DAI/FINNET Technical Note 2.
Microfinance Institution Standards: a Tool for Improving Performance

Microfinance standards have become an important topic of discussion in the past few years. Several world-wide initiatives exist to promote the development of rigorous performance measures using common methodologies to compare the operations of Microfinance institutions (MFIs) in different countries.[1] In addition, MFIs are coming together on regional and national levels to select and define a common framework for performance measures and benchmarks.

The purpose of this Technical Note is to examine why standards have become so important in the microfinance field, to briefly describe some international experiences in standard setting, and to discuss the standard setting process that is taking place in Haiti. The Note will address the following three questions:

1. Why is there so much talk about "microfinance standards?"
2. What exactly are microfinance standards?
3. How are microfinance standards being developed?

I. Why is there so much talk about "microfinance standards?"

Although no one would say that microfinance institutions getting together and deciding on common ways of measuring and benchmarking their performance is a bad thing, it is not immediately clear why this is becoming such a widespread trend. After all, MFIs have been in existence in many countries for 10 to 15 years without showing a clear need to know how their loan repayment record or ratio of salary expense to interest income compare with those of other MFIs—either across town or half-way around the globe. Many of these institutions are getting along fine, reaching a stable clientele with a steady stream of donor and charitable financing. So why the sudden interest in standards and comparative performance measures?

In the past decade, microfinance has experienced a marked shift from being a "field" made up of short-term development programs to being a full-fledged "industry" composed of permanent institutions. This push, by donors and practitioners alike, towards institutional sustainability has led to a "professionalization" of the sector, wherein microfinance institutions strive to apply commercial principles to their operations in order to become a self-sufficient and profitable business. Whereas impact and outreach (i.e. disbursing credit to as many poor households as possible) used to be the main goals of a microfinance program, portfolio quality and institutional soundness have gained

[1] Some examples of world-wide MFI standards and ratings initiatives include MicroRate, a private company that rates the performance of microlenders; the MicroBanking Bulletin published by the Consultative Group to Assist the Poorest (CGAP); and PlaNet Finance's GIRAFE rating system. For credit unions, the World Council of Credit Unions (WOCCU) has developed the PEARLS rating system.

more importance as indicators of success. Microfinance is now being seen as an industry whose objective is to provide a wide range of financial services to poor households, the informal sector, microenterprises, and others with no access to the formal banking system. Consequently, donor-funded projects are increasingly focused on strengthening the foundation and infrastructure of the overall industry, in addition to the traditional provision of one-on-one technical assistance to the microfinance institution itself. These "industry-building" initiatives usually have two end goals: (1) to increase transparency in the system through information sharing and reporting mechanisms and (2) to integrate existing microfinance institutions into the overall financial system. Industry-building activities usually include the development of a legal and regulatory framework, creation of a credit bureau, collaborative research and development, and of course, performance standards.

A second impetus behind the discussion on standards comes from the institutional level. Despite the fact that microfinance has evolved to a greater level of sophistication, one simple fact remains—a wide gap still exists between the number of clients served by MFIs and the potential market of poor people lacking access to credit and savings. Globally, microfinance reaches 60 million people. While the number may sound impressive at first, considering that there are a total of 1.2 billion people living on under US$1/day, this means that MFIs are serving only 5% of the potential market for financial services. In Haiti, recent DAI/FINNET data show a total population of 61,000 MFI borrowers—drawing from credit unions, NGOs, and commercial bank microcredit clients.[2] This compares to an estimated population of 1.5 million informal sector microentrepreneurs—giving a total market penetration rate of just 4%. These numbers indicate two things: (a) the rate of MFIs' portfolio growth remains modest; and (b) the limited amount of donor funds mobilized by MFIs will not be enough to close this gap between supply and demand.

To start bridging this gap, which is hardly unique to Haiti, MFIs would need to do two things:

- Make better use of the resources at hand (i.e. be more efficient in reaching more people with the same amount of funding);
- Attract other sources of funding besides traditional donor sources in order to get exponential growth in outreach.

