Gramalaya Urban and Rural Development Initiatives and Network (Guardian) - Section 25 Company

{third update}

Trichy, Tamil Nadu, India

September 2013

Microfinance Institutional Rating

Investment Grade	Above	α	α+
			α
			α−
		β	β+
			β
	Below		β−
		γ	γ+
			γ

	May 2009	Aug 2011	Aug 2012	Sept 2013
RATING	β	β	β	β
RATING OUTLOOK*	*positive*	*positive*	*positive*	*positive*
Dimensions rated	**Grade**			
Governance & strategy	β	β	β+	β+
Organization & Management systems	β	β+	β+	β+
Financial performance	β	β	β	β

*M-CRIL's viewpoint (positive, neutral or negative) of the future prospects of the organization

Visit: 03-06 September 2013

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    - ✓ Appropriate product design and delivery
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Synopsis

- Gramalaya Urban and Rural Development Initiative and Network (Guardian) was established in November 2007 by its parent organization Gramalaya as a not for profit organization registered under Section 25 of the Companies Act 1956. It provides loans exclusively for Water and Sanitation (WatSan) to the poor households.
- The operations of Guardian started by lending to Gramalaya promoted Self Help Groups (SHGs). Later, Guardian also started lending to Joint Liability Groups (JLGs) and this is the current model.
- As Guardian lends only for WatSan and has over time gained expertise in lending to WatSan, it has a competitive edge because of better understanding of dynamics and risks of this segment.
- Guardian's sole focus being on WatSan loans, most of the borrowers drop-out after first loan which restricts the growth rate of clients and also leads to higher operational cost related to identification of new clients. At present, ~9% of clients have 2nd cycle loan with Guardian.
- As on 31 March 2013, Guardian had its operational presence in 19 blocks in 4 districts of Tamil Nadu. It had a borrower base of 15,962 clients organised in 7,514 groups as on 31 Mar 2013.
- The organization has a strong and experienced Board. A new member has been added as the nominee director of Acumen Fund Inc. The level of participation of the board members in strategic decision making and in exercising oversight is good. The second line of management comprises of Manager- Operations and Manager – Credit. Both are associated with Guardian since its inception.
- Guardian has a good performance in adherence to client protection principles.
- Though 93.5% of Guardian's source of funds comes from borrowings, it continues to be reliant on two funders (IOB and Acumen fund). Being a Section-25 company, limits its attractiveness to raise equity resulting in low capital adequacy ratio (CAR) of 4.9% on 31 March 2013.
- Guardian has recorded operating profit for the first time. However, not only is this profit marginal it is also on account of staff/branch costs of 5 branches being met by Gramalaya through grant support of Water.org.

Synopsis ...continued

Main Performance Indicators				
	31-Mar-10	**31-Mar-11**	**31-Mar-12**	**31-Mar-13**
Gross Portfolio (Rs in lakh)	366.81	528.32	638.68	829.30
Number of active borrowers	8 521	10 784	11 944	15 962
Return on Assets (RoA)	(9.3%)	(2.4%)	(1.9%)	0.2%
RoA after non-operational income*	3.0%	2.1%	1.4%	0.2%
Portfolio Yield	19.8%	20.6%	20.4%	21.0%
Portfolio at Risk (>60days)	0.1%	0.3%	1.3%	2.2%
Operating Expense Ratio (OER)	18.0%	12.3%	14.4%	10.4%
Avg. Loan Disbursement (Rs)	7 071	8 276	8 618	8 739
Avg. Loan Outstanding (Rs)	4 305	4 899	5 347	5 195
Borrowers per field staff	852	770	543	363
Capital Adequacy Ratio	5.8%	6.1%	6.2%	4.9%

In M-CRIL's view, at present Guardian needs to be supported by soft loans from Development Financial Institutions (DFIs). A rating update after one year is suggested to ascertain changes in the creditworthiness of the institution. This rating is valid, subject to no other significant changes in the organizational structure and external operating environment.

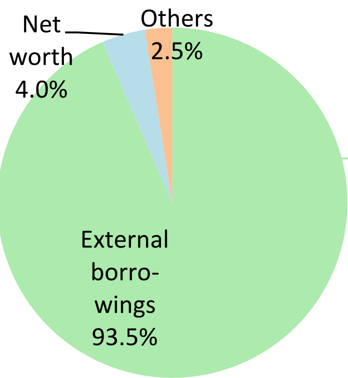
Strengths

- The Board is experienced and qualified; strengthened by the addition of a nominee director from Acumen Fund Inc.
- MIS upgraded to web based Delphix Nano which assists better ageing analysis.
- Improved monitoring with new initiatives including adoption of Units (or Branch) by the senior managers.
- Increased scope of Internal Audit; initiated presentation of summary of audit findings during monthly review meeting.
- Stable second line of management, highly motivated staff.
- Ensured grant support from Water.org to meet operational expenses through Gramalaya
- Standardized systems and procedures and good quality of clients.
- High transparency in communicating interest rates and other product terms to the clients
- Low interest rates at APR of 22.4% in comparison with other MFIs.

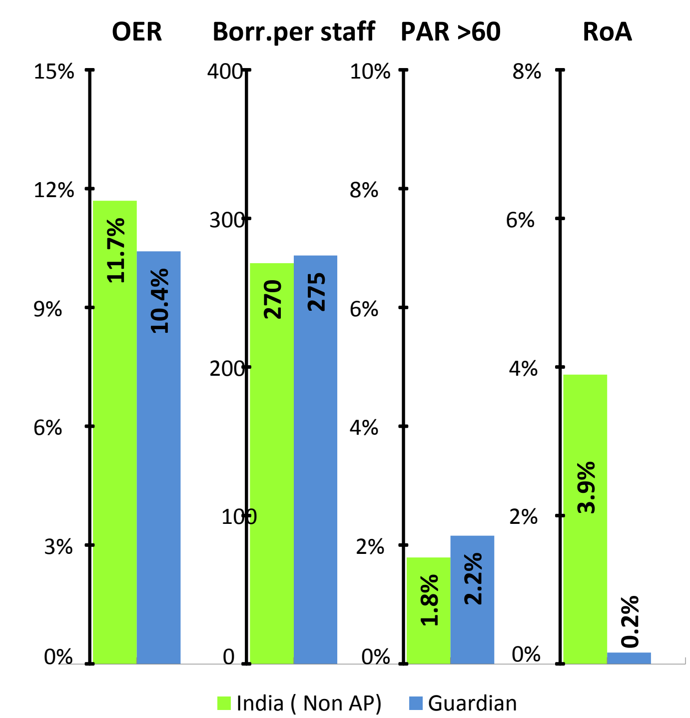
Issues

- Low capital adequacy of 4.9% as on 31 March 2013 which limits the ability of Guardian to leverage debt funds.
- PAR60 increased to 2.2% as on 31 March 2013 but has come down to 1.2% on 31 July 2013.
- The operating expense ratio (OER) has reduced from 14.4% during FY2011-12 to 10.4% during FY2012-13. However if expenses met through Gramalaya are included, the OER for FY2012-13 is 17.4%.
- Higher OER is on account of 5 new branches which are yet to achieve scale.
- Multiple loan clients are not filtered systematically. No formal policy on avoiding multiple lending and addressing client grievances.

