

Analyzing the micro finance sector in:

Bangladesh



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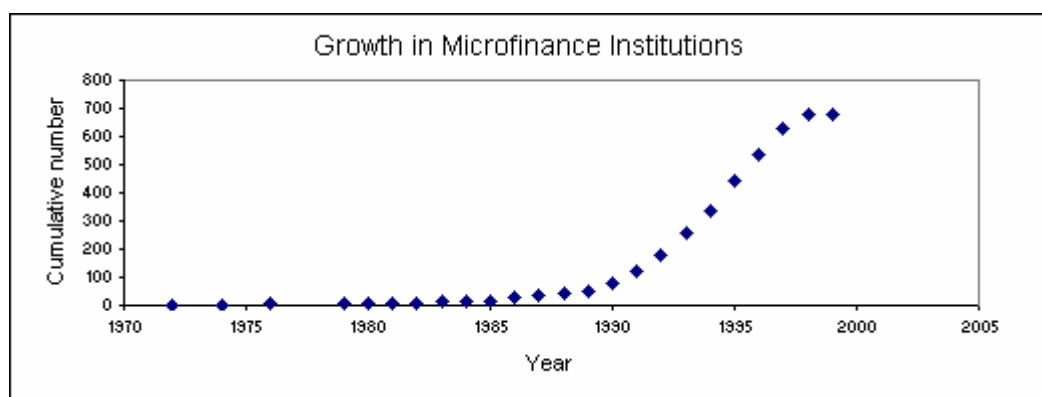
General

General data (per end of 2004) ¹	
GDP per capita (PPP)	USD 2,115
GDP growth	5.4 %
Consumer price inflation	7 %
Population	141.8 million
Informal economy	35.6 %
Exchange rate (Tk/USD)	64.27

Micro/meso level

Based on CGAP information, microfinance in Bangladesh is defined as any loan less than BDT 10,000 that is repayable within 12 months, regardless of the name given to the loan.

Bangladesh is the country where in the late 70's the Jobra experiment was carried out by Prof. Yunus from Chittagong university. This was the start of Grameen Bank. Using micro credit to reach the poor rapidly spread within and beyond Bangladesh. The figure below shows that the increase in MFI's in Bangladesh started in the second half of the 80's and accelerated in the 90's². The growth of the membership of MFI's is parallel.



Today, there are over 1000 MFI's and ngo's that offer micro finance. Mixmarket lists 50 mfi's, MicroCredit Summit lists 103 MFI's that reach a total of 24 million clients.

The 'big four' mfi's are:	<u>clients (million)</u>	<u>loan portfolio (million USD)</u>
Grameen Bank	4	337
BRAC	4	243
ASA	2.8	201
Proshika	1.5	63

Apart from these there are the (government program) Bangladesh Rural Development Board with 3.7 million clients and the (government owned) Sonali Bank with 3.8 million clients for micro credits.

