



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

Sambandh Finserve 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	SFPL 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	SFPL 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	Comprehensive rating grade
30-Sept-2016	SMERA	MF3

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	Sambandh Finserve Private Limited	
Operational Head – Microfinance Business	Name	Mr. Manoj Felix Ekka
	Designation	Dy. CMO
	Mobile No.	7077717501
	Email ID	Manojfelix.ekka@sambandhfin.com
	Date of Joining	20th July 2015
Date of Incorporation/Establishment	3rd July, 1996	
Date of commencement of microfinance business	2nd October, 2006	
Legal Status	NBFC-MFI	
Business of the company	Micro finance under joint liability groups	
Correspondence Address	Plot No- 0-4/9, Area 7&8, Civil township, Rourkela-769004, District- Sundargarh, State- Odisha	
Geographical Reach (As on 28/Feb/2017)	No. of States	3
	No. of Districts	15
	No. of Branches	29
	No. of Active Borrowers	86,604
	No. of Total Employees	337
	No. of Field/Credit Officers	169
Visit of the Assessment team	14 th March, 2017 to 17 th March, 2017	

Product Profile

Products	Description	Loan Size (Rs)	Interest Rate (A) (In %)	Processing Fee (B) (In %)	APR (Interest Rate and Processing fees) (In %) (C=A+B)
SARAL	JLG/SHG	5,000 to 50,000	25.00%	1.00%	26.00%
SUVIDHA	SHG	5,000 to 25,000	25.00%	1.00%	26.00%
WATSAN	Individual-Sanitation	12,000	21.00%	1.00%	22.00%

Capital Structure (As On 28/Feb/2017)

Authorized Capital	In Rs.	15.00 Crore
Paid-up Capital	In Rs.	13.30 Crore

Shareholding Pattern (As On 28/Feb/2017)

EQUITY SHARES	
Shareholders	% Holding
Mr. Deepak Kindo	21.84%
Mr. LivinusKindo	13.13%
Mr. Dibyalochan Jena	0.58%
Mrs. M. M. Kindo	13.70%
Mr. AlokTirkey (Friends of Sambandh Trust)	21.84%
Dia Vikas Capital Pvt. Ltd.	28.91%
Total	100.00%

Optionally Convertible Preference Shares (OCPS)	
Shareholders	% Holding
SIDBI	100.00%
Total	100.00%

Board of Directors/Promoters Profile

Name	Position	Qualification	Brief Profile
Mr. Livinus Kindo(IAS Retd)	Chairman	M.A Economics, M. Phil	Founding member of RRDC, former bureaucrat, philanthropist, eminent socio-economist with rich and varied experience in the area of Cooperatives, he has many publications to his credit. Mr. Kindo is credited with the turnaround of the cooperative banks and societies in the state, and thus has intensive working knowledge in the areas of rural and agriculture finance. He has keen interest in the area of economic development and has been closely associated with Sambandh since its inception.
Mr. Deepak Kindo	MD & CEO	MBA(PGDfM)	Founder of Sambandh, Experienced professional in the MFI sector, specializing in shaping and spearheading MFI initiatives. Mr. Kindo is an MBA from Indian Institute of Forest Management, Bhopal, and has over twelve years of experience in the micro finance sector in which period he has also worked for Friends of Women's World Banking India. He has wide exposure to various models of micro finance at the national as well as international levels.
Mr. Dibyolochan Jena	Director	B.Com	Retired Cooperative Banker, last served as Managing director of a Primary Cooperative Society. Mr. Jena has extended his patronage to Sambandh since its inception, and has been instrumental in giving direction to the organization.
Mr. Saurabh Baroi	Nominee Director	MBA(PGDRM)	Mr.Baroi, is a Post Graduate in Rural Management. His core skill areas include Institutional Development, Partnership Management, Mentoring, Technical Capacity Building, Legal Transformation & Due Diligence of MFIs. Prior to joining DiaVikas Capital, he has worked with both national and international agencies such as CARE India, Access Development Services & CAPART.

