



Micro-Finance Rating - Risk Assessment

BURO, Tangail (BT)

Tangail, Bangladesh

<2 nd Rating Update>		
Rating grade	α+ alpha plus	Assessment: Recommended Very high safety, good systems
Visit dates: 25-30 August 2003		Operational head: Mr Zakir Hossain
Maximum validity of rating*: till end-August 2004		

Rating

BT has maintained its excellent performance on governance and financial aspects. The managerial performance of the organisation has improved as compared to the previous rating and has resulted in an improvement in the overall grade.

In M-CRIL's view, on account of BT's overall good performance, commendable approach to sustainability and self-reliance as well as the growth plans of the organisation, it can absorb – from all sources (commercial borrowings as well as grants/RLF for on-lending) – funds of Tk100 million (US\$1.7 million) over the next one year for on-lending to its borrowers.

A rating update after one year is suggested to ascertain changes in the creditworthiness and absorptive potential of the institution. **This rating is valid, subject to no other substantial inflows of loan funds into the organisation beyond the limits specified here** and to no other significant changes in the organisational structure and external operating environment.

for Micro-Credit Ratings International Ltd

Sanjay Sinha
Managing Director

***Validity** This rating is valid till the next loan proposal made by the MFI to any financial institution or till any other significant change in the structure of the loan programme or in its external environment. A **rating update** (comprehensive repeat rating) is recommended whenever such changes take place or at the end of **one year** from the date of the initial assessment, whichever is earlier. Any substantial additional information that becomes available could also result in a rating update or a rating review (revision of rating grade based on a desk analysis).

Liability The rating assigned is a professional opinion of the assessors and M-CRIL does not guarantee the information and cannot accept any legal responsibility for actions arising out of the recommendations made.

Category wise rating

<u>Category</u>	<u>Rating grade¹</u>
A <i>Governance aspects</i>	α+
B <i>Managerial factors</i>	α
C <i>Financial performance</i>	α+
Overall	α+

Key Risk Factors

- 1 **High client dropout:** BT has faced high client dropouts during the past few years. In some of the branches this has reached alarming levels. In the highly competitive market where BT is operating with many service providers to the same target segment, this will not only increase the cost of operations in the long run, but may also render some of the branches economically unviable if the number of customers falls below critical levels.
- 2 **Environmental factors:** The geographical area in which BT is operating is vulnerable to floods. Disaster in the form of severe floods has the potential to disrupt the normal operations of the organisation. Though this is unlikely to be crippling, it may affect the financial viability of the organisation in the form of loan losses and large payouts in insurance claims.

Key Programme Strengths

Governance, experience and strategy	Management and operations	Financial
<ol style="list-style-type: none"> 1 Long years of experience in microfinance 2 Focussed microfinance operations 3 Wide product range 4 Strong second line of leadership 	<ol style="list-style-type: none"> 1 Qualified, experienced and trained staff 2 Good MIS and accounting system 3 Strong internal audit system 	<ol style="list-style-type: none"> 1 Good portfolio quality and repayment rate 2 High capital adequacy 3 Excellent performance on profitability and sustainability

¹ M-CRIL's grading sheet is attached at the end of the report.



Buro, Tangail – 2nd update

Organisational Profile

Legal form	Years of m-f Operation	Number of			
		Active borrowers	Staff	Branches	Active borrowers/ Staff member
NGO	13.5 years	124,215	953	81	130

Microfinance programme: Operational highlights

Client Savings (million Taka)	Outstanding borrowings of MFI (million Taka)	Loan portfolio of MFI (million Taka)	Cumulative loans disbursed by MFI (billion Taka)	Average loan size from MFI to borrowers (Taka)
168 US\$2.9 million	63 \$1.1 million	474 \$8.2 million	2.8 \$47.3 million	5,601 \$97

Key financial ratios

Portfolio at risk (>=60 days)	Cumulative repayment rate	Risk weighted capital adequacy ratio	Subsidy dependence index	Yield to APR ratio
1.7%	99.6%	49.8%	4.8%	91.9%
Yield on portfolio	Other income to average portfolio	Financial cost ratio	Loan loss provisioning ratio	Operating expense ratio
33.0%	1.7%	4.7%	2.3%	20.2%
Total income to average total assets	Total expenses to average total assets	Return on average total assets	Operational Self Sufficiency	Financial Self Sufficiency
28.2%	22.1%	6.1%	127.7%	109.3%

Notes

1. All figures pertain to the organisation's microfinance programme as on 30 June 2003.
2. Active clients refer to women who save with the BT and attend centre meetings; active borrowers refer to the clients who have loans outstanding. The number of active clients is 159,842 and the number of active borrowers is 124,215.
3. Other income includes income that the organisation receives as membership fee and from the sale of passbooks.
4. The PAR₆₀ figure reported above is after write-offs in June 2003. PAR₆₀ before the write-off is 6.4%.
5. The ratio of repayment rate and PAR₆₀ has been calculated from the MIS reports generated by BT. Accuracy of data generated by the MIS has been verified by the rating team through an audit of the systems at BT.
6. Other financial income includes income that the organisation earns from membership and fees for passbooks, as well as on investments.



Buro, Tangail – 2nd update

Comparative highlights

Grade distribution

Category	Rating grade			Movement ³
	May 1999	November 2001	August 2003	
Governance	α+	α+	α+	↔
Managerial factors	α-	β+	α	↑
Financial performance	α+	α+	α+	↔
Overall	α	α-	α+	↑

Select indicators/ratios

Indicator/ratio	December 1998	September 2001	June 2003	Change ²
1 Growth				
Loans outstanding (Tk million)	173.7	250.3	474.0	Increase
Active borrowers	42,866	63,746	124,215	Increase
Average loan size (Tk)	4,580	5,335	5,601	Increase
2 Credit performance				
Cumulative repayment rate	96.5%	96.3%	99.6%	↑
Portfolio at risk (>=60 days)	6.2%	5.5%	1.7%	↑
3 Efficiency and profitability				
Active borrowers per staff	93	98	130	↑
Loans to total assets	81.2%	64.8%	81.7%	↑
Annual return on assets	0.2%	3.6%	6.1 %	↑
Operating self-sufficiency	100.9%	118.5%	127.7%	↑
Operating expense ratio	27.1%	22.5%	20.2%	↑
Subsidy dependence index	32.5%	19.4%	4.8%	↑

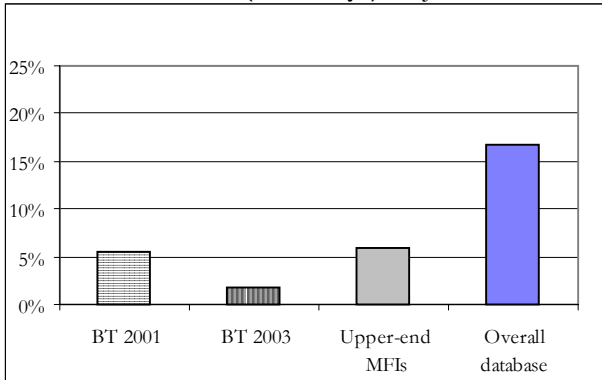
BT has shown improved performance on growth, repayment rate and PAR as well as on profitability and sustainability. The overall rating of BT, however, has improved mainly on account of the strengthening of its second line of leadership, improvement in its staff quality, and a marked improvement in its MIS and internal control systems.

² An upward arrow indicates an improvement over the previous rating and vice versa for a downward arrow; a constant arrow indicates very low or no change.

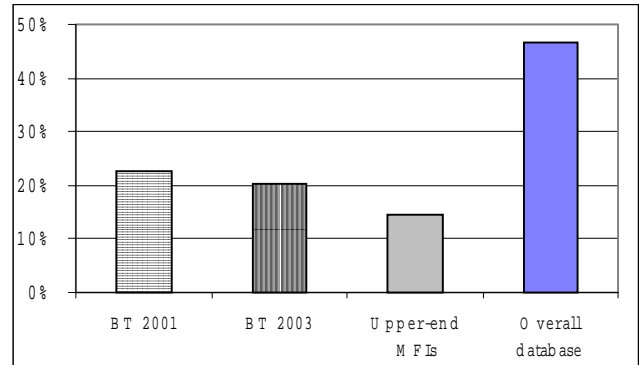


BT – financial overview

Portfolio at risk (>=60 days): 30 June 2003



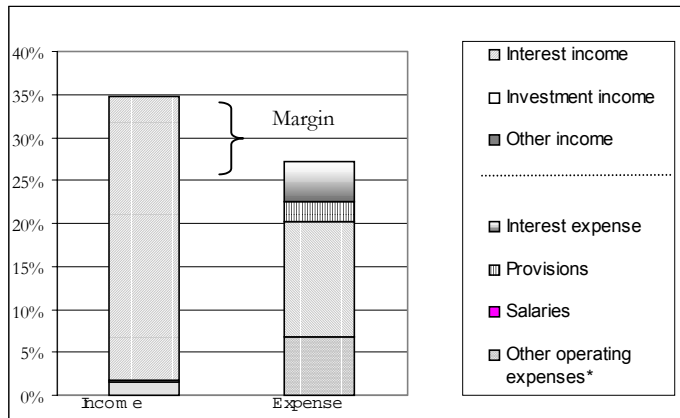
Operating expense ratio: 1 July 2002-30 June 2003



- Note:**
1. $n_{\text{upper-end}} = 9$ $n_{\text{database}} = 86$; Database updated as on 27 February 2002.
 2. Outliers and rated NGOs with no direct lending have been removed for analysis. Upper-end figures reflect MFIs with top 10% scores.
 3. The upper-end MFIs and overall database ratios represent simple averages for their respective samples.
 4. The performance of either the Upper-end MFIs or all MFIs (overall database), do not necessarily reflect M-CRIL's rating standards.

