

R/C

PO-734

1997 Financial Review  
BRAC RDP/RCP Program

Shorebank Advisory Services  
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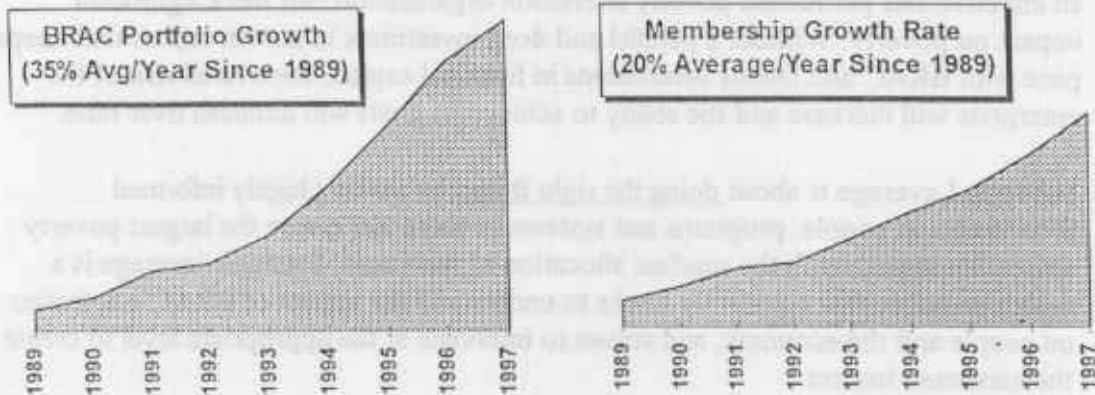
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## Shorebank 1997 Annual Review - Executive Summary Table

Loan Portfolio Growth	<ul style="list-style-type: none"> <li>• 26% annual growth rate, up by Tk 629 million over last twelve months to Tk 3,070 million. Primary growth in younger branches, some older branches more stagnant, thus need to develop some method of renewal and reinvigoration.</li> </ul>
Loan Portfolio Quality	<ul style="list-style-type: none"> <li>• Quality continues to be strong, well recovered from non-cooperation movement. Need to monitor and reduce non-interest bearing loans. Loan loss provision adequate. Need more aggressive loan write-off policy.</li> <li>• 33% of branches have moved to bi-weekly meetings, will increase to 66% in 1998. No problems so far, but must monitor impact on weekly savings and delinquency. Potential opportunity for PAs to mobilize savings with freed-up time.</li> </ul>
Loan Portfolio Management and Strategy	<ul style="list-style-type: none"> <li>• As the portfolio grows and matures, it needs an increased focus on economic impact and an increase in strategic leverage of loans to maximize poverty alleviation. Create wage employment (MELA) as well as self-employment.</li> </ul>
Average Loan Size	<ul style="list-style-type: none"> <li>• Up 11% from Tk 3,721 to Tk 4,137 in last twelve months. Growth results from inflation and increasing maturity of branches and members' borrowing capacity.</li> </ul>
Member Savings Activities	<ul style="list-style-type: none"> <li>• Very strong (over 30%) growth. Weekly savings rate up from Tk 3.76 per week to Tk 5.05 per week. Total savings up from Tk 1,077 million in June 1996 to Tk 1,366 million in June 1997. New savings pilot programs inconclusive. Current Account Savings in right direction but need additional research to develop new savings products with different pricing and maturities.</li> </ul>
Membership Trends	<ul style="list-style-type: none"> <li>• 28% annual growth rate, up by 387,000 to 1.75 million as of September 1997.</li> </ul>
Branch Profitability and Sustainability	<ul style="list-style-type: none"> <li>• Consistent with RDP IV plan, strong performance and continued improvement in earnings. Need continued branch manager training to increase focus on sustainability. Some older branches performing less well than younger branches.</li> </ul>
Management and Human Resource Issues	<ul style="list-style-type: none"> <li>• The growth rate of BRAC's financial capital is out-pacing the growth rate of its employee skills ("human capital"). This needs strong focus on hiring, training, management development, succession and all forms of investment in BRAC's human resources. Very important issue.</li> </ul>
Special Donor Concerns	<ul style="list-style-type: none"> <li>• <u>PSE programs</u>. High impact strategies, good performance, financial and impact reporting could improve.</li> <li>• <u>Computer introduction</u>. Very important to support rapid loan and savings growth. First of three stages. Going well. Big task affecting many parts of BRAC.</li> <li>• <u>VGD program</u>. No financial or sustainability implications for RDP.</li> <li>• <u>Seed Enterprise</u>. Strong proposal &amp; business plan with high development impact.</li> <li>• <u>MELA program</u>. Very high potential impact on wage employment and poorest of poor. High risk. Presents many new challenges: strategy, staffing, funding.</li> <li>• <u>Revised RDP IV budget</u>. Program reallocations and cost increases are appropriate.</li> <li>• <u>BRAC bank proposal</u>. Been submitted, waiting on government, unpredictable.</li> </ul>
Recommendations	<p>Strategic, operational, technical and recommended further research. See Chapter 8.</p>

## 1. Opening Reflections on Growth and Strategic Leverage



The two recurring themes encountered during the process of Shorebank's 1997 Annual Financial Review of BRAC's RDP/RCP Programs were Growth Management and Strategic Leverage. How BRAC meets these two challenges over the coming years is a key question for BRAC and Donors, perhaps more important than other more visible issues such as funding, sustainability and the potential creation of a BRAC Bank. These are not new themes to BRAC, for they are both increasingly visible in various activities throughout the organization, and our comments are not meant to detract from any current initiatives. Our sole intent in these Opening Reflections is to support and intensify the depth and scale of activities focused on meeting these two challenges, for we believe them to be key to BRAC's future.

As the two graphs above illustrate, growth has been BRAC's constant companion since 1989, both in terms of loan portfolio and membership growth. The current decision not to expand beyond 330 branches will not stop this growth, but it will shift its focus from pure new growth to a blend of slower expansion and the strengthening of existing branches and programs. The task will be to manage this growth in RDP's credit, sector and social development programs while being more strategic in its program design and implementation. These twin challenges are a linked pair, growth management is internally focused while strategic leverage is externally focused. Both are necessary, either standing alone is insufficient.

- ◆ Growth Management has to do with operations management, human resources, portfolio risk, employee compensation and benefit practices, management systems and incentives, and leadership development. BRAC's portfolio risk management, management training sessions, and introduction of a branch computer infrastructure, for example, are evidence of a maturing organization wrestling with growth management. Growth Management is focused on doing things right in an increasingly complex organization and social environment.

Growth Management means investing in BRAC's "human capital" much more than ever before. For far more than financial capital, it is the quality and depth of BRAC's employees that will determine whether or not BRAC can achieve its goal of creating an effective and permanent poverty alleviation organization that has a significant impact on poverty. Without a parallel and deep investment in human capital that keeps pace with BRAC and Donor investments in financial capital, the overall risk of the enterprise will increase and the ability to achieve its goals will diminish over time.

- ◆ Strategic Leverage is about doing the right things by making highly informed investments in people, programs and systems in ways that create the largest poverty alleviation impact with the smallest allocation of resources. Strategic leverage is a design principle that constantly works to understand the impact of BRAC's activities on people and the economy, and strives to intervene at the appropriate level to create the maximum impact.

The essence of strategic leverage is making choices, based on a deep and continuing knowledge base of Bangladesh's rural economic and social dynamics. Strategic leverage requires constant research to find the points of greatest leverage. A successful enterprise understands and focuses on the development of its "core competencies", and BRAC must do the same. Strategic leverage looks for root causes, bottlenecks, partnerships, social and financial leverage, sustainability, and ways that BRAC can invest Tk 100,000 to get Tk 1 million value. The MELA enterprise loan product and the PSEs, for instance, are high leverage activities that are evidence of BRAC's growing strategic perspective.

To set the context for a discussion of these two themes, it is necessary first to briefly review the findings of Shorebank's 1997 Financial Review of BRAC's RDP/RCP Program. Overall, the results of our Review were positive and very encouraging.

1. The RDP/RCP portfolio continues to experience strong growth in portfolio, borrowers and savers. The balance between risk and development impact seems to be on an even keel. The portfolio's recovery from the difficult non-cooperation period is a testament to both BRAC staff and the strength of the borrower base. While we found some sectoral soft spots, and noticed an increase in NIBL, none are serious concerns at this point, and the existing loan loss reserve is more than adequate to cover this exposure.
2. 1996-97 performance is consistent with the RDP IV plan and BRAC's intent to become increasingly self-sufficient while maintaining its development impact and reaching the very poor. BRAC is continuing to mobilize new external resources, improve its net interest margin, and grow its base of savings deposits. 1997 was especially notable for the growth in the savings deposit base that BRAC must depend on to achieve its development goals.
3. BRAC is successfully pursuing the implementation of several strategic initiatives, ranging from Program Support Enterprises (PSE) to sectorally focused lending and

technical assistance sector activities. We believe that these initiatives and ones like them, based in an understanding of the markets and rural economy, are the key to BRAC's achieving increasing self-sufficiency while at the same time increasing its development impact.

4. On the "needs improvement" side, we did find several areas that need attention: (a) some older branches are stagnating and are in need of rejuvenation; (b) branch managers too often still relate to their branch as a "cost center" or a service delivery office, rather than as a surplus producing economic development engine that is proactive in looking for opportunities to grow income and employment for their community; and (c) there is an insufficient understanding of the economic and market conditions of BRAC's borrowers and the village economies that BRAC wishes to change, but without that understanding it will be impossible to make informed strategic decisions.

### **The Challenge of Growth Management**

BRAC has been blessed with having access to highly committed staff, strong growth and substantial financial resources in the form of members' deposits and Donor support. It is much easier, however, to raise and retain financial capital than it is to grow, support and retain the much more important "human capital." It is in this task of growing and retaining human resources that BRAC faces its most significant internal challenge.

Like many organizations, BRAC manages its finances to the single Taka, but has no equally serious system to track, manage, develop and invest wisely its vastly more important "deposits" of human capital. We know that BRAC has already begun a process of deeper skills development at the branch level and we strongly recommend that BRAC intensify its efforts with a very focused and well funded program of "human capital development" at all levels. Although not a formal Shorebank recommendation, we would recommend that consideration be given to the creation of a "Growth Management" Executive Committee", with adequate staff, to guide this initiative until it is fully adopted and integrated into all management systems and practices. Such a program would start with an definition of BRAC strategies, create an understanding of what employee skills BRAC needs to succeed in its goals, examine which of those resources it has and does not have, and finally take specific actions to acquire, develop, nurture and retain these key human resources that are at the core of BRAC's "competitive advantage" in its struggle against poverty.

### **The Challenge of Strategic Leverage**

Even though BRAC is a large development organization relative to many of its peers, it is still a very small organization when compared to the size and scope of the Bangladesh rural economy. The only way that it can impact substantially on some of the major economic forces affecting the poor and the poorest of the poor is to: (a) have a very deep understanding of the much more powerful market and economic forces that are shaping

the rural economy and (b) based on that knowledge create high-leverage strategies that work to tap and shape other resources and market forces in ways that improve poor people's lives. While BRAC does not have the size of the public sector or a large national corporation, it has the offsetting assets of creativity, responsiveness and the ability to take risk in the pursuit of innovation which enable BRAC, as we have seen in the past, to make a difference.

In the pursuit of economic change and poverty alleviation, we believe that BRAC must become even more strategic in its activities, and evaluate more activities based on leverage and on final impact on peoples lives. To help achieve this goal, we recommend not only that BRAC explore ways to increasingly organize itself around distinct development (sector) strategies, but also that BRAC develop a strong Training and Research and Development capacity to support RDP/RCP activities.

BRAC must be able to intimately understand and harness knowledge of the markets and economies of rural Bangladesh. BRAC should take advantage of its unique ability to "harvest" the knowledge and information of the village and rural economy via its branch network and staff. A traditional private sector company would give millions of Taka to have BRAC's distribution capacity and market research capacity. BRAC needs to take advantage of the investment that it has made in the branches over the years and "harvest" market and economic information to develop strategies, understand its resource needs, and train employees to be more proactive and effective in their efforts to shape the rural economy.

This report is the product of three weeks work in November/December 1997. As always, it was too short to do everything we wanted to do, and as always it was a great pleasure working with BRAC employees and the Donors during the course of this Review. We hope that the information and insights that follow in these pages are useful to the Donors and BRAC Management. We realize that we have introduced some new ideas, new directions, and new management measures in the following report, as well as reviewing the overall activities of the RDP/RCP program. We hope that these new ideas are "seeds" that are helpful both for BRAC as well as the Donors.

For your convenience, we have included a chapter at the back of this Review that summarizes our recommendations. We very much appreciate all of the time and effort that many, many BRAC employees gave us during the course of this Review. We especially thank Sheila Ryan and all the DLO office staff for their hospitality and for accommodating our crazy work schedules on their premises.



## 2. Portfolio Risk Management and Credit Related Activities

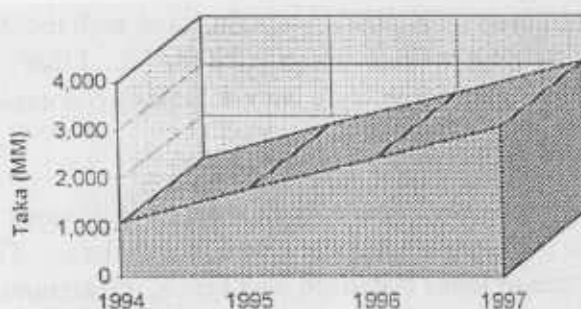
### 2.1 Portfolio Analysis Summary

In spite of continued strong growth (annual growth rate of 25-30%), BRAC's portfolio quality is strong, and vigilant credit management continues to be a focus for branch managers. While there are specific "soft spots" in certain sectors (sericulture and housing) and within some older branches (e.g. in some Year 10, 11 and 12 branches), and with the 2% increase in NIBL, these are not unexpected situations and are small issues relative to the Tk 3.1 billion in the total loan portfolio.

From a Donor/financial management perspective, we see no major problems looming in BRAC's tightly run and well managed portfolio. From a BRAC Senior Management perspective, we see potential to improve the performance in some older branches, as well as the need to develop a deeper understanding of higher risk sectors, and sectors where the portfolio has become concentrated (e.g. in rural trading). As a side comment, we see a benefit to greater coordination and sharing of skills that could occur between the VO credit management team and the newer programs such as MELA and urban lending.

### 2.2 Analyze the implications of any changes in disbursements, outstanding, term mix and average loan size.

Total Portfolio Outstanding



Total principal outstanding (TPO) increased 26% from Tk 2.4 billion June 1996 to Tk 3 billion June 1997.<sup>1</sup> This compares with a 34% rise in TPO from Tk 1,827 MM in June 1995 to Tk 2,441 MM in June 1996.

BRAC prudently focused on portfolio quality rather than portfolio growth after the period of political upheaval in early 1996 which hurt members' ability to make both loan and savings

payments. As a result, between June and October 1996, TPO increased by only 1% as BRAC branch staff focused on restoring member discipline and bringing the portfolio current. Significant growth in outstandings began again in November 1996 when on time repayments were over 85% of TPO -- a level almost equal to BRAC's achievements prior to the non-cooperation period.

Except for the Rural Trading and Food Processing sectors, there were few striking changes in the value of each sector as a proportion of TPO.<sup>2</sup> The increase in outstandings is due both to a rise in the number of loans disbursed as well as an increase in the average loan size. The average loan size increased from Tk 3,700 - Tk 4,100 (see section 5.2 for

an extended discussion of changes in average loan size, and new options for Branch Managers to make loans above the Tk10,000 loan ceiling).

Loans are usually disbursed to first-time borrowers after a period of eight weeks where member discipline is established. BRAC is making an effort to increase its responsiveness to loan requests from repeat borrowers by targeting a response time of one week between loan requests and loan disbursements if the repayment record of borrowers is good. Most branches have achieved this level of responsiveness.

The term mix, another factor which impacts on the number of loans disbursed and hence the size of outstandings, remained relatively unchanged. 99% of BRAC's portfolio now has a loan term of one year. This was a deliberate strategy by BRAC to improve the quality of its portfolio after managers of the credit program discovered a high correlation between the term of the loan and borrower delinquency due to deteriorating member discipline. BRAC found that borrowers are less likely to default when the term of the loan is shorter as they want another loan the following year. All three of the sectors (i.e. fisheries, cottage industry and housing) that currently have more than 1% of their portfolio in medium term loans (i.e. 1-3 years) have a proportionately high delinquency rate.

The rate of on-time repayment, yet another factor which impacts on the number of loans disbursed, also remained relatively stable during 1997.

In response to Donor concern, based on this Review do *not* believe that the increase in outstandings and the rise in the average loan size has compromised the quality of the portfolio, or deterred BRAC from serving poor group members (discussed in 5.2).

**Weekly Meeting Schedule Change.** In early 1996 BRAC experimented with monthly VO meetings in first year branches instead of weekly meetings. BRAC found that although delinquency did not deteriorate significantly, there were at least two notable impacts:

- A portion of members found it difficult to pay a single, large monthly installment. In other words, they found it easier to manage their cashflow on a weekly basis. This put a little downward pressure on the size of loans disbursed, and hence, the amount of interest income earned.
- BRAC field staff and borrowers found that member discipline and staff-borrower interaction suffered slightly as a result of the change from weekly to monthly meetings.

By the third quarter of 1997, BRAC changed meeting frequency to *bi-weekly* meetings for all first and second year branches (i.e. two meetings a month) and the above-referenced problems have since been reduced. At this stage, it is still too early to tell if there will be any negative impacts on portfolio quality. Our judgment is that some members who request larger loans may find it difficult to manage their cashflow between bi-weekly repayments, let alone paying Tk10 in weekly savings twice a month.

BRAC plans to introduce the practice of bi-weekly VO meetings at all branches where the respective branch has a low delinquency rate.

In one of the regions we visited (i.e. Faridpur) all 22 branches had introduced the bi-weekly repayment system with no noticeable deleterious results. BRAC's intention with the bi-weekly system is *not* to reduce the number of PA staff, but rather to free-up their time to do more problem resolution, savings mobilization and social development activities which have been prioritized by RDP head-office management. We feel that savings mobilization is probably the best match for PAs as it builds on their existing skills base as well as complementing their loan disbursement and collection skills. This will only occur, however, if specific targets, responsibilities and workplans are developed for the PAs.

- BRAC anticipates that around 33% of all branches will be on the bi-weekly repayment system by yearend. By the end of 1998, BRAC expects that 60% of branches will meet bi-weekly. Branches where member discipline is poor are *not* encouraged to change their weekly repayment system. The decision as to which branches should be on the bi-weekly system is left up to the branch and regional manager. This is in line with BRAC's objective of giving branches and regions more authority to make their own decisions.

We like BRAC's prioritization of social development and savings alongside credit within its bi-weekly meeting structure as well as its policy of experimental learning or "learning by doing," especially where the risks of doing so are not great.

### Suggestions Related To Disbursements, Loan Size, And Term Mix

1. The "rule" by head-office that no second loans to borrowers should be made occurred at a time when second loans were made fairly indiscriminately, leading to higher delinquency among borrowers who had more than one loan. While this may remain true in general, it still makes sense to give second loans to exceptional borrowers who *can* afford to repay them. We suggest that the managers of branches which have very few past dues seek "exceptional borrowers" who can afford to take out larger loans, or more than one loan, to further develop their businesses. Another advantage to BRAC is that these borrowers will probably also save more.
2. BRAC head-office needs to educate risk-averse branch managers on its recent policy of raising its loan ceiling as described earlier. However, it should do so with clear guidelines as well as training that enable PAs and branch staff to adequately analyze a borrower's cash flow position and her ability to repay.
3. BRAC should track the median first loan size of all borrowers. A small percentage of borrowers receiving a first loan of Tk 2,000 or less may indicate that poorer members are not being adequately reached. BRAC should also monitor both the number of VOs and the average VO size to keep track of new member growth.

4. Branch managers in branches with very few past due loans should slowly begin to allow slightly longer loan terms to selected borrowers who have proved themselves able to handle larger loans over longer terms (say 1.5 to 2 years). The general rule of "one year loan terms only," however, should continue to exist.
5. BRAC should closely monitor whether the change of bi-weekly payments reduces the loan size requested in all its age branches. Specific training to assist members in the increased cash flow management task should be considered. Given that larger sums of money will now be handled by collection agents, thought should be given to security concerns as payments are brought to branch offices. The impact on savings, disbursements, interest income, the quality of the credit portfolio and the quality of BRAC-member interaction should also be assessed.
6. Finally, PA staff should become dedicated savings mobilizers in their freed-up time resulting from their new bi-weekly meeting schedules.

### 2.3 Changes in sector portfolio outstanding and opportunities for growth.

#### Sector Programs: Agriculture, Livestock/Poultry, Fisheries and Sericulture

The total principal outstanding (TPO) in BRAC's four sector programs (agriculture, poultry and livestock, fisheries and sericulture) totaled 24% of the total loan portfolio in June 1997 compared with 25% of TPO in June 1996. The RDP IV Plan target is 25% of TPO, a target reached in 1995 and 1996 but not in 1997. The table below shows that only fisheries increased its proportionate share of TPO over the past year. The share of the other three sectors all dropped by 1%.

If BRAC's sector programs had grown in value terms at the same rate as BRAC's overall portfolio, they would have increased by 26%. The table below reflects this is not the case. The percentage of TPO that the sector programs occupy understates the *number* of members who are benefiting from the sector programs. For example, the average loan required by poultry rearers is only Tk 1,500 compared with a Tk 4,100 average loan for all sectors.

Goat rearers also take a relatively smaller size loan (Tk 3,000) and sericulture rearers often do not require repeat loans to continue operating in the sector. Around 30% (590,120) of all BRAC members are involved in Poultry and Livestock activities.

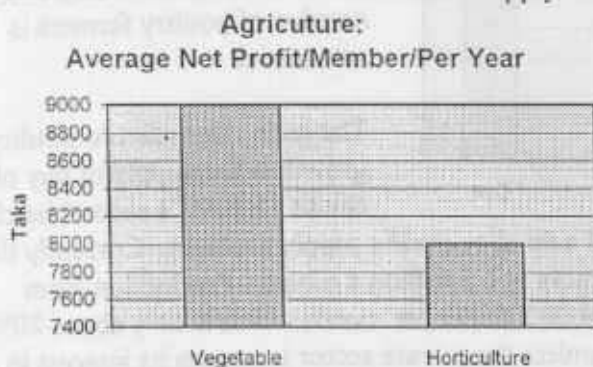
	TPO (taka) in June 1997	% increase in sector June 96 - June 97	Sector's % of TPO in June 1997	Agriculture, Fisheries and Sericulture house members respectively. <sup>3</sup>
All Sectors	3,070,366	26%	24%	
Agriculture	310,813	17%	10%	4%, 6% and 1% of
Fisheries	171,679	38%	6%	members
Sericulture	11,002	-23%	1/2%	respectively. <sup>3</sup>
Poultry and Livestock	237,241	3%	8%	

Loans made under BRAC's sector programs (which focus on value added, productive sectors such as

poultry, fisheries, agriculture and sericulture) generate a higher average net profit and personal income for members and have higher job creation potential than loans made to VO members engaged in local retail and service activities. It is for these reasons that BRAC is actively encouraging growth of these productive enterprises.

