Micro-Finance Rating - Risk Assessment

Bhartiya Samruddhi Finance Limited (Samruddhi)

Hyderabad (Andhra Pradesh)

<2nd Rating Update>

Rating grade α **alpha**	**Assessment**: Recommended High safety, good systems
Visit dates: 6-12 November, 2001 **Operational head**: Mr Vijay Mahajan **Maximum validity of rating***: till 12 November, 2002	

Rating

Samruddhi shows very good performance on governance aspects and managerial factors and good performance on financial indicators. Its portfolio quality has improved over the last rating though the profitability has declined marginally. The organisation needs to improve its portfolio quality further to impact upon its profitability and financial performance.

In M-CRIL's view, on account of Samruddhi's good overall performance, improvement in portfolio quality, plans for expansion and anticipated mobilisation of equity funds, the organisation can absorb – from all sources – loan funds of Rs 50 million over the next one year for on-lending to its borrowers. With expected inflows of large amounts of equity (Rs 165 million), Samruddhi – subject to a reassessment of expansion capacity – can leverage significantly larger amounts of loans in the following years.

Given that the organization is planning to expand rapidly and to new areas, however, a rating update – at the end of one year from now – is strongly recommended. The update is required to ascertain improvements in performance, especially on portfolio quality and profitability and also in absorptive potential. **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 and Guarantees India 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

Category	Rating grade[1]
A *Governance aspects*	α+
B *Managerial factors*	α+
C *Financial performance*	α
Overall	α

Key Risk Factors

1 **Portfolio quality**: The quality of the portfolio has improved since the last rating, however it is a slow improvement and a significant proportion of the portfolio is still at risk. An inability to reduce portfolio at risk significantly could result in a deterioration in portfolio quality as the organisation expands, resulting in an adverse impact on costs and income, making the task of attaining profitability more difficult.

Key Programme Strengths

Governance, experience and strategy	Management and operations	Financial
1 Clearly established strategy for microfinance – separate and focused operations 2 Strong Board to guide operations	1 Committed and professional staff 2 Strong MIS, accounting and internal control measures	1 Good fund mobilisation and asset deployment 2 Good performance on efficiency

[1] M-CRIL's grading sheet is attached at the end of the report.

Organisational Profile

Legal form	Years of m-f operation	Number of			
		Active borrowers	*Members*	*Staff*	*Branches*
NBFC	5.5	20,629	-	159	13

Microfinance programme: Operational highlights

Cash security (Rs)	Loan portfolio of MFI (Rs)	Debt of MFI (Rs)	Cumulative loans disbursed by MFI (Rs)	Average loan disbursed (Rs)
17.1 million	202 million	163 million	607 million	12,067

Key financial ratios

Portfolio at risk (>=60 days)	Cumulative repayment rate	Risk weighted capital adequacy ratio	Subsidy dependence index	Yield to APR ratio
10.5%	95.6%	18%	32.6%	86.6%

Yield on portfolio	Other financial income to average portfolio	Financial cost ratio	Loan loss provisioning ratio	Operating cost ratio
20%	3.7%	9.1%	1.7%	12.8%

Total income to average total assets	Total expenses to average total assets	Return on average total assets	Operational Self Sufficiency	Financial Self Sufficiency
20.4%	20.3%	0.1%	100.5%	80%

Notes

1. All figures are estimated for the organisation's microfinance programme as on 30 September 2001.
2. The members of Samruddhi comprise 20,629 active borrowers, out of which 1222 are organised into SHGs, 4759 in JLGs and the rest are individual borrowers.
3. Staff includes 59 managerial staff of Samruddhi at the head office and field level and 100 Customer Service Agents (CSAs).
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 financial income includes income that the organisation earns from loan processing fees and interest on investments.

Comparative highlights – Samruddhi in June 2000[2] and September 2001

Category	Rating grade		Movement
	Previous	Update	
Governance aspects	α	α+	↑
Managerial factors	α+	α+	⇔
Financial performance	α+	α	↓
Overall	α+	α*	↓

* The downgrade results from the stricter standards (that are based on the changing outlook of the microfinance industry) that M-CRIL now employs on managerial factors, portfolio quality and profitability.

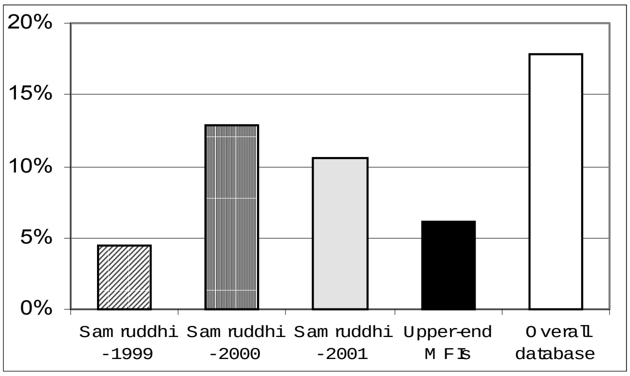
Indicator/ratio	June 2000	September 2001	Change[3]
1 Growth			
Loans outstanding	Rs98 million	Rs202 million	Increase
Outstanding borrowings	Rs99 million	Rs163 million	Increase
Active borrowers	9,174	20,629	Increase
Average loan size	Rs9,889	Rs12,067	Increase
2 Credit performance			
Cumulative repayment rate	92.0%	95.6%	↑
Portfolio at risk (>=60 days)	12.9%	10.5%	↑
3 Efficiency and profitability			
Active clients per field staff	316	206	↓
Annual return on assets	0.2%	0.1%	⇔
Operating self-sufficiency	101.8%	100.5%	⇔
Subsidy dependence index	38.6%	32.6%	↑

2 The information for June 2000, is as stated in the previous rating report.

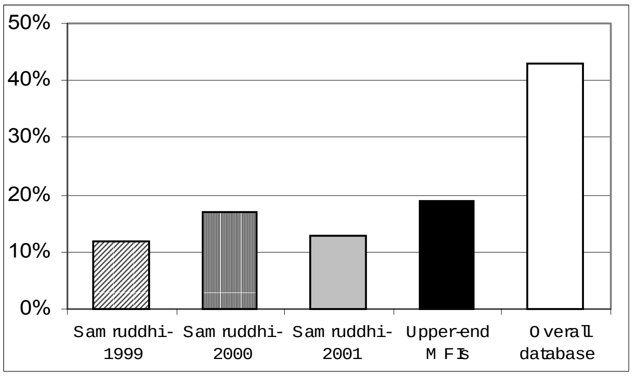
3 An upward arrow indicates an improvement and vice versa for a downward arrow; a constant arrow indicates very low or no change.

