

SOCIAL RATING METHODOLOGY OF MFI & NGO

OVERVIEW AND SCOPE

Social rating is defined as the opinion on how a financial institution performs its financial and social goals (i.e., social performance) and probability of the financial institution to implement and achieve its mission in line of standard social values.

Social value is a part of the society's culture, guidance or standard for social conduct to maintain the stability and uniformity of social order. While social value helps us measure relative importance in the changes experienced throughout one's life, it is neither directly observed in the market price nor measured in the same way the financial value. As a result, social value should be assessed from the perspective of those affected by an organization's work (www.socialvalueuk.org/what-is-social-value/). For social rating purpose, social values encompass:

- Sustainable access to financial services to underprivileged people in the society for improving their living standard,
- Creating benefits for clients
- Implementing client protection measures
- Responsibility of staff, the community and environment

WHY SOCIAL RATING

Social ratings are developed and growing in demand from MFIs and investors over the last decade (since 2008). They are now globally accepted platform for the investors to scrutinize social performance management in light of the international standard. While the credit rating can only perform financial measurement of credit worthiness, social ratings go beyond those financial values by quantifying social impact of the financial institutions on the human lives. Social ratings are useful tool for:

- Assessing the social performance in alignment with mission, vision and goals
- Analyzing and asserting the social performance management for effectiveness of the MFIs and NGO
- Evaluating the social performance in comparison with standard, norms, peers in the industry
- Demonstrating the scope of improvement in social performance
- Communicating with investor for understanding the policies and procedures of implementing MFIs mission, vision, social development activities
- Providing objective information on social performance risk profile of the MFI to the investment decision maker
- Ensuring transparency of the MFIs for capital flow to MFI

SCOPE AND LIMITATION

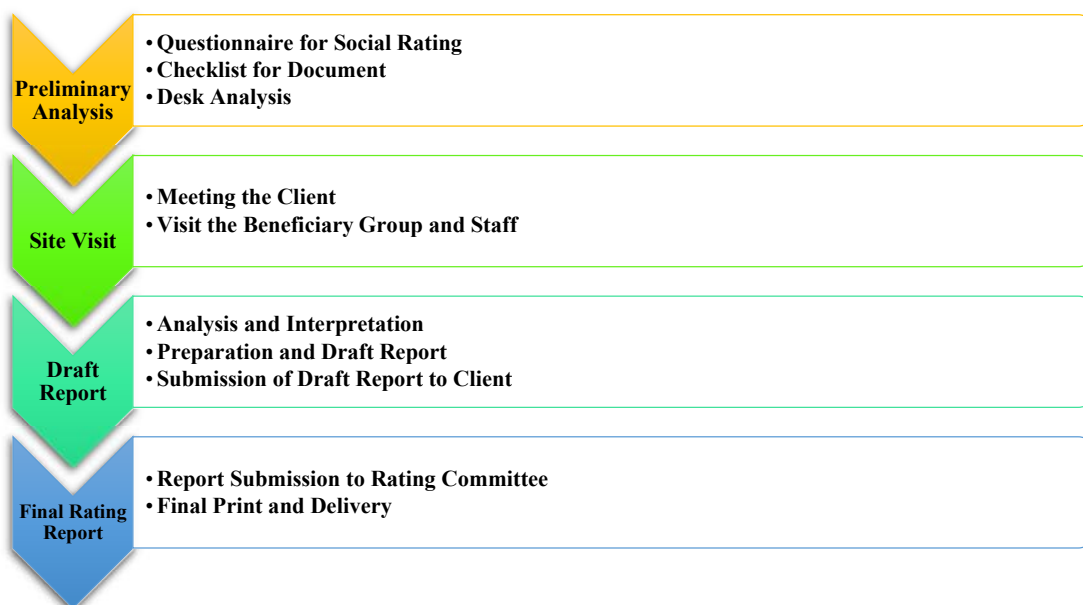
Social rating can be applied to all types of financial institutions and for those entities with double bottom line profitability i.e., financial profit/ loss and social return/impact. NCR has developed proprietary social rating methodology based on the guideline provided by The Rating Initiative. This methodology developed by NCR is applicable and used to appraise MFIs and NGOs active in Bangladesh.

The rating agencies require awareness of the international standard for social performance measurement and social performance task force for alignment with social rating methodology. In addition, social rating methodology requires development within country context, which is ignored here. Further, to

assess the social impact, client and staff survey need to be conducted. However, NCR may use small sample for client and staff survey, and thus the data sample may be biased.

