SMERA RATINGS LIMITED

SMERA Comprehensive Grading

**M3C3**

*(Above Average capacity of the MFI to manage its operations in a sustainable manner and average performance on code of conduct dimensions)*

# Comprehensive MFI Grading

## Nightingale Finvest Private Limited

***Date of Report:***

**29th March, 2017**

***Valid Till:***

**28th March, 2018**

# SMERA's MFI Comprehensive Grading Scale

The grading is done on 8 x 5 matrix. The matrix assesses the entity on two broad parameters:

- Capacity to manage their microfinance operations in a sustainable manner
- Performance on COCA dimensions

| Scale | C1 | C2 | C3 | C4 | C5 |
|---|---|---|---|---|---|
| M1 | | | | | |
| M2 | | | | | |
| M3 | | | M3C3 | | |
| M4 | | | | | |
| M5 | | | | | |
| M6 | | | | | |
| M7 | | | | | |
| M8 | | | | | |

The MFI obtains comprehensive MFI grading of "**M3C3**". It signifies above average capacity of the MFI to manage its operations in a sustainable manner and average performance on code of conduct dimensions.

## Grading Rationale

| | |
|---|---|
| **Microfinance Capacity Assessment Grade** | NFPL obtains **"M3"** as its performance grade which signifies "Above average capacity of the organization to carry out its activities in a sustainable manner". |
| **Code of Conduct Assessment Grade** | NFPL obtains **"C3"** as its Code of Conduct Assessment Grade which signifies average performance on COCA dimensions. |

*Comprehensive MFI Grading provides opinion of the Rating Agency on MFI's capacity to carry out its microfinance operations in a sustainable manner and its adherence to Industry code of conduct. MFI Capacity Assessment Grading has been done on the dimensions of **Capital Adequacy**, **Governance**, **Management Quality** and **Risk Management Systems**. Assessment on Code of Conduct has been done on the indicators pertaining to **Transparency**, **Client Protection**, **Governance**, **Recruitment**, **Client Education, Feedback & Grievance Redressal** and **Data Sharing**. Some of these indicators have been categorized as Higher Order indicators consisting of indicators on **Integrity and Ethical Behaviour** and **Sensitive Indicators**.*

## Conflict of Interest Declaration

The Rating Agency (including its holding company and wholly owned subsidiaries) has not been involved in any assignment of advisory nature for a period of 12 months preceding the date of the comprehensive grading. None of the employees or the Board members of the Rating agency have been a member of the Board of Directors of the MFI during for a period of 12 months preceding the date of the comprehensive grading.

## Disclaimer

This Grading is based on the data and information (Data) provided by the MFI and obtained by SMERA from sources it considers reliable. Although reasonable care has been taken to verify the Data, SMERA, makes no representation or warranty, expressed or implied with respect to the accuracy, adequacy or completeness of any Data relied upon. SMERA is not responsible for any errors or omissions or for the results obtained from the use of the Grading or the Grading Report and especially states that it has no financial liability, whatsoever, for any direct, indirect or consequential loss of any kind arising from the use of its Gradings.

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## Historical Rating Grades

| Date | Rating Agency | Rating/Grading |
|---|---|---|
| 25/Feb/2017 | SMERA Ratings Limited | M3 |

## Microfinance Capacity Assessment Grading symbols and definitions

| Grading Scale | Definitions |
|---|---|
| M1 | MFIs with this grade are considered to have **highest** capacity to manage their microfinance operations in a sustainable manner. |
| M2 | MFIs with this grade are considered to have **high** capacity to manage their microfinance operations in a sustainable manner. |
| **M3** | **MFIs with this grade are considered to have above average capacity to manage their microfinance operations in a sustainable manner.** |
| M4 | MFIs with this grade are considered to have **average** capacity to manage their microfinance operations in a sustainable manner |
| M5 | MFIs with this grade are considered to have **inadequate** capacity to manage their microfinance operations in a sustainable manner. |
| M6 | MFIs with this grade are considered to have **low** capacity to manage their microfinance operations in a sustainable manner. |
| M7 | MFIs with this grade are considered to have **very low** capacity to manage their microfinance operations in a sustainable manner. |
| M8 | MFIs with this grade are considered to have **lowest** capacity to manage their microfinance operations in a sustainable manner. |

## Code of Conduct Assessment scale and definitions

| Grading Scale | Definitions |
|---|---|
| C1 | MFIs with this grade have **excellent** performance on Code of Conduct dimensions |
| C2 | MFIs with this grade have **good** performance on Code of Conduct dimensions |
| **C3** | **MFIs with this grade have average performance on Code of Conduct dimensions** |
| C4 | MFIs with this grade have weak performance on Code of Conduct dimensions |
| C5 | MFIs with this grade have **weakest** performance on Code of Conduct dimensions |

# Company Profile

| | |
|---|---|
| Name of the MFI | Nightingale Finvest Private Limited |
| Year of Establishment | 1997 |
| Year of Commencement of Microfinance Operations | 2004 |
| Legal Status | Non-Banking Finance Company (NBFC-MFI) |
| Business of the Company | Engaged in business of microfinance under JLG model |
| Correspondence address | First Floor, Chakradhar Villa,<br>R.G. Baruah Road,<br>Opp. All India Radio, Krishna Nagar<br>Chandmari<br>Guwahati – 781 003<br>Assam |
| Telephone | (91)(361)(265 5401) |
| Geographical Reach (As on 31/Dec/2016) | No of States : 04<br>No of Branches : 21 |
| Total Employees (As on 31/Dec/2016) | 92 |
| Active Borrowers (As on 31/Dec/2016) | 28,237 |
| Total Portfolio Outstanding (in crores) (As on 31/Dec/2016) | Owned Portfolio – 31.61 |
| Operational Head | Mr. Mantu Nath Sarma, Managing Director<br>Email ID: nightingale20006@gmail.com |
| Visit of the Assessment team | 15th March, 2017 to 18th March, 2017 |

## Background

Nightingale (formerly known as Nightingale Charitable Society which was registered in the year 1998 under Societies Registration Act 1860) commenced its microfinance operations in the year 2004 in the state of Assam. Later in 2013, the promoters obtained a Non-Banking Finance Company (NBFC) license from Reserve Bank of India to carry out microfinance business in the name of Nightingale Finvest Private Limited (hereinafter referred to as Nightingale).