Samruddhi – financial overview

Portfolio at risk (>=60 days): 30 September 2001



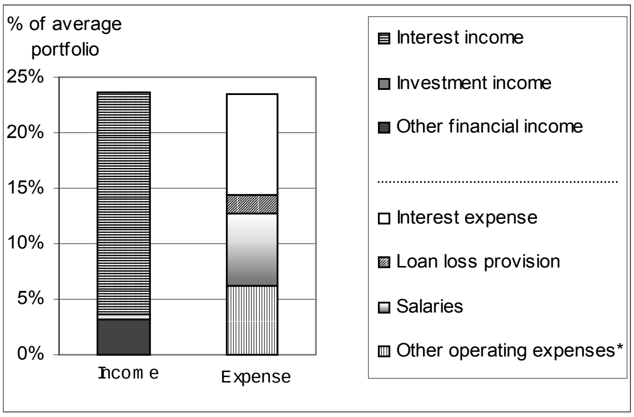
Operating cost ratio: 1 October 2000-30 September 2001



Note: 1. $n_{upper\text{-}end} = 8$ $n_{database} = 70$; Database updated as on 31 August 2001.

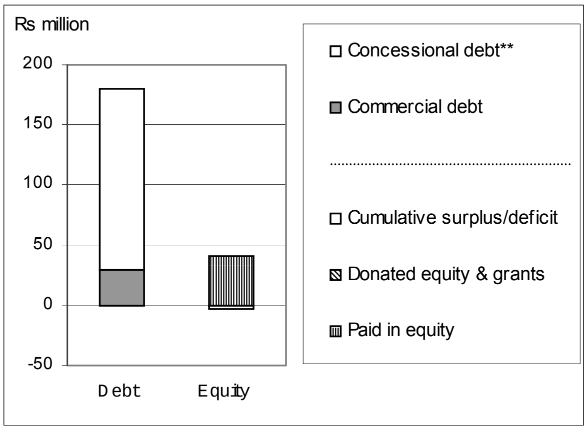
2. Outliers and rated NGOs with no direct lending have been removed for analysis. Upper-end figures reflect MFIs with top 10% scores.
3. The upper-end MFIs and overall database ratios represent simple averages for their respective samples.
4. The performance of either the Upper-end MFIs or all MFIs (overall database), do not necessarily reflect M-CRIL's rating standards.

Income and expense distribution:
1 October 2000-30 September 2001



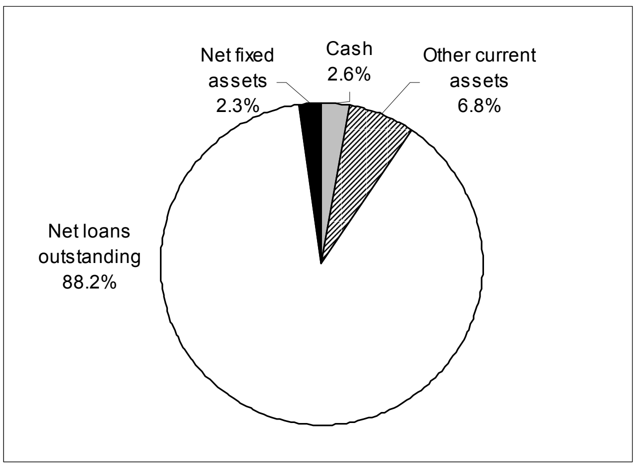
* Other operating expenses include travel, depreciation and administrative expenses

Debt and equity composition:
30 September 2001

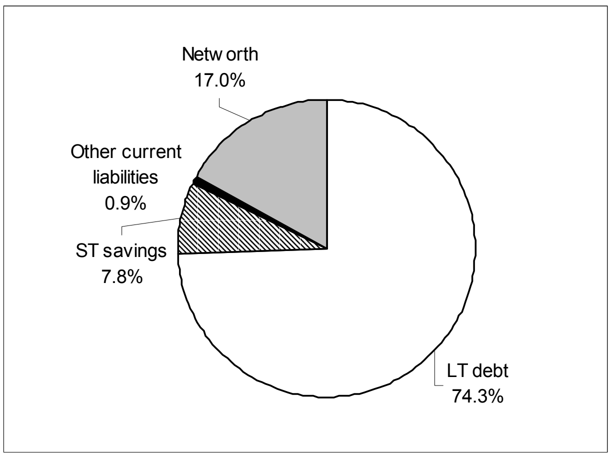


** Concessional debt is borrowing+comp.savings taken at < Bank PLR +50 basis points, & voluntary savings taken at < bank deposit rates

Asset composition: 30 September 2001



Liability & net worth composition: 30 September 2001



1 Organisational background

Bhartiya Samruddhi Finance Limited (Samruddhi) – registered as a Public Limited Company (Non-Banking Finance Company) – was established in 1996, with the aim of providing sustainable financial services to the rural population for the promotion of livelihoods. The organisation is backed by its holding company, BASICS Limited, that provides financial services through Samruddhi and a Local Area Bank (Krishna Bhima Samruddhi LAB)– now operational in the three districts of Raichur, Gulbarga (Karnataka) and Mahabubnagar (Andhra Pradesh) since February 2001– and research, consultancy and some support services (through Indian Grameen Services, a Section 25 Company) to its clientele.

Samruddhi has an 8 member Board comprising of eminent development and finance professionals. At least 7 of the Board's members have significant experience of the micro-finance sector. The Board is responsible for approving the policy and long-term strategy of the organisation

2 Microfinance operations

2.1 Background of microfinance operations

Samruddhi began its microfinance operations in 1996, and since then has significantly increased its coverage under the programme. Since commencing operations, Samruddhi has intensively explored the viability of lending through a number of channels and has been a leading proponent of the use of innovative channels for microfinance lending.

At present, Samruddhi operates through 13 branches (called Unit Offices) in eighteen districts of Andhra Pradesh, Karnataka, Maharashtra and Orissa. In Maharashtra and Orissa, it has one branch each. It is also now in the process of minimising operations and slowly phasing out two of its oldest branches – Raichur-Gulbarga and Mahabubnagar since the LAB has taken over the provision of financial services in these three districts. Some of the newer Unit Offices (Suryapet, Ramayampet and Nizamabad) have been created out of the older Units in order to maintain a scale of operations necessary for management efficiency.

