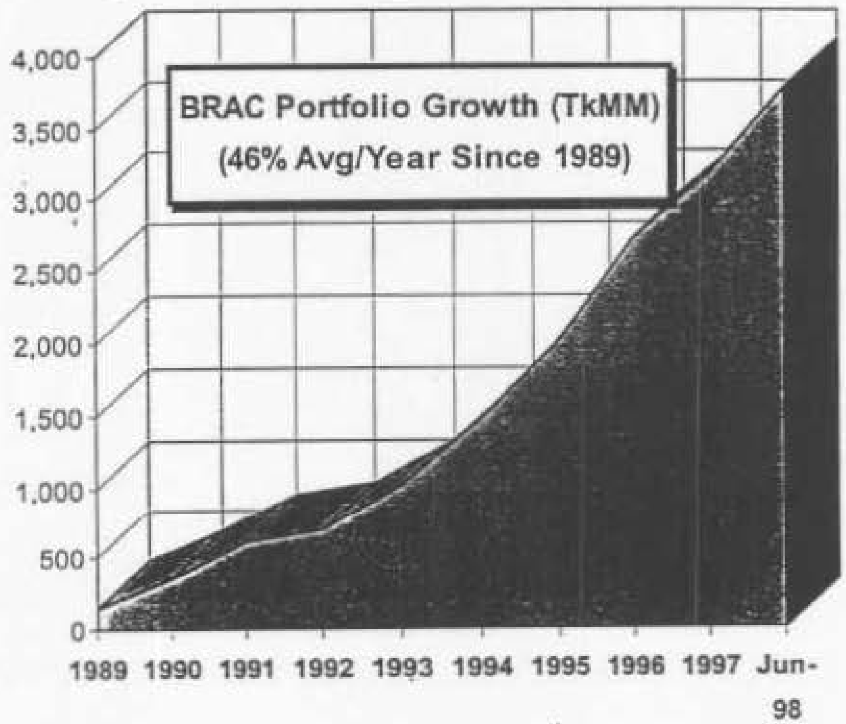
1998 Financial Review
BRAC RDP/RCP Program



The Challenge of Growth Management

Shorebank Advisory Services
Brian Kelley
Lynn Pikholz
December 18, 1998

Table of Contents

Shorebank 1998 Annual Review - Executive Summary Table

Overall Comments	• Against an overall backdrop of BRAC program strength, four primary concerns have surfaced in Shorebank's 1998 Review: (a) funding flood-driven loan demand; (b) effectively managing organizational growth; (c) controlling the BRAC cost structure; and (d) strengthening the BRAC savings program. We see growth management as the most serious long-term issue facing BRAC, and the liquidity crunch caused by the flood to be the most serious short-term issue. • The BRAC RDP/RCP program continues to grow in strength and complexity. With one exception (flood impact), the quality of the portfolio is strong and the system has effectively absorbed an additional Tk712 million over the last twelve months. • The serious exception is the impact of the August flood on portfolio quality and BRAC's cash flow situation. It is likely that the impact of the flood will be to increase average loan size, increase the percentage of members that borrow, reduce member's ability to save, and in some sectors significantly increase delinquency problems. Our initial assessment is that the most acute of the flood-related problems should work themselves out over the coming year, but there will be a residual impact that may last for several years. This assessment is tentative, for given the number of interacting variables the portfolio impact of the flood promises to be very complex.
August-September Flood Impact	• While the flood affected 65% (1.23 million) BRAC borrowers, it will have a disproportionately larger portfolio impact. Looked at through a financial lens, 72% of the portfolio is held by members in flood-affected branches. Over the coming months, the impact of the flood will felt across a number of financial variables. Key projected changes are as follows: increased average loan size, increased delinquency, reduced weekly savings rate, increased savings withdrawals, and an increase in the percent of members that are borrowers. All of these forces will combine to create a "liquidity crunch" for BRAC during 1999. • BRAC has increased its loan loss reserve to 5%, up from 2%. Only 68% of borrowers were current on loan payments during September and October. • Our estimate is that BRAC, as a whole will need between Tk1.3 and Tk2.4 billion to fill the anticipated loan and capital funding gap. Of

that total amount, RDP/RCP will require between Tk600 and Tk1400 million.

Loan Portfolio Growth

- The BRAC portfolio has increased by Tk712 million over last twelve months to Tk3.8 billion in June 1998 (a 23% increase). Overall growth is in line with internal targets across all branches. The percentage of members who have taken a loan is 10% higher in younger branches. Older branch performance is improved from last year but some older branches still need attention. Sector programs as a percentage of the portfolio is flat at 24%, with activity increasing substantially only in the fisheries sector, followed by poultry.

- There will be upward pressure on disbursement following the flood as some members' refinance their businesses, the percentage of members that take out loans will increase, and some members with smaller outstandings will prepay in advance so as to get a larger new loan sooner. With savings deposits down and withdrawals up, BRAC will see increasing pressure on cash flow.

- The plan is to increase BRAC members by 50% over the next five years (including RDP, IGVGD and Urban Lending) and to increase outstandings by 20%-30% annually.

Loan Portfolio Quality

- Portfolio quality remained strong until June 1998, with only a slight deterioration due to switch to biweekly payment system. Loan quality was seriously affected by the flood, with September and October on time repayment dropping to 69% and 68% respectively. The sectors worst affected are poultry, fisheries and agriculture. October's numbers show slight improvement. Recovery will be slower than non-cooperation period as many members lost a substantial amount of their entire asset base.

- The loan loss provision has been increased to 5% of disbursements because of the flood. Given what we know at this time relative to the impact of the flood, we believe that reserves are more than adequate for 1998. BRAC wrote off all NIBL and overdue loans that had been outstanding for three years for the first time ever in December 1997. We believe write-offs should include all NIBL and 100 weeks overdue loans each year. This would bring the expected write-off for December 1998 to almost Tk30 million

- Over 80% of branches have moved to biweekly meetings vs. 33% last year. Members took time to adjust; hence there was a slight increase in delinquency. Weaker branches will continue to repay weekly to reinforce member discipline.

Loan Portfolio Management and Strategy

- The portfolio needs an increased focus on economic impact and strategic leverage of loans to maximize poverty alleviation. MELA is still at the beginning of its learning curve, but has a plan to slowly increase strategic leverage during 1999.

- The current system of loan categorization for RDP/RCP loans is outdated and in some cases so general as to be misleading, so it should be revised. Some categories (e.g., rural trading) are now such a large percentage of the portfolio (54%) that it needs to be subdivided so as to understand and manage portfolio risk.

- MELA and Urban Lending need to draw on RCP credit analysis and management systems more than at present.

Membership Trends

- 20% annual growth rate, up 350,000 members from 1.8 million in June 1997 to 2.2 million in June 1998. Membership will continue to grow, but at a slower pace as BRAC will probably open fewer sub-offices (outposts). MELA, Urban Lending and VGD member growth is likely to be at a faster rate.

Average Loan Size

- Average loan size is up by 9% (Tk4,137 to Tk4,511). Given inflation, this means that there has been essentially no growth in the real value of the average loan. Average loan size of Year Two branches at Tk2,500 indicates poorer households are being served.

Member Savings Activities

- The weekly savings rate declined by 7% to Tk4.62 weekly (or Tk9.24 biweekly) per member between June 1997 and June 1998. Given the shortage of data on the savings program, it is hard to determine causes. This reduction may result from increases in cost of living, member difficulty to save Tk10 biweekly, and the increased intake of poorer (IGVGD) members who can only afford to contribute less.

- Large post flood withdrawals and lower weekly deposits will put continued downward pressure on the savings average during 1999, so this problem should get worse, not better. The overall tracking, management and future of the savings program is a serious cause for concern.

- Growth in total net savings has slowed (up by 13% since December 1997 vs. approximate 20% increase for same period last year). Savings growth in younger branches is far stronger than older branches.

- The results of the new savings pilot programs are inconclusive. Only ten percent of members have opened Current Account Savings. Savings products need additional research, development, staff support and marketing to achieve right pricing and maturity mix.

- Given the importance of the savings program on a number of fronts, we recommend that BRAC create increased a dedicated head-office savings manager directing a team of savings POs (one per region).

Branch Profitability and Sustainability

- In line with RDP IV plan. Strong profitability performance has continued. Without the flood, we estimate that BRAC's total RDP/RCP program (including sector costs) could have broken even by the year 2000. With the impact of the flood, break even will not happen until 2002 if sector program costs are included. Some older branches are still performing much less well than younger branches.

- Sector program cost recovery is below RDP IV targets. Service charges delinquency has increased by 6% over the past year. Costs per member in the sericulture program are very high relative to other programs and we continue to question the viability of this program.

Special Donor Concerns

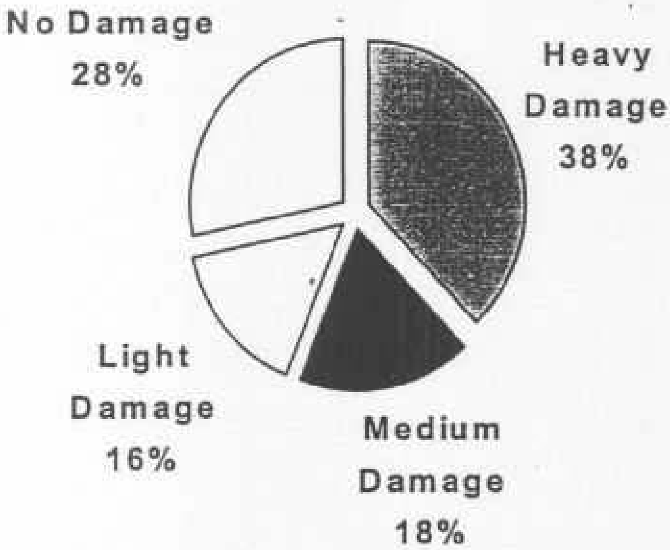
- BRAC trend reports. Detail included in report.
- Computer introduction: Head-Office software has been updated and a 10-branch computerization pilot is in progress. Rollout is on track. Very important growth management strategy, needs to be finished as soon as possible, hopefully sooner than mid-2000.
- VGD program. No financial or sustainability implications for RDP.
- Urban Lending Program: Doubled its membership to 38,000. Plan to increase membership to 150,000 within five years. Only 37% members to date have borrowed.
- MELA program: Lending in 34 branches, just added 17 new branches in November. The goal is 100 branches by December 1999. Delinquency is low, for this remains a "high end VO-loan" program rather than a business enterprise lending program. Most lending is to businesses serving local, not export markets, and thus economic leverage is limited.
- BRAC bank proposal. Awaiting written authorization.
- Head-Office Building Repayments: On track.
- Refund of Group Trust Fund: On track, almost totally refunded.
- Implementation of Shorebank Recommendations: Most introduced to some degree – detail in report.

Recommenda-tions

- Shorebank has made minor suggestions and major recommendations throughout the report. Major recommendations are summarizes in Chapter 8.

1. Opening Reflections: The Twin Challenges of 1999

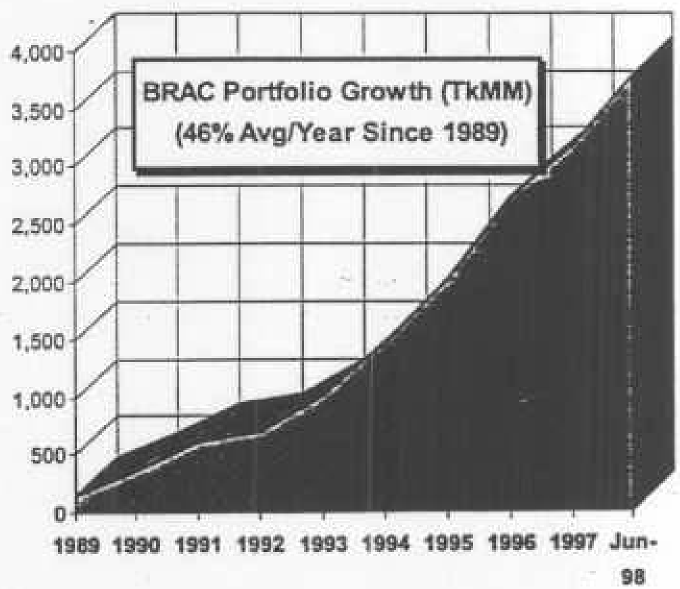
There are two major themes to be found throughout this 1998 Financial Review of BRAC's RDP/RCP programs: (a) the implications of the devastating September 1998 monsoon floods and (b) the continuing challenges of rapid growth management. Both are powerful themes that will perhaps present BRAC with some of the most difficult challenges in its history.



While responding to the flood is a serious and immediate issue, in the long run it is the less serious of the two tasks. How BRAC responds to the challenges of scale and growth management over the coming several years will have a fundamental impact on its future. To make this issue even more important, because of BRAC's international leadership position in the field, how it responds to the challenges of scale and growth will likely affect the future of the microenterprise industry worldwide.

We hope that this review will prove helpful to both BRAC Donors as well as BRAC Management. Given BRAC's long history of exceptional performance, we have full confidence that these challenges will be met successfully.

One quick way to understand the scope and nature of these twin challenges is to examine two graphs. The first graph above shows how the flood damage affected BRAC's loan portfolio, e.g., 38% of the total BRAC portfolio is held by borrowers that live in thanas that suffered heavy flood damage. More specifically, this implies that Tk1.8 billion in loans are held by borrowers that suffered heavy flood damage. While the ultimate impact of the flood on the portfolio will take months to unfold, it is clear that it will have a serious portfolio impact.



The second graph visually shows BRAC continued asset base growth. The challenges of managing this rapid and continuous growth present BRAC's management structure with some of its most difficult challenges. BRAC comes by these issues naturally and these issues are not unique to BRAC. Just because it delivers an unusual "product" does not mean that BRAC is immune to problems which plague rapidly growing companies. All rapidly growing companies, whether they produce computers or garments or issue microcredit, must wrestle with the issues of scale. Like all companies facing continuous and strong growth of this type, BRAC is facing significant stresses and strains in its cost structure, management control systems, employee productivity, and ability to manage an extensive set of ambitious programs. Unfortunately, the flood will only make this challenge more difficult.

Overall, there are four primary concerns that have surfaced in Shorebank's 1998 Review: (a) funding flood-driven loan demand; (b) effectively managing growth; (c) controlling the BRAC cost structure; and (d) strengthening the BRAC savings program.

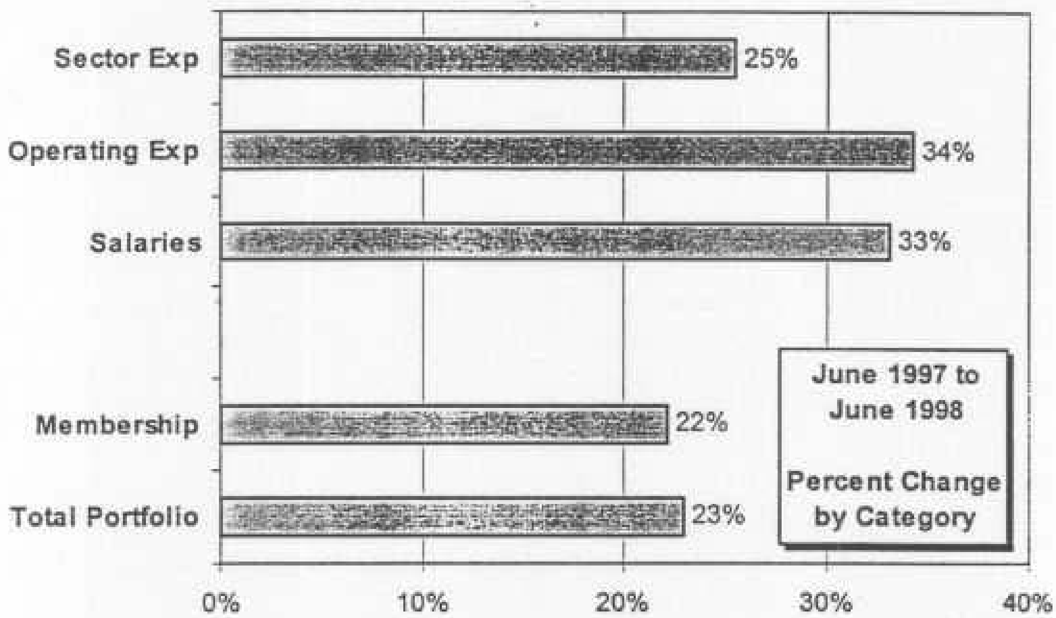
The good news is that until the flood, BRAC's 1998 performance matched RDP IV plans, sustainability levels were increasing, credit quality was good, and several initiatives ranging from MELA to the BRAC Bank proposal were moving forward. The bad news is that the flood has caused immense damage to the country and significant but as yet undefined damage to BRAC's loan portfolio and members. While financial performance remains relatively strong, and at 9% the loan loss reserve is firm, there are still many unanswered questions about how 1999 will play out.

As is so often the case in situations like this, the most troubling issues are like tectonic faults, hidden in what appears to be a solid surface of the earth. The exact nature and severity of these earthquake fault lines is unknown, for they are not easily seen.

Aside from the obvious problems caused by flood, the most disturbing issues raised during this review have to do with BRAC's ability to continue to manage the rapid growth that it has seen since the early 1990's. In many ways, BRAC's management structure, management systems, and system wide program architecture are still more suited to a company with Tk1 billion in assets, rather than the reality of a company with Tk6 billion in assets handling over a million transactions a week. It is always easier to grow assets and hire more employees than it is to renew and develop more capable management systems, capacities and personnel. All too often, companies do not survive such a rapid growth pace because the company is so preoccupied with the constant struggle to cope with the pressures of constant growth that it is unable to and engage in the constant self-improvement that is necessary to survive.

Let us be very clear. Our intent is not to be critical or to cast doubt on BRAC Management. Quite the opposite is true. In fact this "problem" is the result of BRAC's success and growth, not its failure. It is a testament to the strength and competence of BRAC's management that BRAC has done as well as it has, in spite of its extraordinary pace of rapid growth. However, as BRAC management and the group of Donors looks forward to 2000 and beyond, these less immediately visible, underlying stresses of rapid growth are increasing and must receive significant attention, not just "fine tuning."

Our intent is to state explicitly that this is a very serious issue facing BRAC. Now is the time to focus on it and begin to make the complex and systemic changes that will allow BRAC to support continued growth over the coming decade. The time to address these issues is not when the system begins to "break", but before that point. That time is now.



The graph above is just one of many examples of how the stresses of growth are beginning to appear. A classic symptom of rapid company growth is escalating costs. This graph shows that operating and salary costs increased by 34%, while membership and the loan portfolio increased by only 23%. As BRAC obtains the benefits of economies of scale, the reverse should be true: its costs should be increasing at a rate substantially less than its asset base and membership.

The diagnosis of this and other "Growth Management" issues facing BRAC and the development of a plan of response are well beyond the scope of this brief three-week Financial Review. We make no claim that this review offers anything like the comprehensive analysis that must be done to understand and respond to these issues. We do, however, recommend in the strongest terms possible that BRAC set up a permanent, well connected, multi-department "Growth Management" Task Force (involving people inside and outside of BRAC) and give the support of Senior Management.

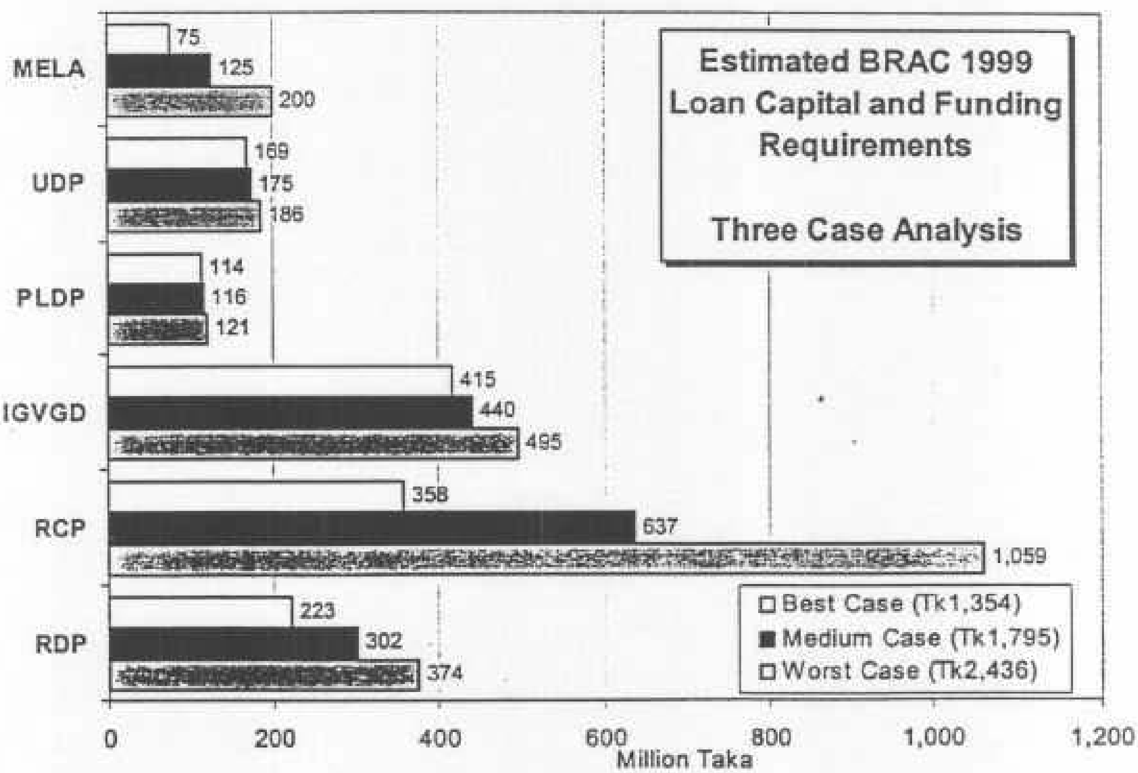
As always, we thoroughly enjoyed working with BRAC employees, the Donors and the DLO Office during the course of this Review. For your convenience, we have included a chapter at the back of this document that summarizes our recommendations.

2. Impact Of the Flood and Funding Requirements

2.1 Total BRAC Funding Summary

A number of expected and unexpected forces will create a need for additional BRAC capital funds during 1999. The expected forces are positive: continuing membership and lending growth and the expansion of specific targeted programs (e.g., MELA and Urban Lending). The unexpected forces are negative: a decrease in the average per member savings amount and the damaging August-September monsoon floods.

Even though each of these factors are quite distinct, they all reinforce each other in creating a "liquidity crunch" for BRAC. There are actually two types of loan capital needed. The first type is "internal" capital needed to keep the current BRAC financial and capital situation healthy (primarily to cover flood related loan losses, loss of interest income, and flood related mandatory loan refinancing). The second type is "external" loan capital necessary to enable BRAC to say "Yes" to new or additional loan demand from existing and new members. As was discussed at the December 7, 1998 Donor meeting, BRAC can always say "No" to new, "external" demand for loans should it not have sufficient funds.



At this point, it is too early to determine the exact amount and timing of the need for additional loan funds, but we have nonetheless attempted to estimate capital needs. As suggested by the graph above, based on a "medium case" of loan demand, BRAC RDP/RCP will require a total of about Tk950 million or US $20 million will be needed to support flood recovery and program growth for the BRAC RDP/RCP programs. Beyond RDP/RCP, an additional Tk800 million will be needed over the coming year to support the continuation of other BRAC loan programs.

Some of these funds will be needed relatively quickly, during the coming six months, as BRAC members work to recover from the flood damage. Other funds will be needed at a more steady pace over the coming 12 months, to support the steady program and lending growth of existing and emerging BRAC lending programs.

Any analysis is only as good as the underlying assumptions. The assumptions for the projected BRAC funding gap are listed in the table below. The most powerful factor is average loan size, followed by the percent of members that are borrowers. Should some indicators get "better" (e.g., average loan size does not increase at the rate projected or savings withdrawals do not increase at the projected rate), then the funding gap will be less. On the other hand, should some key variable get "worse" (e.g., weekly savings rate drops even more), then the funding gap will be greater.

BRAC Funding Analysis Key Assumptions

	Pre-Flood	Best Case	Medium Case	Worst Case
RDP Average Loan Size	Tk3,400	Tk5,500	Tk5,800	Tk5,900
RCP Average Loan Size	Tk4,900	Tk5,900	Tk6,000	Tk6,100
% of Members That Borrow	70%	76%	77%	80%
Loan Loss Reserve	2.0%	3.0%	3.5%	4.0%
Savings Withdrawal Rate	0%	20%	23%	25%
Weekly Savings Rate	Tk4.6	Tk4.1	Tk3.6	Tk3.0

2.2 Possible flood and funding impact indicators

To avoid over-lending or even creating a capital deficit, BRAC needs to devise a set of indicators that will help it to forecast and manage its funding needs, as well as to assess the impact of the flood on credit, savings and sector programs. BRAC's accounting department now has a model to help it monitor the funding needs arising from the flood. To use the model, the following information should be supplied to BRAC monthly from all branches on as frequent and timely a basis as humanly possible.

- Total Number of members (affects savings and indicates potential future loan demand)
- Percent of members who are borrowers (affects disbursements)
- Number of new members (projects level of future disbursements)
- Number of of drop outs (impacts member motivation, savings withdrawal, and repayment)
- Membership at the end of the current month (use for forecasting funding need)
- Total disbursement during the month
- Number of borrowers requesting new loans

- Number of borrowers requesting refinanced loans
- Total Taka refinanced
- Number of new loans disbursed
- average size of all loan requested during current month (all loans including refinancing loans)
- On time repayment (including arrears and advances, paying off arrears and advances usually means that a new, larger loan request is coming)
- On time repayment (excluding arrears and advances)
- Percent of members that made all payments during the month
- Percent of members that made no payments during the month – indicates possible future losses
- APO: percent borrowers with zero past due, 1-4 payments missed, 5-12 payments missed; 13-25 payments missed; over 25 payments missed; (indicates money available to finance future disbursements)
- Percent of active savers (made at least one savings deposit during the month)
- Average biweekly savings rate/ member
- average net savings per branch (all savings deposits – savings withdrawals)
- Number of members in each of the sector programs
- Percent of realized / % due (based on activity, not targets) for each of sector programs.

2.3 Estimated portfolio quality impact of the flood

The flood affected over fifty percent of BRAC's branches. Of those affected, VO members living in 120 areas were badly to moderately affected. The flood had three immediate financial impacts: decreased savings deposits, increased savings withdrawals and decreased on-time repayments of loans. On time repayments (OTR) excluding advances dropped significantly from June 1998 levels in August (down 22%), September (down 37%) and October (down 21%).

It is still too early to say whether the improvement in October's numbers will continue in the months ahead. We are sure, though, that the recovery will oçcur at a far slower pace than the six-month recovery of BRAC's portfolio after the non-cooperation period in early 1996. This is because most households did not lose their assets during the non-cooperation period, they just lost business opportunities. The flood, however, has wiped out the asset base of a large number of BRAC borrowers. This will put downward pressure on the pace of the recovery.

Percent of Members with On Time Repayment (OTR for RDP+RCP+VGD)

	Incl. Arrears + Advances	Exclude. Advances	Exclude Arrears + Advances
June 98 (pre-flood)	122%	99.6%	92%
August 98	92%	78%	77%
September 98	73%	62%	61%
October 98	94%	77%	74%

The aging of the portfolio for September 1998 (including VGD branches) showed that the flood impact was uneven across sectors. Overall, only 68% of the portfolio was 100% current. The sectors most affected were cottage industry, sericulture, poultry and livestock, and housing. Even though rural trading's 100% current portfolio share was 72% (vs. over 90% in June), the fact that it comprises over 50% of the entire portfolio means that there will be a substantial effect if those borrowers do not recover. The impact on agriculture's borrowers was partially insulated, as most maize borrowers had not begun their crop planting. Vegetable growers, however, were severely affected.

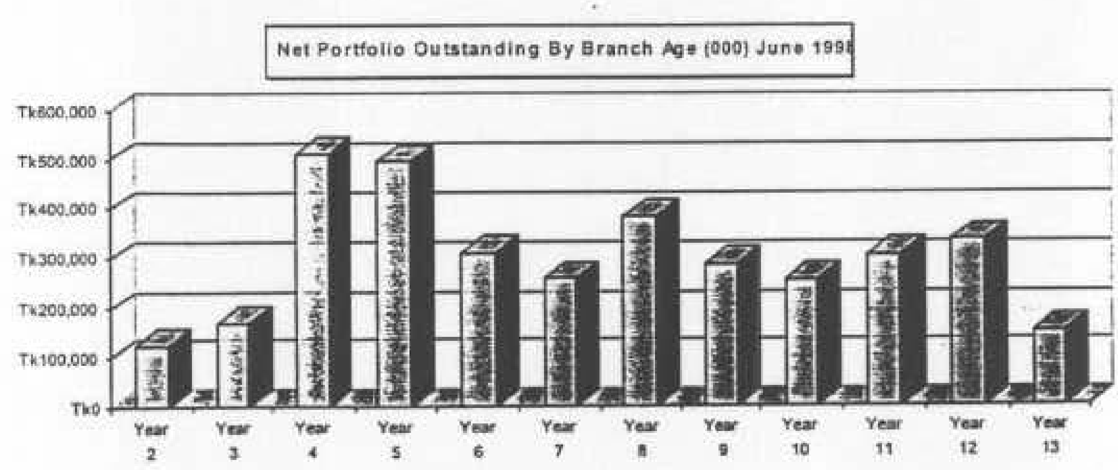
	# Members that made all payments	# Members that missed all payments
June 98 (pre-flood)	1,552,436	93,667
August 98	1,287,778	244,583
September 98	1,016,227	453,124
October 98	1,236,333	304,922

BRAC's strategy to deal with flood-affected areas has been four-fold:

- Supplying emergency relief and replacement of stock for those most severely affected. The relief is financed from outside the RDP budget
- Allowing members to withdraw up to 50% of their savings
- Allowing members to refinance their business up to 50% of the previous loan amount that they received. This will put upward pressure on disbursements over the next six months
- Allowing members who have a good repayment history to pay off the balance of their outstanding loan in advance, so that they can receive a larger new loan. This will also put upward pressure on disbursements.

3. Portfolio Risk Management and Credit Related Activities

3.1 Portfolio Analysis Summary



In spite of continued strong growth (June 97 to June 98 growth rate of 23%), BRAC's portfolio quality is strong, and credit management continues to be a focus for branch managers. While there are "soft spots" in certain sectors (fisheries and food processing) and within some older branches (Year 11 and 13 branches), portfolio performance overall is strong, especially given its size (Tk3.8 billion in June 1998). The 1% increase in NIBL is a full point lower than the increase we reported on last year, and problems in Year 12 branches have been largely resolved.