Except for fisheries, BRAC's other three sector programs (i.e. agriculture, livestock and poultry, and sericulture) declined as a percentage of TPO between June 1996 and June 1997. The following section discusses some of the dynamics of the changes that are occurring in these sectors and the reasons constraining their growth (number of participants and portion of TPO).

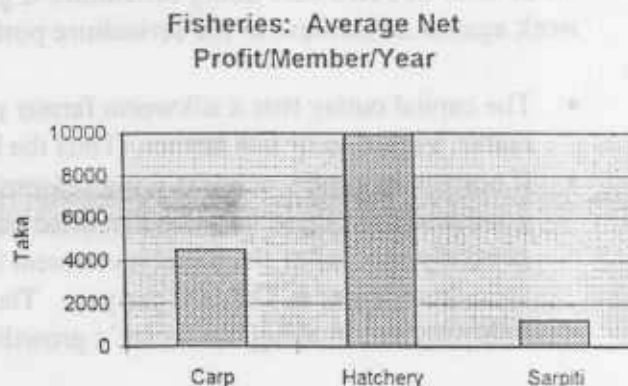
**Agriculture.** Income generation for members in this sector is hindered by the availability of high quality seeds and suitable land. In the past, land availability for expansion of this sector was limited as the available seed supply was unsuitable for a vast portion of the



existing available land (e.g. in North Bengal). BRAC will help to solve this problem by the production of maize seeds through its planned seed production PSE. Maize growth is compatible with the land in North Bengal and other areas. This will enable the expansion of this sector among poorer members of BRAC's target group for whom the vegetable growing opportunity has not been a

viable option. We expect to see a growth of this sector in 1998, both the absolute numbers of members as well as agriculture's share as a percentage of TPO.

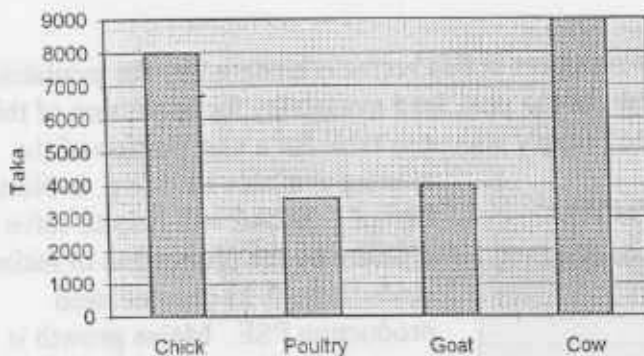
**Fisheries.** The main constraint to future growth in the fisheries sector is the availability of existing ponds. Because excavating a new pond requires a high upfront capital investment which many members are unable to afford, they must depend on existing or unused but easily rehabilitated ponds. BRAC has responded by intensifying its use of existing ponds (e.g. carp and prawn polyculture grow in the same pond) and by making loans to four to five VO members who collectively manage ponds larger than 1/3 acre. We expect positive growth of members to continue in the fisheries sector. However, a sustained increase in the fisheries sector as a proportion of TPO is limited for as long as the availability of ponds remains scarce.



**Poultry.** The stated value of the poultry portfolio is underestimated because members who want to buy poultry know that BRAC staff will only make them one loan of around Tk 1,500. Many members want a larger loan to increase their flexibility and income options. As a result, they tell BRAC PAs that they want a rural trading loan of Tk 3,000 - 4,000. They then purchase poultry for Tk 1,500 and use the balance for rural trading.

This type of outcome is unavoidable for as long as BRAC staff discourage or disallow members to take out more than one loan.

**Poultry and Livestock: Average Net Profit/Member/Year**



Poultry loans are often very small (Tk1,500 - Tk 2,000). Thus, although the value of poultry as a portion of TPO declined and the increase in taka was only 3%, the number of poultry farmers is substantial.

The main constraint to poultry growth is the supply of day old chicks. BRAC's second hatchery

which will come on stream in 1998 will help alleviate the supply problem. Currently the potential market demand for day old chicks is 1.5 million a month. Production from BRAC's two hatcheries will supply 330,000 chicks per month which is only about 20% of total potential market demand. Thus, unless the private sector increases its interest in chick production (unlikely given the more attractive profit potential in the broiler market and the lack of a distribution system to remote rural areas) growth in the rural, layer poultry sector production sector will continue to be constrained.<sup>4</sup>

**Sericulture.** The sericulture portfolio registered a 41% decline in TPO between June 1995 and June 1996. By June 1997, the portfolio fell by an additional 23%. Even when the number of borrowers doing sericulture is growing, there are at least two factors that work against an increase in the sericulture portfolio:

- The capital outlay that a silkworm farmer needs is often small relative to a chick rearer, vegetable or fish farmer. Thus the loan size requested is smaller.
- If borrowers experience two good seasons out of four in one year, the profits generated from these harvests can often pay for future capital requirements which are generally small after the initial investment has been made. The net profit of a sericulture rearer is Tk3,000 per year. Thus, additional loans may not be needed in the following year making the sector's growth more reliant on *new* than repeat borrowers.

The reason for the latest decline in the sericulture portfolio is partially a result of a strategic decision by BRAC to slow down the growth of the sericulture program until a thorough evaluation is done in June 1998. We strongly agree with this decision, and are skeptical of the viability and economic impact of the sericulture sector.

## Recommendations: Sector programs

1. We suggest that BRAC set new targets for its sector programs based on the value to borrowers (increased income, empowerment, skills, etc.), the risk profile of loans in the specific sectors, and the economic impact on the rural economy. BRAC needs to think of these programs as strategic investments, and as such should be clear on two factors: (a) how much they are putting into the investment and (b) what benefits BRAC and the community are supposed to receive from its investment.
2. Since poultry is one of the main livelihoods of the very poor, loan disbursement for poultry production should prioritize extremely poor borrowers, rather than those members who are aiming to increase their scale of production.
3. We encourage BRAC to continue sharing its expertise with establishments who are interested in increasing chick production as well as exploring broiler market opportunities in this fast growing market. The constraints to the growth of BRAC's poultry program seem easier to overcome than the constraints facing fisheries and sericulture. Additional hatcheries should be built in 1998, 1999 and 2000.
4. A decision whether or not to grow sericulture should be the outcome of an extensive evaluation of BRAC's sericulture program, the impact of sericulture on borrowers relative to other sectors, reasons behind the delinquency in the sericulture portfolio, and a study of the likelihood of external forces (e.g. government lifting the tariff on imports) impacting on the sericulture sector.

### 2.4 Monitor and comment on delinquency in the loan portfolio

In the analysis below, we follow a three-step process:

1. We identify the sectorwise distribution of principal outstanding to see how large each sector is relative to the size of the loan portfolio.
2. We evaluate the trends in each aging category of missed payments.
3. We identify those sectors that have the greatest amount principal outstanding that is seriously behind in payments (i.e. more than 26 payments past due).

**Step 1: Distribution of Principal By Sector.** Over the past year, rural trading, as a proportion of TPO increased substantially (7%). The previous year it grew 8%. The latest increase is particularly striking because rural trading already occupied 43% of TPO in June 1996. It now occupies 50% of BRAC's credit portfolio.

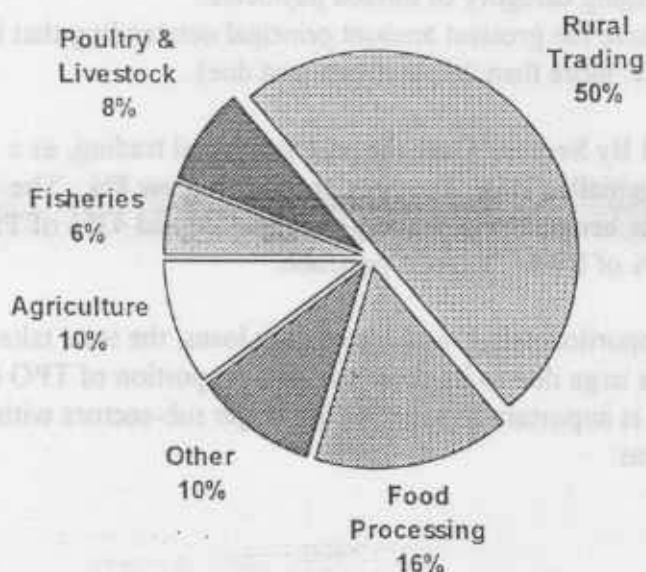
Although rural trading has a disproportionately low share of risky loans, the total taka value of risky loans in this sector is large due to its sheer size as a proportion of TPO (i.e. 1,548 million taka).<sup>5</sup> We think it is important to separate out larger sub-sectors within rural trading for at least two reasons:

- Risk profiles of different sectors within rural trading vary. Those where BRAC is heavily exposed (i.e. over 5% of TPO, or at least, those sectors over 10% of TPO should be understood).
- Extremely poor households tend to take out rice paddy loans which makes up a large part of the rural trading portfolio. BRAC thus needs to monitor both the number of borrowers and the distribution of loan size for these loans.

### Sectorwise Distribution of Principal Outstanding (RDP + RCP)

Sector	June '95 % TPO	June '95 Tk MM	June '96 % TPO	June '96 Tk MM	June '97 % TPO	June '97 Tk MM
Agriculture	12%	224	11%	266	10%	311
Irrigation	4%	75	0%	6	0%	7
Fisheries (& Baor)	4%	80	6%	142	7%	190
Livestock & Poultry	8%	138	9%	230	8%	237
Sericulture	1%	24	1%	14	0%	11
Cottage Industry	3%	49	2%	40	1%	45
Services	0%	5	0%	9	0%	6
Rural Transport	4%	68	3%	85	3%	96
Rural Trading	35%	635	43%	1,043	50%	1,548
Food Processing	20%	373	18%	446	16%	476
Health	0%	2	0%	3	0%	6
Miscellaneous	1%	12	1%	23	1%	26
Housing	8%	142	5%	134	4%	110

BRAC should acknowledge that the rural trading loan category is becoming a "catch all" category that is becoming less and less useful as a management and portfolio analysis category. BRAC should rebalance its system of loan categories and (a) create additional sector divisions that are more accurate and revealing of the actual use of the loan, and (b) to avoid proliferation of sector categories, it should combine some very low use sectors into combined categories. In general, BRAC should track loan categories that exceed 10%



of the value of the total loan portfolio for risk management purposes.

Apart from rural trading, the only other sector which registered an increase in size as a portion TPO was fisheries, where risky loans may become a concern if BRAC intends to grow this sector further.<sup>6</sup> Food processing, the second largest sector, registered a 2% decline. Food processing grew only 7% in value over the year compared with a 26% increase in value of the overall



portfolio. This means that there was a substantial drop in the number of borrowers, which was accentuated by the fact that food-processing loans are often relatively small. BRAC may want to investigate if it was a specific sub-group of food-processing that declined, the reasons underpinning the decline, and if the reduction in loans was evenly spread among BRAC's target group (vs. any particular group not receiving loans).

Housing sector TPO declined to Tk 110 MM from Tk 133 MM a year ago and Tk 142 MM in June 1995. As a proportion of TPO, the housing sector has halved its weight from 8% in 1995 to 4% in 1997. The reduction in housing loans stems from a disproportionately high delinquency rate experienced by borrowers in this sector.

**Step 2: Reviewing APO Trends.** Aging of principal outstanding (APO) enables BRAC to ascertain what the trends of repayment are in the various sectors. In the APO tracking system, if a borrower misses a payment, the entire principal amount of the loan shows up as "past due." This method allows BRAC to monitor how much of the portfolio is at risk at any one time with clear categories of the degree of risk.

**Sectorwise Percentage of Principal with No Payments Missed**

Sector	No Missed Payments June 1995	No Missed Payments June 1996	No Missed Payments June 1997	Sector as a % of TPO June 1997
Agriculture	89%	66%	89%	10%
Irrigation	82%	44%	40%	0%
Baor		73%	77%	1%
Fisheries	91%	81%	76%	6%
Livestock/Poultry	83%	65%	85%	8%
Sericulture		74%	57%	0%
Cottage Industry	86%	58%	94%	1%
Services	92%	83%	92%	0%
Rural Transport	94%	68%	91%	3%
Rural Trading	90%	71%	91%	50%
Food Processing	89%	60%	82%	16%
Health	95%	83%	96%	0%
Misc.	97%	65%	84%	1%
Housing	71%	27%	54%	4%
TOTAL	88%	66%	87%	100%

We believe that the "no payments missed" category of loans is an excellent indicator of where repayment problems are likely to occur down the line. Borrowers that have missed payments in the past are more likely to miss payments in the future.<sup>7</sup>

**Trends.** Most sectors that were hard hit by the non-cooperation period in early 1996 have recovered. Fisheries, sericulture and irrigation were exceptions and their respective "no payments missed category" has deteriorated further. *We feel that an inquiry into the higher rate of delinquency in both fisheries and sericulture is important given that they are two sectors which BRAC is wanting to actively grow.*

Sectors which registered an improvement in loans that were 100% current between 1995 and 1997 are<sup>8</sup>: livestock and poultry; cottage industry; rural trading and health. Sectors which showed a serious deterioration (> 10% drop) in the no payments missed category include irrigation, fisheries, miscellaneous and housing.

The remarkable recovery of BRAC over the past year should not be underestimated. BRAC's on time repayment recovered over the past year from lows of 29% and 66% in March 1996 and June 1996 respectively. Just prior to the political turmoil, the proportion of no payments missed as a percentage of BRAC's TPO was at a strong 87% -- a level which BRAC is once again experiencing. The ability of the credit portfolio to bounce back so substantially is indicative of strong leadership from head-office and extremely hard work by competent staff at the branch and regional levels.

#### Loan Repayment Patterns (June 1993 - June 1997)

Payments Missed	June 1993	June 1994	June 1995	June 1996	June 1997
0	70%	84%	87%	66%	87%
1-4 payments	7%	4%	4%	20%	4%
5-12 payments	5%	3%	3%	6%	2%
13-25 payments	5%	3%	2%	4%	2%
26-50 payments	7%	3%	1%	2%	1%
over 50 payments	5%	4%	3%	3%	5%

Setting aside the period of political unrest during 1996, the table above shows that the deterioration in the aging of the portfolio outstanding (APO) has occurred primarily in the over 50 payments missed category (including all NIBL). In every other category of missed payments, the portfolio has improved.

#### Loan Repayment Patterns (January 1996 - September 1997)

Payments Missed	Jan 96	Mar 96	Jun 96	Sep 96	Jan 97	Mar 97	Jun 97
0	87%	29%	66%	76%	86%	86%	87%
1-4 pmts	5%	60%	20%	10%	5%	4%	4%
5-12 pmts	2%	5%	6%	4%	2%	2%	2%
13-25 pmts	1%	2%	4%	4%	2%	2%	2%
26-50 pmts	1%	1%	2%	3%	2%	2%	1%
over 50 pmts	3%	3%	3%	3%	4%	4%	5%

80% of the over 50 payments category is made up from loans are NIBL (non-interest bearing loans). NIBL is Tk 114 million or over 4% of its total portfolio outstanding. In June 1996, the proportion of NIBL was much lower at 2% of TPO.<sup>9</sup> While this is a deterioration from last year, it can be explained by the fact that BRAC now moves all loans that are over 100 weeks past due into this category. Essentially, NIBL is BRAC's

way of acknowledging that these loans should really be written off, and so this is a good move.

**Step 3: Assessing the Concentration of Risk/Delinquency in the Loan Portfolio.** The next step is to compare the concentration of sectors with the slowest repayment with their overall proportion in the loan portfolio. For example, if irrigation has a high percent of slow repaying loans but is less than 0.5% of TPO, the problem is less worrisome than if a sector like fisheries which is 6% of TPO has many delinquent borrowers.

(Risky Loans defined as > 26 payments missed)	What % of each sector is made up of risky loans (6/96)	What % of each sector is made up of risky loans (6/97)	Did sector increase or decrease as a % of TPO (June 96-97)
Agriculture	4%	5%	decrease
Irrigation	50%	54%	same
Baor	11%	12%	same
Fisheries	7%	10%	increase
Livestock & Poultry	7%	8%	decrease
Sericulture	16%	26%	decrease
Cottage Industry	7%	5%	decrease
Services	1%	4%	same
Rural Transport	4%	4%	same
Rural Trading	3%	3%	increase
Food Processing	4%	7%	decrease
Health	1%	1%	same
Miscellaneous	9%	9%	same
Housing	17%	30%	decrease
<b>Total in All Sectors</b>	<b>5%</b>	<b>6%</b>	<b>N/A</b>

The previous table describes which sectors are "risky," the table below describes how exposed the portfolio is.

#### Principal Outstanding that Missed More than 26 Payments

	A	B	C	D	E	
	Each sector's proportion of >26 payments missed (6/96)	Each sector's proportion of >26 payments missed (6/97)	Each sector's proportion of >26 payments missed plus NIBL (6/96)	Each sector's proportion of >26 payments missed plus NIBL (6/97)	Sector's outstanding as Percent of TPO	
					6/96	6/97
Agriculture	10%	10%	8%	8%	11%	10%
Irrigation	1%	0%	3%	2%	0%	0%
Baor	1%	1%	2%	1%	1%	1%
Fisheries	11%	11%	7%	10%	5%	6%
Livestock & Poultry	10%	7%	14%	11%	9%	8%
Sericulture	1%	2%	2%	2%	1%	0%
Cottage Industry	3%	0%	2%	1%	2%	1%
Services	0%	0%	0%	0%	0%	0%
Rural Transport	1%	1%	3%	2%	3%	3%

Rural Trading	22%	19%	23%	24%	43%	50%
Food Processing	11%	16%	14%	17%	18%	16%
Health	0%	0%	0%	0%	0%	0%
Miscellaneous	0%	1%	2%	1%	1%	1%
Housing	28%	25%	20%	18%	5%	4%
Total: All Sectors	2%	3%	4.5%	6%	100%	100%

Column B and D in the table above should really be compared with Column E for June 1997. If a sector makes up x % of the TPO (see Column E), you would expect it to reflect a similar proportion of risky loans (see Columns B and D). The above table illustrates the following facts for June 1997:

- The risk profile of loans in the agricultural, poultry and livestock, baor, rural transport sectors have improved over the last year.
- Poultry and livestock, and irrigation still are still higher risk sectors relative to their weight in BRAC's total portfolio outstanding.
- Fisheries increased its proportion of higher risk loans both in absolute terms *and* when compared to its weighting in the TPO. Fisheries is the only sector that *expanded* its coverage in despite it having a higher risk profile both last year and this year.
- The risk profile of rural trading improved considerably over the past year. Risky loans only increased by 1% compared with a 7% increase in the portfolio's size.
- The risk profile of food processing, which we considered a seemingly less risky sector based on the June 1996 numbers, deteriorated substantially.
- Sericulture's risk profile worsened.
- The position in housing improved slightly although it remains an extremely high risk sector. Housing continues to represent the highest concentration of risk with the APO > 26 payments missed category registering 18% of the total low performing loans.

Out of BRAC's four sectors which it has chosen to support actively, only Agriculture has a proportional share of the poorly performing loans that is in line with its share in the overall loan portfolio. BRAC has continued to improve its management of the livestock sector. However, livestock still has a greater percentage of poorly performing loans than its share in the whole loan portfolio. As mentioned above, the portion of poor performing loans in the sericulture and fisheries sectors also exceeds the proportion that those sectors occupy in total principal outstanding (TPO).

Finally, it is useful to look at the 13-25 payments missed category as an indicator of what risky loan profile we might expect in June 1998 assuming the sector specific trends that we see over the past year persists. Rural trading increased its share of payments missed in this category by 5% (i.e. from 28% to 33%). The negative association with this is, partially, offset by the sector's growth as a whole. So although rural trading, by far, holds the least amount of low performing loans relative to its size in the loan portfolio, a more damaging interpretation of the same information is that well over 20% of BRAC's risky portfolio is in this "single" sector. Even a small percentage increase in the riskiness of this

sector's needs to be understood in order to better manage the risk exposure of the loan portfolio.

Food processing and fisheries are also in for an increase in their share of risky loans unless BRAC manages to reverse the increase in delinquencies that are occurring.<sup>10</sup> Fisheries increased its portion of TPO by 1% but loans 13 - 25 weeks past due category increased 2%. Food processing decreased its portion of TPO by 2%, but its share of loans in the this category increased 2%.

### Recommendations

1. Because BRAC is deliberately targeting its sector programs, a study of the reasons for delinquency in the fisheries, sericulture and poultry and livestock sectors is necessary. A study will reveal whether poor loan decisions were made by BRAC staff, or whether there is something inherent in the structuring of the loans or the nature of the sector that causes delinquency.
2. As explained earlier, both rural trading at 50% of TPO and food processing at 16% of TPO need to be refined and split out into more accurate and meaningful categories that support analysis as to the cause of delinquencies.
3. Since thirty percent of the housing portfolio is considered high risk (i.e. over 26 payments missed), branch level caution in disbursing housing loans appears to be warranted. If BRAC wants to increase housing loans for developmental reasons, the reasons underpinning the delinquency should be understood. Head-office should give a clear directive to branch managers under what circumstances housing loans are to be made, if at all. We would consider terminating the housing loan program, for its economic and income impact is dubious, while its risk level is much higher than all other sectors, apart from irrigation.

BRAC should put all NIBL loans into the 100 weeks missed category in its APO report. Furthermore, we recommend that any loan that is over three years past due should be formally written off the accounting balance sheet. BRAC should continue efforts to collect these loans should this be possible, and any income should be shown as a recovery, but these loans and their associated loan loss reserve should not be carried on the balance sheet. BRAC should strive to reduce its NIBL to 2% of TPO over the next year.

### Other Strategies to Manage Delinquency: Additional findings and comments

1. BRAC found that its experiment of using a single special credit PAs to track seriously delinquent and mostly inactive members over wide geographic areas was not sufficient. Head-office managers are considering increasing the number of PAs that track overdue borrowers (i.e. missed over 100 weeks in payments) to two PAs in areas which have

many inactive members. BRAC is also considering having PO and regional "work-out specialists" at the branch and regional levels where there are serious overdue problems.

We believe that as long as the PO work-out specialists and the PAs who collect the overdues cover their respective salaries and overhead costs by collecting on overdue loans, BRAC's investment is worthwhile. The same argument can be made at the regional level. The risk that must be actively managed is that regular VO PAs should not be able to easily "hand off" problem loans to the "work-out specialists", but should rather have strict boundaries and reasons that such loans be transferred. It may be a useful training technique to rotate the responsibilities of "work out specialist" among standard VO PAs so as to give as many PAs as possible solid experience with loan collections and work-outs.

