Nepal-Denmark Development Cooperation
UNNATI
INCLUSIVE GROWTH PROGRAMME IN NEPAL

TOOL FOR ASSESSMENT OF COOPERATIVES FOR WHOLESALE LENDING

UNNATI-Access to Finance Project (A2F)

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November, 2017

FOREWORD

UNNATI–Access to Finance (A2F) is a sub-component of UNNATI project funded by the Government of Denmark and implemented by Nepal Rastra Bank with technical support from UNCDF. The purpose of the UNNATI-A2F project is to support financial service providers to more effectively serve the agricultural value chain actors providing appropriate financial products and services. The project is already partnering with a number of commercial banks and micro-finance institutions in this regard.

Till date, the commercial banks have not been fully able to provide financial services to the rural population residing specially in the remote areas as the cost of operation is high there. However, NRB's deprived sector lending provision has encouraged the BFIs to disburse a specified portion of their portfolio to the deprived sector directly by themselves or provide wholesale lending to MFIs and cooperatives. In Nepalese context, micro-finance institutions and cooperatives are playing an instrumental role in expanding the frontiers of financial access and reach-out to the rural areas as they are working across the country. There are approximately 34 thousand cooperatives spread all over the country, out of which, some 14 thousand are savings and credit cooperatives.

Despite their huge numbers, they have not been sufficiently able to lend their members because of lack of adequate fund and also due to their limited capacity. The commercial banks, on the other hand, have not been able to maintain the high comfort level in lending the cooperatives due to the absence of proper system to rate their efficiency and credibility. Since banks and financial institutions also have to run their businesses with certain rules and regulations, and, at the same time, have to be pretty cautious about various risks involved while lending and doing financial activities, a proper assessment of cooperatives has to be done before deciding to partner with them. Therefore a need for standardized cooperatives assessment and rating tool had long been realized as a yardstick to measure various important indicators of the cooperatives.

In this context, UNNATI–A2F Project planned to support banking industry by developing a "cooperative assessment and rating tool" so that it could be used by the BFIs to assess and rate the cooperatives before lending them a wholesale credit. The tool not only helps the banks to assess the cooperatives, but it assists the cooperatives as well to maintain desired fitness at par with the standard norms fixed by the system.

For this, a team consisting of expert consultants from an international consulting firm Micro-Credit Ratings International (M-CRIL), India with the help of experts from Nepal worked-out for developing an assessment tool for wholesale lending to the cooperatives by the banks and financial institutions in Nepal. After a series of ground work such as review of existing literature on the subject, consultative meetings with stakeholders, designing of rating tools and their pilot test, and consultation through workshop with regulators, bankers, wholesale lenders and their associations, we now have finally come up with "Tools for Assessment of Cooperatives for Wholesale Lending by BFIs in Nepal". In this concern, a team was also formed by Nepal Bankers' Association (NBA) representing different banks to discuss this matter which also provided their valuable inputs for this study.

As mentioned above, the sequence of activities that were undertaken to develop the rating tool included:

- Desk review of relevant literature on existing policies, practices and regulatory provisions regarding BFI's current lending processes, terms and conditions, operational procedures and risk assessment practices for wholesale lending to cooperatives in Nepal;
- Inception meetings with relevant stakeholders of wholesale lending to cooperatives in Nepal. Consultation with Nepal Rastra Bank, Nepal Bankers' Association (NBA), Nepal Microfinance Bankers' Association (NMBA), and Nepal Federation of Savings and Credit Cooperative Unions Ltd. (NEFSCUN), Banks and Financial Institutions (BFIs) and Cooperatives;
- Designing of rating tool for wholesale lending to cooperatives after discussion with the management and the staff on the process of wholesale lending, governance and management of cooperatives, key risk and risk management practices, lending processes, products and measures necessary to maintain good portfolio quality and better tool for cooperative assessment/rating and due diligence. The same was also reviewed by NBA Task Force and based on their comments and suggestions, it was revised;

- Pilot testing of the tool with 4 selected cooperatives-two in western and 2 in the eastern region;
- Consultation workshop with regulators, bankers, other wholesale lenders, and associations was held. The tested drat tool along with the guidelines was presented to all the stakeholders. Feedback from the participants was obtained to ensure that the tool and guidelines adequately address the needs of the BFIs.

At the final stage, a one-and-half day training cum orientation session was organized in Kathmandu to brief the representatives of different BFIs and other stakeholders on the study report. The session, in which, I myself attended along with the President of Nepal Bankers' Association was quite interactive, proved to be extremely fruitful. We also received positive feedback from the senior executives and their willingness to customize and adopt this tool in their respective institutions. This is due to this reason that, we felt it quite imperative to publish this document in a manual version and distribute it to all the BFIs as well. I am hopeful that the BFIs, with the help of this Manual, will be able to assess the health and fitness of the cooperatives in one hand and guide/teach the partner cooperatives in other hand if they require any assistance. The assessment exercise may have to be repeated periodically because there are chances that the once perfect institution may either lag behind or do even better in another year or two.

I think this study itself is the first of its kind in Nepal. In this context, I hope that the study will be a very useful reference material for the entire banking industry while assessing the cooperatives. So, the tool may be very useful for both banking and cooperative sectors for the assessment of cooperatives.

Finally, I would like to thank all the concerns who involved directly or indirectly in the study process. Above all, I would like to express my sincere thanks to the team of M-Cril namely, Mr. Gunjan Grover, Team Leader and Mr. Sanjay Sinha, Project Adviser including the local consultants Ms. Ambika Shrestha and Mr. Bishnu Prasad Pathak for their exemplary team work to complete this study in a short period of specified time. Besides, I would like to thank Mr. Anil K. Shah, the President of NBA and all other representatives from different BFIs who directly involved in the study process and contributed significantly for this outcome. I would also like to appreciate the hard work of all the staffs of UNNATI-A2F project, especially Value Chain Finance Expert Ms. Meekha Tuladhar for her active involvement as a focal point in the study process. Moreover, I would like to appreciate the coordinating role of Mr. Ram Hari Dahal, Deputy Director, Nepal Rastra Bank and National Project Manager of the project in this concern.

Last but not the least, I express my sincere gratitude to UNCDF and its officials, especially Ms. Suela Krifsa and Ms. Monisha Shrestha, for their support and involvement in this process and Government of Denmark for their support in this course.

Thank you.

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List of abbreviations:

A2F	Access to Finance
ALM	Asset-Liability Mismatch
APR	Annual Percentage Rate
BFI	Banks and Financial Institutes
BISCOL	Bindabasini Savings and Credit Cooperative
CEO	Chief Executive Officer
CPP	Client Protection Principles
CRAR	Capital to Risk weighted Asset Ratio
HR	Human Resources
IA	Internal Audit
ICRAR	Institutional Capital (fixed and long term capital) to Risk weighted Assets Ratio
IRR	Internal Rate of Return
M-Cril	Micro-Credit Ratings International Limited
MFI	Micro-finance institutions
MIS	Management Information System
NBA	Nepal Bankers Association
NEFSCUN	Nepal Federation of Savings and Credit Cooperative Unions Ltd.
NMBA	Nepal Microfinance Bankers' Association
NPA	Non-Performing Assets
NPL	Non-Performing Loans
NPR	Nepalese Rupees
OSS	Operational Self Sufficiency
PAR	Portfolio at Risk
RoA	Return on Assets
SACCOS	Savings and Credit Cooperative Societies
UNCDF	United Nations Capital Development Fund

1 Tool Development Methodology

A team constituted by Micro-Credit Ratings International was assigned the task of developing an assessment/rating tool for wholesale lending to the cooperatives by the banks and financial institutions (BFIs) in Nepal. The scope of the work included a tool for cooperatives which are engaged in savings and credit activities for their members and include both financial as well as producer cooperatives, though a greater emphasis is on financial cooperatives.

The **sequence of activities** that were undertaken to develop the rating are set out in this work flow chart:

Desk review of relevant literature on policies, practices and regulatory provisions regarding BFI's current lending processes, terms and conditions, operational procedures and risk assessment practices for wholesale lending to cooperatives in Nepal

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Inception meetings with relevant stakeholders of wholesale lending to cooperatives in Nepal. Consultations with

- UNCDF and Nepal Rastra Bank
- Nepal Bankers Association (NBA) and NMBA and NEFSCUN
- Meetings with BFIs – 4 commercial banks and 4 wholesale lenders to cooperatives
- Cooperatives – 2

Coming to a common understanding about the project objectives, discussions were held on the status, constraints, regulations, policies and processes in wholesale lending to cooperatives, identification of processes and mechanisms suitable for the purpose.

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Designing of rating tool for wholesale lending to cooperatives after discussion with the management and staff on the process of wholesale lending, governance and management of cooperatives, key risk and risk management practices, lending processes, products and measures necessary to maintain good portfolio quality and better tool for cooperative assessment/rating and due diligence.

Review by NBA Task Force and revision of the tool based on comments of the task force and other stakeholders.

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Pilot testing of the tool with 4 selected cooperatives – 2 in western and 2 in the eastern region; visited cooperatives were selected in consultation with NBA, wholesale lenders and UNNATI team**.**

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Consultation workshop with regulators, bankers, other wholesale lenders and associations

The tested draft tool along with the draft implementation guidelines was presented to all the stakeholders. Feedback from the participants was obtained to ensure that the tool and guidelines adequately address the needs of the BFIs.

1.1. Inception meetings with various stakeholders

The assessment was initiated by conduction of various inception meeting with various stakeholders. Firstly, a serious of meeting and consultation was carried out with the CEOs and senior executives of Industry Associations namely; Nepal Bankers' Association (NBA), Nepal Microfinance Development Bankers' Association, Nepal Federation of Savings and Credit Cooperative Unions Limited (NEFSCUN), and the member based national apex organization of Savings and Credit Cooperative Societies (SACCOS).

Apart from a meeting with the CEO of the Nepal Bankers' Association, the team met the CEOs of four commercial banks. While most of the CEOs and heads of deprived sector lending were enthusiastic about the need to develop a more robust rating tool to assess the cooperatives, a few also felt that regulations lack clarity in terms of lending to cooperatives to meet their deprived sector lending targets. While most banks believed that lending to cooperatives can be treated as wholesale lending and meet the deprived sector lending targets, some were skeptical since cooperatives are unregulated and they are not able to verify the ultimate user of the funds. While two of the consulted banks see lending to cooperatives as a means to reach the untapped microfinance market by avoiding the already overcrowded MFI lending segment, the other two banks believe that they do not have the resources and branch network to lend to this segment which requires more stringent due-diligence and regular monitoring.

Likewise, meeting and consultations were also conducted with three Wholesale lenders to cooperatives, two cooperatives and Department of Cooperatives which is the regulator for cooperatives. The Department of Cooperatives is the regulator for cooperatives in Nepal requiring societies to report to it annually. During the meeting, the need to provide grants to the cooperatives for developing their capacities rather than providing loans was emphasized. However, it was accepted that the idea of developing an effective mechanism which could assist in the disbursement of wholesale loans to cooperatives.

Apart from this, consultation was also carried out with a Government Fund lending to cooperatives – Youth and Small Entrepreneur Self-Employment Fund, Ministry of Finance. The fund was created by the Finance ministry, Government of Nepal. While creating it, the Government made it mandatory for all the BFIs to allocate one third of their deprived sector loans to this scheme at an annual rate of interest of 3 percent. This contribution was a one-time contribution by the banks.

The fund is managed by a team of 65 and the governing board is chaired by the Finance Minister. The fund charges 5 percent per annum interest from the cooperatives and mandates that individual members lent from this fund should not be charged more than 10 percent interest per annum by the cooperatives.

The maximum loan limit for first time borrowers is NPR 5 million while those who have already borrowed at least once from the fund, can avail up to NPR 10 million. It is mandatory for the Board of Directors, members of account supervisory committee and loan sub-committee to give personal guarantees and they should also submit details of their personal properties to the fund. There is a provision that if loan is paid on-time, 60 percent of the paid interest is refunded to the cooperatives.

However, due to a small team size and a large number of applicants, the fund finds it extremely difficult to complete the due diligence process and there is considerable delay in lending to the cooperative. Considering this, it has designed a fast track lending plan in which it will refinance the loans given to the cooperatives by the banks.

1.2. Summary of observations from pilot testing of the tool at four cooperatives

After the development of tool and the implementation manual, the tool was pilot tested at four cooperatives – two each in Eastern and Western regions. The four selected cooperatives were:

	Large size	Small size
Western Region	Kisan Multipurpose Cooperative Ltd.	Gangamala Swabalamban Bikas Savings and Credit Cooperative Ltd
Eastern Region	Sahara Nepal Savings and Credit Cooperative	Safal Multipurpose Cooperative Ltd.

The key observations from the pilot test of the four broad categories of the tool is presented as follows:

A. Governance and strategy

Differences among cooperatives were observed on parameters like composition of the board, representation of members in the election of board members, regularity of meetings and quality of discussions. Remarkably some of the larger cooperatives with stronger management were observed to be finding it difficult to complete the regulatory requirements of member attendance and in making sure that members are aware of their rights and that they attend meetings. Bigger cooperatives were observed to have de-facto moved on to two categories of members – a large number of micro borrowers who have invested a minimum amount of share capital and others who are large borrowers and have invested a larger amount of share capital. Micro borrowers are often not aware of meetings and participation is weak. This is a serious regulatory and governance risk.

On the indicator of 'Growth strategy', it was observed that there is a temptation to move to non-core sectors and bigger loans without adequate institutional capacity. The concentration of loans with a few individuals and in some high-risk sectors such as real estate is also a risk for cooperatives. Cooperatives could be taking higher risk than their financial and risk management capacities by giving long term deposits, larger long duration loans and investments in other businesses. This may raise compliance issues as well as equity investments in companies is not permitted by cooperative legislation. This has also been adequately covered by the tool.

As was highlighted by a number of stakeholders, concerns about conflict of interest especially in cases where loans were given to Directors, their families and on their personal recommendations without any clearly laid out policy poses a conflict of interest and is detrimental to its sustainability. This is well covered by the tool and adequate weightage has been given.

A high dependence upon an individual or a few individuals and a weak second line of management is a concern observed in almost all cooperatives. This is a risk and is covered by the current tool. Related to this and to 'Conflict of Interest' is the issue of transition from person-driven to policy-driven decision making.

On the changes to be made to the tool for the Governance and Strategy section; it was observed that a few indicators on the quality of the Board are highly correlated and can be merged. This will simplify the tool and avoid duplication and was also a suggestion from one of the BFIs.

B. Quality of operations

It was noted that an adverse external environment posed a serious concern in some of the regions. While some of the smaller cooperatives operating in relatively limited geographies were less affected, the larger ones see their operations disrupted by frequent bandhs/strikes and political tensions.

Another major concern observed in most places has been a rise in multiple lending and the risk of over indebtedness and most cooperatives appear less prepared to manage this. They lack the tools to ascertain and analyse the cashflows of their members.

