



Micro-Finance Rating - Risk Assessment

Spandana

Guntur, Andhra Pradesh

<3rd Rating Update> Rating grade	$\alpha+$ alpha plus	Assessment: Recommended Very high safety
Visit dates: 9-13 August, 2004 Operational head: Ms G Padmaja Reddy		
Maximum validity of rating*: till August, 2005		

Rating

Spandana has performed very strongly on all the major areas of assessment – strategy, governance, management and finance. It has grown tremendously during the past one year in terms of its portfolio, outreach and profitability. However, the capital adequacy of the MFI needs careful monitoring in view of this rapid growth. Its second line of leadership also needs to be strengthened further to consolidate this growth.

In M-CRIL's view, on account of continued good performance in all areas of operations, a clear strategy and focused approach to sustainability and self-reliance, Spandana can absorb – from all sources – loan funds of Rs64 crores (US\$13.8 million) over the next one year for on-lending to its borrowers.

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

- for Micro-Credit Ratings International Ltd

Sanjay Sinha, Managing Director

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

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

Category wise rating

<u>Category</u>	<u>Rating grade</u> ¹
A <i>Governance aspects</i>	α
B <i>Managerial factors</i>	α
C <i>Financial performance</i>	α+
Overall	α+

Key Risk Factors

- **Issues in the legal status of the organisation:** Spandana has been trying to change its structure to that of a partially member-owned NBFC. Though the organisation has worked out the modalities of the transformation and a fair degree of clarity has emerged on a number of the issues involved, the continued uncertainty about the transformation due to a delay in registration with the RBI is a matter of concern.
- **Moderate second line of leadership:** Under the leadership of Ms Padmaja, Spandana has grown tremendously over the past couple of years. With this growth in the volume of operations, however, issues of leadership and governance acquire greater significance. There is a need to strengthen the second line of Spandana in order to sustain the growth of the organisation.
- **Lack of a robust appraisal system for star loans:** Spandana offers high volume loans to borrowers who have completed five cycles of borrowing and have recorded excellent credit performance during this time. While this practice has helped it to grow, there is some risk associated with the category of “star borrowers” as the organisation has not been able to develop a robust system of appraisal for such loan proposals. This could be risky since some of the loans are for amounts as high as Rs3 lakh (~US\$ 6,451).

Key Programme Strengths

Governance and strategy	Management and operations	Financial
1 Clear expansion strategy	1 Streamlined operations	1 Excellent portfolio quality and very good profitability
2 Focused m-f operations	2 Efficient use of infrastructure	2 Diversified debt portfolio
3 Diversified sources of commercial funding		

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	Staff	Branches	Active borrowers/ Staff member
Society	7	115,742	181	31	639

Microfinance programme: Operational highlights

Outstanding borrowings of MFI (Rs, US\$)	Loan portfolio of MFI (Rs, US\$)	Total client savings (Rs, US\$)	Average loan size from MFI to borrowers (Rs, US\$)
37.1 crore	44.1 crore	6.8 crore	~7,200
8.1 million	9.6 million	1.5 million	~157

Key financial ratios

Portfolio at risk (>=60 days)	Current repayment rate	Risk weighted capital adequacy ratio	Weighted average cost of funds	Yield to APR ratio
0.0%	100.0%	12.6%	10.5%	97.2%
Yield on portfolio	Other income to average portfolio	Financial cost ratio	Loan loss provisioning ratio	Operating expense ratio
28.4%	3.7%	10.0%	2.9%	5.7%
Total income to average total assets	Total expenses to average total assets	Return on average total assets	Operational self sufficiency	Financial self sufficiency
28.1%	16.2%	11.8%	172.9%	171.1%

Notes

- 1 All figures relate to the organisation's microfinance programme as on 31 March 2004.
- 2 'Active borrowers' refer to the women who have borrowed from Spandana and participate in the centre meetings coordinated by Spandana, unless otherwise stated.
- 3 All staff members of Spandana are full-time and are dedicated only to the microfinance programme.
- 4 The capital adequacy calculation does not include the transferred equity worth Rs2 Crore to the proposed NBFC. If this amount is included as part of equity, the capital adequacy ratio would come to 16.9%.
- 5 The ratios of repayment rate and portfolio at risk have been calculated from the MIS of the organisation. The accuracy of information generated by the MIS has been verified by the Rating Team.
- 6 Other income includes income the organisation earns from membership, group registration and fines for late attendance.



Comparative highlights – Trend profile of Spandana³

Grade distribution

Category	Rating grade			Movement
	Sep 02	Sep 03	Mar 04	
<i>Governance aspects</i>	α–	α	α	⇔
<i>Managerial factors</i>	α–	α	α	⇔
<i>Financial performance</i>	α+	α+	α+	⇔
Overall	α	α+	α+	⇔

Select indicators/ratios

Indicator/ratio	Sep 2002	Sep 2003	Mar 2004	Change⁴
1 Growth				
Loans outstanding, Rs crore	9.33	23.22	44.08	Increase
(US\$ millions)	(2.0)	(5.0)	(9.4)	
Outstanding borrowings, Rs crore (US\$ millions)	7.26	20.93	37.10	Increase
	(1.6)	(4.5)	(7.9)	
Number of clients	23,501	52,935	116,834	Increase
Active borrowers	21,331	50,254	115,742	Increase
Average loan size, Rs	6,007	~7,500	~7,200	Decrease
2 Credit performance				
Cumulative repayment rate	99.8%	99.9%	99.9%	⇔
Portfolio at risk (>=60 days)	0.34%	0.12%	0.05%	⇔
3 Efficiency and profitability				
Active clients per staff member	323	488	639	↑
Annual return on assets	10.0%	11.6%	11.8%	↑
Operational self-sufficiency	162%	181%	173%	↓
Financial self-sufficiency	152%	163%	171%	↑

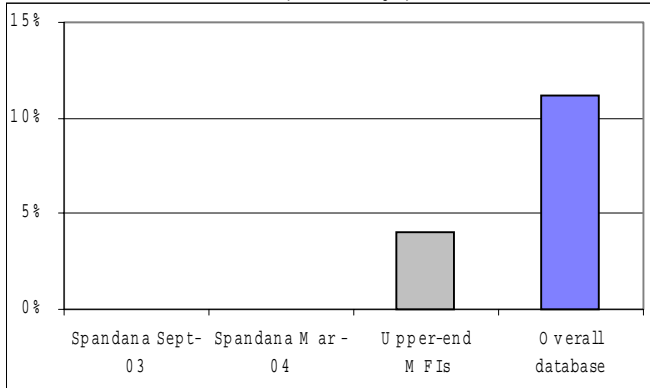
³ The information for September 2002 and September 2003, are as stated in the previous rating report.