Where it does not prove to be cost effective, POs and regional work-out specialists can cover wider geographic areas. The regional work-out specialists should provide training and guidance to the branch level. These costs should also be covered by loans recovered. We also suggest that late loans continue to be collected by the regular credit PAs. This will ensure that they still have an incentive to "collect hard" in the period that the loan is current vs. passing the problem loans off to another PA.

Another recent BRAC idea for non-performing VOs (i.e. VOs which have many inactive members and high past-dues) is to "weed them out." BRAC has found that a lack of borrower discipline in poorly performing branches is contagious. To prevent "good borrowers" from becoming credit risks, BRAC has a "rebuilding strategy" which essentially aims to build up a new, well functioning VO in the same area, and to move across "disciplined members" from the deteriorating VO. At present, BRAC has introduced this system at some of its 37 highly problematic branches where borrower discipline, particularly in some VOs has deteriorated substantially. We think the this idea certainly worth testing for these VOs.

## 2.5 Adequacy of Loan Loss Reserve

In summary, the following analysis shows that the Loan Loss Reserve is more than adequate, provided NIBL does not increase substantially.

Tier 1: Non-Accrual Loans (June 1997) = Identified likely uncollectables

100% of NIBL	Tk 114.1 million
100% of loans >100 wk. past due	Tk 4.1 million
50% of loans >50-100 wk. past due	Tk 24.3 million
Sub total	Tk 142.5 million

Tier 2: Doubtful Loans (accrual status) = Unidentified estimated uncollectables  
of loans estimated at 3% of current loans outstanding (excluding NIBL) as of June 1997

= 2% (2,880.8 - 75.9) Tk 84.2 million

Total Estimated Satisfactory Loan Loss Reserve Tk 226.7 million

Actual LLR as of June 1997 from the RCP & RDP Balance Sheets:

RCP	207.3 Tk million
RDP	71.1 Tk million
Total Loan Loss Reserve	288.4 Tk million

### **Recommendations: Loan Loss Reserve**

1. Each Branch should be required to 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. Branches will need a quarterly APO to do this.
2. Reserving 2% of disbursements across all branches continues to be a good risk management system at a head-office level. We recommend though that branches contribute an amount that reflects their performance, rather than a flat 2% of disbursements. Some variation of the system we used above (i.e. 100% of NIBL and over 100 weeks past due) is suggested.
3. As BRAC expands the MELA program, provisions for losses should be made. We recommend a loan loss expense of 4% until BRAC has a sufficient track record.
4. BRAC at present does not ever formally write off loans on its balance sheet, and we recommend that it change this practice. As the portfolio continues to grow in size, this practice will create a very large loan loss reserve. Current model projections show a loan loss reserve in ten years approaching 50% of the total loan portfolio. This is not practical and creates many misperceptions. We recommend that any loan that is over three years past due should be formally written off the balance sheet. BRAC should continue efforts to collect these loans should this be possible, and any income should be shown as a recovery, but these loans should not be carried on the balance sheet.

### **2.6 Review trends in portfolio composition relative to model branch**

BRAC built its model on the following assumptions that we believe to be reasonable:

- new members in BRAC will grow until the 330 branches as per the RDP proposal have reached their capacity (i.e. around 6,000 members per branch)
- members' income will gradually improve
- repeat loans will be requested by members as they develop their enterprises
- larger loans will be requested by repeat borrowers
- savings deposited by members will increase over the years

Because BRAC never factored inflation (currently at 5% per year but was higher previously) into its model and internal targets, the targets for loan size disbursed are often

smaller than the actual absolute values achieved. However, the real increase (i.e. once inflation is discounted) is often less than the original target set.

**Membership.** BRAC will exceed its target of 1.8 million by December 1997. By September 1997, the total number of members was already close to 1.9 million. There has been a 28% increase in the number of members over the first three quarters of this year (1997). Per branch membership is above BRAC's original model branch plan in every branch year, but more or less in line with BRAC's internal projections, except for years 7, 9, 10, and 12 which each have an average of 1,000 more members than planned.

While we have not seen a decrease in portfolio quality associated with this increase membership (except a slight decrease) in very old branches, we have also not seen older branches bring in the additional savings and interest income to their full potential.

BRAC should be aware of the trade-offs involved in greater coverage of poor people through the existing branch network. Generally, we believe that BRAC's entrepreneurial approach to expanding its market coverage and meeting the credit needs of poor borrowers (e.g. through opening sub-offices) is a positive strategy. The branch managers, who already have a full work load should get the additional support they require from regional managers as the expansion of their portfolio materializes.

**Loans.** Apart from Year 1 branches which were below target, the number of loans per branch increased substantially above BRAC's original targets and more or less in line with internal targets. This is not surprising given the increase in average membership across branches as discussed above. What is surprising is the number of loans did not increase more in Year 9 - 12 branches in line with their rise in membership.

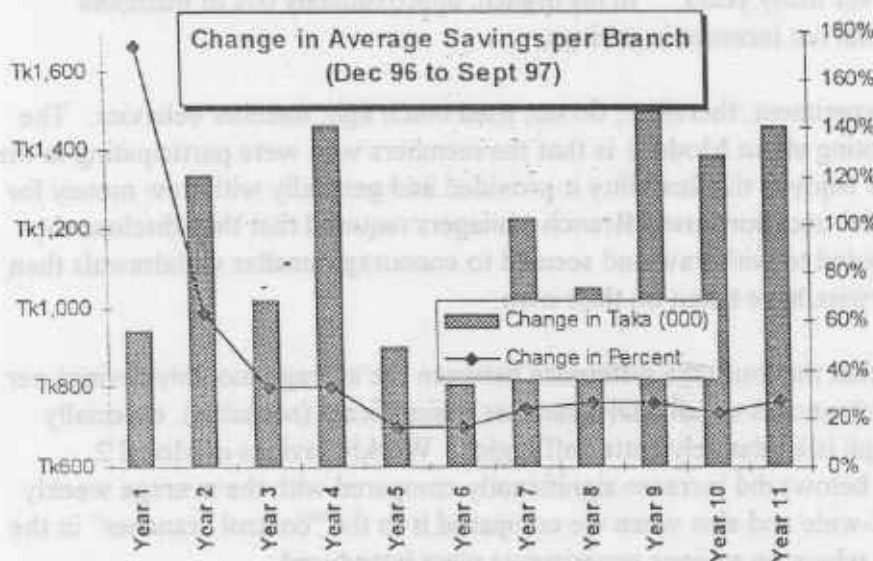
**Disbursements and Outstandings.** The term mix is 99% one-year loans, which means that loans do not build up on the books. On average, loans outstanding were above the original budget and internal targets in branches younger than 4 years (excluding Year 1 branches), and behind budget and internal targets in all the older branches. This is because percent of borrowing members declined. This may be due to a higher number of inactive members in older branches. Still, we would have expected the sharp rise in the number of new members in older branches to have put some upward pressure on outstandings, despite their relatively low first loan size. This was not the case. Overall, the internal targets for the number of loans has not been reached although taka disbursed is above target. This means that BRAC is overestimating the number of loans and underestimating average loan size.

**Branch Operating Costs.** Over the past year costs appear much more in line with targets than prior to 1996 where most branches were substantially overspent. Most branch-years are close to or under the RCP model, with the exception of Year 10 and Year 12 branches. Newer branches are generally more efficient than older ones.



### 3. Management and Analysis of Savings Activities

#### 3.1 Savings Program Summary Performance



There was strong growth in the savings program between June 1996 and June 1997. Not only did average weekly savings per member increase by 20% (Tk 3.9/ week to Tk 4.9/week) but total savings increased by 30% from Tk 1,080 to Tk 1,430 million.

#### 3.2 Review the development of the different pilot savings plans

At the end of July 1996, BRAC began experimenting with two different savings schemes to test member response to more flexible savings products. The schemes, known as Model 1 and Model 2, were each introduced in three branches in the Norshingdi Region. Both schemes pay interest on savings at the same rate as weekly savings in all BRAC branches (i.e. 6%). Members in most of the branches in Norshingdi have a higher average monthly income than the average BRAC branch. We would thus expect weekly savings to be above average in these branches.

Model 1 is the more restrictive model of the two. The model allows members to deposit additional savings *and* to withdraw those savings twice a year, as long as 25% of total savings remained in their account. The withdrawal is treated as an interest-free loan and members are expected to begin repaying it the following week in addition to their usual weekly loan repayments and savings deposits. BRAC only begins to pay interest on savings once the entire "loan amount" is repaid.

The head-office rule was that anyone who wished to partake in the Model 1 scheme could do so, as long as they continued to deposit the required minimum at weekly meetings. The intention was to see the impact on net savings (i.e. would withdrawals increase dramatically with this "new freedom" or not?).

The branch manager we visited introduced his own rules that allow only members who commit to deposit a substantial amount on a regular basis to join the Model 1 scheme. He did this with a sustainability focus to protect the savings base of the branch. It is likely that other branch managers in the other two Model 1 experiments are doing the same thing in an effort to prevent members from withdrawing their weekly savings that they have accumulated over many years.<sup>11</sup> In his branch, approximately 6% of members accounted for the total net increase in savings.

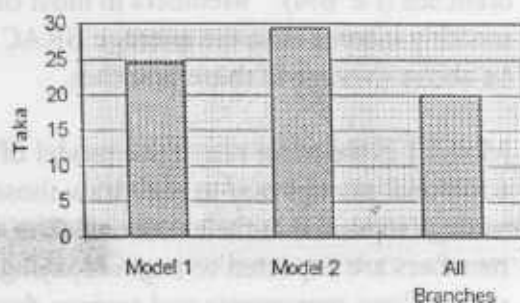
The results of the experiment, therefore, do not shed much light member behavior. The main point worth noting about Model 1 is that the members who were participating in the Model 1 experiment enjoyed the flexibility it provided and generally withdrew money for emergency or "special occasion" use. Branch managers required that they disclose the reason why they needed to withdraw and seemed to encourage smaller withdrawals than members may otherwise have taken on their own.

We do not believe that the four taka difference between the average monthly savings per member in Model 1 branches vs. all RDP branches is significant (see table), especially given that Norshingdi is a relatively better off region. Weekly savings in Model 2 branches (see table below) did increase significantly compared with the average weekly savings rate BRAC-wide and also when we compared it to the "control branches" in the Norshingdi Region where no savings experiments were introduced.

Model 2 was introduced in three younger branches (around 4 - 5 years old) and is the more flexible scheme of the two. Withdrawals are regarded as a separate activity from credit and are unrestricted. Members only need to ensure that they have the minimum required deposit to take out a loan (i.e. 5% of loan size for a second loan and 10% for a third).

The average withdrawal size and deposit size for Model 2 are substantially larger than Model 1. Yet, when ratio of total withdrawals / total deposits rate are considered for both pilots, the withdrawals represents only 31% of the total amount deposited in Model 1 compared with 58% in model two. Net savings for Model 2 is thus significantly higher, despite the fact that members have far more freedom to withdraw funds. This is, perhaps, the most significant finding of the experiment -- *in Model 2 branches, members with freedom to deposit and withdraw at whim are choosing, on average, to save more.*

Average Weekly Savings Per Member: June 1996 - June 1997



### 3.3 Review the recent changes in, and effects of, the new savings policy

Towards the end of 1996, BRAC showed a renewed interest in mobilizing savings. In the past, RDP prioritized weekly savings by members because it encouraged borrower discipline, provided poor people with security for times of emergency and with an "old age funding source," and provided BRAC with a version of "collateral" for lending. BRAC is very aware that mobilization of both weekly and current account savings is critical if wants to be operationally sustainable and financially self sufficient. Presently, most branches are able to finance only 40% of their funding needs from savings.

Now, BRAC intends to mobilize a far greater amount of savings to support growth because it is a less costly source of funds for RDP than borrowing. Savings matter because members want a safe place where they can hold their money and have access to it. Savings also matter because they increase branch sustainability and free up more funds to do other non-income generating activities. Many BRAC members have also expressed a desire to earn interest on their savings. One result of BRAC's focus on savings was a new flexible savings product - Current Savings Account - which was introduced at the branch level in January 1997.

#### RCP and RDP Savings Performance

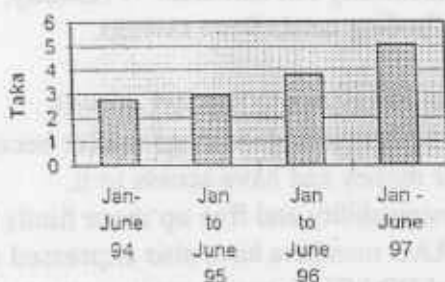
(Taka Million)	June 96 - June 97	June 95 - June 96	June 94- June 95
Compulsory Savings	277	176	107
Members Own Savings	383	247	135
Total New Savings	660	423	242
Transfer of GTF into Members Savings	25	23	0
Members Own Savings excluding GTF	358	224	135
Average Number of Members	1,538,878	1,264,484	941,543
Average Wkly Svgs/Member GTF	4.96	3.91	N/A
Average Wkly Svgs/Member GTF	4.63	3.12	2.86

**Weekly/Bi-Weekly Savings.**<sup>12</sup> Members are expect to contribute an average of Tk5 per week (or Tk20 per month). In the past, contributions over Tk5 were gladly accepted but were not actively encouraged.<sup>13</sup> Over the past year (i.e. between June 1996 and June 1997) the average weekly savings of members increased 28%. This increase is significant, and continues a four year trend. This is the first year that BRAC has achieved its target of Tk 5 savings per week per member.

A visit to eight BRAC branches this month and four last month reveal a wide variation in savings volume across branches. Generally speaking, the branches that had good loan and service charge repayment rates also had a higher average savings rate per member, and visa versa. This is mainly a function of two factors: group discipline and the relative economic "prosperity" of members. Branch staff told us that there is still a large pool of untapped money in the VOs. The challenge for BRAC is to design instruments that draw in this pool of money.

We continue to believe that members should be encouraged to increase savings deposits at weekly meetings. BRAC's experience shows that member discipline is highly correlated with the number of members who choose to save. We think that an average of Tk 5 per member per week (or Tk 10 every two weeks) is a reasonable minimum requirement. However, we have reservations that BRAC should place the same stringent withdrawal rules on any amount that is deposited over and above Tk 5.

Average Weekly Savings Per Member



**Withdrawal of Weekly Savings.** In previous years, most VO members we spoke to liked the idea of a weekly savings requirement because it provided them with a source of security for when they aged. Most did not seem anxious to withdraw their savings. The official policy of BRAC *does* allow members to unconditionally withdraw 25% of their weekly savings after 5 years, and 50% of their savings after 10 years, and 75% of their savings after 15 years and 100% of

their savings after 20 years. The assumption was that after 20 years, the VO member would be old and would need the funds at that stage.

Branch managers, however, make their own rules (with tacit approval from head-office). Most of the branch managers in the 8 branches we visited only let members withdraw their weekly savings in special / emergency circumstances. As there is very scant information on BRAC's members' preferences, and we know that BRAC's sustainability will definitely be enhanced by access to member savings, we suggest leaving the discontinuity between policy and practice in place until further information is available.<sup>14</sup>

**Beyond Weekly Saving.** BRAC's current account or flexible savings product is a totally different instrument from weekly savings. All transactions happen at the branch (vs. the VO meeting) and members can deposit and withdraw any number of times. The original policy stated that members must deposit a minimum of Tk 50 and withdraw a minimum of Tk 50 during any one transaction. Practice at the branches, however, varies widely. No interest is paid on the current account product (vs. 6% on weekly savings).

Current Account Indicators

Jan - June 1997	
# branches	160
# accounts	5491
avg. deposit size	190
avg. withdrawal	673
total deposits	4,741,097
<u>total withdrawals</u>	<u>3,695,982</u>
<u>total net deposits</u>	<u>1,045,115</u>

The current account savings product was introduced in January 1997. Performance to date is reflected in the adjacent table.

Our research and interviews in the branches revealed that the number of current account holders and their average balances varies widely among branches and within branches. For example, three of the branches we visited had less than half the average number of current accounts opened (i.e. 35 - 40 current accounts) and average net current account savings among these member (Tk 375 / member) was far

lower than the average net savings of Tk 653 when the total of 160 branches are considered. Again, variability between members' (and branches) prosperity as well as motivation by branch staff are two of the main factors that seem to impact on the numbers. Most head-office and branch staff felt that current account deposits rose more in recent months and that the momentum to deposit more was increasing.

While the current account product is certainly a move in the right direction, it is worth pointing out some difficulties that it may face:

- Members will not automatically be aware of its advantages (i.e. safekeeping, liquidity and easy access). This means branch staff will have to be highly informed of its "selling points" when they try to increase deposits.
- Empowered and more educated members will demand interest, especially if they leave their funds in BRAC's hands for a long period of time. BRAC needs to work out a pricing system that meets members' expectations as well as its own funding needs.
- Members who live far away from the branch (2km or more) may not like the inconvenience of not being able to deposit at VO meetings. Here, we suggest that BRAC accepts small current account deposits at weekly or bi-weekly VO meetings, and large deposits at the branch. In future, BRAC may decide to employ a special savings PA to collect savings from the homes of members who wish to deposit on a daily basis.
- Finally, with respect to the existing current account policy, we also do not think the restriction of a minimum deposit or withdrawal of Tk 50 is customer-oriented or in BRAC's interests. We do appreciate that other ways to cover transaction costs need to be devised (e.g. collecting smaller deposits at VO meetings).

As no clear understanding of the savings preferences of BRAC borrowers exists, it is difficult to suggest a set of savings products. We believe that significant savings behavior research must be done. When pilots are introduced, we believe that BRAC should monitor and record all impacts of the new products on net savings, disbursements, outstandings and average loan size so that it can better forecast its cash flow needs and tailor its products and services to meet its dual goals of customer responsiveness and internal funding requirements.

Despite the lack of data on savings, we feel comfortable suggesting the following, i.e.:

- BRAC should retain a weekly savings requirement, both for member discipline, collateral, as well as for "old age" security for members.
- Members should be given a choice as to where and how they would like to deposit any amount over the required weekly or bi-weekly minimum.
- BRAC should develop a range of savings products with different structures, pricing and maturities.
- Interest should only be paid on deposits that are, on average, above a certain minimum, and remain in BRAC for a certain length of time. There may initially be two additional products to the weekly savings and current account products that pay members interest if they leave a required minimum of savings in BRAC for 6 months.

or more. For example, a 1 year deposit would earn higher interest for the member than a 6 month deposit.

**Recommendations: Savings** BRAC's understanding of the importance of developing its savings products to serve its own funding needs and to be responsive to members is encouraging. The challenge is to design (and market) instruments that tap the savings market. We suggest the following:

1. Any new savings products that are introduced are grounded in data collected from pilot projects and from an in-depth study of customer preferences.
2. Branch managers are forced to allow members to withdraw freely within the policy guidelines suggested.
3. A range of products with different pricing and maturities should be introduced. Interest should be paid on all deposits over a certain minimum amount which are kept at the branch for longer than six months.
4. Any savings product introduced should incorporate the following features: (a) a convenient location (the VO meeting for small deposits and BRAC branch office for larger deposits); (b) Liquidity: When borrowers come to withdraw, they want their cash immediately; (c) Safekeeping: BRAC must demonstrate that it is a safe place; and (d) A return to the depositor. The depositor should get a positive real return.<sup>15</sup>
5. BRAC should devise a system based on data analysis of savings patterns to forecast its funding needs and the need for liquidity at the branch level.<sup>16</sup> In terms of data collection, we also think it is useful for all branches and head office to track the following on a monthly basis:

Questions that shed light on development impact and sustainability that branch managers should be asking themselves regularly and reporting on to senior management include:

Question	Indicator
Is BRAC reaching the poor?	% active members saving under Tk 2 a week
Is total savings growing?	total savings / total portfolio outstanding
What is the branch's cost of funds?	$[(\text{head-office loan} \times 9\%) + (\text{member savings} \times 6\%) + (\text{current account savings} \times 0\%)]$
Is savings as a funding source growing?	cost of funds (i.e. the above formula) / TPO

### 3.4 Refund of Group Trust Fund

At the end of 1996, BRAC undertook to transfer the outstanding 50% of GTF (Group Trust Funds and Insurance) to members. During 1996, only 25% of this amount was returned, mainly because branches were heavily involved in learning how to work with the new MIS system. BRAC intends to return the total outstanding balance to members savings accounts (if members so choose) in the first quarter of 1998. We recommend that BRAC reports on GTF refunds at the donor meeting in May 1998.

## 4. BRAC Membership Status, Issues and Trends

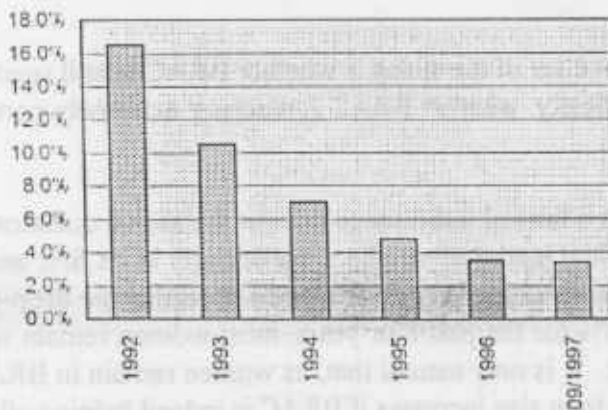
### 4.1. Review the latest trends in the rate of discontinued members and assess the financial implications

**RDP and RCP Membership  
Rate of New Membership and Dropout Membership**

Year	Beginning Members	New Members	Dropout Members	Ending Members	Average Members	% Growth in Avg. Members
1992	598,125	153,963	102,814	649,274	623,700	N/A
1993	667,598	236,917	78,725	825,790	746,694	20%
1994	825,790	275,876	65,412	1,036,254	931,022	25%
1995	1,036,256	226,374	53,721	1,208,909	1,122,583	21%
1996	1,281,418	207,732	47,802	1,441,348	1,361,383	21%
9/97	1,608,974	337,414	58,614	1,887,774	1,748,374	28%

Over the past four years, the rate of dropout members has declined from 16% of average membership in 1992 to under 4% of average membership in both 1996 and 1997. This is due to both stronger member discipline being encouraged by staff, and more responsive following-up of over due loans. It is also an indication of greater member satisfaction with the services that RDP offers members. We expect the rate to stay at around this level.

**Dropout Rate**



If BRAC continues with its plan to introduce flexible savings products while still holding back a minimum weekly savings requirement, it is possible that this rate may even decline further as borrowers who may have left because of the lack of access to their savings may now be encouraged to stay.

When members leave BRAC, there are three potential impacts: (a) the number of loans disbursed falls,

thus reducing interest income, (b) the average loan size falls since first-time borrowers are brought in to replace them, and (c) members withdraw their accumulated weekly and compulsory savings, less any unpaid loans.

