted to those two years. Because the number of respondents has varied from year to year since this study was launched by the Rating Initiative, the history of collected data does not provide consistency in the MFI sample provided by the rating agencies.

Only some figures take into account a longer period (2006-2009) to identify general trends on how the rating market is likely to evolve. Again, to ensure that the sample was consistent, a limited set of data from the same agencies has been taken into consideration for the years 2006, 2007, 2008 and 2009.

In addition to quantitative data, the 2010 edition of the rating market report also took into account the collection and analysis of qualitative data in order to be able to run cross-checks on the results and add to the thought process. For this purpose, online questionnaires were designed and sent to the MFIs and rating agencies included in the sample. Telephone interviews have also been conducted with those same institutions in order to complement the analysis.

Considerations (cont'd)

In order to avoid confusion as to the various types of rating and to make the results more readable, we have established two types of rating:

- **Financial ratings** (including both credit ratings and performance ratings but also the related sub-products),
- **Social ratings**.

By the same token, the report only considers two ways in which an MFI may seek a rating:

- The **first rating**, meaning that it is asking for a rating for the first time,
- The **renewed rating**, regardless of the renewal/update level. In other words, that both includes:
  - Partially renewed ratings, i.e. simple annual update of a previous rating; and
  - Completely renewed ratings consisting in a full new rating exercise.

Table of contents

Set of data

Two types of data have been collected and processed:

- **Quantitative data,** which were collected using Excel spreadsheets sent to the rating agencies only and on which all the tables and graphs shown in this report are based. Each rating under review is identified mainly by its type (financial, social), its status (voluntary, co-funded, etc), the region and the country concerned as well as the name of the MFI and rating agency it relates to. All those data have been processed so as to avoid duplications.
- **Qualitative data**, issued from online questionnaires - sent both to the rating agencies and the microfinance institutions - and from telephone interviews. This second type of data has been used in order to be able to run cross checks on the results, to add to the thought process and to complement the analysis.

Rating agencies which were involved in the collection of quantitative and qualitative data

- *Planet Rating*
- *MICRA*
- *Microfinanza Rating*
- *CRAB*
- *PCR*
- *M-CRIL*
- *Class y Asociados*
- *JCR-VIS*
- *MicroRate*

MFIs which were involved in the collection of qualitative data

- *Asia (1 MFI)*
- *EECA (2 MFIs)*
- *LAC (2 MFIs)*
- *MENA (1 MFI)*
- *SSA (2 MFIs)*

The data collected have been complemented with and cross-checked against the results from the feedback survey conducted with MFIs by the Rating Initiative (128 respondents in September 2010).

Data have been processed anonymously to ensure confidentiality.
To ensure comparability of quantitative data, some of them have been reprocessed further to a discussion with rating agencies.

Representativeness

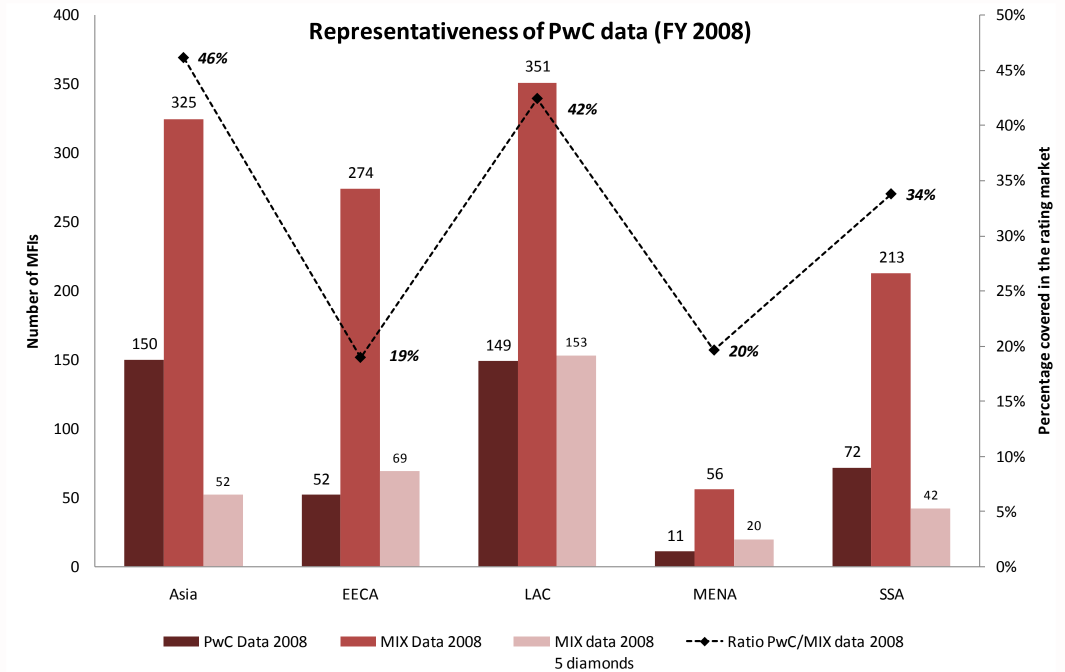
Number of MFIs included in the sample

434 *(2008)* ¦ **411** *(2009)*

Number of rating agencies that responded compared with the total number approached

- Quantitative questionnaire: 9 out of 20
- Qualitative questionnaire: 8 out of 20

The number of rating agencies that took part in the collection of quantitative data decreased compared to previous years. This decrease has had an impact on the completeness, representativeness and relevance of this report, as it can only reflect the information provided.



The representativeness of the data collected has been assessed by comparing the number of MFIs by region for the year 2008 with MIX Market data. Those data include all MFIs covered by the MIX in 2008 as well as those which received a rating (MIX 5 diamonds category).
If we look at the graph, we note that the data distribution and representativeness vary greatly according to the region. It should also be noted that this study collected more financial ratings with grade than MIX Market in two regions (Asia and SSA).

Comment: This representativeness is relative since MIX Market does not identify all MFIs nor all ratings conducted worldwide.

Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010
MixMarket data for 2008 (website)

Table of contents

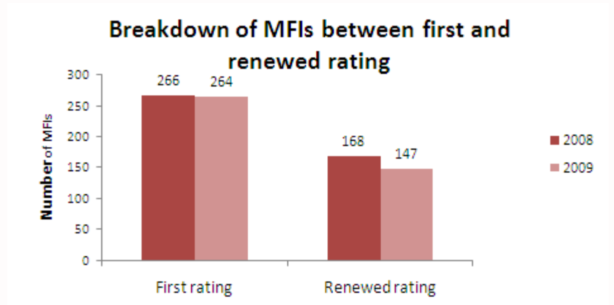
The Rating Initiative
Microfinance and Transparency

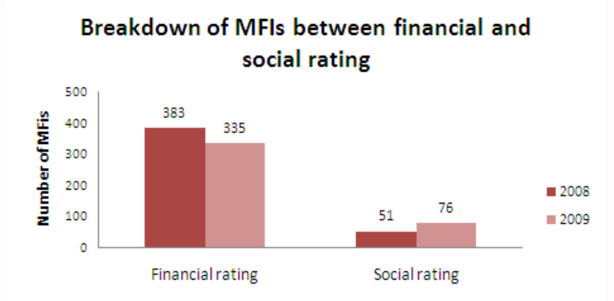
MFI snapshot

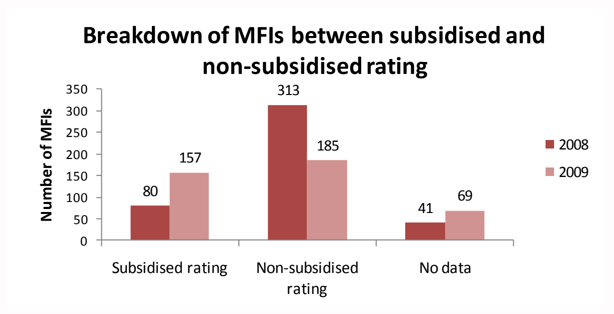
The first results show the breakdown of MFIs according to various criteria relating to the type of rating conducted. These results provide an overview of the situation.