⁴ An upward arrow indicates an improvement and vice versa for a downward arrow; a constant arrow indicates very low or no change.

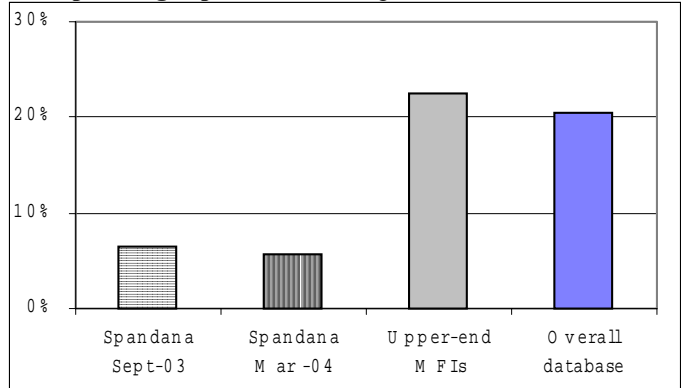


Spandana – financial overview

Portfolio at risk (>=60 days): 31 March 2004



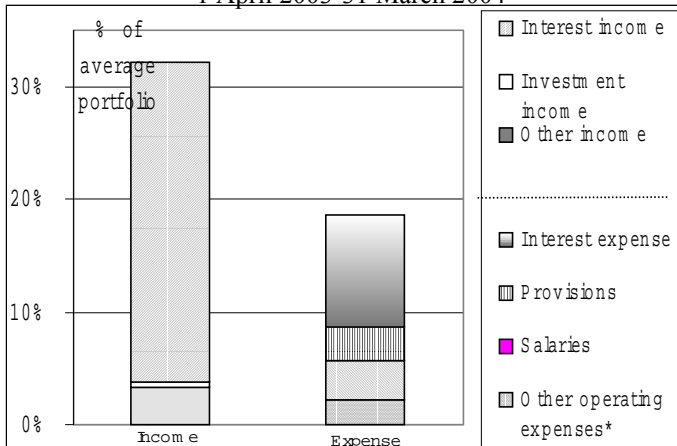
Operating expense ratio: 1 April 2003-31 March 2004



- Note:**
1. $n_{upper-end} = 10$ $n_{database} = 110$; Database updated as on 30 June 2003.
 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.

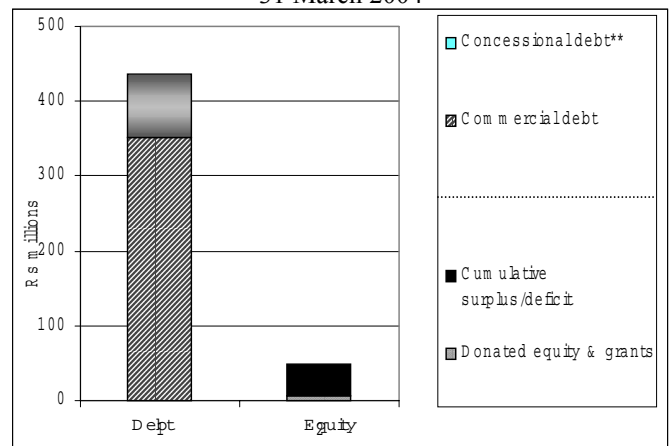
Income and expense distribution:

1 April 2003-31 March 2004



Debt and equity composition:

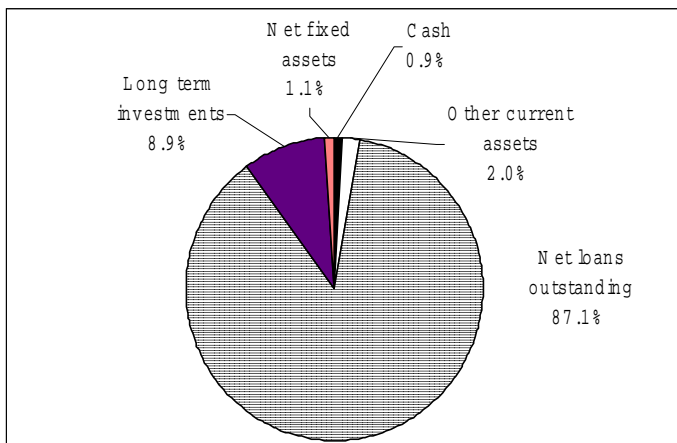
31 March 2004



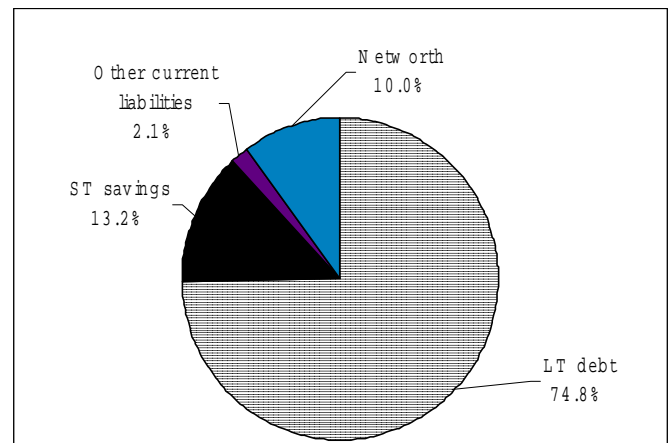
* Other operating expenses include travel, depreciation and administrative expenses

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

Asset composition: 31 March 2004



Liability & net worth composition: 31 March 2004





1 Organisational background

Spandana was registered as a society in 1992, but it remained dormant due to a variety of reasons till 1997. A chance encounter of one of the promoters of the organisation, Ms G Padmaja Reddy with a rag picker however changed the course of Spandana. Seeing the rag picker's poverty stricken situation, through discussions with her Ms Reddy realised the utility of credit as a development intervention. She and her associates provided some credit to the rag picker and soon word spread amongst other rag pickers in the town about the availability of such credit. It prompted Ms Reddy to start activities in the urban slums of Guntur where rag pickers were living. She left her earlier job along with other colleagues and started the micro-finance programme of Spandana in early 1998. The organisation continued to work in areas like health, though the primary focus remained microfinance. Spandana later raised loans from FWWB and grant funds from donors like Misereor and Caritas. While the initial grant funding from foreign donors was for food security activities, they also provided some operational support for the microfinance programme. Over the 4-5 few years, Spandana has obtained substantial commercial funds for its on-lending operations.

