

Session V: Monitoring & Evaluation of Islamic Microfinance Institutions: Promoting Professional and Transparent Management

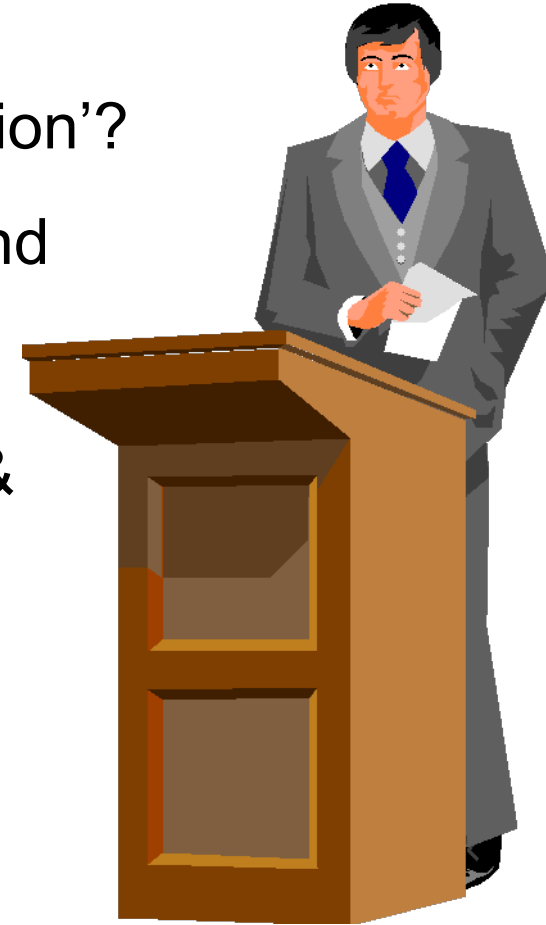


Syed Hassan Alsagoff
Senior Micro & Rural Finance Specialist
Agriculture & Rural Development Department
Islamic Development Bank



Agenda

1. What is a 'Successful Microfinance Institution'?
2. M&E Toolkit Overview- Financial, Social and Shariah Impact Indicators
3. Shariah Impact Performance- Qualitative & Quantitative Indicators
4. Rating Methodology

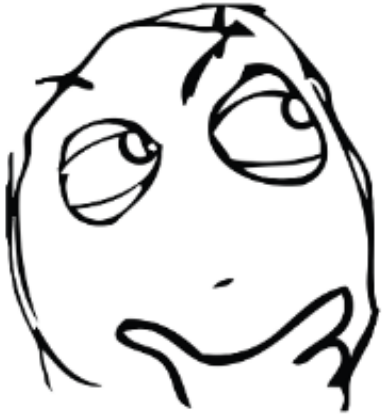


1.

What is a 'Successful Microfinance Institution'?



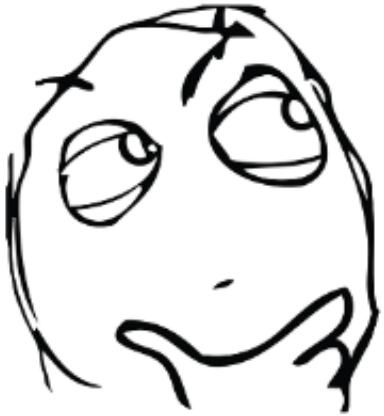
How do you consider a microcredit institution to be successful?



- Has many clients (strong outreach)?
- Provides financial inclusion to the poor?
- Low interest rates?
- Profitable?

Before asking the above question, we should first ask: What is the purpose of the Microcredit Institution?

What is the purpose of Microcredit?



Compartamos: From Nonprofit to Profit

Bloomberg

"A lot of people have suggested that financial inclusion can be a poverty alleviation tool...We're not out to prove that. We're out to provide financial services as opportunities to these clients, realizing that some people might make better use of them than others."

– Carlos Danel

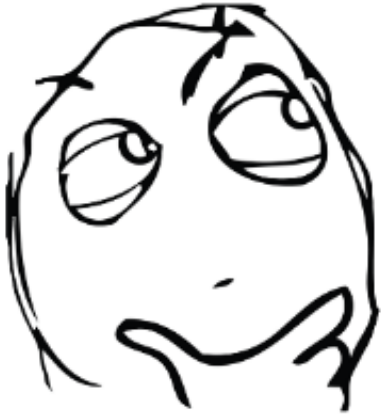
Prof Yunus Blasts Compartamos

Bloomberg

"When you discuss microcredit, don't bring Compartamos into it ...**Microcredit was created to fight the money lender, not to become the money lender.**"

-Prof Mohammed Yunus

So what is the purpose of Islamic microfinance?

