Annual Review

on Credit and Financial Issues

RDP and RCP

October 1994

Prepared By:

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Table of Contents

EXECUTIVE SUMMARY

As part of the October 1994 Mid-Term Review of RDP III, the BRAC Donor Consortium requested a follow-up review to the November 1993 Monitoring Review that focused on credit and financial management issues. The purpose of this Desk Review is four-fold:

(a) To review financial performance of RDP and RCP;
(b) To review the status of the loan portfolio for RDP and RCP;
(c) To assess branchwise profitability in both credit and sectoral program delivery; and
(d) To revise the long-term RCP financial projections and review RCP viability.

This Review is based upon the reports sent to us in October by BRAC and the Donor Liaison Office. That information included: Monthly repayment and portfolio data through August 1994, Quarterly Financial Reports for June 1994, branchwise financial data through June 1994. We examined sectoral cost recovery only as part of branch profitability analysis. The Donors may find it useful to include more thorough cost recovery review in the RDP Appraisal Mission in early 1995.

We have not benefitted from direct interviews with BRAC staff. Normally, we would have honed our initial thoughts with further input from BRAC management. Therefore, these conclusions are based exclusively on financial analysis and our prior knowledge of BRAC's programs. We ask both the Donors and BRAC to read them with that in mind.

<u>Loan Portfolio</u>

- Disbursements and Loans Outstanding increased markedly in the last 12 months. From August 1993 to August 1994, RDP plus RCP loans outstanding grew 47% to Tk 1165 million. In the first six months of 1994, disbursements were Tk 872 million, 57% higher than the same six months in 1993. It appears that BRAC staff must have pushed loan volume very hard after expelling inactive members last year. Because RCP was starting at a lower-than-expected level, loans outstanding remain shy of the RCP model levels.

- Loan repayment and collection continue their excellent improvement. In August 1994, 84% of principal outstanding was current, with no missed payments. For comparison, in August 1992, only 30% of principal outstanding had missed no payments. In this regard, BRAC's efforts are exemplary. However, we cannot determine the magnitude of the "project" loans that were going to have payment "grace" periods, or the extent of loan prepayments. Either factor could distort the loan repayment conclusions.

- In our opinion, BRAC has a core of approximately Tk 30 million in uncollectible loans that are over 100 weeks past due. We believe these should be written off the balance sheet. In addition, the Livestock sector continues to have poorest repayment performance. BRAC should evaluate the effectiveness of its revised lending policies in this sector.

- Sectorwise, loans are essentially distributed in the same way as before, with a slight increase in Agriculture loans as BRAC has pushed the vegetable cultivation program.

- BRAC repurchased many DTW Purchase loans last year, and it now appears that these shares have been resold to new borrowers. It is too early to determine whether these new borrowers will repay their loans more reliably than the first owners. If BRAC accepted our earlier recommendations on this reselling, then the share price did not include the historical losses BRAC incurred on the given well. Otherwise, this would distort the true portfolio position.

Financial Status

- RCP lost money in 1993 for the first time since program inception. We emphasized in our November 1993 report that RCP was close to an unsustainable pattern due to low loans outstanding and vulnerability to higher fixed costs. In 1993, branch operating costs were 134% of the original 1989 model. If the effect of depreciation is removed, branch operating costs were 151% of the original 1989 model. If 1993's actual costs continue into the future (1991 and 1992's costs were closer to the original model projections), then these branches must generate much higher loan volumes to cover their costs.

- Through the first six months of 1994, RCP reported a profit of Tk 23 million, a reversal of the 1993 trend. Much higher loans outstanding provided significantly higher interest income. Per branch operating expenses were slightly less than in 1993 (annualized expenses divided by 90).

- RDP III's total funding needs are close to budget, with serious overspending in VO support services (Institution Building and Income and Employment Generation) offset by low capital expenditures and low NFPE program expenses. We believe that BRAC receives NFPE funding through several different sources, so we cannot determine NFPE's overall program achievement.

- RCP Member Savings are well behind the target set in 1989. Because the Donors provided adequate start-up funding in 1989, this does not pose any short-term problems for BRAC. However, BRAC must collect more member savings in order to fund the planned for loan growth. If savings continue at this slow pace, we anticipate BRAC will require additional outside funding in 2000.

- As RCP grows, it is designed to transition from funding loans primarily with the Donors' 1989 start-up grant to funding loans with members' savings. The pace of this transition will depend on (1) the rate of making new loans, and (2) the amount of members' savings. We conservatively adjusted the long-term financial projections to account for the 1993 loan performance (still under target) and the higher operating costs (actual 1993 performance). We did not alter the original savings formula because we do not have sufficient information to evaluate savings.

- With these conservative changes, the long-range projections predict that RCP would still have sufficient internal funding until the year 2000. We recommend that the RDP IV 1995 Appraisal Mission re-visit the issue of members savings. Based on the first six months of 1994, it is apparent that RCP staff is already addressing some of these issues.

Cost Recovery

- BRAC is spending considerably more in sectoral programs than members are paying in service charges. According to 1993 branchwise income statements, service charges realized reached Tk 3 million, or 6% of the total sectoral program expenses. This is well below the 1993 target of Tk 11 million (per the November 1993 Monitoring Report).

- As anticipated in their RDP III Plan, BRAC is investing heavily in the Sericulture Program, which consumed over 50% of all sectoral expenses. Sericulture collected virtually no service charges.

- BRAC's plan to eventually recover 100% of sectoral expenses is an innovation in international development work that deserves attention. However, as a financial matter,sectoral programs are a comparatively small expense relative to the credit program.

RCP Viability and Branchwise Profitability

- The RCP longterm model was adjusted to reflect 1993 trends in loan growth, operating costs, and loan repayment. The 1993 trends are unsustainable because the program lost money. *The interest income on lower loans outstanding could not cover the higher-than-expected operating costs.*

Per Branch Operating Expenses

	Total	Without Depreciation
1989 Model	891,000	772,000
1991 Model	869,000	
1992 Model	1,023,582	
1993 Actual	1,191,848	1,147,103

- Assuming a 20% interest rate on loans and a continuing zero cost of funds (RCP pays no interest on the BRAC loan), an RCP branch must generate on additional Tk. 250,000 in loans outstanding to cover a Tk. 50,000 increase in operating expenses. The reverse is also true, i.e., for each Tk 50,000 reduction in operating costs, an RCP branch could have Tk 250,000 lower in loans outstanding.

- In 1993, the per branch operating costs were Tk 1.19 million, Tk 300,000 higher than the 1989 model. Therefore, to stay in the same place financially, each branch would have needed to generate Tk 1.5 million more in loans outstanding. Loans earn 20% interest which on an additional Tk 1.5 million in loans outstanding would have earned an additional Tk 300,000.

- We ran two versions of the long-term financial projections, altering only the assumption regarding Per Branch Operating Costs:

    1. Assuming the 1989 budgeted level, without depreciation, of Tk 762,000;
    2. Assuming the 1993 actual level of Tk 1,191,848.

  Under the original 1989 budgeted level, RCP remains viable. By viable, we mean that RCP could be profitable every year, and could therefore expect continual growth in its retained earnings account. Under the second scenario of 1993's actual per branch operating expenses, the model predicts continued negative earnings every single year. Under this scenario, RCP would use up the Donors' start-up funding and require additional funding in the year 2000.

- For the first time, we have branchwise comparisons of financial performance. We analyzed the 1993 branchwise financial data to calculate four basic financia; ratios for each branch. We can now clearly see which branches are performing above and below the norm. BRAC Head Office and Branch Managers can now identify problem areas and measure improvement from period to period.

