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**Introduction: Social Grading Of Microfinance Banks/Institutions**

The concept of micro-financing is a growing phenomenon which aims at poverty alleviation and empowering individuals through the generation of sustainable livelihoods. Microfinance is available through Microfinance Institutions (MFIs), which range from small nonprofit organizations to larger banks, called Microfinance Banks (MFBs). For the purpose of this methodology, both MFBs and MFIs will collectively be referred to as MFBIs. Rapidly expanding MFBIs over the last decade, are playing an important role in the extension of financial services to the under and un served particularly in the rural and low economic parity parts of the country. Beneficiaries of micro-finance generally comprise of small traders, agriculturists, entrepreneurs and self-employed skilled workers who are otherwise marginalized by the formal financial system due to their very low value unit borrowing demand making them largely unable to access commercial banks. Growing demand opportunities, an enabling regulatory environment, innovation in products & technology and an increasing interest of both domestic and foreign investors have been the main drivers for the healthy development of the microfinance sector.

The concept of micro finance is not confined to the extension of micro loans but encompasses the full range of financial and structural support services extended to the poor. The MFBIs are being assessed on their financial performance for a considerable period of time through their credit rating process which largely captures the MFBIs relative positioning for access to credit, however it is unable to capture their social performances, a prime objective of their existence. VIS has initiated an innovative grading product to evaluate these institutions against common benchmarks in the area of socio-economic impact along with readiness and efficacy of the organizational structure in achieving the desired impact.

Given that MFBIs seek funding from sources other than credit/deposit markets, and because the funds obtained may have social considerations attached, it may be helpful to provide a grading of MFBIs operating in the country, to channel special-purpose funds, other than credit. It is therefore important to differentiate institutions by the community influence they exercise and through their impact on the social and economic uplift of the beneficiary persons and areas.

**Social performance indicators are useful for:**

- (a) owners/investors: to assess the social achievements against targets;
- (b) donors: to evaluate the social impact level of an MFBI;
- (c) regulators: make alignments in regulatory environment to maximize the social impact of MFBIs.

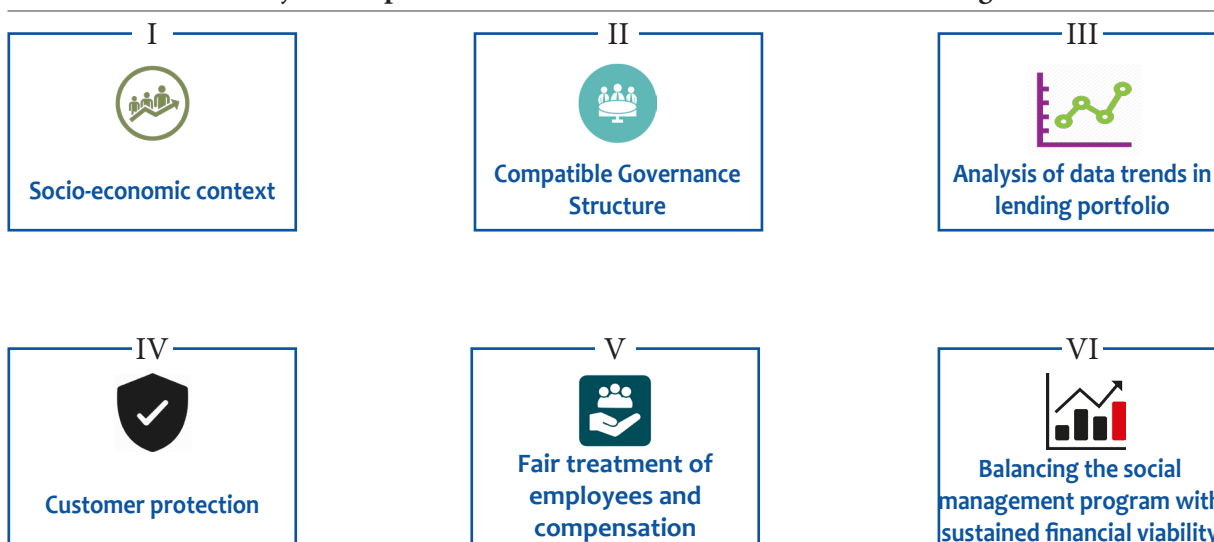
The underlying methodology seeks to capture the relative social performances of MFBIs against internationally accepted social performance benchmarks and their ranking on a social grading scale. Socio Economic grading aims to work in conjunction with credit ratings to provide an overall picture of the financial and social impact of MFBIs in an economy and in the process tacitly indicates imbalances, if any, between the two.

