



SMERA RATINGS LIMITED

## SMERA Comprehensive Grading

**M2C2**

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

## SMERA MFI Grading

Village Financial Services Private Limited

***Date of Report:***

**30<sup>th</sup> May, 2017**

***Valid Till:***

**29<sup>th</sup> May, 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		M2C2			
M3					
M4					
M5					
M6					
M7					
M8					

The MFI obtains comprehensive MFI grading of “M2C2”. It signifies high capacity of the MFI to manage its operations in a sustainable manner and good performance on code of conduct dimensions.

## Grading Rationale

<b>Microfinance Capacity Assessment Grade</b>	VFSPL obtains “ <b>M2</b> ” as its performance grade which signifies “high capacity of the organization to carry out its activities in a sustainable manner”.
<b>Code of Conduct Assessment Grade</b>	VFSPL obtains “ <b>C2</b> ” as its Code of Conduct Assessment Grade which signifies good 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
07-JUL-2016	CARE Rating	Rating BBB-
30-JUL-2016	SMERA Ratings	Grading MF2

## SMERA's MFI Grading Scale

### 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 <b>above average</b> capacity to manage their microfinance operations in a sustainable manner.
M4	MFIs with this grade are considered to have <b>average</b> capacity to manage their microfinance operations in a sustainable manner
M5	MFIs with this grade are considered to have <b>inadequate</b> capacity to manage their microfinance operations in a sustainable manner.
M6	MFIs with this grade are considered to have <b>low</b> capacity to manage their microfinance operations in a sustainable manner.
M7	MFIs with this grade are considered to have <b>very low</b> capacity to manage their microfinance operations in a sustainable manner.
M8	MFIs with this grade are considered to have <b>lowest</b> 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 <b>excellent</b> 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 <b>average</b> performance on Code of Conduct dimensions
C4	MFIs with this grade have <b>weak</b> performance on Code of Conduct dimensions
C5	MFIs with this grade have <b>weakest</b> performance on Code of Conduct dimensions

## Company Profile

Name of the MFI	Village Financial Services Private Limited	
Operational Head – Microfinance Business	Name	Mr. Manas Sarkar
	Designation	Operation Head
	Mobile No.	9874816548
	Email ID	<a href="mailto:msarkar@village.net.in">msarkar@village.net.in</a>
	Date of Joining	13 <sup>th</sup> November, 2006
Date of Incorporation/Establishment	28th June 1994	
Date of commencement of microfinance business	17 <sup>th</sup> January 2006	
Legal Status	Private Limited Company (NBFC-MFI)	
Business of the company	Microfinance activity under Joint Liability Group (JLG)	
Correspondence Address	Eco Space Business Park, Tower-4B Room No. 403, 4th Floor, New Town, Rajarhat Kolkata-700156, West Bengal India	
Geographical Reach (As on 31/Mar/2017)	No. of States	8
	No. of Districts	43
	No. of Branches	159
	No. of Active Borrowers	256,057
	No. of Total Employees	839
	No. of Field/Credit Officers	495
Visit of the Assessment team	08th May, 2017 to 10 <sup>th</sup> May, 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)
Briddhi Loan	Individual through JLG	Rs 5,000/- - Rs 30,000/-	24.58 % (Reducing)	1% of the Loan Amount	25.58
Sri Briddhi Loan	Individual through JLG	Rs 32,000/- - Rs 1,00,000/-	22.83 % (Reducing)	1% of the Loan Amount	23.83

## Capital Structure as on 31/Mar/2017

<b>Authorized Capital</b>	Rs.40.00 crore
<b>Paid Up Capital</b>	Rs.36.18 crore

## Shareholder's –Equity Shares as on 31/Mar/2017

EQUITY SHARES	
Shareholders	Holding (%)
Shivam Investment Advisory Private Limited	56.50%
VFS MBA - Howrah	9.09%
VFS MBA - Nadia	10.51%
VFS MBA - Hooghly	4.72%
VFS MBA - South 24 Prgs	1.59%
Mr. Kuldip Maity	15.22%
Mr. Ajit Kumar Maity	2.36%
<b>Total</b>	<b>100.00%</b>

