



Cambodia Entrepreneur Building Ltd

Phnom Penh, Cambodia

Rating grade	α- alpha minus	Assessment: Recommended, reasonable safety excellent systems
<p>Visit dates: 21-24 May, 2003 Operational head: Mr Bun Mony</p> <p>Maximum validity of rating*: till 31 May, 2004</p>		

Rating

CEB has reasonably good performance on governance and management and its financial performance is good. Poor financial control and management information systems and low client awareness reduce the otherwise good performance on management and governance respectively.

In M-CRIL's view, on account of a significant institutional presence, overall good performance, commendable approach to sustainability and self-reliance and strong current performance on profitability, CEB can absorb – from all sources – loan funds of US\$825,000 over the next one year for on-lending to its borrowers.

Given CEB's weak control systems at present, M-CRIL recommends that lending to the organisation should be contingent on the institution strengthening the internal audit and other financial control functions.

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

Frances 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 grade¹</u>
A <i>Governance aspects</i>	$\beta+$
B <i>Managerial factors</i>	$\beta+$
C <i>Financial performance</i>	α
Overall	$\alpha-$

Key Risk Factors

- 1 **Weak internal controls:** CEB does not have proper internal control systems in place for an organisation of its size. The internal audit function is still not functioning properly and the Branch Managers and Credit Agents have significant financial powers and access to cash, which in the absence of proper checks pose a risk of fraud.
- 2 **Poor risk mitigation systems:** The organisation’s loan portfolio is skewed towards individual loans secured by asset collaterals of doubtful enforceability, which increases the portfolio risk. Even in the case of group loans, CEB – in common with other MFIs in Cambodia – has not been able to put in place adequate norms of joint responsibility and relies on individual collateral. Though the organisation uses other forms of social pressure to “shame” delinquents this in itself could carry substantial risk on account of the still polarised political situation in the Cambodian countryside.

Key Programme Strengths

Governance, experience and strategy	Management and operations	Financial
<ul style="list-style-type: none"> ✓ Horizontal concentration in microfinance programme ✓ High client retention ✓ Good strategies for microfinance 	<ul style="list-style-type: none"> ✓ Stable and qualified staff resources ✓ Reasonable system for tracking overdues ✓ Good utilisation of asset base 	<ul style="list-style-type: none"> ✓ Reasonable capital adequacy ✓ Excellent portfolio quality ✓ Strong performance on profitability and sustainability

¹ M-CRIL’s grading sheet is attached at the end of the report.



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Organisational Profile

Legal form	Years of m-f Operation	Number of				
		Active borrowers	Clients	Staff	Branches	Active borrowers/ staff member
Company	7	5,911	5,911	92	4	64

Microfinance programme: Operational highlights

Client savings (US\$)	Outstanding borrowings of MFI (US\$)	Loan portfolio of MFI (US\$)	Cumulative loans disbursed by MFI (US\$)	Average loan size from MFI to borrowers (US\$)
99,786	1.02 million	1.31 million	10.8 million	131

Key financial ratios

Portfolio at risk (>=60 days) 2.5%	Cumulative repayment rate 96.0%	Risk weighted capital adequacy ratio 43.4%	Subsidy dependence index 28.2%	Yield to APR ratio 99.8%
Yield on portfolio 38.5%	Other income to average portfolio 0.9%	Financial cost ratio 6.7%	Loan loss provisioning ratio 0.7%	Operating expense ratio 30.1%
Total income to average total assets 37.1%	Total expenses to average total assets 35.5%	Return on average total assets 1.6%	Operational Self Sufficiency 105.1%	Financial Self Sufficiency 84.8%

Notes

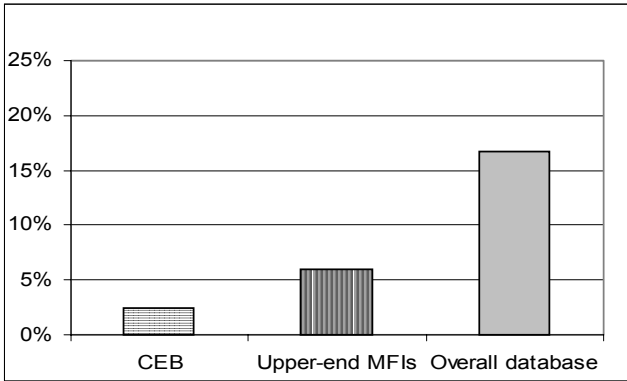
1. All figures are estimated for the organisation's microfinance programme as on 31 March 2003.
2. The clients of CEB comprise 5,911 women. The number of active loanees is 5,911 and the number of loan accounts is 2,856.
3. All staff members of CEB are full-time and are dedicated only to the microfinance programme.
4. The ratios of repayment rate and portfolio at risk have been calculated on the basis of an examination of all loan accounts (borrowers to MFI level), cross verification from office ledgers and during field visits to groups and examination of other office records. The methodology used to measure such ratios is a function of the data with the organisation and the quality of that data.
5. Other income includes income that the organisation earns from membership fees and processing charges for loans.