Prabal Sen	Independent Director	M.A Economics	<p>Mr. Sen, at present, is professor at XLRI and has served the Institute of Rural Management Anand (IRMA) as Bank of Baroda Chair Professor from November 2001 to March 2007. He had earlier taught at the Post Graduate Department of Economics in Burdwan University and served a public sector bank for over two decades occupying senior positions in areas related to economic research, general management and rural credit policy planning and operations. He has carried out several studies on rural credit and development, published a number of papers on related subjects and offered consultancy services, among others, to the Ministry of Rural Development, Government of India and the SIDBI Foundation for Micro Credit. Besides being the Prof. at IRMA for Macroeconomics and Rural Finance related courses, Coordinator Entrepreneur Development cell, Prof Sen currently occupies the positions of (i) Member, Board of Studies, Dept of Banking & Insurance, Faculty of Commerce, MS University of Baroda, (ii) Member, Board of PG Studies in Rural Development & Planning, Nagaland University (a Central University), and (iii) Member, Advisory Committee, School of Management & Computer Application at National Institute of Technology (NIT), Durgapur.</p>
Kuchibhatla Prasad	Independent Director	M.Sc,CAIIB	<p>Mr. Prasad has a wide experience of 33 years with Reserve Bank of India in various capacities with Chief General Manager, RBI as his last position held. His experience covers the areas of Supervision and Examination of Non-Banking Financial Institutions & Banks including the Developmental Financial Institutions. Before joining RBI, functioned as Senior Breeder with USAID and Rockefeller Foundations in developing disease resistant and high yielding Rice Varieties at Hyderabad with All India Coordinated Rice Improvement Project for four years.</p>

<p>Mr. Vinod Kumar Jha</p>	<p>Independent Director</p>	<p>B.Sc</p>	<p>Shri. Vinod Kumar Jha, is an experienced professional providing strategic business advisory solutions in the areas of finance, marketing and business development. A Science Graduate from Mumbai University, he has rich and varied experience in this field for the past 16 years. He is also closely associated with premier organizations like Carbon Minus India in the area of renewable energy and environment protection and is a supporter and advisory for championing the vision of “Zero defect-zero effect” of our Prime Minister. He also has a presence in the socio-economic space and has worked with MFIs including C-DOT, Bihar and has helped them with their strategic and sustainable growth. His core skill areas include Institutional Development, Strategic Ideation, Mentoring and Incubation in New Realms.</p>
<p>Santanu Sarma Barua</p>	<p>Nominee Director</p>	<p>MBA (Finance), M.A Economics, CAIIB, FRM, CFA</p>	<p>A Post Graduate in Economics from Delhi School of Economics with an MBA (Finance) from NMIMS University, Mumbai, Mr. Santanu Sarma Barua has over 20 years of work experience in financial industry encompassing commercial banking, housing finance and development banking. Mr. Barua is a Certified Associate of Indian Institute of Banking & Finance (CAIIB), an accredited Financing Risk Manager (FRM) from Global Association of Risk Professional (GARP) and CFA charter holder from the CFA Institute, USA. Mr. Barua is presently Deputy General Manager in SIDBI MSME International Training Institute (SITI) at Bhubaneswar. During his career with SIDBI, he has worked in Treasury Mid-Office, Market Risk, Resource Mobilization areas at its Mumbai corporate office apart from various branch offices of SIDBI across the country.</p>

Management Team Profile

Name	Position	Qualification	Brief Profile
Mr. Deepak Kindo	CEO & MD	MBA(PGDFM)	Founder of Sambandh, experienced professional in the MFI sector, specialising in shaping and spearheading MFI initiatives. Mr. Kindo is an MBA from Indian Institute of Forest Management, Bhopal, and has over twelve years of experience in the micro finance sector in which period he has also worked for Friends of Women's World Banking India. He has wide exposure to various models of micro finance both at the national as well as the international levels.
Mr. James Raj	Chief Financial Officer	B.Com(Hons), M.Com, PGDBM(LIBA)	Mr. Raj is a MBA in Finance from the Loyola Institute of Business administration, Chennai. He has rich experience of the retail consumer financial industry in personal loans, mortgage and insurance with various capacities in sales, credit and branch operations. He also has prior experience in logistics and accounting with in depth knowledge of whole function. Apart from domain expertise he has considerable experience in delivering trainings on soft skill development. In his current role as Chief Financial Officer he is instrumental in the day to day activities of the company. He also heads all the functions of the organization and takes forward its future expansion.
Mr. Manoj Kumar Ekka	Manager-MIS	M.Sc (Comp. Sc.)	Mr. Ekka has done masters in Computer Science from Utkal University. He has handled software development and has focused on implementation of assignments. He is incharge of MIS at Sambandh and has developed the innovative information system currently in use in the organization. He is accountable for the development and implementation of software at Sambandh.

