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Cash Flow/Character Enterprise-Based Lending Training for Commercial Banks in Nigeria

PRISMS

Promoting Improved Sustainable MSME Financial Services

2005

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CASH FLOW/CHARACTER/ENTERPRISE-BASED LENDING TRAINING FOR COMMERCIAL BANKS IN NIGERIA

Trainer's Guide

OVERVIEW

This training aims to improve the capacity of Nigerian financial institutions—particularly commercial banks—to successfully enter the MSME sector in Nigeria. Cash Flow/Character/Enterprise-based lending, referred to hereafter as "Cash Flow lending", is necessary within the Nigerian context in order to open new markets, particularly in rural regions. Cash Flow lending can ameliorate the current lack of trade finance in Nigeria's MSME sector due, in part, to a lack of tangible collateral. Cash Flow lending can encourage lending to the MSME sector that would, in turn, contribute to business expansion and profit potential, and allow banks to diversify their portfolios.

In order to enter the MSME sector successfully, Nigerian financial institutions will want to ask the following questions:

- What is the effective demand for financial services within the country's MSME sector?
- What are the current impediments, or obstacles, to financial institutions—particularly commercial banks—meeting this demand?
- What opportunities exist for commercial banks to provide such services?
- What are the challenges to commercial banks providing MSME financial services?

The training will explore each of these questions.

WHO SHOULD ATTEND

All participants are expected to have a minimum college-level education, with significant training and/or work experience in the following subject areas: financial accounting, economics, credit analysis, and risk management. This background is necessary for participants to work at the fast pace of the program. Participants should be proficient in reading basic financial statements, such as the balance sheet, income statement, and cash flow statement. In addition, participants should be familiar with standard industry performance ratios and other indicators of financial institution performance, or have overall financial and accounting background necessary to learn these concepts quickly.

Participants are expected to work within any of the following functional areas of their respective institutions: relationship management, loan approval and disbursement, credit analysis, risk management, accounting and financial management.

It is expected that the host institutions will take the lead in identifying the most appropriate participants for the course, and that management will provide the time necessary for completion of the course.

EXPECTED COURSE OUTCOMES

Upon completion of the five-day course, participants should be familiar with the basic concepts and terminology associated with Cash Flow lending to MSMEs. They will have a basic familiarity with international commercial bank lending principles.

While they will not be expected to structure loans at this level, participants will be familiar with the basic elements and principles of loan pricing and structuring.

Finally, upon completion of this course, participants will be prepared to move to the next level of training that will bring them to the proficiency level necessary to apply the concepts learned in this basic set of modules.

AN INTEGRATED TRAINING DESIGN

The training design is an integrated approach to teaching Cash Flow lending principles. The design of the training is based on a participatory training model and incorporates theory, skill development, and practice through exercises, at least one case study, and a field trip to a financial institution currently utilizing a type of non-traditional collateral lending.

Participants will be expected to give both individual and group presentations on the final two days of the course.

USING THE TRAINER'S GUIDE

The Trainers' Guide is a suggested format to facilitate the training. The Guide has been written to <u>facilitate</u> the trainer in conducting a fast-paced five-day training program. Both the learning steps and activities provided in this guide are based on adult learning principles that incorporate theory, skill development, practice, and that relate the learned knowledge to participants' actual work activities. The trainer should exercise discretion in determining the pace of each module. The trainers' knowledge of participants' skill level will help to establish an appropriate daily pace and level at which to explore each topic.

The trainer will utilize a Power Point presentation throughout the course. The presentation slides are brief notes intended to accompany the guide. The trainer may also want to utilize flip charts during the presentation of each module's material, particularly during individual and group presentations.

The first two pages of each module are a description of the goals and objectives for the module and a session plan that includes topics, technique, time, and materials needed.

The training agenda is fast-paced, and assumes that each day's session will comprise approximately 7.5 hours of training. Pre-class assignments will need to be completed before both days 4 and 5. The course should end by early afternoon on the final day to allow sufficient time for wrap-up, evaluation write-ups, and general unwinding.

As the training is very intensive, the trainer may want to incorporate some exercises into each day's class to energize participants and allow them to refocus on the remainder of the class. The Guide includes some suggested refresher exercises. The trainer will need to use discretion in determining the appropriateness of any exercise for the class at hand.

DAILY AND END OF TRAINING EVALUATION

To assess the relevance, timing, and overall flow of each class, trainers should provide ask participants to complete daily course assessments. Trainers should ask participants to complete a more detailed and comprehensive evaluation on the final day of the course.

THE TRAINING TIMELINE

The five-day training timeline describes the flow of training topics and suggested frameworks. The timeframes are for time budgeting only as the actual timeframes will vary depending on both the audience and the trainer. The timeframe includes time for breaks and lunch, but not for evening assignments.

Training Timeline

DAY ONE

DAY TWO

DAY THREE

DAY FOUR

DAY FIVE

Module 1
Introduction to the Cash Flow/Character/Enterprise-based Lending Model

Goal Financial institution participants will articulate how their respective institutions can benefit from using the Cash Flow/Character/Enterprise-based lending model.

Objectives By the end of Module 1, participants will have discussed the following:

1. What is the effective ***demand*** for MSME financial services in Nigeria?
2. What are the ***impediments*** to commercial banks providing these services?
3. What ***opportunities*** exist for commercial banks to provide such services?
4. What are the ***challenges*** to commercial banks' providing MSME financial services in Nigeria?

Duration 20 minutes

Module 1 Summary

Time and Technique	Session	Materials
Lecture and discussion 10 minutes	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion x minutes	**Step 2: Overview of The Introduction to Cash Flow/Character/Enterprise-based ("Cash Flow") Lending Model**	Flipchart Markers
Lecture X hours (1/2 of day one class)	**Step 3: Interactive Discussion on the need and rationale for Cash Flow lending in Nigeria, covering the following:** • The effective demand for MSME financial services • The impediments to commercial banks' providing these services • The opportunities for commercial banks to provide such services • The challenges to commercial banks providing MSME financial services	PowerPoint Slides x-y
Lecture X minutes	**Step 4: Case Studies and Examples of Non-Traditional Collateralized Lending** • Indonesia: P.T. Ukabima • Philippines: Plantersbank • E. Africa: USAID/IDEA, USAID/SPEED, and Centenary Bank	PowerPoint Slides x-y, Handouts

Module 1 Facilitator Notes

Step 1: Introduction

Lecture and Discussion

1 minute

PowerPoint Slide x

Display
PPT Goal and 4 Objectives: Introduction to the Cash Flow/Character/Enterprise-based Lending Model

Describe
The objectives and discuss the topics for this module.
By the end of Module 1, participants will:

- Describe the Cash Flow/Character/Enterprise-based Lending Model and why it can be a useful model for commercial bank lending to MSMEs in Nigeria.
- Discuss how the Model provides an innovative lending methodology and how individual financial institutions can benefit from this methodology.
- Be familiar with the basic element, terminology, and principles of the Model.
- Describe the need and rational for Cash Flow lending in Nigeria, from the perspective of the commercial banker.
- Discuss current lending methodologies in Nigeria, and how the Cash Flow model could improve upon these methodologies.
- Be familiar with the basic framework behind the discussion of the need and rationale for Cash Flow lending, focusing on the demand, impediments, opportunities, and challenges behind such lending.
- Be familiar with some international models and examples of non-traditional collateralized lending methodology.

Step 2:

Lecture and Discussion
X minutes

Flipchart
Markers

Overview of The Introduction to Cash Flow/Character/Enterprise-based (“Cash Flow””) Lending Model

Ask
What is a Cash Flow/Character/Enterprise-based Lending Model?

Write responses on a flipchart.

Ask
How do commercial banks in Nigeria currently make, monitor, and recover business loans?

Write responses on flipchart.

Summarize (if possible based on participants' responses) the main components of the Cash Flow lending model.

The Cash Flow/Character/Enterprise-based lending methodology based on the character of the applicant and his enterprise, and less on traditional tangible collateral. It is a holistic approach to credit analysis that stresses the need for the banker to "know his client and business", using analytical tools, such as the "Five C's" of lending (**C**haracter and **C**redit History, **C**apacity and **C**ash Flow, **C**apital Adequacy, **C**ollateral, and **C**onditions), a careful read of traditional financial statements (balance sheet, income statement, cash flow statement), and a in-depth understanding of the enterprise and the industry in which it functions.

Describe to participants that the training will focus on developing an understanding of the Cash Flow model, and the appropriate tools for using the Model in a Nigerian commercial bank context.

One important part of the Cash Flow lending methodology is to understand how to access the financial statements and other documents that can provide you with important information that can be used for credit analysis. During this training we will focus on a framework that will provide you with tools and resources to develop these financial statements and reports, and use this, and other, data and information for credit analysis.

Provide an overview of the Cash Flow/Character/Enterprise-based Lending Model and include a brief narrative of why the commercial banking sector and MSMEs would benefit from the use of this model in the Nigerian context.

The Cash Flow Lending model comprises the following elements:

Show PPT X

Cash Flow-based Lending Element:

Cash flow analysis is the ability of the lender to assess if the enterprise can complete the production of a product, and realize cash income sufficient to repay the loan. Analysis of the cash flow statement is the underpinning of this element of Cash Flow lending. In brief, the loan officer will want to match the likelihood of repayment against the current and projected flows of liquid assets and disposable income flowing through the enterprise's operations. When reviewing the cash flow statement, you will want to ask if the cash flow is sufficient in amount, and regular in flow, to service both the borrower's current debt as well as run the enterprise, both in the long and short run.

Show PPT X

Character-based Lending Element:

While cash flow analysis may show sufficient cash to service the debt and keep operations running, it does not speak to the intent of the borrower to use the cash in any particular fashion. This is where character-based analysis comes in.

The character-based element of Cash Flow lending looks at the personal and professional reputation character of the applicant as an indicator of debt repayment. You might want to ask the following types of questions of individuals within the applicant's community when using this element in your credit analysis:

- Does the prospective borrower have a good reputation in his community?
- Is he known for operating an enterprise in a competent, efficient, and professional manner?
- Is he known to be honest and fair in both his business and personal dealings within the community?
- Does the borrower have sufficient experience in the business activity in which he is engaged?
- If he is relatively new to the enterprise, does he show sufficient initiative and overall capability to become proficient in running the proposed business in a reasonably short amount of time?

Be sure to question many individuals in the process of your interviews so that you can identify, and remove, any glaring outliers.

Show PPT X

Enterprise-based Lending Element:

While the applicant may have sufficient cash to service his debt, and he may have an outstanding reputation and character within both his professional and social communities, these factors alone may not determine the success of his enterprise. And without a successful enterprise, he will not be able to repay his loan. This is where the enterprise-based element of the Cash Flow model comes to play.

The overall financial health of the enterprise itself will be critical to the ability of the prospective borrower to generate sufficient cash flow necessary to maintain both current account activities, and to have sufficient resources with which to repay current and future debt.

You may want to ask the following types of questions during the enterprise-based assessment portion of the loan screening process:

- What is the condition of the enterprise?
- Is the enterprise operating profitably?
- What are the future prospects of the enterprise, based on an assessment of the prospective borrower's peers, and the overall health of the industry in which it operates?
- How well managed is the enterprise?
- What is the turnover rate of staff in the enterprise?
- Does the prospective borrower maintain complete, timely, and accurate financial records that meet generally accepted accounting principles?
- Is there sufficient demand for the enterprise's products to ensure that current cash flow is sufficient to cover both current and anticipated expenses?
- What is the condition of the market in which the enterprise operates? Is it healthy, and is there room for expansion?
- What competition does the enterprise face, and how dies it plan for, and currently meet, that competition?

Show PPT X

Ask
What information do you think you might need to answer the questions above, and to use the model as described above?

Write responses on flipchart and have participants read out list to class.

Show PPT X

Explain what information participants will need to use the model:

Lenders should have access to audited financial statements, company projections, site visits, character references, information about the applicant from community and business interviews, and industry knowledge.

If the prospective borrower cannot provide audited statements, the lender can work with the MSME operator to reconstruct financial transactions using invoices, receipts, and other financial transaction documents.

The key to using the Cash Flow Lending methodology is for the lender to select an industry, and to learn that industry thoroughly. This in-house knowledge will provide the lender with critical information necessary to “fill in the gaps” arising from missing documents or other standard loan application information**.**

Ask
What do you think might be the overall benefits of the Cash Flow Lending model both to you, and to MSMEs?

Write responses on flipchart and have participants read out responses to class.

Summarize this presentation with the following:

As with any lending transaction, both borrower and lender must perceive some ***tangible benefit*** to the exchange (i.e., capital and interest on the lent funds, respectively). In addition, both borrower and lender should ***share some risk*** in the transaction, and the “rules of engagement” should be clear (i.e., transparent lending principles). The purpose of introducing you to the Cash Flow model is to provide you with a means to develop a credit analysis methodology that relies less on tangible collateral to secure the loan transaction, and more on the character of the applicant and the overall health of his enterprise. By using this model, you will be:

- Encouraging MSME borrowing from commercial banks, and meeting an untapped demand from this sector for commercial financial services.
- Creating and encouraging transparency in both the lending and borrowing parts of the loan transaction by standardizing both application and reporting requirements throughout your industry.
- Developing a strong understanding of the industries with which you will be operating, and more robust partnerships between the banks and clients.
- Reducing the risk of lending to the MSME sector by building into your lending process both stringent application review procedures, as well as specific ways to reclaim assets should the borrower default on his loan.

The Cash Flow model will move the commercial banking industry in Nigeria one step further toward meeting the untapped demand for commercial financial services in the growing MSME sector.

Step 3 Interactive Discussion on the Need and Rationale for Cash Flow Lending in Nigeria

Lecturette
X minutes

Powerpoint
Slides x-y

Ask (after showing question on PPT x)
In Nigeria, ***do individuals and industries optimize credit***?
If so, why?
If not, why not?

Write responses on flipchart.

Ask
What do you think is the effective (i.e., real) demand for MSME financial services in Nigeria?

Write responses on flipchart, and ask participants to summarize and present responses to the class.

Ask

Can you identify some of the impediments to commercial banks' providing financial services to MSMEs in Nigeria?

Write responses on flipchart, and ask participants to summarize and present responses to the class.

Ask

Do you think that there are opportunities for commercial banks to provide financial services to MSMEs in Nigeria? If so, what are these opportunities? In what ways might commercial banks have a comparative advantage over non-commercial banks, or other financial institutions, in providing financial services to MSMEs, both in urban and rural settings?

Write responses on flipchart, and ask participants to summarize and present responses to the class.

Ask

Finally, what would you say are the challenges to commercial banks providing financial services to MSMEs? Can you list these in order of priority? What do you think commercial banks would need to do to overcome these challenges?

Write responses on flipchart, and ask participants to summarize and present ranked responses to the class.

Provide an overview of findings from researched sources to the questions asked above.[1] Raise the point with participants that these findings are to be viewed as supplements to, not substitutes for, the participants' own responses, and that the participants' local knowledge of Nigerian commercial bank and MSME sectors will be critical to any useful implementation of the Cash Flow model. Note also that you are presenting these questions as a way to begin to structure the discussion on how the Cash Flow model, and its different component parts, can begin to address each of the four questions raised above.

Show PPT X

Effective Demand for MSME Financial Services

A survey undertaken recently through the USAID PRISMS[2] project revealed the following:

- ***Effective demand for MSME financing***: MSMEs expressed demand for the following specific financial products, in order of preference: leasing mechanisms, overdraft facilities and "soft loans", and business development services. MSMEs expressed both a willingness, and ability, to pay commercial banks for business development services that would help them develop more competitive enterprises.

- ***Effective demand for financing to MFIs*****:** CGAP estimates that the demand for microfinance credit is nearly one billion clients, and that MFIs currently reach only about 4 percent of self-employed working poor.

[1] Reference documents include the following: (list here)

[2] Research Report on MSME Financial Services Needs and Training/Technical Needs of Financial Service Providers, by Development Associates, under commission of the USAID/Nigeria PRISMS Project, June 2005.

Show PPT X

Impediments to Commercial Banks' Providing Financial Services to MSMEs

- ***Commercial bank constraints to MSME financing:*** Survey results showed that commercial banks are unwilling, or unable, to lend to MSMEs for the following reasons: they lack confidence in the management and record keeping capacity of the MSME operators; the inability of MSMEs to meet banks' current collateral requirements; banks' perception that MSME operators lack sufficient "credit culture" necessary to understand the lending/borrowing process; the costs associated with making many smaller loans exceeds that of fewer large loans; and banks admit to a lack of sufficient knowledge and information about the MSME sector.

Show PPT X

Opportunities for Commercial Banks to Provide Financial Services to MSMEs

- ***Current financing available to MSMEs***: Overall, MSMEs responded that they utilized formal institutions more frequently than informal institutions as a source for debt financing and for maintaining business accounts, while they utilized personal savings and cash from family and friends more for working capital. Nearly 80 percent of enterprises maintain business accounts with commercial banks, and over half of those interviewed expressed satisfaction with their bank services. While the majority of respondents indicated that personal savings and retained earnings comprised the bulk of new finance and working capital, about 26 percent stated that they access this type of financing though commercial banks. With MSMEs currently utilizing formal banking institutions at this rate, banks have a conduit through which to provide improved financial services to the sector.

- ***Meet demand for financial services in rural markets***: Most of Nigeria's poor reside in rural areas, but the rural banking infrastructure—commercial and community banks—and the Nigerian Agricultural and Cooperative Bank—have been unable to make significant contributions to meeting this demand. By providing services through the rural commercial bank branch network, or through community banks, commercial banks could expand their overall client base to this untapped region.

- *"Banking Culture" already inculcated within staff:* Unlike their counterparts in development banks or social mission-based MFIs, commercial bank staff can focus their attention on extending loans to credible clients on the basis of their potential to repay.

- ***Commercial** banks' tendency toward prudent resource management:* Banks that have been operating in the market for any length of time will have established brand name recognition and a reputation that can instill a sense of confidence in MSME borrowers. Both the interest in maintaining this confidence, and the regulations of the banking industry, tend to encourage prudent resource management within the commercial banking industry, giving it a comparative advantage of the more social-mission driven or development oriented financial institutions.

- ***Lower** cost structure:* Commercial banks have already established the physical infrastructure of headquarters and branch networks throughout the Nigerian commercial banking sector, which results in lower start-up costs involved in reaching new MSME markets in both urban and rural settings. In addition, commercial banks would need to modify their existing internal control, administrative, and accounting systems to accommodate this new market, rather than implement entirely new systems.

- ***Access** to plentiful and low-cost funds:* Unlike community banks and MFIs, commercial banks can access capital directly from both local and international capital markets. In addition, the larger commercial banks may have a broad base of savings accounts from which to draw for loan capital. In short, the larger, well-capitalized commercial banks can raise funds for on-lending with a lower cost structure than community banks and MFIs.

Show PPT X

Challenges to Commercial Banks Providing Financial Services to MSMEs

- ***MSME reluctance to utilize commercial bank financing***: The majority of MSME operators cited the following as reasons behind their current reluctance to utilize commercial bank financing: high interest rates and excessive collateral requirements; banks' unwillingness or inability to meet MSME's long-term financing needs with suitable products; a general concern that commercial banks' lending practices lack transparency and accountability and are, as a result, susceptible to nepotism and other market distortions; and commercial banks lack sufficient understanding of the MSME sector and corresponding internal expertise to interact effectively with this sector. If commercial banks do not address these issues, they will not attract and retain a strong base of MSME clients.

- ***Constraints to MSME growth***: While an inadequate supply of financial services is an impediment to MSME growth, other exogenous factors have an equally as adverse impact the sector's growth. The survey results highlighted the following constraints to MSME growth: less than half of those MSME operators interviewed were aware of, or fully understood, the basic details of the SMIEIS Fund, which is an important government-backed scheme intended to direct funds from commercial banks to the MSME sector; the majority of respondents stated that interrupted service in water and power, poor road networks, and high inflation are major obstacles to successful business operations and competitiveness; the ineffective legal structure impacts both lender and borrower's ability to arbitrate legal challenges through the courts; and many MSME respondents believe that current government policy and/or practice favors multinational producers over local producers. If MSMEs do not grow and thrive, they cannot provide a profitable client base for commercial banks.

- *Organizational structure:* The commercial bank will need to ensure that the commitment to lend to the MSME sector is sufficiently integrated within the bank, rather than focused within one or two charismatic drivers. In addition, banks may need to recruit, retrain, and remunerate staff appropriately as they make the switch to lending to a new and unfamiliar client base.

- *Cost-effectiveness of smaller loans:* MSME lending is more costly than making larger loans because of the relatively smaller loan size. Commercial banks will need to develop ways to minimize processing costs, increase staff productivity through incentive programs, and diversify their portfolios to make lending to MSMEs profitable.

- *Overcoming naturally conservative nature:* Shifting to a lending methodology appropriate to the MSME sector will require a paradigm shift in typical commercial bank thinking. The more the bank can identify, and develop strategies for containing, the risks inherent to MSME lending, the more likely commercial banks will be able to make this shift in thinking.

- *Ability to execute collateral requirements:* Commercial banks remain concerned that legal structures are not in place that would allow them to execute any collateral requirements imposed on MSME lending. This is of particular concern if the collateral is land.