## Promoters Profile

Name	Position	Qualification	Brief Profile
Ajit Kumar Maity	Chairman	BSc., B.A	<ul style="list-style-type: none"> <li>• Founder of VFSPL</li> <li>• Mr. Ajit Kumar Maity is having 32 years of experience in the field of microfinance and development.</li> <li>• Ex-Executive Board Member of Sa-Dhan, Ex-member of the SIDBI Project Advisory Committee (Eastern region).</li> </ul>
Kuldip Maity	Managing Director & CEO	Graduate/ Diploma in Management/Bachelor in Business Administration (BBA)	<ul style="list-style-type: none"> <li>• Presently MD of VFSPL.</li> <li>• Mr. Kuldip Maity is having 2 decades of experience in the field of microfinance and social development.</li> </ul>
Sankar Datta	Independent Director	PhD. (Economics)/ Post Graduate Diploma in Rural Management	<ul style="list-style-type: none"> <li>• Presently Vice President in BASIX and Chief Operating Officer (COO) of Indian Grameen Services.</li> <li>• He was closely involved in PRADAN for tribal people teaching and research in IRMA, IIM Ahmedabad and Dean of The Livelihood School.</li> </ul>
A.Ramanathan	Independent Director	MBA	<ul style="list-style-type: none"> <li>• Retired Chief General Manager of NABARD.</li> <li>• Joint Director of Banker's Institute of Rural development (BIRD) .</li> <li>• Mr. A. Ramanathan is having 37 years of experience in research, training, consultation, etc. in NABARD &amp; other organised sector.</li> </ul>
Dr. T.K.Mukhopadhyay	Independent Director	B.Sc. (Honours in Chemistry), B.Tech (Chemical Engg), M.Tech (Chemical Engg), PGDBM, Ph.D.	<ul style="list-style-type: none"> <li>• Retired Chief General Manager and Head (Administration and premises) of IDBI Bank Ltd.</li> <li>• Dr. T. K. Mukhopadhyay is actively involved in various activities related Retail &amp; Corporate finances ,HR, Administration &amp; Premises, Facilities, Customer Relations &amp; Business Development</li> </ul>
Jayshree Ashwin Kumar Vyas	Additional Director	Chartered Accountant	<ul style="list-style-type: none"> <li>• Jayshree Ashwin Kumar Vyas was Managing Director of Shree Mahila Sewa Sahakari Bank, Ahmedabad since 1986.</li> </ul>



Alpana Bhandari	Nominee Director	Higher Secondary	<ul style="list-style-type: none"> <li>She was nominated by the Board of Trustees of the VFS Mutual Benefit Association-Howrah.</li> </ul>
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### Senior Management Profile

Name	Position
Mr. D.K. Ray	Manager-Finance
Mr. Subhasis Ghosh	Manager-Accounts
Mr. Dinesh Mourya	Company Secretary & Compliance Officer
Mr. Jitendranath Mahato	Manager-Audit
Mr. Achyut Kr. Saha	Manager-Training
Mr. Debabrata Sur	Manager-HR
Mr. Manas Sarkar	Operation Head
Mr. Molla Md. Imamuddin	Senior Executive-IT

## **Key Performance Ratios**

<b>Financial Ratios</b>	<b>31/Mar/2015</b>	<b>31/Mar/2016</b>
<u>Capital Adequacy Ratio (CAR)</u>		
Capital Adequacy Ratio (%)	34.64%	20.45%
<u>Productivity / Efficiency Ratios</u>		
No. of Active Borrowers Per Staff Member	246	282
No. of Active Borrowers per field executives	482	498
Gross Portfolio o/s per field executive (Rs in thousands)	3891	6673
Average Outstanding Balance Per borrower (In Rs)	8077	13412
Cost Per Active borrower (In Rs)	931	682
<u>Asset / Liability Management</u>		
Yield on Portfolio (%)	25.36%	23.46%
<u>Profitability / Sustainability Ratios</u>		
Yield on Portfolio (%)	25.36%	23.46%
Operational Self Sufficiency (%)	108.43%	109.37%
Operating Expense Ratio (OER)	12.72%	9.98%
Funding Expense Ratio (FER)	11.73%	12.40%
Return on Assets (RoA)	0.89%	0.96%
Return on Equity (RoE)	2.82%	5.14%
Portfolio at Risk (>30 days)	0.85%	0.18%
Write-offs to average portfolio (%)	0.21%	0.24%
<u>Gearing Ratio</u>		
Total Debt to Equity (Times)	2.4	6.1

\*As per audited financial statements figures.

## Highlights of Microfinance Operations

Particulars	31-Mar-14	31-Mar-15	31-Mar-16	31-Mar-17
No. of States	3	3	8	8
No. of Districts	23	24	33	43
No. of Branches	101	106	124	159
No. of Active Members	155,449	143,681	192,581	269,263
No. of Active Borrowers	136,359	136,839	186,591	256,057
No. of Total Employees	679	557	662	839
No. of Field/Credit Officers	364	284	375	495
No. of SHGs	-	-	-	-
No. of JLGS	31,090	28,736	38,516	53,853
No. of Individual Loans	136,359	136,839	186,591	256,057
<b>OWNED PORTFOLIO</b>				
Particulars	31-Mar-14	31-Mar-15	31-Mar-16	31-Mar-17
Total loan disbursements during the year (in crore) <b>(Owned Portfolio)</b>	150.47	155.13	321.27	552.17
Total portfolio outstanding (in crore) <b>(Owned Portfolio)</b>	89.71	110.52	250.25	381.54
<b>Managed/BC PORTFOLIO</b>				
Particulars	31-Mar-14	31-Mar-15	31-Mar-16	31-Mar-17
Total loan disbursements during the year (in crore) <b>(Managed/BC Portfolio)</b>	-	-	-	33.26
Total portfolio outstanding (in crore) <b>(Managed/BC Portfolio)</b>	-	-	-	27.08