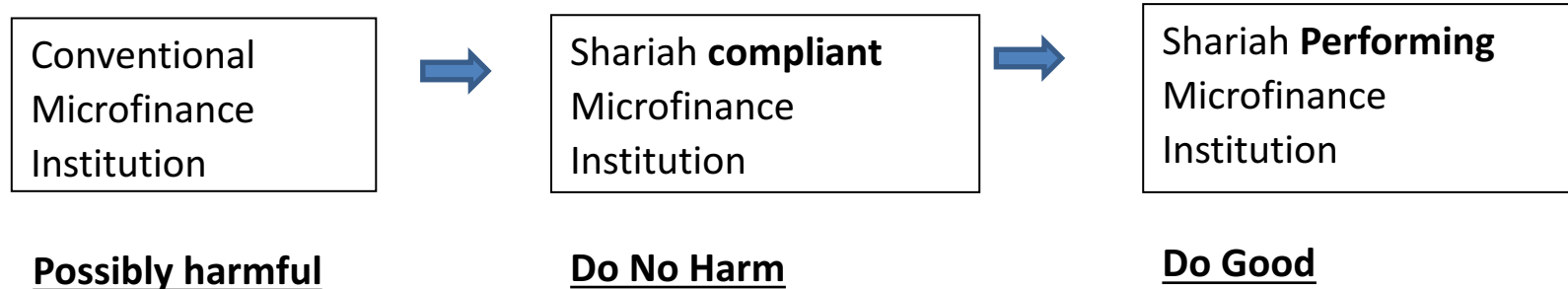


Besides being providers of credit, Islamic microfinance aims to conduct trade and investment with their clients

Similarly.... The purpose of Islamic Microfinance is to 'fight' not just the money lender but also the exploitative middlemen through addressing power inequality in the value chain.

This can be done only if Islamic microfinance institutions truly conduct trade and investment: ie Shariah Performing not just Shariah Compliant

Shariah Complaine vs Shariah Performance



1. Islamic microfinance is about achieving Shariah performance and not just compliance
2. Shariah compliance – Putting in place some measures prescribed by the Shariah to prevent the harmful effects of debt. DO NO HARM APPROACH.
3. Shariah performance- Active involvement in value chain in order to generate a win- win scenario between MFI and client. DO GOOD APPROACH.

How do we measure?

2.

Monitoring & Evaluation Toolkit Overview- Financial, Social and Shariah Impact Indicators



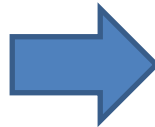
Solution: IMPACT Program

The goal of the program is to create

- a) a platform for experts to share and deepen the understanding on the Islamic Microfinance models; as well as to
- b) create tools and infrastructure in order to share best practices, governance and standards.

5 IMPACT Pillars

- 1) Operations
- 2) Monitoring & Evaluation
- 3) Policy & Standards
- 4) Technology
- 5) Advocacy



Output

- Toolkits
- Research on what works
- Implementation standards
- Capacity Building
- Technology systems

By Working with partners and stakeholders

Monitoring & Evaluation Pillar

Objective

The objectives of the M&E pillar is to develop a monitoring and evaluation framework, including a rating system combining areas of financial sustainability, governance, social performance as well as qualitative and quantitative value-add indicators of Islamic Microfinance.

Output

To deliver a comprehensive M&E and Rating toolkit and self-evaluation framework

How does this compare with conventional microfinance performance measurement?

Difference between Conventional and Islamic Microfinance

Conventional Microfinance

- Financial Performance Assessment
 - Portfolio Quality
 - Efficiency and Productivity
 - Financial Management
 - Profitability and Sustainability
- Social Performance Assessment
 - In line with MFI mission (SPM)
 - Client Protection Principles

Islamic Microfinance

- Financial Performance Assessment
- Social Performance Assessment
- **Shariah Impact Performance Assessment**
 - Qualitative Impact indicators
 - Quantitative Impact indicators

4 Areas of Financial Performance Assessment

1. Portfolio Quality (Credit Risk)
2. Efficiency and Productivity
3. Financial Management
4. Profitability and Sustainability



Financial Performance Assessment- 1) Portfolio Quality

- $\text{PAR 30 (for debt)} = \frac{\text{Outstanding balance of financing that is due more than 30 days}}{\text{Outstanding balance of all loans}}$
- $\text{Unrealized Portfolio Revenue (UPR) (for equity)} = (\text{Expected ROI of investment} - \text{Actual ROI of investment}) * \text{Total financing} * \text{period of financing}$
- $\text{Restructured Portfolio} = \frac{\text{Outstanding Restructured Portfolio in that was in arrears}}{\text{Outstanding balance of all loans}}$
- $\text{Write off Ratio} = \frac{\text{Financing written off during the period}}{\text{Average Outstanding balance of all financing}}$



Financial Performance Assessment- 2) Efficiency and Productivity

- Operating Expense Ratio = Operating Expenses During the Period / Gross Portfolio
- Cost per borrower/client = Operating Expenses During the Period / Average Number of Active Borrowers
- Financing officer productivity = Number of Active borrowers / Number of Financing Officers
- Staff Productivity = Number of Active borrowers / Number of Staff