First, it can be noted that the number of MFIs seeking a first rating has been quite stable: there is indeed a negligible decrease in the number of MFIs that initiated the rating process - from **266** MFIs in 2008 to **264** MFIs in 2009 (only the number of MFIs which asked for a rating renewal has decreased - by **12%**). The lack of growth may partly be accounted for by exogenous factors related to the financial crisis. Indeed, the number is stable despite a significant increase in the number of subsidised ratings (**+96% between 2008 and 2009**), which implicitly points to a decrease in the number of non-subsidised ratings. As a result, one can question the permanence of the industry if subsidies were no longer granted.

Given the number of MFIs which resorted to a social rating (+49 percent between 2008 and 2009), one can note that investors pay increasing attention to the MFIs' compliance with their social purpose. This is reflected by the increasing number of presentations given at conferences which cover such topics as "Microfinance – is there a mission drift?" or "How can social performance be measured?". The consequence is that investors are looking to use social ratings (by asking for them and / or by financing them directly) because they require the information to show that they care about the adequate social performance of the MFI in which they would like to invest.

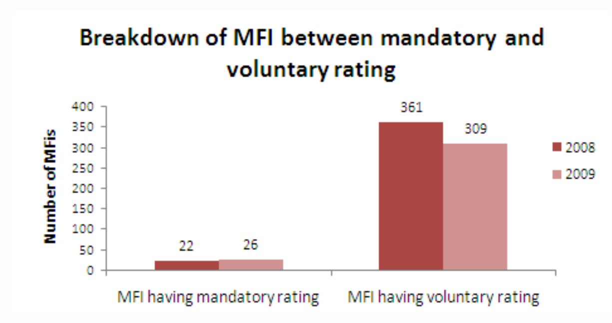






Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010
"No data" label is related to data where the information about the subsidies was missing or incomplete.

Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010
The breakdown of MFIs between mandatory and voluntary ratings is related to financial ratings only.



MFI snapshot (cont'd)

With regard to the legal obligation to conduct a microfinance rating, this is only applicable to financial ratings. In 2009, this requirement to conduct a financial rating only applied to 8% of MFIs. As a result, approximately 92% of MFIs voluntarily undertook a financial rating, which shows that MFIs (or their donors) actively seek information from an external source.

Correlation analysis between co-funding and entering the rating process (2009)

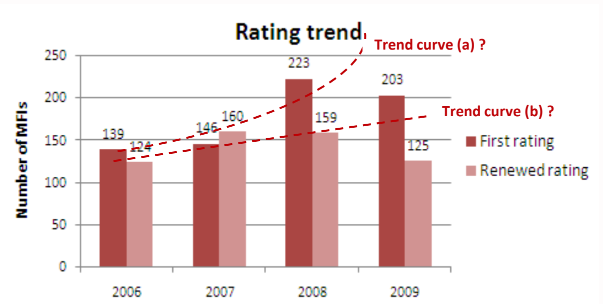
The correlation analysis gives a good idea of the link between two variables (here, whether a rating is co-funded and whether or not it is a first time rating). The result may be interpreted as follows: if we double the number of co-funded ratings (+100 percent), the number of first ratings would increase by 42 percent. Even though this result should be qualified, it still shows the positive impact of co-funding on MFIs entering the rating process.

Correlation	First Rating
Subsidised rating	0.42

The correlation ratio is included in a [-1,1] interval. A nil value means that both variables are independent while the 1 (-1) value means that they evolve side by side (in an opposite fashion).

Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010.

Changes in the demand for ratings



The rating trend for the period from 2006 to 2009 highlights an increase in the number of MFIs that asked for a rating in 2008. This is probably due to the closure of the Rating Fund announced in 2007, which caused many MFIs to rush their requests for co-funded ratings in 2008. A complementary explanation for this rise is that the microfinance industry generated considerable outside interest in 2008.

In addition to this aspect, the rating market seems to be growing (+39 percent from 2007 to 2009 for first ratings). Requests for renewed ratings have decreased, however, even though they were relatively stable in 2007 and 2008.

At this stage, due to the financial crisis, a general trend is quite difficult to predict. (Is the trend exponential or linear? Was 2008 the exception or was it 2009?) The trend will only be able to emerge in the next few years.

Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010.
Constant sub-sample of 5 Rating Agencies (Planet Rating, Microfinanza Rating, M-CRIL, MicroRate, Class y Asociados) representing +/- 65% of the rating market as defined by the whole sample from 2006 to 2009.

MFIs: some facts

Overview of the main reasons why MFIs changed rating agencies

There are a variety of reasons why MFIs changed rating agencies and these reasons vary according to the stakeholder questioned.

+

Number of occurrences

—

According to rating agencies

- A poor rating
- The cost of obtaining a rating
- Internal or domestic regulations requiring that agencies be changed frequently,
- Poor service quality: analyst teams' lack of qualifications, analysis criteria deemed to be irrelevant, asymmetrical information, etc
- Request that the rating be confirmed by a third party
- Comparison between the various methodologies applied by the rating agencies

According to MFIs

- A new way of looking at things, whether or not it is imposed by regulation
- A recommendation from partners or investors
- Poor service quality: analyst teams' lack of qualifications, analysis criteria deemed to be irrelevant, asymmetrical information, etc
- The cost of obtaining a rating

Source: Qualitative data collected by PwC + Rating Initiative with the MFI Feedback survey, 2010

The results show that both stakeholders interpret this change differently. While rating agencies focus on the possible shortcomings in the services provided, MFIs insist on the need for a new way of looking at things, in order to avoid – as in an audit – any favouritism and improve transparency.

Conversely, the main reasons why MFIs stay with the same agency are the following 1) the rating agency is familiar with the MFI's processes and organisation, Conversely, the main reasons why MFIs say they stay with the same agency are the 2) the MFI and its rating agency have a (work, relationship) history together, 3) the costs of obtaining a rating, 4) service quality (professionalism), 5) the MFI's satisfaction with the rating obtained and 6) the comparison of rating updates which make it possible to assess how the MFI evolves.