During this time, Spandana's microfinance programme has grown manifold and it plans to change its organisational structure into a Non-Banking Finance Company (NBFC). A new company Spandana Sphoorthy Financial Services Limited (SFSL) has already been incorporated and an application has been sent to the Reserve Bank of India (RBI) for getting an NBFC license. Once the new entity gets a license, all microfinance operations of Spandana would be transferred to the company and Spandana would continue to work with its broad rural and urban development objectives.

Spandana now has an eight-member Executive Committee that includes the Director (Ms Padmaja Reddy), a representative from SIDBI, two local MFI leaders, a Christian priest, housewives and senior organisational staff. The board meets once in three months during which policy issues are discussed.

2 Microfinance operations

2.1 Background of microfinance operations

Spandana started its microfinance programme with the Self Help Group (SHG) model. However, after some time it changed to the Grameen Bank model to counter some delinquency problems. This served to enhance Spandana's outreach can be rapidly enhanced. Over time, Spandana has brought together features from both the SHG and the Grameen methodologies based on its own experience. The organisation is now working through 31 branches in both the rural and urban areas of four districts (Guntur, Prakasham, Vijayawada and Vishakhapatnam) in the coastal areas of Andhra Pradesh.

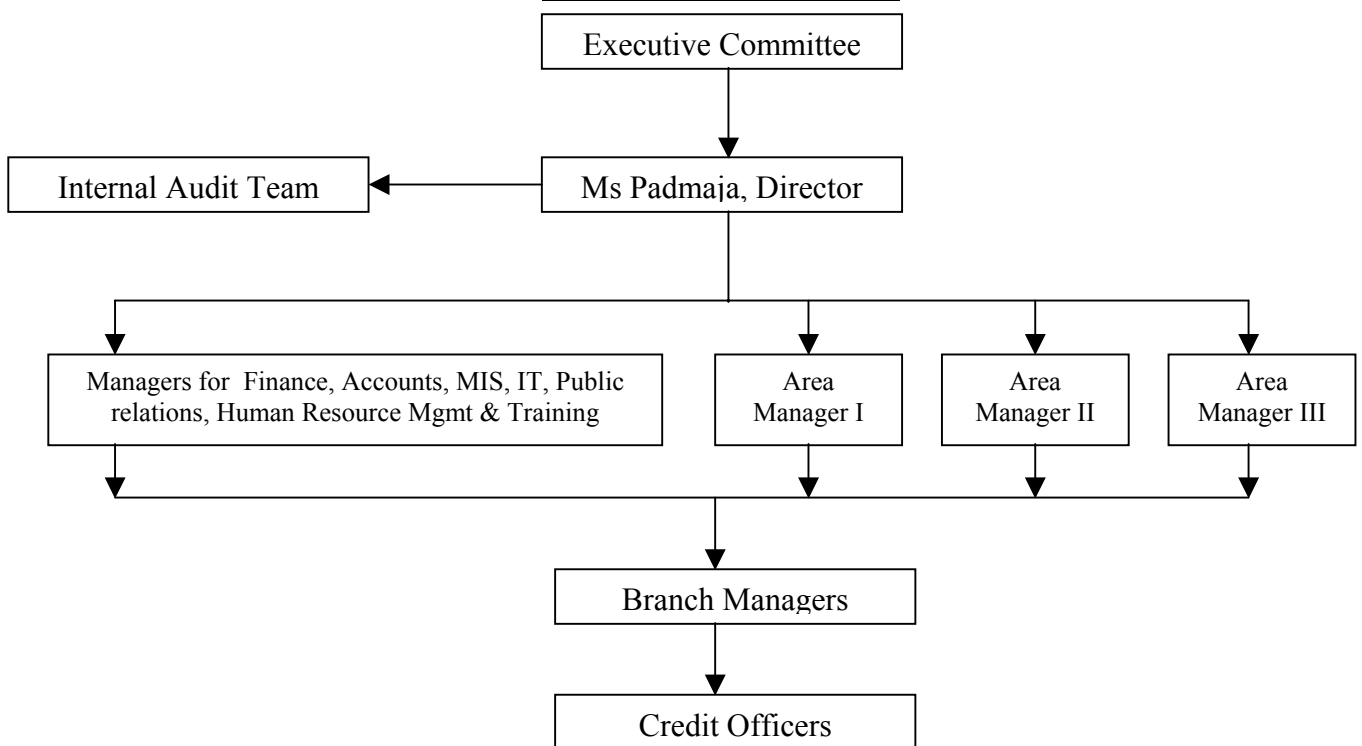
At the branch level, the Branch Managers (BMs) are supported by five-six Credit Officers (COs). They are responsible for managing the field operations of the branches. The COs also take turns to perform the task of Cashier at the branch office. At the head office, apart from the Director, other managerial staff include managers for human resource management and training, MIS, informational technology (IT), accounts, finance, public relations and three Area Managers. There is a full strength internal audit team also at the head office



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reporting directly to the Director.