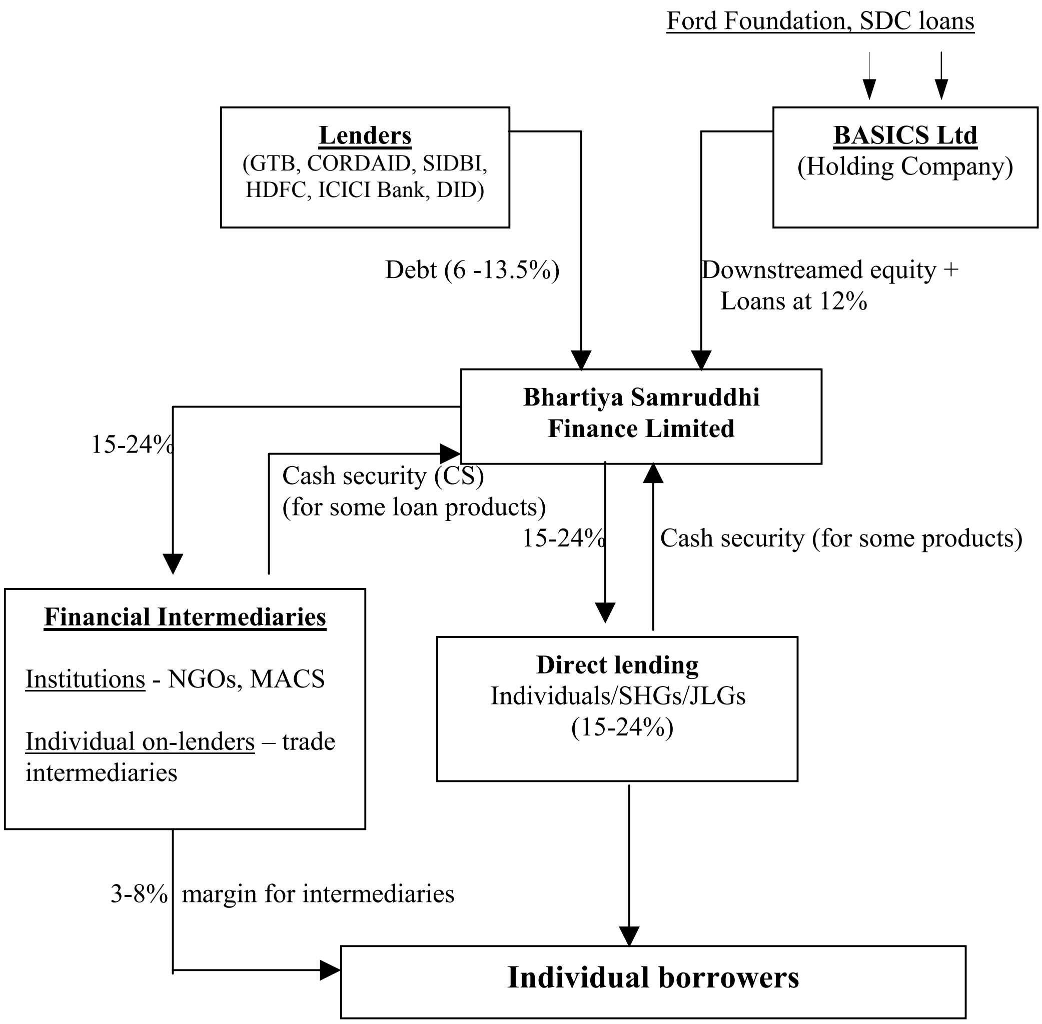
As on 25 September 2001, Samruddhi had a staff-strength of 59 in its programme. Apart from head office management staff, this comprises of a unit head at each unit office and 3-4 field executives each. In addition, the organisation had close to a 100 Customer Service Agents (CSAs) for supporting its field operations. While the CSAs are recruited on a contractual basis and are paid a commission rather than a salary, they function as an integral part of the organisation's operations and are involved full-time in field operations.

Samruddhi has a paid up share capital of Rs 40.49 million (authorized share capital of Rs 250 million), downstreamed from the holding company, with the latter retaining 99.76% control of Samruddhi's equity. Apart from the equity downstreamed from the holding company, Samruddhi has obtained loans from both BASICS Limited and other external sources for its on-lending requirements. The holding company has in turn obtained loan funds from the Ford Foundation and the Swiss Agency for Development and Cooperation (SDC). Details of debt raised externally by Samruddhi are provided in the following table

Lender	Amount disbursed (Rs million)	Borrowings outstanding (Rs millions)	Loan term (years)	Interest charged (p.a.)
CORDAID	20.0	20.0	9	10.0%
Global Trust Bank	16.2	4.0	2	10.5%
SIDBI	50.0	46.1	5	11.0%
HDFC	10.0	9.3	5	12.0%
ICICI Bank		29.4	Line of credit	13.5%
DID, Canada	12.3	12.3	11	6.0%
		121.1		

As on 30 September 2001, Samruddhi had Rs 42.5 million of additional borrowing outstanding from the holding company, at an interest rate of 12%.

The following figure represents the funds flow process at Samruddhi until now



2.2 Microfinance policies

At present Samruddhi offers only loan products because of restrictions imposed upon Non-Banking Finance Companies (NBFCs) on deposit mobilisation by the Reserve Bank of India (RBI). Microfinance policies, products and procedures are very clearly laid out in an Operations Policy Manual.
Samruddhi's loan products that have been designed keeping in mind the diverse needs and demands of the rural sector. It has used two criteria – loan purpose and channel of delivery – to devise its products.

Loan purposes

- Farm loans
- Non-farm loans
- General purpose loans

Delivery channels

- Direct
- Direct with Joint Liability Groups
- Self-help groups
- Through on-lenders

Permutations of these two criteria have yielded the following **loan products**

- Crop loans through Joint Liability Groups (JLGs)
- Crop loans through on-lenders
- Long term agricultural loans for irrigation infrastructure and land development
- Allied loans for activities like Dairy, Poultry and Fisheries
- Micro-enterprise loans, with or without JLGs
- Small Enterprise loans
- Small Trade and Service loans, with or without JLGs
- General purpose loans through SHGs
- General purpose loans to individuals
- General purpose loans through ROSCAs
- General purpose loans through SHG Federations and Mutually Aided Cooperative Societies (MACS)
- House repair and expansion loans
- Vehicle loans to employees/CSAs

Currently the organisation is minimising 'crop loans through on-lenders' due to poor portfolio performance of this product.

Policies

All loans are originated through CSAs (in some cases by Field Executives – FXs). The CSA identifies the potential borrower, registers the borrower with Samruddhi and conducts an initial assessment of the credit-worthiness. If the CSA is convinced of the credibility of the client, either as an individual or as part of a Joint Liability Group (JLG) – depending on whether group collateral is considered necessary (new area of operation, new clients) and depending on the loan product – an application form is filled out which mentions the purpose and amount of loan needed by the client.