On the other hand, the reasons why an MFI chooses a rating agency in the first place mainly have to do with the recommendations from partners / investors and with how renowned the agency is for working with MFIs. Cost is also a factor.

MFIs: some facts (cont'd)

Conducting ratings: main expectations and use

- The arguments explaining the demand may overlap or differ according to who is asked.

The expectations of… / According to…	Rating agency	Microfinance institution
MFI	For an MFI, obtaining a rating means easier access to credit, increased visibility and improving marketing of an instrument. Sometimes, a rating is simply used to assess the MFI's financing capacity and cost or to obtain a clear view of its performance in the industry in which it operates. Through the rating, the MFI hopes to be able to meet the investor's investment criteria. With regard to social ratings in particular, it uses them as a tool to monitor its activities and their resulting social impact.	A microfinance rating is considered to be an independent external assessment (in the same way as an audit) which gives an accurate view of the MFI's current situation; the rating agency can validate the MFI's actions (or not) by giving them a rating. It makes the MFI under review visible at a global level (the rating can be used as presentation material and as a marketing tool to be shown to investors). It also enables the MFI to compare itself to other MFIs (benchmark).
MFI's management committee	Obtaining a rating provides the MFI's management committee with guidelines to measure improvements and performance. It can use it as a tool to respond to the main concerns highlighted and to identify strengths and weaknesses. A microfinance rating also enables the management committee to receive advice at various levels (financial structure, leverage, liquidity ratio, giving a new direction to the activity to improve social impacts, etc.) or to compare its institution to other MFIs	The rating provides the management committee with the necessary tools to evaluate the institution's performance at a management level, measures the progress in achieving key institutional objectives and gauges the progress of the social mission. Similarly, it is used as a reference point to inform corrective actions that may need to be taken on governance matters or global risk management, thus enabling the MFI to move forward. It also reflects the MFI's concern for transparency.

Source: Qualitative data collected by PwC, Rating Initiative, 2010

With regard to the usefulness of the rating for the MFI, the arguments that emerge from the interviews are quite similar. Both the service provider (the rating agency) and the client (the MFI) are aware of the rating's importance but also of the purposes it may serve. Communication between the two parties is clear on this point and does not lead to any confusion.

MFIs: some facts (cont'd)

Conducting ratings: main expectations and use (cont'd)

According to… / The expectations of…	Rating agency	Microfinance institution
Investors	A microfinance rating is a tool which helps to identify new MFIs in line with investment criteria. In addition, it represents an additional external opinion which helps analyse the institutional context, specific risks, the MFI's performance, its weaknesses and its areas of improvement. Ratings can also be used by investors to compare the results from their own analyses. Social ratings enable investors to ascertain whether the MFI's actions are in line with its social purpose. That way, investors can assess the image risk incurred by them vis-à-vis their clients.	In addition to their own analyses (due diligence assignments), investors use ratings as an additional source of information in order to compare their own results (including the non-performing loan rate, indebtedness, liquidity, etc) and / or to obtain an analysis of the MFI's environment. Ratings can also help monitor the regularity of the commitments made by the MFI, when they are conducted more than once. A rating can be compared to a basis which provides information on long-term investment opportunities.
Lawmakers	Lawmakers use ratings to supervise the whole microfinance industry. They are an additional source of information on the MFIs they supervise.	They do not use microfinance ratings themselves but consider them to be an additional supervisory tool which can reflect a requirement for prudential measures.
Technical assistance providers	Technical assistance providers use ratings as a tool to corroborate what they find in their analyses (data and results verification, etc.)	They use ratings as a basis for comparison of their own analyses, which will be used to define their technical assistance programmes.

Source: Qualitative data collected by PwC, Rating Initiative, 2010

MFIs: some facts (cont'd)

Resorting to ratings: main expectations and use (cont'd)

If ratings are seen by MFIs as tools to obtain new financing, they use ratings first and foremost to enhance transparency and improve their management procedures. While those two aspects evidently make MFIs more attractive to investors, the main concern of MFIs seems to be to improve their internal processes before focusing on financing. This is reinforced by the fact that the objective of meeting investors' expectations comes second in terms of priority to that of comparing their performance with their peers. The compliance to the regulatory requirements is the last priority for MFIs.

Main objectives for MFIs in conducting a rating/assessment

Priority Table for MFIs (1 to 6, 1 being the highest priority)	Type of rating		
	Social *(41% MFIs)*	Financial *(32% MFIs)*	Combined *(27% MFIs)*
To access new sources of funding	3	2	3
To compare/benchmark the performance of our institution against others	4	4	5
To gain additional financial performance transparency provided by rating	**1**	3	**1**
To meet regulatory requirements	6	6	6
To meet requirements of current donors or investors	5	5	4
To use rating as an evaluation tool for management	2	**1**	2

Source: Qualitative data collected by Rating Initiative, MFI Feedback survey, 2010

Most useful sections of a rating report according to the MFIs

Priority Table for MFIs (1 to 8, 1 being the highest priority)	Type of rating		
	Social *(41% MFIs)*	Financial *(32% MFIs)*	Combined *(27% MFIs)*
Analysis of institution's financial situation and credit risk	5	**1**	2
Analysis of management and principal processes and systems	4	2	4
Analysis of the institution's strategy, mission, and governance	2	4	3
Benchmarking of the institution with peer institutions	6	6	7
Executive summary or synthesis of key points	3	3	5
Financial / cash-flow projections for the MFI	7	5	6
General country and industry overview	8	8	8
Social objectives and indicators	**1**	7	**1**

Source: Qualitative data collected by Rating Initiative, MFI Feedback survey, 2010

MFIs prioritise the various sections of a rating report depending on the rating they conduct. This points to a trend of MFIs working towards improving their specific performance: in contrast to MFIs having conducted a financial rating, those having conducted a social one will primarily focus on how they meet their social objectives and the way they operate before focusing on the financial analysis. MFIs concerned by the combined rating will consider these different aspects as being more or less at the same level of importance.

Interestingly, MFIs consider the global country and industry review - which is usually used by investors - to be the least important part of the report.