Financial Performance Assessment- 3) Financial Management

- Debt Equity Ratio= (Wadiah Account + Financing From Other Party + Mudharabah Fund) /Total Equity
- Cost of Funds Ratio = Expenses on funding liabilities during the period/ (Average Wadiah Account + Average Financing From Other Party + Average Mudharabah Fund)
- Financial Expense Ratio = Expenses on funding liabilities during the period/ (Average financing Portfolio)/ Average Gross Financing Portfolio
- Liquidity Ratio = Cash and bank deposits + Short term financial investments (<3 months)/ Wadiah Account + Shot-term Financing From Other Party + Mudharabah Fund (short-term)
- Portfolio Yield = Income from financing portfolio (profits and fees) during the period/ Average Gross Financing portfolio



Financial Performance Assessment- 4) Profitability and Sustainability

- $\text{Return on Equity} = \frac{\text{Net Income before grants received and after taxes}}{\text{Average Total Equity}}$
- $\text{Return on Assets} = \frac{\text{Net Income before grants received and after taxes}}{\text{Average Total Assets}}$
- $\text{Operating Self-sufficiency} = \frac{\text{Operating income during the period}}{(\text{Financial expenses} + \text{provision expenses} + \text{operating expenses during the period})}$



Social Performance Assessment (SPM)

- Defined by the Social Performance Task Force is “the effective translation of an institution’s mission into practice in line with accepted social values.”
- Social Performance Task Force was created in 2005
- Smart Campaign was founded in 2009
- 2 Key Dimensions of Social Performance
 - Social Performance Management
 - Client Protection



SPM – 6 Universal Standards

1. Define and Monitor Social Goals
2. Ensure Board, Management and Employee Commitment to Social Goals
3. Design Products, Services and Delivery Channels that Meet Client's Needs and Preferences
4. Treats Clients Responsibly
5. Treats Employees Responsibly
6. Balance Financial and Social Performance

160 Indicators developed by the Social Performance Taskforce



SMART Campaign– 7 Client Protection Principles

1. Appropriate Product Design and Delivery
2. Prevention of Over indebtedness
3. Transparency
4. Responsible Pricing
5. Fair and Respectful Treatment of Clients
6. Privacy of Client Data
7. Mechanisms for Complaint Resolution

86 Indicators developed by the SMART Campaign

3.

Shariah Impact Performance- Qualitative and Quantitative Indicators



Attributes of a Shariah Compliant Microfinance Institution

- Shariah compliant investment
- Debt- oriented instruments (Murabaha)
- Asset or productive activity must be identified for the financing.
- Engagement in the value chain and business risk exposure kept to minimum
- Little differentiating factor to client. Benchmark profit rate is the sector interest rate.
- No additional interest due to delay in payments.
- Focus still on financial inclusion

Since involvement in the value chain is still kept to a minimum, the purpose is still to compete with the traditional 'moneylender'. Interest rates charged by the money lender is still used as the benchmark. **However, the Shariah safeguards in place mitigates the harmful effects of the debt caused by the financing.**

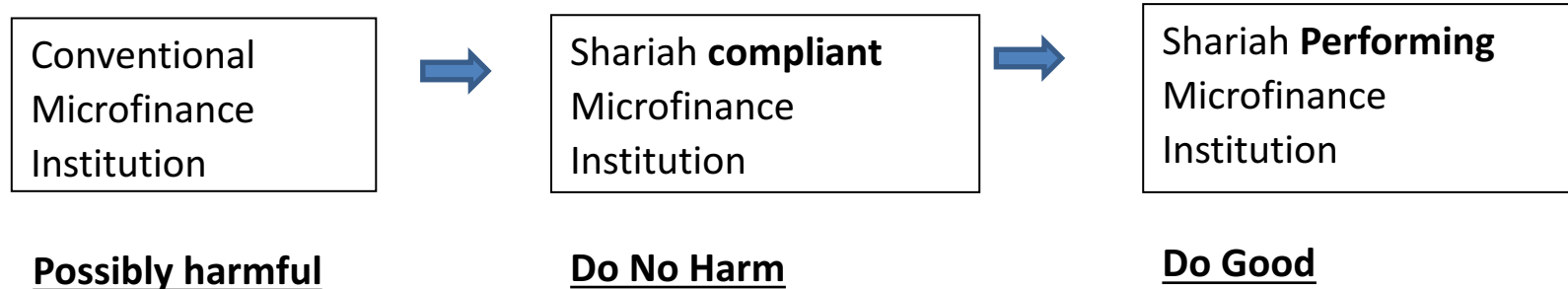


Attributes of a Shariah Performing Microfinance Institution

- Variety of debt- oriented **and equity instruments**
- Funds are **disbursed directly to supplier/activity** in order to ensure that the funds are not diverted for non-intended purposes.
- **Engagement in the value chain practiced effectively. Risks are managed and not avoided. Aims to value add in the business transactions with clients.**
- **Strong Differentiating Factor.** Benefit can be clearly seen by client.
- Focus not only on financial inclusion but **also economic empowerment**. Besides providing access to finance, the microfinance institution also **provide access to markets, technical knowhow, access to management etc.**