Organogram of Spandana



Sources of loan and grant funds

Spandana's microfinance programme operates on loan funds obtained from a variety of sources. The status of the outstanding institutional debt of the organisation on 31 March 2004 is shown in the table below

Source of funds	Outstanding debt		Interest rate (p.a.)	Current exposure
	(crore Rs)	('000 US\$)		
FWWB	4.9	1,059.4	13.5%	13%
SFMC	15.0	3,268.6	10.0-11.0%	41%
CORDAID	2.0	429.4	9.0%	5%
HDFC	1.0	216.0	12.0%	3%
HDFC Bank	4.6	1,001.4	14.0%	12%
ICICI Bank	0.2	43.5	14.0%	1%
ING Vysya Bank	0.5	98.1	14.5%	1%
UTI Bank	2.4	526.7	13.25%	7%
Indian Bank	0.1	33.2	8.0%	0%
Indian Overseas Bank	6.4	1,389.6	13.5%	17%
Total	37.1	8,065.9		100%

As is evident from the table above, Spandana possesses a very diversified debt portfolio – with SFMC, FWWB and IOB being some of the major lenders. Spandana is also implementing the microfinance program in partnership with ICICI Bank. As part of this programme, Spandana is responsible for developing and monitoring the microfinance



portfolio of ICICI Bank in its service area. It is paid a service charge for this on the basis of the size of the managed portfolio and is responsible for the recovery of loans. Currently, this program is being implemented in the urban areas of Vijayawada and Vishakhapatnam and has a portfolio of Rs11.4 Crores (US\$2.5 millions). ICICI Bank has sanctioned an amount of Rs50 Crores (US\$10.9 millions) for this purpose.

2.2 Microfinance policies

Groups promoted by Spandana consist of up to ten members. There is a well-laid out process of group formation, savings, lending and repayment. The process of group formation starts with group identification. A group is considered identified when all its members belong to the same locality, are economically active and show signs of being able to cooperate, obey rules and importantly, ensure repayment of loans. Group members undergo training spread over 6 days that ends with the conduct of a Group Recognition Test (GRT) – based on the results of this test, a decision on the establishment/recognition of the group is taken.

Following group recognition, members are provided passbooks for recording savings that are collected during the weekly meetings. Up to 3-4 groups together – called a Centre comprising between 30-40 members – meet during the weekly transaction meetings. All transactions are recorded during the centre meetings – each CO typically covers 2-3 Centre meetings per day, six days a week.

Soon after the initiation of savings activity, loans are extended to group members. All credit transactions take place at the group level. Apart from the regular microfinance meetings, a separate monthly meeting is organised in all villages/slums where discussions are held on other issues such as the education of girl children and savings.

Savings products

Spandana offers a range of savings products to its clients. However, it has recently done away with compulsory weekly savings at the group level and now offers only the voluntary savings product to the group members.

Product description	Interest paid	Other terms and conditions
<u>Siri savings</u> Compulsory deposit, loan linked (deposit of 10% of the loan amount from the second cycle onwards)	9% p.a.	Amounts are fixed for a minimum tenure of the corresponding loan
<u>Sphoorthy savings</u> Voluntary current account	Zero interest account	Any amount can be deposited or withdrawn by the member



Group level savings facilitated by Spandana		
<u>Sneha savings</u> Voluntary, auction based on 50-member groups	Zero interest account	Members can access group savings through a weekly auction, with the highest bidder getting the total group deposit. Spandana acts only as a facilitator for this product, and does not collect the savings itself
<u>Dream savings</u> Product for husbands of members, savings to be utilised for asset purchase in the future	- do -	Members' husbands can save any amount to buy an asset for their wives in the future

Loan products

The main loan product being offered by Spandana is termed the General Loan and focuses on income generation activities. However, the verification of loan utilisation has now been stopped. The other loan products – that include an education and infrastructure loan – are very insignificant in relation to the overall portfolio. These also carry an interest of 15% flat.

Recently, a consumer loan product has been introduced. Through a sister organisation, it procures various consumer items like television, ceiling fans, chairs and lends to its clients to buy these products at the wholesale price. Interest rates on such loans vary in the range of 10-15% depending on the item purchased.

The following table summarises Spandana's loan products

Loan Product	Interest Rate	Other details
General Loan	15% p.a. plus 1% service charge	To be repaid in 50 equal and weekly instalments. Starts with Rs7,000 (~US\$ 150) in the 1 st cycle and goes up to Rs25,000 (~US\$ 538) in the 5 th cycle
Education Loan	10% p.a. plus 1% service charge	To be repaid in 50 equal and weekly instalments
Infrastructure Loan	10% p.a. plus 1% service charge	-do-
Consumer Loan	10-15% p.a.	-do-
Star Borrower's Loan	14% p.a.	Available only for those who have already successfully completed five loan cycles. Loan amount usually in the range of Rs50,000-Rs3,00,000 (~US\$ 1,075-6,451).



Insurance/social security

Spandana offers insurance cover to its members, which is in-built to its loan products. It has made insurance compulsory for all active borrowers. The premium for the cover is 1% of the loan amount that insures the member against her or her husband's death and fire accidents. The coverage includes the entire loan disbursed; therefore, in the event of death of the member her outstanding loan is written off and the amount already repaid on the loan is refunded to the nominee. In the event of the death of the husband of the member, Rs5,000 (~US\$ 108) is paid to her. This cover applies only while the borrower has a loan outstanding to Spandana. The organisation is negotiating with a number of insurance companies for providing life and non-life insurance to those of its clients interested in additional coverage.

3 Observations

3.1 Governance

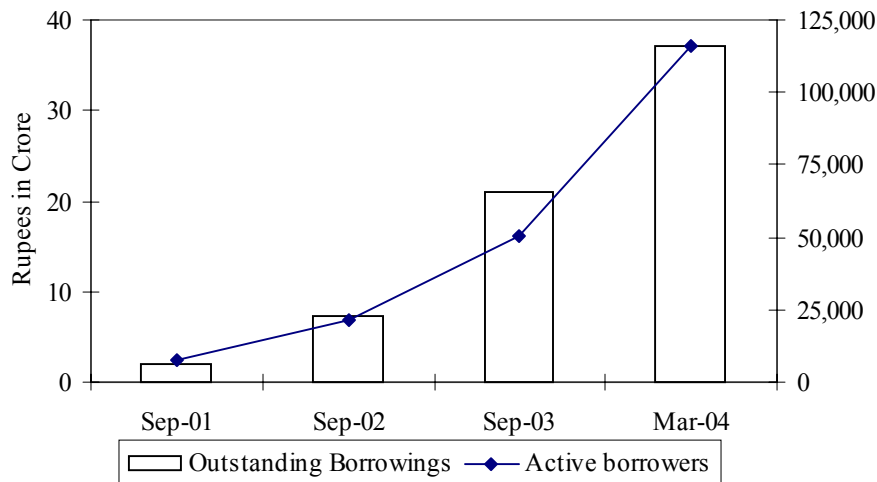
Spandana records very good performance on governance and strategy with a rating grade of α . This is the same as the grade assigned in the previous rating and reflects a sincere approach to sustainability and keenness to reach out to the largest possible number of potential clients in the most cost effective manner. However, hitches in the transformation to a non-bank finance company (NBFC) limit the rating of the organisation to the current level.

