

CAMEL INSTITUTIONAL ASSESSMENT

Name Of the Organisation	SPANDANA
Type of the Organisation	A MFI located in the state of Andhra Pradesh, India registered as a society as per the Indian Societies Act
Address	SPANDANA 5-54-19, 6/18, Brodipet Guntur – 522 002 Andhra Pradesh
Telephone	91 863 350733
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Executive Director	Mrs.G.Padmaja
Date of Assessment	May 8, 2002 to May 14, 2002

RATING TEAM

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2. Mr.S.Anantha Krishnan, SIDBI, Kochi
3. Mrs.Bhavana Srivastava, SIDBI, HO, Lucknow
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6. Mr.A.Sreenivasa Rao, S.M.L, Hyderabad

Program Details

Date of inception	Registered on October 21 1992. However, Micro credit operations were started only In April 1997
No. of active clients (as at March 2002)	13,206
Outstanding Loan portfolio (as at March 2002)	Rs.4,66,88,911
No. of staff	46

Note

The CAMEL Institutional Assessment Tool for Micro credit programs is a tool for the management of such programs, and its objective is to prepare micro credit programs for full integration in national financial markets. The lack of accumulated experience with hundreds of credit entities makes it difficult to apply traditional analysis used in the banking system. Nevertheless, this document illustrates the general, especially financial, situation of the program analysed according to formal and well known standards. The CAMEL is neither an audit nor a certification of results of the program.

The CAMEL assessment process is based on information provided by the program analysed. The numbers from the financial statements might have undergone changes according to the adjustments considered necessary, in order to more fully reflect the real situation of the program.

CAMEL QUANTITATIVE AND QUALITATIVE INDICATORS (weighting by category)

Quantitative Indicators	Qualitative Indicators
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<u>Capital Adequacy</u>		
(15%)		
Capital Adequacy	5%	Ability to raise equity 5%
Adequacy of reserves	5	
<u>Asset Quality</u>		
(21%)		
Portfolio at risk	8%	Portfolio classification system 3.0%
Write offs/write off policy	7	Productivity of long-term assets 1.5
		Infrastructure 1.5
<u>Management</u>		
(23%)		
		Governance/Management 6%
		Human resources 4
		Processes, controls and audit 4
		Information Technology System 5
		Strategic Planning and budgeting 4
<u>Earnings</u>		
(24%)		
Return on Equity	5%	Interest rate policy 4%
Operational efficiency	8%	
Return on Assets	7%	
<u>Liquidity Management</u>		
(17%)		
Productivity of other current assets	2%	Liability Structure 8%
		Availability of funds to meet
		Credit demand 4
		Cash flow projections 3
Total	47%	53%
(100%)		

Scope of work

This CAMEL assessment was conducted based on information provided by SPANDANA and through interviews with the Executive Committee members, senior management and staff at all levels in the organization. It is important to mention some important aspects here in order to ensure better understanding of the report:

1. The rating of quantitative CAMEL indicators is based on audited financial statements of the micro finance program of SPANDANA for the financial years ended March 31st 2002, March 31st 2001, March 31st 2000.
2. The portfolio has been classified by product for each of the periods analysed. It has also been classified by ranges of days past-due (1-30, 31-90, 91-180 and more than 180) in order to better evaluate the quality of the portfolio.
3. The adjustments made by the CAMEL Team include reclassification of donations into equity, subsidized debt adjustment, shadow costs (sponsored training programs attended by the staff, salary of certain staff based on certain allocation, depreciation of fixed assets, telephones and other services etc.), inflation adjustments in equity and fixed assets, provisioning and write offs (loans > 180 days past due)
4. Since the Institution has not effected any write offs in the previous years, the CAMEL Team estimated the write offs corresponding to each of the periods in which the loans got more than 180 days past due for the purpose of calculating Loan Loss Rate.
5. Field visits were undertaken to two branches of SPANDANA with one being an Urban Branch and other a Rural Branch.

CAMEL RATING (Executive Summary)

SPANDANA is a registered society offering Micro finance services besides undertaking other developmental programs in and around Guntur District of Andhrapradesh, India. Micro Finance has been a focused activity of SPANDANA since 1998.

SPANDANA has demonstrated great strengths in Capital Adequacy and Financial Solvency. The continued strengthening of its equity through the capitalization of retained earnings has resulted in a situation where SPANDANA would be able to meet half the minimum capital requirements established in India for creation of a Non Banking Financial Company(NBFC). SPANDANA is now exploring possibility of raising additional equity to meet the above norms.

The quality and size of the loan portfolio is good representing positive trends in real growth. (221.54% CAGR in Active Portfolio) for the periods analyzed by the CAMEL Team. SPANDANA's profitability has also shown an upward trend in line with the growth in average portfolio and improvement in the portfolio quality. At the same time, it is worth mentioning that the noted growth in portfolio also drove a reduction in operating costs with respect to the average portfolio, with operating costs moving down to 8.35% at March 2002 from 23.36% at March 2000. The reduction in costs is also reflected in the increase in the operating margin, which increased to 10.23% at March 2002 from 3.11% at March 2000.

To summarize, SPANDANA today faces new challenges to continue its growth and maintain itself as a strong player in the field of Micro Finance in Guntur and neighboring districts. It has good commercial operations that could however, be effected by the growing competition in Guntur, as increased competition usually causes decline in interest rates. In view of the above, SPANDANA needs to maintain its current operating efficiency levels while attempting to lower/maintain cost of funds.

If SPANDANA is considering transformation into a regulated institution, there will be series of changes and new requirements for the Institution. This implies that SPANDANA not only needs to have excellent commercial operations but also a strong structure which supports the operations adequately with in the regulatory framework. SPANDANA will, therefore, have to begin making adjustments in short term such as establishing clear provisioning policies and write off policy which allows management to clearly identify loan losses and improve its actual portfolio classification system according to the level of risk.