Microfinance performance standards and ratings benchmarks provide a critical tool in helping MFIs achieve both of these goals. First of all, by providing common performance measures and recognized methodologies of calculation to correct for differences in accounting practices and access to subsidies, standards initiatives can provide microfinance managers with a cheap and readily available tool for seeing how their institutions compare against those employing similar methodologies that target a similar clientele. Standards initiatives such as the MicroBanking Bulletin give MFI

[2] Data on the microfinance sector in Haiti is contained in the *Base de Données sur les Institutions de Microfinance*, an annual survey conducted by DAI/FINNET and available online at www.daifinnet.com.

managers a one-stop access to a wide range of comparative performance indicators, based on figures from a sub-group of leading international MFIs using common calculation methods and accounting principles.[3] With this information, MFIs can compare their own performance with their peer groups in such key areas as outreach, financial performance, cost efficiency, and loan officer productivity. MFI managers can utilize these data not only to monitor their institution's progress against the rest of the industry, but also to identify key areas of their operations that require attention or need improvements.

Microfinance standards can facilitate MFIs' access to new sources of funds by providing objective evidence to lenders, investors, and donors that particular MFIs are solid and well-run by international and national standards. As donors reduce the amount of funding that goes directly towards portfolio capitalization, MFIs must begin to access funds from commercial or semi-commercial sources in order to grow their portfolio. Once MFIs are able to tap into these commercially-oriented funds from banks, private investors, wholesale lenders, and capital markets in general, their possibilities for portfolio expansion grow exponentially. However, accessing these market-based sources of funds requires more than just demonstrating an ability to offer services to the poor. Commercial funders and private investors base their financing decision not only on "social criteria" but also on the level of return and their risk exposure. Thus, MFIs must demonstrate that they are earning a rate of return on their operations where they are able to pay for the real cost of commercial funds (i.e. financial self-sufficiency). The MFIs must also demonstrate their ability to manage their lending portfolio effectively by keeping delinquency and portfolio at risk at an acceptable level.

Much of the MFI standards movement is designed to both guide MFI managers along the path to sustainability, as well as to provide benchmarking and ratings services to give commercially-oriented investors and lenders more confidence in MFIs. Many donors themselves are adopting an increasing emphasis on sustainability in making funding decisions. The Consulting Group on Assistance to the Poorest (CGAP) at the World Bank requires that MFIs who apply for funding present financial statements using a common framework that adjusts for the effect of in-kind subsidies, below-market rate refinancing and reductions in the real value of equity through inflation. These CGAP-required adjustments, similar to those that are included in other international standards initiatives, are designed to give a non-distorted picture of MFI sustainability. Some other international standards efforts offer MFI evaluations that are not linked to any specific financing request, but are made public to enhance the confidence levels of potential donors and investors.[4] In all these cases, the existence of standardized performance measurement techniques—whether made public or as part of a private funding evaluation—bring an increased level of transparency by disclosing previously unavailable information about a MFI's financial soundness to the larger pool of funders and investors.

[3] See The MicroBanking Bulletin web site at http://www.microbanking-mbb.org. It should be noted that the MicroBanking Bulletin publishes only aggregate statistics and not information on specific MFIs.
[4] PlanetFinance operates such a public ratings service using its GIRAFE evaluation tool.

II. What Exactly Are Microfinance Standards?

Microfinance standards are more than a series of comparative outreach measures or balance sheet ratios. Common performance standards for microfinance institutions can be characterized by three main features: (1) a common set of performance indicators to be measured and monitored, (2) a common methodology for calculating the selected indicators, and (3) an agreed benchmark or target for each selected indicator. To date, the types of financial ratios that are selected as measures of performance, and the process by which they were selected, have varied depending on the organization requesting the information. Yet, as Table 2 below demonstrates, while the range of financial ratios can seem endless, there are some basic indicators that are commonly agreed to among the different donors, apex networks, affiliate networks, and practitioners. These are the crucial data that make up a kind of "report card" on an institution's performance, and can be used by the MFI, donors, lenders, and investors alike to assess how well the institution is doing.

