



## Cambodia Rural Economic Development Initiatives for Transformation Company Limited [CREDIT]

Phnom Penh, Cambodia

<b>Rating grade</b>	<b>β+</b> beta plus	<b>Assessment:</b> Recommended Reasonable safety, reasonable systems, needs monitoring
<p>Visit dates: 18-22 July, 2005      Operational head: Ms Karen Lewin</p> <p>Maximum validity of rating*: till July 2006</p>		

### Rating

CREDIT has displayed reasonable performance on governance and moderate performance on management parameters; the strength of the organisation is its good financial performance. A moderate second line of leadership is an area of concern for CREDIT, particularly since it plans to change its leadership in the near future. CREDIT's overall operating systems including human resource management, MIS and internal control systems have significant scope for improvement. In financial terms, CREDIT's high operating cost is a constraint in the competitive environment of Cambodia but its good portfolio quality and return on assets as well as a high capital adequacy are mitigating factors from the lender's perspective.

**In M-CRIL's view**, on account of good financial performance and high capital adequacy, CREDIT MFI can absorb - from all sources - loan funds of US\$650,000 till July 2006. However, lenders should monitor the organisation's performance, particularly after the induction of the new leadership.

A rating update after one year is suggested to ascertain changes in the creditworthiness and absorptive potential of the institution. **This rating is valid, subject to no other substantial inflows of loan funds into the organisation beyond the limits specified here** and to no other significant changes in the organisational structure and external operating environment.

For Micro-Credit Ratings International Ltd

Sanjay Sinha, Managing Director

**\*Validity** This rating is valid till the next loan proposal made by the MFI to any financial institution or till any other significant change in the structure of the loan programme or in its external environment. A **rating update** (comprehensive repeat rating) is recommended whenever such changes take place or at the end of **one year** from the date of the initial assessment, whichever is earlier. Any substantial additional information that becomes available could also result in a rating update or a rating review (revision of rating grade based on a desk analysis).

**Liability** The rating assigned is a professional opinion of the assessors and M-CRIL does not guarantee the information and cannot accept any legal responsibility for actions arising out of the recommendations made.

### Category wise rating

<u>Category</u>	<u>Rating grade<sup>1</sup></u>
A <i>Governance aspects</i>	$\beta+$
B <i>Managerial factors</i>	$\beta$
C <i>Financial performance</i>	$\alpha-$
<b>Overall</b>	$\beta+$

### Key Risk Factors

- 1 **Second line of leadership:** CREDIT is presently led by an expatriate from its sponsor organisation, the international NGO, World Relief. World Relief plans to pass on the leadership to a local person by the end of 2005. The new CEO is most likely to be a senior manager from within the organisation. However, the present second line of leadership is not strong enough to manage an organisation of the size of CREDIT and hence poses a risk.
- 2 **Underdeveloped operating systems:** The overall systems of the organisation including MIS, human resource management and internal controls are still under-developed. These systems may not be adequate to handle larger portfolios and a high growth rate.

### Key Programme Strengths

<b>Governance, experience and strategy</b>	<b>Management and operations</b>	<b>Financial</b>
1 Governance in the hands of an experienced INGO capable of providing technical and financial support	<ol style="list-style-type: none"> <li>1 Qualified and professional staff</li> <li>2 Good loan appraisal system</li> <li>3 Effective MIS generating critical reports</li> </ol>	<ol style="list-style-type: none"> <li>1 Excellent capital adequacy</li> <li>2 Good performance on profitability and sustainability</li> <li>3 Good portfolio quality</li> </ol>

<sup>1</sup> M-CRIL's grading sheet is attached at the end of the report.



## CREDIT MFI

### Organisational Profile

Legal form	Years of m-f operation	Number of			
		Active borrowers	Staff	Branches	Active borrowers/ staff member
Limited liability company	4 years	12,046	107	4	113

### Microfinance programme: Operational highlights

Loan portfolio of MFI ('000 Riel, US\$)	Cumulative loans disbursed by MFI ('000 Riel, US\$)	Average loan size from MFI to borrowers ('000 Riel, US\$)
8,348,408 2.0 million	54,628,164 13.6 million	1,092 273

### Key financial ratios

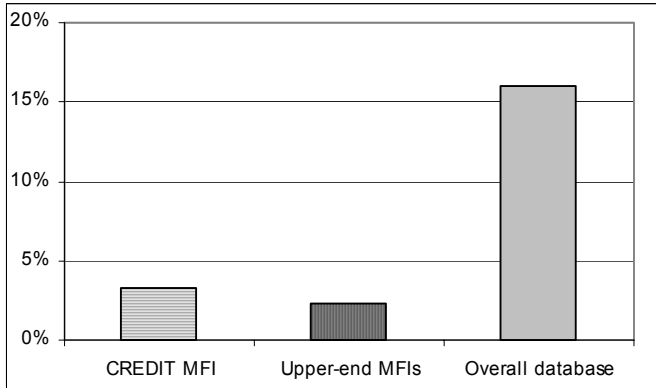
Portfolio at risk (>=60 days)	Current repayment rate	Risk weighted capital adequacy ratio	Weighted average cost of funds	Yield to APR ratio
3.3%	95.8%	93.3%	5.6%	98.4%
Yield on portfolio	Other income to average portfolio	Financial cost ratio	Loan loss provisioning ratio	Operating expense ratio
39.7%	1.3%	1.0%	0.5%	33.6%
Total income to average total assets	Total expenses to average total assets	Return on average total assets	Operational self sufficiency	Financial self sufficiency
30.1%	25.8%	4.3%	116.6%	95.6%

#### Notes

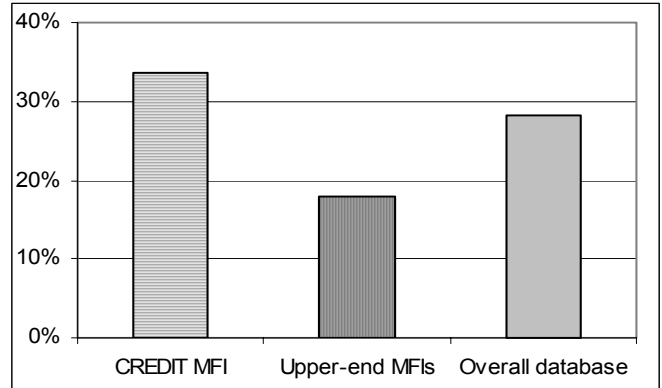
- All figures are as on 30 June 2005.
- The active borrowers' figure includes individual as well as group clients. On 30 June 2005, the MFI had 3,789 individual clients and 8,257 clients in community banking and solidarity groups.
- Other income includes income from sale of obsolete assets, bank interest and service fee.
- Loan loss provisioning of 0.3% has been done and corresponding loan loss reserves were 2.0% of the outstanding portfolio on 30 June 2005. A conservative stand on loan loss reserves has been taken, however, if the portfolio quality is maintained, the reserves can be reduced in the future.
- The ratio of repayment rate and PAR has been calculated from the MIS reports generated by CREDIT. Accuracy of data generated by the MIS has been verified by the rating team through assessment of the systems and sample checks.
- Capital adequacy is extremely high as almost all funds of CREDIT are owing to equity investment by World Relief.