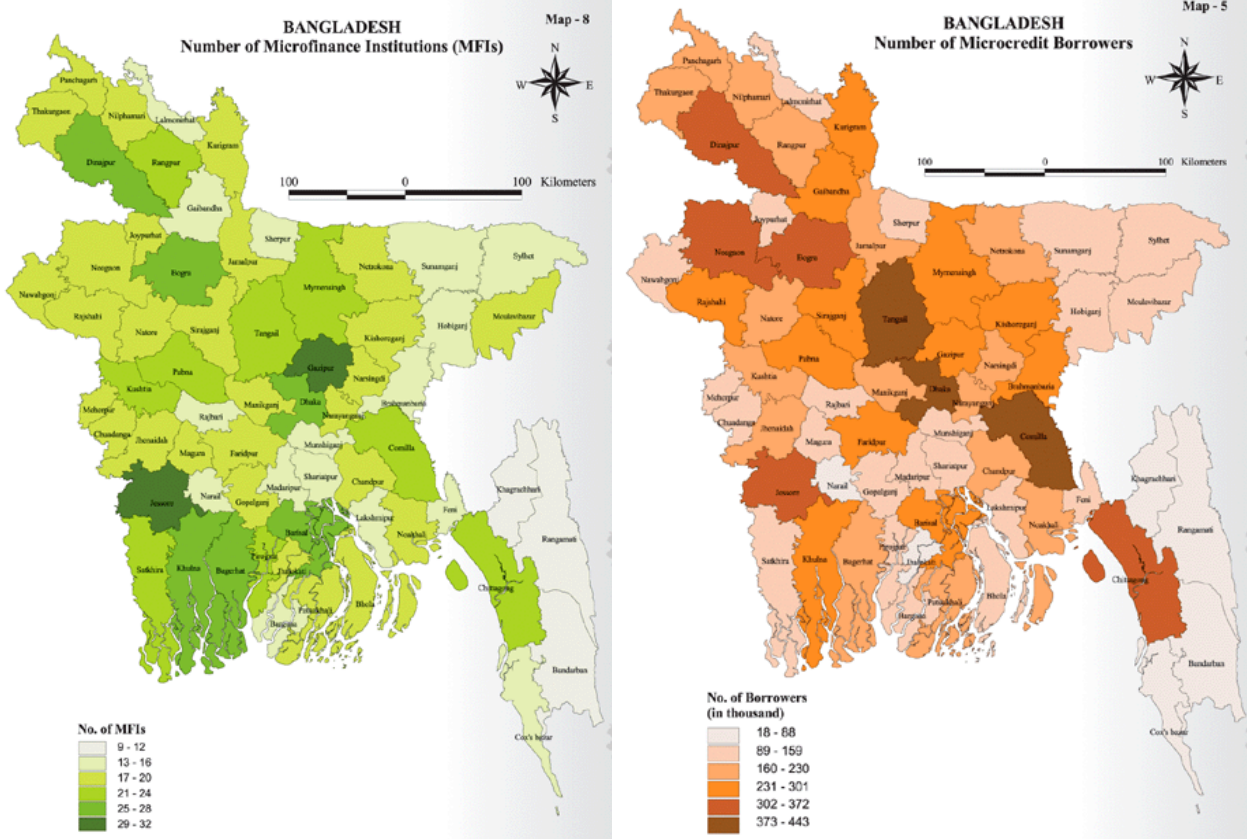
There are big differences between the MFI's. Some offer a wide range of micro finance products with flexible amounts and repayment periods, while others (like Grameen and ASA) have more standardized products.

¹ www.viewswire.com

² See http://www2.microfinancegateway.org/files/23838_file_wps3398.pdf for a good summary of the history of microcredit in Bangladesh.

³ http://www.pksf-bd.org/Microcredit_bangladesh.htm

The two maps below show the distribution of MFI's and borrowers over the country.



Typical interest rates are around 15% for MFI's, but lower at commercial banks: for example Sonali bank charges 8% for agricultural loans and 12% for microenterprise loans. In 2001, loans were disbursed for the following activities (in %):

Agriculture	12.23
Fisheries	4.91
Food Processing	3.78
Small business	43.02
Cottage industries	3.03
Transport	2.78
Housing	1.16
Health	0.45
Education	0.08
Livestock	18.11
Others	10.45

Mixmarket lists 15 sources of funds for micro credit, among which are the following Dutch organisations: CORDAID, Stichting DOEN, Oikocredit and Rabobank. About 30% of funds for micro credit come from member savings.

Palli Karma-Sahayak Foundation (PKSF⁴) is a public-private organisation that does not directly lend to clients but serves as an apex organisation, providing funds to MFI's, building capacity, giving support and networking with international organisations and government. This organisation also developed several policies and a quality system with a total of over 100 performance indicators (for viability of borrowers and institutional viability) and ratings for each indicator. PKSF has helped many MFI's to move toward sustainability. Lobby with the

⁴ <http://www.pksf-bd.org>

government for a good regulatory framework is one of the activities of PKSF. PKSF is an important member of the Microfinance Research and Reference Unit (MRRU) set up by the government for preparing a microfinance regulatory framework (see below).

A number of impact studies were done to evaluate the impact of micro credit programs in Bangladesh⁵. Results of such studies do show the positive impact of micro credit programs. However, reaching the hardcore poor turned out to be difficult. As a result, some MFI's started implementing special programs for this target group: lower start amounts, shorter cycles. An example is Grameen Bank's program for 'struggling members' (beggars), started in 2002. People who participate are not required to form groups, no collateral is needed, loans are very low (USD 8), repayment periods are determined by the client and no interest is charged. 50.000 people are reached by this program.

Many MFI's are not self sufficient. Mixmarket shows that operational self sufficiency for some organisations (including Proshika) is as low as 60%. Others (like ASA) have an operational self sufficiency of over 250%. Reaching self sufficiency in urban areas is only slightly easier than in rural areas, because of the high population density.

Micro credit is available both in rural and urban areas. Self sufficiency is only slightly easier in urban settings: because of the dense population and relatively good road network, even the rural areas can be served with reasonable cost.