Sources of funding



Comparison of Guardian's performance
With benchmarks as per M-CRIL MF Review 2012



Rating rationale

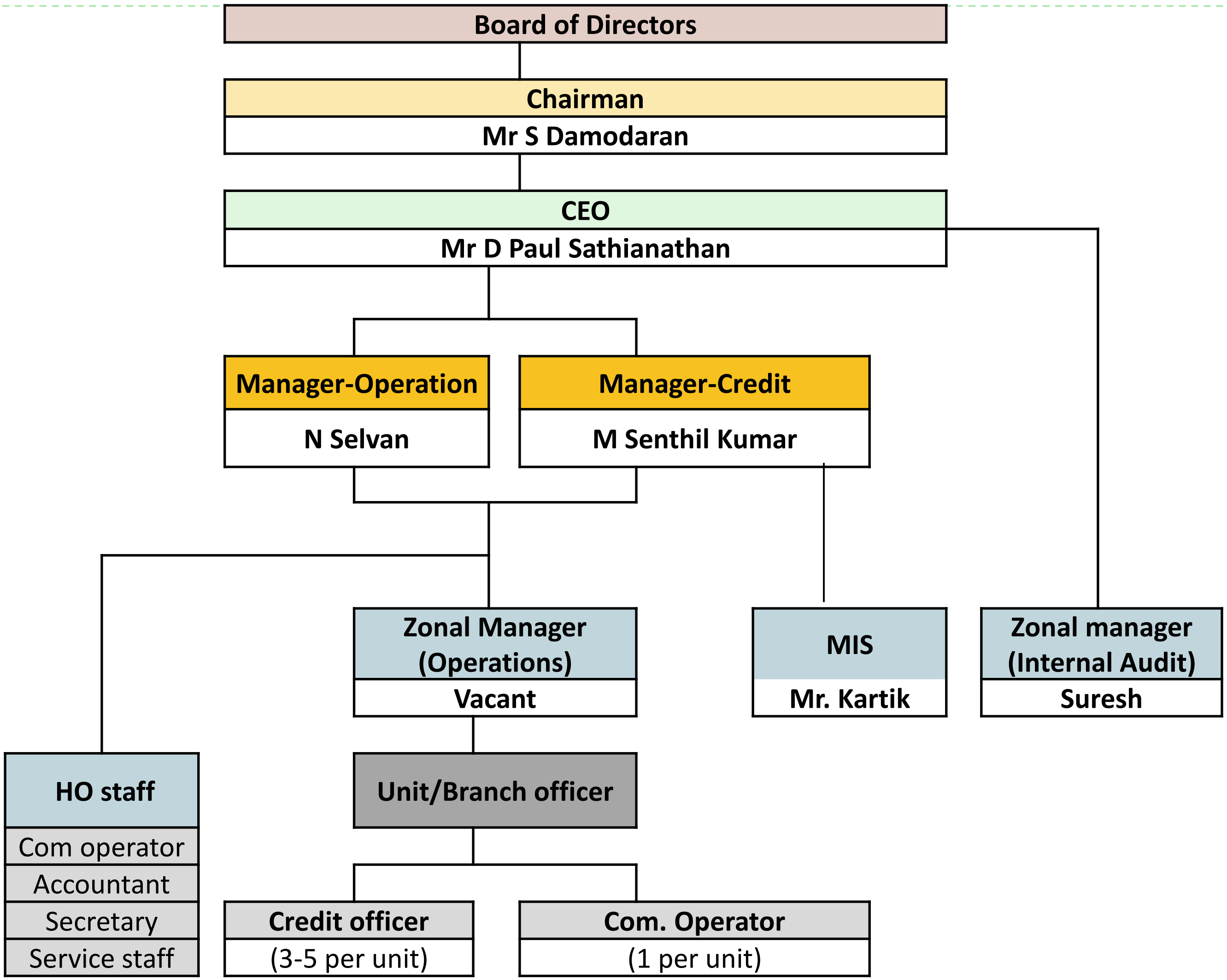
- ✓ Good credibility, strong support from Gramalaya : Guardian has good credibility in its area of work. Strong Board, ensured grant support from water.org, strategic and technical support provided by Gramalaya add to its strength.
- ✓ Stable second line of management: Guardian has been able to have a stable second line of management comprising the Manager- Credit and Manager- Operations. Both have been associated with Guardian since start
- ◆ Operating efficiency has further dipped: Guardian's model results in higher OER and during 2012-13 opening of 5 new branches added to it. Though the OER as per financial statements decreased to 10.4% in FY2012-13, the actual OER after including costs borne by Gramalaya is 17.4%.
- ✓ Improved systems: The MIS has been upgraded to web based Delphix Nano which is capable of providing the required reports to management and external stakeholders.
- ✓ Adherence to client protection principles: The Watsan credit products are suitably designed to meet the client requirement. The interest rates are low and product features are communicated accurately.
- ◆ Fund mobilization: Though Guardian has been able to grow its portfolio by 30% during 2012-13, its dependence on IOB and Acumen fund continues. However, signs of diversification emerging now.
- ✓ Increased scope of Audit: The units are audited every month and there is good system of compliance. Summary of internal audit reports is discussed every month in the PMC meeting.
- ◆ Low capital adequacy: The Capital Adequacy Ratio (CAR) has reduced to 4.9% as on 31 March 2013 due to portfolio growth.
- ✓ Marginal profits: Marginal operating profit with RoA of 0.2% for FY 2012-13, if support of Gramalaya is not included.
- ◆ Slight deterioration in portfolio quality: The portfolio quality of Guardian has deteriorated with PAR_{60} increasing to 2.2% on 31 March 2013 from 1.3% on 31 March 2012. However, it has come down to 1.2% on 31 July 2013.

Introduction

- Guardian was established in November 2007 as a not for profit (section-25) company with the objective of providing microfinance services to urban and rural poor exclusively for creating water and sanitation facilities in their houses. The promoter - Gramalaya, an NGO- is a pioneer in this field and has been working for more than two decades.
- Guardian started by lending to Self-Help Groups (SHGs) promoted by Gramalaya but later opted for Joint Liability Group (JLG) model for expansion in areas with limited presence of Gramalaya.
- As on 31 March 2013, Guardian operates through nine units in four districts of Tamil Nadu – Tiruchirapalli, Puddukkotai, Perambulur and Namakkal. Expansion to last three districts happened in 2012-13. Guardian had 15,962 borrowers with a portfolio of Rs8.29 crore as on 31st March 2013.
- Guardian has a seven member Board, Chaired by the founder Director of Gramalaya NGO, Mr S Damodoran. Mr Nagaraja Prakasam, nominee director of Acumen Fund joined in September 2012.
- Mr D Paul Sathianathan is the Chief Executive Officer (CEO) and he is assisted by two managers – Manager, Credit and Manager, Operations who are responsible for finance, operations, administration, accounting and MIS. CEO handles human resource function directly.

Particulars	Mar-11	Mar-12	Mar-13
Gross loan portfolio (Rs crore)	5.28	6.38	8.29
Outstanding borrowings (Rs crore)	4.91	6.38	9.75
Number of active clients	10 784	11 944	15 962