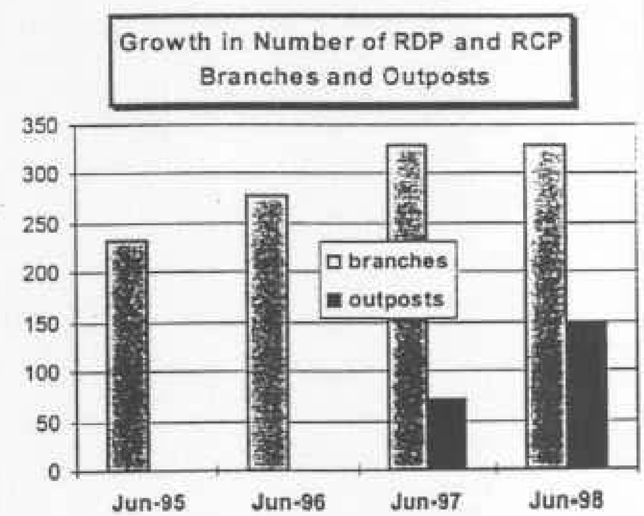
From a Donor/financial management perspective, we see no major problems looming in BRAC's loan portfolio, with the exception of the impact of the flood. From a BRAC Management perspective, we see potential to improve the performance in some of the 11 and 13 year branches, as was done in the case of Year 12 branches over the past year. We also see the need for BRAC to develop a deeper understanding of higher risk sectors (fisheries, food processing, sericulture and housing), and sectors where the portfolio has become concentrated (e.g. in rural trading and food processing).

3.2 *Implications of changes in disbursements, outstanding, and loan size*

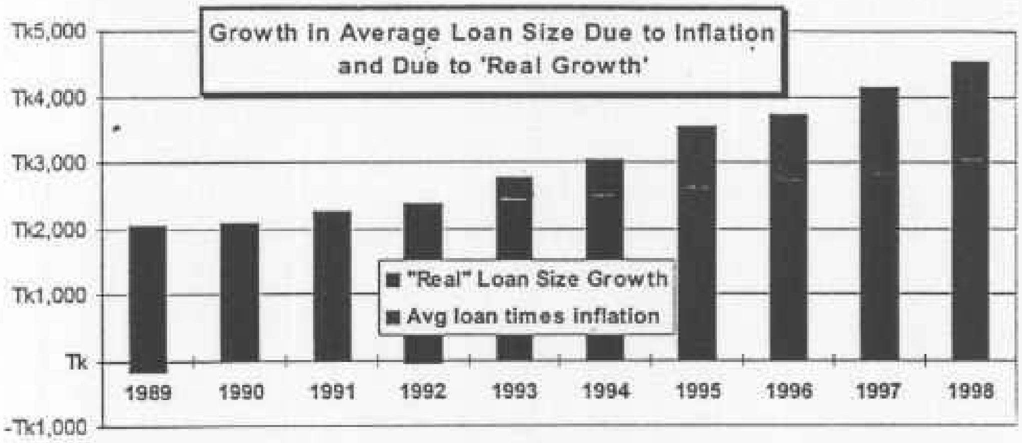
Sectorwise Distribution of Principal Outstanding (RDP + RCP)

	Jun-96	Jun-97	Jun-98
	Sector as % TPO	Sector as % TPO	Sector as % TPO
All Sectors	100%	100%	100%
Agriculture	11%	10%	9%
Irrigation	0%	0%	0%
Baor	1%	1%	1%
Fisheries	5%	6%	6%
Livestock and Poultry	9%	8%	8%
Sericulture	1%	0%	0%
Cottage Industry	2%	1%	1%
Services	0%	0%	0%
Rural Transport	3%	3%	2%
Rural Trading	43%	50%	54%
Food Processing	18%	16%	12%
Health	0%	0%	0%
Miscellaneous	1%	1%	4%
Housing	5%	4%	3%

Total principal outstanding (TPO) increased 23% from Tk3 billion in June 1997 to Tk3.8 billion June 1997.[1] This compares with a 26% rise in TPO from June 1996 to June 1997 and a 34% increase from June 1995 to June 1996. BRAC devoted significant staff time over the past two years to opening new branches and outposts and increasing its membership reach (see graph). These efforts are likely to translate into an increased rate of portfolio growth going forward. The refinancing of a portion of BRAC's portfolio (estimated at around 20% of members in flood affected areas) will put further upward pressure on outstandings over the next year.



Except for the Rural Trading (up 4%) and Food Processing sectors (down 4%), there were few striking changes in the value of each sector as a proportion of TPO. 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 real value of the average loan size increased



between 1% and 2% over the past year. The average loan size increased from Tk4100 to Tk4500 -- a 10% increase vs. an inflation rate increase of between 7% and 10% over the past year. It is interesting to note that the "original" 1989 BRAC first loan amount of Tk1600 would in 1998 be inflation adjusted to be Tk2400.

The term mix remained relatively unchanged. 99% of BRAC's portfolio (excluding MELA) 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.

	% No Pmts Missed-June 97	% No Pmts Missed-June 98 (after write-off of Dec 1997)	% Missed 4-25 Payments June 98
All Sectors	87%	90%	5%
Agriculture	89%	92%	7%
Irrigation	40%	80%	12%
Baor	77%	79%	19%
Fisheries	76%	88%	7%
Livestock and Poultry	85%	92%	7%
Sericulture	57%	71%	8%
Cottage Industry	94%	88%	11%
Services	92%	93%	7%
Rural Transport	91%	93%	7%
Rural Trading	91%	93%	7%
Food Processing	82%	86%	12%
Health	96%	97%	3%
Miscellaneous	84%	80%	17%
Housing	54%	67%	14%

Impact of Biweekly Meeting Schedule Change.

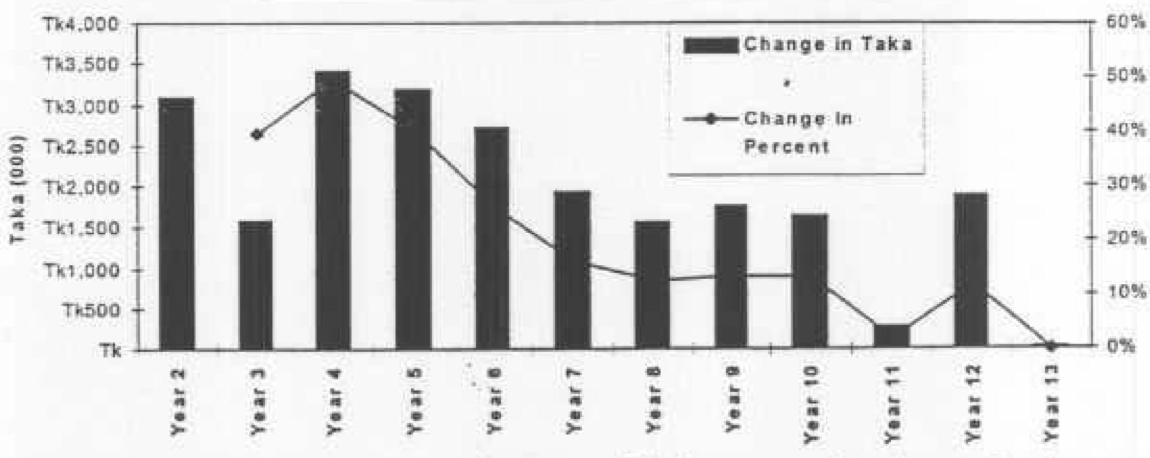
In early 1996 BRAC experimented with monthly VO meetings in first year branches instead of weekly meetings. BRAC found that although delinquency did not deteriorate significantly, there were at least two notable impacts:

- A portion of members found it difficult to pay a single, large monthly installment. In other words, they found it easier to manage their cash flow 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.

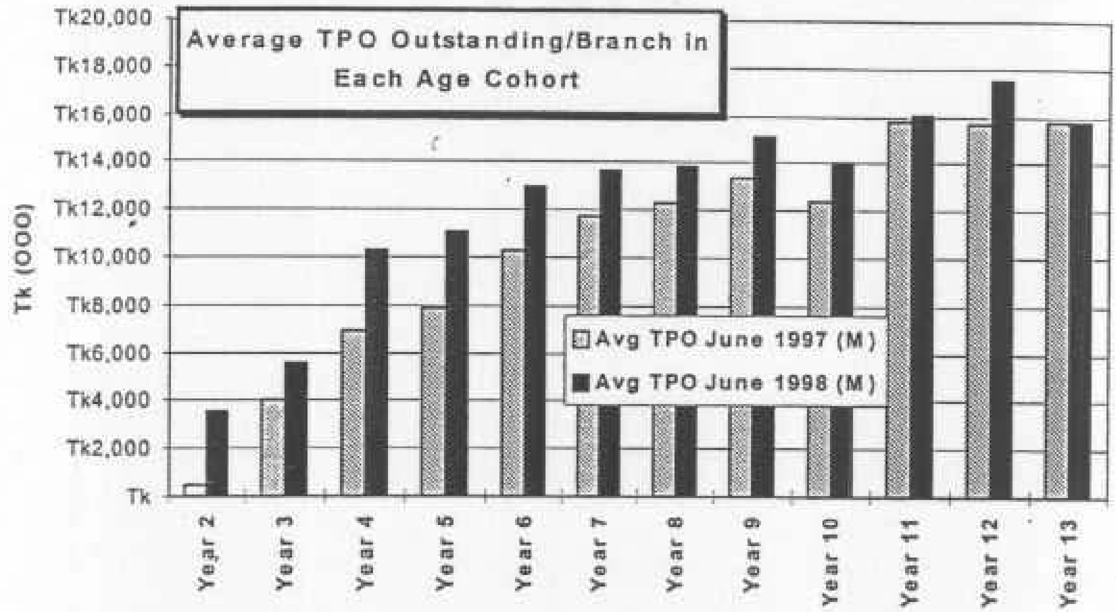
By the third quarter of 1997, BRAC changed meeting frequency to biweekly meetings for all first and second year branches (i.e. two meetings a month). By December 1998, 300 out of 330 branches are using the biweekly meeting structure. During the period of transition to biweekly meetings, there was a substantial increase in delinquency (e.g., no payments missed dropped to 80% in June 1997 from 87% the previous month). The portfolio recovered quickly as members adapted to the larger biweekly installments that were due. Overall, there was a 1% decline in the quality of the portfolio outstanding between June 97 and June 98. If not for the write-offs in December 1997, the no-payments missed category, which currently displays 90%, would be 86% (vs. 87% a year earlier).

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 biweekly 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.

Change in Average TPO / Branch (June 97 - June 98)



As a result of the shift to biweekly meetings, some PAs have more free time to do other work. More staff time will be freed up once branches receive their computers. We feel strongly that a directive should come from head-office as to what additional performance is expected from PAs. As we mentioned last year, we think that a much more serious savings mobilization effort would be an effective use of their time.



Suggestions Related To Disbursements, Loan Size, And Term Mix

1. BRAC should track the median first loan size of all borrowers. A small percentage of borrowers receiving a first loan of Tk2000 or less may indicate that poorer members are not being adequately reached. BRAC should also continue to monitor both the number of VOs and the average VO size to keep track of new member growth.

2. 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.

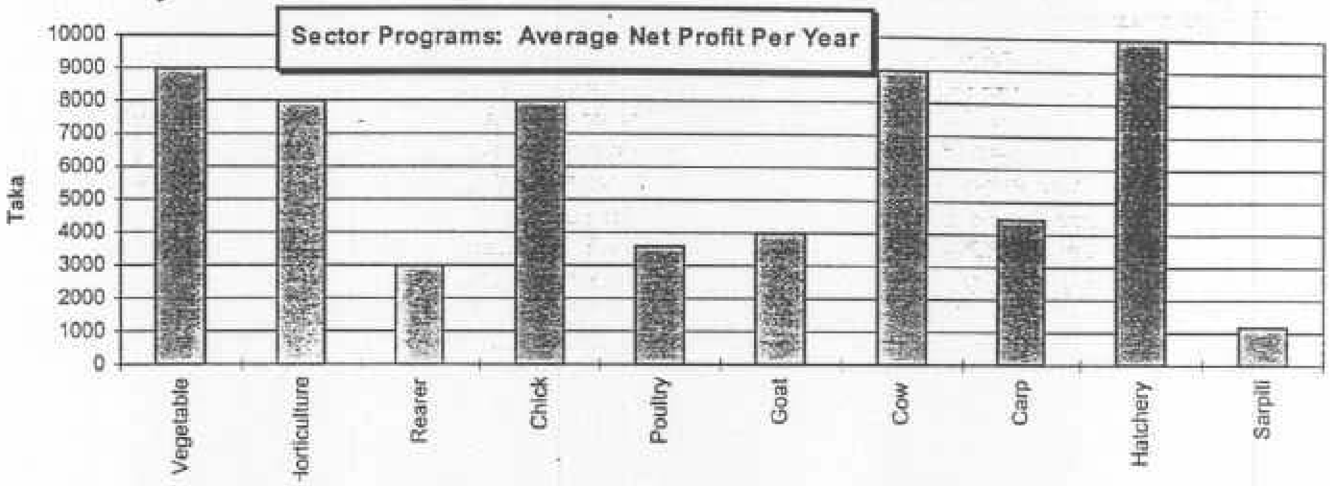
3. PA staff should become savings mobilizers as part of their current job until an alternative staffing arrangement is in place. The shift to bi-weekly meetings should free up some time, as should the shift to the new system of exception only reporting.

4. VOs, where delinquency has increased noticeably since the switch to biweekly meetings should either switch back to weekly meetings, or give specific training to members to assist them manage an increased cash flow.

5. Branch staff should be asked to investigate the slow rate of outstandings growth in Year 11 branches and the "no growth" in Year 13 branches.

3.3 Changes in sector portfolio outstanding

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 1998. The RDP IV Plan target is 25% of TPO, a target reached in 1995 and 1996.

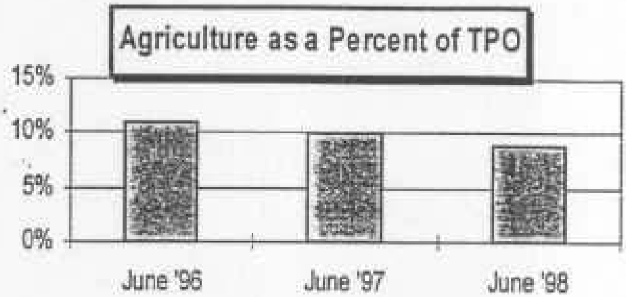


BRAC intends to increase its portfolio in fisheries, livestock/poultry and agriculture in the years ahead. This is because the net-profit for members operating in these sectors is significantly higher than many alternative options. For example, the average income a poor rural household earns is Tk12,000. A vegetable grower or chick rearer can increase their household income by an additional 80% (Tk10,000) a year. The largest long-term opportunities for growth are probably in the poultry and livestock program as agriculture and fisheries need land, which is not easily available, and sericulture to date has not proved economically viable for either members or BRAC.

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 Tk1,500 compared with a Tk4,500 average loan for all sectors.

	% increase in size of sectors: June 97 -98	Sector's % of TPO in June 1998
All Sectors	23%	24%
Agriculture	11	9%
Fisheries	32	7%
Sericulture	-22	0%
Poultry and Livestock	20	8%

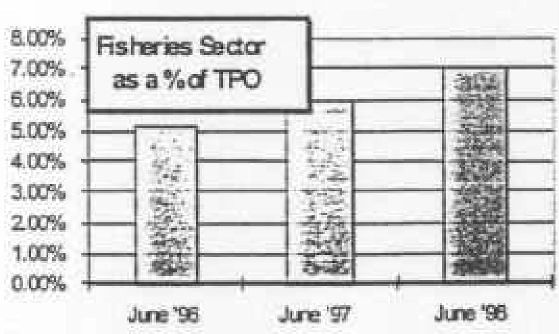
Goat rearers also take a relatively smaller size loan (Tk3000) and sericulture rearers often do not require repeat loans to continue operating in the sector. Around 24% (493,944) of all BRAC RDP members are involved in Poultry. Approximately 7% of members own livestock (cows and goats), 7% are in fisheries, and 5% are in agriculture. Less than 1% of members are involved in sericulture. In the June 1997 – June 1998 period, only the fisheries portfolio, which grew 32%, increased at a faster rate than the average for all sectors, which grew at 23%.



Agriculture. Members in this sector totaled 84,160 in June 1997 vs. 61,324 in June 1998 (excluding around 20,000 – 30,000 maize producers). Income generation for members in this sector is hindered by the availability of high quality seeds and suitable land. BRAC's shift into Maize production which can be grown in poor soils (e.g. in North Bengal), and its seed production center, which produces and distributes high quality seeds, are helping to alleviate these problems. The land constraint is being addressed though approaching landowners and asking them to lease a piece of their land to VO members. Currently, 90% of farmers own their land and 10% lease. We can expect this sector to slowly grow its number of members, with the percentage of members that lease land increasing proportionately.

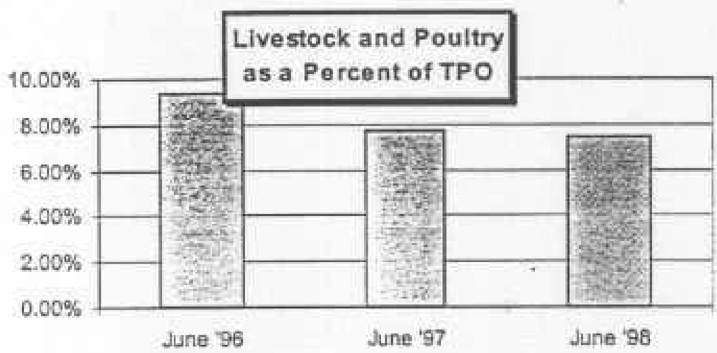
Flood Impact on Agriculture (see projections later). Over eighty percent of the 61,000 vegetable growers, who make up 60% of the agricultural sector, were very hard hit by the flood. At least 50% of these farmers suffered serious losses. Luckily, maize growers who make up the other 40% had not yet planted their crops and thus escaped relatively unscathed. Since most crops have a two-month cycle, the head of the sector expects a substantial degree of recovery by the end of December 1998. He expects 15% of those worst affected to want to refinance their loan.

Fisheries. The fisheries sector increased its members from 141,253 in 1997 to 152,727 in 1998. BRAC is managing to expand this sector by leasing land with ponds, rehabilitating unused ponds, 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.



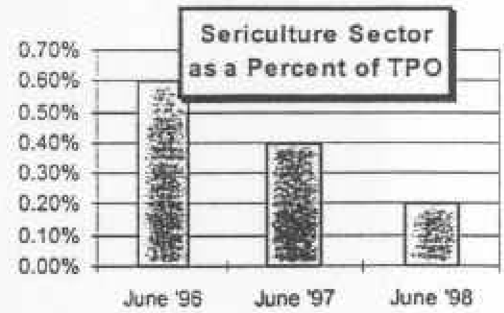
Flood Impact on Fisheries (see projections later). Fisheries were very hard hit by the flood. Thirty percent of ponds experienced serious physical damage and an additional 20% had moderate damage. Eighty percent of fingerlings escaped. Most farmers lost their entire stock, as well as the investment they had made in digging and preparing the pond. Since pond stocking takes place in April / May, and harvesting starts in July August, it will take at least six months to nine months before there is significant recovery among these farmers.

Poultry and Livestock. An additional 30,000 members joined BRAC's poultry sector and an additional 10,000 women participated in BRAC's livestock sector over the past year. 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 Tk1500. 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 Tk3,000 - 4,000. They then purchase poultry for Tk1,500 and use the balance for rural trading. This type of outcome is unavoidable for as long as BRAC staffs discourage members to take out more than one loan.



Flood Impact on Poultry and Livestock (see projections later). The head of the poultry sector estimates that 310 out of 380 branches (including the 50 VGD branches) were very badly affected by the flood. The houses for the poultry were destroyed, as was a large proportion of the stock which members did not manage to sell on time. The market was flooded with chickens and hence the price per chick or hen was very low at the time of sales. He believes that 50% to 55% of members affected will ask for a refinancing loan. The head of the livestock sector estimates that although BRAC may recover most its losses within one year, it will take members two or more years to make up their losses as livestock, especially cows, are a very expensive to replace.

Sericulture. The sericulture portfolio as a percent of TPO continued to decline . There are roughly the same number of members now (i.e. 24,000) as there were in 1997. 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 early 1999.
We strongly agree with this decision, and are skeptical of the viability and economic impact of the sericulture sector.



Impact of Flood on Sericulture (see projections later). Between 60%-70% of all mulberry trees and bushes were destroyed by the flood. Over 60% of members lost a significant portion of their crop and suffered damage to their rearing houses. The heads of the sericulture expect a 25% drop in membership and less Disease Free Larva to be available to existing members. They estimate it will take the sector three years to recover till the trees and bushes get back to their former levels.

Other Comments

BRAC has strengthened its management of the sector programs by transferring two of RDP's top regional managers to head up the Poultry and Livestock portfolios. All four of the largest sector programs now have very strong managers who have sound operational experience. BRAC head-office needs to develop systems that will allow them to track the flows of inputs into the branches as well as cash flows from members to the branches, and from the branches back to the head-office.

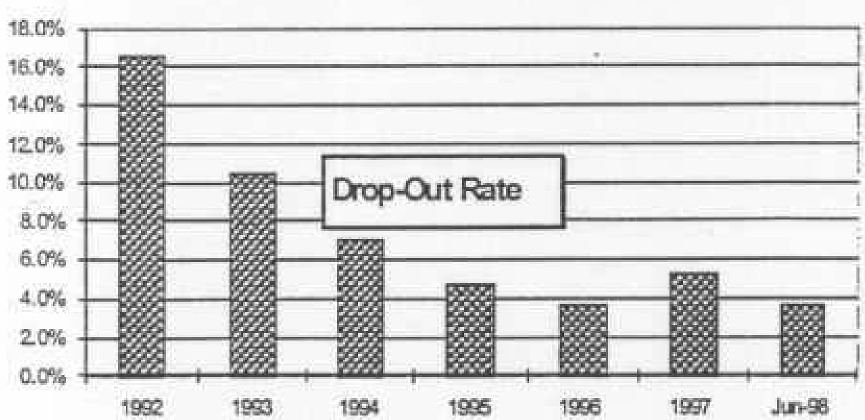
Recommendations: sector programs

1. We suggest that BRAC set new targets for its sector program coverage, which systematically underestimate achievements. This is important for forecasting inputs, cost recovery from service charges as well as for motivating staff to increase their performance.

2. We recommend 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 the impact of external forces (e.g. government lifting the tariff on imports).

3.4 Delinquency in the loan portfolio

Before analyzing BRAC's portfolio it is worth documenting how BRAC managed to decrease delinquency in some of its older branches (mainly last 1997's Year 11 branches). BRAC began what it calls a rebuilding strategy where non-performing VOs (i.e. VOs that have many inactive members and high past-dues) are "weeded out". BRAC has found that a lack of borrower discipline in poorly performing branches is contagious.



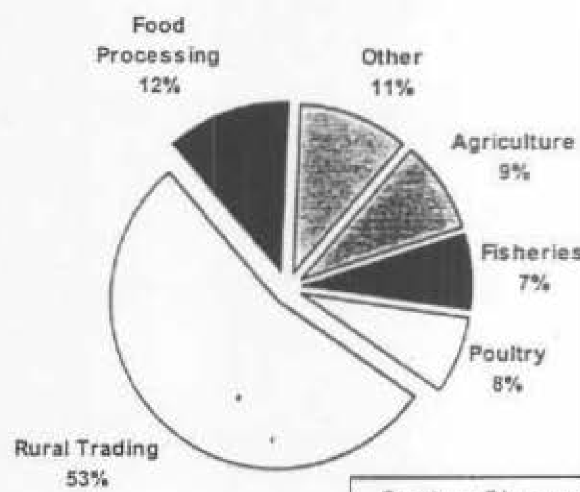
To prevent "good borrowers" from becoming credit risks, BRAC's "rebuilding strategy" builds up a new, well functioning VO in the same area, moves across the "disciplined members" from the deteriorating VO. BRAC introduced this system at some of its 37 highly problematic branches where borrower discipline, particularly in some VOs had deteriorated substantially. The result: decreased delinquency and an increase in the dropout rate of inactive members. Another factor contributing the decrease in delinquency among some older branches and the increased drop-out rate is the fact that all members' whose debt was written off at then end of 1997 were (finally) categorized as inactive, and their outstanding debt was taken off the books.

In our analysis of loan portfolio delinquency, we follow a three-step process:
1. Identify the sectorwise distribution of principal outstanding to see how large each sector is relative to the size of the loan portfolio.
2. Evaluate the trends in each aging category of missed payments.
3. Identify those sectors that have the greatest amount principal outstanding that are 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 an additional 4%. Over the past three years this sector has grown 19%. The latest increase is particularly striking because rural trading already occupied 50% of TPO in June 1997. It now occupies 54% 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. As mentioned in last year's report, we think it is important to separate out larger sub-sectors within rural trading for at least two reasons to assess their risk profile.

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 carefully track loan categories that exceed 10% of the value of the total loan portfolio for risk management purposes.

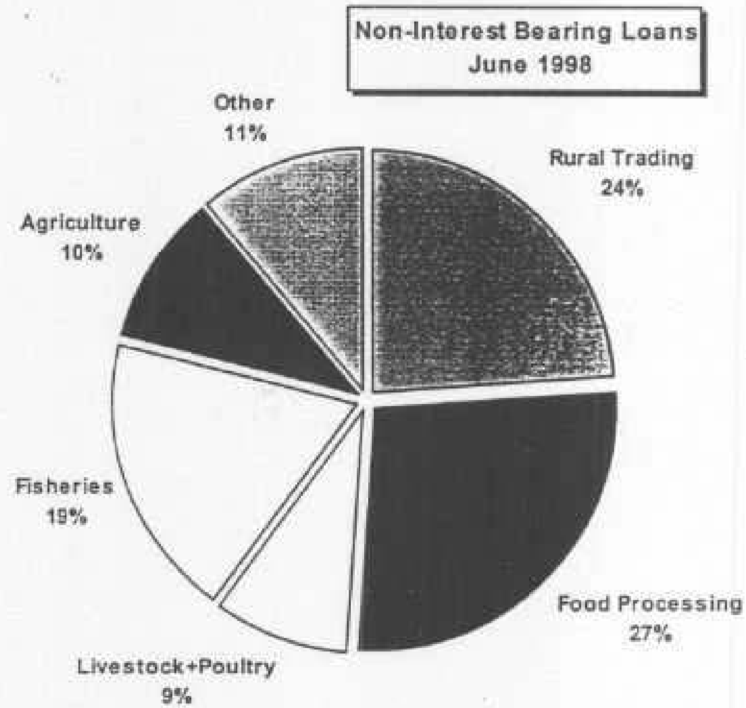


Sectors Share of Portfolio (June 1998)

Apart from rural trading, the only other sector that registered an increase in size as a portion of TPO was the Miscellaneous 'sector' (up 3%) which is impossible to analyze due to the vagueness as to what is contained in this category. Food processing, the second largest sector, registered a 4% decline. 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 the reasons underpinning the decline so as to know which parts of the food processing business was not lucrative for borrowers. This is important as food processing has a disproportionately high risk.

Housing sector TPO declined as a proportion of TPO, the housing sector has shrunk to 3% of TPO vs. 8% in 1995 to 4% in 1997. The reduction in housing loans stems from a management decision not to grant housing loans given their disproportionately high risk historically.

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.



We believe that the "no payments missed" category across sectors (see table earlier) 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.[2]

Payments Missed	Jun-93	Jun-94	Jun-95	Jun-97	Jun-98	Jun-98 no (write-off)
No Payments Missed	70%	84%	87%	87%	90%	86%
1-4 payments	7%	4%	4%	4%	5%	4%
5-12 payments	5%	3%	3%	2%	2%	2%
13-25 payments	5%	3%	2%	2%	1%	1%
26-50 payments	7%	3%	1%	1%	1%	1%
over 50 payments	5%	4%	3%	5%	1%	6%
Payments Missed	29%	17%	13%	13%	10%	100%

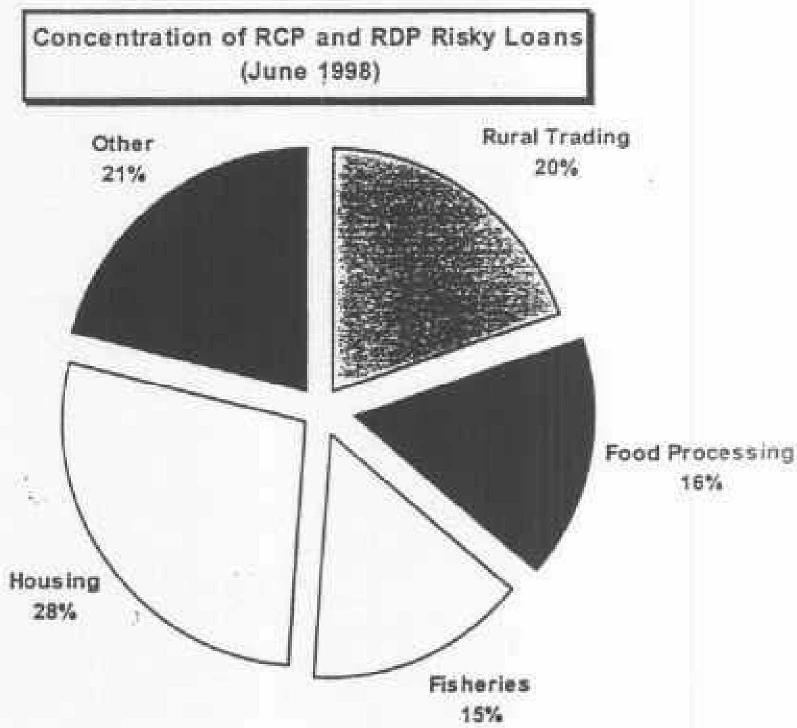
BRAC's overall portfolio has remained strong in line with its performance since June 1995. There has been a slight deterioration in the no payments missed category. Fisheries, sericulture, housing and food processing continue to be higher risk sectors.

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 that 0.5% of TPO, the problem is less worrisome than if a sector like fisheries which is 7% of TPO has many delinquent borrowers.

	A	B	C	D
(Note: Risky Loans are defined as > 26 payments missed plus all NIBL)	What % of each sector are risky loans (6/98)	What % of each sector are risky loans (6/97)	% of total risky loans that sector occupies (6/98)	% of total risky loans that sector occupies (6/97)
Agriculture	1%	5%	6%	8%
Irrigation	8%	54%	0%	2%
Baor	2%	12%	1%	1%
Fisheries	5%	10%	15%	10%
Livestock & Poultry	1%	8%	5%	11%
Sericulture	21%	26%	3%	2%
Cottage Industry	1%	5%	0%	1%
Services	1%	4%	0%	0%
Rural Transport	1%	4%	1%	2%
Rural Trading	1%	3%	20%	24%
Food Processing	2%	7%	16%	17%
Health	0%	1%	0%	0%
Miscellaneous	2%	9%	5%	1%
Housing	19%	30%	28%	18%
Total in All Sectors	2%	6%	100%	100%

Column A ignores the proportion of the portfolio that the sector occupies and merely shows how much of the particular sector's portfolio is risky. We can see that sericulture has the biggest chunk of risky loans in its portfolio compared with other sectors. Housing also has a fifth of its portfolio in the "high risk" category. We can see though, that the position improved dramatically for housing and irrigation over the past year (compare A vs. B above). This is because many of these loans, which should have been written off a several years ago, were finally written off at the end of 1997. Ten percent of the fisheries portfolio and eight percent of the poultry and livestock portfolio is in the "high risk" category.