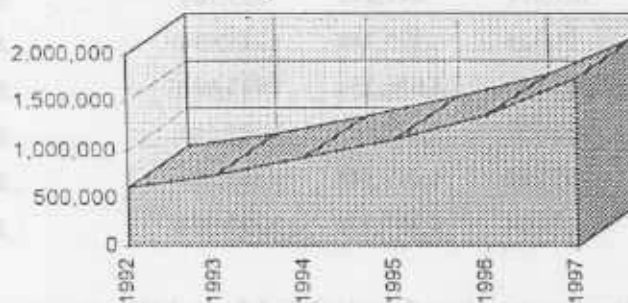
Conceivably, losing long-term members could be a financial drain on BRAC. In practice, comparatively small amounts of savings are refunded as inactive members are not removed from BRAC books till the loan is repaid. Effectively, this means that their accumulated

savings remain as "collateral" with BRAC until they have repaid the outstanding past due. Dropout members are quickly replaced by motivated active members who are keen to save and take out loans, thus minimizing the financial impact of members leaving.

In the light of total size of BRAC membership, this level of dropouts has not created significant negative financial impact. Based on these results, we do not foresee any long-term financial problems stemming from member dropouts so long as the current rate of 4% - 5% dropouts persists.

We do think, however, that like any other organization that experiences rapid expansion, there will be growth pains. RDP has grown its membership by 200% between 1992 and

**Growth in RDP Members**



1997. A highly centralized operation becomes far more difficult with an organization of this size. The challenge for BRAC managers will be to decentralize its operations whilst maintaining the quality of its RDP operations. Investing skills and resources in BRAC's employees and increasing the ability of branch and regional managers to take responsibility for the sustainability

and product quality of their operations is increasing important as BRAC grows.

#### **4.2 Review the size of loans, the type of borrower, average savings, and average loan size trends.**

##### Major Points in Brief

- 1 The main issue raised by the above set of questions is whether BRAC is still reaching its target group, and more specifically, whether BRAC is reaching extremely poor members within its target group.
- 2 Even though average loan size is a limited indicator to answer the above question, on balance, we feel that BRAC's initial intake of members, particularly in its first and second year branches, is certainly reaching very poor women. Because the drop-out rate has been between 3% and 5% for the past four years, most women remain with the branch they joined as it ages. It is only natural that, as women remain in BRAC and branches become older, the loan size increases if BRAC is indeed helping alleviate poverty for these women who can now afford larger loans.
- 3 In addition to the poverty alleviation program of RDP, there are at least three other significant structural factors that would naturally put upward pressure on average loan size, namely: (a) the rate of inflation, (b) BRAC's change in policy where members now receive one larger loan vs. two smaller loans; and (c) a slight increase in the loan



ceiling for a small percentage of VO members who have been able to break-out of the "survival" mode of living. Another more negative reason which would raise the average loan size is if existing, "better-off" VOs preferred to keep their size smaller (i.e. by not admitting new members who, by definition, would have no track record). This is happening in a small number of VOs and BRAC senior management has directed branches to increase their average VO membership size to 45 members where this is the case. Overall, though, new membership as a percentage of existing membership will be higher by December 1997 at around 28% than the previous two years which both registered a 20% increase in new members.

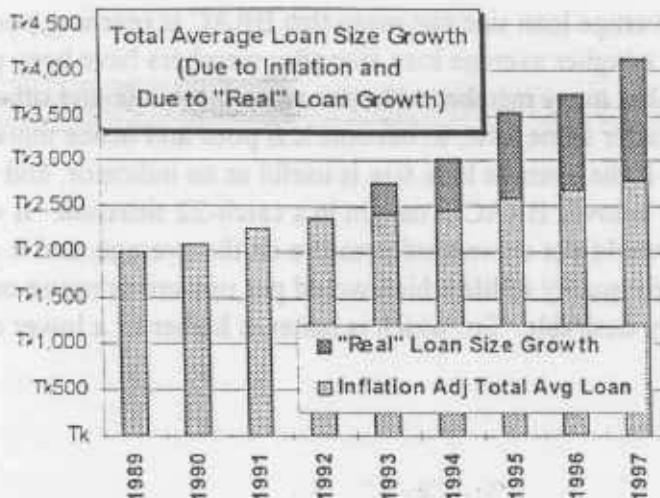
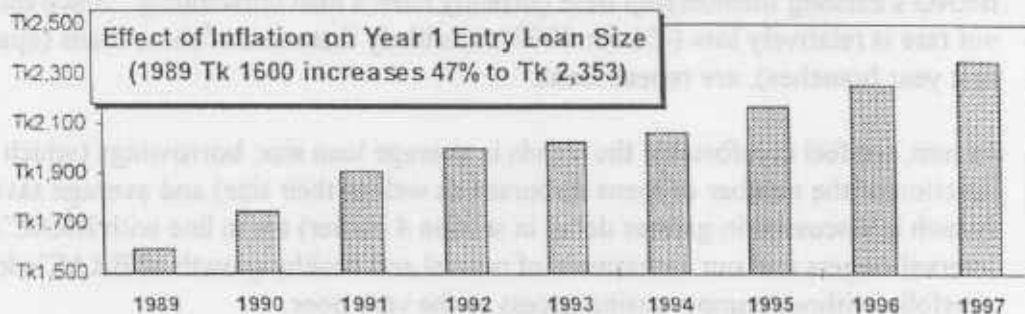
4. Despite the fact that BRAC is reaching the very poor, BRAC's Monitoring Division sample survey revealed that around 40% of members in thanas where RDP is operating are not being served. One monitoring manager estimated conservatively that around 15% of these "potential members" do not want loans, perhaps because they are too poor. These members are often located more than 15 km from the nearest VO meeting location. It is for this reason that BRAC is introducing sub-offices (under existing branch managers in some locations) to increase its coverage of the remaining 25% of very poor households that fall within its target group.
5. Information of the exact number of repeat loans is not available. Our interviews with head-office staff, which were confirmed in the field, reveal that most members take repeat loans each year. In the year 5 and year 11 branches we visited, for example, most members had taken around 4 loans, and 8 -10 loans respectively. Over 85% of BRAC's existing membership base currently have a loan outstanding. Since the drop-out rate is relatively low (4% for 1997), it is likely that most of these loans (apart from first year branches), are repeat loans.
6. In sum, we feel comfortable the trends in average loan size, borrowings (which is a function of the number of loans disbursed as well as their size) and average savings (which is discussed in greater detail in section 4 earlier) are in line with BRAC's internal targets and our assessment of normal and healthy growth of BRAC's loan portfolio without compromising access to the very poor.

**Detailed Analysis** A lower average loan size can mean that BRAC is reaching poorer members. On the other hand, a higher average loan size after members have been part of RDP for some time can mean that many members who are receiving credit and other services from BRAC are able, after some time, to become less poor and hence more able to take out larger loans. Even if the average loan size is useful as an indicator, and we have some doubt that it is (see below), BRAC is caught in a catch-22 situation. It wants to reach the very poor which would put downward pressure on the average, and it also wants members to improve their quality of life which would put upward pressure on the average. Both goals are clearly desirable. So, which is better, a higher or a lower average loan size?

The average loan size (even by branch age) is a very limited indicator and hence does not shed much light on the above-referenced question. Loan sizes vary substantially between members, even in the same year branch. We feel that a distribution of the size of loan disbursed in each branch cohort, or even better, among members in each branch, will provide far more insight into this question. The median loan size in each branch would also help answer this question.

For our analysis we used the average size of the first loan requested by ex-VGD members as a proxy of what loan size an extremely poor person might request. Since the size of the first loan requested by this "most vulnerable group" is usually between Tk 1,200 and Tk 2,000, and the average loan size in both BRAC's first and second year branches which, by far, absorb the largest percentage of new members, is Tk2,000 and below, we feel that BRAC's is certainly reaching the poor in its in-take of new members. As expected, the average loan size for "new" members in both first and second year branch is far lower than the overall average loan size of Tk 4,100 in BRAC.

An encouraging sign is that for the three sectors of BRAC's portfolio that most very poor (including ex-VGD) women initially go into. Poultry, rural trading (i.e. paddy) and food processing (i.e. rice puffing) have, by far, the largest number of VO members in them. Together these three sectors make up almost 75% of TPO. Thus, conservatively, even if only one third of them are among the poorest percentiles *within* its target group, BRAC would be doing extremely well in reaching marginal and extremely poor members.



Another way to check whether the first loan size granted by BRAC has risen above levels projected in 1989 is to take inflation into account -- any increase over and above the inflation rate means that BRAC is granting larger loans to new members potentially indicating that it is veering away from serving the very poor. Even if there was no increase in the purchasing power of a Tk 1,600

first loan in 1989, an annual 4% inflation rate drives up the size of the loan requested to Tk 2,353 by 1997. Thus we can safely say that there is no real increase in the size of loan requested from 1989 levels in those branches where there is the highest intake of new members.

As the graph on the previous page shows, there has been an increase in the average total loan size beyond inflation, beginning in 1993. There are several reasons for this increase:

First, if BRAC is improving the living standards of poor people, we would expect longer-term members to request larger repeat loans as they become less poor. The drop-out rate in branches has been below 5% over the past four years. Each year, it is likely the stable members will request a loan that is larger than the previous year because inflation adds to the price of their inputs and their previous activities enable them to afford a larger loan.

Second, due to delinquency problems in the past where BRAC gave a single borrower more than one loan, BRAC now prefers to give repeat borrowers who can afford it a larger single loan. Two years ago a fourth year VO member would have received one loan of Tk 5,000 and another for Tk 3,000 making the average loan size Tk 4,000. Today the same branch manager will now disburse a single Tk 6,500 loan, thus pushing the loan size average up. Only 10%- 15% of borrowers now have two loans -- less than half the amount of previous years.

Third, BRAC has raised the loan ceiling to Tk 12,000 so as not to stifle the income growth of VO members who have managed to partially break out of the poverty cycle. In addition, a 20% increase in loan size each year over and above Tk 12,000 is also allowed without head-office approval. Finally, if a borrower has a good credit history, she may take an even larger loan if she has a weekly savings deposit of at least 50% of the loan amount requested. Even though relatively few borrowers are in the Tk 10,000+ loan size category, this would put substantial upward pressure on the average loan size.

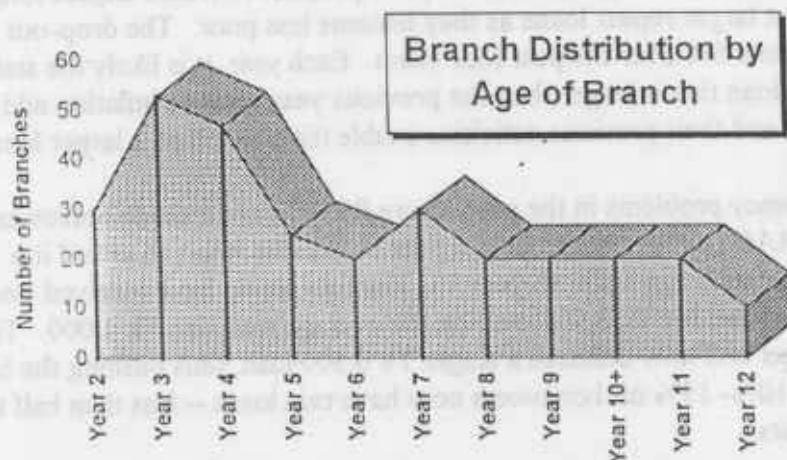
We believe that, in its efforts to be sustainable by the Year 2000, BRAC has not diverted from its objective of serving the very poor. This is evident in the low average loan sizes in its Year 1 & 2 branches. We suggest that BRAC track the first loan size of all new borrowers in all branches, including those who replace drop-outs. BRAC should be trying to mainly target very poor households who would take a first loan out of below Tk2,500.



## 5. Branch Profitability and RDP Financial Sustainability Analysis

### 5.1 Review BRAC's sustainability plan and associated issues

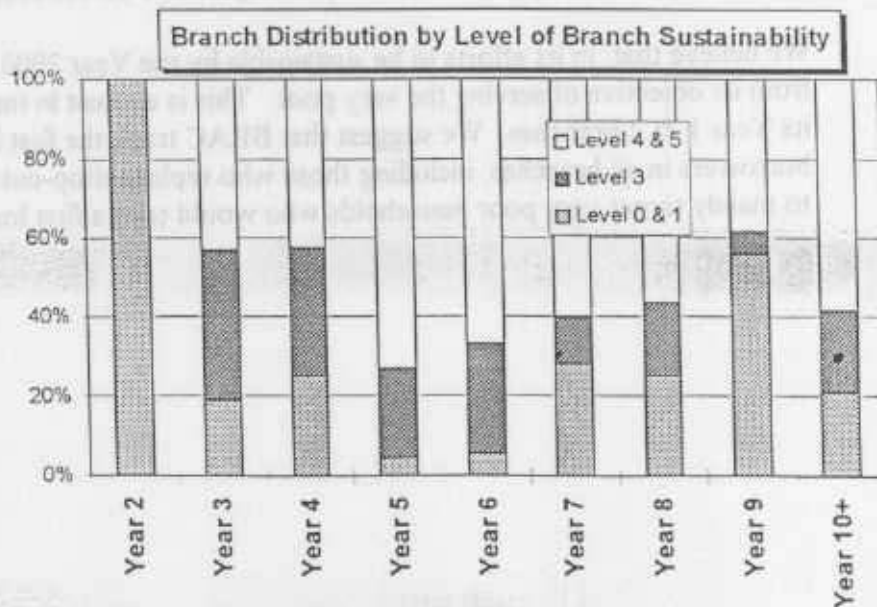
In summary, BRAC is making good progress towards sustainability and is meeting its target levels. To help manage this process, BRAC has developed a five level system which rates each branch with respect to its level of self-sustainability. The system begins



at Levels 1 and 2 to levy variable costs against branch income and progressively moves up to level 5 which levies all variable, fixed and HO allocated costs to the branch. (Level 0 is the level before a branch can cover the main operating costs of its credit program).

The first place to begin an analysis of branch sustainability is to examine the distribution of branches by age. As the graph above illustrates, BRAC branch ages are distributed unevenly across the various cohorts. The largest single grouping is in the three and four year old branches, with a slight bump in Year 7. The reason that branch age is important is because some key sustainability variables are associated with branch age such as average loan size, interest income, accumulated savings, and number of members.

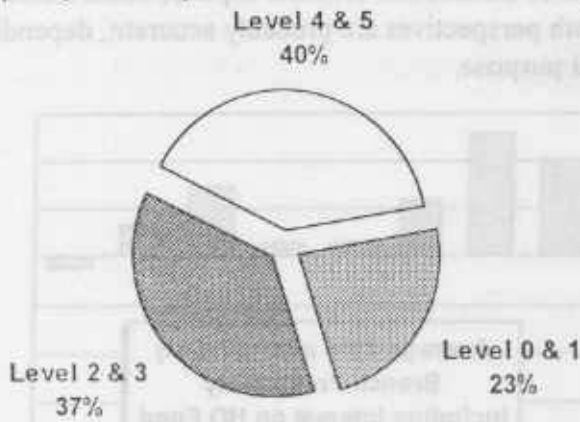
The next step is to examine how the branches have achieved different sustainability levels. The chart to the right illustrates what one might expect, that younger branches are not as self-sustaining as older branches. Year 2 branches are only self-sustaining at the lower, "Level 0



and Level 1" levels because of fewer loans, lower average loan size, less interest income, as well as less accumulated savings. In contrast, the Year 10+ branches are almost 60% self-sustaining at the higher "Level 4 and Level 5" categories. Please note that BRAC sustainability ratings include a branch interest expense of 9% for the HO loan funds.

What is curious is the relatively higher level of sustainability in the year 5,6,7 and 8 Year branches, at an earlier point than one might expect. One possible explanation is that member discipline wears thin as branches age, impacting both on the level of savings accumulated as well as the loan delinquency rate. This lack of discipline thus reduces interest income, number of loans disbursed, and loan losses.

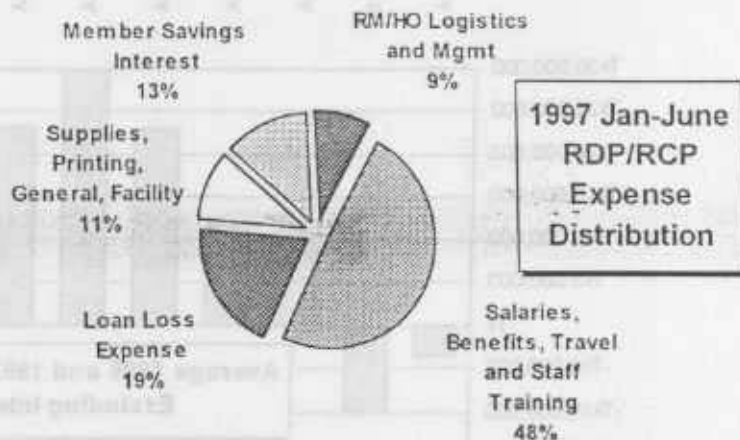
There are many variables that contribute to self-sustainability and to do these complex variables justice is beyond this brief review. The contributing factors are many: total size and cost structure, economic strength of the region, savings level, savings vs. loan levels, quality of loan portfolio, level of non-revenue producing activities, and so forth.



While it is less clear what are the specific factors that cause one branch to be less sustainable than another (beyond age in general), the pie chart to the left clearly illustrates that almost 40% of RDP + RCP branches over two years old have reached Level 4 or Level 5 sustainability. Assuming a continuation of the current progression of branches through the levels of sustainability as they become more mature, this is a positive sign for increased overall RDP sustainability.

### Branch Cost Structure and Profitability

As is normal for a staff intensive economic and community development institution such as BRAC, the RDP/RCP cost structure is largely fixed in nature. While there are some costs that vary over time and with different levels of activity, most expenses are not easily variable. The largest single expense (staff and related) constitutes 48% of the total budget<sup>17</sup>.

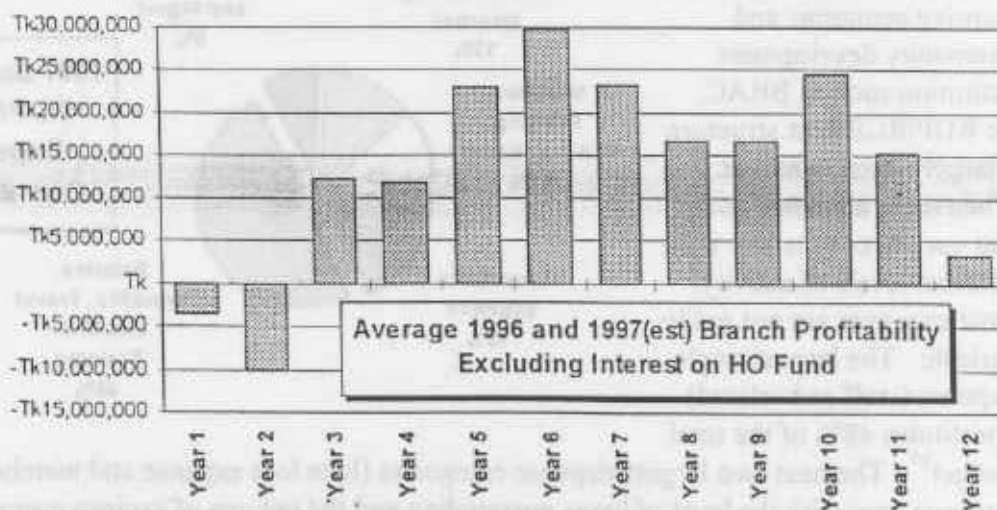
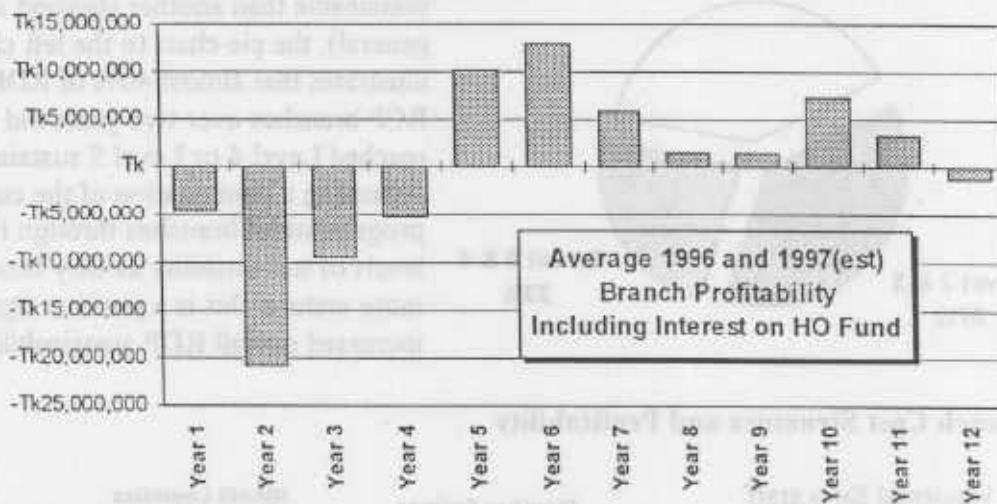


The next two largest expense categories (loan loss expense and member savings interest) vary with the level of loans outstanding and the volume of savings accumulated.

This expense structure changes as branches mature. In Year 1, for instance, salaries constitute 54% of total expenses, but in Year 12 that drops to 43%. As branches mature, they see an increased percent of their budget absorbed by savings and loan loss expense, and a smaller percentage of expenses for staff and overhead.

### Two Views of Branch Profitability

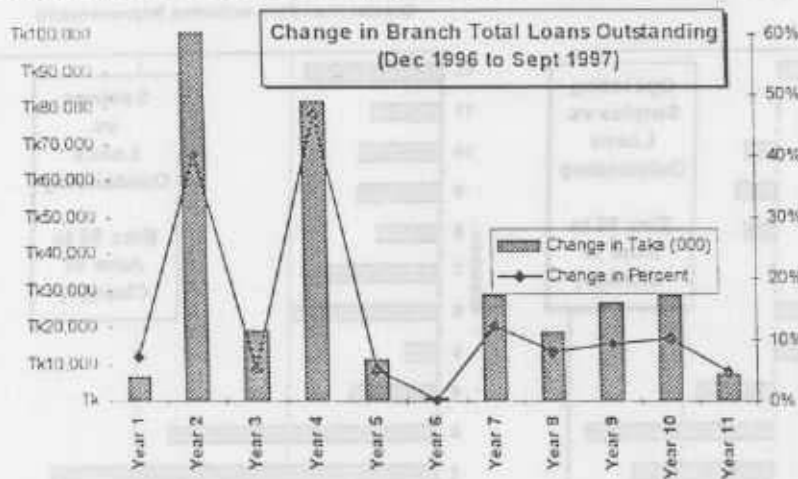
A major internal expense that is allocated to the branches from the head office is a 9% loan fund interest expense. The two graphs below illustrate branch profitability with and without that allocation. From one perspective, this should be an allocated expense that is factored into a sustainability and profitability analysis, for the branches should not treat their loan funds as having zero cost (especially with an eye towards a future BRAC bank and BRAC sustainability concerns). Another perspective would suggest that this expense is, in fact, not a real expense for BRAC or the branches, for BRAC has no external interest payments for these specific loan funds, and to include this artificial expense understates branch profitability and sustainability. Both perspectives are probably accurate, depending on the management context and analytical purpose.



