MicroSave Briefing Notes on Grameen II # 4

Financial Performance

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Grameen and 'Grameen II'

For more on 'Grameen II' and the changes it has made to Grameen Bank's practices, starting in 2002, please see the first Note in this series, 'What is Grameen II?' [1]

A surge in profits

The Bank's audited accounts[2] for 2003 show a six-fold increase in net profits over 2002 – from 60 to 358 million taka (US$6 million). 2003 was the first full year of 'Grameen II', so this surge in profit looks like a good return on the decision to launch Grameen II.

Where did these profits come from? Our first table summarises the main changes in the Income Statement of the bank between 2002 and 2003.

Grameen Bank Income: significant changes 2002 to 2003

	Increase 2003 over 2002 (Million Taka: US$1 = 56 taka)	
Interest income (on loans)	+ 479	+17%
Interest expense (on deposits, etc)	+ 211	+24%
Net interest income	+ 268	+14%
Expenses (excluding Provisions)	+ 106	+7%
Provision for loans and advances	- 77	-12%
Net profit	**+ 298**	

Profits came from growing interest income on loans outstripping even faster growing interest expense on the new range of savings accounts, from containing costs, and from a fall in loan loss provision. Yet only three years ago the Bank admitted to falling repayment rates[3], and Muhammad Yunus, its Managing Director, noted that 'Grameen II' was needed to improve performance through more flexible product design, including the use of quick loan rescheduling using the new 'flexi' loans. He also promised stringent provisioning policies for more transparent accounting of the quality of the loan portfolio.

So what should we make of this reported six-fold jump in profits coming so soon after Grameen II started? Is all well, or is Grameen a microfinance 'Enron' hiding a weakening loan portfolio which will ultimately bring down the whole house of cards? This Note combines a reading of Grameen's published figures with our own analysis of the accounts of three sample branches and our own detailed study of the behaviour and attitudes of staff and clients in those branches, to arrive at our own answers to questions about Grameen's performance.

Loan loss provisioning policy

Introducing Grameen II, Yunus defended the bank's provisioning and write-off policies, promising that Grameen II '…has made these policies still more generous.' [Yunus 2002, p 15-16]. How do the new rules differ from the old? What is really being implemented?

The pre-Grameen II case can be found in the 2001 accounts. The method used that year for provisioning the one-year 'general' loan was:

- General loans outstanding for 2 years and above after expiry: 100% provisioning
- Amounts due for the subsequent year after expiry for one year term general loans: 0%

This is the 'classic' situation that had been criticised: the bulk of the Grameen portfolio had been in one-year loans that were not provisioned in full until they were two full years past maturity.

By contrast, under Grameen II, a borrower failing to make repayment for ten consecutive weeks (or failing to repay the total amount she is required to pay within any six month period) is moved immediately to a flexi loan, whereupon, wrote Yunus, '50% provision must be made for the total balance amount of flexible loan and accrued interest on the annual closing date, even if the repayment rate of flexible loan is 100% for the whole bank.' If the borrower fails to shift to a flexi loan (perhaps because she can't be traced, or simply refuses to comply) '…she becomes a defaulter, [and] 100% provisioning must be made for the unrepaid principal and interest.'

The 2002 and 2003 accounts appear to follow this declared policy, and in 2002 to have been even more stringent (60% rather than 50% provisioning for new flexi loans). The accounts state policy as follows:

	2002	2003
	provision rate	
Basic loans – overdue principal and interest	100%	100%
Flexible loans –		
• Principal outstanding and interest receivable below 2 years from the signing of first contract period	60%	50%
• Principal outstanding and interest receivable for 2 years and beyond from the signing of first contract period	100%	100%
• Overdue - Principal outstanding and interest receivable	100%	100%

Provisioning policy on housing loans, which had suffered especially poor repayment performance, was also sharply tightened in 2003, resulting in a provision of 596 million taka in that year compared with just 96m in 2002. Housing loans constituted 14% of the total portfolio in mid 2002.

[1] Notes in this series are based on the research project 'Grameen II: A Grounded View' commissioned in 2002 by *MicroSave* from a team lead by Stuart Rutherford. The findings are based on close research in the field, using interviews with staff, clients and the public in the areas served by three sample branches, and a review of the accounts of those branches, and of data from the Grameen HQ. We are grateful to the bank for the support it is lending to the research team.