Actively involved in value chain through transactions with its stakeholders, the purpose is still to compete with not only the traditional 'moneylender', but also with the **traditional middleman.**

Shariah Complaine vs Shariah Performance



1. Islamic microfinance is about achieving Shariah performance and not just compliance
2. Shariah compliance – Putting in place some measures prescribed by the Shariah to prevent the harmful effects of debt. DO NO HARM APPROACH.
3. Shariah performance- Active involvement in value chain in order to generate a win- win scenario between MFI and client. DO GOOD APPROACH.

How do we measure?

Why is Impact Assessment unique to Islamic microfinance?

Conventional Microfinance

- Arm's length investments
- No idea on success/income earned by client
- Have to conduct household surveys and compare to control variable (eg. Randomised Control Trials)
- RCTs are very expensive and not suitable in many situations.

Islamic Microfinance

- Directly involved in business transactions
- Able to know how much the client will earn
- Not necessary to conduct household surveys
- Possible to conduct IMPACT studies easily in an inexpensive manner

Murabaha- Qualitative Indicators

| Level | Indicator | Non-Financial Value to address business risks provided |
|---------------------------|--|--|
| 0 (Shariah compliance) | Changes interest to profit. Proper management of late 'fine' payments. Is compliant to the Shariah Guidelines of Murabaha. | Nil. Client acts as purchasing agent for MFI. |
| 1 | Pays directly to supplier and takes ownership of the product prior to selling to client. (eg, MFI validates that the supplier is genuine and the asset is genuine) | <ul style="list-style-type: none"> - Mitigates payment receipt - Ensures the existence of the seller and asset. |
| 2 | Conducts quality check on behalf of the client. MFI checks that the asset meets the required quality specification. | <ul style="list-style-type: none"> - Ensures the quality of the asset based on the needs of the client - Mitigates non-performance of the supplier |
| 3 | Ascertains that asset purchased by client is transferred by arranging for the asset's transportation to the client. | <ul style="list-style-type: none"> - Ensures the asset is safely transferred and is in the possession of the of the client. - Mitigates transportation risks of the client. |
| 4 | Sources alternative assets for client. The spot rate of the asset is lower (up to 10%) than the spot rate quoted by the client and/or the overall selling price is lower than the overall costs (including the average market interest rate) if financed by a conventional microfinance institution. | <ul style="list-style-type: none"> - Help client to negotiate suppliers for lower prices in order to help clients to save money. <p>Eg. Client provides invoice for fertilizer amounting to \$1000. MFI negotiates for a lower price (\$950). In addition, the selling price (after 30% profit ie \$1235) is lower than the overall costs (after 30% interest ie \$1300).</p> |



Murabaha- Qualitative Indicators

| Level | Indicator | Non-Financial Value to address business risks provided |
|-------|---|---|
| 5 | Sources alternative assets for client. The spot rate of the asset is lower than the spot rate quoted by the client by 10% to 20% of the overall selling price is at least 10% to 20% lower than the overall costs (including the average market interest rate) if financed by a conventional microfinance institution. | - Help client to negotiate suppliers for lower prices in order to help clients to save money. Eg. Client provides invoice for fertilizer amounting to \$1000. MFI negotiates for a lower price (eg 15% discount - \$850). In addition, the selling price (after 30%*\$850 profit ie \$1105) is lower than the overall costs (after 30%*\$1000 interest ie \$1300). |
| 6 | Sources alternative assets for client. The spot rate of the asset is lower than the spot rate quoted by the client by 20% to 30% and the overall selling price is at least 20% to 30% lower than the overall costs (including the average market interest rate) if financed by a conventional microfinance institution. | - Help client to negotiate suppliers for lower prices in order to help clients to save money. Eg. Client provides invoice for fertilizer amounting to \$1000. MFI negotiates for a lower price (eg 25% discount - \$750). In addition, the selling price (after 30%*\$750 profit ie \$975) is lower than the overall costs (after 30%*\$1000 interest ie \$1300). |
| 7 | Sources alternative assets for client. The spot rate of the asset is lower than the spot rate quoted by the client by more than 30% and the overall selling price is at least 30% lower than the overall costs (including the average market interest rate) if financed by a conventional microfinance institution. | - Help client to negotiate suppliers for lower prices in order to help clients to save money. Eg. Client provides invoice for fertilizer amounting to \$1000. MFI negotiates for a lower price (eg 35% discount - \$650). In addition, the selling price (after 35%*\$650 profit ie \$845) is lower than the overall costs (after 30%*\$1000 interest ie \$1300). |