## 5.2 Review branchwise financial performance and indicators

BRAC reports several key performance ratios for each branch. At present, these measures are used primarily by head office and regional managers. BRAC is working to make managers in the field more aware of their importance. We believe it will take significantly more training and management attention to change the branch management culture to one more focused on branch sustainability and productivity.

The reason to use ratio analysis is the ease it offers in comparing performance across branches and over time. Ratios allow comparisons while taking out some of the bias created by wide size variations between individual branches. This information can be used to conduct "peer" comparisons between branches or to consistently measure performance to agreed upon targets. The following is a discussion of each ratio, with commentary on December 1996 to June 1997 performance.<sup>18</sup>



**Summary and System-wide Branch Averages.** BRAC's five management ratios tell us that Year 6 to 12 Branches did not change significantly from December 1996 to September 1997 on any measure, with the possible exception of savings to loans outstanding, which did

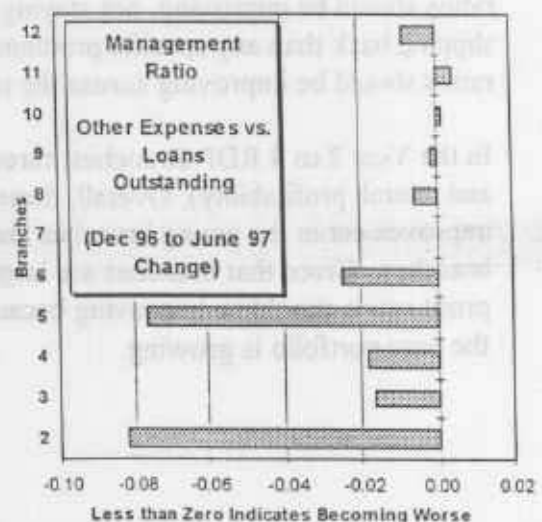
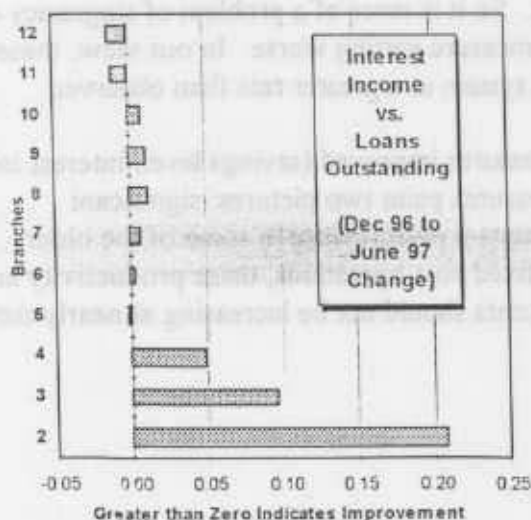
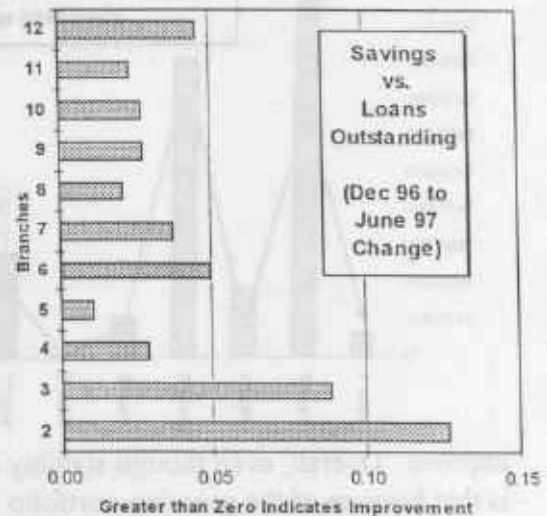
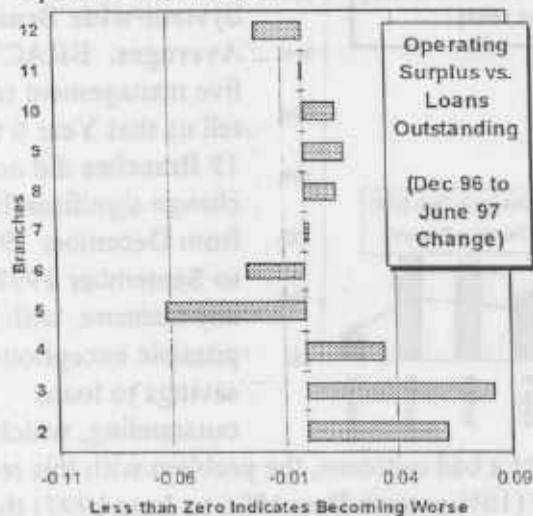
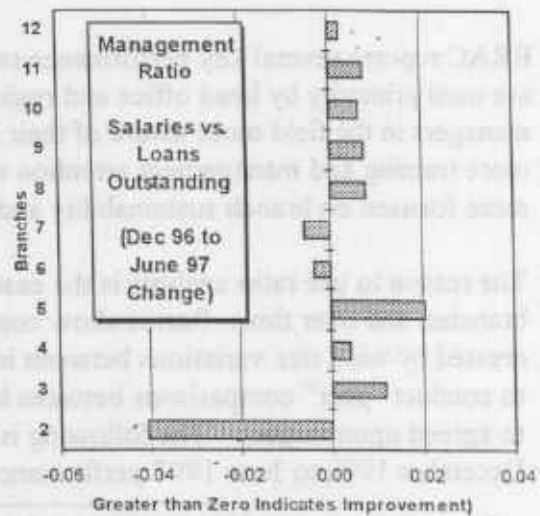
improve. Overall, even though stability is not a bad outcome, the problem with this result is that because of the growing portfolio size (16% growth Dec. 1996 to June 1997) these ratios should be improving, not staying flat. So it is more of a problem of stagnancy or slipping back than any specific problem or measure getting worse. In our view, these ratios should be improving across the total system at a greater rate than observed.

In the Year 2 to 4 RDP Branches, three measures improved (savings level, interest income and overall profitability). Overall, these measures paint two pictures: significant improvement in the young branches and stagnant performance in some of the older branches. Given that branches are largely fixed cost operations, these productivity and profit ratios should be improving because costs should not be increasing at nearly the rate the base portfolio is growing.

## Five Key BRAC Management Ratios

These graphs show how key BRAC ratios have either improved or become worse from December 1996 to June 1997 ratios.

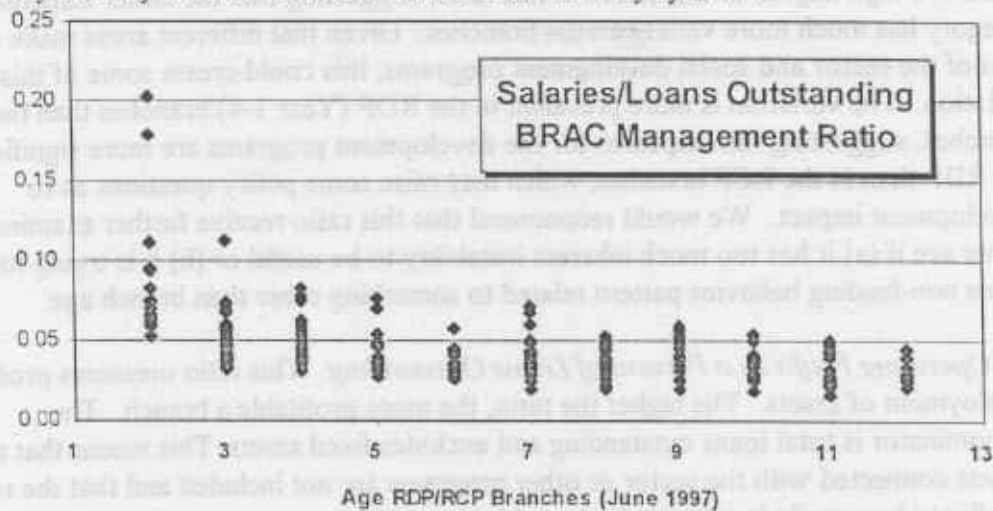
1. No big problems but no improvement in Year 6-12 branches which is a serious concern.
2. Younger branches seeing strong improvement, as expected.
3. Other Expenses getting worse.
4. Savings looking good on average.
5. Need to look beyond average to branch specific information.





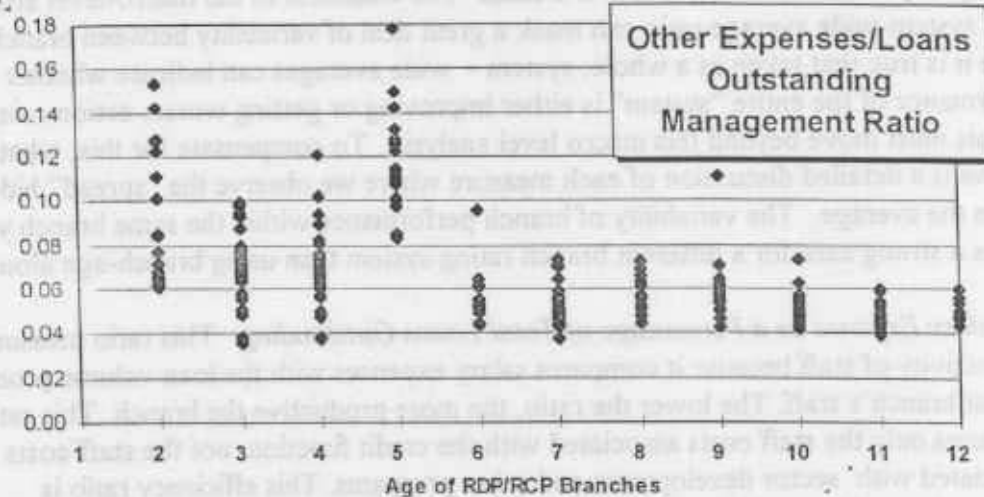
**Management Ratios: Branch Level Detail.** The weakness of the macro-level analysis is that a system-wide average ratio can mask a great deal of variability between branches. While it is true that taken as a whole, system - wide averages can indicate whether the performance of the entire "system" is either improving or getting worse, action oriented analysis must move beyond this macro level analysis. To compensate for this, what follows is a detailed discussion of each measure where we observe the "spread" hidden within the average. The variability of branch performance within the same branch year makes a strong case for a different branch rating system than using branch-age alone.

1. *Salary Expense as a Percentage of Total Loans Outstanding.* This ratio measures the productivity of staff because it compares salary expenses with the loan volume produced by that branch's staff. The lower the ratio, the more productive the branch. This ratio measures only the staff costs associated with the credit function, not the staff costs associated with sector development and other programs. This efficiency ratio is commonly used by credit institutions with branch/delivery systems.



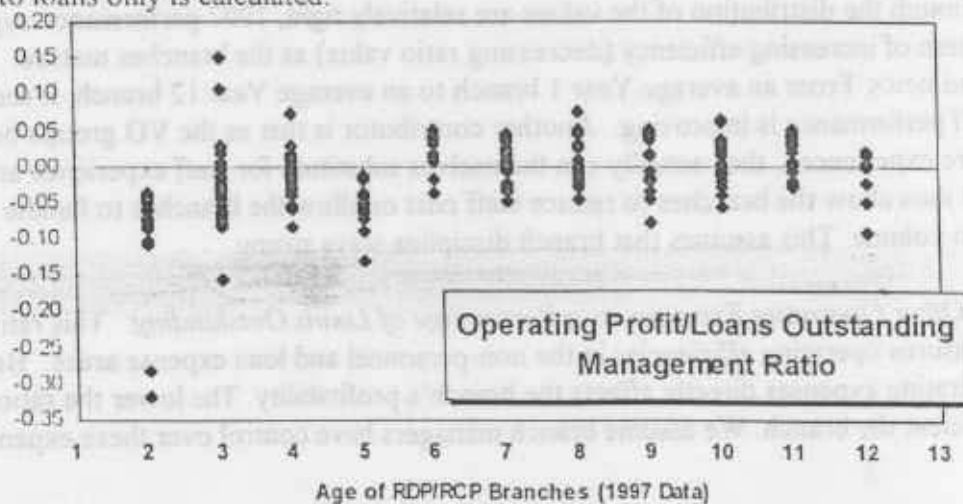
Although the distribution of the values are relatively tight, 1997 performance suggests a pattern of increasing efficiency (decreasing ratio value) as the branches mature. This is good news. From an average Year 1 branch to an average Year 12 branch, it seems that staff performance is improving. Another contributor is that as the VO groups become more experienced, they actually can themselves substitute for staff experience and time, and thus allow the branches to reduce staff cost or allow the branches to handle additional loan volume. This assumes that branch discipline stays strong.

2. *Other Operating Expenses as a Percentage of Loans Outstanding.* This ratio measures operating efficiencies in the non-personnel and loan expense areas. Branch operating expenses directly affects the branch's profitability. The lower the ratio, the more efficient the branch. We assume branch managers have control over these expenditures.



There is a high degree of dispersion in this ratio, suggesting that the Other Expenses category has much more variety across branches. Given that different areas make different uses of the sector and social development programs, this could create some of this variation. The variation is more prevalent in the RDP (Year 1-4) branches than the RCP branches, suggesting that expenses for the development programs are more significant in the RDP than in the RCP branches, which may raise some policy questions as to development impact. We would recommend that this ratio receive further examination to either see if (a) it has too much inherent instability to be useful or (b) it is trying to indicate some non-lending behavior pattern related to something other than branch age.

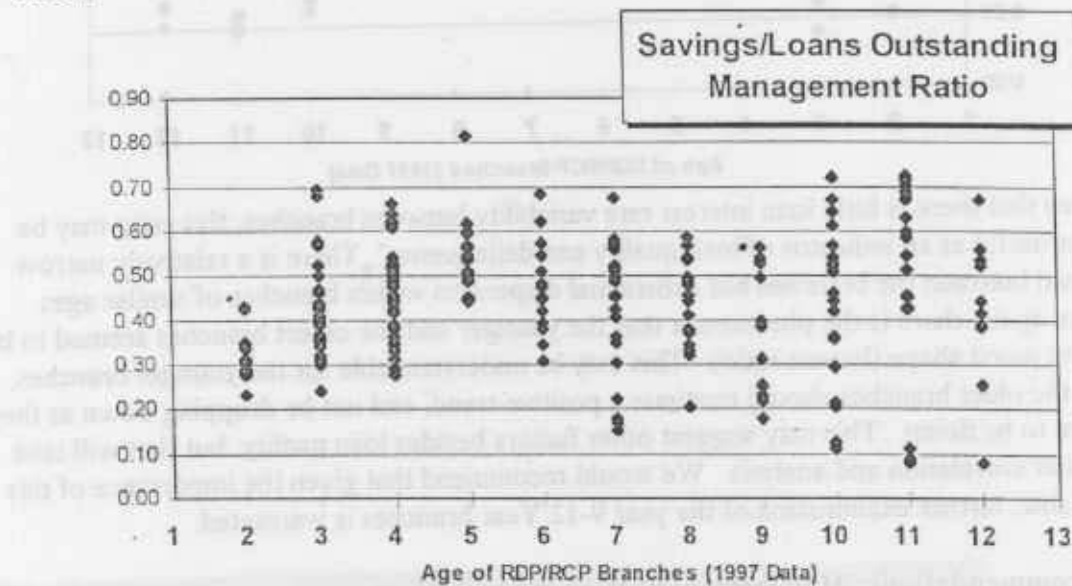
3. *Operating Profit as a Percent of Loans Outstanding.* This ratio measures profitable deployment of assets. The higher the ratio, the more profitable a branch. The denominator is total loans outstanding and excludes fixed assets. This means that the assets connected with the sector or other programs are not included and that the ratio of profits to loans only is calculated.



This ratio does not demonstrate significant variability across the different branch maturities, except that operating profit is lower in the younger branches, which is to be expected. What is a concern is the significant number of mature branches that have a

negative ratio, which would indicate that many of the more experienced branches are: (a) not using the total resources that BRAC has invested in their branches over the years in a way to generate a net surplus at the branch level and (b) not climbing any learning curve. We recommend that this measure be a focus of further research and the branch manager training

4. *Savings as a Percentage of Total Loans Outstanding.* This ratio measures the relationship between member savings to loans outstanding. It shows the ability of the branch to fund loans from its savings fund. Since the cost of member deposits is 3% less than the cost of the loan from HO, member savings allow branches to increase their interest margin and thus increase branch sustainability. The higher the percentage the better.

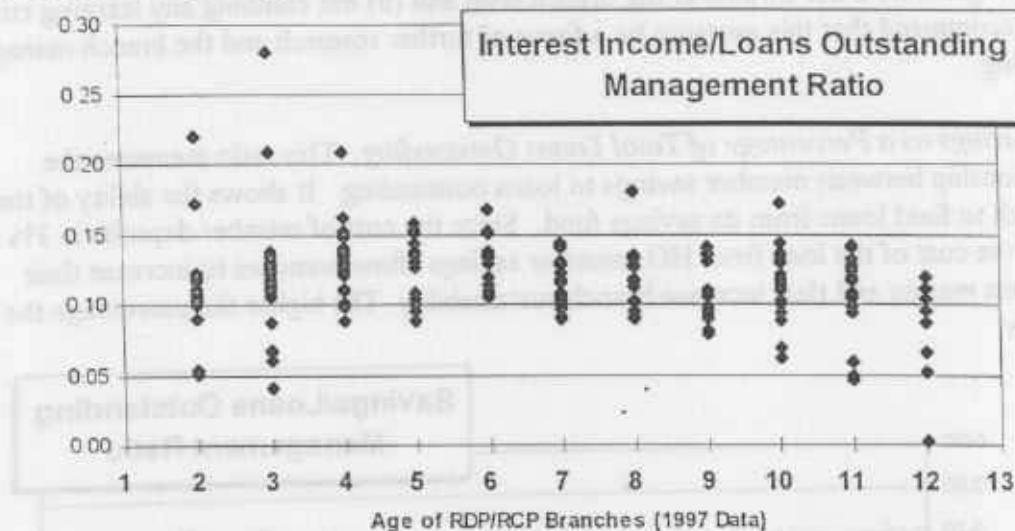


The results of this ratio analysis are much more disturbing than the previous ratios. There is great dispersion between branches and between branch maturities, suggesting that branches vary widely in their ability to develop savings assets and there seems to be no learning curve resulting from experience. What is particularly disturbing is that the older branches that would be expected to have a greater ability to raise member deposits to fund loans actually seem to have a lower ability to fund loans and raise savings deposits.

This is yet another indicator of the serious attention that the entire savings program and strategy needs to receive if BRAC intends to grow and to continue to fund at least 40% (or more!) of its loans outstanding from member deposits. Another potential conclusion is that there are other branch characteristics that are more predictive of a branch's ability to raise savings than branch age, a question which needs further analysis.

5. *Interest Income as a Percentage of Total Loans Outstanding.* This ratio measures the yield on the loan portfolio. It is a quick way for a manager to look at overall interest rate on the portfolio. Since BRAC has only two different types of interest rates, if the rate is lower for a particular branch, it indicates a larger number of Housing Loans (which have a lower interest rate) or a rapid growth in disbursements in the period measured. It could

also indicate a significant number of loans in the NIBL category, since this income is not accrued, but is only recognized when it is received.



Given that there is little loan interest rate variability between branches, this ratio may be most useful as an indicator of loan quality and delinquency. There is a relatively narrow spread between the branches but substantial dispersion within branches of similar ages. Once again, there is the phenomena that the younger and the oldest branches seemed to be in the worst shape (lowest ratio). This may be understandable for the younger branches, but the older branches should continue a positive trend, and not be dropping down as they seem to be doing. This may suggest other factors besides loan quality, but that will take further correlation and analysis. We would recommend that given the importance of this variable, further examination of the year 9-12 Year branches is warranted.

#### Recommendations: Management of Branch Operations

1. It is our belief that while branch age has in the past been a useful indicator of branch behavior and other issues such as sustainability, given the increasing maturity of the branches, there are now going to be other variables that will rise in importance. We recommend below that BRAC begin a multivariate analysis of branch performance, and within several years develop a system of branch categorization that is not based solely on the age of the branch but other, more revealing variables. This system will necessitate a restructuring of BRAC's computer model used for forecasting and projections.
2. Although this is slowly beginning to change, it is our assessment that the branch managers do not have a strong focus on branch sustainability or profitability. The branch manager is still primarily focused on the branch as a "cost center" or a delivery process for program activities. This is not wrong, but it is insufficient, especially for branch and regional managers. With an eye towards a future BRAC bank or just on the efficient use of resources, we would suggest an increased focus on branch profitability and sustainability. Such a focus should take many forms, but at a minimum there should be a

monthly measure and displayed graph tracking branch profitability. This process should be accompanied by specific targets and strategies.

### 5.3 Review the latest cost recovery performance of the sectoral programs

In 1993 BRAC began incrementally collecting service charges for its four sectoral

	PROGRAM	RATE/	UNIT
<b>1. Poultry &amp; Livestock</b>			
	Chicks (DOCs)	1.5	/chick
	Goat Rearer	20	/rearer
	Cow Rearer	50	/rearer
<b>2. Fisheries</b>			
	Carp Polyculture	500	/acre
	Sarputi Culture	300	/acre
	Carp Nursery	1,000	/acre
	Fish Hatchery	1,000	/hatchery
<b>3. Vegetable Cultivation</b>			
	Vegetable Cultivation	500	/acre
	Nursery	150	/nursery
<b>4. Sericulture</b>			
	Sapling	0.1	/sapling
	DFL Egg	1	/DFL

programs. The charges for technical assistance rendered by sector staff can be found in the adjacent table. The introduction of service charges was a mechanism that BRAC devised to make its sector programs self-sufficient over time.

In BRAC's RDP IV proposal, the projected rate of cost recovery for all sectors programs was 17% in 1996, going up to 37% of all sector program costs (including training and the head-office overhead) after four years.

Excluding the once-off training costs of staff, cost recovery both planned (and actual) is substantially higher. The table below compares the projected cost recovery from the RDP IV plan with actual cost recovery in fourth year sector program branches. It shows

BRAC's SECTOR PROGRAMS	% cost recovery in as per RDP IV plan in 2000	actual cost recovery in Yr. 4	actual cost recovery (exclude training)
Poultry/Livestock	63%	33%	77%
Fisheries	36%	43%	98%
Agriculture	51%	39%	97%
Sericulture	24%	18%	45%

that only cost recovery in the fisheries sector is ahead of target as per the RDP IV plan. This is *not* because service charge delinquency is high. On the contrary, service charge collection improved over 1995

delinquency levels of 13% to a 10% delinquency rate in 1996. The first six months of 1997 reflected similar levels of repayment to the 1996 averages. Sericulture past dues are higher than other sectors mainly because of crop failures and reduced net income for members in this high risk sector. Poultry and Livestock delinquency rates improved 6% over last year's numbers.

