Loan Officer Manual
Banco Solidario

Excerpts related to avoiding client over-indebtedness, translated from Spanish

The philosophy “Living Solidarity” can be applied to everything in life. In our personal lives, it can be a value system and a distinct attitude reflected to our community; and here at Banco Solidario, it can be the genuine fulfillment of our Mission, Vision, Principles, Values, and other aspects of the culture and practices that we adopt year after year.

–Michel Burbano, General Manager

This Loan Officer Manual seeks to serve as a permanent reminder to you that you have a responsibility and role to serve as a collaborator in the creation of a better country. It is an informational tool that should guide your actions and help you in your daily tasks.

Keep the manual with you, review it frequently, and above all, commit to yourself that every day you will work with a positive attitude and will improve yourself personally and professionally.

–Fidel Durán, VP of Microfinance
ETHICS CODE FOR LOAN OFFICERS

• Strictly adhere to the procedures, policies, and methods established by the institution.
• Do not conduct personal business or establish business relationships with your clients.
• Never accept gifts from microfinance clients, especially when the client is under your supervision.
• Without diminishing the importance of a client’s financial state and collateral, the essential element recommending credit is the knowledge of your client.
• Credit should be granted with attention first to the moral reliability (willingness to pay) of the client, second to the capacity of the client to generate the funds to execute the appropriate repayment in accordance with their current individual cash flow, and lastly to the merit of the guarantees for the credit recovery.
• The use to which the client intends to put the loan is important. The loan from Banco Solidario should have a specific purpose.
• Always demand that the loans are paid on the exact date agreed upon and that the money comes from the client, not someone else. Don’t allow the client to fall into the debt trap of paying a loan by taking another loan.
• Understand that credit is a service to which one agrees under the observance of certain requirements; never look at it as a favor the bank is doing for the clients, nor vice versa.
• To structure and recommend the approval of credit with inconsistencies is considered a grave mistake at Banco Solidario.
• Actions such as providing credit to people with insufficient information or people who do not own a business and other severe deviations, be they methodological or regarding the target population of Banco Solidario, will be considered grievous and result in the sanctions discussed in the policies and rules (different section).
• Support the financing of micro-businesses solidly based in reality; don’t do it based on illusions or ideals.
• Never recommend the granting of a “lifesaving credit” to clients with financial problems.
• Under no circumstances should you deal with or recommend credit operations with clients who are related to you. Always request that a different loan officer completes the loan evaluation. These cases should be reported to HR through the policy form on conflict of interests.
• Have the courage and strength to say “no.” Never accept threats from clients regarding the amount of credit or the timeline for credit recovery.
• Never generate false expectations in your clients.
• Keep in mind that it’s preferable not to recommend or present a weak credit operation than to later have to deal with the recovery of credit. Your responsibility for the credit ends with its total recovery.
• It is irresponsible for a loan office to recommend a loan without fully evaluating the client.
• Never agree to favors with political, religious, social, or community people or organizations that would alter the free decision and action of the clients.
• Establish long-term relationships with your clients with a focus on the development of their business.
• When in doubt, do not issue credit. A single badly delivered credit can absorb the profits of many good credits.
INTRODUCTION: CLIENT EVALUATION

A solid financial evaluation is fundamental to determining the willingness and capacity of the client to repay their loan. The evaluation must be rigorous because a quality credit analysis will produce a quality portfolio in the long run.

The two basic criteria for evaluating a client are: 1) their willingness to repay the loan, determined by a non-financial evaluation, and 2) their capacity to repay, determined by a financial evaluation.

NON-FINANCIAL EVALUATION

Get to know the client and find out about their non-financial characteristics. Try to meet with as many character references as possible, in a reasonable amount of time. This evaluation is of utmost importance when making a first-time loan because you don't know the client; for subsequent loans, their repayment history should indicate their willingness to pay. During the non-financial evaluation evaluate the following: the client's character, their business management skills, and their living situation.

FINANCIAL EVALUATION

The evaluation of the payment capability or financial evaluation should focus on the evaluation of the business and the family unit with the object of deciding the feasibility of credit based on the determination of the monthly family surplus.

The loan officer should take into account the following analyses:

- **Business Cycle Analysis:** This is to have a close view of the normal cycle of the business during a period of time. It is important to have information on the behavior of purchases and sales, in order to determine the best period of time for the loan and the payment amount that most closely matches the client's cyclical variations of income. The credit officer should investigate the days, weeks, fortnights, and months of greater, normal, and lesser sales and purchases through the history of the business; the format of the Credit Decision Matrix is designed to be filled with the information of one year and determine averages.

- **Profitability Analysis:** The objective is to determine the net income of the business and the family unit, as they are intimately related. The key variations to evaluate are: the monthly family surplus, the sales margin, and the net profit.

- **Liquidity Analysis:** The objective is to determine the level of cash at hand that the business relies on in order to cover its continuing obligations and the ease of providing itself with these resources through the management of its sales and inventory. For this the critical
variables to be studied are the cash at hand, accounts receivable, the inventory, accounts payable and the business movement of sales and purchases.

- **Debt Analysis:** The objective is to evaluate the level of provisions of current business resources and its future possibilities with the goal of avoiding over-indebtedness. This aspect is very important, because it is based on the criteria that the lender must not risk more resources than the owner has invested; this would result in the owner losing the incentive to develop his or her business. Evaluate each case, because businesses differ in economic activity, but in general, use the principal of maintaining the financial autonomy of the business.