- The low level of savings has serious implications for RCP's longterm viability as a bank. A bank collects savings and then lends them out to borrowers. It is nearly impossible for a financial institution to fund new loan growth from earnings. Banks typically fund loans with savings deposits; NGO's and loan funds draw on outside funding sources. As contemplated in the original 1989 Project Document, RCP began funding loans with major "start-up" funding from the Donors. During the first few years, savings were to build up faster than loan volume, so that eventually savings become the funding source for loans. Therefore, even if RCP is profitable from year-to-year, RCP must collect member savings to fund new loans. If BRAC is unable to raise sufficient member savings, then additional outside funding will be necessary to cover loan growth.

- Tight cost control and increased loans outstanding will be essential to RCP viability. RCP branches must be profitable. We strongly believe that RCP and RDP Branch Managers should prepare their own annual budgets (with HO oversight and modification), and then be held accountable for financial performance and development outputs.

<u>Recommendations</u>

- BRAC should prepare a Monthly Trend Report on the loan portfolio each quarter for distribution with Regional and Branch Managers. A one-page cover sheet should perform the 3-step portfolio analysis. This would ensure that HO has thoroughly absorbed the data, and that it is communicated to the field.

- BRAC should provide more information on the types of loans in the NIBL account. This should include a one-page summary statement of the LLR on a quarterly basis.

- To identify and address problem branches quickly, we recommend that BRAC use the branchwise ratio analysis discussed in this report. We suggest four basic ratios to measure profitability, staff productivity, operating costs, and funding position.

- The next in-country review should include Sectoral Cost Recovery, since 1993 realized service charges were far below target.

- Branch Managers should receive a quarterly or semi-annual financial report that includes ratio analysis and cost recovery performance. If BM's help set their financial objectives, they can be held more accountable for achieving them.

We strongly believe that if RCP Branch Managers do not receive the information and the training to understand these financial relationships, then RCP will not become financially viable. BRAC must balance the goals of both the development agenda and the financial agenda so that both are met. BRAC must succeed at both, for to fail at one jeopardizes the other.

I. Overview of RDP and RCP Financial Performance

The basis for this financial review was the December 31, 1993 Financial Statements for RCP, and the June 30, 1994 Quarterly Financial Report for RDP. Without direct discussion with BRAC staff, we cannot provide explanations for the variations from budget. A detailed discussion of the RDP performance to budget is presented in Appendix A.

The RDP III budget was prepared in 1992. The RCP budget was part of the 1989 Project Document and was revised in 1992. Because the RCP budget was prepared nearly five years ago, actual RCP performance tends to have a higher variance from budget than RDP.

A. RDP Performance To Budget January through December 1993

- Institution Building and Income and Employment Generation are Tk 11 million (38%) and Tk 24 million (25%) over budget, respectively, reflecting higher than anticipated costs of training new members, staffing the sectoral programs, and lower than anticipated cost recovery on the sectoral programs. These two categories represent 20% of the total expenditures budgeted for 1993. These costs are higher primarily due to the influx of new members after the expulsion of inactive members in 1992.

- Representing 15% of budgeted expenditures, Branch and Regional Office operating costs are close to budget, as is staff training and development.

- Capital investment is 44% underspent due both lower investment in motorcycles and vehicles and BRAC generally reducing capital investment. The budget for new TARCs is also 58% under budget, in a similar delay of capital expenditures.

- The loan fund requirement is close to budget at Tk. 89.8 million, as the lower than expected volume of housing loans to members and staff continued to offset higher than projected disbursements. Loans outstanding grew 22% in the last 4 months of 1993.

- NFPE, representing 30% of the RDP III budget, was 6% underspent on its budget of Tk. 198 million. We do not have the data or information to analyze that line item sufficiently at this time, however, we suggest that such a large line item in the budget should merit a detailed breakdown of that budget by BRAC.

- Total expenditures for RDP III in 1993 were 6% under budget, and projected interest income on the loan portfolio was 4% above budget, resulting in a net variance of Tk. 42.6 million (7%) underspent on the total 1993 budget of Tk. 612 million.

B. RDP Financial Performance
January through June 1994

- First, we note that the Budget presented in the June 1994 Quarterly Financial Report is different than the 1993 budget (year 1 of RDP III). The 18-month budget for Institution Building and for Income and Employment Generation has been increased by about Tk. 35 million. The budget for Capital Investment, TARCs, and the Management Development Programme has been significantly reduced. The 18 month performance is summarized in the Table on the following page.

- Overall, RDP was 8% underspent on the total budget of Tk 296 million for the first half of 1994. Because the budget was so recently revised, the variances highlight the most difficult areas to forecast. Institution Building was 23% over budget, for example, while Income and Employment Generation was only 6% under budget.

- Capital Investment was a negative Tk. 12 million, compared to a budgeted Tk. 15.6 million. The TARCs were 30% underspent.

- The loan fund requirement was reduced by only Tk 4 million, or 11% of the projected decrease of Tk. 37 million. This reflects the 14.5% growth in outstandings during the first half of 1994. Accordingly, interest income on the loan portfolio was also higher.

- The Sectoral Programmes were significantly underspent for the first six months: NFPE was 30% underspent, or Tk. 33 million. The Management Development Programme was 68% underspent, with a Tk. 16.5 million variance. IGVGD was 20% underspent, with a variance of Tk. 2.5 million. In contrast, Health and Family Planning was 38% overspent with a variance of Tk. 1.8 million.

RDP Financial Performance: Budget vs. Actual for first 18months of RDP III
(in Millions of Taka)

Line Item	Original Budget: 18 months	Revised Budget: 18 months	Actual: 18 months	Variance: Actual to Original	Variance: Actual to Revised
Institution Building	45.6	56.5	60.6	(33%) (over)	(7%) (over)
Income and Employment Generation	158.0	182.2	178.4	(13%)	2% (under)
Branch Operating Costs	147.4	143.8	136.1	8%	5%
Regional Office Op.Cost	11.4	11.0	9.4	17%	14%
Staff Training & Dvpmt	9.7	9.6	8.6	11%	11%
Capital Investment Req.	61.2	41.3	12.9	79%	69%
Loan Fund Requirement	56.0	52.8	85.5	(53%)	(62%)
TARCs	52.0	33.7	27.8	47%	17%
Research, Evaluation.	14.0	11.4	7.9	44%	31%
NFPE	326.0	316.3	283.5	13%	10%
Mgmt Devel. Pgm.	32.0	23.9	7.4	77%	69%
IGVGD	39.0	30.8	28.3	27%	8%
Health & Family Plng.	13.0	14.1	15.9	(22%)	(13%)
Total Expenditure (before Interest Income)	938.0	927.0	862.4	8%	7%

C. *RCP Financial Performance*
January through December 1993

Our earlier reports detail the evolution of the RCP budgets.

- RCP reported a loss of Tk. 31.5 million for 1993, its first net operating loss. Lower than projected loan interest income was outweighed by higher operating expenses for the period.

- Loans outstanding was Tk 290 million, well below the budget level of Tk. 858 million. There are several reasons for this:

    - Since RCP's inception, disbursements have been below projected levels, as reflected in the actual versus model branch data described in Appendix F. In late 1992, however, disbursements grew dramatically and reached Tk 769 million in 1993.[1] This is due in part to the consolidation of membership and the addition of new members who are eligible for loans, as well as to BRAC staff efforts to boost loans outstanding.

    - The term mix of disbursements has been much shorter than budgeted; the 1992 budget projected a term mix of 70% short term (1 year loans), 20% medium, and 10% long term loans. BRAC has consciously shortened the average loan to one year in maturity to improve repayment performance, and the term mix in 1993 was 92% short term loans.

    - On-time repayment performance and the collection of past due loans has improved, further shortening the average length of time loans are outstanding. The repurchase of Deep Tube Well loans in 1992 also reduced loans outstanding.