Organizational structure

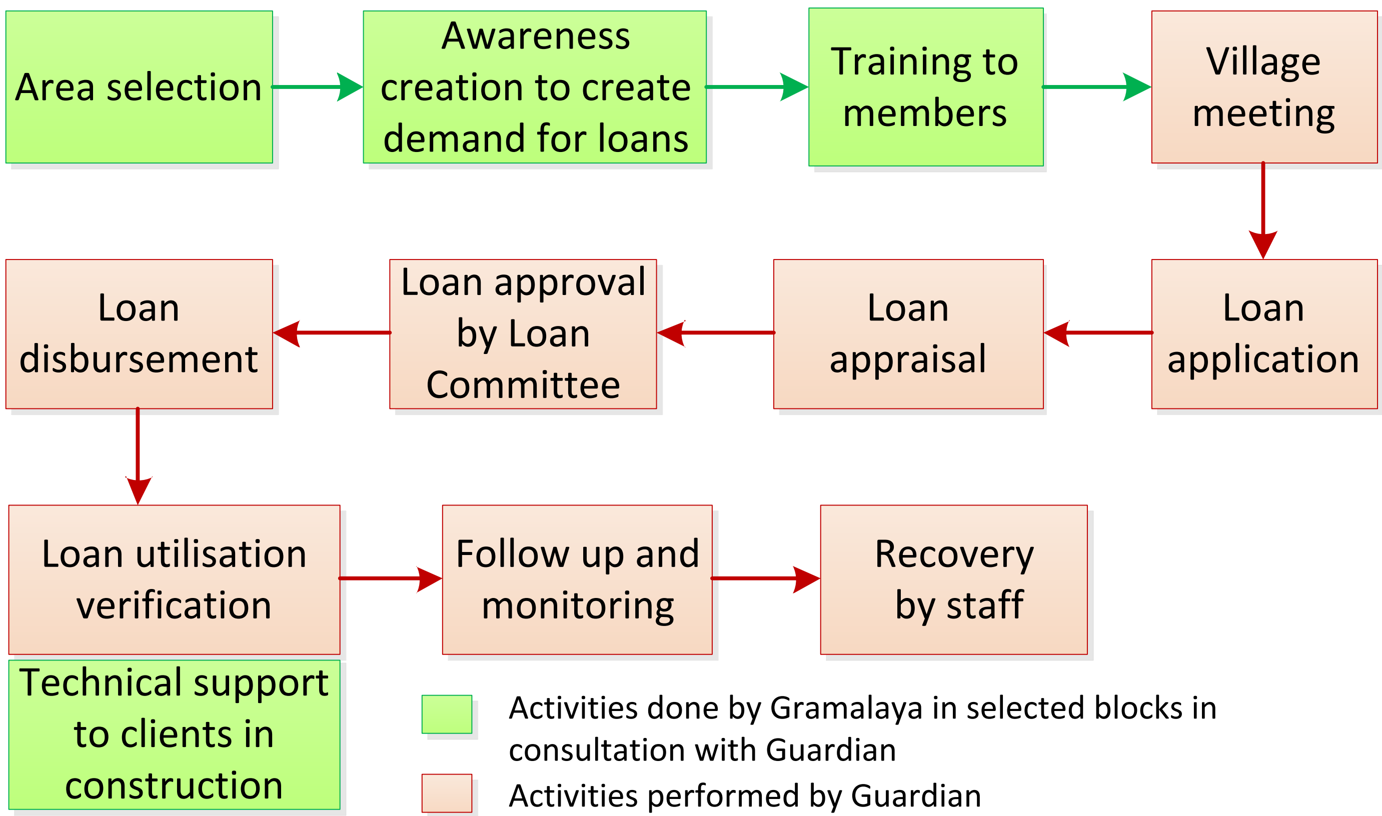


Microfinance policies

- Guardian lends only for WatSan and related activities using both SHG and JLG model. The microfinance policies and processes have not changed significantly since the last rating conducted in August 2012.
- Unit (or Branch) opening process involves a detailed survey of area by the Credit Officer (CO) to estimate the number of target households, number of toilets, water connections and water tanks.
- If the area is deemed to have potential, Guardian's field staff/Credit Officer (CO) conduct village level meetings and explain the product offerings followed by mobilizing the interested individuals into groups.
- Loan application is prepared by the staff and loan amount is recommended on the basis of household income and cash flow of the applicant.
- The Unit Officer (UO) appraises and forwards the loan application to the Loan Committee (LC), which consists of the Chairman/CEO, Manager- Credit, Manager- Operations, Zonal Manager and an HO staff. The LC is based at Head Office (HO). UO appraisal includes visit to client's house
- All loan applications are approved by the LC. Applications are rejected if the group members are close relatives, client's age is more than 55 years or if members have more than one borrowing. Disbursement is done at the Unit Office in presence of all the group members.
- Loan utilization check is compulsory for all disbursements. The CO is supposed to visit the client, 2-4 times, until the work is completed.
- Repayments are collected monthly through group leaders.

Microfinance policies...continued

The following diagram illustrates the lending procedure of Guardian.

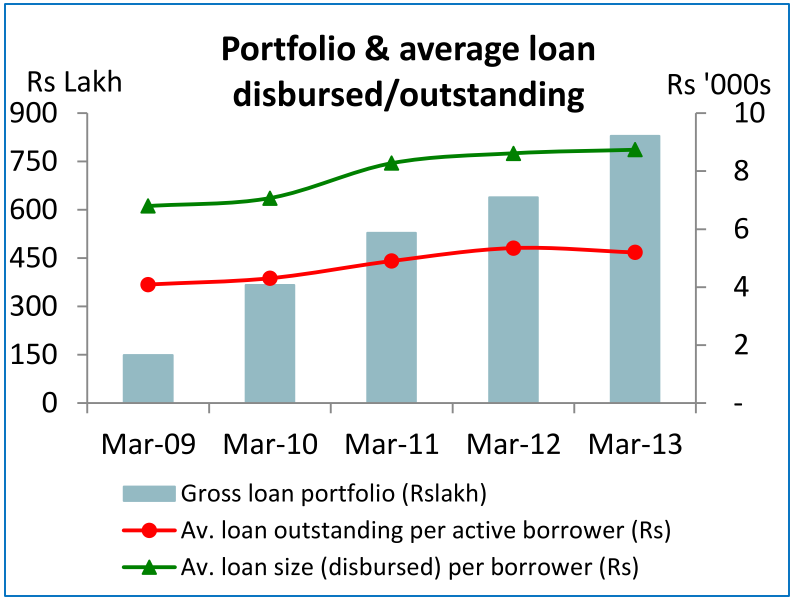


Loan products

- Guardian offers the following five loan products to its clients:

Loan Products	Urban/Rural (in Rs)	Insurance & admin. Fees
New Water Connection	7 000/5 000	100
New Toilet Construction	10 000	100
Renovation (Water / Toilet)	5 000	100
Rain water harvesting*	5 000	100
Water purifier	3 000	100

* No loans have been disbursed for Rain water harvesting



- Guardian also briefly experimented with an income generation loan product(non-WatSan). It was launched in April 2010 but discontinued in November 2010 after lendingrs33.4 lakh to 334 households.
- All loans are repayable in 18 months with monthly repayment. The interest rate for all loan products has been increased to 21% p.a. from 18% p.a. effective since April 2012. However, Guardian no longer collects 5% security deposit and has also reduced processing fee from 2% to 1% to comply with RBI guidelines. The Effective Interest Rate (EIR) on all loan products is 22.4%.
- Though it has a policy to charge a penalty of Rs100/month/group for delay in repayment, it is not followed strictly and is basically used to induce on-time repayment.
- Both foreclosure and prepayments are allowed without any additional charge. Part payment is accepted only in case of overdue cases.

Insurance products

- There has been no change in the insurance product of Guardian.
- Since 2011, Guardian has tie up with Life Insurance Corporation of India (LIC) for providing insurance facility to clients (spouse is not covered) under LIC's group insurance product.
- Insurance is compulsory for all clients. The following table describes the latest insurance product offered by Guardian. The premium has been reduced from Rs200 to Rs 100 since April, 2012.

Product	Premium	Period of Insurance	Coverage
Group insurance (provided only to the clients and not their spouse)	Rs 100 (for all loans disbursed by Guardian)	2 years	Rs 10 000

Governance and Strategy

Board of Directors
Operational growth & Strategy
Competition
Second line of leadership
Funding

Governance and strategy

Guardian has a reasonable performance on governance with a grade of **β+.** The performance is same as the previous rating. During 2012-13, Guardian expanded its operations to three neighbouring districts of Trichy. An experienced venture capitalist Mr Nagaraja Prakasam has joined the Board as the nominee director of Acumen Fund. There is change in second line and operational strategy.

Board of Directors

- During 2012-13, Guardian added a board member [nominee director of Acumen fund, Mr. Nagaraja Prakasam] expanding the board size to seven members. All board members are well experienced and qualified.

- The Board meets at least once every quarter. Key decisions on geographical expansion, rate of interest, senior management appointment and remuneration, use/change of technology, product design, financial planning and fund mobilization are taken by the Board. Apart from regular Board meetings, there is a system of Directors Annual Review Tour (DART) to evaluate the quality of implementation of systems and processes in the field. Feedback from staff and clients are generated which are taken into consideration while preparation/review of business plan and formulation of policies. DART is conducted before the Annual General Meeting (AGM). DART report provides direction to the CEO for future action. Much of the strategic decisions and leadership roles and responsibilities are with the Chairman and the CEO.

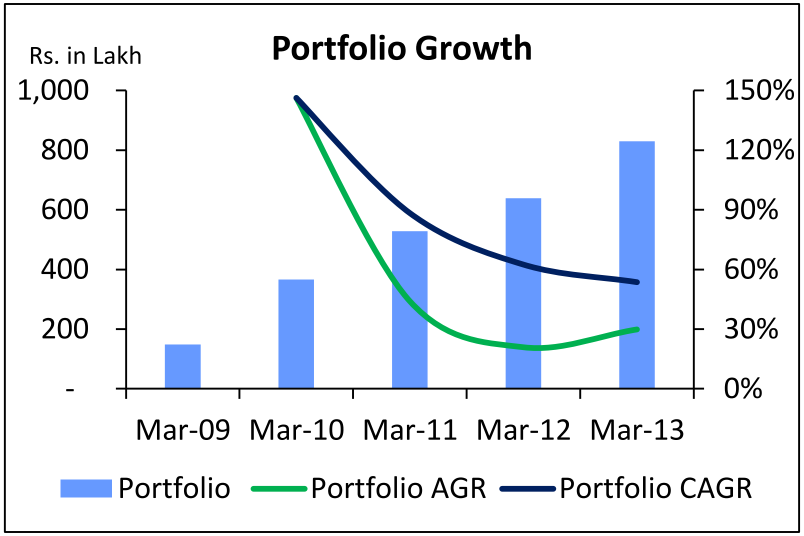
- There are three sub-committees- Project Management Committee (PMC) which comprises the Chairman, CEO, two managers, zonal manager, internal auditor and two UOs; Loan Committee (LC)- one Director, two managers, zonal managers including internal auditor, administrative officer and accounts officer and the Purchase committee - credit manager, operational manager and accounts officer. The committees meet monthly. PMC discusses monthly performance, internal audit findings, fund allocation and operations of all the units and decisions are reviewed by the Board. LC appraises the loan applications for all disbursements.

