

# Appraising Microfinance Institutions

Appraisals are an integral part of the funding process. Appraisals (also commonly called due diligence) help funders to determine the capacity of microfinance institutions (MFIs) and to make decisions related to capitalizing an MFI or providing support for technical assistance. Information obtained as part of an appraisal process helps funders make decisions on funding levels, funding instruments, and the overall structure of a deal.

CGAP's *Appraisal Guide for Microfinance Institutions* offers one approach to conducting an appraisal. It is a comprehensive guide for organizing, implementing, and finalizing an MFI appraisal that can be adapted to the needs of a range of donors and investors. The Guide was updated in 2008 to reflect the latest trends in the industry. It incorporates the latest microfinance knowledge and good practices to form a detailed roadmap that analysts can use to evaluate MFIs. The updated Guide includes new sections on savings, poverty outreach, information systems, and risk management. *Appraisal Guide for Microfinance Institutions* promotes an industry standard for appraisals and is available free to funders, consultants, and others undertaking appraisals.

## What is the purpose of the Appraisal Guide?

While appraisals can take many forms and shapes, the Appraisal Guide serves as a one-stop-shop and an easy reference tool. It contains detailed instructions, probing questions, and data input templates to support both qualitative and quantitative analysis. Funders can use all or portions of the Appraisal Guide as needed. The reports produced can be used to help donors and investors assess the structure, strategy,

and financial and social performance of an MFI. Using the Appraisal Guide helps funders do the following:

- Understand the vision, direction, health, and stage of development of MFIs.
- Assess MFIs' needs and capacity to absorb funds and identify areas of potential support, thus promoting more effective and efficient use of donor and investor resources.
- Establish baseline information to help with performance-based funding management.

## Who should use the Appraisal Guide?

*Appraisal Guide for Microfinance Institutions* is primarily for funders and the consultants they hire to analyze MFIs. It calls for a lot of detailed analysis because it is designed to be used with relatively mature MFIs (for example, MFIs that have more than 3,000 clients). It can be useful to a wide range of funders, including bi- and multilateral development agencies, foundations, and nongovernmental organizations that are considering funding or conducting ex post evaluations. The Guide can also inform or complement other due diligence systems investors are already using. Finally, it also can be used by MFIs to conduct self-evaluations.

## What does the Appraisal Guide cover?

The Appraisal Guide includes seven key areas of analysis:

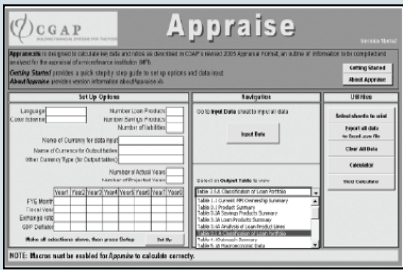
1. **Overview.** Summarizes the MFI's vision and mission, organizational strengths and weaknesses, and macroeconomic, political, and other external environmental factors.
2. **Institution.** Describes the MFI's ownership and governance; management; organizational structure; human resource management; information and communications technology; information quality, availability, and transparency; internal controls; internal and external audits; regulation and supervision; ratings; and external relationships.
3. **Products.** Analyzes the MFI's financial products, such as voluntary savings and credit, and nonfinancial products.

4. **Social performance.** Assesses how well the MFI translates its social goals into practice, looking at systems, outreach, and potential for achieving impact.
5. **Loan portfolio quality.** Reviews how the MFI measures, monitors, and manages its loan portfolio, including its delinquency management and write-off policy and practice.
6. **Financial performance and risk management.** Analyzes the MFI's financial performance, asset-liability management, and risk and liquidity management. The Guide reviews systems of the institution as well as ratio analysis.
7. **Business planning.** Evaluates the MFI's strategic and business planning process, financial projections, and funding strategy.

To support this analysis, the Appraisal Guide is comprised of three interrelated tools: the technical guide, resource manual, and Excel spreadsheet (Appraise.xls).