- Savings and Group Tax Deposits stand at Tk 146 million, compared to the budgeted amount of Tk. 368 million. Group savings are driven in part by disbursements, but individual savings have also been consistently lower than expectations. This has two implications: first, interest income on investments is lower than projected, and second, BRAC may require additional funding if savings volume is insufficient.

- We do not know whether BRAC has made any policy changes to boost savings (such as the pilot program undertaken in *1993 in which members could withdraw savings at any* time and were more likely to make larger savings contributions).

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[1] Based on the Loan Loss Provision of Tk. 15.379 million equalling 2% of disbursements. The Statistical Reports only show cumulative disbursement figures.

- Loan interest income is significantly below budget due to the lower loans outstanding described above.

- Operating Expenses are significantly higher than budget, both at the branch and regional office levels. Branch operating expenses were 44% above budget and regional office expenses were more than 50% higher, resulting in expenditures of Tk. 25 million more than planned. (Operating expenses are described in greater detail in Appendix G).

- The BRAC Loan stands at Tk 222 million, compared to the budget of Tk. 976 million, reflecting RCP's significantly lower funding needs.

D. RCP Financial Performance
January through June 1994

Although we do not have comparison to budget information for RCP's 1994 performance, we can make the following observations:

- RCP reported a profit of Tk. 23.4 million for the first 6 months, a reversal of 1993's operating loss. Net income was 23% of Total revenue, reflecting higher interest income on a larger base of loans outstanding.

- Branch operating costs were Tk. 48 million (including salaries and benefits, travelling and transportation, staff training, and office and staff accommodation), or an annualized Tk 1.067 million per branch slightly lower than the average 1993 branch operating cost.

- Disbursements were Tk. 541 million, indicating a trajectory well above 1993 levels when total annual disbursements were Tk. 769 million

II. Credit and Portfolio Management

BRAC has substantially improved the proportion of loans that are current in their payments. As BRAC moves closer to implementing the BRAC Bank and continues to grow in size, its ability to forecast loans outstanding and anticipate funding needs become more important. Loans outstanding is a key variable for the long-term viability of RCP and BRAC Bank because it drives interest income. Loans outstanding is determined by both the rate of loan repayment and the rate of loan disbursement.

A. Composition of the Loan Portfolio

The total loan portfolio has grown quite quickly in the last 12 months. Total outstanding of General Loans increased 47% from Tk. 797 MM in August 1993 to Tk. 1165 MM in August 1994. This increase was due to a surge in disbursements, as loan collection continued to improve.

As of June 30, 1994, Tk. 794 MM was in RCP (71%)[2] and Tk. 371 MM in RDP (29%).

Housing loans outstanding were Tk. 57.3 MM at the end of June 1994, a 22% increase from Tk. 47 million in September 1993. Although housing loans are not included in the sector breakdown, they represented 4.9% of total outstanding in June 1994. Housing loans are shown only on RDP's balance sheet, so we assume that all housing loans are booked within RDP and no housing loans are in RCP.

As of August 1994, the loan portfolio includes the following categories:

General Loans	Tk. 1135.0 Million	91.9%
Housing Loans	Tk. 70.1 Million	5.7%
Non-Interest Bearing Loans (NIBL)	Tk. 30.3 Million	2.4%
TOTAL	Tk. 1235.4 Million	100.0%

Total outstanding are equivalent to US$30.5 million at an exchange rate of 40 Taka to the dollar.

Disbursements

Loan disbursements for RDP and RCP for 1993 were Tk. 1326 million, 15% above the target described in the December 1993 Statistical Report.[3] Disbursements for RDP and RCP were Tk. 872.3 million in the first six months of 1994, a 57% increase over the Tk. 554.8 MM for the same period in 1993. This sharp increase is due to a combination of factors:

(1) *Number of loans per branch:* The average number of loans per branch is significantly higher in the first six months of 1994 than for the same period in 1993. For the first six months of 1994, the average number of loans by branch year were 52%-68% of the 12-month 1993 figures. Assuming that the past seasonality continues (a higher proportion of loan disbursements in the second half of the year), the total number of loans for 1994 should be significantly higher than in 1993.

(2) *Average Loan Size:* Comparing average loan sizes by branch year, the average loan size as of June 1994 are 3% - 60% larger than those in 1993. This has increased loan disbursements and outstandings significantly during the first half of 1994.

(3) *Term Mix:* The term mix of disbursements between January and December of 1993 was 92% short term (one year), 4% medium, and 4% long. This represents a slight increase in the proportion of long-term loans and a decrease in medium term loans compared to the

[2]Source: June 30, 1994 Quarterly Financial Report.

[3]The December 1993 Statistical Report indicates a disbursements target of Tk 1149 million.

January through June 1993 figures. For the first half of 1993, 92.5% of disbursements were short-term, 5.3% were medium term, and 2% were long-term.

Overall, BRAC has steadily shortened the average maturity of its loan portfolio, increasing the percentage of one-year loans, to improve loan repayment. The exceptions to the one-year maturity that we are aware of are: Deep Tube Well purchase loans; livestock loans; and the new two-year vegetable cultivation loans. Based on the relatively poor repayment performance of livestock loans, BRAC had intended to offer them more selectively than in the past. DTW purchase loans, however, appear to have increased in 1993, perhaps due to the reselling of the DTW shares that had been repurchased from members in 1992 and early 1993 (see November 1993 Monitoring Review on Credit and Financial Management, page 8).

Although we do not have the data for housing loan disbursements for 1993, actual outstandings were Tk. 70 million, and disbursements were well below the target disbursements of Tk. 105 million (as described in December 1993 Statistical Report). Although not shown on the Sectorwise APO Trend Report in Appendix B, Housing loans represented 5.7% of total outstanding as of August 1994, increasing from Tk. 57 million in December 1993 to Tk. 70 million in August 1994. BRAC had adopted more stringent monitoring of housing loans in 1993 to minimize the diversion of loan proceeds to other uses. Housing loans carry an interest rate of 10% compared to 20% for all income-generating loans.

Rate of Repayment

Loan repayment has continued to steadily improve during the first eight months of 1994, with 84% of principal outstanding having missed no payments as of August 1994. This is a significant improvement from August 1993, when 68% of principal outstanding were current in payments. There are some caveats to the interpretation of those figures: Most significantly, we do not know the effects of two policy decisions that BRAC made in 1993: (1) allowing grace periods on certain types of project loans, potentially delaying the visibility of poor repayment, and (2) allowing prepayment of loans, which may understate the level of outstanding for the more recent months. The rapid growth in outstandings makes careful portfolio monitoring even more important.

Distribution Of Principal By Sector

More than 50% of the total loan outstanding continues to fall in two sectors: Rural trading (35% in both periods) and Food processing (25% in August 1994, 28% in August 1993). The next two largest sectors are Agriculture at 11% (compared to 8% in August 1993) and Livestock at 10% (down from 14%).

Distribution of Principal By Sector

BRAC promoted vegetable cultivation last year and that sector has visibly increased as a percentage of total outstanding. BRAC has consciously reduced the number of Livestock loans due to poor loan repayment, and the level of outstanding has fallen significantly. Both Fisheries and Irrigation increased as a percentage of total outstanding: Fisheries increased from 2% to 4%, and Irrigation jumped from a low of 4% to 7%. Appendix B shows the monthly trend report for the sectorwise distribution of the loan portfolio.

The significant sectoral trends are discussed below, based on monthly data from August 1993 through August 1994 excluding the months of October, November, and December. Housing data is provided from a separate report.

Agriculture: Principal outstanding in the Agriculture sector nearly doubled from Tk 63.8 million to Tk 124.9 million from August 1993 to August 1994, increasing from 8% of outstanding to 11%. Agriculture also includes Social Forestry and tree nurseries, a sector in which BRAC was considering an expansion during our last visit.

