Davids & Goliaths in International MicroFinance: The Challenge for Specialized Raters[1]

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[1] This paper owes much to an earlier paper on a similar theme, Sinha, Sanjay, 2005. **Market Transparency: The Role of Specialised MFI Rating Agencies**. Paper presented at the 2005 Financial Sector Development Conference on New Partnerships for Innovation in Microfinance, Frankfurt, 23-24 June.

Starting with just two microfinance raters worldwide in the late 1990s, the rating of microfinance institutions (MFIs) has now become an accepted, if not essential, part of the microfinance landscape. The high demand for microfinance ratings in Latin America particularly Bolivia, Colombia, Peru, is complemented by an established rating activity in India and growing demand in other parts of Asia (Cambodia, the Philippines, Central Asia) and Eastern Europe (the Balkan states, in particular). The author's paper presented at the KFW conference in June last year estimated that some 900 ratings had been conducted to this date and that the annual demand for microfinance ratings amounted to some 200 ratings per year. During 2005, approximately 250 MFI ratings were conducted with two specialized rating agencies – M-CRIL and MicroRate – accounting for over 120 ratings. The other two main specialized microfinance raters undertook another 50 or so ratings, a couple of local raters in Latin America undertook another 50 while the remaining 12 of the Rating Fund's accredited institutions rated just two dozen MFIs between them.[2]

Internationally, the demand for microfinance rating services has slowly but steadily grown as an increasing number of these have been commissioned by a variety of clients. These clients include donors such as DFID, HIVOS, Swiss Development Cooperation, USAID and the World Bank. Also, MFIs seek ratings directly at the request of lenders such as Blue Orchard Finance representing the Dexia Micro-Fund and others, as well as by social funds such as Unitus and MicroVest.

Starting with a standard performance assessment of MFIs – covering their governance, strategic, management and financial performance – the microfinance rating industry has devised a set of related products including monitoring reports and quarterly reviews. More recently, assessments of the development impact of MFIs have also become available as social (as opposed to credit) ratings, though some methodologies are still being tested. The increasing importance of social investors in microfinance has also led to experiments with composite ratings of social investment funds. This paper

[2] Author's estimates based on private exchanges with some and informed guesswork in relation to others. Authoritative information on the ratings of MFIs undertaken worldwide is not available.

discusses some of the differences between the offerings of M-CRIL to the microfinance industry and those of other rating agencies as well as setting out the range of products that has emerged as a result of evolving demand.

The paper also addresses the key challenge for the future of the specialized microfinance rating sector. This challenge is the acceptance by large international investors – pension and mutual funds, insurance companies and so on – of ratings conducted by specialized raters rather than by the conventional rating industry with which the investors are familiar but which lacks a specialized knowledge of microfinance.

1 The nature and use of microfinance ratings

Microfinance rating began as separate initiatives by the three main specialist companies. But, a convergence in the criteria and definitions used has resulted from a series of formal and informal consultations amongst these raters. The key parameters assessed relate to the

- Quality of governance
- Nature of products and delivery systems
- Suitability of information and accounting systems
- Efficacy of the control environment
- Quality of portfolio
- Financial performance
- Fund management, including asset-liability matching
- Strategies for expansion and competition

The analysis addresses the issue of risk to varying degrees. There is no longer any major difference in the financial ratios used by the various agencies: all rely on the Technical Guide on ratios in microfinance that was initiated by MicroRate and published by the SEEP Network in 2003. Competition amongst the specialised raters as well as a concern for quality has ensured that the approach to analysis has substantial similarities between rating agencies. The main differences amongst the specialised raters are in the format of their reports. The extent, detail and style of the presentation of information and analysis may be different but the approaches of the agencies are similar while making allowances for differences in context in different regions.

What has not yet emerged is a single standard judgement, rating scale and grading system for rating MFIs around the world. Such a standardised rating scale could facilitate comparison among MFIs rated by different agencies. However, there are substantial similarities between M-CRIL and MicroRate, with the latter adopting the same Greek alphabet scale used by M-CRIL.