SOCIAL PERFORMANCE MEASUREMENT FACTORS

Based on the social rating guideline outlined by The Rating Initiative, there are six elements examined for social rating of an entity. They are depicted in the following diagram:



RATING SCALE DEFINITION

Rating Scale	Social Rating Definition
AAA	Excellent social performance and financial practice, highest level of commitment to its mission and highest chance to meet the social mission
AA+, AA, AA-	Very Strong social performance and financial practice, very high level of commitment to its mission and very high chance to meet the social mission
A+, A, A-	Strong social performance and financial practice, high level of commitment to its mission and high chance to meet the social mission
BBB+, BBB, BBB-	Adequate social performance and financial practice, moderate level of commitment to its mission and moderate chance to meet the social mission
BB+, BB, BB-	Inadequate social performance and financial practice, low level of commitment to its mission and low chance to meet the social mission
B+, B, B-	Low social performance and financial practice, low level of commitment to its mission and low chance to meet the social mission
CCC, CC, C	Very Low social performance and financial practice, very low level of commitment to its mission and very low chance to meet the social mission
D	Lowest social performance and financial practice, minimum level of commitment to its mission and lowest chance to meet the social mission

QUALITATIVE FACTORS

Goals and Strategies

MFIs goal and Strategies are quite crucial to comprehend the span of operation. In essence, NCR scrutinizes:

- To define the operation of MFI's
- To articulate vision, mission and objectives into the project
- To identify the ways to implement the defined goals i.e., strategic planning and financial projection

Regulatory Compliance

MFIs require abiding by an extensive regulatory process to register and to maintain relationship with donors. In assessing regulatory compliance, NCR examines:

- Registration with MRA
- Track record of MFIs
- Following of established rules and regulations

Governance

MFIs governance practices are crucial as these are the guidance for information flow to stakeholders, policy formulators and have impact on financial capacity and sustainability. In assessing governance, NCR analyses governance data and information systematically and review and individual entity's governance practices. The important aspects are:

- To assess the practices in the operation
- To assess diversity and professional capabilities in the governing bodies
- To identify formulated committee and vested responsibilities
- To evaluate roles and responsibilities

Managerial Procedures

MFIs managerial procedures are important as these factors ensure operational efficiency and mitigation of procedural failure. To evaluate the managerial procedures, NCR examines:

- Human resource management
- Diversity and professional capabilities in the management personnel

Operational Efficiency

MFIs run different programs with different intended objectives. These programs' effective and efficient implementation requires significant operational competence. To assess the operational efficiency, NCR meticulously scrutinizes:

- To find out number of branches and geographic concentration
- Types of programs undertaken
- Networking with the stakeholders (partner organizations)
- Credit approval procedure
- Loan monitoring procedure
- Recovery procedure
- Procedure of appointment of Independent Auditor
- Social Impact of the carry out projects

Reporting and Disclosures

MFIs reporting and disclosures is an obligatory part described the regulator & governing bodies. Proper reporting and disclosures convey information to the stakeholders and ensure true & objective judgment by the regulator and governing bodies. In evaluating the reporting and disclosures, NCR examines:

- Financial reporting structure and disclosures
- To comply documentation level

IT Infrastructure

In today's world IT is indispensable part. Whereas serving mass people at a time IT infrastructure possess quite important part. In assessing IT infrastructure, NCR examines:

- To identify the adaptation of IT

Risk Analysis

Risk exposures to MFIs are considered as crucial part. In assessing risk exposures, NCR examines:

- To identify the market risk/ Industry risk

QUANTITATIVE FACTORS

Capital Adequacy

Capital adequacy of MFI means own fund of MFIs. It further defines the ability of the MFI to absorb any future financial shocks i.e., credit losses resulting in deterioration in assets. In evaluating capital adequacy, NCR examines:

- To assess size of Reserve & Surplus
- To compare with the standard ratio (minimum capital adequacy ratio)
- To recognize the nature of future absorption of credit losses

Asset Quality

Asset quality is the measure of MFIs ability of managing credit quality of their assets. In reviewing the asset quality, NCR scrutinizes:

- To identify the asset category/portfolio
- To find out the trend of asset base
- To evaluate loan recovery status
- To measure the number of beneficiaries
- To trade-off between return & asset base
- To measure the non-performing assets under each category
- To assess loan provision status

Earnings Quality

MFIs solvency is reflected from its **revenue spread** and is therefore an important area for analysis. While MFIs are benefited from the subsidized borrowing cost provided by the government of Bangladesh.

- To derive trend of earnings
- To assess earnings under each category
- To find out cost to savings and borrowing
- To measure through portfolio yield and interest rate spread
- To evaluate under OSS and FSS
- To identify return from asset

Resource Quality

MFIs structure and diversification of funding base is essential part. MFIs require maintaining fixed deposit with the banks as security collateral which cannot be withdrawn to support the daily activities. To assess the funding to different programs, NCR evaluates resources quality. Following areas are taken into account while examining resource quality:

- Resource raising ability
- Cost of funds
- Concentration of funds i.e., deposit & saving

Liquidity Efficiency

MFIs liquidity efficiency measures the ability to meet up short noticed fund requirements and long-term fund requirements whether it may be expenditures or spending to programs. To gauge the liquidity efficiency, NCR examines:

- Expected cash flow
- Capacity to borrow from financial market
- Maintenance of own fund
- Proportion of liquid asset to total asset
- Core assets to stable liabilities
- Liquidity gap



National Credit Ratings Ltd.

Disclaimer:

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