This methodology measures the social, economic, community and gender impact created by individual MFBIs. The grading assigned under this methodology are titled as Socio-Economic Performance Grading (SPG) that measures the social performance of an MFBI and the likelihood that an MFBI meets social goals in line with acceptable social

values. SPG is a 6 point scale, qualified by a plus where warranted. The grading align institutions along a scale of “excellent” to “inadequate” and provides an opinion on the relative maturity of the organizational structure and its demonstrated capacity to achieve socio-economic objectives. For the convenience of MFBI, SPG methodology is designed as a predominantly objective exercise giving the flexibility to clients of submitting information in tranches and online; its evaluation will be largely conducted offsite. To complete the SPG exercise, a number of references such as Human Development Index of UNDP for Pakistan and other published data for district level geographic economic parity assessment and geographical dispersal are to be used.

VIS believes certain qualitative factors play an important role in determining the stability and predictability of an MFBI’s social performance over time. Its assessment approach therefore includes both qualitative and quantitative analyses. VIS has identified six broad parameters, into which the grading imperatives can be split. These are further divided into sub-parameters and factors to analyze in detail the processes and practices followed by the MFBI. VIS acknowledges the references it has drawn from published international resources available on the subject.

### Major Components of Socio-Economic Performance Grading



### KEY SOCIO-ECONOMIC PERFORMANCE GRADING ELEMENTS

#### 1. SOCIO-ECONOMIC CONTEXT

The social performance of any MFBI is largely based on its ability to achieve the national socio economic objectives of poverty alleviation, enhancement of financial inclusion and reaching the under/un served. The extent of social versus profit orientation varies across institutions. As a consequence, the first step in SPG is the understanding of the vision statement of the MFBI being graded. The vision statement is assessed for its level of consistency with the national objectives of poverty alleviation through economic uplift of weak regions/areas along with a focus on financial inclusion and gender balance. The completeness and objectivity of contents covering these goals is evaluated by VIS.

The mission statement is assessed for its focus on under/un served individuals, fair play and quality of service and identification of a target market. These objectives should be defined in clear terms and constitute the terms of reference for the board of directors (BoD) in their actions. The mission should also be achievable in nature and be in keeping with the needs of the society in which the MFBI is functioning. Once the mission has been examined, the adherence to it has to be judged, along with the capacity of the MFBI to implement it in letter and spirit. Numerical targets in mission statements for achieving certain performance indicators are important in assessment.

## 2. COMPATIBLE GOVERNANCE STRUCTURE

VIS reviews the process by which the BoD guides an MFBI toward fulfilling its social mission, and how an MFBI reinforces board members' knowledge and commitment to social performance.

- **Leadership**

The composition of the board in terms of extent of related field's experience and expertise are important grading drivers. The frequency of board and board committee meetings and discussion on social performance indicators is reviewed. Among the various performance areas assessed by the board, geo economic dispersion, gender balances, disbursement volumes and fair pricing in lending products/services against targets are of particular importance from a grading perspective.

- **Exposure of board members**

Participation of board members in to social management awareness programs and forums is also taken into consideration. Review of the aforementioned social indicators at the management committee level is also assessed in terms of extent of coverage, depth of discussion and frequency.

- **Internal control framework:**

The extent and level of coverage of internal control framework for monitoring of socio-economic performances are important to determine. The methodology also focuses on the handling of conflict of interest at various delivery points through documented policies and declarations and their cross check in the internal control framework.

## 3. ANALYSIS OF SOCIAL TRENDS IN PORTFOLIO

A significant analytical tool in assessment of social grading for MFBI is the review of the social trends in their lending portfolio. It is endeavored here to capture the data by the basic geographic unit i.e district level with in the country. The review of these trends focus on the areas of operations of MFBI which disclose the social impact of the lending operations of the same.

- **Geo economic dispersal**

The assessment starts with the geo economic dispersal of the lending portfolio to assess the coverage awarded to weak economic areas. The amount and number of disbursements in low economic parity districts is compared with total disbursements to determine the social impact of lending. The trend in year over year and cumulative disbursements by economic parity is also noted.

- **Gender balancing**

Gender balancing is the next social indicator to be assessed to determine the extent of women clientele in financial inclusion, particularly in weak economic areas. The amount and number of disbursements to women in the low economic parity districts in relation to total disbursements in all districts is a social grading determinant.