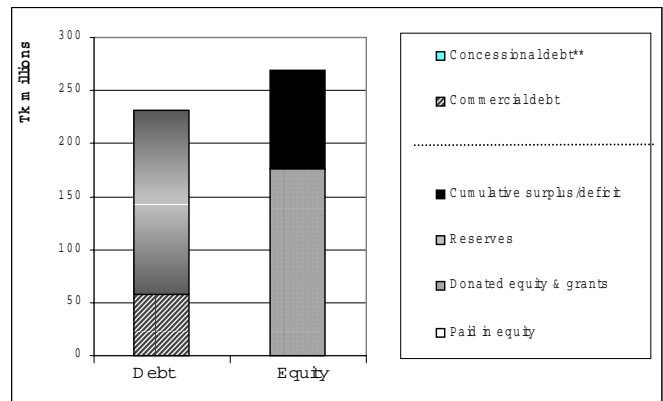
Income and expense distribution:

1 July 2002-30 June 2003



Debt and equity composition:

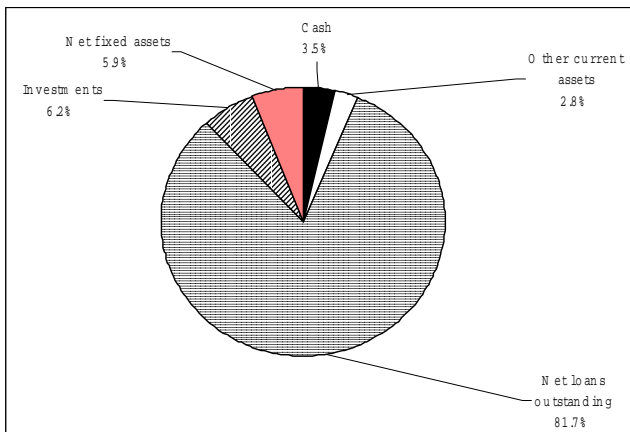
30 June 2003



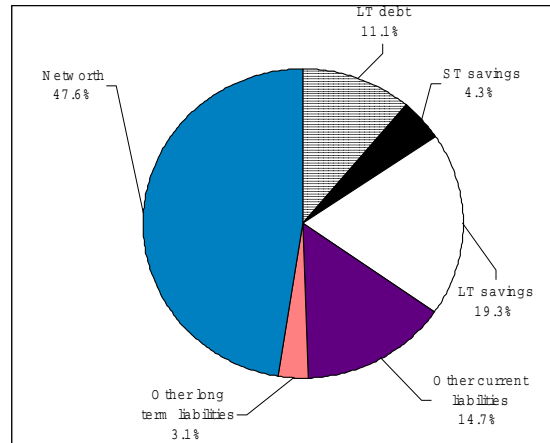
* Other operating expenses include travel, depreciation and administrative expenses

** Concessional debt is borrowing+comp.savings taken at < Bank PLR +50 basis points, & voluntary savings taken at < bank deposit rates

Asset composition: 30 June 2003



Liability & net worth composition: 30 June 2003





1 Organisational background

BURO, Tangail (BT), registered with the NGO Affairs Bureau and the Social Welfare ministry of Bangladesh, started in 1990 with the objective of providing sustainable financial services to the poor. It is also registered with the Board of Investment and can, therefore, mobilise capital from foreign sources for investment in productive activities in Bangladesh. The organisation started its work in Tangail district but has now expanded operations to 17 districts.

The organisation has a 25-member General Body. This appoints a seven member Executive Committee every two years. Mr Zakir Hossain, who is one of the founder members, is the Member Secretary of the Board and also serves as the Executive Director of BT.

On behalf of the Executive Committee, a three-member Implementation Board is responsible for operational policy formulation. This consists of the Executive Director as the Chairperson and the Programme and the Finance Directors. The Executive Committee meets regularly and ratifies policy decisions based on the advice of the Implementation Board.

2 Microfinance operations

2.1 Background of microfinance operations

As on 30 June 2003, BT was working in 17 districts of Bangladesh through 81 branches. It had outreach to 159,842 clients from 3,204 villages.

Apart from the three Directors, other staff at the Head Office are organised into various departments including Finance, Monitoring, Internal Audit, Administration, Human Resources and Training.

Field operations are managed by the two Programme Officers, five Assistant Programme Officers and 19 Area Managers. At the branches, the operations are led by the Branch Managers (BM), supported by one Accountant, one Assistant Accountant, one Branch Organiser and 6-7 Village Development Workers (VDWs).

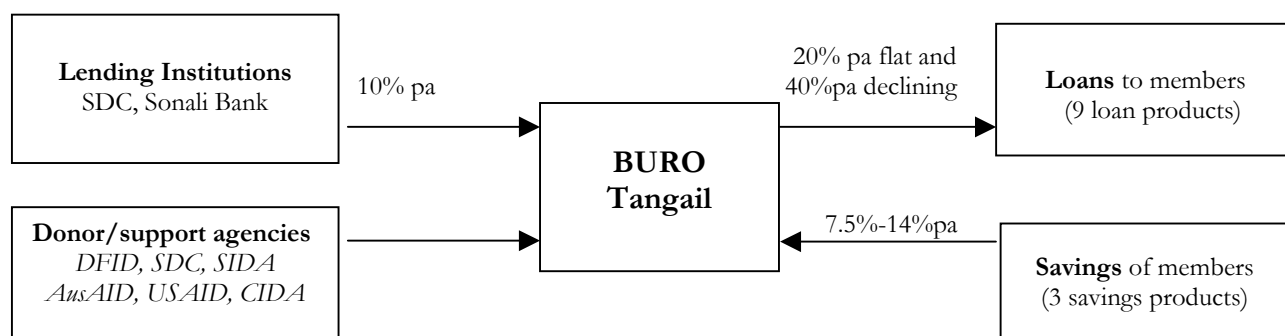
For its credit operations, BT has utilised both loan and grant funds. Grants have been obtained from DFID-UK, SDC, SIDA (Sweden), AusAID, CIDA, UNESCO, GTZ, USAID and PACT Inc. Loans for on-lending have been provided by SDC and Sonali Bank, Dhaka. The details of loans obtained till date are shown in the table below

Source of funds	Cumulative amounts received (Tk mn)	Outstanding on 30 June 2003 (Tk mn)	Rate(s) of interest
SDC	60.5	60.5	10.0%
Sonali Bank	10.0	2.5	10.0%
Total	70.5	63.0	

The flow of funds to and from the organisation is illustrated in the following diagram:



Buro, Tangail – 2nd update



2.2 Microfinance policies

The organisation follows the Grameen model of microfinance. The operational policies of BT are largely the same as in the previous rating. Lending is mainly through women's groups (five members each). Up to eight such groups form a *Kendra* (centre) – the management unit for the organisation. There is a well-defined and formalised process of identification, formation and regularisation of the groups. The members of these groups are designated as the Primary Members.

In addition to these women's groups, micro-business groups (called *samities*) are also formed, mainly in rural market places. The micro-business groups consist of 5-25 members each and the group members are eligible for the Micro-enterprise Loans. The members of these micro-business groups are designated as Associate Members.

For all loans except micro-enterprise loans the primary appraisal is done by the group members who guarantee the loans jointly. The secondary appraisal is undertaken by the Branch Organiser and the final sanction of the loan is done by the Branch Manager. For the micro-enterprise loans it is mainly the Branch Managers and Area Managers who undertake the appraisal.