ROSCA's are absent in Bangladesh but non-rotational saving systems do exist both traditionally and set up by NGO's. Traditionally the *dadon*: forward sales of agricultural crops is used as a lending system⁶. This system is also applied to avoid the Islamic prohibition of interest. Sales discounts replace interest in this case. However, the law of prohibition of interest is not strongly insisted on and this accounts for the high success rate of micro credit programmes, eg as compared with a country like Nepal.

World Bank rates Bangladesh 44 for 'getting credit' which is just above Belgium. The legal rights index indicates to what extent laws are designed to expand access to credit. Bangladesh scores 7, which is far above the regional score of 3.8 and even above the score for OECD countries of 6.3.

Macro level

Poverty Reduction Strategy Paper (2005)

The government of Bangladesh actively recognizes the role of micro credit in poverty reduction. The 2005 Poverty Reduction Strategy Paper of Bangladesh calls micro credit the 'most visible anti-poverty instrument', an 'effective and powerful tool for rural development, income generation, food security, human resource development and ultimately poverty alleviation'. The PRSP mentions four challenges for the micro finance sector:

1. efficiency gains should be translated into lower interest rates
2. downward extension to poorest
3. combine with other products like micro insurance
4. development of appropriate regulatory framework

The government is indeed actively developing a legally sound and effective regulatory framework for the micro-credit sector. This is done by a steering committee composed of sectoral representatives and chaired by the Governor, Bangladesh Bank and assisted by a Microfinance Research and Reference Unit within the Bangladesh Bank. Completion of this task is called a 'key priority'. Along with this, the government is also formulating a banking

⁵ See Zaman, 2004 for a good summary of these impact studies

⁶ <http://www.gdrc.org/icm/country/asia-bangladesh.html>

law which permits MFI's to establish themselves as micro-credit banks, which should solve the current restrictions for MFI's.

Upscaling of loan sizes is another priority point for the government. Typical loan sizes are now 5,000 Taka but there is demand for loans of 20-25,000 Tk. The limiting factor mentioned in the PRSP is conservatism of MFI's and lack of product diversification.

Government has also put emphasis on expanding credit flow for the farmers and rural entrepreneurs. The most promising areas for investment include small businesses as well as high value agriculture, i.e. export quality rice, vegetables, fruits, rural aquaculture, poultry and dairy enterprises.

See appendix 2 for an overview matrix of strategic goals for the micro credit sector from the 2005 PRSP.

Regulation

In 2000 a new regulatory body for the microfinance industry has been created with the Governor of the Bangladesh Bank as its Chairman: Steering Committee for Microfinance Research and Reference Unit⁷, which facilitates the central bank's oversight in this area. This unit developed formats for information systems, financial guidelines and standards, terms of references for internal and for external audits and twelve indicators for performance. PKSf is a main contributor in MRRU and policies and guidelines developed by PKSf seem to be stricter than those developed by the MRRU.

For an overview of regulation, see the table of appendix 1. NGO-MFI's cannot receive loans from investors from abroad, but they can accept savings from members. There are no restrictions on interest rates.

SWOT analysis

General SWOT is in the sector analysis and are not repeated here.

Strengths	Weaknesses
<ul style="list-style-type: none"> Well developed micro finance sector Adaptations made in order to reach the poor better (flexibility increased, special programs) Sometimes high interest rates⁸ PKSF strong apex organisation, providing quality 	<ul style="list-style-type: none"> Many MFI's not yet self supporting High risk members screened out by solidarity groups → ultra poor no access Limited possibilities for successful enterprises to obtain bigger loans (20,000+ Tk) Transparency sometimes questionable, e.g. rationales for interest rates.
Opportunities	Threats
<ul style="list-style-type: none"> Government recognizes value of micro credit – see PRSP Regulatory / legal framework in the making Good communications and road network 	<ul style="list-style-type: none"> Loss of mission / vision to reach the poor Occasional emergencies lead to loss of income

Recommendations for projects and programmes

- Linking up with commercial investors from abroad may be problematic because of prohibitions for ngo's for receiving loans from abroad.
- Capacity building in line with PKSf policies / regulations.
- Diversification of products (e.g. micro insurance) to reduce vulnerability.
- Demand for SMED type of loans → develop / stimulate scaling up of successful enterprises into SME