As mentioned earlier in the governance section, member awareness of products and of membership

rights is a differentiator and bigger cooperatives find it difficult to communicate with all their members. This affects the quality of operations too.
On the appropriateness of products – some of the cooperatives have very attractive long term deposit products, social security products like pension and in house insurance products too. These offer high and fixed rates of return for a very long period. Very clearly, the cooperatives providing these products do not have the actuarial and liquidity and interest rate risk management skills required for this purpose and the products are unsustainable. This is a risk for both the cooperative as well as the members who deposit their money with it. The tool has indicators in 'Quality of Operations", "Management and Systems" and "Financial Performance" as well to capture these risks.

On client protection – it was observed that a few cooperatives had a high proportion of compulsory savings against loans which raised the cost of borrowing for the members and are a form of hidden charges. There are both regulatory and operational risks entailed here. Client Protection Principles (CPP) indicators included in the tool under 'Quality of Operations' are able to capture these issues.

Tracking of overdues was observed to be weak especially in smaller cooperatives with limited full-time staff. It was particularly weak in cooperatives where there are concerns about conflict of interest, that is, if the Directors were themselves not repaying on time. Overall, as a link to quality of Governance – a lack of clarity in processes/division of responsibilities also results in lax tracking of overdues.

C. Management and systems

The pilot revealed that while some of the bigger cooperatives have human resources and systems comparable to those of well managed microfinance development banks, the smaller cooperatives rely on part time staff and have inadequate HR. This results in weak processes particularly affecting collections and results in a rise in delinquencies. The tool covers this aspect well.

Accounting still needs focus even among larger cooperatives. Cooperatives offering long term social security, deposit and insurance products were observed to be providing only a portion of the cost which was on a simple interest basis being added to a fund, rather than the cost of interest based on an Internal Rate of Return (IRR) calculation – which is the method of recognizing cost in order to ensure sustainability.

Smaller cooperatives still need training to improve their MIS and accurately report their Portfolio at Risk. Some of them still only report overdues rather than the full principal outstanding in a delinquent loan as the amount at risk. This results in significant under-reporting.

Internal audit and control need to be preceded by clarity on policies and processes. Once these are properly laid out, control and audit can be put in place. This is also linked to the 'conflict of interest' issue and 'clarity in assigning roles and responsibilities' which are part of the 'Governance' section.

Liquidity Management/Asset-Liability Management need particularly high attention as cooperatives are deposit taking institutions and there is a wide range of deposit products similar to those of banks – cooperatives apparently take a high risk on both liquidity and interest rates, as has been explained in an earlier section.

Credit risk, especially for the large-size loans, is also a concern. As explained in the 'Governance and Strategy' section, there is a trend of increasing the share of larger loans. Cooperatives, even the larger ones, lack the credit appraisal and credit risk management systems to handle such loans; they already have a significantly higher PAR in large-size loans.

The tool adequately covers the observed risk in Management and Systems.

D. Financial performance

The tool adequately captures the important financial components of liquidity management, profitability/ sustainability, capital and loan portfolio quality.

However, unlike other institutions, part of the capital in cooperatives is withdrawable as the regulations allow members to ask for a refund of their paid in capital with some restrictions in the bye laws. The reserves and accumulated profits are more stable than a high amount of capital put in by large borrowers who are usually asked to contribute 10 percent of the loan amount as capital. This high amount is often withdrawn on repayment of the loan and is in the nature of a security deposit. Another indicator on "institutional capital" which represents the non-withdrawable capital has, therefore, been added to the tool.

1.3. Feedback from the BFIs at the consultative workshop

Just after the pilot test of the draft tool, a consultative workshop was organized jointly by the Nepal Bankers' Association and UNNATI A2F project. The aim was to present the tool and the results of the pilot testing and to seek feedback from the BFIs.

The presentation of the tool and learnings from the pilot test were followed by a consultation among the bankers in groups formed for the purpose and the presentation by each group about clarifications needed as well as providing feedback on the tool.

The following was the key feedback from the BFIs

1. The quality of human resources in cooperatives needs attention and the BFIs agreed that the tool should give importance to it.

2. We need to make sure that the information required for the tool is available from the cooperative and the parameters in the final tool should take this into account. It was agreed and lessons from the pilot test would be incorporated in the finalization of the tool.

3. It is important to gauge the satisfaction level of cooperative members and this can be a good indicator in the tool. While agreeing to the suggestion, the study team emphasized that a considerable amount of time involved in the rating goes in field visits and the Client Protection Principles (CPP) parameters are essentially scored on policies, practices in the field and on feedback from the clients so, in a sense, this aspect is covered by the tool.

   Other BFIs also emphasized the measurement of the social impact of cooperatives. A high social impact would mean better involvement of the members and indicate strong governance.

   A different set of weights should be given to new cooperatives. For instance, a new cooperative may not have adequate systems to start with and may be low on profitability and capital adequacy. The point was well appreciated by the study team, however, different tools for different cooperatives will miss the objective of standardization. Micro-Credit Ratings International Limited

4. M-CRIL suggested that while the same tool be used for all cooperatives, BFIs could internally determine a lower threshold for new cooperatives. Thus, if they required a minimum grade of B+ for lending to mature cooperatives, they can keep a requirement of 'B' for new cooperatives. In this way, the objective of working with new cooperatives will be met while the cooperatives will have a clear roadmap and benchmarks to achieve as they grow.

5. Compliance with regulations was emphasized by the BFIs and a deal breaker parameter on legal compliance was agreed. If after the violation, regulatory compliance is achieved, the cooperative could be assessed again and the deal breaker would no longer apply.

6. The BFIs would like the cooperatives to be aware of their (BFI) expectations in entering into long term collaborations to build the cooperatives' capacities along with lending. This suggestion was appreciated and it was suggested that the tool and the user manual be widely circulated with the cooperatives through different channels such as NEFSCUN.
7. A group of BFIs emphasized the importance of strong portfolio quality, high capital, strong growth and profitability as the key factors to make lending decisions. While agreeing to this, the

study team emphasized that other parameters that are part of the Governance and Strategy as well as Management Systems are also important to ensure a sustainable financial performance.

8. The possibility of attaching a weight to licensed cooperatives relative to non-licensed ones was discussed. The NRB officials agreed that since the regulator is not supervising the cooperatives this should not be given any specific weightage.

9. M-CRIL stated that recognition of awards and the results of other ratings are useful for the substantiation of ongoing ratings/assessments, giving weightage to these in the BFI's own rating will amount to duplication as the other ratings would have considered similar parameters.

10. It was suggested that cooperatives in urban locations, especially in metro cities have higher growth and tend to do better than those in rural areas. M-CRIL pointed out that the pilot test suggests that while such cooperatives are growing fast and profitable, the institutions face a number of risks including credit and liquidity as has been described the lessons from the pilot test.

11. On the issue of portfolio diversification, while it is good to diversify an institution's portfolio, lending to non-core sectors beyond the competence of management is a risk that has been covered by the tool.

12. On the use of technology, it depends on the context; a small-sized cooperative using a simple Excel based portfolio tracking system may be able to manage well. In the tool, there is an indicator for the quality of the MIS and the user manual explains the point. A cooperative using technology for providing improved services to its members such as by the use of digital financial technologies in the future, will get a higher score on the parameter 'inclusiveness and innovation' and may also score well on efficiency.

13. Two key points were made on collateral and the Directors' personal guarantee
    i. The tool does not provide any weightage to collateral and guarantee but these may still complement the tool or become a minimum requirement for individual BFIs.
    ii. These may give a sense of safety to the BFIs but the requirement creates a conflict of interest as 'key persons' in the cooperative who give a personal guarantee or pledge personal property as collateral will get the sense of a right to obtain additional benefits/authority from the cooperative.

14. Benchmarks and use of statistics: The study team clarified that the base of the tool is the microfinance rating tool suitably modified based on desk research, the inception meetings and pilot test as part of this project. As the data from the rating of cooperatives builds up, benchmarks can be developed and statistical methods used to improve the tool for future use by BFIs.

15. Reducing the number of parameters to make the tool easier to use at this stage may not be appropriate at this stage – a more extensive tool ensures that all aspects are covered and can be reduced as parameters a merged after the pilot test and the consultative workshop without missing out on any important aspect.

16. The BFIs agreed that on-site inspections are an important component of the rating/assessment of cooperatives.

17. BFIs also suggested a need for the establishment of a credit rating agency for cooperatives.

18. The BFIs feel a need for a cooperatives having representative boards and expressed a strong concern about Asset-Liability Management (ALM) issues. M-CRIL clarified that while it would have liked to place ALM related parameters in the tool, cooperatives would not be able to provide information on it. As an alternative, a much simpler indicator "Current Ratio" has been added.

19. BFIs agreed on the issue related to the withdrawal of capital by members and agreed on the need for another indicator to measure the adequacy of committed institutional capital of cooperatives.

2 Assessment tool

The rationale behind the creation of this assessment tool is to enable BFIs in Nepal objectively to assess cooperatives for wholesale lending, with adequate emphasis on the quality of governance, operational parameters, management capacity and financial performance, based on the relevant benchmarks for each category.

The tool has been developed with the intention to have a universal acceptability in Nepal without limiting it to a set of BFIs, a few value chains or to a region. The tool has been developed to meet the basic requirements of banks and wholesale lending organizations which can be customized as per their requirements.

This assessment tool has been developed acknowledging the characteristics of well- governed cooperatives and risks to cooperatives in general in Nepal's context. The tool provides weights that should be accorded to various aspects of their functioning

The tool is designed to cover four broad categories of the performance indicators of cooperatives which are:

A. Governance and Strategy
B. Quality of Operations
C. Management, Internal Control and Client Protection/responsible practices
D. Financial Performance of the cooperative

The relative weights were assigned to the above mentioned four broad categories based on the industry risk perceptions gauged in consultation with various BFIs, regulators and cooperatives. The overall allocation of weights to the four categories is shown in **Table 1.1**

Table 1.1: Distribution of weights between categories of performance indicator

Parameter	Weightage
A. Governance and Strategy	30 %
B. Quality of Operations	20 %
C. Management, Internal Control and Client protection	20 %
D. Financial Performance	30 %
Total	**100 %**

The tool consists of ***broad categories***, ***indicators*** *(to assess broad parameters*) and ***scales*** denoting marks for measuring performance. The ***weights*** assigned to the sub-parameters vary on the basis of their importance and relevance for the different categories of organization. The rating ***scale*** for each indicator is between 0-10. This ensures uniformity and comparability in scoring.

An indicator is one measurable aspect of the quality of the rated entity and each indicator reflects a criterion that has been selected for rating the entity.

For example, to assess the **Human Resources (HR)** of a cooperative, the indicators selected in the tool are as follows

i. Quality of HR systems and processes
ii. Quality of field staff
iii. Experience of management
iv. Staff attrition rate

The assessor should look at each indicator separately and independent of other indicators. The implications of scores obtained by the institution on different indicators can be considered at the stage of analysis of the assessment made on each indicator. The consolidated sheet of the tool returns a **"grade"** which can be translated into the extent of lending that could be recommended given the current size of the balance sheet of the cooperative. The layout of the tool is explained in **Table 1.2**.

Table 1.2: Layout of the Tool

Indicators (Criteria)	Scale (Rating basis)	Rating given (R)	Weight (W)	Score S=R*W	Maximum possible (W*10)
☞ Individual indicators are listed ☞ The tool consists of 12 broad indicators and 49 sub-indicators. ☞ These indicators are discussed in detail in the succeeding section.	Scale is the range of rating values applied to each indicator to assess performance in a quantitative manner. (Scale: 0-10)	The quantitative value assigned against each indicator is referred to as rating given against the indicator. This rating is based on the performance of the cooperative on that indicator.	Each indicator has also been assigned a weight to reflect the importance of the indicator in the overall tool.	The tool arrives at a score for each indicator by multiplying the rating value given and the weight.	Maximum possible marks are given for each indicator to facilitate evaluation of the cooperative's performance against the indicator.

2.1. Deal Breakers

Each of the four broad parameters have certain **Deal breaking parameters**. Some parameters are of a critical nature and if the analysts believe that the rated institution scores below the critical level, a high negative score is given to make the overall score fall below the minimum required level and thus reject the loan proposal.

Deal breaking parameters

a. Governance

- **i.** Compliance with regulatory requirements – If the institution has violated regulations which are of serious concern and it has done so knowingly or due to complete neglect, the analyst should assign a deal breaking score of -100.
- **ii.** Conflict of Interest – If the Board members take undue advantage of their position while transacting with the cooperative and/or the transactions are not at arm's length, the analyst should assign a deal breaking score of -100.
- **iii.** Linkages with financial institutions/repayment history – if the institution has poor relations with other financial institutions due to defaults in repayment or non-compliance of important covenants, the analyst should assign a deal breaking score of -100.

b. Management and CPP

- **i.** Quality of Accounting – If accounting is of very poor quality and lacks credibility, the analyst should assign a deal breaking score of -100.
- **ii.** Quality of MIS – If the MIS is of poor quality and lacks credibility so much that it is difficult to make a correct assessment of financial position of the cooperative despite additional effort, the analyst should assign a deal breaking score of -100.
- **iii.** Fund Management – If the fund management is poor and short term funds are used to invest in long term assets like land and building or long term loans posing risk of delay in payment to lenders, payment of dues to staff and return of demand deposits, the analyst should assign a deal breaking score of -100.

c. Financial

- **i.** Portfolio Quality – If the portfolio quality as indicated by Portfolio at Risk (PAR>30 days), also called Non-Performing Loans (NPL), rescheduled loans and re-financing of overdue loans (ever-greening) is poor (more than 15 % loans are non-performing), the analyst should assign a deal breaking score of -100.
- **ii.** Capital Adequacy – If the capital adequacy is negative and it is unlikely that the institution

can achieve a positive net worth within the next one year, the analyst should assign a deal breaking score of -100.

iii. Savings to total assets ratio – Member deposits indicate the trust of members in the cooperative. If the savings as a percent of total debt after disbursement of the proposed loan are less than 30 percent, the analyst should assign a deal breaking score of -100. This in a way provides an upper limit to the amount of loan that can be lent to a cooperative based on the savings. In other words, the total external debts from BFIs should not be more than 2.33 times its total deposits.

2.2. Governance and Strategy

This chapter deals with the first of the four sections of the assessment. This section covers the institution's capabilities in terms of indicators of

a. Quality of Governance (including compliance with regulations)
b. Strategy adopted by the cooperative for developing its financial inclusion programme including its relationships with lenders and credit history

While more emphasis is placed on governance indicators in this section, a significant weight is placed on the repayment history of the cooperative. The relative weight distribution within this section is shown in **Table 2.1**

Table 2.1: Weight distribution in Governance and Strategy

Category	Relative weight in the section (%)
Quality of Governance	52 %
Strategic positioning	48 %
Total	**100 %**

The assessors should gather information on the composition, background, skill and experience of the Board, regularity and quality of Board meetings, and transparency of the organization. Copies of the bye laws, minutes of various meetings, composition of the board over time should be taken into consideration. The indicators that have been used are below.

2.2.1. Quality of Governance

1) Composition of the Governing Board - Board members' experience, education and reputation

Definition: The indicator includes the promoters' and Board members' standing, academic qualification, history of work experience, recognition in the field and level of involvement. Reputation among the community/members and among industry stakeholders and credibility are of prime importance. The indicator also requires active board members and no close relatives in the Board to enable transparent discussion and decision making. The board members should be ordinary members who have made a substantial commitment to the operations of the cooperative.