Nightingale provides loans to joint liability group (JLG) members, who come together for the purpose of availing bank loan on individual basis or through group mechanism against mutual guarantee. Nightingale offers loans in the range of Rs.15,000 to Rs.35,000 depending on the clients repayment capacity, type of business activity, etc. with tenure varying from 12 months to 24 months at an effective interest rate of 20% to 25% (on a reducing balance).

### Shareholders– Equity Shares as on 31/Mar/2016

| Name of Shareholders | Shares in % |
|---|---|
| Mantu Nath Sarma | 16.96 |
| Pratap Chakravarty | 12.83 |
| Rukunuddin Ahmed | 10.35 |
| Jiten Bhagabati | 07.50 |
| Dipmani Sharma | 05.70 |
| North Eastern Development Finance Corporation Ltd. (NEDFI) | 16.18 |
| Others | 30.48 |
| **Total** | **100.00** |

### Optionally Convertible Preference Shares as on 31/Mar/2016

| Shareholder | Amount (in lacs) |
|---|---|
| Small Industries Development Bank of India (SIDBI) | 50.00 |
| **Total** | **50.00** |

**Product Profile**

| Product | Description | Loan size (Rs) | Repayment ( in Months) | Interest Rate (In %) Reducing Balance | Processing Fees (In %) | Insurance (In %) |
|---|---|---|---|---|---|---|
| JLG Loan | Income Generation Loan | 10,000 to 35,000 | 12 months to 24 months | 25.00 | 1.00 | As per insurance company policy |
| JLG Loan | | | | 20.00* | 1.00 | |
| JLG Loan | | | | 04.00* | 1.00 | |

**Funding availed from NEDFI for OBC category, and unbanked and under-served areas of North Eastern region.*

**Promoters Profile**

| Name of Director | Designation | Profile |
|---|---|---|
| Mr. Mantu Nath Sarma (Co-Founder) | Managing Director & Chief Executive Officer | • Mr. Mantu Nath Sarma, a postgraduate in commerce, possesses over 16 years of experience in the field of MSME and Microfinance. |
| Mr. Pratap Chakravarty (Co-Founder) | Director | • Mr. Pratap Chakravarty is a graduate in Arts and an NGO activist with more than 14 Years of experience in microfinance.<br>• He has been working for empowerment of the less privileged women in rural and urban areas. |
| Mr. Rukunuddin Ahmed | Director | • Mr. Rukunuddin Ahmed has a diploma in engineering, with over 16 years of experience in micro credit, financial structuring and Administration. |
| Ms. Olee Bora | Nominee Director (North Eastern Development Finance Corporation Limited) | • Ms. Olee Bora is a graduate from the University of Allahabad and an MBA from the University of Guwahati.<br>• She is the General Manager (MSE, MF, HRD & Administration) in North Eastern Development Finance Corporation Ltd, Guwahati. |
| Mr. Kanchan Dutta | Independent Director | • Mr. Kanchan Dutta is a practicing Chartered Accountant at Kolkata.<br>• He is associated with a number of leading microfinance institutions in India as an advisor and auditor.<br>• Mr. Dutta is an expert in governance, fund management, accounting and administration. |
| A.Ramanathan | Independent Director | • He is ex-Chief General Manager retired from NABARD.<br>• He is presently Director of another five NBFC-MFIs and have a good knowledge of microfinance and have worked at Faculty in different Training Institutes in India. |

## SMERA Comments

- Nightingale has six-member on its board as on Dec 31, 2016 having extensive experience in the banking and finance segment. The board has three promoter directors, one nominee director (representatives from Investors) and two independent directors with banking & finance/microfinance expertise.

- The board meets on a quarterly basis and if required frequency of the meeting increases. The board is actively involved in strategy formulation, developing & approving business plans, fund mobilization. The board meetings also cover the overall performance, recruitment, updating policy, to ensure the use of resources, approve annual work plan and budgets, implement programmes that are in line with the mission and vision, monitor MFI's performance and review monthly reports. The management team updates the board regularly on operations and key developments in each department.

## Senior Management Profile

| Name | Designation |
|---|---|
| Gopal Chandra Kalita | Advisor (Internal Control) |
| Rajibur Rahman Choudhury | Assistant Manager (Internal Control) |
| A. Ramanathan | Advisor (Finance) |
| Atanu Bhattacharjee | Manager (Accounts) |
| Mrinmoy Das | Assistant Manager (MIS & IT) |
| Kabita Das | Assistant Manager (Operations) |
| Rabin Goswami | Assistant Manager (Operations) |

## Key Performance Ratios

| Ratios | Mar-2014 | Mar-2015 | Mar-2016 |
|---|---|---|---|
| | 12 | 12 | 12 |
| | | | |
| **Capital Adequacy Ratio (CAR)** | | | |
| Capital Adequacy Ratio (%) | 17.88% | 18.58% | 19.37% |
| | | | |
| **Productivity / Efficiency Ratios** | | | |
| No. of Active Borrowers Per Staff Member | 387 | 345 | 352 |
| No. of Active Borrowers per field executives | 841 | 766 | 777 |
| Gross Portfolio o/s per field executive (Rs in thousands) | 6,727 | 7,236 | 7,458 |
| Average Outstanding Balance Per borrower (In **Rs**) | 7,993 | 9,450 | 9,602 |
| Cost Per Active borrower (In **Rs**) | 198 | 747 | 606 |
| | | | |
| **Asset / Liability Management** | | | |
| Yield on Portfolio (%) | 10.2% | 22.2% | 22.7% |
| | | | |
| **Profitability / Sustainability Ratios** | | | |
| Operational Self Sufficiency (%) | 143.4% | 132.9% | 132.0% |
| Operating Expense Ratio (OER) | 4.4% | 8.8% | 7.1% |
| Funding Expense Ratio (FER)** | 1.68% | 8.36% | 9.11% |
| Return on Assets (RoA) | 2.7% | 4.6% | 4.1% |
| Portfolio at Risk (>30 days) | 0.0% | 0.0% | 0.00% |
| Return on Equity (RoE) | 7.92% | 21.25% | 19.34% |

**Funding Expense Ratio (FER) is calculated after taking into consideration subsidised funding availed from NEDFI for OBC category, and unbanked and under-served areas of North Eastern region. NFPL has maintained the margin cap as specified by the RBI.