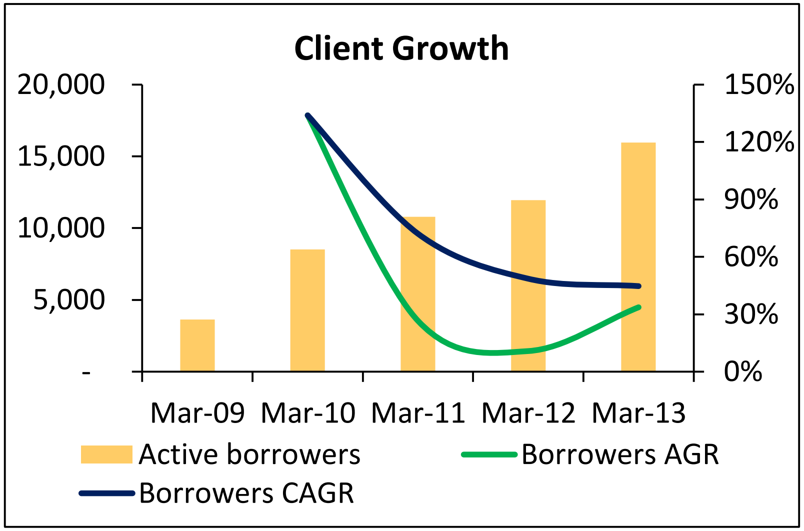
Alignment of practices with mission

- Guardian remains focussed on its mission to promote water and toilet facilities and continues to offer loans only for water and sanitation activities. The income generating product was discontinued to retain the focus.
- Gramalaya, the promoting NGO provides social intermediation through awareness building in the communities, capacity building of staff and stakeholders and technical support to Guardian.
- The interest rates on the loan products is also priced lower at APR of 22.4% in comparison to the allowable limits for MFIs (cost of funds + 10%/12% which is in the range of 26% to 28% for the NBFC-MFIs as prescribed by RBI) as Guardian targets the lower income segment.
- The individual loan appraisal format includes the details of the existing water and toilet facilities in the households. Loans are not disbursed if the member indicates any other purpose for the loan.
- The LUC visit by the credit officers are spread over from the date of disbursement till the completion of work which ensures the use of the loan for stated WatSan activity.

Operational growth and strategy– *expanded in three adjacent districts of Trichy*

- Till March 2012, Guardian's operations were concentrated in Trichy district. It expanded its operations to 3 adjacent districts (Pudukkottai, Namakkal and Peramblaur) and opened 5 new branches during FY2012-13 with operational grant support of Water.org through Gramalaya.
- The portfolio of Guardian has grown steadily at 53.6% CAGR (base year March 2009) over the last four years to reach Rs8.29 crore as on 31 March 2013. Guardian recorded a relatively low annual growth rate of 20.9% in FY 2011-12 and 29.8% in FY 2012-13 respectively on account of its limited capacity to mobilize debt funds. It has high dependence on IOB and Acumen fund which have provided around 95% of its total funds.
- As Guardian disburses loans only for WatSan activities, most of the borrowers drop-out after first cycle loan which restricts the growth rate of clients. At present, ~9% clients have 2nd cycle loan with Guardian
- The organization had a borrower base of 15,962 clients organised in 7,514 groups as on 31 Mar 2013. The client base of Guardian has grown at 44.7% CAGR in the last four years.





Competition – *limited*

- Though various MFIs like ASA GV (Grama Vidiyal), Sarvodaya Nano Finance Limited, Kurinji Social Welfare Society, Peoples Action for Transformation, New Life, Equitas Microfinance India Pvt. Ltd, Sarva Jana Seva Kosh and Fullerton are operational in Guardian's area, ASA GV has a dominant presence. Banks such as ICICI and BoI are also present through BC model.
- However, Guardian has limited competition dervied from its exclusivity based on WatSan loans *(construction for toilet, connection for water supply, renovation of toilet and water connections)* at relatively lower interest rate.
- Strong relationship with clients and support services provided by its parent organization Gramalaya add to its competitive edge.
- So far, the organization has not faced problems due to competition, however,some cases of multiple lending were found in the groups visited by the rating team.

Second line of management – *stable*

- Guardian has a strong second line of management which is with it since start.
- The second line of management includes two operational heads, Mr N Selvan who leads the field operations and ensures monitoring of units and Mr M Senthil Kumar who is responsible for credit, accounting, MIS and fund management.
- Both have gained good experience in managing microfinance operations, exhibit excellent field knowledge and are capable of handling the operations independently.
- The zonal manager (operations) resigned a day before the rating visit and the management plans to promote one of senior branch staff for the position.

Fund mobilization

- Guardian has been trying to expand its resource base and has been in contact with commercial banks and other financial institutions for debt.
- Till 31 March 2013, Guardian had received commercial loans from Indian Overseas Bank (IOB) of Rs105 million, which constitutes 63.0% of total source of funds since inception. Other banks have not been willing to fund it primarily due to its low CAR as well as low profitability.
- With the support of Water.org, Guardian obtained funds of US$ 1 million (Rs51.6 million) from Acumen Fund Inc (a not-for-profit venture fund)during FY 2011-12 and FY 2012-13 @ 5.0% +libor.
- Milaap (a P2P venture) started partnership with Guardian in November 2011 and it has received Rs1 crore through this arrangement during the last two years.

Name of the lender	Outstanding on 31 March 2013 (in Rs)	Interest rate (%)
Indian Overseas Bank (IOB)	4 79 88 934	12.25
Milaap, Bangalore	52 33 194	7.5
Acumen Fund, USA	4 42 37 565	5.0+ libor
Total	**9 74 59 693**	
Weighted Average Cost of Borrowings		**~9.9**

- Guardian has tapped debt of Rs25 lakhs from FWWB in June 2013 The pipeline visibility (nearly assured debt) as on September 2013 is Rs6 crore from IOB and Rs3 crore from Manaveeya; and talks are in progress with NABARD for Rs50 lakhs and Unitus for Rs10 – 20 lakhs. A proposal has also been submitted to Bank of India for a loan of Rs2 crore.

Organization and Management

Human resource quality & management
Staff Productivity
Operational efficiency
Accounting & MIS
Loan tracking system
Internal control system
Financial planning
Quality of clients and member groups
Client Protection

Organization and management

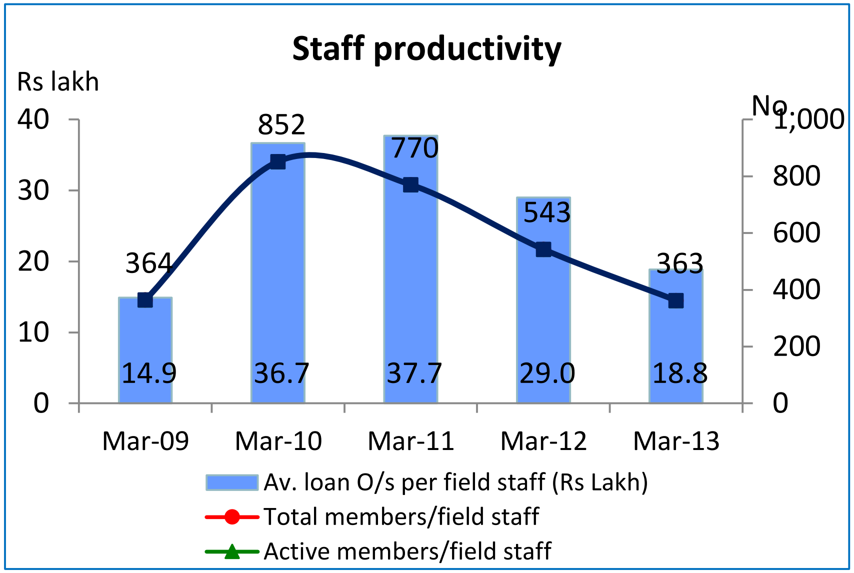
Guardian has maintained its performance under organisation and management with a grade of **β+.** Guardian has operationalised a web based software, Delphix Nano and also improved monitoring by adopting units by senior managers. Scope of audit has increased and audit findings summary is being presented in monthly review meetings.