MFIs: some facts (cont'd)

Resorting to ratings: main obstacles

Even though the rating market has progressed over the years, some obstacles remain which prevent MFIs from entering the rating process:

According to rating agencies

- MFIs do not consider rating to be a necessity
- There is a certain lack of recognition from the market as to the added value of a rating
- The cost of obtaining a rating is an obstacle
- The cost-to-benefit ratio is not really advantageous
- The various types of rating products and sub-products are not understood properly

According to MFIs

- The cost of obtaining a rating is an obstacle
- There is a certain lack of recognition from the market as to the added value of a rating
- The various types of rating products and sub-products are not understood properly
- MFIs do not consider rating to be a necessity
- The cost-to-benefit ratio is not really advantageous

Source: Qualitative data collected by PwC, Rating Initiative, 2010

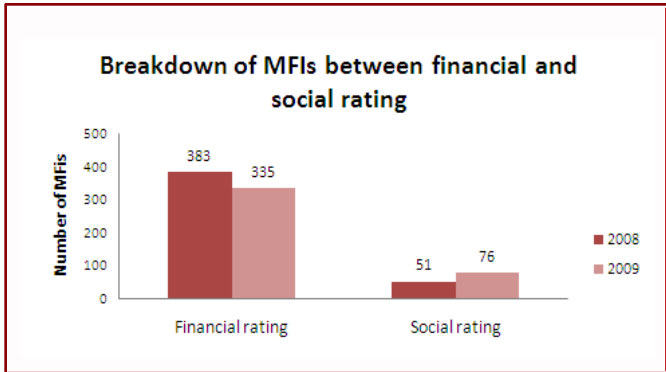
While MFIs consider the cost of the rating to be the main obstacle to entering the rating process, rating agencies, on the other hand, consider that the cost obstacle comes second to the lack of recognition, both from the MFIs and the market itself. This perception is at odds with previous results which showed that MFIs acknowledged the ratings' usefulness.
The lack of market recognition, acknowledged by both parties, can be accounted for by the lack of harmonised rating methodologies, scales and products between the various agencies, but also by a lack of communication between investors and rating agencies on the methodologies adopted. As investors do not have a good view of the work carried out by rating agencies, they are compelled to conduct their own analyses to ensure completeness. In any event, however, the purpose of the rating is not to fully replace the analyses conducted by investors, who have their own scope of investigation.

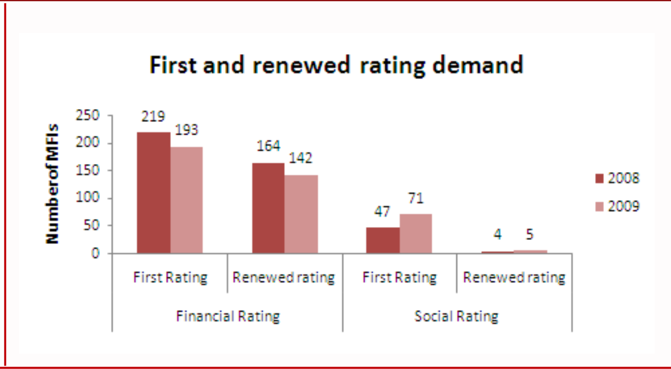
The replies provided by the participants in the analysis point to a lack of agreement between the various players (rating agencies, MFIs and investors), which can partly be accounted for by the fact that supply (services provided) is not in line with demand (real needs and expectations).

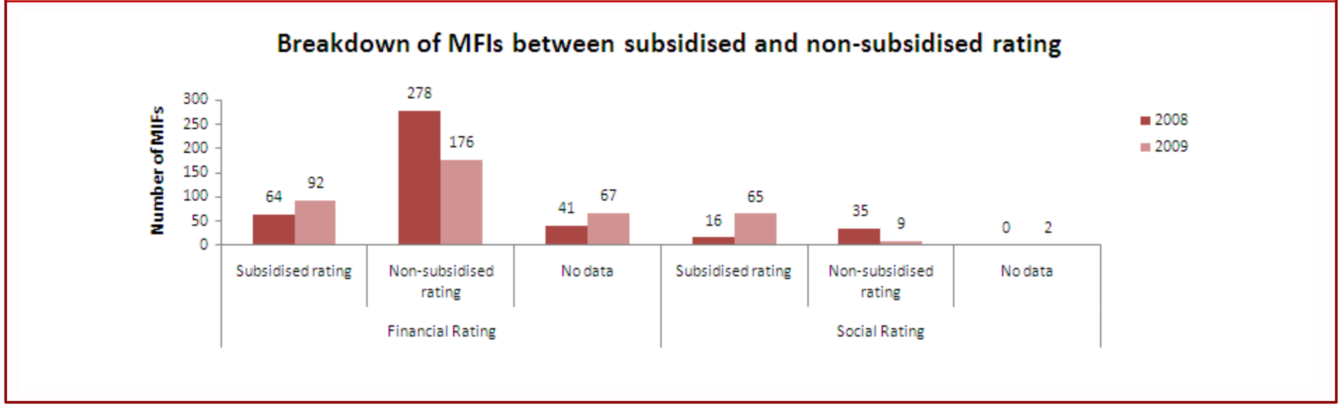
Product snapshot

The product analysis shows that social ratings made significant progress in 2009. Compared with financial ratings, social ratings are the only product which increased in terms of first ratings (**+51%, from 47 ratings in 2008 to 71 ratings in 2009**), renewed ratings (**+25%, from 4 to 5 ratings**) and subsidised ratings (**+306%, from 16 to 65 ratings**).

As far as subsidised ratings are concerned, it would seem that MFI demand for social ratings is largely based on subsidies (86 percent of social ratings were subsidised in 2009).







Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010
"No data" label is related to data where the information about the subsidies was missing or incomplete.

Products: some facts

Product diversity

The market offers a wide range of products and sub-products. Besides financial and social ratings, there are a significant number of sub-products which enable MFIs to enter the rating process before engaging in a full rating. These sub-products were designed by rating agencies in an effort to diversify their offer, create a new demand and open up new markets(*). It should be noted that this multitude of sub-products and the way they are marketed are not likely to help MFIs understand the services offered.

(*) This trend was encouraged during the closing of the Rating Fund I further to a request made by the CGAP and based on the Inter-American Development Bank report (IADB) dated 2007.

Sub-products listed by the surveyed rating agencies

- Strength report
- Governance report
- Mutual fund ranking
- MIV evaluation
- MIV rating
- Good corporate practice report
- Mini rating
- Institutional diagnostic
- Shares/stock rating
- Debt
- Securitisation (cash flow and asset forecast)
- Rapid appraisal
- One day assessment
- Interactive assessment

Over three quarters of the surveyed rating agencies (78 percent) believe that (sub-)products are well defined. The remaining 25 percent acknowledge a certain lack of clarity in the definition of sub-products and too great a diversity in the terms and approaches adopted by rating agencies. The most specialised rating agencies did not make a significant effort to communicate on the various products they offer. The fact that additional services – such as consulting services – are also available only adds to the confusion. Only if product names and rating scales were harmonised and if greater clarification on rated elements were provided, might this put an end to the reigning confusion.