## Highlights of Microfinance Operations

| Particulars | 31-03-14 | 31-03-15 | 31-03-16 | 31-12-16 |
|---|---|---|---|---|
| No. of States | 1 | 3 | 4 | 4 |
| No. of Districts Covered | 7 | 9 | 10 | 13 |
| No. of Branches | 10 | 13 | 18 | 21 |
| No. of Villages | 100 | 257 | 352 | 458 |
| No. of JLGs | 3887 | 4135 | 5282 | 5648 |
| No. of Active Borrowers | 19,345 | 20,675 | 26,407 | 28,237 |
| No. of Loan Officers (LO) | 23 | 27 | 34 | 43 |
| No. of Employees | 50 | 60 | 75 | 92 |
| Loan disbursements during the period (Rs. in thousands) | 184,060 | 242,731 | 261,456 | 308,260 |
| Portfolio outstanding (Rs. in thousands) | 154,630 | 195,382 | 253,565 | 316,074 |

## SMERA Comments

As on Dec 31, 2016, the company had an outstanding portfolio of Rs. 30.82 crore spread over 21 branches of 13 districts with about 28,237 borrowers. The disbursement has increased over the years on account of inflow of funds from banks and financial institutions. Further Nightingale's Assets under Management (AUM) in FY2016 witnessed robust growth of 29.78% over FY2015 (26.35% growth seen in FY2015).

In FY2016, the company expanded its borrower base by adding five new branches in FY2016 and three new branches in current financial year till Dec 31, 2016.

As on Dec 31, 2016, Nightingale's portfolio is concentrated in the state of Assam accounting for ~ 93 percent, and ~ 07 percent in the states of Shillong, Arunachal Pradesh and Mizoram respectively.

# Compliance with RBI's Directives

| RBI's Direction | Nightingale Status | Compliance |
|---|---|---|
| 85% of total assets to be in the nature of qualifying assets | Qualifying assets forms 87.50 % of total assets as on 31/Dec/2016 | Complied |
| Net worth to be in excess of Rs 5 Crore | Net Owned Funds stood at Rs 5.96 crore as on 31/Dec/2016 | Complied |
| Income of borrower not to exceed Rs. 100,000 in the rural areas and Rs. 160,000 in the urban and semi-urban areas | Nightingale extends loans to borrowers whose income does not exceed Rs.100,000 in the rural areas and Rs.160,000 in the urban areas | Complied |
| Loans size not to exceed Rs 60,000 in first cycle and Rs 100,000 in subsequent cycles | Nightingale offers loan in the range of Rs 10,000 to Rs 35,000 depending on client repayment capacity, type of activity etc. | Complied |
| Total indebtedness of the borrower not to exceed Rs 100,000 (excl medical and education loans) | Nightingale conducts credit bureau check on the loans outstanding from other MFIs. The company ensures the total indebtedness of the borrower does not exceed Rs.100,000 | Complied |
| Tenure of loans not to be less than 24 months for loan amount in excess of Rs 30,000, with prepayment without penalty | Nightingale offers loans of Rs 15,000 for a tenure of 12 months and loans of Rs 20,000 to Rs 30,000 for a period of 18 months and loans above Rs 30,000 for 24 months | Complied |
| Pricing guidelines are to be followed | Loans are provided in range of 20% to 25.00% reducing balance basis which meets the RBI criteria. | Complied |
| Transparency in interest rates to be maintained | Interest, Processing fees and insurance premium charged are duly mentioned in the loan card provided to the client | Complied |
| Not more than two MFIs lend to the same client | Nightingale verifies the same through credit check from credit bureaus | Complied |

| RBI's Direction | Nightingale Status | Compliance |
|---|---|---|
| Loan pricing to include processing fee (not exceeding 1% of the loan amount) | Nightingale is charging processing fee of 1.00% on the disbursed loan amount plus applicable service tax | Complied |
| Collateral free loans | Nightingale does not accept any Collateral for extending the credit. | Complied |
| MFIs shall not collect any Security Deposit / Margin from the borrower. | Nightingale does not collect any security deposit / margin from the borrower. | Complied |
| No late payment or prepayment penalties | Nightingale does not take late payment or prepayment penalties from the clients. | Complied |
| Share complete client data with at least one Credit Information Company (CIC) established under the CIC Regulation Act 2005, as per the frequency of data submission prescribed by the CIC. | Nightingale shares its client data with Crif Highmark, Equifax, Experian and CIBIL. | Complied |
| Aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs | Nightingale provides more than 90 % of total loans for income generation activities as on 31/Dec/2016. | Complied |
| NBFC-MFIs shall maintain a capital adequacy ratio consisting of Tier I and Tier II Capital which shall not be less than 15 percent of its aggregate risk weighted assets. | As per provisionals CRAR of Nightingale stood at 18.33 % as of 31st Dec 2016 which complies with the minimum CRAR requirement of 15% for NBFC-MFIs as prescribed by RBI. Nightingale does not have any exposure in Andhra Pradesh. | Complied |
| The aggregate loan provision to be maintained by NBFC-MFIs at any point of time shall not be less than the higher of a) 1% of the outstanding loan portfolio or b) 50% of the aggregate loan installments which are overdue for more than 90 days and less than 180 days and 100% of the aggregate loan installments which are overdue for 180 days or more'. | The statutory auditor has certified the appropriate provisions have been made | Complied |

# Section 1: Microfinance Capacity Assessment Grading

## Operating Environment

- SMERA estimates the MFI sector to grow at a CAGR of 20%-25% and is expected to touch Rs.100000 crore by the end of FY2019.

- MFIs have reported an increase of ~58% in average loan per borrower in FY2016 as compared to FY2014. SMERA believes seasoned customer profile over multiple loan cycles have helped MFIs to increase its loan ticket size.

- The fund flow to the sector has improved on account of increased confidence on MFI sector coupled with reduction in interest rate (100-150 bps). Further large MFIs are exploring the route of Non-convertible debentures (NCDs) and Pass through Certificates (PTCs); whereas small –mid size MFIs have an increased access to funds from banks and financial institutions

- SMERA expects licensing of small finance banks to MFIs to fuel competition for deposits and bring innovative banking solutions to customers

- Support systems such as Self-Regulatory Organizations (SRO), Credit Information Bureaus (CIB) among others have been established to ensure credit check and process adherence among MFIs. This regulatory framework will bring more accountability and transparency within the sector.

- Despite all developments in the sector the inherent risk exist such as unsecured nature of lending, vulnerable customer profile, exposure to vagaries of political situation in states, and cash handling (though which is expected to reduce with demonetization step taken by Government), and so on.

- On the contrary, recent demonetization drive restrained MFIs disbursement and collection process which is expected to moderate microfinance sector growth in FY2016-17 as compared to the previous year.