Measures: Assessor(s) need to collect information about board members' background from the institution. Annual reports of the institution would generally state their qualifications and expertise. Competence is the key criterion, the number of years of work experience supplements the judgement made. Minutes of meetings and discussions with the Directors will highlight the time and attention given to the cooperative.

Scale:

>= 10 years of relevant experience, highly competent and highly involved in cooperative	10
5-10 years of relevant and reasonably good competence and reasonably well involved in cooperative	7-9
1-5 years of relevant and reasonably competent and somewhat involved	4-6
=<1 year and/or weak market standing/competence/not involved	0-3

Standard: At least 5 years of relevant experience and a reasonably good competence level to manage the institution combined with a reasonable level of involvement

2) Well represented and democratically elected Board

Definition: This determines whether the institution's Board members has been elected democratically by the members or is dominated by a small group of promoters and other influential members.

Measures: Directors should be appointed as per the bye laws and relevant legislation. Members should have been given adequate opportunity to nominate and elect. Elected members should represent all class of members.

Scale:

High level of representation - board members have been elected democratically	10
Reasonable level of representation	7-9
Moderate level of representation	2-6
Promoter held Board, elections are not held in true democratic spirit, members are not given adequate notice and are not aware of their rights	0-1

Standard: While it is difficult to expect a perfectly democratically elected board and most cooperatives would have some presence of influential members, there should be a reasonable level of representation of the ordinary members and they should be able to nominate and elect a majority of members of their choice.

3) Regularity of Board meetings and quality of discussion in the meetings

Definition: The Board should meet at least four times in a year. The Board should be involved in strategic decision making, approval of business plans, policies and procedures, review of growth/progress and appointment of key management personnel. Minutes of meetings should have a record of issues discussed and decisions taken.

Measures: Assessors should observe the meeting minutes of the Board; the minute book should be checked for meetings held and compared with the rules laid down in the by-laws.

Scale:

Excellent: Regularity of meetings, high level discussion on business plan, progress, financial performance, fund mobilization, internal audit findings, HR planning, appointment of top management, policies or amendments of policies, risk management and compliance, and update on the conflict of interest policy	10
Good: Regularity of meetings, good discussion on business plan, progress, financial performance, fund mobilization, internal audit findings, HR planning, policies or amendments of policies, risk management and compliance, and update on the conflict of interest policy	7-9
Moderate: Regularity of meetings, moderate discussion on business plan, progress, fund mobilization, internal audit findings, HR planning, policies or amendments of policies, risk management, and compliance	3-6

Poor: Irregular meetings or limited/no discussion during Board meeting on related issues. Lack of Board involvement in oversight	0-2

Standard: Regular meetings as per norm and quality discussion on policy formation and modification, review of the institution's progress and discussion on strategic guidance to the management.

4) Regularity of General body meetings, attendance and quality of discussions in the meetings

Definition: Members should meet at least once in a year. General body should be involved in review of growth/progress and appointment of Directors.

Measures: Reasonable attendance of members suggests their involvement. Minutes of meetings should have a record of issues discussed and decisions taken.

Excellent: Meetings held every year, attendance of more than 25 percent members, adequate information made available to the members to review performance and explained by the Chairman or the Secretary. Members ask questions from the Board and the Management. Members are involved in appointment of Directors and occasionally nominate new Directors.	10
Good: Meetings held, attendance of more than 20 percent members, information made available but only moderate discussion by members. Members are involved in appointment of Directors and occasionally nominate new Directors.	7-9
Moderate: Meetings held, attendance of more than 15 percent members, information made available but no discussion by members. Members are involved in appointment of Directors but do not nominate new Directors.	2-6
Poor: If either the meetings are not held, attendance is less than 15 percent , information not shared with members or members are not involved in the appointment the Directors.	0-1

5) Compliance with regulatory requirements and Transparency

Definition: Ensure that the cooperative is fully compliant with regulations; reports regularly to the cooperative department (also to NRB in case it is licensed). This can be ascertained by interaction with the top management and verification of records. Apart from being compliant, cooperative should be transparent in disclosing its performance, policies to members and other stakeholders.

Measures: It can be evaluated by referring to available documentation, filing of returns, board meeting minutes and current practices. Good quality external audit reports, promptness in sharing information with lenders would be an indicator of transparency. Presence in industry association and sharing of financial statements with them would also be an indicator of transparency. Sharing of information on a portal which is open for everyone to access is desirable but not essential.

Scale:

The cooperative complies with all regulations in letter as well as spirit and is financially transparent	10
The cooperative complies with all major regulations but lacks adequate systems to ascertain compliance with all regulations and has adequate disclosure practices	6-9
The cooperative is in violation of some regulations due to errors and weak systems which can be rectified. (Score will also depend upon the seriousness of violations)	0-5
The cooperative has violated regulations which are of serious nature and are difficult to rectify	-100*

*deal breaking score

Standard: Prompt compliance with all regulatory guidelines/rules at all times.

6) Conflict of Interest - strength of policies and their implementation

Definition: This is an important indicator in the context of the cooperatives. Cooperative bye laws should provide policies to avoid conflict of interest for Directors in using the financial services of the cooperative. For instance, it may not allow any board member or their family members to borrow while they are Board members.

Measures: Assessor(s) should look at the by-laws and ensure its compliance by ascertaining the loan approval processes. The assessor should make sure that the Directors, their relatives and other influential members have not been given undue advantage in any of the transactions with the cooperative.

Scale:

Strong policies and good implementation	9-10
Reasonably strong policies and good implementation	6-8
Reasonably strong policies and reasonable level of implementation	3-5
Moderate policies or moderate implementation	0-2
Weak policies and serious concerns on conflict of interest in decision making	-100*

*deal breaking score

2.2.2. Strategic positioning

7) Cooperative's experience in years to execute the Board policy and strategy in microfinance in the defined target market sector

Definition: Making policies and strategies is not enough; policies must be transposed into action. Implementation refers to the transformation of a decision into action. The indicator assesses the extent of implementation of board policies in practice. Cooperative's experience to execute microfinance strategy, judged on its experience in lending, mobilizing deposits and competitive strength.

Measures: Good governance makes sure there are good quality human resources, field practices and staff structure to execute Board policies and strategies. Assessors needs to evaluate the level of practice/action of Board policies and strategies in the field.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	0

Standard: This is a subjective indicator and assessor should make sure that the cooperative’s plan and policies are effectively implemented in the field and that it has resources to do so sustainably.

8) Second-line of leadership

Definition: The second line of leadership refers to any person who can take over from the CEO/head of institution without much prior notice. Such a person(s) is usually groomed from amongst the top management, so that in the CEO’s absence there is at least one competent person to take on the mantle of leadership.

Measures: This can be ascertained by interaction with the senior management. It is necessary to spot individual(s) who can take over the leadership role smoothly. The current CEO/head of institution can be asked to identify a potential successor, and state what efforts are being made to groom him/her for the future.

Scale:

Presence of strong second line, with requisite qualifications, experience and grooming	10
Presence of reasonable second line, with requisite qualifications, experience and grooming	6-9
Individual not identified yet, various capable persons, but none with ALL aspects (requisite qualifications, experience and grooming)	1-5
CEO centric, no second line, lack of developed leadership capabilities in the other top management	0

Standard: At least one person should have requisite qualifications, experience to manage operations in the absence of the CEO/head of institution.

9) Growth Strategy

Definition: This covers the expansion strategy for the operations of the institution. Geographical diversification may not always be possible in case of cooperatives but diversification in terms of purpose of loans reduces risk. Also, the rate of growth should be reasonable and commensurate with the size and market characteristics of the cooperative's operational area. Sudden jumps in growth may indicate large transactions with low diversification and may be risky. Concentration of loans with a few individuals/sectors should be avoided.

Measures: For this, a list of borrowers with loan outstanding and list of depositors can be sought from the cooperative. Purpose of loans should also be ascertained for at least bigger loans. List of top 10 percent loans and deposits should be carefully verified.

Scale:

Excellent: Steady growth, diversification among different loan uses and strategy to reduce multiple lending to clients	10
Good: Fairly steady growth, diversification among different loan uses and strategy to reduce multiple lending to clients	7-9
Moderate: Lesser degree of diversification	3-6
Fair: Fair degree of concentration either in area or loan use. Risk of multiple lending is present	1-2
Poor: High degree of concentration area or type of loan. Risk of multiple lending is high	0

Standard: Steady growth and diversification. Ensure no multiple lending and no concentration of loan or savings portfolio with a few.

10) **Linkages with financial institutions** (other than BFIs assessing the cooperative) **and a good credit history**

Definition: Linkages with financial institutions and associations indicate that the cooperative has gained the confidence of several agencies and has gone through several due diligence processes. Also, the proportion of risk borne by other BFIs will be less if it is only one among several lenders. This indicator measures past working relationship with BFIs, level of satisfaction and the historical performance of the institution in the repayment of BFIs loans.

Measures: This can be ascertained by interaction with the senior management and by examining the experience of BFIs – communication between BFIs and the institution, information on sources of finance and from checking their financial statements as well as fund flows.

Scale:

Excellent: has borrowed from three or more financial institutions in the past and has met all the repayment obligation and debt covenants	10
Good: has borrowed from two or more institutions and has a good repayment track record with all repayments made with less than one month delay	7-9
Average or no credit history: Has not borrowed or borrowed only one loan with less than 6 months of repayment track record	0
Poor: Has borrowed in the past and has delayed repayments by more than a month but less than 3 months (has not turned Non-Performing Assets)	-10
Very poor: Is an Non-Performing Assets (NPA) in the books of the lender(s)	-100*

*deal breaking score

2.3. Quality of Operations

This chapter focuses on the operational aspects (including portfolio quality, efficiency and sustainability) and external factors that are affecting the institution. The broad parameters used in this section can be clubbed into the following categories

- **a.** Clients and products
- **b.** Indebtedness and tracking of overdues
- **c.** Efficiency and sustainability
- **d.** External factors

The relative weight distribution within operation is shown in **Table 3.1**

Table 3.1: Weight distribution in Operations

Broad parameter	Relative weightage
Clients and products	30 %
Indebtedness and overdue tracking	26 %
Efficiency and sustainability	31 %
External factors	13 %
Total	**100 %**

2.3.1. Clients and Products

1) Quality of clients/members

Definition: Quality of clients includes level of clients' awareness about product features and the institution's process and procedures, credit discipline, satisfaction with the institution's products and services.

Measures: This can only be ascertained by interaction with clients. Assessors need to appraise the level of clients' awareness, credit discipline, attendance in various meetings, quality of discussion, cohesiveness among clients and satisfaction with the cooperative's products and services.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	0

Standard: High level of client awareness, good credit discipline and satisfaction level with cooperatives products and services and with the behavior of staff in their interaction with clients.

2) Membership retention rate

Definition: The quality of services and utility of cooperative can be ascertained from the retention rate. Low member retention rate will indicate that there is a low level of satisfaction with the products or policies of the institution. This could result in deeper problems related to portfolio quality or liquidity crisis later.

Measures: Discussions with **randomly** chosen client groups will generate feedback about policies and procedures. There should also be checks on the recorded retention rate for the last year. The retention rate calculation is

$$\textbf{Retention rate} = \frac{\text{(Total number of members end of the year (or period) – New members)}}{\text{Total number of members in the beginning}}$$

Scale:

Retention rate =>80 %	10
Retention rate >65 % - <80 %	6-9
Retention rate >50 % - <65 %	1-5
Retention rate <= 50 %	0

Standard: 70 %

3) Appropriate product design and delivery

Definition: The cooperative has the responsibility to exercise good faith in designing products that are suitable to the needs of the members. The institution should take active steps to consider the characteristics of the target clients during the design process. Products should provide good value for money, and not be deceptive. Products and delivery channels should be designed with client characteristics taken into account.

Measures: This can be ascertained by interaction with clients and also with the management (to determine their intentions in determining a particular product design). Assessors need to judge the suitability of product features to clients' needs and capacity, simplicity of products in terms of understanding and relative affordability.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	0

Standard: Good product design in line with clients' needs as well as the institution's vision and mission. There should be a suitable product delivery system.

4) Clarity in division of roles between Board and the management - properly laid out systems/ authority for the approval of loans, fund management, signing of cheques and other key decisions

Definition: An important indicator for the cooperatives as many times, Board assume membership role and exercise excessive influence in day to day decision making. This is also linked to the indicator on avoiding conflict of interest in the Governance section. The cooperative should have clearly segregated authority of the management and the Board. Key decisions and authority such as sanctions of loans of various sizes and signing of cheques should be clearly documented and well known to the members, board and the staff. No individual should have excessive authority and there should be adequate checks and delegation of authority.

Measures: Assessors need to ascertain the cheque signing authority, loan approval process and documentation on division of authority between the management and the Board. The by-laws should have this information and should be implemented properly.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	0

Standard: Subjective indicator and assessor should make sure division of authority at various levels.

5) Strategies, policies and quality of systems for prevention of over-indebtedness

Definition: The cooperative should take care in all phases of their credit process to determine that clients have the capacity to repay without becoming over-indebted. In addition, the cooperative should implement and monitor internal systems that support the prevention of over-indebtedness and foster efforts to improve credit risk management in this context.

Measures: This can be ascertained by interaction with the senior management and evaluating systems and processes. Assessors need to examine the client credit appraisal process (including credit information sharing), loan terms and conditions, sales techniques, staff incentives, monitoring systems and market initiatives. Usually high sales linked staff incentive should be avoided to prevent mis-selling. In over-heated markets of Nepal, the system of ascertaining existing debt (in the absence of information on microfinance borrowers from credit bureau) by the lender becomes crucial.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	0

Standard: Cooperative takes adequate care and puts systems in place to determine client repayment capacity before loan disbursement.

2.3.2. Credit risk and tracking of overdues

6) Tracking system for overdues

Definition: The presence of a tracking system for overdues is very important for all lenders. Cooperative should have a policy and set of processes. There should be prompt action on overdues. MIS should support prompt tracking and responsibilities should be assigned.

Measures: Assessors need to base their evaluation on the systems – formal or informal – that the cooperative may have for tracking overdues. The rating on this indicator needs to be given not only based on the quality of information maintained but also after considering the degree of success in implementing its policies, formal or informal, for tracking of overdues. The implementation can be measured in terms of the quality of follow up that is carried out at the field level and the importance (discussions during office meetings on this issue and the regularity of such follow up) attached to the tracking system.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	0

Standard: A formal tracking of overdue system in place with quality of information as well as strict follow up by field staff.

2.3.3. Efficiency and sustainability

7) Borrowers per field staff (staff productivity)

Definition: This ratio captures the productivity of the institution's staff – the higher the ratio the more productive the institution. It is one of the best recognized performance ratios in the microfinance industry. The standard for the caseload differs based on the model of operations used.