Human resource quality and management - *good*

- The branch expansion during 2012-13 led to increase in total staff strength to 58 (44 field staff) as on 31 March 2013, this is almost double of previour year numbers.
- The managerial staff of Guardian is well experienced and qualified. Commitment and motivation of staff at all levels is high. The CEO, Manager- Credit and Manager- Operations have the required experience and expertise in microfinance as well as in managing WatSan loan products.
- The CEO manages the human resource (HR) function in Guardian. Guardian has a well developed HR manual. HR policies and procedures are well documented and include code of conduct and grievance re-dressal policy.
- The recruitment and orientation process is well defined. Most of the candidates apply through references. To tide over this, Guardian is recruiting at Trichy and sending people to new areas.
- The applicants are screened by the functional heads and are invited for two round of interviews. The induction of selected candidates includes an orientation of 2 days at the HO by the functional heads and two weeks of field training. Probation period is 3 months. Remuneration of field staff at Guardian is reasonable compared to other MFIs. Performance based incentive system for field staff is linked to on-time repayment. Monthly performance review for each unit is done by the PMC. Staff appraisal is done annually.
- Guardian has introduced various staff perks like LTC, interest free personal loan of Rs 25,000 for hospital expenses, interest free festival advance has been increased from Rs3,000 to Rs5,000
- Opportunities for promotions are limited due to small scale of operations, however, in view of the recent expansion plan, COs are being promoted to UOs.
- The staff dropout rate for FY 2012-13 was 12.1%, which is reasonable and it has also slightly decreased from 12.9% in FY 2011-12.

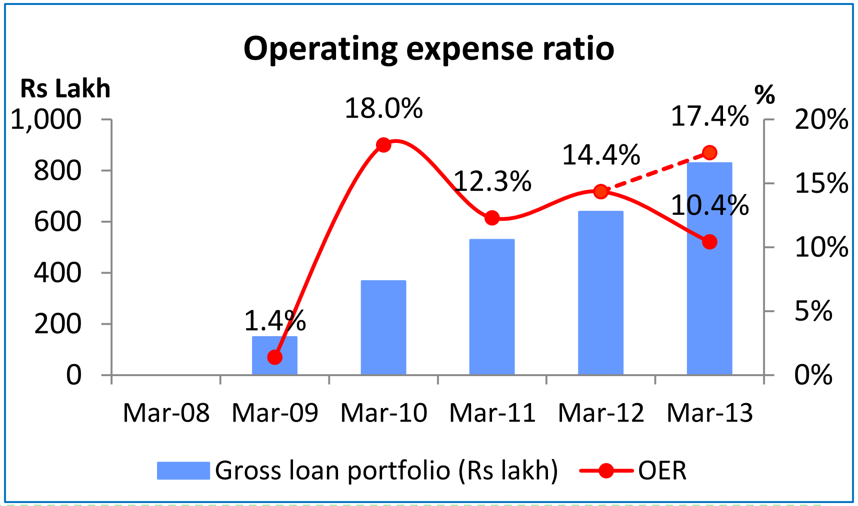
Staff productivity – *decreased due to new branches yet to achieve scale*

- The active borrowers per field staff decreased from 543 as on 31 March 2012 to 363 on 31 March 2013 as Guardian has opened 5 new units (which are yet to achieve scale) and recruited staff for this expansion. The field staff number doubled this year to 44.
- Portfolio per field staff also decreased from Rs29.0 lakh on 31 March 2012 to Rs18.8 lakh on 31 March 2013.



Operating efficiency – *has further dipped due to new branches*

- The operating expense ratio (OER) as per financial statements has reduced from 14.4% during FY2011-12 to 10.4% during FY2012-13.
- However, this does not take into account the operating cost of 5 new branches met through Gramalaya. If the support of Gramalaya is included, the OER goes up to 17.4%. This was due to increased average portfolio outstanding during FY2012-13 with the operating expense remaining similar both the years.
- Guardian was earlier also receiving such support but it was part of Guardian's financial statements.



Accounting and MIS – *a web based software (Delphix Nano) fully operationalised*

- Guardian has improved its MIS by operationalizing Delphix Nano software and has a good accounting system with a well developed accounting manual.
- Guardian has shifted its MIS in August 2013 from 'FAMIS' software to Delphix Nano, both developed by BASIX. It is a web based software financed by grant support from Acumen Fund Inc through Gramalaya.
- The software allows real time data update and tracking. Each unit has a high degree of automation via centralised technology back-ends coupled with standard process.The software has advanced security and storage features. This software has improved the ageing analysis at Guardian. However, the software takes time to generate the reports.
- Guardian has been using 'Tally' for accounting. There is monthly reconciliation of data between Tally and Delphix.
- The entries in the software are done only after LCM sanction and disbursement until which manual records are kept. The repayment schedule is automatically generated through the MIS. Every field staff is given a MIS generated collection sheet at the beginning of every month for collection as the repayment is collected from 5^{th} to 10^{th} every month.
- The collection sheet and the receipts issued in the field are then used to feed data in the MIS. The computer operator does data entry and accounting function at the unit level. The data entry is checked at the HO by the MIS operator Mr. Kartikeyan. The unit staff do not have any permission for ratification.
- Each unit maintains detailed manual cash book and staff collection register. UO verifies manual entries in cash book with that in the MIS software at the end of each working day. Monthly consolidation of portfolio accounts, DCB and overdue ageing of each unit is done at HO. The dropout member tracking is also done every month end.
- Plan to pilot hand held device in one of the unit in Sept'13 supported by Acumen fund.

Accounting and MIS ...continued

- All income (incl. interest income) and expenses are recorded on accrual basis. Depreciation is accounted on the written down value method. As per policy, interest on overdue loans are accrued.
- Loans are written off in case of death of the borrower or if the overdue is for more than one year. Guardian has written off loan (including principal and interest on overdues) worth Rs 2.21 lakh which was PAR>365(0.27% of gross portfolio) during FY 2012-13.

Loan tracking system – *Improved*

- Guardian has a formal process of tracking overdue. Each unit maintains CO wise collection sheet and overdue is tracked on a daily basis.
- Loan repayments are made between 5^{th} to 10^{th} of each month. Group is reminded over phone by the CO, two days before the due date.
- In case of overdue, CO enforces joint liability and ensures repayment. In case of delinquency, CO makes repeat visits to the defaulting groups. The repayment of the whole group is kept on hold even if a single member defaults to ensure joint liability. If the group is unable to repay even after 2-3 CO visits, UO intervenes and visits members.
- Any loan overdue by more than one week is monitored by HO, the Manager Operations visits the groups with overdue.
- However, the portfolio quality deteriorated (PAR_{60} increasing to 2.2% on 31 March 2013 from 1.3% on 31 March 2012) due to 3 COs in Unit-1 leaving Guardian. Soon after this, the management decided to adopt units by the senior managers. Improved monitoring as a result of this led to improvement in the portfolio quality (PAR_{60} reduced to 1.2% on 31 July 2013).

Internal audit and control – *good, IA now presents a summary of findings during monthly review meeting; monitoring team introduced for better internal control*

- Internal audit is handled by Mr T. Suresh who has is managed by the Internal Auditor which o is at an equivalent designation of zonal manager, Mr T. Suresh who was earlier designated as the Team Leader. He is the only member responsible for internal audit in Guardian.
- Guardian has an internal audit manual and a checklist for the auditor to follow a standardised process for unit audit. The scope of the audit has increased by few checks including JLG details, overdue list, staff time and sheet.
- The auditor is well qualified and has been associated with Guardian for 5 years and before this for 10 years with Gramalaya as a project coordinator. He was been trained on auditing processes and procedures before being designated as an internal auditor.
- Units are audited monthly while HO is audited quarterly. The tentative audit visit schedule is shared with the CEO and the visits to units are surprise visits. The auditor spends 2 days for auditing a Unit including half day in field. Internal audit includes complete audit of records, verifying previous audit compliance, visit to groups and verifying loan utilization. There is a de-brief with the UO at the end of the internal audit.
- Internal audit report is sent to the CEO, Managers- Credit and Operations within a week and is shared with the units. The reports prepared by the auditor were found to be exhaustive. The UO is expected to rectify the mistakes and submit a compliance report to the CEO and ZM – Internal Audit within 15 days.