## Reasonable track record of operations and extensive industry experience of promoters

- Nightingale (formerly known as Nightingale Charitable Society which was registered in the year 1998 under Societies Registration Act 1860) commenced its microfinance operations in the year 2004 in the state of Assam. Later in 2013, the promoters obtained a Non-Banking Finance Company (NBFC) license from Reserve Bank of India to carry out microfinance business in the name of Nightingale Finvest Private Limited (hereinafter referred to as Nightingale).

- Nightingale has six-member on its board as on Dec 31, 2016 having extensive experience in the banking and finance segment. The board has three promoter directors, one nominee director (representatives from Investors) and two independent directors with banking & finance/microfinance expertise.

- Mr. Mantu Nath Sarma (Managing Director and CEO), a postgraduate in commerce, possesses over 16 years of experience in the field of MSME and Microfinance.

## Diversified resource profile

- As on Dec 31, 2016 Nightingale has developed funding relationships with 10 lenders (three Banks & seven NBFCs) however their resources profile continues to remain concentrated towards borrowings from NBFCs which stood at ~ 94% of total borrowings (outstanding debt) as on Dec 31, 2016.

- The overall cost of funds (COF) for Nightingale is relatively lower at 9.11% in FY 2016 on account of majority of borrowings at economical rate from North Eastern Development Finance Corporation Limited (NEDFI) which stood at ~ 60% of total borrowings (outstanding debt) as on Dec 31, 2016. However, the loans availed from NBFCs like Electronica Finance Limited and MAS Financial Service Private Limited carry higher interest rate and hence the company has to explore its funding base to Banks.

## Moderate capitalisation and comfortable liquidity profile

- The company's capitalisation stands moderate with capital adequacy ratio (CAR) of 19.37 per cent as on Mar 31, 2016 as against CAR of 17.88 per cent as on March 31, 2014. The NBFC-MFI capitalisation in relation to managed asset base has been comfortable on account of equity infusion and internal accruals at regular interval. In order to support the projected growth Nightingale's infused additional equity through issue of Optionally convertible preference shares of Rs. 50 lacs during the financial year (FY 2015-16), subsequent to which the networth of the company has increased to Rs. 5.05 crore as on March 31, 2016.

- Nightingale has a comfortable liquidity position due to well matched maturity of assets and liabilities. The tenure of loans is about 12-24 months, whereas the incremental bank funding is typically with tenure of about 12-36 months. However regular flow of funds is critical to maintain the projected growth and the same would have a key bearing on its liquidity profile.

- Nightingale intends to grow its portfolio in the range of 30% to 40% over the medium term and hence the company requires an equity infusion to support its growth plans.

## Geographical Concentration

- The company is exposed to geographical concentration risk. As on Dec 31, 2016, Nightingale's portfolio is concentrated in the state of Assam accounting for ~ 93 percent, and ~ 07 percent in the states of Shillong, Arunachal Pradesh and Mizoram respectively.

- It would be key grading sensitivity factor for the company to replicate its systems, processes and sound asset quality in the newer geographies while improving portfolio diversity.

## Sound asset quality*

| Period | FY 2014 | FY 2015 | FY 2016 | 31-Dec-16 |
|---|---|---|---|---|
| | Value of Portfolio o/s (in thousands) | Value of Portfolio o/s (in thousands) | Value of Portfolio o/s (in thousands) | Value of Portfolio o/s (in thousands) |
| On time | 154,629 | 195,382 | 253,564 | 316,074* |
| 1-30 days | 0 | 0 | 0 | 0 |
| 31-60 days | 0 | 0 | 0 | 0 |
| 61-90 days | 0 | 0 | 0 | 0 |
| 91-180 days | 0 | 0 | 0 | 0 |
| 181-360 days | 0 | 0 | 0 | 0 |
| > 360 days | 0 | 0 | 0 | 0 |
| **Total** | **154,629** | **195,382** | **253,564** | **316,074*** |

**provided by the management. The rating assessment team has not independently verified the entire portfolio outstanding of Rs.31.06 crore as on 31/Dec/2016.*

- The NBFC-MFI has maintained sound asset quality with 100% on time repayment over the years. Adequate credit appraisal processes, monitoring and risk management mechanisms have supported the company to keep asset quality indicators under control.

## Income and Profitability

- The company reported a profit after tax of Rs. 0.85 Crore (ROA of 4.1%) on total income of Rs.5.58 crore in FY2016 and Rs.0.69 crores (ROA 4.6%) on Rs 4.24 crore in FY2015 compared to Rs.0.19 crores (ROA 2.7%) on Rs 0.95 crore in FY2014. The marginal reduction in ROA during FY2016 and FY2015 was largely increase in the size of assets towards end of the year supported by increase in disbursements. Futher the Company's operating expense stood at 7.10% for FY2016 as compared to 4.4% for FY2014.

- Improvement in operational efficiency indicated by high Operational Self Sufficiency (%) which stood relatively better in relation to other MFIs rated by SMERA in the past.

- Return of Equity (ROE) increased in FY2016 over the previous year was largely due to rise in profits driven by increase in portfolio with marginal increase in capital base.

| Profitability / Sustainability Ratios | 2014 | 2015 | 2016 |
|---|---|---|---|
| Operational Self Sufficiency (%) | 143.4% | 132.9% | 132.0% |
| Operating Expense Ratio (OER) | 4.4% | 8.8% | 7.1% |
| Funding Expense Ratio (FER) | 1.68% | 8.36% | 9.11% |
| Return on Assets (RoA) | 2.7% | 4.6% | 4.1% |
| Portfolio at Risk (>30 days) | 0.0% | 0.0% | 0.00% |
| Return on Equity (RoE) | 7.92% | 21.25% | 19.34% |