A. Selecting a Set of Performance Indicators

The range of possible indicators of MFI performance is practically limitless. Most attempts at defining microfinance standards focus on two broad categories of performance measures: outreach and sustainability. Outreach is considered a critical component of MFI success, since the underlying vision behind virtually all MFIs focuses on supplying financial services to large numbers of poor people on one hand and achieving economies of scale on the other. Outreach measures are designed to capture the numbers of people served, as well as information on their level of poverty. The most common indicators include: number of active loans or clients, number of savers, number or percentage of clients below the poverty line, average loan size, and the percentage of loans below a certain amount.[5]

Measures of financial performance and overall institutional sustainability are usually divided according to three major categories:

1. *Portfolio quality*. Because the loan portfolio is the most important revenue-generating asset of a microfinance institution, the quality of the portfolio plays a major role in the overall financial health of the institution. The indicators under this category enables the institution to monitor the overall performance of its loans and to manage its level of arrears before they run out of control.
2. *Financial soundness or stability*. The long-term viability of a MFI can best be ensured by achieving self-sufficiency, i.e. the institution's ability to cover the operating costs and financing costs for its products and services.

[5] Because information on actual incomes of borrowers is difficult to collect, loan size statistics are often used as a proxy for measuring clients' poverty level. Lower loan sizes are assumed to be linked to lower client incomes and higher levels of poverty. While the validity of this proxy indicator might be questionable to pure academic researchers, the measure is widely accepted for its practicality and ease of measurement.

3. *Efficiency*. In order to become self-sufficient, an institution should be able to run its credit operations in a cost-effective manner. These measures allow the institution to monitor the productivity of its input in relation to its output.[6]

Table 1 below provides an overview of some common measures of financial performance and sustainability that are used by Women's World Banking (WWB), the MicroBanking Bulletin (MBB), the World Council of Credit Unions (WOCCU), the Consultative Group to Assist the Poorest (CGAP), ACCION International, and the UNDP MicroStart Programme to appraise and/or monitor MFIs.

Table 1: Common Measures of MFI Financial Performance and Sustainability

Indicator	WWB	CGAP	MBB	Micro-Start	WOCCU	ACCION
Portfolio Quality						
▪ Repayment rate	X	X				
▪ Portfolio at risk	X	X	X	X		X
▪ Arrears rate		X		X	X	
▪ Loan loss		X		X		
Financial soundness/stability						
▪ Operational sustainability	X	X	X	X		
▪ Financial sustainability	X	X	X			
▪ Return on assets (adjusted and non-adjusted)		X	X		X	X
▪ Return on equity (adjusted and non-adjusted)		X	X		X	X
▪ Liquidity	X	X		X	X	X
▪ Loan loss provision		X	X		X	X
Efficiency						
▪ Cost per loan	X	X				
▪ Cost per borrower		X	X	X		
▪ Cost per unit of money lent	X	X	X	X		X
▪ Number of loans per credit officer	X	X	X	X		
▪ Amount of loans per credit officer	X	X				
▪ Ratio of credit officers to total staff		X	X			X
▪ Administrative efficiency		X	X			
▪ Personnel costs		X	X			

The list of indicators in the above table is hardly exhaustive. There exist other ways of measuring physical and financial productivity that are potentially useful to MFI managers. The overall number of indicators that anyone should pay attention to depends largely on the purpose for which they are used. Large multi-country comparative

[6] The April 2001issue of the *MicroBanking Bulletin* discussed "productivity" as an indicator of a MFI's efficiency and self-sufficiency. Among the "drivers" or measures of productivity are client retention, staff retention, staff renumeration, and staff training.

standards efforts such as the MicroBanking Bulletin track many indicators with data from participating MFIs, since their major purpose is to serve as an international reference for MFI managers and the more points of comparison they can establish, the more useful the initiative is to its intended audience. The point is not to establish prescriptive targets, but to offer a comprehensive reference so that individual MFI managers can have an idea how their institution compares against a wide range of peers on a whole inventory of operational and financial indicators. In contrast, standards initiatives which are more prescriptive in outlook and which are meant to help create a shared vision among a group of MFIs, or to push groups of like-minded institutions to higher degrees of professionalism, tend to be more focused on just a few key measures. These differences are further discussed in Section III of this Note.

B. Developing a Common Methodology for Calculating Indicators

Performance indicators require a common calculation method in order to be considered standardized and comparable. Exact formulas for the indicators should be defined, and agreement on how to adjust the financial data from participating MFIs should be made. The latter aspect is critical if a true "level playing field" is to be established on which to measure MFI performance, since un-adjusted measures may not only reflect differences in objective performance, they may also reflect differences in accounting practices and access to subsidies.