Murabaha- Quantitative Indicators

| Type of products/ interventions | Quantitative indicators |
|---------------------------------|--|
| Murabaha | <p>Savings generated from choosing Islamic loan compared to conventional loan</p> <ul style="list-style-type: none"> - Murabaha selling price-Cost of conventional loan (principle + interest) <p>Savings generated due to negotiation conducted by microfinance institution</p> <ul style="list-style-type: none"> - Initial Spot purchase price – Negotiated purchase price of microfinance institution. <p>Savings generated as a result of negotiation that is contributing to poverty alleviation</p> <ul style="list-style-type: none"> - Additional income due to savings as a result of negotiation/ financing tenor in number of days) / Poverty Line |

Salam- Qualitative

| Level | Indicator | Non-Financial Value to address business risks provided |
|-------|---|--|
| 1 | Is compliant to the Shariah Guidelines of Salam. Pays directly to client and takes ownership of the produce after an agreed period. | <ul style="list-style-type: none"> - Mitigates price volatility - Provides access to markets as MFI is liable to sell the products for profit. |
| 2 | Conducts quality check and helps client to fulfill quality specification required by MFI buyer. MFI markets and packages produce such that it is acceptable to buyer. | <ul style="list-style-type: none"> - Ensures the quality of the asset based on the needs of the buyer/ market. - Mitigates non-performance of the client - Supports the marketing and packaging of the product for market. |
| 3 | Ascertains that asset purchased by client is transferred by arranging for the produce's transportation to the client. | <ul style="list-style-type: none"> - Ensures the asset is safely transferred and is in the possession of the buyer. - Mitigates transportation risks of the client. |
| 4 | Markets produce for client by negotiating with the buyer so that the client earns a bonus of up to 10%. The sale price of the produce is higher than the expected sale price that the client can sell on its own. The client earns up to 10% more than if he were to borrow from a conventional microfinance institution. | <ul style="list-style-type: none"> - Help client to negotiate buyer for higher prices in order to help clients to earn more money. <p>Eg. Client sells tomatoes for using Salam amounting to \$1000. At the time of delivery, price of tomatoes is \$1300. MFI negotiates for a higher price (\$100 more). Microfinance institution shares 50% of the negotiated amount to the client in the form of a bonus of \$50 more representing 5% of the Salam price of tomatoes.</p> |

Salam- Qualitative

| Level | Indicator | Non-Financial Value to address business risks provided |
|-------|---|---|
| 5 | Markets produce for client by negotiating with the buyer so that the client earns a bonus of 10% to 20%. The sale price of the produce is higher than the expected sale price that the client can sell on its own. The client earns 10% to 20% more than if he were to borrow from a conventional microfinance institution. | <p>- Help client to negotiate buyer for higher prices in order to help clients to earn more money.</p> <p>Eg. Client sells tomatoes for using Salam amounting to \$1000. At the time of delivery, price of tomatoes is \$1300. MFI negotiates for a higher price (\$300 more). Microfinance institution shares 50% of the negotiated amount to the client in the form of a bonus of \$150 more representing 15% of the Salam price of tomatoes.</p> |
| 6 | Markets produce for client by negotiating with the buyer so that the client earns a bonus of 20% to 30%. The sale price of the produce is higher than the expected sale price that the client can sell on its own. The client earns 20% to 30% more than if he were to borrow from a conventional microfinance institution. | <p>- Help client to negotiate buyer for higher prices in order to help clients to earn more money.</p> <p>Eg. Client sells tomatoes for using Salam amounting to \$1000. At the time of delivery, price of tomatoes is \$1300. MFI negotiates for a higher price (\$500 more). Microfinance institution shares 50% of the negotiated amount to the client in the form of a bonus of \$250 more representing 25% of the Salam price of tomatoes.</p> |
| 7 | Markets produce for client by negotiating with the buyer so that the client earns a bonus of more than 30%. The sale price of the produce is higher than the expected sale price that the client can sell on its own. The client earns more than 30% if he were to borrow from a conventional microfinance institution. | <p>- Help client to negotiate buyer for higher prices in order to help clients to earn more money.</p> <p>Eg. Client sells tomatoes for using Salam amounting to \$1000. At the time of delivery, price of tomatoes is \$1300. MFI negotiates for a higher price (\$700 more). Microfinance institution shares 50% of the negotiated amount to the client in the form of a bonus of \$350 more representing 35% of the Salam price of tomatoes.</p> |

Salam- Quantitative Indicators

| Type of products/ interventions | Quantitative indicators |
|---------------------------------|--|
| Salam | <p>Additional Profits generated from selling product compared to usual profits received by farmers</p> <ul style="list-style-type: none">- (Revenue received from microfinance institution from Salam transaction – (revenue received by farmers in local market – cost of market interest rates)) <p>Increase in proportion of value received by Producers in the value chain</p> <ul style="list-style-type: none">- (Negotiated Producer price / End consumer price) – (usual producer price/ End consumer price) |

