Qualitative Analysis of Social Rating Products

Conducted on behalf of

The Rating Initiative
Microfinance and Transparency

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This publication was prepared by ADA asbl in collaboration with the Consultants.

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

Any feedback or comments can be sent to admin@ratinginitiative.org or adainfo@microfinance.lu

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ABBREVIATIONS

ADA	Appui au Développement Autonome (ADA asbl)
AMT	African Microfinance Transparency Forum
CGAP	Consultative Group to Assist the Poor
GRI	Global Reporting Initiative
ICCO	Interchurch Organisation for Development Cooperation
IFI	International Financial Institutions
LAC	Latin America and the Caribbean
M-CRIL	Micro Credit Rating International Ltd.
MIL	Microfinance Initiative Liechtenstein
MFI	Microfinance institution
MIV	Microfinance investment vehicle
MIX	Microfinance Information Exchange
NBFI	Non bank financial institutions
NGO	Non governmental organization
NPL	Non performing loan (formerly portfolio at risk)
OeEB	Oesterreichische Entwicklungsbank
PAT	Poverty Assessment Tool
PPI	Progress Out of Poverty Index
QAT	Quality Audit Tool
ROE	Return on equity
SDC	Swiss Agency for Development and Cooperation
SEEP	The Small Enterprise Education and Promotion Network
SPI	Social Performance Indicators
SPTF	Social Performance Task Force
SSA	Sub-Saharan Africa
ToR	Terms of reference

Where currency figures have been used in this report, €1 = $1.35

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I. Executive Summary

The Rating Initiative has been providing subsidies for social ratings since September 2008 in an effort to:

- Address the lack of available, transparent information on the social performance of microfinance institutions (MFIs) for investors, donors and other microfinance stakeholders, including the MFIs themselves
- Develop a sustainable microfinance social rating market, as well as providers to serve it

Since the Rating Initiative began funding social ratings, the number of ratings completed has grown significantly, including in Sub-Saharan Africa (SSA), a target region. To date, this growth has outpaced projections; however, the numbers of MFIs renewing social ratings as well as the number of non-subsidized social ratings decreased in all regions from 2008 to 2009.

Social ratings are a new and dynamic product group. While all four rating agencies use essentially the same indicators to measure social performance, their philosophies about social ratings, their methodologies for gathering and analyzing information, their grading scales and their reporting formats are distinct. But users—MFIs, Investor/Donors[1] and other microfinance stakeholders—lack enough experience with the rating agencies and their products to fully understand the differences between them and to make significant comparisons.

For the most part the Investor/Donors interviewed for this study have their own processes for conducting due diligence and reviewing their microfinance partners. Social performance indicators are increasingly being incorporated into these processes based on each Investor/Donor's social and financial priorities. Still, most of the Investor/Donors interviewed do not require or significantly utilize social ratings in their decision-making. In fact, to date they are not yet familiar enough with any of these products to discuss their strengths and weaknesses. The contributing factors to this are:

- Investor/Donors are not clear on exactly what or how the rating agencies rate.
- Rating reports contain too many indicators and the reports are too long.
- Investor/Donors cannot compare ratings between MFIs.
- Too many different products are being touted, making the market confusing to Investor/Donors.

All Investor/Donors, however, would like greater transparency and believe that social ratings can shed light on the social performance of MFIs.

The MFI users interviewed are familiar with some of the rating products, though their experience with social ratings is nascent. Most choose a social rating agency and tool for arbitrary reasons instead of comparing price, reporting format, rating methodology, etc. MFIs choose to conduct a social rating mainly for internal, management-related reasons: they expect that undergoing a social rating will help them to learn about social performance and allow them to plan and

[1] Investors and donors are used as a single term (Investor/Donor) as it was discovered during interviews that the responses were similar for both groups.

improve their social performance management in line with industry standards and agreed-upon best practices. To this end, user satisfaction with social ratings is high among MFIs. Of social ratings, MFIs report:

- They are useful.
- Their findings are accurate.
- They are easy to use.
- The services of the rating agencies are well accepted.

All MFIs interviewed received heavy subsidies for their social ratings. No consensus on "reasonable cost" could be determined, but the most common range was between $5,000 (~€3,700) and $10,000 (~€7,400).

Based on the research and interviews conducted during this project, the consultants recommend that in order to add greater value and transparency to the industry through social ratings:

- Social rating grades should be eliminated. MFIs and Investor/Donors generally do not understand how the grades are calculated, they often have issues with the perceived weight of specific indicators in grade calculation and they do not find grades comparable between reports. Rating agencies should instead concentrate on clearly and transparently evaluating MFI performance based on a small set of universally accepted social indicators, which should be presented in the report so that each user can focus on those that best match their own social priorities.

- The Rating Initiative should develop and execute strategies to give potential users greater and easier access to social rating report information. This may promote greater use and understanding of the products, leading to greater market demand and development. "Negative" social performance should be objectively identified and transparently reported to maintain credibility of social ratings within the industry.

- The Rating Initiative should systematically collect more user feedback (from MFIs and Investor/Donors) on the social rating agencies and products so that more meaningful analysis may be conducted on them. In this way, more consequential *User Reviews*[2] can be generated and published.

- To strengthen coordination between actors, stakeholders should work to identify a small number (10-15) of universally accepted and understood social indicators. As much as possible, these indicators should be tested to clearly demonstrate correlation to progress in social performance. The results will lead to greater clarity in what is measured, greater agreement on the importance of what is measured and perhaps lead to greater uptake in social performance monitoring, including social performance evaluation.

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[2] The *User Reviews* are a series of "peer" evaluations of social performance tools used in microfinance based on the experiences of those who have used them. The purpose of the *User Reviews* is to help potential users determine which tool or tools are most appropriate for their institutional needs. They may be found at http://www.sptf.info/page/user-reviews-of-sp-tools.

II. Background

A. The Rating Initiative

The Rating Initiative was created after the closing of the Multi-Donor Microfinance Rating and Assessment Fund (the Rating Fund) which had co-funded rating services to MFIs based in developing countries since 2001.[3] The Rating Initiative, conceived as a response to the fact that the continuation of rating subsidies was considered vital for the industry to truly mature, is driven by the following 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.

Co-funding of ratings is the principal activity of the Rating Initiative and it funds five types of rating services: performance ratings, credit ratings, social ratings, combined ratings, and diagnostics/assessments. Each service targets different institutions with different needs and at different stages of development. The table below shows the breakdown of products approved by the Rating Initiative for co-funding by quarters for 2010 (through September 30th) and for 2008 and 2009 combined.

Co-funding approval by product

	Sep-'10	Jun-'10	Mar-'10	Total '10	Total '08 & '09	Total
Total Ratings	**48**	**25**	**26**	**99**	**157**	**256**
Financial Ratings	**15**	**5**	**8**	**28**	**70**	**98**
Diagnostics/Assessments	1	1	0	2	16	18
Performance Ratings	14	4	8	26	54	80
Social Ratings	**33**	**20**	**18**	**71**	**87**	**158**
Social Ratings w/ Client Survey	6	2	4	12	22	34
Social Ratings w/o Client Survey	27	18	14	59	65	124
Simultaneous Fin. & Soc. Ratings	*25*	*14*	*9*	*48*	*56*	*104*

The Rating Initiative sought to address specific asymmetries in the development of the rating market in its four-year plan. Regional growth of rating penetration has not been uniform across countries and regions. Further, social ratings are relatively new products and consequently are not at the same level of maturity as financial ratings. To address the first issue, the Rating

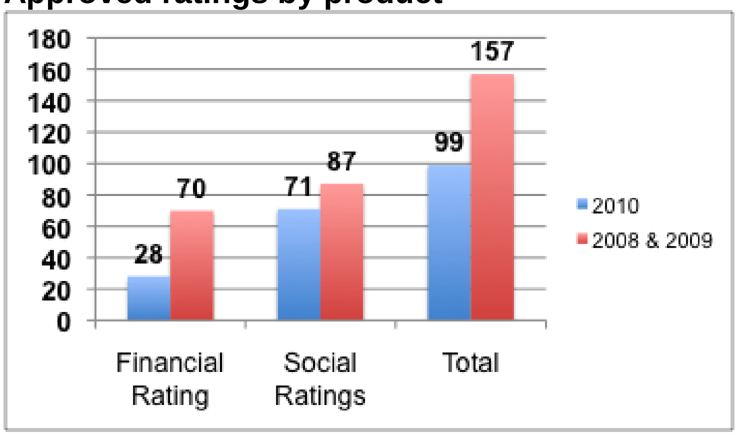
[3] The Rating Initiative was launched by ADA in collaboration with the Government of Luxembourg, the Microfinance Initiative Liechtenstein, the Swiss Development Cooperation, Oxfam Novib, the Oesterreichische Entwicklungsbank (OeEB), ICCO, the Principality of Monaco and Blue Orchard. The Rating Initiative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

Initiative is attempting to develop a "rating culture" for the SSA microfinance industry. In 2010 the Rating Initiative planned that at least 75% of all co-funded financial ratings should take place in Africa.[4] Additionally, it planned to participate in six promotional events in the region.[5] To address the second issue, the Rating Initiative has designed its strategy to encourage more MFIs to undertake social ratings.