## SMERA Comments

As on Mar 31 2017, the company has an outstanding loan portfolio of Rs.408.61 (including owned portfolio of Rs 381.54 crore and BC of Rs 27.08 crore). crore spread over 159 branches of 43 districts with about 256,057 borrowers. VFSPL's Assets under Management (AUM) witnessed a robust growth of ~63.28% in FY2017 over the previous year (~126.42% growth in FY2016).

In FY2017, the company expanded its borrower base by adding 35 new branches.

In FY 2017, the disbursement almost increased by 82.22 per cent compared to the previous year on account of good funding from banks and financial institutions.

As on Mar 31, 2017, the company remains exposed to geographical concentration risk with major portfolio outstanding in the state of West Bengal with ~74.31 per cent and remaining (only 19.06 per cent) across seven states Bihar, Assam, Jharkhand, Odissa, Sikkim, Tripura and Uttarakhand.

## Compliance with RBI's Directives for MFIs

RBI's Direction	VFSPL Status	Compliance
85% of total assets to be in the nature of qualifying assets	More than 85% of assets are qualifying assets as on 31/Mar/2017	Complied
Net worth to be in excess of Rs 5 Crore	Net owned funds are in excess of Rs.5.00 crore as on March 31, 2017.	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*	VFSPL extends loans to households whose income does not exceed Rs 100,000 in rural and Rs 160,000 in urban areas.	Complied
Loans size not to exceed Rs 60,000 in first cycle and Rs 100,000 in subsequent cycles*	VFSPL offers loan in the range of Rs 60,000 to Rs 1,00,000 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)*	Apart from taking declaration from the client, VFSPL conducts credit check on the loans outstanding through credit bureaus	Complied
Tenure of loans not to be less than 24 months for loan amount in excess of Rs 30,000, with prepayment without penalty*	VFSPL offers loans of Rs.15,000 for tenure of 12 months and loans of above Rs.30,000 for 24 months.	Complied
Pricing guidelines are to be followed	The interest rate on loan products offered by VFSPL is in the range of 22.83%-24.58%	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	VFSPL verifies the same though credit check from credit bureaus	Complied

BI's Direction	VFSPL Status	Compliance
Loan pricing to include processing fee (not exceeding 1% of the loan amount)	VFSPL is charging processing fee of 1.0% on the disbursed loan amount	Complied
Collateral free loans	VFSPL does not accept any collateral for extending the credit.	Complied
MFIs shall not collect any Security Deposit / Margin from the borrower.	VFSPL does not collect any security deposit / margin from the borrower.	Complied
No late payment or prepayment penalties	VFSPL 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.	VFSPL shares its client data with all Credit Bureaus.	Complied
Aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs	VFSPL provides loans for income generation activities. The aggregate amount of loans is over 85% as on March 31, 2017.	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.	VFSPL has a CRAR of 20.45% as on March 31, 2016.	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'.	VFSPL has made appropriate loan loss provisions	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.
- 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 has brought more accountability and transparency within the sector.
- On the contrary, recent demonetization drive restrained MFIs disbursement and collection process which has moderated microfinance sector growth in FY2016-17 as compared to the previous year.

### **Long track record of operations and extensive industry experience of promoters**

Village Financial Services Private Limited (VFSPL), a Private Limited Company registered under the Company's Act, 1956 was incorporated in June 1994. VFSPL is a NBFC-MFI carries microfinance and social development activities in the state of West Bengal, Bihar, Assam, Jharkhand, Odissa, Sikkim, Tripura and Uttarakhand.

The day-to-day operations of the company are managed by Mr. Kuldip Maity, Managing Director & CEO. Mr. Kuldip Maity is having an experience of around 2 decades in microfinance and social development segment.

VFSPL's management team and second line of management have relevant experience in the MFI industry and better understanding in banking, microfinance and social development.

As on March 31, 2017, VFSPL has seven members in its board with one nominee director and three independent directors with relevant experience in the banking, finance and microfinance space.

Name	Position
Ajit Kumar Maity	Chairman
Kuldip Maity	Managing Director & CEO
Sankar Datta	Independent Director
A.Ramanathan	Independent Director
Dr. T.K.Mukhopadhyay	Independent Director
Jayshree Ashwin Kumar Vyas	Additional Director
Alpana Bhandari	Nominee Director

### **Diversified Resource Profile**

- VFSPL has developed funding relationships with a large number of lenders i.e. 43 lenders (including PSU Banks/Private Banks/Financial Institutions). These relationships have helped the company in meeting its funding requirements to meet the projected growth.
- The diversification in the resource profile has facilitated VFSPL to build healthy owned loan portfolio of Rs.381.54 crore. Apart from owned portfolio, the company has BC portfolio of Rs.27.08 crore. The total portfolio outstanding stood at Rs.408.62 crore as on March 31, 2017.
- The cost of borrowing stood comfortable at 12.40% for the period ended March 31, 2016.