Mr. Bimal Lakra	Manager- HR	MA(Public Administration)	Mr. Lakra holds a graduate degree in Science and is prosecuting his Masters in Public Administration. Mr. Lakra joins the organization as a fresher, and brings in commendable experience in the areas of communication and interpersonal skills. Mr. Lakra has keen interest in social service and community development. At SAMBANDH he is responsible for identifying key areas for staff training and improvement and subsequently design the training calendar for the organization. He is also responsible for the creation of the various organizational manuals and updating the same on a regular basis.
Mr. Felix Xess	Manager, Accounts	B. Com	Mr. Xess is an expert in accounting with a Bachelor degree in Commerce and Tally. He has drawn a rich experience from his past service in Christian Missionary organizations at Bangalore and Ranchi. He has an extensive working experience in Tally and supervises the entire book keeping and accounting processes at SAMBANDH.
Mr. P Elias Lugun	Manager, Internal Audit & Control	MBA	Mr. Lugun is an MBA in Marketing from Sambalpur University. Before Internal Audit he had prior experience in the Field Operations department at Sambandh since inception. He is very familiar with the organizational policy and procedures and was part of policy formulation during the early stages of the organization. In his current role as head of Internal Audit and Control, he is accountable for review of internal control system, checking compliance of organizational policy and detection of frauds in the organization. He reports to the audit committee of the board. He has an experience of 9 years.

Key Performance Ratios

Financial Ratios	31-Mar-15	31-Mar-16	31-Dec-16
<u>Capital Adequacy Ratio (CAR)</u>			
Capital Adequacy Ratio (%)	23.79%	22.72%	18.05%
<u>Productivity / Efficiency Ratios</u>			
No. of active borrowers per staff member	238	279	257
No. of active borrowers per field/credit officers	552	749	512
No. of active borrowers per branch	2,436	3,064	2,986
Gross portfolio o/s per field/credit officers (In Rs.)	6235022	10765484	6361938
Average outstanding per borrower (In Rs.)	11,291	14,373	12,415
<u>Profitability / Sustainability Ratios</u>			
Yield on Portfolio (%)	25.22%	25.91%	25.49%
Operational Self Sufficiency (%)	111.78%	111.12%	107.15%
Operating Expense Ratio (OER)	10.67%	10.46%	11.41%
Funding Expense Ratio (FER)	14.82%	15.05%	15.12%
Return on Assets (RoA)	1.10%	1.19%	0.85%
Return on Equity (RoE)	0.07	0.09	0.07
Portfolio at Risk (>30 days)	0.11%	0.22%	0.37%
Write-offs to average portfolio (%)	-	0.07%	-

Highlights of Microfinance Operations

Particulars	31-Mar-14	31-Mar-15	31-Mar-16	28-Feb-17
No. of States	2	3	3	3
No. of Districts	4	6	11	15
No. of Branches	7	17	22	29
No. of Active Members	23,309	51,299	85,253	111,521
No. of Active Borrowers	20,583	41,416	67,413	86,604
No. of Total Employees	72	174	242	337
No. of Field/Credit Officers	32	75	90	169
No. of SHGs	-	-	-	-
No. of JLGS	3,124	5,523	7,925	11,616
No. of Individual Loans	-	-	-	-
OWNED PORTFOLIO				
Particulars	31-Mar-14	31-Mar-15	31-Mar-16	28-Feb-17
Total loan disbursements during the year (in crore)	18.71	37.38	81.37	67.94
Total portfolio outstanding (in crore)	19.65	37.19	68.01	79.12
Managed/BC PORTFOLIO				
Particulars	31-Mar-14	31-Mar-15	31-Mar-16	28-Feb-17
Total loan disbursements during the year (in crore)	-	13.68	19.98	25.68
Total portfolio outstanding (in crore)	-	9.57	16.57	17.57
Securitized & Assigned Portfolio				
Particulars	31-Mar-14	31-Mar-15	31-Mar-16	28-Feb-17
Total loan disbursements during the year (in crore)	-	-	13.75	9.64
Total portfolio outstanding (in crore)	-	-	12.32	10.83