Technical Guide	Resource Manual
<ul style="list-style-type: none"> <li>• Instructions and probing questions that focus on key analytical areas</li> <li>• A checklist of information to be gathered by experienced analysts</li> </ul>	<ul style="list-style-type: none"> <li>• Detailed elaboration on the Technical Guide, with additional probing questions</li> <li>• Appendix containing resources and references, including, for example:               <ul style="list-style-type: none"> <li>– Sample terms of reference</li> <li>– Management information system evaluation checklist</li> <li>– Social performance measures</li> <li>– Financial statement terms and analytical adjustments</li> <li>– Financial risk management analysis guidelines</li> <li>– Bibliography</li> </ul> </li> </ul>

Excel Spreadsheet
 <ul style="list-style-type: none"> <li>• Excel spreadsheet for each area of analysis</li> <li>• User-friendly format: language settings can be adjusted among English, French, and Spanish, while output tables can be easily converted into other document formats</li> </ul>

## How can donors and investors structure and conduct appraisals?

Whatever the approach or tool used, the following suggestions can help make the appraisal process efficient and effective for both funders and the MFIs they seek to support.

### *Ensure a knowledgeable analyst is involved.*

Appraisals typically cover a wide range of data on the MFI, from management issues to financial statement reconstruction. A highly skilled financial analyst with a broad understanding of the institutional development of MFIs and financial performance is ideal for overseeing and/or conducting the appraisal. The analyst should have direct experience with microfinance appraisals or ratings and should be fluent in the working language of the MFI. Depending on the skill set of the analyst, the size and complexity of the MFI, and the depth of the appraisal, a team of specialists may be needed.

### *Match the length of appraisal to the desired outputs and deliverables.*

The time required to conduct an appraisal depends on the funder's desired outputs and deliverables, as well as the amount of potential funding being considered. A complete appraisal is appropriate only for significant funding decisions, and even then, the topics for analysis should be carefully selected. An analyst would need at least two or three weeks to complete a comprehensive appraisal—including a site visit of five to seven days or more—depending on how much information is readily available from the MFI. A shorter

appraisal, using a subset of questions, may involve two to three days in the field and lighter reporting.

Funders should consider a full or shortened appraisal only if preliminary discussions indicate that funding is reasonably likely, because gathering and analyzing information needed for an appraisal requires the MFI to collect substantial preparatory data. Funders can conduct an initial screening to determine if the MFI's strategic priorities are aligned with their own, and whether to move ahead with an appraisal.

In some cases, if an MFI has a high-quality and recent rating report, the information provided in it may even be sufficient for making a funding decision.

### *Tailor appraisal approach to project requirements.*

The terms of references for the appraisal should be adapted based on the appraisal's purpose, the type of funding proposed, and the features of the MFI gleaned from a rating or other informed source. The appraisal template must be streamlined according to data availability, resource constraints, and case-specific information requirements to minimize the burden on both MFIs and funders.

The Appraisal Guide's sample terms of reference can be useful to tailor appraisals to ensure that only the most essential information is collected. Whenever possible, funders should consider partnering with other donors and investors considering investment in the same MFI to conduct a joint appraisal.

*Maintain an open dialogue.* Throughout the appraisal, the funder should communicate clearly and often with the MFI to clarify expectations and processes. It is particularly important to involve the MFI's leadership from the outset. Irrespective of the ultimate investment decision, discussing appraisal results can be a valuable exercise for both funders and institutions, enhancing funder understanding and MFI effectiveness. Rigorous, objective feedback can be invaluable in helping to improve the health of the MFI.

## Resources

Isern, Jennifer, Julie Abrams, and Matthew Brown. 2008. *Appraisal Guide for Microfinance Institutions*. Technical Guide, Resource Manual, and Appraise.xls. Washington, D.C.: CGAP.

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## AUTHORS

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