The use of microfinance ratings has varied in nature. Using the experience of M-CRIL as an example, the purposes that rating services have served can be broadly classified as

- Initiatives to raise debt financing – from domestic apex funds or international lenders
- Facilitation of seed capital finance for emerging MFIs
- Benchmarking of performance and identification of institutional weaknesses
- [In the early stages of the rating industry] Demonstration to commercial banks of the utility of the rating service, and, more recently,
- Assessment of the social performance of MFIs – in relation to their own missions and overall development goals.

Thus, the demand for microfinance ratings – particularly in Asia – started with

i Initiatives to raise debt financing

M-CRIL's first client, Swiss Development Cooperation in Bangladesh, used the rating as an appraisal for deciding on a guarantee of a Bangladeshi commercial bank loan, Sonali Bank, to an MFI in Dhaka. Similarly, the apex wholesale lender, the Small Industries Development Bank of India (SIDBI) became a major client of M-CRIL through its microfinance division, SFMC.

ii Facilitation of seed capital finance for emerging MFIs

The Dutch NGOs, Hivos and Cordaid, have used M-CRIL's rating for their programmes that provide seed capital to emerging MFIs. Ratings have been used to advise on the suitability of rated MFIs for support under the programme and for determining appropriate capitalisation levels over a three year period. Such ratings have covered an MFI in Kazakhstan, another in Timor-Leste and four MFIs in Indonesia.

In Myanmar, M-CRIL's rating methodology was used to recommend the future capitalisation of three UN-funded microfinance initiatives. At the request of the UNOPS,[3] no specific rating grade was assigned to the MFIs but detailed projections were made to determine the capitalisation requirements of the three projects. In addition, the analysis of performance identified areas for capacity building and institutional development of the projects.

iii Benchmarking of performance and identification of institutional weaknesses

Others have used rating for benchmarking purposes and to identify shortcomings in MFIs' capacity to provide microfinance services in an effective and cost-efficient manner. Essentially, benchmarking compares the performance of the rated MFI with "best practice" norms emerging either from the specialised raters' own databases or by comparison with the international averages available from the Microbanking Bulletin. This exercise requires no extra effort on the part of the rater since benchmarking against the performance of best practice institutions is an essential component of the rating exercise.

- The World Bank neatly incorporated M-CRIL's ratings into its own "Access to Finance" study in Nepal. The ratings of MFIs were used as the basis of a microfinance sector report for that country.
- Friends of Women's World Banking, India (FWWB) has used the rating service to cross-reference the appraisals conducted by its own staff and to identify problem areas in the operations of its MFI partners.

[3] United Nations Office for Project Services – the executing agency for the UNDP-funded programme.

- The Asian Development Bank has used M-CRIL's services to benchmark the performance of its microfinance initiative in Timor-Leste, to identify its weaknesses and to chart a future growth path for the organisation.
- Some large MFIs in Sri Lanka and India have used M-CRIL's ratings to benchmark their own performance and to identify and accelerate institutional development initiatives.

iv Demonstration to commercial banks of the utility of the rating service

- A Bank Indonesia pilot initiative in 2002 funded by USAID/Asia Foundation rated three BPRs (licensed micro-banks) to determine the suitability of M-CRIL's rating methodology as a basis for obtaining commercial bank funding for BPRs. This exercise led to a discussion about the establishment of a joint venture rating agency focused on BPRs. The revenue model for this joint venture is based on the expectation that the commercial banks and the BPRs would share the cost of the rating.
- In Nepal the technical support network, the Centre for Microfinance, commissioned four ratings by M-CRIL in 2000 to determine the utility of the rating exercise for the local microfinance industry.

Overall, ratings in microfinance have been driven largely by investment motives. Most of the specialised raters' activities have contributed to the policy objective of financial market deepening[4] adopted by apex lending agencies, international investors and commercial banks that use the rating service to inform their lending decisions. Much of the rest of the work – whether through the CGAP Rating Fund, or donors such as USAID or the Swiss Agency for Development and Cooperation (SDC) – has either promoted or experimented with the promotion of relationships between commercial investors such as banks or funds and MFIs. To the significant extent that these efforts augment the flow of finance to MFIs, these initiatives also deepen financial markets for low-income clients.