Compliance with RBI's Directives for MFIs

RBI's Direction	Company Status	Compliance
85% of total assets to be in the nature of qualifying assets	Qualifying assets forms 92.52 % 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. 10.70 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	SFPL 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	SFPL offers loan in the range of Rs 10,000 to Rs 50,000 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)	SFPL 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	SFPL offers loans of Rs 15,000 for a tenure of 12 months and loans of over Rs. 15000 for a period of 24 months	Complied
Pricing guidelines are to be followed	Loans are provided in range of 22.84% to 25.96% 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	SFPL verifies the same through credit check from credit bureaus	Complied

RBI's Direction	Company Status	Compliance
Loan pricing to include processing fee (not exceeding 1% of the loan amount)	SFPL is charging processing fee of 1.00% on the disbursed loan amount plus applicable service tax	Complied
Collateral free loans	SFPL does not accept any Collateral for extending the credit.	Complied
MFIs shall not collect any Security Deposit / Margin from the borrower.	SFPL does not collect any security deposit / margin from the borrower.	Complied
No late payment or prepayment penalties	SFPL 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.	SFPL 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	SFPL 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.	CRAR of SFPL stood at 18.05% as of 31st Dec 2016 which complies with the minimum CRAR requirement of 15% for NBFC-MFIs as prescribed by RBI.	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

Long track record of operations and extensive industry experience of promoters

- Sambandh Finserve Private Limited (SFPL) was established in 1992 under the name of Regional Rural Development Centre (RRDC) with the objective of village and community development. RRDC started its microfinance operations on October 2, 2006 with its first disbursement in Sundargarh district of Odisha with support from FWWB under its project “Sambandh”.
- Later in October 2009, to expand its micro credit presence RRDC promoters acquired a Non-Banking Finance Company (NBFC) named Modline Buildcap Private Limited which was later renamed as Sambandh Finserve Private Limited (SFPL) on June 17, 2010.
- SFPL’s core management team and second line of management has an adequate understanding of MFI ecosystem with rich experience in banking, microfinance and social development. Mr. Deepak Kindo, Managing Director who previously worked with Friends of Women’s World Banking India (FWWB) has almost two decades of experience in field of micro finance.
- SFPL has eight-member on its board as on Dec 31, 2016 having extensive experience in the banking and finance segment. The board has promoter directors, 3 independent directors and 2 nominee directors with banking & finance/microfinance expertise.

Diversified resource profile

- As on Dec 31, 2016, SFPL has developed funding relationships with 15 lenders (five Banks & 10 NBFCs/FIs) however their resources profile continues to remain concentrated towards borrowings from NBFCs/FIs which stood at ~ 90% of total borrowings (outstanding debt) as on Dec 31, 2016.
- The overall cost of funds (COF) for SFPL is relatively higher at 15.15% as on December 31, 2016 on account of majority of borrowings from NBFCs/FIs. The loans availed from NBFCs/FIs carry higher interest rate in the range of 14%-16% and hence the company has to explore its funding base majorly towards PSU Banks/Private Banks for reducing its cost of borrowing.

Moderate capitalisation and comfortable liquidity profile

- The company's capitalisation stands moderate with capital adequacy ratio (CAR) of 18.05 per cent as on Feb 28, 2017 as against CAR of 22.65 per cent as on March 31, 2016. The NBFC-MFI capitalisation in relation to managed asset base has been comfortable on account of equity infusion and internal accruals at regular interval.
- SFPL 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.