➤ Strategy for microfinance operations

Spandana has demonstrated one of the most cost effective models of microfinance service delivery in urban India. It has been proactive in securing funds to enhance its outreach and has been innovative in product design. In order to secure funds for microfinance from a commercial source while limiting its risk, Spandana has recently got into an agreement with ICICI Bank to finance the portfolio of its urban branches in Vijayawada and Vishakhapatnam (this loan portfolio remains on the balance sheet of ICICI bank and not of Spandana). Apart from making available low cost funds, this has brought down the organisation's risk while maintaining capital adequacy as all these loans have been transferred to the books of ICICI Bank. Apart from this, Spandana has expanded its lender base by including new sources like ING Vysya Bank and Indian Overseas Bank during the last financial year. It has also successfully negotiated with the existing lenders for lowering its cost of funds.

The rate of growth of Spandana has been made possible by the sound operating systems it has developed over the past few years. Its good performance on repayment and profitability is a clear indication of this. As **Figure 1** below shows, its recent growth has been fuelled by funds sourced from a number of commercial sources. A compounded annual growth of 227% in commercial funds obtained over the last three and half years has resulted in an annual growth of nearly 212% in the number of borrowers.

Figure 1: Commercial Borrowing Vis-à-vis the Outreach of operations



Spandana has successfully dealt with the past problem of sourcing funds from individuals at high interest rates and, as on 31 March 2004, it had no loan outstanding from individuals. It has also responded to competition from other MFIs in the region by effectively marketing its products and service delivery strengths. It has introduced a very innovative product for urban low-income slum dwellers in the form of consumer loans. It has also launched a Star Borrower loan for its old and loyal borrowers. A borrower who has successfully repaid loans for five cycles is entitled to “star” loans. Though a system of appraisal for such loans is in place, this appears to be inadequate considering the size of loans extended in such cases. This poses a potential risk considering that thousands of borrowers would be joining the ranks of star borrowers within a couple of years and the lack of an effective appraisal system could significantly affect portfolio quality.

Spandana has also increased its vertical concentration in its service area. It has plans to expand in the urban areas of coastal districts of Andhra Pradesh and also in the urban areas along the highway to Hyderabad and Vishakhapatnam. It plans to bring down its portfolio in the rural areas to just 20%. This is a sound strategy considering the high cost of delivery in the rural areas and intense competition from various government and non-government organisations.

However, there are few areas of concern related to the recent growth in its operations. One of these is the moderate capability of its second line of leadership. Despite serving more than 115,000 clients, with an effective portfolio of more than Rs55 crore (US\$12 million), most of the decisions of the organisation are still taken by the Director. Though, she has inducted a number of staff and plans to induct even more in different decision-making positions, there is still a long way to go in developing a second line of leadership for the organisation.

The social security product being offered by Spandana to its clients continues to be a major area of concern. Though this service has been working fine until now – with an increase in the volume and size of the organisation, the risk of moral hazard has gone up significantly. With a contingent liability almost equal to its existing portfolio, continuation with such a product is not in the interests of the organisation.



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As indicated above, Spandana plans to transfer its microfinance programme to a separate company. The application for obtaining an NBFC (Non-banking Finance Company) license has already been made and subsequently an inspection has been carried out by the RBI though there is still uncertainty over the issuing of the license.

3.2 Management

Spandana's performance on management indicators is good with a grade of α . This is the same as the grade assigned during the previous rating. It results primarily from the sound management practices it has adopted. Though the internal audit continues to be an area for improvement, the overall outlook of Spandana's operational systems is very good.

➤ Human resource quality and management

Spandana has developed an HR manual for its staff and has been putting this into practice. This details various aspects of the organisation's human resource policies. The manual sets out processes for staff selection, induction and promotion. Spandana has qualified and efficient staff whose performance is closely linked to remuneration. The staff drop-out rate during the last few months has been quite low and, therefore, lends confidence to the notion of stability in operations. The recent drop-outs have resulted mainly from termination of service because of poor performance or fraud.

➤ Accounting and MIS

The accounting system and MIS at Spandana are systematic and result in a reasonably fast flow of accurate information. All financial information is recorded in the CO registers, which serve as the primary document for accounts and the MIS. Information is transferred from the CO registers on a daily basis to the cash book at the branch, and the cash book is used to update the branch ledgers on a weekly basis. Receipts and Payments statements are prepared by each branch on a weekly basis and submitted to the head office.

Accounts information is updated at the head office from the weekly Receipts and Payments statements. This is compiled to prepare an Income Statement and Balance Sheet for the entire programme as and when required. The organisation has clear policies for the creation of a loan loss reserve and carries out its provisioning on the basis of an age statement of overdues.

Along with the Receipts and Payments statements, all branches submit a weekly progress report that covers other operational aspects like new members, number of clients, portfolio quality by staff, member drop-outs, number and value of loans disbursed and recovered and a demand collection balance statement. The MIS, though manual, adequately covers important financial and operational information and assists in decision making.

Spandana has started the process of computerising its MIS and accounts. It is likely to complete this process by the end of the current fiscal year. The computerisation and



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further networking of the branches will assist the fast track growth of the organisation and ensure easy and accurate decision making at various levels.

➤ Tracking system for overdues

Spandana has a strong system for tracking overdues and for taking follow up action on such accounts. While the weekly formats report all overdue accounts and are tracked as such, there are standing instructions to the staff as well to report to the head office any instance of overdue on the same day. Collective staff action is taken immediately on these reports, with the Branch Manager, Area Manager and the concerned CO visiting the borrower within days and impressing upon her the need to repay.

Overall, the institution has succeeded in conveying a message of zero tolerance of overdues, to both its staff as well as to its members.

➤ Financial planning and control systems

Spandana has very good planning and control systems though these continue to be dependent largely on the Director. The organisation has drawn up five-year plans from the head office, and these are broken down into standard verifiable indicators for the branch and the staff. Variances are closely monitored, almost on a weekly basis, and staff are rewarded/penalised immediately via an incentive system linked to growth and quality projections.