B. Objectives, terms of reference of the study

Since its official launch in September 2008 through September 30, 2010, the Rating Initiative co-funded a total of 157 social ratings. In 2008, social ratings made up 11.8% of co-funded ratings, while in 2009 that number had increased to 18.5%.[6] In light of these strong quantitative results, the Rating Initiative Steering Committee decided that a thorough analysis of the market uptake and use of the social rating products would assist in the development of the burgeoning market. Per the Terms of Reference (ToR) for this study it "should be an invaluable tool for driving the project forward, supporting the qualitative development of the social rating industry, and strengthening the coordination between the various actors involved in this field."

Approved ratings by product



C. Methodology used

Two consultants undertook the study working closely with the Rating Initiative stakeholders in developing and finalizing the outputs. The study was conducted using the following steps:

- Preparation: The consultants first reviewed key documentation selected by the Rating Initiative to learn relevant background on the project and the scope of the consultancy. An outline and format of the final report was developed and shared with the Rating Initiative for comments. The consultants jointly conducted phone interviews with representatives from each organization sitting on the Rating Initiative's Steering Committee and Advisory Board, as well as the four specialized rating agencies. The purpose of these interviews was to learn from the stakeholders their goals and objectives for the study, as well as to solicit input on how to select users to interview, particularly from the Investor/Donor group.

- Interviews: Based on what was learned during preparation, the consultants developed interview questionnaires for each of the user groups and selected MFIs and Investor/Donors

[4] The Rating Initiative. (2010). Work Plan. p.2.
[5] Ibid.
[6] The Rating Initiative. (2010). Microfinance Rating Market Review 2010. p17.

to interview. The questionnaires were shared with the Rating Initiative to ensure that the scope and content was agreed upon and corresponded to the tasks outlined in the approved ToR.

  - Eleven MFI users were selected in order to ensure that 2-3 users of each tool were interviewed. As much as possible, MFIs were selected from different regions, (including SSA), different sizes and maturity levels, different institutional types (banks, NBFIs, NGOs, cooperatives, etc.) A table listing the MFI users interviewed as a basis for this report may be found in Annex A, Table 1.[7]

  - The other user group in this study included approximately 20 different stakeholders representing international financial institutions (IFIs), the private-investment arm of public development agencies; private social investors; commercial investors; donors and other interested parties. Some members of this group are also part of the Rating Initiative Steering Committee. This user group included organizations long in history (more than 35 years supporting microfinance) and newcomers to the asset class (less than 2 years). Their portfolios range in size from less than $2.701 million (€2 million) to over $2,701 billion (€2 billion). The investors predominately provide debt facilities (senior as well as subordinate debt), with some undertaking equity investments as well. The donors provide capital for operations and several also underwrite technical assistance.

- Report writing: Once interviewing was complete, the consultants jointly wrote this report. A draft report was shared with the Rating Initiative for comments, and then submitted to both the Steering Committee and the Advisory Board for comments.

- Additional research and revision: Based on the Steering Committee and the Advisory Board comments, the consultants revised their draft. One primary request was for greater depth in the report sections describing user perception of the rating tools. Consultants were given access to survey responses from MFIs that had received Rating Initiative funds. These responses were analyzed and compared with the responses collected during the user interviews. Unfortunately, due to the small pool of Investor/Donors, as well as their lack of familiarity with social rating tools, the consultants were unable to add greater depth than was already reported (See footnote 13, below.)

D. Social ratings and other social performance assessment tools

Social performance assessment tools are designed to evaluate the extent to which institutions meet their social objectives. Social performance assessment includes analyzing "the declared social objectives of institutions, the effectiveness of their systems and services in meeting these objectives, related outputs (for example, reaching larger numbers of very poor households) and success in effecting positive changes in the lives of clients."[8]

A *social rating* in the microfinance industry is an independent assessment of an organization's

[7] The consultants judged that, in light of the deadlines specified in the approved ToR, insufficient time was available to conduct a survey of users utilizing formal sampling methodology.
[8] CGAP. (2010). *Introduction to Social Performance Tools.* http://www.microfinancegateway.org/p/site/m/template.rc/1.11.48260/1.26.9235/

social performance using a standardized rating scale.[9] Utilizing the "Social Performance Pathway" developed by the SPTF (pictured on p.7), social ratings focus their evaluation on the intentions, systems and outputs of an MFI. The ultimate goal of social performance is achievement of positive social impact, yet proving that a given intervention has caused a certain social outcome is a complex econometric exercise. Impact measurement falls outside the scope of a social rating.[10]

In addition to measuring social performance, social ratings also aim to assess social risk (the risk of an MFI not achieving its social mission). Most MFIs and those who support them (e.g., donors, investors, policy makers, etc.) have a social mission. Social missions can take a variety of forms and include extending access to financial services, gender empowerment, employment creation, poverty alleviation, etc. Until recently, MFIs rarely attempted to provide systematic, credible evidence regarding fulfillment of their social missions. Social ratings aim to fill part of this gap and in doing so contribute to greater social transparency within the financial sector. When placed alongside a financial rating, the social rating enables the comparison of an MFI's financial and social performance. As such, it assists investors and donors in making effective use of scarce resources to achieve financial and social goals, as well as assisting MFIs in reporting on and improving their social performance.

The specialized microfinance rating agencies (M-CRIL, MicroFinanza Rating, MicroRate and Planet Rating) began developing social rating products in 2004. In 2007, nineteen social ratings were performed out of a total of 539 ratings, representing 3.5% of the rating market.[11] Aided by donor initiatives, the number of social ratings increased dramatically, to 76 in 2009[12]; however, until users demonstrate a willingness to pay for social ratings without subsidies, it is unclear if the product can fully establish itself as a complement to a financial rating.

<u>Social ratings with client survey vs. social ratings without</u>

There are two general types of social rating products. The first collects and analyzes data and information available at the institution level. This type is inconsistently referred to as a "basic," "standard," or "thin" social rating—or as a "social rating without client (or field) survey." All four rating agencies provide this type of social rating. A second type of social rating includes one with a client (or field) survey, which involves the collection of client-level data through a variety of techniques (surveys, interviews and focus groups) as part of the rating process. This type of social rating is inconsistently referred to as a "comprehensive" or "fat" social rating—or as a "social rating with a client (or field) survey." Such surveys may utilize poverty measurement tools, such as the Progress Out of Poverty Index (PPI) scorecard. It is important to note that in the case of social ratings with client surveys, the actual client surveys are carried out by third parties or by the MFI staff after receiving training and supervision from the rating agency; the rating agencies do not conduct the client surveys themselves.

<u>Other social performance assessment tools</u>

Social ratings may be briefly compared to the following social performance assessment tools:

- Social Diagnostics/Assessments: These tools are essentially social ratings without a

[9] The SPTF defines social performance as, "the effective translation of an institution's social goals into practice in line with accepted social values." More on the definition may be found at ***http://www.sptf.info***

[10] The Rating Initiative. (2010). *Services Funded/Offered: Social Ratings* from ***http://www.ratinginitiative.org/index.php?id=35***

[11] ADA. (2008). The Microfinance Rating Outlook Report. p.14.

[12] The Rating Initiative. (2010). Microfinance Rating Market Review 2010. p.17.

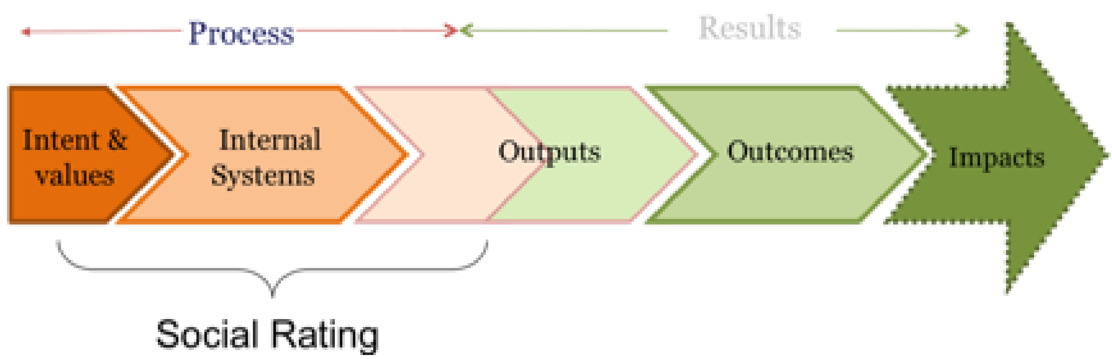
grade. Institutions that want to undergo the analysis of a social rating in order to improve their social performance, but that do not yet want to have their performance graded may solicit a social diagnostic/assessment from a rating agency.

- Social Audit Tools: Like social rating tools, social audits assess an MFI's intentions, systems and actions to determine whether they have the capacity to attain their social objectives. Unlike social ratings, social audit tools are designed for use by MFI staff with or without external facilitation. These tools are generally available for download and require the user to investigate key areas of social performance, ask and answer social performance related questions and gather and report on standard social performance indicators. Social audit tools include the CERISE Social Performance Indicators (SPI), the Microfinance Centres Quality Audit Tool (QAT) and the Global Reporting Initiative (GRI). Social Diagnostics/Assessments are also frequently referred to as "social audits."

- Poverty Assessment or Poverty Measurement Tools: Unlike social ratings and social audit tools, poverty measurement tools seek to specifically measure outcomes and outputs, such as client conditions and poverty. Two commonly used poverty measurement tools are the PPI and the Poverty Assessment Tool (PAT). These tools aim to quantify microfinance clients' absolute poverty levels and benchmark those with international and national poverty lines.