### **Moderate capitalisation and comfortable liquidity profile**

- VFSPL has a moderate capitalisation marked by high gearing of 8.6 times as on March 31, 2017 as compared to 6.1 times in the previous year. CRAR has declined and it stood at 20.45% in FY2016 as compared to 34.64% in FY2015. The CRAR has further declined in FY2017, however
- VFSPL 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.

### **Sound Asset Quality**

- VFSPL has a sound asset quality marked by on-time repayment rate of 98.46% as on 31<sup>st</sup> March, 2017. The company's on-time repayment has declined from 99.79% in FY2015-16 to 98.46% in FY2016-17.
- The PAR 0-30 days stood at 0.59% as on 31<sup>st</sup> March, 2017 as compared to 0.03% as on 31<sup>st</sup> March, 2016. The PAR >30 days stood at 0.96% as on 31<sup>st</sup> March, 2017 as compared to 0.18% as on 31<sup>st</sup> March, 2016. The PAR % has remained comfortable despite being impacted due to demonetization in the month of November 2016.

Period	FY 2015	FY 2016	31-Mar-17
	Portfolio o/s	Portfolio o/s	Portfolio o/s
	(in crore)	(in crore)	(in crore)
On-time	109.53	249.73	375.65
1-30 days	0.05	0.07	2.24
31-60 days	0.02	0.07	1.36
61-90 days	0.03	0.04	0.89
91-180 days	0.10	0.07	0.99
181-360 days	0.07	0.05	0.16
> 360 days	0.72	0.22	0.25
<b>Total</b>	<b>110.52</b>	<b>250.25</b>	<b>381.54</b>

### **Moderate Geographical Reach**

- VFSPL's operations are spread in eight states i.e. West Bengal, Bihar, Assam, Jharkhand, Odissa, Sikkim, Tripura and Uttarakhand. However ~80% of the loan portfolio is highly concentrated in West Bengal as on Mar 31, 2017.

Name of the State	No. of Branches	No. of Borrowers	Portfolio o/s	PAR %	% of Total Portfolio o/s
			(in crore)	(>30 days)	
West Bengal	104	186,041	303.65	1.14%	79.59%
Bihar	13	27,316	39.95	0.16%	10.47%
Assam	5	7,372	8.61	0.27%	2.26%
Jharkhand	5	3,253	4.60	1.22%	1.21%
Odissa	4	3,606	4.92	0.40%	1.29%
Sikkim	2	809	0.89	0.45%	0.23%
Tripura	15	12,542	18.13	0.10%	4.75%
Uttarakhand	3	702	0.79	1.63%	0.21%
<b>Total</b>	<b>151</b>	<b>241,641</b>	<b>381.53</b>	<b>0.96%</b>	<b>100.00%</b>

- VFSPL is exposed to high level of political uncertainty in the state of West Bengal and Bihar where the company has majority of the microfinance operations. Any political intervention in the existing states would significantly affect the company's asset quality indicators. It would also 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.



### **Improvement in operational performance in FY2017**

- As per provisional financial statements, the company has reported net profit of Rs.5.73 crore on operating income of Rs.77.96 crore in FY2017, as compared to net profit of Rs.2.08 crore on operating income of Rs.44.13 crore in the previous year.
- The operational self-sufficiency (OSS) of the company has improved over the past three years. The OSS stood at 113.7% in FY017 as compared to 109.3% in the previous year.
- As on Mar 31 2017, the company has an outstanding loan portfolio of Rs.408.62 (including owned portfolio of Rs 381.54 crore and BC of Rs 27.08 crore) spread over 159 branches of 43 districts with about 256,441 borrowers. VFSPL's Assets under Management (AUM) witnessed a robust growth of ~63.28% in FY2017 over the previous year (~126.42% growth in FY2016). In FY2017, the company expanded its borrower base by adding 35 new branches. In FY2017, the disbursement almost increased by 82.22 per cent as compared to the previous year on account of better funding from banks and financial institutions.