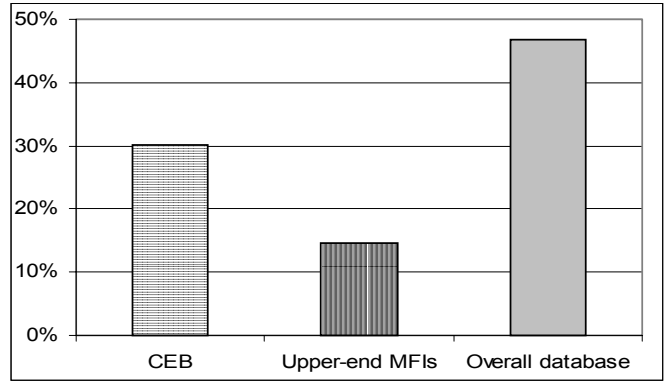
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CEB – financial overview

Portfolio at risk (>=60 days): 31 March 2003

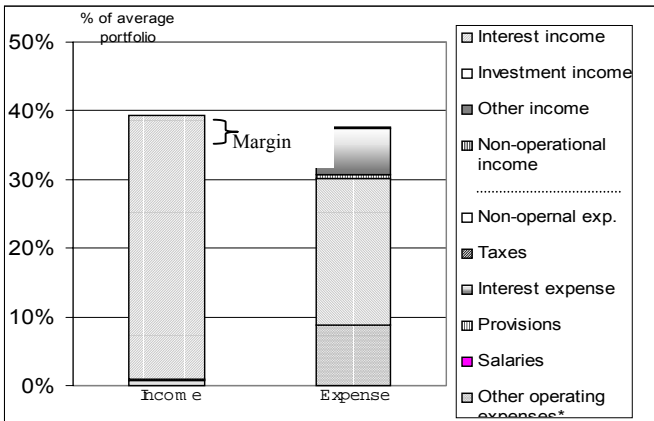


Operating expense ratio: 1 April 2002-31 March 2003

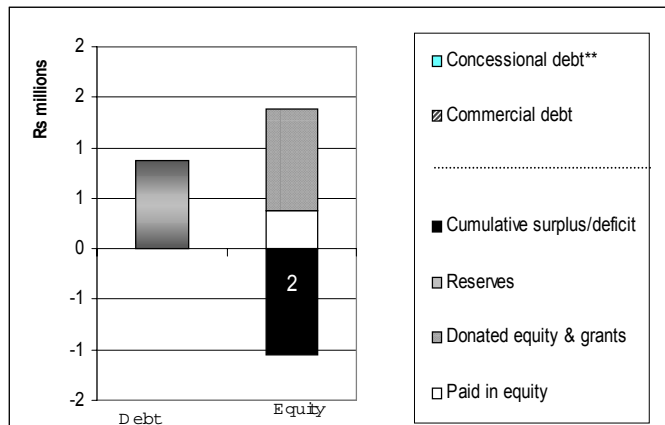


- Note:**
1. $n_{upper-end} = 9$ $n_{database} = 86$; Database updated as on 27 February 2002.
 2. Outliers and rated NGOs with no direct lending have been removed for analysis. Upper-end figures reflect MFIs with top 10% scores.
 3. The upper-end MFIs and overall database ratios represent simple averages 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 April 2002-31 March 2003



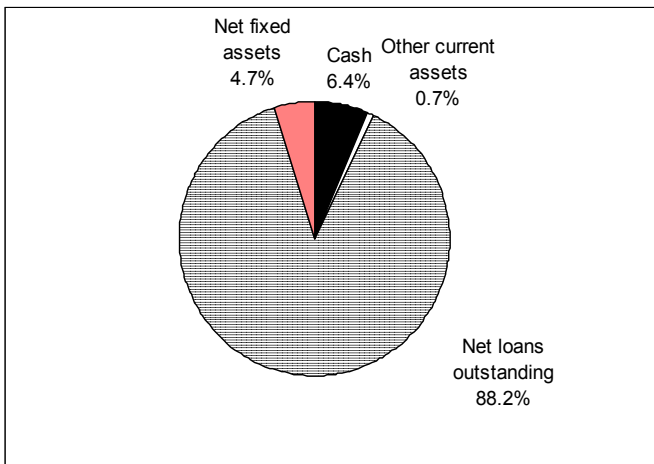
Debt and equity composition: 31 March 2003



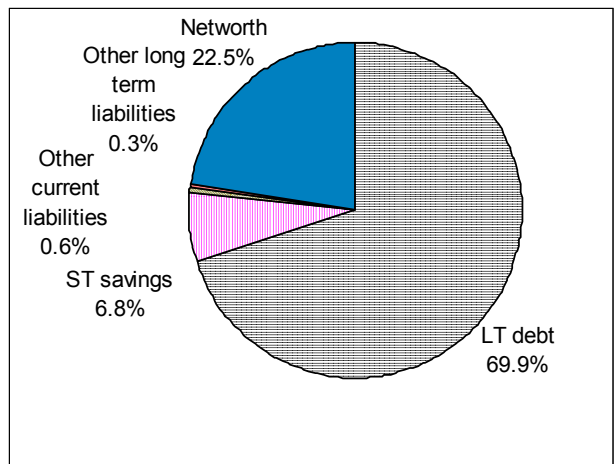
* Other operating expenses include travel, depreciation and administrative expenses

** Concessional debt is borrowing+comp.savings taken at < Bank PLR +50 basis points, & voluntary savings taken at < bank deposit rates

Asset composition: 31 March 2003



Liability & net worth composition: 31 March 2003





Country Profile

The Cambodian economy grew by 5.3 percent in 2001, 4.5% in 2002 and is expected to grow by more than 6% in 2003 (source: Asian Development Outlook, 2003, An Asian Development Bank publication). Agriculture, which contributes around 30% to GDP and employs close to 80% of the population, continues to be the mainstay of the economy and grew by around 5% during the last 2 years despite a major natural calamity in the form of flood. The industrial sector is dominated by garment production and grew at more than 10%. However, the per capita income has been growing at just 2%.

Inflation has been under control in the recent past and is expected to remain below 5% in the next one year. Confidence in the monetary system continues to be weak with the economy functioning mainly in US dollars. The financial sector remains unstable with a number of commercial banks going bankrupt in the recent past. Some stability was brought about after the establishment of the National Bank of Cambodia in 1996 and the introduction of new banking laws, which also regulate microfinance. The sector outlook remains buoyant with rapid growth being recorded in the recent past. However, in pricing their loans, international lenders would need to consider the relative fragility of the political and financial systems in the country.