Internal audit and control … continued

- The unit wise internal audit reports are reviewed during monthly PMC meeting. The Internal Auditor prepares summary report of all units and presents it during monthly review meetings. The Internal Audit findings are not presented to the Board.
- Monitoring and internal control systems are good for the present level of operations. Each unit is visited by the senior management monthly. The managers do not prepare monitoring visit report, but mention the observations in the unit visit register kept at the Unit office. The Board visits the units annually under the new initiative - DART. They also check the monthly internal audit reports on a random basis.
- At unit level, the UO is responsible for supervising the COs and the Computer Operator; ensuring adherence to procedures. The COs are supposed to conduct loan utilization checks of the clients until the completion of the work (of toilet/water connection/ renovation).

Financial planning and cash management– *good*

- Cash planning and liquidity management is the responsibility of the Manager-Credit and is done on the basis of monthly estimates. He estimates monthly loan demand and allocates funds. Fund transfer is done from HO to bank account of Unit through cheque and from unit to HO through RTGS. The CEO checks and signs the cash and bank balances of HO everyday.
- Guardian has prepared a business plan for next 5 years. The growth in lending activities projected (both in terms of outstanding portfolio and outreach) seems ambitious but achievable.
- The HO holds PMC meeting on 25th every month and reviews targets against achievements and plans for the next month. Each unit sends monthly expected recovery and tentative loan disbursement statements to HO. The HO receives recovery, cash and bank status from each unit by the end of each day.
- Branch level cash balances are tracked daily by finance department. The cash management is effective at unit level. The average cash and bank balances as a percentage of average total assets for FY 2011-12 was 3.9% which slightly reduced to 3.1% for the FY 2012-13. Money transit Insurance of Rs10 lakhs is done for all units.
- The repayments to all the lenders are well planned and schedule is rigorously followed.

Infrastructure – *adequate*

- All its offices are in rented premises including head office. During 2012-13, Guardian received support from water.org through Gramalaya for meeting the infrastructure expenses of 5 new units.
- The book value of its net fixed assets is Rs10.9 lakhs on 31 March 2013 which is 1.05 % of the total assets.
- Fixed assets mainly include computer, office equipment, furniture and fixtures. The current level of infrastructure seems adequate and is employed effectively.

Client protection – adherence to the client protection principles

Assessment with reference to the seven client protection principles (Smart Campaign)

Guardian follows the unified code of conduct (CoC) which is jointly issued by two microfinance industry networks (Sa-Dhan and MFIN) though it is not a member of the networks. Guardian sends the data (financial and limited social) to the MIX Market which has given it five stars (highest score) for the level of disclosure of financial data.

1 **Appropriate product design and delivery** – *WatSan products designed to suit the need of clients*

- Guardian is the only microfinance institution in India (and probably in the World) focussing exclusively on water and sanitation . Guardian received an award in 2011 from European Microfinance Network for 'Best Product Innovation' and was first runner up in National Urban Water Award in 2009.
- About 87.3% of Guardian's portfolio is for toilet construction and renovation and 12.7% portfolio is for new water connection and buying of water purifier.
- The loan size offered by Guardian is appropriate for constructing low cost toilets and obtaining new water connections. Guardian has fixed loan repayment period (18 months) with monthly repayment frequency, which is also appropriate for the clients.
- Gramalaya (the promoting NGO) provides orientation/training to Guardian's clients in selected blocks where it has a tie up with Guardian on importance of WatSan and construction of toilets. Before loan sanction, Guardian provides information to clients on suppliers of construction material, quality of materials and their prices.
- Guardian has a policy of continuous monitoring till completion of construction ensuring proper use of loans.

2 Prevention of over-indebtedness – *no formal policy; check of multiple loans compulsory*

- Guardian does not have a formal and written policy on avoiding multiple lending. However, Guardian has a policy of not lending to members with more than one existing loan but in absence of credit bureau check, this is sometimes not adhered to.
- Guardian has reduced its operations in urban areas to avoid multiple lending and all the new units are targeting rural households.
- Guardian introduced a loan appraisal format to capture data on other borrowings and family's income and expenditure. It also analyses the cash flow of the clients to assess their repayment capacity.
- All loans are approved by the HO loan committee after considering the repayment capacity of the client.
- Credit bureau checks not undertaken for loans at present (though in near future it will be made compulsory).
- Over-indebtedness among clients is not verified by the internal auditor as there is no formal policy.

3 Responsible Pricing – *interest rate increased to 21% on declining basis*

- The interest rates on the loan products is also priced at a lower level at an APR of 22.4% in comparison to the allowable limits for MFIs *(cost of funds + 10%/12% which is in the range of 26% to 28% for the NBFC-MFIs as prescribed by RBI)* as Guardian targets the lower income segment.
- Guardian allows prepayments and foreclosure of loans without any charges.
- Penalty for late repayment of Rs 100/group/month is taken from clients but is adjusted in the last instalment.

4 Transparency – *consistent as last year; monitoring team formed*

- The loan product features are explained during the group formation, collection of loan application and loan disbursement. After loan disbursement, the CO makes 2-4 visits to ensure the work completion.
- The loan documents are in the local language. The terms and conditions are also printed on the loan document. A printed repayment schedule is provided to the clients at the time of loan disbursement.
- The majority of the visited customers were aware about the interest rate, processing fee, insurance fee and instalment amount.
- Receipts are issued to groups for all cash transactions. The internal audit checks the transactions by comparing client loan schedules with the unit records.
- Rating team's client interaction at 3units (of Musri, Manachanallur and Keeranur) indicates that clients have good awareness about loan product terms and conditions but their understanding on insurance product is relatively low

5 Fair and respectful treatment of clients – *followed, need to include in manual*

- Guardian gives importance to moral and ethical values. Respectful behaviour with clients is part of the orientation training curriculum. The supervisory staff are supposed to regularly monitor the behaviour of their subordinates with the customers. Staff members are supposed to behave friendly even with the overdue clients.
- The disbursement procedure does not include too much of paper work but it takes around one month to sanction and disburse the loan.
- The Operations Manual emphasizes on ensuring credit discipline, however, appropriate/inappropriate collection practices and staff behaviour are not clearly listed.

6 Mechanism for complaint resolution - *moderate*

- The contact number of the unit office and unit officer are mentioned in the group register. After receiving a complaint, the unit staff is supposed to immediately respond to the client, however, there is no formal process for escalation of complaint.
- There is no formal complaints' desk/box at unit/branch and HO. The clients can make a complaint to the CO or at the unit office.
- During their field visits, monitoring staff, internal auditor and CEO take feedback from the members and try to solve issues.
- The Board has initiated an annual program where they meet the clients of all units and take their feedback on the services provided by Guardian.
- HO does not maintain any database of complaints received at the units. Also, there are no checks to ensure proper redressal of clients' grievances by the units.

7 Privacy of client data – *no data shared as of now*

- Guardian is yet to develop a formal policy on external sharing of client data.
- Guardian is in discussion with High Mark Credit Bureau to share the borrowers' database. Guardian shares the relevant client data with the Insurance company. Guardian has not yet taken any data sharing permission from the clients.
- No evidence for data being misused for any other purpose.

Financial performance

Profitability and sustainability
Portfolio quality
Capital adequacy
Asset & Liability composition

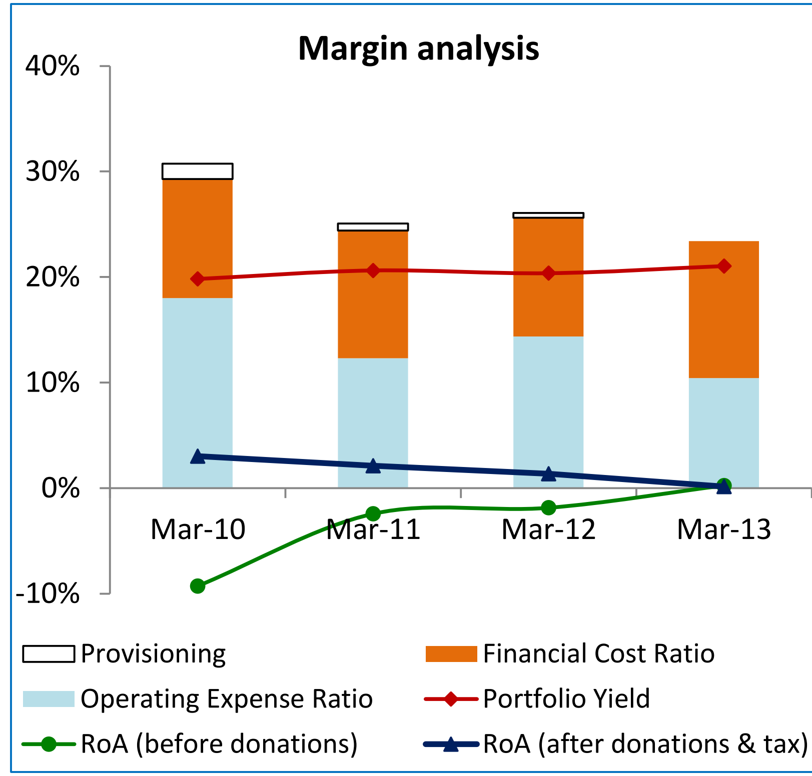
Financial performance

Guardian's financial performance is moderate at β. The performance is constrained due to high operational cost, low capital adequacy and marginal profits. The portfolio quality deteriorated in FY2012-13 but has improved as on 31 July 2013.