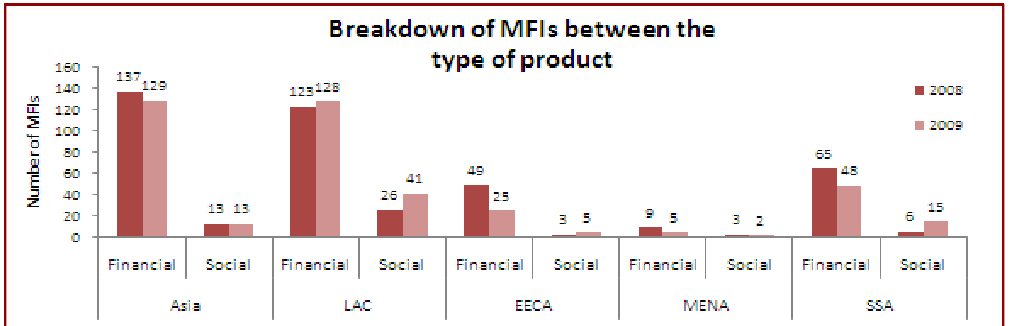
Source: Qualitative data collected by PwC, Rating Initiative, 2010

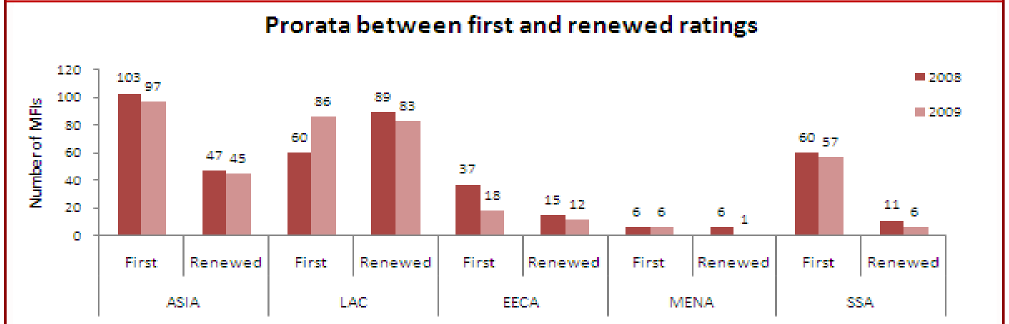
It should be noted that several efforts are already being made to clear up the confusion. They include the upcoming creation of an association grouping together the largest rating agencies, combined with the development of a code of conduct which sets out the principles to be complied with by members by a given date. This code of conduct, which is to be complied with at all times, should help improve the quality of the ratings and ensure that the services offered meet a certain number of key criteria.

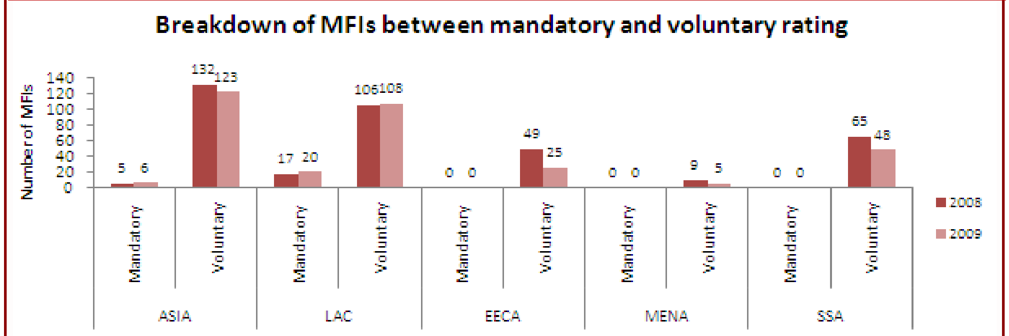
Regional snapshot

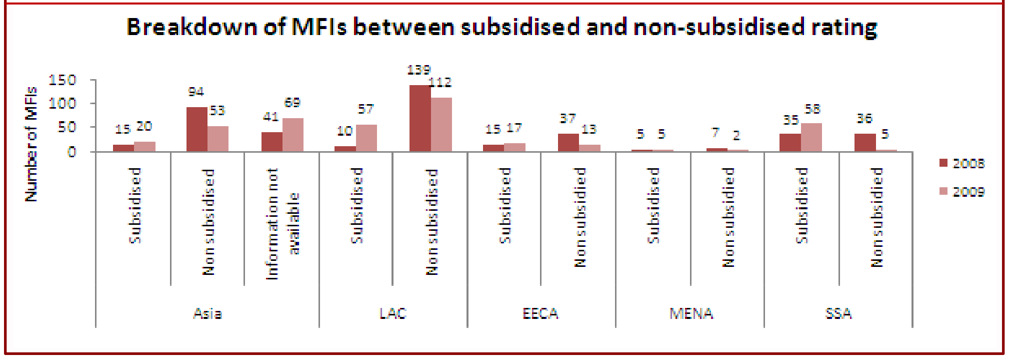
In addition to confirming that the LAC and Asia regions are mature markets, the regional snapshot of the rating market points to several region specific features:

- LAC is the only region where social and financial ratings have increased (**+58% between 2008 and 2009 for social ratings and +4% for financial ratings**).
- SSA and LAC regions display the highest growth rates in terms of social ratings (**+150% for the SSA region and +58% for the LAC region**). This is a surprising trend in Africa in many respects given that ratings (all types taken together) have globally been on a downwards trend in that region.









Regional breakdown by type of product

2009	Financial rating	Social rating
ASIA	39%	17%
EECA	7%	7%
LAC	38%	53%
MENA	2%	3%
SSA	14%	20%
Total	100%	100%

Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010

The breakdown of MFIs between mandatory and voluntary ratings is related to financial ratings only.

“No data” label is related to data where the information about the subsidies was missing or incomplete.

Regional snapshot (cont'd)

Detailed analysis

After conducting a more in-depth regional analysis of the subsidy and renewed rating parameters, we are able to explain the observations made earlier.

Subsidies have helped the LAC region increase its ratings significantly (**8** times more MFIs undertook subsidised financial ratings between 2008 and 2009, and 5 times more MFIs undertook social ratings), while subsidies have caused the SSA region to increase its social ratings (**3.5** times more subsidised ratings). The combined action of the Rating Initiative and the *African Microfinance Transparency Forum* (AMT) can partly explain this trend. The data available for the MENA region were insufficient to enable us to draw any conclusions.

Generally, it can be observed that demand for social ratings is largely driven by subsidies (on the contrary to what happened in 2008). In the SSA region, where ratings dropped from **34** in 2008 to **4** in 2009, one can question the long-term penetration rate of rating agencies in that market. Similarly, demand for financial ratings is driven upwards by the demand for social ratings (it is difficult to secure the second without having resorted to the first).

Detailed analysis on the number of MFIs having subsidised/non subsidised ratings

ASIA	Financial			Social		
	Subsidised	Non subsidised	No data	Subsidised	Non subsidised	No data
2008	13	83	41	2	11	0
2009	10	52	67	10	1	2
Growth rate	-23%	-37%		400%	-91%	

LAC	Financial			Social		
	Subsidised	Non subsidised	No data	Subsidised	Non subsidised	No data
2008	3	120	0	7	19	0
2009	23	105	0	34	7	0
Growth rate	667%	-13%		386%	-63%	

EECA	Financial			Social		
	Subsidised	Non subsidised	No data	Subsidised	Non subsidised	No data
2008	14	35	0	1	2	0
2009	12	13	0	5	0	0
Growth rate	-14%	-63%		400%	-100%	

MENA	Financial			Social		
	Subsidised	Non subsidised	No data	Subsidised	Non subsidised	No data
2008	3	6	0	2	1	0
2009	3	2	0	2	0	0
Growth rate	0%	-67%		0%	-100%	

SSA	Financial			Social		
	Subsidised	Non subsidised	No data	Subsidised	Non subsidised	No data
2008	31	34	0	4	2	0
2009	44	4	0	14	1	0
Growth rate	42%	-88%		250%	-50%	