1 Organisational background

Cambodian Entrepreneur Building Limited (CEB) – registered as a company in December 2002, was initially set up in 1995 as Cambodian Community Building (CCB) and registered as an NGO for offering microfinance services to poor women entrepreneurs for promoting self-employment. The organisation was initially established with the support of World Relief Corporation, USA and GTZ, Germany but became autonomous in 1999 after parting with World Relief. In December 2002, CEB was formed and registered as a company promoted by the NGO, CCB and its employees with a shareholding 81% and 19% respectively.

The operations of CEB are entirely focused on microfinance and are governed by a four-member board consisting of two senior staff of CEB, a credit manager of the Rural Development Bank (RDB) of Cambodia and an independent banking consultant. Since its formation as a company, the board meets once a month for operational decision-making.

2 Microfinance operations

2.1 Background of microfinance operations

The credit programme was started in 1995 by CCB with the objective of providing credit to women entrepreneurs. CEB currently works in 578 villages, spread over five provinces of 29 districts. It operates through four branches and 3 satellite offices and has a total staff strength of 92 – 84 in the branches and 8 at the head office in Phnom Penh.

The General Manager, Mr Bun Mony heads the operations of CEB. Mr Mony has been associated with CEB and CCB as a founder member and was earlier working with World Relief. The General Manager is assisted by an Operations and HR Manager and a Finance



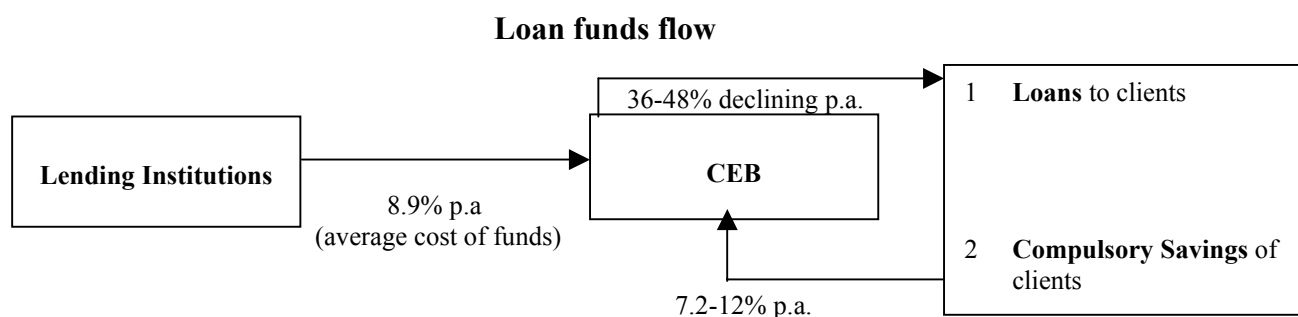
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Manager. Other staff at the head office include an Auditor, MIS Manager and an Accountant. At the branch level, operations are led by the Branch Manager (BM) who is supported by a Deputy Branch Manager, Accountant, Head Credit Officer, Cashier and a team of Credit Agents (CAs). An Auditor is also present at the Siem Reap branch.

For its operations, CEB has obtained loan funds from the Rural Development Bank (RDB) and IFAD, as well as a subordinated loan from the parent NGO, CCB. Repayment to lenders has been timely. The summary of borrowings is as follows

Source of funds	Cumulative amount (US\$)	Outstanding debt (US\$)	Interest rate (p.a.)
RDB- I	350,000	-	12%
RDB- II	30,000	30,000	10%
RDB – III	800,000	600,000	8%
IFAD	154,000	140,000	7%
CCB NGO	256,000	256,000	2%

The flow of funds for on-lending is depicted in the following diagram.



2.2 Microfinance policies

CEB operates with solidarity groups and individual entrepreneurs. The solidarity groups consist of 2-8 entrepreneurial women who guarantee each other's loans. The individual clients are also women entrepreneurs, but typically take larger loans owing to greater size of the enterprise. Solidarity groups are generally given loans for meeting the working capital needs of the enterprise or for expansion purposes. Individual loans are meant largely for expansion of the existing business. The selection of target area is done by the CAs, followed by a socio-economic survey and meetings with leaders of the communes. The eligibility criteria for both solidarity groups and individual clients are

- The client should be a poor woman with a minimum experience of one year in carrying out income generating activities.
- The client should have a good reputation in the community.
- There should be availability of assets like land, house, motorcycle, livestock or valuable household items that could serve as loan collateral.

The members of solidarity groups are informed about CEB procedures in a meeting before



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collecting loan applications. The Credit Agent (CA) informs individual clients of these procedures while completing the loan application. The CA helps all clients prepare applications for the loan. The CA does the preliminary screening of loan applicants and all loans above \$300 are appraised by the management team at the branch, which comprises of the Branch Manager, Deputy Branch Manager and the Head CA. However, CAs with greater experience are allowed to appraise loans below \$300. Surprise checks of such loans are carried out by the Branch Manager. In case of larger loans a detailed feasibility analysis of the proposed investment is carried out by the CA. An upfront service charge of R500 to R15,000 is made for Riel loans and \$1 to \$5 for dollar loans. The clients are supplied passbooks free of charge and repayment schedules for each loan are pasted on them.

Loan disbursement and collection are done both at the CA level and at the branch office level, according to the convenience of the client. Collateral papers of twice the loan size are collected from clients and kept at the branch office for the duration of the loan. The *family books* of the clients are also collected by CEB to discourage them from seeking loans from other MFIs during the period of the CEB loan.