CREDIT – financial overview

Portfolio at risk (>=60 days): 30 June 2005



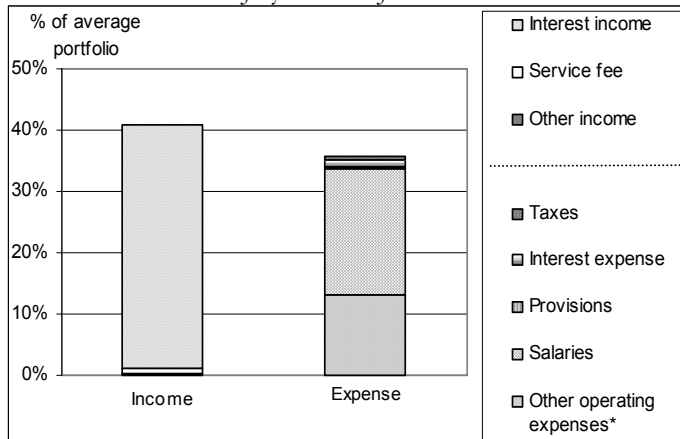
Operating expense ratio: 1 July 2004-30 June 2005



- Note:**
1.  $n_{upper-end} = 10$        $n_{database} = 212$  (excluding outliers); Database figures as on 31 December 2004
  2. Outliers and rated MFIs with no direct lending have been removed for analysis. Upper-end figures reflect top 10 MFIs.
  3. The upper-end MFIs and overall database ratios represent simple averages for their respective samples.
  4. The performance of either the Upper-end MFIs or all MFIs (overall database), do not necessarily reflect M-CRIL's rating standards.

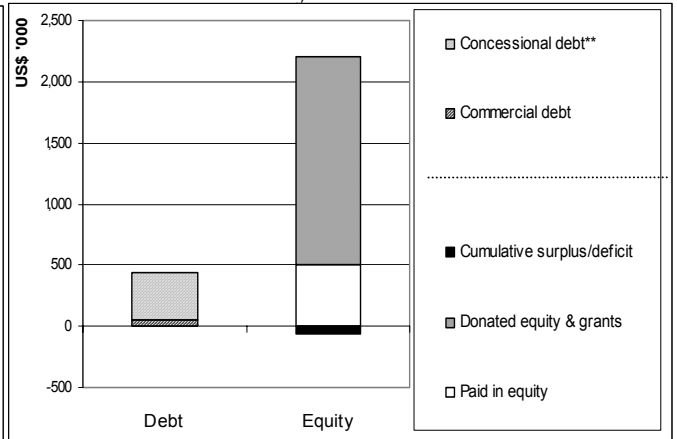
Income and expense distribution:

1 July 2004-30 June 2005



Debt and equity composition:

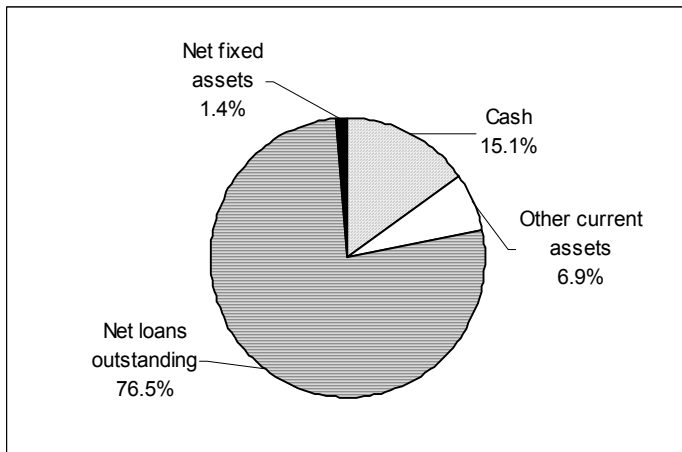
30 June 2005



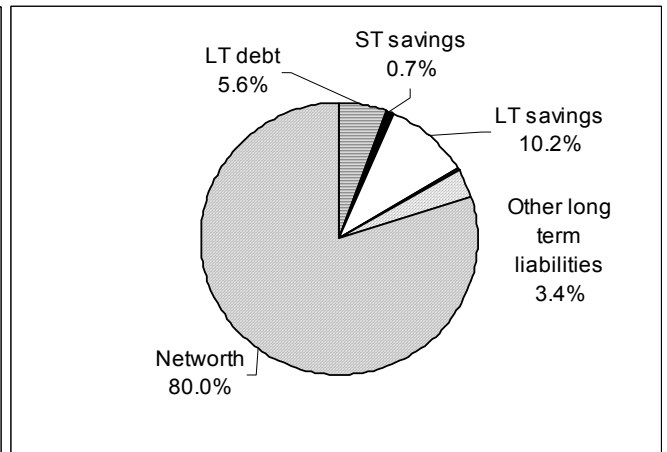
\* Other operating expenses include travel, depreciation and administrative expenses

\*\* Concessional debt is borrowing+comp.savings taken at < Bank PLR, voluntary savings taken at < bank deposit rates

Asset composition: 30 June 2005



Liability & net worth composition: 30 June 2005



## Country Profile

Cambodia lies at the heart of the Indochina peninsula, bordered by Thailand to the west, Laos to the north and Viet Nam to the east. Cambodia is a Khmer speaking Buddhist country, which is governed by a parliamentary democracy and a constitutional monarchy. It is one of the poorest countries in the world (ranks 130 out of 177 countries in the year 2005 on the human development index of the United Nations Development Programme). Subsistence farming employs 75% of the workforce, with the Mekong River providing fertile, irrigated fields for rice production. Well over half of Cambodia is forested. Cambodia suffered a long period of political and economic upheavals during the 1970s and 1980s, and it was only in the 1990s that some semblance of peace and economic stability returned to the region.

After the period of political turmoil, the revival of Cambodia's economy was heavily dependent on international institutions – the Asian Development Bank, the World Bank, the European Union have been the largest contributors to the country's development. With the exception of one year, Cambodia's overall economic and financial performance, since the late 1980s has been generally positive. The economy grew by an average of 7.6% annually from 1987 until 1993 and then by about 4.5% annually during 1994-99. Economic growth in recent years has been supported by the continued expansion of exports, especially of the garments sector (15%), tourism (41% increase in visitors) and agriculture (5% growth of rice production and 6% for other crops). The exchange rate has been fairly stable, averaging around 4,000 Riels to US\$1 over the last three years.

The improvement of the overall economic situation also reflects changes in sectoral contributions to the economy. The services sector leads the way with 43% of the national GDP, while agriculture has gone down to 37% and industry has increased to 20%. The garment industry alone now employs some 100,000 workers, mainly young women. The informal sector – especially small enterprise, trade and services – has expanded significantly, allowing for the employment of a large labour force that the formal market could not absorb. It is expected that this favourable outlook will continue to benefit microfinance as the economy tries to catch up with its ASEAN neighbours.