Measures: Staff productivity is calculated by dividing the number of active borrowers of an institution by the total number of credit officers. The number of active borrowers is defined as individually identifiable borrowers who have at least one current outstanding loan.

$$\textbf{Borrowers/field staff} = \frac{\text{Number of active Borrowers}}{\text{Number of field staff}}$$

Scale:

>300	7-10
>200 up to 300	4-6
> 100 up to 200	1-3
<100	0

Standard: The numbers should be changed based on geographical and product variations. Average of peer groups should be used to benchmark.

8) **Field staff to total staff ratio** (staff productivity)

Definition: This ratio captures the productivity of the cooperative's total staff – the higher the ratio the more productive the institution is. Support staff as a percent of the total staff should be limited. Excessive managerial staff, accountants, cashiers and other support functions reflect inefficiencies and add to cost.

Measures: Field staff are the staff who execute transactions with the clients in the field. Supervisors and support functions even if based in the branch offices are not counted as field staff.

$$\textbf{Field staff/Total staff} = \frac{\text{Number of field staff}}{\text{Number of total staff}}$$

Scale:

>70 %	10
>60 % up to 70 %	7-9
>50 % up to 60 %	3-6
>40 % up to 50 %	1-2
<=40 %	0

Standard: The numbers should be changed based on nature of services and geographical variations. Average of peer groups should be used to benchmark.

9) Inclusiveness and innovation

Definition: The term 'inclusiveness' in microfinance means – promoting institutional diversity, and promoting diverse financial services to a broad range of clients. The indicator assesses the focus coverage of poor households; diversity of operational areas, clients and the range of financial services. Operating in priority regions, gender focus, innovations in product development or distribution, branchless banking and market linkages add to the competitive strength, client satisfaction, operating efficiency, linkages with donor and lenders and indicate a strong management.

Measures: This can be ascertained by interaction with the senior management, analysing products and services, distribution systems /operating model, use of methods and technology.

Scale:

Very high focus	10
High focus	8-9
Moderate focus	5-7
Limited	1-4
No focus	0

Standard: Good coverage of poor, diversified areas and clients and diverse financial services.

2.3.4. External factors

The goal is to understand the sources of risk for the specific country/region/institution. This should ultimately lead to the creation of Early Warning Indicators. An Early Warning Indicator is an important component of overall risk management.

10) Adverse socio-political environment

Definition: This indicator shows the degree of adverse socio-political factors prevailing in the cooperative's operational area. How does the domestic social, macroeconomic and political environment affect the institution's operations, including its ability to execute its stated strategy?

Measures: This can be ascertained by interaction with the management, country review, interaction with community leaders. The assessors also get a sense of the local situation during the field assessment.

Scale:

Low	8-10
Moderate	4-7
High	0-3

Standard: Favourable socio-political conditions prevailing in cooperative's operational area.

11) Prone to natural calamities

Definition: The indicator assesses the risk of natural calamities in the cooperative's operational area.
Measures: Assessment of the likelihood of natural calamities in the area based on discussion with the management, the Board of Directors and local enquiry with key persons.

Scale:

Low	8-10
Moderate	4-7
High	0-3

Standard: Cooperative's operational area not extraordinary prone to natural calamities.

12) Risk of negative rumors/ loss of reputation

Definition: This indicator specifies the degree of negative publicity about the cooperative in the market/ region of operation and that can adversely affect their long-term operational and financial sustainability.

Measures: Information through electronic and print media about the institution as well as discussion with key persons, peer institutions, field staff, members and public in the operational area.
Scale:

Low	8-10
Moderate	4-7
High	0-3

Standard: Absence of negative rumours about the cooperative.

13) Strategic move by competitors and other funders

Definition: This indicator shows the changes in strategic position, brand and systems and procedures in comparison with the cooperative's microfinance competitors.

Measures: The assessor should have a good understanding of the financial sector and knowledge about competitors' strategies in the operational area to assess this indicator.

Scale:

Low	8-10
Moderate	4-7
High	0-3

Standard: Cooperatives should have strategies, systems and procedures to manage competition in the industry.

2.4. Management, Internal Control and Client Protection

This chapter focuses on management capacity of the cooperative, internal control, accounting and information systems and responsible practices towards members as stipulated in globally accepted Smart Campaign's client protection principles. The broad indicators used in this section can be clubbed into the following categories

a. Human resource management
b. Quality of systems
c. Client protection principles

This section is based on the correlation between the performance of the credit programme with the quality of human resources and control systems. The relative weight distribution within this section is shown in **Table 4.1**

Table 4.1: Weight distribution in management, internal control and client protection

Broad parameter	Relative weight
Quality of Human resource and productivity	42 %
Quality of systems	42 %
Client protection principles	16 %
Total	**100 %**

2.4.1. Human resource management

1) Quality of HR systems and processes

Definition: The quality of the human resource management system is considered one of the key factors in the improvement of product quality, service delivery and staff productivity. The indicator determines the quality of HR systems in terms of effectiveness and efficiency.

Measures: This can be determined by reviewing the existing documents on HR policies, plans and practices in the cooperative. The documents will be examined for completeness, effectiveness in achieving set objectives and constraints to their use.

Scale:

Excellent: Cooperative has HR systems in place, has an HR manual, training policy and good adherence to policies, a performance appraisal and incentive system and regular update of HR files.	10
Good: Cooperative has HR system in place, does not have fully written policies but carries out trainings, performance appraisal, performance incentive and updates HR files.	6-9
Average: Cooperative has reasonable adherence to policies, has some sort of performance appraisal and incentive system in place and maintains HR files.	1-5
Poor: Cooperative does not have HR, training, performance appraisal, performance incentive policies and lacks HR filing system.	0

Standard: Articulated HR policy *(including recruitment, appraisal, training and incentive policies)* in place and adherence to the policy; regular update of HR files (maintenance of staff records).

2) Quality of field staff

Definition: Quality of field personnel is extremely important for microfinance institutions as the operations are field centric. The quality is indicated by staff's education (at least education up to grade 10 is recommended), knowledge of responsibilities, trainings imparted to them in the beginning and on a regular basis and experience.

Measures: The hiring policy details minimum qualifications expected from the staff. Selection process and induction and other training policies should be analyzed. Discussions with staff reveal knowledge of responsibilities.

Scale:

Excellent: trained and experienced with good knowledge of responsibilities	10
Good: trained and experienced with good knowledge of responsibilities	7-9
Average: moderately trained and average knowledge of responsibilities	5-6
Poor: not well trained, gaps in knowledge of responsibilities	1-4
Very Poor: untrained, severe gaps in knowledge of responsibilities	0

Standard: Most of the field personnel should be well trained, have average one year's experience and good knowledge of responsibilities.

3) Experience of senior management

Definition: This would determine whether the key personnel in management have enough expertise to handle the operations of the cooperative.

Measures: Information can be sought from the institution regarding the key persons (or heads of department) involved in management and previous relevant experience they have, in microfinance/economics/banking/finance/audit/HR/rural development.

Scale:

Excellent: well qualified and experienced with complete knowledge of responsibilities	10
Good: qualified and experienced with good knowledge of responsibilities	7-9
Moderate: moderately qualified, average knowledge of responsibilities	3-6
Poor: low qualifications, gaps in knowledge of responsibilities	1-3
Very Poor: very low qualifications, severe gaps in knowledge of responsibilities	0

Standard: The key personnel should have relevant qualifications and at least 5 years of experience in the related field.

4) Staff attrition rate

Definition: Staff attrition refers to the loss of employees. A high attrition rate can adversely affect the institution due to the cost of training new employees and can impact quality of operations.

Measures: The calculation of staff attrition rate is

$$\textbf{Staff attrition rate} = \frac{c}{a + b}$$

a = No. of employees at the opening of the year/period
b = No. of employees joined during the year/period
c = No. of employees left (or terminated + absconding + resigned) during the year/period

Scale:

<=10 %	10
10-30 %	1-9
>30 %	0

Standard: less than 15 percent during the year

2.4.2. Quality of systems

5) Quality of Accounting

Definition: This indicator includes having prudent policies on income and expense recognition, loan loss provisioning, write-off, depreciation. Records should be updated regularly and accurately.

Measures: Based on an examination of the books of accounts that are maintained by the institution – the number of conceptual or other mistakes that are found in random checks of the account books of the institution needs to be computed as part of rating on this indicator. Assessors need to determine the application of policy in practice.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	-100*

*deal breaker score

Standard: Prudent accounting policies (including policies for loan loss provisioning, depreciation, write-off) in place, separate accounts (including financial statements) for microfinance operations and other businesses/projects with timely updates and accuracy of recording.

6) Quality of Management Information System (MIS)

Definition: This is an important constituent of management systems. The consolidation of accurate information and preparation of reports which are useful for management decisions is of prime importance. Portfolio quality tracking must be quick so that corrective action can be taken. Aspects surrounding data security should be checked. Minimum lag between transactions and recording is ideal. All the transactions should be properly recorded with adequate monitoring, safety measures and data protection. The system should allow analysis of portfolio quality, growth trends, classification by nature and quantum of transactions and detection of extra-ordinary large transactions and fluctuations.

Measures: Checks can be made during the field visit. The entire process of flow of data from the field, and into the system (whether manual recording or software) should be analyzed for gaps in accuracy. Gaps in tracking of overdues in accuracy and delays in reporting overdues, methods of mis-reporting should be checked by comparing client level records and branch and head office reports. Authorization of transactions like making changes to the database should be checked. Who has the authority and what is the mechanism to check data security? Who checks and validates/verifies the accuracy of reports?

Scale:

Excellent: Extensive accuracy checks, security of data and meets the requirements as mentioned above in the definition	10
Good: 1-2 day lag for information, extensive accuracy checks, security of data and meets most of the requirements	7-9
Average: 1 week lag for information, strong accuracy checks, security of data and meets important data requirements including portfolio quality	3-6
Poor: More than one week lag in getting information, medium/ low accuracy checks, medium/ low security of data and does not allow analysis of data for reporting on portfolio quality, classification by nature and size	0-2
Very Poor: Data transfer delay > 15 days, low accuracy of data, low security and/or does not allow even basic portfolio reports	-100*

*deal breaker score

Standard: Prudent accounting policies to provide true reflection of the profitability, portfolio quality and capital adequacy. Error proof MIS in place, maximum a week time lag in providing portfolio reports and adequate safety of data from tempering.

7) Quality of Internal audit and control systems

Definition: Cooperatives that get their internal audit done regularly are likely to have better control over their financial operations. The quality of the internal audit depends on its frequency and coverage, quality of reporting, the extent to which it follows sound assessment practices and compliance and follow up of audit findings. Smaller cooperatives may not have a separate team but a team from management selected to perform the audit. The cooperative should also have optimal controls policies and procedures, as measured by the rarity of instances of fraud and financial misstatements.

Measures: For measuring this indicator, internal audit reports of the organization should be examined, check the frequency, coverage, quality of internal audit reports and compliance processes. Instances of fraud and mismatches in cash balances in the field or in bank reconciliation statements should be verified.

Scale:

Excellent: The internal audit (IA) function is both competent and independent. Good coverage of IA, good frequency, quality of reporting and timely compliance. The institution has optimal controls and its control policies and procedures are comprehensive and effective, as measured by the rarity of instances of fraud, financial misstatements.	10
Good: The IA is adequate. Reasonable coverage of IA and quality of reporting. The institution has good controls and with adequate policies and procedures. Fraud, financial misstatements, and damage to or theft of assets has been minimal.	7-9
Moderate: The IA function exists but exhibits some deficiencies related to coverage and reporting. The institution has had to deal with a few incidences of fraud, misstatements and damage to or theft of assets.	3-6

Poor: The IA is non-functional and inadequate. The institution has dealt with numerous incidences of fraud, misstatements and damage to or theft of assets.	1-2
Very poor: No IA function exists. Weak controls have resulted in serious incidents of fraud.	0

8) Fund management

Definition: Quality of fund management can be defined as how well funds are used to generate income for the organization, nature of deposits, borrowings and other liabilities. It measures optimum utilization of available funds and how effectively the cooperative manages external liabilities. Liquidity or Idle fund ratio will depend upon the size and nature of savings deposits, borrowings and other liabilities. For instance, a large proportion of withdrawable deposits and/or very short term deposits will require higher liquidity/idle funds. This will also depend upon the quality and duration of assets. The Cooperative may not be able to prepare detailed Asset-Liability Mismatch (ALM) reports but should make analysis with same principles.

Measures: This can be ascertained by interaction with the head of finance. **Assessors should examine the nature of assets and liabilities and verify cases wherein short term funds are used to invest in long term assets like land and building or long term loans.** Monthly cash flow report, fund transfers and promptness in meeting external liabilities.

Scale:

Excellent: Good liquidity management	10
Good: Good liquidity management	7-9
Moderate: Moderate liquidity management	3-6
Weak Liquidity management	1-2
Very weak liquidity management and high risk of default on deposits, staff liabilities and external borrowings	-100*

*deal breaking score

Standard: Cash flow reporting system in place, maintaining a reasonable level of average idle funds (cash and bank balances), no delay in payment to external funders, staff dues and on demand deposits.

2.4.3. Client protection principles - SMART Client Protection Principles

9) Responsible pricing

Definition: Cooperative should price its products and services in a way that contributes to the long-term financial health of their clients while meeting its own needs for financial sustainability. Transparency is a pre-condition for responsible pricing because it enables clients to understand and compare products and providers. The institution should not pass the cost of inefficiency to the clients.
Measures: Assessors need to measure the cooperative's formal (internal) pricing procedure for each product that considers the cost of providing the product; compare with peer institutions' price structure and formal pricing/interest spread cap in the country. Affordability for clients can be ascertained by interaction with them.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2

Very poor	0

Standard: Price structure in accordance with affordability for clients and its own long term financial sustainability.

10) Transparency to clients

Definition: The institution communicates clear, sufficient and timely information in a manner and language the members/clients can understand so that they can make informed decisions. It enables clients to take responsibility for their own financial decision making.

Measures: This can be ascertained by interaction with members/clients and verification of documents related to the clear use of language, complete cost and non-cost information, timely provision of information and advising clients of their rights.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	0

Standard: Clear, sufficient and timely communication to members on product features, organisation policies and procedures.

11) Fair and respectful treatment of clients

Definition: Institution's staff should treat members and clients fairly and respectfully. The institution ensures adequate safeguards to detect and correct corruption as well as aggressive or abusive treatment by their staff, particularly during the loan appraisal, disbursement and collection processes.

Measures: This can only be ascertained by interaction with members and clients. The assessors also determine the efficacy of the institutional culture and systems in place to safeguard their clients.
Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	0

Standard: Members satisfied with staff behaviour and interaction.

12) Mechanism for grievance redressal

Definition: The cooperative should have in place timely and responsive mechanisms for complaints and problem resolution for its members and clients. Cooperative should ensure that members and clients are aware of their right to report issues and that they know how to lodge a complaint; the process is easy for them to use.

Measures: This can be ascertained by interaction with the members and staff, examination of systems and procedures in place related to communications with members and clients about their rights and about how to register a grievance, handling of complaints, oversight of the complaints process, and use of a compilation of complaints to identify broader problems.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	0

Standard: Members are aware of their rights and about how to lodge a complaint and the responsiveness of the mechanism for resolution of complaints.

13) Privacy of client data

Definition: The privacy of member and client data should be respected. Such data should only be used for the purposes specified at the time the information was collected or as permitted by law, unless otherwise agreed with the member andclient.