- Investor-generated assessments: Many Investor/Donors have begun to develop their own internal social performance scorecards that reflect the social issues that are of particular importance to that Investor/Donor. These scorecards are used by the Investor/Donors as part of their due diligence process. The scorecard is based on specific metrics. The Investor/Donor then creates its own weighting scale so as to create a social performance score for that MFI. The score and scorecard are generally included in the investment review and approval process. The scorecard may also be updated periodically so the Investor/Donor can monitor that MFI.

Social Ratings in relation to the Social Performance Pathway
Source: SPTF (2010) Social Rating Overview.ppt. Available at http://www.sptf.info/page/social-performance



III. Findings

A. Investor/Donor use of social ratings

1. Familiarity with social ratings and social performance assessment tools

Social performance is just beginning to register on microfinance Investor/Donors' radar screens. Although all of the respondents have heard of social ratings and other social performance tools, most cannot discuss them in detail. They have had limited exposure to the rating agencies' methodologies for social ratings and do not know what the rating process entails, the length of time it takes to get a rating, or the costs. The consensus is that too many products exist and the market and the products are confusing.

All Investor/Donors regardless of size, or years of experience do their own due diligence. The larger more experienced Investor/Donors have a very defined due diligence process (including both financial and social reviews) using internally developed social scorecards that support their funders' view of what is socially important. These Investor/Donors also do annual reviews with their investee MFIs that allows them to follow up. It is important to note that social priorities and the definition of "progress" vary among different Investor/Donor and MFIs. While many of those interviewed said that they look at available social rating reports as part of their due diligence and review process, no one interviewed indicated that a social rating is a required step or could replace part or all of their internally developed processes. Some Investor/Donors said that they encourage MFIs to get a social rating, and a small number reported that if a MFI has a social rating that it made it more likely that they would undertake an initial investment review (this was particularly true of smaller/newer MFIs). Two social investors did say that if a MFI had a rating that they give the MFI a reduction in interest rate.

2. Strengths and weaknesses of the social rating and the social rating report [13]

While all respondents are aware that several social rating tools are available, most are still not familiar enough with the different products to comment on specific differences between them. Rating agencies are not equally represented in all regions, and most of those interviewed are only familiar with one or two tools. Respondents often said that they are not clear on the distinct methodologies used by the rating agencies, though they perceive that they differ greatly from one rating agency to another.

Most Donor/Investors remarked that they are not clear on exactly what each of the rating agencies rate. Since the rating schemes and quantitative measurements used and reported are not understood, most do not believe that they can compare ratings from one MFI to another MFI

[13] Investor and donor responses are combined throughout this report because of the limited number of respondents in any category, as well as the similarity of their responses. While it would be ideal to provide detailed information based on type (e.g., very social investor, double bottom line investor, commercial investor, and donor) it was not practical in this case because: 1) although more than twice as many respondents as the ToR requested were interviewed for this report, not enough people were interviewed in any category to provide scientific results; 2) donors and investors cannot be easily categorized and no criteria was established to provide for a classification; 3) participants were assured that responses would be kept confidential. As a result the use of the terms "some", "most", and "many" seems the best way to convey the sentiment particularly as responses crossed investor and donor classifications.

even if the rating agency is the same. Even more problematic is trying to compare the ratings from different rating agencies. One respondent suggested that the raters define what it takes to achieve a particular rating grade so that it could be quantitatively compared. Another respondent said that the grade is irrelevant—the report findings are of primary importance.

In general, commercial investors are less inclined to support the social rating process, as they believe a correlation exists between the quality of the portfolio and positive social impact. A commonly shared opinion is that good client relationships and sound, rigorous credit approval processes equate to fair treatment of customers and a strong focus on repayment capacity. Some Investor/Donors interviewed said that some measurements used to track poverty alleviation are contrary to their goal of fostering economic development. For example, the measurement of average loan size or number of women borrowers is not necessarily relevant based on the specific mission of an MFI or the Investor/Donor. Likewise, an increasing average loan size over time might not mean mission drift but rather that microentrepreneurs are building larger, more successful enterprises that require more capital. However, some Investor/Donors interviewed believe that under the current rating methodology, an increase in average loan size could reduce the rating grade of an MFI.

3. What Donors/Investors want out of rating reports

All the Investor/Donors interviewed favor greater transparency in microfinance, though there is no consensus support of the increase in emphasis on social performance. Some commercial investors fear it is a distraction for management that could undermine an organization's sustainability. This contrasts with some microfinance investment vehicles (MIVs) that believe that the focus on financial performance and efficiency cause management to diminish its attention to client welfare and benefit. Most important is the standardization of relevant definitions and measurements—a common set of proven indicators. Similar to the financial definitions used to assess financial performance, respondents said that social performance needs a universal language. This will help MFIs in terms of time and cost in collecting data and will improve the quality of the input, which in turn will increase the value of the output. Once investors have these indicators they can figure out which ones match their individual social priorities. Some respondents also questioned the strategy of developing and rating against metrics for activities not yet proven to improve social or financial performance. For example, there are indicators for measuring staff trainings on social performance, yet there is no evidence that such training actually affects the social performance of an institution or the improvement of client services.

Most of the Investor/Donor respondents stated that they felt the social ratings with a client (field) survey are more useful than those without surveys. These Investor/Donor users believe that such surveys provide an independent verification that the MFI is doing what they say, making the rating more than just a review of social performance policies. Field surveys are seen as being very useful, as they get the information that the investor can't collect doing due diligence on their own.

Most Investor/Donors felt the rating reports are too long and too detailed, though all those that actually use the reports agree that the report was the most useful part of a rating. Most want a more concise report focused on a smaller subset of measurements. Suggestions range from tracking 10-15 indicators to focusing on only the social metrics integral to "success." It is important to note that each Investor/Donor's definition of success, and hence their required metrics, vary based on their social priorities. Those who use the ratings the most seem to be the original drivers of the social rating process, and their primary focus is measuring poverty alleviation. Other Investor/Donors were more interested in financial inclusion, rural lending, or gender empowerment. Only one Investor/Donor commented that the rating grade was more useful than the report.

Comprehensive ratings

Most Investor/Donors think that a comprehensive rating report (including both financial and social performance in a single report) is a good idea. They liked that the report would be shortened and areas common to both financial ratings and social ratings would not be repeated. They believed that in many cases weaknesses on the financial side would be more evident with the addition of the social context. Most however, cannot provide insight into how the actual rating grade would work and a few are worried that the social rating would be reduced substantially, overshadowed by the financial rating. Some suggested that the social rating report be an annex to the financial rating report and contain a set of indicators that could be quickly assessed and understood.

Social rating reports: A MFI management tool? An Investor/Donor tool?

Investor/Donors are split as to whether social rating reports should be a management tool, an Investor/Donor tool, or both. All felt social rating tools allow Investor/Donors to gain insight into MFI operations and to promote transparency. Most agreed that social ratings do provide feedback to MFI management, particularly if they are done with a field survey. Investor/Donors do point out however, that the rating report is not designed to give suggestions or develop strategies to improve performance. Some Investor/Donors made the suggestion that social ratings could be seen as a positive force in the market if used responsibly by regulators. (This study did not focus on regulatory input or use of the social rating by regulators. A separate study could be undertaken to determine if regulators would use social ratings in their oversight capacity to verify that organizations claiming to provide social benefit actually do. Such a study would need to take into account that microfinance regulation varies greatly from country to country.)

Client Protection Principals

Almost all Investor/Donors encourage MFIs to sign on to the Client Protection Principles, as these seem to be a universal set of ideas. Many Investor/Donors would like to see a set of definitions and measurements that could be used to assess a MFI's compliance with these principals and these could be incorporated into the rating process.

4. Rating costs and who should pay?

No consensus opinion was apparent among the Investor/Donors interviewed as to who should pay for social ratings. Some respondents think it depends on characteristics of the individual MFI, such as its size, its legal form, its operational sustainability, etc.

Most respondents realize that substantial time is involved in conducting a social rating, particularly for ratings with a field survey, but did not know how much it should cost. Geographical location of the MFI is a significant factor in determining the price: costs in Latin America differ from those in Eastern Europe.

B. MFI use of social ratings

1. Regional coverage/uptake of social ratings

As noted earlier, social ratings are new products. By subsidizing social ratings, the Rating Initiative has helped increase the market demand for them in the short-term. This is evident in the table below, which shows an increase in both subsidized ratings and first-time ratings from 2008 to 2009. However, the small number of renewed ratings coupled with the decrease in non-subsidized ratings underscores concerns about the lasting impact of subsidies on the market. The 2010 market review reports that only MFIs in the Latin America & the Caribbean region (LAC) incorporate rating costs (financial or social) into their operating costs.[14] Therefore, even though 73% of respondents surveyed by the Rating Initiative say that they would be willing to take a social rating without access to Rating Initiative co-financing,[15] it is reasonable to expect that without further subsidies, demand for social ratings will decline unless another funding source steps in.