While the calculation of performance ratios seems relatively straightforward at first glance, a closer look reveals that divergent opinions exist in terms of what formulas should be used, and what number should be used in the numerator and the denominator of a ratio. As shown in a recent CGAP Focus Note, MFIs should be vigilant about the numbers that are behind a ratio calculation since the result can vary widely in certain instances and may give the institution an inaccurate picture of its financial performance.[7] For example, in calculating the arrears rate, institutions who include their total active portfolio in the denominator rather than the portion of the loans coming due for that period only, or an average of the beginning and ending balance of the portfolio for the period calculated, will come up with a deceptively low percentage that will not reflect reality. Consequently, in developing a calculation methodology, appropriate considerations should be given to factors that could affect financial ratios such as the lending methodology, the average loan size, the frequency of reimbursements, and the geographic coverage of the institution.[8]

The second aspect in establishing a common calculation methodology—the adjustment of financial statements—also represents a contentious issue. At their most rigorous,

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[7] CGAP Focus Note 23, *Measuring Microcredit Delinquency: Ratios Can Be Harmful to your Health*, June 1999. Available in English and French on www.cgap.org.

[8] The calculation of ratios can also be distorted for multipurpose institutions that provide both financial and non-financial services because of variations in the chart of accounts and difficulties in allocating overhead costs accurately.

initiatives to develop common standards usually make three types of corrections to financial statements:

- **Adjustments for different loan loss provisioning practices**. MFIs participating in a common standards initiative may agree on some common principles for recognizing loan loss provisions and write-offs as a regular operating expense.[9] Vastly different practices in this regard can mask large differences in portfolio quality and interest income figures. Among leading international MFIs, all of whom have high quality portfolios, these differences are immaterial. For MFIs with lax provisioning practices and questionable portfolios, however, this is a critical adjustment.

- **Adjustments for the effect of inflation on equity**. A hidden element to the "cost of funds" that does not show up in financial statements is the erosion of equity by inflation. Institutions that maintain constant equity on their balance sheet actually suffer a decline in the real value of that equity that is equal to the rate of inflation. This inhibits their ability to maintain the real value of their loan portfolio. Many standards initiatives, therefore adjust financial statements to reduce the value of equity for inflation, which has the effect of increasing financial expense on the income statement. Essentially, this correction recognizes that equity has a real cost even if most NGO "shareholders" do not demand monetary returns. This is an important adjustment for MFIs in high-inflation countries that are funded mainly through equity or donor grants.

- **Adjustments for subsidies**. Since differences in MFI financial performance may reflect differential access to subsidies, rather than true operational differences, corrections to financial statements to take into account subsidies are a critical aspect of most MFI standards initiatives. Adjustments are usually made to increase interest expense to reflect subsidized loans received, make sure that free in-kind services are expensed and ensure that cash donations to cover operating expenses are not counted as income. These adjustments most affect MFIs that fund much of their portfolio through below-market loans and receive significant start-up operational subsidies.

Once all these adjustments made, most of the indicators given in Table 1 can be presented on both an adjusted and non-adjusted basis. The most commonly used indicator that requires adjustment of financial statements is the notion of *financial sustainability,* which is calculated on the basis of financial statements adjusted for some or all of the three factors above.

[9] The MicroBanking Bulletin, for example, provisions 50% for all loans over 90 days late and 100% for all loans over 180 days delinquent. All loans are written-off within one year of their initial delinquency. The financial statements of all MFI with a less aggressive provisioning policy are revised to reflect these standards.

Making all of these adjustments to a MFI's financial statements in a rigorous manner is a complicated process. The first steps in developing standards may focus on operational indicators that do not require adjustments to financial statements and subsequently, move towards developing a common framework for producing adjusted measures.

C. Establishing a Benchmark or Target for Indicators

The third component of standardization involves the elaboration of common targets and/or benchmarks for the chosen indicators. Benchmarking provides MFIs with a concrete "goal post" towards which to drive their institution. It also helps to pinpoint potential trouble spots or areas where MFIs need to focus their resources to achieve improvement.