Measures: Assessors gauge policy and procedures on privacy of client data, information security, information provided to clients about their rights and responsibilities, waivers of privacy rights, data that could be used for discriminatory purposes and sharing of client data.

Scale:

Excellent	10
Good	7-9
Moderate	3-6
Poor	1-2
Very poor	0

Standard: Has formal policy on privacy of client data, high information security and explicit/applied policy of not sharing client data without the client's permission.

2.5. Financial Performance

This chapter focuses on the financial performance of the cooperative which is a savings and credit institution. Though, it is unregulated and usually smaller than banks, the fact that **it avails savings makes it imperative to manage liquidity well**. The impact of a sound organizational background, development strategy, management and resource base would be on its financial performance. The parameters used in this section are in three broad categories

a. Loan portfolio quality or credit quality
b. Financial performance and sustainability
c. Capital adequacy and composition of assets and liabilities.

The relative weight distribution within financial performance is shown in **Table 5.1**

Table 5.1: Weight distribution in financial performance

Broad parameter	Relative weight
Loan portfolio quality	33.3 %
Financial performance and sustainability	27.8 %
Capital adequacy and composition assets and liabilities	38.9 %
Total	**100 %**

2.5.1. Loan portfolio quality

1) Portfolio at Risk

Definition: This indicator measures the risk associated with the cooperative's loan portfolio. It shows that portion of the loan portfolio which is at risk as indicated by the total portfolio in loan accounts with overdues not repaid for greater than 30 days. It is calculated by dividing the outstanding balance of all loans with arrears over 30 days, plus all refinanced (restructured) loans, by the outstanding gross portfolio on a certain date. The following formula is used:

$$\textbf{PAR30} = \frac{\text{Principal balance of loans with arrears > 30 days + refinance \& rescheduled loans}}{\text{Total outstanding portfolio}}$$

Measures: Ratio can be calculated from the financial statements of the institution

Scale:

0 up to 2 %	10
>2 % up to 4 %	8-9
>4 % up to 6 %	6-7
>6 % up to 10 %	3-5
>10 % up to 15 %	0-2
>15 %	-100*

*deal breaking score
Standard: <3 %

2) Repayment rate

Definition: This measures the collection efficiency of the cooperative by ascertaining the percent of the dues collected by the cooperative from the borrowers.

Measures: Assessors need to calculate the amount due first which should be done after understanding the product features. It should be made sure that the cooperative accounts for interest repayments before principal repayments. Repayment rate can be calculated using the formula.

$$\textbf{Repayment rate} = \frac{\text{Total collections made less prepayment during last 12 months}}{\text{Total amount due to be repaid by borrowers in last 12 months}}$$

Scale:

>=99 %	10
90 % to 99 %	5-9
80 % to 90 %	2-4
<80 %	1-2

Standard: >95 %

3) Yield to APR

Definition: This is a surrogate indicator for the repayment rate of the institution. It provides the proportion of real interest rate charged that is collected by the cooperative as portfolio yield. A high repayment rate will also translate in the cooperative collecting a high proportion of the interest income charged from the clients.

Portfolio yield measures how much cash income (interest and fee) the cooperative actually receives from its clients during the period.

Measures: Assessors need to calculate portfolio yield first. Portfolio yield is calculated by dividing total cash financial revenue (all income generated by the loan portfolio, but not accrued interest) by the period average gross portfolio. Yield can be calculated from the financial statements of the institution, using the formula.

$$\textbf{Yield} = \frac{\text{Interest and other portfolio related incomes}}{\text{Average gross portfolio outstanding}}$$

APR is computed by calculating the effective rate of interest (IRR in financial parlance) which is charged by the cooperative from its borrowers. This should be ascertained from the repayment schedule or product policies of the cooperative.

Then the assessors can calculate the yield to APR ratio

$$\textbf{Yield to APR} = \frac{\text{Yield}}{\text{APR}}$$

Scale:

>=95 %	10
80 to 95 %	5-9
70 % - 80 %	3-4
<70 %	0-2

Standard: The optimal percentage should be 100 % but over 90 % is normally considered good.

2.5.2. Financial performance and sustainability

4) Operational Self Sufficiency (OSS)

Definition: OSS helps to identify whether the institution can meet its operating expenses from its operating incomes.

Measure: The assessor must recast the financial statement of the cooperative to reflect the expenses related to salaries, travel, administration, depreciation, interest payments and loan losses for the rating period. Can be calculated from the financial statements of the cooperative:

$$\textbf{OSS} = \frac{\text{Operating Income}}{\text{Operating Expenses}}$$

*[Salaries + Travel + Administrative Costs + Interest Expense + Loan Loss Provision + Other Explicit Expenses]; [**Grants are not an operational income, and therefore should not form a part of the OSS**]*

Scale:

>110 %	10
95-110 %	7-9
85-95 %	3-6
<85 %	0-2

Standard: OSS should be >100 %.

5) Return on Assets (RoA)

Definition: Return on assets is an overall measure of profitability that reflects both the profit margin and the efficiency of the institution. Simply put, it measures how well the institution uses all its assets.

Measures: RoA is calculated by dividing net income (after taxes and excluding any grants or donations) by period average assets. It can be calculated from the financial statements of the institution:

$$\textbf{RoA=} \frac{\text{Net surplus}}{\text{Average total assets for the period}}$$

RoA should ideally always be positive, and the higher, the better – though if it is too high this could indicate overcharging by the cooperative.

Scale:

Current year >=2.5 % and average for three years >2 %	8-10
Current year >1 % and average for three years >0 %	5-7
Current year negative 1 % to positive 1 % and average for three years >negative 1 %	1-4
Current year <negative 1 % or average for three years <negative 1 % or cases not covered by above	0

If the cooperative is not in existence for last three, instead of average of last 3 years, take average of all the years of existence.

Standard: >2 %.

6) Operating Expense Ratio (Operating efficiency)

Definition: To measure the cost associated with the institution. This ratio provides the best indicator of the efficiency of a lending institution. For this reason, the ratio is also commonly referred to as the efficiency ratio, it measures the institutional cost of delivering loan services. The lower the operating expense ratio, the higher the efficiency.

Measures: The operating expense ratio is calculated by dividing all expenses related to the operation of the institution (including all the administrative and salary expenses, depreciation and board fees) by the period average gross portfolio.

$$\textbf{Cost of delivery ratio =} \frac{\text{Operating expenses}}{\text{Average gross portfolio for the period}}$$

Scale:

Average for three years <=12 %	10
Average for three years 22-12 %	7-9
Average for three years 35-22 %	3-6
Average for three years >35 %	0-2

Standard: Equal to or better (lower) than the industry average for the period.

2.5.3. Capital Adequacy and composition of assets and liabilities

7) Total Capital to Risk weighted Asset Ratio (CRAR)

Definition: Capital adequacy indicates whether the capital of the institution is sufficient to cover the risky assets on its books. It indicates the loss absorption capacity of the institution, in case the risky assets go bad. Risks weights should be assigned based on assessment of risk on assets. In the absence of regulations for the cooperatives, generally accepted risk weights – 0 percent on cash and bank balances, 50 percent on land and building and 100 percent on loan portfolio and all assets. The slabs mentioned here may be changed based on regulatory requirements and growth plans.

Measures: Can be calculated from the financial statements of the cooperative.

$$\textbf{CAR} = \frac{\text{Net worth}}{\text{Risk weighted assets}}$$

Scale:

>18 %	10
>15 % up to 18 %	9
>12 % up to 15 %	7-8
>8 % up to 12 %	5-6
>4 % up to 8 %	3-4
>=0 % up to 4 %	0-2
<0%	-100*

*deal breaker score

Standard: the capital base of the cooperatives is usually low except for older ones with adequate free reserves. As a standard CRAR for cooperative should be 8 percent .

8) Institutional Capital (fixed and long term capital) to Risk weighted Assets Ratio (ICRAR)

Definition: Institutional Capital indicates the capital which is non withdrawable. As mentioned earlier, it was observed that a part of the capital in cooperatives is withdrawable as the regulations allow members to ask for the refund of their paid in capital with reasonable restrictions in the bye laws. The reserves and accumulated profits are more stable than a high amount of capital put in by large borrowers who are usually asked to contribute 10 percent of the loan amount as capital. This high amount is often withdrawn on completion of the loan and is in the nature of security deposits. It was decided that another indicator on institutional capital be also added to the tool.

While the numerator will be Institutional capital, the denominator, that is, the risk weighted assets, will be same as that in the previous indicator.

Measures: Can be calculated from the financial statements of the cooperative.

$$\textbf{ICRAR} = \frac{\text{Long term capital}}{\text{Risk weighted assets}}$$

Scale:

>12 %	10
>8 % up to 12 %	9
>6 % up to 8 %	4-8
>=2 % up to 6 %	2-4

<2 % up to 0 %	0-2
<0 %	-100*

*deal breaker score

Standard: the capital base of the cooperatives is usually low except for older ones with adequate free reserves. As a standard ICRAR for cooperative should be 5%.

9) Debt Equity Ratio (after disbursement of the proposed loan)

Definition: The debt-to-equity ratio indicates the relationship of debt to equity financing. The ratio expresses the relationship between funds contributed by creditors and that belong to the owners, here the members of the cooperative. It expresses the degree of protection provided by the owners for the creditors. This ratio is of particular interest to lenders because it indicates the extent to which there is a safety cushion in the institution to absorb losses.

Measures: Separately add all the liability and equity accounts in the balance sheet of the institution. Then, divide the Sum of Liabilities by the Sum of Equity to obtain the Debt-Equity Ratio. Equity in case of cooperative will include share capital, free reserves and accumulated profits. **Debt should include deposits from the members** and the proposed loan to compute this ratio after the disbursement of the loan being considered.

$$\textbf{Debt-Equity ratio} = \frac{\text{Debt}}{\text{Equity}}$$

Scale:

0 up to 2	10
>2 up to 6	7-9
>6 up to 8	5-6
>8 up to 12	1-4
>12	0

Standard: <=8

10) Savings to total debt ratio (after disbursement of the proposed loan)

Definition: Defined as the contribution by total savings mobilized from members in the total debt of the cooperative. A high proportion of savings from own members which is a debt from members as compared to the external debt from BFIs gives confidence to the prospective lenders as members who are closer to the cooperatives have shown their trust by putting their own money in the institution.

Measures: Can be calculated from the financial statements of the cooperative.

$$\textbf{Savings to total debt (after disbursement of the proposed loan)} = \frac{\text{Total saving deposits}}{\text{External liabilities}}$$

[External liabilities includes outstanding external borrowings and payables and also the proposed loan]

Scale:

>90 %	10
>70 % up to 90 %	7-9
>50 % up to 70 %	2-6

>=30 % up to 50 %	0-1
<30 %	-100*

*deal breaking score

Standard: 50 %

11) Current ratio

Definition: This is the ratio of current assets to current liabilities. This indicator measures the liquidity of the organization's funds and provides an indication whether the current assets are adequate to meet the short-term obligations of the organization (current liabilities). Current assets include loan portfolio that is to become due within one year and current liabilities includes borrowings that must be repaid within one year. This is the ratio of assets (or part of assets) that will turn in to cash within one year (< one year maturity) to liabilities (or part of liabilities) including member deposits that need to paid off or are expected to be paid off within one year.

Measures: The latest available balance sheet of the organization should be used to calculate this ratio. In cases where the audited balance sheet does not show all the current assets or liabilities, estimates should be made.

$$\textbf{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Scale:

>3	10
>1.5 up to 3	6-9
>1 up to 1.5	2-5
>0.5 up to 1	1
<=0.5	0

Standard: 1.5.

Cooperative Assessment tool

A cooperative rating tool is developed for the BFIs to undertake credit assessments/ ratings of Cooperatives. A manual serves as a guideline for the implementation of the rating tool. The tool was refined after the Pilot testing in selected cooperatives and a consultation meeting with UNCDF and financial institutions to generate feedback on the piloted rating tool was held. A training of BFI staff was conducted to explain the tool and methodology finalized after the pilot and the subsequent consultation meeting.

Assessment of Cooperatives for debt financing

A Governance & Strategy

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
1	**Governance, Promoter's background**	The entity should have well represented, democratically elected and educated members on its Board. They should have active involvement in governance and the entity should have set of guidelines to avoid conflict of interest for Board members. The entity should have proven track record of objective decision-making.					
A1	**Quality of Governance**						
1.1	**Composition of the Governing Board. Board members' background in terms of experience, education and reputation.**	Board members' standing, education, experience and recognition in the field. Time and attention spent in cooperatives is also to be observed.	**7**	**5**	**35**	**50**	**No**
	>= 10 years of relevant experience, highly competent and involved in cooperative	10					
	5-10 years of relevant experience, reasonably good competence and reasonably well involved	7-9					
	1-5 years of relevant, reasonably competent and somewhat involved	4-6					
	=<1 year and/or weak market standing/ competence/low involvement	0-3					
1.2	**Well represented and democratically elected Board**	Directors should be appointed as per the bye laws and relevant legislation. Members should have been given adequate opportunity to nominate and elect. Elected members should represent different class of members	**6**	**10**	**60**	**100**	**No**

Assessment of Cooperatives for debt financing

A Governance & Strategy

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
	High level of representation - board members have been elected democratically	10					
	Reasonable level of representation	7-9					
	Moderate level of representation	2-6					
	Promoter held Board, elections are not held in true democratic spirit, members are not given adequate notice and are not aware of their rights	0-1					
1.3	**Regularity of Board meetings and quality of discussions in the meetings**	Board should meet at least four times in a year. Board should be involved in strategic decision making, approval of plans, policies and procedures, review of growth/progress and appointment of key management personnel. Minutes of meetings should have a record of issues discussed and decisions taken	**5**	**8**	**40**	**80**	**No**
	Excellent: Regularity of meetings, high level discussion on plans, progress, financial performance, fund mobilization, audit findings, HR planning, appointment of top managment, policies or amendments of policies & compliance and update on the conflict of interest policy	10					
	Good: Regularity of meetings, good discussion on business plan, progress, financial performance, fund mobilization, audit findings, HR planning, policies or amendments of policies & compliance and update on the conflict of interest policy	7-9					

Assessment of Cooperatives for debt financing

A Governance & Strategy

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
	Moderate: Regularity of meetings, moderate discussion on business plan, progress, fund mobilization, audit findings, HR planning, policies or amendments to a policies and compliance	3-6					
	Poor: Irregular meetings, limited/no discussion during Board meeting on related issues. Lack of Board involvement in oversight	0-2					
1.4	**Regularity of General body meetings, attendance and quality of discussions in the meetings**	Members should meet at least once in a year. General body should be involved in review of growth/progress and appointment of Directors. Reasonable attendance of members suggests their involvement. Minutes of meetings should have a record of issues discussed and decisions taken.	**5**	**10**	**50**	**100**	**No**
	Excellent: Meetings held every year, attendance of more than 25% members, adequate information made available to the members to review performance and explained by the Chairman or the Secretary. Members ask questions from the Board and management. Members are involved in appointment of Directors and occassionally nominate new Directors.	10					