## Moderate IT Systems and Audit Mechanism

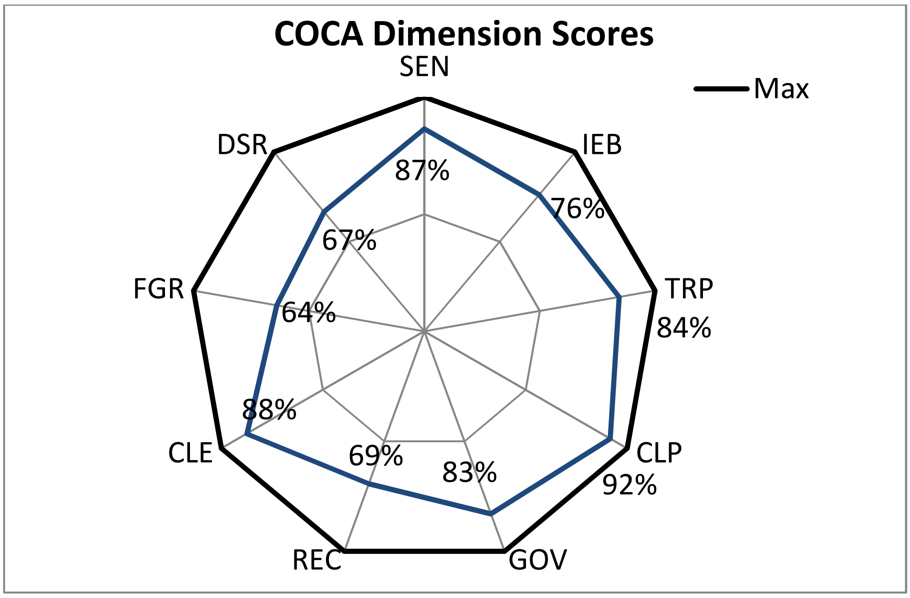
- Nightingale has moderate IT systems in HO and across all branch offices. The company also has an internal audit team which undertakes branch and borrower audit once in three months.

## Inherent risk prevalent in the microfinance sector

- Nightingale's business risk profile is susceptible to regulatory and legislative risks, along with the inherent risk exist such as unsecured nature of lending, vulnerable customer profile, exposure to vagaries of political situation in states, and cash handling associated with the NBFC-MFI sector. However, Nightingale has an experienced team of professionals that monitors regulatory, compliances and frame policies to mitigate the probability of such risks.

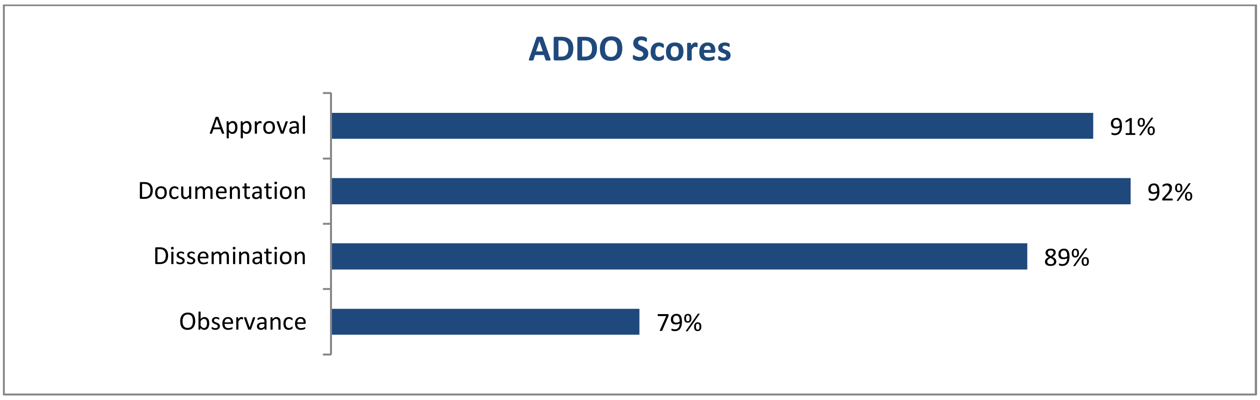
# Section 2: Code of Conduct Assessment

**COCA Grading – C3 (Average Performance on Code of Conduct dimensions)**




**SCORES ON PARAMETERS**

| Code of Conduct Parameters | Code | % Performance |
|---|---|---|
| Sensitive | SEN | 87% |
| Integrity and Ethical Behavior | IEB | 76% |
| Transparency | TRP | 84% |
| Client Protection | CLP | 92% |
| Governance | GOV | 83% |
| Recruitment | REC | 69% |
| Client Education | CLE | 88% |
| Feedback & Grievance Redressal | FGR | 64% |
| Data Sharing | DSR | 67% |




NFPL with an overall grade of “**C3**”, indicate **average Performance on Code of Conduct dimensions**.

# Code of Conduct Assessment Summary

The Code of Conduct report for Nightingale Finvest Private Limited (NFPL) evaluates the company's adherence to various code of conduct parameters. The study examines and comments upon the common minimum indicators such as:

- Sensitive Indicators
- Integrity and Ethical Behaviour
- Transparency
- Client Protection
- Governance
- Recruitment
- Client Education
- Feedback and Grievance Redressal
- Data Sharing

SMERA believes that NFPL exhibits average performance on COCA dimensions. This document details SMERA's approach and methodology for this study and gives observations of its assessment team while conducting the evaluation. The Approval; Documentation; Dissemination and Observance (ADDO) framework has been used for assessment and measuring NFPL's adherence towards ethical operational practices.

# Strengths and weaknesses pertaining to Code of Conduct

| Strengths | Weaknesses |
|---|---|
| • Board approved policies, compliant with the RBI guidelines.<br>• Membership with MFIN.<br>• Board with rich experience from development and finance background.<br>• Developed its own client protection principles and is displayed in all the branches<br>• Credit policies are well established documented and communicated.<br>• Adequate loan appraisal & monitoring systems.<br>• Compulsory training on products terms and conditions to client prior to every loan.<br>• Compulsory check on over indebtedness of every borrower. | • NFPL needs to strengthen its governance structure by inducting more independent members in its Board.<br>• Limited system to track cash flow analysis and surpluses.<br>• Awareness to its clients/members pertaining to interest rate and insurance claim settlements found average.<br>• Moderate Management Information System (MIS) and Information Technology (IT) considering the current scale of operations and projected growth.<br>• Internal Audit checklist should cover more aspects like awareness regarding Reserve Bank of India (RBI) compliance and Self-Regulatory Organization (SRO) among its staff members.<br>• Awareness among client and staff on SRO Grievance Redressal mechanism was found to be moderate.<br>• Awareness among the staff on RBI compliance was found to be moderate.<br>• Limited disclosure of financial and operational data on public domain.<br>• Prepayment policy not documented. |