The development of a comprehensive benchmarking system consists of a multi-step process, spanning from data collection and data adjustment to the creation of peer groups to ensure comparability of results. Because the microfinance industry consists of a range of institutions and operating environments, a MFI needs to be compared to similar institutions for the reference points to be useful. The criteria chosen to create peer groups can vary depending on the number of institutions involved, their location, as well as their size. The MicroBanking Bulletin, for example, forms their peer groups using three main criteria: region, scale of operation, and target market. Table 2 below lists the criteria for these peer groups.

Table 2. MicroBanking Bulletin Peer Group Criteria

Region	**Scale of Operations** Total Loan Portfolio (US$)	**Target Market** Average loan balance/GNP per capita
Africa **Africa/MENA** **MENA/Central Asia**	**Large**: > 5 million **Medium**: 900,000 to 5 million **Small**: < 900,000	**Low-end**: < 20% OR Avg. Loan Balance ≤ US$150
Asia **Asia (Pacific)** **Asia (South)**	**Large**: > 8 million **Medium**: 1 to 8 million **Small**: < 1 million	**Broad**: 20% to 149% **High-end**: 150 to 249%
Eastern Europe **Latin America**	**Large**: > 10 million **Medium**: 1.5 to 10 million **Small**: < 1.5 million	**Small Businesses**: ≥ 250%

Source: MicroBanking Bulletin, April 2001.

Several practitioner networks such as Women's World Banking, ACCION, and Catholic Relief Services (CRS) establish a specific target to reach, or a set of reference values within whose range their affiliates will need to fall. In addition to prescribing a quantitative result, these networks also closely monitor the downward or upward trend of performance results to ensure that the institution is headed in the right direction. Table 3 illustrates some performance benchmarks that are in use in the microfinance sector today.

Table 3. Some Illustrative Performance Benchmarks
(Women's World Banking, ACCION, CRS)

Indicator	Target	Trend
Monthly reimbursement rate	>90%, >95%	Increasing
Cost per unit lent	35%, 15%	Decreasing
Portfolio at risk (> 31 days)	<10%, < 9-5%, <3%	Decreasing
Portfolio at risk (>1 day)	< 15%	Decreasing
Loan loss	<4%, < 2%	Decreasing
Operational self-sufficiency	90-100%	Increasing
Financial self-sufficiency	70-100%	Increasing

III. How are Microfinance Institution Standards Developed?

The process for developing microfinance standards depends on the type of institution that spearheads the effort, the overall objective of the exercise, and the ways in which the standards will be used. Current standards initiatives can be broken down into three major categories—those led by donor organizations, those led by private sector companies, and those led by microfinance institutions.

A. Donor-led efforts

Donor-led multi-country comparative standards efforts, such as the MicroBanking Bulletin, are essentially defined by the sponsoring organization who then seeks to convince MFIs to participate and supply the data required to calculate the various indicators. MFIs are motivated to do this to develop a higher institutional profile with greater visibility to potential funders, as well as to benefit from the detailed analysis of their operations that is a part of the evaluation. The MicroBanking Bulletin was constituted on a pro-bono basis and has always been fully funded by donors, with CGAP being the primary funder at this date. Institutions send in questionnaires, evaluations and audited financial statements. In return, they receive a detailed financial performance report from the MicroBanking Bulleting team at no cost.

B. Private sector-led efforts

Private sector standards initiatives resemble donor efforts in that the MFIs are being rated or evaluated on a pre-selected set of indicators. The main difference, however, lies in the fact that the organizations involved in these efforts are striving to become a commercial rating company similar to Standard & Poor's or Moody's, where institutions willingly pay a fee to be included in a formal network of certified institutions. The ratings that are given by Standard & Poor's or Moody's tend to be the barometer by which private investors judge the soundness and quality of a company. Because the data reported in the MicroBanking Bulletin are self-reported, with less than 20% of respondents submitting information that have been independently analyzed and verified, a niche market exists for the development of an autonomous rating company to whom potential investors in microfinance could turn to as an arbiter of quality. Two principal actors are currently in this market—PlaNet Finance and MicroRate.[10]

Planet Finance, through its program Planet Rating, provides evaluation and rating services to microfinance institutions using the GIRAFE methodology. The GIRAFE evaluation examines six major institutional areas and includes a total of 26 quantitative and qualitative indicators. The six areas are **g**overnance and decision making process; **i**nformation and management tools; **r**isk analysis and control; **a**ctivities and loan portfolio; **f**inancing (liabilities and equity); and **e**fficiency and profitability. The evaluator utilizes a grid to rank each indicator, from which a final score is derived based on the weighting that is assigned to that indicator. Annex A provides a summary of the indicators under each category and their respective weighting.