### **Moderate MIS & IT infrastructure considering the current scale of operations**

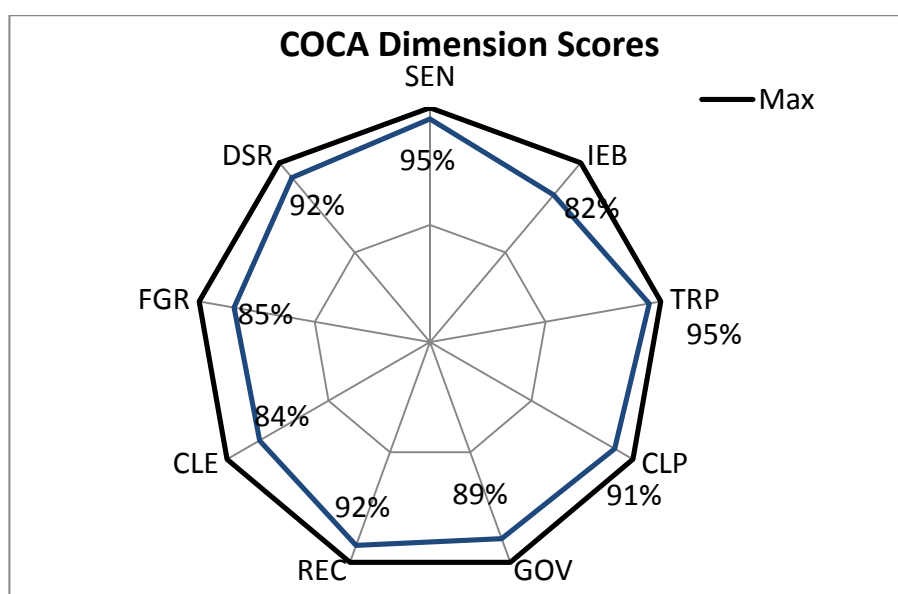
- VFSPL's management information system (MIS) and Information Technology (IT) infrastructure is moderate for its current scale of operations. It has dedicated MIS and IT team at Head Office to ensure smooth flow of operational data between Head Office and branches.
- The current MIS system deployed in VFSPL is 'BIJLI' customized software which seems to be moderate to handle the current and projected growth. The MIS lacks real time tracking of micro finance activities as Head office have to be dependent on branches for extracting information.

### **Inherent risk prevalent in the microfinance sector**

- VFSPL's business risk profile is susceptible to regulatory and legislative risks, along with the inherent risk exist such as unsecured nature of lending, cash handling, vulnerable customer profile and exposure to vagaries of political situation in the area of operation.

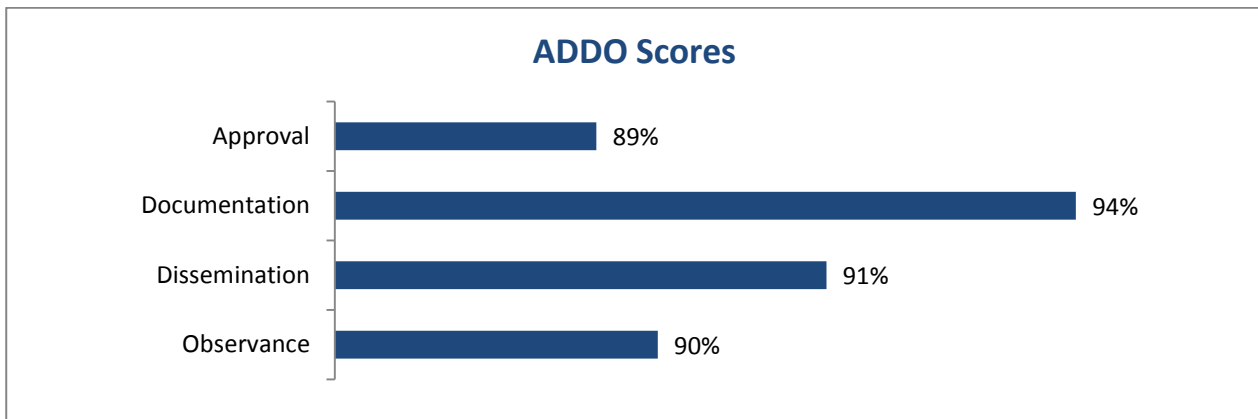
## Section 2: Code of Conduct Assessment

COCA Grading – C2 (Good Performance on Code of Conduct dimensions)



### SCORES ON PARAMETERS

Code of Conduct Parameters	Code	% Performance
Sensitive	SEN	95%
Integrity and Ethical Behavior	IEB	82%
Transparency	TRP	95%
Client Protection	CLP	91%
Governance	GOV	89%
Recruitment	REC	92%
Client Education	CLE	84%
Feedback & Grievance Redressal	FGR	85%
Data Sharing	DSR	92%



VFSPL with an overall grade of “C2”, indicate **Good Performance on Code of Conduct dimensions.**

## Code of Conduct Assessment Summary

The Code of Conduct report for VFSPL 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 VFSPL exhibits good 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 VFSPL's adherence towards ethical operational practices.