Step 4 Case Studies and Examples of Non-Traditional Collateralized Lending

Discussion

At this point, let's introduce some examples of programs and banking services that employ, in one fashion or another, a non-traditional collateral lending methodology. You should keep these in mind for discussion later in Module 5, after you have been exposed both to the three elements of the Cash Flow lending model, and to a range of possible loan products from which to choose. You should also revisit the "suggested roles for Nigerian commercial bankers" in Module 5 to see if these are viable within the context of your own operations.

- **Indonesia: P.T. Ukabima**

Created in 1998 through a USAID MIP grant with Catholic Relief Services, P.T. Ukabima has evolved into one of Indonesia's largest wholesale microfinance lending institutions. With headquarters in Jakarta, P.T. Ukabima extends credit to a network of 43 BPRs, or "people's village banks", throughout central Java, Bali, and Sumatra, and one microfinance institution in Java. Recognizing that most of its clients are rural-based and involved in at least one agricultural enterprise, Ukabima management made a conscious decision to integrate agricultural extension support into its overall lending operations. First, all loan officers will either have direct agriculture experience, or will have substantial contacts within the Ministry of Agriculture's agricultural extension network. With this information, the loan officer is in a position to make informed decisions regarding an applicant's farming product, the cost of inputs and supplies, and the likely price for his product at harvest. Second, those clients whose activities are primarily agriculturally-based are required to participate in a farmer's support group which meets regularly to discuss issues of common concern, including the best sources of low-cost inputs, and any issues that might adversely impact upon their productivity. By integrating agricultural support services into its overall banking operations, Ukabima is able to identify and contain risk associated with rural lending, and lending to farmers. (Reference Ukabima case study.)

- **Phillipines: Plantersbank**

The Planters Development Bank, or Plantersbank, began lending to SMSEs in 1972 with an asset base of $107,000 and paid-in capital of $18,000. It has grown to become the largest private development bank in the Philippines today, and is the recognized leader in SME finance. With a nationwide network of 63 branches and resources of over $540 mn, it is the 22nd largest banking institution in the Philippines. In addition to providing extensive SME lending, Plantersbank has established, and trains through, technical centers throughout the developing world, primarily with support from the IFC and Netherlands Development Finance Company, two of its major shareholders.

- **East Africa: USAID/IDEA Project, USAID/SPEED, and Centenary Bank**

Two USAID-supported programs in Uganda, IDEA and SPEED, provide lending methodologies that can be used directly, or in a modified form, to support both microfinance institutions and SMEs. The third program, established through Uganda's Centenary Bank, shows great promise for commercial bank rural outreach.

IDEA's Stockist Guarantee Program: The objective of this program was to increase the availability of critical farm inputs at the local village level by a) reducing the travel and transport time of stockists to get supplies to the village level, b) developing a robust network of stockists for wholesale distributors that would keep supplies plentiful and low-cost and c) providing training and other technical assistance both to the distributors and stockists to ensure transparent and efficient operations. The distributor provided stockists with materials on consignment, received a 70% guarantee on default of payment in cash or in-kind from IDEA, and had an approximately 3-4 month seasonal exposure before he could receive his payment from the stockist and replenish the stockists' inventory. The distributor agreed to take a 30% risk share, and the guarantee was removed after two seasons. Once the guarantee was removed, the stockist was in a position to approach an MFI directly for a loan to increase his inventory, and he could use the distributor as a credit and character reference. Because the distributor had a strong incentive to make sure he was repaid in cash or in kind at the end of his exposure period, he selected stockists with the greatest potential to repay, and monitored his investment throughout the exposure period. IDEA succeeded in developing a network of stockists from 35 to over 400 by the end of the program.

Suggested Role for Nigerian Commercial or Community Banks:

The commercial or community banks could play the role of IDEA in providing a limited guarantee to the distributors in an effort to build a more robust and effective supply chain network between distributors and stockists. This would support MSMEs by getting the critical inputs for their production down to the most local level, thereby reducing transport costs and the overall costs of inputs. A loan guarantee from DCA, or a comparable program, could initially reduce the risk exposure to the bank, but this guarantee should be limited to no more than 70% with a graduated phase-out clause in place. A challenge in implementing this program would be to convince any NGOs within Nigeria not to contaminate the program by providing side-by-side subsidies to stockists or distributors.

USAID/SPEED: Two of the key components of the The Support for Private Enterprise Expansion and Development in Uganda program were a) to close the gap between SMEs and their access to financial services, and b) to integrate MFIs more closely into the commercial banking system. Through technical assistance, loan officer mentoring, and specialized training, SPEED built the capacity of commercial banks to develop SME financial products. The program was intended specifically to increase access to financial services to the “missing middle”—those SME clients seeking loans between US$1500 and US$ 250,000 mainly to procure assets for their enterprise. These clients are typically uninterested in the group lending methodology, require larger loans than MFI’s will extend, but cannot easily access non-collateral based loans from commercial banks. Under this model, SPEED facilitated commercial banks’ use of a US$30 mn USAID Development Credit Authority (DCA) loan guarantee program in which seven participating commercial banks received a 50 percent guarantee for loans to SMEs and MFIs. In addition, SPEED provided training and technical assistance to commercial lenders on how to develop SME loan products, evaluate SME loan applications, and realize a profit from a previously ignored client base. The training was built into the existing Uganda Institute of Bankers (UIB) curriculum, and is now a stand-alone, fee-based component of their curriculum. Finally, SPEED designed and implemented a post-approval loan mentoring program with technical staff from Shorebank Advisory Services. Through which loan officers received virtual technical review and support on SME loan applications.

The combination of training, mentoring, and the DCA loan guarantee program reduced Ugandan commercial banks' wariness of lending to the SME market, and has increased flows of capital to this growing economic sector.

Recommendation for Nigerian Commercial and Community Banks:

Utilizing lessons learned from the SPEED project, Nigerian commercial and community banks could develop a program that utilizes the existing base of Nigerian human capital and educational facilities, the USAID DCA facility, and links with technical support entities, such as Shorebank Advisory Services, to develop an integrated approach to encourage commercial bank entry into SME lending.

Centenary Bank's Small Farmer's Window: With the support of IDEA, Centenary Bank began a pilot program to extend microfinance loans to small farmers. With agricultural technical support provided by IDEA, Centenary opened its first "small farmer's window" in Mbale in 1998. In an effort to contain both the real and perceived risk of lending to small rural farmers, IDEA participated in the recruitment of agriculturalists that were given subsequent training in microfinance lending. IDEA also worked with Centenary's management to stress the importance of supporting the farmers in the long run. This involved IDEA's encouraging a mental shift away from an expectation of immediate profit from clients whose business enterprises relied heavily on exogenous factors beyond their immediate control.

Suggested Role for Nigerian Commercial or Community Banks:

The commercial or community banks could consider partnering with NGOs that can provide technical assistance related to managing risk associated with extending credit to rural farmers. Both P.T. Ukabima and Centenary Bank recognized that many of their clients would be involved in at least some on-farm enterprise, and that it was in their interest to identify ways to reduce the risk of lending to such clientele. At the same time, both banks recognized the potential for profits by lending to this growing and underserved population, and integrated risk management into their operations as they ventured into this new territory. Integrating agricultural technical assistance into ongoing bank operations is a relatively low-cost way to contain the risks associated with rural and agricultural lending.

Module 2
Financial Statements and Reports

Goal	To construct and analyze financial statements and reports and show the relevance of using these documents in the Cash Flow/Character/Enterprise-based lending module. Participants will focus on the cash flow statement as a critical document for non-traditional collateral lending credit analysis.
Objectives	By the end of Module 2, participants will: 1. Describe the income statement, balance sheet, cash flow statement, portfolio report and non-financial data report, and explain their significance and how they are related. 2. Construct financial statements and reports using the data provided. 3. Discuss how the financial statements and report are interrelated. 4. Explain how the cash flow statement can yield useful information regarding the credit-worthiness of a loan applicant.
Duration	4 hours

Module Summary

Time and Technique	Session	Materials
Lecturette and discussion 10 minutes	**Overview of Financial Statements and Reports** Facilitator provides an overview of the session goal and objectives.	Powerpoint slides 13-14 (renumber)
Guided Discussion Demonstration Activity 1 hour 20 minutes	**Step 2: Income Statement** • Overview of income statement • Income statement construction • Terminology, definitions, xrefs • Practice	Overhead/handout 2.1 Income Statement Template 2.2 Sample Income Statement 2.3 Case Study Instructions w/Income and Expense Information
Guided Discussion Demonstration Activity 1 hour 20 minutes	**Step 3: Balance Sheet** • Overview of balance sheet • Construction of a balance sheet • Terminology, definitions, xrefs • Practice	Overhead /handout 2.4 Balance Sheet Template 2.5 Sample Balance Sheet 2.6 Case Study Instructions w/Balance Sheet information
Guided Discussion Group Activity Demonstration 1 hour 20 minutes	**Step 4: Cash Flow Statement** • Overview of cash flow statement • Cash Flow construction • Terminology, definitions, xrefs	Overhead 2.7 Classification of Cash Receipts and Payments Overhead/Handout 2.9 Cash Flow Template 2.10 Sample Cash Flow Activity Material 2.8 Cash Flow Activity 2.11 Indirect Cash Flow Example 2.12 Case Study Cash Flow Instructions

Discussion Activity 45 minutes	**Step 5: Linking Financial Statements** • Importance of understanding the links between financial statements • Links between the financial statements and reports	Overhead/Handout 2.16 Matrix Need handouts 2.2 2.5, 2.10, 2.13

Module 2 Facilitator Notes

Step 1:	Overview of Financial Statements and Reports[1]
Discussion 10 minutes Powerpoint slides 13-14	**Show PPT 13 and explain objectives of module 2 Financial Statements and Reports. Describe what will be covered during this module.** **Ask** What is financial management? **Write answers on a flipchart.** • Timely and accurate production of financial reports • Financial records • Recording financial transactions and categorizing them by groups, and summarizing the information **Ask** What types of statements and reports are included in a financial management system? **List answers on flipchart.** After a statement or report has been identified ask the class for a brief description of the statement. **Answers should include the following:** • Income Statement (or profit and loss statement) A flow statement that summarizes all revenues, expenses, gains, and losses over a given period. • Balance Sheet (or statement of financial position) A stock statement that shows the financial position of the institution at a point in time, including its economic resources, claims on those resources, and the residual interest in them. • Cash Flow Statement A flow statement that summarizes the inflows and outflows of cash for an institution over a given period.

[1] This entire section, Module 2, is adapted from Measuring Performance of Microfinance Institutions: A Framework for Reporting, Analysis, and Monitoring, Trainer's Guide. SEEP Network, 2005. While some of the examples used are specific to MFIs, the concepts of using standard reporting terminology and statements also applies to credit analysis of individual businesses and operations. Including reference to accounts more appropriate for MFI analysis (such as loan income) will provide participants with analytical tools to use if they find themselves needing to assess the credit worthiness of a potential financial intermediary partner, such as a community bank.

	Explain that credit officers should use the statements and reports in the credit analysis process. If the applicant cannot provide audited financial statements, the loan officer can work with the applicant to try to construct financial documents, using the structure of the statements below as a template.
Step 2 Guided Discussion Demonstration 1 hour 20 minutes Handouts: 2.1 Income Statement Template 2.2 Sample Income Statement 2.3 Case Study Instructions and Micro MFI Income and Expense Information Overheads: 2.1 Income Statement	**Income Statement** **Handout** Give participant's handout 2.1 The Income Statement. **Ask** What is an income statement? **Expected responses:** • Is a flow statement • Represents activity over a given period, day, month, quarter or year • Summaries of the revenue and expense transactions for a defined period • Shows profit and loss (which flows to the net worth of the balance sheet) **Summarize the income statement** The income statement reflects a dynamic picture of (1) what is earned from the provision of financial services, (2) what the total costs involved in carrying out those activities, and (3) whether a net surplus or deficit (profit or loss) exists for the period. **Show the overhead 2.1 Sample income statement.** Point out that an income statement is divided between revenue accounts and expense accounts. Write Financial Revenue at the top of the income statement (I1) and Financial Expense (I7). Ask participants to fill in their income statements as you go along. **Ask. Write responses on flipchart.** What are revenue accounts? What are expense accounts?

	Summarize revenue and expenses. As defined by IAS, REVENUE is the gross inflow of economic benefits during a period arising in the course of ordinary activities of an institution when those inflows result in increases in *equity* other than increases relating to contributions from *equity* participants. As defined by IAS, EXPENSES are decreases in economic benefits during the accounting *period* in the form of outflows, depletions of *assets,* or incurred *liabilities* that result in decreases in *equity* other than those relating to distributions to *equity* participants. **Say that an income statement usually includes a division of operating accounts and non-operating accounts.** **Write on the overhead** Operating Expense (I16), Non Operating Revenue (I23), Non-Operating Expense ((I24). **Ask** What are operating accounts? What are non-operating accounts? **Summarize** Operating accounts include all *revenue* and *expense* accounts related to the institution's core business—the provision of financial services. Non-operating accounts include all r*evenue* and *expense* accounts not related to the institution's core business—the provision of financial services. This could include training or the sale of merchandise. Add that donations and grant funds from donors are considered to be non-operating revenue. In this Framework, all donations for loan capital and operating expenses are included in the income statement. **Ask** What accounts are included under financial revenue? Responses include: • Financial revenue from loan portfolio to include interest on loan portfolio and fees and commissions on loan portfolio • Financial revenue from investments • Other operating revenue

Write the account names on the overhead.
Participants could use different terminology for account names. The Facilitator must understand the type of account that is being discussed and translate the account to the terminology that is described in the templates used in class. The terminology used in this course, and in the templates, is the terminology that participants are encouraged to use.

Review the definition of each account of financial revenue
As you review the definition of each account identify the cross-reference statement. Note that many of the accounts listed in these statements will apply to financial institutions, such as MFIs. The statements are general enough to use for MSME operators, as well. The inclusion of both institution and client account information is made so that participants can use these statements for a broad range of analysis, including an analysis of individual client loan applications, and an analysis of an institution with which it may want to partner, such as a community bank.

Ask participants how you calculate Financial Revenue from Loan Portfolio? (This would be relevant if you were to want to analyze the financial documents of a community bank partner.)

Response:

Interest on Loan Portfolio + Commission and Fees on Loan Portfolio I3 +I4. Write this calculation on the overhead under calculations for Financial Revenue from Loan Portfolio.

Tell
Financial revenue is the total value earned from the provision of financial services.

Ask
How do we calculate financial revenue?

Response

Financial Revenue from Loan Portfolio + Financial Revenue from Investments + Other Operating Revenue I2 + I5 + I6. Write this calculation on the overhead under calculations for financial revenue (I1).

Ask
What accounts are included under financial expense?

Responses include:

- Financial expense on funding liabilities to include

	interest and fee expense on deposits and interest and fee expense on borrowing • Other financial expense **Write the account names on the overhead/word document.** Participants might use different terminology for account names. The Facilitator must understand the type of account that is being discussed and if necessary translate that language to use the terminology that is described in the Framework. The terminology in the Framework is the terminology that participants are encouraged to use. **Review the definition of each account** **Ask** How do you calculate Financial Expense on Funding Liabilities? **Response** Interest and Fee Expense on Deposits + Interest and Fee Expense on Borrowings I9 + I10. Write the response on the overhead in the calculation column for Financial Expense on Funding Liabilities (I8). **Ask** How do you calculate Financial Expense? **Response** Financial Expense on Funding Liabilities + Other Financial Expense (I8 + I11) Write the response on the overhead in the calculation column for Financial Expense (I7). **Tell** The Net value of financial earnings from financial services is called Net Financial Income. **Write** Net Financial Income on (I12). **Ask** How do you calculate Net Financial Income? **Response** Financial Revenue – Financial Expense (I1) – (I7). **Ask**

	What does the net financial income tell you? **Describe Impairment Losses on Loans, Provision Expense for Loan Impairment, and Value of Loans Recovered** <u>Impairment Losses on Loans</u>: Previously knows as net loan loss provision expense, it is ([I14]) Provision for Loan Impairment net of the (I15]) Value of Loans Recovered. This amount is used to create or increase the (B5) Impairment Loss Allowance on the balance sheet <u>Provision Expense for Loan Impairment</u>: Previously known as the Gross Loan Loss Provision Expense, the non-cash expense calculated as a percentage of the value of the loan portfolio that is at risk of default. This value is calculated in the portfolio report. <u>Value of Loans Recovered</u>: Total value of principal recovered on all loans previously written off. This includes principal on partially recovered loans and those recovered in full. Subsequent recoveries of loans previous written off decrease the amount of the (I14) Provision for Loan Impairment, and the net amount is booked as (113) Impairment Losses on Loans. **Ask** What accounts are included under Operating Expense? (These could be the operating expenses of either an individual MSME operator, or those of a partner institution, such as a community bank.) **Responses include**: • Personnel Expense • Administrative Expense to include depreciation and amortization expense and other administrative expense **Write the account names on the overhead.** Participants might use different terminology for account names. The Facilitator must understand the type of account that is being discussed and use the terminology that is described in the Framework. The terminology in the Framework is the terminology that participants are encouraged to use. **Review the definition of each account (for definitions see XXX)** When reviewing the definitions remember to discuss how to calculate Administrative expense. The response you are looking for is: Depreciation and amortization expense + other administrative expense. I19 + I20. Remember to write this calculation on the overhead. **Ask**

	How do you calculate the total Operating Expenses? (I17) Personnel + (I18) Administrative Expenses **Describe Net Operating Income** Net Operating Income is the net earnings from the provision of financial services. To calculate this you must: Net Financial Income - Impairment Losses on Loans – Administrative Expenses I12 – I13 – I18 **Review non-operating revenue and non-operating expense** Summarize or ask participants to review what was discussed about non-operating revenue and expense. <u>Non-operating Revenue</u>: All revenue not directly related to core microfinance operations, such as revenue from business development services, training, consulting services, management information system sales, or sale of merchandise. It does not include donations (see I28). This account also includes any exceptional gains and revenues. Large or relevant non-operating revenue categories should be listed as separate line items as appropriate. <u>Non-Operating Expense</u>: All expenses not directly related to the core microfinance operation, such as the cost of providing business development services or training. This account also includes any exceptional losses and expenses. Large or relevant expense categories should be listed as separate line items as appropriate. **Point out on the overhead these two accounts.** **Describe Net Non-Operating Income/(Expense) and how it is calculated.** The net earnings from products and services not directly related to core microfinance operations. Institutions should disclose large material amounts of non-operating revenue separately by creating accounts under (I23) Non-Operating Revenue or (I24) Non-Operating Expense. **Ask** What is net income (before taxes and donations)? **Response to include** All net earnings from the institution's operations before the inclusion of taxes and donations. **Describe how to calculate Net Income** Net Operating Income + Net Non-Operating Income/(Expense) I21 + I22

	Write the calculation on the overhead. **Discuss and define Taxes and Net Income (After Taxes and Before Donations.** <ins>Taxes</ins>: Includes all taxes paid on (I26) Net Income or other measure of profit as defined by local tax authorities <ins>Net Income (After taxes and before donations)</ins>: All net earnings from the institution's operations, net of (I26) Taxes, and before the inclusion of (I28) Donations. **Ask how Net Income is calculated.** Response Net Income Before Taxes and donations – Taxes I25 – I26 **Discuss donations** It was described earlier that in this Framework all donations are included in the income statement. This includes donations for loan capital and donations for operating expenses. **Write** Donations for Loan Capital (I29) and Donations for Operating Expenses (I30) on the income statement overhead. **Ask** Why are donations in the income statement? To increase transparency. **Show that (I28) Donations is the value of all donations recognized as revenue during the period, whether restricted or not.** To calculate Donations: Donations for Loan Capital + Donations for Operating Expenses (I29) + (I30) **Ask** How do we calculate Net Income (After Taxes and Donations)? Net Income (After Taxes and Before Donations) + Donations (I27) + (I28) **Ask** What does Net Income tell you about the institution? **Describe** Institutions may want to create subaccounts under some of the income statement and balance sheet accounts for management purposes. As an

example, the Framework contains only two categories of Administrative Expenses: (I19) Depreciation and Amortization; and (I20) Other Administrative Expenses.

Ask
How would you add additional accounts under (I20) Other Administrative Expense?

(I20) Other Administrative Expense
(I20-1) Rent
(I20-2) Transportation Expenses
(I20-3) Office Supplies

Describe
Adding subaccounts enables users to track certain accounts particular to their business while maintaining consistency with industry standards. Note that this Framework is not a substitute for a chart of accounts, and any accounts added are for analytical rather than accounting purposes.

Show
Sample income statement (handout 2.2) on overhead projector. Give participants a copy of the income statement .

Practice mapping income and expense information into the income statement.
After introducing the income statement participants need to practice and use the new information.

Tell
Participants they will start to work with financial information from Micro MFI, a micro finance institution. As managers your job is to map the income and expense information into the income statement. While you will more likely be working with individual MSME operators, this exercise is still useful in that both the individual business and the MFI will have similar expenses that they will need to track through the income statement.

Divide
Participants into pairs. These teams will work together during the training when working on the case study. It is recommended to have participants from the same organization work together during the case study.

Distribute
Handout 2.3 Micro MFI Income and Expense Information. This

handout has 4 pages: an instruction page, Micro MFI Income and Expense Information (2 pages), a blank income Statement.