The Area Managers, and especially the Director, who keeps a close check on operations, apply financial controls at Spandana. AMs visit centre meetings, check disbursements and utilisations and visit branches on a random, sample basis. Monitoring reports are submitted to the Director and, at times, even loan balance reconciliation is carried out at the head office in case of any doubts or errors at branches. Overall, financial controls are effective but require a large proportion of the Director's time and effort. While financial controls are also internalised in the functions of the Area Managers and the Director, a formal internal audit system has also been established. The recently appointed internal auditor reports directly to the Director. There is a three-member team which visits the branches on a regular basis for this purpose. The team follows a proper internal audit manual which also details its Terms of Reference (ToR) along with the reporting format. The reporting format is quite broad and elaborate. However, the current expertise and strength of the team needs to be built further in order to cater to the growing size of operations of the organisation.

➤ Quality of clients/member groups

Member groups visited show good overall understanding of policies and procedures. Centre meetings focus on financial transactions only, and a strong culture of discipline is in place. Compliance with policies, both financial and operational (like attendance, late fines) is good and results in propagating the message of discipline.



➤ Infrastructure

Spandana operates with a low infrastructure base under its m-f operations – the total value of fixed assets is Rs54.8 lakhs (~US\$ 0.1 million) which is only 1.1% of the total assets of the organisation as on 31 March 2004. Fixed assets mainly comprise land for constructing an office building, and vehicle in addition to furniture, fixtures and computers at the head office and branches. However, considering the growth potential and size of operations of the organisation, it would make sense for Spandana to build its own infrastructure.

3.3 Financial performance

The financial performance grade of Spandana continues to be very good at $\alpha+$. The organisation retains its previous grade on account of sustained strong performance on portfolio quality, efficiency and profitability. However, a steep growth in portfolio has resulted in diluting its capital adequacy thereby bringing the possibility of a downgrade in its rating on this segment. The organisation needs to monitor its capital adequacy in relation to its portfolio size.

➤ Credit performance and portfolio quality

Spandana maintains very good credit performance, with a cumulative repayment rate of 99.9% and a PAR₆₀ of 0.05% on 31 March 2004. Spandana does not restrict the use of loans, but collects information about utilisation. It has a well diversified portfolio. The following table gives the position of its portfolio on 31 March 2004 for different types of loans:

Type of Loan	Amounts	
	(in crore Rs)	(in '000 US\$)
General Loan	40.163	8,637.2
Infrastructure Loan	0.009	1.9
Educational Loan	0.001	0.2
Individual Loan	0.600	129.0
Consumer Loan	3.317	713.3
Loan under partnership	11.370	2,445.2
Total	55.460	11,926.9

➤ Mobilisation of funds

Spandana has an excellent debt portfolio, with as many as 10 current institutional sources. This indicates the confidence of institutional lenders and banks in the organisation, while enabling it to manage cash flows in an efficient manner.

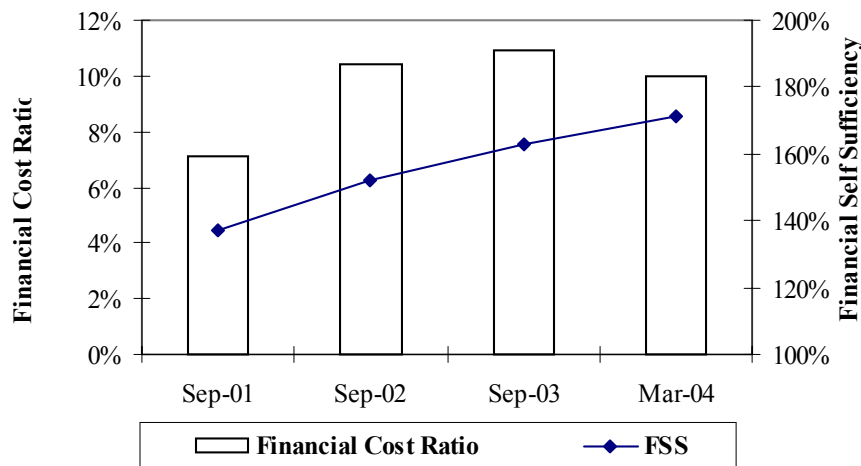
As on 31 March 2004, external funds accounted for about 84% of the loan portfolio, and member savings 15%. Another advantage in the debt portfolio is that almost all of it



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(~99%) is long-term debt in the range of two-five years, thereby, allowing easier cash flows for the organisation. This is an indication of a sound asset-liability management of Spandana as most of its portfolio is repayable within a year. The dependence on the commercial fund augurs well for the sustainability of the organisation too. As **Figure 2** below shows the growth of operations through commercially borrowed funds has increased its financial costs, though its financial self-sufficiency has improved considerably on account of this.

Figure 2: Trends in financial cost ratio and financial self-sufficiency



➤ Asset, liability and equity composition

The asset composition of Spandana is very good, with nearly 89% of assets deployed in loans to clients. The organisation's cash management is also very efficient and allows it to operate with low cash levels. As on 31 March 2004, the cash balance and other liquid current assets account for only close to 3% of the total, a very modest level considering the weekly system of collection from clients.

In terms of liabilities, long-term borrowings and member savings account for 88% of funds. The risk weighted capital adequacy ratio of the organisation is placed at 12.8% as on 30 March 2004. This is well below the level of 17.6% on 30 September 2003 recorded during the last rating. This has resulted primarily from a rapid growth of portfolio over the last few months and the transfer of Rs2 crore (\$435,000) to the proposed NBFC as equity. Considering the fact that the amount remains within the system, if this amount is added back to the equity the capital adequacy position improves to a comfortable level of 16.9%. However with its plans for faster growth in the near future, Spandana needs to monitor its capital adequacy position carefully.

➤ Sustainability and profitability

The organisation's financial sustainability in terms of its self-sufficiency and its return on average assets continues to be excellent. Spandana's Financial Self-Sufficiency (FSS) and Operational Self-Sufficiency (OSS) at 171% and 173% respectively and Return on Average Assets (RoA) at 11.8% are all excellent. Though FSS and RoA have improved



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over the previous rating, OSS has come down partially from the earlier level of 182%. The Return on Equity (RoE) for the last year (105%) is also a significant improvement over 77% observed during the previous rating.