Financial Ratios	31-Mar-10	31-Mar-11	31-Mar-12	31-Mar-13
Capital Adequacy				
Risk Weighted Capital Adequacy Ratio	5.8%	6.1%	6.2%	4.9%
Asset Quality				
Portfolio at Risk (>60 days)/ Gross Loan Portfolio	0.1%	0.3%	1.3%	2.2%
Loan Loss Reserves/ Gross Portfolio	2.0%	2.0%	2.0%	1.3%
Management				
Operating Expenses / Avg. Gross Loan Portfolio	18.0%	12.3%	14.4%	10.4%
Financial cost/Avg. Gross Loan Portfolio (FCR)	11.3%	12.1%	11.3%	13.0%
Number of Borrowers / Field Staff	852	770	543	363
Number of Borrowers / total Staff	406	359	362	275
Cost per borrower (Rs)	571	553	602	442
Earnings				
Net operational income / Avg. Assets (RoA) *before donations*	(9.3%)	(2.4%)	(1.9%)	0.2%
RoA *after donations and tax*	3.0%	2.1%	1.4%	0.2%
Operating Self Sufficiency (OSS)	65.9%	89.7%	90.4%	101.4%
Portfolio Yield	19.8%	20.6%	20.4%	21.0%
Other income / Avg. Gross Loan Portfolio	0.4%	1.9%	3.2%	2.7%
Interest and fee exp. / Avg. Gross Loan Portfolio	11.3%	12.1%	11.3%	13.0%
Liquidity				
Avg. Cash & Bank balances / Avg. Total Assets (excluding FDs)	2.4%	0.8%	3.9%	3.1%
Debt/Equity ratio	17	15	16	23

Profitability and sustainability

- Guardian's profitability is affected on account of its high OER and low interest rates resulting in negative operating returns since inception. It has been able to breakeven due to grant support of Water.org resulting in positive RoA after including grant support.
- From FY 2012-13, the grant is now not being routed to Guardian, thus it is not reflected in its statements. However, the cost of expansion of new branches and staff cost of those branches is met by Gramalaya with grant support from Water.org
- The profitability (RoA of 0.2%) during 2012-13 is on account of the cost externalisation to Gramalaya. If this cost is included, its operations show loss.
- Portfolio yield has remained at around 20% since the last 3 years. OER decreased from 14.4% during 2011-12 to 10.4% in 2012-13 due to increased portfolio (after including Gramalaya support it is 17.4%).



- The FCR has increased from 11.8% for FY 2011-12 to 13.0% for FY 2012-13. This has been due to an increase in debt dependence for financing the portfolio
- Going forward, for meeting the credit demand of clients in the new units, Guardian will need to mobilize more debt funds which may increase its cost of funds. To become profitable, Guardian will need to reduce OER or increase its yield.

Portfolio quality – *deteriorated in FY2012-13 but has improved by 31 July, 2013*

- The portfolio of Guardian has grown significantly from Rs14.9 million on Mar'09 to Rs82.9 million on March'13. Though the portfolio quality of Guardian has declined slightly over the last couple of years, it can be still considered good with PAR60 of 2.2% as on 31 March 2013. The yield to APR ratio of more than 90% over the last four years substantiates this.
- However, regular monitoring and tracking of overdue has lowered PAR>60 to 1.2% on 31st July 2013.
- Guardian did not need to create high provisions due to its good portfolio quality. Till 2011-12, it was maintaining a 2% loan loss reserve (LLR). Despite not making any provisions the LLR during 2012-13, LLR is still adequate at 1.3%.

Portfolio ageing on 31 March 2013

Overdue period (in days)	**Loan principal outstanding**	**PAR %**
Current	8 11 26 975	0.0%
1-30 days	8 739	0.01%
31-60 days	0	0.00%
>60 days	17 94 268	2.16%
Gross portfolio	**8 29 29 982**	**2.22%**

Capital Adequacy– *low; decreased compared to the last year*

- The capital adequacy (CAR) of Guardian has decreased from 6.2% on 31 March 2012 to 4.9% on 31 March 2013 on account of no increase in equity but 30% growth in portfolio. The net worth has increased slightly from Rs40.85 lakh in March 2012 to Rs 42.1 lakh by end of March 2013. This results in high debt-to-equity at about 23 times. Its current legal structure constrains its ability to raise equity from external investors.
- Although Guardian has so far been able to mobilise bank finance for on-lending purposes, its current level of CAR constrains its capacity to raise commercial debt finance.

Asset liability and equity composition

- Net loan portfolio formed 78.5% of the total assets on 31 March 2013. Cash and bank balance (incl. FDs), net fixed assets and other assets account for 17.2%, 1.05% and 3.2% respectively of total assets as on 31 March 2013.
- The average cash and bank balances (excl. FDs) as a proportion of its average total assets for 2012-13 was low at 3.1% however on including FDs it was 17.2%.
- Guardian's external borrowings constitute 93.5% of total funds (from IOB, Milaap and Acumen Fund) while the net worth, comprising equity constitutes 4.0% of the total source of funds.

Future plans and prospects

- Guardian will continue to focus on water and sanitation. It does not want to change the approach and lending model for its microfinance operations in the long term.
- Guardian has expanded to four districts through 9 units and now will concentrate on vertical penetration to make the units self-sustaining. There are no immediate plans for further geographical expansion.
- Guardian has reduced its operations in urban areas and targets to intensify its water credit activities for rural households where WatSan facilities are limited.
- As per business plan, the target of Guardian is to reach 1 lakh customers by end of March 2017 with loan disbursement of about Rs20 crores. In order to support its portfolio growth, Guardian plans to mobilize funds from IOB, Acumen Fund, Manaveeya, FWWB and other Development Finance Institutions (DFIs).
- Overall, Guardian has good prospects, main challenge will be to reduce its operating expenses and increase capital adequacy.

Financial Statements of Guardian's microfinance programme

Balance Sheet on

31-Mar-10	31-Mar-11		31-Mar-12	31-Mar-13
		ASSETS		
		Current assets		
17 25 625	2 32 706	Cash in hand and bank	16 08 660	43 33 478
33 50 000	35 40 000	Fixed deposits	72 30 000	1 36 35 000
13 34 148	11 80 519	Advance(rent, festival, staff and project) receivable	9 69 568	23 23 511
88 468	4 60 835	Advance taxes (IT & TDS)	3 68 440	0
1 87 264	1 66 499	Staff loans	2 07 769	4 10 595
		Investments - GMF	6 00 000	6 00 000
		Loans outstanding		
3 66 81 139	5 28 32 381	Gross loan outstanding	6 38 68 022	8 29 29 982
(7 33 623)	*(10 56 648)*	*Loan loss reserve*	(12 77 360)	(10 55 996)
3 59 47 516	5 17 75 733	Net loans outstanding	6 25 90 662	8 18 73 986
4 26 33 021	**5 73 56 292**	**Total current assets**	**7 35 75 099**	**10 31 76 570**
10 87 794	12 13 442	Net property and equipment	11 69 197	10 93 638
4 37 20 815	**5 85 69 734**	**Total Assets**	**7 47 44 296**	**10 42 70 208**