[2] www.grameen-info.org

[3] Muhammad Yunus *Grameen Bank II : Designed to Open New Possibilities*, Grameen Bank, Dhaka, 2002

Portfolio quality measurement

The new loan loss policies, then, are more prudent than under classic Grameen, and were respected in the preparation of the accounts in 2002 and 2003. But why is it that annual loan loss charges decreased so markedly since 2001 (the first year that Grameen II emerged in some branches) as follows?:

Grameen Bank, loan loss charges, 2000 to 2003, Million Taka

Y2000	Y2001	Y2002	Y2003
623	717	673	596

For answers to that question, we turn from the central accounts to our fieldwork in our three sample branches. We refer to these as branches C, S and T: they were carefully selected to illustrate a range of performance and other branch characteristics. Their accounts confirm a significant improving trend in the loan portfolio quality.

Leaving aside housing loans, the ratio of bad and doubtful loans (defined as all overdue basic loans and all flexi loans) to total outstanding loans was calculated for the sample branches. The best of them (branch S) has not reported any bad and doubtful loans after December 2001. The trend in the other two branches was as follows:

Bad & doubtful loans as % of portfolio, branches C & T

Branch	Dec 2001	Dec 2002	Dec 2003	June 2004
C	21%	15%	4%	4%
T	21%	13%	1%	2%

Where does this dramatic improvement in portfolio quality come from?

Growth

The number and age of borrowers can impact the portfolio, and the number of members in the sample branches, and of GB as a whole, has grown sharply during 2003 and 2004 as shown in the following table:

Number of members in sample branches and in GB

	Dec'02	Dec'03	Sept'04
Branch C	2594	2852	3028
Branch S	1436	1837	2672
Branch T	1995	2856	3574
Total	6025	7545	9274
Annual growth		25%	23%
GB (millions)	2.483	3.124	3.833
Annual growth	4%	26%	23%

These many new members start with small loans that tend to be free of repayment problems because weekly instalments are small. That has no doubt helped the overall quality of the portfolio. But membership growth involves not only new members but also past members who had left but returned after Grameen II started.

This is evidenced by the remarkable rise since 2002 in recovery of bad debts: that is, loans that had been written off but subsequently recovered[4]:

Recovered loan debt, Grameen Bank, millions of taka:

Y2000	Y2001	Y2002	Y2003
10	47	105	132

Not all who repaid old debt returned to membership, but our field-level investigation show that the majority of such payments are made by members seeking to return to Grameen and to borrow again. It seems, therefore, that Grameen II loan products have managed to both satisfy new members and attract back old ones, and satisfied clients tend to repay loans well.

Sound practices in the field?

The new flexibility in loan design in Grameen II is intended in part to help staff keep borrowers out of trouble, and by and large they are succeeding. But is this being done within the rules, and in a way that does not disguise loan weakness?

Since Grameen II allows premature payment of loans we first checked in our sample branches for evidence of 'roll-over' – issuing fresh loans to borrowers in trouble, paying off the previous with the new loan. But we found very few instances of large repayment sums being made shortly before new loans were issued: 'roll-over' is not being systematically practiced.

Is the loan 'top-up' system being abused? Are workers issuing very low or even zero-value top-ups and extending the loan term, so that troubled loans are 'managed' by having their instalments sizes decreased? If this were so, it would be an evasion of the principles of Grameen II, which favour transparent identification of loans in trouble. But we found that zero- or low-value top ups are too rare to make any real difference.

A good start: a good future?

We conclude that the improvement in the bank's financial performance is real, and is related to the greater attractiveness of Grameen II's wider range of more user-friendly loan products, and to its decision to attract deposits in much greater volume, which has allowed it to expand its loan portfolio and serve many new borrowers.

Can this be sustained? In 2005 we will be on the look out for evidence on whether the fast-rising number of bigger business loans perform well, and whether the many new members with small loans continue to perform well as their loan sizes rise. There is also evidence of growing competition from the other giants of microfinance (above all BRAC and ASA), with members choosing more often than ever to switch between providers, and some stress on staff from having to work very long hours.

But the news so far is genuinely good news.

[4] In early 2005 Grameen's HQ issued a new circular to staff suggesting new techniques to collect the shrinking but still-large pool of debt from written-off loans and to entice more old borrowers back into membership.