**Business Evaluation and Payment Capacity**

Business Evaluation and Payment Capability is divided into three parts:

- Part 1: Sales and Procurement Analysis
- Part 2: Financial Position
- Part 3: Financial Indications

**Part 1: Sales and Procurement Analysis**

The loan officer calculates the client’s monthly sales and monthly purchases based on their average weekly transactions. Take into account the frequency and amount of purchases made.

**Part 2: Financial Position**

The calculation of the financial position of the business is key for determining the repayment capacity of the client.

The cash flow is a financial position that presents the projections of actual income and expenditures of the micro-business in a determined period. In the base analysis period, the client should already have sufficient family surplus to cover the payments of the requested loan.

**Part 3: Financial Indicators**

The Loan Officer must analyze evolution of the business. The financial indicators on their own give indices, but analyzing the relationship between them allows the loan officer to: deepen the analysis, revise the loan amount, or simply reject the loan request.

The indicators are not to be used alone; the final decision to approve or reject the credit will depend on the integrated analysis.

In the field, the loan officer calculates the basic indicators, however the analysis of the other complementary indicators will be done in the approval sub-process (credit committee).

**The financial indicators can be classified into four groups:**
1. Liquidity: measures the ability of the client’s business to fulfill its short-term obligations. This indicator establishes how difficult or easy it is for the business to pay its current liabilities by converting assets into cash. There are three types of liquidity ratios.

   a. Working Capital Ratio: It tells us if the business has sufficient resources to function, for which the result should always be positive. In cyclical activities like agriculture this ratio is not very helpful, because an agriculture-based business will have high activity and high expenditures in some months, and only nominal activity in other months.

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   \text{Working Capital Ratio} = \frac{\text{Current Assets} - \text{Current Liabilities}}{} 
   \]

   b. Current Ratio: measures the ability of the client’s business to fulfill its short-term obligations. The higher the ratio the better, and anything less than a 1:1 ratio is not desirable.

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   \text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} 
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   c. Acid Test Ratio: measures the ability of the client’s short-term assets to cover its immediate liabilities, without having to rely on the sale of inventory. A 1:1 ratio (or very close) represents a solid current position.

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   \text{Acid Test Ratio} = \frac{(\text{Cash} + \text{Accounts Receivable})}{\text{Current Liabilities}} 
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2. Indebtedness: Loan officers must assess to what extent and in what form Banco Solidario should offer credit to a client. This assessment entails: establishing the risk run by the bank and the client, and establishing the appropriateness of a given level of indebtedness. There are the following types of indicators of indebtedness:

   a. Activity: measures the efficiency with which the business uses its assets, according to the speed of recovery of the values applied to them. All the assets should contribute as much as possible to the business, as unproductive assets are not healthy for a business.

   b. Rotation of accounts receivable: Is calculated taking the average of the accounts receivable using the following formula:

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   \text{Rotation of Accounts Receivable} = \frac{\text{Accounts Receivable from Previous Period} + \text{Accounts Receivable from Current Period}}{2} 
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3. Portfolio turnover: measures the number of times that the accounts receivable rotate, on average, in a determined period; i.e. the number of times that the accounts receivable are converted into cash in a period. In general, the time chosen is a month.

4. Selling on Credit (Retail Account Receivables) per period

   a. Average accounts receivable: Corresponds to the number of days in which the business is able to recover its portfolio. In other words, the total portfolio that is converted to cash in a 30-day period.
b. Portfolio turnover
   
i. Inventory Turnover: The number of times that the total inventory is converted into cash in a determined period.

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   \text{Inventory Turnover} = \frac{\text{Sales}}{\text{Total inventory}}
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5. Return: Measures how effectively the client is managing the business—controlling costs and expenses and converting sales into profits. From the point of view of the credit program, this measures the profits on investment. A way of measuring this is through marginal income, the percentage of gross earnings or the cost of sales that each unit sold. In other words, for each unit sold in one month, the business gets a determined profit accounted for after costs of sales. It should be larger or at least in the amount of the installment.

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   \text{Marginal income} = \frac{\text{gross sales} \times 100}{\text{sales}}
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**EVALUATION OF COLLATERAL**

The credit analysis emphasizes the evaluation of the business and of the family unit in order to determine the ability and desire to pay. Collateral is *complementary* to the client’s ability to pay, and does not influence the *ability* of the client to pay. Understand for example, that the possession of important collateral does not in and of itself increase the client’s actual capacity to pay. We understand that the guarantee could be carried out at a later time and serve as an element of psychological pressure or actual pressure to promote repayment.

Collateral is a complementary coverage of risk. It should remain clear that under no circumstances should it serve as an element of judgment in the granting of credit, because it does not modify the level of risk of the client but only contributes to generating incentives for the debtor to complete the repayment of credit. Neither should one go to the other extreme and not ask for collateral. Collateral must be used as pressure for the recovery of credit if this case were to arise.

Collateral should be considered as an element that can assure a reasonable recovery of credit in the event of failure to repay in a timely manner or for unexpected causes. The Credit Officer should adopt all necessary precautions for the corresponding execution of the collateral, before an eventual failure on the part of the client. For these purposes, depending on the type of collateral, the periodic update of relevant information is required.

**EVALUATION OF EXISTING CLIENTS**

The evaluation of returning clients is based on the analysis of their payment history and their capacity to pay. Once again, the Loan Officer will be in charge of selling the credit services, without waiting for the client to solicit a new loan. Before the cancelation of the current loan the loan officer will receive the information necessary to conduct the new credit evaluation of the
client, with the goal that the client receives his or her next loan on the same day that his or her previous loan is paid.