In this scenario, microfinance is one of the areas that have attracted the attention of policy makers and the country has made significant progress in microfinance policy and regulation. The National Bank of Cambodia – the central bank – has been instrumental in bringing about regulatory changes that include the provision of a separate license for microfinance institutions. This has increased the incentive for MFIs to become professionally managed and operated sustainable institutions.



## 1 Organisational background

Cambodia Rural Economic Development Initiatives for Transformation Co. Ltd (CREDIT) was initiated by World Relief Cambodia, an international non-profit organisation registered with the Ministry of Foreign Affairs in Cambodia. The organisation was started with the objective of providing financial services to the poor in Cambodia. CREDIT began its operations in the year 2000 with one branch in Kampong Cham province. In June 2003, CREDIT became a limited liability company and was registered under the Ministry of Commerce (MoC). In May 2004, CREDIT received a license from the National Bank of Cambodia (NBC) to conduct business as a microfinance institution for a three-year period commencing 18 May 2004. The license must be renewed after the completion of the term. Presently, the entire paid-up capital of CREDIT has been contributed by World Relief units in USA and Canada. The table below shows their equity holdings in the MFI.

Shareholders	Share capital (US\$)	% of share capital
World Relief – USA	415,000	83%
World Relief – Canada	85,000	17%
<b>Total (US\$)</b>	<b>500,000</b>	<b>100%</b>

CREDIT MFI has also borrowed from the Stromme Foundation and the Microfinance Alliance Fund (MAF). The details of these borrowings are presented in the table below.

As on 30 June 2005

Source of funds	Amount received (US\$)	Outstanding (US\$)	Interest (%)
Stromme Foundation	100,000	100,000	6.0%
MAF	50,000	50,000	10.0%
<b>Total (US\$)</b>	<b>150,000</b>	<b>150,000</b>	

## 2 Microfinance operations

### 2.1 Background of microfinance operations

Outreach: In June 2005, CREDIT was operating through a network of 4 branches, 9 sub-branches and 2 unit offices spread across 7 provinces. At the time of this rating, one of CREDIT's sub-branches at Prey Veng province was in the process of being up-graded into a branch office.

Organisational structure: An expatriate Programme Director (PD) supported by a Deputy Programme Director leads CREDIT. Other departments include operations, finance, administration, training and marketing. While administration is directly under the Deputy Programme Director; training and marketing officers report to the Operations Director. Apart from these departments Finance and Internal Audit also report directly to the Programme and Deputy Programme Directors.

At the branch level there is a Branch Manager (BM), cashier, bookkeeper, money counter and teller. Field activities are undertaken by Promotion officers (PO) and Collection Officers (CO). The PO has the responsibility for promoting new groups, identifying new clients, carrying out loan appraisal and following up overdues and bad loans. The CO has the responsibility for attending loan disbursement along with the PO and supporting the latter in loan appraisal and



## CREDIT MFI

repayment collection. Based on the geographical spread of operations, a branch may have 2-3 - sub-branches and unit offices. Unit offices only have credit officers who report to the sub-branch manager (SBM), who in turn reports to the Branch Manager.

The Governing Body: The governing body of CREDIT MFI is the Board. The Board has 4 members including the Chairperson and an advisor. The Board members have long years of experience in international finance and banking.

Executive Committee: CREDIT also has a decision making body called the Executive Committee which is comprised of the Programme Director, Deputy Programme Director, Finance Officer and all the branch managers. All operational decisions are taken by this committee.

### 2.2 Microfinance policies

CREDIT has community banking, solidarity groups and individual clients. Community banking is the old village-banking model which had large groups. However, gradually the group sizes in community banking have come down. Community banks can also be seen as associations of solidarity groups. According to CREDIT's policy, a community bank must have at least two groups and a minimum of 8 members. CREDIT has community banks only in Kampong Cham and Phnom Penh. Solidarity groups are smaller groups ranging from 2-12 members, with only one member from each household. On 30 June 2005, CREDIT had 96 community banks with an average of 11 members per bank, 2,390 solidarity groups with an average of 3 members per group and 3,789 individual clients.

For opening a new branch the organisation relies on analysis by the Marketing Officer and the Finance Department. The market survey report provides details of the general profile of the area, economic potential, livelihood scenario, competition and the break-even analysis. For starting operations in any Province, permission is sought from the Governor of the Province. Permission is also sought from the Commune Chief and at the village level, the Village Chief becomes the first line of communication. The Promotion Officer (PO) informs the Village Chief about CREDIT and its work and collects information about the village. The report is then prepared and submitted to the sub-branch and the Branch Manager who in turn verify the information. The PO then identifies individual clients and forms the solidarity groups or community banks. Members of these groups are informed about CREDIT's products and policies.

Loan appraisal: After the identification of clients, the PO invites loan applications and prepares loan documents. The PO has to collect basic information and carry out analysis before submitting the loan documents to the SBM or the BM for approval. The analysis includes an estimation of cash flow of the client's household and assessment of household assets and liabilities including loans taken from other sources, repayment ratio, collateral ratio, characteristics of the client and other conditions. After submission of the loan documents with this analysis, SBM or BM has to verify all the details through house visits. The loan-sanctioning authority of staff at different levels is set out in the following table

Loan amount (million Riel*)	Sanctioning authority
< 0.7	Promotion Officer
0.7 – 1.5	Sub-branch Manager
1.5 – 16	BM and Operations Director
>16	Credit Committee

\*1US\$ = Riel 4,000

The Credit Committee is comprised of the Branch Manager of the concerned branch, the Operations Director, the Deputy Programme Director and the Programme Director. CREDIT lends in Cambodian Riel, the local currency, as well as in US Dollars. While group loans are disbursed and repayments are collected at village level, individual loans are disbursed and repayments are collected only at branches and sub-branches. Only in case the branch and sub-branch are far from the village, does the Credit Officer collect repayments from individual borrowers as well.

