



## MICROS – MFI Evaluation Framework

MICROS® - The broad analytical framework adopted by CRISIL to evaluate MFIs is, to a large extent, similar to the one used for banks, financial institutions and other financial intermediaries. CRISIL employs the CRAMEL methodology in the credit rating of financial entities (refer Table 1); this methodology has been modified to address issues that are specific to MFIs, after taking account of the fact that the microfinance sector is still in its infancy.

**Table 1: MICROS - Modified application of CRAMEL to MFIs**

### CRAMEL – credit rating of entities in financial sector

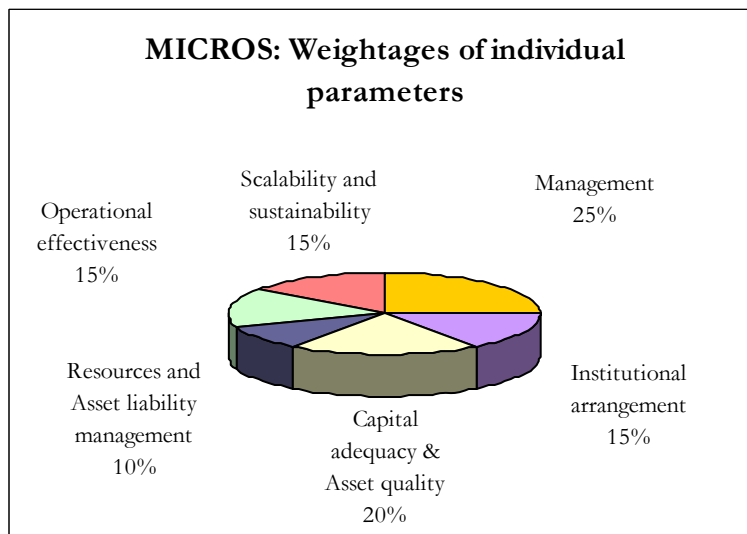
Capital adequacy
Resource raising ability
Asset quality
Management and systems evaluation
Earnings potential
Liquid/Asset liability management

### MICROS – MFI grading of MFIs

Management
Institutional arrangement
Capital adequacy and Asset quality
Resources and Asset liability management
Operational effectiveness
Scalability and sustainability

The focus of MICROS is on management/institutional analysis to assess the sustainability and scalability of the MFIs’ operations. Weightage for the main parameters in the MICROS methodology are highlighted in Chart 1:

**Chart 1: MICROS – Weightages assigned to each parameter**



## Management

CRISIL's management analysis focuses on evaluating the practices and systems of the MFI vis-à-vis the best practices among financial intermediaries. It is imperative for MFIs to have formalised processes for identification of client segments, loan disbursements, and monitoring of loan accounts and collections. Formalised processes and systems are key to achieving a sustainable and scalable business model. This parameter is analysed using the following sub-parameters:

- Track record in microfinance, alliances and networks with other agencies (donors, associations, tie-ups)
- Documentation levels and adherence to them
- Systems for client identification, group formation, credit appraisal, loan overdue monitoring, cash flow management and fraud control
- Processes, controls and audit; nature of internal audit, quality of accounting practices and reporting
- Use of information technology: hardware and software infrastructure, adequacy of systems and degree of computerisation, perceived benefits from IT implementation, security and disaster recovery management
- Human resources management
- Social/local impact: Findings of impact assessment studies, local/social impact observed by CRISIL team during interactions/observations on field

## Institutional Arrangement

CRISIL assesses institutional arrangement by examining the quality, track record and inter-relations among the MFI's management, promoters and board. It also evaluates the articulated vision of the management/board to the stakeholders. Institutional arrangement is scored on the following sub-parameters:

- Quality of management, ownership and governing board
- Governance practices
- Goals and strategies – Articulation of vision, goals and strategies, quality of planning

## Capital Adequacy and Asset Quality

CRISIL's assessment of an MFI's capital adequacy level is based on the perception of relative profitability, and the institution's risk profile and asset quality. The analysis encompasses the following factors:

- Size of capital
- Quality of capital, internal accretions, access to capital grants/donations (for non-corporate/cooperative legal forms)
- Capital position with respect to domestic capital requirements (for banks and non-bank finance companies)

CRISIL evaluates asset quality by assessing the MFI's ability to manage credit risks. The analysis is based on information provided by the MFI, or obtained at meetings with management or on visits to the field for interactions with branch staff and customers, or a random review of documentation and experiences of other MFIs. The analysis is based on the following:

- Profile of clients and quality of lending, loan conditions
- Seasoning of loan portfolio

- Concentration of credit risk
- Loan loss levels and movement of provisions and write-offs

## Resources and Asset Liability Management

CRISIL analyses the resource position of MFIs on the basis of their ability to maintain a stable resource base and obtain borrowings at competitive rates. CRISIL's analysis factors in the legal status of the MFI (which imposes restrictions on the acceptance on savings/deposits) and the regulatory environment in the country in which the MFI operates. In other words, CRISIL does not penalise the MFI for the constraints imposed by its legal status and operating/regulatory environment under this parameter. Constraints of legal status and operating environment are considered under scalability and sustainability. Moreover, regulatory risks, if any, are considered separately. The key factors analysed under this parameter include:

- Composition of borrowings
- Diversity in borrowing profile
- Cost of borrowings
- Asset liability maturity profile of the MFI, liquidity risk and interest rate risk

## Operational Effectiveness

In measuring operational effectiveness, the key considerations are operational efficiency and profitability. MFIs are incorporated under different legal forms; in most countries they are not regulated and do not need to follow standard accounting practices. CRISIL, therefore, performs appropriate analytical adjustments, which are in line with the practices adopted worldwide in evaluating MFIs. The factors analysed under this parameter include:

- Office outreach and quality of infrastructure
- Productivity and efficiency
- Diversity of income sources – composition of fund and fee-based income
- Profitability
- Impact of inflation on earnings (used in countries that have experienced high inflation in the past)

## Scalability and Sustainability

An MFI needs to create a sustainable and scalable business model; its products and processes need to be evolved so as to attain institutional and financial resilience. To assess an MFI's ability attain institutional and financial resilience, the following sub-parameters are analysed:

- Fund and resource base sustainability – sustainability of capital with respect to growth in the MFI's loans, plans to raise capital, and resource diversification strategies in place
- Organisational sustainability – legal structure, governance, succession, human resource issues
- Programme sustainability – sectoral expertise, ability to diversify product mix, enter new regions, retain market share in existing operational areas, long term strategy of the MFI/NGO-MFI in microfinance activity