At the same time, significant improvements in Human resources will also be necessary to expand the processes beyond personnel recruitment and selection, salary scales, internal training programs, promotion and performance evaluation processes. In addition an appropriate computerized information system needs to urgently put in place along with systems infrastructure so that the MIS is capable of supporting all operations in an integrated and reliable manner.

There is a need to improve the internal control environment. SPANDANA's decision to recruit an Internal Auditor is a step in the right direction. The present manual MIS coupled with the significant growth could pose high risk which needs to be addressed by SPANDANA urgently.

Finally, monthly budgeting and cash flow projections for a period up to 90 days are important for charting out a course of action to achieve the overall goals. These tools would also help in anticipating the fund requirements and identifying alternative resources.

	<u>RATING</u>		<u>WEIGHT</u>		<u>RESULT</u>
<u>CAPITAL ADEQUACY</u>					
Capital Adequacy	5.00	*	5.0%	=	<u>0.25</u>
Ability to raise equity	4.00	*	5.0%	=	<u>0.20</u>
Reserve Sufficiency	5.00	*	5.0%	=	<u>0.25</u>
<u>ASSET QUALITY</u>					
Portfolio at risk	5.00	*	8.0%	=	<u>0.40</u>
Loan Loss rate	5.00	*	7.0%	=	<u>0.35</u>
Portfolio Classification system	3.00	*	3.0%	=	<u>0.09</u>
Productivity of non current assets	3.50	*	1.5%	=	<u>0.05</u>

Fixed Assets/Infrastructure	3.00	*	1.5%	=	<u>0.05</u>
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MANAGEMENT

Governance/Management	2.50	*	6.0%	=	<u>0.15</u>
Human Resources	3.00	*	4.0%	=	<u>0.12</u>
Processes, controls and audit	3.00	*	4.0%	=	<u>0.12</u>
Information technology System	2.00	*	5.0%	=	<u>0.10</u>
Strategic Planning & Budgeting	3.00	*	4.0%	=	<u>0.12</u>

EARNINGS

Return on Equity(ROE)	5.00	*	5.0%	=	<u>0.25</u>
Operating Efficiency	5.00	*	8.0%	=	<u>0.40</u>
Return on Assets(ROA)	5.00	*	7.0%	=	<u>0.35</u>
Interest Rate Policy	3.50	*	4.0%	=	<u>0.14</u>

LIQUIDITY

Liability Structure	4.50	*	8.0%	=	<u>0.36</u>
Availability of funds to meet Credit Demand	3.00	*	4.0%	=	<u>0.12</u>
Cash flow projections	2.50	*	3.0%	=	<u>0.08</u>
Liquidity management	4.00	*	2.0%	=	<u>0.08</u>

100%	<u>4.02</u>
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CAPITAL ADEQUACY SPECIFIC DESCRIPTION OF THE INSTITUTIONAL CAPITAL/RESERVES POLICIES Quantitative Indicator

CAPITAL ADEQUACY

SPANDANA has demonstrated favorable financial solvency as a result of the fact that its equity has been increasing every year through the capitalization of retained earnings and donations. By March 2002, the percentage after adjustments of retained earnings in the institution to total equity was at (58%) compared to donations of (12%).

The financial solvency of the institution (measured as Risk Assets/ Adjusted Equity) is reflected at 4.78 for FY 2002 indicating that there is still some scope for SPANDANA to increase its portfolio with the same equity levels. However, keeping in view the typical characteristics of micro finance such as volatility of the loans and also the significant growth which SPANDANA has recorded in its portfolio during the last year, it is fast reaching the maximum levels of risk weighted assets/equity of 6:1 as recommended by

the norms of CAMEL methodology. Therefore, SPANDANA needs sufficient equity infusion, in the medium term, in order to support its portfolio growth.

It may be mentioned here that the above indicator of financial solvency for FY 2000 and FY 2001 had remained more or less static, with increase to 4.78 only in FY 2002. This indicates that during FY 2002 SPANDANA managed to leverage its equity effectively to attract external debts thereby increasing its assets portfolio. Accordingly, the DER for the above period has marginally increased from 2.52 in FY 2000, to 2.63 in FY 2001 with significant jump to 4.08 in FY 2002.

In conclusion, it is recommended that SPANDANA needs to bring in equity in the short-medium term so as to sustain its significant growth.

RATING: 5.0

**CAPITAL ADEQUACY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
CAPITAL/RESERVES POLICIES
Quantitative Indicator**

ABILITY TO RAISE EQUITY

The adjusted equity had a significant increase from Rs.4.1 million on March 31,2001 to Rs.10.1 million on March 31, 2002. Out of this amount, the retained earnings accounted for Rs.6 million.

SPANDANA has been strengthening its equity base by investing its equity base by investing 100% of its retained earnings. In addition, SPANDANA, by virtue of its cost efficient system of credit delivery methodology, is self-sufficient. It has been able to attract donations from various funding agencies and donors.

SPANDANA has already contacted few individual and social investors (Non-Resident Indians) for investing in their equity. The appraisal of the same is likely to be done some time in June 2002. However, for SPANDANA to attract formal financial institutions, the minimum equity level requirement of Rs.20 million needs to be raised. SPANDANA has already brought in Rs.10 million (plough back of retained earnings) as on March 31,2002.

In extreme case of liquidity problems, and when the NBFC is in place the Executive Members / Governing Body members could contribute with resources towards equity.