Balance Sheet on ...continued

31-Mar-10	31-Mar-11		31-Mar-12	31-Mar-13
		LIABILITIES AND NET WORTH		
		Current liabilities		
28 59 151	45 51 601	Cash security	51 05 998	25 30 047
	9 14 909	Interest payable to Acumen Fund	13 63 968	
4 60 310	5 05 141	Income tax	3 76 920	
2 83 207	1 47 770	Others Payables	12 730	
	20 000	Others current liabilities	7 296	70 000
36 02 668	**61 39 421**	**Total current liabilities**	**68 66 912**	**26 00 047**
		Long term liabilities		
		Long term debt		
3 78 75 981	4 90 13 964	IOB	3 64 41 415	4 79 88 934
	1 00 000	Milaap	28 68 169	52 33 194
		Acumen Fund Inc, USA	2 44 83 026	4 42 37 565
7 000		Gramalaya trust		
3 78 82 981	**4 91 13 964**	**Total long term liabilities**	**6 37 92 610**	**9 74 59 693**
		Net worth		
5 88 075	5 82 778	Reserves(Risk Fund)	5 47 165	5 32 685
7 24 134	16 47 091	Retained net surplus/(deficit)	27 33 571	35 37 609
9 22 957	10 86 480	Current net surplus/(deficit)	8 04 039	1 40 173
22 35 166	**33 16 349**	**Total net worth**	**40 84 774**	**42 10 467**
4 37 20 815	**5 85 69 733**	**Total Liabilities and Net Worth**	**7 47 44 296**	**10 42 70 208**

Income Statements for the period

FY 2009-10	FY 2010-11		FY 2011-12	FY 2012-13
		Income		
43 59 238	86 25 612	Interest on loans	86 96 252	1 33 13 885
9 97 080	13 74 760	Processing fees received	14 92 740	9 17 350
88 496	2 89 540	Investment income	5 61 185	6 49 222
	5 07 700	Insurance fee received	9 02 130	10 60 800
32 634	1 10 714	Other income	1 46 667	1 11 139
54 77 448	**1 09 08 326**	**Total operational income**	**1 17 98 974**	**1 60 52 396**
		Financial costs		
27 37 285	57 17 692	Interest paid and payable on borrowings	55 98 014	82 13 854
3 09 900	1 50 000	Loan processing fees	0	
		Other charges	38 949	5 67 684
24 30 263	**50 40 634**	**Gross financial margin**	**61 62 011**	**72 70 858**
3 91 708	3 27 931	Provision for loan losses & write-off	2 20 713	0
20 38 555	**47 12 703**	**Net financial margin**	**59 41 298**	**72 70 858**
		Operating expenses		
26 06 040	31 60 574	Personnel Cost	38 85 357	35 80 889
5 70 672	4 14 215	Travel	6 87 148	4 31 736
282170	3 58 950	Depreciation	3 39 490	2 82 461
14 08 588	20 26 460	Administrative expenses	22 72 950	27 32 131
1614	1 840	Other expenses	2 961	4 951
		Bad debts written off		19 095
48 69 084	**59 62 039**	**Total Operating expenses**	**71 87 906**	**70 51 263**
(28 30 529)	**(12 49 335)**	**Net Surplus/Deficit (Before tax & donations)**	**(12 46 608)**	**2 19 595**
45 41 984	31 69 145	Non-operational income /operational grants	34 55 756	23 453
3 28 188	3 28 189	Non-operational expenses	10 28 189	1 02 875
4 60 310	5 05 141	Taxes	3 76 920	0
9 22 957	**10 86 480**	**Net Surplus/Deficit (after tax & donations)**	**8 04 039**	**1 40 173**

Annexes

Profile of the Board

S.No.	Board Member	Position on Board	Experience	Since
1	Mr. S.Damodaran	Chairman	He is a double post graduate in commerce and business administration. He is the founder chairman of Gramalaya and has more than 25 years of experience in WatSan. He is a member of National Task Force under Ministry of Urban Development of Govt. of India and Executive Committee member in State-level Sanitation Society of Govt. of Tamil Nadu. He has participated in various SME and MF trainings and conferences.	October, 2011
2	Mrs. J.Geetha	Director	She is a graduate in Science and Sociology and has 12 years of experience in water and sanitation. She is also the CEO of Gramalaya Microfin Foundation, which is a section 25 company.	Inception
3	Mrs. S.Muthulakshmi	Director	A graduate in Economics and has 20 years of experience in water & sanitation. She is also the Administrative Officer of Gramalaya.	Inception
4	Mr. M.Elangovan	Director	He is a post graduate in commerce with more than a decade's experience in the development sector. He is also the Executive Director of Gramalaya.	Inception
5	Mr. S.Kumarasamy	Director	Over 35 years of experience in Health Dept. and 8 years in social service. Exposure to various microfinance models and has undergone various trainings on microfinance. He is also an excellent trainer and imparted various trainings on SHG model. He is the co-founder of Guardian	Inception
6.	Mr D. Paul Sathianathan	CEO, Ex-officio	He has worked for more than two decades with government in animal husbandry. He is also the co-founder of Guardian	Inception
7	Mr. Nagaraja Prakasam	Nominee Director	He is appointed as the director by Acumen Fund Inc. Nagaraja is a MBA from Kennesaw State University and has rich experience in the financial sector. He is currently a venture advisor with Unitus Seed Fund.	September 2012

M-CRIL rating grades

M-CRIL Grade	Description
α+	Strong governance, excellent systems and healthy financial position. Without a foreseeable risk ➢ Most highly recommended
α	Good governance, excellent/good systems, healthy financial position ➢ Highly recommended
α–	Good governance, good systems and good financial performance; Low risk, can handle large volumes ➢ Recommended
β+	Reasonable performance, reasonable systems. Reasonable safety but may not be able to bear an adverse external environment and much larger scale ➢ recommended, needs monitoring
β	Moderate systems. Low safety ➢ acceptable only after improvements are made on specified areas
β–	Weak governance, weak systems. Significant risk ➢ not acceptable but can be considered after significant improvements
γ+	Weak governance, poor quality systems. High risk ➢ needs considerable improvement
γ	Weak governance, poor systems, weak financial position. Highest risk ➢ not worth considering

In addition, a 'Positive' outlook given by M-CRIL suggests that the institution is expected to improve its rating in one year period to one higher notch, 'Neutral/Stable' suggests that the institution is likely to retain its rating till the end of one year from the rating, and 'Negative' outlook suggests that it is expected that the institution will lower its rating performance by one notch in one year period.

Abbreviations

CAR	Capital Adequacy Ratio
CEO	Chief Executive Officer
CO	Credit Officer
Guardian	Gramalaya Urban and Rural Development Initiatives & Network
HO	Head Office
HR	Human Resource
IOB	Indian Overseas Bank
JLG	Joint Liability Group
LLR	Loan Loss Reserve
M-CRIL	Micro-Credit Ratings International Limited
MFI	Micro-Finance Institution
MIS	Management Information System
OER	Operating Expense Ratio
OSS	Operating Self-Sufficiency
PAR	Portfolio at Risk
PMC	Project Management Committee
RoA	Return on Assets
SHG	Self Help Group
UO	Unit Officer
WatSan	Water and Sanitation
WPI	Water Partners International

Glossary

Current repayment rate: Ratio of principal recovered (net of pre-payments) to the principal due for the last one year.

Portfolio at risk (PAR>0): Ratio of the principal balance outstanding on all loans with overdues greater than 0 days to the total loans outstanding on a given date.

Yield on portfolio: The interest income on loans divided by the average loan portfolio for the year.

Financial cost ratio: Total interest expense for the year divided by the average portfolio.

Loan loss provisioning ratio: Total loan loss provisioning expense for the year divided by the average portfolio.

Operating expense ratio: Ratio of salaries, travel, administrative costs and depreciation expenses to the average loan portfolio.

Average loan portfolio: This represents the average loan outstanding for the year computed on a monthly basis.

Average total assets: This represents the average total assets for the year calculated on an annual basis.

Operational Self-Sufficiency: Ratio of total income to total costs for the year.

Risk weighted capital adequacy ratio: Ratio of net worth to risk weighted assets

M-CRIL Risk weights: 100% for all assets except the following: Fixed assets: 50%; Cash and fixed deposits with banks: 0%. Portfolio outstanding is taken net of loan loss provisioning. As managed loans also appear on the balance sheet as on 31st December 2011, 100% risk weightage has been shown for these. Intangible assets and share application money are reduced from net worth.

Return on assets: Ratio of net income/(loss) after tax to average total assets

Return on equity: Ratio of net income/(loss) after tax to average net worth