Column C shows the four sectors that make up over 60% of the risky loans in the portfolio (housing, food processing, fisheries, and rural trading). We expect rural trading to house a large chunk of risky loans given that 54% of the total portfolio is in this sector. However, the same is not true for fisheries, housing or food-processing which all have a substantially higher percentage of risky loans than their respective weights in the loan portfolio. While the proportion of risky loans has declined in both the poultry/livestock and agriculture sectors over the past year, the position of fisheries and sericulture have deteriorated further. We feel strongly that BRAC should examine the causes of delinquency in these sectors if it intends to reduce losses in the future.

Recommendations

1. Because BRAC is deliberately targeting its sector programs, a study of the reasons for delinquency in the fisheries and sericulture 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 54% of TPO and food processing at 12% 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 18 percent of the housing portfolio is considered high risk (i.e. over 26 payments missed), continued branch level caution in disbursing housing loans appears to be warranted.

4. BRAC should put all NIBL loans into the 100 weeks missed category in its APO report and should continue to write off all NIBL loans and all loans that are two years past due (at most three years) as it did in December 1997.

3.5 Adequacy of Loan Loss Reserve

In summary, the following analysis shows that the BRAC Loan Loss Reserve is more than adequate, subject to the possibility that the impact of the flood will be greater than projected at this point.

Tier 1: Non-Accrual Loans (June 1998) = Identified likely uncollectables

100% of NIBL	Tk20.4 million
100% of loans >100 wk. past due	Tk2.9 million
50% of loans >50-100 wk. past due	Tk8.0 million
Sub total	Tk31.3 million[3]

Tier 2: Doubtful Loans (accrual status) = Unidentified estimated uncollectables of loans estimated at 3 % of current loans outstanding (excluding NIBL and overdues past 50 weeks as at June 1998) = Tk113 million[4]

Based on this analysis, the total estimated satisfactory loan loss reserve for June 1998 is Tk144 million (including VGD as at September it is Tk175 million). Fortunately, the actual loan loss reserve as of June 1998 from the RCP & RDP balance sheets is Tk287 million, or almost 200% of the necessary loan loss reserve. :

In September a further 5% of disbursement provision was made because of the flood bring the total to Tk456 million. Even including the 50 VGD branches, a safe provisioning for September 18 would only require a reserve of Tk175 million. Provisioning is thus more than adequate.

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.

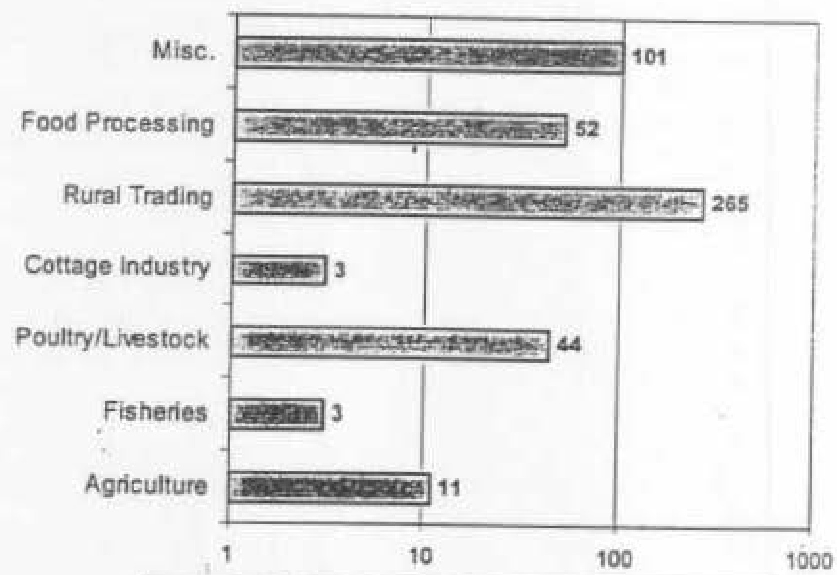
2. As a general rule, reserving 2% of disbursements across all branches continues to be a good risk management system at a head-office level. We recommend though that branches contribute an amount that reflects their performance, rather than a flat 2% of disbursements. Some variation of the system we used above (i.e. 100% of NIBL and over 100 weeks past due) is suggested.

3. As BRAC expands the MELA program, increased provisions for losses should be made. We recommend a loan loss expense of 4% until BRAC has a sufficient track record.

4. We recommend that any loan that is over three years past due plus all NIBL 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.

3.6 *Possible sectoral loan concentration risk issues*

In support of research on an alternate system of branch categorization (section 5.11), Shorebank did an analysis of the degree of sector concentration of branch portfolios. To do it adequately, this analysis needs more time than that available as part of the Financial Review. Early indications, however, give rise to a concern about sector concentration. As the graph to the right suggests, there are many branches that have a significant concentration in a single



Number of Branches/Outposts With Greater Than 30% of Portfolio in Single Sector

sector. That lack of diversification may create significant risk management issues that should be explored further. It may be, however, that the basic data which describes which sector a loan is made in is so flawed that this analysis must wait on a significant improvement in loan sector information quality. For more detail on this analysis, see section 5.11.

3.7 Portfolio trends relative to model branch

BRAC built its model on the following assumptions:

- 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 7% - 8% per year) 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. RDP membership far exceeds the original RDP plan of 6,000 members per branch. All Year 8 to Year 13 branches have between 7,000 and 8,000 members. While we have not seen a decrease in portfolio quality associated with this increased 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.

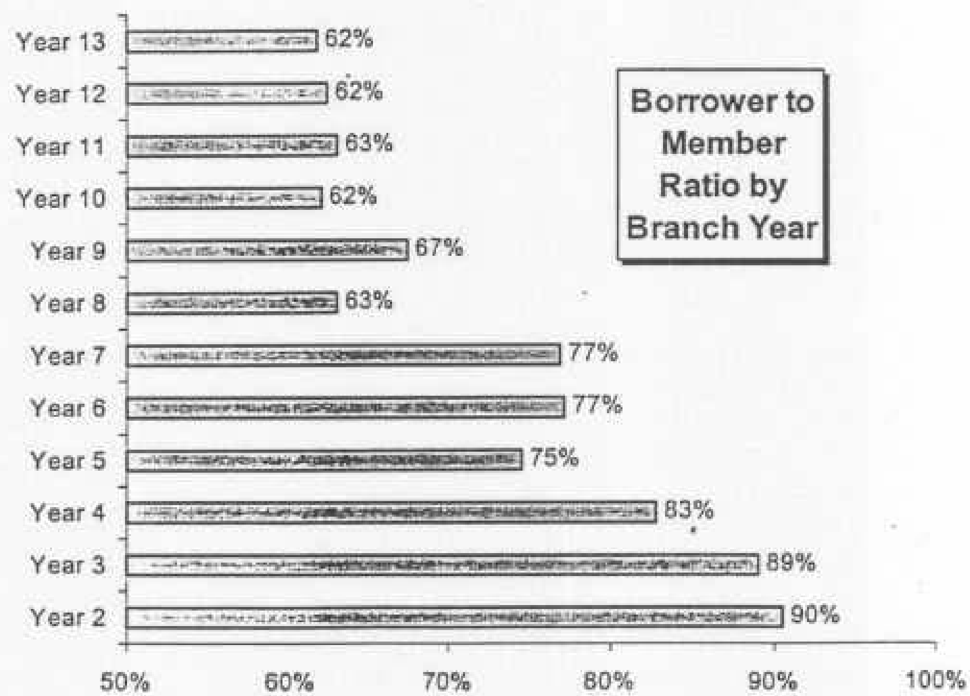
BRAC should be aware of the trade-offs involved in greater coverage of poor people through the existing branch network. Generally, we believe that BRAC's entrepreneurial approach to expanding its market coverage and meeting the credit needs of poor borrowers (e.g. through opening sub-offices) is a positive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

Loans. 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 - 13 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, loan outstandings are in above original budgets (which did not take inflation into account) and in line with internal targets. 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. Member to Borrower ratios are 20% higher in younger branches than in older branches. If it is true that older members have done so well that they no longer need loans, we should be able to capture an increasing amount of savings from this target group.

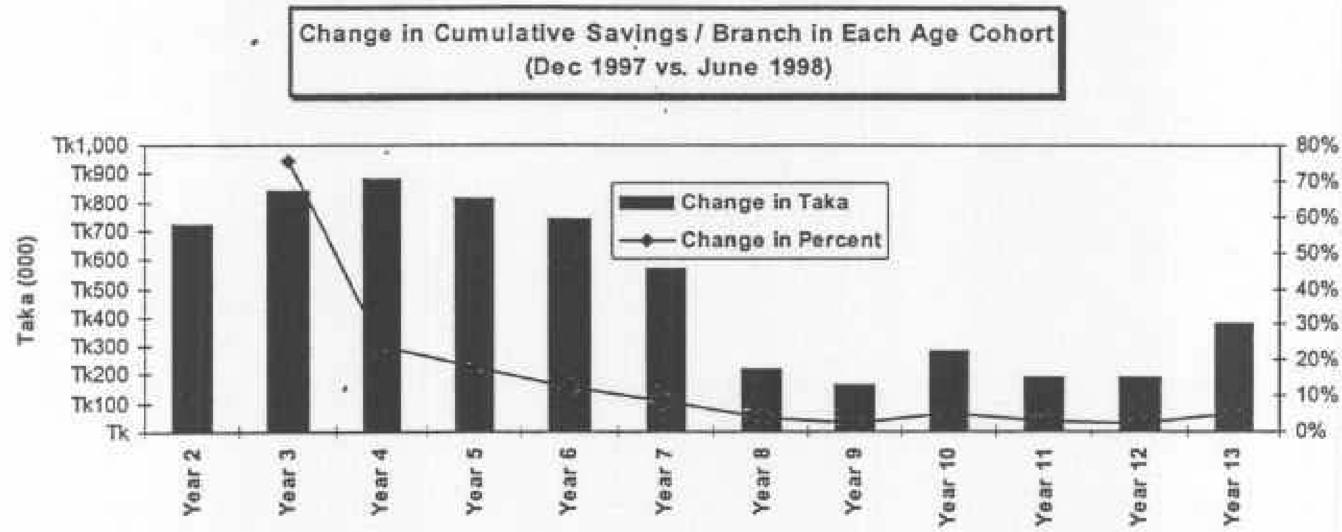
Borrower to Member Ratio. One are for further examination is the ratio between borrowers and members in a branch. Drawing on the June 1998 Model Branch information, the chart below was developed. The total number of members was divided by twice the number of loans that had been disbursed during the first six months of the year. If anything, this overstates this ratio.

The result is a graph that suggests that borrowing activity drops significantly as the branch ages. This is an important phenomenon to understand, and is an important ingredient in understanding both future loan demand as well as providing some insight into branch function and vitality. Weighted by the number of branches in each branch year, the weighted average for the total system is a borrower to member ratio of 75%.

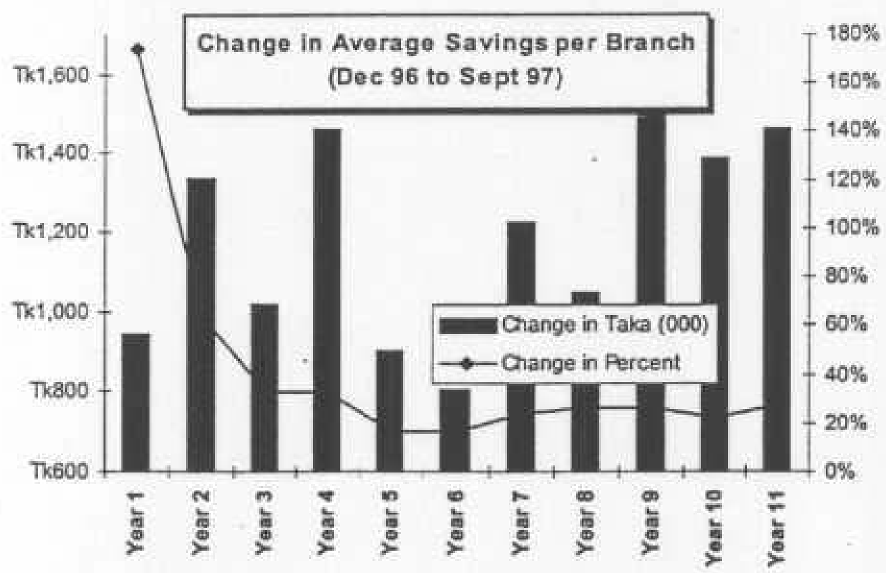


4. Management and Analysis of Savings Activities

4.1 Savings Program Summary Performance

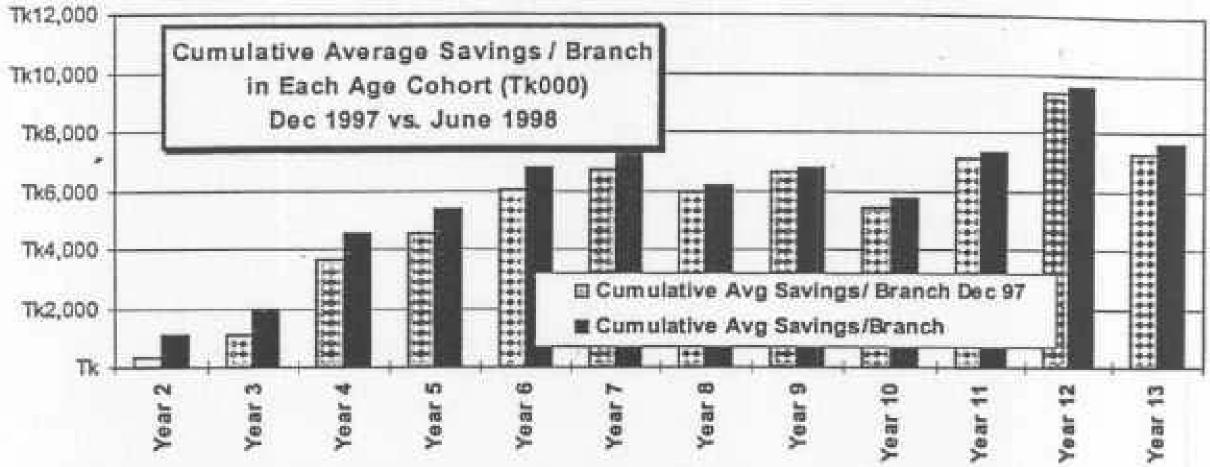


The diagram above shows that the strong growth in savings reflected between December 1996 and September 1997 (see adjacent chart) did not repeat itself over the past year. On average, relatively little growth occurred in older branches where savings accumulation might be expected to be higher.



Whereas the average weekly savings per member increased 20% between June 1996 and June 1997 to Tk4.98, it fell by 7% over the past year (June 97 – June 98) to Tk4.62 per member per week. Total savings increased 22% from Tk1,430 in June 1997 to Tk1,741 in June 1998 (vs. a 30% increase in growth the previous year).

The chart below shows growth in the same set of branches between December 1997 and June 1998. Clearly, a noticeable higher savings growth rate is occurring in younger branches. To an extent this is counter-intuitive, as one would expect greater asset accumulation to be happening in the older branches.

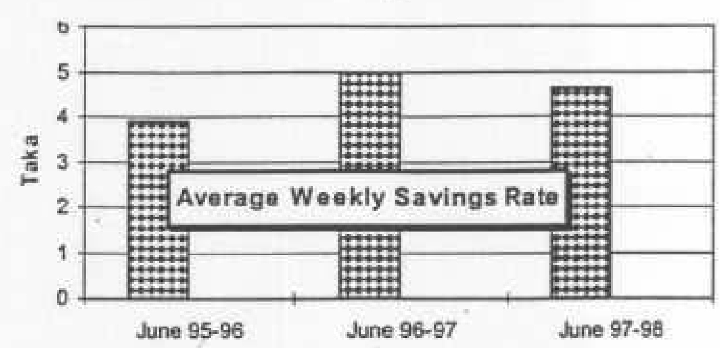


There may be at least four reasons that could have contributed to the lower per member average weekly savings rate, and the slower total savings growth rate:

1. Intake of Poorer Members: BRAC has integrated a larger number of VGD members into its program than in the past and head-office managers have also been prioritizing absorbing poorer members into the RDP program in the past. The argument here would be that a higher percentage of poorer members are unable to afford to pay Tk10 bi-weekly; hence the downward pressure on the rate. Over the past year, over 100,000 VGD members have been absorbed as part of regular branch expansion in BRAC's RDP credit program.

2. A Cash Management Problem: Due to the bi-weekly system, a portion of BRAC's members may not be able to manage their cash in a way that enables them to dole out a double loan repayment plus a double savings deposit every two-weeks. Managing cash from week to week is far easier than managing it for twice the length of time.

3. Impact of Inflation: Real personal disposable income available for savings decreases every year in line with the rate of inflation. Seen in this light, a similar decline in savings deposits is not an unlikely outcome.



4. Unwillingness to Save: Lack of access to weekly savings is probably another reason why many members choose not to deposit any more than they can get away with. Even though savings withdrawals are officially allowed after five years, most members are not aware of this. This is because many branch managers

keep this information from members because their performance, as managers, is measured on the extent to which they mobilize net savings.

Two other factors that affect the savings rate are member discipline and branch prosperity. On our field trips to12 branches last year, we found that branches with less delinquency, has higher savings rates. Also, more prosperous areas also, on average, had higher savings rates.

RCP and RDP Savings Performance

(Taka in million)	June 97-June 98	June 96 - June 97	June 95 - June 96	June 94- June 95
Compulsory Savings	311	277	176	107
Members Own Savings	459	383	247	135
Total New Savings	770	660	423	242
Transfer of GTF into Members Savings	5	25	23	0
Members Own Savings excluding GTF	454	358	224	135
Average Number of Members	1,985,418	1,538,878	1,264,484	941,543
Average Wkly Svgs/Member GTF	4.62	4.96	3.91	N/A
Average Wkly Svgs/Member GTF	4.57	4.63	3.12	2.86

BRAC must increase its savings mobilization, either out of self-interest for liquidity purposes, or because it believes that asset accumulation for poor people is a worthwhile pursuit. To support that goal, it must do field research to find out what motivates households to save, and how households prefer to invest their accumulated resources (in cash vs. in seeds or livestock, etc.).

4.2 Development of the 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?).

Last year we reported that 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. We also observed that it was likely that the other two branch managers in the Model 1 pilot did the same thing. These branch managers also required that members disclose the reason why they needed to withdraw and seemed to encourage smaller withdrawals than members may otherwise have taken on their own. Managers do this with a sustainability focus to protect the savings base of the branch.

Over the past year, an additional one Taka, on average, was deposited by Model 1 branch members per week, vs. the average for all RDP branches. This represents a 20% increase in weekly savings mobilization over RDP branches, and a 10% increase over the control branches used in the experiment.

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 monthly member is Tk31 for model two branches vs. Tk20 in the control branches and Tk.18.5 for all BRAC RDP branches. This represents a significant 55% increase over the control branches and a 75% increase over RDP monthly savings mobilization numbers.

Without doing a field visit to the pilots this year, we feel that the only significant finding to take away from data presented to us is that in younger branches, members with freedom to deposit and withdraw at whim are choosing, on average, to save more. This finding bodes well for BRAC, which plans to introduce a range of more flexible savings products for members than in the past.

4.3 *Effects of the Current Account savings plan*

Current Savings Accounts were introduced at the branch level in January 1997. 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 Tk50 and withdraw a minimum of Tk50 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).

Performance to date is reflected in the table below:

	Jan-June 97	July – Dec 97	Jan – June 98.
# branches	160	292	292
Number of accounts	5491	20,459	20,459
Average deposit	190	134	251
Average withdrawal	673	489	379
Net Deposits	1,045,115	2,217,874	2,290,258
Avg. Net deposits/ a/c holder (6 Mnth)	190	108	112
Avg. Net deposits/branch (6 Mnth)	6,531	7,595	7,843

There has been a 20% increase in the total net deposits per branch over the past year and a 120% increase in total current account deposits held at BRAC branches. While these numbers sound impressive, we should bear in mind that the increase is off a very low base, and to date, only 10% of all BRAC members have opened current savings accounts. The average net deposit per member is on average three times smaller than the average net withdrawal. Average net deposits per member over the January to June period decreased from Tk190 in 1997 to Tk112 in 1998. Because savings behavior varies widely between borrowers, calculating the median deposit and withdrawal size would be far more useful. Once BRAC's branch computer system is up and running, we recommend very close tracking of savings behavior of members. This is important not only to design new products, but also to forecast funding needs and how much cash to have on site at the branch.

- In order to grow deposits BRAC should actively market the product through branch staff. 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.
- BRAC should accept small current account deposits at weekly or bi-weekly VO meetings, and large deposits at the branch. This will enable members who live far away from the branch (2km or more) from being inconvenienced. 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 Tk50 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, they should be consistently implemented (unlike the current pilots). 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. This data will also help 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.

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. Products 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
2. 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.
3. We believe that if BRAC is serious about savings, a Head-Office Savings Manager who has a key staff person in each region that is dedicated to savings mobilization should be hired.
4. Individual level and branch level savings data needs to be collected and analyzed with the same dedication that individual and branch levels disbursements and outstandings are tracked.
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, terms of data collection, we also think it is useful for all branches and head-office to track the following on a monthly basis:
6. The new branch rating system should include a savings measure (e.g. total net savings/outstandings), and branch staff performance should be partially rated on savings mobilization.
7. The current account savings product should continue to be marketed until alternative/additional products are developed.
8. Branch managers are forced to allow members to withdraw freely within the policy guidelines suggested.

4.4 Refund of Group Trust Fund

BRAC returned the outstanding 25% of the GTF money to members. Since June 1997, an additional twenty million was transferred to members. Currently, there is Tk3 million in the GTF account which BRAC is in the process of transferring to RCP members. The balance in the RDP GTF account is zero.

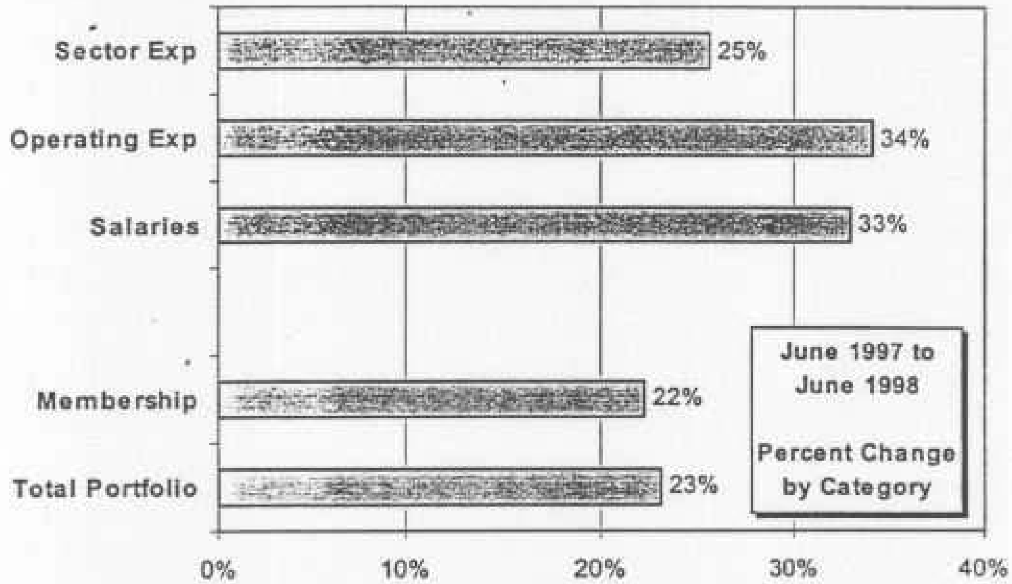
5. Branch and RDP Financial Sustainability

5.1 Summary

1998 has been and 1999 will continue to prove difficult for BRAC with respect to the issues of long-term program sustainability and its component parts (specific cost behavior and control, interest and sector revenue, loan loss rates, portfolio growth, and loan size).

The combination of forces created by BRAC's continued growth and the 1998 flood will continue to create serious organizational and financial stress.

While the following chapter works at length to examine the details of BRAC's multi-dimensional cost and financial performance, the graph below perhaps best expresses one underlying question facing BRAC management in the area of financial sustainability.



From June 1997 to June 1998, BRAC's portfolio expanded by 23% and the membership base grew by 22%. In contrast, operating expenses grew by 34% and salaries increased by 33%
What does this imply for RDP/RCP program sustainability?

This basic challenge of cost management can be simply stated, but understanding and resolving the forces that are causing unsustainable cost increases will be a complex task. Based on our initial analysis of this issue, we recommend this task is given to a dedicated BRAC multi-departmental (membership from inside and outside of BRAC) "Cost Management Task Force." The problem of costs growing significantly faster than revenues & assets is a common problem for many rapidly growing companies, and it would seem that this is also a challenge for BRAC. This issue will be made more difficult as the financial implications of the flood become visible and the full effect of the September Program Officer salary increase filters through the cost system.

5.2 1997 to 1998 cost structure changes analysis

As the summary BRAC RDP/RCP income statement below describes, many expense categories grew from June 1997 to June 1997 at a rate far greater than that supported either by member growth or by portfolio growth. As the graph in section 5.1 suggests, this is a subject that will require significant research and management attention during 1999.

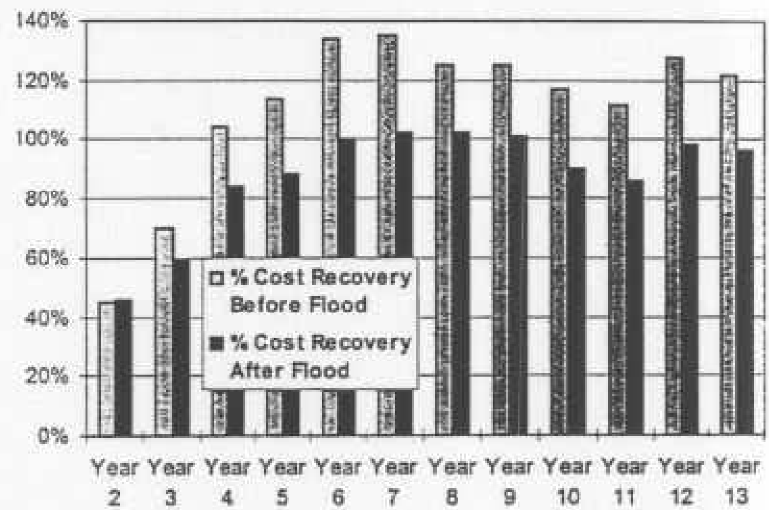
(all amounts in 000's)	Jan-June 1997	Jan-June 1998	97-98 % change
Financial Income			
Service charge on loan	356,973	512,438	44%
Interest paid on deposits	37,009	50,074	35%
Interest on head office fund	87,542	87,128	0%
Total financial costs	124,551	137,203	10%
Gross financial margin	232,422	378,361	63%
Provision for loan loss	57,638	68,123	18%
Net financial margin	174,784	310,237	77%
Operating Expenses			
Salaries and benefits	125,688	167,141	33%
Travel/transport	10,505	14,949	42%
Staff training	2,194	4,512	106%
Maintenance	2,749	4,534	65%
General expenses	4,414	6,712	52%
Utilities	3,610	4,779	32%
Stationary	2,166	2,708	25%
Depreciation	7,302	7,140	-2%
Home office supplies	10,182	11,639	14%
Office rent	3,839	3,495	-9%
Rent, utili, stationary for HO	-2,107	-3,126	48%
Regional manager office cost	12,949	20,988	62%
Home Office logistics	6,676	9,649	45%
Total operating expenses	190,167	255,125	34%
Total operating cost per branch	576	773	34%
Sector Program Expenses			
Poultry and livestock	20,217	22,584	12%
sector members	608,229	646,671	6%
cost per member	33	35	5%
Fisheries	8,013	12,108	51%
sector members	98,201	135,866	38%
cost per member	82	89	9%
Social forestry	4,302	6,448	50%
sector members	12,065	16,065	33%
cost per member	357	401	13%
Sericulture	9,524	10,326	8%
sector members	23,655	24,054	2%
cost per member	403	429	7%
Horticulture and vegetable	9,179	12,820	40%
sector members	84,160	61,324	-27%
cost per member	109	209	92%
Total expenditure sector	51,235	64,286	25%
Sector Income			
Poultry & livestock	4,905	4,889	0%
Fisheries	2,318	2,857	23%
Forestry	312	225	-28%
Sericulture	1,092	782	-28%
Rural enterprise	214	167	-22%

Horticulture	2,383	2,909	22%
Total realized	11,227	14,804	32%
Total deficit for sector	-43,103	-63,035	46%
Total deficit for credit & sector	-58,491	-192,089	228%
Total income as % of exp.	86%	98%	14%
Membership	1,800,000	2,200,000	22%

5.3 Review BRAC's progress towards sustainability

Despite the disturbing trend of increasing operating expenses, it is true that BRAC has been making continued progress towards sustainability and was meeting its RDP IV target levels prior to the flood. As the graph to the right illustrates, the flood has significantly impacted the ability of the RDP credit program to recover its costs (become sustainable).

% Cost Recovery in Branch Age Cohorts Pre and Post Flood (Jan -June 98 vs. Jan-Sept 98)



In its January to June 1998 income statement, RDP's 330 branches generated a net operating surplus of Tk55 million for its credit program compared with a loss of Tk15 million for the same period last year. This positive achievement was more due to a significant increase in revenues rather than a decrease in costs.

The RDP IV target for year-end 1998 was for BRAC to achieve a Tk27 million profit in its credit program. If not for the flood, we believe that RDP would have made this goal. The flood, however, has impacted RDP severely and in its January to September income statement, the credit program suffered a net deficit of Tk110 million. Whereas the credit program's cost recovery (i.e. total credit related expenses vs. total credit related income) was at 112% over the January to June period, it dropped to 88% by September.