Loan products

CEB offers two loan products to its clients

Loan product	Loan amount	Interest rate	Repayment norms
<u>Dollar loans</u>	Solidarity loans - \$25 to \$350 Individual loans - \$350-\$5,000	36% pa, calculated on a declining basis	<ul style="list-style-type: none"> Loan duration – 3-12 months, depending on projected cash flow Repayment schedule – weekly, four-weekly and monthly
<u>Riel loan</u>	Solidarity loans – R100,000 to R1,500,000 Individual loans – R1,500,000 to R8,000,000	48% pa, calculated on a declining basis	<ul style="list-style-type: none"> Loan duration – 3-12 months, depending on projected cash flow Repayment schedule – weekly, four-weekly and monthly

Savings products

CEB has a compulsory savings product, the size of which is linked to the size of the loan. In case of Riel loans, the compulsory savings are 5% of the total loan amount, while in case of the dollar loans, they are 2% of the loan amount. In both cases, 50% of the savings are to be deposited before loan disbursement and the remaining amount is collected in equal instalments during the loan term. An interest rate of 12% p.a. is paid on the Riel savings and 7.2% p.a. on the dollar savings. These savings are non-withdrawable during the period of the loan and become withdrawable after the loan term has ended. CEB also offers a voluntary and withdrawable savings product, at the same interest rates.

3 Observations

3.1 Governance

CEB has a reasonable performance on organisational aspects with a grade of $\beta+$. The grade is reflective of the organisation's efforts to put in place a strong governance structure in the newly formed company but is constrained by the relative nascence and lack of clarity of this structure. The strategic problem of poor client awareness and collateral enforceability inherited from its predecessor, CCB also affect its performance adversely.

➤ Strategy for microfinance operations

CEB shows a reasonable overall performance on strategy aspects. Its aim is to foster micro enterprises in Cambodia and it has been continuously adapting its operational strategy based on market realities to achieve this end. The recent National Bank of Cambodia (NBC) license to the organisation for providing microfinance services in the country is a result of its strong market position.

The company has put in place a board representative of different stakeholders- promoters, employees and microfinance experts. However, the overall operating parameters for the board's functioning are still being worked out and more clarity is required on this aspect.

The operations are fully focused on microfinance with a strategy of gradual growth. As the organisation operates mostly in urban and semi-urban areas, its concentration is low in percentage terms but it has a reasonable client retention rate, which implies high client satisfaction. Its geographical coverage has thus far been limited largely to Phnom Penh, Siem Reap and their adjacent areas and significant scope exists for expansion. Its loan products are priced slightly above some of its competitors but remain competitive due to their service flexibility.

An area of concern is client awareness as a large percentage of clients visited were not aware of operational details like interest rate. The problem is more serious in the case of solidarity group clients who deposit savings with CEB and are not aware of their savings balances, thus giving rise to the potential for fraud by CAs.

Another potential problem area is the organisation's policy of relying on asset collaterals for loan security. Most of these collaterals are in the form of land title deeds valued by the local community office, which results in an arbitrary valuation of the asset. Moreover, it is very difficult to enforce this security under Cambodian law, something the organisation accepts. In case of an economic downturn when significant default occurs, it faces the risk of being left with a loan security of doubtful enforceability that has no market. CCB has, however, resorted to innovative approaches of collecting overdue loans. The staff visits the delinquent client and starts measuring the land or estimating the value of collateral. This often has the



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effect of embarrassing the client into paying up the overdue amount.

This is further magnified by its strategy of raising relatively small amounts in savings from its clients, though it is allowed to raise deposits as an NBC licensed financial company. This reduces the clients' financial exposure to CEB – presently just 7.7% of the loan portfolio - and can cause problems in case of significant default. Though this is a prudent strategy given the lack of stability in Cambodia's financial sector, which has led to bankruptcies in the commercial banking sector in the recent past, this also makes CEB dependent on institutional debt for funding ongoing operational expansion and can cause fund problems if loan funds are delayed/stopped.

CEB follows a non-membership based system where the client's relationship with CEB is limited to loans only and the relationship is terminated once the loan term is over. While this gives the client flexibility, it can pose problems in the longer term if clients switch loyalties, a possibility given the increasing competition in the market.

➤ Experience in microfinance

CEB itself has only recently come into existence as a company with multiple stakeholders and is still developing a framework to satisfy them. It has, however, gained intensive market knowledge from its 7 years' experience as an NGO. It has been a fast learner and has adapted well to the market situation. It started as a lender to community banks – larger groups of more than 20 members, which it felt was a low-cost and empowering strategy. However, this led to poor portfolio quality and operational problems in fund management by groups and resulted in the change to lending to smaller groups and individuals.

CEB has also forged strong partnerships with several independent experts and resource providers like the Mekong Project Development Facility (MPDF), which have made useful contributions to its operations. It is also in the process of partnering with CARD MBA, which has significant experience in microfinance.

3.2 Managerial factors

CEB exhibits reasonable performance on managerial factors with a grade of $\beta+$. It has reasonably qualified and dedicated staff but lacks adequate management information and financial control systems.

➤ Human resource quality and management

CEB has committed staff for the microfinance programme and staff dropout rates have been fairly low. The staff members are reasonably qualified and experienced in microfinance.

The recently introduced performance based incentive system for CAs aims to introduce a target orientation in the staff but its effects are still not visible in the field. The system has also been limited only to the CAs and may lead to a situation where only the CAs are held accountable for poor performance without responsibility being



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assigned up the hierarchy. The exposure of staff, especially middle management, to critical microfinance implementation functions of financial analysis and control is also limited.

➤ Accounting and MIS

The accounting and management information system at CEB is reasonable but suffers from certain design and capacity lacunae.