The application form is then used by the Field Executive to conduct an appraisal of the borrower. Loans that are recommended at this stage are put before a loan committee that provides the final sanction. A Unit Loan Committee (ULC) sanctions loans smaller than Rs 50,000. Loans greater than Rs 50,000 (and all new/repeat loans to SHGs/Federations of SHGs/MACS) are sanctioned by the Head Office Loan Committee (HOLC). After the sanction, disbursement is made (mostly at the unit office, but sometimes off-site too) with due verification of the required documentation.

At the time of disbursement, the borrower is informed of the repayment schedule, either in writing or verbally. Repayment collection is then carried out from the borrower's doorstep in accordance with the repayment schedule by the CSA.

The **lending norms** for different loan products are shown below

Loan product	Interest rate (p.a.)	Principal repayment norms
1 Farm loans – upto Rs 50,000		
1.1 Crop loans (20% cash security)	24%	Minimum 2 instalments, repayment within 11 months
1.2 Agri term – agriculture equipment, land Development, irrigation	24%	Cash-flow based monthly or quarterly repayments, maximum term of 3 years
1.3 Agri allied – animal husbandry	24%	Cash-flow based monthly repayments, quarterly repayments for goat and sheep rearing, maximum term of 2 years
2 **Micro-enterprise loans – upto Rs 50,000** (10% cash security)	24%	Cash-flow based monthly repayments, maximum term of 2 years (3 years with proper justification)
3 General Purpose loans		
3.1 SHGs – with CS (20% cash security)	15%	Monthly/bi-monthly repayment, maximum term of 2 years
3.2 SHGs – without CS	21%	- do -
3.3 SHG Federation/MACS	18%	- do -
3.4 Individual – upto Rs 10,000	24%	12 EMIs
4 House repair and expansion – upto Rs 50,000	18%	Monthly repayments, term upto 3 years
5 Vehicle loans to employees – upto Rs 40,000	15%	Monthly repayments, term upto 5 years

For all loan products, the following guidelines also apply

- A loan processing fee (LPF) of 2% is charged up-front for all loans except the employee vehicle loans and crop loans. However, a timely closure incentive (TCI) of 2% of the loan amount is also paid for on-time repayment of loans.
- Co-obligation of an acceptable individual is essential for all first time applicants.
- For all loans, maximum grace period (moratorium) is two months, except for crop loans, agricultural investment and allied loans (goat and sheep rearing) – six months.
- Loans to all new borrowers/firms are restricted to Rs 50,000. Loans to SHGs/SHG Federations/MACS can be of a higher amount. Existing loans above Rs 50,000 to individuals/firms are not renewed.
- No collateral security of assets is required for loans less than or equal to Rs 20,000.
- Agri-term loans can be considered for new customers in existing villages of operation which have at least ten borrowers with an on-time repayment rate >= 95%.
- No borrower can have more than one loan at a time, except for agricultural term loans, general purpose individual loans and housing loans that may be concurrent with existing crop loans or non-farm loans.
- Housing loans are offered only to third time repeat borrowers.

In addition, each unit is expected to adhere to the following guidelines with respect to **portfolio diversification**.

Loan product/purpose	Limit
Farm loans	Not more than 45%
Crop loans	Not more than 25%
Agri term loans	Not more than 5%
Agri allied loans	Not more than 15%
Micro-enterprise loans	At least 45%
General purpose loans – SHGs	At least 15%
General purpose loans – individuals	Not more than 5%
Housing loans	Not more than 5%

New products

In addition to the existing loan products, Samruddhi plans to introduce a new loan product – Sudama loans – especially for very poor borrowers. The size of the loan will range between Rs 1,000-10,000. To minimise transaction costs in making small loans, Samruddhi plans to use smart cards, hand-held devices and computers to make these loans through STD booth operators. Samruddhi will now start to pilot these loans and the process involved in 4 locations in Ananthapur district.

In addition, Samruddhi is negotiating with insurance companies to offer their products to its clients.

3 Observations

3.1 Governance aspects

Samruddhi shows very good performance on governance aspects with a grade of α+. This is higher than the previous rating grade of α. This is due to the continued strategy of a focussed microfinance programme and the increased experience of the organisation.

- Strategy for microfinance operations

  The organisation continues its focussed microfinance implementation along with a moderate rate of expansion. In the last one and a half years, it has opened three new branches, which includes expansion to Orissa, geographically contiguous to its areas of operation in Andhra Pradesh.

  Strategically, it is continuing to use varied channels and products for providing financial services to its clients, however, it has identified the trouble spots and learnt from previous experience. It now aims to minimise lending though on-lenders and restricting loans above Rs 50,000 to SHGs/federations/MACS. As part of its lending policy, it is also trying to limit the proportion of crop loans in its total portfolio. Samruddhi has plans to introduce new products for its clients – at least one new loan product and insurance services.

  In terms of concentration, the organisation has decided to increase the depth of its concentration by increasing the number of clients it is working with in its villages/areas of operation, however this has still to take effect at the time of writing and depth of concentration within villages remains low.

- Experience in microfinance

  The organisation now has more than 5 years of microfinance experience, since its inception in 1996. It has shown itself to be a learning organisation over this period and has thus gained from the experiences of the past 5 years. It also gains substantially from the 8 members on its Governing Board, all of whom are professionals and have experience either in microfinance or corporate finance.

3.2 Managerial factors

Samruddhi exhibits very good performance on managerial factors with a grade of α+. This is the same as the previous rating grade of α+. Specific aspects of the systems are discussed in detail below.

- Human resource quality and management

  Samruddhi has highly qualified managerial staff. Field executives and unit mangers are mostly recruited from local management institutes or possess post-graduate degrees in relevant fields. Before taking on full responsibility all field executives go through a six-month on-the-job training, are then confirmed, based on performance and provided specialised classroom based training. Unit Managers work as field executives before being promoted as unit executives, this gives them good exposure and provides them the experience necessary for taking responsibility for operations in their units.

Managerial staff at the head office is very well qualified and drawn from banking /finance backgrounds and thus possess ample knowledge of finance.

Field staff (CSAs) also go through extensive training – classroom and on-the-job – which provides them a very good orientation to the activities of Samruddhi and their responsibilities. In addition, the organisation has put in place a very good performance based incentive system for the CSAs – their commission is linked to the size and quality of their portfolio.

Commitment and motivation at all staff levels is high and the staff's understanding of microfinance, the organisation's systems and financial performance is good. However, relative to the staff at the newer branches, staff members at the older units need marginally greater orientation towards credit discipline and loan appraisal techniques.