## Strengths and weaknesses pertaining to Code of Conduct

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>Board with rich experience from banking and finance domain.</li> <li>Experienced and qualified management who have considerable experience in microfinance industry are instrumental in growth of VFSPL till date.</li> <li>Transparency in loan pricing and policies.</li> <li>Adequate software based MIS to handle current scale of operations.</li> <li>Compulsory training on products terms and conditions to client prior to every loan.</li> <li>Compulsory check on over indebtedness of every borrower.</li> <li>Board approved policies, compliant with the RBI guidelines.</li> <li>Code of Conduct framed as per the VFSPL's mission, vision, values and displayed in all branch offices &amp; HO.</li> <li>Membership with MFIN.</li> <li>Credit policies are well established documented and communicated.</li> <li>Adequate loan appraisal &amp; monitoring systems.</li> <li>Data sharing with all credit bureaus.</li> </ul>	<ul style="list-style-type: none"> <li>VFSPL needs to strengthen its internal audit team, process and system in order to cope with rising portfolio growth across geographies.</li> <li>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.</li> <li>VFSPL need to strengthen its insurance claim settlement process.</li> <li>Awareness among client on the company's Grievance Redressal mechanism was found to be moderate.</li> <li>Awareness among the staff on RBI compliance was found to be moderate.</li> <li>VFSPL do not take written consent from the client for sharing client data for third party disclosure.</li> </ul>

## Significant Observations

HIGHER ORDER INDICATORS	
<b>Integrity and Ethical Behaviour</b>	<ul style="list-style-type: none"> <li>• The MFI does have the policy to place reports on COC compliance before the board at the end of every financial year.</li> <li>• The audit committee of the Board reviews the adequacy of audit staff strength and scope of Internal Audit.</li> <li>• Board has approved a policy of recovering delinquent loans</li> <li>• MFI prepares monthly reports about the number, nature and resolution of grievances and feedback received for management review and same is presented to audit committee set up at board level.</li> <li>• The MFI has a practice that 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, however the same have not been documented in HR manual.</li> <li>• In all the branches visited, the contact number and address of Grievance Redressal officer was properly displayed.</li> <li>• Staff satisfaction related to compensation and incentive is not covered under scope of Internal Audit.</li> <li>• Awareness among client on the company's Grievance Redressal mechanism was found to be moderate.</li> <li>• Fixed Component compensation of staff is not impacted in event of overdues. VFSPL, in its fair practices code provides importance for transparency in pricing and clear communication to the clients.</li> </ul>
<b>Sensitive Indicators</b>	<ul style="list-style-type: none"> <li>• Clients interviewed were moderately aware of the charges and price for all services availed.</li> <li>• Awareness among the staff on RBI guidelines was found to be moderate.</li> <li>• There are no adverse observations in the Auditor's report regarding accounting standards followed by the MFI.</li> <li>• VFSPL shares accurate data with all credit bureaus.</li> <li>• VFSPL 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.</li> <li>• The MFI gets an external CA agency to certify its compliance with RBI's directions for NBFC-MFIs.</li> </ul>

<b>BUILDING BLOCKS</b>	
<b>Transparency</b>	<ul style="list-style-type: none"> <li>• Awareness among the staff on RBI guidelines was found to be moderate.</li> <li>• VFSPL has documented the pricing of its loan products in its operational manual. In the branches visited loan documents had been maintained in local languages.</li> <li>• Circulars with the most recent directions were available in the visited branches.</li> <li>• VFSPL's in its fair practices code provides importance for transparency in pricing and clear communication to the clients.</li> <li>• The loan interest rate and processing fees is mentioned on the loan passbook and loan agreement provided to the client.</li> <li>• Clients interviewed were moderately aware of the charges and price for all services availed.</li> <li>• Audit committee verifies through the audit reports whether all clients have received the necessary loan documents.</li> <li>• Displays the details of the loan products including their interest rates and client grievance redressal system on its website.</li> <li>• VFSPL issues loan agreement to the clients with all terms and conditions of the loan including annualized interest rates. However all the details are captured in the loan agreement provided to the client.</li> <li>• Code of conduct compliance report of VFSPL &amp; previous financial year annual financial statement and report is available in the public domain.</li> </ul>
<b>Client Protection</b>	<ul style="list-style-type: none"> <li>• VFSPL has a board-approved policy regarding client data security.</li> <li>• Employees are trained on aspects of appropriate behavior with the clients.</li> <li>• VFSPL has documented policy on client data security which forms part of its fair practice code.</li> <li>• VFSPL do not take written consent from the client for third party disclosures. VFSPL does not offer Non-credit products to its clients as a pre-condition for getting the loan.</li> <li>• VFSPL has framed a Fair Practice Code and has also adopted the RBI fair practices code.</li> <li>• Employees are given training on aspects of appropriate behavior with the clients. However SMERA believes there is a scope for further improvement.</li> <li>• Staffs were found to be aware of the need to have professional conduct with the clients.</li> <li>• Internal Audit checklist is comprehensive but can be strengthened further by incorporating more aspects like awareness regarding Reserve Bank of India (RBI) compliance among clients/members and staff, Privacy of client information.</li> </ul>
<b>Governance</b>	<ul style="list-style-type: none"> <li>• VFSPL maintain high standards of governance by inducting persons with good and sound reputation as members of Board of Directors/Governing body.</li> <li>• VFSPL have 1/3rd of independent persons in its Governing Board, and the Board is actively involved in all policy</li> </ul>