Assessment of Cooperatives for debt financing

A Governance & Strategy

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
	Good: Meetings held, attendance of more than 20% members, information made available but only moderate discussion by members. Members are involved in appointment of Directors and occassionally nominate new Directors.	7-9					
	Moderate: Meetings held, attendance of more than 15% members, information made available but no discussion by members. Members are involved in appointment of Directors but do not nominate new Directors.	2-6					
	Poor: If either the meetings are not held, attendance is less than 15%, information not shared with members or members are not involved in appointing the Directors.	0-1					
1.5	**Compliance with regulatory requirements and Financial transparency**	The cooperative should adhere to all regulations in letter as well as spirit. The level of transparency in the performance reporting by the entity as represented by its disclosure practices, accounting practices, auditing practices and effective MIS.	**4**	**4**	**16**	**40**	**No**
	The cooperative complies with all regulations in letter as well as spirit and is financially transparent	10					
	The cooperative complies with all major regulations but lacks adequate systems to ascertain compliance with all regulations and has adequate disclosure practices	6-9					

Assessment of Cooperatives for debt financing

A Governance & Strategy

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
	The cooperative is in violation of some regulations due to errors and weak systems which can be rectified. (Score will also depend upon the seriousness of violations)	0-5					
	The cooperative has violated regulations which are of serious nature and difficult to rectify	-100					
1.6	**Conflict of Interest -** strength of policies and their implementation	Cooperative bye laws should provide policies to avoid conflict of interest for Directors in availing financial services from the cooperative. For instance, it may not allow any board member or their family members to borrow till they are Board members.	**7**	**10**	**70**	**100**	**No**
	Strong policies and good implementation	9-10					
	Reasonably strong policies and good implementation	6-8					
	Reasonably strong policies and reasonable level of implementation	3-5					
	Moderate policies or moderate implementation	0-2					
	Weak policies and serious concerns on conflict of interest in decision making	-100					
A2	**Strategy and positioning**						
1.7	**Cooperative's experience in years** to **execute the Board policy and strategy** in microfinance in the defined target market sector	Cooperative's experience to execute microfinance strategy, judged on its experience in lending, mobilising deposits and competitive strength	**7**	**7**	**49**	**70**	**No**
	Excellent	10					
	Good	7-9					

Assessment of Cooperatives for debt financing

A Governance & Strategy

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
	Moderate	3-6					
	Poor	1-2					
	Very poor	0					
1.8	**Second Line of Leadership**	Second line of leadership refers to an individual who can replace the CEO and/or principal in charge	**7**	**10**	**70**	**100**	**No**
	Presence of strong second line, with requisite qualifications, experience and grooming	10					
	Presence of reasonable second line, with requisite qualifications, experience and grooming	6-9					
	Individual not identified yet, various capable persons, but none with ALL aspects (requisite qualifications, experience and grooming)	1-5					
	CEO centric, no second line, lack of developed leadership capabilities in the other top management	0					
1.9	**Growth strategy**	This covers the expansion strategy for the operations of the institution. Rate of growth should be reasonable and commensurate with the size and market characteristics of the cooperative's operational area. Sudden jumps in growth may indicate large transactions with low diversification and may be risky. Concentration of loans with a few individuals/sectors should be avoided	**7**	**7**	**49**	**70**	**No**

Assessment of Cooperatives for debt financing

A Governance & Strategy

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
	Excellent: Steady growth, diversification among different loan uses and strategy to reduce multiple lending to clients.	10					
	Good: Fairly steady growth, diversification among different loan uses and strategy to reduce multiple lending to clients.	7-9					
	Moderate: Lesser degree of diversification	3-6					
	Fair: Fair degree of concentration either in area or loan use. Risk of multiple lending is present	1-2					
	Poor: High degree of concentration in particular area or type of loan. Risk of multiple lending is high	0					
1.10	**Linkages with financial institutions and a good credit history**	Assess track record of relations with financial institutions. Established relations with other financial institutions will reduce the risks and indicate market standing	**0**	**20**	**0**	**200**	**No**
	Excellent: has borrowed from three or more financial institutions in the past and has met all the repayment obligation and debt covenants	10					
	Good: has borrowed from two or more institutions and has a good repayment track record with all repayments made with less than one month delay	7-9					
	Average or no credit history: Has not borrowed or borrowed only one loan with less than 6 months of repayment track record	0					

Assessment of Cooperatives for debt financing

A Governance & Strategy

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
	Poor: Has borrowed in the past and has delayed repayments by more than a month but less than 3 months (has not turned NPA)	-10					
	Very poor: Is an NPA in the books of the lender(s)	-100					
	Total of Governance & Strategy indicators			**91**	**439**	**910**	**0**
	in terms of percentage				**48.2%**		

Weight distribution

Governance and Strategy	% Weight	% Category score
Quality of Governance	52%	**57.7%**
Strategy and positioning	48%	**38.2%**
Total	**100%**	**48.2%**

Assessment of Cooperatives for debt financing

B Quality of Operations

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
2	**Operations**	There should be systems in place for objective decision making. Microfinance processes should be rigorous and policies well formulated, and well communicated at all levels. MFI should have responsible practices towards its clients.					
B1	**Clients and products**						
2.1	**Quality of clients/members**	Awareness about the cooperative, its products, policies, credit discipline & history, record keeping and loan utilisation	**9**	**10**	**90**	**100**	**No**
	Excellent	10					
	Good	7-9					
	Moderate	3-6					
	Poor	1-2					
	Very poor	0					
2.2	**Membership Retention Rate** as indicator of suitability and sustainability of the cooperative	Quality and success of Board strategy as measured by Client retention rate	**4**	**5**	**20**	**50**	**No**
	Retention rate =>80%	10					
	Retention rate >65% - <80%	6-9					
	Retention rate >50% - <65%	1-5					
	Retention rate <= 50%	0					
2.3	**Appropriate product design and delivery**	Cooperative takes adequate care to design products and delivery channels in such a way that they do not cause clients harm. Products and delivery channels designed with client characteristics taken into account.	**7**	**5**	**35**	**50**	**No**
	Excellent	10					
	Good	7-9					

B Quality of Operations

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
	Moderate	3-6					
	Poor	1-2					
	Very poor	0					
2.4	**Clarity in division of roles between Board and the management, properly laid out systems/authority for the approval of loans, fund management, signing of cheques and other key decisions**	The cooperative has clearly segregated the authority of the management and the Board. Key decisions and authority such as sanctions of loans of various sizes and signing of cheques are clearly documented and well known. No individual has excessive authority and there are adequate checks and delegations.	**8**	**10**	**80**	**100**	**No**
	Excellent	10					
	Good	7-9					
	Moderate	3-6					
	Poor	1-2					
	Very poor	0					
2.5	**Strategies, policies and quality of systems for prevention of over-indebtedness**	The cooperative takes adequate care in all phases of its credit process to determine that clients have the capacity to repay without becoming over-indebted. In addition, the cooperative should implement and monitor internal systems that support prevention of overindebtedness and fosters efforts to improve market level credit risk management (such as credit information sharing).	**8**	**5**	**40**	**50**	**No**
	Excellent	10					
	Good	7-9					
	Moderate	3-6					
	Poor	1-2					

Assessment of Cooperatives for debt financing

B Quality of Operations

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
	Very poor	0					
B2	**Overdue tracking**						
2.6	**Tracking system for overdue**	Response to overdues and its effectiveness. Cooperative should have a policy and set of processes. There should be prompt action on overdues. MIS should support prompt tracking and responsibilities should be assigned.	**10**	**6**	**60**	**60**	**No**
	Excellent	10					
	Good	7-9					
	Moderate	3-6					
	Poor	1-2					
	Very poor	0					
B3	**Efficiency & sustainability**						
2.7	**Borrowers per field staff**	Active borrowers/field officer	**8**	**5**	**40**	**50**	**No**
	>300	7-10					
	>200 up to 300	4-6					
	> 100 up to 200	1-3					
	<100	0					
2.8	**Field staff to total staff ratio**	Support staff as a % of the total staff should be limited	**5**	**5**	**25**	**50**	**No**
	>70%	10					
	>60% up to 70%	7-9					
	>50% up to 60%	3-6					
	>40% up to 50%	1-2					
	<=40%	0					

Assessment of Cooperatives for debt financing

B Quality of Operations

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
2.9	**Inclusiveness and innovation**	Operating in priority districts, gender focus, innovations in product development or distribution, branchless banking, market linkages etc	**6**	**5**	**30**	**50**	**No**
	Very high focus	10					
	High focus	8-9					
	Moderate focus	5-7					
	Limited	1-4					
	No focus	0					
B4	**External Factors**	The industry knowledge gathered from sector wide reports as well as experiences gained from field visits which underline pressures arising from external environment to adversely affect the sector as a whole and cooperatives in particular.					
2.10	**Adverse sociopolitical environment**		**10**	**3**	**30**	**30**	**No**
	Low Risk	8-10					
	Moderate Risk	4-7					
	High Risk	0-3					
2.11	**Risk of natural calamities such as floods**		**8**	**3**	**24**	**30**	**No**
	Low	8-10					
	Moderate	4-7					
	High	0-3					
2.12	**Risk of negative rumors/ loss of reputation**		**8**	**3**	**24**	**30**	**No**
	Low	8-10					

Assessment of Cooperatives for debt financing

B Quality of Operations

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal breaker
	Moderate	4-7					
	High	0-3					
2.13	**Strategic moves by competitors**		**8**	**3**	**24**	**30**	**No**
	Low	8-10					
	Moderate	4-7					
	High	0-3					
	Total of Operational indicators			**68**	**522**	**680**	**0**
	in terms of percentage				**76.8%**		

Weight distribution

Management, systems and CPP issues	% Weight	% Category score
Clients and products	51%	**75.7%**
Indebtedness and overdue tracking	9%	**100.0%**
Efficiency and sustainability	22%	**63.3%**
External factors	18%	**85.0%**
Total	**100%**	**76.8%**

C Management, Interal Control and Client Protection Issues

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal Breaker
3	**Management Systems Operating effectiveness and adherence to responsible client/member protection practices**	There should be systems in place for objective decision making. Microfinance processes should be rigorous and policies well formulated, and well communicated at all levels. Cooperative should have responsible practices to safeguard the interest of its members in letter and in spirit.					
C1	**Human resource and productivity**						
3.1	**Quality of HR systems and processes**	Quality of HR systems in place, HR policy manual, training to staff, staff appraisal system, reasonable performance incentives, grievance redressal mechanism	**6**	**10**	**60**	**100**	**No**
	Excellent: Cooperative has HR systems in place, has an HR manual, training policy and good adherence to policies, a performance appraisal and incentive system and regular update of HR files	10					
	Good: Cooperative has HR system in place, does not have fully written policies but carries out trainings, performance appraisal, performance incentive and updates HR files.	6-9					
	Average: Cooperative has reasonable adherence to policies, has some sort of performance appraisal and incentive system in place and maintains HR files.	1-5					
	Poor: Cooperative does not have HR, training, performance appraisal, performance incentive policies and lacks HR filing system.	0					

Assessment of Cooperatives for debt financing

C Management, Interal Control and Client Protection Issues

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal Breaker
3.2	**Quality of field staff**	Level of education, and competence of the credit officers and risk management team in terms of knowledge of their responsibilities, ability to cope with the requirements of the job	8	10	80	100	No
	Excellent: trained & experienced with good knowledge of responsibilities	10					
	Good: trained & experienced with good knowledge of responsibilities	7-9					
	Average: moderately trained and average knowledge of responsibilities	5-6					
	Poor: not well trained, gaps in knowledge of responsibilities	1-4					
	Very Poor: untrained, severe gaps in knowledge of responsibilities	0					
3.3	**Qualifications and experience of the management**	Level of education, and competence of the management in terms of knowledge of their responsibilities, ability to cope with requirements of the job	8	10	80	100	No
	Excellent: well qualified & experienced with complete knowledge of responsibilities	10					
	Good: qualified & experienced with good knowledge of responsibilities	7-9					
	Average: moderately qualified, average knowledge of responsibilities	3-6					
	Poor: low qualifications, gaps in knowledge of responsibilities	1-3					
	Very Poor: very low qualifications, severe gaps in knowledge of responsibilities	0					
3.4	**Staff attrition rate**	Attrition rates mentioned below may be suitably modified based on the regional context	8	5	40	50	No

C Management, Interal Control and Client Protection Issues

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal Breaker
	<=10%	10					
	10-30%	1-9					
	>30%	0					
C2	**Quality of systems**						
3.5	**Quality of Accounting**	Relevant policies - Income and expense recognition, loan loss provisioning, write-off, depreciation. Records should be updated regularly and accurately	**0**	**10**	**0.0**	**100.0**	**No**
	Excellent	10					
	Good	7-9					
	Moderate	3-6					
	Poor	0-2					
	Very poor and unreliable	-100					
3.6	**Quality of MIS**	All key activities and processes should be documented. All the transactions should be properly recorded with adequate monitoring, safety measures and data protection. The system should allow analysis of portfolio quality, growth trends, classification by nature and quantum of transactions and detection of extra-ordinary large transactions and fluctuations.	**8**	**5**	**40.0**	**50.0**	**No**
	Excellent: Extensive accuracy checks, security of data and meets the requirements as mentioned above (in cell D36)	10					

Assessment of Cooperatives for debt financing

C Management, Interal Control and Client Protection Issues

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal Breaker
	Good: 1-2 day lag for information, extensive accuracy checks, security of data and meets most of the requirements	7-9					
	Average: 1 week lag for information, strong accuracy checks, security of data and meets important data requirements including portfolio quality	3-6					
	Poor: More than one week lag in getting information, medium/ low accuracy checks, medium/ low security of data and does not allow analysis of data for reporting on portfolio quality, classification by nature and size	0-2					
	Very Poor: Data transfer delay > 15 days, low accuracy of data, low security and/or does not allow even basic portfolio reports	-100					
3.7	**Quality of Internal audit & control systems**		**5**	**10**	**50.0**	**100.0**	**No**
	Excellent: The internal audit (IA) function is both competent and independent. Good coverage of IA, good frequency, quality of reporting and timely compliance. The institution has optimal controls and its control policies and procedures are comprehensive and effective, as measured by the rarity of instances of fraud, financial misstatements.	10					

Assessment of Cooperatives for debt financing

C Management, Interal Control and Client Protection Issues

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal Breaker
	Good: The IA is adequate. Reasonable coverage of IA and quality of reporting. The institution has good controls and its control policies and procedures are adequate. Fraud, financial misstatements, and damage to or theft of assets has been minimal.	7-9					
	Moderate: The IA functions exists but exhibits some deficiencies related to coverage and reporting. The institution has had to deal with a few incidences of fraud, misstatements, and damage to or theft of assets.	3-6					
	Poor: The IA function is nonfunctional and inadequate. The institution has dealt with numerous incidences of fraud, misstatements, and damage to or theft of assets.	1-2					
	Very poor: No IA function exists. Weak controls have resulted in serious incidences of fraud.	0					
3.8	**Fund management**	Liquidity or Idle fund ratio will depend upon the size and nature of savings deposits, borrowings and other liabilities. This will also depend upon the quality and duration of assets. The Cooperative may not be able to prepare detailed ALM reports but should make analysis with same principles	**7**	**10**	**70.0**	**100.0**	**No**
	Excellent: Good liquidity management	10					
	Good: Good liquidity management	7-9					
	Moderate: Moderate liquidity management	3-6					