Spandana continues to operate at very high efficiency levels, and sets a very high standard in this regard. Its Operating Expense Ratio (OER) has come down to 5.7% from the previous rating OER of 6.4%. This is one of the best in the microfinance sector.

4 Conclusions

Strengths	Weaknesses
<p><u>Organisational</u></p> <ul style="list-style-type: none"> ✓ Clear focus and strategy for microfinance with distinct staff allocation and operations ✓ Strong leadership ✓ Spirited response to competition & innovative products to suit market demand <p><u>Managerial</u></p> <ul style="list-style-type: none"> ✓ Strong and disciplined groups ✓ Good system for tracking overdues ✓ Streamlined MIS and accounting systems <p><u>Financial</u></p> <ul style="list-style-type: none"> ✓ Strong performance on profitability ✓ Excellent portfolio quality ✓ Well diversified portfolio ✓ Comfortable capital adequacy ✓ Diversified debt portfolio 	<p><u>Organisational</u></p> <ul style="list-style-type: none"> ✗ Moderate second line of leadership ✗ Flawed social security product ✗ Uncertainty on the legal status of the organisation <p><u>Managerial</u></p> <ul style="list-style-type: none"> ✗ Inadequate system of appraisal for star loans ✗ Under-equipped internal audit team <p><u>Financial</u></p>

5 Creditworthiness

Spandana has achieved a rating grade of *alpha plus* ($\alpha+$).⁶ In terms of creditworthiness this implies very high safety. While Spandana's performance on financial parameters is excellent, there is still some scope for improvement on management and governance indicators. This could further enhance its performance. On governance, Spandana needs to develop a more capable second line of leadership and on management, it needs to develop better systems for appraising star borrowers' loans and for conducting internal audits.

Spandana has performed very strongly on all the major areas of assessment – strategy, governance, management and finance. It has grown tremendously during the past one year in terms of its portfolio, outreach and profitability. However, its capital adequacy position needs to be watched carefully in the light of this rapid growth, as there is the possibility of a downgrade in the overall rating if capital adequacy issues remain an area of concern. The second line of leadership also needs to be strengthened further specially in the context of this growth.

In M-CRIL's view, on account of continued good performance on all parameters, a clear strategy and focused approach to sustainability and self-reliance, Spandana can absorb – from all sources – loan funds of Rs64 crores (US\$13.8 million) over the next one year for on-lending to its borrowers.

⁶ 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.



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Financial statements for Spandana

Balance Sheet - as on 31 March 2004

31 March 2003	<u>Assets</u>	<u>Rs</u>	<u>Rs</u>	<u>US\$</u>	<u>US\$</u>
	<u>Current assets</u>				
7 46 639	Cash in hand and bank	45 89 403		99,770	
11 42 419	Advances	68 70 619		149,361	
2 78 855	Interest receivable on deposits	13 33 770		28,995	
	Interest receivable on loans	14 01 213		30,461	
	Printing Stocks	1 72 203		3,744	
	<u>Loans outstanding</u>				
	[Loans under partnership]	[11 37 33 700]		[2,472,472]	
15 29 39 166	Direct loans outstanding	44 08 98 831		9,584,757	
- 5 49 594	(Loan loss reserve)	- 88 17 977		-191,695	
15 23 89 572	Net loans outstanding	43 20 80 854		9,393,062	
	Total current assets	44 64 48 062		9,705,393	
	<u>Long term assets</u>				
67 50 000	Fixed Deposits	4 41 99 600		960,861	
21 76 428	Net property and equipment	54 84 249		119,223	
89 26 428	Total long term assets	4 96 83 849		1,080,084	
16 34 83 913	Total Assets	49 61 31 911		10,785,476	
If final numbers,	<u>Liabilities and Networth</u>				
	<u>Current liabilities</u>				
86 90 683	Client savings – voluntary	3 17 14 055		689,436	
1 17 80 400	Client savings – Siri	3 36 13 300		730,724	
42 492	Client savings – Sneha	22 960		499	
4 66 577	Client savings – compulsory				
9 77 605	Interest payable to lenders	25 62 997		55,717	
5 01 010	Interest payable on savings	22 89 747		49,777	
	Salaries and other expenses payable	12 26 347		26,660	
	Caution Deposit from Staff	1 55 510		3,381	
	HDFC Bank Vehicle Loan	8 91 413		19,379	
	Advance from Spandana MBT	32 17 130		69,938	
38 79 500	Individuals				
2 63 38 267	Total current liabilities	7 56 93 459		1,645,510	
	<u>Long term liabilities</u>				
	<u>Long term debt</u>				
60 00 000	ICICI Bank	20 00 000		43,478	
	ING Vysya Bank	45 14 745		98,147	
	Indian Bank	15 30 000		33,261	
2 76 33 000	FWWB	4 87 30 000		1,059,348	
87 50 000	HDFC Bank	4 60 62 500		1,001,359	
87 28 100	UTI Bank	2 42 28 100		526,698	
50 00 000	Indian Overseas Bank	6 39 20 050		1,389,566	



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2 42 85 700	SIDBI	15 03 56 000	3,268,609
44 44 462	HDFC	99 38 694	216,059
2 11 07 132	CORDAID	1 97 52 361	429,399
62 14 494	Global Trust Bank		
11 21 62 888	Total long term debt	37 10 32 450	8,065,923
11 21 62 888	Total long term liabilities	37 10 32 450	8,065,923
	<u>Net worth</u>		
	Donated equity	60 19 866	130,867
6 83 700	Grants for on-lending	97 838	2,127
1 00 60 364	Retained net surplus/(deficit)	42 68 759	92,799
1 42 38 695	Current net surplus/(deficit)	3 90 19 539	848,251
2 49 82 759	Total net worth	4 94 06 002	1,074,044
16 34 83 914	Total Liabilities and Net Worth	49 61 31 911	10,785,476