RATING: 4.0

**CAPITAL ADEQUACY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
CAPITAL/RESERVES POLICIES
Quantitative Indicator**

ADEQUACY OF RESERVES

SPANDANA has introduced a policy of providing for loan loss reserves @1% of its average loan outstanding from FY 2002 only. Accordingly, it has created adequate reserves for FY 2001002. This provisioning policy is positive for the institution because in the previous years SPANDANA was not providing for any reserves , and with this practice

the institution may cover the potential portfolio losses. Therefore, it is imperative that SPANDANA continues to implement the policy of making portfolio reserves, which would be helpful in its transformation to a regulated institution.

CAMEL team had made loan loss reserve adjustments to the institutional reserves, according to the following percentages. These percentages were established based on a technical study of the behavior of micro finance portfolio of MFIs as well as provisioning norms stipulated by different Central Banks.

S NO	Ranges of Past 0 Due	Provisions
1	1 to 30 days	10%
2	31 to 90 days	30%
3	91 to 180 days	60%
4	> 181 day	100%

By applying the above percentages to the portfolio classification by balances and ages, the CAMEL team calculated a reserve of Rs.78,378 for FY 2002, Rs.56,589 for FY 2001 and Rs.50,075 made by the institution for FY 2002 is more than 3 times the reserve of Rs.78,378 calculated by the CAMEL team. The institution was, thus, over0provisioned and had sufficient reserves for the write0offs of Rs.57,260 proposed by CAMEL. The adequacy of Reserves indicator which is measured as a ratio of the institution's actual loan loss reserve after CAMEL adjusted write0offs (Rs.243,445) divided by the CAMEL adjusted loan loss reserve (Rs.21,118) is 1152.78% at FY 2002. As a result, the provision for FY 2002 was not required to be adjusted. After the CAMEL adjustments for loan loss reserves were made for each financial year, the following balances have been arrived at:

Financial Year	Balances (Rs.)
1999-2000	629
2000-2001	75
2001-2002	243,445

In order to show a true picture of the portfolio at risk situation, it is recommended that SPANDANA adopt a provisioning policy based on the age of the balances past0 due of the portfolio.

RATING:5.0

**ASSET QUALITY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRNG TO ASSETS
Quantitative Indicator**

PORTFOLIO AT RISK

Analyzing the portfolio at risk according to CAMEL parameters of " portfolio past due over 30 days plus rescheduled/refinanced loans" , after write off adjustments, SPANDANA demonstrated the following indicators: 0.03% for FY 2000, 0% for FY 2001 and 0.05% for FY 2002. SPANDANA has been able to maintain this low level of PAR (which is better than the industry average) mainly on account of appropriate measures taken by its management, improvements made in the lending methodology and good repayment culture of the clients.

It may be pertinent to note that the loan portfolio of SPANDANA has grown phenomenally over the last three years (272% in FY 2000, 197% in FY 2001 and 248% in FY 2002). This is a reflection of improved portfolio management, efficient collection policy and proper selection of clients. However, at one of its branches there are some delayed payments which could result in higher PAR in future years and needs immediate attention to sort out the same.

The percentage of pre0payments has increased in the last quarter of FY 2001-02. These pre0payments represented 2% of the expected demand during the last fiscal year. SPANDANA needs to study the cause and effects of these pre-payments carefully and understand if these prepayments would constitute a risk at a later date.

RATING: 5.0

**ASSET QUALITY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRNG TO ASSETS
Quantitative Indicator**

LOAN LOSS RATE

SPANDANA does not have any write off policy and no amount has been written off in the past three years. It is recommended that the institution adopt a write0off policy as soon as possible, especially as it is considering transformation into a regulated institution.

As per CAMEL methodology, once a loan becomes 180 days past0due or is in legal collection, it should be written0off. In order to analyze the loan loss rate, the CAMEL team effected a write0off adjustment of Rs.57,260 as at March 31,2002, determining that this total should be assigned to each of the above periods in which the loans became past0due over 180 days in the following manner:-

March 31, 2000- Rs.49, 446

March 31, 2001- Rs.7, 068

March 31, 2001- Rs.746

The above adjustments allowed the CAMEL team to calculate the following loan loss rate indicators for each period analyzed: 2.22% for March 31, 2000, 0.09% for March 31, 2001 and 0% for March 31, 2002. This low loan loss rate reflects a good portfolio quality, a strong culture of repayment among clients as well as a efficient and effective collection policy.

However, it is pertinent to note that although a clear write-off policy is being recommended, this does not imply that all collection efforts on written-off loans be halted. On the contrary, such efforts should continue as long as possible, keeping in view the cost-benefit of such efforts. Sometimes, the efforts to collect such small amounts may not be worth the additional expense.

RATING: 5.0

**ASSET QUALITY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRING TO ASSETS
Quantitative Indicator**

PORTFOLIO CLASSIFICATION SYSTEM

SPANDANA classifies its portfolio by balances if any repayment is not received beyond a period of 4 weeks from the due date. SPANDANA , therefore, classifies its portfolio by ageing schedule of 31 to 60 days, 61 to 90 days and > 90 days.

Considering the significant growth of SPANDANA and increased risk of the entire portfolio balance of past-due loans it would be prudent and practical for SPANDANA to classify its portfolio based on overdue balances and by ageing schedule i.e. 1 to 30 days. 31 to 60 days. 61 to 90 days, 91 to 180 days and > 180 days. It is recommended that SPANDANA separately classifies its portfolio under legal recovery.

In addition, it is recommended that SPANDANA begin to classify its portfolio according to level of risk. SPANDANA could also client disappearance, non-intention to pay and guarantees.

Using the classification systems as explained above, SPANDANA would be able to identify the portfolio at risk through its information system. These parameters will demonstrate to management the possibility of recovery or loss of the portfolio and indicate the true risk inherent in the portfolio at any given moment. These classifications should be formally documented.