Regional breakdown of social ratings by subsidy and round[16]

	Subsidized	Unsubsidized	First-time	Renewed
Asia				
2008	2	11	12	1
2009	10	1	12	1
Total*	12	12	24	2
EECA				
2008	1	2	3	0
2009	5	0	5	0
Total	6	2	8	0
LAC				
2008	7	19	23	3
2009	34	7	37	4
Total	41	26	60	7
MENA				
2008	2	1	3	0
2009	2	0	2	0
Total	4	1	5	0
SSA				
2008	4	2	6	0
2009	14	1	15	0
Total	18	3	21	0
TOTAL	***81***	***44***	***118***	***9***

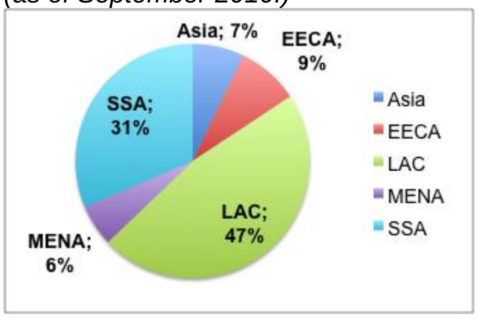
Social rating uptake has not been evenly distributed across regions of the world. As of September 2010, roughly half of global social ratings were implemented in the LAC. As a result, nearly half of Rating Initiative subsidies went to the region. This regional difference can partly be explained by differences in regional markets: the LAC market is mature, which likely leads to greater uptake of rating products. Also, the LAC mostly speaks Spanish, which makes it easier for rating agencies to design, implement and market their products. All of the MFI users from

[14] Rating Initiative. (2010). Microfinance Rating Market Review 2010. p.28.
[15] Survey results as of January 2011.
[16] Rating Initiative. (2010). Microfinance Rating Market Review 2010. p.26.

LAC interviewed for this study had experience with financial ratings before, and one had undergone multiple social ratings.

As noted earlier, the Rating Initiative has been working to develop a rating culture and market in SSA; however, there has been a decrease new ratings and rating renewals overall in the region.[17] The number of subsidized social ratings increased from four in 2008 to 14 in 2009, but non-subsidized social ratings decreased from two to one during the same time period. All social ratings in both years were first-time ratings. The 2010 market review posits that this may be due to a discrepancy between available funding and true market demand. (The decrease in financial ratings was even greater in the SSA region: in 2008 there were 34 non-subsidized financial ratings, while in 2009 there were only four.)[18]

Regional uptake of social ratings
(as of September 2010.)



The consultants reached out to numerous MFI users in SSA, but unfortunately only two were available to discuss their experience. Both MFIs said that awareness of social ratings was increasing in the region, resulting in a corresponding increase in social rating use. However, both also reported that general awareness of social performance, and the benefits of having a social rating, is currently low.

Most respondents, in all regions, said that the development of social ratings has been driven by a balance of interests (both those of MFIs and Investor/Donors.) Some respondents said the development was driven more by Investor/Donors. No respondents said that the development was being driven by the interests of MFIs over those of Investor/Donors. Table 1 in Annex A presents the countries of all the MFI users interviewed for this study.

2. Familiarity with social rating products and services

While the number of social ratings conducted has grown rapidly, few institutions have undergone multiple social ratings. Fewer still have used different rating agencies for their social ratings. Nearly all MFIs interviewed had undergone a financial rating before having the social rating. Only three MFIs had undergone two social ratings—all had used the same rating agency both times. The social rating industry is still at a stage where MFIs do not have enough information or experience to make meaningful comparisons between products and service providers. As a result, the MFIs interviewed choose the rating agency for mostly arbitrary reasons (because it is recommended by a colleague, it is recommended by a funding agency, they used it for their financial rating, etc.) Only one MFI user interviewed claimed to have compared social rating reports to decide which agency to choose (it compared only two rating reports.) The 2010 Microfinance Rating Market Review noted similar findings.[19]

[17] Rating Initiative. (2010). Microfinance Rating Market Review 2010. p.8.
[18] Ibid. p. 27.
[19] Ibid. p.19.

3. Motivations for undertaking a social rating

Nearly all MFI users interviewed reported that their motivation for having a social rating was primarily an internal one; they did it to inform management decision-making. Specifically stated purposes include:

- To check mission fulfillment/mission drift, sometimes at the request of founders, shareholders
- To gauge and monitor social performance, particularly so that performance could be improved
- To get a better understanding of social performance and social performance indicators and industry standards

Some MFIs received grants from Investor/Donors to conduct a social rating (in addition to receiving Rating Initiative funding) which was the basis for their decision to undertake the social rating.

4. How cost affects the choice of social ratings

The cost of the rating was not a significant factor in selecting one rating agency over another, though it did factor into deciding whether or not to implement a social rating with a field survey. All the social ratings of the MFIs interviewed were heavily subsidized, which probably had a distorting affect on responses. (Two MFIs reported that their social rating was free, which was the basis for deciding to undertake it in the first place. Several MFIs were unaware of the actual cost of the rating.) The table below shows the average subsidy given for social ratings by region and rating round.

Average subsidy by region and round

Region	Average Subsidy	
ASIA (1st time)	$8,750	(€ 6,481)
LAC (1st Time)	$8,267	(€ 6,123)
LAC (2nd Time)	$4,825	(€ 3,574)
LAC (Total)	$8,602	(€ 6,372)
EECA (1st time)	$10,899	(€ 8,074)
SSA (1st Time)	$9,293	(€ 6,884)
SSA (2nd Time)	$5,103	(€ 3,780)
SSA (Total)	$9,103	(€ 6,743)
MENA (1st time)	$7,564	(€ 5,603)

Figures as of September, 2010

Unfamiliarity with other tools may also explain why cost was not a significant factor in selecting a rating agency. According to the Rating Initiative statistics, no MFI has chosen to receive a rating with field survey twice. Two MFIs who had a rating with a field survey said that cost would be one factor to prevent them from undertaking them yearly (allowing the MFI time to implement change was another factor.)

There was no clear consensus among MFIs interviewed of how much a social rating should cost. Answers ranged from between $4,000 and $20,000 (€2,960 and €14,800), but the most common responses were between $5,000 and $10,000 (€3,700 and €7,400). Responses appeared dependent upon the person interviewed not the institution's size, type, funding sources or geographical location. Several MFIs said that a social rating should cost less than a financial rating, because a financial rating is seen as a requirement from investors or regulators.

5. Satisfaction with social ratings

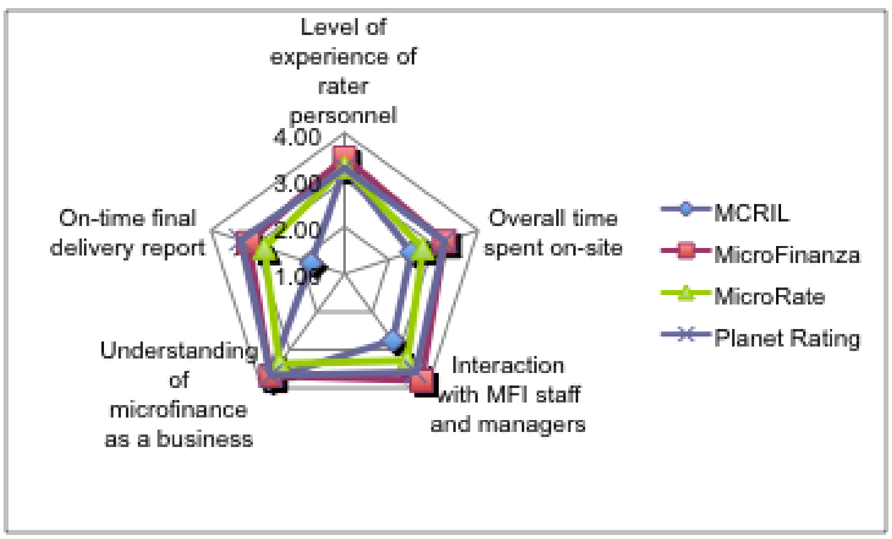
Overall Satisfaction

MFI satisfaction with the social ratings is quite high. Nearly all MFIs interviewed said they were "mostly satisfied" or "completely satisfied" with both their rating experience and the resulting report, citing that their expectations for the rating were met. This was true regardless of the rating agency or whether or not the rating included a field survey. Despite the sharp increase in the number of ratings implemented in the two years since the *User Reviews* were published, overall satisfaction with social rating tools appears to have increased slightly.

This was also reflected in the survey responses given by recipients of the Rating Initiative who filled out surveys based on their experience. The following graph presents average user responses when asked to rate rating agency performance in certain categories from "Poor" (=1) to "Excellent" (=4). With the exception of M-CRIL, which had a limited number of respondents, satisfaction levels in each category were similar for all rating agencies.

It is important to note that this does not represent a statistically valid analysis: only those recipients who chose to submit responses did so. Additionally, the number of respondents among rating agencies varied greatly, with MicroFinanza Rating and MicroRate having 25 respondents each, Planet Rating 12 and M-CRIL only four. It is equally important to note that nearly all the respondents' experience with the social rating tools is limited to just one rating agency and social performance rating tool: the answers do not represent a true comparison of rating agency performance.

Average of responses rating aspects of performance from "Poor" (1) to "Excellent" (4)



Includes 66 responses: MicroFianza Rating (25), MicroRate (25), Planet Rating (12), and M-CRIL (4). Responses through January 2011.