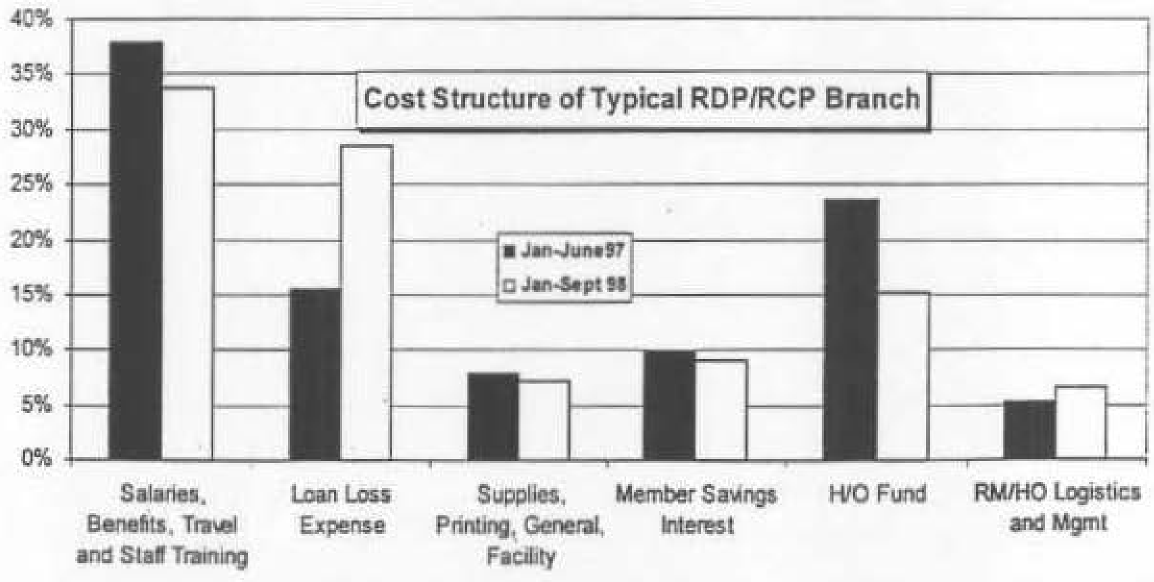
The major single factor driving up costs was the increase in the loan loss provision expense. BRAC increased its loan loss provision expense from 2% of disbursements to 5% of disbursements in September because of the flood. This means that an extra Tk150 million was taken as an expense. Seen in this light, a shift from a profit of Tk55 million to a loss of Tk110 million is understandable. While it is still too early to know the full effects of the flood on the portfolio, and whether or not this 5% allocation will be sufficient, it seems to be the appropriate action to take at this time.

There were two other forces that also contributed to the losses. First, interest income was less than expected because of an increase in delinquency both during and after the flood. Around 400,000 families (or over 20% of all members with a loan outstanding) did not make a single payment during the month of September. Second, BRAC increased the salaries of its approximately 3,000 Program Assistants by 30% to bring them more in line with comparable programs and the general labor market. This also will have a significant impact on the cost structure.

We support both the increase in the loan loss provision and PO salary levels, but it is clear these changes have impacted significantly on the RDP cost structure, and on BRAC's sustainability, at least in the short term. The trend discussed earlier of costs increased at a faster pace than revenues is a more disturbing factor that will have medium and long term impacts if it is not addressed. It is hoped that this flood impact, while serious, is not permanent, in contrast to the increase in the salary structure, which will have an enduring impact. The challenge to BRAC management will be to support the additional salary expense with increased productivity, reduced losses, reduced staff turnover expenses, and decreasing its overall cost structure.

Key Cost Changes: Loan Loss and Salary Expense

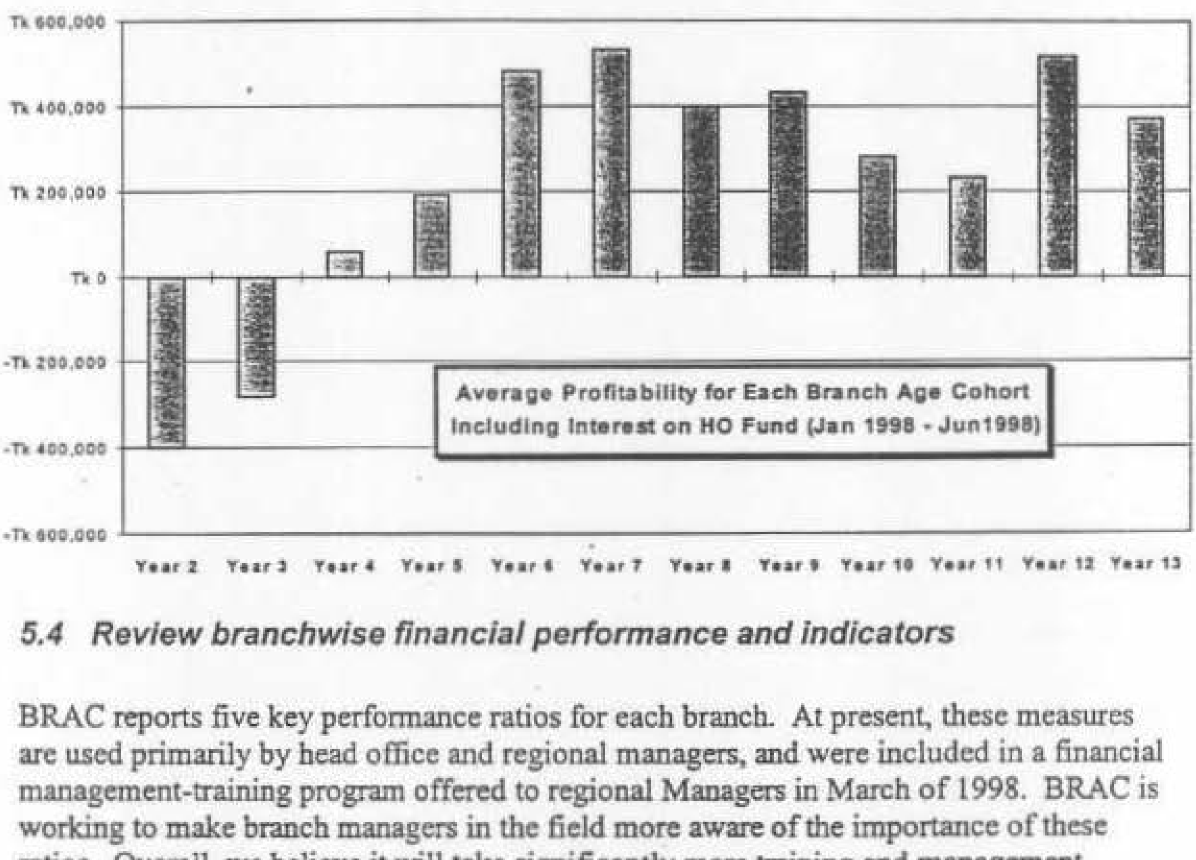
As the following graph illustrates, each RDP/RCP branch has a relatively simple cost structure that is primarily composed of fixed costs with a smaller percentage of variable costs. The costs that tend to behave as fixed are staff salaries and travel expenses, supplies, interest savings costs, and logistics. The expenses which are more variable, and



which fluctuate with the growth of the portfolio, are the loan loss expense and the cost of capital (head office fund costs). As discussed previously, the largest single expense increase was the loan loss expense increase from 2-5%, due to the anticipated portfolio impact of the flood. Ironically, while the absolute amount of the salary expense also increased vs. 1997, due to the large increase in loan loss expense, as a percent of total expenses salaries dropped from 1997 to 1998.

Progress Towards Branch Sustainability

While the flood has created a setback, BRAC continues to make progress towards a system of branches that are able to cover their costs. This will be threatened by the underlying rapid growth of costs. The graph below describes the sustainability status of the branches as of June 1998. In this financial review, the terms sustainability and profitability are used interchangeably. However, given that "profit" in an unincorporated, non-profit program is not a commonly used term or well defined, our preference is to use the term sustainable, meaning the ability to cover program costs or generate a program surplus.



5.4 Review branchwise financial performance and indicators

BRAC reports five key performance ratios for each branch. At present, these measures are used primarily by head office and regional managers, and were included in a financial management-training program offered to regional Managers in March of 1998. BRAC is working to make branch managers in the field more aware of the importance of these ratios. Overall, we believe it will take significantly more training and management attention to change the branch, regional and head office 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 targets. The following is a discussion of each ratio, with commentary on how branches have improved from June 1997 to June 1998.

Financial ratio performance summary

Shorebank has found a detailed analysis of branchwise performance on five financial variables to be useful in getting below the "average performance" of the system as a whole, and as we did in 1997, we submit the following analysis of these variables. Because this analysis is based on July 1997 to June 1998 data and comparisons, the effect of the flood is not reflected. We still believe, however, that this analysis indicates trends in the underlying cost and management structure of BRAC's branch system, and is thus useful to examine trends and suggest areas for improvement and focus.

The following five pages of graphics visually illustrate the 1997-1998 change in how branches performed for the selected financial indicators. The table immediately below summarizes how all branches as an total system performed. As discussed below, this average performance obscures a more detailed year by year and branch by branch analysis that is more revealing in terms of specific action steps that must be taken.

In general, BRAC RDP branches have improved in four of the five credit program indicators, with the exception of the salary cost or staff productivity ratio. While improvement in four out of five variables is good, and should not be understated, it is also true that the 1998 ratio improvement was better than the 1997 performance in only two of five ratios, indicating that the rate of improvement is slowing down.

Financial Indicator	Average 1996-97 Change	Average 1997-1998 Change	1998 Better or Worse than 1997?
Interest income over outstanding portfolio	2% better	2% better	Flat
Overall ratio pulled down by some specific branches; overall the great majority of branches had strong performance improvement.			
Branch savings over outstanding portfolio	6% better	5% better	Worse
There was wide variability in how branches performed with respect to savings accumulation, but overall the focus on savings dropped during 1998.			
Salaries over outstanding portfolio	Flat	1% worse	Worse
This suggests that salaries grew at a rate faster than the portfolio which is a cause for concern, for this is a largely fixed cost which potentially has strong economies of scale, and so the ratio should be improving as the portfolio grows. This concern is even stronger for these ratios do not include the significant staff salary increase of September 1998, which will make this ratio even worse.			
Branch sustainability ratio	1% better	3% better	Better
The improvement in this ratio is more due to an increase in revenues than any specific cost management, which still must occur. It is not that 3% improvement is not good, but it should be far greater improvement than this. This does not include the impact of the flood, which will likely create a drop in branch 1998 sustainability vs. 1997.			
Other expenses over outstanding portfolio	2% worse	1% better	Better
There is a high degree of variability in this measure, and it should be the focus of increased research to better understand its components. It is not clear what this ratio indicates beyond the insight generated by the other four ratios.			

5.5 *Financial Ratios: Branch Level Detail*

The weakness of the macro-level analysis in the previous section 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 following five pages of detailed charts are provided for additional illustration of the 1997-1998 behavior of these financial ratios.

Overall, we recommend that each branch manager know the status of his or her branch ratios, and project their performance for each coming year. All ratios should be measured as frequently as possible, and each manager should have a target for ratio improvement on a quarterly basis.

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.

1998 performance of this ratio is disturbing, for as the portfolio continues to grow at about a 25% annual rate, the salary/TPO ratio should decrease at a significant rate instead of increasing as it did in 1998. While there are clearly reasons that suggest that the ratio should not improve at the exactly same rate as the TPO is growing, to have the salary ratio worsen by 1% rather than improve is a serious problem. As the data in the previous section illustrated, salaries grew at a rate of 33%, far beyond that supported by either portfolio or membership growth. This issue will require intense scrutiny. There is also a very wide variation between branches in this ratio, much more than that suggested by differences in branch age or portfolio size, which suggests different levels of management attention to this issue. As the histogram shows, most branches actually increased their salaries by over 2%, double that amount suggested by the overall 1% average.

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. As in 1997, 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. As with salaries, however, given the growth of the portfolio, this ratio should be decreasing at a rate far more than the 1% improvement from 1997-1998.

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. Overall, this ratio improved on average by 3% from 1997 to 1998, which is the right direction but not the right amount. As the graphs suggest, there is also a very significant dispersion in this ratio among branches and across yearwise branches which suggests that there are relevant variables that can be explored to improve this ratio. Compared with the 1997 ratio analysis, fewer mature branches that have a negative ratio, but the presence of any mature branches which has a negative ratio is a cause for concern. More than any measure, this one should be a focus of branch and regional 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 savings. 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. While an average growth of 5% in this ratio is positive, the presence of a significant number of branches of all ages that were able to grow their assets by between 10-20% suggest that it is very possible to do much better than 5%. There are branches that are performing so poorly that they are pulling the total average down by a significant margin.

As in 1997, the results of this savings ratio analysis are very disturbing, given the importance of mobilizing savings resources to support membership asset growth and lending activities. There continues to be great dispersion between branches and between branch maturities, suggesting that branches have an extreme variation 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 and retain 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.

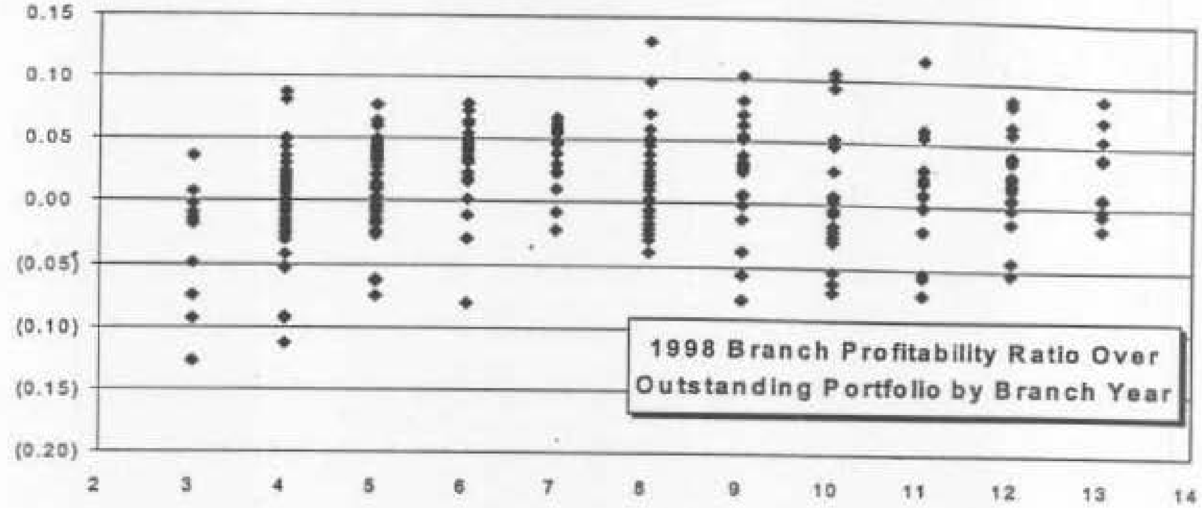
5. *Interest Income as a Percentage of Total Loans Outstanding.* This ratio measures the yield on the loan portfolio. It is a quick way for a manager to look at overall interest yield on a branch's loan portfolio. Lower performance could indicate loan quality problems and could also indicate a significant number of loans in the NIBL category, since this income is not accrued, but is only recognized when it is received.

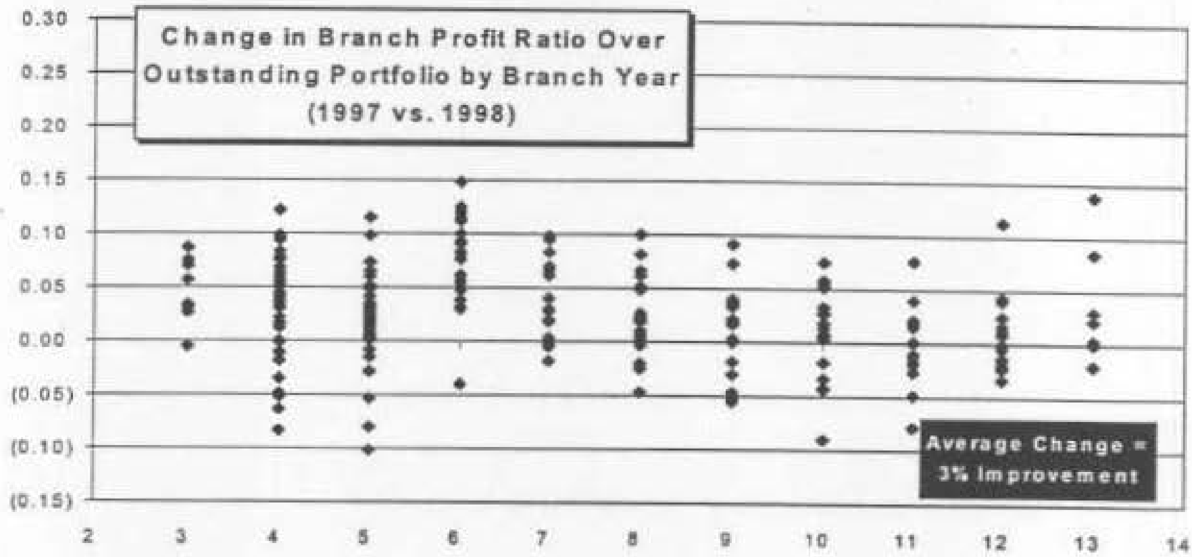
Given that there is little loan interest rate variability between branches, this ratio may be most useful as an indicator of loan quality and delinquency. In general, the 1998 results are good, which is consistent with BRAC's strong focus on credit quality. There is a relatively narrow spread between the branches but substantial dispersion within branches of similar ages.

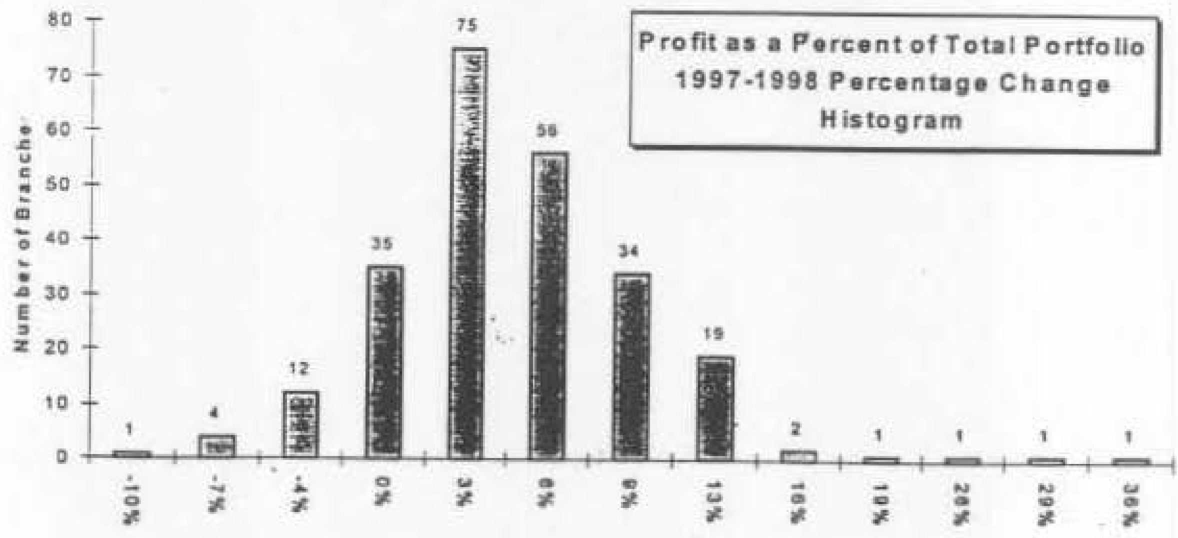
Recommendations: Management of Branch Operations

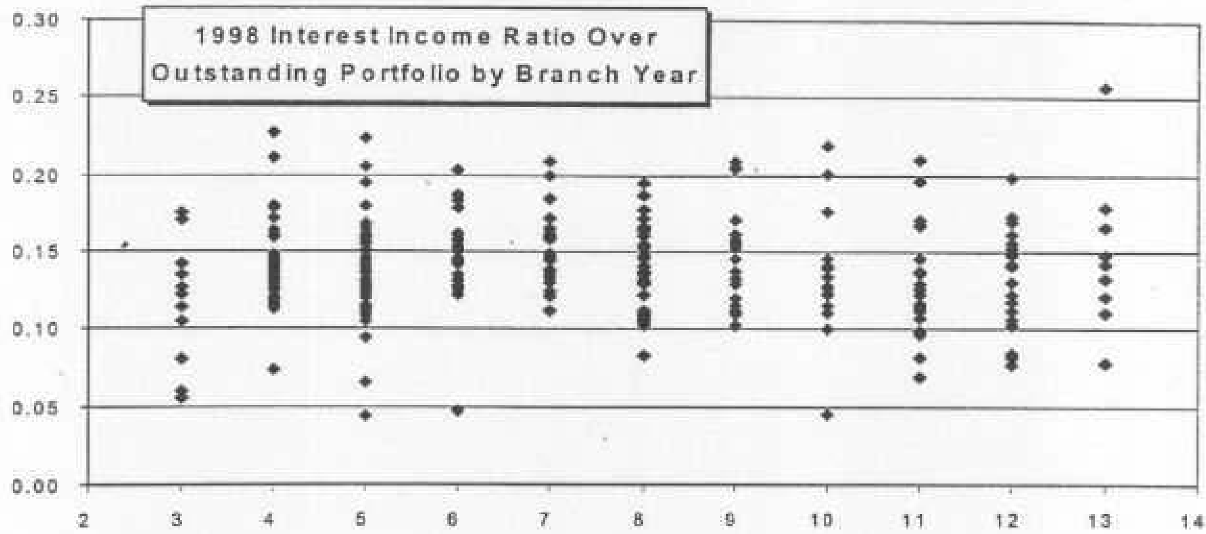
1. It is our belief that while branch age has in the past been a useful indicator of branch behavior and other issues such as sustainability, given the increasing maturity of the branches, there are now going to be other variables that will rise in importance. We recommend below that BRAC begin a multivariate 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 internal as well as external economic and demographic variables. This system will necessitate a restructuring of BRAC's computer model used for forecasting and projections.

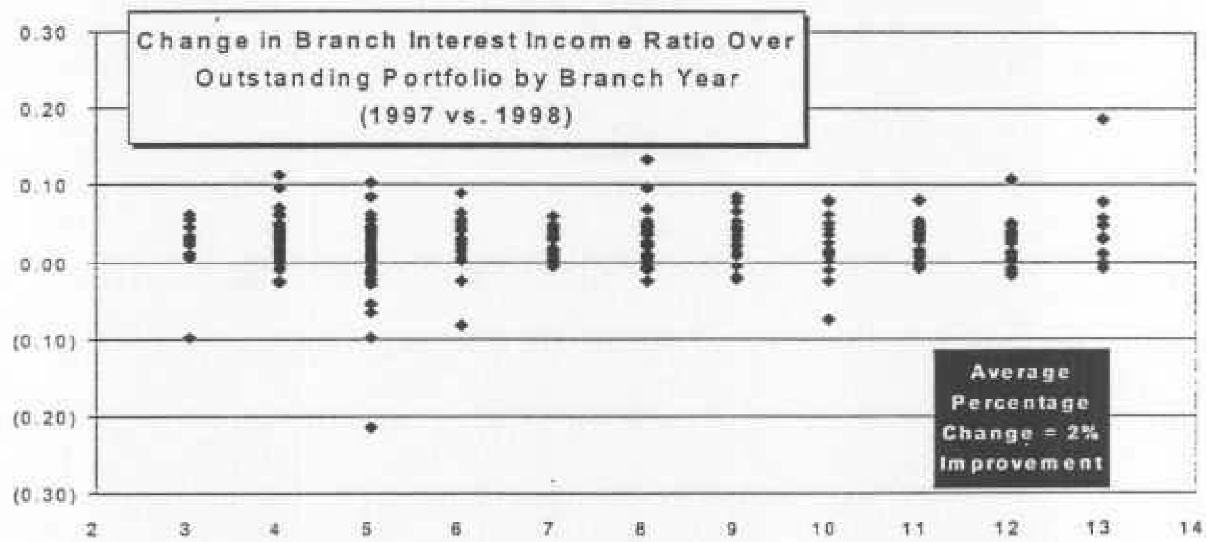
2. Although this is slowly beginning to change, it is our assessment that the branch managers do not have a strong focus on branch sustainability or profitability. The branch manager is still primarily focused on the branch as a "cost center" or a delivery process for program activities. This is not 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.

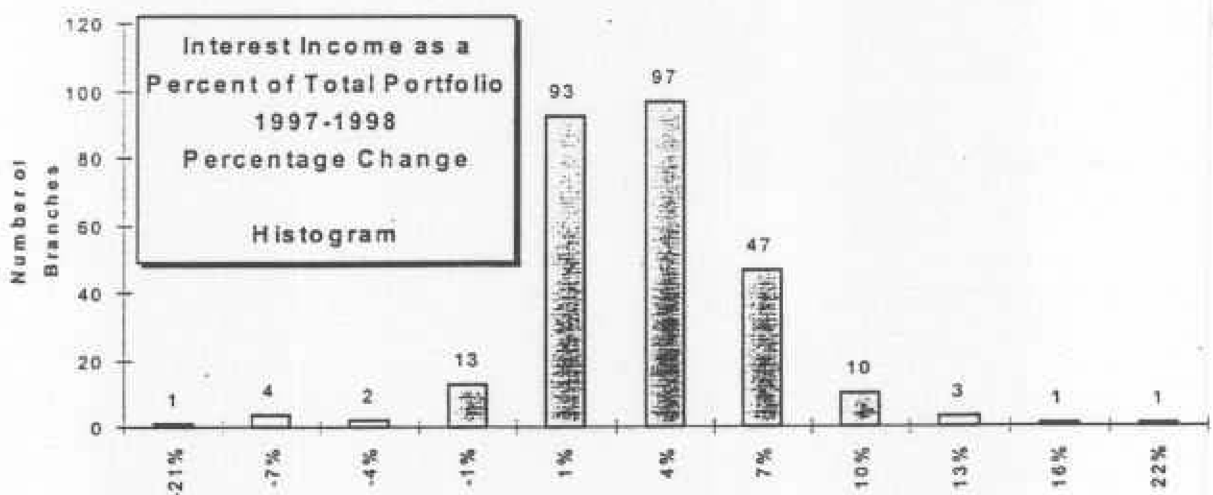

1998 Branch Profitability Ratio Over Outstanding Portfolio by Branch Year
0.15
0.10
0.05
0.00
(0.05)
(0.10)
(0.15)
(0.20)
2 3 4 5 6 7 8 9 10 11 12 13 14

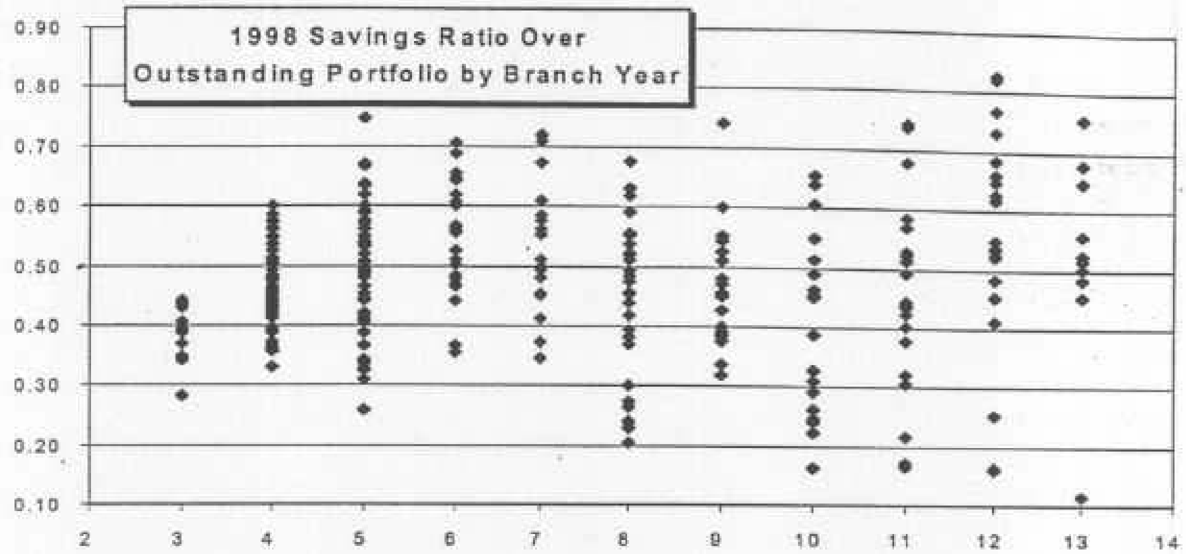

Change in Branch Profit Ratio Over Outstanding Portfolio by Branch Year (1997 vs. 1998)
Average Change = 3% Improvement
0.30
0.25
0.20
0.15
0.10
0.05
0.00
(0.05)
(0.10)
(0.15)
2 3 4 5 6 7 8 9 10 11 12 13 14

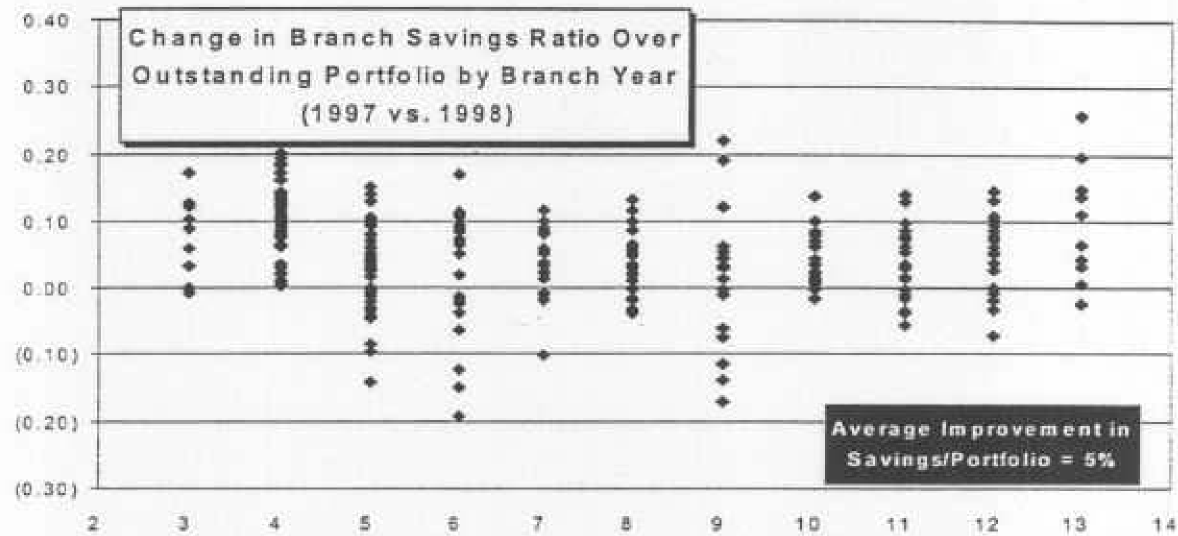

Profit as a Percent of Total Portfolio 1997-1998 Percentage Change Histogram
Number of Branche
80
70
60
50
40
30
20
10
0
1 4 12 35 75 56 34 19 2 1 1 1 1
-10% -7% -4% 0% 3% 6% 9% 13%