Detailed analysis on the number of MFIs having first/renewed ratings

ASIA	Financial			Social		
	First rating	Renewed rating	No data	First rating	Renewed rating	No data
2008	91	46	0	12	1	0
2009	85	44	0	12	1	0
Growth rate	-7%	-4%		0%	0%	

LAC	Financial			Social		
	First rating	Renewed rating	No data	First rating	Renewed rating	No data
2008	37	86	0	23	3	0
2009	49	79	0	37	4	0
Growth rate	32%	-8%		61%	33%	

EECA	Financial			Social		
	First rating	Renewed rating	No data	First rating	Renewed rating	No data
2008	34	15	0	3	0	0
2009	13	12	0	5	0	0
Growth rate	-62%	-20%		67%	0%	

MENA	Financial			Social		
	First rating	Renewed rating	No data	First rating	Renewed rating	No data
2008	3	6	0	3	0	0
2009	4	1	0	2	0	0
Growth rate	100%	-83%		-33%	0%	

SSA	Financial			Social		
	First rating	Renewed rating	No data	First rating	Renewed rating	No data
2008	54	11	0	6	0	0
2009	42	6	0	15	0	0
Growth rate	-22%	-45%		150%	0%	

Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010

Regions: some facts

The difficulties encountered by rating agencies in regions where the rating culture is considered to be poor are mainly due to the unavailability of data and their lack of reliability.

The integration of rating costs in the MFI's operational costs (similar to the way audit costs are integrated in the MFI's operational costs) is partly linked to the legislative background, even where there is a strong rating culture (Asia and LAC).

As far as subsidies are concerned, donors and national initiatives and programmes are not the only ones who contribute financially to an MFI's rating; investors are also involved in this process (e.g. IFC, Rabobank, Oikocredit, etc). Consequently, MFIs can avail themselves of numerous funding opportunities. This growing trend points to a change in the rating outlook: is the rating an assessment for the MFI or a service for the investor?

Source: Qualitative data collected by PwC from rating agencies, Rating Initiative, 2010

Region	Rating culture	Integration of rating costs in the MFI's operational costs
Asia	Demand is mainly driven by investors. Developed for some countries (India, Cambodia, Viet Nam, Sri Lanka) but still perfectible in Afghanistan, Bangladesh, Indonesia, Mongolia, Nepal, Pakistan and Philippines.	Rarely integrated
EECA	Demand is mainly driven by investors. Generally developed but with differences between regions (Eastern & Central Europe and Central Asia, Balkans and Caucasus).	Rarely integrated
LAC	Generally developed and supported by national legislations for the main countries (Bolivia, Peru, Equator). Differences for the other countries.	Generally integrated
MENA	Mixed, depending on the countries (strong culture in Egypt & Morocco, not really the case elsewhere).	More or less integrated
SSA	Poor, generally pushed by funders. Efforts made by national regulators.	Rarely integrated

Region	Organisations subsidising/co-funding ratings such as reported by the sample (not exhaustive)
Asia	Rating Initiative, AKAM, Cordaid, HIVOS, IFC, Opportunity, Rabobank, UNCDF
EECA	Rating Initiative, AKAM, AZERI Fund, GTZ, ICCO, KfW, Société Générale, UNDP
LAC	Rating Initiative, AECID, Cordaid, DWM, Ford Fdn, IFC, Oikocredit, Rating Fund II
MENA	Rating Initiative, AFD, Grameen Jameel, IFC, PlaNet finance, UN
SSA	Rating Initiative, AFD, Africap, AMFI, CIDR, Cordaid, DANIDA, EU, FED, Grameen Fdn, HIVOS, MITAF, MyC4, Opportunity, PRESEM, Terrafina

Table of contents

Global overview

Over the whole 2006 to 2009 period, **19%** of MFIs renewed their first ratings, initiated in 2006 (**20%** for financial ratings and **13%** for social ratings).

More specifically, we note that, based on the sample, **36%** of MFIs on average renewed their first rating dating from 2006 over the same period (**50** MFIs out of **140**). This percentage decreases to **18%** for those dating from 2007 (**27** MFIs out of **146**) and **9%** for those of 2008. In other words, **a little over one third of MFIs would renew the rating process within three years of completing their first rating**.

In most instances, MFIs maintain the impetus derived from a subsidy, because it enables them to continue to provide third parties with all the elements they need to have their performance and risk profile assessed, etc, including all the benefits this may create further down the line (e.g. access to new financing). This should, however, be looked at on an MFI-by-MFI basis and relevant legislations should be taken into account. Let us give three examples:

- an MFI which can collect savings and whose national supervision agency does not require ratings, will feel no specific need to renew its rating;
- an MFI whose rating deteriorates over the years will be less inclined to ask for a renewal;
- an MFI which has access to international funding at a cost that is more attractive than what is offered locally will want to update its rating on a regular basis.

Number of MFIs having renewed their ratings from 2006

	Total		Financial		Social	
2006						
First ratings	**140**	100%	130	100%	9	100%
2007						
First ratings	**146**	100%	130	100%	16	100%
Renewal first ratings as of 2006	**31**	22%	31	24%	0	0%
Total renewed ratings	**31**	**22%**	**31**	**24%**	**0**	**0%**
2008						
First ratings	**223**	100%	176	100%	47	100%
Renewal first ratings as of 2006	**26**	19%	25	19%	1	11%
Renewal first ratings as of 2007	**16**	11%	13	10%	3	19%
Total renewed ratings	**42**	**15%**	**38**	**15%**	**4**	**16%**
2009						
First ratings	**203**	100%	135	100%	68	100%
Renewal first ratings as of 2006	**16**	11%	16	12%	0	0%
Renewal first ratings as of 2007	**13**	9%	13	10%	0	0%
Renewal first ratings as of 2008	**21**	9%	16	9%	5	11%
Total renewed ratings	**50**	**10%**	**45**	**10%**	**5**	**7%**
Total MFIs having renewed their ratings (WITH redundancy)						
Renewal first ratings as of 2006	**73**	52%	72	55%	1	11%
Renewal first ratings as of 2007	**29**	20%	26	20%	3	19%
Renewal first ratings as of 2008	**21**	9%	16	9%	5	11%
Total (from all first ratings)	**123**	**24%**	**114**	**26%**	**9**	**13%**
Total MFIs having renewed their ratings (WITHOUT redundancy)						
Renewal first ratings as of 2006	**50**	36%	49	38%	1	11%
Renewal first ratings as of 2007	**27**	18%	24	18%	3	19%
Renewal first ratings as of 2008	**21**	9%	16	9%	5	11%
Total (from all first ratings)	**98**	**19%**	**89**	**20%**	**9**	**13%**

Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010.

Constant sub-sample of 5 Rating Agencies (Planet Rating, Microfinanza Rating, M-CRIL, MicroRate, Class y Asociados) representing +/- 65% of the data collected in the survey such as defined by the whole sample from 2006 to 2009.