Irrigation: Principal outstanding in Irrigation reversed its downward trend in the fourth quarter of 1993, jumping from 4% to 7% of outstanding. During 1994, outstanding peaked at 9% of outstanding in April, and then dropped back to 7%. We do not have the detailed data for DTW purchase and operating loans and can therefore only offer a theory for this increase. This pattern is consistent with BRAC's intention to resell the DTW shares that had been repurchased in the second half of 1992. Deep Tube Wells are highly seasonal, typically going into service in the fall to irrigate the Te Aman crop (harvested in December and January) and then the larger Boro crop (harvested in June/July). Accordingly, outstanding jumped between September and January, as members borrowed to purchased shares and finance season operating costs. In past years, many borrowers have fallen behind in their weekly payments during the months prior to the harvest, partly explaining the increase to 9% of total outstanding during April.

Livestock: The Taka outstanding in Livestock loans stayed flat at Tk. 113.5 million, but the sector fell from 14% of total outstanding to 10% due to rapid growth in other sectors. We cannot confirm whether the policy changes adopted in 1993 have been fully introduced. Those policy changed were intended to minimize the use of medium-term, larger livestock loans for other purposes, and to improve monitoring of those loans for prompt repayment.

Rural Trading: Rural Trading represents 35% of total loan outstanding and grew from Tk. 279 million to Tk. 397 million (a 42% increase). Both Rural Trading and Food Processing are one-year loans and often the most popular for new members. Their parallel growth with the entire portfolio may reflect the influx of new, replacement members at RDP and RCP branches after BRAC expelled many inactive members in 1992 and early 1993.

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Food Processing: This sector fell to 25% of total outstanding, compared to 28% in August 1993. This appears to be consistent with a pattern of representing 25% to 28% of outstanding over the past 24 months.

Housing Loans: Although not shown on the Sectorwise APO Trend Report, housing loans were 5.8% of total outstanding as of August 1994, increasing from Tk. 57 million in December 1993 to Tk. 70 million in August 1994. This sector should always be monitored carefully, due to longer loan terms and because of the potential diversion of funds by borrowers.

The remaining sectors -- Fisheries, Cottage Industry, Services, Health, and Miscellaneous -- represented 8.9% of total loans outstanding.

B. Loan Repayment Performance

BRAC has adopted monthly reporting of the internal delinquency monitoring system to better track loan repayment performance in the loan portfolio. As a reminder, this system, known as APO and OTR reporting, measures the portfolio by two parameters: the Aging of Principal Outstanding (classifying loans outstanding by how many payments it has missed[4]) and On-Time Realization rates (payments received in the last four weeks as a percent of payments due). The APO report remains the most valuable and accurate measure of loan repayment. Although BRAC Head Office has adopted the APO and OTR reporting system, we cannot determine whether regional managers and branch managers have switched from the old Current, Late, and Overdue loan classification system. We urge BRAC to conduct some analysis of the APO data on a quarterly basis.

In summary, the percentage of total loans outstanding that had missed no weekly payments jumped from 65% in August 1993 to 84% in May through August 1994. The percentage of principal outstanding that had missed more than 26 weeks of payments fell from 12.5% of total outstanding in June 1993 to 7% a year later. Consistent with our expectations, a core of poorly repaying loans has steadily "fallen" to the lowest repayment category.

We begin the analysis by putting the data from the monthly APO reports into the Sectorwise Monthly Trend Report format seen in Appendix B. We then go through three steps of portfolio analysis:

1. Identify the sector-wise (and possibly regionwise) distribution of principal outstanding to see how large each sector (and region) is to the size and quality of the loan portfolio;

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[4]For example, if a loan has missed five payments in a row the principal would be classified as five weeks past due; similarly, a loan that had missed five payments intermittently over the life of the loan, the total principal outstanding would appear in the 5-12 weeks past due category.

2. Evaluate the trends in each aging category (0 payments missed, 1-4 weeks past due, 5-12 weeks past due, etc.); and

3. Identify those sectors that have the greatest principal outstanding that is seriously behind in payments (more than 26 weeks past due, for example).

APO classifies principal outstanding according to how many payments have been missed. We believe APO is the most important measure because it shows the borrower's payment performance over the entire loan. The second measure, On Time Realization (OTR), measures the percent of realized payments versus the realizable payments in the most recent four weeks. OTR is a short-term glimpse at current payment behavior. It reflects prepayments, seasonal fluctuations, and other factors. But it does allow BRAC to evaluate the effectiveness of its efforts to convince delinquent borrowers to continue repayment.

Step 1: Distribution of Principal

This step identifies the largest sectors, because large sectors have the greatest effect on the loan portfolio.

- Approximately 18% of the total portfolio (Agriculture and Irrigation) is directly exposed to Government of Bangladesh agricultural policy, such as the government-mandated price of rice.

- Total Deep Tube Well exposure remains high, despite the steady reduction in Irrigation as a percentage of total outstanding. If April/May is the peak seasonal exposure and August /September is the seasonal low point, total Irrigation sector loans ranged from Tk. 93.5 million to TK.. 79.5 million.

- The growth in Agriculture, Irrigation, and Housing loans, all of which are longer than one year in term, suggests that BRAC should closely watch these sectors to detect poor repayment performance.

- Housing loans are now almost 6% of total outstanding and should be part of a quarterly portfolio review.

- The category of Non-Interest Bearing Loans (NIBL) represents loans that BRAC has prudently put on non-accrual status (so that interest payments are only recognized as income when they are actually received). If BRAC is using the suggestions from the November 1993, report these loans include 100% of 100 weeks past due and 50% of loans 50 weeks past due. Overall, this category is 2.4% of total loans outstanding. However, this figure is a low percentage partly because of the fast growth in loan disbursements.

Step 2: Review of APO and OTR Trends

Aging of Principal Outstanding is most important because it reflects the complete historical repayment experience. If a loanee misses a payment on her loan, the entire principal amount of the loan shows up as "past due" principal. If she has missed six payments and then makes up two installments, the remaining outstanding principal shows up as four weeks past due. This method allows BRAC to see how much of the portfolio is "at risk" at any one time, with clear categories of degree of risk (1-4 weeks past due vs. 26 weeks, for example). Loans that have missed payments in the past are more likely to miss payments in the future. The OTR rates show that this is true: collection rates for loans fall off quickly as soon as the borrower misses any payments at all.

First, a note on the data. BRAC has excluded the Non-Interest Bearing Loan category (NIBL) from the Sectorwise Monthly Trend Report. The effect of this is to exaggerate the improvement in the collecting the loans that have missed payments over 100 weeks. To compare apples to apples, we have added the NIBL category into the category of loans >100 weeks missed payments.

- *The portion of principal outstanding with no missed payments increased to 84%.* BRAC staff have again increased the percentage of total principal outstanding that has missed no payments, a 30% improvement over the 65% figure in August of 1993. Although all sectors show improved repayment performance, the areas of potential concern include Livestock and Housing.

Sectorwise Percentage of Principal with No Payments Missed

Sector	% of Total Outstanding August 1994	No missed payments August 1992	No missed payments August 1993	No missed payments August 1994
Agriculture	11%	37%	75%	94%
Irrigation	7%	2%	22%	95%
Fisheries	4%	32%	60%	94%
Livestock	10%	16%	54%	74%
Cottage Industry	5%	38%	79%	89%
Services	0%	32%	79%	79%
Rural Transport	3%	19%	52%	87%

Rural Trading	35%	46%	70%	85%
Food Processing	25%	48%	69%	83%
Health	0%	15%	62%	89%
Miscellaneous	0%	42%	58%	72%
Housing	6%			53%
TOTAL*	100%	33%	65%	84%

* Not including Housing Loans

- *The amount of principal on which more than 26 payments were missed fell from 12.5% of total outstanding in June 1993 to 7% in June 1994.* The Taka amount fell slightly from Tk. 94.5 million to Tk. 79.3 million.