Qard Hassan- Qualitative

| Level | Indicator | Non-Financial Value to address business risks provided |
|-------|---|---|
| 0 | Is compliant to the Shariah Guidelines of Qard Hassan. Provides Qard Hassan at the cost of the true cost of administration of the loan. However, the cost of administration is higher than the market interest rate | Nil, inefficiency require that client pay more for the financing. |
| 1 | Provides Qard Hassan at the cost of the true cost of administration of the loan which is up to the market interest rate of the financing. | - Low cost of financing |
| 2 | Provides Qard Hassan at zero cost for the loan. | - Zero cost of financing |
| 3 | Provides Qard Hassan at zero cost for the loan. Also provides non-financing support (eg. Training, markets etc) | - Capacity building provided to clients in addition to zero cost of financing |



Qard Hassan- Quantitative Indicators

| Type of products/ interventions | Quantitative indicators |
|---------------------------------|--|
| Qard Hassan | <p>Savings generated from obtaining a Qard Hassan instead of a Conventional loan</p> <ul style="list-style-type: none">- Interest costs of the loan – service fees of Qard Hassan (typically zero) |



Ijarah- Qualitative

| Level | Indicator | Non-Financial Value to address business risks provided |
|-------|--|--|
| 1 | Is compliant to the Shariah Guidelines of Ijarah. Pays directly to supplier and takes ownership. MFI validates that the supplier is genuine and the asset is genuine. Ownership of asset remains with MFI throughout lease period. | <ul style="list-style-type: none"> - Mitigates payment receipt - Ensures the existence of the seller and asset. - Mitigates ownership risks of asset. |
| 2 | Arranges for adequate protection of asset in the form of takaful. Ensures that the quality and value of the asset remains through regular maintenance and checks. | <ul style="list-style-type: none"> - Ensures appropriate takaful to avoid risks related to destruction and theft of the asset. - Ensures that the asset remains productive throughout lease period |
| 3 | Provide options to client to return, renew lease or purchase asset at the end of the lease period | <ul style="list-style-type: none"> - Provides flexibility for client to maximize his benefit at the end of the lease period. |
| 4 | Negotiate for a lower price for the asset. The spot rate of the asset is lower (up to 10%) than the spot rate quoted by the client and/or the overall selling price is lower than the overall costs (including the average market interest rate) if financed by a conventional microfinance institution. | <ul style="list-style-type: none"> - Help client to negotiate suppliers for lower prices in order to help clients to save money. Eg. Client provides invoice for a tractor amounting to \$10,000. MFI negotiates for a lower price (\$9,500). In addition, the selling price (after 30% profit ie \$12,350) is lower than the overall costs (after 30% interest ie \$13,000). |

Ijarah- Qualitative

| Level | Indicator | Non-Financial Value to address business risks provided |
|-------|---|---|
| 5 | Negotiate for a lower price for the asset. The spot rate of the asset is lower than the spot rate quoted by the client by 10% to 20% of the overall selling price is at least 10% to 20% lower than the overall costs (including the average market interest rate) if financed by a conventional microfinance institution. | <p>- Help client to negotiate suppliers for lower prices in order to help clients to save money.</p> <p>Eg. Client provides invoice for tractor amounting to \$10,000. MFI negotiates for a lower price (eg 15% discount - \$8,500). In addition, the selling price (after 30%*\$8,500 profit ie \$11,050) is lower than the overall costs (after 30%*\$10,000 interest ie \$13,000).</p> |
| 6 | Negotiate for a lower price for the asset. The spot rate of the asset is lower than the spot rate quoted by the client by 20% to 30% and the overall selling price is at least 20% to 30% lower than the overall costs (including the average market interest rate) if financed by a conventional microfinance institution. | <p>- Help client to negotiate suppliers for lower prices in order to help clients to save money.</p> <p>Eg. Client provides invoice for tractor amounting to \$10,000. MFI negotiates for a lower price (eg 25% discount - \$7,500). In addition, the selling price (after 30%*\$7,500 profit ie \$9,750) is lower than the overall costs (after 30%*\$10,000 interest ie \$13,000).</p> |
| 7 | Sources alternative assets for client. The spot rate of the asset is lower than the spot rate quoted by the client by more than 30% and the overall selling price is at least 30% lower than the overall costs (including the average market interest rate) if financed by a conventional microfinance institution. | <p>- Help client to negotiate suppliers for lower prices in order to help clients to save money.</p> <p>Eg. Client provides invoice for fertilizer amounting to \$10,000. MFI negotiates for a lower price (eg 35% discount - \$8,500). In addition, the selling price (after 35%*\$6,500 profit ie \$8,450) is lower than the overall costs (after 30%*\$10,000 interest ie \$13,000).</p> |