Social Rating Utility

Nearly all the MFIs interviewed said the social rating was useful as an internal management tool. The rating process and report helped MFI managers to identify social performance strengths and weaknesses, aided in including social performance in institutional planning, and led to the development of social performance activities and systems. As a result, all MFIs reported that they are improving their social performance as a result of having undergone a social rating, regardless of the rating agency used, or whether or not the rating included a field survey. About half reported that having a social rating helped them improve their understanding of social performance concepts, best practices and indicators. More than a third of the MFIs reported that they found the social rating useful for improving their products and services. Once again, this was reported regardless of the rating agency used, or whether or not the rating included a field survey.

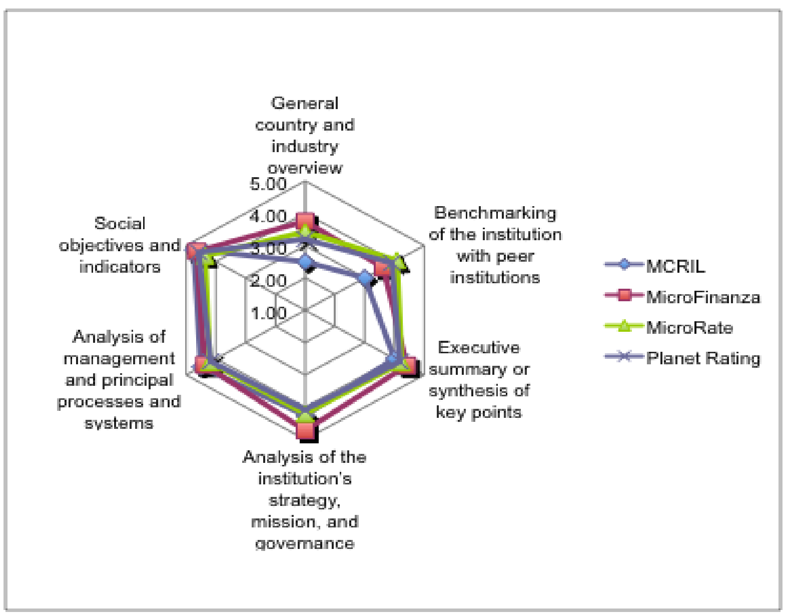
More than half the MFIs interviewed reported that they found the rating tool useful or very useful for communicating with external entities, such as funders, networks and regulators. Specific uses reported include:

- As a marketing tool—MFIs that were happy with their grade shared their report with various external parties. Some MFIs interviewed have not shared their reports with external parties because they want to enact change in order to get a better grade first.

- To attract investments—Three of the MFIs interviewed reported that their social rating helped them to attract funding, or obtain better funding terms, while eight reported that it had not helped. About half of the MFIs interviewed say that investors and lenders do not ask for social ratings or use them in decision-making. This is a marked difference from the *User Reviews,* when no MFI claimed that having had a social rating helped them to attract funding.

A review of Rating Initiative survey responses demonstrates that MFI perception of the utility of the different rating tools was quite similar for all aspects listed for all rating agencies. As noted earlier, this does not represent a statistically valid analysis. However, it is a good indication that based on their limited experience with the social rating agencies and tools, MFI users report a high level of satisfaction with the usefulness of social ratings regardless of the agency or tool used.

Average responses of users on which sections of rating reports were most useful (from 1 to 5, 5 being the highest grade)



Includes 66 responses: MicroFianza Rating (25), MicroRate (25), Planet Rating (12), and M-CRIL (4). Responses through January 2011.

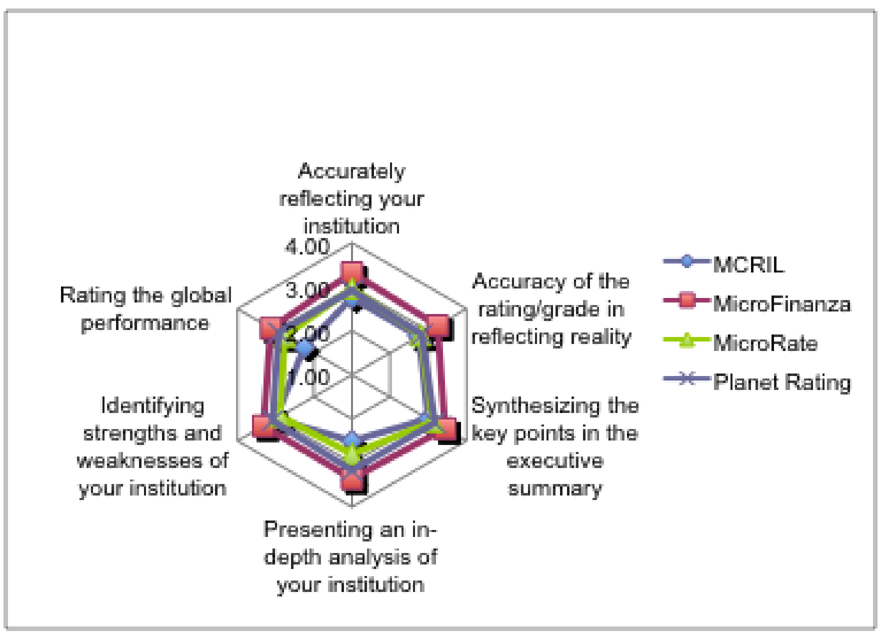
Robustness
In general, MFIs interviewed view all of the rating tools as robust and accurate, citing a high level of confidence in the report and findings. Some MFIs had less confidence in the rating results, but no rating agency or product was cited as stronger or weaker than the rest. There seems to be no correlation between MFIs who had a rating with a field survey and their reported opinion of the robustness of the social rating. MFIs who had ratings without a survey had similar opinions of robustness. The lack of familiarity with the different agencies and rating products may be a factor, as those unfamiliar with the client survey cannot judge if it increases robustness. The MFIs in this study, as well as those consulted in the *User Reviews,* listed "poverty assessment" as a strength of rating tools that do not use client surveys. (This despite the fact that only the social ratings with client surveys actually conduct a poverty assessment.) This high opinion of the robustness of all social rating agencies and products is perhaps influenced by two factors:

- The social indicators that all four rating agencies use are the same, as they were designed in committee in the SPTF and agreed to by all rating agencies.

- The SPTF, the Imp-Act Consortium, the Ford Foundation, and others have been very active in recent years to raise awareness in all global regions of social performance, educating microfinance networks and MFIs on which social performance indicators are "correct."

A review of Rating Initiative survey responses confirms that MFIs in general perceive that all rating agencies produce robust, accurate results with their social rating products, regardless of their different methodologies and focus. The fact that the number of social ratings has increased drastically in the past two years has not diminished this perception, it appears.

Average of user responses to the question, "How would your qualify the content of the rating report in: "Poor" (1) to "Excellent" (4)



Includes 66 responses: MicroFianza Rating (25), MicroRate (25), Planet Rating (12), and M-CRIL (4). Responses through January 2011.

The 2010 market review observed a growing trend of rating agencies conducting "repeat business" with rated MFIs. The market study cautioned that rating agencies' neutrality might be compromised as they develop closer relations with the MFIs they rate. Several MFIs interviewed are repeat customers for one rating agency and appear hesitant to use different ones. One MFI switched rating agencies for the social rating precisely because it disagreed with the grade received on an earlier financial rating. This underscores the pressure raters face in making these nuanced evaluations.

Ease of use
Generally, all the MFIs reported that rating agencies are flexible about scheduling ratings to accommodate the MFI's requirements. Professionalism of rating agency staff, preparation instructions and use of appropriate indicators were listed as strengths across the board, regardless of rating agency or rating product. Nearly all MFIs reported that having two evaluators in a team is a good number. One MFI reported that only one person conducted the social rating, which was considered insufficient.

The MFI's perception of the ease of implementation of the tools corresponds more clearly with internal capacity and the level of development of internal systems (in particular MIS) rather than the rating agency or type of rating. Those using social ratings more than once said, "the second time is easier."

Duration
The time required to submit draft and final reports was listed as a weakness across the board, regardless of rating agency or rating product. This echoes the findings of the *User Reviews* from two years ago; while the duration and satisfaction levels have generally improved, MFIs of all rating agencies still complained about the length of time required to finalize the social rating reports. In some cases, the delays were caused due to MFI responsiveness, but generally MFIs attributed the delays at least partially to the rating agencies. This was the greatest source of dissatisfaction among MFIs.

6. Compatibility of social ratings for different institutional types

Based on the interviews conducted, no specific rating agency or rating product (with or without field survey) appears to be more or less appropriate for a MFI user based on institutional size, maturity level or institutional type (banks, NBFIs, NGOs, cooperatives, etc.) A review of the source data for the *User Reviews*[20] also failed to detect a preference.

MFI user opinion of combining financial ratings and social ratings into one product
In contrast to the Investor/Donor users, nearly all MFI respondents said that it is better to keep the social rating separate from the financial rating if combining them means losing the detail provided in the current social ratings. Some MFI users said that the potential reduction in time and cost associated with a combined financial/ social rating product would make such a product attractive in the future.

[20] Reports available at http://sptf.info/page/user-reviews-of-sp-tools

IV. Recommendations on supporting development of the social rating industry

A. How do social ratings add greater value in the effort to bring transparency to the microfinance industry

Issue: The microfinance industry is not ready for graded ratings on social performance, as each constituent (MFIs, Investor/Donors, support organizations) has different social priorities.