Assessment of Cooperatives for debt financing

C Management, Interal Control and Client Protection Issues

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal Breaker
	Weak Liquidity management	1-2					
	Very weak liquidity management	-100					
C3	**Client Protection Principles**	SMART Client Protection Principles (http://www.smartcampaign.org/about-the-campaign/smart-microfinance-and-the-client-protection-principles)					
3.9	**Appropriate product design and delivery**	Cooperative takes adequate care to design products and delivery channels in such a way that they do not cause harm to its members. Products and delivery channels will be designed with client characteristics taken into account.	**Already covered under 'Quality of Operations'**				
3.10	**Strategies, policies and quality of systems in prevention of over-indebtedness**	Cooperative takes adequate care in all phases of their credit process to determine that clients have the capacity to repay without becoming over-indebted. In addition, cooperative should implement and monitor internal systems that support prevention of overindebtedness and fosters efforts to improve market level credit risk management (such as credit information sharing).	**Already covered under 'Quality of Operations'**				
3.11	**Responsible Pricing**	Pricing, terms and conditions are set in a way that is affordable to clients while allowing for financial institutions to be sustainable. Cooperative should strive to provide positive real returns on deposits.	**7**	**2**	**14.0**	**20.0**	**No**
	Excellent	10					
	Good	7-9					
	Moderate	3-6					
	Poor	1-2					

C Management, Interal Control and Client Protection Issues

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal Breaker
	Very poor	0					
3.12	**Transparency**	Cooperative should communicate clear, sufficient and timely information in a manner and language clients can understand so that clients can make informed decisions. The need for transparent information on pricing, terms and conditions of products is highlighted.	**7**	**2**	**14.0**	**20.0**	**No**
	Excellent	10					
	Good	7-9					
	Moderate	3-6					
	Poor	1-2					
	Very poor	0					
3.13	**Fair and respectful treatment of clients**	Cooperative should treat clients fairly and respectfully. It will not discriminate. Cooperative should ensure adequate safeguards to detect and correct corruption as well as aggressive or abusive treatment by its staff, particularly during the loan sales and debt collection processes.	**7**	**2**	**14.0**	**20.0**	**No**
	Excellent	10					
	Good	7-9					
	Moderate	3-6					
	Poor	1-2					
	Very poor	0					
3.14	**Mechanism for complaint resolution**	Cooperative should have in place timely and responsive mechanisms for complaints and problem resolution for its clients and should use these mechanisms both to resolve individual problems and to improve their products and services.	**7**	**2**	**14.0**	**20.0**	**No**

Assessment of Cooperatives for debt financing

C Management, Interal Control and Client Protection Issues

	Criteria	Rating basis	Rating given	Weight	Score	Max. possible score	Deal Breaker
	Excellent	10					
	Good	7-9					
	Moderate	3-6					
	Poor	1-2					
	Very poor	0					
3.15	**Privacy of client data**	The privacy of individual client data is respected in accordance with the laws and regulations of individual jurisdictions. Such data will only be used for the purposes specified at the time the information is collected or as permitted by law, unless otherwise agreed with the client.	**7**	**1**	**7.0**	**10.0**	**No**
	Excellent	10					
	Good	7-9					
	Moderate	3-6					
	Poor	1-2					
	Very poor	0					
	Grand total of organisational indicators			**79**	**483**	**790**	**0**
	in terms of percentage				**61.1%**		

Weight distribution

Management, systems and CPP issues	% Weight	% Category score
Quality of HR and productivity	44%	**74.3%**
Quality of systems	44%	**45.7%**
Adherence to CPP	11%	**70.0%**
Total	**100%**	**61.1%**

Assessment of Cooperatives for debt financing

C *Financial performance*

S. No.	Criteria	Rating basis	Rating given	Weight	Score	Max. possible	Dealbreaker
4.1	**Financial Systems and Performance Indicators**	The financial section contains critical indicators of the loan portfolio, efficiency & funding and indicators of financial performance of the cooperative.					
D1	**Portfolio Quality**						
4.1	**PAR> 30 days + Loans Rescheduled (outstanding as % of total portfolio)**	(Portfolio at Risk greater than 30 days + amount of loan outstanding of the rescheduled loans)/ Portfolio Outstanding)	**2**	**10**	**20.0**	**100.0**	**No**
	0 up to 2%	10					
	>2% upto 4%	8-9					
	>4% upto 6%	6-7					
	>6% upto 10%	3-5					
	>10% upto 15%	0-2					
	>15%	-100					
4.2	**Repayment rate**	(Total collections made less prepayment) during last 12 months / Total amount due to be repaid by borrowers in last 12 months	**2**	**10**	**20.0**	**100.0**	**No**
	>=99%	10					
	90% to 99%	5-9					
	80% to 90%	2-4					
	<80%	1-2					
4.3	**Yield to APR**	Yield on Portfolio(YOP) / Annualised Percentage Rate (APR)	**8**	**10**	**80.0**	**100.0**	**No**
	>=95%	10					
	80 to 95%	5-9					
	70% - 80%	3-4					

Assessment of Cooperatives for debt financing

C *Financial performance*

S. No.	Criteria	Rating basis	Rating given	Weight	Score	Max. possible	Dealbreaker
	<70%	0-2					
D2	**Financial performance and sustainability**						
4.4	**Operational Self Sustainability**	Total Operating Income for the period/ Total Operating, Financial and Loan Loss Provision Expenses for the period	**8**	**5**	**40.0**	**50.0**	**No**
	>110%	10					
	95-110%	7-9					
	85-95%	3-6					
	<85%	0-2					
4.5	**Return on Assets**	Net Surplus for the period / Average total assets for the period	**6**	**10**	**60.0**	**100.0**	**No**
	Current year >=2.5% and average for three years >2%	8-10					
	Current year >1% and average for three years >0%	5-7					
	Current year negative 1% to positive 1% and average for three years >negative 1%	1-4					
	Current year <negative 1% or average for three years <negative 1% or cases not covered by above	0					
4.6	**Operating Expense Ratio**	Operating expenses for the period/ average portfolio outstanding for the period (standards may be changed depending upon the model and regions of operations)	**7**	**10**	**70.0**	**100.0**	**No**
	<8%	10					

Assessment of Cooperatives for debt financing

C *Financial performance*

S. No.	Criteria	Rating basis	Rating given	Weight	Score	Max. possible	Dealbreaker
	<12% up to 8%	7-9					
	<18% up to 12%	3-6					
	>=18%	0-2					
D3	**Capital Adequacy and composition of assets and liabilities**						
4.7	**Total Capital to Risk weighted Assets Ratio (CRAR)**	Risks weights should be assigned based on assessment of risk on assets. In the absence of regulations for the cooperatives, generally accepted risk weights - 0% on cash and bank balances, 50% on land and building and 100% on loan portfolio and all assets. The slabs mentioned here may be changed based on regulatory requirements and growth plans.	**0**	**5**	**0.0**	**50.0**	**No**
	>18%	10					
	>15% up to 18%	9					
	>12% up to 15%	7-8					
	>8% up to 12%	5-6					
	>4% up to 8%	3-4					
	>=0% up to 4%	0-2					
	<0%	-100					

Assessment of Cooperatives for debt financing

C *Financial performance*

S. No.	Criteria	Rating basis	Rating given	Weight	Score	Max. possible	Dealbreaker
4.8	**Institutional Capital (fixed and non withdrawable capital) to Risk weighted Assets Ratio (ICRAR)**	Only non withdrawable capital as per the by laws of the cooperative should be taken in the numerator. Risks weights should be assigned based on assessment of risk on assets. In the absence of regulations for the cooperatives, generally accepted risk weights - 0% on cash and bank balances, 50% on land and building and 100% on loan portfolio and all assets. The slabs mentioned here may be changed based on regulatory requirements and growth plans.	**0**	**5**	**0.0**	**50.0**	**No**
	>12%	10					
	>8% up to 12%	9					
	>6% up to 8%	4-8					
	>=2% up to 6%	2-4					
	<2% up to 0%	0-2					
	<0%	-100					
4.9	**Debt Equity Ratio (after disbursement of the proposed loan)**	Debt/Equity	**10**	**5**	**50.0**	**50.0**	**No**
	0 up to 2	10					
	>2 up to 6	7-9					
	>6 up to 8	5-6					
	>8 up to 12	1-4					
	>12	0					
4.10	**Savings to total debt ratio (after disbursement of the proposed loan)**	Higher member deposits indicate higher trust of members in the cooperative and reduces risk for an external lender	**7**	**10**	**70.0**	**100.0**	**No**
	>90%	10					
	>70% up to 90%	7-9					

Assessment of Cooperatives for debt financing

C ***Financial performance***

S. No.	Criteria	Rating basis	Rating given	Weight	Score	Max. possible	Dealbreaker
	>50% up to 70%	2-6					
	>=30% up to 50%	0-1					
	<30%	-100					
4.11	**Current Ratio**	Ratio of assets (or part of assets) that will turn in to cash within one year (< one year maturity) to liabilities (or part of liabilities) including member deposits that need to paid off or are expected to be paid off within one year .	**7**	**10**	**70.0**	**100.0**	**No**
	>3	10					
	>1.5 up to 3	6-9					
	>1 up to 1.5	2-5					
	>0.5 up to 1	1					
	<=0.5	0					
	Grand total of financial indicators			**90**	**480**	**900**	**0**
	in terms of percentage				**53.3%**		

Weight distribution

	% Weight	% Category score
Portfolio Quality	33.3%	**40.0%**
Financial Performance and Sustainability	27.8%	**68.0%**
Capital Adequacy and Composition of assets and liabilities	38.9%	**54.3%**
Total	**100%**	**53.3%**

Assessment of Cooperatives for debt financing

Final Score and Grade	53.3%	C+
-		
Organisation name ____________.		
Period of assessment ____________.		

-	Category	Ratings												
		Weightage (%)	Score	Grades										
				A+	A	A-	B+	B	B-	C+	C	C-	
1	*Governance & Strategy*	30.0%	48.2%	-	-	-	-	-	-	-	C	-	Grades auto-linked. No inputs required for any cells in this table.
2	*Quality of Operations*	20.0%	76.7%	-	-	A-	-	-	-	-	-	-	
3	*Management, Interal Control and Client Protection Issues*	20.0%	61.1%	-	-	-	-	B	-	-	-	-	
4	*Financial performance*	30.0%	53.3%	-	-	-	-	-	-	C+	-	-	
			53.3%										
	Overall totals (unadjusted)	**100.0%**	**58.0%**	-	-	-	-	-	B-	-	-	-	
Final grade			53.3%	-	-	-	-	-	-	C+	-	-	

Final grade subject to minimum conditions

Parameters affecting overall grades		Auto-linked. No input required.		CHECK CATEGORY WISE GRADES!!	58.0%	A+	This section limits the overall grade. No input required.
Section score: Governance	48.20%				58.0%	A	
Section score: Financial	53.30%				58.0%	A-	
PAR	1.00%				58.0%	B+	
ROA	5.00%	Input PAR & RoA.			58.0%	B	
					55.0%	B-	

	53.3%	**53.3%**	**53.3%**	**53.3%**	**53.3%**	**53.3%**	**53.3%**	**53.3%**	**53.3%**	This section limits the financial grade. No input required.
A+	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	
A	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	
A-	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	
B+	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	
B	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	
B-	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	53.3%	

	PAR	**RoA**	This defines limits for assigning the financial grade. No input required.
A+	0	5	
A	2.5	3.5	
A-	5	2	
B+	7.5	0.5	
B	10	-1	
B-	12	-2	

Annex:

Summary of observations from inception meetings with various stakeholders

Assessment tool parameters and overall grade computation

A	**Governance & Strategy**
1	**Quality of Governance**
1.1	Composition of the Governing Board. Board members' experience, education and reputation
1.2	Well represented and democratically elected Board
1.3	Regularity of Board meetings and quality of discussions in the meetings
1.4	Regularity of General body meetings, attendance and quality of discussions in the meetings
1.5	Compliance with regulatory requirements and Transparency
1.6	Conflict of Interest - strength of policies and their implementation
2	**Strategy and positioning**
2.1	Cooperative's experience in years to execute the Board policy and strategy in microfinance in the defined target market sector
2.2	Second Line of Leadership
2.3	Growth strategy
2.4	Linkages with financial institutions and a good credit history
B	**Operations indicators**
3	**Clients and products**
3.1	Quality of clients/members
3.2	Membership Retention Rate as indicator of suitability and sustainability of the cooperative
3.3	Appropriate product design and delivery
3.4	Clarity in division of roles between Board and the management, properly laid out systems/ authority for the approval of loans, fund management, signing of cheques and other key decisions
3.5	Strategies, policies and quality of systems for prevention of over-indebtedness
4	**Overdue tracking**
4.1	Tracking system for overdue
5	**Efficiency & sustainability**
5.1	Borrowers per field staff
5.2	Field staff to total staff ratio
5.3	Inclusiveness and innovation
6	**External Factors**
6.1	Adverse sociopolitical environment
6.2	Risk of natural calamities such as floods
6.3	Risk of negative rumors/ loss of reputation
6.4	Strategic moves by competitors
C	**Management, Internal Control and Client Protection Issues**
7	**Human resource and productivity**
7.1	Quality of HR systems and processes
7.2	Quality of field staff

7.3	Quality and experience of management
7.4	Staff attrition rate
8	**Quality of Systems**
8.1	Quality of Accounting
8.2	Quality of MIS
8.3	Quality of Internal audit & control systems
8.4	Fund Management
9	**Client Protection Principles**
9.1	Responsible Pricing
9.2	Transparency to clients
9.3	Fair and respectful treatment of clients
9.4	Mechanism for grievance redressal
9.5	Privacy of client data
D	**Financial performance**
10	**Financial risk cover**
10.1	Portfolio at Risk
10.2	Repayment Rate
10.3	Yield to APR
11	**Financial performance and sustainability**
11.1	Operational Self Sustainability (OSS)
11.2	Return on Assets
11.3	Operating Expense Ratio
12	**Capital Adequacy and composition of assets and liabilities**
12.1	Capital to risk weighted Assets Ratio (CRAR)
12.2	Institutional Capital to risk weighted Assets Ratio (ICRAR)
12.3	Debt Equity Ratio
12.4	Savings to total Debt Ratio
12.5	Current Ratio

The last sheet “Consolidated”, presents the section wise grades and the consolidated (**overall**) grade. **No manual entries are required in this sheet by the analysts**.

While computing the consolidated grade, the system limits the overall grade based on four critical values. These are - PAR, RoA, overall score in Governance section and overall score in Financial section. While there are adequate checks in individual sections to limit the overall scores on critical parameters, in case because of high performance on certain other parameters a cooperative is able to score a high grade despite a low score on any of the abovementioned 4 parameters, this filter reduces the overall grade automatically.