The MIS is computerised and operates on a spreadsheet based customised software loaded in all branches. A daily due collection report (the *daily schedule*) is generated which has CA wise amount due for the day and is used for collecting repayment. Collections are entered in the MIS daily but consolidated monthly, as the *Monthly Activity Report*, for reporting to the head office. All information is maintained separately for Riel and US Dollar loans and a *Loan Fund Reconciliation* report is generated for combining the two. As CAs are paid on performance, a *CA Efficiency Report* is generated for analysis, which includes various parameters like disbursement and repayment performance. The system is quite flexible with options for data analysis but this capacity remains under-utilised due to a lack of trained human resources. It is weak on security aspects with no clear definition of access rights and may cause problems of data integrity as operations expand. The processing capacity of the system is also limited.

Accounting is done manually at the branches, which feeds into centralised software-IDEAS-at the head office. Loan related information is maintained in the software while all other transactions are accounted for manually. At the end of each month, the MIS generates a voucher summary for all debits and credits at a branch – *cash debit, loan out and savings*. This is used for updating the accounting system at the head office. This system of maintaining loan information solely in soft format and monthly updating of the accounting software with no formal process of cross-verification can lead to the passing of erroneous entries.

Cash balances are reconciled only when a senior management representative goes to the branch. Monthly financial statements – income statement, balance sheet – are prepared for branch level operations separately for Riel and Dollar accounts as well as consolidated. The accounting system has thus far functioned reasonably. This is reflected in the annual financial statements being audited within 1-3 months after completion of the financial year and internally generated monthly financial statements being prepared within 2-3 days of the end of the month. The organisation has clear policies for loan loss provisioning and write-offs. However, its income (accrual) and expense (cash) recognition policies go against internationally accepted prudential norms. There is also an account head for interest receivable in the audited statements, which has remained the same since the last 3 years although the portfolio has grown significantly. The exact explanation for this entry was not made available to the rating team.

➤ Tracking system for overdues



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The systems for tracking arrears at CEB are adequate. An overdue is recognised the day an instalment is not paid though the information is conveyed monthly to the head office. There has been inadequate follow up on part of the organisation and this has resulted in a significant amount of write offs over the past few years. At present the organisation does not have much by way of arrears – owing to a very strong emphasis on credit discipline.

➤ Financial planning and control systems

CEB has weak financial control systems. At the branch level, daily cash reconciliation is not undertaken though accounts are closed every day. Cross checks of member wise loan outstanding with branch loans outstanding is also not undertaken.

CEB has a team of two internal auditors that goes from branch to branch and functions independently, and is supposed to report directly to the board. However, the system is not properly functional yet and the audit checks are very irregular. To obviate this lacuna, the field and monitoring visits of the senior management are used for cross verification of information on a sample basis. Although these have so far been effective deterrents to any potential deviations/errors in record keeping and implementing operational procedures, it poses a significant risk to the organisation in the light of an increasing loan portfolio. Also, the internal auditors only visit the overdue loans. There is no provision for visiting of other clients by the internal auditor. This poses a risk of ghost loans/dummy accounts in the organisation. However, no special attention to checking voluntary savings balances with the clients is paid and this may lead to a misappropriation of funds by the CAs. The CAs also operate in overlapping areas. This poses a risk of unhealthy competition resulting in poor client appraisal.

The CA and the BM make loan sanctions and disbursements jointly and this also has significant potential for fraud. In fact the organisation has had a few instances of dummy loan accounts and this problem has also plagued a number of its competitors. The BM also has unlimited access to the branch cash which is usually kept in a safe vault at the branch.

In terms of planning, CEB uses a three-year business plan prepared by an external consultant. Operational branch level fund requirements are estimated on a weekly basis and requests for funds are sent to the head office on a monthly basis. However, operational projections and achievements are not compared for variance.

➤ Decision making

The overall decision-making process is very standardised with operational procedures being clear. This system facilitates smooth conduct of routine field operations. The Chief Executive of CEB along with the board takes most policy decisions while operational decisions are decentralised. The branch level staff, under the Branch Manager, is responsible for all such decisions.



➤ Quality of clients/member groups

CEB's clients fall in two broad categories – solidarity groups and individuals and both show low understanding of applicable operational policies like interest rates. In solidarity groups there are no set norms of joint responsibility and the group guarantee remains only on paper. Though this is in the knowledge of the organisation and is to some extent deliberate, it gives rise to a significant risk of default, which is further increased by poor detection systems. Clients can change their groups after the end of a loan cycle. Most of the group members interviewed had no knowledge of the interest rates on their loan and savings products.

Incidences of repeat loans by members have been high. The members of solidarity groups have been observed as graduating to larger, individual loans after strengthening of their businesses and successful completion of a few group loan cycles.

Furthermore, in the context of the long-term viability of the company, the level of effort in enhancing client awareness and participation on these aspects is inadequate.

➤ Infrastructure

CEB has a low infrastructure base for its microfinance operations (total value of fixed assets of CEB microfinance operations is around US\$ 68,000 on 31 March 2003). All the buildings are rented and the asset base consists of office equipment. The current level of infrastructure is being employed effectively in the overall management of the microfinance programme.

3.3 Financial performance

The financial performance of CEB is good at α . This has resulted from good repayment and portfolio quality, high capital adequacy as well as good performance on profitability and sustainability. This has scope to improve further if the operating costs are brought down from current levels.