Microfinance industry stakeholders have diverse social aims and priorities. Those driving the development of the current list of social performance indicators—the SPTF, the Microfinance Information exchange (MIX), etc.—have attempted to capture this diversity, and to keep all players “at the table,” by involving numerous stakeholder groups in selecting and defining the indicators used within the industry. Through committees of the SPTF, the four rating agencies have worked together to more-or-less standardize what is measured in a microfinance social rating. However, unlike financial rating indicators (debt/equity ratios, ROE, NPL, etc.), few causal relationships have been demonstrated between the social indicators collected and social or financial success. The methodologies of the rating agencies understandably reflect the social priorities of their supporters or intended audiences, (for example, adding greater weight to poverty measurement and alleviation over access to finance; rural outreach over employment generation, etc.) For this reason, it may be impossible to harmonize a grading scale between rating agencies without excluding certain stakeholders. Furthermore, since the rating agencies attempt to measure how well each MFI is achieving its own social mission, grades are partially based on “moving targets,” rendering them even less comparable. Yet, if they are not clear and comparable, rating grades are meaningless to Investor/Donors and MFI users alike. This is not to say that a third party evaluation of social performance is meaningless; on the contrary, nearly all users (MFIs and Investor/Donors) found such evaluations and their findings useful.

Recommendations:

1. Eliminate social rating grades. Calculating a single social performance grade requires judging certain social priorities as greater than others. Rather than calculating a single grade, the rating agencies could instead report against a set of standardized social indicators, which will make the reports easier to understand and more useful for users with differing social aims. Based on the reported indicators, users will be able to come up with their own “grade” by weighing indicators according to their own social priorities. Conducting social performance evaluations in this way would still maintain their primary function—to serve as a rigorous, third party evaluation of institutional performance against standardized social indicators.

   Currently M-CRIL is piloting a new rating product for MIVs that utilizes this concept. Several members of the Rating Initiative Steering Committee strongly believe that transferring this type of methodology to the MFI social ratings may provide an opportunity to maintain social rating “grades,” while at the same time allowing report users to segregate areas of the rating according to their own social priorities. The consultants were not asked, nor able, to evaluate user satisfaction with the MIV product; however, the idea does appear to align with this recommendation. The Rating Initiative may want to study whether this approach will be useful for MFI social ratings as the protocol develops.

2. Simplify the rating process, methodology and reporting to make them more concise. Standardize definitions of social indicators and ratios (see Recommendations in section IV.

C., below) and then measure and clearly report on those. This will allow users to focus on relevant indicators and weight them to match their social priorities.

3. Increase access to the rating reports, potentially by eliminating subscription fees and translating all reports into English, Spanish and French. The value of social ratings lies in opening MFI users to review and making those reviews available to the public—this is where transparency is created. While sustainability of the rating products is an important consideration, currently, there does not appear to be enough users of the rating reports to support the products through subscription-based access. If the reports are not being read and used, then transparency is not increased.

4. Avoid mandating the use of social ratings. The field of social performance measurement is a dynamic one, still very much in a development stage. The market is not ready to support a social rating requirement; however, the market does appear ready to support organizations that make institutional performance, including social performance, more transparent and more measureable. Only when the metrics and standards have been properly established, as well as market acceptance of the evaluation tools used, should a requirement be considered.

5. Negative performance must be clearly and transparently communicated. Some users questioned the transparency of social ratings when negative information can be so easily hidden from, or not made available to, the general public. Currently, if an MFI suspects that it will get a poor grade, it can choose to have an ungraded social diagnostic/assessment rather than a graded rating. Once the grade is given, the MFI can simply choose not to share the report with external stakeholders—the “publicized” results are not so easily accessible unless one knows where to look. Finally, there are incentives for rating agencies to maintain business relationships with clients who can, and do, change rating agencies due to lower-than-expected grades.

Issue: Social rating reports are not being used by Investor/Donors to make investment decisions.

In theory Investor/Donors want to invest in MFIs that are not only financially sound but provide a high social return. Social ratings were thought to provide an objective assessment of a MFI’s social performance by measuring social performance indicators that matched the outcomes that Investor/Donors desire. The rating agencies produce grades and reports to provide this external objective assessment; however, to date social ratings have not been able to bridge the gap, partly due to the following:

- The measurements taken are yet to be proven to validate the premise (cause and effect).

- The rating grades reflect a particular mindset (weighting of social performance indicators) that does not reflect the focus of a large percentage of Investor/Donors.

- The social rating grade is not transparent, the philosophy of the rating agency and the weighting scale used by each rating agency to create a rating grade have not been clearly articulated to users.

- Investor/Donors have a very limited understanding of social rating products and confusion exists in the marketplace as too many tools and approaches are being touted.

- The rating report is cumbersome to read

As a result, the ratings are only used as a secondary source of information, and are not being systematically used to assess MFI performance.

Recommendations:

1. Validate the social performance indicators used in the evaluation process. Generate and present statistically sound evidence that certain metrics actually measure the goals that the stakeholders claim as their mission, and make these indicators core to the evaluation. As new evidence is generated and indicators achieve greater acceptance, they may be considered “core,” and be added to the standard evaluation.

2. Reduce the number of assessment tools. The number of assessment tools and methodologies are too numerous, confusing stakeholders as to which measures what. Comparisons between rating agencies and tools are not possible because the methodologies are different and no benchmarks exist that correlate the different scores.

3. Educate potential users, particularly the Investor/Donors on the rating process, methodology, indicators and products (performance ratings, social ratings, social ratings with surveys, social ratings without survey, etc.) to increase understanding. This may lead to greater acceptance and use of the reports.

4. Have the rating agencies independently verify MFI activities, but design the rating reports so that the report user can mold the information in a way that reflects their individual social priorities.

5. Combine the social report with the financial report and rating for a complete picture of the performance of a MFI. This will allow the reader of the report to put the social factors in the financial context of the MFIs performance.

6. Clearly define the measures and methodology that each rating agency is using. Disseminate that information broadly to Investor/Donors, MFIs and other stakeholders. Make it easy to find.

B. Recommendations for the Rating Initiative: How can it add greater value

Issue: To conduct meaningful statistical analysis requires more data and more statistically relevant sampling methods than were available in both this study and the previous User Reviews.

Recommendations:

1. Satisfaction surveys that ask for user opinion on rating characteristics (cost, duration, robustness, etc.) can be incorporated into the Rating Initiative process such that MFIs <u>are required</u> to fill them out before reimbursement and Investor/Donors are requested to give feedback when downloading a rating. In this way, meaningful comparison between tools can

be analyzed and Consumer Reports-like analyses of rating products can be produced.[21] The existence of such reports could be published, allowing potential users an opportunity to truly compare products before selecting them. Annexes C and D provide recommended questions for these surveys.

Issue: There is no easy way for potential users to access the information generated by social ratings

Two of the Rating Initiative's global objectives are to increase transparency and increase the availability of microfinance information (both about MFIs and the rating sector in general) to potential users.[22] To this end, the Rating Initiative has created a page on its website (*Rating Reports)* where a user can access rating reports summaries for each rating funded by the Rating Initiative.[23] Select rating reports are also available on the MIX website; however, this information is difficult to locate for those who do not know where to find it. Once found, there are significant barriers to understanding the information for all but the most knowledgeable user. Barriers to access include:

- A Google search of "social rating reports" does not quickly direct a potential user to the Rating Initiative site. There are nine or more other sites, including CGAP and the SEEP Network that have to be scrolled through before one would find the Rating Initiative site.

- Once at the Rating Initiative's *Rating Reports* page, what is available varies widely in its usefulness.

    - There are many different types of reports available. A new user visiting the *Rating Reports* page might not know the difference between an "assessment", a "performance rating", or a "social rating." There is no easy way to find this information on the page.

    - Reports are available in only one language, limiting the audience for each report.

    - Most reports are only summaries of the report. These summaries contain little or no explanation of the grading scale, the methodology used or even the areas evaluated. An unfamiliar user might not even have enough information to determine if it is worth accessing the full report, let alone paying for it.

In short: transparency is increased only for those who know where the information is located and how to interpret highly technical and/or esoteric terminology.

Recommendations:

1. Utilize search engine optimization so that potential users can find rating reports easily and intuitively (i.e., by searching "rating reports", "social rating reports", etc.) or consider putting banners on searches advertising their location.

[21] *Consumer Reports* is a magazine and website that publishes comparative reviews and buying guides of products and services based on reporting and results of an in-house testing facility.
[22] The Rating Initiative. (2010). Business Plan. P 7.
[23] In reviewing the reports on the website, the consultants noticed that the MicroFinanza social rating reports are available in their entirety. This is reportedly because they have not provided the summaries for publishing.

2. Make the Rating Reports page more user-friendly.

    a. There are no product descriptions on the *Rating Reports* page*.* A user must navigate back to the *Services Offered* page to learn the difference between a performance rating and a social rating, etc. It would be helpful on this page to offer links to, or pop-up boxes that contain, a description of the different types of products found here (perhaps a "What's This?" link below the product name). [24]

    b. Indicate the language of the report contained.

    c. Indicate if the social rating included a client survey.

3. Clearly define terms and other necessary information so that potential users can understand the rating reports they access on the Rating Reports page. For example:

    a. The grading scale and methodology associated with each rating agency.

    b. A glossary of common terms (such as "depth of outreach") and how each item is measured or assessed.

    c. A sample of each rating agency's full report.

4. Find out from the rating agencies what it would take for them to make their entire reports available on the Rating Initiative website until a sufficient understanding/market for the reports has been generated.