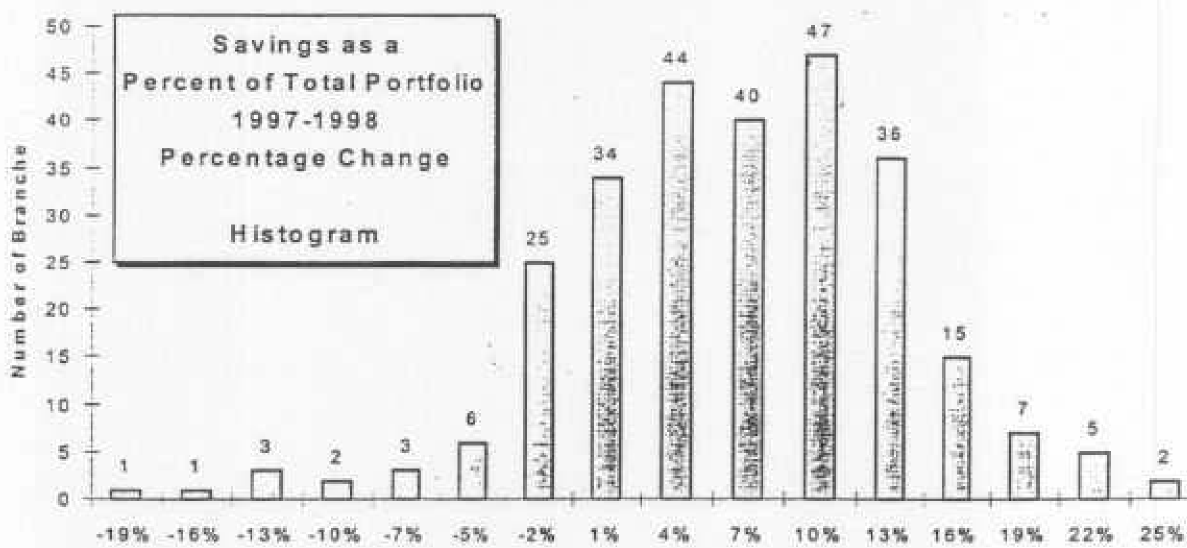

1998 Interest Income Ratio Over Outstanding Portfolio by Branch Year
0.30
0.25
0.20
0.15
0.10
0.05
0.00
2 3 4 5 6 7 8 9 10 11 12 13 14

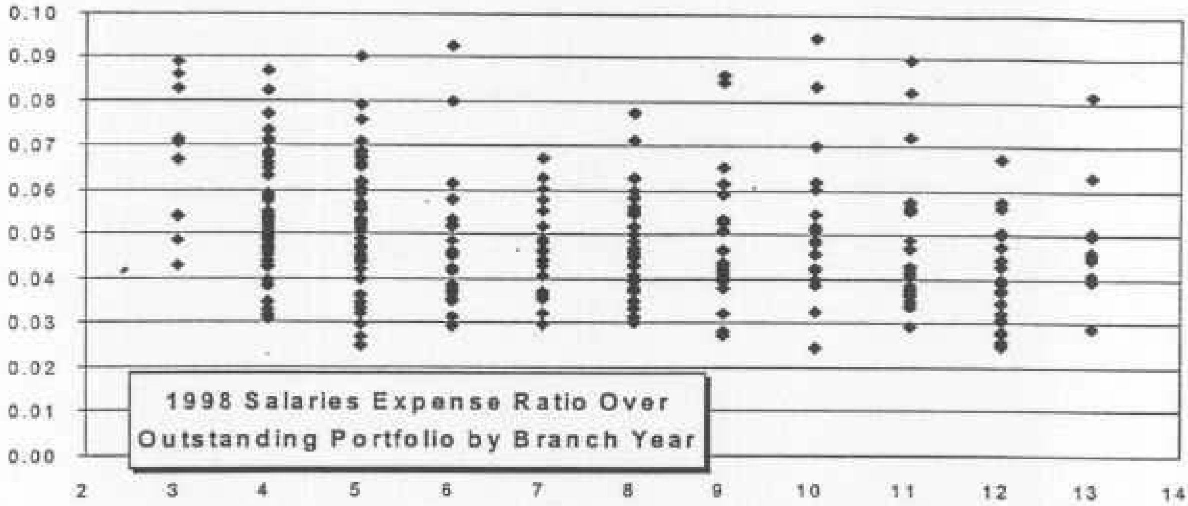

Change in Branch Interest Income Ratio Over Outstanding Portfolio by Branch Year (1997 vs. 1998)
0.30
0.20
0.10
0.00
(0.10)
(0.20)
(0.30)
Average Percentage Change = 2% Improvement
2 3 4 5 6 7 8 9 10 11 12 13 14

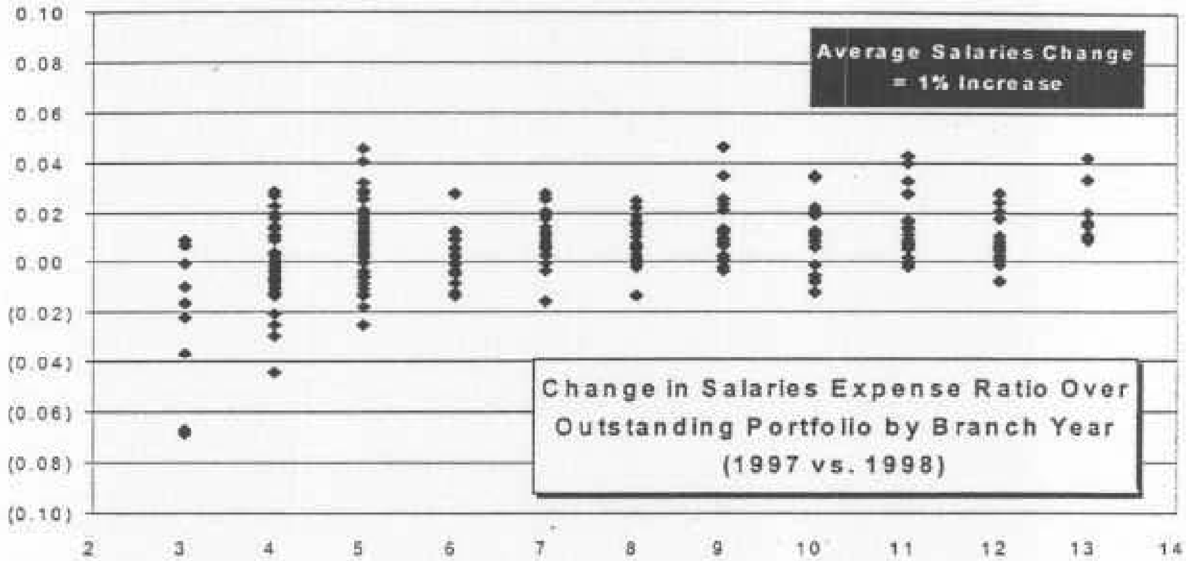

Interest Income as a Percent of Total Portfolio 1997-1998 Percentage Change
Histogram
Number of Branches
120
100
80
60
40
20
0
1 4 2 13 93 97 47 10 3 1 1
-21% -7% -4% -1% 1% 4% 7% 10% 13% 16% 22%

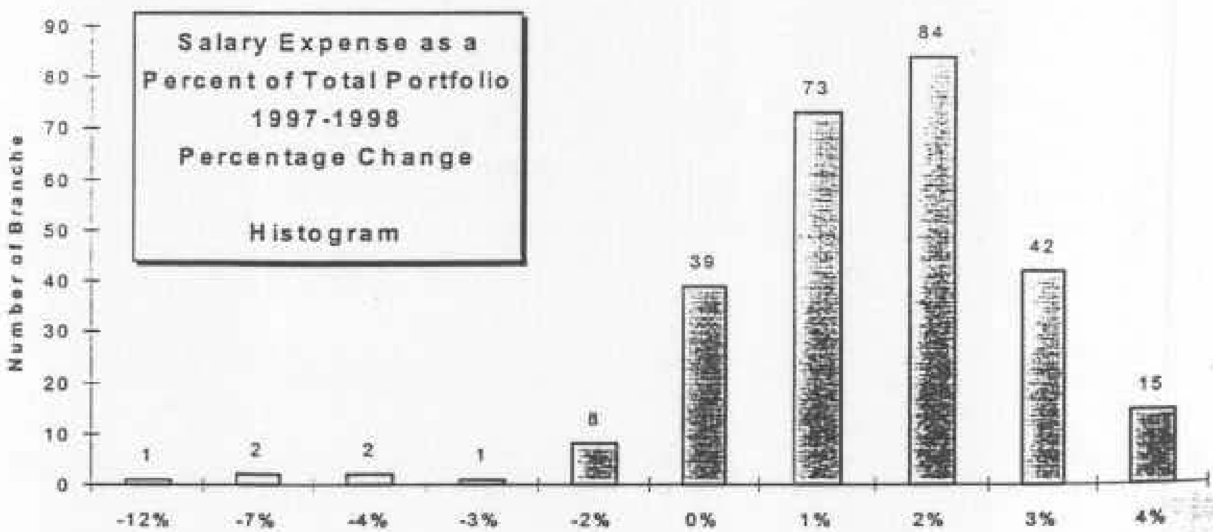

1998 Savings Ratio Over
Outstanding Portfolio by Branch Year
0.90
0.80
0.70
0.60
0.50
0.40
0.30
0.20
0.10
2
3
4
5
6
7
8
9
10
11
12
13
14

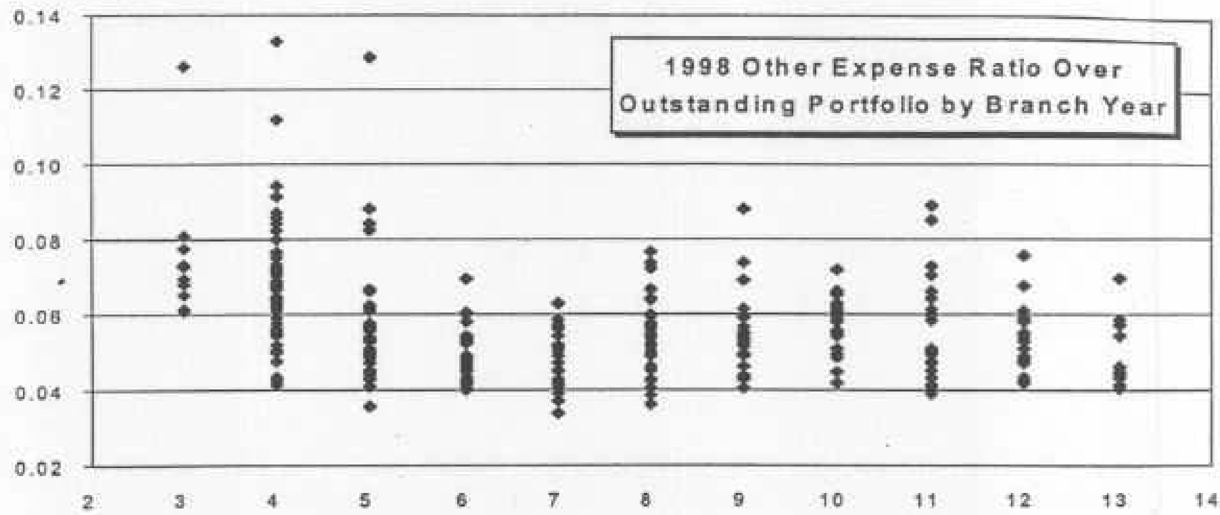

Change in Branch Savings Ratio Over
Outstanding Portfolio by Branch Year
(1997 vs. 1998)
0.40
0.30
0.20
0.10
0.00
(0.10)
(0.20)
(0.30)
Average Improvement in
Savings/Portfolio = 5%
2
3
4
5
6
7
8
9
10
11
12
13
14

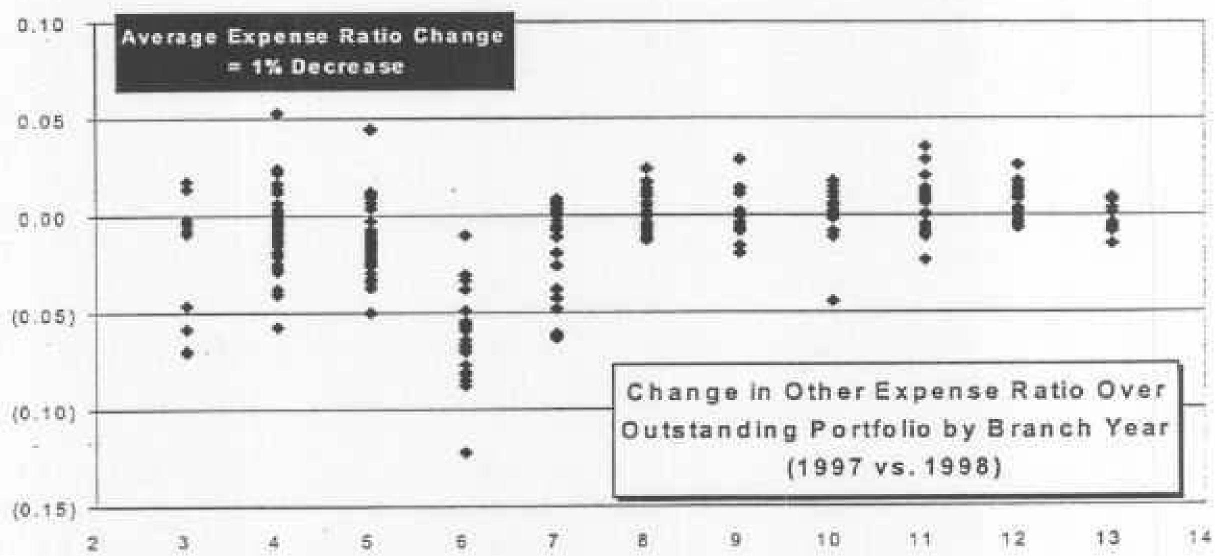

Savings as a
Percent of Total Portfolio
1997-1998
Percentage Change
Histogram
Number of Branche
50
45
40
35
30
25
20
15
10
5
0
1
1
3
2
3
6
25
34
44
40
47
36
15
7
5
2
-19%
-16%
-13%
-10%
-7%
-5%
-2%
1%
4%
7%
10%
13%
16%
19%
22%
25%

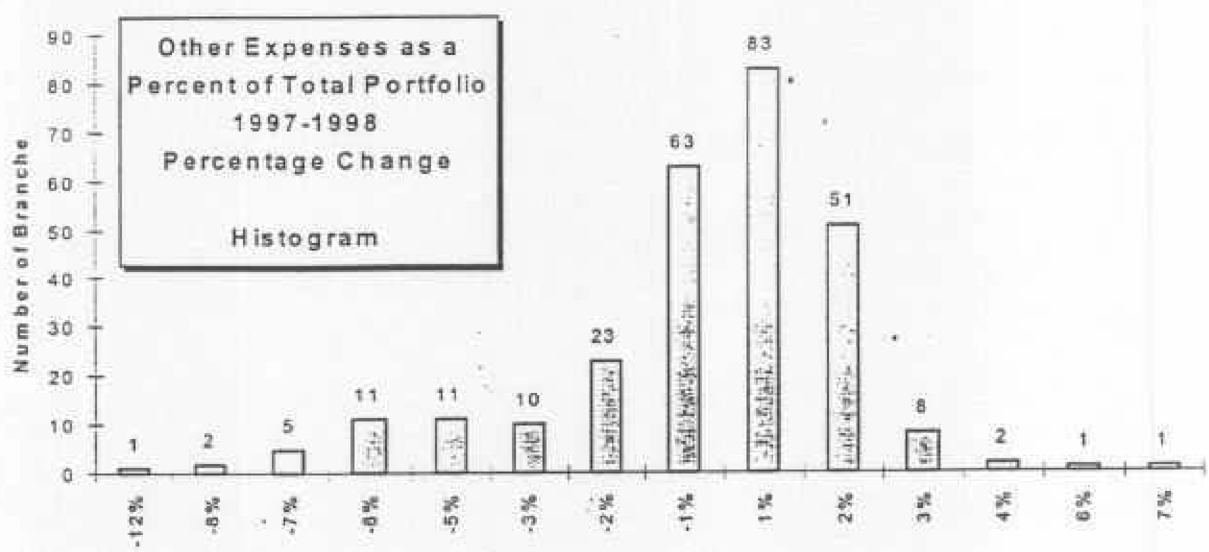

1998 Salaries Expense Ratio Over Outstanding Portfolio by Branch Year
0.10
0.09
0.08
0.07
0.06
0.05
0.04
0.03
0.02
0.01
0.00
2 3 4 5 6 7 8 9 10 11 12 13 14


Average Salaries Change = 1% Increase
Change in Salaries Expense Ratio Over Outstanding Portfolio by Branch Year (1997 vs. 1998)
0.10
0.08
0.06
0.04
0.02
0.00
(0.02)
(0.04)
(0.06)
(0.08)
(0.10)
2 3 4 5 6 7 8 9 10 11 12 13 14


Salary Expense as a Percent of Total Portfolio 1997-1998 Percentage Change
Histogram
Number of Branche
90
80
70
60
50
40
30
20
10
0
1 2 2 1 8 39 73 84 42 15
-12% -7% -4% -3% -2% 0% 1% 2% 3% 4%


1998 Other Expense Ratio Over Outstanding Portfolio by Branch Year
0.14
0.12
0.10
0.08
0.06
0.04
0.02
2
3
4
5
6
7
8
9
10
11
12
13
14


Average Expense Ratio Change = 1% Decrease
Change in Other Expense Ratio Over Outstanding Portfolio by Branch Year (1997 vs. 1998)
0.10
0.05
0.00
(0.05)
(0.10)
(0.15)
2
3
4
5
6
7
8
9
10
11
12
13
14

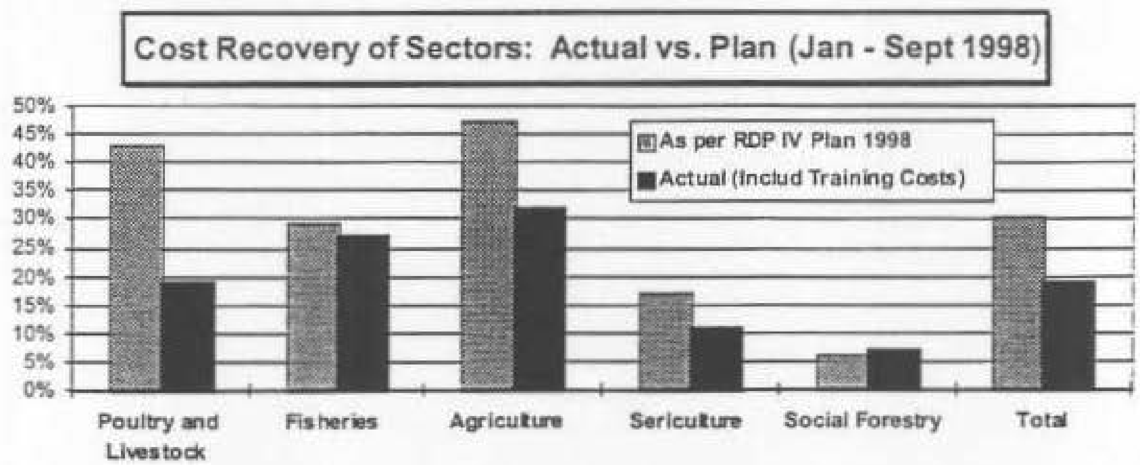

Other Expenses as a Percent of Total Portfolio 1997-1998 Percentage Change
Histogram
Number of Branche
90
80
70
60
50
40
30
20
10
0
1
2
5
11
11
10
23
63
83
51
8
2
1
1
-12%
-8%
-7%
-6%
-5%
-3%
-2%
-1%
1%
2%
3%
4%
6%
7%

5.6 Cost recovery performance of the sector programs

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

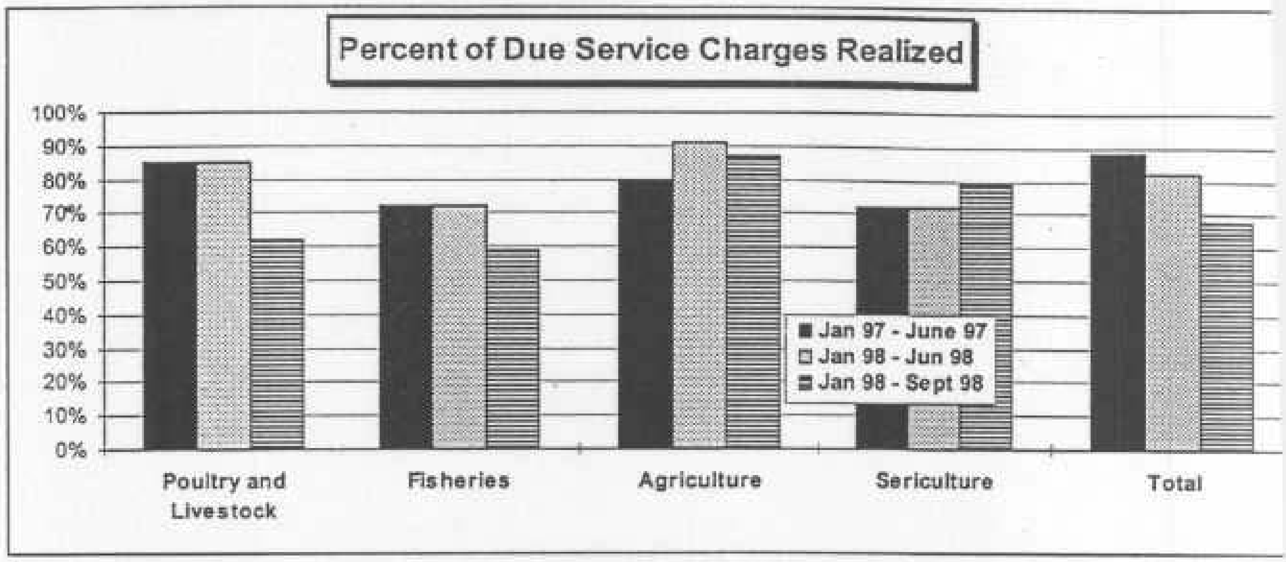
In 1993 BRAC began incrementally collecting service charges for its four sectoral programs. The charges for technical assistance rendered by sector staff can be found in the adjacent table. The introduction of service charges was a mechanism that BRAC devised to makes its sector programs self-sufficient over time.

In BRAC's RDP IV proposal, the projected rate of cost recovery for all sectors programs was 30% for 1998. The chart below compares the projected cost recovery from the RDP IV plan (i.e., 30%) with actual cost recovery of all the sector programs which was 11% below the projected target at 19%. The chart shows that only cost recovery in the social



forestry sector is ahead of target as per the RDP IV plan. Cost recovery in the fisheries sector is almost on target and it was possible that, absent the flood, this target would have been met by the end of 1998. The same does not hold true for the Agriculture and Poultry and Livestock sectors, which are substantially below their target. Sericulture, which had extremely low cost recovery targets to begin with, is also behind budget.

There are two possible reasons why sector cost recovery is below target: (a) the targets were unrealistic to begin with; or (b) costs are higher than projected and/or service charges realization is below expectations. We do not have enough information to analyze whether targets set were realistic or not. Our instinct, however, is that they were not overly ambitious.



We do know that there is certainly room for improvement with respect to service charges realization. Even before the September flood, there was an increase in total service charge delinquency if we compare collections between January and June 1997 with collections during the January – June 1998 period. Actual delinquency is worse as BRAC's information system can presently only track delinquency in the current period. Delinquent service charge payments from any previous period go unchecked. Total overdues are thus far greater.

There are several reasons why people may not pay service charges that are due:

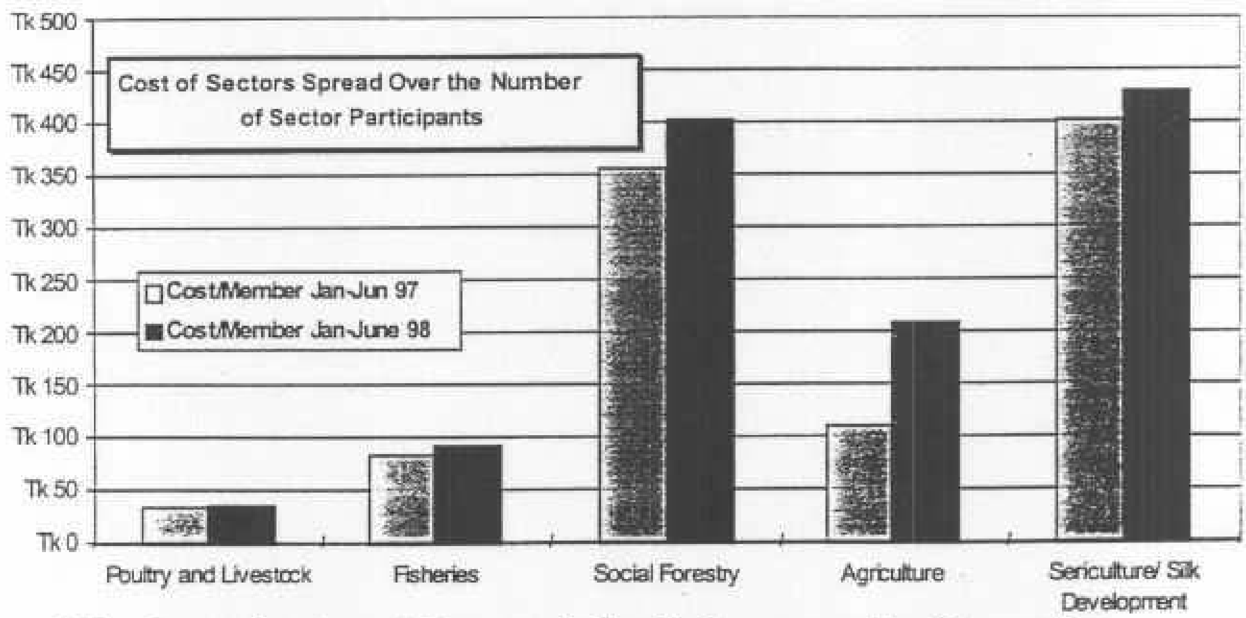
- BRAC staff do not spend enough effort on tracking and following up overdues
- Members are dissatisfied with the service provided and thus are not prepared to pay. Perhaps the service was not provided at all (e.g. in the case of chicks, they pay for the technical assistance at the point that they buy the chick. What is the incentive then for the Poultry PA to ensure service if payment is already received).
- Members cannot afford to pay. This is a dubious argument as the basic premise of the sector programs is that it increases the household incomes of members substantially.
- Members do pay charges, but money does not reach the branch office.

Apart from sericulture participants who have often had business failures and therefore are unwilling and/or unable to pay service charges, we believe that payment of service charges is not due to a lack of affordability by members. This is especially so if the estimated annual net profit/member that were given to us for the various sectors is true. This leaves two causes: either the quality of the service delivered is poor or RDP staff are not persistent enough in chasing overdues.

The good news is that both these causes can be fixed. A good MIS system to enable branch management and staff to track overdues, and a performance incentive system to encourage their collection is necessary to reinforce good collection behavior of staff. (See Appendix 1 for notes concerning the design of the sector program and MIS system.)

Until the delivery system for technical advice is changed (see below), 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 up-front. 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.

Fixing poor quality service delivery is more difficult. Is it because staff members are not trained adequately, or is it because they are unable to train and assist VO members effectively? This is an area that BRAC will need to research. We believe that it is important to tie payment for services to value received by participants. Our suggestion is to privatize the delivery of technical assistance (See Appendix 1). BRAC can train, and perhaps certify, village participants to deliver the service. Thereafter, it is entirely up to them to sell their services in the village. BRAC has already done this with some of its services (e.g. para-vets) and is actively considering implementing some version of the above.



Addressing service charge delinquency deals with the revenue side of the equation. Reducing cost or expenses in each of the sectors is the other side that BRAC needs to address. Sector costs have increased because of inflation, increases in staff salaries, and increases in the number of staff. The chart above shows takes the sector costs for the first six months of 1998 and divides them by the number of participants in the each sector as at June 1998. It does the same for 1997.

Costs per member have gone up in all sectors, with much more remarkable increases in the Social Forestry and Agricultural Sector. The number of participants in vegetable production shrunk over the past year, which accounts for a substantial portion of the increase as the costs are positively correlated with the number of participants in the sector. Sericulture, which has around 24,000 participants has a far higher cost per member than poultry and livestock which has over 400,000 members. Because the sector program has not developed a good MIS tracking system, it has been difficult for BRAC to know how many PAs to cut back on when membership in a sector drops, or how many to add when membership grows. As a result, Sericulture, for example, is overstaffed.

Recommendations: sector program charge recovery

1. A sound MIS tracking system is necessary for BRAC to improve its service charge realizations as well as to be able to cut costs where feasible. This is the single most important recommendation we have for this sector, and most recommendations below should be incorporated as part of this tracking system. The system should track inputs to branches and cost recovery, activity of the sector programs, staffing, and service charge realization against service charges due.

2. 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).

3. 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.).

4. 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.).

5. 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.

6. Finally, we believe that BRAC should start thinking about a way that members pay only for services that they feel add value. Privatizing services, as discussed above, is one way to do this.

5.7 Review the RCP financial model

Substantial improvements have been made to BRAC's financial model since last year. Last year we observed that, given the new challenges and questions BRAC faces, the model should have an: 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. What follows is a brief update on improvements that have already been addressed:

(a) MELA loan growth has been factored in, but further adjustments need to be made as MELA's growth trajectory becomes more explicit.
(b) A more formal write-off policy has been factored into the model.
(c) The use of the PKSF loans to fund loan growth still needs to be factored in.
(d) Current projections of savings growth have been revised and provision for realistic withdrawals have been added. The model needs to be expanded to include other savings products, as they become available.
(e) The loan portfolio has been structured to allow it to grow beyond the current Tk300 million level.
(g) Provisions for additional, longer-term loan products supporting MELA requirements were incorporated.
(h) A way to measure asset/liability management needs was incorporated into the model.
(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. Still to be done.
(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. Still to be done.
(k) More extensive use of graphs as analytical indicators are now being used.
(l) The net interest margin behavior in light of different liquidity scenarios needs to be understood better. Still to be done.
(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. Still to be done.

5.8 Implications for RDP/RCP of the VGD program

Although the number of VGD women has increased both inside and outside of RDP, we see no impact on the financial sustainability on RDP. Neither do we see any reason why VGD-related funding requirements from donors should vary much from the amount in the revised RDP IV budget. The 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 a separate program from RDP and is required to be separate not due to BRAC's wishes, but due to government and WFP requirements.