### Loan products

CREDIT provides loans for agriculture and business. Interest rates on loans in the two currencies are different. Details of the loan products are given below:

#### **Community Banking**

<b>Loan details</b>	<b>Agriculture loan</b>	<b>Business loan</b>
Currency	Riel	Riel
Loan size	Up to 1.2 million Riel	Up to 2 million Riel
Interest rate	42% pa declining balance	42% pa declining
Loan term	Max. of 8 months	Max. of 12 months
Repayment frequency	Interest monthly, principal at the end of the cycle	Generally bi-weekly, but can be decided by the group
Collateral requirement	Guarantee by group within community banking	Guarantee by group within community banking

#### **Solidarity Groups**

<b>Loan details</b>	<b>Agriculture loan</b>	<b>Business loan</b>
Currency	Riel	Riel or US\$
Loan size	Up to 1.2 million Riel	Up to 2 million Riel
Interest rate	42% pa declining balance	42% pa declining for Riel 36% pa declining for US\$ loan
Loan term	Max. of 12 months	Max. of 12 months
Repayment frequency	Interest monthly, principal at the end of the cycle	Generally four-weekly, but can be decided by the group
Collateral requirement	Guarantee by group; Primary collateral – at least one member (land) Secondary collateral from others (household assets). Individual with loan >500,000Riel must provide primary collateral	Guarantee by group; at least one member provides primary collateral (land), others can provide secondary collateral (household assets). Any individual taking a loan >800,000Riel must provide primary collateral

#### **Individual loans**

<b>Loan details</b>	<b>Agriculture loan</b>	<b>Business loan</b>
Currency	Riel	Riel or US\$
Loan size	0.5-2 million Riel	0.5-40 million Riel
Interest rate	42% pa declining for Riel 36% pa declining for US\$ loan	42% pa declining for Riel 36% pa declining for US\$
Loan term	Max. of 12 months	Max. of 12 months
Repayment frequency	Four-weekly	Generally four-weekly, but can be decided by the borrower
Collateral requirement	Primary collateral (land)	Primary collateral (land)



## CREDIT MFI

Broadly, most of the loans are 12 months loans with four-weekly repayments. US\$ loans have 36% declining interest per annum while Riel loans bear 42% declining annual interest rate. In case of individual loans, primary collateral is compulsory.

### Saving products

CREDIT also offers saving products to its clients. Savings can be broadly classified into compulsory savings and voluntary savings.

Compulsory savings: Linked to the loan products. Each borrower has to pre-save 5% of the loan amount – the client has to deposit 5% of the loan amount with CREDIT at the time of taking the loan. Another 5% of the loan amount has to be saved during the loan cycle which is called cycle saving. CREDIT pays an interest of 0.6% per month on savings in Riel and 0.25% per month on savings in US\$. These savings can be used as collateral in case of default.

Voluntary savings: At the time of the rating CREDIT had only one voluntary savings product called Passbook Savings. Any client can save \$2-\$25,000 in it and can withdraw the savings amount at any time. The interest paid by CREDIT on these savings is 2% per annum for saving in US\$ and 5% per annum for saving in Riel.

## 3 Observations

### 3.1 Governance & strategy

CREDIT has shown reasonable performance on governance with a grade of  $\beta+$ . The grade is an outcome of the organisation's experienced Board, its focus on microfinance and concentrated operations. However, it has been restricted by the slow growth of the organisation and its moderate second line of leadership.

#### ➤ Strategy for microfinance operations

Governance: Although CREDIT has a small (four-member) board, the members have many years of experience in finance, banking and development in the Asian region. The Board has participated actively in the formation of CREDIT and actively monitors operations. Monthly reports of performance are sent to the Board for review. However, it has only one member who is a Cambodian.

Expansion: CREDIT's growth in the last three years has been moderate in terms of clients, while the portfolio growth has been good.

Figure 1: Growth

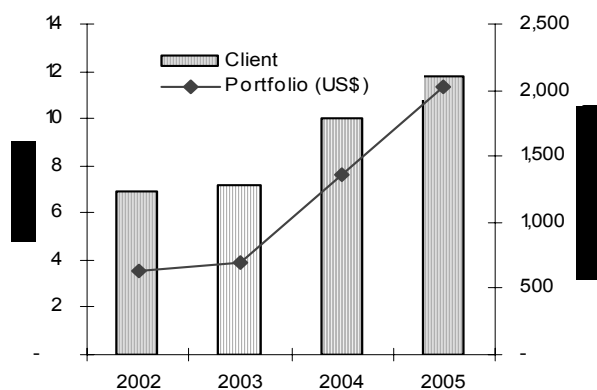


Figure 2: Growth rates





## CREDIT MFI

During the period 2002 to 2005 the number of clients has grown by 71% (in absolute terms this is an addition of around 5,000 clients in 3 years) while the portfolio has gone up by over 200%. However, **Figure 2** shows the growth rate, which has not been uniform for CREDIT. While there was negligible addition in clients and portfolio in 2003 over 2002, CREDIT has grown well in 2004, particularly in terms of portfolio. Its growth has again slowed down in 2005.

In terms of geographic spread, CREDIT's operations have remained concentrated in Phnom Penh and the surrounding provinces. This is a good strategy as it helps in controlling costs in the early stages of an MFI. CREDIT already has high operating expenses and these would have been even higher if the organisation had scattered operations. CREDIT has recently opened a new branch in Siem Reap, which is the only branch that is far from the Head Office. This decision was taken based on the market potential in Siem Reap and relatively less competition in that province.

Second line of leadership: CREDIT is being led by an expatriate Programme Director (PD) at present. The organisation plans to transfer the leadership to a Cambodian, preferably to a senior manager of the MFI by the end of this year. Although, the idea of transferring leadership to someone within the organisation is good, the second line of leadership is still moderate, particularly in terms of the management skills needed to lead an organisation. A conscious effort to build the capacity of its top level management staff will be required for this purpose.

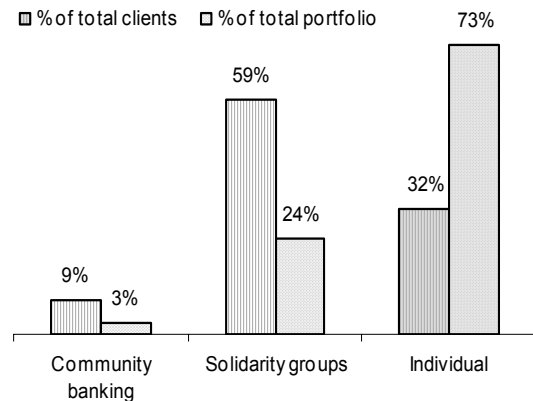
Competition: CREDIT faces stiff competition from a number of MFIs working in all the provinces where it is working. However, based on its internal survey the MFI decided to open a new branch in Siem Reap to work in and around the town. This was decided as competition in the area is relatively limited and it is an important international tourist destination, which offers good market potential. Presently, the interest rates charged by CREDIT are comparable to those of other MFIs on loans less than US\$1,000 but higher for bigger loans. This has been done deliberately by CREDIT since it wants to keep its focus on small loans. However, owing to high operating costs the MFI would find it difficult to operate if its competitors cut their interest rates. The organisation also has a limited range of financial products, both in loans as well as savings, relative to others. Conversely, it offers financial products in Riel as well as in US Dollars, unlike others. This is a good strategy as there is a high demand for dollar loans, particularly in the case of individual loans.

Microfinance model and portfolio distribution: CREDIT has community banks (CB), solidarity groups and individual clients. Community banks are larger groups and can be seen as an association of 2 or more solidarity groups. The joint liability for repayment lies with the solidarity groups within the community banks and not with the whole CB. While having Community Banks creates complications in managing records, it does not provide any extra benefit either to clients or to the organisation. For all practical purposes these are associations of smaller solidarity groups.