5. Once the report site has been revised/upgraded, launch a campaign, including a blast and announcement on relevant websites (SEEP, CGAP, Ford Foundation, SPTF, Rating Initiative funders, etc.) to direct attention to the site.

Issue: It is unclear what is the appropriate level of subsidy for social ratings to encourage sustainable market development.

Concern for the long-term sustainability of the social rating market is valid. It is reasonable to assume that the availability of subsidies has increased market demand for the tools. This was confirmed in interviews, as some users reported that the reason they tried a social rating was because it was free or highly subsidized. Further, based on the statistics from the Rating Initiative's database 1) in 2009, 86% of social ratings were subsidized;[25] and 2) from 2006 to 2009, only 36% of MFIs renewed their social rating within three years after completing their first rating.[26] (It is unclear if this result is due to the fact that subsidies for repeat ratings are generally less than for first-time ratings, or if it is because some think that social ratings should be conducted every 2 to 3 years, instead of annually.) However, durability of the demand for social ratings without continued subsidies is doubtful. Both indicators above imply that the demand for the social rating product is not robust.

[24] Neither is there any description of these on the page titled *Rating Scales & Product Descriptions*—only links to the rating agency websites.

[25] Rating Initiative (2010) Microfinance Rating Market Review 2010 p 24.

[26] Ibid, p. 30.

Recommendation:
Making any recommendation on appropriate subsidy levels at this time is difficult for three reasons: 1) neither user group interviewed yielded a clear idea on what the ratings should cost or what to the market will pay for them 2) the ToR did not provide for a separate study focusing on the effect of subsidies on the social rating market and 3) currently there is little information available from which to draw any firm conclusions.

The consultants believe that removing or lowering subsidies will weaken demand for social ratings until the market value of the social rating can be established. The 2010 Market Review found that the market value for social rating tools has not yet been established,[26] a finding confirmed by interviews with both user groups. A further study to determine what, if any, subsidy level will facilitate an increase in market demand may be warranted.

In the mean time, the consultants recommend that resources should be spent on marketing the benefits of social ratings, particularly to investors, in addition to making the social rating more transparent and accessible. Examples of actions include providing funding to support the translation of rating reports into more than one language, hosting sessions at conferences to educate the market, and funding workshops with the rating agencies and the user groups to make the product more responsive to their needs.

C. How to strengthen coordination between various actors in the field

Issue: The stakeholders (Investors, Donors, MFIs, Rating Agencies, and Other Interest Groups) don't appear to be working from a common understanding.

From conversations with Investor/Donors, the current parameters of the social rating appear to be driven by one segment of stakeholders whose mission is different from many other stakeholders. Additionally, with so many tools and methodologies stakeholders are confused on what to use, how things are measured and if there even is a correlation between their mission and what is being measured.

Recommendations:

1. Work together to identify a small number (10-15) of social indicators that everyone can agree to as indicative of "good social performance." While it is important to consider a wide range of potential indicators, the confusion of too many indicators has proven to be an insurmountable obstacle for one key stakeholder group: the Investors. It is critical this group be well represented in the indicator-refining process. This does not mean that other indicators should not be developed, piloted, tracked, etc.; however, the indicators used in ratings should be those few that everyone can agree upon. Annex E provides a starting point for discussions on a reduced set of indicators.

2. Standardize the definitions, calculations and ratios for those indicators. (The Consumer Protection Principals seem to be a common ground for all the constituents although this might require more investigation.)

3. Once the indicators have been properly identified and agreed to, then define measurements that evaluate the MFI's ability to put these principals into practice and report on it.

[26] Ibid, p. 31.

4. The industry needs to be flexible as more data correlating microfinance to improved lives (be that poverty alleviation, financial inclusion, women empowerment, etc.) becomes available. New indicators should be included and, where no correlation exists, indicators should be dropped or revised.

5. Create a forum for stakeholders to interact and provide input into the social rating product (process and output). The Rating Initiative could sponsor and moderate sessions at conferences that would bring the stakeholders together. The rating process and reports could be discussed by a panel (made up of the rating agencies, MFIs and investor/donors) and discussed with the audience. Sessions could be held at conferences throughout the world so that regional issues could be addressed. [i.e. SPTF meeting]

Annexes

A. Selected tables, charts

Table 1. MFI Users Interviewed for Review

MFI (Country)	*Social Rating Tool*	*No. of borrowers*	*Loan portfolio (US$)*	*Avg loan balance (US$)*	*Legal Form*
Bai Tushum (Kyrgyzstan)	M-CRIL	27,526	38.1 million	1,385	NBFI
Tameer (Pakistan)	M-CRIL	70,671	18.2 million	258	Bank
IPR Ltd (Cambodia) ^	M-CRIL	3,720	3.77 million	1,016	Foundation*
Comixmul (Honduras) *	MicroFinanza	19,094	6.51 million	341	Cooperative
Hofokam (Uganda) ^	MicroFinanza	14,259	2.4 million	168	NGO
PRASAC (Cambodia)	MicroFinanza	87,945	64.4 million	733	Foundation*
Gooming Centre (Nigeria) *	MicroRate	86,000	7.65 million	89	NGO
FMM Popayan (Colombia)	MicroRate	293,079	203.9 million	696	NGO
AMC de RL (El Salvador)	MicroRate	13,773	16.0 million	1,163.4	Unregulated NBFI
AZDB (Azerbaijan)	Planet Rating	37,953	259.2 million	6,829.5	Bank
FONDESURCO (Peru)	Planet Rating	9,850	12.4 million	1,263.2	NGO

Source: MIX Market (http://ww.mixmarket.org, accessed October 2010) unless indicated by an "*".
All statistics from 2009 unless indicated by an "^"

Table 2. Investor/Donors Users Interviewed for Review

African Microfinance Transparency Forum (AMT)**	**www.amt-forum.org**
Blue Orchard*	**www.blueorchard.com**
Consultative Group to Assist the Poor (CGAP)	**www.cgap.org**
Deutsche Bank	**www.db.com**
Double Dividend BV	**www.doubledividend.nl**
Ford Foundation	**www.fordfoundation.org**
ICCO*	**www.icco.nl**
IncoFin	**www.incofin.be**
International Association of Microfinance Investors (IAMFI)	**www.iamfi.com**
KfW Bankgroup	**www.kfw.de**
Luxembourg Microfinance and Development Fund	**www.lmdf.lu**
Microfinance Initiative Liechtenstein*	**www.microfinance.li**
MIX Market	**www.mixmarket.org**
Norwegian Microfinance Initiative	**www.nmimicro.no**
Oesterreichische Entwicklungsbank (OeEB)*	**www.oe-eb.at**
OikoCredit	**www.oikocredit.org**
Oxfam Novib*	**www.oxfamnovib.nl**
ResponAbility**	**www.responsability.com**
Social Performance Task Force**	**www.sptf.info**
Swiss Development Cooperation*	**www.sdc.admin.ch/**
Terrafina	**www.terrafina.nl**
Triple Jump	**www.triplejump.eu**

***Steering Committee members**
****Advisory Committee members**

B. Selected resources on Social Ratings, Social Performance Tools

The Rating Initiative	http://www.ratinginitiative.org/
The SEEP Network Social Performance Map	http://www.seepnetwork.org/Resources/6033_file_SPMap_final_.pdf
The Social Performance Task Force	http://www.sptf.info/
The User Reviews of Social Performance Tools	http://www.sptf.info/page/user-reviews-of-sp-tools
The MIX Market Social Performance Data	http://www.mixmarket.org/social-performance-data
CGAP: Introduction to Social Performance Tools	http://www.microfinancegateway.org/p/site/m/template.rc/1.11.48260/1.26.9235/

C. MFI Feedback Form

Congratulations for the completion of your social rating/assessment!

The next step is now to take this survey by either:
- Filling in this feedback form and send it back to us at: admin@ratinginitiative.org
- Directly filling it out on line at
http://www.surveymonkey.com/

This is very important for us to:
1. Understand how helpful the social rating/assessment was for your institution
2. Learn more about your experience with the Rating Initiative

Key Info

Name of MFI: [ ]
Your name: [ ]
Your email address: [ ]

Date: [ ]
Country [ ]
Phone number: [ ]

Name of Rater: [Choose a rating agency]

Rating or Assessment: [Choose a product]

Date of Rating Exercise: [Choose Date] Date of Report: [Choose Date]

1. How many ***social*** ratings/assessments has your institution previously had? [Select number]
2. Have you received a subsidy for a ***social*** rating/assessment in the last 2 years
3. Yes/No] [select %]
4. Have you used any of these other social performance assessment tools in the past two years? [Select all that apply: PPI, PAT, other Poverty Assessment Tool (FCAT, CASHPOR), social audit tool (SPI, QAT, GRI)]
5. What rating agencies have you used previously ***(for either a social rating/assessment or financial rating)***: [Choose all that apply]
6. If you changed rating agencies to conduct this social rating/assessment, why did you change?
   [Select all that apply:
   a. Required to change companies
   b. Want to try out new company
   c. Lower cost
   d. Did not like the grade of previous rating agency
   e. Previous rating agency did not meet our expectations for quality of service
   f. Previous rating report took too long to be issued]

Part A: About the Rating Exercise

7. What were your main objectives for conducting a social rating/assessment? (Please score them from 1-5, 5 being the highest and 1 being the lowest)
   a. To use the rating as an evaluation tool for management [ ]
   b. To meet regulatory requirements [ ]
   c. To meet requirements of current donors or investors [ ]

d. To access new sources of funding [ ]
e. To compare/benchmark the performance of our institution against others [ ]
f. To learn more about social performance best practices [ ]
g. Other (please specify): [ ]

8. How well did this rating experience meet your objectives? (Please score them from 1-5, 5 being the highest and 1 being the lowest. ***If you did not have a listed objective in mind when undertaking the rating, please select [NA].***)
   a. To use the rating as an evaluation tool for management [ ]
   b. To meet regulatory requirements [ ]
   c. To meet requirements of current donors or investors [ ]
   d. To access new sources of funding [ ]
   e. To compare/benchmark the performance of our institution against others [ ]
   f. To learn more about social performance best practices [ ]
   g. Other (please specify): [ ]
9. If you believe your organization has received new funding as a result of your rating, please indicate the type, source, amount and term of the new sources received or under negotiation.