Summary of observations from inception meetings with various stakeholders

During the team's inception visit, meetings were held with the following

A. **UNNATI A2F** project team which included representatives of NRB and UNCDF

B. **CEOs and other senior executives of Industry Associations**
   a. Nepal Bankers' Association (NBA)
   b. Nepal Microfinance Development Bankers' Association and
   c. Nepal Federation of Savings and Credit Cooperative Unions Ltd. (NEFSCUN), the member based national apex organization of Savings and Credit Cooperative Societies (SACCOS)

C. **CEOs/ microfinance product heads of Commercial Banks**
   a. NMB Bank
   b. Janata Bank
   c. NABIL Bank
   d. Bank of Kathmandu Lumbini

D. **Wholesale lenders to cooperatives**
   a. Rural Microfinance Development Centre (RMDC)
   b. Sana Kisan Bikas Bank
   c. National Cooperative Bank

E. **A Government Fund lending to cooperatives –** Youth and Small Entrepreneur Self-Employment Fund, Ministry of Finance

F. **Cooperatives**
   a. Jana Jagriti Vegetable and Fruits Cooperative Ltd
   b. Bindabasini Savings and Credit Cooperative Society Ltd (BISCOL)

G. **Department of Cooperatives** – the regulator for the cooperatives

1. Inception meeting with UNNATI A2F – members from NRB, UNCDF and UNNATI A2F Project

The meeting focused on the project objectives, context, plan of action and schedule. It was discussed that while at present, many banks and wholesale lenders have developed and are using cooperatives assessment tools, the tool that will be designed as part of this project should have universal acceptability in Nepal without limiting it to a set of BFIs, a few value chains or to a region. UNCDF emphasized that even though UNNATI project is working in the EDR with specific agri value chains, they would like to take a wider set of BFIs and their needs into account. The tool need not be limited to EDR and should be applicable though out Nepal. Also, since the **objective is to assist the BFIs in wholesale lending** to cooperatives, the tool should be able to assess the cooperatives which are engaged in micro-lending. The tool should be able to meet the basic requirements of banks and wholesale lending organizations and should be easy to customize as per their requirements.

2. Meetings with industry associations

NBA is the industry association for commercial banks. The CEO of NBA who is also the CEO of Mega Bank expressed the strong desire to participate in the process of developing a rating tool to assess the cooperatives. He indicated that, as the deprived sector lending targets are linked to the banks' overall lending, which is going to increase significantly, it is important that we have a robust and formal tool to assess the cooperatives. The CEO suggested the formation of a task force of bankers to provide feedback to the M-CRIL team in designing, testing and finalizing the tool to ensure the tool's appropriateness for users. To gauge the need of the bankers, a questionnaire may also be circulated to the task force. It was decided that NBA take the lead in the formation of the task force.

NEFSCUN has 2,900 member SACCOS and is working in 74 of the 75 districts of Nepal. The association has developed a tool to assess these cooperatives.

Apart from the assessments carried out at the time of lending, NEFSCUN provides a three-level certification programme; cooperatives can opt on a voluntary basis to get themselves audited by NEFSCUN in any of the following three certification programmes

1. ACCESS (A1 Competency Courses for Excellence in Services and Soundness), a tool with 86 indicators to assess the performance of the SACCOS. The tool is developed by the Asian Confederation of Credit Unions (ACCU); 12 cooperatives in Nepal have been certified and a total of 46 are currently enrolled in the program.
2. NEFSCUN has designed a national level certification called Program for Building Absolute Professionalization (PROBATION) which uses 55 of the 86 parameters of ACCU; 12 cooperatives have been certified and a total of 86 SACCOS are participating in this program.
3. Recently, it has also designed a risk based monitoring programme which uses around 30 parameters out of ACCU's 86 parameters

A cooperative may voluntarily apply for these certifications by paying a fee which is intended to provide additional credibility to help cooperatives raise deposits from members and loan funds from BFIs. However, the number of cooperatives which have enrolled in these three certification programmes is extremely low. Only 12 cooperatives have received the Asia and national level certification and 20 are part of the third risk based monitoring programme. Also, the level of awareness among BFIs about these certification programmes is currently low and some banks also expressed their lack of confidence in the due diligence process used by NEFSCUN, partly on account of the conflict of interest in an association certifying its own members.

3. Meetings with commercial banks ('A' category banks)

Apart from a meeting with the CEO of the Nepal Bankers' Association, the team met the CEOs of four commercial banks.

While NMB Bank and Bank of Kathmandu Lumbini see lending to cooperatives as a means to reach the untapped microfinance market by avoiding the already overcrowded MFI lending segment, the other two banks believe that they do not have the resources and branch network to lend to this segment which requires more stringent due-diligence and regular monitoring.

NMB Bank has suggested the setting up of an independent agency which may be a separate legal entity to select/shortlist deserving cooperatives.

NMB Bank's existing tool emphasizes on the following

1. Capital or net worth of the cooperative
2. Board of Directors – experience and the manner in which they are elected
3. Quality of Management
4. Risk in the industry and the geography in which the cooperative is operating

5. Risk of competition
6. Quality of the loan portfolio

While it requires collateral from most of the cooperatives, a few large and reputed cooperatives are lent to without collateral. The collateral is usually on key persons' (Directors/management) property and personal guarantees.

The quality of audit of cooperatives is usually weak and accounting policies and quality of accounts need thorough checking. Only a few cooperatives get their accounts audited by Chartered Accountants (class A auditors) and most are audited by class C or D auditors. However, the quality of accounting is not much different for those with Class A auditors. The Credit Information Bureau does not provide much information in the case of lending to cooperatives.

The risk perception in lending to cooperatives is high resulting in a rate of interest differential of 2 percent to 3 percent in lending to them as against lending to MFIs since the latter are regulated by the NRB.

Janata Bank sees challenges in lending to cooperatives. It finds much higher comfort in lending to the MFIs as they are regulated and follow prudential norms. It has lent to 3 to 4 cooperatives only with sufficient collateral (at least 200 % of the loan amount) of fixed property and charges around 2 persent higher rate of interest than the MFIs. The bank lacks the branch network and presence in the regions to identify eligible cooperatives and lacks the resources to perform frequent due-diligence and regular monitoring. Non-availability of data from credit bureau on repayment history of the cooperatives is also a constraint. The bank suggests sharing of operational costs by donors to facilitate increased lending to the cooperatives.

Bank of Kathmandu Lumbini (BoKL) has a dedicated Development Credit Unit which was initially involved in wholesale lending activities to MFIs but has, since 2004, followed a strategy to downscale to direct microfinance lending including lending to small cooperatives. As a long term and differentiating strategy, the bank aims to diversify its loan portfolio to the micro and small enterprise segment. The bank also has a strategy to offer financial services to farmers. The bank has developed products for micro-enterprises and farmers after carrying out studies in support from a few external agencies.

BoKL is the first bank to lend to non-licensed cooperatives and has developed a rating tool to assess cooperatives. The tool reviews Governance, Managerial capacities and Financial performance of the cooperatives. The size of the loan varies from NPR10mn to 100mn per institution, but the loan amount should not exceed 1/3rd of the total assets of the cooperative and is limited to 5 times the share capital of the cooperative. The bank has currently lent to 40 non-licensed cooperatives from its six branches in the Far West Region. The bank lends to cooperatives without the personal guarantees members or directors and only takes a corporate guarantee; this is a unique feature. The bank till now has no NPAs among cooperative borrowers. The banks plans to lend from 25 branches by the end of this fiscal year. The bank believes that the tool developed by M-CRIL will be a value addition to assess the cooperatives even though it already has a tool to assess cooperatives. The Bank believes that it is also important to develop the technical capacities of the cooperatives.

NABIL Bank does not focus on lending to cooperatives and has only 4 cooperative borrowers. It believes that lending to cooperatives cannot be counted as deprived sector lending as cooperatives are not regulated. It is also concerned about political and communal influences present in cooperatives which can affect its portfolio quality. If banks lend to non-licensed cooperatives, they have to ensure that the end use is microfinance which is difficult for a bank to do with limited resources for field monitoring.

The bank like most other commercial banks is concerned about the 2 percent direct lending target mandated by the NRB in the current year and suggests that cooperatives should act as banks' agents in microfinance lending.

For its cooperative borrowers, it follows a similar due diligence process as that for MFIs and is enthusiastic about receiving a separate tool to assess cooperatives.

4. Meetings with wholesale lenders to cooperatives

Rural Microfinance Development Centre (RMDC) has long experience of lending to MFIs and cooperatives and has deep understanding of the risk in such lending. Around 50 percent of the cooperative applicants are rejected. The due diligence team looks at the following broad parameters

- Governance – the involvement of members and process in selection of the board; lending policies should not benefit the directors
- Management systems such as internal audit, accounting, quality of credit and HR policies, quality of management and staff and training systems
- Lending by other BFIs to the cooperative improve confidence; a good repayment history is also a big plus – this has to be checked from the cooperatives own records as credit bureaus do not provide such information as yet
- Quality of the loan portfolio of the cooperative; it should have a minimum of 98 percent repayment rate
- Should have a good capital base with a minimum net worth of NPR 5 lakh
- Quality of collateral – RMDC requires collateral from the Directors and if the Directors change, new directors have to offer their personal property as collateral
- Personal guarantee of the CEO is also required
- The directors and the management should have a good personal credit history
- A positive trend of increase in net worth, profitability, savings and loan portfolio
- Financial performance as measured from RoA, RoE and OSS and savings to credit ratio

RMDC management agreed that the risk of multiple lending is increasing and in the absence of information from credit bureau, the risk is high. Currently they do not consider the extent of concentration of MFIs in their assessments, but it should be included.

Sana Kisan Bikas Bank lends mainly to small agricultural cooperative societies as part of its mission; many of these are promoted by Sana Kisan itself. Over 600 agriculture cooperatives are associated with Sana Kisan Bikas Bank. Most of these cooperatives provide savings and credit services to farmers. The bank promotes cooperatives and once they achieve 375 members and can manage operations independently, the management is handed to the members. As a prudent practice, it requires at least 60% of the total assets to be funded by members' deposits to ensure their ownership and trust.

National Cooperative Bank is a **'**D' category bank mandated to lend exclusively to the cooperatives. It has 9,000 members, of which 2,500 are borrowers. Out of these 2,500 cooperative borrowers, 1,900 are SACCOS while 600 are multi-purpose or agricultural cooperatives. NCBL has borrowed only NPR 1 billion from the commercial banks as part of their deprived sector lending while deposits from member cooperatives constitute NPR11 billion. It has been able to lend only NPR 8 billion to the cooperatives. The remaining amount is kept with commercial banks as deposits. The key reason for this excess liquidity is a high rejection rate among the cooperative applicants and a limited number of eligible cooperatives. Most of the cooperatives are not able to meet the stringent collateral requirements of the bank. NCBL requires either cooperatives or its board members to provide land and building as registered mortgage. The bank has in the past liquidated some assets to make recoveries and feels this to be an important requirement for lending to cooperatives.

NCBL uses an internally developed tool to assess cooperatives which rates them on governance, financial performance and past transaction with banks. It also uses the PEARLS indicator as part of its tool. Cooperatives which score the highest grade of A+ do not need collateral while all others need collateral (land and building). However, none of the cooperatives has scored A+.

The average loan size is NPR 10 million and NPA is currently at 3 percent.

NCBL feels that it can contribute to the formation of a credit bureau for cooperatives as it has the repayment history of a large number of cooperatives. However, all efforts made to form such a bureau have failed in the past. NCBL has shown keen interest to participate in the process of designing the tool and will provide feedback on the draft shared with it.

5. Meeting with a Government fund - **Youth and Small Entrepreneurs Self Employment Fund**

The fund was created by the Finance ministry, Government of Nepal. While creating it, the Government made it mandatory for all the BFIs to allocate 1/3rd of their deprived sector loans to this scheme at an annual rate of interest of 3 percent. This contribution was a one-time contribution by the banks.

The fund is managed by a team of 65 and the governing board is chaired by the Finance Minister. The fund charges 5 percent per annum interest from the cooperatives and mandates that individual members lent from this fund should not be charged more than 10% interest per annum by the cooperatives.

The following are the eligibility requirements wholesale loans to cooperatives

Working areas	Minimum Share Capital NPR lakh	Minimum Membership	Other requirements/Remarks
Metropolitan	10	500	Cooperatives should be at least two years old and should be in profit over the past two years
Sub-Metropolitan	8	400	
Municipalities	5	300	
Village Development Committees	3	200	Cooperatives should be at least one year old and should have generated profits in past year
For remote areas and producer cooperatives in rural areas	1	50	Cooperatives should be at least one year old
For all	-	-	NPA < 5%

6. Visit to Cooperatives

Shree Jana Jagriti Vegetable and Fruit Cooperative, Dhulikhel has 1,351 members and has collected NPR 3.53 crore as members' savings and has disbursed NPR 3.65 crore in loans to its members.

The cooperative disburses loans for three years to it members. Interest is paid monthly at 13 percent per annum while principal is repaid quarterly. It pays 7-10 percent interest per annum on deposits. It does not take collateral while providing loans up to NPR 2 lakh and a loan limit is NPR 15 lakh. It has a small amount overdue of NPR 7 lakh.

The cooperative has received awards for its good governance and management. It uses an accounting software and follows prudent accounting policies in recognizing cost mainly interest on deposits and provisioning on NPAs.

It is evident that members find their money safe with a well-managed cooperative and growth of deposits is a good indicator of that.

Bindabasini Savings and Credit Cooperative, Banepa was established in 1996 and has a limited license from NRB. It is one of the most reputed cooperatives in Nepal with 23,516 members and 6,000 child savers. The cooperative has share capital of NPR17 crore, savings of NPR 131 crore and a loan portfolio of NPR 146 crore. It has 8,000 borrowers.

BISCOL has a limited amount of external borrowing from three lenders – NPR 75 lakh from First Microfinance Bank, NPR 90 lakh from NIC Asia and NPR 5 crore from Machhapuchchhre Bank. The cooperative follows PEARL indicators for good governance and does not allow borrowings to exceed more than 5 percent of its total assets even though these borrowings are cheaper than member deposits.

BISCOL's Chief Manager and the Chairman believe that they are a highly rated cooperative because they ensure the following

1. A good capital base
2. High loan recovery rate
3. A prudent accounting policy to make loan loss provisions
4. Good governance practices
    a. Role of BoDs and management are clearly defined
    b. BoDs do not avail loans from the cooperative
    c. All operating policies including lending policies are clearly laid out

5. Good quality management system
    a. Accounting and MIS
    b. Internal audit
    c. Accounting policies

6. The Chairman also emphasized that cooperatives with a good membership base and reasonable lending practices do not face fluctuations in their liquidity as deposits and loan sizes are relatively small and well diversified

7. It is also important to follow all the regulatory requirements and cooperative principles

8. Satisfaction of members and management/staff is also an important indicator.

7. Meeting with the Registrar, Department of Cooperatives

The Department of Cooperatives is the regulator for cooperatives in Nepal requiring societies to report to it annually. During the meeting, the Registrar emphasized the need to provide grants to the cooperatives for developing their capacities rather than providing loans. However, he accepted the idea of developing an effective mechanism which could assist in the disbursement of wholesale loans to cooperatives.

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