There are presently 50 VGD branches outside of RDP branch office areas. These branches have around 300,000 members and the program is run very similarly to BRAC's RDP model. Each branch has its own branch management staff that is separate from RDP branch office staff. RDP's regional managers and regional sector staff, however, do oversee the VGD offices. The VGD program pays for the regional managers and sector staff time on a pro-rata basis. For example, if the 30 regional managers oversee an extra one or two branches over their 10 RDP branches, then 1/11 of the salary of the regional manager is paid for by the VGD program.

Within BRAC's branch office areas, VGD participants are all part of BRAC's regular target group. No additional costs are thus incurred. Around 300,000 of RDP's regular members are either VGD or ex VGD recipients. As BRAC is focusing on admitting very poor members into its program, this number is expected to grow.

5.9 Review the status of the BRAC Bank Proposal

BRAC management tried several times (late 1980's, 1990, 1996) to get special legislation to allow RCP to become an independent microfinance bank which was not open to be used as a football by political parties. This was not politically possible. BRAC was then faced with two alternatives: (1) to drop the idea of a Bank that could mobilize resources for its RCP program and other development initiatives, or (2) to pursue a commercial bank charter. BRAC chose the latter and reapplied in 1998, this time for a commercial bank charter. BRAC is currently waiting written authorization from the Central Bank. Once it receives this written authorization, it will devise a business plan and governance structure for the Bank.

Not much more is clear at this point, except that it might be very difficult to absorb RCP branches into the bank. There are three reasons for this:

1. The Central Bank controls very closely who, where, and how many branches any particular bank may open. RCP has 330 branches. Generally, opening a single branch is a highly bureaucratic, time consuming and politicized matter.
2. The government regulates the interest rate for commercial banks. BRAC's RCP program will be put under severe financial pressure if the effective interest rate is suddenly reduced by 10%, which is likely to be the case. Grameen got special permission to charge higher rates because it is not a commercial bank. BRAC is unlikely to be able to do the same.
3. Most commercial banks lend to borrowers who have collateral. Most of RCP's members to do not any collateral that could be realistically claimed against losses.

The role the Bank plays vis a vis BRAC's RCP microfinance program is a crucial issue that will need to be worked out in coming months. BRAC management is seeking the advice of outside specialists to help them find the best way to ensure that the Bank can make a serious community economic development impact that directly affects the lives of the poor in Bangladesh. The future of RCP will be an important part of that solution.

We believe that commercial banks have a number of attributes making them particularly attractive as community development institutions. As a regulated, large-scale institution, a bank is known, trusted, legitimate, well capitalized and self-sustaining. It has (and this will certainly be true in BRAC's case) an unusual capacity to be continuously knowledgeable about the local economy. Further, a bank can convert ordinary deposits into development loans; through doing so, it leverages its capital multiple times over. Finally, as a regulated business, the bank is forced to work to a bottom line discipline that ensures a focus on being effective and efficient.

A bank alone, however, cannot accomplish these objectives in the context of distressed communities with dysfunctional markets. Other development capacities that complement the investment activities of the bank are necessary. In the case of BRAC Bank, its relationship with RCP will be especially important. The challenge is to devise a structure that safeguards the interests of the rural poor (both the donor capital, as well as savings deposits of members), and at the same time, enables BRAC to continue to expand the depth and breadth of its poverty alleviation programs with maximum impact.

5.10 Review RDP financial status against RDP IV projections

This was an explicit category of Shorebank's terms of reference but has been covered throughout this report. Sections 5.1 and 5.2 provide a deeper discussion of this question.

5.11 Explore the creation of an improved branch rating system

The primary mechanism that BRAC uses to categorize and analyze branches is the "age" of each branch (e.g., Year 2 branch, ... Year 13 branch). For the past decade, this may have been a useful system of categorization, but as the total program matures this category system has less and less meaning. Based on our analysis, there is as much variability between branches of the same age as there is between branches of different ages. The creation of a totally new branch evaluation, categorization and rating system is well beyond the scope of this financial review, but the brief comments and analysis that follows may be useful as this conversation continues to be explored.

The first step in this process is to be clear on the purpose of any branch categorization system. While there may be many reasons for a branch categorization system, the one that is relevant for Shorebank's review is that BRAC needs an improved ability to forecast portfolio risk, portfolio growth, funding and staff requirements, and differential branch behavior. A branch with a high degree of concentration in the poultry or food processing sector might well have different staffing and portfolio risk characteristics than one with a high concentration in rural trading. This dynamic may increase with the growth of the MELA program, given its greater vulnerability to sectoral market issues.

There seem to be at least two new set of branch characteristics that may prove useful in predicting future branch and portfolio behavior. The first type of data involves the examination of the sectorwise distribution of each branch's portfolio. The second set of data involves the demographic and economic context of each branch, e.g., is the branch in an economically strong thana, or within a purely agricultural community or a manufacturing region, or a region of higher than normal population density, etc.

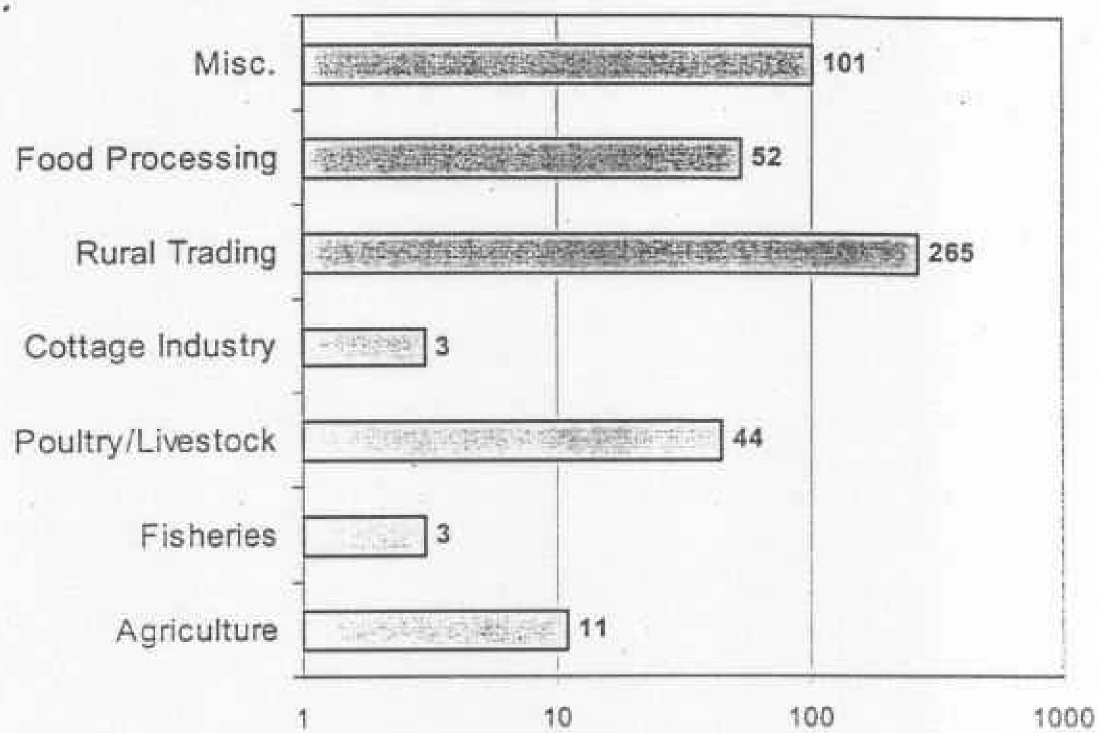
What follows is an examination of the sectorwise distribution of the portfolio across branches. Shorebank does not have access to any demographic or economic information about the thanas surrounding the various branches. This data is hopefully available from the relevant Bangladesh government agencies that track and measure demographic, economic and social variables. Obtaining this second type of data and exploring this second type of branch categorization must of necessity be pursued by BRAC.

Sample sector-based branch categorization system

Of the roughly 500 total BRAC lending entities (RDP and RCP branches and outposts, IGVGD branches, and urban lending branches), a significant percentage have more than

30% of their portfolio in a single sector. The most common portfolio concentration is in rural trading, not surprising given that overall there is over 50% of the entire RDP loan portfolio in the rural trading sector.

An obvious first question that has to be asked is whether or not the "loan sector" information in the BRAC credit tracking system is accurate. There are arguments that suggest that because this information has not traditionally been an important piece of



Number of Branches/Outposts With Greater Than 30% of Portfolio in Single Sector

information to BRAC management, this sector information is not accurate. Similar to this question is the previously raised point that the rural trading sector classification has turned into a "catch all" category that covers a multitude of enterprise sectors, and is thus not useful. It is not within the scope of this review to be able to determine the quality of data of the "sector" loan designation, but that clearly must be done.

Assuming, however, that the quality of sector information is sufficient to support a preliminary analysis, the scatter diagrams and histograms on the following three pages suggest that it may be useful to explore the benefits of a limited sectoral branch classification system. The following is one suggested system for branches that are particularly sector focused.

Sector Category	Degree of Concentration	Comment
Rural Trading	Branches > 60% concentration	Combination of sectoral focus and qudality of data issue
Food Processing	Branches > 30% concentration	Specific sector and market risk

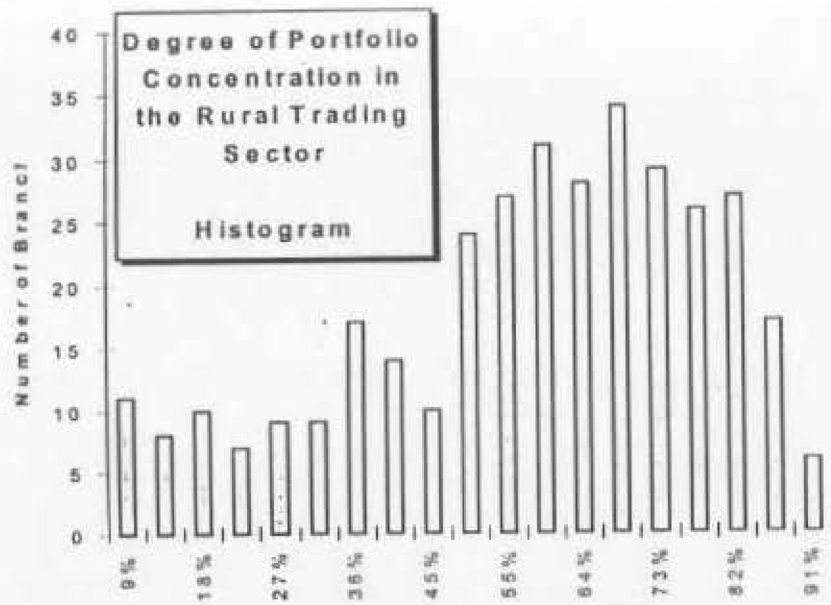
		and technical support needed
Misc. Sector	Branches > 30% concentration	Data problem, needs to be cleaned up
Fisheries	Branches > 15% concentration	Risky sector, needs special attention
Poultry & Livestock	Branches > 20% concentration	Specific sector and market risk and technical support needed

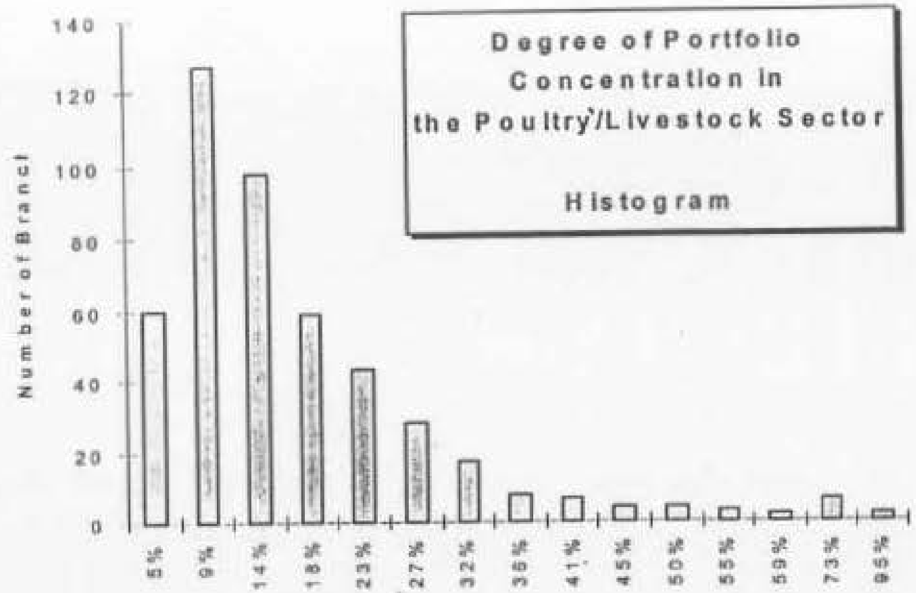
This analysis is by no means sufficient to implement a new branch classification system, even on a trial basis, but is meant to be indicative of the type of analysis that is necessary and possible. Additional analyses grouping branches and thanas based on similar economic, demographic, and social criteria need to be explored as well.

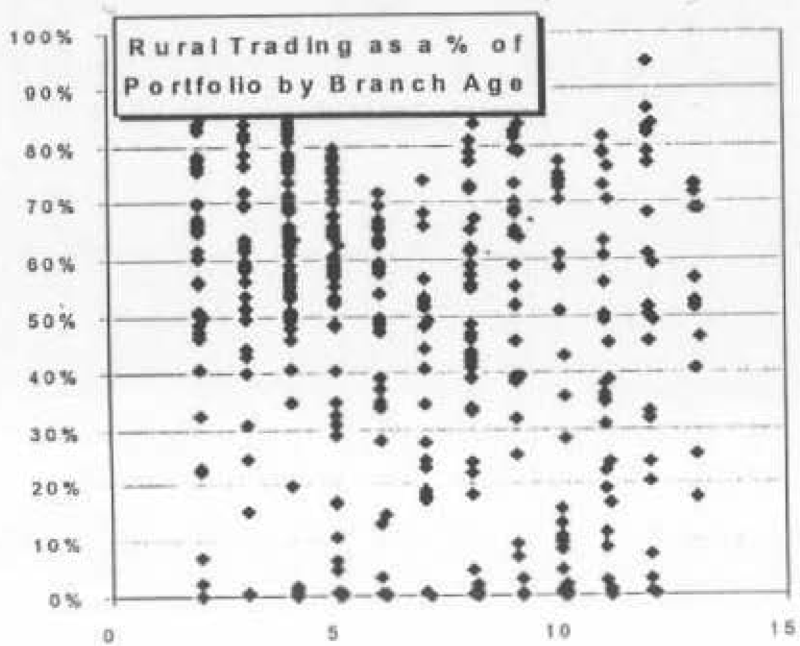
Other Categorization Systems

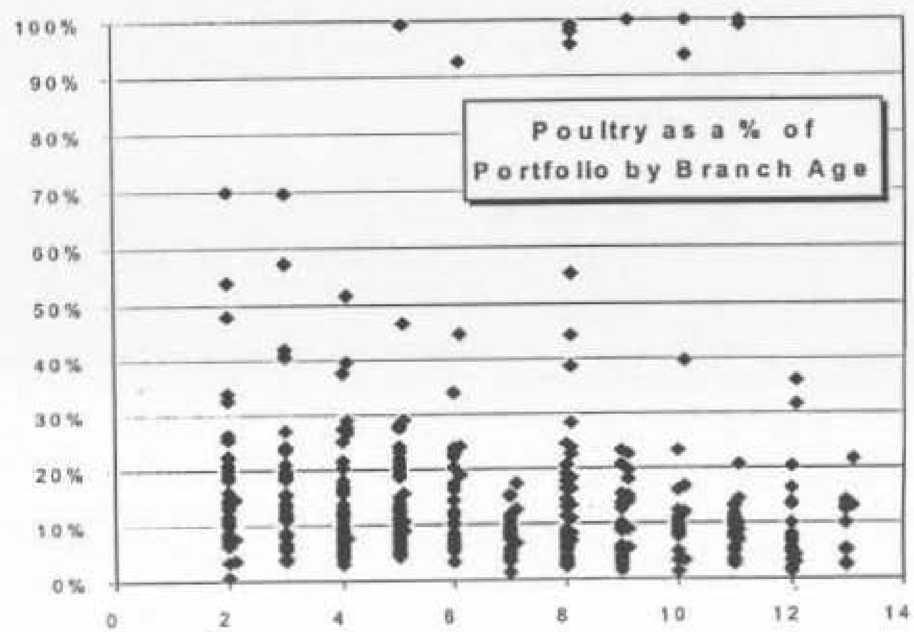
Besides sectoral concentration and thana demograhic and economic variables, two additional systems might be explored. The rate of growth of a branch over a period of years might suggest that different management systems, measures and progams should focus in a different manner, depending on whether the branch is low, medium or high growth. The problems faced by these three different types of branches may very well be different enough to warrant a different level or nature of management attention and support.

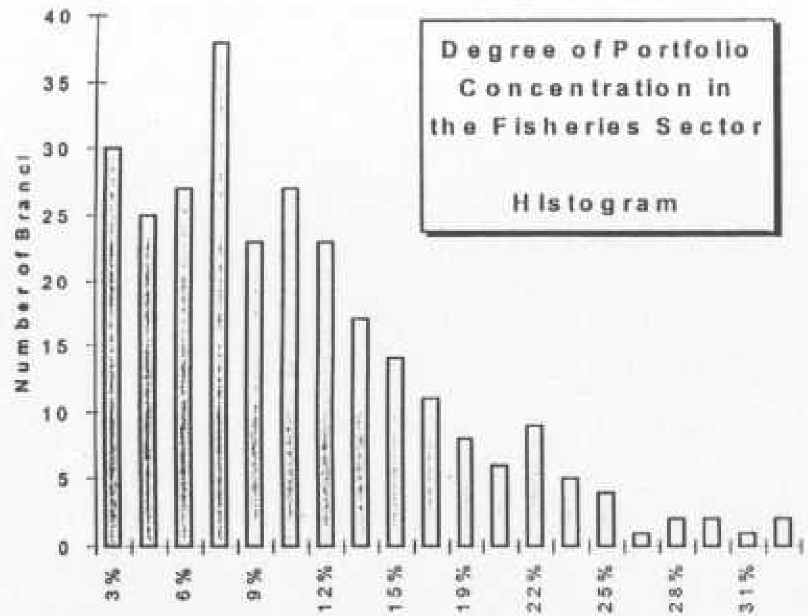
Additionally, using emerging geographic information system (GIS) software may allow BRAC for the first time to understand different portfolio characteristics by location, natural resource base, proximity to larger cities, or similar geographic characteristics.

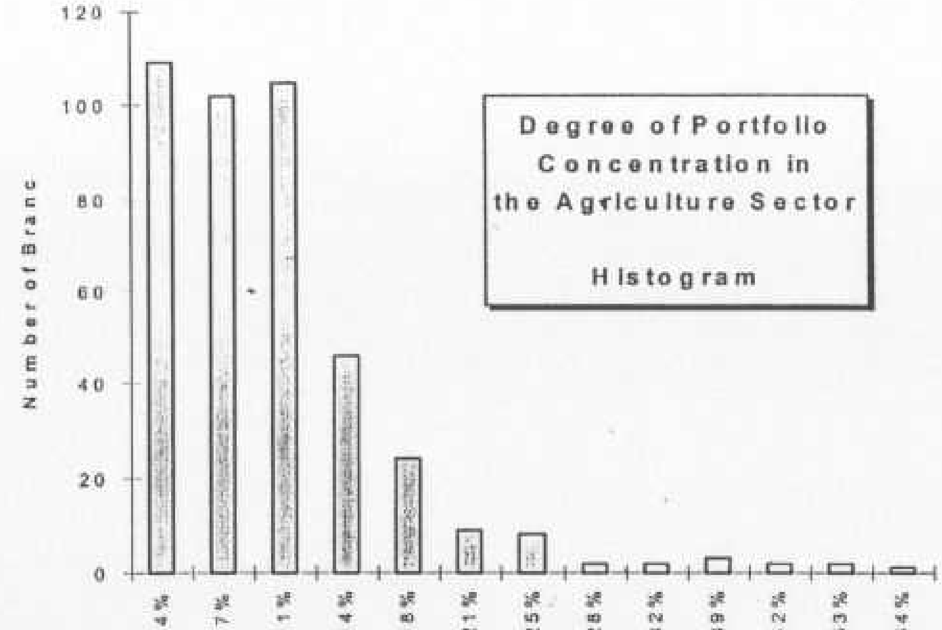

Degree of Portfolio Concentration in the Rural Trading Sector
Histogram
Number of Branc
40
35
30
25
20
15
10
5
0
9%
18%
27%
36%
45%
55%
64%
73%
82%
91%

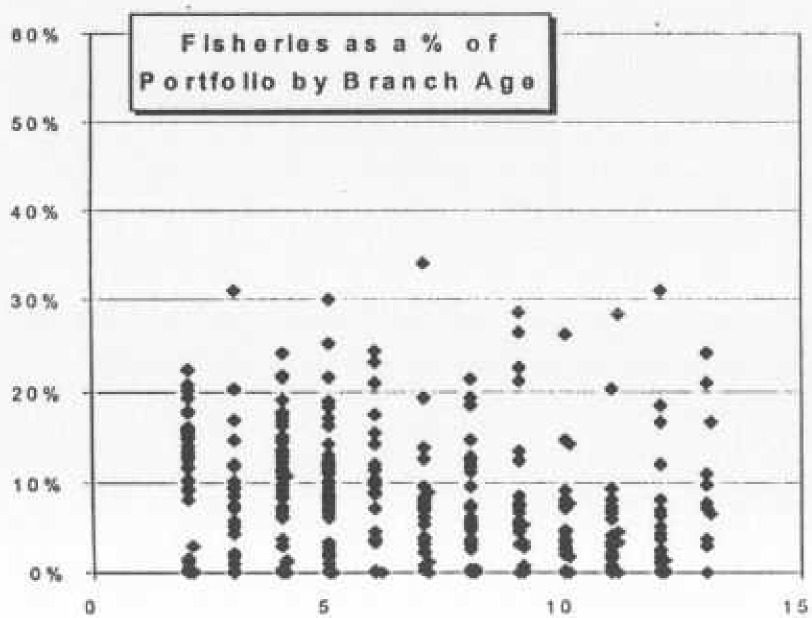

Degree of Portfolio Concentration in the Poultry/Livestock Sector
Histogram
Number of Branc
140
120
100
80
60
40
20
0
5%
9%
14%
18%
23%
27%
32%
36%
41%
45%
50%
55%
59%
73%
95%

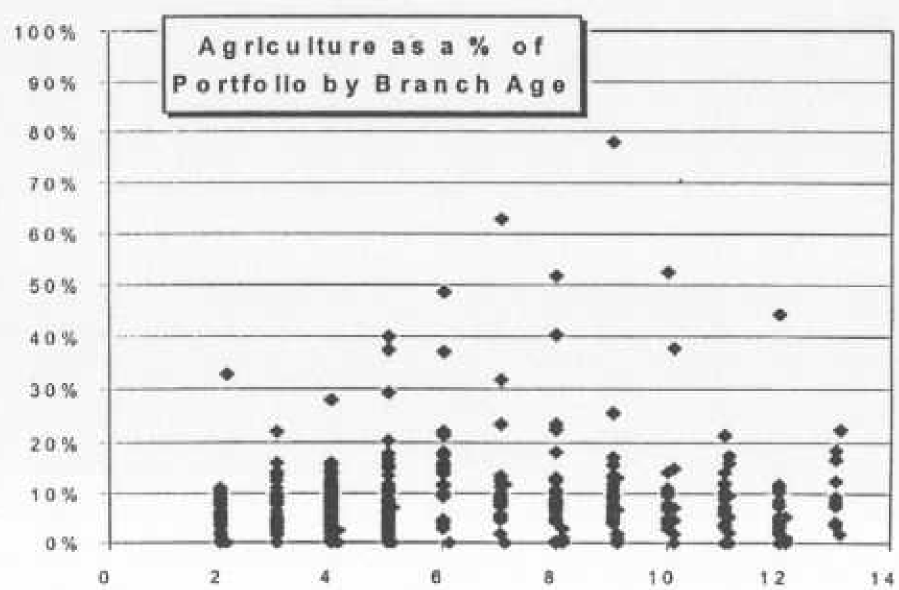

Rural Trading as a % of Portfolio by Branch Age
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
0
5
10
15

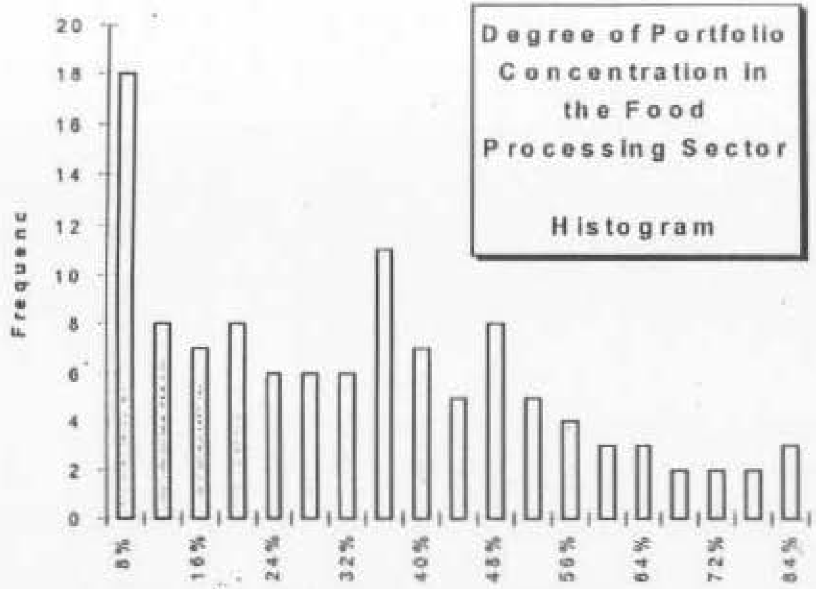

Poultry as a % of Portfolio by Branch Age
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
0
2
4
6
8
10
12
14

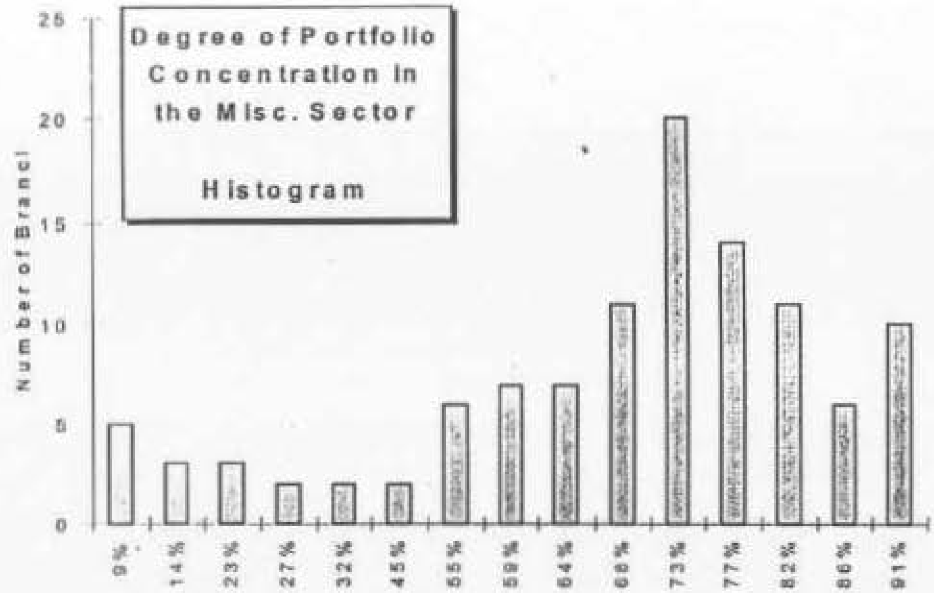

Degree of Portfolio Concentration in the Fisheries Sector
Histogram
Number of Branc

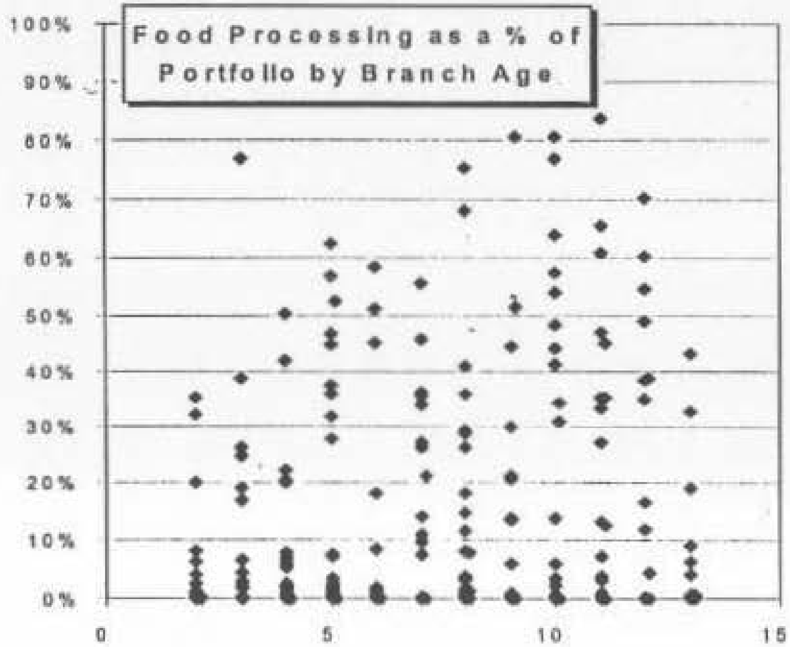

Degree of Portfolio Concentration in the Agriculture Sector
Histogram
Number of Branc

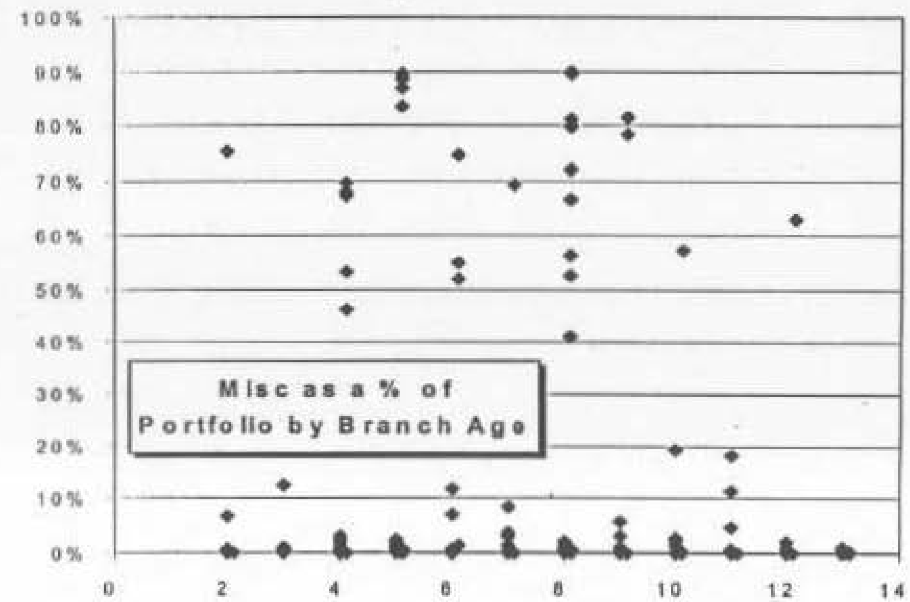

Fisheries as a % of Portfolio by Branch Age


Agriculture as a % of Portfolio by Branch Age


Degree of Portfolio Concentration in the Food Processing Sector
Histogram
Frequenc


Degree of Portfolio Concentration in the Misc. Sector
Histogram
Number of Brancl


Food Processing as a % of Portfolio by Branch Age


Misc as a % of Portfolio by Branch Age

6. Notes on the Challenge of Growth

Diagnosing and researching the issues of growth management for BRAC is not within the Donor Terms of Reference for this Financial Review, nor was there adequate time during our time in country to give this issue the attention that it deserves. It is clear, however, from a number of perspectives, that this is a fundamental issue for BRAC. The few comments that we offer here should be seen as only a brief indication of the issues and the possible steps that might be taken to take this analysis further.