RATING: 3.0

**ASSET QUALITY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRNG TO ASSETS
Quantitative Indicator**

PRODUCTIVITY OF LONG-TERM ASSETS

SPANDANA's long-term assets represent approximately 2.26 % of total assets (including land and building [apportioned] for the proposed micro finance training center, which is under construction) as on March, 2002, implying that the institution's assets are concentrated in the micro finance portfolio. In addition, the participation of long-term assets has decreased over the past two years due to significant increase seen in the portfolio outstanding

Long term assets constitute 4.68% of the total assets as on March 2000.
Long term assets constitute 6.43% of the total assets as on March 2001.
Long term assets constitute 2.26% of the total assets as on March 2002.

SPANDANA's long-term assets are basically its fixed assets, which have been managed well and do not represent any significant risk to the financial result of the institution. SPANDANA has begun the construction of a training center with internal resources and some grant funds. However, the construction has been put on hold due to resource constraints. SPANDANA proposes to finish the construction with grant funds. It is recommended that SPANDANA undertake a cost-benefit analysis for all future capital investments.

It is important to mention that SPANDANA is planning to use the land and building which is under construction as guarantees for obtaining additional credit from lending agencies. The policy of acquiring further fixed assets is largely based on availability of grant funds.

It is recommended that SPANDANA acquire computers and vehicles urgently which, despite significant initial investment, would result in increased efficiency over the medium and long-term.

RATING: 3.5

**ASSET QUALITY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRNG TO ASSETS
Quantitative Indicator**

FIXED ASSETS/INFRASTRUCTURE:

SPANDANA has a network of 6 branches with a separate Head Office. All the branches and the Head Office are on rented premises. SPANDANA's intentions of setting up the Head Office in owned premises have not materialized due to lack of resources. However, SPANDANA has set up its own training centre in a two-acre plot of land, which was mostly funded out of the grants received for non-micro credit operations.

The Head Office and the branches visited by the CAMEL team are well located, with adequate working space, sufficient lighting and ventilation.

Separate arrangements exist in the branches for keeping cash for the next day's disbursements. However, there exists a potential risk of keeping large overnight cash balances in the branches. It is recommended that SPANDANA devise alternative ways in order to minimize overnight cash balances in the branches.

SPANDANA does not have vehicles to transport credit officers. Sometimes they need to travel long distances, especially in the rural areas. It is felt that availability of vehicles for the credit officers may further improve their productivity.

RATING: 3.0

**MANAGEMENT
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRING TO ASSETS
Quantitative Indicator**

GOVERNANCE/MANAGEMENT

The Director of SPANDANA is a professional with good knowledge of micro finance industry and practices. She has good leadership qualities and commands respect from all levels in the organisation. The Director holds staff meetings periodically to explain the objectives and goals of SPANDANA and to discuss operational issues.

The organisation has a core management team comprising of the Director, three Area Managers, one Training Manager and one Human Resource Manager. However, there is a high degree of centralization of management looks forward to the Director for taking crucial decisions relating to the operations. This high level of centralization could, at times, divert the attention of the Director from high priority strategic issues. The Director is forced to spend her time on routine operational issues leaving little time for resource mobilization. Other critical issues such as transformation of SPANDANA into an appropriate legal entity, which assume importance in the present context, need time from the Director and senior management. In short, the role of the Director has been diluted in the absence of a General Manager for operations.

SPANDANA also has an Executive Committee comprising of local persons, development activists and practitioners from finance industry. It is felt that the committee could perform better with professionals in finance, banking, legal etc. The committee, which is independent of the management, meets every quarter and participates in the deliberations. It is recommended that the Committee be broad based and also meet more frequently to discuss strategic issues.

RATING: 2.5

**MANAGEMENT
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL**

POLICIES REFERRING TO ASSETS Quantitative Indicator

HUMAN RESOURCES

SPANDANA did not have a separate and formal Human Resources Division for the major part of FY 2002. Instead, the tasks related to this area were mostly handled by the Director. About four months back, a person with postgraduate qualification in HRD has been recruited by SPANDANA with the objective of setting up a formal Human Resources Division. However, the HR Manager's job description has not been clearly defined.

The recruitment of staff is normally done through advertisement in newspapers followed by formal interviews. In addition, SPANDANA has been recruiting its staff, especially Credit Officers, through informal sources and by word of mouth. Before their formal recruitment and appointment, the Credit Officers are required to furnish an indemnity bond duly signed by two government officials to SPANDANA. This practice is being followed by SPANDANA as it feels that honesty and integrity are one of the essential requirements of the Credit Officers for efficient discharge of their responsibilities.

SPANDANA has a structured orientation process for Credit Officers spread over a period of 3 months. It comprises of a brief classroom training on understanding the credit policy followed by on-the-job training and exposure on maintenance of records and registers related to the administration of credit, bookkeeping, conducting of group meetings, formation of new groups etc.

SPANDANA does not have a formal training budget. The staff members attend short term training courses conducted mostly in-house. A need is left for the operating staff to get exposure to the micro finance programs of other successful MFIs in the country which would help them in honing up their skills. Likewise, the staff also needs to be trained on basic skills required for the operation of computers. It is recommended that SPANDANA make an assessment of the training needs of the staff and prepare a training calendar for its staff.

SPANDANA has a manual of job description and responsibilities of Area Managers, Branch Managers and the Credit Officers. However, the organization needs to prepare job description of new positions such as Internal Auditor, Training Manager, Human Resource Manager etc.

The performance reviews of the Branch Manager and the Credit Officers are done every month. The Credit Officers and the Branch Managers have a variable salary structure with a policy of monthly incentives. In order to arrive at the annual increment in salary for each level of staff, it is recommended that SPANDANA develop a formal and documented policy of performance evaluation.

