

Microfinance Institution Tier Definitions

The industry is in need of an objective set of criteria that acts as a proxy for the maturity of microfinance institutions (MFIs). Historically, the microfinance industry referenced a system of three or four "tiers" to differentiate between MFI types¹. However, previous tier definitions – often vague or based only on one indicator such as size – failed to adequately capture an MFI's level of institutional development.

MFI tier system

MicroRate proposes a tier system that defines MFI peer groups by institutional maturity to provide a foundation for industry analysis and informed dialogue. To maximize its utility and adoption, the tier system adheres to the following parameters:

- Simple to understand and easy to calculate
- Conventional, universally accepted metrics (i.e. no microfinance-specific indicators)
- Based on publically available or easily attainable data
- Global (i.e. no regional calculation differences/exceptions)
- Universal across all MFI types (e.g. regulated banks, NBFIs, NGOs, Coops, etc.)

The system is based on a three-tier structure that applies three simple, objective indicators that, *together*, act as proxies for MFI maturity. The three indicators are **sustainability** (return on assets, RoA), **size** (total assets in U.S. dollars) and **transparency** (level of regulation/reporting).

Tier definitions

| | Tier 1 | Tier 2 | Tier 3 |
|-----------------------|---|--|--|
| Description | <i>Mature, financially sustainable, and large MFIs that are highly transparent</i> | <i>Small or medium sized, slightly less mature MFIs that are, or are approaching, profitability</i> | <i>Start-up MFIs or small NGOs that are immature and unsustainable</i> |
| Sustainability | (i) Positive RoA for at least 2 of the last 3 years AND (ii) No RoA <-5% in the last 3 years | (i) Positive RoA for at least 1 of the last 3 years and other years >-5% OR (ii) Positive trend in RoA in last 2 years and >-5% | The rest |
| Size | >\$50 million | \$5 - \$50 million | <\$5 million |
| Transparency | (i) Regulated financial institution OR (ii) Rated at least once in the last 2 years | Audited financial statements for at least the last 3 years | The rest |

Scoring guidelines:

1. The MFI is assigned the lowest tier of all three criteria
2. All indicators must be calculated with the latest data available

¹ Consultative Group to Assist the Poor (CGAP) and Grameen Foundation USA are most commonly referenced.

Example: MFI_{XYZ}

| | 2009 | 2010 | 2011 | Tier |
|--|--------------------|--------------------|--------------------|----------|
| Sustainability | -1.2% | 1.7% | 2.8% | 1 |
| Size | \$3.2 million | \$3.8 million | \$4.8 million | 3 |
| Transparency | Audited statements | Audited statements | Audited statements | 2 |
| Final Tier of MFI_{XYZ} | | | | 3 |

Tier criteria

Sustainability: RoA, calculated as net operating income less taxes as a percentage of average total assets, serves as an indicator for profitability, sustainability, and efficient use of capital. For tier purposes, positive RoA is more important than absolute level of RoA.

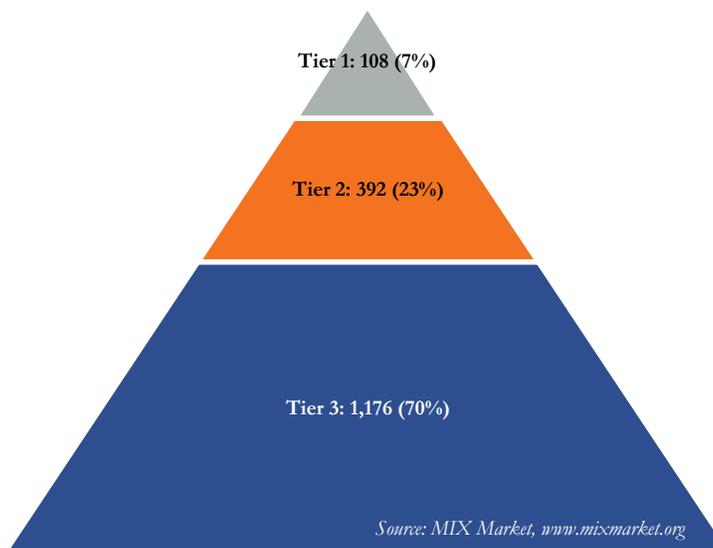
Size: Size is an objective proxy for maturity and total assets is a reasonable criterion for tier purposes. Smaller tier 3 MFIs (below \$5 million) are usually either young, operate in a small market, or have not been able to grow organically. Larger institutions are typically stable and consistent.

Transparency: Transparency serves as a proxy for maturity by reflecting both the MFI’s willingness and ability to be accountable to the public. Regulated financial institutions represent the highest level of transparency because of the standards imposed by most local banking authorities. In countries that lack adequate regulation, or for MFIs that do not pursue regulation, Tier 1 transparency can also be assigned to MFIs that have been rated at least once in the last two years.

Tier breakdown and application

The proposed tier system produces the following results (see diagram at right; number and corresponding percent of total institutions) from a MIX Market sample of 1,676 MFIs with data as of December 31, 2011.

By using common tier definitions, stakeholders will have a framework to conduct more accurate research and peer group analysis of the microfinance industry. MicroRate has already adopted this system to enhance its comparative analysis of MFIs and, through its Luminis service, to classify MIV portfolios in terms of their target MFI tiers.



MicroRate would like to thank the e-MFP Action Group of Investors in Tier 2/3 MFIs for their extensive feedback during the development phase of this tier system and for [their support of its dissemination](#).

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