Source	Type	Amount	Term	Interest Rate
	[Select]			

10. Have you shared the social rating/assessment report with external parties? If so, to whom? [Select from: Donors, Funders (bank, investors), Regulators, Network organizations.]
11. Where do you feel the rating has been most useful to you? (Please score them from 1 to 5, 5 being the highest grade)
    a. Internal decision-making, management, operations [ ]
    b. Institutional strategy [ ]
    c. Funding Access [ ]
    d. Relations with external parties (Donors, regulators, network orgs) [ ]
    e. Other (please specify) [ ]

12. How would you qualify your satisfaction with the content of the rating report in:
    a. Presenting an in-depth analysis of your institution's social performance [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied, completely satisfied]
    b. Accuracy in reflecting the true social performance of your institution [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied, completely satisfied]
    c. Accuracy of the final social rating/grade [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied, completely satisfied]
    d. Synthesis of the key points in the executive summary [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied, completely satisfied]
    e. Identifying social performance strengths and weaknesses of your institution [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied,

completely satisfied]

13. Which of the following sections of the social rating/assessment report did you find most useful. (Please score them 1 to 5, 5 being the highest grade)?
    a. General country and industry overview [ ]
    b. Benchmarking of the institution with peer institutions [ ]
    c. Executive summary or synthesis of key points [ ]
    d. Analysis of the institution's strategy, mission, and governance [ ]
    e. Analysis of the "social risk" of the institution [ ]
    f. Analysis of management and principal processes and systems [ ]
    g. Social objectives and indicators [ ]
    h. Other (please specify): [ ]

14. Please rate your satisfaction with the following rating/assessment characteristics:
    a. Cost: [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied, completely satisfied]
    b. Duration of onsite visit: [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied, completely satisfied]
    c. Timeliness of completion of rating report: [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied, completely satisfied]
    d. Robustness of analysis: [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied, completely satisfied]
    e. Clarity of direction/communications from rater [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied, completely satisfied]
    f. Knowledge of rating team about Social Performance: [select: completely unsatisfied, somewhat dissatisfied, somewhat satisfied, completely satisfied]

15. Does your institution plan to repeat the social rating or assessment in the future? [Select: Never, Yearly, Every two years, 3-5 years]
16. Would you use the same rating agency to conduct another social ratings/assessments, in the future? [yes, no, NA]
17. If no, why would you change?
    [Select all that apply:
    Required to change companies
    Want to try out new company
    Lower cost
    Did not like the grade of previous rating agency
    Previous rating agency did not meet our expectations for quality of service
    Previous rating report took too long to be issued]

18. In choosing your next social rating agency, please rate you're the importance of the following rating/assessment characteristics (Please score them from 1 to 5, 5 being the highest grade):
    a. Cost: [ ]
    b. Duration of onsite visit: [ ]
    c. Timeliness of completion of rating report: [ ]
    d. Robustness of analysis: [ ]

e. Accuracy of the report: [ ]
f. Clarity of direction/communications from rater [ ]
g. Knowledge of rating team about social performance: [ ]

19. How much of the cost do you expect to pay for your next rating? [Select %]

20. What do you think is a reasonable cost for
    a. A stand-alone social rating (with a poverty assessment component)? [ ]
    b. A stand-alone social rating (without a poverty assessment component)?[ ]
    c. A combined financial/social rating? [ ]

21. Please provide below any further comments on the rating agency: [ ]

Part C: About the Rating Agency

22. How did you learn about the Rating Initiative? Choose your answer
    If other, please specify: [ ]

23. If you did not have access to the Rating Initiative, would you still be willing to take a rating/assessment? [Yes No]
24. Please rate the following aspects of the Rating Initiative:
    a. Convenience of application: [Excellent, good, satisfactory, poor]
    b. Time to receive approval: [Excellent, good, satisfactory, poor]
    c. Time to receive reimbursement: [Excellent, good, satisfactory, poor]
25. Please list any suggestions you have regarding the Rating Initiative 's management to improve its services: [ ]

D. Investor/Donor Questionnaire

Thank you for taking the time to complete this survey.

You may fill out this survey by either:
- Filling in this feedback form and send it back to us at: admin@ratinginitiative.org
- Directly filling it out on line at http://www.surveymonkey.com/

Key Info

Name of your Organization: [ ] Date: [ ]
Your name: [ ] Country [ ]
Your email address:[ ] Phone number: [ ]

1. Please select the type of organization: [Select: donor organization; commercial investor; social investor; other? (Please specify.)]
2. Please select all that you provide to MFIs [Select: debt; equity; grants; other]
3. How large is your portfolio? [ ]
4. What percentage of your portfolio is in microfinance? [ ]
5. How long have you been investing in microfinance? [ ]
6. Are you familiar with [Select all that apply: microfinance rating tools (MicroFinanza Social Rating; MicroRate Social Rating; M-CRIL Social Rating; Planet Rating Social Rating); poverty assessment tools (PPI, PAT, CASHPOR, etc.); social audit tools (SPI, QAT, GRI)]
7. Which of these reports, if any, have you used in your work with microfinance institutions? [Select all that apply: MicroFinanza Social Rating; MicroRate Social Rating; M-CRIL Social Rating; Planet Rating Social Rating; social audit tools (GRI, QAT, SPI)]

Part A: About the Rating Reports

Please indicate the rating report reviewed:

1. Name of MFI: [ ] Date: [ ]
2. Rating Agency: [Select: MicroFinanza Social Rating; MicroRate Social Rating; M-CRIL Social Rating; Planet Rating Social Rating)
3. What we your main objectives in reviewing this report? [ ]
4. Did the report fulfill your objective? [Yes/No]
5. Overall, how satisfied are you with the rating report? [Completely dissatisfied] [Mostly dissatisfied] [Mostly satisfied] [Completely satisfied]

6. Please score the following from 1-5, 5 being the highest and 1 being the lowest.

	Interest to your	Actual Usefulness
The rating grade	[ ]	[ ]
Benchmark information	[ ]	[ ]
Written analysis		
a. General country and industry overview	[ ]	[ ]
b. Executive summary and synthesis of key points	[ ]	[ ]
c. Analysis of mission, strategy and governance	[ ]	[ ]
d. Analysis of management and principal processes and systems	[ ]	[ ]
e. Analysis of MFI's financial situation and credit risk	[ ]	[ ]
f. Financial and cashflow projections	[ ]	[ ]
g. Social performance indicators	[ ]	[ ]
h. Other, (please specify)	[ ]	[ ]

7. What additional information would you have liked from the rating? [ ]
8. Does having a rating make you [Select: more; less; same; NA] likely to invest?
9. Please select all the tools that you may require of your MFIs [Select: financial ratings; social ratings; other performance tools]
10. Do you have your own internal social performance tool? [Yes/No]
11. How often do you refresh it? [ ]
12. If yes, why do you use ratings in addition? [ ]
13. How did you find the report [Select: too long; too short; just right]?
14. If the report contained a grade, was it meaningful to you? [Yes/No]
15. Can you compare it with other grades given from different rating organizations? [Yes/No]
16. In your opinion, how long is a rating relevant? [Select: 12 mo; 18 mo; 24 mo]
17. Did you pay for this report? [Yes/No]
18. If yes, how much? [ ]
19. Was it worth that amount of money? [Yes/No]
20. If you did not pay for this report, would you consider paying for such a report? [Yes/No]
21. How much? [ ]

Other

22. What recommendations do you have for the tool developers? [ ]

E. Suggestions for a Reduced Set of Social Performance Indicators

The consultants were asked to provide some suggestion as to what a small set of social performance indicators might look like in this report. Both consultants believe strongly that an acceptable set of indicators can emerge only as a result of close collaboration between key stakeholder groups. Further, neither consultant is an expert in social performance indicators or has been closely involved in the process to develop social performance indicators. However, to provide a starting point for debate, the following rough outline of indicators is presented.

Mission:

1. # of women
2. # of rural clients
3. # jobs created
4. # of people accessing financial services for the first time
5. poverty level of clients

Efficiency:

6. Cost of service to clients

Responsibility to staff:

7. Ratio of salary/benefits of CEO vs. field staff

Responsibility to the environment:

8. Support of environmentally friendly jobs/projects

Consumer Protection Principles (1 appropriate indicator for each of the following principles):

9. Avoidance of over indebtedness
10. Transparent and responsible pricing
11. Appropriate collection practices
12. Ethical staff behavior
13. Mechanism for redress of grievances
14. Privacy of client data