MicroRate, formerly known as PSIC (Private Sector Initiative Corporation), is a for-profit private company based in Washington, D.C. whose objectives are to quantify MFI investment- and credit-risk for potential investors or creditors. The company conducts MFI ratings as a commercial venture at a projected price of $5,000 to $10,000 per year. Since its founding in 1997, the company has evaluated over 60 MFIs, most in Latin America, with follow-up missions performed at least once a year for selected institutions to serve as an update.

MicroRate's methodology is "risk driven," focusing on enterprise-critical risk factors such as portfolio at risk, return on equity, and debt to equity ratio. During each evaluation mission, the team interviews all levels of management and personnel, evaluates the management information system, collects and verifies financial and operational data, and samples portfolio quality. MicroRate's evaluation and supervision missions examine the following categories of performance measure: portfolio quality, information systems, internal controls, market environment, financial health of the MFI, and operational efficiency.

C. MFI-led efforts

Standards initiatives that are led by MFIs usually aim to establish prescriptive norms and a common vision. These standards are arrived at through a lengthy and reiterative consultation process at the international level among MFIs adhering to a common network (such as Women's World Banking) or at the national level. The following examples show how two different organizations have approached the standard setting process.

[10] Donor such as CGAP and IDB are encouraging the development of a private market for microfinance ratings and assessment services. This is one of the impetus behind the joint CGAP-IDB Rating and Assessment Fund that was established in May 2001. The Rating Fund will finance 80% (or up to $8000) of the cost of the rating or assessment, and will also finance rating or evaluation updates on a declining basis (60% for the cost of the second update and 40% for the third update).

The Philippine Microfinance Coalition for Standards (PMCS). In 1996, a group of NGOs came together to begin the process of developing nation-wide microfinance standards. The impetus for this initiative came from a core group of MFI directors from two different Philippine networks, who saw that Philippine MFIs were not achieving significant impact in terms of outreach or poverty alleviation. This group felt that in order to make a significant contribution, MFIs in the Philippines had to grow exponentially but that this would not be possible unless there was a widespread improvement in operating standards and principles. With technical assistance from USAID, this group formed the Philippine Microfinance Coalition for Standards (PMCS) and embarked on a two-year process of consultations, meetings, and working groups to convince MFIs of the viability of the project and to arrive at agreed-upon common standards and methods of calculation.

The standards development process used by the PMCS consisted of four key steps: (1) formation of the Coalition itself, which ultimately brought together 69 MFIs, the Central Bank, several commercial banks, research organizations and donors; (2) conducting a national inventory of microfinance institutions along with an in-depth survey of a smaller number of selected MFIs in order to build a database for benchmarking and standards definition; (3) having working groups develop proposals for standards based on international best practices and the results of the PMCS's investigations; and (4) meetings to discuss the propositions and arrive at an overall consensus. In August 1998, this two-year process culminated in the adoption of a basic standard framework.

The framework adopted by the PMCS has two levels. The first is comprised of "Minimum Standards" to which all members must adhere in order to join the Coalition. These are not meant to rate or compare different MFIs but are meant to be the minimum prerequisites for being considered a "serious microfinance NGO." The second level consists of a series of eight performance indicators for which a scoring system is applied to assign numerical scores and attribute weights to arrive at a single overall institutional rating. The framework is provided in Annex B.

The SEEP Network's Performance Monitoring Toolkit. During the past year, the Small Enterprise Education and Promotion Network (SEEP), a network of US-based NGOs working in enterprise development and microfinance, has been working with three MFI networks to develop, test, and produce a toolkit for MFI data collection and benchmarking. The purpose of the toolkit is to facilitate MFI networks in their efforts to establish performance standards and benchmarking tools for their members. Even though the majority of the MFI members are not financed with deposits from the general public and thus are not supervised by government entities, MFI networks have the potential for positive, quasi-external influence on the financial management and performance of their MFI members. Thus, the development of the toolkit will contribute to building the supervisory capacity of MFI networks by providing them with a management tool for evaluating strengths and weaknesses, and a roadmap for improving MFI performance.