Geographical Concentration

- The company is exposed to geographical concentration risk. As on Feb 28, 2017, SFPL's portfolio is concentrated in the state of Odisha accounting for ~ 87 percent, and ~ 13 percent in other two states i.e. Chhattisgarh and Jharkhand.
- 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

- SFPL has maintained sound asset quality with on-time repayment rate of 99.21% and PAR (>30 days) of 0.42% as on Feb 28, 2017. 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. 10995 thousands on total income of Rs. 172241 thousands in FY2016 and a profit after tax of Rs. 5956 thousands on total income of Rs 80492 thousands in FY2015. The Company's operating expense stood at 11.41% as on 31-December-2016.

Profitability / Sustainability Ratios	31-Mar-15	31-Mar-16	31-Dec-16
Yield on Portfolio (%)	25.22%	25.91%	25.49%
Operational Self Sufficiency (%)	111.78%	111.12%	107.15%
Operating Expense Ratio (OER)	10.67%	10.46%	11.41%
Funding Expense Ratio (FER)	14.82%	15.05%	15.12%
Return on Assets (RoA)	1.10%	1.19%	0.85%
Return on Equity (RoE)	0.07	0.09	0.07
Portfolio at Risk (>30 days)	0.11%	0.22%	0.37%

Moderate IT Systems and Audit Mechanism

- SFPL 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

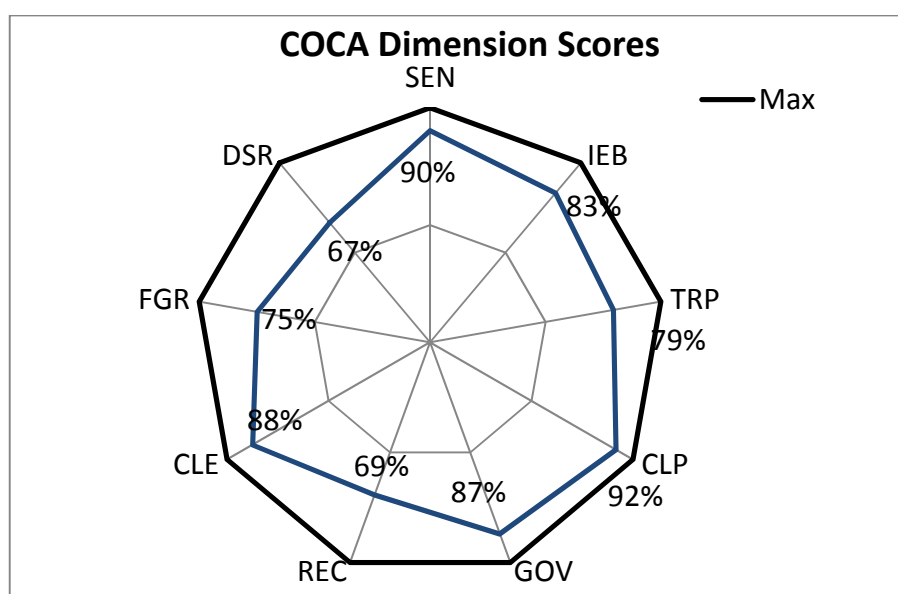
- SFPL's business risk profile is susceptible to regulatory and legislative risks, along with the inherent risk exist such as unsecured nature of lending, vulnerable customer profile, exposure to vagaries of political situation in states, and cash handling associated with the NBFC-MFI sector. However,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

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.