Savings

BT offers the following savings products to its clients

General savings	Contractual savings	Time deposits
Eligibility: Primary members	Eligibility: Primary and Associate members	Eligibility: Primary and Associate members
Minimum Tk10 per week per member	Weekly or monthly recurring deposits for 3,5 or 10 years	Fixed deposits up to 7 years
Interest: @7.5% pa	Interest: @9%, 12% and 14% respectively	Interest: @9%-12% depending on the maturity of the deposit
Withdrawal on demand	Single withdrawal on maturity	Single withdrawal on maturity



Buro, Tangail – 2nd update

Loan products

BT offers 9 loan products to its clients as described in the table below

Loan type	Loan amounts & other criteria	Period, no of instalments	Interest charged (p.a.)	Purpose
1 General loan (GL)	Offered to primary members. Maximum of Tk5,000-56,000 (loan cycles 1-21)	53 weeks, 50 weekly instalments	20% flat	Income generation purposes only
2 Supplementary loan (SL)	50% of GL, provided after repayment of 25 GL instalments	53 weeks, 50 weekly instalments	20% flat	For supporting GL activity
3 Micro-enterprise loan (ML)	Tk15,000-200,000; offered to associate members, fully secured borrower should have a contractual savings account	Term – 1-3 years, repayment in weekly instalments	20% flat	For micro-enterprises (mainly service/trade ventures)
4 Project/business loan (PL)	Tk15,000-200,000; offered to the primary members who have completed 3 cycles of the general loan, fully secured, borrower should have a contractual savings account.	Term – 1-3 years, repayment in weekly instalments	20% flat	For rural production activities
5 Line of Credit (LoC)	Credit line of Tk15,000-50,000, offered to primary member who have completed three cycles of the general loan, fully secured, borrower should have a contractual savings account	1-3 years, weekly interest payment, annual renewal	40% declining	For trade/service
6 Tubewell loan (TL)	Maximum Tk5,000 (only once/borrower)	53 weeks, 50 weekly instalments	20% flat	For installation of tube-wells
7 Sanitary loan (SnL)	Maximum Tk3,000 (only once/borrower)	53 weeks, 50 weekly instalments	20% flat	For construction of latrines
8 Emergency loan (EL)	Maximum Tk3,000	3 months, payable either in weekly instalments or as a bullet payment.	20% flat	For household emergencies
9 Disaster loan (DL)	Maximum Tk3,000	53 weeks, 50 weekly instalments	10% flat	For widespread disasters (floods)

General guidelines about the loan products

- 1 A client can have, at most, two loans at a time running in her name. An exception is made in the case of the disaster loan, which can be the third loan.
- 2 A supplementary loan cannot be obtained without a general loan.
- 3 A client can have only one, at a time, of the General Loan, the Project/Business Loan or the Line of Credit running in her name.

Insurance

Emergency fund: Till December 2002 BT collected, from borrowers, 2% of the loans disbursed (GL and SL up to Tk15,000) as a contribution to an emergency fund. The amount in the emergency fund was used to compensate any client's family (whether active borrower or not)



Buro, Tangail – 2nd update

with Tk2,500 in the event of her death. The amount in the emergency fund was also used for minor maintenance requirements of the centres (such as purchase of mats, tables and chairs).

Customer Security Fund: From January 2003 BT has started collecting Tk50 per loan for loans up to Tk10,000 and Tk100 for loans more than Tk10,000 from the clients of the GL, LoC, BL and ML as contribution to the Customer Security Fund. The amount in the fund is used to compensate the family members of the concerned borrower in the event of her death during the loan period. The amount of compensation is 100 times the contribution of the borrower to the fund.

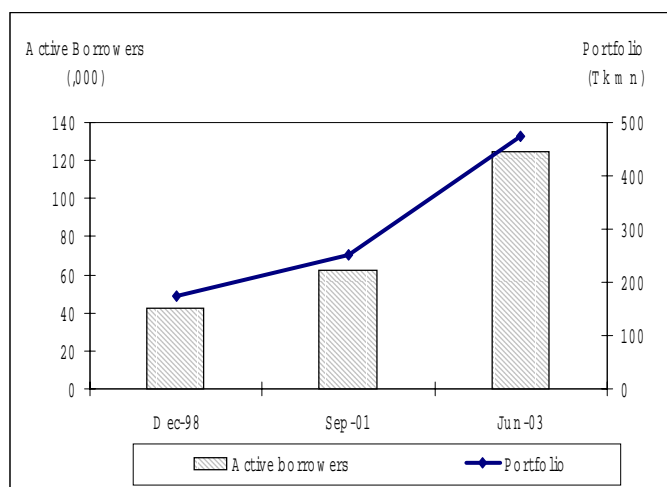
3 Observations

3.1 Governance & strategy

BT continues to show very good performance on governance with a grade of $\alpha+$. This is the same as for the last rating. It reflects the increasing experience of the organisation, which now has a stronger second line of leadership and has continued to focus on growth and sustainability.

➤ Strategy for microfinance operations

BT has maintained its focus on microfinance and has grown steadily both in terms of outreach and portfolio outstanding. Between December 1998 (the first rating) and June 2003 (4.5 years), the number of active clients increased from about 43,000 to over 124,000 registering a growth rate of 26.5% per annum. During the same period its portfolio grew at 25.1% per annum – increasing from about Tk173 million to Tk474 million.



With the increase in BT's outreach the number of its branches has gone up from 41 in December 1998 to 81 in June 2003. The number of active borrowers per branch has also increased over the period – rising from 1,045 to 1,535 clients. The average number of active clients is, however, still much below the optimum level as defined by BT (2,000-2,500 per branch), mainly because some of the new branches are functioning below their full capacity partly on account of a high client-dropout rate.

BT has tried to strengthen its second line of leadership by giving senior staff more responsibilities, increasing their role in policy formulation and by giving them sufficient training and exposure. The management of BT expects that its second line of leadership will be its strength in its future expansion plans.

In terms of concentration of operations the branches of BT cover most of the villages in



Buro, Tangail – 2nd update

their geographical areas of operation (70-80% as estimated by the rating team), but the coverage of target households within most of the villages remains low (20-30% as estimated by the rating team). This is mainly because of the intense competition from other MFIs operating in the same areas.

An issue of concern for BT is the high client-drop out rate, estimated to be about 12% for the year 2002. The dropout rate is as high as 25% in some of the branches. (The dormancy rate defined by BURO, as the customers not paying their savings for more than 4 weeks and not having any other transactions in the group, has been taken as the measure of client dropout by the rating team). High client dropout seen together with low concentration in the villages and high competition in the area has the potential to render branches with high dropout rates economically unviable.

Another area of concern relating to its product features is the high rate of interest paid on long-term deposits. The rate of interest is as high as 14%pa in the case of 10-year recurring deposits. Even the 7.5% interest paid by BT on General Savings is much higher than the bank rate of 5.5% and the 4.5-6.0% range of other MFIs. Though it may make short term sense for BT to offer high interest rates on its savings products to attract and retain its clients, having particularly long-term liabilities with high interest commitments may not be a prudent strategy, in the falling interest rate regime, highly competitive market and fluid regulatory environment that BT currently faces.

The insurance product offered by BT is another issue of concern. Though the premium charged by the organisation is apparently sufficient to cover its claim liabilities in normal times, it could result in a large outgo of funds in the event of a catastrophe (discussed further in **Section 3**).

The geographical area in which BT has been working is prone to natural disasters in the form of floods. The response of BT to this disaster and the robustness of its financial performance in relation to the potential for another such disaster is discussed in **Section 3.3**

➤ BT's expansion plans in a competitive environment

It is apparent from the discussion of BT's growth (above) that the organisation is trying gradually to increase the geographical coverage of its operations. It is currently working in 17 districts (8 during the last rating) of Bangladesh, though about 50% of its branches are still in Tangail district. As a future growth strategy, BT plans to increase its geographical coverage further to cover most of the districts of Bangladesh in the medium-term.

In its main areas of operation, BT faces competition from a number of other MFIs. BT's home in Tangail district is, by itself, a crucible of Bangladeshi microfinance with all the large MFIs and many small MFIs operating there. Specifically, BT faces competition in microfinance from three of the 4 large MFIs – BRAC, Grameen Bank, ASA – and two other medium-large MFIs – Thengamara Mohila Sabuj Sangha (TMSS) and the Society for Social Service (SSS) that are in the same size bracket as BT.³

³ The fourth large MFI – Proshika – is not currently regarded as a threat due to governance and management problems it is facing at the national level and also because of operational difficulties with its microfinance programme.



Buro, Tangail – 2nd update

Over the past few years, in particular, BT has positioned itself as a provider of flexible financial services for its clients. It has carried out extensive research to develop new products as well as to modify the existing ones and develop a set of client-friendly products. Thus, BT has created a niche for itself, by being one of the few MFIs, offering a flexible savings product – the **General Savings** product – that allows members to deposit any amount (above Tk10) and withdraw their savings at any time. This is quite unlike the rigid savings products offered by their competitors, where the savings are locked in and untimely withdrawals are all but impossible. The interest rate is also higher at 7.5% than the 4.5-6% paid by competitors. Similarly, BT's **Contractual Savings** – a recurring deposit akin to the compulsory savings products of other MFIs – offers variable tenure of 3, 5 or 10 years, with the interest rates offered being much higher than the banks as well as other MFIs.