- *The Irrigation loan repayment improvement has been very strong thus far in 1994, but many overstate the quality of the Irrigation portfolio.* The 95% of principal that has missed no payments may be an overstatement of the true condition of the Irrigation portfolio for two reasons: (1) The share repurchase in late 1992 and resale of those shares in 1993 shows up in the portfolio data as if those loans were rescheduled -- old, past due loans were "repaid" and new loans were made to new members; (2) We believe that a high proportion of those loans more than 50 weeks past due are Irrigation loans and are reflected in NIBL rather than in the Monthly Trend Report.

- *The proportion of Livestock loans that are past due remains high.* The percentage of Livestock loans with no payments past due has increased steadily to 74%, but remains significantly lower than other sectors. Further, Livestock loans are 32% of loans more than 26 weeks past due, but represent only 10% of total outstanding. The OTR rates for past due Livestock loans have worsened since August 1993, suggesting that the effect of BRAC's policy changes may have been temporary and that borrowers have resumed their previous repayment patterns.

- *Housing loans continue to demonstrate low repayment performance and should be part of a quarterly portfolio review.*

- *OTR has continued to improve overall, but the percentage of principal more than 5 weeks past due continue to receive less than 50% of realizable payments for the previous four weeks.* As noted above, OTR is a rough measure of the repayment behavior of borrowers for the previous month. Although OTR for all sectors was 105% (OTR rates greater than 100% indicate "catch-up" payments, prepayments, and full repayment of loans), the OTR fell to 76% for loans 1-4 weeks past due, 37% for loans 5-12 weeks past due, 20% for loans 13-26 weeks past due, and 11% for loans more than 26 weeks past due. This trend

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Step 3: Assess Concentration of Risk

The third step in the loan portfolio analysis is to compare the concentration of sectors with the slowest repayment with their overall distribution of the loan portfolio. We have always reviewed all loans more than 26 weeks past due as the sign of those loans that pose significant credit risk to BRAC.

We have adjusted the APO report data by adding the Tk. 32 million in NIBL (Non-Interest Bearing Loans) that BRAC has placed on non-accrual status. This adjustment more accurately reflects total principal that is more than 26 weeks past due. We do not have the sectorwise composition of NIBL, however, and cannot determine whether any particular is overrepresented in that category. The table below presents concentration of risk by sector.

Sectorwise Distribution of Principal with >26 Payments Missed

Sector	Percent of Principal Outstanding August 1994	Percent of Principal >26 missed Payments June 1994
Agriculture	11%	4%
Irrigation	7%	5%
Fisheries	4%	2%
Livestock	10%	31%
Cottage Industry	5%	2%
Services	0%	0%
Rural Transport	3%	6%
Rural Trading	35%	28%
Food Processing	25%	22%
Health	0%	0%
Miscellaneous	0%	0%

The major observations from Step 3 in our analysis are:

- *Principal with more than 26 payments missed shrank from 12.5% of outstanding in June 1993 to 7% in June 1994.* The total taka outstanding has remained flat and slightly down from 1993 levels (Tk. 79.3 million in June 1994) despite rapid growth in the total loan portfolio. Since outstanding increased dramatically in the first half of 1994, there will be a delay in when any poorly performing loans would appear in the more than 26 weeks category.

- *Livestock represented 31% of seriously past due loans, compared to 10% of total outstanding.*

- *Rural transport represented 6% of seriously past due loans, compared to only 3% of total outstanding.*

- *Rural Trading and Food Processing continue to represent less than proportionate shares of seriously past due loans.* These two sectors represent 60% of total outstanding and 20% of principal that has missed more than 26 payments.

- *Irrigation exposure continues to be very small (in large part to the Tk 32 million share repurchase of 1992), but increased slightly to 5% of total past due loans.* We hypothesize that a significant proportion of the Tk. 32 million in NIBL may be Irrigation loans.

- *Agriculture and Cottage Industry both appear to have strong repayment performances.* Agriculture has consistently represented 11% of outstanding in 1994, yet represented 4% of seriously past due principal. Although a small percentage of the total portfolio at 5%, cottage industry also appears to repay well, representing 2% of principal that is more than 26 weeks past due.

- *Reported separately, about 33% of Housing loans had missed more than 26 payments*, or Tk. 23 million of Tk. 70 million in total outstanding.

- The total principal outstanding that is more than 50 weeks past due is Tk 44.5 million, or 3.8% of total outstandings.

- Tier 1 of the loan reserve should equal Tk 30.3 million, if BRAC is using the 1993 recommendations. This tier recognizes known credit problems. The tier 2 portion of the LLR is a cushion for unanticipated losses. The current loan loss reserve for RDP and RCP is Tk. 90 million, of which Tk 60 million would be the tier 2 reserve for unanticipated losses.

- BRAC continues to build the Tier 2 portion of the Loan Loss Reserve by taking 2% of disbursements as an annual loan loss provision. The total LLR equals Tk 8.0% of total outstandings; Tier 2 equals approximately 5% outstandings. Based on our current information, we believe this level is adequate at present.

C. Credit Recommendations

1. *Prepare a Monthly Trend Report at least quarterly and share it with Senior and Regional Managers.* The Mouthly Trend Report (See Appendix A) provides managers with a quick look at trends and allows them to identify areas that require further inquiry. It also allows BRAC to evaluate the impact of some of its recent loan policies regarding particular sectors.

2. *The Monthly Trend Report should include a cover page that summarizes the observations from the 3-step portfolio analysis.* This ensures that HO has thoroughly reviewed the data and trends, and simplified the sharing of that analysis with Regional and Head Office Managers.

3. *Provide more information on the NIBL account to improve transparency of reporting for management.* We see two options: First, BRAC could include the NIBL loans in the sectorwise APO reports; Second, similar to the way a bank manages the loans that are "written off," BRAC could prepare a quarterly one-page statement showing the composition of the NIBL category sectorwise. The goal is for management to "see" those loans and what happens to them over time. (Management questions might include: are they increasing in absolute terms or as a percentage of the loan portfolio? Are they being repaid slowly or not at all?)

4. *Also similar to western banking practices, BRAC should prepare a one-page summary statement of the Loan Loss Reserve* on a quarterly basis that reconciles the balance sheet figure with the treatment of various loans. An example is presented below.

LOAN LOSS RESERVE REPORT - As of June 30, 1994

		Amount	% of O/S
Tier 1:	Non-Accrual Loans		
	Previous Balance:		
	NYT as of June 1994	Tk. ___	
	100% of loans> 100 weeks past due	Tk. ___	
	50% of loans > 50 weeks past due	Tk.___	
	50% of housing loans > 50 weeks past due	Tk.___	
	Previous Tier 1 Total	Tk.___	___%
	Plus:	Tk. ___	
	Less:	Tk. ___	
	New Total Tier 1:		
Tier 2:	Unallocated Reserve (accrual status)		
	Previous Balance	Tk. ___	
	Plus: 2% of disbursements between ___ and ____	Tk. ___	
	Less:	Tk. ___	
	Total Tier 2	Tk. ___	___%
Total LLR		Tk. ___	___%

III. Branch Profitability and Financial Management

We believe that BRAC should implement sharper tools to measure branch operating performance. In a rapidly growing organization, and with the objective of transferring mature branches into a self-sufficient BRAC Bank, senior management should not rely on overall financial figures.

We suggest that senior management: (1) convert the figures into four simple ratios, and (2) hold Branch Managers accountable for these performance measures. A system of ratio analysis would help BRAC answer several key questions:

- How well is a particular branch (or the average branch for that year) performing relative to the model branch in the long-term financial projections?

- Are operating costs relative to total outstanding consistent with the model branch assumptions? When are operating costs too high and?

- How well are particular branches covering the cost of Sectoral Programs? Which programs have the highest cost recovery and what are the relevant variables?