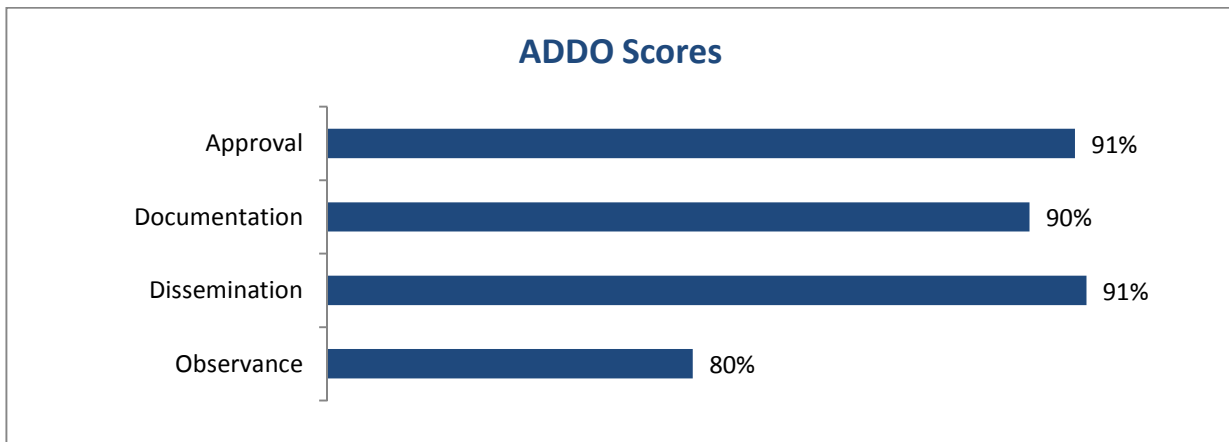
Section 2: Code of Conduct Assessment

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



SCORES ON PARAMETERS

Code of Conduct Parameters	Code	% Performance
Sensitive	SEN	90%
Integrity and Ethical Behavior	IEB	83%
Transparency	TRP	79%
Client Protection	CLP	92%
Governance	GOV	87%
Recruitment	REC	69%
Client Education	CLE	88%
Feedback & Grievance Redressal	FGR	75%
Data Sharing	DSR	67%



SFPL 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 SFPL 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 SFPL 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 SFPL's adherence towards ethical operational practices.

Strengths and weaknesses pertaining to Code of Conduct

Strengths	Weaknesses
<ul style="list-style-type: none"> • Board approved policies, compliant with the RBI guidelines. • SFPL has eight-member on its board as on Dec 31, 2016 having extensive experience in the banking and finance segment. • Membership with MFIN and Sa-dhan. • Developed its own client protection principles and is displayed in all the branches • Credit policies are well established documented and communicated. • Adequate loan appraisal & monitoring systems. • Compulsory training on products terms and conditions to client prior to every loan. • Compulsory check on over indebtedness of every borrower. • SFPL complies with all RBI guidelines. • Moderate Management Information System (MIS) and Information Technology (IT) considering the current scale of operations and projected growth. 	<ul style="list-style-type: none"> • Limited system to track cash flow analysis and surpluses. • Awareness to its clients/members pertaining to interest rate and insurance claim settlements found average. • 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. • Awareness among client and staff on SRO Grievance Redressal mechanism was found to be moderate. • Awareness among the staff on RBI compliance was found to be moderate. • Code of compliance report, financial and operational data for FY 2016 is not available on the website of SFPL. • Prepayment policy not documented.

Significant Observations

HIGHER ORDER INDICATORS	
Integrity and Ethical Behaviour	<ul style="list-style-type: none"> • 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. • Audit findings related to grievance and field audit are presented at board level. • Board has approved a policy of recovering delinquent loans • Limited policy on time frame and process for client's complaint resolution. • Framed client protection included policies on expected staff conduct with employees • As informed by the management that the MFI has not recruited any staff from another MFI in the past. • In all the branches visited, the contact number and address of SRO nodal official was properly displayed. • Staff compensation and incentive is not covered under scope of Internal Audit. • Awareness among client and staff on SRO Grievance Redressal mechanism was found to be moderate. • Fixed Component compensation of staff is not impacted in event of overdues. SFPL, in its fair practices code provides importance for transparency in pricing and clear communication to the clients.
Sensitive Indicators	<ul style="list-style-type: none"> • In the sample of clients during COCA on the total indebtedness of borrower was within the prescribed limit stipulated by RBI. • Interactions with clients revealed that they had not been made to pay for a service or product as a precondition for loan. • 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. • Awareness to its clients/members pertaining to interest rate and insurance claim settlements found average. • SFPL provides acknowledgement and sanction letters to the clients. • SFPL provide repayment schedule to the clients including break-up of principle and interest. • Awareness among the staff on RBI compliance was found to be moderate. • There are no adverse observations in the Auditor's report regarding accounting standards followed by the MFI. • SFPL shares data with all credit bureaus prescribed by SRO. • SFPL 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.