**Figure 3** shows the shares of client and portfolio distribution across different models. The graph indicates that CB in terms of clients as well as portfolio has low significance. Comparing solidarity groups and individual models, shows that solidarity groups with 59% of the total clients have only 24% of the portfolio, while individual clients hold 73% of the portfolio although they constitute only 32% of total clients. It is apparent that while solidarity loans are important from the organisation's mission point of view; individual loans could be critical for CREDIT's financial viability and sustainability. Hence the organisation

needs to be competitive in individual loans as well and may need to reconsider its interest rate policy in that product.

Experience: CREDIT has been involved in credit activities since inception. CREDIT has good experience of microfinance activities and presently the organisation has a 100% focus on microfinance. Its staff and Board have long years of collective experience. However, CREDIT so far has worked on grants and lacks experience in handling commercial borrowings. In June 2005, external borrowings formed only 5.6% of the total liabilities of the organisation.



### 3.2 Managerial factors

CREDIT has displayed moderate performance on managerial factors with grade of  $\beta$ . This grade is on account of the moderate quality of management systems employed by the organisation which may prove inadequate to manage a larger portfolio or handle fast growth. However, experienced and dedicated staff at HO as well as at the field level are a major strength of the organisation

➤ Human resource quality and management

CREDIT has experienced and dedicated managerial and field staff. The training and induction system for all staff members is systematic and thorough. Staff performance is assessed at the end of each year and increments are decided on various parameters such as portfolio outstanding, clients and write offs.

The organisation has an elaborate staff structure at the branch level, which has scope for optimisation. For handling cash, accounts and data entry, CREDIT has created as many as four posts viz. teller, money counter, bookkeeper and cashier. While the teller deals with clients, the money counter just counts and segregates cash according to denominations and passes it to the cashier, the cashier enters the details in the computers while the bookkeeper makes the MIS entries. Comparing CREDIT's operations to any efficient MFI, much of this work is done by the credit officers themselves. Even for Cambodia this form of staff structure appears to be inefficient.

➤ Accounting and MIS

CREDIT has a good accounting system. Vouchers support all transactions. Debit and Credit vouchers are separately maintained for all transactions. All the transactions are entered daily into the system, cash is reconciled everyday and a cash count sheet is prepared. However, in some branches the cash count sheet is prepared only once in a week. The organisation has a good financial policy, which includes prudential norms for loan loss reserves and write offs.

The MIS of CREDIT is Lotus based at all its branches and HO. The MIS being used is not a software but a complex link of sheets and formulae capable of generating almost all the required reports. The bookkeeper enters any new group or clients, loan disbursement details,

repayment details, savings etc. At the time of repayments again the information is entered into these sheets. After the information is entered the MIS can generate reports like repayment schedules, which are provided to each client, demand on a particular day, overdues, ageing of overdues, PAR and repayment rates. It can also generate other information related to savings, loans, loan purpose break-up etc. The branches send all the information physically through zip drives to HO on a weekly basis where the information is consolidated. Each branch also prepares a monthly progress report, which provides all operational details of the branch. The report is submitted to HO. The HO consolidates all the information and prepares a consolidated monthly progress report for the organisation, which is submitted to the Programme Director and the Board.

Although the MIS is working fine at present, it has its limitations as it does not offer any security feature and is highly prone to errors and modifications. Since there is no security feature the entire data is accessible to anyone and everyone. Moreover, any deletion or modification of any formula or link even by mistake can result in erroneous reports being generated. It is also difficult to spot the problem among the numerous links that the spreadsheets have. The rating team did spot errors in some of the reports that had been generated by the MIS; the errors were primarily because of incorrect links or formulae, which were mistakenly changed. The MIS of CREDIT will prove to be a major limitation in managing a larger portfolio and in expansion.

➤ Tracking system for overdues

CREDIT has reasonable systems for tracking overdues. The present MIS of the organisation can generate information on overdues and can also provide an ageing analysis. The monthly progress reports provide details of overdues and at branch level the BMs can monitor overdues on a daily basis as the MIS is able to generate reports immediately after the collections for the day has been entered. Overdues are tracked by the COs and, in case the CO is not able to collect, the PO who had appraised the loan has to take a hand. If the loan is still not repaid the SBM and the BM have to follow up.

➤ Financial planning and control systems

CREDIT has a moderate planning and control system. The organisation has prepared a three-year strategic business plan for the period 2005-07. The plan shows the projected growth of the organisation in terms of operational area, portfolio and clients. It also shows the organisation's plans to introduce new products including savings.

Cash planning at HO and Branch level is weak. The branches prepare a plan giving details of disbursements, collections, cash position and requirement only for a week. Such short-term plans do not prove effective in enabling sound cash management as, based on one week's plan, the transfer of cash from one branch to another is not possible. This results in the branches sometimes having a high amount of idle cash.

The overall control systems of CREDIT are also moderate. The organisation does not have a policy of transferring or rotating its field staff. Apart from the internal audit checks, controls from other departments like finance and operations are moderate and *ad hoc*. The internal audit system is reasonable. The audit team has 3 members, who provide a detailed visit schedule to the PD. The team is able to audit each branch 3 times in year. The department has a detailed manual for internal auditing. After auditing the team prepares a report and submits it to the DPD and the PD. However, with increasing operations the size



of the current team will be inadequate.

➤ Quality of clients/member groups

Visited member groups and individual clients showed reasonable performance on overall discipline and credit culture. The clients were aware of the interest rates and policies and procedures of CREDIT. The meeting of clients for repayment is limited only to financial transactions. The records of the visited groups and individual clients were updated and documents were in accordance with organisational policies.

➤ Infrastructure

CREDIT has adequate infrastructure at HO as well as at branch level. The organisation had an infrastructure base of US\$37,511 as on 30 June 2005. This includes computer hardware and software, vehicles, furniture and fixtures at branches and the head office. All branches, sub-branches and Head Office are in rented premises. The current level of infrastructure is adequate and is being employed effectively in the overall management of the microfinance programme.

**3.3 Financial performance**

The financial performance grade of CREDIT is good at **α-**. The grade is on account of its good profitability and portfolio quality as well as high capital adequacy. However, the organisation has a very high operating expense ratio, which is a major constraint.

➤ Credit performance and asset quality

CREDIT has good portfolio quality with PAR<sub>60</sub> of 3.3% and current repayment rate of 95.8% as on 30 June 2005. CREDIT has been writing off loans on account of bad debts. However, the portfolio quality over the years has improved and write offs have come down significantly. The table below shows the amount written off and write off collections each year.

	Written off (US\$)	Collection (US\$)
2002	56,688	232
2003	65,451	2,054
2004	19,446	5,485*

\* Collection figure includes collections made from January 2004 till June 2005

The collection of written off amounts is relatively low primarily because CREDIT writes off only those bad loans, which become highly unlikely to be recovered.