The surprising finding is that, even though 12% of service charges in the fisheries sector are past due, cost recovery as per the RDP IV plan is ahead of target. This means one of two things, either the RDP IV plan was off by a sizable margin, or the growth in the fisheries sector has an economies of scale effect thereby reducing costs.

	% of Service Charges Past Due in 1995	Amount Overdue (taka)	% of Service Charges Past Due in 1996	Amount Overdue (taka)
Poultry/Livestock	9%	1,032,030	2%	273,179
Fisheries	17%	831,159	12%	660,889
Sericulture	16%	871,371	17%	490,572
Agriculture	13%	734,333	17%	1,163,217
Total All Sectors	13%	24,281,589	10%	26,567,866

We are particularly impressed that despite the increase in coverage in the fisheries and poultry and livestock, sector program staff managed to reduce overdues substantially. The 17% increase in the size of the agriculture portfolio (in taka) met a different fate -- a 5% worsening of the % past due. Seasonal fluctuations and floods only account for a portion of this deterioration in repayment patterns in this generally profitable sector.

It is possible that the particularly low rate of delinquency in poultry and livestock is due to two reasons: less seasonal vulnerability and therefore, more steady income, and the fact that the service charge payment falls due on a particular day (either, on receipt of the day old chick or on their sale after 8 weeks)

We found that the service charges of the other sectors (i.e. excluding poultry) fall due "some time during the quarter" and if the harvest was not a good one, service charges past due could be paid after the next harvest. Variability among the branches that collected service charges in the agriculture and fisheries depended more on management style and less on how good or bad the harvest was. *Branch managers who demand "on-time" collection from staff, by and large, achieve those results.*<sup>19</sup>

We feel that a fixed point in time (rather than "some time" during the season) should be set where members are expected to pay. Our general rule is that the fixed time should occur sooner rather than later. For example, chick service charges should be paid on receipt of the day old chick. Ongoing profits from chick rearing are substantial enough to pay this relatively small amount upfront. Exceptions in all sectors should only be made for members who truly cannot afford to pay them, and this should happen only with the consent of the sector PO or branch manager.

It is worth noting that even we are impressed in the overall reduction in the percentage of service charges past due, the absolute amount outstanding increased around Tk 1.8 million.

### **Recommendations**

1. We believe that, like BRAC's credit program, it is important to set up tight collection systems, which members know are not flexible. This means that, where possible, fixed dates for payments should be set (e.g. during the first week of the harvest season, or immediately on receipt of a chick)
2. In line with setting up clear guidelines for service charge collection, we feel that past due service charges should be tracked over time as per the APO model (e.g. 0 weeks, 1 - 4 weeks etc.)
3. The performance of sector staff at the branch should be based not only on the percentage of on-time collections, but also on the quality of the past dues (i.e. how many weeks overdue etc.)
4. Because activity varies widely from the planned activity for each sector, we suggest that branch staff officially revise activity targets on a quarterly basis in conjunction with head-office. This will result in better forecasting of credit and input needs etc. as well as more accurate forecasts of anticipated revenues from service charges. Collections of service charges should always be measured against the real amount due (based on activity), as opposed to the targeted amount which branch staff (and head-office) are currently using on a regular basis. Activity variances can be measured separately.
5. Despite a relatively low percentage of past-dues, actual cost recovery of fourth year branches varies widely from the optimistic surpluses projected in BRAC's plan for each sector. We therefore, suggest a more realistic revision of these projections based on results to date.
6. Finally, we believe that BRAC should start thinking about a way that members pay only for services that they feel add value. This is likely to improve the quality of sector services provided as members would only "demand" and pay for those services which added value to their enterprises. This is in line with BRAC's plan for a federation system that builds individual and group empowerment among members.

### **5.4 Review the RCP financial model**

Shorebank and BRAC staff reviewed the financial model at length. BRAC's financial model is an extensive model designed to project financial performance over a twenty year period. It has served BRAC well over the past 4-5 years, but given the new challenges and questions BRAC faces, it should be updated. The modifications that should be made are in general in a relatively few areas, some of which are technical and some of which are more policy oriented: increased focus on liquidity management, more accurate projections of savings growth and savings products, additional loan products, incorporation of the PKSF loan funds, and different MELA loan products. Specifically, the following changes should be made:

- (a) MELA loan growth should be factored in;
- (b) loan loss reserve should be reduced on a regular basis by a more active formal write-off of loans (after three years, as suggested previously) and it should not be allowed to accumulate beyond an appropriate level;
- (c) use of the PKSF loans to fund loan growth should be factored in;
- (d) current projections of savings growth are unreasonable, and should be revised for they create a misleading impression of liquidity and net interest margin growth;
- (e) the loan portfolio should be allowed to grow beyond the current Tk 300 million level, based on considerations of liquidity and risk management;
- (f) additional savings products should be designed and incorporated into the model;
- (g) additional, longer term loan products supporting MELA requirements should be incorporated;
- (h) a way to measure asset/liability management needs to be incorporated;
- (i) the current model places significant reliance on the category of investments as a way to compensate for growth and profits, and this should be largely reduced for it is not the best use of funds, excess funds should be targeted for loan portfolio growth;
- (j) the model should be split up into different spreadsheets within the same workbook, and updated to use the capabilities of the more recent versions of Lotus or Excel;
- (k) more extensive use of graphs as analytical indicators should be used as a standard way to understand what the model and different scenarios are indicating;
- (l) net interest margin behavior in light of different liquidity scenarios needs to be understood better, and
- (m) credit programs need to be more formally separated from noncredit programs, so as to understand the level of subsidy and interaction between the various program areas.

### **5.5 Review the Implications for RDP/RCP of the VGD program**

**Summary.** Although the number of VGD women has increased both inside and outside of RDP, we see no impact on the financial sustainability on RDP or any reason why VGD-related funding requirements from donors should vary much from the amount in the revised RDP IV budget. The short reason for the above is that almost all costs *outside* of RDP are being financed by the Government/WFP for current VGD members and by PKSF for ex-VGD members. This is run as an entirely separate program from RDP and is required to be separate not due to BRAC's wishes, but due to government and WFP requirements. Within RDP, BRAC has managed spend far less than planned and is thus able to finance the intake of an additional tranche of VGD members without incurring additional costs in terms of both the quality and sustainability of its portfolio.

**Background.** Women who are selected as VGD participants by the government are among the poorest decile of rural populations. Until 1996, women selected as VGD participants were entitled to two years of support from the government and the World Food Program (WFP). Government/WFP supplied the first loan capital for participants as well as wheat. RDP donors and WFP bore the training costs of participants in RDP areas. Last year, the term of the VGD program was shortened to 1.5 years. This means that there will be three groups of VGDs between 1996 and 2000 instead of the two groups of approximately 125,000 - 150,000 each that BRAC had originally requested donor funding for. At the end of 1.5 years, the participants are known as ex-VGDs.

**Implications of VGD Members Within RDP.** In its RDP IV plan, BRAC budgeted for an intake of 300,000 VGD women. The budget line-item of Tk 209,964 requested is



virtually unchanged in BRAC's revised budget (i.e. a 0.21% increase) even although BRAC will be serving an additional 125,000 VGD members by the year 2000 within its RDP program. The following paragraphs explain how this is possible.

VGD participants are all part of BRAC's regular target group. It thus made sense to incorporate them into its regular RDP program instead of running a parallel program which would have both the disadvantage of unnecessarily increasing costs, as well as ostracizing concentrations of very poor people into a separate program. Donors supported the funding for the skills training of current VGDs, with other funding being supplied from other sources.

BRAC did not use all the funds allocated in its budget because it decided (with the consent from donors) not to run parallel VGD programs in thanas where there is already a BRAC area office. This large reduction in costs means that BRAC is now able to absorb an additional 125,000 VGD participants by the year 2000. Because BRAC has area offices where many VGD participants are located, it has spread its intake over 76 thanas with no cost implications for donors (vs. the 56 thanas as per the original proposal).

BRAC admits VGD participants as regular new members to its regular branch structure. In so doing, it is reaching the poorest decile of the population. In some cases, BRAC has set up sub-offices to cover members beyond 10km of the RDP areas. There are 36 such sub-offices and capital for loans (for ex-VGDs) comes from the PKSF fund. The office is one small room with minimal costs. As with its "non-VGD" branches, one PA serves 500 VO members. The interest income from members pays for the salary of the PAs (i.e. as per normal operating expenses of branches). The branch manager and accountant do have an increased, but seemingly manageable workload in these cases.<sup>26</sup>

**VGD Participants Outside of RDP.** PKSF agreed to provide BRAC with funds so that it could provide loans and similar services to a group of VGD women (around 307,000 by the year 2,000) in 42 thanas that fall outside of existing RDP office areas. The reason this PKSF funded program is run separately is merely for accounting purposes. PKSF wants to track the progress and impact on the specific VGD members that pass through it program. No RDP staff are involved in this program.

Government provides the skill training and the first loan for VGD participants and WFP provides the wheat. Future loans are provided out of PKSF's loan fund and staff costs for credit and sector program staff are covered by interest.

BRAC believes that the impact of development on this "most vulnerable" group in the 42 thanas outside of RDP can be improved if they receive funding essential health care. It is for this reason that BRAC has requested Tk23 million from the donor consortium. This represents 0.005 of the total revised budget. There is an additional small amount of money (i.e. 12 million taka in BRAC's existing RDP fund under the line item Vulnerable Group Development) which may be available to be used for human rights training for ex-

VGD members in the 42 thanas. We believe this will have no deleterious impact on the VGD members within RDP.

### **5.6 Review status of BRAC Bank proposal**

The BRAC Bank proposal was resubmitted to the appropriate government agencies in May of 1997. No reply has yet been received. BRAC Management still desires the creation of a bank to support its future growth and ability to alleviate poverty, but at this point it is difficult to make specific plans, given the lack of government direction. In short, BRAC is in a holding pattern with respect to this proposal.

### **5.7 Review overall RDP/RCP financial status against RDP IV projections**

This is discussed in the various chapters pertaining directly to membership, savings management and portfolio and credit. In particular, please see sections 2.2, 2.6 in chapter 2 and chapter 3. It suffices here to reiterate a couple of points:

- The growth in members weekly savings that now average Tk 5 per member for the first time (up over Tk 1 from a year ago) as well as the rise in compulsory savings is reducing BRAC's cost of funds and contributing to branch sustainability. On average, branches can fund around 40% of their loan requirements from saving. As discussed in Chapter 3, there is wide variability in savings levels between Yearwise branches and within any particular age cohort. In general, it is the younger branches that are exceeding savings targets and contributing the most to raising the weekly savings average.
- Average loans outstanding are more or less on target or exceeding target for most branch ages except older branches which are lagging a little behind. Higher outstanding means more interest income and hence more sustainability assuming most costs do not increase at the same rate as outstandings. Lower outstandings in some older branches is due to three reasons: some branches lack discipline thus slowing the rate of disbursement, older branches have many more inactive members than young branches, hence pulling down the average; and the drop-out is higher in older branches and the new members who come in take smaller loans putting further downward pressure on outstanding.

## 6. Management Responsibility and Human Resource Issues

### 6.1 Review progress in delegating responsibility for financial performance and development outputs to Branch Managers

**Budgeting and forecasting at the branch level.** In 1996, for the first time, BRAC set its annual internal targets beginning with the branch managers. The branch managers submitted a proposed annual target for both financial and sector achievements. Through discussion with Head-office and the regional managers, this target was negotiated and refined. This process was repeated and refined this year with head-office *first* providing target guidelines for each branch year as well as a suggested process about how branches should proceed with their forecasts. The willingness of head-office to develop forecasting and budgeting abilities at the branch level is indicative of its increasing commitment to local autonomy and decision-making in its branches.

**Financial Training.** Decentralization's meaning is lost without branch and regional managers having the necessary skills to perform effectively. During 1997, BRAC head-office prioritized the development of a "BRAC - specific" training course for branch managers to assist them manage their branches as businesses.

The training, developed with the assistance of consultants, field staff and senior BRAC staff, will begin in early 1998. The "test training" took place with one group of regional managers and one group of branch managers in the third quarter of 1997. Materials were then revised and are currently being reviewed. Consultants will lead the training in conjunction with BRAC trainers, head-office and regional staff for the first round of the course. Thereafter, BRAC will do all the training itself.

The objective of the course is to train branch managers to analyze their branch performance with a view to improving branch performance and profitability. Management is hoping that branches will: become more profitable and more service-oriented; focus more seriously on attracting savings deposits; and be better able to forecast their resource needs. In addition to financial training, the training courses are designed to entice field staff to look for opportunities to create development impact, for example, to be responsive to requests for slightly larger loans above the Tk10,000 maximum where a borrower is a good credit risk.

Other "evidence" of greater branch autonomy are, for example:

- From November 1997, branch managers will be doing their own portfolio and costs and expenditures forecast

#### Course Modules

- Achieving Sustainability: Profitability/Productivity/Efficiency
- Managing Credit
- Managing Savings
- Overseeing Sector Programs
- Forecasting
- Staff Development, Motivation and Appraisal
- Loan Analysis
- Area Manager as a Development Manager

- From 1998, income statements will be prepared at branches on a monthly basis and sent to head-office. (Head-office will also prepare a full version as a check.)
- Head-office plans to put a computer in every branch by the year 2000
- Both branch and regional managers are now able to make loans above the Tk 10,000 ceiling following certain guidelines (e.g. 20% increase allowed over the previous year's loan size or if the borrower has a large pool of savings loan size can go up to Tk 20,000).<sup>21</sup>
- Credit POs have been given more responsibility and will be playing a more active role in monitoring the performance of credit PAs who report to them. A new form with indicators to measure PA performance has been designed. Previously, this work was done at the branch manager level. Branch managers will now have a tool to evaluate POs on the performance of their "PA team".
- Head-office is considering giving performance based incentives to branch managers, for example, a percentage increase of the savings they generate through lowering their cost of funds. We encourage management to refine and operationalize these ideas some time during 1998.
- Branch managers are being encouraged to become "advocates" on behalf of sector program participants. Although they are not directly responsible for sector program performance, it is their responsibility to ensure that BRAC's sector staff are accountable to members.

In sum, all indications point to an incremental growth in the decision-making capability of branch managers as well as head-office's willingness to allow branch and regional managers greater leverage in making business decisions. We strongly encourage BRAC to continue its efforts in this direction.

### Recommendations

1. Reinforcement of the training is necessary to help Branch Managers develop their skills as business managers. We suggest that Branch Managers submit a brief quarterly report to head-office and regional managers on their key indicators for profitability, savings, portfolio, membership and sector programs with a sentence or two of explanation where performance has diverged from plan, and what the trend over the past quarter indicates. Regional Managers could do the same thing on a consolidated basis for their regions.
2. Head-office should also provide regional and branch managers with a standardized set of performance indicators which they can use to evaluate individual and team performance. An example of possible indicators is included in section 6.3 below.
3. Since devolving authority and responsibility to the branch level means goes beyond the branch managers to all branch staff, branch managers should be given training on how to grow and develop and utilize their staff efficiently and fairly.

## 6.2 Advise on changes required to trend and summary reports

Excluding qualitative data on employees and VO participants, there is no shortage of raw data both on the production and the financial side for sectors, PSEs and the VO credit. This is good news because it means that data is available to create any report that managers might find useful.

To date, only the credit program has set up trend reports that track key ratios and key variables over time. These are updated regularly. Most other programs track absolute numbers on a monthly basis which vary for a variety of reasons. For example, costs may increase because the program is less efficient (i.e. a negative reason), or they may increase because production far exceeded target (a positive reason). A ratio of cost to production ratio could immediately tell the manager whether the rise in costs is problematic or not. Similarly, calculation expenditure/revenue ratios on a monthly (or production cycle basis) will shed more light on sustainability of the program than tracking the absolute costs and revenues values separately.

Part of the reason for the lack of meaningful financial reporting in the PSEs and to a lesser extent, in the sector programs (e.g. see recommendations on service charge collection and recording in section 5.3 ) is because these programs are far newer and managers are focusing on more immediate operational concerns. There may also be a tendency by managers to see their programs as a "softer" business vs. the credit program.

We recommend that the managers of the respective sectors programs and PSEs identify key indicators (production, quality, and financial) and set up reports to track their progress both over time, and against original target. We also suggest that targets are revised on a quarterly basis where actual numbers have varied substantially from their projected levels.

The MELA program and urban lending program are just beginning and have not yet set up mechanisms to manage risk and analyze key indicator trends. We recommend this is done as soon as possible.

### 6.3 Identify key variables and performance benchmarks, for both BRAC management and for inclusion in revised reports to Donors

The two new areas that Donors needs to be aware of and BRAC needs to manage are: (a) decentralization of management operations and responsibility to the branch and regional level and (b) savings and liquidity management. The following table draws on recent BRAC Branch Management training, and is our suggested list of measures that BRAC should collect quarterly, and report to the Donors on an annual basis.

**BRAC Branch Management  
Summary of Proposed Management Indicators<sup>22</sup>**

Category	Performance Indicators	Management Tools
Portfolio Quality	Delinquency of Current Loan <i>Delinquency of Total Portfolio</i> Reduction in Overdue Loan Loss Reserve Ratio (B/S) Higher risk (>26 weeks)/Portfolio Growth Rate (Disbursements, Outstandings)	OTR for recent period # Loans/PA Taka outstanding/PA Missed payments/PA Disbursement growth
Savings & Liquidity	Avg. Savings per Member <i>Savings as % of TPO</i> # Active Savers/# Members Growth Rate in Savings	Savings/PA # Current Account Savers/ PA Taka Current Account Savings/PA
Sector Programs	Active Members/Total Members <i>% Cost Recovery (Sector year-wise)</i> Service Charge Collection Rate Sector loans as % of portfolio	# Active members/PA # Missed Service Charge Pmts/PA % Cost Recovery (monthly) Delinquency of sector loans
Profitability	Profit Margin (Revenue/Expenses) <i>Profit Total Loans</i> Cost of Funds	Operating Profit Margin (monthly)
Productivity & Efficiency	Operating Costs/Total Portfolio <i>Salary Expense/Total Portfolio</i> <i>Yield on Loans (revenues/TPO)</i> Avg. Cost of Funds Drop-out rate	Total Portfolio/PA # Loans/PA # Active borrowers/PA (?) Savings/PA Average loan size/member

\* These focus on financial management and do not include indicators for Outreach and VO Discipline, for example.

\*\* Those ratios in italics are recommended as primary ratios for reporting/benchmarking.

#### 6.4 Proposed RDP/RCP Training and Research Capacity

In order to engage in the program design, strategic analysis and employee training that will be necessary for BRAC to achieve its goals over the next several years, we believe that RDP/RCP will need a dedicated and highly specialized internal RDP/RCP specific research and training staff (some full-time, in-house and others on a market specific, consulting basis). This would be a small unit (4-5 staff) composed of staff that have expertise in economic development and market analysis, small business management, and staff training.

Developing this type of research and training capacity will not come quickly or easily, but it is a very high leverage investment in BRAC's human capital assets. With this type of research and training capacity, not only will BRAC be in a position to get a higher level of development impact out of its current "investment" in staff and loan portfolio, but it will also be in a position to do the necessary research on business and economic development strategies that will greatly leverage the poverty alleviation impact of its programs.

From the most conservative perspective, if the only accomplishment of this research and training group was to reduce the annual loss rate of BRAC's loan portfolio by 1/10% (0.001), then on a Tk 3 billion portfolio this capability will save BRAC Tk 3 million per year. Among a wide range of activities, this unit could work on projects such as the following:

- Manage the detailed and in-depth savings product market research and design program that will support the design of new savings products with differential pricing and maturities.
- Support and direct the research that will develop a new more relevant category system for ranking branches and understanding the different behavior and risk levels of different "clusters" of branches (replacing the current yearwise category scheme).
- Design and implement a targeted MELA lending program, based on a focused economic development strategy for value added enterprises in the villages, with new lending instruments and risk control techniques.
- Design and support the associated training system for MELA and other similar employees.
- Explore the dynamics of the older branches, and determine viable strategies to rejuvenate their lending, saving and economic development impact.
- Support the targeted expansion of other PSE-type enterprises that can provide a critical "missing link" in the market economy of the rural communities, and thereby achieve significant development impact on the community income base.
- Overall, this would be the primary training group for RDP/RCP that would work to track, manage, and "invest" in the employees of the RDP/RCP program.

## 7. Other Areas of Special Donor Concern

### 7.1 Review Project Support Enterprises and reporting procedures

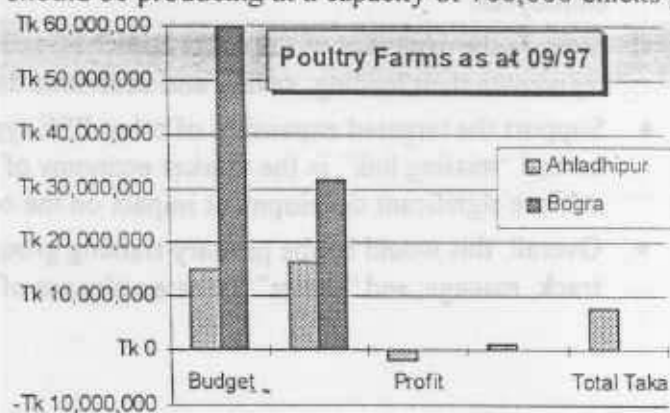
The PSEs are relatively small, yet high impact enterprises with simple production processes and relatively low staffing requirements. In general, performance is "on track" or ahead of budget with the exception of sericulture which is stagnant due to changing market opportunities.

To the best of our knowledge useful financial reports (as opposed to raw absolute numbers) for all the PSEs are only done at a head-office level by the Accounting Department at a very summarized level. We believe that the PSE managers, as managers of other businesses, should prepare their own financial reports on a monthly basis (or after each production cycle) as well as a trend report. Other key financial, activity and quality indicators should also be identified and tracked over time. (General recommendations in section 6.2 also apply here).

We believe that BRAC could benefit by changing its organizational structure of the PSE/EIG programs to reflect the deepening expertise that is being accumulated in each specific sector. By this, we mean that there should be a one manager in charge of all aspects of a single sector. In the case of Sericulture, PSE staff in the reeling centers, grainages and sericulture sector staff could account to him/her. Similarly, agriculture sector staff, the seed processing PSE and the seed production PSE should have one head who is responsible for development impact and cost recovery in all aspects of agriculture, and so on for all programs. In this way, there will be one core person in each sector that is dedicated to making an impact sector-wide, rather than on a specific part of the chain of activities that take place. All the sector/PSE specialists should report into one head who is the "chief" of EIG/PSEs and is ultimately responsible for strategy development and development impact across all sectors. This "chief" could also direct key research necessary to support and develop sector activities.