At the same time, the rates of interest on BT's loans – 20% flat compared to the 15% flat of most MFIs – are higher than those charged by other MFIs but it has still managed to grow, adding both branches and members at a fast pace. Essentially, BT has been able to convince its clients that in order to offer high interest rates on savings the interest rate on loans extended by the organisation must also be higher. The study team's discussions with clients indicate that the high interest paid on savings is a major attraction. BT also argues that its range of 9 loan products provides a better and more flexible menu of choices for their borrowers than those offered by its competitors.

Other factors cited by staff and management as contributing to BT's popularity vis-à-vis their competitors are

- Friendly relations between staff and clients
- Transparency of BT's accounts
- Other large MFIs leaving gaps in their operations once local targets are achieved, thus leaving significant numbers of customers for BT to tap.

The last point bears discussion. While the above factors enable BT to add new members, despite competition, the last point also means that the organisation's own achievement of targets depends, to some extent, on the other MFIs allowing them to expand. If the others, who charge lower rates of interest, become more aggressive, and start demanding more business from their branch staff, then there would be a problem for BT to find good clients. As it is, even now when BT achieves its targets in its new branches, in areas where the Big3 (BRAC, Grameen, ASA) are established, it means that BT never gets to tap the better potential clients, since they would already be members of the other MFIs. This could represent a weakness in the long term.

The fact that BT is the only MFI (in the Top 20 in Bangladesh) charging such high interest rates from its borrowers, could limit the organisation's growth plans. It will need to look for places, where other MFIs have a relatively limited presence. In a country like Bangladesh, where there are more than 1,000 MFIs, this strategy could slow the growth of BT. After a while, it will cease to find new areas, where higher interest rates can continue to be charged. In this context, a detailed examination of the areas targeted by BT for expansion in the near term is essential. Such an examination is undertaken in the **Annex** to this report.

3.2 Managerial factors



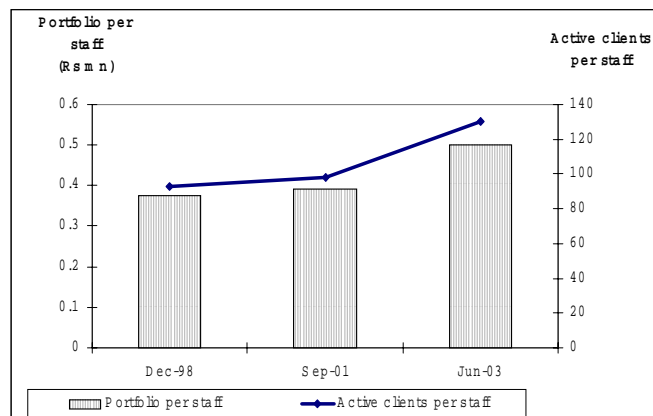
Buro, Tangail – 2nd update

BT displays good performance on managerial factors with a grade of α . This is significantly higher than the previous grade of $\beta+$. This results from an improvement in the quality of its staff, improvement in the MIS and the tracking system for overdues as well as a more effective internal audit system.

➤ Human resource quality and management

BT has highly qualified and professional managerial staff. The training and induction system for all staff members is systematic and thorough. Apart from in-house training most of the managerial staff have received training on various aspects of microfinance from the training institutes of international repute. Many of its staff members have also got exposure to other microfinance programmes. The understanding of the staff, both managerial and field, of the various operational, procedural and technical aspects is adequate.

As a result, the productivity of BT's staff – measured in terms of active clients per staff member and portfolio size – has shown a slow but steady improvement over the years. The average number of active borrowers per staff member grew from 93 to 130 between December 1998 and June 2003. Similarly, the average portfolio per staff member has increased from Tk0.3 million to Tk0.5 million during the same period.



➤ Accounting and MIS

BT has a manual and partly integrated accounting system and MIS. The branches prepare monthly trial balances, balance sheets and profit and loss accounts. The quality of the accounts at the branches is good with all the vouchers properly documented and authenticated. The financial statements of all the branches and the head office are consolidated on a monthly basis. The accounts at BT are audited once annually by an external auditor.

Weekly collection sheets prepared by the VDWs form the basic input for the MIS of BT. This is used to compute overdues and Portfolio at Risk (PAR) by fieldworker, product and by branch. Provisioning for bad and doubtful loans is done on the basis of ageing analysis of the overdues. The calculation of the PAR, repayment rate and ageing of the portfolio have also been corrected since the last rating and are now accurately done.

The other components of MIS generate information on the number of active clients, number of villages, number of centres and dropouts. The MIS, though manual, is working efficiently for BT because of simple and user friendly formats for collection of data and lack of any redundancy in consolidation and reporting. The management of BT is conscious of the need to have an efficient and effective MIS and keeps on improving it on the basis of the feedback from the clients, staff and independent observers as well in response to change in product design and operational procedures.



➤ Tracking system for overdues

BT has very good systems for tracking overdues. With the weekly collection sheets – revised and improved since the last rating – that the VDWs carry to centre meetings, the overdues are known immediately. BT has maintained strict credit discipline on overdues. Barring exceptional circumstances, the VDWs cannot return from the centre meeting unless all dues for the particular week are collected. This has helped the organisation to maintain the quality of its portfolio.

➤ Financial planning and control systems

The financial planning systems at BT are detailed and feed into the decision making process of the organisation. Annual operational and financial budgets are prepared for each month for each branch, and variances are analysed closely. Monthly branch meetings are also held for a review of targets and achievements. Medium-term (five year) financial and operational plans are also prepared and reviewed at periodic intervals.

BT has a good internal control mechanism and a number of internal checks to detect and prevent accounting errors and misappropriation. The organisation also has an 8-member internal audit team that carries out regular audits at the branches. All the branches are now being compulsorily audited twice a year. The process of audit is quite comprehensive and includes the audit of financial transactions, of the MIS reports and of process compliance at the branches. The audit report of each branch is discussed in an Audit Review Committee which comprises of the representatives from the Board of Directors, concerned auditors, and the concerned Branch Managers. The internal audit team also prepares a report for the directors in which it summarises its key findings and suggestions.

Though BT prepares annual cash flow estimates at the head office, at the branches it has an informal cash planning system. The branch managers depend on the experience of the past weeks to estimate their cash requirements for the coming weeks. Often, they adopt a conservative attitude for the estimates which results in excess cash accumulation at the branches. BT is in the process of developing a formal cash planning system for the branches, but according to the management the success of this system will be limited by the absence of good financial service infrastructure (mainly relating to transfer of funds) in rural Bangladesh.

Similar to cash planning, the branches rely on the experience of past weeks for their asset liability management (ie to estimate how much savings maturities are likely in the coming weeks). The informal asset-liability management together with informal cash planning system runs the risk of a liquidity crisis particularly if the volume of time deposits in the liability structure of branches becomes significant in the future.

BT has, at present, a system of grading the performance of its branches mainly on the basis of their achievement of growth targets. Though the branches are treated as profit centres, only the variable costs of the branches are considered while working out their profitability. For the purpose of management analysis the cost of borrowed funds and head office overheads are not allocated to the branches. This often results in incorrect performance appraisal of the branches and may result in non-optimal utilisation of resources in the future.



Buro, Tangail – 2nd update

According to a branch-breakeven analysis carried out by the M-CRIL team, at the current scale of operations the breakeven portfolio of the branches is about Tk3.5 million. This is estimated after allocation of all head office overheads and cost of funds @5% pa to the branches (present average cost of funds is 4.3% of the average portfolio). Analysis carried out by the rating team estimates that 22 out of the 81 branches of BT (27%) are making losses. The proportion of loss making branches is as high as 41% (33 out of 81) if the cost of funds is assumed to be 10% pa taking into account the normal rate of return on equity expected of commercial organisations. While some of the branches may be having low portfolio because they are new, in many branches the low portfolio results from the high dropout of clients and an adverse business environment. Since the branches are the profit centres of the organisation it is important to assess the profitability of the branches on a continuing basis. This will help the organisation to improve its planning as well as its allocation of resources.

➤ Decision making

Decision making at BT is participative and the staff at most levels have a reasonable degree of autonomy. The Directors also involve senior staff members in strategy and policy formulation.

➤ Quality of clients/member groups

Visited member groups showed very good performance on repayment of loans and overall discipline. Group meetings concentrate largely on financial transactions and are conducted efficiently. In addition, awareness about the organisation's rules/norms is very high and members display a clear understanding of loan and savings products, amounts, instalments and interest rates. This reflects the high degree of consistency in policies of the organisation and their effective and quick dissemination at the lowest level.