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[4] Financial market deepening occurs when the financial sector, or in this case a specific part of the financial sector, grows faster than the "real" or non-financial sectors of the economy. Where financial market deepening is constrained by policy limitations or other barriers, the financial sector may remain too small, and not be able to play a significant role in economic progress. Initiatives that deepen financial markets or specific parts of financial markets promote growth by reducing costs and expanding access to financial services.

2 Innovations in the product offering

2.1 Credit rating or performance assessment?

A criticism that has sometimes been leveled at specialist microfinance raters by investors and industry observers (such as CGAP) is that specialist microfinance raters undertake performance assessments rather credit ratings. Specific concerns that have emerged in this context are that, unlike traditional corporate raters that attach a safety grade to a specific financial instrument, MF raters do not assess the level of risk attached to the ability of an MFI to service its existing or proposed debt. Thus, specialized raters neither

- Provide an assessment of the level of investment they are expressing an opinion on or attaching a rating grade to, nor
- Undertake asset-liability matching to determine the likelihood of the MFI facing cash flow difficulties in meeting its repayment obligations over the tenure of the debt recommended.

M-CRIL has, from a very early stage, used the MFI's growth plans and its own assessment of the practicality of those plans, to undertake its own projections (summary business planning) of the MFI's immediate future. The emerging projection is not only attached to all of M-CRIL's rating reports, it also serves as the basis for indicating a limit up to which M-CRIL recommends lending to the MFI over the next 12-month period. In effect, M-CRIL attaches a grade to loans/or other investment in the rated MFI up to a certain level of financing <u>and not beyond</u> that level.

Further, M-CRIL's projections take the concern of asset-liability matching into account as an integral part of the process since cash flows must be worked out if reasonable levels of financial deployment are to be determined. More specifically, partly in response to the criticism, M-CRIL has started specifically to present in its reports analyses of asset-liability matching and present and projected current ratios to assure rating users of the validity of the rating opinion expressed.

2.2 Monitoring and desk reviews

Experience (in Asia) has shown that repeat ratings are commissioned at intervals ranging from 12-24 months. The current average interval for repeat ratings undertaken by M-CRIL is of the order of 16 months. Apart from using ratings as a form of appraisal – or at least an important contribution to the appraisal process – a number of rating clients, particularly donors and investors, would like to control the cost of the rating while maintaining a greater frequency than the 16-month average. For this purpose, M-CRIL offers a desk review product. This entails a set of activities incorporating an initial rating visit, followed by the monitoring of MFI performance, both quantitative and qualitative, via quarterly reporting by the MFI to the rating agency. Key indicators include portfolio quality, profitability, operating cost, client drop-outs, staff turnover, management concerns and other operational challenges. Using the information provided by the MFI, the rating agency uses its experience to make a judgement of the MFI's performance and submit a desk review to the client.

Following the investment phase, M-CRIL was asked by Hivos to undertake quarterly desk reviews (based on information provided by the MFI) and periodic rating updates. The object of this process is to enable the MFI to obtain near-commercial funding. The Kazakhstan Loan Fund (KLF) has become the first to graduate in this way from a seed capital partner of Hivos to a borrower of Triodos Bank. This model is also currently being implemented by M-CRIL in the case of MFIs in Indonesia and East Timor (for Hivos), though these institutions are at a much less mature phase of development than the KLF.

Another model is that favoured by SIDBI: MFIs are covered by six-monthly desk reviews that are based on a one-day visit to the organisation and which supplement the findings of ratings undertaken on a 12 monthly cycle.

It is essential on this model that the information be reviewed by the same agency that undertakes the rating to ensure consistency of cross-checking based on first hand knowledge of the MFI. The quarterly review is supplemented by annual rating visits to validate information and reporting systems and to update the rating agency's assessment of the MFI's governance and management capacity.