The employee salaries are currently in line with the market trends. The personnel costs as percentage of average portfolio is low (4.18% for FY002) offering scope for SPANDANA to improve the salary structure for maintaining the requisite productivity standards. The productivity of the field staff is quite high with the ratio of total clients to average loan officers being 467. This ratio is one of the best in the Indian micro finance industry and can be attributed to the effective design of the credit delivery mechanism and simple and user-friendly records and bookkeeping being followed by SPANDANA.

The employee turnover is relatively high (28% in FY002 and 78% in FY001) with a few instances attributed to acts of indiscipline as well as isolated incidences of fraud. Considering the plans of SPANDANA to open more branches in future, a formal mechanism of assessing the reasons of staff leaving the organisation is recommended. Such an assessment may help SPANDANA in bringing down the rate of employee turnover.

In the context of the growth plans of SPANDANA in terms of loan portfolio and geographical reach, the functioning of Human Resources Division needs to be streamlined further. The internal training needs of the organisation are required to be assessed at the beginning of each year in order to facilitate professional development of staff at all levels in the organisation.

RATING: 3.0

**MANAGEMENT
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRING TO ASSETS
Quantitative Indicator**

PROCESSES, CONTROLS AND AUDIT

The institution's key policies and procedures are documented in manuals and have been updated recently. The institution is also planning to design a more comprehensive manual using the services of a consulting agency. The institution's policies and procedures have been communicated to field staff.

Controls over the accounting system, especially at the field level, need to be strengthened as there have been few instances of fraud in the recent past.

The internal audit function is presently non-existent. Although an internal Auditor has been recruited recently, neither the audit manual nor his job descriptions have been properly defined as yet. The external auditor is independent and follows established accounting standards although he did not visit any branch during last FY.

Previously, in the absence of an internal auditor, a team consisting of Area Manager, Training Manager and the Director looked after the function. The controls consisted primarily of verification of loan ledgers and other documents, clients visits, verification of loan ledger and other documents client visits, verification of end-use of loans etc. With the appointment of an internal auditor and also an increase in the number of Area Managers (corresponding to the increase in volumes), the internal control function has been strengthened.

Finally, it is recommended that SPANDANA:

- strengthen the internal control environment for each of the areas of the institution,
- design its internal audit manual urgently,
- keep updating the operations and audit manual regularly,
- reduce the risk of handling cash by going in urgently for a cash-in-transit policy,
- adopt a computerized accounting and MIS so as to minimize the instances of fraud and also to reduce the workload of its staff,

- include in the internal audit functions the review of not only the credit related operations, but also of the financial, administrative, human resource and systems(as and when SPANDANA acquires it).

RATING: 3.0

**MANAGEMENT
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRING TO ASSETS
Quantitative Indicator**

INFORMATION TECHNOLOGY SYSTEMS

SPANDANA does not have a computerized management information systems. All records at the branches are being maintained manually. However, a noteworthy feature of SPANDANA's programme is the simple and cost effective design of operational records. The loan monitoring is the simple and cost effective design of operational records. The loan monitoring and accounting reporting formats are standardized with minimal duplicity. Only crucial information and indicators are captured. The information captured allows analysis of costs and portfolio. All branch level portfolio analysis and income and revenue statements are prepared by the respective Branch Manager and reviewed by the Director on a weekly basis. Information from branches is consolidated at the HO and analyzed using Excel worksheets.

SPANDANA's micro credit programme has growth rapidly in the past two years. This growth in portfolio necessitates the use of reliable, robust and integrated software. In the absence of a computerized MIS, the organisation is not able to generate accurate and timely reports. Consolidated accounting for both credit and non0credit programme was being done till last FY at the HO using Tally0a standardized accounting software. However, separate books of accounts for micro finance programme have been opened in the accounting software from the current FY(I.e.2002-03).

The HO currently has four stand0alone computers and four printers. As on date, only MS work and MS Excel are being used for consolidation and analytical purposes. Currently, the data back0up at the HO is taken on floppies, which has, in the past, resulted in loss of data. There has been an incident of system crash in the past resulting in loss of critical accounting data for FY 2001, which had to be re-entered.

It is recommended that SPANDANA install an appropriate software (suited to its requirements) that integrates both loan tracking and accounting modules. This would not only help in avoiding duplicity but also help in reducing the current workload of the branch level staff. The software should have necessary security control. Further, it is recommended that SPANDANA take urgent steps to take back0up of all crucial data using reliable and robust back0up devices. At the time of installation and operationalisation of the software, SPANDANA should put in place a disaster recovery plan and take necessary steps to shift the manual data into the software.

RATING: 2.0

**MANAGEMENT
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRING TO ASSETS
Quantitative Indicator**

STRATEGIC PLANNING AND BUDGETING

There is no annual budgeting process followed in SPANDANA. As a result, there is no way of determining budgeted results versus actual results. However, SPANADANA has realized the need for annual budgeting and its implications.

At present, each Credit Officer is assigned a target of admitting 40 new members (4 groups) per month. Based on these monthly targets, the Director along with the Branch Managers prepares the annual business plan. At the beginning of each financial year, the annual business plan is discussed with the Executive Committee, which gives the final approval.

SPANDANA has also prepared long term projections for the next 5 years based on which external funding has been estimated and efforts are being made to mobilize them. The first such projections were made in FY 199902000 which was reviewed in December 2001 due to unexpected line of credit from ICICI.

However, it was observed that the actual results for FY 2002 were at variance with the projections. It is, therefore, suggested that the institution review its long term projections to make it more meaningful and realistic.