➤ Infrastructure

BT has an adequate infrastructure level (5.9% of total assets on 30 June 2003) for effective conduct of operations. As on 30 June 2003, the total value of fixed assets (net of depreciation) was Tk33.1 million. This consisted mainly of land and buildings for the head office and a few branches, vehicles, and furniture and other office equipment. The use of assets is efficient.

3.3 Financial performance

The financial performance grade of BT is good at $\alpha+$. This is the same as that in the previous rating and reflects continued good performance on portfolio quality, repayment rate, profitability and sustainability. The organisation has improved its performance on profitability and sustainability since the last rating but this improvement is not so great as to result in an improvement in the rating grade for this component.

➤ Credit performance and asset quality

BT has excellent credit performance. Its cumulative repayment rate is 99.6% and the PAR₆₀



Buro, Tangail – 2nd update

is 1.7% as on 30 June 2003. PAR₆₀, however, has been calculated after the write-offs in June 2003. PAR₆₀ before the write-off is 6.4%. The amount written off in June 2003 mainly represents the loans lost during the floods of 1998 and is, therefore, reasonable. Indeed, given that no loans had been written off in the intervening period, this 6.4% PAR₆₀ of June 2003 compares very well with the 6.2% of December 1998. This strong performance of the organisation can be attributed to an efficient MIS and tracking system for overdues, its strong credit culture and high levels of discipline at all levels of staff (especially field staff) and clients.

In terms of diversification, BT's portfolio is skewed towards trade and services which account for about 63% of the portfolio. About 9% of the portfolio is in animal husbandry, 7% in manufacturing, 5% in agriculture related and 16% in consumption loans.

➤ Mobilisation of funds

BT has done well to mobilise a good level of savings as well as debt and grant funds for its operations.

Member savings constitute about 30% of the total of liabilities and net worth of the institution. The organisation has consistently maintained a high share of client savings throughout the past years of operation (average clients savings have grown from Tk506 client on 31 December 1998 to Tk926 per client on 30 June 2003). This is commendable given the absence of compulsory savings and large proportion of new clients in its customer base.

In addition, the organisation has obtained a diverse range of donor funds, and has also begun obtaining debt finance from sources such as the Sonali Bank (Bangladesh's leading commercial bank) and SDC (a donor agency). The five-year SDC loan of Tk60.5 million was made at a 4.5% interest rate in 1998 increasingly in steps to the near commercial rate of 10% in 2003 – the same as the Sonali Bank's rate.

➤ Asset, liability and equity composition

BT has utilised its assets well with about 82% deployed in loans. The liability and equity composition of the institution is appropriate, with a good mix of medium and long-term borrowings and savings. BT's capital adequacy is also very comfortable on account of significant levels of donated equity and its own retained surplus. Its risk weighted capital adequacy ratio is very good at 49.8%. BT can use its high capital adequacy to leverage borrowed funds for future expansion.

The causes of some concern regarding the liability structure of the organisation are the large contingent liability in the form of insurance claims and the presence of relatively high cost savings of long-term nature on its balance sheet.

➤ Operating expenses, Profitability and Sustainability



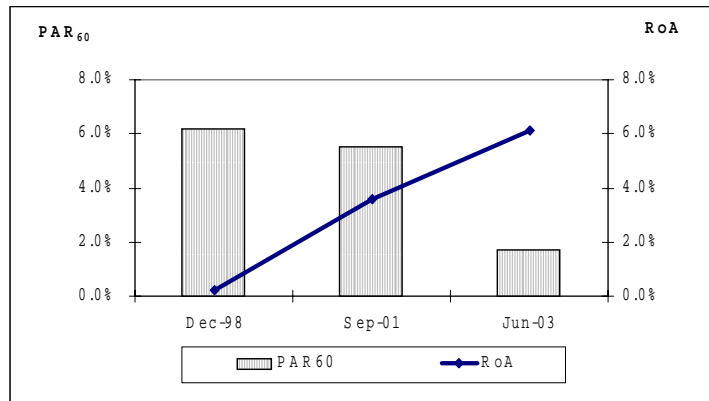
Buro, Tangail – 2nd update

The Operating Expense Ratio (OER) is relatively high for an organisation of BT's size but is declining. Between December 1998 and June 2003 BT's operating expenses grew at 21.7% annually, significantly slower than the 25.1% pa rate of growth of the portfolio. This resulted in a steady improvement in the Operating Expense Ratio (OER) – down from 27.1% in December 1998 to 20.2% in June 2003. Despite this improvement, however, the OER is still relatively high for an organisation of BT's size and there may be some scope for reducing it by minimising dropouts, streamlining the process of establishing new branches and further increasing staff productivity.

Nevertheless, the organisation's financial sustainability and profitability in terms of its independence from subsidies and its return on funds is excellent. Similarly its Financial Self-sufficiency (FSS) at 109.3% and Subsidy Dependence Index (SDI) at 4.8% are also very good.

BT's profitability performance has improved consistently over the

years with the RoA improving from a meagre 0.3% in December 1998 to a healthy 6.1% in June 2003 as both efficiency and its scale of operations has increased.



➤ Ability to cope with disasters

The main types of disaster likely to affect Bangladesh are cyclones and floods. Buro Tangail's main operating areas Tangail district and others in both northern Bangladesh and those in the proximity of Dhaka are relatively distant from the coastline and are likely to be affected not so much by cyclones as by floods. The most recent example of such a disaster was the devastating flood of September 1998.

The flood of 1998 had a very significant effect on the operations of BT which resulted in the long term loss of a part of its portfolio and disruption of group activities for a considerable time. In June 2003, BT undertook an analysis of its delinquent loans in order to clean up the portfolio by writing-off loans that were in long term default. In this case, the BT management decided to classify all outstandings on loans disbursed during 1994-99 as being in default and to treat overdues on more recent loans as delinquency and to ensure that the reserves of the organisation were adequate to cover the likelihood of loss on the delinquent amounts.

BT's default analysis – presented in the document “Default Loan Recovered/ Adjusted Working Policy, dated June 2003 – shows that Tk21.9 million of principal disbursed in 1998 and 1999 (13% of the average outstandings of around Tk170 million) could not be recovered and was written off in June 2003. Since BT's loan loss reserve in December 2002 was Tk13.9 million an additional provision of Tk9.4 million was made in June 2003. After making some of the write-offs from member savings and member emergency funds, this left Tk11 million in the loan loss reserve, nearly twice as much as the Tk5.9 million now required to cover for “expected losses” from the remaining portfolio.



Buro, Tangail – 2nd update

Table 3.1 (below) uses M-CRIL’s projections of BT’s expected financial performance over the next five years to present an analysis of the organisation’s likely ability to absorb possible loan losses from its accumulated reserves (without letting its net worth turn negative). As the table shows, BT can absorb 10% loss of its expected portfolio over the next few years simply by using its loan loss provision during the year plus the entire expected surplus for the year – the Write-off Coverage Index being more than one in the last row of the table.

Table 3.1
Analysis of BT’s financial capacity to cope with future disasters

	<i>'000 taka</i>				
for the year ending...	June 2004	June 2005	June 2006	June 2007	June 2008
Surplus + Loan Loss Provn.	56,607	80,070	102,501	127,428	157,292
Surplus + Loan Loss Reserve	67,688	93,303	119,507	148,226	181,876
Surplus + LLR + 15% member savings	97,148	132,255	169,701	211,461	260,172
<u>% of portfolio lost</u>					
15%	85,192	113,393	141,762	170,181	202,821
13%	73,833	98,274	122,861	147,490	175,778
10%	56,794	75,595	94,508	113,454	135,214
8%	45,435	60,476	75,607	90,763	108,171
<u>Write off coverage index - incl</u> member savings					
@15% loss	1.14	1.17	1.20	1.24	1.28
- surplus + LLR @13% loss	0.92	0.95	0.97	1.00	1.03
- surplus +LLP @10% loss	1.00	1.06	1.08	1.12	1.16

Even though BT does not expect a loss beyond this level, the analysis has been extended to cover losses of 13% and even as much as 15% in the table. As the table shows, to cover a 13% loss, BT would need to absorb its entire loan loss reserve as well as the surplus for the year. If the loss were to rise as high as 15% the entire surplus, loan loss reserve and (assuming the savings of the defaulting members were also to be forfeit) the savings of defaulting members would comfortably cover the entire amount needing to be written off.

The sufficiency of reserves, however, should not lead the management to be complacent as it simply indicates who will absorb the losses in the event of disaster. The actual ability of the management to cope with the disasters will be determined by the appropriateness and adequacy of risk management practices.