**Poultry Farm.** By December 1998, production of day old chicks should exceed 500,000, and in 1999 the farm at Ahladipur should be producing at a capacity of 700,000 chicks per year. Spending is less than 1% over budget and break-even is expected next year. From our visit and interviews, it appears operations are running smoothly and staff are well equipped to handle operations.

The second poultry farm will have a production capacity of 3.3 million chicks per year.





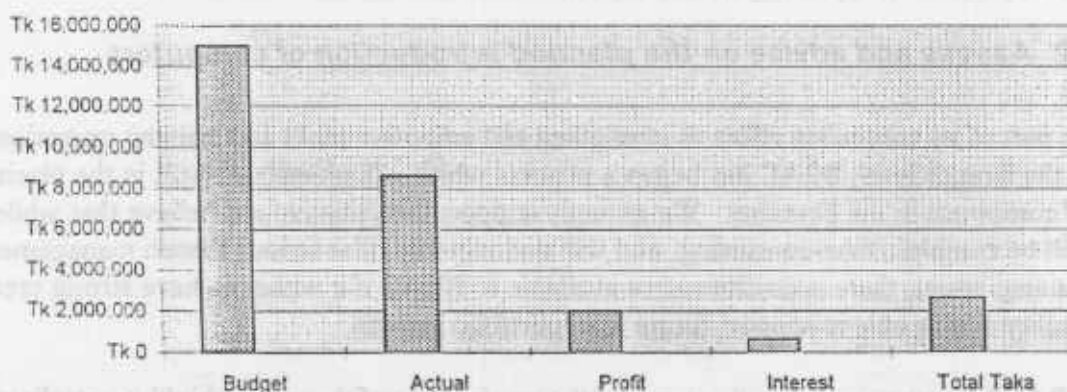
This is five times higher than the original plan. Costs will be four times higher. BRAC's revised budget requests an additional Tk 46 million from donors. Based on the high impact of this sector and its reach, particularly to the most vulnerable VO members within RDP, we are highly supportive of this expansion, especially since it should break even in its second year. BRAC's two hatcheries barely make a dent in meeting the market demand of 1.5 million day old high quality chicks per year. BRAC's new facility is expected to produce 700,000 day old chicks in 1998, 2.4 million in 1999 and will be operating at capacity in the third year (i.e. at 3.3 million chicks per year). Our only reservation with respect to the expansion is that BRAC does not underestimate the managerial challenges of running a larger operation.

#### Recommendation

BRAC should invest in another hatchery in both 1999 and 2000 as demand still falls far short of supply provided skilled staff are available to run it.

**Feed Mills.** We have no concerns about the feedmills which are ahead of budget and have higher production levels than anticipated. The Manigonj feed mill will exceed its target of 4,000 metric tons of feed by year end. Production is expected at 7 metric ton in 1998. Full capacity will be reached in 1999 at 8,500 metric ton of feed. The newer feed mill in Nilphamari will exceed its target of 2,000 metric ton for January 1998 as production was at 1,600 metric ton in October. Capacity is at 7,500 metric ton.

Manikgonj and Nilphamari Feedmills as at 09/97

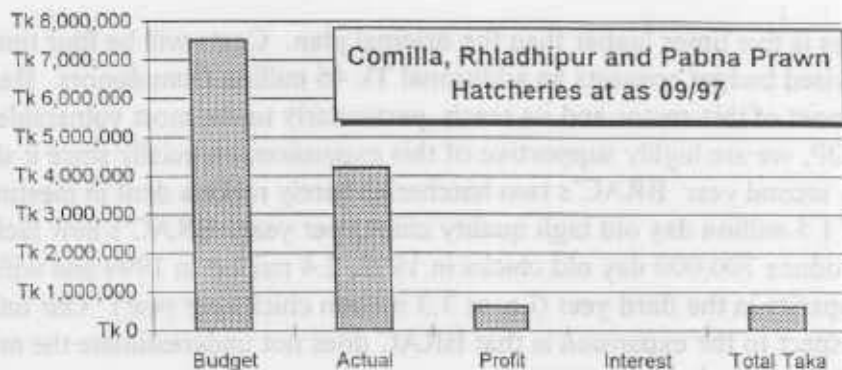


**Sericulture.** Reduced investments took place in Grainages and Reeling Units when compared with the original RDP IV plan. This resulted in "savings" of Tk 33 million which has been reallocated to the construction of the bigger hatchery discussed above. The investment in Grainages declined because the World Bank supported the Bangladesh Silk Foundation to set up a supply of disease free larva (DFL). Similarly, other NGOs have set up reeling operations and are buying silk cocoons from BRAC producers, hence reducing the demand on BRAC's own reeling centers. Plans for six new reeling centers have been eliminated. We think that BRAC's responsiveness to market forces is appropriate and see no problems with their revised plan, specially in the light of our hesitation with respect to the profitability of the sericulture program.

### Prawn Hatcheries.

Prawn hatcheries are a relatively lucrative business for VO members with the average net profit per year often reaching Tk 10,000. The average annual income of most rural households is

probably around or below Tk 12,000. Tk 10,000, therefore represents an 80% improvement in income. BRAC now has 10 prawn hatcheries compared to an original plan for 5. It was able to do this within budget because land cost and staff facility costs went down when BRAC decided to use land and office buildings that it already owned located in its regional training centers.



Market conditions for fresh water prawn have improved as sea-water prawn "catchers" are under increasing pressure from environmentalists who prefer to buy fresh water prawn. Prices for exported prawns have improved. We expect profit margins to increase in 1998. Unfortunately, expansion of this sector is limited by the availability of ponds.

**Seed Processing and Seed Production PSEs** The seed business is high impact business for VO discussed separately in section 7.4

### 7.2 Assess and advise on the planned introduction of computers

As part of its continuing effort to strengthen and empower credit and training operations at the Branch level, BRAC has begun a process which will ultimately result in the placing of computers in the Branches. We strongly support this initiative and believe that while it will be complex, time-consuming, and will undoubtedly raise serious branch management training issues, there is no alternative available to BRAC if it wishes to have strong credit quality and be able to support future loan portfolio growth.

BRAC Management is keenly aware of the weaknesses of the current highly centralized system of credit data and analysis, in that it places too much dependence on the Dhaka based BRAC computer and analysis systems. When there were only 400,000 loans, this degree of centralization might be tolerated. Given that there are more than 2 million loans currently outstanding, the current level of centralization of data input and management is not appropriate.

At present, because loan payment, credit quality and savings information is only entered in the portfolio management data (MIS) system in the head office, this implies a long turnaround time between the branches submitting the data to the central office and the receipt back from the central office of the appropriate portfolio status and credit quality

reports. Given that the branch is the level at which action can be taken to respond to credit and savings issues, this delay imposes a serious constraint on timely branch action.

The process of "computerization" of a wide network of physically remote offices raises significant implementation issues. While the initial focus is often on the physical computer itself, the reality is that distributing computers to outlying areas raises as many "soft" issues such as management behavior and practice, employee skills and training, and communication issues as it does raise the "hard" issues involving the physical computer and infrastructure.

Another common issue encountered in the process of developing computing capacity in an extended network is that people hold so many preconceptions about the role of computers. As we observed in our field visits, the "wish list" or unconscious expectations that people can create around computers is quite broad and often unrealistic. Management and employee expectations range from data collection to data quality management to communication to credit quality management to reporting and analysis to history and research. A computer, however, is just a tool. As such it is limited by the skills of the computer user and the context in which it is operated. While in theory it is possible to expect the use of a computer to fulfill a very wide variety of tasks such as that suggested above, this is usually not the case.

BRAC Management seems to be very much aware of the dynamics and challenges that it will encounter as it works to bring computing capacity to the branches. It is working closely with an external consultant that is a specialist in these matters. In addition, it has been working to gain insights from how other similar NGOs have introduced computers in the field.

The first step in its progress towards computerization has been to revamp the data management system and software at the Head Office so as to be more compatible with a system of distributed processing and decentralized data input and management. This stage is in the process of being completed.

The second step has been to set up a system of "exception only" reports that greatly facilitate the communication of quality information from the branch office to the head office. By realizing that the great majority of loan payment and savings activities are the same from week to week, the Head Office has created a system by which the branch staff can focus most effectively on non-standard and irregular payment and savings situations. The result will be higher data quality, better focus on irregular situations, and reduced time taken by non-value added data input activities by both branch and head office staff. The full implementation of this second step will take at least six months.

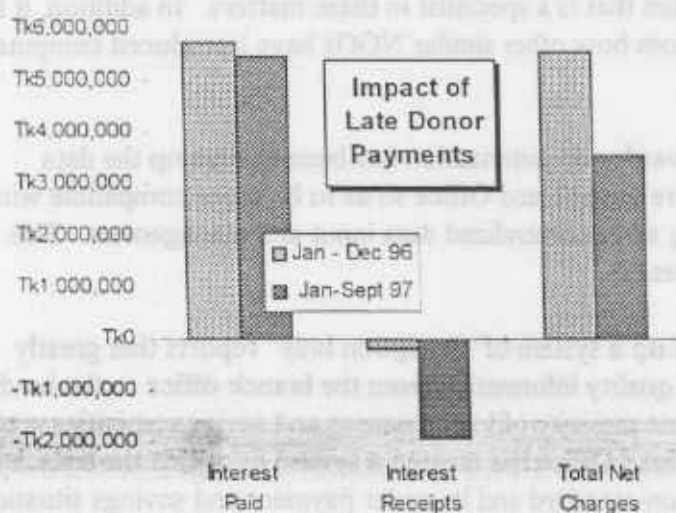
The third step will be the actual location of computers in selected branch and regional offices. A selected sample of branches will be the first target for this effort.

BRAC management seems to be fully aware that this significant investment in computers will only bear fruit when accompanied by an ongoing and strong investment in computer skill training for branch employees.

### Recommendations

- BRAC should fully implement the second stage of its process of computerization as described above before it begins the process of physically putting computers into the branches.
- Management should continue working with its external computer consultant to develop a multi-stage and multi-dimension process of computer installation involving not only the physical computer and infrastructure issues, but also the necessary and ongoing computer system support and training. Specific learning and branch feedback systems should be created.
- BRAC should continue to learn from other NGO and private sector computerization efforts, and should not underestimate the challenges and requirements for training, the ongoing maintenance of data quality, and infrastructure support.
- Special care should be taken to be very clear on what are and what are not the goals and expectations of branch staff and the use of computers.

### 7.3 Review consequences of delayed Donor disbursements of funds



BRAC incurred interest charges on money borrowed as a result of expenditure deficits caused by the delayed disbursement of funds. The total net charges for both 1996 and 1997 to date was Tk 11,259,247. This amount was slightly offset by interest earned on some early payments by donors (see interest receipts in graph). Thus, the total net charges that BRAC paid for January 1996 - September 1997 for the RDP program was Tk 9.1 million.

### 7.4 Review BRAC's Seed Enterprise Proposal

The challenge constantly facing BRAC is how to leverage a limited amount of financial and organizational resources in ways that will have a poverty alleviation impact many times greater than the resources employed by selected program activity. One powerful tactic to multiplying BRAC and Donor resources is to look for activities in which a market

“bottleneck” or constraint is present, and in which a targeted application of BRAC resources can open an economic “pipeline” much larger than the resources involved.

After reviewing the OSSP, we believe that this is a high-leverage program activity that can have an impact on very low income residents much larger than the Tk30 million invested. Even if the projected benefits are reduced by 50%, a solid case can be made that over a three year period this project leverages a Tk30 MM investment into Tk120 MM in increased income for VO members, generating a solid economic development return. Not only does it seem that the OSSP will have a substantial economic development impact, but it seems to be a sound business operation as well. Although it will not generate very high profits, Donor funds will enable the OSSP to be nonetheless self-sustaining over the long run and function as an internal BRAC PSE. We believe BRAC’s assertion that it has acquired sufficient experience and staff expertise to implement this project, but have no way to verify this, other than the impressive credentials on their resumes.

**OSSP Project Overview and Economic Impact.** BRAC proposes to develop two high quality seed production centers that will grow and distribute maize and sunflower seeds. This is not a private company or separate from BRAC, but a PSE program within BRAC. The farmers served will be VO members.

Seed production in Bangladesh is not a sufficiently attractive private sector activity. Seed production is a specialized business requiring significant investment capital and yielding only modest returns. When faced with other less specialized, export-oriented businesses that can generate higher profits, the private sector has avoided investing funds in the seed production sector. Compounding this dynamic is the fact that banks are reluctant to provide the large scale funding to such a specialized project that is dependent on an internal market and complex distribution requirements. The only other source of seed is the public sector BADC agency, and this agency not only falls short in terms of the volume that it is capable of producing, but the quality and type of seed.

This market “gap” creates a high-impact opportunity for BRAC to respond to a specific need faced by low income communities and low income farmers working marginal land that is suitable for maize and sunflower growing. This project will have a very impressive level of synergy with the existing VO loan system and the distribution network developed by both the VO program and the Essential Health Care program.

Strengthening the case for this BRAC activity are two facts: (a) the existing private and public sector seed production capacity can meet only 30% of potential market demand and (b) the existing seed supply is not targeted at low income regions of Bangladesh or low income farmers served by the BRAC village organization network. Overall, there are three market “gaps” that the OSSP will address: quality of seed, volume of seed and distribution of seed to low income farmers and families.

**Recommendation:** We support the OSSP proposal and recommend its funding.

### **7.5 Review the Micro Enterprise Lending Assistance (MELA) Program**

The MELA program is a pilot program aimed at stimulating growth of small enterprises in order to create wage employment for BRAC's target group as well as to grow the value-added, "traded" productive sector in the rural areas. Loans range from Tk20,000 to Tk200,000. The average loan to date is around Tk30,000. The program is ten months old, with the first loan being made in December 1996. 27 areas are currently covered, but loans have only been made in thirteen areas. BRAC's loan capital allocation for the MELA program is Tk100 million, and of that amount Tk13 million has been lent out as of the end of October to 457 borrowers, 92% of whom are VO members. 335 (73%) of the borrowers are women. MELA has had no delinquencies or loan losses.

The MELA program is like an iceberg: most of the management implications, credit challenges, strategic choices, and high development potential of this program are hidden from immediate view, submerged below the water level of pre-existing BRAC/VO credit operations and historical behavior.

We fully support the MELA program, and see it as a watershed program activity for BRAC that should be encouraged and supported at all levels. Relative to the level of resources invested, the MELA program has the potential for strong development impact. This program may even hold more ability to positively impact the very "poorest of the poor" than does the current VO loan program, in that the MELA program will create wage income employment that may be more accessible and more desired by some members of this very low income target group than the VO self-employment program.

This is not to suggest that the MELA program is in any way better than the current VO loan program. This is to suggest that the MELA program is an excellent complement to the existing VO loan program, that the synergy between the two programs can be very powerful, and MELA will provide not only an economic development impact but also help respond to the needs of the BRAC target group in a more comprehensive fashion. As described below, the MELA program (combined with BRAC sectoral strategies) will have a structural, economic development impact in that it will work to increase the community "income base" that supports the more local customer oriented RDP/VO program.

The good news is that the MELA program has the potential to be a cost-effective strategy to create "net new jobs" and "new income" for very poor village residents and rural communities (in contrast to recirculating pre-existing community income via the VO support of retail and service enterprises). The MELA program can strengthen the underlying rural economy, improve the village "balance sheet" of community income and assets, and help to resist the forces that are causing rural to urban migration and rural incomes to fall behind the more prosperous urban areas.

The bad news is that (as with an iceberg) most of the operational implications and strategic choices inherent in the MELA program are not immediately visible to an

organization and borrower network used to implementing VO-style loans. As a result, the new implications of the MELA program can be easily overlooked or ignored. A MELA loan is not just a "large VO loan" and is in fact different than a VO loan on almost every dimension. Treating the MELA program as a "big VO program" will be a natural and understandable tendency within the overall context of BRAC management systems, credit practices, training, borrower expectations, and overall strategy. However, the MELA program is a complex and higher risk program that requires a type of strategic choice, credit analysis, technical support, and risk management that is not found in the current RDP/VO lending system.

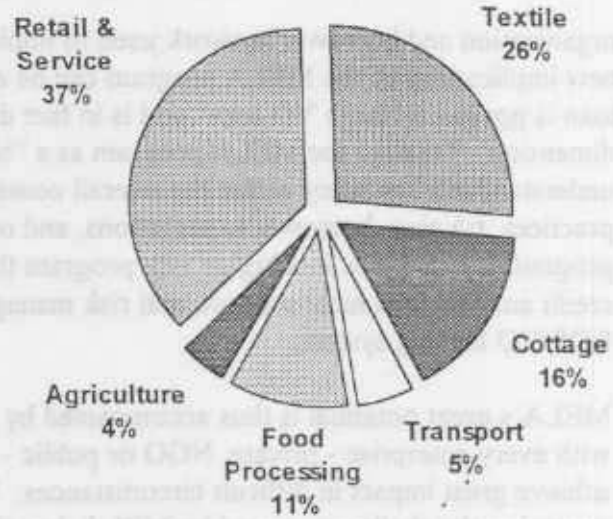
MELA's great potential is thus accompanied by great challenge and great risk. It is thus with every enterprise - private, NGO or public - that treads new paths and works to achieve great impact in difficult circumstances. We believe that BRAC is capable of managing the challenges posed by MELA, but that it must move cautiously and with great strategic focus. As with all activities that are attempting to leverage limited resources to achieve the greatest overall impact, the boundaries and underlying strategies of the MELA program must be clearly set (what it will do and what it will not do). To effectively manage risk and maximize poverty alleviation impact, the program must be grown slowly and with clear boundaries.

**Key Strategic and Risk Management Decisions.** A full discussion of the design, implementation, risk management and strategic choices facing the MELA program is both beyond the scope of this document and consulting assignment as well as premature given the pilot nature of MELA. However, given the high potential and innovative nature of this program, the following is a very brief list of some key issues.

- What is the desired impact of the MELA program on village economies and very low income people?
- How can MELA target its resources to achieve greatest impact?
- How can BRAC manage the risks of MELA lending as well as train staff to manage this loan program?
- How can BRAC fund the growth of the MELA program, and how will it interact with other related program activities of BRAC and other NGOs?
- If a significant goal is to create wage employment for the "poorest of the poor" that would not otherwise avail themselves of a VO loan (or members who wish to add to the income generated by their VO loan), what are the ways to increase the odds that these individuals will be employed by MELA borrowers?
- What sectors have the biggest impact on the village economy, and will bring the greatest number of net new jobs and new income into the village economy?

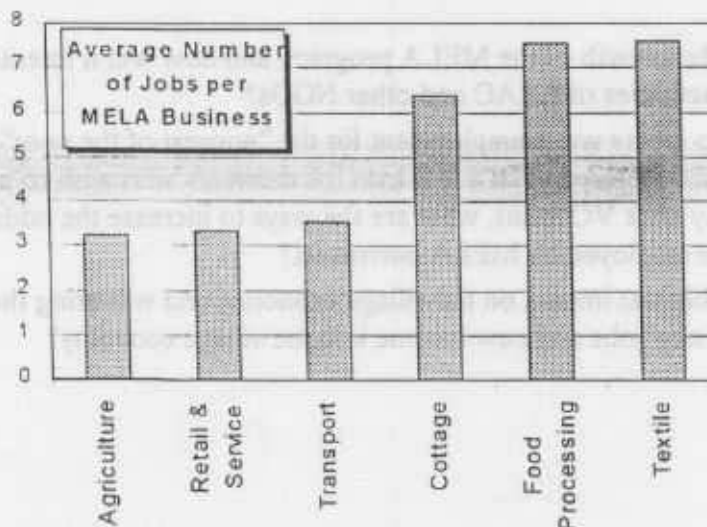
### MELA Program Results to Date

The current MELA loan portfolio distribution by type of enterprise is quite varied. Roughly 57% of the current loan portfolio supports enterprises that bring "new income" into the village from markets and customers outside of the village (food processing, cottage, agriculture and textile) and 43% supports enterprises that serve local customers and thus recirculates income that already exists within the village (retail, service, hotels, restaurants, transport).



Even though the MELA program can lend up to Tk 200,000, the average loan size to date has been relatively modest, ranging from Tk 25-35,000. Field interviews with two MELA POs indicated that only 20% of their MELA loan applicants are being funded as a result of the more extensive credit analysis and collateral review process supporting this program.

	Number of Enterprises	Number of Direct Jobs	Avg. Jobs per Enterprise	Avg. Loan per Enterprise
Agriculture	22	71	3	Tk26,364
Retail/Service	195	648	3	Tk25,615
Transport	26	92	4	Tk27,692
Cottage	66	422	6	Tk32,424
Food Processing	41	309	8	Tk35,366
Textile	107	811	8	Tk32,944
<b>Totals</b>	<b>457</b>	<b>2,353</b>	<b>5</b>	<b>Tk29,344</b>



Different enterprises have different capacities to generate employment. With respect to the 457 businesses that compose the current MELA loan portfolio, more jobs per enterprise are created in the food processing and textile sectors. This type of experience can help inform BRAC strategies.



**MELA "Cost Per Job" and Creating Net "New Jobs".** Given BRAC's constant desire to maximize the impact of its limited resources on poverty alleviation and economic development, one measure that may be useful is "cost per job", or the amount of loan capital that is required to create a net new job in an enterprise.

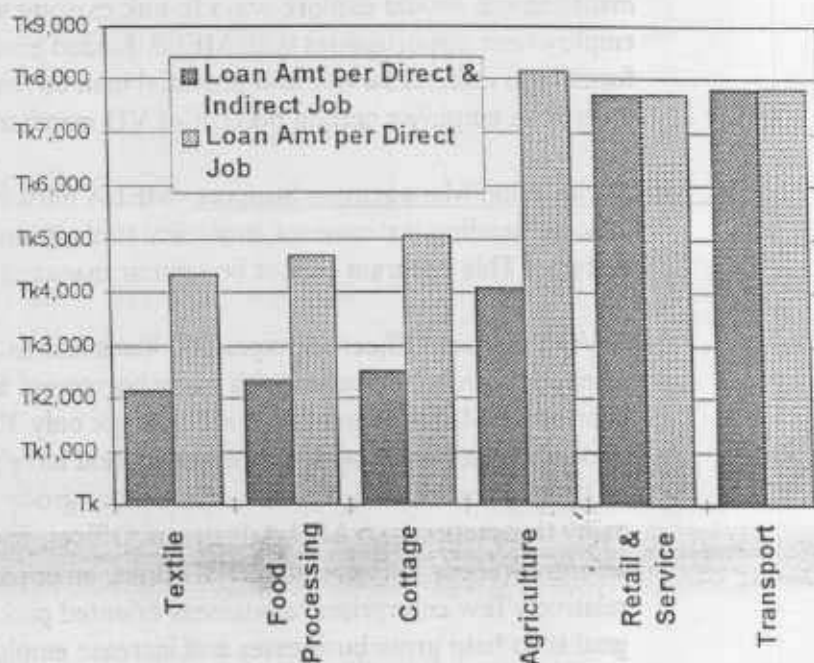
One key factor here is that some types of enterprises bring "new income" or sales revenue into a community because their customers are outside of the community. Because they bring new income into the community, and because wage income is spent by enterprise employees at local retail and service businesses, this income can be understood to recirculate within the community and thus create an income and employment "multiplier effect." Employment in those enterprises supports employment in the local, retail and service sectors. These enterprises that create this multiplier effect are variously described, as traded-sector, value added, export oriented, or productive sector. Enterprises that depend on local customers and income and wealth that already exists in the community do not create a "multiplier effect", and these enterprises are described as retail, service, or local market oriented businesses.