Describe
To participants that in their teams they need to review the income and expense information provided. Based on this information they need to map Micro MFI's income statement into the income statement. This task requires identifying what account information from the institutions previous statements needs to be relocated into new accounts for the statement format. Participants need to create an Income Statement for two years. Participants have 30 minutes to work on this.

Review activity in large group. Depending on time there are a few ways to process this activity.

1. Option one: The facilitator can show an overhead of the completed Income Statement. The facilitator can walk participants through the mapping of the income and expense information through question and answer.

2. Option two. Using a blank overhead of the Income Statement the facilitator can ask one group at a time for specific information. For example, ask" What is the Financial Revenue from Loan Portfolio?" Ask what financial information they used to get this financial revenue? Write this information into the overhead. Continue asking each group for specific pieces of information to fill in the Income Statement.

Ask
Participants what was difficult/challenging about mapping the information? How can this be done efficiently in their organizations?

Step 3:	The Balance Sheet
Guided Discussion Demonstration 1 hour 20 min Handouts: 2.4 Balance Sheet Template 2.5 Sample Balance Sheet Overhead: 2.3 Balance Sheet Template	**Give participants handout 2.4 The Balance Sheet** **Ask** What is a balance sheet? When is a balance sheet produced? **Summarize the balance sheet** • The balance sheet is a *stock* statement. • Captures the *financial position* or *financial structure* of an MFI or business at a moment in time. • A balance sheet is usually produced monthly or quarterly (at a minimum, annually. • The balance sheet summarizes the ending balance of all asset, liability, and equity accounts **Ask** What are the three major categories of accounts of the balance sheet? ▪ Assets—everything a business *has* (such as investments, vehicles) or is owed (such as microloans, interest receivable); ▪ Liabilities—everything the business owes to others (such as borrowings, deposits); and ▪ Equity—the business' net worth; that is, the difference between assets and liabilities. As the name implies, the balance sheet is presented in a way that shows the following: **Write on flipchart** Assets = Liabilities + Equity **Describe short-term and long-term** • Assets and liabilities are divided into short-term and long-term accounts in financial statements. Short-term (or current) assets and liabilities can be turned into cash within a year from the date of the statement or report - not from the date of disbursement, issuance, or purchase. • In addition, short-term assets and liabilities include any portion of a long-term asset or liability that is receivable or payable within a year, even if the final maturity date is more than a year from the report or statement date.

Ask
How do you group assets and liabilities on the balance sheet?

According to IAS, the most useful approach to the classification of assets and liabilities on a balance sheet is to group them first by *type* and second by *maturity*.

Ask a participant to review what an asset is.
Everything an MFI or an individual business operator *has* (such as investments, vehicles) or is owed (such as microloans, interest receivable); A resource controlled by an institution or a business as a result of past events and from which future economic benefits are expected to flow to the institution.

Generate a list of assets to include on the balance sheet. Ask participants What accounts are included as Assets?

- Write this list on a flipchart.
- Facilitator to remember that the terminology participants' use may be different then the terminology in the Framework. Understand what kind of account a participant is describing and then translate that to use the terminology from the Framework.
- Any accounts that are not introduced by the participants must be described by the Facilitator.

Additional talking point about assets on the balance sheet

- Contra Asset Accounts: Most accounts have positive numbers. In a few cases, accounting principles require an account that has a negative number. These subaccounts represent a *reduction* of an asset and are referred to as *contra asset accounts*. A typical contra asset account for an MFI is (B5) Impairment Loss Allowance (previously known as Loan Loss Allowance), which has the effect of reducing the value of the gross loan portfolio on the balance sheet. You will only encounter such an account if you are analyzing a financial institution or intermediary.

Define and record assets on the balance sheet as presented in the Framework

- Facilitator to specifically note that the Framework balance sheet refers to (B2) Trade Investments and (B8) Other Investments rather than short-term and long-term investments. This reflects IFRS principles that state that an MFI or individual business operator's *use* or *intended use* of a financial asset is more relevant than its actual maturity.

	• Include a description of how to calculate Net Loan Portfolio, Net Fixed Assets, and Total Assets. **Review what liabilities are. Ask a participant to summarize liabilities.** Everything the MFI or an individual business owner owes to others (such as borrowings, deposits) represents a present obligation of the institution or businessman arising from past events, the settlement of which is expected to result in an outflow from the institution of resources with economic benefits. **Generate a list of liabilities** Tell participants to turn to their neighbor and work on a list of accounts to include as liabilities on the balance sheet. (5 minutes) Go around the room and ask each group to name and describe one liability account. Write this on a flipchart. When all accounts have been identified write the liability accounts on the balance sheet. • Facilitator to remember that the terminology that participants use may be different then the terminology in the Framework. Understand what kind of account a participant is describing and then use the terminology from the Framework. • Any accounts that are not introduced by the participants must be described by the Facilitator. **Define liabilities on the balance sheet as presented in the Framework** **Review Equity** As defined by IAS, the residual interest in the *assets* of an institution after deducting all its *liabilities* represents the MFI or individual businessman's net worth. **Generate a list of accounts to include under Equity. Write these on the flipchart** • Facilitator to remember that the terminology participants' use may be different then the terminology in the Framework. Understand what kind of account a participant is describing and then use the terminology from the Framework. • Any accounts that are not introduced by the participants must be described by the Facilitator.

	Define and record equity accounts on the balance sheet as presented in the Framework Ask participants to list the equity accounts so that you can write them on the balance sheet. **Remember** to use the terminology presented in the framework. **Additional talking point** • Donations - This Framework recommends the income approach to donations so that all donations for operations and loan funds used in the current operating period are recorded as (I28) Donations on the income statement, which flow into (B25) Donations, Current Year on the balance sheet. At the beginning of a new year, they are transferred from (B25) to (B24) Donations, Previous Years. Donations for operations and loan funds to be used beyond the current operating period are recorded as deferred revenue. If the donation or grant agreement specifies when the donations must be used, record those that must be used within 12 months as (B17) Accounts Payable and Other Short-term Liabilities, and record the remainder as (B20) Other Long-term Liabilities. When a portion of donations is used, that portion is transferred to the income statement (I28) Donations. For the individual MSME operator, donations can be defined as contributions to business operations by family members or friends, with the expectation that these funds will not be repaid. - MFIs may record grants for fixed assets as deferred revenue (B20) Other Long-term Liabilities. When the asset is purchased, an the purchase amount is transferred to (I30) Donations for Operating Expense. Again, for the individual MSME operator, “grants” would be defined as any contribution or gift to the business operator. - If fixed assets are donated, MFIs should record their value as deferred revenue in (B20) Other Long-term Liabilities. Each accounting period, usually monthly or quarterly, an amount equal to the period's depreciation for the donated asset is transferred to (I28) Donations for Operating Expense, and the same amount is credited to (I17) Depreciation and Amortization. If the MFI is not recognizing a fixed asset donation in this manner, it should include the value of the fixed asset as part of the

	adjustment. Include a description of how to calculate Donated Equity B24 + B25 Retained earnings B27 + B28 Total Equity B22 + B23 +B26 +B29 +B30 + B31 **Handout and show overhead 2.5** **Tell** Participants will continue to work with financial information from Micro MFI. They now have the information from Micro MFI’s balance sheet. As was done with the income statement, participants must map the financial information from the balance sheet into the balance sheet format. **Tell** Participants they will work in their same groups as before. **Distribute** Handout 2.6 Micro MFI Balance Sheet Information. This handout has 4 pages: an instruction page, Micro MFI Balance Sheet (2 pages), a blank sample Balance Sheet. Also included is the Micro MFI Balance Sheet Information with notes for facilitator, and a completed sample Balance Sheet with Facilitator notes. **Describe** To participants that in their teams they need to review the information provided. Based on this information they need to map Micro MFI’s balance sheet financial information into the sample balance sheet. This task requires identifying what account information from the institutions previous statements needs to be relocated into new accounts for the balance sheet format. Participants need to create a balance sheet for two years. Participants have 30 minutes to work on this. **Review** activity in large group. Depending on time there are a few ways to process this activity. 1. Option one: The facilitator can show an overhead of the completed Balance Sheet. The facilitator can walk participants through the mapping of the balance sheet through question and answer. 2. Option two. Using a blank overhead of the Balance Sheet the facilitator can ask one group at a time for specific information. **Ask** Participants what was difficult/challenging about mapping the

	information? How can this be done efficiently in their organizations? .
Step 4 Guided Discussion Activity 1 hour 20 min Handouts: 2.8 Cash Flow Template 2.9 Sample Cash Flow Overhead: 2.6 Classification of Cash Receipts and Payments 2.8 Cash Flow Template 2.10 Indirect Cash Flow Activity Material: 2.7 Cash Flow Activity Prepared Flipchart: Cash Flow Statement Categories with Definitions	**The Cash Flow Statement** Note to Facilitator: This session reviews in detail a Direct Cash Flow Statement. At the end of the session the Indirect Cash Flow Statement is mentioned but not in detail. Depending on time, participant interest, and knowledge the indirect cash flow statement can be expanded or just referenced. **Ask** What is a cash flow statement? What valuable information does a cash flow statement provide? Why would a loan officer be interested in analyzing the cash flow statement as part of the credit analysis of a loan applicant? • The cash flow statement is a flow statement that represents the inflows and outflows of cash during a specified period. • The cash flow statement summarizes each transaction or event that causes cash to increase (sources of cash) or decrease (uses of cash). • The cash flow statement **Describe that a cash flow statement classifies the inflows and outflows of cash into three major categories.** • Operating Activities • Investing Activities • Financing Activities The loan officer will always need to be concerned with the cash flow risk of the borrower, namely the risk that the cash generated will not be sufficient to repay the loan. A business may not be able to repay its loan out of profits because its profits may be tied up in inventory or accounts receivable. Understanding the cash flow of the financial institution or MSME is one of the most important tasks of the loan officer. Note, however, that while the institution or businessman might have cash on had, this does not mean that your loan will be paid off first. The owner may decide to replace a fixed asset, or increase his inventory, with this excess cash. Continual monitoring of the business may be necessary to understand how funds are flowing through the business entity. The cash flow statement is a good starting point in this analysis. Character- and

enterprise-based assessment will also help the loan officer understand the true flow of the entity's funds, as well as the likelihood of repayment based on the client's character and overall health of the enterprise.

Ask what each of the categories is? Have a prepared flipchart with the following information:

Cash Flow Statement Categories with Definitions

- *Operating Activities*, the cash receipts and payments related to the MFI's ongoing provision of financial services, including lending and deposit services;
- *Investing Activities*, the cash receipts or outlays for acquiring or selling (B10) Fixed Assets or financial investments; and
- *Financing Activities*, the borrowing and repayment of borrowings, the sale and redemption of (B22) Paid-In Capital, and the payment of dividends.

Show overhead 2.6 Classification of Cash Receipts or Payments or a flipchart that has a similar table

So that participants understand the differences of the classifications ask the group to list examples of receipts and payments for each classification. Responses that can be included are on the following page.

Classification	Receipts	Payment
Operating Activities	▪ Principal repayments ▪ Interest and fee receipts on the (B4) Gross Loan Portfolio and investments ▪ Other receipts for the provision of financial services ▪ Funds received from accepting deposits	▪ Loan disbursements ▪ (B2) Purchase of Trade Investments ▪ Interest and fee payments ▪ Payment to Personnel or for (I18) Administrative Expenses ▪ Taxes paid ▪ Funds repaid to depositors
Investing Activities	▪ Proceeds from the sale of an investment ▪ Proceeds from the sale of (B10) Fixed Assets	▪ Purchase of (B8) Other Investments ▪ Purchase of (B10) Fixed Assets
Financing Activities	▪ Funds received from borrowings ▪ Receipt of (B22) Paid-In Capital from the sale of shares or membership	▪ Principal repaid on borrowings ▪ Repurchase of (B22) Paid-In Capital ▪ Payment of dividends

Explain that there are two ways a cash flow statement can be constructed

	• Direct method that shows all the cash transactions in and out of the Cash and Due from Banks account. • The direct method for preparing a cash flow statement is the most intuitive of the methods. It reconstructs the income statement by tracing the movement of cash and adds other events not included on the income statement that have caused an inflow or outflow of cash. • Indirect method deduces the movement of cash based on the changes in specific income statement and balance sheet accounts. • It begins with the (I28) Net Income (After Taxes and Before Donations) and then adds back all other sources of cash (such as loan payments) and subtracts all other uses (such as loan disbursements) that can be deduced by changes in balance sheet accounts. **Add that both methods can be used for this Framework.** **Construct, Define and review a direct cash flow statement.** 1. Pass out to all participants 1 or 2 cards from material 2.7 (Constructing a Cash Flow Statement) and a copy of overhead/handout 2.8 Direct Cash Flow Statement Template. Each card has one term written on it from either operating activities, investing activities, or financing activities. Depending on how many participants are in the training, each person should get at least one card. If some people need to get more than one card, make sure the cards they have are from the same category. Make sure that the cards are large enough so that people can read them from the back of the room. 2. Instruct participants to group themselves according to what "category" of account they have. For instance, operating, investing, or finances activity. 3. Once all participants are in their appropriate category, tell them to arrange themselves according to how a cash flow statement is constructed. 4. Start with the operating activities group. Ask them to describe how they constructed this category. Write this on the overhead 2.8 Direct Cash Flow Statement or on a prepared flipchart. 5. Ask the large group what they think about the ordering of this account. Change the account ordering on the overhead or flipchart when/if appropriate.

	6. Ask the investing activities group how they constructed this category. Write this on the overhead 2.8 Direct Cash Flow Statement or on a prepared flipchart. 7. Ask the large group what they think about the ordering of this account. Change the account ordering on the overhead or flipchart when/if appropriate. 8. Finish with asking the finances activities group how they constructed their account. Write this on the overhead 2.8 Direct Cash Flow Statement or on a prepared flipchart. 9. Ask the large group what they think about the ordering of this account. Change the account ordering on the overhead or flipchart when/if appropriate. Show overhead 2.8. Starting with the first account of the direct cash flow statement Cash Received from interest, fees, and Commissions on Loan Portfolio, ask the participant with that card to describe the account in more detail. Ask other participants for additions or corrections to the definition. Ask the participant to cross-reference the account. Tell participants the cross-reference if necessary. Write a brief definition and the cross-reference on the overhead/projector. Proceed with working your way through the other terms until the Cash Flow Statement is complete. **Show and handout overhead/handout 2.9 Sample Direct Cash Flow Statement.** **State that many of the accounts used for the indirect cash flow statement are the same as those in the direct cash flow statement.** **Show overhead 2.10 Indirect Cash Flow Statement**. **Review the accounts of the Indirect Cash Flow Statement, specifically identifying the cross-references to the Direct Cash Flow Statement.** **Tell** Participants they will work on their case study in their same groups as before. **Distribute** Handout 2.12 Micro MFI Cash Flow. This handout has 3 pages: an instruction page, Micro MFI Cash Flow Data, a blank Cash Flow

Statement. Also included is a completed Cash Flow statement.

Describe
Participant teams will need to review the information provided. Based on this information, they need to map Micro MFI's cash flow financial information into the cash flow statement. This task requires identifying what account information from the institutions previous statements needs to be relocated into new accounts for cash flow statement format. Participants need to create a cash flow statement. Participants have 30 minutes to work on this.

Review activity in large group. Depending on time there are a few ways to process this activity.

3. Option one: The facilitator can show an overhead of the completed cash flow statement. The facilitator can walk participants through the mapping of the cash flow through question and answer.

4. Option two. Using a blank overhead of the cash flow statement the facilitator can ask one group at a time for specific information. For example "Describe the financial data for cash flow from operating activities. Write this information into the overhead. Continue asking each group for specific pieces of information to fill in the cash flow statement.

Ask
Participants what was difficult/challenging about mapping the information? How can this be done efficiently in their organizations?

NOTE TO FACILITATOR
At the end of the day there is time allocated for participants to continue with inputting data into the spreadsheet tool.

Step 7	Linking Financial Statements
45 minutes Overhead/handout 2.16 Matrix to Identify Linkages between Financial Statements	**Review key points about financial statements and reports. Emphasize:** • A lot of time was spent on reviewing financial statements, learning how to categorize data into statements and reports, and becoming familiar with new terminology. • The financial statements and reports presented in this chapter include the minimum of information necessary to present accurately an MFI's activities and results. All information presented in this framework is significant and noteworthy. • Every item is also necessary for managers to analyze the MFI's performance and condition and to create performance monitoring reports for themselves and others. • Communicating less (but meaningful) information is sometimes better than providing detailed information without explanation. Executive summaries, narratives, and footnotes are vital to making financial statements transparent and accessible to non-financial readers and financial analysts alike. **Say** The financial statements used in this Framework are linked. Managers should learn the primary connections among the statements. **Ask** Why is it important to know and understand the linkages between the financial statements? What does this tell us? **Describe activity** To understand and become more familiar with how the financial statements are linked we will work on an activity. The purpose of the activity is for participants to compile a list of main links between financial statements that we have worked with. For this activity participants will need their copy of handout 2.2 Sample Income Statement, handout 2.5 Sample Balance Sheet, handout 2.10 Sample Direct Cash Flow Statement, handout 2.13

	Sample Portfolio Report. 1. Describe the outcome of this activity: Each group is to identify as many linkages between the financial statements (income statement, balance sheet, cash flow statement, and portfolio report.) in 20 minutes. Using the handout/overhead 2.16 Matrix to Identify Linkages Between Financial Statements the groups are to write the main links they can identify between the statements and determine the relationship in the last column. There is one example of a link in the matrix. The facilitator can show the overhead 2.16 and describe the example. 2. Divide participants into groups of 3 people. Tell participants that each person needs a copy of the sample income statement, balance sheet, direct cash flow statement, and portfolio report. They need to consult these statements to identify the common links. Remind participants that cross references are included in their sample statements. 3. Give each participant a copy of handout 2.16. 4. The groups have 20 minutes to work. 5. Process activity. At the end of 20 minutes review the list of links that the groups identified. 6. Ask one group at a time to discuss one link they identified. They need to articulate the link between the statements and then describe the relationship. Write the information on the overhead 2.13 Matrix. Go around the room so all groups discuss at least one link. **Ask again** Why, as managers, do we need to know and understand the links between the financial statements? What information can this tell us or reveal to us?

Income Statement Template

Ref.	X-Ref.	Account Name	Calculation
I1			
I2			
I3			
I4			
I5			
I6			
I7			
I8			
I9			
I10			
I11			
I12		**Net Financial Income**	
I13			
I14			
I15			
I16			
I17			
I18			
I19			
I20			
I21		**Net Operating Income**	
I22			
I23			
I24			
I25			
I26			
I27			
I28			
I29			
I30			
I31			

[a] If an MFI uses cash accounting, these accounts will have the same value as the cross-referenced accounts. If the MFI uses accrual accounting, these values will not be the same as the cross-referenced account.

Sample Income Statement

Ref.	X-Ref.	Account Name	From 1/1/2004 to 12/31/2004	From 1/1/2003 to 12/31/2003
I1		**Financial Revenue**	**18,976,898**	**10,521,727**
I2	**C1**[a]	Financial Revenue from Loan Portfolio	17,053,668	9,302,491
I3		Interest on Loan Portfolio	13,867,568	7,494,464
I4		Fees and Commissions on Loan Portfolio	3,186,100	1,808,027
I5	**C2** [a]	Financial Revenue from Investments	1,597,830	1,003,556
I6	**C3** [a]	Other Operating Revenue	325,400	215,680
I7		**Financial Expense**	**1,287,719**	**853,197**
I8	**C5**[a]	Financial Expense on Funding Liabilities	1,039,719	797,869
I9		Interest and Fee Expense on Deposits	256,343	250,000
I10		Interest and Fee Expense on Borrowings	783,376	547,869
I11	**C6**[a]	Other Financial Expense	248,000	55,328
I12		**Net Financial Income**	**17,689,179**	**9,668,530**
I13	**C29**	Impairment Losses on Loans	439,972	162,862
I14	**P8**	Provision for Loan Impairment	489,154	297,368
I15	**P10**	Value of Loans Recovered	(49,182)	(134,506)
I16	**C7**[a]	**Operating Expense**	**15,072,242**	**6,633,187**
I17		Personnel Expense	8,700,000	4,594,436
I18		Administrative Expense	6,372,242	2,038,751
I19	**C28**	Depreciation and Amortization Expense	1,597,669	317,057
I20		Other Administrative Expense	4,774,573	1,721,694
I21		**Net Operating Income**	**2,176,965**	**2,872,482**
I22	**C22**[a]	**Net Non-Operating Income/(Expense)**	**(1,403,143)**	**(1,838,992)**
I23		Non-Operating Revenue	586,471	—
I24		Non-Operating Expense	(1,989,614)	(1,838,992)
I25	**C27**	**Net Income (Before Taxes and Donations)**	**773,822**	**1,033,490**
I26	**C8**[a], **C30**[a]	Taxes	760,816	732,306
I27	**B28**	**Net Income (After Taxes and Before Donations)**	**13,006**	**301,184**
I28	**B25, C20**[a], **C44**[a]	Donations	4,582,000	**3,442,986**
I29		Donations for Loan Capital	—	1,258,291
I30		Donations for Operating Expense	4,582,000	2,184,695
I31		**Net Income (After Taxes and Donations)**	**4,595,006**	**3,744,170**

[a] If an MFI uses cash accounting, these accounts will have the same value as the cross-referenced accounts. If the MFI uses accrual accounting, these values will not be the same as the cross-referenced account.