Since the flood of 1998, BT has devised a number of strategies to deal with any disaster that may strike again. These include the following

- Reforming the groups to make them viable
- Pulling out from the areas which are disaster prone
- Increasing the geographical spread of its operations



Buro, Tangail – 2nd update

- Training staff as well as clients in disaster management and preparedness
- The introduction of a disaster loan product – through an Emergency Disaster Fund now worth around Tk39 million – designed to enable clients to recoup their livelihoods
- Creation of a pool of liquid investments out of the Emergency Disaster Fund to be used in the event of a disaster.

These measures will have the effect of creating a geographically diversified portfolio, ensuring sufficient liquidity and minimising the disruption of operations in the event of a disaster. The M-CRIL study team concludes from the above analysis that along with these strategies, BURO Tangail is now in a much stronger position to cope with disasters than it was in 1998.

➤ The implications of the insurance product in the event of high mortality

As mentioned earlier, BT's insurance product could result in a large payout in the form of claims if there is high mortality amongst its clients in the event of a disaster or epidemic. An analysis of the impact of such mortality is presented in **Table 3.2**.

Table 3.2:
Analysis of impact of high mortality

Mortality	For the year ending...	Jun 2004	June 2005	June 2006	June 2007	June 2008
0.5%	RoA	8.0%	8.6%	9.1%	9.5%	9.7%
	CAR	47.1%	45.6%	46.6%	49.4%	51.4%
1%	RoA	5.5%	6.4%	7.0%	7.4%	7.6%
	CAR	41.6%	41.2%	42.9%	44.6%	45.8%
2%	RoA	3.5%	4.5%	5.2%	5.7%	5.9%
	CAR	39.5%	39.2%	41.0%	42.8%	44.1%
3%	RoA	1.6%	2.7%	3.4%	3.9%	4.3%
	CAR	37.5%	37.3%	39.1%	41.0%	42.4%
5%	RoA	-2.27%	-1.04%	-0.23%	0.50%	1.05%
	CAR	33.4%	33.4%	35.3%	37.3%	39.0%
8%	RoA	-9.47%	-7.94%	-6.97%	-5.94%	-5.07%
	CAR	27.3%	27.5%	29.6%	31.9%	33.8%
10%	RoA	-12.0%	-10.3%	-9.3%	-8.1%	-7.1%
	CAR	21.7%	22.2%	24.4%	26.9%	29.1%

Note: The analysis takes into account the impact of insurance claims as well as loan losses on profitability.

In M-CRIL's current projections (annexed to this report), the normal mortality rate amongst BT's clients has been assumed to be 0.5% which is well covered by the 1% premium that the organisation charges on the insurance product. The premium collected by BT is 1% of the claim amount, if the mortality rate is less than 1%, the payout can be made out of the

premiums of that year. If the mortality rate is higher than 1% this will need to be paid from the profits on other financial services. It is clear from **Table 3.2** that even if the mortality rate – in a particular year – climbs as high as 3%, that year’s profit will be sufficient to cover the payout. The capital adequacy of the organisation remains within comfortable limits even if the mortality levels reach 10%. This substantial cushion in the form of a high net worth, however, should not give rise to complacency and BT should, ideally, obtain a more sophisticated actuarial analysis to understand the extent of risk on its insurance products.

➤ The implications of a new regulatory regime

It became apparent during the visit of the study team in August 2003, that the Steering Committee on the Regulation of MFIs in Bangladesh has submitted its report to the Finance Ministry and that the report is under the consideration of the Bangladesh Government. Despite the extensive work undertaken by the committee, however, knowledgeable sources in the country do not expect any statutory regulation to be introduced within the next 2-3 years.

Nevertheless, BT must prepare itself for potential regulation of microfinance in the future and, for this reason, an analysis of its projected performance is presented in **Table 3.2** below vis-à-vis the regulatory measures likely to be introduced. In brief the major regulatory measures expected are

- a Capital Adequacy Ratio (CAR) of 20%, and
- b Statutory Liquidity Ratio (SLR) of 20-25% of the volume of deposits,

both to be maintained at all times.

Table 3.2
Projected performance of BT vis-à-vis potential regulatory requirements

for the year ending...	30 June 2004	30 June 2005	30 June 2006	30 June 2007	30 June 2008
Capital Adequacy Ratio, %	47.1	45.6	46.6	49.4	51.4
Calculation of Liquidity Ratio in original projections, %	23.2	19.4	16.4	23.7	29.2
Projected external borrowing:					
million Taka – Original	100	80	80	100	100
Revised projections	104	92	85	100	100
Additional borrowing required in million Taka	4	12	15	0	0

It is apparent from the information presented in the above table that the proposed regulatory restraints will not affect BT’s operations greatly. M-CRIL’s projections show that the Capital Adequacy Ratio is expected to stay around the 45-50% level. In the case of the Liquidity Ratio, the second row in the table shows that this is expected to be somewhat lower than the (highest expected) 25% requirement at least in 2005 and 2006. However, the additional amount that would need to be mobilised by BT as external borrowings is no more than Tk12 million and Tk15 million in these two years. This is a significant but not substantial additional amount.



4 Conclusions

Strengths	Weaknesses
<p><u>Organisational</u></p> <ul style="list-style-type: none"> ✓ Long years of experience in microfinance ✓ Focussed microfinance operations ✓ Strong second line of leadership <p><u>Managerial</u></p> <ul style="list-style-type: none"> ✓ Professionally trained and qualified managerial cadre ✓ Good tracking system for overdues ✓ Strong internal audit system 	<p><u>Organisational</u></p> <ul style="list-style-type: none"> ✗ Low depth of coverage in the existing villages ✗ High client dropout <p><u>Managerial</u></p> <ul style="list-style-type: none"> ✗ Relatively weak cash planning at branches ✗ Inadequate system of performance appraisal for the branches
<p><u>Financial</u></p> <ul style="list-style-type: none"> ✓ Excellent repayment rate and portfolio quality ✓ Productive deployment of assets in the loan portfolio ✓ Good performance on profitability and sustainability ✓ Good capital adequacy 	<p><u>Financial</u></p> <ul style="list-style-type: none"> ✗ Large contingent liability for insurance ✗ Relatively high operating expenses

5 Creditworthiness



Buro, Tangail – 2nd update

BT has achieved a rating grade of *alpha plus* ($\alpha+$).⁴ In terms of creditworthiness this implies **very high safety**. BT's performance on governance and financial aspects is excellent and its managerial performance is now very good. BT has been able to improve its rating grade relative to the last rating on the strength of its stronger second line of leadership and human resource quality as well as its improved MIS and internal control systems. BT can still improve its managerial performance through better cash planning, branch performance appraisal and asset-liability management system.

In M-CRIL's view, on account of its overall very good performance, commendable approach to sustainability and self-reliance as well as the growth plans of the organisation, BT can absorb – from all sources (commercial borrowings as well as grants/RLF for on-lending) – funds of Tk100 million (US\$1.7 million) over the next one year for on-lending to its borrowers.

A rating update after one year is suggested to ascertain changes in the creditworthiness and absorptive potential of the institution. **This rating is valid, subject to no other substantial inflows of loan funds into the organisation beyond the limits specified here** and to no other significant changes in the organisational structure and external operating environment.

⁴ The Rating Grade given measures performance on the rigorous standards established by M-CRIL. The assessment uses an instrument designed specifically for the conditions and nature of MFIs operating in Asia and is comparable with other ratings done by M-CRIL in this region.



Buro, Tangail – 2nd update

Financial statements for BT's microfinance operations

Balance Sheet - as on 30 June 2003

<u>Assets</u>	<u>Tk</u>	<u>Tk</u>	<u>US\$</u>	<u>US\$</u>
Current assets				(1US\$=Tk58)
Cash in hand and bank		19,908,345		343,247
Investments		34,947,729		602,547
Other current assets		15,721,616		271,062
<u>Loans outstanding</u>				
Restructured/refinanced				
Gross loans outstanding	474,234,062		8,176,449	
(Loan loss reserve)	(11,080,551)		(191,044)	
Net loans outstanding		463,153,511		7,985,405
Total current assets		533,731,201		9,202,262
Long term assets				
Net property and equipment	33,168,074		571,863	
Total long term assets		33,168,074		571,863
Total Assets		566,899,275		9,774,125
Liabilities and Net Worth				
Current liabilities				
General savings	58,518,400		1,008,938	
Bank overdraft	24,624,820		424,566	
Other current liabilities	24,496,429		422,352	
Total current liabilities		107,639,649		1,855,856
Long term liabilities				
Insurance fund		17,446,764		300,806
Time deposits		2,560,560		44,148
Contractual savings		106,658,280		1,838,936
<u>Long term debt</u>				
SDC	60,516,368		1,043,386	
Sonali bank	2,500,000		43,103	
Total long term debt		63,016,368		1,086,489
Total long term liabilities		189,681,972		3,270,379
Net worth				
Donated equity	173,898,650		2,998,253	
Capital grants for fixed assets	1,848,581		31,872	
Retained net surplus	63,175,627		1,089,235	
Current net surplus	30,654,796		528,531	
Total net worth		269,577,654		4,647,891
Total Liabilities and Net Worth		566,899,275		9,774,125