It is also recommended that SPANDANA do a thorough monthly budgeting and strategic planning exercise taking into account not only the strict norms of provisioning policies, write off, portfolio quality etc. but also the number of groups likely to be formed and assisted, availability of funds, quality of human resource, operational and credit goals, etc.

In addition, it is suggested that SPANDANA prepare projected financial statements (Balance sheets, Income Statement and Cash Flow) in complete detail on a monthly basis with active participation of the senior management and Branch Managers. The monthly financial results may be compared with the projections and analysed in detail. It is felt that these methods would help in arriving at a meaningful decision from time to time.

RATING: 3.0

EARNINGS
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRING TO ASSETS
Quantitative Indicator

RETURN ON EQUITY

SPANDANA's operating return on equity for the period ended March 31, 2002 was 42.98% after CAMEL adjustment, registering during this fiscal year a net operating income of Rs.3.0 million. During the three periods studied, this indicator has shown a consistent improvement moving up from a negative figure of 12.98% in FY 2000 to 20.58% in FY 2001 and finally 42.98% in FY 2002. As regards the equity, the institution has been able to increase its equity base primarily through its retained earnings from operations adjusted for inflation.

Among the main factors that contributed to the improvement in ROE is the significant growth of 436% in operating income during FY 2002. The growth in income is due to the fact that the average portfolio increased by 235% during FY 2002. Coupled with the growth in income, the organisation's operating expenses in relation to average portfolio has also shown a sharp downward trend reducing from 23.36% in FY 2000 to 12.44% in FY 2001 and 8.35% in FY 2002 and is, therefore, comparable to the best in the Indian micro finance industry. However, the financial expenses in relation to average portfolio showed a slight increase from 9.92% in FY 2000 to 10.84% in FY 2001 and 11.27% in FY 2002 largely due to high cost of commercial borrowings and provision expenses during FY 2002.

The reduced operating costs in relation to the average portfolio is also reflected in an increased operating margin which increased from 03.11% in FY 2000 to 6.40% in FY 2001 and then to 10.23% in FY 2002. However, as the financial costs increased during the period under review, the financial margin actually dipped from 20.25% in FY 2000 to 18.84% in FY 2001 and then to 18.58% in FY 2002. The decrease in financial margin is also explained by the fact that operating revenue as a percentage of average portfolio at 29.85% in FY 2002 did not show any marked improvement over the previous year's figures of 29.68% in FY 2001 and 30.17% in FY 2000. This paradox of growing portfolio with near stagnant operating revenue is explained by the fact that SPANDANA reduced the interest rates on its General Loans from 20% flat to 15% flat during the last fiscal year. It may be mentioned here that General Loans constitute 99% of the portfolio and therefore contribute maximum revenue for the organization.

The above analysis suggests that the reduction in financial margin is attributed to high cost of funds coupled with constant operating revenue. In view of the fact that the organisation has received commitments from various other commercial lending agencies, its financial margin could further decrease.

Although the organisation presently has a positive difference between interest revenue in relation to average portfolio (29.85%) and minimum yield to cover financial and operating costs (19.6%), of 10.2% , it is recommended that SPANDANA deploys its funds optimally so as to maximise revenue and sustain its profitability so as to maintain similar levels of return on equity.

RATING: 5.0

EARNINGS
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRING TO ASSETS
Quantitative Indicator

OPERATING EFFICIENCY

SPANDANA's operating efficiency indicator has demonstrated a positive trend over the past few years, as operating expenses as a percentage of average loan portfolio have decreased to 8.35% (FY 2001002) from 23.36% (FY 199902000). This productivity is explained by the lower increase in operating expenses in relation to increase in portfolio. It must be noted that while average loan portfolio grew by 235% in FY2001002, the operating expenses grew by just 125% during the same period. It may be mentioned that the portfolio growth is principally explained by the increase in the number of active borrowers of 212% (from 4,228 in FY 2001 to 13,206 in FY 2002) resulting in a higher coverage of clients.

Increased staff productivity, minimization of administration costs achieved through standardisation of records and low transportation costs have enabled the institution to contain costs and improve efficiency. Salaries and training of the credit program is the major operating expense which, accounted for 64.16% of the total operating expenses in FY 2001002. However, the salaries and training as a percentage of average portfolio reduced to 4.25% (FY 2002) from 14.27% (FY 2000) Similarly, the transportation costs as percentage of average portfolio have decreased to 0.97% (FY 2001002) from 3.22% (FY 2000).

The productivity of credit officers measured as the number of clients to credit officer has increased over the years. For FY 2001002, this ratio was 467 clients per average number of credit officers, which is higher than the industry average, while the productivity for FY 1999000 was 199 clients. The clients to total staff ratio of 256 would have been much higher, if credit officers hired towards end FY 2001002 were excluded. During the branch visits, the team had also observed few credit officers handling more than 600 clients.

The improved employee productivity is partially explained by the credit officers' handling three centre meetings a day against industry average of two centre meetings a day. By implementing a smart strategy of opening centres close to the branches, employee productivity has been maximised while transportation costs have been minimised. This is particularly true for urban branches. Also, the average disbursement per loan during this period has increased to Rs.5,865 from Rs.4,956 indicating that the older clients have moved to higher value loans, resulting in delivery cost per client reducing further.

Finally, another element that reflects the high operating efficiency is the ratio of credit officers to total staff of 73%, which is much above the minimum acceptable level of 50%. This indicated that the organisation is appropriately staffed at the branch and head officer level to cater to its clients.