	<ul style="list-style-type: none"> • 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.
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BUILDING BLOCKS	
Transparency	<ul style="list-style-type: none"> • Awareness among the staff on RBI guidelines was found to be moderate. • SFPL has documented the pricing of its loan products in its operational manual. In the branches visited loan documents had been maintained in local languages. • Circulars with the most recent directions are available in the visited branches. • SFPL, in its fair practices code provides importance for transparency in pricing and clear communication to the clients. • The loan interest rate and processing fees is mentioned on the loan passbook provided to the client. • Clients interviewed were aware of the charges and price for all services availed. • Prepayment policy on loans not documented. • SFPL 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. • SFPL 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. • Code of conduct compliance report of SFPL & previous financial year annual financial statement and report is not available in the public domain. • SFPL provide repayment schedule to the clients including break-up of principle and interest. • SFPL do not document why a loan has not been sanctioned against an accepted loan application.
Client Protection	<ul style="list-style-type: none"> • SFPL do not have a board-approved policy regarding client data security. • Employees are trained on aspects of appropriate behavior with the clients. • SFPL has documented policy on client data security which forms part of its fair practice code • Framed client protection included policies on expected staff conduct with employees. • Staffs were found to be aware of the need to have professional conduct with the clients. • 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.

	<ul style="list-style-type: none"> Limited backup of client's data maintained in electronic form. Awareness among the branch staff on RBI compliance was found to be moderate.
Governance	<ul style="list-style-type: none"> SFPL has eight-member on its board as on Dec 31, 2016 having extensive experience in the banking and finance segment. SFPL have disclosed its CEO compensation in its audited report FY2016. Audit findings related to grievance and field audit are presented at board level 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. The MFI has got its accounts audited in a timely manner after the end of the most relevant financial year. No adverse observations in the Auditor's report regarding accounting standards followed by the MFI. Action taken audit report not available at branch level. Staff satisfaction related to compensation and incentive is not covered under scope of Internal Audit. Branch staff interviewed was not fully aware of reschedulement policy and procedure.
Recruitment	<ul style="list-style-type: none"> SFPL'S Board has reviewed its recruitment policies at least once annually There is documentary evidence to suggest that MFI has honored the notice period for all employees who have left it. 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. SFPL do not have a documented policy when it recruits staff from another MFI, the said staff will not be assigned to the same area he/she was serving at the previous employer for a period of one year.
Client Education	<ul style="list-style-type: none"> SFPL, in its fair practices code provides importance for raising clients' awareness of the options, choices and responsibilities regarding financial products and services. SFPL does not charge clients for the trainings provided to clients, itself or through a related party. Awareness to its clients/members pertaining to interest rate and insurance claim settlements found average.
Feedback and Grievance Redressal	<ul style="list-style-type: none"> 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. SFPL has a policy on time frame and process for client's complaint resolution. Clients were found to be aware of the helpline number In all the branches visited, the contact number and address of SRO nodal official was properly displayed. The company maintains a record of the action taken and complaints resolved. Awareness among client and staff on SRO Grievance Redressal

	<p>mechanism was found to be moderate.</p> <ul style="list-style-type: none"> • A Complaint Register is maintained at visited Branches and all complaints received are recorded with resolution. • SFPL do not prepare monthly reports about the number, nature and resolution of grievances and feedback received for management review.
<p>Data Sharing</p>	<ul style="list-style-type: none"> • SFPL do not have documented process for sharing data with the credit bureaus. However they share data with all Credit Bureaus prescribed by SRO. • Financial and operational data for FY 2016 is not available on the website of SFPL. • SFPL has provided data called for by RBI and SRO.



SMERA RATINGS LIMITED

ANNEXURES

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 policies 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.