Buro, Tangail – 2nd update

Income Statement – for the period 1 July 2002-30 June 2003

<u>Income</u>	<u>Tk</u>	<u>Tk</u>	<u>US\$</u>	<u>US\$</u>
				(1 US\$= Tk58)
Interest and fees on loans	134,172,342		2,313,316	
Interest on investments	449,421		7,749	
Other income	<u>6,514,093</u>		112,312	
Total income		141,135,856		2,433,377
<u>Financial costs</u>				
Interest on borrowings	6,614,137		114,037	
Interest on member savings	<u>12,377,929</u>		<u>213,413</u>	
Gross financial margin		122,143,790		2,105,927
Provision for loan losses	<u>9,353,000</u>		<u>161,259</u>	
Net financial margin		112,790,790		1,944,669
<u>Operating expenses</u>				
Salaries	54,118,546		933,078	
Travel	3,679,382		63,438	
Depreciation	3,522,273		60,729	
Administrative/office expenses	<u>20,815,793</u>		<u>358,893</u>	
Total Operating expenses		82,135,994		1,416,138
Net Surplus		30,654,796		528,531



Notes to the financial statements

1. The Financial Statements have been estimated for the microfinance operations and represent an approximate picture only. This has involved appropriate modifications to the existing financial statements using data gathered and assumptions made during the rating exercise.
2. Income includes interest income, fees and earnings from other microfinance related services offered by the MFI rated. All loan portfolio related income is recognised only when it is actually received (**cash basis**). Grants allocated to the organisation's microfinance programme are treated as donated equity in the balance sheet (and not regarded as operational income).
3. Financial costs (interest on borrowings and savings, if any) and operating costs are calculated on an **accrual basis**. Loan loss provisioning expense and the corresponding balance sheet entry (loan loss reserve) has been computed based on the quality of the portfolio.

Glossary

1. Cumulative repayment rate
Ratio of cumulative principal recovered (net of pre-payments) to the cumulative principal due till the date of measurement.
2. Portfolio at risk (PAR₆₀)
Ratio of the principal balance outstanding on all loans with overdues greater than or equal to 60 days to the total loans outstanding on a given date.
3. Yield on portfolio
The interest income on loans divided by the average loan portfolio for the year.
4. Other income to average portfolio
Total income other than from the interest on loans divided by average portfolio.
5. Financial cost ratio
Total interest expense for the year divided by the average portfolio.
6. Loan loss provisioning ratio
Total loan loss provisioning expense for the year divided by the average portfolio.
7. Operating expense ratio
Ratio of salaries, travel, administrative costs and depreciation expenses to the average loan portfolio.
8. Average loan portfolio
This represents the average loan outstanding for the year computed on a monthly basis.
9. Subsidy Dependence Index
The Subsidy Dependence Index broadly measures the net subsidies received as a proportion of the income of the organisation. A higher ratio indicates that there is a higher level of dependence on subsidies. Subsidies can be in the form of grants and savings deposits/ borrowings at a rate lower than market rate. Computation of subsidies is done with respect to the market rate of interest.
10. Average total assets
This represents the average total assets for the year calculated on an annual basis.
11. Operational Self-Sufficiency
Ratio of total income to total costs for the year.
12. Financial Self-Sufficiency
Ratio of total income to total adjusted expenses for the year. Adjustments have been made for subsidised cost of funds (w.r.t. market interest rate), equity (w.r.t. inflation) and in-kind donations.
13. Risk weighted capital adequacy ratio
Ratio of net worth to risk weighted assets (Risk weights: 100% for all assets except the following: fixed assets & interest bearing deposits: 50%; cash 0%).



6 Recommendations

Strategy for m-f implementation

Growth strategy: The concentration of BURO, Tangail (BT) in most of the villages in which it has been operating is relatively low. This is partly because of intense competition from other MFIs and partly because of a high rate of client dropout in some of the branches. As a future growth strategy, BT should try to strengthen its market research and market analysis based on the results of the research (see **Annex** to the rating report). It should try to expand its operations in those areas where the data shows there are significant numbers of unreached clients and it is possible, therefore, to concentrate operations. This will not only have a favourable impact on the cost of operations, but will also help in creating a significant institutional presence in those areas.

Dropouts and operating expenses: The high client dropout rate in some of BT's branches could result in some of the branches becoming economically unviable if the number of members falls below critical limits. In order to understand fully the reasons for this situation BT should conduct field research amongst the clients who have dropped out. Impact studies covering such issues in India show that a scientifically designed and carefully conducted study of this type can form the basis for determining appropriate measures to minimise the dropout rate and, thereby, keep operating expenses under control.

Financial prudence: The long-term savings and the insurance products of BT are issues needing to be addressed in the context of financial prudence. BT should try to rationalise interest rates on its savings products considering the future interest rate scenario in the economy as well as its future competition management strategy, so that it does not become locked into a high-cost financial system in the long term. Acknowledging that the high interest paid on savings accounts is part of BT's competition management strategy it would appear prudent for the organisation to put in place a formal policy of linking the interest paid on savings to market rates. Since Sonali Bank is the largest commercial bank in Bangladesh, an appropriate "guideline rate" would possibly be the rate paid by the bank on equivalent products – Savings Bank accounts, Recurring Deposit accounts and Fixed Deposit accounts – plus 2%. In a situation of falling interest rates, any organisation that stays as much as 2% ahead of the major alternative service provider is likely to retain its competitive edge. [If other MFIs do not lower their savings rates in line with those of the commercial banks, BT will, of course, have to modify its strategy accordingly].

There are two other measures of financial prudence that should ideally be taken by BT

- a Though there is presently no statutory requirement for MFIs in Bangladesh to maintain a proportion of their funds in liquid instruments (a Statutory Liquidity Ratio, SLR) as a matter of financial prudence it would be appropriate for BT to introduce a policy of maintaining such liquidity. Since a 25% SLR is a common requirement for non-bank financial institutions in most parts of the world, it would be appropriate for BT to maintain liquidity at this level. As the analysis undertaken by the study team shows this will not put a substantial strain on BT's finances while bolstering the credibility of its management.
- b In addition, as indicated in the report above, BT should ideally use the services of a qualified actuary to evaluate its insurance products so as to understand fully the extent of risk the organisation carries on its insurance products.

Sources of finance: The proportionate utilisation of different types of sources of finance contributing to the revolving loan fund (RLF) of some of the leading MFIs in Bangladesh is presented in **Table 6.1**. The table shows the (high) extent to which some of BT’s competitors are dependent on PKSF for loan funds. BT, by contrast, has a much higher level of donor funds – though currently these are not all donations since it has a Tk60 million loan at the commercial rate of 10% from SDC.

BT’s current strategy is to approach commercial sources for further loan funds – which will increase substantially the proportion of funding by local banks in the table below. While BT is one of the leading organisations in the region in terms of demonstrated commercial viability (leading to long term sustainability), BT should also consider whether this is the most commercially appropriate strategy; would it not, for instance, make sense to borrow a proportion of its requirements, at lower cost and on an experimental basis, from PKSF. If the latter will bend its rules a little to accommodate BT’s lending conditions or if BT can designate certain new areas where PKSF funds will be used within the constraints of PKSF’s terms, this could open up an additional source of funds for BT. In a situation where the commercial banks are still relatively reluctant to lend to MFI’s, such a financing strategy could be worth trying.

Table 6.1
Sources of RLF of some leading MFIs in Bangladesh

MFI	Member savings	PKSF	Local bank	% of total
				International donors
BRAC	31.5	28.9	8.5	17.5
ASA	24.1	31.1	5.7	11.6
TMSS	17.4	61.3		
SSS	31.7	39.8	1.3	10.2
BURO Tangail	25.3		2.1	44.1

Source: CDF Statistics, December 2001

Branch performance analysis

The branch performance analysis and grading system that BT is using at present is inadequate and could result in inappropriate classification of the branches as well as non-optimal allocation of resources. BT needs to formulate a comprehensive instrument to grade the branches. The tool should take into consideration factors such as growth, staff efficiency, and portfolio quality as well as profitability and sustainability. A tentative instrument developed by M-CRIL for BT is attached as an Excel file. BT can use this as a guide to develop an appropriate instrument to suit its needs.

Cash planning system

The Cash Planning system that BT has at present is less than optimal and often results in accumulation of cash at the branches. BT needs to develop a more sophisticated cash planning system based on a weekly forecast of cash requirements at its branches and link this to a system of cash transfer from the branches to the common account at the head office.