- Accounting and MIS

The accounting system and the MIS at Samruddhi hold the same status as during the last rating. They are run on and integrated with the help of a customized FoxPro software (FAMIS). However, Samruddhi now also uses an Oracle Discoverer tool that enables them to run queries on data generated from the FAMIS and enables greater flexibility.

All transactions beginning from client registration to loan approval to disbursement to repayment are recorded at the Unit Office on FAMIS. The MIS is used to generate CSA wise demand reports that help the CSAs to follow up with clients on repayments. These are used to generate reports on operational summary, product wise performance, portfolio quality analysis, employee performance and an income-expenditure statement every month for the unit. These reports are sent to the Head Office along with a back up of all data. This leads to updating of the Head Office MIS every month.

The Head Office also consolidates the information received from all unit offices every month to generate progress reports, portfolio quality reports and relevant financial statements. Trial balances are then prepared for each unit and sent to the units.

The MIS enables the organisation to analyse data and generate reports on various aspects of unit/employee/organisation performance. Samruddhi has also worked constantly on upgrading its software to enable analysis of data in better ways to improve management understanding of its performance. For instance, the CSA-wise demand report shows overdues and dues against each client separately as against the outstanding report which clubbed the two together under the category of overdues.

The organisation is now planning to upgrade to an RDBMS based software in the near future. A software company has been commissioned and has designed a software called Delphix that is presently in the demonstration stage. This would enable faster flow of information and would also provide users with more flexibility in data analysis.

- Tracking system for overdues

Samruddhi has a very good system for tracking overdues. Monthly reports generated from the FAMIS show CSA/FX wise overdues and overdues by unit or loan product. Overdues are categorised by age and the system is regularly used to follow up on clients with overdues.

The credit policy manual lays out a detailed procedure for follow-up of overdues in the field. CSAs do the initial follow up with clients that have overdue loans and all loans greater than 30 days overdue are to be followed up by the field executive. Unit heads pursue all accounts overdue beyond 60 days. All loans with overdues greater than 90 days are personally reviewed by the Associate Vice President/Vice president to ensure that all necessary action is taken for recovery. All units follow these policies with some minor variations and this has helped Samruddhi in recovering some fairly old overdue loans too.

Given the recent problem of portfolio quality that Samruddhi has been facing, all units have begun serious follow-up of overdue loans. However, the culture of credit discipline is more internalised in the new units as compared to the older units.

- Financial planning and control systems

Samruddhi has very good and detailed financial planning and control systems. Financial planning originates at the unit level with each unit preparing projections for growth in terms of clients and outstanding. This is done at the CSA level and for each product that is then consolidated to prepare month-wise cash flows and financial statements for each unit. This exercise is carried out at the beginning of each financial year so that all units know the kind of targets they need to achieve. Variances from these targets are also monitored every month by the units.

In addition, each month the units send their bank balance status to the head office so that the latter is able to monitor and plan for the cash position. If a unit requires extra funds, it sends an internal note to the head office.

Samruddhi has commissioned local independent auditors to carry out internal audits of all units every month. In some cases, this audit happens once in every two-three months. The internal auditors prepare reports and these reports are sent to the unit offices and head office. The report covers adherence to accounting policies and procedure related issues and some comments on whether overdues are being followed up by the unit. The reports are fairly detailed and are reviewed by the Financial Manager and the Unit Service Centre at the Head Office.

- Decision making

The decision making process at Samruddhi is very participative and effective. Unit level operational decisions are taken at the unit and planning for the units is done in close coordination with them. All operational decision making for the organisation is carried out by the Chief Operating Officer at the Head Office, while the Board meets every quarter for policy decisions.

- Quality of clients/member groups

Samruddhi works with some SHGs/Federations of SHGs, Joint-Liability Groups and individuals. Clients visited showed a reasonably good understanding of loan terms and conditions, though there is scope for Samruddhi to improve this further. At the client level the organisation gives its clients a receipt when a loan instalment is repaid.

SHGs function better than JLGs in terms of adherence to group norms and regular meetings, however, JLG members visited also showed a good understanding of the purpose of a JLG and awareness of their group members. All members display a good sense and awareness of their businesses and the role of external funds in their business.

- Infrastructure

Samruddhi has an adequate infrastructure base of Rs 5.04 million as on 30 September 2001. The fixed assets mostly include computers and other such professional equipment and some furniture and office equipment. The utilisation of fixed assets is extremely appropriate and efficient.

3.3 Financial performance

The financial performance grade of Samruddhi is good at α. However, this is lower than the previous rating grade of α+ due to stricter M-CRIL standards on profitability and portfolio quality and also due to a marginal decline in profitability and due to the portfolio quality not improving adequately.

- Credit performance and asset quality

Samruddhi's credit performance is reasonable. It has a cumulative repayment rate of 95.6% and a PAR_{60} of 10.5% on 30 September 2001. The performance on portfolio quality has improved since the last rating - PAR_{60} was 12.9% as on 30 June 2000 – though not adequately. The following table shows the PAR_{90} over the last one and a half years that demonstrates a slow, but gradual increase.

As on:	PAR >90 days

	(%)
30 June 2000	11.2
30 September 2000	11.0
31 December 2000	11.0
31 March 2001	9.7
30 June 2001	9.8
30 September 2001	8.9

This is a result of strong follow-up and action that is being taken to ensure that overdue loans are recovered. A detailed analysis of the portfolio suggests that the organisation is slowly recovering loans overdue for a long period. For instance, 75% of the amount overdue >210 days as on 31 March 1999 has been recovered as on 30 September 2001. Similarly, 44% of the amount overdue >210 days as on 31 March 2000 had been recovered by 30 September 2001. Also, the rate of emergence of new overdues is slower than before (as a proportion of total outstanding) and it is mainly the older units that are contributing to a large proportion of these new overdues.

Thus while Samruddhi has done well to improve portfolio quality, it needs to expedite and strengthen its efforts. Specifically, the older units need to tighten their credit discipline paying particular attention to its non-farm micro-enterprise loans that contribute to 26% of the total PAR_{90} (though non-farm loans do form approximately 37% of total portfolio). Crop loans (through on-lenders and JLGs) still make up the largest proportion of PAR_{90} (35%).

In the context of portfolio quality, Samruddhi has done well to reduce its exposure to crop loans. The proportion of crop loans in the total portfolio has reduced from 50% on 30 June 2000 to 33% on 30 September 2001. In terms of other purposes too, Samruddhi's portfolio is reasonably well diversified with 19% of total portfolio in animal husbandry, 37% in non-farm trading and production activities, 9% in general purpose loans and 2% in other activities.