⁷ <http://www.bangladesh-bank.org/about/dept/mrru/mrru.html>

⁸ sometimes three times higher than MFI's pay to commercial banks

Appendix 1: regulation

Information from GCAP database. For references, see www.cgap.org

Ownership structure of banks (and financial institutions if available)	There are currently four nationalized commercial banks, five government owned banks, 30 domestic private banks, 10 foreign banks and 28 non-bank financial institutions. The financial system also includes insurance companies, stock exchanges and co-operative banks. The banking system is dominated by the four nationalized commercial banks, which together control more than 54% of deposits and operate 3396 branches (55% of the total) as of June 30, 2003.
Regulated microfinance institutions	Commercial and specialized banks; Grameen Bank
Non-regulated sources of microfinance	NGOs are the most prevalent organizational form offering microfinance in Bangladesh, providing both credit and deposit services. Microfinance is also provided by government-sponsored microfinance projects. No NGOs offering microfinance in Bangladesh are regulated or supervised by the central bank, the <i>Bangladesh Bank</i> [www.bangladesh-bank.org/] (BB). In April 2004, the steering committee of the BB's Microfinance Research and Reference Unit was appointed as interim regulator of NGO-MFIs. Moreover, most large and medium size NGO-MFIs receive funding from Palli-Karma Sahayak Foundation (PKSF), which provides regular monitoring of standard financial and performance indicators. Some NGO-MFIs have begun borrowing from commercial banks, which also provide some performance monitoring.
Predominant informal finance mechanisms (ROSCAs, tontines, etc.)	Moneylenders
Wholesale Lender(s)	Palli-Karma Sahayak Foundation (PKSF)
Definitions of microfinance or microcredit	Any loan for less than US \$171 (10,000 BDT) and repayable within less than 12 months, regardless of the name given to the loan. [See BRPD Circular No. 16 dated December 06, 1998 effective from January 01.1999.]
Ongoing microfinance policy development status	There is ongoing debate within the Bangladeshi government, and with donors, stakeholders, and consultants concerning the appropriate way to regulate Bangladesh's large and unsupervised microfinance market. A Microfinance Research and Reference Unit was set up at the <i>Bangladesh Bank</i> [www.bangladesh-bank.org/] in 2000. Recommendations have been made and no decisions have been taken for going forward.

General Participation in the Financial Services Market

No. of institutions

No. of clients

Total Assets

Deposits

<i>Banks</i>	49		US \$25.18 billion [1453.06 billion BDT] (as of 2002)	US \$17.74 billion [1023.53 billion BDT] (as of 2002)
<i>Cooperatives</i>	399 (2001) (WOCCU)	106,580 (2001) (WOCCU)	US \$12,120,615 (2001) (WOCCU)	
<i>NGO-MFIs</i>		12.7 million (2002)	US \$3.257 billion [187.339 billion BDT] disbursed, and the total loans outstanding are US \$509.4 million [29.297 billion BDT] (2002)	net savings was US \$208.29 million [11.978 billion BDT] (2002)

General Approach to Regulating

	Legal basis for regulating	Definition or description of institution	Regulator(s) and role of regulator(s)	Activity that determines required regulatory status
<i>Banks</i>	<i>Bank Companies Act, 1991</i> <i>Prudential Regulations for Banks</i>	Any business conducting banking business, meaning accepting deposits and making them withdrawable by check, draft, or otherwise	<i>Bangladesh Bank</i> www.bangladesh-bank.org/ (BB)	Accepting deposits for the purpose of lending or investments
<i>Cooperatives</i>	Cooperative Societies Ordinance, 1984 (cited as "Ordinance."); Cooperative Societies Rules 1987 [cited as "Rule"]	Credit cooperatives are established to create funds to be on-lent to members [Rule 2(2) (vi)]	Registrar of Cooperative Societies	Membership-based societies offering deposit and lending services
<i>NGOs</i>	None		In April 2004, the steering committee of the BB's Microfinance Research and Reference Unit was appointed as interim regulator of NGO-MFIs.	