Three networks are involved in this initiative: Ghana Microfinance Institutions Network (GHAMFIN) in Ghana, Credit and Development Forum (CDF) in Bangladesh, and the

Center for Microfinance for NIS/CEE[11] in Poland. With the technical assistance of the MicroBanking Bulletin and the USAID Microenterprise Best Practices project, the following tools will be developed:

- a standardized format for financial statements;
- a questionnaire for collecting data on performance; and
- a database that contains forms for data input, enables automatic adjustments of financial statements, and produces a variety of reports.

The next step in this initiative is to hold a working conference in each region to come to an agreement on a core set of indicators, the calculation methodology, and the target for each of the selected indicators. Once standards have been established at the regional level, the toolkit will be pilot-tested by selected MFI members and appropriate adjustment will be made before being rolled out to the wider membership.[12]

Setting Standards in Haiti

As part of DAI/FINNET's objective to strengthen the infrastructure of the microfinance industry in Haiti, the project is working with its key microfinance partners to establish appropriate common standards. Two training seminars were held for partner institutions in December 2000 and February 2001 to discuss the importance of standards, to understand how standards are used, and to examine some international standards that are in use currently. The second seminar was focused on the use of performance standards as tools for decision-making and portfolio management. Through the use of case study, participants learned how to calculate the DAI/FINNET performance indicators, how to analyze the results and interpret trends, and how to use the indicators as warning signals that would warrant preventive action on the part of the MFI.

During the second seminar, consensus was reached on an initial set of core performance indicators for monitoring and reporting according to four categories: outreach, portfolio performance, efficiency, and financial stability. Secondly, a working group was formed, composed of four non-bank partner institutions of DAI/FINNET: ACLAM, ACME, COD/EMH, and MEDA. The working group was tasked with the following mandates:

- to revisit the elements making up the calculation formula for the selected indicators and propose a common definition for these indicators;
- to identify norms for each indicator by referring to standards already established by other institutions, such as ACCION, WWB, CGAP, etc., and make recommendations as to which should be adopted by the four institutions involved; and,
- to develop a system to facilitate the collection of these indicators and to make the information available to the four institutions.

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[11] Newly Independent States/Central and Eastern Europe.

[12] For more information on the SEEP Network's Performance Monitoring Toolkit, visit http://www.seepnetwork.org/

In September 2001, the working group presented the proposed performance indicators and their calculation method to the key personnel of the four partner institutions. These indicators are presented in Table 4 below.

Table 4. DAI/FINNET Performance Indicators

Category	Indicator
Outreach	▪ Number of credit clients
Portfolio quality	▪ Portfolio at risk (>1 day) ▪ Portfolio at risk (>30 days) ▪ Monthly repayment rate ▪ Loan write-off ratio ▪ Loan loss ratio
Efficiency	▪ Cost per unit lent
Financial stability	▪ Administrative self-sufficiency ▪ Operational self-sufficiency ▪ Financial self-sufficiency

Three distinctions were made by the Haiti working group in the selection of indicators that are worth noting:

- Under outreach, the number of credit clients measures the number of *persons* who have an outstanding loan or an *activity/enterprise*, if that activity involves more than one person.
- Under portfolio quality, a distinction was made between loan write-off and loan loss. The former measures the loans that are written off but for which the institution will continue to collect, while the latter indicates the *actual* loan loss amount after taking into account the amount that has been recovered. These ratios assume that the institution follows a procedure where (a) it performs a write off two times a year for all loans that are at least 6 months overdue, and (b) it continues to collect delinquent loans up to 12 months after it became overdue.
- For the financial stability category, a series of three indicators were selected that reflect the evolution of a microfinance institution. Administrative self-sufficiency measures an institution's ability to cover basic administrative costs such as salary, rent, transport, and communications expenses. Operational self-sufficiency measures an institution's ability to cover administrative expenses plus interest charges and provision requirements. Finally, financial self-sufficiency measures an institution's ability to cover the costs comprised under operational self-sufficiency plus the imputed cost of capital, taking into account inflation and market rate for commercial non-concessional financing.