1. *Step One: Acknowledge the issue, build capacity to respond*

There are many ways to diagnose and respond to the complex issues generated by rapid company growth, and what follows is only one type of approach. The first suggested step is to acknowledge that as long as BRAC grows at above 20% per year, it needs to acknowledge that "growth management" will continue to be an issue. At the current pace of about 25% annual growth, BRAC is doubling its asset and membership base every three years. This is an incredible pace of growth for any organization, let alone an organization dealing with the host of complex issues that BRAC works with.

Managing growth is not and will not be a one-time event, nor will it be an ad-hoc "project" that creates an "answer" that can then be implemented to solve the problem. Constant and strong growth is much more of an ongoing and systemic issue that affects all parts of the company, from physical space needs to human capital & training to loan capital funding requirements to many other elements. Just as "quality control" is a constant issue for a manufacturing company and "customer satisfaction" is a constant issue for a service company, "growth management" for BRAC will be a constant fact of life that requires ongoing attention.

The first step is to realize that this is a task that must be managed on a continuous basis, and as a result it is necessary to create capacity to understand and help the organization manage this issue over time. We suggest a permanent management task force be created with a representative of key parts of BRAC as well as representatives of some outside consulting resources. There must be dedicated staff resources to support the necessary R&D behind this task—this is not the kind of work that one does "on the side" as part of another job. The best result would be a combination of internal BRAC staff combined with external consultants skilled in organizational analysis and in diagnosing the problems of growth.

2. *Step Two: Diagnosis*

There are many ways to diagnose the organizational issues created by rapidly growing companies, and only a few are discussed here.

Productivity measures and relationships. One of the most common measures of organizational stress is to examine measures of productivity, for it is here where the inefficiencies introduced through growth often appear. No single measure is the "right" measure. An appropriately balanced selection of measures will enable management to see where the stresses of rapid growth are showing up. The key is that the measure is an indication of a process or an ability of BRAC to transform one resource into another (e.g., staff expenses into loans, sector TA into revenues or income created). In BRAC's situation, the following measures may be examples of useful indicators:

- Salaries divided by outstanding loan portfolio
- Operating expenses divided by outstanding loan portfolio
- The number of Taka it requires in expenses to disburse one Taka of debt to a borrower
- The number of POs to the number of members or borrowers or sector participants
- Number of loans processed per month per branch staffperson or PO
- Branch level profitability
- Savings per member or loan amount per member
- Loss rates per branch or even per single loan officer/PO
- Time or turnaround behavior: significant changes in the time it takes to achieve a task such as making a loan, creating a report, getting information into regional or head office.

Span of Control. Another measure that often can indicate where growth stresses require some attention comes under the general heading of span of control. As an organization grows, key management levels often experience the number of factors, resources or variables they must manage increasing to an unwieldy or ineffective level. Most common varieties of this are managers that are managing too many "direct reports", too many "programs", too many transactions, or too many assets. There is no magic number for these. The task is to look for areas where there has been a rapid increase between a position and scope of responsibility in terms of people, decision making responsibility, resources, assets (or liabilities), number of transactions, etc.

Sometimes it is possible that a specific position is able to absorb a significant increase in output or responsibility through excess capacity utilization, use of technology, increased training, etc. All too often, however, this is not the case, and the result is decreased efficiency, increased organizational risk, staff burnout and associated costs, and other negative results. The "savings" in staff expense are usually far outweighed by the additional risk that the organization incurs by not addressing this issue.

Reporting level or detail. An issue that is related to span of control has to do with reporting and management detail. Example: when BRAC had 500,000 members perhaps it was appropriate and possible for someone at the Head Office to be examining branch level detail. Given BRAC's current 2.2 million and rising membership, that level of involvement from that far up the management change is not appropriate or possible. Examining what decision authority and reporting detail is being "carried up" the management chain from branch to region and from region to head office is another possible indicator of places where the old system is no longer appropriate to the current scale of operations.

Staff morale and turnover. Another area where rapid growth problems show up has to do with the "human capital" of an organization. Looking for positions or areas that are showing increasing staff turnover, sickness, absentee rates, and so forth can be another indicator of an structure that has grown beyond its ability to be effective. Another related indicator might be tenure or time in position. If there are specific levels or types of positions that show a continuous trend of shorter and shorter time in that position, that indicates a possible area of increased risk where there is insufficient time to support an adequate learning curve.

3. Step Three: Response and resolution

There are as many possible responses as there are problems, so this section is necessarily general and only suggestive in content.

Sources of help for problem resolution are other organizations, management consultants, and accountants or managers that have had experience with rapidly growing companies. Often individuals that have worked with the "franchise" industry have expertise in spotting and resolving these issues. It is important at this stage to involve people from outside of BRAC, for often they can see alternate paths or resolutions.

It is not always work harder or faster

A rapidly growing organization often approaches boundaries or discontinuities that suggest that the "old way" of doing something cannot be "fine tuned" any further, and a totally new set of management tools have to be implemented. The best current example is the process to computerize the branch reporting process. Clearly, the limits had been reached on the "paper reporting process", and continuing to refine that manual, paper based process would have yielded only very marginal improvements. The decision was made that a totally new system of reporting and date collection needed to be adopted.

The same will be true of other issues. It may be, for instance, that a totally new way of managing, measuring and staffing branches will be necessary to support increased growth, scale and management delegation from Head Office. It may be that a new level of management in certain areas will need to be created, to respond to rapidly increasing span of control issues. It may be that a new department of employee training or credit R&D will need to be created to respond to issues and tasks that used to be handled as a due matter of course from a senior managers desk. The list could go on. The important fact is to realize that as an organization grows, it sometimes has to totally shift to a new way of understanding or managing a task, and realize that "improving" the old process is not a sufficient response.

7. Other Areas of Special Donor Concern

7.1 *Micro Enterprise Lending Assistance (MELA) Program*

Overview

The MELA program is aimed at stimulating growth of small enterprises. The program is under two years old with the first loan being made in December 1996. Loans range from Tk20,000 to Tk125,000. The average loan is around Tk30,000.

The primary management and policy question that remains to be resolved for the MELA program is simply stated, but hard to answer: "What is the purpose of the MELA program?" The nonexclusive choices are twofold:

(a) MELA can serve as a "high-end VO lending program" that serves to support local retail and service businesses and thus functions to redistribute preexisting village wealth from non-MELA borrowers to MELA borrowers; or

(b) MELA can serve as an "economic development" lending program that serves value-added (often manufacturing) enterprises with customers outside of the village/region, and thus serves the economic development function of bringing new wealth and income into the village, and overall strengthens the existing economic and asset base of the community.

Clearly, the MELA program can make either type of loan – local or export oriented. The question is what is the balance of the desired MELA overall portfolio. The natural tendency of the BRAC "system" will be to make local market, retail sector loans, because that sector has most of the village enterprises and that is primary area of branch staff experiences. The argument for making local loans is that they are much easier to make, draw on existing VO member relationships, are lower risk, require less staff skill development, and represent a nearly limitless market opportunity. The argument against local loans is that because they support businesses that serve local markets and customers, they primarily result in redistribution and reshuffling of existing village assets and income. As a result, their actual economic development impact on improving the total income and asset base of the rural community is almost nonexistent.

To date 1,655 MELA entrepreneurs have received a total of Tk51 million. The outstanding MELA portfolio for September was Tk28 million The average loan size for September was Tk37,000. The overall average loan size since the beginning of the program is significantly smaller at around Tk30,000. By the end of this year, the number of areas covered will have almost doubled from 27 to 51 branches where the MELA product is being offered. 17 of these 51 branches were just opened in November, so active lending has not yet begun.

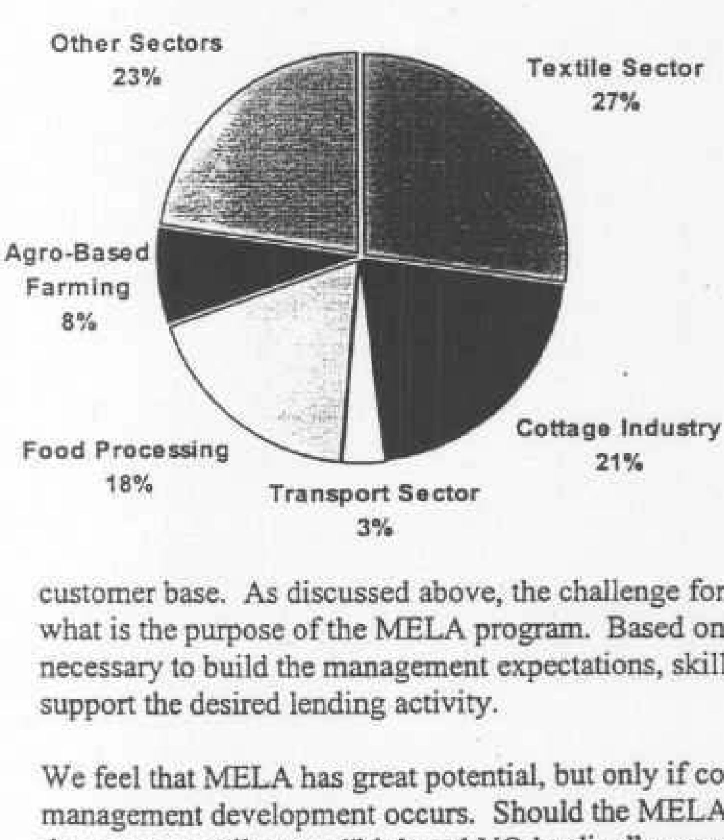
The program is expected to continue to grow rapidly. The projection is that an additional 49 branches will be opened by year end 1999, for a total of 100 branches covered.

Management projects that the program will add 100 branches per year through 2001 until nearly all branches are covered.

By the end of the year 2001 BRAC expects conservatively that an average of 80 entrepreneurs will be financed by MELA in 300 branches. This would require an annual disbursement of Tk960 million, assuming an average loan size of Tk40,000. BRAC's loan capital allocation for the MELA program is currently only Tk100 million, so this suggests a shortfall of Tk860 million (around $17 million). This is a very serious funding requirement.

MELA Program Results to Date

Currently, the MELA program is functioning as a high-end "VO Lending Program", in that loans are being made primarily on the basis of preexisting relationships, character and collateral - not business or enterprise analysis. September 1998 data shows that 94% of borrowers are VO members, and 80% of borrowers are women. Over 80% of loans have been to businesses that have at least a 75% local customer base, and usually a customer base that is 100% local. The almost 100% on-time payment situation is more a function of preexisting PO-borrower relationships, guarantors and "creaming" the borrower market than it is as a result of significant financial business analysis and risk management. The current portfolio relies almost totally on PO borrower relationships and not on any overall system of analysis and risk management.



This is not an unexpected program status at this stage, as it is natural to build on an existing mode of lending and a known customer base. As discussed above, the challenge for BRAC Management is to decide what is the purpose of the MELA program. Based on that policy decision, it will then be necessary to build the management expectations, skills and experience required to support the desired lending activity.

We feel that MELA has great potential, but only if concerted program, staff and management development occurs. Should the MELA program choose to grow beyond the current retail sector "high end VO lending" program, it will represent a departure from the traditional VO based BRAC lending program. As such it will require significant management determination, staff training and discipline to achieve MELA's economic development potential. With significant focus, it can be a strong tool to bring new income to the rural areas, respond to the root issues of poverty in the rural economy, and counteract the economic drain from rural to urban communities. We believe that it is worth the effort, for it will chart a new course for BRAC for decades to come, pave the way for the BRAC Bank, and will address some of the underlying structural economic issues facing rural communities. The current MELA lending practices and loan portfolio, however, are not targeted at enterprises that have this economic development impact.

MELA Program: Proposed Design Principles

Principle 1. There are two MELA Programs: MELA/Local and MELA/Export

MELA can evolve to have two distinct loan portfolios within one loan program. The first (MELA/Local) is primarily a retail market lending program and the second (MELA/Export) is a primarily an economic development, wage employment creation program. These two portfolios are related, but quite different.

The description MELA/Local is not meant to limit these loans only to retail firms, but to suggest that this category of loans is for businesses that sell to local customers, and thus function to recirculate income that already exists in the rural or village economy. These loans can be to all types of local retail and service businesses. The key is who is the customer and is the sales income generated "new" to the community or just redirected income that already existed in the community.

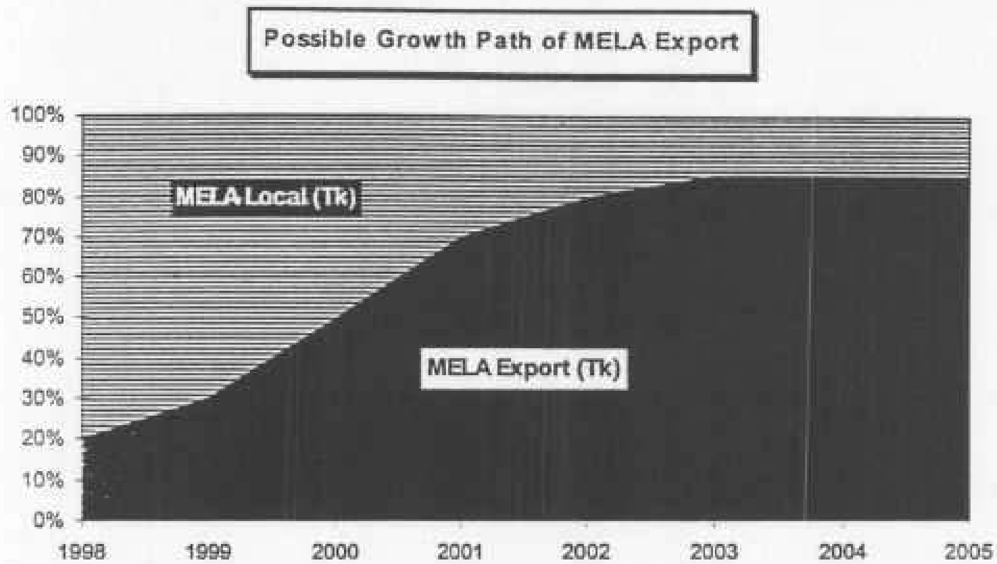
MELA/Local lending is a small business lending activity that could, in time, form the target market and core portfolio for the emerging BRAC Bank. The market demand for loans between Tk25,000 to Tk250,000 is nearly infinite relative to the available BRAC resources. The small service and retail lending market, especially in rural communities, represents an extraordinary market opportunity for the BRAC Bank as it grows over time. It has volume, can be profitable, draws on BRAC's existing delivery system and competitive strengths. Over 90% of the current 1600 loans are MELA/Local loans.

MELA/Export lending is aimed at value added businesses, i.e., businesses that have customers external to the village economy. The goal of MELA/Export loans is the creation of "new income" and "new jobs" for a region. The designation MELA/Export is not meant to restrict these loans only to manufacturing concerns, but to firms that sell to external customers and bring new income into the rural economy. The focus is to increase the available income and assets of the community. This is an economic development and business development program, not just a lending program. This program is focused on growing businesses, providing management assistance, and targeting export oriented firms serving external markets. Less than 10% of the current MELA loans are MELA/Export loans.

Principle 2. The two MELA portfolios must have specific goals

While MELA/Local lending represents an important activity and may ultimately form the core portfolio for the BRAC Bank, the primary focus of the MELA program should be MELA/Export if maximum economic impact is desired. As suggested by the graph below, this does not mean that there will not be any MELA/Local loans in the MELA portfolio, for these lower risk, local market loans can assist in overall portfolio balance, generating earnings, and risk management.

This does mean, however, that MELA/Local should not ultimately be the focus of MELA, and should not be more than 10% of the MELA Economic Development lending program. That is the exact opposite of the current portfolio, however, in that MELA/Local loans compose 90% of the portfolio. MELA/Local could be a major component of the emerging BRAC Bank, but that is a different conversation.



Proposed Portfolio Composition (1999-2005)

Principle 3. MELA is not a VO loan program; MELA staff need advanced skills

Lending criteria, staffing, risk management, portfolio size, marketing and distribution, scale, and the need for additional business assistance can emerge to be MELA's distinguishing program characteristics. Until these differences are fully understood and incorporated in the management and operations of the MELA program, there is risk that the "VO experience" will contaminate the MELA program with inappropriate assumptions and risk management habits.

The risk of a MELA portfolio is much greater than the VO portfolio, not only because the size of the loans will be 10-100 times greater than the normal VO loan. The primary focus of the MELA program is on more complex businesses that have to wrestle with much more difficult competitive and operational issues. Especially for MELA/export lending, a MELA loan officer must have some understanding of regional markets, cost accounting, inventory management, longer cash flow cycles, and many other issues not relevant to retail lending.

The MELA staffing mixture must be able to draw on a wide range of skills: formal bank lending skills, small business management skills, market development and analysis skills, accounting expertise, and other unusual skills and experiences. Without creating a sense of hierarchy, for BRAC to successfully navigate the risks inherent in this type of lending, it must staff MELA with the most highly skilled of its employees. It must also recruit from the outside and bring in lateral transfers, for it will be unable to grow some of the needed skills "from the inside".

Assuming that the program grows to 100 branches by the end of 1999, each with a moderately sized MELA loan portfolio of eighty Tk40,000 loans, the total MELA portfolio will be Tk320 million. If having the appropriate lending and business consulting staff reduces the loan losses by only 1/3 of 1%, this represents an annual savings of Tk1 million, more than enough to pay any expanded MELA staff costs.

Principle 5. MELA/Local focuses on the borrower; MELA/Export targets the employee

The first goal, best served by MELA/Local lending, is to directly serve a specific targeted constituency - women, low income people, village enterprises, the poorest of the poor, etc. The primary goal with MELA/Local here is to redistribute income and to provide access to capital to a particular group of borrowers (<u>access</u> to income and wealth).

In contrast, MELA/Export lending is not focused on the borrower, but rather on the economic impact and the ability of the firm to create net new village income and net new jobs. This represents an enormous change for BRAC, in that BRAC has always focused on the borrower and not the net economic impact for a village/region. The entrepreneur may not be a woman, may not be poor, and even may have access to some existing bank credit. The entrepreneur, however, will create jobs and new income for the target population, however. The focus is not the borrower but rather on the ability of the firm to create new income and employment in the community.

> *MELA/Export loans cannot be restricted to or focused on VO members, and in fact VO members will ultimately form a very small percent of MELA/Export loans. The reason is simple: there are few VO members that can or will create firms which sell to external customers. To restrict or focus these loans on VO members will defeat the economic and income development function of MELA/Export.*

<u>Key MELA Management Challenges</u>

Setting aside the challenge of hiring new and retraining existing staff, management has two additional challenges: (a) creating policies that distinguish MELA/Local from MELA/Export; (b) creating incentives that will support the goals of MELA.

The incentive question is a particular challenge. Every existing MELA PO loan officer will be much more comfortable making loans to borrowers that they know, serving local markets and customers for whom the risks are less and easier to analyze. Unfortunately, the "easier" loans will have little if any economic impact. The task for MELA Management is to create incentives and guidelines that support BRAC's economic development goals while at the same time acknowledging the pressures on the MELA PO to make local market loans. The second challenge is how to differentiate between the two types of loans: MELA/Local and MELA/Export. In some cases the distinction is clear, but in others it is not.

A proposed preliminary rule to separate the two categories is as follows: A MELA/Export loan is to a business that generates over 85% of its sales revenue from customers who live in one of the following Bangladesh cities (Dhaka, Chittagong, or other big urban areas) or outside of the country. Shorebank's proposal for this program is that it would be BRAC's intention that the MELA program will bring income and wealth from the richer and economically stronger urban areas to rural areas, not just transfer income between equally poor rural thanas or districts even though they are a distance from one another.

BRAC will also have to provide guidelines to MELA POs regarding the types of businesses that create greater economic impact (i.e. those that export). There will be exceptions to this classification system but the burden will be on the MELA PO to prove a specific loan is an exception to the rule so that it can be counted as one of the MELA PO's export loans to achieve their targets set by BRAC Head Office.

List of MELA Loans by Business Type (September 1998)

Sector	Cumulative # of Enterprises	# of full-time Equiv. Direct Jobs[5]	Jobs per Enterprise	Average Loan/ Enterprise
Textile	428	3109	7.3	Tk37,000
Cottage	322	2055	6.4	Tk35,000
Transport	65	145	2.2	Tk40,000
Food Processing	271	1310	4.8	Tk43,000
Agro-based farming	120	341	2.8	Tk39,000
Retail/Service	449	1081	2.4	Tk37,000

MELA Program Recommendations

1. **Create a Strategic Plan for MELA.** The first task will be to create a strategic plan for the MELA program which answers the question: what is the purpose of MELA?

2. **Focus MELA on MELA/Export lending, to maximize economic impact on communities.** 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. The desired balance would be 90% MELA/Export, and 10% MELA/Local. The emerging BRAC Bank could support MELA/Local lending, in that MELA/Local will fit the higher volume, lower risk requirements of the BRAC Bank.

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 economic impact with this program and reach the very poor.

3. **Create a MELA Loan Portfolio Aging and Past Due Measurement process.** The current system of past due measures for the MELA program understates portfolio risk, for it is not distinguish between a loan that is 30 days past due and a loan that is 120 days past due. This system of "Aging" the average portfolio outstanding (APO) is already in place for the standard VO lending program, and needs to be implemented for the MELA lending program.

4. **Determine the purpose of the MELA program, and the resulting specific overall BRAC portfolio balance of MELA loans that are to be MELA/Export and MELA/Local.** Senior management must determine what the purpose of MELA is to be, and what the resulting MELA portfolio composition should be. Is MELA to be a high-end VO lending program, supporting the growth of retail and local market businesses? Or is MELA to be an economic development program that brings new income into the rural communities? Or (if both) what is the balance of these two goals? Once this determination is made, at least for 1999, then branch and regional targets must be set and management reporting procedures adopted.

5. **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 primarily 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.

6. **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.

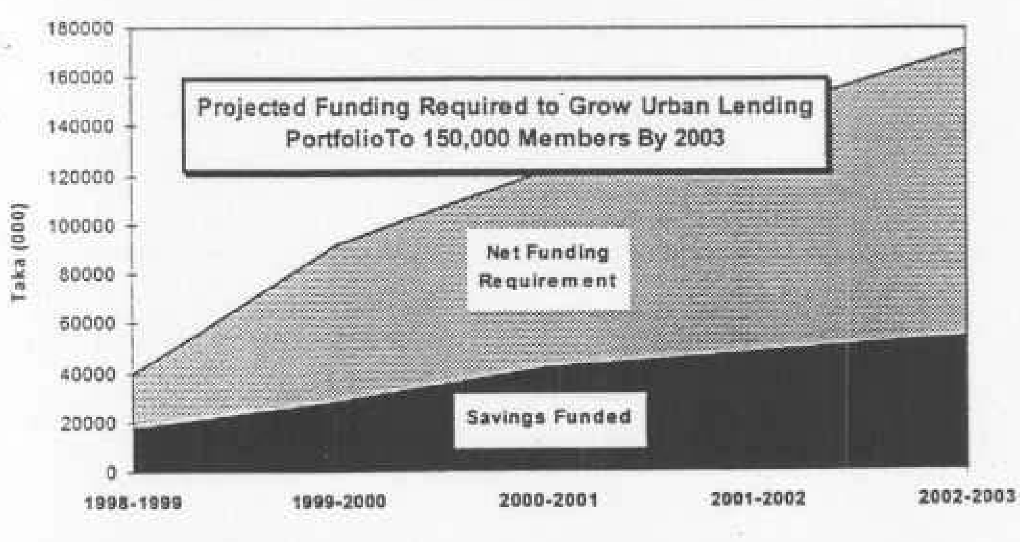
   A VO Program Officer manages 500 loans and as a result is more of a "systems" manager with brief contact with many borrowers and limited risk per borrower. In contrast, a MELA loan officer will manage only 30-50 loans, develop a much more in-depth relationship with the borrower, and have more substantial 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. **Revise the current system of loan categories and schemes.** The current system of MELA loan categories are at best misleading, and should be revised to reflect the MELA/Local and MELA/export loan divisions. Under the current category of "Textile Sector", for instance, is both a hand loom weaver, a tailor and retailer of cloth. Given the desire to understand how MELA is serving either a local market or an export-producing enterprise, the current information is not useful.

7.2 Review status of the Urban Lending Program

The Urban Lending Program is not an RDP funded program. In 1996, BRAC made a decision to extend its poverty alleviation program to urban areas with the intention of having an impact on urban poverty among squatters. The urban program has been modeled on BRAC's rural program (e.g. up to 40 members made up of groups of five comprise the urban organization (UO); first loan maximum is Tk4,000, meetings are biweekly, one PA will serve a maximum of 500 members, etc.).

This urban program, which had 18,000 members in 10 branches as of November 1997, has doubled its membership base to 37,700 by October 1998. Four hundred and seven slums housing 1,277 slum organizations or urban organizations (UO) are covered. BRAC plans to expand its Urban Lending Program in the future due to the increasing



incidence of poverty in and around major cities. A membership base of 150,000 is anticipated by 2003. Thirty branches will be covered with around 5,000 members per branch. This means an average annual growth of 20,000 members a year.
To fund 127,500 members (assuming 85% of 150,000 are borrowers), each with an average outstanding of Tk4,000 by 2003 means that a total of around Tk510 million is

needed. The amount increases as inflation is taken into account. Over the five year period, BRAC estimates that out of loan capitalization need of Tk570 million, Tk236 million will be funded by savings. This leaves the total funding required to capitalize BRAC's urban lending program at Tk457 million .

BRAC Urban Program Projections	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003
TPO Funding Required	40,000	92,000	122,100	145,200	171,699
Savings Funded	17,360	27,880	41,800	47,880	54,000
Net Funding Requirement	22,640	64,120	80,300	97,320	117,699

Currently, approximately 37% of members are borrowers and the average loan outstanding is Tk3,000. The total saving to outstanding ratio is 85%. Excluding compulsory savings, the ratio is 79%. This is approximately double that of RDP and means that the urban lending program can currently fund a major portion of its portfolio from savings. This is because loan sizes are still relatively small and most members are not yet borrowing.

Urban lending staff has taken precautions 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 the government to ensure that it lends to squatter settlements that are "permanent" in nature, rather than being subject to forced removals. In spite of this effort, the overall dropout rate for members is 6%, which is higher than RDP levels for similarly young branches.

Another difference between the RDP program and the Urban Development Program is that UO members are required to deposit double the amount into their savings account (i.e., Tk40 per month). To date, members have on average been depositing this amount monthly. 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. Members are required to deposit 5% compulsory savings against their first loan vs. 2% of the total loan amount in RDP for the same reasons.

While we agree with BRAC's approach of treading carefully as it feels its way in this new market, we believe that it is important to immediately set up comprehensive management and analysis systems to monitor portfolio risk, management and cost recovery at the branches. There is a wealth of expertise within the RDP program that can be used to assist urban lending staff in this regard. The costs of not doing this in the very near future will impede management's ability to prevent and catch problems early on.

Finally, we think that the Urban Program could be more strategic in its goals and objectives from the outset. Accumulating expertise in specific high impact sectors, and establishing linkages between VO enterprises and UO enterprises so that both benefit are two examples.

7.3 Report on repayments to RCP by BRAC for the HO building

BRAC borrowed Tk150 million for the purposes of building the BRAC Center building. As per the agreement, Tk15 million was repaid to RCP in June of 1997, leaving Tk135 million outstanding. Since then, an additional Tk30 million has been paid in two six-monthly installments with the next installment scheduled for December 1998. Currently, TK105 million remains outstanding.

7.4 Update on RDP / RCP computerization

The BRAC computerization program is a very important initiative, and we fully support it and in fact hope that it will be implemented as quickly as possible, for it is a key growth management tool for BRAC.

All RDP and RCP branches now report on loan collections on an exception basis. This appears to be working very well as over 70% of members pay according to BRAC's standardized schedule (i.e. members make 23 bi-weekly payments of equal amounts over the year with the 15% interest rate factored into those payments). This means that only 30% of transactions are subject to the possibility of errors. Computer validation checks have further reduced errors. BRAC's Computer Department estimates that the quality of their information is now 99.5% error free. There have also been significant time and cost savings, both a the branch level and at the head-office MIS department.

The other notable change is the progress that RDP has made with testing out its newly developed software in branches. Ten branches in one region now have computers. BRAC is expecting to computerize all branches within three years (rate of 100 branches a year). We believe the challenges will be threefold:

1. Ensuring "problem computers" are quickly fixed
2. Training branch staff in using computers to report
3. Training branch staff to use the information that they gather to more effectively manage their branches.

Substantial thinking has already gone into the first two bullets above. However, we feel the real value to the branches lies in bullet # 3, and we encourage BRAC to develop a process to meet this need. Clearly, Regional Offices should also all be equipped with computers and software that enable regional managers to do detailed branchwise analysis of their region. This information should then be summarized at the regional level for head-office use. Finally, an effective MIS system for tracking (and managing) individual and branchwise savings and sector activity still needs to be developed.

7.5 Future of RDP Program post 2000

By the year 2001, the remaining 120 RDP branches will be part of the RCP program. RDP, as such, will no longer exist. All credit activities should be fully sustainable by that time and cross subsidy of the sector programs will be taking place.