# Significant Observations

| HIGHER ORDER INDICATORS | |
|---|---|
| **Integrity and Ethical Behaviour** | • The MFI does not have the policy to place reports on COC compliance before the board. However the same is reviewed by management level at regular interval.<br>• Audit findings related to grievance and field audit are presented at board level.<br>• Board has approved a policy of recovering delinquent loans<br>• Limited policy on time frame and process for client's complaint resolution.<br>• Framed client protection included policies on expected staff conduct with employees<br>• As informed by the management that the MFI has not recruited any staff from another MFI in the past.<br>• In all the branches visited, the contact number and address of SRO nodal official was properly displayed.<br>• Staff compensation and incentive is not covered under scope of Internal Audit.<br>• Awareness among client and staff on SRO Grievance Redressal mechanism was found to be moderate.<br>• Fixed Component compensation of staff is not impacted in event of overdues. NFPL, in its fair practices code provides importance for transparency in pricing and clear communication to the clients. |
| **Sensitive Indicators** | • In the sample of clients during COCA on the total indebtedness of borrower was within the prescribed limit stipulated by RBI.<br>• Interactions with clients revealed that they had not been made to pay for a service or product as a precondition for loan.<br>• Not a single instance was found where security deposit/collateral/blank cheques/stamp papers had been obtained from a client, whose loan has been classified as a microfinance loan.<br>• Awareness to its clients/members pertaining to interest rate and insurance claim settlements found average.<br>• NFPL provides acknowledgement and sanction letters to the clients.<br>• NFPL provide repayment schedule to the clients including break-up of principle and interest.<br>• Awareness among the staff on RBI compliance was found to be moderate.<br>• There are no adverse observations in the Auditor's report regarding accounting standards followed by the MFI.<br>• NFPL shares data with only all credit bureaus prescribed by SRO.<br>• NFPL does not charge any extra fees from client apart from processing fee and insurance premium. The loans are issued to the clients without any collateral and no security deposit is accepted. Further no penalty is charged for overdue and pre-closure of loans. However the organization does not have a well-documented policy on pre-payments. |

| | |
|---|---|
| | • The MFI get an external CA agency to certify its compliance with RBI's directions in relation to margin for lending by MFIs to qualify as priority sector loans. |

| BUILDING BLOCKS | |
|---|---|
| **Transparency** | • Awareness among the staff on RBI guidelines was found to be moderate.<br>• NFPL has documented the pricing of its loan products in its operational manual. In the branches visited loan documents had been maintained in local languages.<br>• Circulars with the most recent directions are available in the visited branches.<br>• NFPL, in its fair practices code provides importance for transparency in pricing and clear communication to the clients.<br>• The loan interest rate and processing fees is mentioned on the loan passbook provided to the client.<br>• Clients interviewed were aware of the charges and price for all services availed.<br>• Prepayment policy on loans not documented.<br>• NFPL do not charge any extra fees from client apart from processing fee and insurance premium. The loans are issued to the clients without any collateral and no security deposit is accepted. Further no penalty is charged for overdue and pre-closure of loans. However the organization does not have a well-documented policy on pre-payments.<br>• NFPL issues sanction letters to the clients. However all terms and conditions of the loan including annualized interest rates are covered in the loan agreement provided to the client.<br>• Code of conduct compliance report of NFPL & previous financial year annual financial statement and report is available in the public domain.<br>• NFPL provide repayment schedule to the clients including break-up of principle and interest. |
| **Client Protection** | • NFPL do not have a board-approved policy regarding client data security.<br>• Employees are trained on aspects of appropriate behavior with the clients.<br>• NFPL has documented policy on client data security which forms part of its fair practice code<br>• Framed client protection included policies on expected staff conduct with employees..<br>• Staffs were found to be aware of the need to have professional conduct with the clients.<br>• Internal Audit checklist should cover more aspects like awareness regarding Reserve Bank of India (RBI) compliance and Self-Regulatory Organization (SRO) among its staff members.<br>• Limited backup of client's data maintained in electronic form. |
| **Governance** | • NFPL needs to strengthen its governance structure by inducting |

| | |
|---|---|
| | more independent members in its Board.<br>• NFPL have disclosed its CEO compensation in its audited report FY2016.<br>• Audit findings related to grievance and field audit are presented at board level<br>• The MFI does not have the policy to place reports on COC compliance before the board. However the same is reviewed by management level at regular interval.<br>• The MFI has got its accounts audited in a timely manner after the end of the most relevant financial year.<br>• No adverse observations in the Auditor's report regarding accounting standards followed by the MFI.<br>• Action taken audit report not available at branch level.<br>• Staff satisfaction related to compensation and incentive is not covered under scope of Internal Audit. |
| **Recruitment** | • NFPL'S Board has reviewed its recruitment policies at least once annually<br>• There is documentary evidence to suggest that MFI has honored the notice period for all employees who have left it.<br>• MFI obtains NOC or relieving letter from the previous employee. As informed by the management that the MFI has not recruited any staff from another MFI in the past. |
| **Client Education** | • NFPL, in its fair practices code provides importance for raising clients' awareness of the options, choices and responsibilities regarding financial products and services<br>• NFPL does not charge clients for the trainings provided to clients, itself or through a related party.<br>• Awareness to its clients/members pertaining to interest rate and insurance claim settlements found average. |
| **Feedback and Grievance Redressal** | • The Board has approved a policy for Redressal of its clients' grievances, which requires board to be updated on the functioning of grievance Redressal mechanism.<br>• Limited policy on time frame and process for client's complaint resolution.<br>• Clients were found to be aware of the helpline number<br>• In all the branches visited, the contact number and address of SRO nodal official was properly displayed.<br>• The company maintains a record of the action taken and complaints resolved.<br>• Awareness among client and staff on SRO Grievance Redressal mechanism was found to be moderate. |
| **Data Sharing** | • Financial data for FY 2016 is available, but latest operational data is not available on the website of NFPL.<br>• MFI has a well-defined process for sharing data with the credit bureaus.<br>• NFPL shares data with all Credit Bureaus prescribed by SRO.<br>• NFPL performs compulsory credit bureau checks for all its clients. |

# Microfinance Grading Methodology

## A) Operational Track Record

Business Orientation and Outreach of the MFI is an important parameter to gauge the growth strategies of the MFI and to assess its strategies for development. This parameter is analysed using the following sub-parameters.

- Direction & Clarity
- Ability to raise funds
- Degree of association with promoter institution
- Alternate avenues for funds
- Outreach (No. of offices, No. of clients, No. of employees, Portfolio diversification)

## B) Promoters & Management Profile

The elements in this parameter helps in assessing the Promoter & management quality evaluated on the basis of the basic educational qualification, professional experience of the entrepreneur; and business attitude that is related to the motivation of carrying out the business and pursuing business strategies. This parameter is analysed using the following sub-parameters.