Other figures

Main reasons why MFIs have their ratings renewed

The most frequently mentioned reasons for MFIs to renew their ratings were as follows:

According to rating agencies

- Building up the MFI's reputation, which enables the MFI to have improved access to financing
- Requests from investors
- Confirming or improving the previous rating
- Satisfaction with the quality of the services provided

According to MFIs

- Requests from investors
- Ongoing need for funds
- Assessing the changes initiated in the wake of the previous rating: looking for improved efficiency
- Change in the MFI's governance
- Satisfaction with the quality of the services provided

Source: Qualitative data collected by PwC, Rating Initiative, 2010

The reasons put forward by both parties (rating agencies and MFIs) are quite different but both mainly consider ratings to be a means for facilitating access to funding. MFIs also highlight a search for greater efficiency / transparency and view ratings as a diagnostic tool that can help them improve their organisation or structure.

While subsidies may help start up the rating process, they do not ensure its durability.

Based on the responses from rating agencies, there is a contradiction in the way they analyse the market: on the one hand, they highlight that the rating is useful to build up the MFI's reputation, and on the other hand, they cite the lack of market recognition on the benefits of a rating as an obstacle to resorting to rating. A possible explanation would be that the reasons mentioned by rating agencies could be understood like a sales pitch rather than a reason deemed to be key by MFIs. This points to differences of opinion between the various players as to the actual needs and the service offering.

Besides the reasons for renewing ratings, the main obstacles that were mentioned are the costs and the lack of recognition from the market as to the added value of a rating (because methodologies and products are not harmonised, etc).

Table of contents

General overview

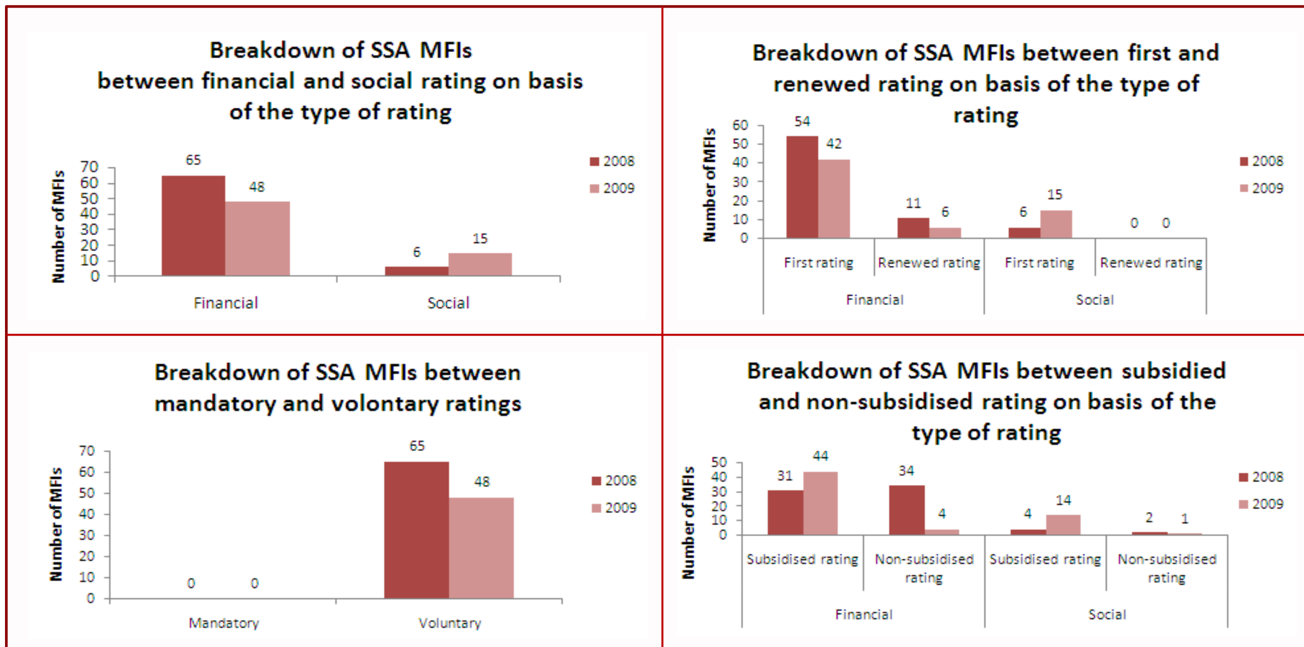
The main observations relating to Africa, based on the interviews conducted for this study, are the following:

- The rating culture varies geographically according to the incentives and requirements coming from both donors and various countries;
- The way the MFIs are managed internally sometimes lacks rigour. Culturally, there is often a search for compromise, which may weaken the quality of management. Furthermore, information may not always be available or reliable and the rating momentum may be low;
- There is a lack of recognition as to the added value of a rating compared to that of an audit for instance.

These observations are reflected indirectly in the results from the sample (Africa represents 15 percent of ratings in the sample).

Overall, we observe a significant increase in co-funded ratings (**+66%**), even though the total number of ratings conducted has decreased due to the fall in financial ratings (**-26%**). However, social ratings have increased by a factor of **1.5.** This situation reflects the idea that MFIs are currently more keen to get a social rating rather than a financial one (subsidised or not).

No mandatory ratings have been conducted in Africa .



Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010
4 out of 9 rating agencies included in the sample are present in Africa.

Products: snapshot

Source: Quantitative data collected by PwC from rating agencies, Rating Initiative, 2010
"No data" label is related to data where the information about the subsidies was missing or incomplete.

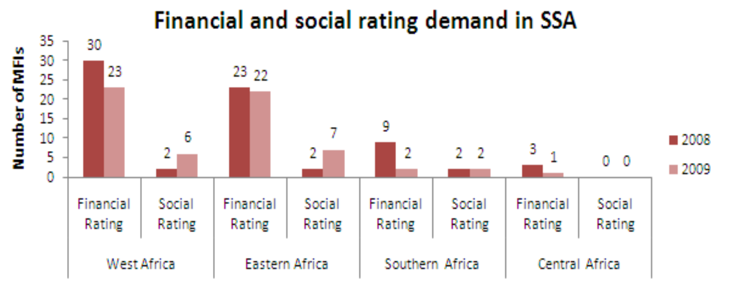
Detailed analysis

In East and West Africa, the results point to a significant increase in the number of social ratings. Conversely, financial ratings have been decreasing.

More importantly, there is a generalised decrease in non-subsidised financial ratings. If this trend is confirmed, an in-depth analysis of the cause will be required. In any event, a combination of several factors is likely to have resulted in this situation: there is no binding regulatory framework, the internal control systems within the MFIs could be improved, the cost-to-benefit ratio of a rating is not advantageous enough, the offers from rating agencies are not in line with needs, etc.

We can note the increasing importance of co-funding in the African rating process. Conversely, the renewal rate (which only applies to financial ratings) is on the wane. The results related to Central and Southern Africa are provided for information only, since they are not very representative of the market as a whole.