	<p>formulations and other important decisions.</p> <ul style="list-style-type: none"> <li>• VFSPL disclose its CEO compensation in its audited reports (Ref. Audit Report 2016).</li> <li>• An audit committee of the Board with an independent director as chairperson.</li> <li>• The MFI has got its accounts audited in a timely manner after the end of the most relevant financial year.</li> <li>• No adverse observations in the Auditor's report regarding accounting standards followed by the MFI.</li> <li>• Action taken report based on the last audit report is available in the branches visited.</li> <li>• Staff satisfaction related to compensation and incentive is not covered under scope of Internal Audit.</li> </ul>
<p style="text-align: center;"><b>Recruitment</b></p>	<ul style="list-style-type: none"> <li>• VFSPL's board has reviewed its recruitment policies at least once annually.</li> <li>• VFSPL do not have a defined and documented process for responding to reference check requests.</li> <li>• As informed by the management, VFSPL has honored the notice period for all employees who have left the organization. However no supporting document is provided to SMERA.</li> <li>• As informed by the management, VFSPL obtain NOC or relieving letter from the previous employee, in case employees are recruited from other MFIs. However no supporting document is provided to SMERA.</li> <li>• The MFI has a practice that 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, however the same have not been documented in HR manual.</li> </ul>
<p style="text-align: center;"><b>Client Education</b></p>	<ul style="list-style-type: none"> <li>• VFSPL in its fair practices code provides importance for raising clients' awareness of the options, choices and responsibilities regarding financial products and services</li> <li>• VFSPL does not charge clients for the trainings provided to clients, itself or through a related party.</li> <li>• Awareness among client on annualized Interest rate &amp; Insurance claim settlement process was found to be moderate.</li> <li>• VFSPL need to strengthen its insurance claim settlement process.</li> </ul>
<p style="text-align: center;"><b>Feedback and Grievance Redressal</b></p>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• MFI prepares monthly reports about the number, nature and resolution of grievances and feedback received for management review and same is presented to audit committee set up at board level.</li> <li>• VFSPL do not provide acknowledgement to its grievance clients.</li> <li>• VFSPL do not take declaration letter from the client that the complaints lodged have been satisfactorily resolved by the Redressal officer.</li> <li>• Clients were found to be aware of the helpline number</li> </ul>



	<ul style="list-style-type: none"> <li>• Feedback mechanisms are tracked and monitored. However, there is further scope of improvement.</li> <li>• In all the branches visited, the contact number and address of customer grievance officer was displayed.</li> <li>• Awareness among client on Grievance Redressal mechanism was found to be moderate.</li> <li>• Dedicated team at HO level to documents and follow up on the client complaints.</li> </ul>
<p style="text-align: center;"><b>Data Sharing</b></p>	<ul style="list-style-type: none"> <li>• Operational &amp; Financial data for FY 2016 is available on the website of VFSPL.</li> <li>• MFI has a well-defined process for sharing data with the credit bureaus.</li> <li>• MFI has provided data called for by MFIN and RBI as and when required as per compliance.</li> <li>• VFSPL shares accurate data with all credit bureaus.</li> <li>• VFSPL performs compulsory credit bureau checks for all its clients.</li> </ul>

## 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.

<b>Highest Order</b>	
Sensitive Indicators	
<b>Higher Order</b>	
Integrity & Ethical Behaviour	
<b>Building Blocks</b>	
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
<b>Total</b>	<b>250</b>

## 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 has covered following branches of the MFI. The details of the branches are provided below.

Sr. No.	Branch	State	No of clients interviewed
1	Bandel	West Bengal	25
2	Srirampore	West Bengal	19
3	Budge Budge	West Bengal	21
4	Maheshtala	West Bengal	22
5	Domjur	West Bengal	24
6	Ranihati	West Bengal	18
7	Katihar	Bihar	22
8	Kishanganj	Bihar	21
<b>Total</b>			<b>172</b>