- What level of outstanding and what repayment rates are needed to each breakeven, and which units are profitable and why?

- Which policies can help influence manager to collect more savings?

We have taken the BRAC Finance Department data and picked out the most important Balance Sheet and Income Statement items. The key operating information and ratios for RDP and RCP are presented in Appendices C and D. An analysis of Sector Cost Recovery by Branch is in Appendix E.

A. Branch Profitability

The Finance Department already prepares a branchwise balance sheet and income statement, but there are too many branches for the HO or RO to examine the raw data effectivly. We propose a summary sheet that shows key figures and four basic ratios.

Financial institutions typically use ratio analysis to convert income statement items (costs or income over a period of time) to a percentage of Average Loans Outstanding. This denominator (calculated by adding the year end loan outstanding for the current and prior period and dividing by 2) allows comparisons between branches of different sizes and focuses on the relationships between gross numbers. Average Loans Outstanding for the year is more accurate than Loans Outstanding at the end of a single period if the loan portfolio is changing in size. Since BRAC's loans outstanding are growing rapidly, an average balance is a more accurate and useful denominator. However, because we did not have last year's outstandings by branch, we used the December 1993 figures.

<u>Suggested Ratio Analysis</u>
The four ratios measure (1) productivity of staff, (2) operating efficiency of Other Operating Costs, (3) profitability, and (4) funding position. In addition we suggest a ratio measuring housing loans as a percentsge of loans outstanding (for RDP branches).

1. *Salary Expense as a Percentage of Average Loans Outstanding:* This reveals staff productivity because it compares salary expenses with the loan volume produced by that staff. Generally, RDP branches have lower loans outstanding, and therefore have a high Salaries/Loans Outstanding ratio RCP branches, however, should have higher loans outstanding, and therefore the Salaries/Loans Outstanding ratio should be lower. <u>The lower the Salaries/Loans Outstanding ratio, the more productive the branch.</u>

2. *Other Operating Expense as a Percentage of Average Loans Outstanding:* This ratio compares Other Operating Expenses with Loans Outstanding. Similar to salary expense, branch operating expenses directly affect the branch's profitability. The lower the Other Operating Expense/Loans Outstanding ratio, the more efficient the branch. The RCP long-term financial projections are highly sensitive to operating costs per branch. RCP branches reflect only the operating costs related to credit delivery; RDP branches include the costs of credit and sectoral programs.

3. *Operating Profit as a Percentage of Total Assets (or Average Loans Outstanding):* Either one of these ratios measures the profitability of a given branch relative to its assets (or to its Loans Outstanding). The higher the Profit/Assets or Profit/Loans Outstanding ratio, the more profitable a branch is for the level of BRAC investment. Because RCP branches run only credit programs, Total Assets should be approximately equal to Loans Outstanding. As long as BRAC applies the ratio consistently, either denominator will work. RDP branches administer both credit delivery and sectoral programs, and therefore total assets include both activities. This ratio is the most consistently useful measurement of branch profitability as it shows how efficiently branch assets are being managed to generate income.

4. *Savings as a Percentage of Average Loans Outstanding:* The Savings/Loans Outstanding ratio compares the level of member savings (group and individual savings) to loans outstanding. The higher the Savings/Loans Outstanding ratio, the more a branch is meeting its funding needs with member savings (rather than from Donor funds or other outside sources). To truly function as a bank, RCP must raise member savings to fund its loans. In Western banking practice, this is described as "intermediating" between depositors and borrowers. If RCP does not raise sufficient savings, and instead relies on Donors or other outside funding to fund loans, then its credit program will not be a bank, it will be a loan fund with a related smaller savings club. As the Savings/Loans Outstanding ratio grows, RCP is functioning more as an "intermediator" between depositors and borrowers.

5. *Housing Loans as a percentage of Total Loans Outstanding:* RDP records contain this data as well. The Housing Loans/Total Loans Outstanding ratio compares the volume of housing loans to the total branch portfolio. The higher the Housing Loans/Total Loans Outstanding ratio, the greater the proportion of housing loans. This adversly affects profitability, since housing loans carry a 10% interest rate.

The ratios make it easy to compare branches. By identifying the financial relationships that are consistent with the model branch assumptions and by tracking performance of well-performing branches, BRAC head office can begin to determine the "optimum" relationships between key operating factors. In addition, Branch Managers can compare themselves to other branches and determine how they can either reduce costs or increase revenue to increase profitability. The Table below displays tho these ratios by branch-year.

Average Ratio Calculations By Branch Year
December 31, 1993

Branch Year	Salaries/ Loans O/S	Other Exp/ Loans O/S	Profit/ Total Assets	Savings/ Loans O/S
RCP - 8 year	11%	9%	0%	29%
RCP - 7 year	11%	11%	(1%)	39%
RCP - 6 year	11%	11%	(1%)	34%
RCP - 5 year	12%	11%	(4%)	30%
RDP - 4 year	12%	7%	6%	34%
RDP - 3 year	15%	8%	25%	33%
RDP - 2 year	22%	12%	49%	35%
RDP - 1 year	17%	9%	31%	34%
Total	11%	10%	(2%)	34%

As expected, Salaries/Loans Outstanding is higher in the younger branches, because loans outstanding are relatively small. Although we can say that the *pattern* from younger branches to older branches fits our expectations, the *absolute level* of salaries is much higher than budgeted in the 1989 RCP projections. This is discussed later in this report.

The Other Expense/Loans Outstanding shows a surprising pattern: The RCP 1989 financial projections anticipated that Other Operating Expenses would remain constant as the loan portfolio grew. If this were true, then the ratio should decline for older branches. In fact, it appears that the Year 4 and Year 3 branches are more efficient. RCP managers should investigate why the ratio remains constant for the older branches. Based on the June 1994 RCP financials, RCP branch performance has improved, but we did not receive branchwise data to calculate these ratios.

RCP was not profitable in 1993, and the Profit/Assets ratio confirms this. The Year 5 branches were the biggest money losers, with a Profit/Assets ratio of (5%). Again, this does not refer to the *absolute* level of profitability (i.e., it may be that other branches lost more taka), but refers to the *comparative* profitability for the assets invested in those branches.

The Savings/Loans Outstanding ratio also reveals surprising information. The ratio shows that all the branch years have collected member savings equal to between 29% and 39% of Loans

Outstanding. RCP projections would have anticipated faster growth in savings, relative to the level of loans outstanding. This has not happened, partly due to the expulsion of members in 1992 (and the return of their savings) and perhaps due to greater emphasis on loans and other non-financial programs.

Selected Branch Comparisons
For comparison, we picked out a few 7th year branches that were high performers and low performers to see how the ratio analysis works:

Branch	Salaries/ Loans O/S	Other Expenses/ Loans O/S	Profit/ Assets	Savings/ Loans O/S
Kotwali	9%	7%	3%	25%
Rangpur	8%	11%	1%	37%
Mohera	15%	15%	(7%)	58%
7th Year Average	11%	11%	(1%)	39%

Rangpur is one of the best in Salaries/Loans Outstanding at 8%, compared to the 7th Year Average of 11%. However its performance is dampened by higher Other Expenses/Loans Outstanding that is average for its branch age. Rangpur also has a Savings/Loans O/S ratio that is close to the branch-year average

Kotwali is also a strong performer in staff productivity, because the Salaries/Loans O/S ratio is better than average. Kotwali's performance is also especially strong in controlling Other Expenses. Its ratio of Other Expenses/Loans O/S is just 7%, which brings its overall performance above Rangpur's. This can be seen in the Profit/Assets ratio, which shows that while both Rangpur and Kotwali were profitable, Kotwali earned 3% on its assets and Rangpur earned 1%.

Rangpur is stronger than Kotwali, however, in collecting member savings. Rangpur is supporting its large loans outstanding with good savings collection. In this regard, Kotwali is far behind the 7th year average. Kotwali has room for improvement here.