- Mobilisation of funds

Samruddhi has done well to mobilise loan funds from a variety of lenders including GTB, SIDBI, CORDAID, ICICI Bank, HDFC and DID. Since June 2000, it has mobilised additional funds from SIDBI (Rs 30 million) and Rs 12.3 million from DID, Canada. In addition, the cash security taken from clients continues to serve as an important source of funds for Samruddhi – it forms 7.8% of total liabilities and equity. The weighted cost of external borrowings is around 11.3%. The repayment performance on all external loans has been excellent so far.

Samruddhi has also done well to attract investment directly in the form of equity capital. Within the next month, Samruddhi expects infusion of equity to the tune of Rs 165.5 million. A source-wise break up of this equity is given in the following table:

Source	Amount (Rs million)
IFC	47.0
Shorebank	23.5
Hivos-Triodos Fund	23.5
ICICI	10.0
HDFC	5.0
BASICS (holding company)	56.5

This will increase paid-in equity from the current Rs 40.5 million to Rs 206 million, thus substantially increasing its potential debt leverage. However, the organisation would also need to factor in appropriate dividend payouts to its investors in the future, and the long-term cost of new equity would need to be offset through increased returns on the equity invested.

➢ Asset, liability and equity composition

The asset composition of Samruddhi is good with about 92% of its total assets deployed in loans to clients. The portfolio was 85% of total assets in September 2000 and 78% in March 2001. Cash and bank balances and fixed assets are at a minimum (5.7% and 2.3% of total assets respectively on 30 September 2001).

Samruddhi's risk weighted capital adequacy ratio is moderate at around 18% - this is likely to improve substantially in December 2001 with the infusion of equity capital as indicated above.

➢ Sustainability and profitability

The organisation's financial sustainability in terms of its independence from subsidies is fairly good with a Subsidy Dependence Index of 32.6% and a Financial Self Sufficiency of 80%. Samruddhi has also achieved Operational Self-Sufficiency, which is at 100.5%.

Samruddhi has done well to control its operating costs (with an operating cost ratio of 12.8%) though the latest financials indicate a decline in the return on assets at 0.1%. As the organisation has a good yield of 20% compared to its APR of 23%, the decrease is essentially due to its moderate performance on portfolio quality resulting in a high loan loss provision. Thus, as the organisation improves portfolio quality, profitability performance would automatically improve. The infusion of equity funds – which will lower the overall cost of loanable funds – will also have a positive impact on the future profitability performance of the organisation.

4 Suggestions

Samruddhi records very good performance on governance and managerial factors and reasonably good performance on financial aspects. While it has proved to be a learning organisation and is continuously attempting to improve its performance, the following suggestions should be considered.

4.1 Governance aspects

Concentration strategy

Samruddhi should take steps to improve the concentration of its operations in the areas where it is currently working. This will require both an increase in the villages covered and also an increase in the number of clients in villages where it is currently working. Apart from reducing costs, this is also likely to have a positive impact on portfolio quality.

4.2 Management systems

MIS and accounting

Samruddhi should aim to install the planned RDBMS based computerised software for its MIS and accounting system at the head office and branches as soon as possible. This will facilitate more sophisticated and flexible analysis of its performance. Given that the organisation aims to expand significantly, an RDBMS is critical for managing the volumes of data that it is likely to generate. This is essential for maintaining control of its increasingly dispersed operations.

Staff

While the organisation has very well qualified and motivated staff, there is a need to increase their orientation towards the importance and role of credit discipline in financial performance. This is especially required for the staff of older branches.

4.3 Financial performance

Portfolio quality

Samruddhi has shown marginal improvement in portfolio quality, however the improvement is slow and the current PAR_{60} at 10.5% is still high enough to be a cause of concern for the organisation. The net increase in the amount at risk since the previous rating is more than Rs8.5 million (~67%), which gets somewhat disguised by an over 100% growth in the size of the loan portfolio. In absolute terms, there has not been any noticeable improvement in the portfolio quality. While the organisation has taken steps to improve performance on this front, it needs to expedite and strengthen efforts further. This could include greater orientation of staff at older branches and clearer communication with borrowers on loan terms and repayment conditions. It also needs to analyse carefully the reasons for relatively high delinquency in non-farm loans.

Profitability

Samruddhi needs to improve its performance on profitability. The main factor impacting profitability is moderate portfolio quality. Improvements in portfolio quality should result in a positive impact due to increased income and lower costs (especially loan loss provisioning costs and average cost of loanable funds).

5 Conclusions

Strengths	Weaknesses/Areas for improvements
Governance/organisational ✓ Focussed microfinance implementation with moderate expansion in geographically contiguous areas ✓ Well qualified and experienced Board ✓ Learning organisation	Governance/organisational ✗ Potential for increasing concentration within currently existing districts and depth of coverage within villages
Managerial ✓ Professionally trained and experienced management ✓ Committed staff members with good field level skills ✓ Training and incentive systems for staff and CSAs ✓ Well integrated MIS and accounting system ✓ Good overdue tracking system ✓ Well developed financial planning and control systems	Managerial ✗ Inadequate communication of loan terms to borrowers ✗ Relatively lower orientation to credit discipline of staff of older units
Financial ✓ Improvement in portfolio quality ✓ Productive deployment of assets into the loan portfolio ✓ Good diversification of loan portfolio, shift away from high percentage of crop loans ✓ Good external fund mobilisation ✓ High efficiency in operations	Financial ✗ Moderate portfolio at risk ✗ Low profitability

6 Creditworthiness

Samruddhi has achieved a rating grade of ***alpha (α)***.[4] In terms of creditworthiness this implies **high safety and good systems,** however it represents a lower grade than that received during the previous rating **– alpha single plus** (α+). While its portfolio quality has shown an improvement, due to stricter standards of M-CRIL on portfolio quality and profitability, the grade has gone down. Samruddhi's performance on governance aspects and managerial factors is very good and its financial performance is also reasonably good. Improvement in portfolio quality and infusion of equity funds (which will lower the overall cost of loanable funds) will also have a positive impact on the future profitability performance of the organisation that could lead to a improved rating grade in the future.

In M-CRIL's view, on account of Samruddhi's good overall performance, improvement in portfolio quality, plans for expansion and expected mobilisation of equity funds (to the extent of Rs 165 million), the organisation can absorb – from all sources – loan funds of Rs 750 million (50-250-450 millions) over the next three years for on-lending to its borrowers. This absorption capacity is projected on the basis of the large amount of equity investment Samruddhi expects within the next few weeks which reduces the need for loan funds in the first year of the projection. The projection for later years takes account of this equity inflow that will enable Samruddhi to leverage a substantial amount of debt over the next few years. The estimated requirement is subject to a reassessment of expansion capacity related to staff and management systems.