RATING: 5.0

EARNINGS
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRNG TO ASSETS
Quantitative Indicator

RETURN ON ASSETS

SPANDANA's operating return on assets as at March 31, 2002 was 9.23% after CAMEL adjustments and has significantly improved over the periods analyzed from 03.60% as at March 31, 2000. The improved return on assets is primarily due to significant decrease in operating expenses with respect to average portfolio, which experienced significant growth during the above period. Another reason for high profitability is the relatively closeness of portfolio yield(26.8%) to the average effective interest rate of 33.6% (including interest rate and fees). Timely recoveries and prepayments which result in additional five week interest fee are the main contributors to the high portfolio yield.

The good portfolio quality indicated by loan loss reserve to total portfolio ratio of 0.52% has similarly contributed to the high return on assets.

There is a big difference between ROA and ROE indicators mainly on account of funding of SPANDANA's accounts through borrowings and liabilities rather than equity. The institution has wisely deployed these borrowings in productive assets.

RATING: 5.0

EARNINGS
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRING TO ASSETS
Quantitative Indicator

INTEREST RATE POLICY

SPANDANA had a variable interest rate policy for rural (15% flat) and urban (20% flat) branches based on the relative risk perceptions in these regions. In January 2002, the interest rate on general loans in urban regions was reduced to 15% flat from 20% flat. The effective annual interest rate (the internal rate of return) on a general loan with a loan size of Rs.5,000 and a term of 50 weeks adjusted for loan processing fee, pass book fee and insurance fee works out to 33.68% per annum. Similarly, SPANDANA charges 12% flat rate on education loans and 10% flat rate on infrastructure loans. The effective interest rates on these two recently introduced loans work out at 28% and 24.07% respectively. As general loans rate charged to the client works out to 33.61% per annum. Infrastructure and educational loans are normally given to older clients (loan cycles 3 and above) which are perceived to be less risky and are hence priced accordingly.

Loan Type	% of Portfolio	Adjusted *	Wt.Avg. interest	Wt. Avg. interest
		nominal interest rates	rate (including fees)	rate (not including fees)
General	99.20%	33.68%	33.41%	28.97%
Infrastructure	0.80%	24.07%	0.19%	0.16%
Education	0.00%	28.00%	0.00%	0.00%
			33.61%	29.12%

*adjusted for 1% of loan processing fee on the amount disbursed, Rs.2 as pass book fee and 1% of insurance over amount disbursed (with a minimum of Rs.50) on a loan size of Rs.5,000.

The recent interest rate cut in the urban areas has been done taking into account the competition from other MFIs operating in the region. During the interest rate review, the management of SPANDANA has deliberated on the implication of interest rate revision on of interest rates would allow the organisation to generate a profit margin on its credit program. However, there is no documented technical study available, indicating the rationale for a 5% reduction in flat rate of interest. In a declining interest rate scenario, it would ideal for SPANDANA to put in place a more scientific mechanism of determining the effective interest rates charged to its clients.

RATING: 3.5

LIQUIDITY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRING TO ASSETS
Quantitative Indicator

LIQUIDITY MANAGEMENT/PRODUCTIVITY OF OTHER CURRENT ASSETS

SPANDANA currently has 18 bank accounts at the head office and one bank account each at the branch level. Most of these accounts have been opened at the insistence of the lenders. It is suggested that SPANDANA should close the bank accounts related to those lenders where the loans are completely repaid. In order to ensure better liquidity management SPANDANA should also close other dormant accounts. Since the saving accounts earn an interest rate of 4% annually, SPANDANA should explore having a combination of current and saving accounts, leaving the minimum amount in the former and larger amounts in the latter.

SPANDANA raises short-term loans by keeping unutilised grants of non-credit programmes as deposits with the bank. As of March 31, 2002 an amount of Rs.15,00,000/0 was kept as fixed deposit with Indian Bank earning interest at 8%. This is a good practice and has helped the organisation to tide over temporary liquidity crisis in the past.

There is a marginal variation of 14.11% between the actual interest income earned by the institution during FY 2001002 (Rs 23,226) and the interest income that it could have earned (Rs 27,041), had it maximised the use of its cash, bank accounts and short-term investments. This is to say that the SPANDANA earned an 85.89% of the interest income estimated by CAMEL. This indicates relatively high productivity of other current assets like cash and cash equivalents. It is recommended that SPANDANA could explore avenues for reducing the cash balances at branches to bare minimum.

RATING: 4.0

**LIQUIDITY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRNG TO ASSETS
Quantitative Indicator**

LIABILITY STRUCTURE

Currently, SPANDANA has a policy of capitalising the retained earning which has helped the organisation to achieve significant growths over the years. SPANDANA has a diversified funding base comprising of financial institutions, commercial banks as well as support institutions.

As on March 31, 2002 SPANDANA had outstanding debts from the following lenders. The terms and other details are as under:-

Sl. No.	Name of the Lender	Amount Outstanding (Rs.)	Interest rate/Range	Security Offered	Remarks
1	FWWB	13,848,700	Most loans are @ 13.5% but a few of them are @ 1% and 6%	Nil	Mostly commercial debt
2	RMK	450,000	8.00%	Nil	Subsidized
3	NMDFC	48,805	8.00%	Nil	Subsidized
4	Indian Bank	450,000	7.00%	Fixed Deposits	Commercial
5	ICICI	10,000,000	14.00%	Cash Deposits	Commercial
6	UTI Bank	10,000,000	13.25%	Nil	Commercial

In addition, SPANDANA has received firm commitments from SIDBI (for a loan of Rs.100,00,000) and Global Trust Bank (for a loan of Rs.100,00,000). Both the loans are commercial in nature.

SPANDANA also enjoys overdraft facility with Indian Bank that has been used in times of liquidity problems. This facility is available to the organisation against security of Fixed Deposits of other non0credit programmes. This overdraft is available to the extenet of 75% of the amount of fixed deposits at 2% over and above the deposit rate. In the past, SPANDANA had also been successful in mobilizing funds from its employees, board members and other individuals to tide over temporary liquidity problems.