- Past experience of the management
- Vision and mission of the management
- Profile of the Board Members
- Policies and Processes
- Transparency and corporate governance

## C) Financial Performance

SMERA analyses the credit worthiness of the organization through the following financial parameters. Various financial adjustments are done to get more accurate ratios for comparison. Financial analysis helps the MFI to know its financial sustainability. This parameter is analysed using the following sub-parameters.

- Capital adequacy
- Profitability/Sustainability ratios
- Productivity and efficiency ratios
- Gearing and Liquidity ratios

## D) Asset Quality

The loan portfolio is the most important asset for any MFI. SMERA analyses the portfolio quality of the MFIs by doing ageing analysis, sectoral analysis, product wise analysis etc. SMERA compares the portfolio management system with organizational guidelines and generally accepted best practices. This parameter is analysed using the following sub-parameters.

- Ageing schedule
- Arrears Rate / Past Due Rate
- Repayment Rate
- Annual Loan Loss Rate

## E) System & Processes

SMERA analyses the polices and processes followed by the MFIs, their ability to handle volume of financial transactions, legal issue and disputes, attrition among the employees and client drop out which impact the productivity of the organization. SMERA also analyses asset liability maturity profile of the MFI, liquidity risk and interest rate risk. This parameter is analysed using the following sub-parameters.

- Operational Control
- Management Information System
- Planning & Budgeting
- Asset Liability Mismatch

# COCA Methodology

The Code of Conduct Assessment (COCA) tool was developed as a response to the need expressed in a meeting of stakeholders in Indian microfinance by the Small Industries Development Bank of India (SIDBI) and the World Bank in December 2009. The code of conduct dimensions were identified by reviewing the various norms for ethical finance. These included RBI's fair practices guidelines for Non-Banking Financial Companies, industry code of conduct (Sadhan-MFIN) and Smart Campaign's Client Protection Principles (CPP).

In 2016, need was felt to harmonize COCA to the most recent industry code of conduct and to standardize COCA tools of different rating/assessment agencies. This grading is based on the harmonized COCA tool. In the harmonized COCA tool, the dimensions were classified in three categories – highest order, higher order and building blocks. This grading is based on the harmonized COCA tool.

<table>
<tr><th colspan="2">Highest Order</th></tr>
<tr><td colspan="2">Sensitive Indicators</td></tr>
<tr><th colspan="2">Higher Order</th></tr>
<tr><td colspan="2">Integrity & Ethical Behaviour</td></tr>
<tr><th colspan="2">Building Blocks</th></tr>
<tr><td>Governance<br><br>Transparency<br><br>Client Education</td><td>Client Protection, Recruitment<br><br>Feedback/Grievance Redressal<br><br>Data Sharing</td></tr>
</table>

*Chart: COCA Indicators Framework*

### Number of indicators in each category is presented below

| Higher Order Indicators | Number of Indicators |
|---|---|
| Integrity and Ethical Behaviour | 32 |
| Sensitive indicators | 26 |
| **Building Blocks** | **Number of Indicators** |
| Transparency | 40 |
| Client Protection | 122 |
| Governance | 30 |
| Recruitment | 13 |
| Client Education | 14 |
| Feedback & Grievance Redressal | 25 |
| Data Sharing | 6 |
| **Total** | **250** |

### Methodology

The Code of Conduct exercise is spread over four to eight days. The first day is spent at the head office. The assessment team visits the branches over the next three to eight days. Depending upon the size and the operational area of the MFI, eight to fifteen branches and between 120 and 300 clients are sampled for primary survey (except in cases where number of branches in an MFI is less than eight).

### Sampling guidelines

The following is taken as the guideline to determine the sample size for a COCA exercise.

| MFI Size | No. of branches to be visited | No. of borrowers to be visited |
|---|---|---|
| Small MFI (Less than 8 branches) | All branches | 15 clients per branch covering minimum two centers. |
| Small / Mid-size MFI (up to 2,50,000 borrowers) | 8 – 10 branches (geographically distributed) | 120-150 clients (15 clients per branch covering minimum two centers). |
| Large MFI (>2,50,000 borrowers) | 12 – 15 branches (geographically distributed) | 240-300 clients (20 clients per branch covering minimum two centers). |
| Large MFI (>2,50,000 borrowers) and having gross loan portfolio (GLP)> Rs 500 crore | 18 – 20 branches (geographically distributed) | 360-400 clients (20 clients per branch covering minimum two centers). |

**Code of Conduct Assessment exercise requires:**

1. Discussions with key staff members and the senior management at the head office, particularly the senior operational management team as well as the human resources team. These discussions focus on key issues of the code of conduct identified above.
2. Review of policy documents and manuals at the head office. These are reviewed in order to assess the policy as well as documentation regarding important aspects of the code of conduct. The last audited financial statements will also be required.
3. Sampling of branches at the head office. The assessment team samples branches for review. The branches are chosen in across different states in case the MFI operates in more than one state. Care is exercised to include older branches as well as branches that are distant from the head office or the regional office. The sampling of the branches is performed at the head office of the MFI.
4. Discussions with the branch staff at the branch office. Discussions with branch managers and the field staff is carried out to assess their understanding of the key code of conduct principles.
5. Sampling of respondents in the selected branches. A judgmental sampling is performed on the MFI's clients by the assessment team to draw respondents from the interest group, in order to maximize the likelihood that instances of non-adherence can be detected.
6. Interview with the clients. Information from the clients is collected ideally during the group meetings. If this is not possible, visits are made to the clients' locations for collecting information.
7. Review of loan files at the branch office. This review focuses on loan appraisal performed before disbursing loans as well as the documents collected from the clients.