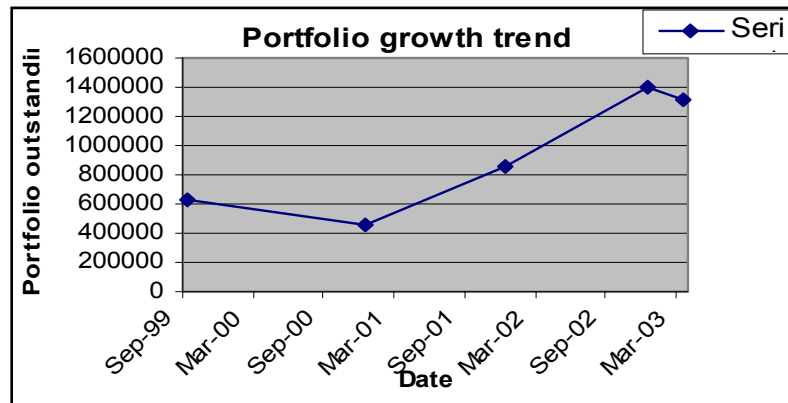
➤ Credit performance and portfolio quality

CEB has shown excellent credit performance. The PAR₆₀ is 2.5% as of 31 March 2003 and the cumulative repayment rate is 96%. However, there have been significant write-offs of \$103,773 over the last four years, which indicates that most of the PAR has to be written off. This represents just under 1% of the cumulative disbursements and about 7.9% of the current outstanding portfolio. Although writing off bad loans is a prudent policy, the figures suggest delinquency at the field level, which need attention. The overall good recovery performance is also a result of being able to use compulsory savings to settle the last instalment of the loan and pending loan balances where recovery becomes an issue.

Although the present portfolio quality is good, its continued maintenance is doubtful in the face of an increase in the number of clients coupled with a weak appraisal and follow up system.



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CEB provides loans only for income-generation activities. The portfolio of CEB is skewed towards trading/service activities accounting for 61% of the current loans. Manufacturing activities (including food processing) account for 28% of the loans while about 11% of the loans are deployed in agriculture and animal husbandry.

➤ Mobilisation of funds

CEB has mobilised loan funds mainly from RDB and IFAD and has been regular in repayment to its lenders. CCB holds 81.65% of the equity shareholding of CEB while the remaining 19.35% is owned by the staff members. CEB has also received a subordinated loan from CCB. Some more equity investment in CEB is expected over the next one year.

CCB has been weak in savings collection owing to a poor savings culture in Cambodia, the current levels of savings being only around \$90,000.

➤ Asset, liability and equity composition

The asset composition of CEB is good with 88.2% of its total assets deployed in loans. On the liability side, the organisation has relied mainly on various lenders for loan funds. The risk weighted capital adequacy ratio is reasonably high at 43.4%, owing to high levels of equity and the donated equity from CCB received from World Relief and other donors. It is expected that over the next couple of years the capital adequacy position will strengthen with significant equity investment and loan funds coupled with increasing accruals of profits (refer below to the projected financial statements).

➤ Sustainability and profitability

The organisation's financial sustainability in terms of its independence from subsidies and its return on average assets is good. CEB's Financial Self-Sufficiency at 84.8%, its Subsidy Dependence Index (SDI) at 28.2% and return on assets at 1.6% are all good. Similarly, the Operational Self-Sufficiency (OSS) ratio is good at 105.1%. While the Operating Expense Ratio needs to be brought down from the current level of 30.1%, the high yield on portfolio (38.4%) and a high yield to APR at 99.8%



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resulting from good repayment performance compensates for the relatively high cost structure.

4 Conclusions

Strengths	Weaknesses
<p><u>Organisational</u></p> <ul style="list-style-type: none"> ✓ Horizontal concentration in microfinance programme ✓ High client retention ✓ Good strategies for microfinance <p><u>Managerial</u></p> <ul style="list-style-type: none"> ✓ Stable and qualified staff resources ✓ Reasonable system for tracking overdue ✓ Good utilisation of asset base <p><u>Financial</u></p> <ul style="list-style-type: none"> ✓ Reasonable capital adequacy ✓ Excellent portfolio quality ✓ Strong performance on profitability and sustainability 	<p><u>Organisational</u></p> <ul style="list-style-type: none"> ✗ Low depth of coverage in existing operational areas ✗ Poor emphasis on capacity building of clients ✗ High levels of competition <p><u>Managerial</u></p> <ul style="list-style-type: none"> ✗ Lack of adequate levels of awareness amongst clients on interest rates ✗ Poor control systems and lack of follow up ✗ Competition amongst CAs might result in poor loan appraisal <p><u>Financial</u></p> <ul style="list-style-type: none"> ✗ Poor savings mobilisation ✗ Non-enforceability of collateral ✗ High operational cost model

5 Creditworthiness

CEB has achieved a rating grade of *alpha minus* ($\alpha-$).² In terms of creditworthiness this implies **reasonable safety**. CEB's performance on governance and managerial performance is reasonable and its performance on financial aspects is good. While CEB has shown good performance on portfolio quality and repayment, the factors that have brought down overall performance are the high risk of fraud owing to poor internal control systems coupled with low client awareness, low savings mobilisation and an MIS not equipped to handle greater portfolio sizes. Higher levels of equity infusion and adoption of more stringent norms for client appraisal and internal controls may significantly improve the rating in the future.

In M-CRIL's view, on account of significant institutional presence, overall good performance, commendable approach to sustainability and self-reliance and good current performance on profitability, CEB can absorb – from all sources – loan funds of US\$825,000 over the next year for on-lending to its borrowers.

Given CEB's weak control systems at present, M-CRIL recommends that lending to the organisation should be contingent on the organisation strengthening its Internal Audit and other financial control functions.

A rating update of the organisation 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.

²

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.