Mohera is the lowest performing branch among 7th years. Both its staff costs and other expenses are above average. This is shown in the high Salaries/Loans O/S ratio and the high Other Expenses/Loans O/S ratio. The result is a very negative Profit/Assets ratio as well. The only positive in Mohera's financial performance is that it is collecting a high level of member savings compared to the size of its loan portfolio. This means that although Mohera is losing money, it is not requiring a great deal of funding to support its loan portfolio.

We recommend that BRAC management review branch performance in this way. The ratios should prompt HO to ask more thorough follow-up questions, as there may be good reasons in the field to explain performance.

B. Sector Cost Recovery

For this review, we reviewed only the cost recovery data that was presented in the branch-wise income statements for 1993. The realized service charges and expense related to sectoral programs appears in RDP branches only. RDP branches provide sectoral technical assistance to RCP members on a fee-for-service basis, however, the fees are being phased in gradually.

The major observations from the branchwise cost recovery analysis are:

- *Total service charges collected for all sectoral programs was Tk. 3 million, or 6% of the total sectoral expense of Tk. 46.6 million.* In November 1993, BRAC revised the schedule of fees to be charged for each sectoral program and revised its budget for overall cost recovery of the sectoral programs during RDP III and identified a 1993 target of Tk. 11.7 million.. BRAC projected total service charges of Tk. 64 million for the 1993, 1994, and 1995 period. According to that schedule, 1993 service charges would be significantly lower than that for 1994 and 1995. Even so, 1993 service charges are far lower than projected.

- *Sericulture represented 52% of all sectoral program expense in 1993, but earned the smallest amount of service charges.* This is consistent with BRAC's planned total investment in sericulture during RDP III of nearly US $6 million. This also reflects the considerable "infrastructure" required to build this sector. Of the remaining sectors, Poultry & Livestock represented 23% of total sectoral program expense, Social Forestry & Horticulture 10%, Fisheries 9%, and Irrigation 6%.

- *Social Forestry & Horticulture reported the highest percentage of cost recovery, earning service charges equal to 19% of total expense.* Irrigation earned 15%, Poultry & Livestock earned 12%, Fisheries earned 10%, and Sericulture earned 0%. These figures, and the percentage of spending on each sectoral program, are shown below.

1993 Cost Recovery of Sectoral Programs – Based on Branchwise Revenues and Expense

Sectoral Program	% of Total Sectoral Program Expense	Realized Service Charges/ Sectoral Expense
Poultry & Livestock	23%	12%
Irrigation	6%	15%
Fisheries	9%	10%
Social Forestry & Hortic.	10%	19%
Sericulture	52%	0%
Total	100%	6%

Therefore, it appears that BRAC will need to dramatically increase the realization of service charges in 1994 and 1995 to reach the plan of Tk. 64 million. We suggest that Cost Recovery should be part of the next in-country TOR, since BRAC has no doubt learned much from the previous year's experience.

The presentation format in Appendix E allows BRAC to see cost recovery by sector and overall for individual branches. Since the sectoral programs have been introduced at differing times to branches of different maturities, there can be no comparisons to a standard branch. However, BRAC can forecast how many years a specific sectoral program should require to reach full cost-recovery.

C. Recommendations

We repeat many of our recommendations from the November 1993 Monitoring Review, although BRAC may have already implemented some of these recommendations.

1. *Branch managers should participate in annual budgeting and forecasting, of both credit and sectoral programs.* This will both develop their financial skills and awareness of each branch as a profit (or cost) center, and also allow BRAC to hold them increasingly responsible for meeting budgeted performance.

2. *Branch Managers should receive quarterly financial statements that include the basic ratio analysis for their branch.* BRAC's Finance Department has already revised RDP financial statements to better distinguish cost recovery and credit operations. These quarterly statements should also include the four basic ratios and a comparison of that

branch to the rest of the branches and to the model branch. These might also include a ratio of service charges realized as a percentage of total sectoral program expense.

3. *Again, we believe that Annual Performance Reviews of individual Branch Managers would help shift their focus from "meeting target" to managing an efficient branch.* Such a review would of course need to include performance in meeting both development and financial objectives.

IV. *Longterm Financial Projections for RCP*

We first examined RCP's long-term financial viability in our November 1993 report. Many changes had occurred in RCP since the original 1989 projections, and we factored these into the computer model[1]: slow loan repayment, low member savings, and low loan disbursements. At *that time, we used BRAC's 1993 Internal Targets as the "model branch" to project loan volumes.* The financial model predicted that RCP remained financially viable with several important assumptions. The table below summarizes the key assumptions in our earlier *financial projections* and how those assumptions have changed in light of experience:

Old Model Assumption	*Circumstance Today*	*Financial impact on* **Nov. 1993 Computer Model**
No payments to BRAC on its RCP investment.	No payments made.	No impact.
Loan loss provision set at the amount necessary to maintain a reserve of 5% of loan outstanding.	BRAC has conservatively maintained the provision at a high 2% of loan disbursements.	Increases expenses by Tk 22 million for the period beginning from 1990.
Loan disbursements increased *to the level of the '93 BRAC* Internal Targets;	In 1993, Year 5 achieved 91% of *target disbursements, Year 6* branches achieved 99% and Year 7 achieved *103%* of target.	Low disbursements *decreased income.*

[1] BRAC's long term projections are built on the assumption that branches' loan volume will *grow annually according to a predetermined pattern. The model assumes that annual operating* expenses per branch are constant.

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Loan disbursements increased to the level of the '93 BRAC Internal Targets;	In 1993, Year 5 achieved 91% of target disbursements, Year 6 branches achieved 99% and Year 7 achieved 103% of target.	Low disbursements decreased income.

[1] BRAC's long term projections are built on the assumption that branches' loan volume will grow annually according to a predetermined pattern. The model assumes that annual operating expenses per branch are constant.

No type of fixed cost increased.	Per branch operating costs (excluding interest received on loans or interest paid on savings) were Tk 311,000 over the model. Several categories of branch operating costs may not have been included in the model, including Travelling, Maintenance, Utilities, Stationeries, and HO Supplies. Staff training was modelled at Tk 800,000 for all of 1993, but was actually Tk 3.3 million. The model includes an allocation from the RO and the HO that we do not see on the actual statements. Perhaps these costs were saved in the consolidation of RDP and RCP RO's?	With 70 branches, this increased overall expenses by Tk 22 million. These unbudgeted costs amounted to Tk 134,000 per branch, or Tk 9 million total in 1993. Staff training was underestimated by Tk 36,000 per branch, or Tk 2.4 million total in 1993. The model estimates Tk 9.0 million in RO and HO costs that are not evident on RCP's 1993 income statement.
On-time realization rates remain constant.	OTR improved and therefore we improved the model assumptions: New Model / Old Model Short 95% / 98% Medium 85% / 90% Long 80% / 85%	Improved cash flow, but no impact on profitability due to accrual accounting.
Term mix constant	Term mix has become longer: Old Model / New Model Short 94% / 92% Medium 2% / 4% Long 4% / 4%	This will eventually mean higher interest income due to higher outstandings.

In brief, since our last visit , BRAC made substantial improvements in collecting past due installments and in increasing loan disbursements almost up to the target, but these positives were overwhelmed by very high branch operating expenses.

Branch Operating Costs

RCP branch operating costs have become significantly higher in the last three years. The attached chart compares actual performance with the :model branch":

Actual Per Branch Operating Costs versus "Model Branch"

Expense	1991	1992	1993
Salaries	88%	110%	126%
Transportation	121%	113%	118%
Staff Training	230%	454%	466%
Depreciation	29%	32%	38%
Other	Not Budgeted	Not Budgeted	Not Budgeted
Total Expenses	98%	115%	134%

In 1993, per branch operating costs were Tk 260,000 higher than the model branch. This means that to stay in the same place financially, each branch would have needed to generate Tk 13.0 million more in loans outstanding (20% interest on Tk 13.0 million equals Tk 260,000). As mentioned, the branches are still just shy of the target, much less Tk 13.0 million ahead of it.