As part of this assessment, SMERA visited following branches of the MFI. The details of the branches visited are provided below.

| Sr. No. | Branch | State | No of clients interviewed |
|---|---|---|---|
| 1 | Chandmari | Assam | 23 |
| 2 | Maligaon | Assam | 18 |
| 3 | Beltola | Assam | 20 |
| 4 | Kalapahar | Assam | 17 |
| 5 | Bongaigaon | Assam | 16 |
| 6 | Nagaon | Assam | 18 |
| 7 | Morigaon | Assam | 15 |
| 8 | Mangaldoi | Assam | 17 |
| 9 | Shillong | Meghalaya | 21 |
| **Total** | | | **165** |

# Financials

**Profit & Loss Account (Rs. In Thousands)**

| Financial Year | FY 2014 | FY 2015 | FY 2016 |
|---|---|---|---|
| Months Covered By P/L | 12 | 12 | 12 |
| **Income** | | | |
| Financial revenue from operations | 9,478 | 42,419 | 55,887 |
| Other Operating Revenue | 583 | 3,629 | 4,827 |
| **Less:** Financial expenses from operations | 1,340 | 16,055 | 25,742 |
| **Gross financial profit** | **8,138** | **26,364** | **30,145** |
| | | | |
| Less: Provision for Loan Loss | 1,449 | 408 | 582 |
| | | | |
| **Net financial profit** | **6,689** | **25,956** | **29,563** |
| | | | |
| **Less: Operating expenses** | | | |
| Depreciation and Amortization Expense | 57 | 808 | 742 |
| Personnel Expense | 2,242 | 8,058 | 9,655 |
| Administration Expense | 1,523 | 6,581 | 5,604 |
| **Net income Before Tax** | **2,867** | **10,509** | **13,562** |
| Less: Income Tax | 909 | 3,565 | 5,085 |
| **Net income After Tax** | **1,958** | **6,944** | **8,477** |

SMERA RATINGS LIMITED

**Balance Sheet (Rs in Thousands)**

| Date | 31/Mar/2014 | 31/Mar/2015 | 31/Mar/2016 |
|---|---|---|---|
| **SOURCES OF FUNDS** | | | |
| Paid up Capital | 28,900 | 30,900 | 35,900 |
| Reserves & Surplus | (1,694) | 3,761 | 10,278 |
| Provision for Loan Loss | 388 | 489 | 634 |
| Statutory Reserves | 612 | 2,001 | 3,697 |
| **TOTAL EQUITY(A)** | **28,206** | **37,151** | **50,509** |
| | | | |
| **LIABILITIES** | | | |
| SHORT-TERM LIABILITIES | | | |
| Short-term borrowings | | | |
| Commercial Loans from banks/FI for microfinance | 0 | 136,989 | 184,977 |
| Account payable &Other short-term liabilities | 1,060 | 1,536 | 860 |
| TOTAL SHORT TERM LIABILITIES(B) | **1,060** | **138,525** | **185,837** |
| | | | |
| LONG-TERM LIABILITIES | | | |
| Long-term borrowings | | | |
| Commercial Loans from banks/FI for microfinance | 157,201 | 89,957 | 153,519 |
| TOTAL LONG TERM LIABILITIES(C) | **157,201** | **89,957** | **153,519** |
| | | | |
| TOTAL OTHER LIABILITIES(D) | **158,261** | **228,482** | **339,356** |
| | | | |
| Provision for Loan Loss (E) | 1,547 | 1,954 | 2,536 |
| | | | |
| Other Provisions (F) | 1,336 | 3,644 | 5,118 |
| | | | |
| **TOTAL LIABILITIES (A+B+C+D+E +F)** | **189,350** | **271,231** | **397,519** |

| APPLICATION OF FUNDS | 31/Mar/2014 | 31/Mar/2015 | 31/Mar/2016 |
|---|---|---|---|
| **Fixed Assets** | | | |
| Fixed Assets | 2,760 | 2,885 | 4,292 |
| Less: Depreciation | 116 | 922 | 1,663 |
| **Net Fixed Assets(A)** | **2,644** | **1,963** | **2,629** |
| | | | |
| **Cash and Bank Balances(B)** | 29,897 | 70,416 | 135,044 |
| | | | |
| **Investments in Shares (C)** | 0 | 01 | 01 |
| | | | |
| **Loan Portfolio** | | | |
| Gross Loan Portfolio | 154,710 | 195,382 | 253,565 |
| Less: Impairment Loss Allowance | - | - | |
| **Net Loan Portfolio(D)** | **154,710** | **195,382** | **253,565** |
| | | | |
| **Accounts Receivable and Other Assets(E)** | 1,658 | 2,895 | 5,653 |
| | | | |
| **Deferred Tax (F)** | 441 | 574 | 627 |
| | | | |
| **TOTAL ASSETS (A+B+C+D+E+F)** | **189,350** | **271,231** | **397,519** |

# Financial Ratios

| Financial Ratios | 31/Mar/2014 | 31/Mar/2015 | 31/Mar/2016 |
|---|---|---|---|
| **Capital Adequacy Ratio (CAR)** | | | |
| Capital Adequacy Ratio (%) | 17.88% | 18.58% | 19.37% |
| | | | |
| **Productivity / Efficiency Ratios** | | | |
| No. of Active Borrowers Per Staff Member | 387 | 345 | 352 |
| No. of Active Borrowers per field executives | 841 | 766 | 777 |
| Gross Portfolio o/s per field executive (Rs in thousands) | 6,727 | 7,236 | 7,458 |
| Average Outstanding Balance Per borrower (In **Rs**) | 7,993 | 9,450 | 9,602 |
| Cost Per Active borrower (In **Rs**) | 198 | 747 | 606 |
| | | | |
| **Asset / Liability Management** | | | |
| Yield on Portfolio (%) | 10.2% | 22.2% | 22.7% |
| | | | |
| **Profitability / Sustainability Ratios** | | | |
| Operational Self Sufficiency (%) | 143.4% | 132.9% | 132.0% |
| Operating Expense Ratio (OER) | 4.4% | 8.8% | 7.1% |
| Funding Expense Ratio (FER)** | 1.68% | 8.36% | 9.11% |
| Return on Assets (RoA) | 2.7% | 4.6% | 4.1% |
| Portfolio at Risk (>30 days) | 0.0% | 0.0% | 0.00% |
| Return on Equity (RoE) | 7.92% | 21.25% | 19.34% |

**Funding Expense Ratio (FER) is calculated after taking into consideration subsidised funding availed from NEDFI for OBC category, and unbanked and under-served areas of North Eastern region. NFPL has maintained the margin cap as specified by the RBI.

## About SMERA

SMERA Ratings Limited is a joint initiative of Small Industries Development Bank of India (SIDBI), Dun & Bradstreet Information services India Private Limited (D&B) and leading public and private sector banks in India. SMERA commenced its operations in 2005 and is empanelled as an approved rating agency by the National Small Industries Corporation Ltd. (NSIC) under the 'Performance & Credit Rating Scheme for Micro & Small Enterprise' of the Ministry of MSME, Government of India. SMERA is registered with the securities and Exchange Board of India (SEBI) as a Credit Rating Agency and is accredited by Reserve Bank of India (RBI) as an External Credit Assessment Institution (ECAI), under BASEL- II norms for undertaking Bank Loan Ratings.

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