Financial statements for CEB's microfinance operations

Balance Sheet - as on 31 March 2003

<u>Assets</u>	<u>US\$</u>	<u>US\$</u>
<u>Current assets</u>		
Cash in hand and bank		94,495
Interest bearing deposits		500
Advances (imprest amount)		197
Advances (prepaid expenses)		9,070
<u>Loans outstanding</u>		
Gross loans outstanding	1,311,459	
(Loan loss reserve)	(14,719)	
Net loans outstanding		1,296,739
Total current assets		1,401,001
<u>Long term assets</u>		
Net property and equipment	68,408	
Total long term assets		68,408
Total Assets		1,469,409
<u>Liabilities and Networth</u>		
<u>Current liabilities</u>		
Short term liabilities		8,141
Client savings - compulsory-Riels		38,131
Client savings - compulsory-Dollars		61,655
Total current liabilities		107,927
<u>Long term liabilities</u>		
Other long term liabilities (Staff savings)		3,860
<u>Long term debt</u>		
RDB (8% loan)	600,000	
RDB (10% loan)	30,000	
IFAD	140,000	
Sub-ordinate loan (Loan from CCB NGO)	256,587	
Total long term debt		1,026,587
Total long term liabilities		1,030,447
<u>Net worth</u>		
Staff shares	1,463	
Paid up equity	372,000	
Donated equity	1,007,026	
Retained net surplus/(deficit)	-1,071,523	
Current net surplus/(deficit)	22,069	
Total net worth		331,035
Total Liabilities and Net Worth		1,469,409



CEB Assessment

Income Statement: Statement from 1 April 2002 – 31 March 2003

<u>Income</u>	<u>US\$</u>	<u>US\$</u>
Interest and fees on loans	487,216	
Interest on investments	225	
Registration & fees	9,129	
Other income	<u>1,396</u>	
Total income		497,966
<u>Financial costs</u>		
Interest on borrowings	78,845	
Interest on member savings	<u>5,997</u>	
Gross financial margin		413,124
Provision for loan losses	<u>8,905</u>	
Net financial margin		404,219
<u>Operating expenses</u>		
Salaries	269,411	
Travel	27,620	
Depreciation	29,135	
Administrative/office expenses	<u>53,753</u>	
Total Operating expenses		379,919
Net Surplus/Deficit		24,300
Non-operational expenses	<u>2,231</u>	
Profit before tax (PBT)		22,069
Tax		<u>0</u>
Profit after tax (PAT)		22,069



Notes to the financial statements

1. The Financial Statements have been estimated for the microfinance operations and represent an approximate picture only. This has involved appropriate modifications to the existing financial statements using data gathered and assumptions made during the rating exercise and also allocations based on an estimation of the degree of use of overall fixed assets and the value of the total staff time being spent on microfinance activities. Such modifications can result in differences between the income statement and balance sheet prepared by the organization itself and the statements presented above.
2. Income includes interest income, fees and earnings from other microfinance related services offered by the MFI rated. All loan portfolio related income is recognised only when it is actually received (**cash basis**). Grants allocated to the organisation's microfinance programme are treated as donated equity in the balance sheet (and not regarded as operational income).
3. Financial costs (interest on borrowings and savings, if any) and operating costs are calculated on an **accrual basis**. Loan loss provisioning expense and the corresponding balance sheet entry (loan loss reserve) has been computed based on the quality of the portfolio.

Glossary

1. Cumulative repayment rate
Ratio of cumulative principal recovered (net of pre-payments) to the cumulative principal due till the date of measurement.
2. Portfolio at risk (PAR₆₀)
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. Subsidy Dependence Index
The Subsidy Dependence Index broadly measures the net subsidies received as a proportion of the income of the organisation. A higher ratio indicates that there is a higher level of dependence on subsidies. Subsidies can be in the form of grants and savings deposits/ borrowings at a rate lower than market rate. Computation of subsidies is done with respect to the market rate of interest.
10. Average total assets
This represents the average total assets for the year calculated on an annual basis.
11. Operational Self-Sufficiency
Ratio of total income to total costs for the year.
12. Financial Self-Sufficiency
Ratio of total income to total adjusted expenses for the year. Adjustments made for subsidised cost of funds (w.r.t. the market interest rate), equity (w.r.t. inflation) and in-kind donations.
13. Risk weighted capital adequacy ratio
Ratio of networth to risk weighted assets (Risk weights: 100% for all assets except fixed assets and interest bearing deposits (50%) and 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 savings and credit methodology used by the organisation.

1 Basic Assumptions

(see also Notes to Cash Flow Projections below)

For the year ending:	31-Mar-03	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08
Members	5,911	7,389	8,867	9,753	10,728	11,801
Savings per member/year (US\$)	3	3	3	4	5	5
Yield on average portfolio	38.6%	38.6%	38.6%	38.6%	38.6%	38.6%
Interest paid on savings	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%
Cost of external funds	8.9%	7.4%	8.1%	8.5%	8.8%	9.0%
Repayment rate from groups	96.0%	96.5%	97.0%	98.0%	99.0%	99.0%
Loan loss reserve ratio	1.1%	1.2%	1.0%	1.0%	1.0%	1.0%
Number of active loanees/loan a/cs	5,911	7,389	8,867	9,753	10,728	11,801
Number of loans disbursed		7,093	8,497	9,310	10,241	11,265
Average loan size to borrowers (US\$)	296	370	426	489	563	619