➤ Mobilisation of funds

So far CREDIT has not mobilised much money from external sources. The only external borrowings it has is a soft loan of US\$100,000 from the Stromme Foundation and a commercial loan of US\$50,000 from the Microfinance Alliance Fund (MAF). The microfinance programme is mostly dependent on donated equity received from World Relief US and World Relief Canada. The organisation has also mobilised client savings, which is another cheap source of funds, however the proportion of savings is still low. Client savings formed almost 14% of CREDIT's portfolio as on 30 June 2005. Since the organisation so



## CREDIT MFI

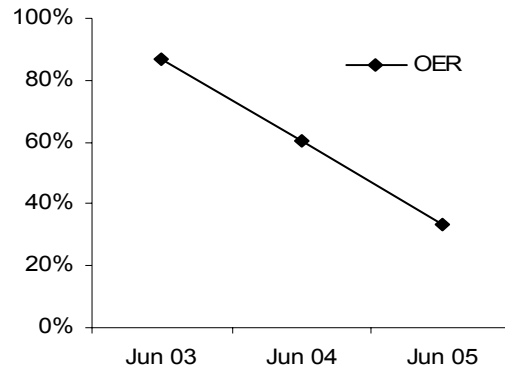
far has been able to mobilise funds from non-commercial sources, not much commercial borrowings has been necessary. However, as CREDIT's operations grow and it aims to become a sustainable MFI, it will require external commercial borrowing. Handling commercial borrowings without prior experience would be one of its challenges in future.

### ➤ Asset, liability and equity composition

CREDIT has reasonable asset composition, loans outstanding formed 76.5% of the total assets while cash formed 15.1% of the assets as on 30 June 2005. The high cash balance was on account of fresh equity infusion from CREDIT's promoters in the month of May and June 2005. CREDIT's liquidity policy is good and it is in fact more conservative than prescribed by the NBC. CREDIT maintains liquidity to the extent of 20% of its compulsory savings and 50% of its voluntary deposits. The organisation also maintains liquidity for staff benefits such as health, accident insurance and severance pay. On account of this, the current assets of the organisation were 6.9% of the total assets, while fixed assets were low at 1.4%. On the liability side, net worth comprised 80.0% of total liabilities. The net worth of CREDIT is high as most of its fund is donated equity. The organisation has been receiving regular grants from World Relief. Due to such high net worth the organisation had an excellent capital adequacy of 93.3% on 30 June 2005. Client savings formed 10.2% of the total liabilities, which is another important source of funds and commercial debt formed only 5.6% of total liabilities.

### ➤ Profitability and Sustainability

There has been an improvement in CREDIT's profitability and sustainability over the past year. While the MFI lost money last year, it has made a profit during the year ending 30 June 2005. The organisation had a good RoA of 4.3% for this period, while its OSS was 116.6%. Since CREDIT is heavily dependent on grant funds, the FSS of the organisation was a little below sustainability at 95.6% on 30 June 2005. The yield of the organisation is also high at 39.7%. However, one of its major constraints is its high operating expense ratio of 33.6%, although the OER has shown a declining trend during the last three years.



The organisation's efficiency of 113

borrowers/staff member is low though the efficiency of its Credit Officers at 204 borrowers/CO is reasonable. Salaries form the major component of operating expenses constituting 61% of total operating expenses.

## 4 Conclusions

Strengths	Weaknesses
<p><u>Organisational</u></p> <ul style="list-style-type: none"> <li>✓ Professional and experienced board</li> <li>✓ Good experience of organisation in microfinance operations</li> </ul> <p><u>Managerial</u></p> <ul style="list-style-type: none"> <li>✓ Qualified, professional and dedicated staff</li> <li>✓ Good infrastructure</li> <li>✓ Good loan appraisal system</li> </ul> <p><u>Financial</u></p> <ul style="list-style-type: none"> <li>✓ Good portfolio quality</li> <li>✓ Good performance on profitability and sustainability</li> <li>✓ High capital adequacy</li> </ul>	<p><u>Organisational</u></p> <ul style="list-style-type: none"> <li>✗ Slow growth in terms of client outreach</li> <li>✗ Moderate second line of leadership</li> <li>✗ Weak staff structure particularly at the branch level</li> </ul> <p><u>Managerial</u></p> <ul style="list-style-type: none"> <li>✗ Inadequate operating systems such as MIS, planning and control for handling a larger portfolio or for sustaining growth</li> </ul> <p><u>Financial</u></p> <ul style="list-style-type: none"> <li>✗ High operating expenses</li> <li>✗ Low leverage despite a high net worth</li> </ul>

## 5 Creditworthiness

CREDIT has achieved a rating grade of *beta plus (β+)*.<sup>3</sup> In terms of creditworthiness, this implies **reasonable safety**. CREDIT's performance on governance is reasonable owing to its experienced board; focus on microfinance and its concentrated operations. However, CREDIT has shown moderate performance in managerial parameters, as most of its operating systems are inadequate to manage a larger portfolio. Its MIS is error prone, planning and controls are moderate while staff structuring is weak. One of the major issues for the organisation is to develop its second line of leadership particularly since it has plans to change leadership by the end of 2005. The comforting factor is the strong board which has shown active involvement in the activities of the organisation. Amidst all these issues, the organisation has displayed good financial performance by maintaining good portfolio quality and making its operations sustainable. However, high operating costs erode the organisation's margin.

**In M-CRIL's view**, on account of good financial performance and high capital adequacy, CREDIT MFI can absorb – from all sources – loan funds of US\$650,000 till July 2006. However, the lender should periodically monitor the organisation's performance, particularly when the leadership is due for a change and the second line of leadership is not strong.

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<sup>3</sup> The Rating Grade given measures performance on the rigorous standards established by M-CRIL. The assessment uses an instrument designed specifically for the conditions and nature of MFIs operating in Asia and is comparable with other ratings done by M-CRIL in this region.



CREDIT MFI

**Financial statements for CREDIT MFI Ltd**

**Balance Sheet**

as on 30 June 2004		as on 30 June 2005	
US\$	Assets	US\$	US\$
	<b>Current assets</b>		
424,128	Cash in hand and bank		403,875
121,085	Interest bearing deposits		168,748
24,270	Other current assets		16,587
	<b>Loans outstanding</b>		
1,126,617	Gross loans outstanding	2,087,102	
-33,799	(Loan loss reserve)	-41,742	
1,092,818	Net loans outstanding		2,045,360
<b>1,662,301</b>	<b>Total current assets</b>		<b>2,634,570</b>
	<b>Long term assets</b>		
49,437	Net property and equipment	37,511	
<b>49,437</b>	<b>Total long term assets</b>		<b>37,511</b>
<b>1,711,738</b>	<b>Total Assets</b>		<b>2,672,081</b>
	<b>Liabilities and Net worth</b>		
	<b>Current liabilities</b>		
805	Short-term liabilities	1,313	
31,815	Voluntary savings	18,048	
<b>32,620</b>	<b>Total current liabilities</b>		<b>19,361</b>
	<b>Long term liabilities</b>		
155,270	Client savings	272,966	
77,819	Other long-term liabilities	91,001	
	Loan MAF	50,000	
	Loan Stromme Foundation	100,000	
<b>233,089</b>	<b>Total long term liabilities</b>		<b>513,967</b>
	<b>Net worth</b>		
	Paid up equity	500,000	
1,595,089	Donated equity	1,704,634	
	Retained net surplus/(deficit)	-149,060	
-149,060	Current net surplus/(deficit)	83,178	
<b>1,446,029</b>	<b>Total net worth</b>		<b>2,138,752</b>
<b>1,711,738</b>	<b>Total Liabilities and Net Worth</b>		<b>2,672,080</b>