2.3 Documentation and support to capacity enhancement

To reinforce the sector-wide spread of its activities and strengthen the microfinance industry as a whole, M-CRIL has taken the initiative to aggregate and present MFI level information in its database. An analysis of the performance of the first 50 MFIs rated through end-2000 was published in 2001 and a second analysis of 120 MFIs rated through June 2003 was published as the M-CRIL Microfinance Review in 2004. The third analysis of all MFIs rated until end-2005 is to be published in 2006. The M-CRIL Review has played an important role in setting benchmarks for the rating process in the Asian region, and has also been used by networks (particularly Sa-Dhan in India) to make their members more conversant with industry standards. A comparison of performance indicators like portfolio at risk, operating expense ratio and return on assets, with averages for the best performers from M-CRIL's database, has increased the awareness of standards in the industry as a whole. This has reinforced the impact of the SWOT analysis incorporated in M-CRIL's reports by encouraging and enabling the design of capacity building and systems improvement programmes by the MFIs themselves and by their donors/investors. MicroRate also produces an analytical review of the performance of the MFIs it rates in a periodic publication entitled The Finance of Microfinance.

During 2002, M-CRIL expanded and documented its accumulated knowledge on systems and best practices in microfinance, starting in India. This was undertaken for a selection of the country's leading MFIs using good practice in various aspects of microfinance operations.[5] The practices covered include governance and institutional linkages, operational strategy, products and delivery mechanisms, management information systems, internal control for risk management, financial management and accounting policies and human resource management. The document that emerged was published in a user-friendly format and disseminated through a national-level workshop attended by

[5] Supported by End Poverty Foundation, California.

a large number of MFIs from the South Asian region and followed by extensive mailing. Feedback from users indicated that the report was well received, making a significant contribution to learning about good practices in microfinance operations.

2.4 Social rating

The social and ethical basis for microfinance as an activity creates a need to rate and benchmark peer groups on non-financial dimensions. For instance, peer groups can be developed on the basis of

- mission alignment and clarity: those whose mission addresses widely held "development values" of concern to ethical investors,
- depth of outreach: the proportion of clients who, when they join a microfinance programme, may be categorised as poor or very poor, and/or
- financial inclusion: the proportion of clients belonging to identified marginal groups in a country or region, including those previously excluded from formal financial services, women, micro-entrepreneurs; operations in remote or underserved areas.

However, there are far more difficult methodological and definitional issues here than there are in peer group benchmarking based on size, clientele and modes of delivery, presenting a highly complex challenge. In particular, social mission and goals are usually seen as something unique to each institution in comparison with financial goals which appear more easily standardised. Or at least they appear so now, after several years of debate around the key indicators for profitability, sustainability and efficiency.

Recent microfinance research has focused on developing a clearer understanding of social performance and defining relevant indicators and methodologies for social assessment.[6] Rating agencies are responding by providing a separate assessment of an MFI's social performance which can be viewed side by side with the credit rating. A social rating is designed to assess whether an MFI

[6] The main approaches are by CERISE (Social Performance Indicators Initiative) and the Imp-Act programme (Social Performance Management)

adheres to its (explicit or implicit) social mission and has systems in place to ensure this, consistent with accepted values of social responsibility. The rating includes an assessment of outreach – to underserved areas and poor clients – and appropriateness of products.

A framework for social rating, derived from different initiatives in progress, is given in **Box 1** below and reflects a consensus of the specialist rating agencies and others.

The social rating is undertaken via staff discussions, systems review, and analysis of available data and study reports. The approach developed by M-CRIL includes a field-level sample survey and focus group discussions carefully designed to provide a socio-economic profile and substantive feedback from clients.[7] This is the '*fat*' or comprehensive approach and has evolved, incorporating ideas from the framework of the CERISE social performance indicators initiative and the Imp-Act programme based in the UK. A '*thin*' approach, is also being tested. This relies on proxy indicators available from MFI data – such as the 'number and range of products' for product appropriateness, and the ratio of average outstanding loan to per capita GNI for depth of outreach – without independent field assessment.[8]

[7] Details are posted on the M-CRIL website, www.m-cril.com

[8] These proxies however are relatively weak indicators, primarily reflecting the supply side. The type of products provided by an MFI are partly determined by local regulation, as well as the stage of evolution of the MFI. In the case of average loan outstanding, various studies have shown that small loan sizes do not necessarily deter the non-poor, due to their limited access to alternative credit. Imp-Act studies; EDA, 2004.