Overhead and Handout 2.2

Micro MFI Income And Expense Information

Case Study Instructions

Handout 2.3

Micro MFI, a microfinance institution that you work for as a manager, has made a decision to use the SEEP Framework as part of their performance monitoring system. In order to use the framework Micro MFI must create financial statements in the SEEP Framework format. As managers your job is to map the income and expense information into the SEEP Framework income statement.

1. The task for your team is to create an income statement using the SEEP Framework Format.

2. The first step is to review the income and expense information and the trial balance of Micro MFI. When reviewing this information you need to determine what accounts, if any, need to be relocated into different accounts based on the SEEP Framework Income Statement.

3. Map the financial information into the SEEP Framework Income Statement format. To do this use the worksheet Micro MFI Income and Expense Information. The last column in this worksheet is to write the reference number for the SEEP Framework Income Statement. The last column is a guide for you to use if you choose.

4. Complete Micro MFI's SEEP Framework Income Statement for the current year and the past year.

Micro MFI Income and Expense Information

Handout 2.3

in thousands	From Income Statement		From Trial Balance	Current Year	Last Year	Framework Account
Interest and Fees on Loans	136,896.4	77,975.4	Interest on Loans	128,777.9	67,290.8	
			Registration Fees	6,097.2	3,704.0	
			Loan Application Fees	2,021.3	-	
			Risk Premium		6,980.6	
Direct Expenses						
Interest Expense	3,923.8	1,165.4	Interest on Loan	30.0	124.7	
			Interest on Savings	3,893.8	1,040.7	
Provision for Loan Losses	10,034.8	5,138.1				
Total Direct Expenses	13,958.6	6,303.5				
Net Interest after Provision for Loan Loss	122,937.8	71,671.9				
Other Operating Revenue	1,473.3	814.0	Bad Debt Recovered	503.5		
			Bank Interest Received	13.5	9.5	
			Income on Investments	260.5	254.2	
			Pass book sales	184.5	228.7	
			Sale of Fixed Assets	100.0	-	
			Other	411.3	321.6	
Net Operating Revenue	124,411.1	72,485.9				
Non-Interest Expenses						
Salaries and Benefits	45,252.4	28,575.3				
Administrative Expenses	42,283.6	22,676.7	Finance and Bank Charges	2,029.9		
			Services Charges	725.9		
			Overdraft Interest	1,304.0		
			Occupancy Expenses	2,226.0	1,840.0	
			Travel	15,399.6	9,250.0	
			Telephone	3,302.7	2,540.0	
			Printing and Stationary	4,987.8	3,878.5	
			Board Meetings	1,292.7	1,140.3	

			Professional Fees	3,547.7	1,580.7
			Licensing and Insurance	502.6	
			Cleaning	873.9	587.4
			Advertising	124.1	
			Repairs and Maintenance	5,751.4	586.8
			Training Expenses	2,245.2	1,273.0
Depreciation of Fixed Assets	5,139.1	3,654.3			
Other Expenses	3,108.4	1,791.5	Audit Expense	217.0	580.1
			MIS Expenses	1,964.6	
			Miscellaneous	926.8	
			Bank Charges		1,211.4
Total Non-interest Expenses	95,783.4	56,697.8	Service Charges		664.1
			Overdraft Interest		547.3
Net Operating Surplus/(Loss)	**28,627.7**	**15,788.1**			
Operating Grants	-	748.2			
			Loan Capital Grants	20,897.2	43,159.9
			Fixed Asset Grants	-	-
Net Surplus After Grant	**28,627.7**	**16,536.3**			

Micro MFI Income and Expense Information - Facilitators Notes

in thousands	From Income Statement		From Trial Balance	Current Year	Last Year	Account
Interest and Fees on Loans	136,896.4	77,975.4	Interest on Loans	128,777.9	67,290.8	I3
			Registration Fees	6,097.2	3,704.0	I4
			Loan Application Fees	2,021.3	-	I4
			Risk Premium		6,980.6	I4
Direct Expenses						
Interest Expense	3,923.8	1,165.4	Interest on Loan	30.0	124.7	I10
			Interest on Savings	3,893.8	1,040.7	I9
Provision for Loan Losses	10,034.8	5,138.1				I14
Total Direct Expenses	13,958.6	6,303.5				
Net Interest after Provision for Loan Loss	122,937.8	71,671.9				
Other Operating Revenue	1,473.3	814.0	Bad Debt Recovered	503.5		I15
			Bank Interest Received	13.5	9.5	I5
			Income on Investments	260.5	254.2	I5
			Pass book sales	184.5	228.7	I6
			Sale of Fixed Assets	100.0	-	I6
			Other	411.3	321.6	I6
Net Operating Revenue	124,411.1	72,485.9				
Non-Interest Expenses						
Salaries and Benefits	45,252.4	28,575.3				I17
Administrative Expenses	42,283.6	22,676.7	Finance and Bank Charges	2,029.9		
			Services Charges	725.9		I19
			Overdraft Interest	1,304.0		I10
			Occupancy Expenses	2,226.0	1,840.0	I19
			Travel	15,399.6	9,250.0	I19
			Telephone	3,302.7	2,540.0	I19
			Printing and Stationary	4,987.8	3,878.5	I19

			Board Meetings	1,292.7	1,140.3	I19
			Professional Fees	3,547.7	1,580.7	I19
			Licensing and Insurance	502.6		I19
			Cleaning	873.9	587.4	I19
			Advertising	124.1		I19
			Repairs and Maintenance	5,751.4	586.8	I19
			Training Expenses	2,245.2	1,273.0	I19
Depreciation of Fixed Assets	5,139.1	3,654.3				I19
Other Expenses	3,108.4	1,791.5	Audit Expense	217.0	580.1	I19
			MIS Expenses	1,964.6		I19
			Miscellaneous	926.8		I19
			Bank Charges		1,211.4	I19
Total Non-interest Expenses	95,783.4	56,697.8	Service Charges		664.1	I19
			Overdraft Interest		547.3	I10
Net Operating Surplus/(Loss)	**28,627.7**	**15,788.1**				
Operating Grants	-	748.2				I30
			Loan Capital Grants	20,897.2	43,159.9	I29
			Fixed Asset Grants	-	-	I30
Net Surplus After Grant	**28,627.7**	**16,536.3**				

SEEP FRAMEWORK INCOME STATEMENT

Handout 2.3

Ref.	Term	Current Year	Last Year
I1	**Financial Revenue**		
I2	Financial Revenue from Loan Portfolio		
I3	Interest on Loan Portfolio		
I4	Fees and Commissions on Loan Portfolio		
I5	Financial Revenue from Investments		
I6	Other Operating Revenue		
I7	**Financial Expense**		
I8	Financial Expense on Funding Liabilities		
I9	Interest and Fee Expense on Deposits		
I10	Interest and Fee Expense on Borrowings		
I11	Other Financial Expenses		
I12	**Net Financial Income**		
I13	Impairment Loss on Loans		
I14	Provision for Loan Impairment		
I15	(Value of Loans Recovered)		
I16	**Operating Expense**		
I17	Personnel Expense		
I18	Administrative Expense		
I19	Depreciation Expense		
I20	Other Administrative Expense		
I21	**Net Operating Income**		
I22	**Net Non-operating Income/(Expense)**		
I23	Non-operating Revenue		
I24	(Non-operating Expense)		
I25	**Net Income (Before Taxes and Donations)**		
I26	Taxes		
I27	**Net Income (After Taxes and Before Donations)**		
I28	Donations		
I29	Donations for Loan Capital		
I30	Donations for Operating Expense		
I31	**Net Income (After Taxes and Donations)**		

SEEP FRAMEWORK INCOME STATEMENT

Facilitator Notes

The result is the following income statement for the past two years.

Ref.	Term	Current Year	Last Year
I1	**Financial Revenue**	**137,866**	**78,789**
I2	Financial Revenue from Loan Portfolio	136,896	77,975
I3	Interest on Loan Portfolio	128,778	67,291
I4	Fees and Commissions on Loan Portfolio	8,119	10,685
I5	Financial Revenue from Investments	274	264
I6	Other Operating Revenue	696	550
I7	**Financial Expense**	**5,228**	**1,713**
I8	Financial Expense on Funding Liabilities	5,228	1,713
I9	Interest and Fee Expense on Deposits	3,894	1,041
I10	Interest and Fee Expense on Borrowings	1,334	672
I11	Other Financial Expenses		
I12	**Net Financial Income**	**132,638**	**77,077**
I13	Impairment Loss on Loans	9,531	5,138
I14	Provision for Loan Impairment	10,035	5,138
I15	(Value of Loans Recovered)	(504)	-
I16	**Operating Expense**	**93,553**	**56,151**
I17	Personnel Expense	45,252	28,575
I18	Administrative Expense	48,300	27,575
I19	Depreciation Expense	5,139	3,654
I20	Other Administrative Expense	43,161	23,921
I21	**Net Operating Income**	**29,555**	**15,788**
I22	**Net Non-operating Income/(Expense)**	**(927)**	**-**
I23	Non-operating Revenue		
I24	(Non-operating Expense)	(927)	
I25	**Net Income (Before Taxes and Donations)**	**28,628**	**15,788**
I26	Taxes		
I27	**Net Income (After Taxes and Before Donations)**	**28,628**	**15,788**
I28	Donations	20,897	**43,908**
I29	Donations for Loan Capital	20,897	43,160
I30	Donations for Operating Expense	-	748
I31	**Net Income (After Taxes and Donations)**	**49,525**	**59,696**

Balance Sheet Template

Ref.	X-Ref.	Account Name	As of 12/31/2004	As of 12/31/2003	Calculation
Assets					
B1					
B2					
B3					
B4					
B5					
B6					
B7					
B8					
B9					
B10					
B11					
B12		Total Assets			
Liabilities					
B13					
B14					
B15					
B16					
B17					
B18					
B19					
B20					
B21		Total Liabilities			
Equity					
B22					
B23					
B24					
B25					
B26					
B27					
B28					
B29					
B30					
B31					
B32		Total Equity			

Overhead and Handout 2.4

Sample Balance Sheet

Ref.	X-Ref.	Account Name	As of 12/31/2004	As of 12/31/2003
Assets				
B1	**C26, C50**	Cash and Due from Banks	3,261,195	1,146,142
B2		Trade Investments	10,611,928	27,096,586
B3		Net Loan Portfolio	54,338,636	33,471,489
B4		Gross Loan Portfolio	55,609,309	34,701,961
B5		Impairment Loss Allowance	(1,270,673)	(1,230,473)
B6		Interest Receivable on Loan Portfolio	1,604,993	954,993
B7		Accounts Receivable and Other Assets	1,610,308	1,010,308
B8		Other Investments	1,165,420	1,165,420
B9		Net Fixed Assets	5,567,936	4,272,836
B10		Fixed Assets	10,640,051	7,747,282
B11		Accumulated Depreciation and Amortization	(5,072,115)	(3,474,446)
B12		**Total Assets**	**78,160,416**	**69,117,773**
Liabilities				
B13		Demand Deposits	—	—
B14		Short-term Time Deposits	3,423,878	1,030,868
B15		Short-term Borrowings	2,737,009	1,371,768
B16		Interest Payable on Funding Liabilities	237,177	137,177
B17		Accounts Payable and Other Short-term Liabilities	500,100	548,000
B18		Long-term Time Deposits	3,000,000	3,000,000
B19		Long-term Borrowings	16,661,750	16,661,750
B20		Other Long-term Liabilities	3,699,498	4,199,498
B21		**Total Liabilities**	**30,259,412**	**26,949,061**
Equity				
B22		Paid-In Capital	12,000,000	10,000,000
B23		Donated Equity	37,175,822	32,593,822
B24		Prior Years	32,593,822	29,150,836
B25	**I28, C20[a], C44[a]**	Current Year	4,582,000	3,442,986
B26		Retained Earnings	(1,401,678)	(914,683)
B27		Prior Years	(1,414,683)	(1,215,867)
B28	**I27**	Current Year	13,006	301,184
B29		Reserves	126,860	489,574
B30		Other Equity Accounts		
B31		**Adjustments to Equity**		
B32		**Total Equity**	**47,901,004**	**42,168,713**

[a] If an MFI uses cash accounting, these accounts will have the same value as the cross-referenced accounts. If the MFI uses accrual accounting, these values will not be the same as the cross-referenced account.

Micro MFI Balance Sheet And Trial Balance Information
Case Study Instructions
Handout 2.6

To continue your work in organizing Micro MFI's financial statements into the SEEP Framework formats, you have been given the balance sheet information. You must map the balance sheet data into the SEEP Framework balance sheet

1. The task for your team is to create a balance sheet using the SEEP Framework Format.

2. The first step is to review the balance sheet and the trial balance from Micro MFI. When reviewing this information you need to determine what accounts, if any, need to be relocated into different accounts based on the SEEP Framework Balance Sheet.

3. Map the financial information into the SEEP Framework Balance Sheet format. To do this use the worksheet Micro MFI Balance Sheet and Trial Balance Information. The last column in this worksheet is to write the reference number for the SEEP Framework Balance Sheet. The last column is a guide for you to use.

4. Complete Micro MFI's SEEP Framework Balance Sheet for the current year and the past year.

Balance Sheet and Trial Balance Information Handout 2.6

Handout 2.6

in thousands	Current Year	Last Year	From Trial Balance	Current Year	Last Year	Account
Assets	From Balance Sheet					
Cash and Bank Balances	20,444	5,458				
Deposits and Short-term Investments	3,450	9,450				
Loan Portfolio	248,875	179,816				
Less Reserve	(6,177)	(4,058)				
Loan Portfolio (net of reserve)	242,698	175,758				
Other Current Assets	27,414	14,050	Prepayments	1,712	1,421	
			Employee Advances	16,351	5,486	
			Accrued Interest	2,650	2,354	
			Capitalized MIS Expenses	1,913	2,476	
			Subsidiary Investments	4,788	2,313	
Total Current Assets	294,005	204,716				
Fixed Assets (Net)	49,402	40,897	Vehicles	9,067	8,717	
			Computer Equipment	5,987	1,508	
			Furniture	14,232	9,419	
			Machinery	3,992	2,727	
			Land and Building	35,505	33,597	
			Accumulated Depreciation on:			
			Vehicles	(6,820)	(6,891)	
			Computer Equipment	(2,519)	(627)	
			Furniture	(4,767)	(3,697)	
			Machinery	(840)	(151)	
			Land and Building	(4,434)	(3,706)	
Long-Term Investment	22,310	22,360		49,402	40,897	
Total Non-current Assets	71,712	63,257				
Total Assets	365,717.50	267,973.24	0			
Liabilities						
Client Deposits	101,062	58,799	Members Savings	97,168	58,799	
			Interest Due	3,894	-	
Other Liabilities	9,517	3,297	Accounts Payable	463	657	
			Bank Overdraft	3,196	2,380	

			Accrued Audit Fees	350	260
			Due to Subsidiaries	3,604	
Total Current Liabilities	110,579	62,096	Deferred Grants	1,904	
Long-Term Debt	54,805	53,680			
Total Liabilities	165,384	115,776			
Equity					
Loan Fund Grant	99,298	78,401	Previous Year Loan Fund Grant Balance	78,401	35,241
			Increase in Loan Fund Grants	20,897	43,160
Capital Grant	43,310	43,310	Previous Year Capital Grant Balance	43,310	43,310
				-	-
Accumulated Surplus	57,725	30,486	Previous Year Accumulated Operating Surplus	15,788	(3,700)
			Previous Year Accumulated Operating Grants	19,034	18,286
			Net Operating Surplus	28,628	15,788
			Operating Grants	-	748
Total Equity	200,334	152,197	Difference	(5,725)	(637)
Total Liabilities and Equity	365,718	267,973			

Balance Sheet and Trial Balance Information Facilitator Notes

in thousands	Current Year	Last Year	From Trial Balance	Current Year	Last Year	Account
Assets	From Balance Sheet					
Cash and Bank Balances	20,444	5,458				B1
Deposits and Short-term Investments	3,450	9,450				B2
Loan Portfolio	248,875	179,816				B5
Less Reserve	(6,177)	(4,058)				B5
Loan Portfolio (net of reserve)	242,698	175,758				B4
Other Current Assets	27,414	14,050	Prepayments	1,712	1,421	B7
			Employee Advances	16,351	5,486	B7
			Accrued Interest	2,650	2,354	B6
			Capitalized MIS Expenses	1,913	2,476	B10
			Subsidiary Investments	4,788	2,313	B8
Total Current Assets	294,005	204,716				
Fixed Assets (Net)	49,402	40,897	Vehicles	9,067	8,717	B10
			Computer Equipment	5,987	1,508	B10
			Furniture	14,232	9,419	B10
			Machinery	3,992	2,727	B10
			Land and Building	35,505	33,597	B10
			Accumulated Depreciation on:			
			Vehicles	(6,820)	(6,891)	B11
			Computer Equipment	(2,519)	(627)	B11
			Furniture	(4,767)	(3,697)	B11
			Machinery	(840)	(151)	B11
			Land and Building	(4,434)	(3,706)	B11
Long-Term Investment	22,310	22,360		49,402	40,897	
Total Non-current Assets	71,712					

		63,257				
Total Assets	365,717.50	267,973.24	0			
Liabilities						
Client Deposits	101,062	58,799	Members Savings	97,168	58,799	B14
			Interest Due	3,894	-	B16
Other Liabilities	9,517	3,297	Accounts Payable	463	657	B17
			Bank Overdraft	3,196	2,380	B15
			Accrued Audit Fees	350	260	B17
			Due to Subsidiaries	3,604		B17
Total Current Liabilities	110,579	62,096	Deferred Grants	1,904		B17
Long-Term Debt	54,805	53,680				B19
Total Liabilities	165,384	115,776				
Equity						
Loan Fund Grant	99,298	78,401	Previous Year Loan Fund Grant Balance	78,401	35,241	B24
			Increase in Loan Fund Grants	20,897	43,160	B25
Capital Grant	43,310	43,310	Previous Year Capital Grant Balance	43,310	43,310	B24
				-	-	B25
Accumulated Surplus	57,725	30,486	Previous Year Accumulated Operating Surplus	15,788	(3,700)	B27
			Previous Year Accumulated Operating Grants	19,034	18,286	B24
			Net Operating Surplus	28,628	15,788	B28
			Operating Grants	-	748	B25
Total Equity	200,334	152,197	Difference	(5,725)	(637)	B30
Total Liabilities and Equity	365,718	267,973				

Seep Framework Balance Sheet

Handout 2.6

Ref.	X-Ref.	Term	As of 31/12/2004	As of 31/12/2003
		ASSETS		
B1		Cash and Due from Banks		
B2		Short-term Investments		
B3		Net Loan Portfolio		
B4		Gross Loan Portfolio		
B5		Loan Loss Allowance		
B6		Interest Receivable on Loan Portfolio		
B7		Accounts Receivable and Other Assets		
B8		Other Investments		
B9		Net Fixed Assets		
B10		Fixed Assets		
B11		Accumulated Depreciation		
B12		**Total Assets**		
		LIABILITIES		
B13		Demand Deposits		
B14		Short-term Time Deposits		
B15		Short-term Borrowings		
B16		Interest Payable on Funding Liabilities		
B17		Accounts Payable and Other Short-term Liabilities		
B18		Long-term Time Deposits		
B19		Long-term Borrowings		
B20		Other Long-term Liabilities		
B21		**Total Liabilities**		
		EQUITY		
B22		Paid-in Capital		
B23		Donated Equity		
B24		Prior Years		
B25		Current Year		
B26		Retained Earnings		
B27		Prior Years		
B28		Current Year		
B29		Reserves		
B30		Other Equity Accounts		
B31		**Adjustments to Equity**		
B32				

Seep Framework Balance Sheet

Facilitator Notes

Ref.	X-Ref.	Term	As of 31/12/2004	As of 31/12/2003
		ASSETS		
B1		Cash and Due from Banks	20,444	5,458
B2		Short-term Investments	3,450	9,450
B3		Net Loan Portfolio	242,698	175,758
B4		Gross Loan Portfolio	248,875	179,816
B5		Loan Loss Allowance	(6,177)	(4,058)
B6		Interest Receivable on Loan Portfolio	2,650	2,354
B7		Accounts Receivable and Other Assets	18,063	6,907
B8		Other Investments	27,097	24,673
B9		Net Fixed Assets	51,316	43,373
B10		Fixed Assets	70,697	58,445
B11		Accumulated Depreciation	(19,381)	(15,072)
B12		**Total Assets**	365,718	267,973
		LIABILITIES		
B13		Demand Deposits	-	-
B14		Short-term Time Deposits	97,168	58,799
B15		Short-term Borrowings	3,196	2,380
B16		Interest Payable on Funding Liabilities	3,894	-
B17		Accounts Payable and Other Short-term Liabilities	6,321	917
B18		Long-term Time Deposits	-	-
B19		Long-term Borrowings	54,805	53,680
B20		Other Long-term Liabilities		
B21		**Total Liabilities**	165,384	115,776
		EQUITY		
B22		Paid-in Capital		
B23		Donated Equity	161,643	140,745
B24		Prior Years	140,745	96,837
B25		Current Year	20,897	43,908
B26		Retained Earnings	44,416	12,088
B27		Prior Years	15,788	(3,700)
B28		Current Year	28,628	15,788
B29		Reserves		
B30		Other Equity Accounts	(5,725)	(637)
B31		**Adjustments to Equity**		
B32			200,334	152,197