Given that Samruddhi is planning to expand rapidly and to new areas, however, a rating update – at the end of one year from now – is strongly recommended. The update is required to ascertain improvements in performance, especially on portfolio quality and profitability and also in absorptive potential. **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.

[4] 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 South Asia and is comparable with other ratings done by M-CRIL in this region.

Financial statements for Samruddhi's microfinance operations

Balance Sheet - as on 30 September 2001

Assets	Rs	Rs	USD	USD
Current assets				
Cash in hand and bank		5,828,000		121,417
Interest bearing deposits		6,810,000		141,875
Advances		2,831,000		58,979
Interest receivable on loans		5,201,931		108,374
Deferred expenditure		177,000		3,688
Loans outstanding				
Gross loans outstanding	202,176,000		4,212,000	
(Loan loss reserve)	(7,964,250)		(165,922)	
Net loans outstanding		194,211,750		4,046,078
Total current assets		**215,059,681**		**4,480,410**
Long term assets				
Net property and equipment	5,038,000		104,958	
Total long term assets		**5,038,000**		**104,958**
Total Assets		**220,097,681**		**4,585,368**
Liabilities and Networth				
Current liabilities				
Cash security		17,114,000		356,542
Interest payable to lenders		962,000		20,042
Other current liabilities		1,017,922		21,207
Total current liabilities		**19,093,922**		**397,790**
Long term liabilities				
Long term debt				
ICICI	29,372,000		611,917	
HDFC	9,303,000		193,813	
GTB	4,020,000		83,750	
CORDAID	20,000,000		416,667	
DID	12,329,000		256,854	
SIDBI	46,071,000		959,813	
BASICS Ltd – holding company	42,500,000		885,417	
Total long term debt		163,595,000		3,408,229
Total long term liabilities		**163,595,000**		**3,408,229**
Net worth				
Paid in equity	40,495,000		843,646	
Retained net surplus/(deficit)	(3,217,953)		(67,041)	
Current net surplus/(deficit)	131,172		2,774	
Total net worth		**37,408,759**		**779,349**
Total Liabilities and Net Worth		**220,097,681**		**4,585,368**

Income Statement: Statement from 1 October 2000 – 30 September 2001

Income	Rs	Rs	USD	USD
Interest received on loans[5]	32,245,726		671,786	
Interest received on investments	719,387		14,987	
Other financial income (registration & fees)	5,202,548		108,386	
Total income		**38,167,661**		**795,160**
Financial costs				
Interest on borrowings	14,678,491		305,802	
Interest paid on member savings	0		0	
Gross financial margin		**23,489,170**		**489,358**
Provision for loan losses	2,666,776		5,558	
Net financial margin		**20,822,394**		**433,800**
Operating costs				
Salaries	10,638,362		221,633	
Travel	2,741,818		57,121	
Depreciation	320,515		6,677	
Administrative/office expenses	6,919,065		144,147	
Total operating costs		**20,619,760**		**429,578**
Net Surplus/Deficit		**202,634**		**4,222**
Tax		70,922		1,478
PAT		**131,712**		**2,744**

5 Interest received on loans has been estimated for current loans and loans overdue 1-60 days on the basis of information provided by the organisation's MIS and accounting system.

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 (PAR_{60})
   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 financial income to average portfolio
   Total financial 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 cost 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 operating income to total operating expenses for the year.
12. 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. 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 the following: fixed assets & interest bearing deposits: 50%; cash 0%).

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, wherever merited, 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 interest income is **accrued** for all current loans and loans overdue 1-60 days. 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) 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.

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:	*Sep-01*	Sep-02	Sep-03	Sep-04	Sep-05	Sep-06
Members	20,629	37,132	59,412	83,176	108,129	129,755
Cash security per member/year	432	475	522	575	632	695
Dividends as a percentage of equity	0%	1%	3%	4%	5%	8%
Yield on average portfolio	20.0%	20.0%	20.5%	20.5%	21.0%	21.5%
Operating cost ratio	12.8%	11.5%	11.0%	11.0%	10.5%	10.0%
Cost of external funds	11.3%	11.3%	11.3%	11.3%	11.5%	11.5%
Repayment rate from groups	95.6%	96.6%	97.5%	98.0%	98.5%	98.8%
Loan loss reserve ratio	3.9%	3.5%	3.4%	3.4%	3.4%	3.3%
Number of active loanees	20,629	37,132	59,412	83,176	108,129	129,755
Number of loans disbursed		28,881	44,559	59,412	74,859	86,503
Average loan size to borrowers	12,067	13,877	15,959	17,554	19,310	21,241

2 Projected balance sheets

As on:	*Sep-01*	Sep-02	Sep-03	Sep-04	Sep-05	Sep-06
Assets						
Cash balance	*5,828,000*	29,731,816	25,131,779	86,271,415	77,882,392	80,330,421
Advances & SLR investments	*9,818,000*	9,818,000	19,452,973	24,622,833	30,917,804	37,550,681
Interest receivable on loans	*5,201,931*	9,017,450	16,461,437	26,720,855	40,213,194	55,994,582
Loans outstanding	*202,176,000*	361,414,649	642,331,513	986,988,897	1,406,653,578	1,848,845,403
Loan loss reserve	*-7,964,250*	-12,649,513	-21,839,271	-33,557,622	-47,826,222	-61,011,898
Net loans outstanding	*194,211,750*	348,765,136	620,492,241	953,431,274	1,358,827,357	1,787,833,505
Net fixed assets	*5,038,000*	5,777,001	6,495,718	6,777,533	7,481,045	8,657,824
Total Assets	***220,097,681***	**403,109,403**	**688,034,148**	**1,097,823,910**	**1,515,321,792**	**1,970,367,013**
Liabilities and Net Worth						
External borrowings	*163,595,000*	176,751,130	375,789,336	727,414,336	1,070,890,570	1,436,515,570
Cash security	*17,114,000*	17,631,225	31,030,956	47,787,672	68,336,371	90,204,010
Deposits	*0*	0	64,233,151	98,698,890	140,665,358	184,884,540
Other liabilities	*1,979,922*	1,979,922	1,979,922	1,979,922	1,979,922	1,979,922
Paid in equity	*40,495,000*	205,495,000	205,495,000	205,495,000	205,495,000	205,495,000
Retained surplus/deficit	*-3,217,953*	-3,086,241	1,252,126	9,505,783	16,448,090	27,954,571
Current surplus/deficit – PAT	*131,712*	4,338,367	8,253,657	6,942,307	11,506,481	23,333,400
Total Liabilities and Net Worth	***220,097,681***	**403,109,403**	**688,034,148**	**1,097,823,910**	**1,515,321,792**	**1,970,367,013**