- **Geographic coverage**

Geographic coverage of MFBI lending outreach is also an important grading rationale; the assimilation of this data with the economic parity level of the area provides an important tool for social grading. VIS looks at the overall distribution of the branch network in terms of the trend in total branches outstanding and those in low economic parity districts. The branch expansion strategy is also studied with respect to the number of branches opened in low economic parity districts versus high economic parity districts. With respect to MFIs holding national license, VIS also analyzes the provincial concentration of loans disbursed.

- **Pricing**

Lastly, for an MFBI to achieve its social mission, it is important to ensure that pricing of products is affordable to the client while allowing for MFBI to be financially sustainable. Accordingly, fair pricing in lending products/services offered is evaluated through analysis of concentration in pricing and type of loans by amount and number of loans disbursed. Pricing data of the loans is gathered along with asset class distribution of loans to understand the competitiveness of lending and the focus areas of lending. Loans for productive purposes are more important to enhance the revenue stream of clientele in under served areas.

#### 4. CUSTOMER PROTECTION

The client base of MFBI's largely comprises of individual with some group lending. The clientele is generally from low income group with little or no prior experience of documented borrowing. Given the afore and their weak educational background, their fair treatment and protection from undesirable borrowings is an important social grading ingredient. Three grading attributes are important here:

- **Structured avoidance of miss/over selling, documentation understanding and ease; and awareness programs to select suitable loan products. Debt burden recognition and matching with client resources.**

VIS examines an MFBI's written policies as they relate to customer protection issues. Existence of a code of ethics/policies defining the ethical and professional standards for employees is considered important. Key guidelines include fair and respectful treatment of the client, avoidance of over-selling and prevention of over indebtedness. Pricing transparency which refers to how well customers understand the all-in cost of loans or other product offerings, can be evaluated through brochures, loan documentation and awareness programs conducted by the MFBI. Moreover, loan evaluation documents are examined for the quality of their guidelines and the quality of income/debt evaluation of borrower. The loan approval process is examined in detail to ensure that the process is objective and tailored to the needs of the client. Availability of loan documentation in native language adds to social grading.

- **Customer retention ratios and feedback surveys. Privacy of customer's loan and deposit data.**

An evaluation of customer retention entails how an MFBI handles customers that are leaving or opting out of certain products, including its use of exit interviews, surveys or other methods that can help identify customer dissatisfaction. The contents and scope of customer data privacy policy and implementation status is reviewed.

- **Extent of community support programs. Customer complaint handling mechanism and its awareness.**

VIS looks to see how effectively an MFBI's management monitors customer complaints and complaint resolutions. It is assessed whether customers are appropriately informed and encouraged to give feedback and make complaints. Apart from this, a review of whether an MFBI is involved with its target community in ways other than those directly related to its core business such as community involvement, is also conducted.

#### 5. FAIR TREATMENT AND COMPENSATION

The role of human resource of an MFBI is an essential ingredient in its social performance level determination. A motivated and competitively compensated human resource, well aware of the social performance objective is important. Human resource strength assesment is drawn from the following two grading attributes:

- **Well-developed HR function with fair and disclosed policies.**

The social mission of an MFBI encompasses not only its customers but also the employees that work for it. Accordingly, the depth of human resource (HR) function in terms of Board level policy formation and review and Management level oversight in implementation of policies is important. The coverage of HR policies in terms of gender balance, promotion of merit and institution of work ethics is evaluated. The recruitment mechanism should entail a well-defined policy, a documented and transparent recruitment process with focus on merit and no gender bias is among the grading drivers. Employee satisfaction surveys at regular intervals add to the efficacy of the HR function and social grading.

- **Competitive compensation, grievance handling and job satisfaction.**

The extent of women and ethnic minorities' representation is compared with the general population, and the extent to which equal opportunities are available to them is taken into grading consideration. Other areas measured by VIS include the extent of training opportunities provided, employee turnover ratios and mechanism for performance incentives. The structure and access to employee grievance redressal system is analyzed to determine its effectiveness. In employee performance evaluation use of social performance achievements/benchmarks is also a grading factor.

## **6. BALANCE FINANCIAL AND SOCIAL PERFORMANCE**

It is considered imperative that an MFBI's targeted growth rates are sustainable regardless of its overall mission. Sustainable growth allows an MFBI to maintain good customer service, respect clients' rights, and ensure manageable workloads for employees. Accordingly, VIS examines if an MFBI has firstly set sustainable growth targets and secondly, if it monitors financial indicators such as number of loans outstanding, infection ratio, productivity and outstanding portfolio on a periodic basis. Presence of social performance targets in annual plans is also important along with the monitoring of spreads in social lending products. Financial analysis of social impact with the extent of CSR activities are also taken into consideration. The visible adoption of "double bottom line" approach is considered an important ingredient in managing financial risk along with social achievements.