Classification of Cash Receipts and Payments

Classification	Receipts	Payment
Operating Activities		
Investing Activities		
Financing Activities		

Overhead 2.7

Material 2.8 Cash Flow Statement Activity

Cash Received from Interest, Fees, and Commissions on Loan Portfolio Operating Activity	**Net (Purchase)/Sale of Other Investments** Investing Activity
Cash Received from Interest on Investments Operating Activity	**Net (Purchase)/Sale of Fixed Assets** Investing Activity
Cash Received as Other Operating Revenue Operating Activity	**Net Cash from Investing Activities** Investing Activity
Value of Loans Repaid Operating Activity	**Net Cash Received /(Repaid) for Short- and Long-term Borrowings** Financing Activity
(Cash Paid for Financial Expenses on Funding Liabilities) Operating Activity	**Issuance/(Repurchase) of Paid-In Capital** Financing Activity
(Cash Paid for Other Financial Expenses) Operating Activity	**(Dividends Paid)** Financing Activity
(Cash Paid for Operating Expenses) Operating Activity	**Donated Equity** Financing Activity
(Cash Paid for Taxes) Operating Activity	**Net Cash from Financing Activities** Financing Activity
(Value of Loans Disbursed) Operating Activity	**Net Cash Received/(Paid) for Non-Operating Activities** Financing Activity
Net (Purchase)/Sale of Trade Investments Operating Activity	**Net Change in Cash and Due from Banks** Financing Activity
Deposits/(Withdrawals) from Clients Operating Activity	**Cash and Due from Banks at the Beginning of the Period** Financing Activity
Cash Received/(Paid) for Other Operating Assets and Liabilities Operating Activity	**Exchange Rate Gains/(Losses) on Cash and Cash Equivalents** Financing Activity
Net Cash from Operating Activities Operating Activity	**Cash and Due from Banks at the End of the Period** Financing Activity

Overhead and Handout 2.9 **Direct Cash Flow Statement Template**

Ref.	X-Ref.	Account Name	Period	Period	Calculation
Cash Flows from Operating Activities					
C1					
C2					
C3					
C4					
C5					
C6					
C7					
C8					
C9					
C10					
C11					
C12					
C13					
Cash Flows from Investing Activities					
C14					
C15					
C16					
Cash Flows from Financing Activities					
C17					
C18					
C19					
C20					
C21					
C22					
C23					
C24					
C25					
C26					

Sample Direct Cash Flow Statement

Ref.	X-Ref.	Term	From 1/1/2004 to 12/31/2004	From 1/1/2003 to 12/31/2003
Cash Flows from Operating Activities				
C1	**I2**[a]	Cash Received from Interest, Fees, and Commissions on Loan Portfolio	16,403,668	8,847,498
C2	**I5**[a]	Cash Received from Interest on Investments	1,597,830	1,003,556
C3	**I6**[a]	Cash Received as Other Operating Revenue	325,400	215,680
C4	**C31**	Value of Loans Repaid	137,620,072	107,900,427
C5	**I8**[a]	(Cash Paid for Financial Expenses on Funding Liabilities)	(939,719)	(810,692)
C6	**I11**[a]	(Cash Paid for Other Financial Expenses)	(248,000)	(55,328)
C7	**I16**[a]	(Cash Paid for Operating Expenses)	(13,522,473)	(7,426,274)
C8	**I26**[a]	(Cash Paid for Taxes)	(760,816)	(732,306)
C9	**C32, P2**	(Value of Loans Disbursed)	(159,603,437)	(121,456,864)
C10	**C33**	Net (Purchase)/Sale of Trade Investments	16,484,658	3,406,301
C11	**C34**	Deposits/(Withdrawals) from Clients	2,393,010	1,030,868
C12		Cash Received/(Paid) for Other Operating Assets and Liabilities	(1,100,000)	(1,010,308)
C13	**C37**	**Net Cash from Operating Activities**	**(1,349,808)**	**(9,087,441)**
Cash Flows from Investing Activities				
C14	**C38**	Net (Purchase)/Sale of Other Investments	—	334,580
C15	**C39**	Net (Purchase)/Sale of Fixed Assets	(2,892,769)	(747,282)
C16	**C40**	**Net Cash from Investing Activities**	**(2,892,769)**	**(412,702)**
Cash Flows from Financing Activities				
C17	**C41**	Net Cash Received /(Repaid) for Short- and Long-term Borrowings	1,365,241	6,533,518
C18	**C42**	Issuance/(Repurchase) of Paid-In Capital	2,000,000	1,000,000
C19	**C43**	(Dividends Paid)	(500,000)	—
C20	**I28**[a], **C44, B25**	Donated Equity	4,582,000	3,442,986
C21	**C45**	**Net Cash from Financing Activities**	**7,447,241**	**10,976,504**
C22	**I22**[a], **C46**	Net Cash Received/(Paid) for Non-Operating Activities	(1,403,143)	(1,838,992)
C23	**C47**	**Net Change in Cash and Due from Banks**	**1,801,521**	**(362,632)**
C24	**C48**	**Cash and Due from Banks at the Beginning of the Period**	**1,146,142**	**900,000**
C25	**C49**	Exchange Rate Gains/(Losses) on Cash and Cash Equivalents	313,532	609,774
C26	**C50**	**Cash and Due from Banks at the End of the Period**	**3,261,195**	**1,146,142**

[a] If an MFI uses cash accounting, these accounts will have the same value as the cross-referenced accounts. If the MFI uses accrual accounting, these values will not be the same as the cross-referenced account. In the example above, the MFI uses accrual-based accounting for financial revenue, financial expense, and operating expenses so that (C1), (C5), and (C7) are not the same value as their income statement references.

Sample Indirect Cash Flow Statement

Ref.	X-Ref.	Account Name	From 1/1/2004 to 12/31/2004	From 1/1/2003 to 12/31/2003
Cash Flows from Operating Activities				
C27	**I25**[a]	Net Income (Before Taxes and Donations)	2,176,965	2,872,482
C28	**I19**	Depreciation and Amortization	1,597,669	317,057
C29	**I13**	Impairment Losses on Loans	439,972	297,368
C30	**I26**[a]**, C8**	(Cash Paid for Taxes)	(760,816)	(732,306)
C31	**C4**	Value of Loans Repaid	137,620,072	107,765,921
C32	**C9, P2**	(Value of Loans Disbursed)	(159,603,437)	(121,456,864)
C33	**C10**	(Increase)/Decrease in Trade Investments	16,484,658	3,406,301
C34	**C11**	Increase/(Decrease) in Deposits	2,393,010	1,030,868
C35		(Increase)/Decrease in Receivables and Other Assets	(1,250,000)	(1,465,301)
C36		Increase/(Decrease) in Payables and Other Liabilities	(447,900)	(1,122,967)
C37	**C13**	Net Cash from Operating Activities	**(1,349,808)**	**(9,087,441)**
Cash Flows from Investing Activities				
C38	**C14**	(Increase)/Decrease in Other Investments	—	334,580
C39	**C15**	(Increase)/Decrease in Book Value of Gross Fixed Assets	(2,892,769)	(747,282)
C40	**C16**	Net Cash from Investing Activities	**(2,892,769)**	**(412,702)**
Cash Flows from Financing Activities				
C41	**C17**	Increase/(Decrease) in Short- and Long-term Borrowings	1,365,241	6,533,518
C42	**C18**	Increase/(Decrease) in Paid-In Capital	2,000,000	1,000,000
C43	**C19**	(Dividends Paid)	(500,000)	—
C44	**C20, I28**[a]**, B25**	Donated Equity	4,582,000	3,442,986
C45	**C21**	Net Cash from Financing Activities	**7,447,241**	**10,976,504**
C46	**I22**[a]**, C22**	Net Cash Received/(Paid) for Non-Operating Activities	**(1,403,143)**	(1,838,992)
C47	**C23**	Net Change in Cash and Due from Banks	**1,801,521**	**(362,632)**
C48	**C24**	Cash and Due from Banks at the Beginning of the Period	**1,146,142**	**900,000**
C49	**C25**	Effect of Exchange Rate Changes on Cash and Cash Equivalents	313,532	608,774
C50	**C26, B1**	Cash and Due from Banks at the End of the Period	**3,261,195**	**1,146,142**

Micro MFI Cash Flow Information
Case Study Instructions
Handout 2.12

You have now been told to create a cash flow for Micro MFI. You know from experience that Micro MFI does not usually create this document on its own. In preparation for your task Micro MFI has created a chart that you can use that compares how balance sheet accounts have increased or decreased. Micro MFI does not have detailed information for 2002 and decides that you should construct a cash flow for 2004, showing the movement in cash from the end of 2003 to the end of 2004. Using the financial data presented create a cash flow using the indirect method.

1. The task for your team is to create a Micro MFI cash flow, using the indirect method, for the period from the end of 2003 to the end of 2004.

2. The first step is to review the financial data. When reviewing this information determine what accounts, if any, need to be relocated into different accounts based on the SEEP Framework Indirect Cash Flow.

3. Map the financial information into the SEEP Framework Cash Flow format.

Cash Flow Information

Handout 2.12

	Current Year	Previous Year	Difference Net Change
Loans to Clients			
Beginning	179,816		
Loans Disbursed	620,532		
Loans Repaid	(543,696)		
Principal Before Write-Off	256,652		
Write-off of Bad Debt	(7,777)		
Principal Balance At End	248,875		
Demand Deposits	-	-	-
Short-term Time Deposits	97,168	58,799	38,369
Long-term Time Deposits	-	-	-
Total Deposits			38,369
Short-term Investments	3,450	9,450	(6,000)
Interest Receivable on Loan Portfolio	2,650	2,354	296
Accounts Receivable and Other Assets	18,063	6,907	11,156
Other Investments	27,097	24,673	2,424
Total Other Assets			13,876
Interest Payable on Funding Liabilities	3,894	-	3,894
Accounts Payable and Other Short-term Liabilities	6,321	917	5,404
Other Long-term Liabilities	-	-	-
Total Liabilities			9,298
Other Investments	27,097	24,673	2,424
Fixed Assets	70,697	58,445	12,252
Short-term Borrowings	3,196	2,380	816
Long-term Borrowings	54,805	53,680	1,125
Total Borrowings			1,942

SEEP Framework Cash Flow

Handout 2.12

Ref.	X-Ref.	Account Name	From 1/1/2004 to 12/31/2004	From 1/1/2003 to 12/31/2003
		Cash Flows from Operating Activities		
C27	**I25**[a]	Net Income (Before Taxes and Donations)		
C28	**I19**	Depreciation and Amortization		
C29	**I13**	Impairment Losses on Loans		
C30	**I26**[a]**, C8**	(Cash Paid for Taxes)		
C31	**C4**	Value of Loans Repaid		
C32	**C9, P2**	(Value of Loans Disbursed)		
C33	**C10**	(Increase)/Decrease in Trade Investments		
C34	**C11**	Increase/(Decrease) in Deposits		
C35		(Increase)/Decrease in Receivables and Other Assets		
C36		Increase/(Decrease) in Payables and Other Liabilities		
C37	**C13**	Net Cash from Operating Activities		
		Cash Flows from Investing Activities		
C38	**C14**	(Increase)/Decrease in Other Investments		
C39	**C15**	(Increase)/Decrease in Book Value of Gross Fixed Assets		
C40	**C16**	Net Cash from Investing Activities		
		Cash Flows from Financing Activities		
C41	**C17**	Increase/(Decrease) in Short- and Long-term Borrowings		
C42	**C18**	Increase/(Decrease) in Paid-In Capital		
C43	**C19**	(Dividends Paid)		
C44	**C20, I28**[a]**, B25**	Donated Equity		
C45	**C21**	Net Cash from Financing Activities		
C46	**I22**[a]**, C22**	Net Cash Received/(Paid) for Non-Operating Activities		
C47	**C23**	Net Change in Cash and Due from Banks		
C48	**C24**	Cash and Due from Banks at the Beginning of the Period		
C49	**C25**	Effect of Exchange Rate Changes on Cash and Cash Equivalents		
C50	**C26, B1**	Cash and Due from Banks at the End of the Period		

Micro MFI Cash Flow

Facilitator Note

Ref.	X-Ref.	Term	From 1/1/2004 to 31/12/2004	From 1/1/2003 to 31/12/2003
Cash Flows from Operating Activities				
C26	**I21**	Net Operating Income	29,555	
C27	**I19**	Depreciation	5,139	
C28	**I13**	Impairment Loss on Loans	9,531	
C8	**I26***	(Cash Paid for Taxes)	-	
C29		Value of Loans Repaid	543,696	
C30	**P2**	(Value of Loans Disbursed)	(620,532)	
C31		(Increase)/Decrease in Short-term Investments	6,000	
C32		Increase/(Decrease) in Deposits	38,369	
C33		(Increase)/Decrease in Receivables and Other Assets	(13,876)	
C34		Increase/(Decrease) in Payables and Other Liabilities	9,298	
C35		**Net Cash from Operating Activities**	**7,179**	
Cash Flows from Investing Activities				
C36		(Increase)/Decrease in Long-Term Investments	(2,424)	
C37		(Increase)/Decrease in the Book Value of Gross Fixed Assets	(12,252)	
C38		**Net Cash from Investing Activities**	**(14,676)**	-
Cash Flows from Financing Activities				
C39		Increase/(Decrease) in Short-and Long-term Borrowings	1,942	
C40		Increase/(Decrease) in Paid-in Capital	-	
C41		Dividends paid		
C42	**I28*, B25**	Donated Equity	20,897	
C43		**Net Cash from Financing Activities**	**22,839**	
C21	**I22***	Net Cash Received/(Paid) for Non-operating Activities	**(927)**	
C44		**Net Change in Cash and Due from Banks**	**14,414**	
C45		**Cash and Due from Banks at the Beginning of the Period**	**5,458**	
C46		Effect of Exchange Rate Changes on Cash and Cash Equivalents	571	
C47	**B1**	**Cash and Due from Banks at the End of the Period**	**20,444**	**5,458**

Sample Portfolio Report

Ref.	X-Ref.	Account Name	From 1/1/2004 to 12/31/2004		From 1/1/2003 to 12/31/2003	
			Number of Loans	Value of Portfolio	Number of Loans	Value of Portfolio
Portfolio Activity						
P1, P2	**C9, C32**	Loans Disbursed	32,148	159,603,437	26,990	121,456,864
P3, P4	**B4**	Loans Outstanding	14,587	55,609,309	11,183	34,701,961
Movement in Impairment Loss Allowance						
$P5^0$	**$B5^0$**	Impairment Loss Allowance, Beginning of Period		1,230,473		933,150
$P5^1$	**$B5^1$**	Impairment Loss Allowance, End of Period		1,270,673		1,230,473
P6, P7		Loans Written Off	147	448,954	0	0
P8	**I14**	Provision for Loan Impairment		489,154		297,368
P9, P10		Loans in Recovery or Recovered	14	49,182	53	134,506
Portfolio Aging Schedule						
			Number of Loans	**Value of Portfolio**	**Loss Allowance Rate (%)[a]**	**Impairment Loss Allowance**
P11, P12		Current Portfolio	8,729	51,155,003	0	-
P13, P14		Portfolio at Risk 1 to 30 days	2,110	2,224,372	10	222,437
		Portfolio at Risk 31 to 60 days	2,022	1,112,186	25	278,047
		Portfolio at Risk 61 to 90 days	927	556,093	50	278,047
		Portfolio at Risk 91 to 180 days	556	166,828	75	125,121
		Portfolio at Risk more than 180 days	204	244,681	100	244,681
P15, P16		Renegotiated Portfolio 1–30 days	28	55,609	50	27,805
		Renegotiated Portfolio > 30 days	11	94,536	100	94,536
P3, P4	**B4**	Loans Outstanding	14,587	55,609,309		1,270,673

Overhead and handout 2.13

Micro MFI Portfolio Report
Case Study Instructions
Handout 2.14

Another Micro MFI manager has prepared the Portfolio Report and you are asked to review the report.

1. The task for your team is to review the prepared Portfolio Report to determine if Micro MFI has appropriately represented the Portfolio Activity, Movement in Impairment Loss Allowance, and the Portfolio Aging Schedule.

2. If your group determines that data in the report needs to be modified, identify that information and determine what you would do to the data.

Micro MFI Portfolio Report

Handout 2.14

Ref.	X-Ref.		From 1/1/2004 to 31/12/2004		From 1/1/2003 to 31/12/2003	
			Number of Loans	Value of Portfolio	Number Of Loans	Value of Portfolio
Portfolio Activity						
P1, P2	C9, C30	Loans Disbursed during the period	52,146	620,532	28,440	361,190
P3, P4	B4	Loans Outstanding, end of period	31,254	248,875	21,053	179,816
Movement in Impairment Loss Allowance						
			Number of Loans	**Value of Portfolio**	**Number of Loans**	**Value of Portfolio**
$P5^0$	$B5^0$	Loan Loss Allowance, beginning of period		4,058		-
$P5^1$	$B5^1$	Impairment Loss Allowance, end of period		6,010		4,058
P6, P7		Loans Written Off	1,155	8,083		-
P8		Provision Expense for Loan Impairment		10,035		4,058
P9		Loans Recovered		504		0
Portfolio Aging Schedule						
			Number of Loans	**Value of Portfolio**	**Loan Loss Allowance Rate**	**Loan Loss Allowance**
P10, P11		Current Portfolio	23,286	223,646	1%	2,236
P2,P 13		Portfolio at Risk 1 to 30 days	4,315	12,328	1%	123
		Portfolio at Risk 31 to 60 days	1,974	4,650	25%	1,163
		Portfolio at Risk 61 to 90 days	687	2,368	50%	1,184
		Portfolio at Risk 91 to 180 days	401	1,286	50%	643
		Portfolio at Risk over 180 days	120	459	100%	459
P14, P15		Renegotiated Portfolio	420	3,469	1%	35
		Renegotiated Portfolio over 31 days	51	669	25%	167
P3, P4	B4	Gross Loan Portfolio	31,254	248,875		6,010

Sample Non-Financial Data Report

	Account Name	As of 12/31/2004	As of 12/31/2003
Operational Data			
N1	Number of Active Clients	14,658	11,458
N2	Number of New Clients during Period	7,584	7,589
N3	Number of Active Borrowers	13,472	10,857
N4	Number of Voluntary Depositors	752	254
N5	Number of Deposit Accounts	752	254
N6	Number of Savers Facilitated	13,005	11,023
N7	Number of Personnel	115	89
N8	Number of Loan Officers	75	48
Macroeconomic Data			
N9	Inflation Rate	5.6%	4.3%
N10	Market Rate for Borrowing	9.5%	8.6%
N11	Exchange Rate (Local Currency: U.S. Dollar, Euro, or other)	48.0	45.0
N12	Gross National Income (GNI) per capita	12,000.0	12,000.0

Matrix to Identify Linkages Between Financial Statements

Income Statement (Table 2.1)	Balance Sheet (Table 2.3)	Cash Flow Statement (Tables 2.6 and 2.8	Portfolio report (Table 2.10)	Relationship
(I14) Provision for Loan Impairment	(B5) Impairment Loss Allowance		(P7) Value of Loans Written Off	$B5^1 = B5^0 + CI14^1 – P7^1$

Overhead/Handout 2.16

Matrix to Identify Linkages Between Financial Statements

Facilitator Notes:

Income Statement (Table 2.1)	Balance Sheet (Table 2.3)	Cash Flow Statement (Tables 2.6 and 2.8	Portfolio report (Table 2.10)	Relationship
(I14) Provision for Loan Impairment	(B5) Impairment Loss Allowance		(P7) Value of Loans Written Off	$B5^1 = B5^0 + CI14^1 – P7^1$
(I19) Depreciation and Amortization Expense	(B11) Accumulated Depreciation and Amortization	(C28) Depreciation and Amortization		$B11^1 = B11^0 + I19^1$
(I28) Donations	(B25) Donated Equity, Current Year	(C20, C44) Donated Equity		$B24^1 = B24^0 + I28^0$
(I27) Net Income (After Taxes and Before Donations)	(B28) Retained Earnings, Current Year			I27 = B28
	(B1) Cash and Due From Banks	(C23) Net Change in Cash and Due from Banks; (C25) Exchange Rate Gains/(Losses) on Cash and Cash Equivalents		$B1^1 = B1^0 + C23 + C25$
	(B4) Gross Loan Portfolio	(C9) Value of Loans Disbursed; (C4) Value of Loans Repaid	(P4) Value of Loans Outstanding; (P7) Value of Loans Written Off; (P2) Value of Loans Disbursed	$B4^1 = B4^0 + C9 – C4 – P7$

Module 3
Basics of the Character-based Element of the Cash Flow/Character/Enterprise-based Lending Model

Goal

Participants will be able to articulate the characteristics of the character-based element of the Cash Flow lending model and articulate how this analysis can be incorporated into commercial bank lending operations to MSMEs.