CEB Assessment

2 Projected balance sheets

As on:	Mar-03	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08
	US\$	US\$	US\$	US\$	US\$	US\$
Assets						
Cash balance	104,262	95,907	143,637	134,199	156,605	199,795
Loans outstanding	1,311,459	1,678,138	2,292,638	2,853,169	3,556,914	4,304,836
Loan loss reserve	-14,719	-20,138	-22,926	-28,532	-35,569	-43,048
Net loans outstanding	1,296,739	1,658,001	2,269,712	2,824,637	3,521,345	4,261,788
Long term investments	0	0	0	0	0	0
Net fixed assets	68,408	264,067	246,660	230,994	225,895	221,305
Total Assets	1,469,409	2,017,975	2,660,010	3,189,831	3,903,845	4,682,888
Liabilities and Net Worth						
External borrowings	1,026,587	1,334,587	1,882,137	2,272,137	2,662,837	2,943,787
Member savings	99,786	119,022	146,922	183,822	227,922	281,022
Other liabilities	12,001	12,001	12,001	12,001	12,001	12,001
Donations and equity	1,380,489	1,600,489	1,600,489	1,600,489	1,700,489	1,900,489
Retained surplus/deficit	-1,071,523	-1,049,454	-1,048,124	-981,540	-878,619	-699,404
Current surplus/deficit	22,069	1,330	66,584	102,921	179,215	244,993
Net worth	331,035	552,365	618,949	721,870	1,001,085	1,446,078
Total Liabilities and Net Worth	1,469,409	2,017,975	2,660,010	3,189,831	3,903,845	4,682,888

3 Projected Income Statements

For the year ending:	Mar-03	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08
	US\$	US\$	US\$	US\$	US\$	US\$
Income						
Interest	487,216	576,370	766,000	992,000	1,236,000	1,516,000
Other income	10,750	11,825	13,000	14,000	15,000	17,000
Total Income	497,966	588,195	779,000	1,006,000	1,251,000	1,533,000
Cost						
Financial	84,842	98,304	145,762	191,376	235,034	271,631
Gross revenue tax @ 1% of gr rev		5,764	7,660	9,920	12,360	15,160
Loan loss provision	8,905	5,418	2,789	5,605	7,037	7,479
Depreciation	29,135	29,341	27,407	25,666	25,099	24,589
Operating expenses (excl. depr.)	353,015	447,706	512,152	644,782	747,450	907,899
Total Cost	475,898	586,533	695,770	877,349	1,026,981	1,226,759
Surplus/Deficit	22,069	1,662	83,230	128,651	224,019	306,241
Income tax @ 20% of profit		332	16646	25730	44804	61248



CEB Assessment

Projected Cash Flow Statements

For the year ending:	Mar-03	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08
	US\$	US\$	US\$	US\$	US\$	US\$
Inflows						
Opening cash		104,262	95,907	143,637	134,199	156,605
External borrowings		825,000	1,200,000	1,250,000	1,475,000	1,575,000
Repayments from members		2,257,320	3,001,000	3,995,000	5,059,000	6,225,000
Equity		20,000	0	0	100,000	200,000
Member savings deposits		21,374	31,000	41,000	49,000	59,000
Grant		200,000				
Interest income		576,370	766,000	992,000	1,236,000	1,516,000
Other income		11,825	13,000	14,000	15,000	17,000
Total Inflow		4,016,151	5,106,907	6,435,637	8,068,199	9,748,605
Outflows						
Disbursement		2,624,000	3,615,500	4,555,530	5,762,746	6,972,922
Repayments to lenders		517,000	652,450	860,000	1,084,300	1,294,050
Withdrawals of savings deposits		2,137	3,100	4,100	4,900	5,900
Operating expenses (excl. depr.)		447,706	512,152	644,782	747,450	907,899
Interest paid on borrowings		91,740	137,784	181,453	222,682	256,362
Interest paid on savings		6,564	7,978	9,922	12,352	15,268
Taxes		6,096	24,306	35,650	57,164	76,408
Fixed assets purchase		225,000	10,000	10,000	20,000	20,000
Total Outflow		3,920,243	4,963,270	6,301,438	7,911,594	9,548,810
Net cash balance		95,907	143,637	134,199	156,605	199,795

5 Key projected performance ratios

For the year ending:	Mar-03	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08
Operational self-sufficiency	105%	100.3%	112.0%	114.7%	121.8%	125.0%
Return on average assets	1.6%	0.1%	3.6%	4.4%	6.3%	7.1%
Operating expense ratio	30.1%	31.9%	27.2%	26.1%	24.1%	23.7%
Average outstanding/borrower (US\$)	222	227	259	293	332	365
Portfolio growth rate	19.3%	28.0%	36.6%	24.4%	24.7%	21.0%
Savings to total assets	6.8%	5.9%	5.5%	5.8%	5.8%	6.0%
Risk weighted capital adequacy ratio	43.4%	30.9%	25.9%	24.6%	27.5%	33.1%



CEB Assessment

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. Number of active loan accounts relative to client base is projected to be 100% based on the current and historical relationship.
4. Average loan size to clients increases by 10-15% every year.
5. Net group level savings/client increases at the rate of 10-15% per year and is in line with the projected growth in loan portfolio as savings are loan linked.
6. Repayment from clients is taken based on assuming that for each of the first four months of every year, 5% of annual disbursement takes place; disbursement for the remaining eight months is 10% of annual disbursements. Repayments are calculated after factoring in the loans outstanding of last year and the repayment rate for the current year.
7. Interest income is taken as [yield on portfolio*average portfolio for the year]. Yield movements are projected to increase over time to levels closer to the effective interest rate of the organisation. For CEB the yield declines after one year based on suggested changes in the pricing structure for loans.
8. Other income is the income that the organisation earns on loan fee and increases by 10% every year.
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 current growth levels and future expansion potential and capacity. Increase in active clients is taken at rates between 10-25% per year.
11. Repayments to lenders ranges from 25-50% of last year-end's outstanding debt depending on the expected source of funds and the present and future expected liability structure.
12. Interest paid is taken as the [average cost of external funds * the average external borrowing liability figure].
13. Fixed assets purchase is estimated based on likely requirements of the organisation and is taken at levels between US\$ 0.01-0.2 million per year.
14. In the projections the net worth figure includes donations and equity, retained surpluses and current surplus.
15. A tax of 1% on gross interest income has been taken as per Cambodian law
16. The applicable income tax rate is 20%



M-CRIL's Microfinance Rating Symbols

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