Ijarah- Quantitative Indicators

| Type of products/ interventions | Quantitative indicators |
|---------------------------------|---|
| Ijarah | <p>Savings generated from choosing Ijara compared to conventional leasing loan</p> <ul style="list-style-type: none"> - Ijarah total leasing price-Cost of conventional loan(principle + interest) <p>Savings generated due to negotiation conducted by microfinance institution</p> <ul style="list-style-type: none"> - Initial Spot purchase price – Negotiated purchase price of microfinance institution. <p>Savings generated as a result of negotiation that is contributing to poverty alleviation</p> <ul style="list-style-type: none"> - Additional income due to savings as a result of negotiation/ financing tenor in number of days) / Poverty Line |

Musharakah/ Mudarabah/ Diminishing Musharakah- Qualitative

| Level | Indicator | Non-Financial Value to address business risks provided |
|-------|--|--|
| 2 | Shariah compliant partnership agreement between microfinance and client that reflects a fair arrangement between the parties. The client's share of profits is at least the portion of capital injected by the client. | - Fair partnership arrangement with client which recognizes the contributions between the parties equitably. |
| 3 | Microfinance institution is involved in the business planning of the venture. Market studies are conducted to determine the feasibility of the venture in ensuring a win-win situation for both microfinance institution and client. | - Help client plan for setting up with the business by determining stakeholders involved, budget, risks etc. |
| 4 | Provides the needed know-how in the running of the company including introducing innovation or technology. | <ul style="list-style-type: none"> - Provides access to information in order to help client make key decisions. - Provides technology and/or innovation to improve productivity. |

Musharakah/ Mudarabah/ Diminishing Musharakah- Qualitative

| Level | Indicator | Non-Financial Value to address business risks provided |
|-------|--|---|
| 5 | Microfinance institution is involved in providing access to markets through introducing and negotiating with buyers. | - Support client in providing access to markets. |
| 6 | Microfinance institution is involved in supporting the venture in its management through mentoring, consulting or as a board member. <i>Client ability to pay is considered when making installments to purchase equity (for Diminishing Musharakah).</i> | - Help client in the management of the company through capacity building and mentoring. - May be actively involved in the management of the venture if required. |
| 7 | Microfinance institution has a clear exit plan including how clients will be able to continue operating the venture in a sustainable manner. <i>Client is able to make early installments to purchase equity so the microfinance institution will exit earlier than expected (for diminishing musharakah).</i> | - Develops clients capabilities to continue running the venture independently. |

Musharakah/ Mudarabah/ Diminishing Musharakah- Quantitative

| Type of products/ interventions | Quantitative indicators |
|---|---|
| Musharakah/ Mudarabah/ Diminishing Musharakah | <p>Profits earned by client from the transaction</p> <ul style="list-style-type: none">- Share of profits earned by clients per annum <p>Profits earned by client from the transaction compared to opportunity cost</p> <ul style="list-style-type: none">- Share of profits earned by clients per annum/ GDP Per capita <p>Profits earned by client from the transaction Poverty Line</p> <ul style="list-style-type: none">- Share of profits earned by clients per annum/ Poverty Line |

4.

Rating Methodology



Microfinance Institutional Rating (Financial)

| Microfinance Rating PLUS | | Common rating grade classification for all microfinance rating agencies | |
|--------------------------|--|---|--|
| Grade | Definition | Classification | Definition |
| AAA | Excellent capacity to manage risks. This capacity is not expected to be affected by a foreseeable deterioration of the operations or economic conditions. Extremely strong and stable fundamentals. Excellent client protection systems. | EXCELLENT | Low or well-managed short-medium term risk. Strong performance |
| AA+, AA, AA- | Very strong capacity to manage risks. This capacity may be slightly affected by a deterioration of the operations or economic conditions. Very strong and stable fundamentals. Excellent client protection systems. | | |
| A+, A, A- | Strong capacity to manage risks. This capacity may be affected by a deterioration of the operations or economic conditions. Strong and stable fundamentals. Good client protection systems. | | |
| BBB+, BBB, BBB- | Good capacity to manage risks. However, this capacity is likely to be affected by a deterioration of the operations or economic conditions. Good fundamentals. Adequate client protection systems. | GOOD | Modest or well-managed short- medium term risk Good to moderate performance |
| BB+, BB, BB- | Adequate capacity to manage risks. However, this capacity may be significantly affected by a deterioration of the operations or economic conditions. Adequate fundamentals. Adequate client protection systems. | | |
| B+, B, B- | Moderate capacity to manage risks. This capacity is vulnerable to a deterioration of the operations or economic conditions. Moderate fundamentals. Moderate client protection systems. | FAIR | Moderate to moderate-high risk Moderate performance |
| CCC+, CCC, CCC- | Modest capacity to manage risks. This capacity is highly vulnerable to a deterioration of the operations or economic conditions. Modest fundamentals. Modest client protection systems. | | |
| CC+, CC, CC- | Weak capacity to manage risks. Modest fundamentals. Poor client protection systems. | POOR | High risk Poor performance |
| C+, C, C- | Weak capacity to manage risks. Weak fundamentals. Poor client protection systems. | | |
| D | Extremely weak capacity to manage risks. Extremely weak fundamentals. Poor client protection systems. | | |