Box 1

A Framework for Social Rating in Microfinance[9]

Social rating is a tool to determine whether an MFI is achieving or is likely to achieve its social mission, and whether it is in line with commonly accepted social values. Various initiatives relevant to social rating, or social reporting, are currently in progress. Organisations involved in these initiatives, particularly the specialist rating agencies, have shared their experiences with a view to identifying areas of convergence and agreeing on a common framework. The framework comprises elements of governance and management, social responsibility, and achievement of social goals.

The key dimensions of this common framework for social performance are as follows, along with some of the relevant parameters:

Social Performance Management [SPM]: clarity and internal communication of mission; consistent alignment of governance, strategies and systems to social mission (including reporting, use of MIS, HR policies and incentives)

Social Responsibility to CLients [SR-CL]: issues of transparency, communication and ethical practice; options also for Non-Financial Services [NFS], Gender Approach [GA] and Member Governance [MG]

Social Responsibility to CoMmunity [SR-CM]: community investment, policy on activities provided micro-credit

Social Responsibility to Staff [SR-S]: employee policies, pay and benefits

Social Responsibility to Environment [SR-E]: environment related polices and types of enterprises provided micro-credit

Social Goal – Outreach [SG-O]: depth and width of outreach – number of clients, proportion of clients who are poor when they join a programme; operations in regions at different levels of development; indirect outreach through employmen in credit supported enterprises

Social Goal – Appropriate Financial Services [SG-AFS]: range of financial products, alignment with client needs and capacities

Social Goal – Change [SG-C]: the effects of microfinance services – indicators linked to the MFI's social objectives, and to wider development objectives as reflected in the Millennium Development Goals (primarily poverty reduction)

The acronyms are a first start to develop a notation for social performance which can be the counterpart of the notation of financial performance (FSS, OSS, OER, PAR).

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[9] This reflects discussions of the sub-committee on Social Rating and Social Reporting, of the Social Performance Task Force. Members of this sub-committee include the specialist microfinance rating agencies (M-CRIL, Planet Rating, Microfinanza, Micro-Rate) and other related/interested initiatives (Accion, USAID-AMAP, CERISE, Imp-Act, Integer, SIDI). This sub-committee is chaired by M-CRIL.

[10] Details are posted on the M-CRIL website, www.m-cril.com

[11] These proxies however are relatively weak indicators, primarily reflecting the supply side. The type of

products provided by an MFI are partly determined by local regulation, as well as the stage of evolution of the MFI. In the case of average loan outstanding, various studies have shown that small loan sizes do not necessarily deter the non-poor, due to their limited access to alternative credit. Imp-Act studies; EDA, 2004.

The comprehensive approach to social ratings requires a unique set of field level research and assessment skills. M-CRIL was able to launch this product because of the experience of EDA Rural Systems, its parent organisation, in research on the impact of microfinance programmes. The first social rating was undertaken by M-CRIL/EDA in December 2004. The report is posted on the CGAP website[12] and M-CRIL has now undertaken six other social ratings of MFIs. The service is available to MFIs, donors and investors in conjunction with credit rating or as a stand-alone assessment. Two of the other specialised raters – Planet Rating and Microfinanza – have also undertaken initiatives to develop social rating instruments and benchmarking systems drawing upon the work of the CERISE initiative and the Imp-Act programme.