### **SPG SCALE & VALIDITY**

Based on the six assessment areas for socio economic performance grading identified above, comprehensive data and document/information collection is undertaken for each of the sections. The data/information collection is designed for offline and/or online submission of data/information. Special focus is placed in data collection on social data trends in lending portfolio where data and its trends relating to Geo Economic Dispersal of Lending, Gender Balancing of Loans, Geographic Representation of Branches and Pricing and Distribution of Loans is comprehensively obtained in timeline tabular format to facilitate determining its ranking in the published geo-social district wise data for economic parity and available human development index.

VIS SPG Scale extends from SPG1A to SPG5. SPG1A may be assigned to MFBI's with Excellent organizational focus on social responsibility with portfolio exhibiting extensive financial inclusion in underserved areas with advantageous gender balance. A robust socially oriented HR structure delivers ethically and competitively its business products. SPG 5 is assigned to institutions with inadequate organizational focus on social responsibility with portfolio exhibiting low financial inclusion in underserved areas with weak gender balance. HR structure is inadequate in social and ethical orientation to deliver its business products. The details of SPG Scale and definitions of each grade are provided on the following page. The grade assigned to an MFBI will be valid till such time as withdrawn and is reviewed generally on an annual basis. VIS may at any time deem necessary to change the grading assigned to the firm depending on changes to corporate practices affecting the social performance profile of the institution.

## GRADING SCALE & DEFINITIONS: [SOCIO-ECONOMIC PERFORMANCE GRADING](#)

### **SPG 1A**

Excellent organizational focus on social responsibility with portfolio exhibiting extensive financial inclusion in underserved areas with advantageous gender balance. An exceptional socially oriented HR structure delivers ethically competitive business products.

### **SPG1++, SPG1+, SPG1**

Strong organizational focus on social responsibility with portfolio exhibiting extended financial inclusion in underserved areas with favorable gender balance. A robust socially oriented HR structure deliver ethically competitive business products.

### **SPG2++, SPG2+, SPG2**

Sound organizational focus on social responsibility with portfolio exhibiting well distributed financial inclusion in underserved areas with equitable gender balance. A sound socially oriented HR structure delivers ethical business products.

### **SPG3++, SPG3+, SPG3**

Adequate organizational focus on social responsibility with portfolio exhibiting fairly distributed financial inclusion in underserved areas with adequate gender balance. A socially oriented HR structure delivers its business products in a fairly ethical and competitive manner.

### **SPG4++, SPG4+, SPG4**

Weak organizational focus on social responsibility with portfolio exhibiting weakening of financial inclusion in underserved areas with fading gender balance. HR structure needs improvement in social and ethical orientation to deliver its business products.

### **SPG5++, SPG5+, SPG5**

Inadequate organizational focus on social responsibility with portfolio exhibiting low financial inclusion in underserved areas with poor gender balance. HR structure inadequate in social and ethical orientation to deliver its business products.



### Faheem Ahmad

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*Founder, VIS Group*

*Chairman, Association of Credit Rating Agencies in Asia*

Mr. Ahmad possesses 30+ years experience in financial risk assessment with focus on Islamic finance, venture capital and general management. He has top level management experience at international level in the fields of credit ratings, Islamic and conventional financial risk assessment modeling, industrial management and construction engineering. Mr. Ahmad is an active participant at international forums on Credit Ratings. He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters Degrees in Engineering and Business Administration from USA.



### Javed A. Callea

*Advisor*

Mr. Callea is a professional in the financial sector with over 35 years of experience mostly in the financial institutions with certain exposure to service and infrastructure sectors in Pakistan. He has held the position of Chief Executive of a leasing company for 10 years. His core areas of expertise cover leasing, development financing, project management, investment & merchant banking, strategic investment management and real estate. Major financial institutions he worked for include Pakistan Industrial Credit and Investment Corporation, State Life Insurance Corporation, Bankers Equity, Crescent Leasing Corporation and Saudi Pak Ind. & Agri. Inv. Company. He has also served as Member Finance of Water & Power Development Authority of Pakistan and as member of the Inquiry committee on stock exchange crises in 2000 commissioned by the SECP. He earned his MBA degree from the Institute of Business Administration in 1974.



Jahangir Kothari Parade (Lady Lloyd Pier)

Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose generosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

*Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.*

*Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.*



Jahangir Kothari Parade

## National Excellence, International Reach

VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors.

The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, VIS continues its endeavor to remain an emblem of trust.

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