Objectives

By the end of Module 1, participants will:

1. Be familiar with the "Five C's of Credit" credit analysis principles and how these principles are applied in international lending practices.
2. Understand the importance of character assessment in credit analysis and give examples of how such assessment can be incorporated into Nigeria's commercial bank lending methodology to MSMEs.

Duration

20 minutes

Module 3 Summary

Time and Technique	Session	Materials
Lecture and discussion 1 minute	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 10 minutes	**Step 2: Overview of the Character-based Element of the Cash Flow Lending Model** • The “Five C’s of Credit”. • Overview of how the character-based element fits within the Cash Flow lending model. • Overview of how character-based assessment fits within overall credit analysis.	Flipchart Markers
Lecture 10 minutes	**Step 3: Incorporating the Character-based element Into the Cash Flow Lending Model** • Reviewing key financial documents. • Collecting character references. • Interviewing the applicant.	PowerPoint Slides x-y

Module 3 Facilitator Notes

Step 1: Introduction

Lecture and Discussion	**Display** PPT X Goals and Objectives:
1 minute PowerPoint Slide X	**Describe** The objectives and discuss the topics for this module. By the end of Module 3, participants will: • Be familiar with the "Five C's of Credit" analysis principles and how these principles are applied in international lending practices. • Understand the importance of character assessment in credit analysis and how character assessment can be incorporated into Nigeria's commercial bank lending methodology, particularly with MSMEs. • Identify the tools and skills necessary to gather and analyze information about an applicant's character to use in credit analysis.

Step 2: Overview of the Character-based Element of the Cash Flow/Character/Enterprise-based Lending Model

Lecture and Discussion
10 minutes

Ask
How, if at all, do you currently incorporate any information about an applicant's character into your credit analysis? What would you consider the most important personal characteristics of a successful applicant? Please rank these characteristics in order of importance, giving a rationale for your ranking.

Flipchart
Markers

Write responses on a flipchart.

Ask
Why is an applicant's character relevant to analysis of his creditworthiness?

Write responses on flipchart.

- Character assessment can help analysts determine the *intent* of the applicant to repay his loan.
- If available, past repayment history can be a useful indicator for current and future repayments.
- Information about an applicant's business management potential can be a useful indicator regarding the viability of the enterprise, and its ability to yield profits with which to service debt.

Summarize (if possible based on participants' responses) the key components of the character-based element of the Cash Flow model.

The character-based element of the Cash Flow model focuses on the personal and professional characteristics of the prospective borrow and how these, viewed in total, can yield useful information regarding the intent and ability of the borrower to service his debt.

Describe to participants that the training will focus on developing a different way of viewing credit analysis by incorporating personal and professional characteristics of the applicant into the credit analysis process.

Provide an overview of the "Five C's of Lending"

The "Five C's of Lending" is a guideline used by credit officers to assess loan applications. The objective of including this list is to provide you with a backdrop against which the proposed Cash Flow lending model can be assessed, using international lending standards as the example. Here is the "Five C's of Lending":[1]

1. **Character and Credit History**
   - Credit Report: A credit report is a strong indicator of character because it provides a prospective lender with a history of the applicant's current and past obligations. If the lender operates an existing business, a lender will want to have an objective picture of how the business handles its financial obligations. In the U.S., a lender will review business credit reports that provide trade payment histories; public record information; company background; and comparative data that compares a company's payment performance with its industry peers.

   - Credit Bureaus: In the U.S., two credit bureaus specialize in small business data, *Dun and Bradstreet* and *Experian*. Both provide company profiles and score a business' financial condition. Even though these companies provide sufficient information for determining a company's creditworthiness, the availability of credit reports is still limited. Generally, business reports are not available for enterprises with less than ten employees (ABA, 1999). Lenders typically require guarantees and credit reports from all underlying company principles.

   - Character and Integrity Factors: In addition to personal and credit history, a lender will look for other character and integrity factors, including the applicant's length of residency, education level, experience in his profession, and his standing in his community. One of the main reasons for business failure is poor business management. Therefore, it is reasonable to expect a lender to assess if the applicant has relevant job experience, or if the current management structure is staffed with workers critical and key to the enterprise's functions. Overall, a lender is trying to assess what type of person and company he is dealing with.

[1] This list is adapted from *The Five C's of Lending*, by Robert Andoh and Jeff Sanford. Georgia Small Business Development Center.

2. **Capacity and Cash Flow**
    - The Importance of Cash Flow Analysis: The most important question for the lender is "Can the lender realistically repay this loan?" The key to a company's ability to repay is its *cash flow*. Simply put, cash flow is the net of cash inflows and cash outflows. A prospective borrower must show how the enterprise's sources of cash exceed its uses of cash.

    - Reading the Cash Flow Statements: A sound cash flow projection will show how the loan proceeds will be used, how long the business will generate a positive cash flow, and how the business will cover cash "gaps". Gaps are typically caused by fluctuations in inventories, accounts receivables, accounts payable, and increases in assets. A lender will want to know how a business plans to manage these "gaps", and ascertain if the plan is reasonable, given historical data or projections.

    - Profit and Loss Statements: If an applicant operates an existing business, the lender will initially assess its audited profit and loss statements, balance sheets, and cash flow statements to determine if, historically, the company has sufficient cash flow with which to service the loan. A lender will also look at personal and corporate tax returns to support these financial statements, and require at least two years' of cash flow projections. Such an assessment will be difficult to make for a start-up company. Realistic cash flow projections are the most important financial statement and applicant will have in his loan proposal. Applicants should be able to provide two to three years of audited financial statements and projections.

    - Nature of the Loan Request: The nature of the loan request must be realistic and reasonable for its scope and terms. A lender will ask questions like the following: How much does the business realistically need? How will loan proceeds really be used? What is the length of the requested financing? A lender will need to determine the reasonableness of the loan request and, ultimately, determine if the cash flow matches the requested loan structure.

3. **Capital Adequacy**
    - Evidence of Strong Commitment from Borrower: Lenders are looking for strong evidence of commitment on the part of the borrower to repay the loan fully and on time. Most of the time, this commitment takes the form of the equity invested in

the business. Equity can be in the form of cash or other business or personal assets such as receivables, equipment, land, and buildings. The lender may also ask to see evidence of personal assets ready to be pledged against the loan, such as home equity. Lenders understand that there is a positive correlation between a borrower's commitment and the likelihood that the loan will be repaid.

- Amount of Equity Commitment: The amount of equity required by a lender will vary. Depending on the risk of the proposed venture, the borrower may be required to infuse up to 50 percent of the total requested capital. On average, lenders request between 20 to 25 percent equity commitment.

4. **Collateral**
    - Covering Risk: Even the best managed business and most well intending borrower may face unanticipated events that threaten prospects for loan repayment. Natural disasters, economic downturns, sudden changes in macroeconomic indicators, such as interest rates and inflation, lawsuits bottlenecks in receivables and supplier problems, and changes in demand can quickly halt a business' cash flow. Due to the risk that a lender takes, a loan will likely be secured by collateral. If a borrower defaults on a loan, the bank has the legal option to foreclose and liquidate the collateral. Business and personal assets, or a combination of both, can be used as collateral. If a business is purchasing land, equipment, or a building, the assets that are purchased can themselves be used to secure a loan.

    - Loan-to-Value Ratios: Lenders have developed a variety of loan-to-value ratios to value assets pledged against loans. Factors that influence ratios include factors such as the age and condition of the asset, and the liquidation value and costs associated with the liquidation. Loan-to-value ratios may also be based on lending criteria rather than the underlying market value of the collateral.

    - Additional Collateral Requirements: If an applicant is borrowing for "soft" reasons, such as inventory, working capital, or leasehold improvements, a lender will likely require additional collateral and/or equity to fully secure the loan. In general, the term of the loan should match the useful life of the asset being financed. So, a computer with a relatively short useful life would not likely be approved for financing over two years. In addition, assets may have poor liquidation values and may require additional collateral to back it.

- UCC Agreement: When collateral is pledged against a loan from a U.S. commercial bank, a Uniform Commercial Code *UCC) Security Agreement is drawn up between the lender and borrower. With this agreement, the lender has the legal right to take possession of the collateral without having to resort to going to court. The agreement provides the lender with the rights to the proceeds from the collection, sale, or exchange of the collateral.

5. **Conditions**
   - Exogenous Factors: Assessing the overall soundness of the loan proposal involves an assessment of many factors external to the enterprise in question, including: the economic environment in which the enterprise operates; industry and market trends; changes in technology.

   - Importance of Sound Management: The strength and experience of the applicant's management structure and strategic vision are critical in the overall assessment of its current and prospective soundness. Many lenders have and share with others "black lists" of businesses that show consistently poor risk ratings due to poor management. Successful applicants are those that can show evidence of a sound management team and strong leadership skills, a unique or comparative advantage over its competition, and a strong and loyal customer base.

   - Openness and Honesty of Applicant: Prospective borrowers have the opportunity to address any major challenges they believe they will face during the life of the loan, such as economic, legal, staff, supplier, or exogenous factors. Addressing such issues honestly in an application is a signal of sound character, and often improves an otherwise weak application.

Ask

What types of questions would you want to ask in your effort to gather information about the applicant's personal and professional character? You would want to ask these questions of both the applicant and members of the applicant's professional and business communities. How would you control for bias in your responses?

Write responses on a flipchart.

Summarize (if possible based on the participants' responses) the types of questions a credit officer might ask of a prospective borrower that employ the Character-based Element of the model.

Provide participants with a summary sheet of representative questions they may want to ask when incorporating the Character-based Element into their credit analysis.

- Does the prospective borrower have a good reputation in his community?
- Is he known for operating an enterprise in a competent, efficient, and professional manner?
- Is he known to be honest and fair in both his personal and business dealings?
- Does he have sufficient experience in the business activity in which he is engaged?
- If he is relatively new to the enterprise, does he show sufficient initiative and overall capability to become proficient in running the proposed business in a reasonable amount of time?

Module 4
Basics of the Enterprise-based Element of the Cash Flow/Character/Enterprise-based Lending Model

Goal

Participants will be able to articulate the characteristics of the enterprise-based element of the Cash Flow lending model and articulate how this analysis can be incorporated into commercial bank lending operations to MSMEs.

Objectives

By the end of Module 4, participants will:

1. Understand how the overall financial health of the enterprise itself will be critical to the applicant's ability to service debt.
2. Be familiar with how to use supplementary financial documents, such as invoices and purchase orders, in lieu of audited financial statements, to reconstruct the business flow of an enterprise.
3. Understand the importance of enterprise assessment in credit analysis and give examples of how such assessment can be incorporated into Nigeria's commercial bank lending methodology to MSMEs.

Duration

20 minutes

Module 4 Summary

Time and Technique	Session	Materials
Lecture and discussion 1 minute	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 10 minutes	**Step 2: Overview of The Enterprise-based Element of the Cash Flow Lending Model** • Higher Risk Inherent in MSME Lending • Overview of how the enterprise-based element fits within the Cash Flow lending model. • Overview of how enterprise-based assessment fits within overall credit analysis.	Flipchart Markers
Lecture 10 minutes	**Step 3: Incorporating the Enterprise-based Element into the Cash Flow Lending Model** • The Role of Bank as Partner • The Importance of External Evaluations of MSMEs • Using the “Cluster Approach” to Lending • “Securing” Transactions through Purchase Order and Invoice Analysis	PowerPoint Slides x-y

Module 4 Facilitator Notes

Step 1: Introduction

Lecture and Discussion 1 minute PowerPoint Slide X	**Display** PPT X Goals and Objectives: Module 4 Basics of the Character-based Element of the Cash Flow/Character/Enterprise-based Lending Model **Describe** The objectives and discuss the topics for this module. By the end of Module 4, participants will: • Understand the • xxx • xxx

Step 2: Overview of the Enterprise-based Element of the Cash Flow Lending Model

Lecture and Discussion
10 minutes

Flipchart
Markers

Ask
Do Nigerian commercial banks currently assess a prospective borrower's enterprise or business as part of the credit analysis? If so, how? If not, why not?

Write responses on a flipchart.

Ask
Why do you think it might be useful to include enterprise assessment in the credit analysis process?

Write responses on flipchart.

- While cash flow analysis can give information about the businessman's current cash receipts and payments, it generall provides an incomplete basis for assessing prospects for future cash flows because it cnnot show interperiod relationships. Many current cash receipts, especially from operations, have their origins from activities of earlier periods, and many current cash payments are intended, or expected, to result in future, not current, cash receipts. So, statements of earnings and comprehensive income, especially if used in conjunction with statements of financial position, usually provide a better basis for assessing future cash flow prospects of an entity than do cash flow statements alone. Still, ***financial statement analysis alone cannot help predict future prospects for loan repayment.***

- A major weakness of MSMEs in Nigeria is their inability to provide convincing or credible financial statements and business planning documents. Undertaking an external assessment of the enterprise can provide you with useful information about the current and future prospects for the entity's viability in the absence of these financial documents.

- Nigerian MSMEs typically lack traditional, tangible collateral for securing a loan. You can sometimes use other financial documents, such as invoices and purchase orders, to identify stages within the business' production cycle where you can take possession of inventory and reclaim the loan in the event of default. Understanding how the enterprise works will be useful if you are to use this methodology, which is referred to as the ***asset conversion cycle.***

Summarize (if possible based on participants' responses) the characteristics of the enterprise-based element of the Cash Flow lending model.

Here is a quick review of the elements we have discussed so far comprising the Cash Flow lending model:

- **Cash Flow Analysis:** The cash flow analysis focuses on the ability of the enterprise to produce sufficient cash to cover both immediate operating expenses, and to service any outstanding debt. The extent to which the borrower is able to meet these expenses will be determined by the overall viability of the underlying enterprise. Understanding the asset conversion cycle, the lender can determine when he can assign risk to the borrower, and when he can reduce his own risk by claiming assets, either tangible inventory, or the promise of payment on completed goods as evidenced by a purchase order.

- **Character-based Analysis**: In the absence of conventional references, the lender must rely on collecting as much information as possible regarding the borrower's professional and personal interactions within his community as a way to determine his integrity. However, while the analysis may speak well of the borrower's commitment and intent to repay the loan, it does not speak to the capability or capacity of him to do so.

- **Enterprise-based Analysis**: An objective assessment of the overall health and viability of the enterprise underlying the loan is a critical component of the overall analysis of the likelihood of repayment. While such analysis can involve some time and effort on the part of the lender, it is the one piece of the analysis that can yield the most objective analysis of the viability of the application. Once he has assembled key industry and economic documents, the lender can assess the enterprise against the backdrop of such indicators and assess the capacity of the borrower to service the loan.

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Step 3: Incorporating the Enterprise-based Element into the Cash Flow Lending Model

Lecture and Discussion
X minutes

Ask
Would you say that Nigerian commercial banks act as “partners” with creditors? If so, how? If not, why not?

Write responses on flipchart

Flipchart
Markers

Summarize (if possible based on participants’ responses) ways in which the lending officer may need to act more as “partner” in the Cash Flow lending process.

- Loan Review Process: In the absence of standard financial statements, you may need to spend time collecting surrogate documents and forms, and interviewing the prospective borrower, to reconstruct business transactions in an effort to determine the true cash flow analysis and health of the enterprise.

- Loan Disbursement Process: Should the loan be conditional on the borrower’s reaching certain established performance benchmarks, and if the loan is released in gradual payments, you may need to make the performance assessments a part of an extended review process.

- Loan Collection Process: Should you anticipate delinquency or other difficulties in the borrower’s servicing the loan, you may need to make frequent visits to the borrower at or near the time of collection to ensure payment on the loan.

Ask

Can you explain why external evaluation of either your MSME partner, or any financial intermediary with which you might work, would be an important part of your lending process?

Write responses on flipchart.

Summarize (if possible based on participants’ responses) the importance of external evaluations of MSMEs in the credit analysis

process.

- If you were to partner with a financial intermediary, such as a community bank or MFI, you will need to make sure that the institution itself has strong financial and management capacity to on-lend your bank's credit. You can use the Community Bank Assessment Tool developed by Chemonics International to assess your community bank partner, and you can use the Global Performance Management Tool developed by SEEP to assess your MFI partner. (The SEEP tool and training manuals are free and available to the public, and can be downloaded from the http://www.seepnetwork.org website.)

- The lending institution will want to develop as much in-house expertise on the industry sector, or cluster of sectors, to which it intends to lend. Lenders should begin lending with the less risky sectors, and expand into more risky ventures as their experience and experience with and expertise in MSME lending grows. This "cluster approach" to lending will provide the lending institutions with the time necessary to enter and succeed in the MSME market.

Ask

How might you be able to secure your loans in the absence of traditional, tangible collateral?

Write responses on flipchart.

Summarize (if possible based on participants' responses) the mechanics of asset conversion, and how asset conversion analysis can help credit analysts secure loans.

If prospective borrowers cannot provide audited financial statements, you can work with him to try to reconstruct financial transactions using invoices, receipts, and other financial transaction documents. The key to using this methodology is for you to select an industry, to learn that industry thoroughly, and to use these financial transaction documents to determine ways in which you can reduce your risk by identifying specific points in the asset conversion cycle at which you can reclaim assets to cover a defaulted loan.

Let’s work through an example.

(put purchase order example here)

Class Exercise:

Now, have a look at the attached purchase order and invoice (attachment x), and work in groups to try to identify points in the asset conversion cycle where you could make a claim on a physical asset to recover a defaulted loan.

Module 5
Loan Products, Pricing and Structuring for Use in the Cash Flow/Character/Enterprise-based Lending Model

Goal

Participants will be able to discuss the details of a range of loan products that may be suitable for MSME lending, and discuss the basic principles of structuring these loans.

Objectives

By the end of Module 4, participants will:

1. Be familiar with a variety of loan products from which commercial banks could choose when lending to MSMEs.
2. Be familiar with the basic principles of loan pricing and structuring.
3. Understand how to integrate non-collateral lending principles into the design of loan products.

Duration

20 minutes

Module 5 Summary

Time and Technique	Session	Materials
Lecture and discussion 1 minute	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 10 minutes	**Step 2: Overview of Loan Products, Pricing and Structuring for Use in the Cash Flow Lending Model** • Xxx • Xxx • xxx	Flipchart Markers
Lecture x minutes	**Step 3: Loan Product Types for MSME Lending** • Purchase Order Financing • Equipment Leasing • Lines of Credit • Short-term Loans • Senior Long-term Loans • Subordinated Long-term Loans • Convertible Subordinated Loan, or "Quasi-Equity" • Solidarity Group Loan • Individual Microfinance Client Loan	PowerPoint Slides x-y
Lecture and Guided Discussion X minutes	**Step 4: Pricing Strategies for MSME Products** • Role of the Treasury • Lessons from Microfinance	

Lecture and Guided Discussion X Minutes	**Step 5: Structuring MSME Loan Products** • Assessing the True Financing Needs of the MSME • Determining the Optimal Loan Terms and Conditions • Frequency of Payments within the Loan Cycle • Grace Periods on Interest Payments and Initial Interest-only Periods • Optimal Loan Size • Revising Original Loan Terms to Mitigate Risk	

Module 5 Facilitator Notes

Step 1: Introduction

Lecture and Discussion 1 minute PowerPoint Slide X	**Display** PPT X Goals and Objectives: Module 5 Loan Products, Pricing and Structuring **Describe** The objectives and discuss the topics for this module. By the end of Module 5, participants will: • xxx • xxx • xxx

Step 2: Overview of Loan Products, Pricing and Structuring for Use in the Cash Flow Lending Model

Lecture and Discussion
10 minutes

Flipchart
Markers

Ask
Describe the current product line your bank has for commercial loans. What are the characteristics of each product—i.e., collateral requirements, interest rates, duration, etc?

Write responses on a flipchart.

Ask
What types of financial services products do you think might be most suitable for lending to the MSME sector?

Write responses on flipchart.

Summarize (if possible based on participants' responses) the range of financial services products that could be extended to the MSME sector.

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Step 3: Loan Product Types for MSME Lending

Lecture and Discussion
X minutes

Flipchart
Markers

Ask
Describe the current product line your bank has for commercial loans. What are the characteristics of each product—i.e., collateral requirements, interest rates, duration, etc.?

Write responses on flipchart

Summarize (if possible based on participants' responses) the current range of commercial financial services in Nigeria.

Ask

Now that you have learned about the elements of the Cash Flow lending model, and how you can lend without requiring traditional collateral, let's think of a broader range of financial services that we might want to extend to the MSME community. Here are some examples of a variety of loan products to get us started.

- Purchase Order Financing: These are usually short-term loans, ranging from 4-15 weeks with repeat cycles. The loan is based on purchase order needs, with flow of funds determined by cash disbursements and receipts from payment on purchase orders. The purpose of the loan is to support the inventory and labor financing needs of start-up enterprises that lack financial history and sufficient collateral.

Ask

How might the risk of a purchase order loan be reduced? How might you secure the transaction through this type of loan? What would be the points of opportunity and points of risk for each partner in the transaction?

Write responses on flipchart.

Summarize (if possible based on participants' responses).

The risk of a purchase order loan can be reduced by identifying points of risk for the borrower and points of opportunity for the lender to reclaim the bank's loan throughout the asset conversion cycle. Here is how this could work. Let's assume that the loan was extended for the production of inventory to produce a good, say a chair, and that the borrower has a sound purchase order for the product, which he has pledged to the lender as collateral against the loan. The analyst can break the inventory down to its productive stages, starting from the loan, to the purchase of raw materials, to the work in progress (the half-finished chair), on to the final product for sale.