For the period ended FY 02, SPADANA's loan outstanding has a weighted annual interest rate of 14.01%. The outstanding debt represents 68.5% of the total loan portfolio after write offs. Majority of the debt is maturing in 2004005 whereas SPANDANA's assets generally mature in 52 weeks time providing opportunities for recycling of the debt funds.

It is important to note that SPANDANA has established its credibility within the commercial financial sector as, at present, various institutions have sanctioned loans aggregating to Rs.25 million including a bridge loan of Rs.5 million. These loans are expected to be drawn by the organisation after the completion of disbursement formalities.

SPANDANA should also identify alternate sources of short term funds to meet the liquidity problems. These problems have occurred primarily during the last few months on account of certain procedural delays on the part of the lending agencies.

RATING: 4.5

LIQUIDITY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRING TO ASSETS
Quantitative Indicator

AVAILABILITY OF FUNDS TO MEET CREDIT DEMAND

Loans to clients are normally disbursed within a week of receiving an application at SPANDANA. The current practice is appropriate given the fact that all disbursements are done only in weekly meetings. This is also in line with the practice prevailing in other MFIs in India.

In the past, SPANDANA has faced some problems with regard to the availability of funds that have resulted in occasional delays in disbursing loans to the clients. However, SPANDANA has been able to tide over such problems by raising shortterm small loans from its employees, board members and other individuals.

In addition, SPANDANA also enjoys overdraft facility with Indian Bank that has been used in times of liquidity problems. This facility is available to the organisation against security of Fixed Deposits of other non-credit programme.

However, the organisation has been facing some liquidity problems during the last two months due to certain procedural delays on the part of the lending agencies to disburse loans to SPANDANA. It is recommended that SPANDANA should identify alternate source of shortterm funds to overcome such problems that may have an adverse effect on clients retention.

RATING: 3.0

LIQUIDITY
SPECIFIC DESCRIPTION OF THE INSTITUTIONAL
POLICIES REFERRNG TO ASSETS
Quantitative Indicator

CASH FLOW PROJECTIONS:

SPANDANA prepares cash flow projections that include cash inflows from repayments, registration, and other sources as well as cash outflows from disbursements, repayment of savings and other expenses. These projections are made weekly upto 15 days at the branch level by Branch Managers and consolidated at the organisational level by Area Mangers.

It is recommended that SPANDANA prepare weekly cash flow projections for a period upto 90 days so that the institution could know in advance the liquidity needs and, therefore, identify sources of funds to meet the credit demand. It is also advised that in the yearly budget SPANDANA prepare monthly cash flow projections so that the institution could monitor the seasonal behavior of the monthly cash flow projections so that the institution could monitor the seasonal behavior of the micro credit loans.

RATING: 2.5

BALANCE SHEET SPANDANA Nominal Currency Rs			
	31-Mar-02	31-Mar-01	31-Mar-00
<u>ASSETS</u>			
Cash and Cash Equivalent	2,446,444	675,591	83,658
Short0term Investments	-	-	-
Current Portfolio and Portfolio Past-Due 1-30 Days	46,609,251	13,395,670	4,509,034
Portfolio Past0Due > 31 days and Rescheduled Portfolio	22,400	-	1,362
(Loan Loss Receivable)	-243445	-75	-629
Accounts Receivable	217,175	183,084	-
Accrued Interest Income Receivable	-	-	-
Other Current Assets	32,500	-	-
TOTAL CURRENT ASSETS	49,084,325	14,254,270	4,593,425
Equipment	298,896	176,918	179,036
Vehicles	83,015	103,768	54,605
Property	811,321	706,786	16,851
Accumulated Depreciation	-62417	-49143	-28825
TOTAL FIXED ASSETS	1,130,815	938,329	221,667
Revaluation Fixed Assets	28,572	41,514	3,624
Permanent Investmetns	1,000,000	-	-
Other Assets	-	-	-
TOTAL ASSETS	51,243,712	15,234,113	4,818,716
<u>LIABILITIES</u>			
Bank Overdrafts	0	0	0
Public Deposits	6,023,698	2,328,105	826,063
Short0Term Commercial Debt	-	1,015,778	497,428

ShortTerm Subsidized Debt	498,805	823,750	700,000
Accounts Payable	80,000	0	0
Benefits Payable	0	0	0
Interst Payable	253,573	0	0
Deferred LIABILITIES	0	0	0
Other Current LIABILITIES	0	0	0
TOTAL CURRENT LIABILITIES	6,856,076	4,167,633	2,023,491
Long Term Debt	33,848,700	6,621,300	925,000
Mortagages	0	0	0
Subsidized Debt	450,000	250,000	500,000
Bonds in Circulation	0	0	0
Funds in Administration	0	0	0
Reserve for Personnel Benefits	0	0	0
Other LongTerm LIABILITIES	0	0	0
TOTAL LONG TERM LIABILITIES	34,298,700	6,871,300	1,425,000
TOTAL LIABILITIES	41,154,776	11,038,933	3,448,491
EQUITY			
Capital	2,069,248	1,239,548	1,067,048
Reserves	-	-	-
Reclassified Donations	1,209,851	1,555,876	243,020
Adjustment to Equity	146,754	174,920	23,469
Capitalization of Subsidized Debt	63,297	115,847	40,840
Capitalization of Shadow Costs	559,740	144,113	84,800
Prior Period Retained Earninigs	2,970,707	349,628	-
Current Period Retained Earnings	3,069,340	615,249	-88953
TOTAL EQUITY	10,088,936	4,195,180	1,370,225
TOTAL LIABILITIES & EQUITY	51,243,712	15,234,113	4,818,716