In terms of program growth from current levels, senior BRAC staff have indicated that they expect membership growth of all BRAC's credit programs to increase by around 50% over the next three to five years. RCP's growth will be fuelled by the intake of VGD members in existing RCP areas. As mentioned in our section on BRAC Bank, the portfolio growth of the 330 RCP branches may be funded by BRAC Bank. It is unclear whether the $30 million capital that the donors put into RCP/BRAC Bank will remain inside RCP or the whether it will be used in some from or another (e.g. to buy debentures) in the Bank. The table below shows existing membership of BRAC's credit programs, as well as our best guess (based on interviews) of future program growth. Clearly, growth of the nature will put accentuate already existing human capital needs that BRAC is facing.

	June 1998	June 2003	% Change
RDP	570,000		
RCP	1,600,000	2,900,000	81%
VGD (50 branches)	300,000	500,000	66%
MELA	1,600	24,000	1,400%
Urban	35,000	150,000	328%
Total	2,506,600	3,874,000	54%

7.6 Review BRAC's implementation of Shorebank's 1997 recommendations

1. **Portfolio Management**
   1.1. *Credit PAs should focus on savings mobilization with the time now available by moving to biweekly meetings.*
   Credit PAs have continued to focus on increasing the membership base of existing branches and reaching into poorer areas. Even so, BRAC agrees with us that there was not sufficient focus on savings mobilization, and savings growth has been much too low during the year.
   1.2. *To support good borrowers and economic growth, branch managers should be allowed to make more than one loan to exceptional borrowers.*
   Approximately 20% of BRAC borrowers now have a sector program loan as well as a general loan. Generally there is a Tk10,000 cap but exceptions are made for faster growing entrepreneurs.
   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.*
   Branch managers have received training and are more aware of upside flexibility with respect to loan size. Credit evaluation guidelines have not been introduced.
   1.4. *Branch managers with very few past due loans and good borrowers should begin to allow longer term loans on a pilot basis.*
   BRAC has allowed this to occur in its MELA program so that monthly payments of larger loan amounts are more manageable for borrowers. 24% of MELA loans have a term of 18 months and 13% of MELA loans have a twenty-four month term.
   1.5. *BRAC should design specific methods to closely monitor the impact of the shift to biweekly meetings on loan payments and savings.*
   BRAC's existing systems have been able to sufficiently monitor the

impact of bi-weekly meetings. As a result, management was able to dedicate attention to the increase in delinquency that resulted in the initial months following the introduction of the system. Qualitative fieldwork is still needed to understand why weekly savings numbers have declined slightly.

1.6. *The first loan size should be vigilantly tracked as an indicator that BRAC is reaching very poor borrowers.*
No separate report has been set up to track the first loan size across all branches. We still recommend that this gets done and/or the median loan size of each branch is tracked and managed.

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).*
Targets or budgets for most sectors have not been reset. Activity levels and estimates of service charges due were underestimated by 25% for poultry, 15% for social forestry and 57% for fisheries as a result of not setting more realistic targets.

2.2. *The poultry program should prioritize extremely poor borrowers to maximize impact of this sector on the very poor.*
This is occurring, especially among VGD members.

2.3. *Additional poultry hatcheries should be built in 1999 and 2000 to meet demand in this sector.*
The second poultry farm was completed in 1998 and BRAC is now in a position to consider new proposals for additional capacity to meet the outstanding demand for chicks.

2.4. *Sericulture should continue its current mode of no serious expansion pending the proposed program and market evaluation.*
No reeling centers were established in 1998 and sericulture lending as a proportion of the total portfolio outstanding contracted further over the past year as anticipated.

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

3.1. *Given the focus on the sectors programs, there should be an in-depth study of the business dynamics and possible delinquency problems in the following sectors: fisheries, sericulture and poultry/livestock.*
A study on sericulture will take took place in early 1999. No in-depth studies of the fisheries and livestock sector have taken place yet.

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.*
Currently only rural trading and food processing comprise more than 10%

of the total portfolio outstanding. Since the type of rural trading done by members is very fungible and lines of trade change regularly, there is some doubt over the usefulness of this break-down. However, we still feel that some broad category breakdown may be helpful (e.g. rice paddy and husking, livestock trading, vegetables, non-food items etc.).

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.*
Although no formal housing lending policy exists, all BRAC managers are extremely wary about making housing loans due to the disproportionately high risk historically in the sector. The housing portfolio shrunk both in absolute terms as well as a percentage of TPO for the second year in a row.

3.4. *All NIBL loans should be put into the 100 weeks APO category.*
BRAC does treat the riskiness of NIBL loans as if they are in the 100 weeks category and, for the first time ever, it wrote all these loans off in December 1997. On the January to November monthly report sheets, however, NIBL still appears across all aging groups. We do not see this as a problem if provisioning is adequate as has been the case in the past, and these loans are written off each year.

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.*
This was done. BRAC did their first official write-off in December 1997. Branch staff still pursues the loans written off so as not to encourage active members to become less disciplined.

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.*
Not yet implemented.

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 that will be made easier when branches have computers.*
This is likely to happen only once computers are installed in branches. Currently only ten 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).*
As a first step, BRAC has trained all its branch managers how to provision for risky loans at their branch. This way, they can see whether the allocated 2% of disbursements covers their losses. In future, BRAC is planning to allocate contributions to the loan loss reserve based on performance at branches.

3.9. *A loan loss reserve expense of 4% should be set aside for the MELA program.*
This has not yet been done as MELA POs are still lending to very low risk clients and are being extremely risk averse. Once more normalized growth and higher impact lending begins to take place in the MELA program, this reserve will need to be increased.

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.*
Not much done in this area over the past year, other than training branch managers in the importance of mobilizing savings. The RDP Director is prioritizing this area for 1999 and has already given thought to different product types, etc.

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 a issue that needs to be resolved.*
Training of branch managers on BRAC's savings policy has taken place. Incentives and performance measures to reinforce this still need to be institutionalized.

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.*
BRAC plans to do this in 1999.

4.4. *Customer and PA education on the benefits of saving should be increased, and connected to BRAC's overall organizational and development strategies.*
This is beginning to take place, but further buy-in from branch managers reinforced by incentives and performance management tools is needed before PAs get the message from their seniors.

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.*
Not yet done.

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.*

BRAC has asked Shorebank to help them address this issue. We are presently working with BRAC to see if a weighted rating based six key financial ratios and one "poverty-reach" indicator makes sense.

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.*

BRAC has transferred some of its top regional managers to head up the operations management of the sector programs, with an increased emphasis on efficiency and cost recovery. Better MIS tracking of inputs and money flows still needs to occur.

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.*

Not happening yet.

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.*

Not done for most sectors.

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.*

BRAC agrees in principle and is in the process of thinking about ways that this can take place. For example, BRAC could train and help establish sector specialists in the community. These specialists could then market their own services to group members who pay only for services requested and received.

5.6. *Thirteen specific technical and assumption changes are proposed for BRAC's financial model.*

Most of these changes have been made in the financial projection model which, according to the Accounts Department, is now far more useful to BRAC.

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 to understand the distribution of branches across the management variables.*

BRAC RDP has developed the capacity to do these branchwise trend reports although it has not yet implemented them on a regular basis. Impact performance measures are still done through the Monitoring Department.

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.*
BRAC/RDP is building its own internal training capacity to meet the growing specialized needs of building the skills of RDP staff (one person has been hired). A research and development capacity has not yet been established.

6.2. *Branch managers should be given training on how to grow and develop their staff effectively.*
Around 350 branch managers participated in training courses in which a module was dedicated to staff development, motivation and management. Senior management needs to reinforce these practices by growing branch managers themselves, as well as measuring the performance of branch managers not only on financial indicators, but on staff development indicators as well.

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.*
A set of indicators has been developed. Now that almost all the branch managers have received training, it is possible to institutionalize these reports quarterly. The reports will be sent out for completion at the end of the first quarter of 1999.

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.*
Not implemented. Needs further thought.

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.*
Not done yet.

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.
Not done.

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.*
The computer department has given this issue serious consideration and is monitoring non-hardware needs in its pilot project.

7.2. *We recommend the approval of the Organized Seed Production Project.*
The project was implemented and was operational in the first half of 1998.

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.*
On a second visit to BRAC after last year's annual review, we concluded that although the above recommendation should stand as is as an end goal, it is better for MELA POs to gain experience in this new type of lending by starting with lower risk businesses. These enterprises are mostly local, less complicated, and do not have substantial leverage potential. This is what has occurred to date. After additional MELA PO training which will occur in early 1999, there will be an incremental shift to lending to the value-added productive sector.

7.4. *MELA should coordinate with the VO program to support wage employment opportunities created by MELA borrowers.*
This is not yet happening in any formalized way although MELA staff report that local hires are the main source of labor for the businesses.

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 program cannot be managed as a "Big VO loan" program. This will require training of existing staff and the hiring of new staff from outside of BRAC that has strong entrepreneurial backgrounds.*
Due to lack of appropriate skills among MELA POs, the program is to date being managed, by and large, as a Big VO Program. This will begin to change once the POs receive training. However, more fundamental changes are needed before MELA can become a high impact program.

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

8. Summary of Major Shorebank 1998 Recommendations

In Shorebank's 1997 Financial Review, we made over fifty specific recommendations for changes and possible improvements in BRAC operations and policies. While we believe that level of detail is useful, we will employ a different strategy this year concerning recommendations. In the body of the text, we have included in most sections a section on suggestions and recommendations. We have also continued to incorporate many of our 1997 recommendations that still need action. What will be summarized here, however, are just the major twenty five recommendations.

1. **Portfolio and Credit Management**
   1.1. As in 1997, we suggest that BRAC create an R&D department to work solely within the credit program. There is a significant need to understand the risk and credit dynamics of specific sectors and types of loans, but no resources to explore those questions. This is especially important with respect to the MELA program, but also applies to the general credit program.
   1.2. We also suggest, again, that BRAC should create a dedicated credit and finance training unit that designs and implements credit, savings and business analysis training for RDP/RCP staff. There are enough RDP staff to support a continuous training and human capital "investment" process. This is a growing need, and a growing gap.
   1.3. Credit evaluation guidelines should be created that make clear what branch managers should or should not do with respect to refinancing, loan size, required savings balances, and the specific issue of the flood credit issues.
   1.4. Branch managers with good borrowers and excellent overall credit history should be able to extend the terms of loans. This is an option that will support development needs, and if managed well will allow branches to support a larger TPO without the transaction costs imposed by shorter-term notes. This should be managed on a pilot basis.
   1.5. First loan levels should be tracked, to understand more clearly what population the credit programs are involving, i.e., the poorest borrowers.
   1.6. Overall, the most important task for the MELA program is to invest in "human capital", and to significantly upgrade the training and skills of the MELA POs. In general, we would recommend that BRAC <u>not significantly grow</u> either the MELA portfolio or the number of branches covered. The risk of the program at this point is still too high, and the skills of the POs are still too limited. The MELA program needs to develop a strategic plan that determines what type of lending it wants to do, what level of economic impact, what staff training and product research is necessary, and what level of funds it needs.

   Expansion of the MELA program should proceed very slowly, for it will be very easy to get "ahead of" the existing strategy and skill base, and run into serious credit problems. We suggest freezing the current number of MELA branches and grow the portfolio very slowly in targeted sectors by only deepening the outstanding portfolio in the existing branches, rather than expanding the number of branches and number of MELA PO's. The current level of staff experience and expertise of MELA PO staff is not adequate to support the current program, let alone a significantly expanded program. The investment that needs to occur over the next 12 months is in the MELA loan officers, not the financial portfolio.

First, MELA must decide on a strategy and then significantly strengthen lending staff expertise and sectoral focus. After that point, BRAC should consider expanding the number of branches beyond the current fifty, but not until the current "product research" and staff training and development is finished. It may well be possible to grow the total MELA portfolio at the existing branches, but we would recommend against expanding this program to more branches until the concept and risk management process is proven out at the current branches. The risk for losses in this program is still very high, and the collective experience in this type of lending is still very low.

2. Savings Program

2.1. BRAC should create a senior position at Head Office that is focused solely on the design, implementation and growth of the savings program. Each region should also have a staff person that focuses only on the design, growth and health of the savings program within that region. Without this single-minded focus, it is much less likely that the savings program will grow and provide the capital that BRAC needs to grow and to support its membership.

2.2. A much more explicit and computerized system of tracking individual savings behavior needs to be installed, for the summary level savings data is insufficient to either yield program insights or to insure that savings are being managed effectively and correctly.

2.3. Additional and more formal research needs to be implemented with respect to understanding member's savings preferences. It is likely that BRAC will have to offer a range of savings products, and the necessary product and consumer research needs to be implemented.

2.4. Credit PO's should focus more on savings mobilization, under the direction of the regional savings specialist.

3. APO, Loan Loss Reserve, and Delinquency Management

3.1. Using the resources of the newly created RDP/RCP applied research finance group, there needs to be research of the financial and credit dynamics of the various sectors, so that more insight can be gained into the reasons for higher levels of delinquency and losses in some sectors. This is a business, marketing and finance oriented research effort—not social science. The current BRAC research unit does not have the business and finance experience necessary.

3.2. A new, more informative system of loan sector classification needs to be created. The current system is both inaccurate and large classifications such as rural trading are such a large percentage of the total portfolio as to be not useful for understanding varying levels of risk.

4. Branch Sustainability

4.1. There needs to be a continued push on branch managers to think of their branch as a sustainable "profit center". This implies they should turn in a business plan for their branch every year, with projected costs, revenues, assets and liabilities, and the associated "bottom line" of level of sustainability. This plan should include both the credit as well as the sector programs. Regional managers should, in turn, create a regional "business plan" that shows the level to which that region will be sustainable during the coming year. Branch and regional managers should continue to receive training and reinforcement of this perspective of managing their branches.

4.2. Branch managers should project their financial ratio performance for the coming year, as well as specific budget items and savings and credit targets.

4.3. The branch computerization system should be implemented as quickly as possible, for only through this process will branch managers be able to access the most effective information necessary to enable them to manage their branch as a profit center, as a business.

5. Sector Program

5.1. The business model that should be adopted is that BRAC is moving towards privatizing as much of the sector and TA program as possible. Current data collection efforts, and the raining of staff, should occur within that framework.

5.2. The sector program should move to be a demand-driven not a supply-driven system that is managed collectively along with the credit program by branch and regional managers.

5.3. The quality of the sector APO needs great improvement, and should be supported by an improved sector program design, and supporting MIS information. Appendix 1 makes some specific suggestions as to program and MIS design.

6. Growth Management

6.1. A senior "Growth Management" Task Force should be created and staffed, and it should first implement a series of research efforts designed to diagnose the most critical areas where rapid growth is impacting on the BRAC organization. With the support of senior management, it should then help to design and implement responses to these issues.

6.2. BRAC will encounter funding and liquidity issues for the foreseeable future, and thus needs an improved process of managing capital requirements and allocation of capital between programs. This should be managed by Head Office, but every effort should be made to educate regional managers as to the process of capital flows within BRAC, so that they can help manage this issue—during the flood response time, as well as afterwards.

6.3. The computerization program should be accelerated as much as possible, for it is a key growth management tool, and a key tool to support savings generation.

6.4. We recommend that to cope with the significant capital growth needs that BRAC will experience over the coming years (RCP, Urban Lending, MELA, flood impact, BRAC Bank, etc.) that it designate a full time staff person whose only job is to raise capital for BRAC.

Appendix 1: Notes on an MIS System for Sector Programs

This is a special section on a particular area of concern to Donors and BRAC Management, that of cost recovery of the sector programs, and what might be done to design a management and MIS system that could help improve the current situation. It is not meant to be a full report or analysis, but only some notes that may be helpful.

The cost recovery for the sector programs is running at 19%. The target for 1998 was that 30% of all sector program costs should be covered. RDP management believes that it needs a good MIS system to be able to effectively reduce costs and increase revenues. We agree, but believe that before designing and implementing an MIS system, the underlying design of cost recovery, service charge collection practices, assumptions about customer demand and value added, and staffing should all be examined before implementing an MIS system. We believe that the current system has flaws that need to be addressed before BRAC begins designing a system to measure costs, revenues and the impact of the sector program.

While we recognize that we have not done in-depth research into the sector program this visit, we have given the topic serious thought. What follows is a summary of our preliminary views as well as a set of measures that BRAC can begin to implement immediately to increase cost recovery in the sector programs. We believe this is critical for the long-term sustainability of the sector program.

Guiding Principles

- Demand for technical assistance and advice should be demand driven, not supply driven. At the moment, it is "supply push" rather than "demand pull."
- Payment for inputs (e.g. seeds, chicks, prawn culture, feed, DFL) should always be at the point of transaction. In other words, the participant pays cash immediately on receipt of product.
- Payment for technical assistance or advice should take place at the point of transaction if the service is privatized (e.g. in the case of the Para-Vets), or at the closest feasible point to it (e.g. at the first biweekly credit VO meeting following the delivery of the advice).
- All transactions in the sector program should be monitored for each participant through a MIS system. A manager should be able to pull up a participants record and see what type of advice she has been requesting, what quantity of inputs she ordered, how much she paid for the inputs, and whether she is current on her service charges payments. The manager should also be able to pull up summary information of these variables for the branch.

Our vision for the Year 2000: Privatization of Technical Assistance Provision

It is important to understand the basic "business model", for the sector program. Is it the "government provides service" business model, or the private sector "franchise" sector model. We suggest the latter. It is our view that BRAC should aim to privatize all or nearly all of the sector technical assistance provision for its sector programs by the year 2000. To support that direction, BRAC should use the time between now and 2000 to learn about the market and operational dynamics of providing this TA, so that it will be in a position in 2000 to effectively "franchise" this service delivery network.

The essence of a private system of service delivery is that selected local participants will receive training and certification from BRAC and then will independently provide (sell) the various sector services to other sector participants who request it. BRAC can choose whether or not to subsidize the cost of the services, for example, through giving low-income members and participants vouchers that they can use to buy the services.

Privatization is not new to BRAC. BRAC has already privatized aspects of the sector programs by using Poultry Workers and Para-Vets as direct service providers. Once BRAC has trained and certified local providers, its role will be limited to a monitoring and certification function to ensure that poor households get access to these services, and that quality services are being delivered. Where poor households initially cannot afford the services (e.g. if they are just starting our in the program), BRAC may choose to provide them with vouchers that will entitle them to a couple of sessions of free training.

In general, we believe that once members have received a critical mass of training, their demand for advice will taper off, unless unusual circumstances strike (e.g. a new disease breaks out). Providers of technical advice in the villagers must thus constantly be seeking new clients to sell their services to. This is a radical shift away from the captive and somewhat stagnant customer base that sector PAs currently have.

Presently, a sector participant is expected to pay for a service whether she requested it or not, whether the actual service was delivered or not, and whether the service was of a good quality or not. This is clearly a supplier driven market where service provision (both quantity and quality) has no bearing on value-added to customers. The nearly unavoidable outcome is over capacity, inefficient service delivery, and a stagnant customer base.

In order for BRAC to effectively privatize its technical assistance component of its sector programs by the year 2000, it needs to begin preparing itself now. A simple way to envision the privatization of the sector programs is to imagine that BRAC will develop extensive knowledge of a franchised service; it knows how to help a farmer grow high quality birds (or fish or vegetables or cocoons). BRAC, as the franchisor then trains its franchisees (i.e. selected village participants who become trainers) in how to grow successful farmers, as well as how to run successful consulting businesses. Now for BRAC to be a successful franchisor, it must understand exactly what it takes to make that farmer successful and what it takes to run a viable technical service provision business. Here is where historical documentation and research of what it has learned to date in its sector program will be invaluable.

Going forward, BRAC needs an excellent MIS system which tracks what advice members request, what inputs they find most valuable, and what services they are willing to pay for, etc. From one perspective, BRAC must engage in deep and intensive "business planning research" over the coming two years, so that it will be in a position to privatize as much as possible of its sector programs after the year 2000.

Between now and 2000

Apart from the very important task of preparing itself to be the Franchisor of "Growing Successful Farmers," BRAC needs to address sector program activity, cost recovery and impact on participants. All three are directly related to one another. If a value-added service is delivered, members will pay for that service (i.e. cost recovery improves) and existing members will expand their business and new members will want to join the program. Increased impact on members thus correlates positively with increasing activity and coverage.

The only source of direct revenue for the sector program is service charges. The premise underlying service charges is deceptively simple: Members get value added, make more income, and are therefore willing to pay for the service they receive. If the customer is satisfied, she is likely to pay without coercion (e.g. threatening not to disburse a loan to her because she is delinquent on her service charge payments). The challenge for BRAC is to devise a system where payment for services is directly related to benefits received.

Who to serve?

It is a flawed system that continues to assume that all participants who require inputs will continually need sector specialist advice. After a chick rearer has learnt about disinfectant, vaccinations, feed and keeping the area warm, there is a limited amount of value that further technical advice can deliver (unless there is a change in technology). The same applies to a fish farmer who has learnt what different types of fish can be farmed in the same pond and what the water balance should be, and how to drain and clean her pond etc. Similarly, a vegetable grower can also learn what there is in know about vegetable farming in a couple of visits.

We believe that members will request advice *and pay for it,* where it adds value. Technical advice should be demand or market driven, not supply driven as it is currently. There are enough examples that PAs and Poultry Workers can point to show the value of their work. Participants should pay for their service charges at the bi-weekly meeting after the service is due.

It is likely that BRAC will be able to cut "advice giving staff" significantly in all its sector programs where it is not adding value. Ultimately, as discussed above, we believe it is better for BRAC to train and certify sector workers who can then carry out the services, rather than keeping a possibly bloated staff on its payroll.

In sum, it is likely that the number of sector participants that will use technical advice, if given the choice, is far lower than BRAC's current assumptions. We believe members should be given this choice. Members only benefit by paying only for services they feel add value. BRAC benefits by cutting surplus staff where value is not being added, and by ensuring that only high quality services are delivered, thus increasing the program's development impact.

Members who do not pay for services that they requested should not receive assistance in future. Clearly, where there is a negative externality or a risk to others (e.g. if a member refuses a vaccination and a disease may spread, exceptions should be made).

When to collect?

As a general rule, we believe that the point of transaction (or as close to it as possible) is the best time to collect on the service delivered. This is sometimes not feasible where potential for corruption exists. We have developed a rough set of draft suggestions with respect to BRAC's Poultry Program, which could be used to further develop a comprehensive reporting system for all RDP's sector programs.

Expample: Suggested Changes to Poultry Program
Service Charge Collection Process

Type of Service / Product	Benefit to Participant	Service Charge Collection Point
Day Old Chick and Feed	Higher quality chick and feed	Current Process: At point of chick or feed purchase. Credit sales allowed by some branch managers. Pricing for higher quality not included (?) Suggested: At point of chick purchase or feed purchase (a quality "fee" should be included in price of chick). Only cash sales.
Advice on Chick Rearing	Lower Chick Mortality Higher Price fetched	Current Process: Member pays for services whether she requested assistance or not. Payment sometimes occurs only after 8 weeks when chicks are sold. Payment takes place at VO credit meeting. If payment missed, sector PA tries to collect at participant's house. Suggested: Once monthly at VO credit meeting if service has been requested and received by VO member. Ideally, this service should be privatized and payment should go directly to the provider. BRAC should only be responsible for training and certifying providers of the service.
Vaccinations	Lower Mortality	Current Process is fine: Service is Privatized. Payment directly to Paravet for Service. BRAC's role is only to monitor system to ensure quality inputs are provided.

The same logic applies to all inputs that are supplied to all the sector programs. Cash should be paid on receipt of the inputs and a system at the branch should identify every individual transaction that takes place, when it was paid for, and what quantity was delivered. The branch should price a fee for distributing higher quality seeds (or chicks) into the cash price that the VO member pays.

Similarly, any advice that is not yet privatized should be paid for at the biweekly meeting following the giving of the advice. BRAC needs to devise a standard rate per advice-giving visit that members can afford. Only members that request the advice, presumably because they find it useful, should be served. If BRAC determines that paying at the biweekly meeting following service delivery is not feasible, we recommend that an alternative system is set up which is tells members clearly when payment for advice requested and delivered is due (e.g. the first biweekly meeting following the harvest, or the middle of the harvest, rather than some time over the next three months). It is important to set up tight collection systems so that members know when their payments are due.

Measuring service charges delinquency

Collections of service charges should 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. In line with setting up clear guidelines for service charge collection, past due service charges should be tracked over time as per the APO model (e.g., 0 weeks, 1 - 4 weeks, etc.). Unless activity is accurately measured (and this does not seem to be the case to date), it will be difficult to project service charge collections and income from inputs sold.

Measuring activity

Activity in the poultry, sericulture and agriculture, and fisheries sector (prawn only) can be measured by the number of members who purchase inputs using cash, as well as the quantity of inputs being purchased. Both indicate program growth. If the number of members who purchase the inputs grows, clearly more members are part of the program. If the amount of inputs purchased grows (even if the number of members does not), it indicates that the more enterprise is getting done. This is also a positive indicator.

The number of members who request technical advice from PA staff and pay for it is a secondary measure that can be used to track activity. Similarly, the size of fish ponds or agricultural tracts of land being farmed can also be used as secondary measures of activity.

Before a MIS system is devised, RDP management should set clear guidelines for each sector. Branch and regional managers should observe the standard ratios / guidelines that BRAC HO management sets in conjunction with them.

- Number of sector participants: PA. The number of sector participants/PA should assume that only a portion of participants buying inputs will continually want the same technical advice from the sector PA). This is very different to the credit program where all members are either saving and/or borrowing. Our guess is that most participants will continue to want inputs and loans but continual advice is not necessary.

- Number of sector participants: Poultry Worker (Same argument as above applies here)
- Number of Poultry Workers: PA
- Number of PAs: PO
- Number of Any other sector specialist (e.g. trainer): sector participants
- taka per technical advice visit in response to a request for that advice.
- Standard training cost (package) per new PA: budget guideline per PA
- Update on training for PAs: a budget guideline per PA should be set. MIS crosschecks should be set in place to check whether PAs, in fact, did receive training. Our interviews have revealed that branch staff and/or training staff may be claiming training costs from Head-Office that may not have been spent on training staff.

Measuring Activity

- A monthly summary report prepared by the branch manager for *each sector* for the regional manager should contain some version of the following
- Number of active participants this month (members that purchased inputs)
- Percent of change in number of active participants from previous month and analysis of reason for the change
- quantity of inputs bought for cash (both units and in Taka)
- average quantity bought per member (both units and in Taka)
- Percent of change from previous month and analysis of reason for change
- Number of members requesting technical advice this month
- Percent of change from previous month
- Number of members receiving technical advice this month (based on payment for services received).
- Percent of change from previous month
- description of type of advice given by service providers

Measuring Delinquency

Branch managers should submit a form monthly to regional managers that identifies their recovery of service charges. BRAC could build on the following format to measure the occurrence of delinquency and the aging of service charges outstanding.

Poultry Sector	Jan	Feb	Mar	Apr	May	Jun	Jul	Dec
Projected Budget of SC For this month								
Projected Activity for this month								
Actual Activity this month								
Variance from projected activity (%)								
SC due this month based on actual activity								
Service Charges realized this month based on activity								
Taka 0verdue for this month								
Due/realized (%)								

% Change from previous month	
Total Taka Overdue (including from previous months)	
Cumulative % of service charges over 3 periods overdue	
Cumulative taka over three periods overdue.	

Summary Sheet of Collection/Due

SC realized / SC due	Target Based on Actual Activity for Current period Q1	Q2	Q3	Q4	Q 1 % Cost Recovery	Variance from Target	Q2 % Cost Recovery	Variance from Target
	Tk %	Tk %	Tk %	Tk %	Tk %	Tk %	Tk %	
Poultry								
Livestock								
S. Forestry								
Sericulture								
Agriculture								
Total								

Sample Single-Sector Quarterly Expense Report

Cost	Budget for Year	Period 1 (Quarterly) Tk (1)	% change from prev period from budget (2)	variance (3)	Period 2 Etc.
Staff Salary					
Travel and Transport					
Staff Training					
PA Salary					
VO Training					
Total Expenses					
Service Charges Realized					
% of Cost Recovery					

Quarterly Cost Recovery Summary Sheet for All Sector Programs

Expenditure	Budget for Year	Period 1	Period 2	Period 3	Etc.
Poultry					
Livestock					
Fisheries					
Social Forestry					
Sericulture					
Agriculture					
Total Costs					
Revenues (Service Charges Realized)					
Poultry					
Livestock					
Fisheries					
Social Forestry					
Sericulture					

Agriculture

Total Revenues
Sector Program Deficit
% Cost Recovery

Validity Checks

The logistics or other suppliers of inputs or services (e.g. the TARC) should also send a monthly report to the regional manager of what quantity of inputs were delivered, when they were requested, when they were delivered and how much taka is due.

Performance measurement of staff

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.). Branch management should be measured on progressive improvement of cost recovery ratios of their sector programs as well as increases in activity.

Systems should be set up to ensure that costs claimed for training are valid. Some staff interviewed told us that there may be a problem. Unrealistic targets for head-office staff or regional managers should not set sector growth. In the past, one of the reasons that branch staff supplied chicks on credit to participants was because they had to get a supply of chicks out the door and there was not sufficient demand for them. Unless there is vigilant tracking of the number of chicks/other inputs delivered at a branch (vs. the number that the PSE said they sent), credit sales will be very difficult to monitor. Participants should not be coerced (e.g. told they will not get a loan) if they do not request either inputs or technical assistance.

Examples of other summary of types of sector information that should be regularly monitored:

(1) Flow of inputs from Supplier to Branch					
# Chicks / input requested and date of request. Also % change from previous month	# Chicks delivered to Branch and date. Also % variance from request	Taka due to supplier and date due	Taka paid to supplier (and date paid)	Taka overdue to supplier	Aging of Taka Overdue (need separate form as per credit APO)
(2) Flow of inputs to members; Flow of taka to branch					
# Chicks /input sold to sector participants (cash sale) Also % change from previous month	Taka due from sector participants	Taka collected from sector participants Also % realized/ % due	Taka overdue this month	Cumulative Taka overdue	Aging of Taka Overdue (need separate form with # Taka plus %)
(3) Indicators of sector program activity					
Total # Active Participants (active = buying inputs) at beginning of month	# of new members (receiving inputs)	# drop-outs (no inputs over past 2 months)	Total # Active Participants at end of month	% Change from previous month	
(4) Indicators of technical advice provision: demand, supply and payment					
# Members requesting advice (request could take place at bi-weekly VO meeting)	# Members who received advice requested during month Also % change from previous month	Taka due for advice rendered for services delivered that month. Also total taka due for past services rendered but still unpaid	Taka realized for services rendered (excluding arrears and including arrear payments	% Realized for current period/due for current period. Also give taka overdue	Aging of service charges due (need separate form as per APO)

---

[1] At a US exchange rate of 49 Taka to the dollar, total principal outstanding was US$ 78 MM in June 1998.

[2] 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.

[3] The same number calculated for September 1998 including the VGD program is Tk38 million.

[4] The same number calculated including the VGD program for September 1998 = Tk137 million.

[5] MELA management only tracks the total number of jobs in the businesses, rather than the net number of new jobs facilitated by financing the business.