The graph below shows the average MELA loan amount that has been necessary to create or support both a direct job (in the borrowing enterprise) as well as the indirect jobs (local market jobs created via the multiplier effect, assumed here to be a ratio of 1:1).

For the productive sector, it takes Tk 2,000 to create a job (combined direct and indirect job). In the local market sector, it takes Tk 7-8,000.

It must be noted that this analysis has taken great liberties with a complex set of variables. These numbers are used only to illustrate the increased employment and economic development leverage of an investment in productive

sectors vs. local market sectors. It is a fact that multiplier factors vary with the type of enterprise (e.g., agriculture vs. manufacturing), and that some jobs are full-time, some part-time, some pre-existing, and some new. To determine these numbers with precision is beyond the scope of this analysis and the available data, but the principles are all valid and the strategic implications for BRAC are the same, regardless of whether the loan amount per job is Tk 2,000 or Tk 3,000.



## **Recommendations: MELA Programme**

**A. Strategic Focus.** To increase MELA's economic and wage employment producing impact, we believe that the program should strictly limit itself solely to enterprises that sell to customers and markets outside of the village. If BRAC focuses the MELA program in this way, it will greatly increase its impact on the village economy and ultimately increase its ability to create wage employment jobs in the village by 200-300%. It will also bring in new community income to support the existing VO-funded retail and service enterprises.

Limiting the customer base for MELA will be a difficult task that will require very strict guidelines from the head office, for the pressure on the MELA PO to lend to the much greater number of local retail and service businesses will be very strong. Stringently selecting borrowers by business type and economic impact goes against BRAC's historical behavior, but that must be a MELA requirement if BRAC desires to have any significant impact with this program and reach the very poor.

**B. Synergy with the VO Program and Membership.** BRAC's VO program should continue to support the local retail and service sector and the emerging MELA program should support solely the value-added productive sector. BRAC management should explore ways to link existing and new VO members to employment opportunities with MELA funded enterprises via an informal or formal job referral service and potential loan covenants requesting that the MELA enterprise employ a certain percent of VO members.

**C. MELA Staff and Management Support.** MELA must have a separate set of program officers, lending instruments, analytical tools, training programs, and management systems. This program cannot be seen or managed as a "big VO loan" program.

A VO Program Officer manages 500 loans and as a result is more of a "systems" manager with brief contact with many borrowers and limited risk per borrower. In contrast, a MELA loan officer will manage only 30-50 loans, develop a much more in-depth relationship with the borrower, and have more substantial risk to manage. VO staff must be skilled in communication, group management, and in handling many transactions. A MELA Program Officer, in contrast, must be understood as an entrepreneur with credit analysis skills, an unpaid consultant working with relatively few enterprises, a business-oriented problem solver, and a person whose goal is to help grow businesses and increase employment, not just make loans or manage payment transactions.

It is understood that hiring and training this type of MELA staff capacity will present BRAC with new challenges, but without this effort the MELA program will not succeed. We believe that with patience and focus, this is an extremely worthwhile and achievable task as BRAC moves forward.

## 7.6 Briefly review status and progress in the Urban Lending Program

The Urban Lending Program is not an RDP funded program. In 1996, BRAC took a decision to extend its poverty alleviation program to urban areas with the intention of making an impact on urban poverty among squatters. The program, started earlier this year, has 18,000 members in 10 branches. By December 1997, the program will have around 20,000 members and the with a credit portfolio of around 1,000 loans will be made. The intention is to grow the program slowly as BRAC accumulates expertise in urban lending. The budget allocated to the urban program from BRAC Own Funds is still very small. Expenditure is around Tk400,000 - Tk500,000 per month.

The urban program has been modeled on BRAC's highly successful rural program (e.g. up to 40 members made up of groups of five comprise the urban organization (UO); first loan maximum is Tk 4,000, meetings are bi-weekly, 1 PA will serve a maximum of 500 members etc.). Precautions have been taken to minimize the risk of "member flight" which often plagues urban lending programs (e.g. members should have lived in Dhaka for a length of time etc.) BRAC is also coordinating more closely with government to ensure that it lends to squatter settlements which are "permanent" in nature, rather than being subject to forced removals.

One notable difference between the two programs is that UO members are required to deposit double the amount into their savings account (i.e. Tk 40 per month). We think that the risk of lending to urban borrowers is likely to be higher, and that the required savings will both be an early warning of member discipline problems, as well as serving as collateral.

It is far too early to evaluate the urban development and we agree with BRAC's approach of treading carefully as it feels its way in this new market. There will be many questions to answer. Some examples which head-office staff are probably already toying with are the following:

- What problem does BRAC want to fix and how can BRAC maximize its impact?
- Who is the competition and how large is the market?
- What kinds of impacts does lending to different sectors have on employment and income levels?
- Is there a way to structure productive linkages between VO enterprises and UO enterprises (e.g. VO member markets product through UO vendors)?
- Will UO members need larger loans because urban land, labor and input costs are higher?
- Will BRAC increase the size of its collateral (i.e. the compulsory savings deposit) to insulate it from risks associated with lending to a more mobile, less cohesive population who have choices as to who they lend from? What other measures can BRAC use to reduce potential delinquency? Will weekly payments or smaller UO sizes work better in urban areas?

- How can BRAC ensure that the expertise in setting up credit management systems and its skill at managing delinquency in its VO credit program (both at head-office and at the branch level) is catapulted into its urban lending program?
- Will BRAC tolerate a higher loan loss rate in urban areas than rural areas.

We recommend that BRAC carefully monitor the results of its "learning by doing," but also advocate that tools (like the APO tracking system) are set up immediately to assist staff in spotting problems, opportunities and trends early on.

### **7.7 Report on repayments to RCP by BRAC for the HO building**

BRAC borrowed Tk 150 million for the purposes of building the BRAC Centre building. As per the agreement, Tk 15 million was repaid to RCP in June of 1997, leaving Tk 135 million outstanding. The plan is to repay the loan with a payment of Tk 15 million every six months, with the next Tk 15 million repayment scheduled for December 1997.

### **7.8 Comment on the revised budget for RDP IV.**

BRAC is requesting 2.5% (Tk 55 MM) increase in donor funds to cover the gap between its expected revenues and costs to the year 2,000. We think this differential is relatively small, especially given that BRAC never took inflation (currently running at 4% per year) into account when it did its projections. The land and building costs of BRAC's area offices, for example, rose at a rate well above that. Between 1995 and 1997 alone, land costs went up over 30% and construction materials and costs increased by 40%.

The more relevant issue for consideration is how the revised budget is allocated, and the potential impacts of any major changes from the original proposal. The most striking changes in the budget allocations are in the sector programs and in Capital Investment.

- The budget gap of Tk 46 million for Poultry and Livestock is to cover the costs of BRAC's second hatchery which has a production capacity five times larger than planned. As discussed in our section on PSEs, we see this as a high leverage, worthwhile investment which impacts on the poorest of the poor and which will help alleviate the dearth of day old chicks -- the main constraint to the sector's growth.
- Sericulture's budget has been reduced by 8.72% (i.e. by Tk 33 million). Given the constraints to this sector's growth (i.e. shortage of land for trees, DFL that is not sufficiently resistant to local temperature conditions and diseases), together with the fact that the sector is profitable only after a government subsidy as well as a "donation" of land for trees, we believe that likelihood of success is limited. However, we believe BRAC should reserve its judgment until after the Sericulture Review team shares its verdict. Meanwhile, we see no problem in BRAC shifting its funds into a sector (i.e. poultry) which very poor people often choose to engage in, and where demand and success is proven.

- BRAC has requested Tk 23 million to supply essential health care services to very poor women in its VGD program in 42 thanas that are *not* part of RDP. Although the thanas are not part of RDP, we see no conflict of interest for donors who have always supported a focus on the very poor women who constitute VGD's membership base.
- Finally, BRAC has requested a 12.59% increase (i.e. Tk 34,255) for capital investment. This is necessary to purchase the land and to construct area offices in 95 of its localities which are operating out of make-shift buildings on leased land. The request for additional funds stems from the sharp increase in both land and construction costs.

**Recommendation.** Approval. We are comfortable that BRAC's reallocation of RDP funds is reflective of changing market conditions and opportunities, and fully consonant with its mission to impact on the lives of the very poor.

### **7.9 Review BRAC's implementation of recommendations made in the 1996 Annual Financial Review Report**

Generally, BRAC realizes itself when changes are needed to improve program performance. Well argued and grounded recommendations made by any consultant on key areas are seriously considered. We have pointed out BRAC's progress in many areas relating to recommendations made by the Financial Review Team throughout this report.

We find it encouraging that three central recommendations on relatively new areas for BRAC are being taken particularly seriously (i.e. flexible savings products and savings mobilization, skill building for branch managers as a forerunner to greater devolution of responsibility, and the introduction of larger enterprise loans).

Although head-office has acknowledged the importance of tracking service charge delinquency against activity in the sectors rather than the target set so as not to underestimate the amount due, this (as well as the aging of service charges outstanding) has not been implemented yet.

## 8. Summary of Shorebank Recommendations

### 1. Portfolio Management

- 1.1. Credit PAs should focus on savings mobilization with the time now available by moving to bi-weekly meetings.
- 1.2. To support good borrowers and economic growth, branch managers should be allowed to make more than one loan to exceptional borrowers.
- 1.3. Head office needs to be clear on its policy of raising the loan ceiling, and educate branch managers in the specifics, as well as provide credit evaluation guidelines.
- 1.4. Branch managers with very few past due loans and good borrowers should begin to allow longer term loans on a pilot basis.
- 1.5. BRAC should design specific methods to closely monitor the impact of the shift to bi-weekly meetings on loan payments and savings
- 1.6. The *first loan size* should be vigilantly tracked as an indicator that BRAC is reaching very poor borrowers.

### 2. Sector Program

- 2.1. BRAC needs to set new activity targets for its sector programs based on the amount invested in the programs vs. the impact on individual and community income (i.e., a return on investment concept).
- 2.2. The poultry program should prioritize extremely poor borrowers to maximize impact of this sector on the very poor.
- 2.3. Additional poultry hatcheries should be built in 1999 and 2000 to meet demand in this sector.
- 2.4. Sericulture should continue its current mode of no serious expansion pending the proposed program and market evaluation.

### 3. APO, Loan Loss Reserve and Delinquency Management

- 3.1. Given the focus on these sectors, there should be an in-depth study of the business dynamics and possible delinquency problems in the following sectors: fisheries, sericulture and poultry/livestock.
- 3.2. Both rural trading and food processing sectors need to split out into smaller and more revealing sub-sectors (especially rural trading at 50%) so that it can be a more effective management tool. Very small sectors can be combined. Any business grouping that comprises more than 10% of TPO should be separately classified to support concentration analysis, risk management, and the development of technical assistance programs.
- 3.3. Housing loans should be made only after a formal review of the portfolio and clear guidelines are created to describe under what circumstances housing loans should be made, if at all.
- 3.4. All NIBL loans should be put into the 100 weeks APO category.
- 3.5. Any loan that is over three years past due should be formally written off, but that should not preclude continuing collection efforts. Collection efforts

need to be motivated and managed by branch and regional management, not whether or not a loan is formally on the books or not.

- 3.6. Regular VO PAs should be rotated through a position of "work-out specialist" so as to give as many PAs solid experience with loan collections and work-out situations. This is a lending skills development activity.
- 3.7. A one page reconciliation of the loan loss reserve needs to be created at the branch level every quarter. This will require the production of the branch level APO on a quarterly basis, a task which will be made easier when branches have computers.
- 3.8. Branches should contribute to their loan loss reserve based on their performance, rather than a flat 2% (which does not reward good performance).
- 3.9. A loan loss reserve expense of 4% should be set aside for the MELA programme.

#### **4. Savings Program**

- 4.1. Significant additional and much more formal research and market testing of new savings products is required. "Mistakes" in this area will have severe implications for BRAC's funding and liquidity situation. An in-depth study of consumer and saver preferences needs to be made.
- 4.2. Branch managers need to be directed to follow the current HO policy guidelines on savings withdrawals or the guidelines need to be changed. The discontinuity between practice and guidelines is an issue that needs to be resolved.
- 4.3. Assuming a serious research program, a range of products with different pricing and maturities should be explored. Products should reflect consumer preferences, and incorporate issues of location, liquidity, safekeeping and interest rate pricing.
- 4.4. Customer and PA education on the benefits of saving should be increased, and connected to BRAC's overall organizational and development strategies.
- 4.5. A more sophisticated system of savings tracking, management, and forecasting savings behavior needs to be developed to reflect the increasing importance of the savings programs to BRAC's financial health and development impact. This needs to be tracked at the branch and regional levels, not just at the head office level.

#### **5. Branch Profitability, Sector and Operations Management**

- 5.1. The current system of classifying branches year-wise is becoming less and less relevant as the branches mature and the non-age related differences and clusters become more significant. A formal research effort needs to explore different methods of categorizing branches based on type of lending, regional economy, risk and portfolio characteristics, membership behavior and status, sectoral focus, local demographic patterns, etc. While year-wise categories may be retained for more technical or historical

reporting reasons until the end of the RDP IV plan period, a more powerful and revealing category system needs to be developed and made the primary measurement category.

5.2. Fixed dates and tighter payment systems for sector program payments must be adopted. Past due charges should be tracked, as with the APO system, at the branch level.

5.3. The performance of sector staff should be based not only on percent of on-time collections but also on quality (APO) of past dues.

5.4. Branch staff should revise activity targets on a quarterly basis in conjunction with the head office. The current targets for activity levels are too low and targets for cost recovery are too high.

5.5. Payment systems for sector services should move increasingly to a "value added" basis in which the member pays for services they feel add value.

5.6. Thirteen specific technical and assumption changes are proposed for BRAC's financial model. See section 6.3 for specifics.

5.7. Management at HO and regional levels should track not only the total yearwise branch trends of the average of the five management ratios, but should also do a branch-wise trend distribution (as in section 5.2) to understand the distribution of branches across the management variables. Branch average ratios are misleading, in that they obscure the increasing dispersion of branch performance. Additional ratios needs to be explored that focus on economic and income impact.

## 6. Management Systems and Human Resources

6.1. A Training and Development section should be created that focuses specifically on economic development and business research as well as managing, developing and providing specialized training to RDP/RCP employees. This needs to be staffed with experienced staff from inside or outside BRAC that will have credibility with the field staff and an understanding of BRAC's strategic direction and the importance of human capital development, as well as the necessary technical skills.

6.2. Branch managers should be given training on how to grow and develop their staff effectively.

6.3. To increase the focus on branches as enterprises, Branch Managers should submit on a quarterly basis to the head office a report of key indicators (detail in Review) with explanation of any divergence from plan. Regional Managers should do the same on a consolidated basis. Head office should provide branch and regional managers with a standardized set of indicators to evaluate team and individual performance.

6.4. A much deeper and more detailed system of tracking and management of employee skills, experiences and career growth needs to be developed. To increase its leverage and economic development impact, BRAC should integrate its PSEs and Sector programs under one program head for each section. For example, one person should head up everything to do with



sericulture. The programs within this portfolio, however, should still be tracked separately for financial and development impact reasons.

6.5. Reporting on financial and other key indicators needs improvement in the PSEs to allow managers to better analyze their performance. This should be done in the field at the PSE level.

6.6. We recommend the creation of a BRAC RDP/RCP Executive level "Growth Management Workgroup" that can focus on the issues and tasks necessary to resolve as BRAC continues its rapid growth. This group would focus on internal, operations and management issues, not external strategic development issues.

## 7. Other Donor Concerns

7.1. We support the computerization process, and encourage a special focus on the non-hardware training and management systems implications of this project.

7.2. We recommend the approval of the Organized Seed Production Project.

7.3. To create an economic impact that justifies the risk and the program, we recommend that the MELA program focus exclusively on value-added, productive sector businesses that sell to a customer base outside of the community, and not lend to local service and retail businesses.

7.4. MELA should coordinate with the VO program to support wage employment opportunities created by MELA borrowers.

7.5. MELA must design a separate set of lending instruments, management guidelines, training programs and analytical tools that are aimed at this program. The MELA programme cannot be managed as a "Big VO loan" programme. This will require training of existing staff and the hiring of new staff from outside of BRAC that has strong entrepreneurial backgrounds.

7.6. We recommend the approval of the modified RDP budget.

## Appendices

### Appendix 1

#### Distribution of NIBL Across Sectors for June 1996 and June 1997

	A	B	C	D	E
	June '96 Sector's NIBL as % total NIBL	June '97 Sector's NIBL as % total NIBL	June '96 Sector's NIBL as % Sector's Portfolio Outstanding	June '97 Sector's NIBL as % Sector's Portfolio Outstanding	June '97 Whole Sector as % TPO
Agriculture	6%	8%	1%	3%	10%
Irrigation	5%	3%	43%	51%	0%
Baor	3%	1%	7%	9%	1%
Fisheries	2%	10%	1%	6%	6%
Livestock and Poultry	18%	14%	4%	7%	8%
Sericulture	3%	2%	10%	17%	0%
Cottage Industry	2%	2%	2%	4%	1%
Services	0%	0%	1%	2%	0%
Rural Transport	5%	3%	3%	3%	3%
Rural Trading	24%	28%	1%	2%	50%
Food Processing	18%	19%	2%	4%	16%
Health	0%	0%	1%	1%	0%
Miscellaneous	4%	2%	8%	8%	1%
Housing	10%	9%	4%	10%	4%
All Sectors	100%	100%	2%	4%	100%

A comparison of column A and B reveals that the greatest increase in NIBL occurred in the fisheries sector (i.e. a 8% rise). One reason that explains a part of the increase in delinquency are the floods in the second half of 1996. Another partial explanation stems from loans that were substantially delinquent in 1995 but were only placed into the NIBL in 1997. Rural trading experienced the second highest increase in NIBL (i.e. a 4% rise).

Column E tell us the weighting of each sector as a percentage of the TPO. If there is any worsening in the NIBL position of the heaviest weighted sectors (i.e. agriculture, fisheries, livestock, rural trading and food processing), it means that the delinquency problem is affecting many borrowers in these sectors. This is particularly true for the largest sectors (i.e. rural trading and food processing) which experienced a doubling of their proportions of TPO that are made up of non-interest bearing loans (see Column C vs. Column D). Despite the relatively low percentage of rural trading's portion of NIBL relative to its size, the absolute value of taka in rural trading at risk is significant because of the sheer size of its portfolio.

The percentage of NIBL loans in fisheries increased dramatically, being surpassed only by Irrigation, Housing and Sericulture which are identified as particularly high risk sectors. NIBL in the poultry and livestock portfolio also increased.

<sup>1</sup> At a US exchange rate of 43 Taka to the dollar, total principal outstanding was US\$ 71.4 MM in June 1997.

<sup>2</sup> Distribution of TPO among sectors is discussed in depth in the following section.

<sup>3</sup> Source: table prepared by Manager of EIG (Sector Programs).

<sup>4</sup> To the extent that the shortage of day - old chicks from the private sector is a distribution problem only, BRAC can perhaps consider economically viable mechanisms to help bridge the distribution gap to rural areas.

<sup>5</sup> The lower risk of profile of rural trading loans may be related to the fact that the capital of borrowers is fungible and they are able to deploy their money more easily towards market opportunities that present themselves. Rural traders regularly switch between activities such as eggs, poultry, agricultural produce and paddy.

<sup>6</sup> Discussed later in the APO analysis.

<sup>7</sup> An even more sensitive indicator of declining borrower discipline and potential repayment problems is when borrowers begin to neglect to deposit their compulsory weekly savings at VO meetings.

<sup>8</sup> The lows in the first half of 1996 were a direct result of the political upheaval in the country related to the non-cooperation period and not reflective of normal periods. For this reason we have also focused on trends since June 1995.

<sup>9</sup> NIBL is discussed more fully in the section below.

<sup>10</sup> Recommendations on addressing delinquency in these two sectors was addressed earlier.

<sup>11</sup> Only older branches with large savings amounts accumulated were selected as Model 1 candidates.

<sup>12</sup> Bi-weekly VO meetings now take place in many BRAC branches and are discussed in more detail under Portfolio Analysis.

<sup>13</sup> 5% of each loan disbursed is deposited into the VO member's savings account. This component is called compulsory savings. In addition, BRAC requires that borrowers save an amount equal to 2% of their first loan request, 5% of their second loan request, and 10% of all further loan requests before loans are disbursed.

<sup>14</sup> Suggestions on types of information to gathered are briefly mentioned towards the end of the discussion on savings.

<sup>15</sup> A positive real return means that the return should be at least equal to the rate of inflation.

<sup>16</sup> Whereas, weekly savings deposits are long term and allow BRAC head-office to use that money for a certain period of time, no-one yet knows the deposit and withdrawal pattern that will emerge from current account deposits. It is important, therefore, that the monthly changes to the separate savings products are tracked separately so that trends can be more easily anticipated.

<sup>17</sup> The 9% interest payment from the branches to the home office for loan funds is not included in this pie chart expense analysis.

<sup>18</sup> Computer software limitations prevent analysis of more than 250 branches at a time, so Year 1 branches were dropped, and an identical percentage of branches from each Year were removed. Initial examination suggests that this did not change the results of the analysis.

<sup>19</sup> source: interviews with sector staff at head-office and in the field.

<sup>20</sup> BRAC is increasing the size of some of its "non-VGD" branches through the setting up of sub-offices to extend its coverage to meet the needs of very poor people who are still unserved. Senior branch staff (manager and accountant) are not duplicated and interest income from new members covers the salaries of PAs.

<sup>21</sup> Maximum loan size guidelines for branches are: first loan - Tk 4,000; second loan - Tk 6,000; third loan - Tk 10,000. Two percent of savings must be deposited for the first loan and 5% for each loan thereafter.

<sup>22</sup> The best denominator for performance indicators is average total loans outstanding because BRAC's portfolio continues to grow rapidly. For ease in the Branch, month-end portfolio outstandings could be used for monthly ratios. The unit for "At A Glance" indicators is the PA because they are the core branch staff. Regional managers may find it useful to calculate all of these ratios "per Branch" to allow better comparisons among branches of varying sizes and ages etc.