3 Challenges in Microfinance Rating

Microfinance rating has been available as a commercial service for approximately 8 years. During this time, the rating of MFIs has become well established and recognized as a professional service internationally. While most donors and development banks are now willing to accept a rating by a specialised agency, many more traditional investors such as pension and private investment funds, large corporations as well as individual investors are not yet willing to do likewise. Such investors are more accustomed to using the ratings of the traditional corporate rating agencies for making "traditional" investments in international equity and debt markets but are unfamiliar with both the product and the skills of specialised rating agencies for MFIs.

For this reason, it is possible that as MFIs improve and professionalize they may increasingly use public credit risk rating services offered by corporate raters. In this context, the positioning and viability of specialised MFI rating agencies could become an issue. However, the main reason MFIs may increasingly use public credit risk rating services is that the ratings of the specialised agencies are not accepted by international commercial investors and by regulators. The response to this situation so far by the international microfinance support agencies, such as CGAP, has been to devote development resources to encourage the traditional

[12] See Social Rating of Bullock-Cart Workers Development (BWDA) on www.ratingfund.org

corporate agencies to rate MFIs in addition to the Fund's support for the specialised agencies.

Yet, the commercial logic of this strategy of luring traditional raters to cover MFIs is doubtful. The corporate rating agencies are large organisations with turnover in hundreds of millions of dollars, while the microfinance rating business – with about 200-250 ratings conducted per year – is currently worth perhaps no more than $2.5 million a year. It is difficult to see the corporate agencies treating microfinance rating as anything more than a niche service offered for "social" rather than commercial reasons and, therefore, treated as a peripheral rather than a mainstream activity with minimal resources devoted to understanding microfinance. The logic of the IDB-CGAP Rating Fund accrediting as many as 16 agencies for a $2.5 million market is questionable. If each employed an average of just 4 microfinance analysts, there would be about four ratings per analyst-year to go round! As it is, even some specialist raters undertaking fair numbers of ratings find it difficult to break-even…

For specialised agencies, on the other hand, microfinance is their main or unique area of specialization ensuring that they make an intensive, undiluted effort to understand microfinance and its risk profile. Since rating is an ethics and confidence-based business, the leading specialised MFI raters have been careful to build confidence in their product and go out of their way to deliver high quality, trustworthy assessments with careful analytical orientation and independent rating committees to oversee and validate their findings. In this, as much as in their technical competence, they have matched the standards of the worldwide rating industry. Therefore, CGAP and other development support institutions would do well to use their resources to encourage both regulators and commercial investors to accept the assessments of those specialised raters that have demonstrated commitment and skills for microfinance rating. This would be a far better fulfilment of their development mandate than chasing the elusive goal of persuading corporate raters to take the very small microfinance rating market seriously.

Furthermore, while the specialised rating agencies have the knowledge, skills and commitment to microfinance to develop new products like social ratings, corporate raters have neither the specialised knowledge nor the incentive to innovate in this way. This represents another contribution to serving the interests of social investors in microfinance – a matter that is better understood by specialised raters.

The main issues that need to be addressed here are the international investors' concerns that

i. Microfinance raters do not have the large database of information on the performance of different asset classes that traditional raters have built up over their decades of experience with rating different types of institutions and companies
ii. Specialised microfinance raters – even the four main raters, M-CRIL, MicroRate, Planet Rating and Microfinanza – have different rating scales and it is difficult to make a clear comparison between their assessments to select a potential MFI for investment (or lending) over another MFI assessed by a different MF rater.

i Microfinance rating databases – *where specialised raters score over the others*

Since microfinance, as an investment opportunity, is a relatively recent phenomenon, the perception that traditional rating agencies would be able to relate MFIs as an asset class to their 'large' databases is almost certainly misplaced. To the extent that substantial information on microfinance is available and to the extent that any trend information at all is available, this information is available with the specialised raters. M-CRIL's database now extends over 8 years of performance for some MFIs and now covers some 250 MFIs in Asia and beyond. Similarly, MicroRate's database covers a substantial number of MFIs – particularly in Latin America – and incorporates information over a number of years for a significant number of these. No traditional rater, however large, has access to the volume of information about microfinance that M-CRIL and MicroRate have access to. On this basis, as in the matter of direct knowledge about and experience of microfinance, it could be argued that the specialist raters are far better suited to assessing MFIs than are the traditional rating agencies.