Income Statement – for the year ending 31 march 2004

<u>Income</u>	<u>Rs</u>	<u>Rs</u>	<u>US \$</u>	<u>US \$</u>
Interest and fees on loans	8 17 37 065		1,776,893	
Interest on investments	12 22 058		26,566	
Loan fees & other operational income	95 54 477		207,706	
Total income	9 25 13 600		2,011,165	
<u>Financial costs</u>				
Interest on borrowings	2 68 15 870		582,954	
Interest accrued on savings	18 82 425		40,922	
Gross financial margin	6 38 15 305		1,387,289	
Provision for loan losses	82 68 383		179,747	
Net financial margin	5 55 46 922		1,207,542	
<u>Operating expenses</u>				
Salaries	99 71 812		216,779	
Travel	13 02 041		28,305	
Depreciation	9 56 275		20,789	
Administrative/office expenses	42 97 255		93,419	
Total Operating expenses	1 65 27 383		359,291	
Net Surplus/Deficit	3 90 19 539		848,251	



Notes to the financial statements

1. The Financial Statements refer to 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. 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. Average total assets
This represents the average total assets for the year calculated on an annual basis.
10. Operational Self-Sufficiency
Ratio of total income to total costs for the year.
11. Financial Self-Sufficiency
Ratio of total income to total adjusted expenses for the year. Adjustments have been made for subsidised cost of funds (w.r.t. market interest rate), equity (w.r.t. inflation) and in-kind donations.
12. Risk weighted capital adequacy ratio
Ratio of networth to risk weighted assets (Risk weights: 100% for all assets except the following: fixed assets & interest bearing deposits: 50%; cash 0%).



Projected Cash Flows and Financial Statements for five years

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

1 Basic Assumptions

(see also Notes to Cash Flow Projections below)

For the year ending:	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09
Members	115,742	225,000	350,000	500,000	675,000	850,000
Savings per member/year	585	600	600	650	650	700
Yield on average portfolio	28.4%	28.0%	25.0%	25.0%	20.0%	20.0%
Interest paid on savings	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%
Cost of external funds	11.8%	13.3%	11.4%	9.8%	8.3%	7.1%
Repayment rate from groups	100.0%	99.5%	99.5%	99.0%	99.0%	99.0%
Loan loss reserve ratio	2.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Number of active loanees/loan a/cs	133,465	213,750	332,500	475,000	641,250	807,500
Number of loans disbursed		209,746	326,088	465,025	627,000	788,263
Average loan size to borrowers	7,500	8,000	8,500	9,000	9,500	10,000



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2 Projected balance sheets

Rs in millions

As on:	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09
Assets						
Cash balance & other current assets	14	32	42	73	193	454
Loans outstanding	441	1,026	1,697	2,579	3,673	4,863
Loan loss reserve	-9	-10	-17	-26	-37	-49
Net loans outstanding	432	1,016	1,680	2,554	3,636	4,814
Long term investments	44	44	48	53	60	72
Net fixed assets	5	7	9	13	16	19
Total Assets	496	1,099	1,778	2,692	3,905	5,359
Liabilities and Net Worth						
External borrowings	371	806	1,230	1,714	2,426	3,161
Member savings	68	122	206	336	511	749
Other liabilities	8	7	10	15	23	34
Donations and equity	6	6	6	6	6	6
Retained surplus/deficit	4	43	159	327	620	939
Current surplus/deficit	39	115	168	294	318	470
Net worth	49	165	333	627	945	1,415
Total Liabilities and Net Worth	496	1,099	1,778	2,692	3,905	5,359

3 Projected Income Statements

Rs in millions

For the year ending:	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09
Income						
Interest	82	205	340	535	625	854
Other income	11	12	13	14	16	17
Total Income	93	217	353	549	641	871
Cost						
Financial	29	83	124	160	200	238
Loan loss provision	8	1	7	9	11	12
Depreciation	1	1	1	1	2	2
Operating costs (excl.depr.)	16	17	54	85	111	149
Total Cost	53	102	185	255	323	401
Surplus/Deficit	39	115	168	294	318	470



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4 Projected Cash Flow Statements

Rs in millions

For the year ending:	Mar-05	Mar-06	Apr-07	Mar-08	Mar-09
<u>Inflows</u>					
Opening cash	14	32	42	73	193
External borrowings	640	700	950	1,475	1,776
Repayments from members	1,093	2,101	3,303	4,863	6,692
Member savings deposits	135	210	325	439	595
Interest income	205	340	535	625	854
Other income	12	13	14	16	17
Total Inflow	2,099	3,397	5,169	7,491	10,127
<u>Outflows</u>					
Disbursement	1,678	2,772	4,185	5,957	7,883
Repayments to lenders	205	277	465	763	1,041
Withdrawals of savings deposits	81	126	195	263	357
Operating expenses (excl. depr.)	17	54	85	111	149
Interest paid on borrowings	77	114	143	174	200
Interest paid on savings	8	10	16	25	38
Fixed assets purchase	2	3	5	5	5
Total Outflow	2,067	3,355	5,096	7,298	9,673
Net cash balance	32	42	73	193	454

5 Key projected performance ratios

For the year ending:	Mar-04	Mar-05	Mar-06	Apr-07	Mar-08	Mar-09
Operational self-sufficiency	173%	213.0%	190.7%	215.2%	198.6%	217.3%
Return on average assets	11.8%	14.4%	11.7%	13.1%	9.6%	10.1%
Operating expense ratio	5.7%	2.3%	4.0%	4.1%	3.6%	3.5%
Average outstanding/borrower (Rs)	3303	4,801	5,103	5,430	5,727	6,022
Portfolio growth rate	262.6%	132.8%	65.3%	52.0%	42.4%	32.4%
Savings to total assets	13.6%	11.1%	11.6%	12.5%	13.1%	14.0%
Risk weighted capital adequacy ratio	12.6%	15.5%	19.2%	24.0%	25.5%	28.9%



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 loans disbursed is equal to the loan accounts as all are 50 week loans. The ratio of members to active loans is based on improvements in the historical figures.
4. Average loan size to members increases gradually over the next five years.
5. Interest income is taken as [yield on portfolio*average portfolio for the year]. Yield movements are projected to stay the same as there is not likely to be any change in the overall interest structure.
6. Other income is the income that the organisation earns on membership fees, administrative charges and service charges.
7. Disbursements are taken as the [number of loans disbursed during the year*average loan size to borrowers].
8. 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.
9. Repayments to lenders is 25% per annum on the projected liability structure and the actual repayments due on the present outstanding debt.
10. Interest paid is taken as the [average cost of external funds * the average external borrowing liability figure].
11. In the projections the net worth figure includes donations and equity, retained surpluses and current surplus.



M-CRIL’s Microfinance Rating Symbols

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