Throughout this production cycle, the borrower and lender have opposite points of vulnerability (potential loss) and opportunity (potential gain). When the materials are still in a raw, unfinished state, they have value to the lender (i.e., they can be resold to another producer at market value). Once the work is in progress, however, the half-completed chair, in this case, is worth more to the borrower than it is to the lender, so this represents a vulnerable point for the lender. When the product is finished (i.e., a completed chair), the lender could sell the product, if necessary, so this stage is a point of opportunity to the lender. If the loan is not repaid, the lender can collect on the purchase order he has held as collateral and recapture some, if not all, of the value of the bank's loan.

- Equipment Leasing: The leasing company, which could be a bank or subsidiary, purchases the asset and leases it to the borrower, who makes regular payments on the lease. Alternatively, the bank finances a lease issued by a leasing company, on behalf of the MSME. No money flows directly from the bank to the enterprise.

Ask

How might you secure the bank's loan through the equipment leasing transaction?

Write responses on flipchart.

Summarize (if possible, based on participants' responses):

No money flows directly from the bank to the MSME in the equipment leasing transaction. If the borrower defaults, the equipment is repossessed and sold, with cash proceeds pledged to the bank to cover principle, interest, and collection costs.

The bank must ensure that the equipment involved is of sufficient quality to withstand the transaction, and to be liquid, with market value at least equal to the cash value of the loan, in the event of default. The reputation and character of the equipment leasing company will, therefore, be an important consideration in such a transaction. The collateral in a lease loan is the equipment itself, which can be reclaimed if the borrower defaults on payments against the lease.

- Lines of Credit: In this type of loan, the source of repayment is customer revenues, with the amount of the loan based on receivables and, in some cases, inventory. Loan advance rates generally are no more than 75 percent of anticipated receivables and 50 percent of existing inventory. This is generally a good method for applicants with little credit repayment history and no traditional collateral.

Ask:

How might you reduce the risk of the loan through the line of credit product? What risks might be associated with this type of lending?

Write responses on flipchart.

Summarize (if possible, from participants' responses):

The lender and borrower can develop a strong partnership through this method. This could result in the lender's developing confidence in extending future credit with fewer conditions, as the lender will have developed a good understanding of the MSME's operations and management. The lender will want to look closely at the asset conversion cycle of the MSME, this time focusing on the time it takes to settle the accounts receivable account. If the borrower has agreed to let the vendor pay several weeks after receipt of the order of finished product, for example, then the lender will also need to wait to receive payment for the goods, if the purchase order has been seized against a defaulted loan.

- Short-term Loans: Most useful for working capital or small asset purchases, this loan type is appropriate for enterprises with a relatively strong credit history and proved record of record keeping and sales. This short-term loan method is not directly tied to anticipated receivables or to existing inventory. Rather, it will typically require monthly payments, so cash flow analysis will be critical to the review and approval process.

Ask:

What would be the most important issues for you to address when making this type of loan? How would you rate the level of risk for this loan type relative to the loan types previously discussed?

Write responses on flipchart.

Summarize (if possible, from participants' responses):

The risk is higher to the lender using the short-term loan product as the loan is not fixed directly to receivables or to inventory. Therefore, the loan officer will want to make a careful analysis of cash flow statements and other projections for this type of loan.

- Senior Long-term Loans: This loan type is typically used to finance larger fixed asset purchases for larger, more established enterprises. They typically are collateralized with at least the assets being purchased, and often with supplemental collateral comprised of additional assets and personal guarantees.

Ask

If you were to make such a loan to an MSME, what types of collateral would you demand? What risks might be associated with such a loan?

Write responses on flipchart.

Summarize (if possible, from participants' responses):

While the level of risk may appear lower due to the higher collateral requirement, the lender will need to confirm that the quality of the collateral is sufficient to ensure liquid assets with high market value at least equal to the cash value of the loan. This will require some assessment and monitoring on the part of the lender.

- Subordinated Long-term Loans: While the lender has the potential of higher returns on this type of loan than on traditional products, subordinated debt carries the highest risk to the lender and requires both lending and industry- knowledge expertise. The lender takes a subordinated, or secondary, interest in the collateral after other lenders, exposing him to more risk. It is unlikely that you would engage in these types of loans at this point, but it worth knowing that they exist.

- Solidarity Group Loan: In this model, the lender could make a group loan directly to a solidarity group through a microfinance window in the bank, or to an MFI intermediary that would on-lend to the group. Solidarity groups do not pledge traditional collateral, and so the character of the clients is a key determinant of the prospects for repayment. Each solidarity group self-selects its members who will guarantee each members' loan. If any member's defaulted loan is not repaid, the entire group forfeits the opportunity to obtain a subsequent loan. This method results in typically higher than average levels of loan repayment.

Ask

What might be the pros and cons of making a loan of this type?

Write responses on flipchart.

Summarize (if possible, from participants' responses):

The level of risk of a solidarity loan is relatively low given the in-build guarantee mechanism of solidarity lending. However, the bank must become familiar with the overall microfinance industry, ant the nature of the underlying microfinance business activities, to ensure a level of comfort necessary to make such loans.

- Individual Microfinance Client Loan: The commercial or community bank can lend directly to an individual microfinance client through an integrated microfinance unit window, or lend through an intermediary, such as an MFI. Microfinance clients are typically not required to pledge traditional collateral against their individual loans, although some MFIs do require titles for physical assets to secure their loans. MFIs often possess the collateral and hold it until the client pays, sometimes selling the goods to recover a defaulted loan. Such collateral mechanisms only work when a) the titles have legal meaning and relevance within the operation context, and b) there are legal means through with to exercise one's collateral call. More likely, the bank will need to rely on the past repayment performance of the individual client within a group loan context, and the bank will need to make an informed decision about the viability of the client's enterprise.

Ask

What types of skills do you think you might need to make a loan such as this one? What risks do you see associated with microfinance lending? What benefits?

Write responses on flipchart.

Summarize (if possible, from participants' responses):

Microfinance loans are often triple secured—by individual or group deposits or "forced savings", by small group guarantees, and by the larger group, i.e., "group solidarity". In addition to these in-built mechanisms, the bank can further contain some of this risk of microfinance loans by extending small and graduated loans, and by benchmarking any increased tranche disbursements to sound repayment performance. In addition, the bank can, and should, partner with strong MFIs that can provide character references for any group-loan graduates who are requesting individual loans through commercial sources.

Summary Discussion:

Ask

Now that you know something about non-traditional collateral lending, let's decide which of the above loan products might best suit your bank's

MSME lending strategy.

Write responses on flipchart.

Summarize (if possible based on participants' responses)

Purchase order financing, equipment leasing, and lines of credit against receivables or inventory have the most potential for reducing risk to the lender. In each case, the lender can tie a part of the MSME's business cycle into the loan transaction and create opportunities for recovery of a defaulted loan.

Step 4: Pricing Strategies for MSME Products

Ask

How is pricing of loan products determined within your bank? What, if any, role does your particular unit play in this process? Can you explain how loan price is determined within your bank? How might the pricing of smaller MSME loans differ from that of larger commercial loans?

Write responses on flipchart

Summarize (if possible, based on participants' responses)

The pricing of loan products is typically determined within the Treasury unit of a bank, which is, among other things, determined with setting the reference rate for use in the effective interest rate calculations. While your individual unit may not be directly involved in pricing of loans, it might be helpful to understand some of the basic concepts underlying loan pricing so that you can see how MSME loans differ from standard commercial loans.

For one thing, the costs of making the smaller types of loans you might make to MSMEs will be higher in percentage terms than would be the cost of making a large loan. Let's work through an example. If the actual cost per loan is $25, the percentage cost is 0.25 percent for a $10,000 loan, but 25 percent for a $100 loan.

Here is a standard formula applying what is known as the "user-cost approach" to determine loan and deposit prices.

For loans:

Loan Price = [{Earned interest income + Fees/Average loan balance} – Reference rate]*1000

Where:
Earned interest income includes all interest actually received in a given month for the portfolio of loans being priced. The average loan balance is calculated by averaging the ending daily balances of the loans in the portfolio over the month. In principle, the reference rate should be a benchmark rate indicating an opportunity cost. One way to compute the reference rate would be as with other interest rates: the reference rate would be the interest income from government securities divided by the balance sheet entry for such securities. Again, the bank's treasury department would provide the reference rate or cost of funds rate to other units within the bank.

For deposits:

Deposit Price = [Reference rate – {Interest payments – Earned fees/Average deposit balance}[*1000

Where:
Interest payments include all interest actually paid to depositors. Earned fees should include all fees. The deposit balance is calculated by taking the average of the ending daily balances of the portfolio.

For both price equations, the calculation within the outer brackets results in a rate, multiplied by 1000 to yield a service price that is used in the index calculation.

Step 5: Structuring MSME Loan Products

Ask

Given what you now know about non-traditional collateralized lending, can you give some examples of how you might want to structure a loan product to an MSME? What types of considerations might go into your loan structuring methodology?

Write responses on flipchart.

Summarize (if possible, based on participants' responses).

Assessing the True Financing Needs of the Enterprise:

- ***Estimating the elements of the Proposed Activity's Cost***: Alongside the cash flow statement, the projected cost assessment is a critical piece of the borrower's loan application. The assessment should break down all costs to include the following: a) owner's contribution and proposed loan contribution, and b) per-item breakdown of project costs, including overhead expenses if the loan is expected to cover these in part or fully. The more clearly defined and broken out the line items are, the more clearly the borrower can justify to the lender any significant deviations in the projected cost assessment during the life of the loan, should such cost fluctuations adversely impact upon the borrower's ability to repay the loan.

- ***Lender's Assessment of Projected Cost Assessment***: Some of the key questions the loan officer should ask when reviewing projected costs are as follows: are the costs reasonable, complete, and verifiable within the context of the enterprise's market for inputs and supplies?

- ***Lender's Assessment of Owner's Past, Current, and Projected Contribution***: Again, the lender should determine through a critical review of financial statements if the owner's past contributions are realistic and reasonable, and if his cash flow analysis supports his current and projected estimates of cash contributions to the projected activity. Note that only those funds invested by the enterprise owner in the last fiscal year, plus funds that will be invested before, or at the same time as the disbursal of the loan, should be counted as owner's contribution.

Determining the Optimal Loan Terms and Conditions

- ***Duration of Loan--Short-term vs. Long-term***: Setting a loan term that does not fit the borrower's cash flow can result in the borrower's inability to make monthly payments. Choosing a duration that is beyond the borrower's real needs can make it difficult for a borrower to access larger loans until the term is completed. In addition, the borrower may be paying more interest than might be necessary. An excessively long loan term could result in the borrower's using the loan for unintended purposes, including meeting consumption needs rather than employing the capital for productive purposes. ***Short-term debt*** with a life of up to 12 months is suitable for the following types of projects and cash flows: working capital finance, such as maintaining sufficient inventory levels; financing for advertising and other forms of marketing (such as packaging); financing for tools and lower-cost equipments, such as spare parts; annual privatization payments; and financing for highly seasonal businesses. ***Medium- to long-term debt*** with a life over 12 months is more suited for the following types of activities and cash flows: larger fixed and capital assets, such as farming equipment and vehicles; real estate, including acquisition, construction, and renovation; some start-up situations; and the purchase of livestock.

Frequency of Payments within the Loan Cycle and Loan Size

- ***Cash Flow Analysis as a Guide:*** Payments can be defined as: equally monthly payments for the life of the loan, equal monthly payments after a short period of interest only payments, unequal monthly payments, and seasonal payments. The cash flow analysis will determine the appropriate frequency of payments within the loan cycle.

- *Considerations Unique to MSME:* In addition to the cash flow statement, some unique aspects of the business activity can determine loan frequency repayment. For those activities requiring an initial start-up phase or the receipt of critical operating inputs, such as equipment, the loan can include an initial interest-only feature. Such activities might include real estate purchases that require construction or settlement of land purchase; and fixed asset purchases requiring an allowance of time both to receive and install the equipment prior to operation. Asymmetric or seasonal payments could make it less burdensome for borrowers to repay loans acquired for seasonal activities, such as on-farm agricultural enterprises, or with construction work wherein payment to laborers is made in installments.

- ***Grace Periods on Interest Payments and Initial Interest-only Periods***: Caution should be used in factoring interest rate grace periods and initial interest-only periods into loan terms. The bank should carefully assess its cost structure to determine the maximum amount of interest it can forego before entering a grace period into an agreement. Initial interest-only periods should not exceed six months as any longer period would jeopardize the borrower's opportunity to build equity from his investment.

- ***Optimal Loan Size***: Extending credit beyond the real needs of the borrower could compromise the borrower's capacity to repay, despite his commitment to do so.

Revising Original Loan Terms to Mitigate Risk and Better Match Lender's Risk Appetite and Borrower's Capability

Purpose: In some cases, the lender may determine that the proposed activity is sound, but that the applicant is unable to meet the terms of a standard loan. In these cases, the lender can choose to modify the original terms of the loan request to mitigate some of the real or perceived risk to the lending institution. The following is a sample list of some of the ways in which the original loan request can be modified to reduce risk. It must be noted that the bank will possibly be incurring new and additional risks both to the borrower and lending institution in the process of lending to a "sub-standard" applicant, despite his best efforts to mitigate the risks perceived from the original application.

- ***Tranche Distributions with Performance Benchmarks:*** The lender can approve the requested loan amount, but only disburse the loan in installments, upon successful completion of established and agreed-upon performance benchmarks. The lender can also disburse only when the borrower needs the money, rather than in one lump sum disbursement.

- ***Matching Owner's Contribution with Loan Disbursement***: The lender ensures that the owner's contribution is made before, or with, the loan disbursement. In this way, the lender is increasing the proportion of risk taken on by the borrower that should, in principle, result in the borrower's more careful scrutiny of the amount of debt he wants to take on.

- ***Loan Disbursal Made Directly to Supplier of Inputs***: If the loan is to pay a vendor for inventory or other supplies, the lender can disburse the loan in the form of a payment directly to the vendor. This approach would be suitable for a model wherein the distributor could be paid directly for increasing inventory, and the loan disbursement would not go directly to the stockist. While such an approach does reduce the risk on the part of the lender, it does not provide the borrower with the opportunity to establish a true credit history and could as a result, further delay his chances of getting future credit on his own merits.

- ***Monitoring Use of Loan Proceeds***: To the extent feasible, the lender can monitor the use of the loan proceeds from the time of disbursement to the time of full repayment. There will be labor costs associated with this approach that should be factored into the bank's overall cost structure.

- ***Collecting at "Point of Harvest:"*** In some cases of rural agricultural lending, lenders have been known to accompany borrowers to the point of sale of harvested goods to ensure the repayment of the loan.

- ***Revise terms of proposed project:*** In this case, the lender will propose to the borrower certain cost-saving revisions in the scope and nature of the original project, or ask that the borrower consider the postponement of non-critical components of the overall activity. The risk of such revisions will fall almost entirely on the borrower as he may cut into activities that are critical to the overall viability of the enterprise.

- ***Assessment of Risk the Bank is Willing to Take On***: Prior to making any loan approval, and particularly when assessing a sub-standard application, the lender must clearly articulate how much risk the lending institution is prepared to take with this individual transaction, and how this level of risk fits in with the bank's overall risk pool. Once such an assessment has been made, the lender will need to ensure that its capital adequacy and loan loss provision bases sufficiently matches the risk profile it has established.

Module 6
Preparing for the Field Trip

Goal

Participants will be able to see firsthand a non-traditional collateral lending methodology, through the operations of a local microfinance institution, both from the lender and client's perspective.

Objectives

By the end of Module 1, participants will:

1. Be familiar with how the "Five C's of Credit" credit analysis principles might still be relevant in a non-traditional collateral lending context.

2. Assess the relevance of customer satisfaction through interviews with MFI clients.

3. Understand the importance of character assessment in credit analysis and give examples of how such assessment can be incorporated into Nigeria's commercial bank lending methodology to MSMEs, using the MFI's lending methodology as a reference point.

Duration

20 minutes

Module 6 Summary

Time and Technique	Session	Materials
Lecture and discussion 1 minute	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 10 minutes	**Step 2: Overview of the Principles of Microfinance Lending** • • •	Flipchart Markers
Lecture 10 minutes	**Step 3: Establishing Teams and Team Assignments for the Field Trip** • Client Interviews (see Individual Client Study Guide questions) • Loan Officer Interviews (see Promoter Study Guide questions) • Community Group Interviews (see Community Group Study Guide questions)	PowerPoint Slides x-y

Module 6 Facilitator Notes

Step 1: Introduction

Lecture and Discussion	**Display** PPT X Goals and Objectives:
1 minute PowerPoint Slide X	**Describe** The objectives and discuss the topics for this module. By the end of Module 6, participants will: • Be familiar with the basic principles of microfinance lending. • Be familiar with the role of character-based assessment in microfinance lending and explain how this relates to the Cash Flow lending model.

Step 2: Overview of the Principles of Microfinance Lending

Lecture and Discussion
10 minutes

Ask

Are you familiar with any of the principles of microfinance lending? Can you explain how these principles might relate to what we have learned thus far about the role of character-based assessment in non-traditional collateralized lending?

Write responses on a flipchart.

Flipchart
Markers

Ask
Why, again, is an applicant's character relevant to analysis of his creditworthiness?

Write responses on flipchart.

- Character assessment can help analysts determine the *intent* of the applicant to repay his loan.
- If available, past repayment history can be a useful indicator for current and future repayments.
- Information about an applicant's business management potential can be a useful indicator regarding the viability of the enterprise, and its ability to yield profits with which to service debt.

Summarize (if possible based on participants' responses) the key components of the character-based element of the Cash Flow model.

The character-based element of the Cash Flow model focuses on the personal and professional characteristics of the prospective borrow and how these, viewed in total, can yield useful information regarding the intent and ability of the borrower to service his debt.

Describe to participants that the purpose of incorporating a visit to a local microfinance institution is so that we can focus on developing a different way of viewing credit analysis by incorporating personal and professional characteristics of the applicant into the credit analysis process.

Provide an overview of the Principles of Microfinance Lending

Insert Here

Ask

What types of questions would you want to ask during tomorrow's field trip in your effort to gather information about the applicant's personal and professional character? How would you best go about asking these questions of both the applicant and members of the applicant's professional and business communities. How would you control for bias in your responses?

Write responses on a flipchart.

Summarize (if possible based on the participants' responses) the types of questions a credit officer might ask of a prospective borrower that employ the Character-based Element of the model.

Step 3 Establishing Teams and Team Assignments for the Field Trip

Participants will divide themselves as evenly as possible into groups of three, with each group identifying an individual to record interview notes, and at least one interviewer. The facilitator will provide each group with a suggested list of questions and a matrix for use in recording their interview responses.[1] The three groups will comprise the following:

Group #1: Client Interviews

This group will be responsible for interviewing microfinance clients. Please review the list of suggested questions and matrix for recording your responses, and revise, as necessary, by including as many of the principles from prior modules as possible.

Group #2: Loan Officer, or Promoter Interviews:

[1] These questions and matrices are taken from Catholic Relief Service's MAGI Planning Assessment User's Guide which is, itself, a composite of tools developed by, among others, Robert Peck Christen (Banking Services for the Poor: Managing for Financial Success), Tony Sheldon and Chuck Waterfield (Business Planning and Financial Modeling for Microfinance Institutions: A Handbook), and USAID's Microenterprise Best Practices Project.

This group will interview loan officers. Again, review the suggested questions and modify, as necessary.

Group #3: Community Group Interviews

Finally, this group will interview the community groups, including the association members and leadership. Review your set of suggested questions and revise, as necessary, with a particular focus on the character-based element of the Cash Flow lending model, and the character-based elements of the "Five C's of Lending".

Field Trip Logistics:

You will meet with MFI management and staff and undertake your interviews between approximately 9:00 a.m. to 2:00 p.m., after which point you will return to the classroom to discuss your findings.

Module 7
Discussion of Field Trip Findings

Goal

Participants will discuss their findings from observing firsthand a non-traditional collateral lending methodology, through the operations of a local microfinance institution, both from the lender and client's perspective.

Objectives

By the end of Module 1, participants will:

1. Discuss specifically how the "Five C's of Credit" credit analysis principles might still be relevant in a non-traditional collateral lending context.

2. Assess the relevance of customer satisfaction through interviews with MFI clients.

3. Understand the importance of character assessment in credit analysis and give examples of how such assessment can be incorporated into Nigeria's commercial bank lending methodology to MSMEs, using the MFI's lending methodology as a reference point.