Highest Order	
Sensitive Indicators	
Higher Order	
Integrity & Ethical Behaviour	
Building Blocks	
Governance	Client Protection, Recruitment
Transparency	Feedback/Grievance Redressal
Client Education	Data Sharing

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	Rajgangpur	Odisha	19
2	Rourkela	Odisha	14
3	Belpahar	Odisha	26
4	Jharsuguda	Odisha	28
5	Sundargarh	Odisha	26
6	Simdega	Jharkhand	20
7	Ranchi	Jharkhand	22
8	Jamshedpur	Jharkhand	27
Total			182

Financial Statements

Profit and Loss Account (Amount in Thousands)

Financial Year	2014	2015	2016
Months	12	12	12
	Audited	Audited	Audited
Financial revenue from operations (a)	43,919	80,492	1,72,241
Interest and fee revenue from loans	42,175	73,250	1,44,634
Other Operating Revenue	1,744	7,242	27,607
Financial expenses from operations (b)	17,984	43,664	1,01,219
Interest and Fee Expense on Borrowings	17,901	43,480	99,484
Other financial expenses related to financial services	83	184	1,735
Gross financial margin (c=a-b)	25,935	36,828	71,022
Impairment Losses on Loans (d)	1,594	1,754	3,456
Provision for Loan Loss / Bad Debts Written off	1,594	1,754	3,456
Write off loss assets	0	0	0
Net financial margin (e=c-d)	24,341	35,074	67,566
Operating expenses (f)	17,574	27,932	50,635
Personnel Expense	9,795	13,821	28,840
<u>Administrative Expense</u>			
Depreciation and Amortization Expense	1,316	3,704	4,025
Other Administrative Expense	6,463	10,407	17,770
Net operating income (g=e-f)	6,767	7,142	16,931
Net Non-Operating Income/(Expense)	-35	1,500	346
Non-Operating Revenue (h)	583	1,500	346
Non-Operating Expense(i)	618	0	0
Net income before tax (j=g+h-i)	6,732	8,642	17,277
Income Tax (k)	0	2,686	6,282
Net income after tax (j-k)	6,732	5,956	10,995

Fiscal Balance Sheet As On Date (Amount in Thousands)

As on date	31-Mar-14	31-Mar-15	31-Mar-16
	Audited	Audited	Audited
SOURCES OF FUNDS			
Shareholders' Funds			
Share Capital	86,000	90,785	1,18,057
Share Capital	86,000	90,785	1,18,057
Retained Earnings			
Prior Year	507	1,417	2,609
Current Year	910	1,191	2,199
Surplus	2,413	3,938	9,485
Share Premium	0	215	2,943
TOTAL EQUITY	89,830	97,546	1,35,293
Liabilities			
Short-term liabilities	1,18,499	3,04,191	5,19,798
<u>Short-term borrowings</u>			
Commercial Loans from banks/FI	1,17,664	2,81,188	4,82,395
Unsecured Loan	0	4,452	28,383
Interest payable on funding liabilities	321	1,749	4,687
Account payable & Other short-term liabilities	514	16,802	4,333
Long-term liabilities	68,121	1,29,736	2,49,376
<u>Long-term borrowings</u>			
Commercial Loans from banks/FI	68,121	1,29,736	2,49,376
TOTAL OTHER LIABILITIES	1,86,620	4,33,927	7,69,174
Provision for Loan Loss	1,965	3,719	6,801
Other Provisions	5,848	7,876	12,481
Provisions	7,813	11,595	19,282
TOTAL LIABILITIES	2,84,263	5,43,068	9,23,749

As on date	31-Mar-14	31-Mar-15	31-Mar-16
	Audited	Audited	Audited
APPLICATION OF FUNDS			
Fixed Assets			
Gross Block	3,268	4,392	5,302
Less: Accumulated Depreciation and Amortization	767	0	0
Net Block	2,501	4,392	5,302
Cash and Bank Balances	42,291	23,046	38,969
Investment in FD	34,836	1,23,287	1,59,301
Loan Portfolio			
Gross Loan Portfolio	1,96,510	3,71,929	6,80,051
Less: Provisions	0	0	0
Net Loan Portfolio	1,96,510	3,71,929	6,80,051
Accounts Receivable and Other Assets	8,125	19,935	39,647
Deferred Tax Asset	0	479	479
TOTAL ASSETS	2,84,263	5,43,068	9,23,749

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.

Corporate Office

102, Sumer Plaza
Marol Maroshi Road, Marol
Andheri (East)
Mumbai - 400 059
Tel: +91 22 6714 1111
E-mail: info@smera.in
Website: www.smera.in