## Financial Statements

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

Financial Year	2014	2015	2016
Months	12	12	12
	<b>Audited</b>		
<b>Income</b>			
<b>Financial revenue from operations</b>	<b>2,61,144</b>	<b>2,65,406</b>	<b>4,41,386</b>
Interest and fee revenue from loans	2,52,169	2,53,500	4,22,692
Other Operating Revenue	8,975	11,906	18,694
<b>Financial expenses from operations</b>	<b>1,14,222</b>	<b>1,17,422</b>	<b>2,23,751</b>
<u>Financial Expense on Funding Liabilities</u>			
Interest and Fee Expense on Borrowings	1,14,222	1,17,422	2,23,751
<b>Gross financial margin</b>	<b>1,46,922</b>	<b>1,47,984</b>	<b>2,17,635</b>
<b>Impairment Losses on Loans</b>	<b>0</b>	<b>0</b>	<b>17,704</b>
Provision for Loan Loss / Bad Debts Written off			17,704
<b>Net financial margin</b>	<b>1,46,922</b>	<b>1,47,984</b>	<b>1,99,931</b>
<b>Operating expenses</b>	<b>1,33,842</b>	<b>1,27,354</b>	<b>1,62,363</b>
Personnel Expense	95,852	83,096	94,189
<u>Administrative Expense</u>			
Depreciation and Amortization Expense	1,748	1,737	1,724
Other Administrative Expense	36,242	42,521	66,450
<b>Net operating income</b>	<b>13,080</b>	<b>20,630</b>	<b>37,568</b>
<b>Net Non-Operating Income/(Expense)</b>	<b>42</b>	<b>96</b>	<b>758</b>
Non-Operating Revenue	42	96	758
Non-Operating Expense			
<b>Net income before taxes and donations</b>	<b>13,122</b>	<b>20,726</b>	<b>38,326</b>
Current Tax	3,783	6,628	17,208



Deffered Tax charge/(credit)	(81)	(51)	315
Tax for Earlier Year		3,199	
<b>Income Tax</b>	<b>3,702</b>	<b>9,776</b>	<b>17,523</b>
<b>Net income after Tax and before Donations</b>	<b>9,420</b>	<b>10,950</b>	<b>20,803</b>

*Note: Above financials are taken audited statements.*

**Balance Sheet (Rs in Thousands)**

As on Date	31/03/14	31/03/15	31/03/16
	<b>Audited</b>		
<b>SOURCES OF FUNDS</b>			
Owners Capital	270,650	271,346	361,795
Reserves & Surplus			
Statutory Reserve	26,565	28,754	32,914
Reserve Fund/General Reserve	5,752	6,300	1,040
Share Premium	4,610	4,914	-
Surplus	74,908	83,120	19,485
<b>TOTAL EQUITY(A)</b>	<b>382,485</b>	<b>394,434</b>	<b>415,235</b>
<b>Liabilities</b>			
<b>Short-term liabilities</b>			
Short-term borrowings			
Commercial Loans from banks/FI for microfinance	485,864	649,795	1,353,636
Interest payable on funding liabilities	3,750	2,301	8,349
Account payable & Other short-term liabilities	11,984	9,602	20,835
<b>Total Short Term Liabilities(B)</b>	<b>501,598</b>	<b>661,698</b>	<b>1,382,820</b>
<b>Long-term liabilities</b>			
Long-term borrowings			
Commercial Loans from banks/FI for microfinance	213,055	289,905	1,035,566
Concessional Loan/Subordinated Debt			100,000
<b>Total Long Term Liabilities(C)</b>	<b>213,055</b>	<b>289,905</b>	<b>1,135,566</b>
<b>TOTAL OTHER LIABILITIES(D)</b>	<b>714,653</b>	<b>951,603</b>	<b>2,518,386</b>
<b>PROVISION FOR LOAN LOSS(E)</b>	<b>13,588</b>	<b>11,459</b>	<b>24,221</b>
Contigent Provisions against Standard Assets (Long Term Provisions)	116	165	804
Other Provisions (F)	947	1,356	10,724
<b>Total Provision</b>	<b>14,651</b>	<b>12,980</b>	<b>35,749</b>
<b>TOTAL LIABILITIES (A+B+C+D+E +F)</b>	<b>11,11,789</b>	<b>13,59,017</b>	<b>29,69,369</b>

<b>APPLICATION OF FUNDS</b>			
<b>Fixed Assets</b>			
Gross Block	16,020	17,014	20,054
Less: Accumulated Depreciation and Amortization	9,897	11,111	12,778
<b>Net Block</b>	<b>6,123</b>	<b>5,903</b>	<b>7,276</b>
<b>Investment in Equity Instruments</b>	500	500	965
Cash and Bank Balances	82,558	42,820	1,17,042
Security Deposits			
Investment in FD	1,05,844	1,74,462	3,09,202
<b>Loan Portfolio</b>			
Gross Loan Portfolio	8,97,152	11,05,239	25,02,503
Less: Provisions/Less: Managed Portfolio (IDBI BC)			
<b>Net Loan Portfolio</b>	<b>8,97,152</b>	<b>11,05,239</b>	<b>25,02,503</b>
Advances Given For Programmes			
Accounts Receivable and Other Assets	18,849	29,472	32,100
Deferred Tax Asset	474	525	210
Intangible Assets	289	96	71
<b>TOTAL ASSETS</b>	<b>11,11,789</b>	<b>13,59,017</b>	<b>29,69,369</b>

## 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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