CREDIT MFI

Income Statement – for the year ending

30 June 2004		30 June 2005	
	<u>Income</u>	<u>US\$</u>	<u>US\$</u>
379,541	Interest on loan	639,866	
6,900	Fee on loans	14,086	
20,062	Other income	6,120	
<b>406,503</b>	<b>Total income</b>		<b>660,072</b>
	<u>Financial costs</u>		
	Interest on borrowings	1,500	
12,418	Interest on savings	15,400	
<b>394,085</b>	<b>Gross financial margin</b>		<b>643,172</b>
14,613	Provision for loan losses	7,944	
<b>379,472</b>	<b>Net financial margin</b>		<b>635,228</b>
	<u>Operating expenses</u>		
317,812	Salaries	329,527	
29,407	Travel	46,222	
16,497	Depreciation	18,003	
160,883	Administrative/office expenses	138,563	
1,414	Rebates	8,842	
<b>526,013</b>	<b>Total Operating expenses</b>		<b>541,157</b>
<b>(146,541)</b>	<b>Profit before tax</b>		<b>94,071</b>
2,519	Tax*		10,893
<b>(149,060)</b>	<b>Profit after tax (transferred to B/s)</b>		<b>83,178</b>

\*Tax had been charged on account of donations which have been removed from this income statement



## Notes to the financial statements

1. Other current assets include receivables, advances and pre-paid expenses. Other long-term liabilities includes staff benefits
2. Other income includes bank interest and income from sale of obsolete assets.
3. Last year there was no paid up equity as the process of transfer of assets and liabilities could not be completed till then.

## Glossary

1. Current repayment rate  
Ratio of current principal recovered (net of pre-payments) to the principal due during the period.
2. Portfolio at risk (PAR<sub>60</sub>)  
Ratio of the principal balance outstanding on all loans with overdues greater than or equal to 60 days to the total loans outstanding on a given date.
3. Yield on portfolio  
The interest income on loans divided by the average loan portfolio for the year.
4. Other income to average portfolio  
Total income other than from the interest on loans divided by average portfolio.
5. Financial cost ratio  
Total interest expense for the year divided by the average portfolio.
6. Loan loss provisioning ratio  
Total loan loss provisioning expense for the year divided by the average portfolio.
7. Operating expense ratio  
Ratio of salaries, travel, administrative costs and depreciation expenses to the average loan portfolio.
8. Average loan portfolio  
This represents the average loan outstanding for the year computed on a monthly basis.
9. Average total assets  
This represents the average total assets for the year calculated on an annual basis.
10. Operational Self-Sufficiency  
Ratio of total income to total costs for the year.
11. Financial Self-Sufficiency  
Ratio of total income to total adjusted expenses for the year. Adjustments have been made for subsidised cost of funds (w.r.t. market interest rate), equity (w.r.t. inflation) and in-kind donations.
12. Risk weighted capital adequacy ratio  
Ratio of net worth to risk weighted assets (Risk weights: 100% for all assets except the following: fixed assets & interest bearing deposits: 50%; cash 0%).

## Projected Cash Flows and Financial Statements for five years

- The following assumptions and projections - derived from the limited information available from the organisation on its future financial projections – are tentative in nature. These **should not be viewed in isolation nor be regarded as a basis for investing in the future** - only the main risk rating report provides an opinion on investments.
- All assumptions are based on the data gathered during the rating exercise and the credit methodology used by the organisation.

### 1 Basic Assumptions

(see also Notes to Cash Flow Projections below)

For the year ending:	<i>Jun-05</i>	Jun-06	Jun-07	Jun-08	Jun-09	Jun-10
Clients	<i>12,046</i>	17,500	20,000	23,000	25,500	28,000
Savings/member per year	<i>9</i>	10	11	13	14	15
Yield on average portfolio	<i>39.7%</i>	38.0%	37.0%	36.0%	36.0%	36.0%
Interest paid on savings	<i>4.0%</i>	4.0%	4.0%	4.0%	4.0%	4.0%
Cost of external funds	<i>7.8%</i>	8.0%	8.3%	8.4%	8.4%	8.3%
Repayment rate from groups	<i>95.8%</i>	95.0%	96.0%	97.0%	97.0%	97.0%
Loan loss reserve ratio	<i>2.0%</i>	2.0%	1.8%	1.5%	1.3%	1.2%
Number of active loans	<i>12,046</i>	17,150	19,600	21,850	24,225	26,600
Number of loans disbursed		16,789	19,086	21,262	23,570	25,873
Average loan size to borrowers	<i>213</i>	250	320	360	420	500

**2 Projected balance sheets**
*US\$ in thousands*

<b>As on:</b>	<i>Jun-05</i>	<i>Jun-06</i>	<i>Jun-07</i>	<i>Jun-08</i>	<i>Jun-09</i>	<i>Jun-10</i>
<b><u>Assets</u></b>						
Cash balance	404	212	228	317	420	566
Interest bearing deposits	169	186	204	225	247	272
Other current assets	17	18	20	22	24	27
Loans outstanding	2,087	2,938	4,010	4,971	6,381	8,350
Loan loss reserve	-42	-59	-72	-75	-83	-100
Net loans outstanding	2,045	2,879	3,938	4,896	6,298	8,250
Net fixed assets	38	79	116	172	222	267
<b>Total Assets</b>	<b>2,672</b>	<b>3,374</b>	<b>4,506</b>	<b>5,632</b>	<b>7,211</b>	<b>9,381</b>
<b><u>Liabilities and Net Worth</u></b>						
External borrowings	150	500	1,092	1,517	2,284	3,451
Member savings	291	418	578	780	1,026	1,324
Other current liabilities	92	102	112	123	135	149
Donations and equity	2,205	2,305	2,505	2,755	3,005	3,305
Retained surplus/deficit	-149	-66	49	220	458	761
Current surplus/deficit	83	115	171	237	303	392
Net worth	2,139	2,354	2,725	3,212	3,765	4,458
<b>Total Liabilities and Net Worth</b>	<b>2,672</b>	<b>3,374</b>	<b>4,506</b>	<b>5,632</b>	<b>7,211</b>	<b>9,381</b>