Buro, Tangail – 2nd update

Asset-liability management

Though BT at present does not face any serious asset-liability mismatches it would be prudent to develop an asset-liability management system. This could include the classification of assets and liabilities in comparable maturity brackets (preferably monthly) and their regular monitoring to look for any potential asset-liability mismatches.



Projected Cash Flows and Financial Statements for five years

- The following assumptions and projections - derived from the limited information available from the organisation on its future financial projections – are tentative in nature. These **should not be viewed in isolation nor be regarded as a basis for investing in the future** - only the main risk rating report provides an opinion on investments.
- All assumptions are based on the data gathered during the rating exercise and the savings and credit methodology used by the organisation.

1 Basic Assumptions

(see also Notes to Cash Flow Projections below)

For the year ending:	30-Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Active clients	159,842	185,417	213,229	236,684	260,353	286,388
Savings per member/year	327	344	361	379	398	418
Yield on average portfolio	33.0%	33.3%	33.7%	34.0%	34.3%	34.7%
Interest paid on savings	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%
Cost of external funds	10.0%	10.2%	10.5%	10.8%	10.9%	10.8%
Repayment rate from groups	99.6%	99.5%	99.5%	99.0%	99.0%	99.0%
Loan loss reserve ratio	2.3%	2.0%	2.0%	2.0%	2.0%	2.0%
Number of active loanees	124,215	148,333	166,319	186,981	208,282	229,111
Number of loans disbursed		160,755	181,152	203,613	226,980	249,939
Average loan size to borrowers	5,600	6,720	7,661	8,274	8,770	9,559



Buro, Tangail – 2nd update

2 Projected balance sheets

Tk in thousands

As on:	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Assets						
Cash balance	19,908	52,247	57,147	61,676	110,856	168,130
Investments	34,947,729	35,447,729	35,947,729	36,447,729	36,947,729	37,447,729
Loans outstanding	474,234	661,653	850,253	1,039,912	1,229,167	1,475,118
Loan loss reserve	-11,081	-13,233	-17,005	-20,798	-24,583	-29,502
Net loans outstanding	463,154	648,420	833,248	1,019,114	1,204,583	1,445,615
Other assets	15,722	22,250	27,720	33,136	39,053	45,822
Net fixed assets	33,168	34,351	35,416	36,375	35,437	33,693
Total Assets	566,899	792,715	989,478	1,186,749	1,426,877	1,730,708
Liabilities and Net Worth						
External borrowings	63,016	150,834	176,958	176,443	180,080	193,420
Member savings	167,737	225,066	294,290	374,971	468,158	575,788
Insurance fund	17,446,764	22,269,410	27,703,974	33,812,352	40,621,763	48,119,927
Other liabilities	49,121	70,514	90,196	102,484	115,336	138,325
Donations and equity	175,747	175,747	175,747	175,747	175,747	175,747
Retained surplus/deficit	63,176	93,830	148,285	224,583	323,291	446,934
Current surplus/deficit	30,655	54,454	76,298	98,708	123,643	152,373
Net worth	269,578	324,032	400,330	499,038	622,681	775,054
Total Liabilities and Net Worth	566,899	792,715	989,478	1,186,749	1,426,877	1,730,708

3 Projected Income Statements

Tk in thousands

For the year ending:	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Income						
Interest	134,172	189,226	254,385	321,209	389,457	468,796
Other income	6,964	7,660	8,426	9,268	10,195	11,215
Total Income	141,136	196,886	262,811	330,478	399,652	480,010
Cost						
Financial	18,992	30,035	41,094	49,120	57,434	67,319
Loan loss provision	9,353	2,153	3,772	3,793	3,785	4,919
Depreciation	3,522	3,817	3,935	4,042	3,937	3,744
Operating expenses (excl. depr.)	78,614	106,427	137,712	174,815	210,853	251,655
Total Cost	110,481	142,431	186,513	231,770	276,009	327,637
Surplus/Deficit	30,655	54,454	76,298	98,708	123,643	152,373



Buro, Tangail – 2nd update

5 Projected Cash Flow Statements

Tk in Thousands

For the year ending:	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Inflows					
Opening cash	19,908	52,247	57,147	61,676	110,856
External borrowings	100,000	80,000	80,000	100,000	100,000
Repayments from members	892,854	1,199,170	1,494,963	1,801,383	2,143,311
Grants	0	0	0	0	0
Member savings deposits	63,699	76,916	89,646	103,541	119,589
Interest income	189,226	254,385	321,209	389,457	468,796
Insurance fund	4,822,646	5,434,564	6,108,378	6,809,411	7,498,163
Other income	7,660	8,426	9,268	10,195	11,215
Total Inflow	1,278,170	1,676,578	2,058,341	2,473,062	2,961,265
Outflows					
Disbursement	1,080,273	1,387,770	1,684,622	1,990,637	2,389,263
Repayments to lenders	12,183	53,876	80,516	96,363	86,660
Withdrawals of savings deposits	6,370	7,692	8,965	10,354	11,959
Operating expenses (excl. depr.)	106,427	137,712	174,815	210,853	251,655
Interest paid on borrowings	12,359	17,723	19,003	19,493	20,342
Interest paid on savings	17,676	23,371	30,117	37,941	46,978
Net changes in other assets and liabilities	-14,864	-14,212	-6,872	-6,935	-16,220
Investments	500	500	500	500	500
Fixed assets purchase	5,000	5,000	5,000	3,000	2,000
Total Outflow	1,225,923	1,619,431	1,996,665	2,362,206	2,793,136
Net cash balance	52,247	57,147	61,676	110,856	168,130

5 Key projected performance ratios

For the year ending:	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Operational self-sufficiency	128%	138.2%	140.9%	142.6%	144.8%	146.5%
Return on average assets	6.1%	8.0%	8.6%	9.1%	9.5%	9.7%
Operating expense ratio	20.2%	19.4%	18.7%	18.9%	18.9%	18.9%
Average outstanding/borrower (Tk)	3818	4,461	5,112	5,562	5,901	6,438
Portfolio growth rate	40.3%	39.5%	28.5%	22.3%	18.2%	20.0%
Savings to total assets	29.6%	28.4%	29.7%	31.6%	32.8%	33.3%
Risk weighted capital adequacy ratio	49.8%	47.1%	45.6%	46.6%	49.4%	51.4%



6 Notes to the projections

1. The Operating expense ratio is based on current levels and is projected based on changes in overall productivity and growth in staff, branches and portfolio.
2. Estimated external borrowings are subject strictly to performance based on the findings of this microfinance capacity assessment (credit rating).
3. All external inflows have been assumed to be from the borrowings, no grant flow for onlending has been assumed.
4. Average loan size to members increases in the range 5%-15% during the projection period.
5. Interest income is taken as [yield on portfolio*average portfolio for the year]. Yield movements are projected to stay the same as, at present, there is not likely to be any change in the overall interest structure.
6. Other income is the income that the organisation earns on membership fees, and fee for the passbooks from the clients. Other incomes are assumed to increase by 10% pa.
7. Disbursements are taken as the [number of loans disbursed during the year*average loan size to borrowers].
8. The increases in the insurance fund of the organisation is assumed to increased based on an average premium income of Tk60 per loan disbursed and the mortality rate of the population is assumed to be 0.5% pa.
9. Other assets and other liabilities are assumed to bear almost the same proportion to the total assets in all the years in the projection period.
10. Estimates on growth in outreach and demand for loans from the organisation have been made based on current growth levels and future expansion potential and plans of the organisations. Increase in clients is taken at rates between 10-15% per year.
11. Repayments to lenders is 25%per annum on the projected liability structure and the actual repayments due on the present outstanding debt.
12. Interest paid is taken as the [average cost of external funds * the average external borrowing liability figure].
13. In the projections the net worth figure includes donations and equity, retained surpluses and current surplus.



M-CRIL's Microfinance Rating Symbols

M-CRIL Grade	Description
$\alpha+++$ alpha triple plus	Highest safety, excellent systems ➤ most highly recommended
$\alpha++$ alpha double plus	Highest safety, very good systems ➤ most highly recommended
$\alpha+$ alpha single plus	Very high safety, good systems ➤ highly recommended
α alpha	High safety, good systems ➤ highly recommended
$\alpha-$ alpha minus	Reasonable safety, good systems ➤ recommended
$\beta+$ beta plus	Reasonable safety, reasonable systems ➤ recommended, needs monitoring
β beta	Moderate safety, moderate systems ➤ acceptable, needs improvement to handle large volumes
$\beta-$ beta minus	Significant risk, poor to moderate systems ➤ acceptable only after improvement
$\gamma+$ gamma plus	Substantial risk, poor systems ➤ needs considerable improvement
γ gamma	Highest risk, poor systems ➤ not worth considering