Further, it is the common practice internationally for investors to use more than one rating of the same company/institution to inform their decision making. If lack of familiarity with the MF raters' competence and track record is the issue for investors, there would be a case for the larger MFIs around the world, such as ACLEDA Bank or Equity Microfinance Bank, to obtain ratings from both a traditional rater and a specialised rater. This would enable investors to see how the MFI fares on a scale that is familiar to the investors and, at the same time, to see how the MFI performs in relation to other MFIs through the medium of the specialised rater. In Asia, only a few such as BASIX in India, have tried this. What emerged were very similar assessments of the MFIs' systems but the resulting risk perceptions were very different. M-CRIL rated BASIX highly for being a professional organisation with a high ability to cope with the conditions of the rural economy, whereas the corporate rater gave a low grade on its perception that an institution that worked with the poor was "inherently risky". Hence, inevitably, microfinance would be forever condemned by corporate raters to be below investment grade. This in spite of the fact that portfolios at risk in the better MFIs rarely exceed 10% while banking portfolios all over Asia carry non-performing loans of anything up to 30%.

Only if the strategy of undertaking dual ratings, as well as other means of increasing contacts between MF specialised raters and international investors were to be promoted over time, would the familiarity of investors with the MF raters' product grow. A greater focus of CGAP and other international development institutions on such a strategy would better serve the interests of the microfinance sector than merely persuading corporate raters to set up microfinance rating teams.

ii **Rating scales –** *need to develop a comparison matrix*

Comparison of rating scales is an important and legitimate issue for international investors faced with a range of choices for investing in MFIs in different parts of the world. Comparability would certainly be an issue for MFIs assessed by different raters in the same way as it is an issue for companies (or, indeed, countries) receiving ratings from more than one rater or for different companies assessed by different traditional raters. In the latter case, a comparison between the ratings of different agencies is facilitated by a matrix developed specifically for the purpose of making such comparisons. A similar solution can be devised in the case of microfinance ratings. As it is, the ratings of M-CRIL and MicroRate have a high degree of comparability on account of an exchange of information between these two agencies about methodologies and rating scales; bringing the other two agencies into the same bracket would not be a major task provided a coordinated effort is made. This is a role for the Rating Fund in its closing months, during late 2006 through 2007. The result is likely to be a matrix of rating grades awarded by the leading MF raters and how these grades compare with each other in terms of the performance of the MFIs assessed. This ought to dampen considerably the concern about comparability.

The final (and ultimate) challenge for some specialised raters is the **challenge of sustainability**. This is an issue of revenue (in terms of what the market is willing to bear) relative to the cost incurred by the raters. It has become apparent over the past few years that the international market (at its current size and level of demand) stretches relatively easily to the level of $10,000 to $12,000 of revenue per rating but that there is some resistance beyond that level. This level works for those raters in relatively low cost locations in Latin America or Asia but not for those based in Western Europe or North America. This is a challenge that is being addressed through some specialised raters establishing offices, or placing rating analysts, in locations like Peru and Senegal. Whether or not the model of placing analysts in different locations while maintaining a head office in an expensive city will work is yet to be seen.

To conclude on the matter of the sustainability of specialised raters: The main issue is not the possibility of a takeover of the MFI rating market by corporate raters. On the contrary, the current state is a market caught in limbo: specialised raters being unacceptable to private investors largely because of the latter's lack of knowledge and familiarity with the former's commitment and skills, while corporate raters drag their feet over an unviable market scenario of MFIs that they, in any case, regard as "inherently risky" on accounting of working with low income families. The solution to the problem must be a concerted effort by both the specialised raters and, as a public service, by microfinance support organisations like CGAP to increase the familiarity of investors, central banks and regulators with specialised microfinance raters who have clearly demonstrated their knowledge of and commitment to microfinance market development.

[Revised, 25 June 2006]