High branch operating costs are an especially important cost to control, because RCP is adding "young" Year 5 branches at a very fast rate. These Year 5 branches are projected to have the same branch operating costs as older branches, but will have lower income because their loan portfolios are smaller. The ratio analysis showed that in fact branch operating expenses are increasing from year to year, so that the Operating Expense/Loans Outstanding ratio is not decreasing in the way it was originally projected.

The fast pace of adding "young" branches continues through 2001. In the year 2001, RCP will be the most vulnerable because it will then have the highest proportion of "young" branches.

Loans Outstanding

Loans earn RCP 20% interest. RCP does not pay interest to fund these loans, because the amount of the Donors' funds is greater than loans outstanding. Although RCP does pay interest on members' deposits, the amount of deposits is quite small. Assuming a 20% interest rate on the loans, for each Tk 10 million higher in loans outstanding, RCP earns an additional Tk 2 million in income. (Only when the loan portfolio grows to be larger than the BRAC debenture is RCP "borrowing" from depositors to fund the loan portfolio. According to the old model, this would not happen until 2000. If higher costs and lower profitability persist, this will happen sooner.)

What it will take to return to profitability and long-term viability

BRAC's projections assume that branch staffing and branch operating costs remain constant, even with more members and more loans on the books. We can easily calculate the effect of higher branch operating expenses on RCP viability: Assuming a 20% interest rate on the loans (and no cost to BRAC for making these), for each Tk 300,000 increase in branch operating costs, the branch must generate an additional Tk 1.5 million in loans outstandings. to earn sufficient interest income to cover those costs. The reverse is also true: for each Tk 250,000 lower in loans outstanding, branch operating costs must come down Tk 50,000. Every branch manager should be aware of this relationship. This is why we have recommended consistently that Branch Managers receive quarterly financial statements.

We ran two versions of the long-term financial projections, altering only the assumption regarding Per Branch Operating Costs:

1. Assuming the 1989 budgeted level without depreciation of Tk 762,000;
2. Assuming the 1993 actual level of Tk 1,191,848.

Under the original 1989 budgeted level, RCP remains viable. By viable, we mean that RCP could be profitable every year, and could therefore expect continual growth in its retained earnings account. Under the second scenario of 1993's actual per branch operating expenses, the model predicts continued negative earnings every single year. Under this scenario, RCP would use up the Donors' start-up funding and require additional funding in the year 2000.

We strongly believe that if RCP Branch Managers do not receive the information and the training to understand these financial relationships, then RCP will not become financially viable. BRAC is a development agenda and the financial agenda so that both are met. BRAC must succeed at both, for to fail at one jeopardizes the other.

APPENDIX A

RDP FINANCIAL PERFORMANCE RELATIVE TO BUDGET
January through December 1993

The 1993 Monitoring Review provided a comparison of RDP performance for the first nine months of *1993* with the budget prepared in *1992*. *This section briefly reviews the full 1993* annual performance. BRAC has tracked both cumulative expenditures for RDP (to manage the overall RDP III Budget) and compared actual to budget for specific periods. This review focuses on actual performance during the calendar year 1993, not cumulative RDP III.

The primary observations are

- Institution Building expense was Tk. 10.9 million (38%) overspent. This is consistent with the first nine months of 1993 in which BRAC reported institution building as Tk. 5.2 million (24%) overspent due to the extra training required for new, replacement members after the 1992 expulsion of inactive members.

- Income and Employment Generation activities were Tk. 23.9 million (25%) overspent. This category includes the salaries and expenses for sectoral program staff, training for group members, compared to being Tk. 6.1 million (10%) overspent as of September, 1993, due to higher salary expense and travel and transportation expense. In addition, the budget for cost recovery was reallocated, with lower service charges projected in 1993 and 1994 and higher service charges realized in 1995. A question for BRAC is why the fourth quarter expense was so much higher than the nine month figure.

- Branch and Regional Office Operating Costs were Tk. 3.6 million (3.6%) underspent. This compares to being 16% underspent as of September, 1993. BRAC attributed the September figure to a reduction in the number of Pos at RDP branches as a result of the expulsion of inactive members and a lower average PO salary than budgeted (due to an increased number of new Pos). BRAC anticipated that this expense would grow, however, due to the recruiting of new, replacement members by the end of 1993 and the strength of the remaining VOs.

- Staff Training and Development was on budget at Tk 6.6 million. We suggest that BRAC calculate an actual training cost per member to better compare trends in staff development costs over time.

- Capital Investment Requirement was Tk 20 million (44%) under budget for 1993, compared to being Tk 27 million underspent (66%) in September 1993. In November 1993, BRAC explained the lower than expected expenditures as due to several factors.

- RDP expenses for land and physical equipment for new branches were lower than expected;

    - Proceeds from the sale of RDP branches to RCP were less than expected (bricks and mortar and equipment, only);
    - BRAC spent nearly Tk. 11 million less than projected on vehicles and office equipment for Regional Offices;
    - BRAC is deferring other capital expenditures due to the budget overruns on operating costs.

- Loan Fund Requirement was Tk.4 million (4%) underspent, compared to being Tk. 6.5 million overspent in September 1993. As described in Appendix B of the November 1993 Monitoring Review, the Loan Fund Requirement has five components:

    - The increase in Loans Outstanding (general loans);
    - The proceeds from the sale of RDP branches to RCP (sale of the loan portfolio);
    - Proceeds from SIDA for Hoar Development Programme (4 branches);
    - The increase in housing loans to members;
    - The increase in housing loans to staff.

  Housing loans have grown much more slowly than projected, therefore requiring fewer funds than projected. This offset the increased funding needed to finance higher than projected disbursements and lower than projected proceeds from the sale of RDP branches.

  The Loan Fund Requirement for RDP is funded entirely by the Donors; member savings appear on the RDP balance sheet but not on the funds flow statement because BRAC is holding those savings on behalf of members and not using savings to fund its lending activities.

- Support Services (TARCs and Research, Monitoring, and Evaluation) was 52% underspent. TARCs spending was 42% of the Tk. 31 million budget, and Research, Monitoring, and Evaluation expenditure was 65% of the budgeted Tk. 8.6 million. This line item anticipated construction of 3 new TARCs in 1993; those are now planned for late 1994. Research and Monitoring projects were running behind schedule.

- Representing 30% of the total expenditures for RDP III, Non-Formal Primary Education (NFPE) was 6% underspent on a total budget of Tk. 198 million. As of September, 1993, the program was 12% underspent due to a slight shortfall in the number of schools opened thus far during the year. The RDP III portion of NFPE is only one part of the NFPE program and we do not have sufficient information to evaluate the status of the NFPE budget.

- Management Development Program was 108% underspent for 1993, showing a budget of Tk. 7.3 million and actual expenditures of (Tk. 600,000). We assume this means that the MDP is on hold and that BRAC is earning a small amount of income from renting the completed facility to others.

- IGVGD is Tk. 8.9 million (31%) underspent, compared to being 44% underspent for the first nine months. Last November, BRAC explained that due to a delay in renewing the contract with the Government, the IGVGD programs are 6 months behind schedule.

- Net interest income was slightly above budget due to higher average loans outstanding, and reached 7% of the total budget. If NFPE, IGVGD, and other special programs are excluded, RDP earned 11% of its operating costs from internally generated funds.

Overall, the RDP III 1993 actual expenditures were 6% below budget. Net of interest income on loans outstanding, total 1993 expenditures were 7% underspent on a total budget of Tk. 612 million.