As a starting point, data on performance indicators will be collected for the four institutions. Over time, it is hoped that performance information on other MFIs will also be collected and included in a central database that will serve as a national standard for Haiti. It is envisioned that the existence of standards will not only help to formalize microfinance as a viable industry in Haiti, it will also provide previously unavailable data about Haitian MFIs to interested parties inside and outside of the country.[13]

Conclusion

The emergence of microfinance standards as a major topic of discussion reflects the evolution of microfinance into a more sophisticated and formalized industry, composed of institutions committed to operating along principles consistent with those governing formal financial institutions. The fact that a variety of actors are involved in this standardization process—MFI, networks, donors, private sector—seems to underscore the extent to which "buy-in" about the importance of having comparable measures of performance has been spread.

A major challenge for standards initiatives seems to lie at the practical level of data collection. As the Philippine Coalition found out through their efforts, it was easier to get philosophical agreement on the value of standards than to generate the information necessary to rate the MFIs. For the majority of institutions, some substantial "housecleaning" will need to be done before reliable data could be gathered and made available to the public.

In addition, it is too early to tell whether the existence of standards and ratings will facilitate MFI access to capital markets. While an increasing number of MFIs are beginning to access non-donor private financing and are paying for the cost of funds (albeit still at below market rate), most of the 10,000 microfinance institutions in the world are far from ready to access international capital markets. Having access to performance information may reduce some of the transaction uncertainty, but it remains doubtful whether MFIs would be able to generate the level of return that is expected by investors.

Nevertheless, the first big step has been made and there is now widespread recognition that the industry is heading towards more standardization, transparency, and openness. The foundation has been laid and it is now up to the individual MFIs to build on the existing structure.

[13] For more information on DAI/FINNET's work on standards, please visit the project website at http://www.daifinnet.com.

ANNEX A. PlaNet Finance's GIRAFE Indicators and Weighting

Area of Evaluation	Indicators	Weight
Governance and decision making process (18%)	▪ Maturity of institution	2%
	▪ Balance and efficiency of the governance system	2%
	▪ Technical organization of governance	3%
	▪ Weight of governance in relation to expenses	2%
	▪ Internal skills	4%
	▪ Staff turnover ratio	2%
	▪ Training efficiency	3%
Information and management tools (12%)	▪ Technical support for information systems	4%
	▪ Information management	4%
	▪ Organization of technical departments	4%
Risk analysis and control (12%)	▪ Identification of risks	7%
	▪ Coverage of risks by internal control	5%
Activities and loan portfolio (23%)	▪ Global balance of assets on balance sheet	4%
	▪ Relevance of services	5%
	▪ Loan portfolio management	5%
	▪ Write off ratio	4%
	▪ Portfolio at risk (> 31 days)	5%
Financing: liabilities and equity (12%)	▪ Overall assessment	6%
	▪ Ratio of transformation equities into assets	6%
Efficiency and profitability (23%)	▪ Staff efficiency/work expenses	2%
	▪ Administration efficiency	2%
	▪ Operating efficiency	5%
	▪ Adjusted return on average assets	4%
	▪ Adjusted return on average equity	3%
	▪ Operating self-sufficiency	3%
	▪ Financial self-sufficiency	4%

ANNEX B. Philippines Microfinance Coalition's Performance Standards

Minimum Standards	1. Track Record ▪ Minimum of 3 consecutive years of microfinance experience ▪ At least 500 clients ▪ No unfavorable credit rating for past 3 years 2. Outreach ▪ Must have vision and mission statements with commitment to reach low-income clients ▪ At least 75% of active clients have loans below P 25,000 (US$ 558) 3. Internal Controls ▪ Written internal controls and/or audit manual ▪ External audits once a year ▪ Regular internal audits 4. Operations Manuals exist to govern credit and administration 5. Management Information Systems exist that give timely reports on loan portfolio, outreach, and treasury. 6. Financial statements are produced with an operating plan on at least an annual basis. 7. Loans are provisioned for and written off according to a clear policy.
Performance Indicators	1. Outreach (30% weight) ▪ Number of active clients 2. Collection efficiency and portfolio quality (20% weight) ▪ Repayment rate ▪ Portfolio at risk 3. Sustainability (30% weight) ▪ Operating cost ratio ▪ Operational sustainability ▪ Financial sustainability 4. Capital Adequacy (10% weight) ▪ Capital adequacy ratio 5. Liquidity (10% weight) ▪ Current ratio (current assets/current liabilities)