**3 Projected Income Statements**
*US\$ in thousands*

<b>For the year ending:</b>	<i>Jun-05</i>	<i>Jun-06</i>	<i>Jun-07</i>	<i>Jun-08</i>	<i>Jun-09</i>	<i>Jun-10</i>
<b><u>Income</u></b>						
Interest	640	955	1,285	1,617	2,043	2,652
Other income	20	23	27	31	35	41
<b>Total Income</b>	<b>660</b>	<b>978</b>	<b>1,312</b>	<b>1,647</b>	<b>2,079</b>	<b>2,692</b>
<b><u>Cost</u></b>						
Financial	17	45	94	143	206	301
Loan loss provision	8	17	13	2	8	17
Depreciation	18	9	13	19	25	30
Operating costs (excl.depr.)	523	764	947	1,144	1,407	1,783
<b>Total Cost</b>	<b>566</b>	<b>834</b>	<b>1,068</b>	<b>1,308</b>	<b>1,645</b>	<b>2,131</b>
<b>Surplus/Deficit</b>	<b>94</b>	<b>144</b>	<b>244</b>	<b>339</b>	<b>433</b>	<b>561</b>
Tax	11	29	73	102	130	168
<b>PAT to balance sheet</b>	<b>83</b>	<b>115</b>	<b>171</b>	<b>237</b>	<b>303</b>	<b>392</b>



## CREDIT MFI

### 4 Projected Cash Flow Statements

US\$ in thousands

For the year ending:	Jun-06	Jun-07	Jun-08	Jun-09	Jun-10
<b>Inflows</b>					
Opening cash	404	212	228	317	420
External borrowings	400	800	850	1,450	2,200
Change in current liabilities	9	10	11	12	14
Repayments from members	3,346	5,035	6,694	8,489	10,967
Grants and Equity investments	100	200	250	250	300
Member savings	181	228	289	352	425
Interest income	955	1,285	1,617	2,043	2,652
Other income	23	27	31	35	41
<b>Total Inflow</b>	<b>5,419</b>	<b>7,797</b>	<b>9,969</b>	<b>12,950</b>	<b>17,018</b>
<b>Outflows</b>					
Disbursement	4,197	6,107	7,654	9,899	12,937
Repayments to lenders	50	208	425	683	1,033
Change in deposits	17	19	20	22	25
Change in current assets	2	2	2	2	2
Withdrawal of savings	54	68	87	106	128
Operating expenses (excl. depr.)	764	947	1,144	1,407	1,783
Interest paid on borrowings	31	74	116	170	254
Interest paid on savings	14	20	27	36	47
Tax	29	73	102	130	168
Fixed asset purchase	50	50	75	75	75
<b>Total Outflow</b>	<b>5,207</b>	<b>7,569</b>	<b>9,652</b>	<b>12,530</b>	<b>16,452</b>
<b>Net cash balance</b>	<b>212</b>	<b>228</b>	<b>317</b>	<b>420</b>	<b>566</b>

### 5 Key projected performance ratios

For the year ending:	Jun-05	Jun-06	Jun-07	Jun-08	Jun-09	Jun-10
Operational self-sufficiency	117%	117.3%	122.9%	125.9%	126.3%	126.3%
Return on average assets	4.3%	4.8%	6.2%	6.7%	6.7%	6.8%
Operating expense ratio	33.6%	30.7%	27.6%	25.9%	25.2%	24.6%
Average outstanding/borrower (US\$)	173	171	205	227	263	314
Portfolio growth rate	85.3%	40.8%	36.5%	23.9%	28.4%	30.9%
Savings to total assets	10.9%	12.4%	12.8%	13.8%	14.2%	14.1%
Risk weighted capital adequacy ratio	93.3%	80.1%	67.9%	64.2%	58.5%	53.0%

**6 Notes to the projections**

1. The Operating expense ratio is based on current levels and is projected based on changes in overall productivity and growth in staff, branches and portfolio.
2. Estimated external borrowings are subject strictly to performance based on the findings of this microfinance capacity assessment (credit rating).
3. Equity and donations have been assumed to be coming into the organisation.
4. Average loan size to members has been assumed to be going up as the organisation has plans to give bigger loans in future.
5. Interest income is taken as [yield on portfolio\*average portfolio for the year]. Yield has been slightly increased as the present yield to APR is low and is expected to improve in future.
6. Yield on portfolio has been assumed to be coming down. This is has been done as CREDIT presently has higher interest rates than its competitors. Hence in future the yield is likely to come down if CREDIT revises its interest policy.
7. Interest on savings has been kept constant at 6%.
8. Other income is the income that the organisation earns on bank interest, sale of old assets and write off collection.
9. Disbursements are taken as the [number of loans disbursed during the year\*average loan size to borrowers].
10. Estimates on growth in outreach and demand for loans from the organisation have been made based on the organisation's own business plan.
11. Repayments to lenders is 33% per annum on the projected liability structure.
12. Interest paid is taken as the [average cost of external funds \* the average external borrowing liability figure].
13. The tax has been calculated as 30% of the surplus.



## CREDIT MFI

### 7 List of abbreviations

APR	Annual Percentage Rate
BM	Branch Managers
CREDIT	Cambodia Rural Economic Development Initiatives for Transformation Co. Ltd
CB	Community Banks
CCB	Cambodia Community Building
CEO	Chief Executive Officer
CO	Collection Officer
DPD	Deputy Programme Director
FSS	Financial Self Sufficiency
HO	Head Office
HR	Human Resource
INGO	International Non-Government Organisation
LLP	Loan Loss Provisioning
LLR	Loan Loss Reserve
LT debts	Long Term Debts
M-CRIL	Micro-Credit Ratings International Ltd
MD	Managing Director
MFI	Micro Finance Institution
MIS	Management Information System
MoC	Ministry of Commerce
NBC	National Bank of Cambodia
NGO	Non Government Organisation
OER	Operating Expenses Ratio
OSS	Operational Self Sufficiency
PAR <sub>30</sub>	Portfolio At Risk (greater than 30 days)
PAT	Profit after tax
PBT	Profit before tax
PD	Programme Director
PO	Promotion Officer
PLR	Prime Landing Rate
RoA	Return on Assets
SBM	Sub-branch Manager



## M-CRIL's Microfinance Rating Symbols

M-CRIL Grade	Description
<b>α+++</b> alpha triple plus	Highest safety, excellent systems ➤ most highly recommended
<b>α++</b> alpha double plus	Highest safety, very good systems ➤ most highly recommended
<b>α+</b> alpha single plus	Very high safety, good systems ➤ highly recommended
<b>α</b> alpha	High safety, good systems ➤ highly recommended
<b>α-</b> alpha minus	Reasonable safety, good systems ➤ recommended
<b>β+</b> beta plus	Reasonable safety, reasonable systems ➤ recommended, needs monitoring
<b>β</b> beta	Moderate safety, moderate systems ➤ acceptable, needs improvement to handle large volumes
<b>β-</b> beta minus	Significant risk, poor to moderate systems ➤ acceptable only after improvement
<b>γ+</b> gamma plus	Substantial risk, poor systems ➤ needs considerable improvement
<b>γ</b> gamma	Highest risk, poor systems ➤ not worth considering