Duration

20 minutes

Module 7 Summary

Time and Technique	Session	Materials
Lecture and discussion 1 minute	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 10 minutes	**Step 2:** Participants provide general impressions of their visit to the local MFI.	Flipchart Markers
Lecture 10 minutes	**Step 3: Teams Presentations of Findings from the Field Trip** • Client Interviews (see Individual Client Study Guide questions) • Loan Officer Interviews (see Promoter Study Guide questions) • Community Group Interviews (see Community Group Study Guide questions)	PowerPoint Slides x-y

Module 7 Facilitator Notes

Step 1: Introduction

Lecture and Discussion	**Display** PPT X Goals and Objectives:
1 minute PowerPoint Slide X	**Describe** The objectives and discuss the topics for this module. By the end of Module 6, participants will: • Be familiar with the basic principles of microfinance lending. • Be familiar with the role of the character-based element in microfinance lending •

Step 2: Participants Provide General Impressions of their Visit to the Local MFI

Ask

Lecture and Discussion 10 minutes

What were your general impressions of the lending operations of the MFI? Could you see any similarities or differences between the lending practices in your institutions? What, if any, lessons could you bring from the MFI's lending practices over to a non-traditional collateral lending methodology in your own institution?

Flipchart Markers

Write responses on a flipchart.

Ask
Why, again, is an applicant's character relevant to analysis of his creditworthiness?

Write responses on flipchart.

- Character assessment can help analysts determine the *intent* of the applicant to repay his loan.
- If available, past repayment history can be a useful indicator for current and future repayments.
- Information about an applicant's business management potential can be a useful indicator regarding the viability of the enterprise, and its ability to yield profits with which to service debt.

Summarize (if possible based on participants' responses) the key components of the character-based element of the Cash Flow model.

The character-based element of the Cash Flow model focuses on the personal and professional characteristics of the prospective borrow and how these, viewed in total, can yield useful information regarding the intent and ability of the borrower to service his debt.

Describe to participants that the purpose of incorporating a visit to a local microfinance institution is so that we can focus on developing a different way of viewing credit analysis by incorporating personal and professional characteristics of the applicant into the credit analysis process.

Given that this was the focus of the field trip, let's now look at your group findings.

Ask

What types of questions did you ask field trip in your effort to gather information about the applicant's personal and professional character? How did go about asking these questions of both the applicant and members of the applicant's professional and business communities. How did you control for bias in your responses?

Write responses on a flipchart.

Summarize (if possible based on the participants' responses) the types of questions a credit officer might ask of a prospective borrower that employ the Character-based Element of the model.

Step 3 Team Presentations and Findings from the Field Trip

Group #1: Client Interviews

This group was responsible for interviewing microfinance clients. Please go over with the class the questions you asked of clients, and tell us your findings. What were the most striking findings from your interviews? The most revealing?

Group #2: Loan Officer, or Promoter Interviews:

Please follow the same steps as above. Could you imagine yourselves in the role of the loan officers and promoters you interviewed? What was unique about their roles in the lending process compared to what you are familiar with in your own day-to-day operations?

Group #3: Community Group Interviews

Please follow the same steps as above. Did you find the community group structure a sufficient mechanism for securing the loans? If so, why? If not, why not? Did you learn of any difficulties faced by the community groups in enforcing loan repayment?

Module 8

Case Study

Goal

Participants will bring together the concepts they have learned in Modules 1-7 by completing a Case Study exercise that simulates a loan application process.

Objectives

By the end of Module 4, participants will:

1. Articulate the principles of the Cash Flow/Character/Enterprise-based Lending methodology in a simulated loan application process.
2. Incorporate principles from the "Five C's of Lending" into their simulated credit analysis.
3. Be conversant in the basic principles of microfinance lending, and explain how some lessons from microfinance's character-based lending methodology might be applied to the Cash Flow lending model.

Duration

20 minutes

Module 8 Summary

Time and Technique	Session	Materials
Lecture and discussion 1 minute	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 10 minutes	**Step 2: Overview of The Cash Flow/Character/Enterprise-based Lending Model** • Main elements of the Model • The "Five C's of Lending • Lessons from Microfinance • Summary sheets for Case Study	Flipchart Markers
Lecture 10 minutes	**Step 3: Incorporating the Cash Flow Lending Model into Credit Analysis** • Participants pair off in teams of three • Participants undertake "interview" • Participants write up credit analysis • Participants present decision to "senior credit officer"	PowerPoint Slides x-y
Discussion	**Step 4: Course Wrap-up and Evaluation** • Facilitator will guide discussion on what participants have learned from the course. • Participants complete evaluations.	Evaluation Forms

Module 8 Facilitator Notes

Step 1: Introduction

Lecture and Discussion 1 minute PowerPoint Slide X	**Display** PPT X Goals and Objectives: Module 8 Basics of the Character-based Element of the Cash Flow/Character/Enterprise-based Lending Model **Describe** The objectives and discuss the topics for this module. By the end of Module 8, participants will: • Understand the main elements of the Cash Flow lending model. • Explain how the “Five C’s of Lending” can be incorporated into their MSME credit analysis. • Describe how lessons from microfinance lending can be incorporated into their MSME credit analysis. • Undertake a simulated credit analysis.

Step 2: Overview of the Cash Flow/Character/Enterprise-based Lending Model

Lecture and Discussion
10 minutes

Flipchart
Markers

Ask
What are the main elements of the Cash Flow/Character/Enterprise-based lending model?

Write responses on a flipchart.

- **Cash Flow Analysis:** The cash flow analysis focuses on the ability of the enterprise to produce sufficient cash to cover both immediate operating expenses, and to service any outstanding debt. The extent to which the borrower is able to meet these expenses will be determined by the overall viability of the underlying enterprise. Understanding the asset conversion cycle, the lender can determine when he can assign risk to the borrower, and when he can reduce his own risk by claiming assets, either tangible inventory, or the promise of payment on completed goods as evidenced by a purchase order.

- **Character-based Analysis**: In the absence of conventional references, the lender must rely on collecting as much information as possible regarding the borrower's professional and personal interactions within his community as a way to determine his integrity. However, while the analysis may speak well of the borrower's commitment and intent to repay the loan, it does not speak to the capability or capacity of him to do so.

- **Enterprise-based Analysis**: An objective assessment of the overall health and viability of the enterprise underlying the loan is a critical component of the overall analysis of the likelihood of repayment. While such analysis can involve some time and effort on the part of the lender, it is the one piece of the analysis that can yield the most objective analysis of the viability of the application. Once he has assembled key industry and economic documents, the lender can assess the enterprise against the backdrop of such indicators and assess the capacity of the borrower to service the loan.

Ask
What are the main elements of "The Five C's of Lending"?

Write responses on a flipchart

Summarize (if possible, based on participants' responses):

- Character and Credit History: Includes credit reports and overall character and integrity factors.

- Capacity and Cash Flow: Importance of cash flow analysis, profit and loss statements, and understanding the true nature of the loan request.

- Capital Adequacy: Evidence of strong commitment on the part of the borrower and the amount of equity committed to loan request.

- Collateral: Covering risk, loan-to-value ratios, additional collateral requirements.

- Conditions: Exogenous factors, importance of sound management, and honesty of applicant.

Step 3: Incorporating the Cash Flow Lending Model into Credit Analysis

Class Exercise and Discussion X minutes

- **Participants divide up into teams of three**

Participants will identify a loan applicant, junior loan officer, and senior loan officer.

- **Participants undertake "interview"**

Flipchart Markers

Participants will spend approximately one hour on the interview, utilizing the following documents:

1. Completed loan application (Attachment x)
2. Case Study (Attachment x)
3. Summary documents (Attachments x-y)

- **Participants write up credit analysis**

While other team members are free to work together, the senior loan officer should not be part of the application or credit write-up process.

- **Participants present decision to "senior credit officer"**

The junior loan officer will present his credit analysis to the senior credit officer. The senior credit officer is encouraged to challenge any parts of the analysis if he thinks this is necessary. Remember—use your summary documents as aides in your decision.

- **Team spokesman will present team findings to class**

Teams will present their findings to the class.

- **Class will discuss common themes and other findings from the class exercise**

Teams will write findings on a flipchart and facilitator will draw out similarities and differences from the list of presentations.

Discussion **Step 4: Course Wrap-up and Evaluation**

- **Facilitator will guide discussion on what participants have learned from the course**

- **Participants complete evaluations**

Module 8

Case Study

Background

NigChem chemical production company has been producing agricultural chemicals (fertilizers and pesticides) in Lagos for over 12 years. For over 10 years, NigChem has been producing all of its product line in its own production facility. Over the past two years, NigChem has passed all national and international production safety standards, and its products are suitable for export. Some components of one of its products, a pesticide, are imported from the U.S. Within the past three years, NigChem has ploughed much of its profits back into the company by improving the quality of its product line and to increase the productivity by using more modern equipment imported from India.

The demand for NigChem's products has increased to such a level that they need more production space. They would like to buy new production space in a nearby town, but they do not have cash to purchase the building at this point in time. They would like to pay the owner of the building in the form of fertilizers and pesticides that he can use on his own farm. The market value of the bartered goods is approximately Shs 100 mn, which is the approximate market value of the building (Shs 75 mn), plus Shs 25 mn of repairs the current owner has agreed to make on the building to bring it up to standard. The current owner has a good reputation within his business community, so NigChem is confident that he will refurbish the building to their expectation.

NigChem will deliver the barter goods to the current building owner within the next five months. They would like to sign a contract outlining the terms of the agreement with the current owner within the next two weeks. NigChem will also need to budget approximately Shs 10 mn of its own resources to install the appropriate chemical production equipment and utility lines into the new building over the next month if it expects to move into the building within the next two months, at the latest.

NigChem expects to fill a purchase order with a Ghanaian agricultural company within the next six months. This contract is expected to be worth approximately Shs 250 mn per year for approximately 3 years. The loan officer has already confirmed that this purchase order is legitimate, but only through informal discussions with a junior staff person within the Ghanaian company.

At this time, NigChem has a current outstanding debt of approximately Shs 25 mn with its U.S. supplier, but it hopes to pay off this balance within the next two months as the contract with the company in Ghana is filled.

Loan Request:

NigChem is requesting a loan of Shs 75 mn from your bank. The request is broken down as follows: Shs 65 mn for raw materials necessary to meet the order for the company in

Ghana, and Shs 10 mn that they will need to get the building ready for production. NigChem can offer its current production hall as collateral against the loan, and they note that the hall is in the prime real estate district of Lagos near good roads and other facilities. The market value of the hall, which could be used both for commercial and residential purposes, is approximately Shs 200 mn, according to recent real estate assessments.

Suggested Questions for Case Study

1. How would you structure a loan for NigChem? From the list of suggested loan products, what would you use? Why? Would you include a grace period with your loan? Explain fully your reasons for choosing the structure of the loan.

2. NigChem has agreed to contribute financially to the loan. Do you believe that this is an appropriate form and amount of owners' contribution for this loan? How would you verify that they have these funds to put toward the loan?

3. How would you evaluate the collateral NigChem is willing to pledge toward the loan?

4. How would you distribute the loan? In one lump sum? In tranche distributions? If in tranche distributions, what benchmarks would you apply to the loan?

5. Would you approve this loan request? Why, or why not? What do you believe might be the most significant risks associated with this loan request?

Facilitator Guidelines for Responses to Case Study Questions

1. How would you structure a loan for NigChem? From the list of suggested loan products, what would you use? Why? Would you include a grace period with your loan? Explain fully your reasons for choosing the structure of the loan.

Two loans:

Short-term working capital (up to one year) for raw materials (

Long-term loan (two years and over, depending on NigChem's cash flow) for equipment—up to Shs x mn (depending on both NigChem's casn flow and owners' contribution to the purchase of equipment).

2. NigChem has agreed to contribute financially to the loan. Do you believe that this is an appropriate form and amount of owners' contribution for this loan? How would you verify that they have these funds to put toward the loan?

The barter order NigChem has agreed to fill with the current building owner is too far off in the future to secure this loan. There is no guarantee that NigChem will be able to make this future payment, given its current financial situation.

The bank should require partial contribution from NigChem for both the short-term and long-term loans. The loan officer will want to work closely with NigChem to make sure that this request does not burden the applicant, given the current payments NigChem is making on its outstanding debt, and its need to refurbish the building before it begins new production. The bank may need to be prepared to modify this request if it proves too burdensome to the applicant.

3. How would you evaluate the collateral NigChem is willing to pledge toward the loan?

The loan officer should gather as many assessments on the current market value of the property pledged as collateral and take the average of these estimates to arrive at a realistic value figure.

4. How would you distribute the loan? In one lump sum? In tranche distributions? If in tranche distributions, what benchmarks would you apply to the loan?

Distribute the short-term loan first as this will be needed to purchase the raw materials necessary to fill the order with the company in Ghana. The benchmark to apply to this loan will be the filling of the order.

Once the first order with the Ghanaian company has been filled, distribute the second, long-term loan.

5. Would you approve this loan request? Why, or why not? What do you believe might be the most significant risks associated with this loan request?

The loan is approved. Although NigChem's products are seasonal, they have a proven record of keeping good stock of inventory and filling orders throughout the year, so they do not appear to have many spikes in their income cycle.

The request comprises two separate activities: NigChem's proposed move to a larger facility, and meeting a purchase order request for the company in Ghana. Both activities require immediate funds if NigChem is to expand its production. The bank may approve the first request conditioned on the submission of a contract of the real estate in a satisfactory format for the bank (title to building, recently appraised market value). The second activity's approval is conditioned upon NigChem's producing sufficient documentation from authorized individuals within the Ghanaian agricultural company to confirm every stage of this order's completion.

Finally, NigChem should continue to make payments on its current debt and verify these payments with the bank. This will help NigChem remain in good standing with its debtor and improve its chances of repaying this loan.

Module 1 Summary (Day 1)

Time and Technique	Session	Materials
Lecture and discussion 9.00-9.10 (10 minutes)	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 9.10-9.55 (40 minutes)	**Step 2: Overview of The Introduction to Cash Flow/Character/Enterprise-based ("Cash Flow") Lending Model**	Flipchart Markers
9.55-10.15 (20mintues)	Tea Break	
Lecture 10.15-11.15 (1 hour)	**Step 3: Interactive Discussion on the need and rationale for Cash Flow lending in Nigeria, covering the following:** • The effective demand for MSME financial services • The impediments to commercial banks' providing these services • The opportunities for commercial banks to provide such services • The challenges to commercial banks providing MSME financial services	PowerPoint Slides x-y
Lecture 11.15-12.00 (45 minutes)	**Step 4: Case Studies and Examples of Non-Traditional Collateralized Lending** • Indonesia: P.T. Ukabima • Philippines: Plantersbank • E. Africa: USAID/IDEA, USAID/SPEED, and Centenary Bank	PowerPoint Slides x-y, Handouts

Module Summary 2 (Day 1 contd')

Time and Technique	Session	Materials
Lecturette and discussion 12.00-12.10 (10 minutes)	**Overview of Financial Statements and Reports** Facilitator provides an overview of the session goal and objectives.	Powerpoint slides 13-14 (renumber)
Guided Discussion Demonstration Activity 12.10-1.10 (1 hour)	**Step 2: Income Statement** • Overview of income statement • Income statement construction • Terminology, definitions, xrefs • Practice	Overhead/handout 2.1 Income Statement Template 2.2 Sample Income Statement 2.3 Case Study Instructions w/Income and Expense Information
1.10-2.10	Lunch Break	
Guided Discussion Demonstration Activity 2.10-3.10 (1 hour)	**Step 3: Balance Sheet** • Overview of balance sheet • Construction of a balance sheet • Terminology, definitions, xrefs • Practice	Overhead /handout 2.4 Balance Sheet Template 2.5 Sample Balance Sheet 2.6 Case Study Instructions w/Balance Sheet information
Guided Discussion Group Activity Demonstration 3.10-4.30 (1 hour 20 minutes)	**Step 4: Cash Flow Statement** • Overview of cash flow statement • Cash Flow construction • Terminology, definitions, xrefs	Overhead 2.7 Classification of Cash Receipts and Payments Overhead/Handout 2.9 Cash Flow Template 2.10 Sample Cash Flow Activity Material 2.8 Cash Flow Activity 2.11 Indirect Cash Flow Example 2.12 Case Study

		Cash Flow Instructions
Discussion Activity 4.30-5.10 (40 minutes)	**Step 5: Linking Financial Statements** • Importance of understanding the links between financial statements • Links between the financial statements and reports	Overhead/Handout 2.16 Matrix Need handouts 2.2 2.5, 2.10, 2.13

Module 3 Summary (Day 2)

Time and Technique	**Session**	**Materials**
Lecture and discussion 9.00-9.10 (10 minutes)	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 9.10-10.00 (1hour)	**Step 2: Overview of the Character-based Element of the Cash Flow Lending Model** • The "Five C's of Credit". • Overview of how the character-based element fits within the Cash Flow lending model. • Overview of how character-based assessment fits within overall credit analysis.	Flipchart Markers
10.10-10.30	Tea Break	

Lecture 10.30-12.00 (1.30minutes)	**Step 3: Incorporating the Character-based element Into the Cash Flow Lending Model** • Reviewing key financial documents. • Collecting character references. • Interviewing the applicant.	PowerPoint Slides x-y

Module 4 Summary (Day 2 contd')

Time and Technique	Session	Materials
Lecture and discussion 12.00-12.10 (10 minute)	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 12.10-1.30 (1hr 20 minutes)	**Step 2: Overview of The Enterprise-based Element of the Cash Flow Lending Model** • Higher Risk Inherent in MSME Lending • Overview of how the enterprise-based element fits within the Cash Flow lending model. • Overview of how enterprise-based assessment fits within overall credit analysis.	Flipchart Markers
1.30-2.30	Lunch Break	
Lecture 2.30-4.00 (1hr 30 minutes)	**Step 3: Incorporating the Enterprise-based Element into the Cash Flow Lending Model** • The Role of Bank as Partner • The Importance of External Evaluations of MSMEs • Using the "Cluster Approach" to Lending	PowerPoint Slides x-y

	• "Securing" Transactions through Purchase Order and Invoice Analysis	

Module 5 Summary (Day3)

Time and Technique	Session	Materials
Lecture and discussion 9.00-9.10 (10 minutes)	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 9.10-10.10 (1hr)	**Step 2: Overview of Loan Products, Pricing and Structuring for Use in the Cash Flow Lending Model** • Xxx • Xxx • xxx	Flipchart Markers
10.10-10.30		
Lecture 10.30-12.00 (1hr 30min)	**Step 3: Loan Product Types for MSME Lending** • Purchase Order Financing • Equipment Leasing • Lines of Credit • Short-term Loans • Senior Long-term Loans • Subordinated Long-term Loans • Convertible Subordinated Loan, or "Quasi-Equity" • Solidarity Group Loan • Individual Microfinance Client Loan	PowerPoint Slides x-y

Lecture and Guided Discussion 12.00-12.50 (50minutes)	**Step 4: Pricing Strategies for MSME Products** • Role of the Treasury • Lessons from Microfinance	
12.50-1.50	**Lunch Break**	
Lecture and Guided Discussion 1.50-2.30 40 Minutes	**Step 5: Structuring MSME Loan Products** • Assessing the True Financing Needs of the MSME • Determining the Optimal Loan Terms and Conditions • Frequency of Payments within the Loan Cycle • Grace Periods on Interest Payments and Initial Interest-only Periods • Optimal Loan Size • Revising Original Loan Terms to Mitigate Risk	

Module 6 Summary (Day3 contd')

Time and Technique	**Session**	**Materials**
Lecture and discussion 2.30-2.40 (10 minutes)	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 2.40-3.40 (1hr)	**Step 2: Overview of the Principles of Microfinance Lending** • • •	Flipchart Markers

Lecture 3.40-5.00 (1hr 20 minutes)	**Step 3: Establishing Teams and Team Assignments for the Field Trip** • Client Interviews (see Individual Client Study Guide questions) • Loan Officer Interviews (see Promoter Study Guide questions) • Community Group Interviews (see Community Group Study Guide questions)	PowerPoint Slides x-y

DAY 4 - FIELD TRIP

Module 7 Summary (Day 5)

Time and Technique	Session	Materials
Lecture and discussion 9.00-9.10 (10 minute)	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 9.10-10.40 (1hr 20 minutes)	**Step 2:** Participants provide general impressions of their visit to the local MFI.	Flipchart Markers
10.40-11.00	Tea Break	
Lecture 11.00-12.30 (1hr 30 minutes)	**Step 3: Teams Presentations of Findings from the Field Trip** • Client Interviews (see Individual Client Study Guide questions) • Loan Officer Interviews (see	PowerPoint Slides x-y

	Promoter Study Guide questions) • Community Group Interviews (see Community Group Study Guide questions)	
12.30-1.30	Lunch Break	

Module 8 Summary (Day 5 contd')

Time and Technique	Session	Materials
Lecture and discussion 1.30-1.40 (10 minutes)	**Step 1: Introduction** Facilitator provides an overview of the session goal and objectives.	Powerpoint Slide x
Lecture and Guided Discussion 1.40-3.00 (1hr 20 minutes)	**Step 2: Overview of The Cash Flow/Character/Enterprise-based Lending Model** • Main elements of the Model • The "Five C's of Lending • Lessons from Microfinance • Summary sheets for Case Study	Flipchart Markers
Lecture 3.00-4.30 (1hr 30 minutes)	**Step 3: Incorporating the Cash Flow Lending Model into Credit Analysis** • Participants pair off in teams of three • Participants undertake "interview" • Participants write up credit analysis • Participants present decision to "senior credit officer"	PowerPoint Slides x-y
Discussion 4.30-5.00 30minutes	**Step 4: Course Wrap-up and Evaluation** • Facilitator will guide discussion on what participants have learned from the course. • Participants complete evaluations.	Evaluation Forms