3 Projected Income Statements

For the year ending:	*Sep-01*	Sep-02	Sep-03	Sep-04	Sep-05	Sep-06
Income						
Interest	*32,245,726*	56,359,065	102,883,982	167,005,342	251,332,460	349,966,141
Other income	*5,921,935*	7,106,322	8,527,586	10,233,104	12,279,724	14,735,669
Total Income	***38,167,661***	**63,465,387**	**111,411,568**	**177,238,446**	**263,612,184**	**364,701,810**
Cost						
Financial	*14,678,491*	19,229,556	31,218,536	62,331,007	103,402,532	144,175,853
Loan loss provision	*2,666,776*	4,685,263	9,189,759	11,718,351	14,268,599	13,185,677
Depreciation	*320,515*	457,240	524,311	589,540	615,117	678,967
Administrative expenses	*20,299,245*	29,165,816	49,685,435	80,651,360	113,099,607	146,497,454
Total Cost	***37,965,027***	**53,537,875**	**90,618,041**	**155,290,259**	**231,385,856**	**304,537,951**
Surplus/Deficit	***202,634***	**9,927,511**	**20,793,527**	**21,948,187**	**32,226,329**	**60,163,859**
Tax	***70,922***	3,534,194	7,402,496	7,813,554	11,472,573	21,418,334
PAT	*131,712*	**6,393,317**	**13,391,032**	**14,134,632**	**20,753,756**	**38,745,525**
Dividends	*0*	2,054,950	5,137,375	7,192,325	9,247,275	15,412,125
Profit (after tax and dividends)	*131,712*	**4,338,367**	**8,253,657**	**6,942,307**	**11,506,481**	**23,333,400**

4 Projected Cash Flow Statements

For the year ending:	Sep-02	Sep-03	Sep-04	Sep-05	Sep-06
Inflows					
Opening cash	5,828,000	29,731,816	25,131,779	86,271,415	77,882,392
External borrowings	50,000,000	250,000,000	450,000,000	550,000,000	700,000,000
Repayments from members	241,538,850	430,176,926	698,280,175	1,025,846,775	1,395,213,849
Equity	165,000,000	0	0	0	0
Cash security	17,631,225	31,030,956	47,787,672	68,336,371	90,204,010
Deposits	0	64,233,151	98,698,890	140,665,358	184,884,540
Liquidation of investments	0	0	9,634,973	14,804,833	21,099,804
Interest income	52,543,546	95,439,995	156,745,924	237,840,121	334,184,752
Other income	7,106,322	8,527,586	10,233,104	12,279,724	14,735,669
Total Inflow	**539,647,942**	**909,140,431**	**1,496,512,517**	**2,136,044,598**	**2,818,205,016**
Outflows					
Disbursement	400,777,499	711,093,790	1,042,937,559	1,445,511,457	1,837,405,674
Repayments to lenders	36,843,870	50,961,794	98,375,000	206,523,766	334,375,000
Repayment of cash security	17,114,000	17,631,225	31,030,956	47,787,672	68,336,371
Administrative expenses	29,165,816	49,685,435	80,651,360	113,099,607	146,497,454
Interest paid on borrowings	19,229,556	31,218,536	62,331,007	103,402,532	144,175,853
SLR investments	0	9,634,973	14,804,833	21,099,804	27,732,681
Deposit withdrawal	0	0	64,233,151	98,698,890	140,665,358
Fixed assets purchase	3,534,194	7,402,496	7,813,554	11,472,573	21,418,334
Tax	1,196,241	1,243,028	871,355	1,318,630	1,855,745
Dividends paid	2,054,950	5,137,375	7,192,325	9,247,275	15,412,125
Total Outflow	**509,916,126**	**884,008,652**	**1,410,241,102**	**2,058,162,205**	**2,737,874,595**
Net cash balance	**29,731,816**	**25,131,779**	**86,271,415**	**77,882,392**	**80,330,421**

5 Key projected performance ratios

For the year ending:	*Sep-01*	Sep-02	Sep-03	Sep-04	Sep-05	Sep-06
Operational self-sufficiency	*101%*	118.5%	122.9%	114.1%	113.9%	119.8%
Return on average assets	*0.1%*	0.9%	1.0%	0.7%	0.7%	0.9%
Average outstanding/borrower (Rs)	*9,801*	9,733	10,812	11,866	13,009	14,249
Savings to total assets	*43%*	79%	78%	54%	43%	31%
Portfolio growth rate	*7.8%*	4.4%	4.5%	4.4%	4.5%	4.6%
Risk weighted capital adequacy ratio	*18%*	57%	33%	22%	16%	14%

6 Notes to the projections

1. The operating cost ratio is based on current levels and is projected to improve based on likely increase in overall productivity, growth in portfolio and consolidation of operations.
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 membership is based on the current and historical relationship and projected growth trends.
4. Average loan size to members increases by 10-15% every year.
5. Cash security per member year increases by 10-15% every year. The security is a short term liability for a one year period.
6. Repayment from members has been calculated as a sum of 30% of the year's disbursements and 60% of the opening outstanding balance for the year.
7. Equity inflow for the first year is the sanctioned equity fund to be received in November 2001.
8. Deposits are those that BASIX plans to mobilise from the public. They have been estimated at 10% of the loans outstanding for the year. These are a short term liability for the period of one year.
9. 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.
10. Other income is the income that the organisation earns on investments and registration and fee income and increases by 20% every year.
11. Disbursements are taken as the [number of loans disbursed during the year*average loan size to borrowers].
12. SLR investments are mandatory liquidity requirements against the deposits. These have been estimated at 15% of the deposit liability.
13. 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 members is taken at rates between 20-80% per year.
14. Repayments to lenders is based on the actual repayment schedules for present liabilities and is 25% of last year-end's outstanding debt for the future expected liability structure.
15. Administrative expenses is taken as the [discounted operating cost ratio (to account for non-cash expenses) * the average portfolio].
16. Interest paid is taken as the [average cost of external funds * the average external borrowing liability figure].
17. Fixed assets purchase is estimated based on likely requirements of the organisation.
18. Tax has been calculated at 35.6% of the surplus from operations.
19. Dividend payouts have been calculated at 1-10% of the total paid up equity. Payouts start from September 2002

M-CRIL's Microfinance Rating Symbols

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