	Countries included in the sample
Western Africa	Benin, Burkina Faso, Ivory Coast, Gambia, Ghana, Guinea, Mali, Niger, Nigeria, Rwanda, Senegal, Sierra Leone, Togo
Eastern Africa	Ethiopia, Kenya, Madagascar, Soudan, Tanzania, Uganda
Southern Africa	Malawi, Mozambique, South Africa, Zambia
Central Africa	Cameroon, DRC Congo, Chad



Detailed analysis on the number of MFIs having subsidised/non subsidised ratings

West Africa	Financial			Social		
	Subsidised	Non subsidised	No data	Subsidised	Non subsidised	No data
2008	15	15	0	1	1	0
2009	21	2	0	6	0	0
Growth rate	40%	-87%		500%	-100%	

Eastern Africa	Financial			Social		
	Subsidised	Non subsidised	No data	Subsidised	Non subsidised	No data
2008	14	9	0	2	0	0
2009	20	2	0	7	0	0
Growth rate	43%	-78%		250%	0%	

Southern Africa	Financial			Social		
	Subsidised	Non subsidised	No data	Subsidised	Non subsidised	No data
2008	1	8	0	1	1	0
2009	2	0	0	1	1	0
Growth rate	100%	-100%		0%	0%	

Central Africa	Financial			Social		
	Subsidised	Non subsidised	No data	Subsidised	Non subsidised	No data
2008	1	2	0	0	0	0
2009	1	0	0	0	0	0
Growth rate	0%	-100%		0%	0%	

Detailed analysis on the number of MFIs having first/renewed ratings

West Africa	Financial			Social		
	First rating	Renewed rating	No data	First rating	Renewed rating	No data
2008	24	6	0	2	0	0
2009	19	4	0	6	0	0
Growth rate	-21%	-33%		200%	0%	

Eastern Africa	Financial			Social		
	First rating	Renewed rating	No data	First rating	Renewed rating	No data
2008	21	2	0	2	0	0
2009	21	1	0	7	0	0
Growth rate	0%	-50%		250%	0%	

Southern Africa	Financial			Social		
	First rating	Renewed rating	No data	First rating	Renewed rating	No data
2008	7	2	0	2	0	0
2009	1	1	0	2	0	0
Growth rate	-86%	-50%		0%	0%	

Central Africa	Financial			Social		
	First rating	Renewed rating	No data	First rating	Renewed rating	No data
2008	2	1	0	0	0	0
2009	1	0	0	0	0	0
Growth rate	-50%	-100%		0%	0%	

Findings

These results can be explained by a combination of several factors:

- In Africa, microfinance is perceived in part as a form of aid, whereas in other regions of the world, it tends to be seen as a financial tool developed for micro-entrepreneurs and their families.
- In Africa, the majority of the poor lives in a rural environment. By comparison, in Latin America, a vast majority of the poor population lives in cities (76 percent of the population lives in an urban environment). As a result, microfinance services are more difficult to provide to the scattered populations of rural Africa. An indirect consequence is that the operational costs of a rating might potentially be higher when a field visit is made.
- There is competition among MFIs in the countries where there is a rating culture. Consequently, not conducting a rating could be detrimental from an image standpoint. In Africa, ratings might be equated with a risk of receiving a poor rating, which points to a lack of maturity of the rating sector in that region.
- Legislative and supervisory frameworks governing MFIs vary greatly from one African country to the next.

Type of legislation	Countries
Specialised Microfinance laws	Burundi, CEMAC countries (6), Comoros, Democratic Republic of Congo, Ethiopia, Gambia, Guinea, Kenya, Madagascar, Mauritania, Mozambique, Rwanda, Uganda, WAEMU countries (8), Zambia
Drafting Microfinance Laws	Cape Verde, Sudan, Zimbabwe
MFIs implicitly or explicitly fall under the broader banking or non-banking financial institutions legislation	Angola, Botswana, Djibouti, Ghana, Lesotho, Liberia, Malawi, Mauritius, Namibia, Nigeria, Sierra Leone, Sao Tome, South Africa, Tanzania, Zimbabwe, WAEMU countries
No legislation/no framework	Eritrea, Somalia, Swaziland, Seychelles

Source: Sub-Saharan Africa Policy Mapping, CGAP, August 2008.

Findings (cont'd)

- In Africa, the microfinance world is largely represented by cooperative credit savings and loans associations whose target audience is made up of groups of individuals. These groups are under less pressure to seek additional funding since they have some capital available to them in the form of collected savings. In other regions, the microfinance sector is more strongly represented NGOs that have turned into regulated institutions and / or MFIs which are not allowed to collect savings, forcing them to seek external funding. As a result, the approaches vary from one region to the next.
- African MFIs do not believe a rating has any particular added value for several reasons:
  - The market is oriented towards donors rather than investors.
  - Even though they lack transparency, they are able to obtain local and international funding quite easily, due to the abundance of supply.
  - According to them, a good audit is an adequate tool.
- Other possible factors include the nature of the economy which is largely rural and / or how politically stable the MFI's environment is. They also include the MFI's financial limitations due to budgetary constraints, etc.

Possible solutions

Approaches to microfinance should be adapted according to the region and the culture. If we take for example the context of diversified legislative frameworks existing in Africa, it is possible to design frameworks that are more suitable to the region's background. In most cases, microfinance and banking laws do not apply to savings banks – and the microfinance sector in Africa is mostly made up of savings banks. Consequently, every suitable option should be considered to strengthen those banks' freedom to operate.

Generally speaking, reinforcing institutions, regulations and legislations helps strengthen the microfinance sector by imposing audit and / or reporting requirements on supervisory authorities which fully have the means to play their role. A certain amount of lobbying is therefore necessary for this sector to be able to develop. At the same time, those authorities should be provided with support through technical and financial assistance. Several efforts are being made in this direction, for instance with the Central Bank of West African States (BCEAO) in West Africa.

The few avenues mentioned by the rating agencies and the MFIs would to be to increase the use of legislative leverage to make ratings compulsory. Initiatives, such as those conducted by ADA, AMT and any other (local and / or international) association / platform to promote and raise awareness to ratings, should also be encouraged, while extending the target audience to influential political and financial circles.

Bibliography

The main documents consulted as part of this study were:

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The Rating Initiative was launched by ADA in collaboration with the Government of Luxembourg, the Microfinance Initiative Liechtenstein, the Swiss Development Cooperation, Oxfam Novib, the Oesterreichische Entwicklungsbank (OeEB), ICCO, the Principality of Monaco and Blue Orchard. The Rating Initiative collaborates with ResponsAbility, the African Microfinance Transparency Forum (AMT) and the Social Performance Task Force in all aspects related to ratings, including a specific emphasis on social ratings.

The Rating Initiative is driven by the following 3 objectives:

- Promote and contribute to the establishment of a financially viable, sustainable and healthy global microfinance rating market both from the demand and supply side in underserved regions for financial ratings and in all regions for social ratings.
- Address in the long term the lack of available, transparent information on MFIs for investors, donors and other microfinance stakeholders, including the MFIs themselves.
- Ensure the availability of market information not just on MFIs but on the microfinance rating sector in general.

The Rating Initiative
Microfinance and Transparency