Social Performance Rating

| Grade | Definition |
|-----------------|--|
| ^s AA | Excellent social performance management and client protection systems. High likelihood of achieving the social mission. |
| ^s A | Good social performance management and client protection systems. Social mission likely to be achieved. |
| ^s BB | Adequate social performance management and client protection systems. Satisfactory alignment to the social mission. |
| ^s B | Moderate social performance management and client protection systems. Partial alignment to the social mission |
| ^s C | Weak social performance management and client protection systems. Medium risk of mission drift |
| ^s D | Poor social performance management and client protection systems. Risk of mission drift. |

Shariah Impact Performance Rating

| Grade | Definition |
|----------|---|
| A | Excellent capacity to manage business risks by doing business with the customer through engaging with various stakeholders in the value chain. Provides excellent non-financial support to clients in need of economic empowerment. Excellent likelihood that the intervention would generate a positive impact to clients. |
| B | Very good capacity to manage business risks by doing business with the customer through engaging with various stakeholders in the value chain. Provides very good non-financial support to clients in need of economic empowerment. Very Good likelihood that the intervention would generate a positive impact to clients. |
| C | Good capacity to manage business risks by doing business with the customer through engaging with various stakeholders in the value chain. Provides good non-financial support to clients in need of economic empowerment. Good likelihood that the intervention would generate a positive impact to clients. |
| D | Adequate capacity to manage business risks by doing business with the customer through engaging with various stakeholders in the value chain. Provides adequate non-financial support to clients in need of economic empowerment. Adequate likelihood that the intervention would generate a positive impact to clients. |
| E | Moderate capacity to manage business risks by doing business with the customer through engaging with various stakeholders in the value chain. Provides moderate non-financial support to clients in need of economic empowerment. Moderate likelihood that the intervention would generate a positive impact to clients. |
| F | Weak capacity to manage business risks by doing business with the customer through engaging with various stakeholders in the value chain. Provides weak non-financial support to clients in need of economic empowerment. Weak likelihood that the intervention would generate a positive impact to clients. |
| G | Poor capacity to manage business risks by doing business with the customer through engaging with various stakeholders in the value chain. Provides poor non-financial support to clients in need of economic empowerment. Poor likelihood that the intervention would generate a positive impact to clients. |



Combined Rating

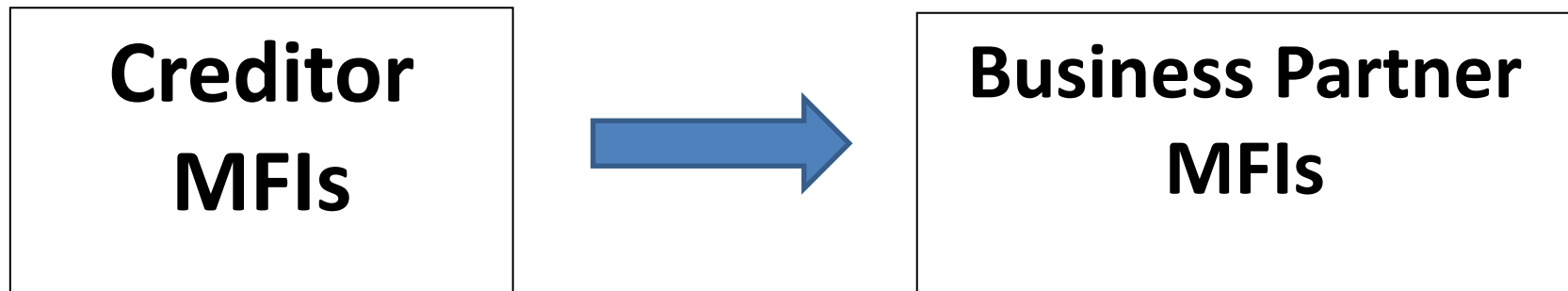
| Financial | Social | Shariah Impact |
|-----------|--------|----------------|
| A | A | A |
| B | B | B |
| C | C | C |
| D | D | D |
| E | E | E |
| F | F | F |
| G | G | G |

Incorporate indicators into MIS system. Validate through third party raters or consultants/supervision missions.

Main Opportunity of Islamic Microfinance Institutions

To be achieve Shariah Performance not just Shariah Compliance

- Mindset Shift from Creditor to Business Partner MFIs
- Capacity Building in managing business risks not just credit risks





Contact:
salsagoff@isdb.org

PO Box 54069
Jeddah 21514
Kingdom of Saudi Arabia

<http://www.isdb-pilot.org/>

Together We Build a Better Future

Disclaimer

© 2017 IDBG., a Multilateral Islamic Organization, based in Jeddah, Kingdom of Saudi Arabia. All rights reserved. The IDBG names & logos are registered trademarks. The information provided herein is confidential & for the sole use of intended recipient with discretion. Any other use, disclosures or reproduction of any information contained herein is strictly prohibited. This package & any additional information provided must be returned to IDBG upon the request of IDBG.