Organizational Registration

	Laws and regulations governing registration	Agency administering registration	Required legal form of organization	Restrictions on ownership
<i>Banks</i>	<i>Companies Act 1994</i>	Unknown	Company	Unknown
<i>Cooperatives</i>	Unknown	Registrar of Cooperative Societies [Ordinance 6]	Unknown	Must have at least 10 members
<i>NGOs</i>	NGO-MFIs may register under the Societies Registration Act of 1960, the Voluntary Social Welfare Agencies Ordinance of 1961, or the <i>Companies Act of 1994</i>	Depends on legal form of organization	Varies	Unknown

Licensing Requirements and Standards

	Standards for ownership officers	Feasibility study/business plan	Auditing Requirement	Operating Manuals
<i>Banks</i>	Unknown	Unknown	<i>Bangladesh Bank will examine financial position of the company and its ability to pay claims of present and future depositors (at initial and renewal license application)</i>	Unknown
<i>Cooperatives</i>	Shall be set forth in the cooperative's by-laws.	Unknown	Unknown	Unknown
<i>NGOs</i>	Unknown	Unknown	Unknown	Unknown

Risk Management Guidelines

	Guidelines & restrictions on financial services	Guidelines & restrictions on interest rates	Concentration of risk	Connected/insider business

<i>Cooperatives</i>	Permitted: loans and deposits to members; deposit-taking from non-members allowed if outlined in cooperative's bylaws.	Interest rates must be published in cooperative's bylaws	Maximum loans to one member to be prescribed by the rules of the cooperative	Unknown
<i>NGOs</i>	None specified by law, however, most NGO-MFIs both accept deposits and make loans	None currently exist, although fear of interest rate restrictions being imposed may be preventing the furtherance of legal and regulatory reform.		

Reporting and Supervision

	Supervision Method	Disclosure and reporting requirements	Depositor protection mechanisms (e.g., deposit insurance or lender of last resort)
<i>Banks</i>	Bangladesh Bank can carry out on-site inspections at anytime	Monthly reports must include details on all loans Semi-annual asset and liability reports Annual: Balance sheet, profit and loss account, and full, audited financial report	Deposits of all scheduled banks are insured up to US \$1,684 (100,000 BDT) per depositor. (See The Bank Deposit Insurance Act, 2000)
<i>Cooperatives</i>	Surprise on-site inspections as deemed appropriate by the registrar	Annually must provide a report detailing cash accounts, balance sheet, profit and loss account, and a profit and loss appropriation account. Quarterly returns must be submitted by central and national level societies	

Appendix 2: Strategic goals for micro credit in PRSP

Policy Matrix 9: Scaling up Poverty Reduction through Micro Credit

Strategic Goal	Key Targets	Actions taken/Underway	PRSP Policy Agenda (FY 05-FY 07)	Future Priorities	Responsibilities
(1) 1. Reaching the ultra poor	(2) <ul style="list-style-type: none"> Provide pre-credit maintenance and training support Streamline credit delivery through smaller loans, diversified financial services and non-financial support Extend larger sized credit for small entrepreneurs graduating from micro credit-based operations 	(3) <ul style="list-style-type: none"> Extensive micro credit programmes of various public organisations and NGOs New innovations introduced for reaching the ultra poor through GO-NGO collaboration 	(4) <ul style="list-style-type: none"> Extend and deepen GO-NGO collaboration Review delivery systems of major micro credit providers 	(5) <ul style="list-style-type: none"> New experimentation on reaching the ultra poor 	(6) RDCCD, NGOs
2. Supporting mature clients and new entrepreneurs and tomorrow's poor	<ul style="list-style-type: none"> Provide non-financial services such as technology, marketing and risk management Establish networking of specialised service agencies (including public bodies, NGOs and private organisations) 	<ul style="list-style-type: none"> Government policy recommended for providing collateral free larger sized loans to small entrepreneurs Several NGOs providing larger size loans for entrepreneurs 	<ul style="list-style-type: none"> Initiate implementation of policy recommendation on collateral free loans Strengthen capacity building of the entrepreneurs Support entrepreneurship development, product diversification and market development 	<ul style="list-style-type: none"> Put in place an appropriate regulatory framework and legal cover as necessary Provide financial institutions with risk cover including loanable funds Make micro credit available for the "Future Poor" Extend micro credit for the urban poor 	MoF, MoJPA, Financial Institutions, NGOs
3. Using credit as a development tool for the poor	<ul style="list-style-type: none"> Make rules of credit disbursements and repayment more flexible Avoid overlapping Reduce interest rates Ensure supply of loanable funds Regulate savings mobilization and utilisation in a flexible manner 	<ul style="list-style-type: none"> Limited activities undertaken by some NGOs 	<ul style="list-style-type: none"> Initiate coalition of all stakeholders BRDB to collaborate with specialised service-providing public bodies Examine other experiences of separate poverty foundation, e.g. CIDA 	<ul style="list-style-type: none"> Support setting up of specialised service organisation Review experiences in providing business advisory services to new entrepreneurs 	BRDB, NGOs, private sector agro-processing and marketing services organisations including super market chains
4. Making micro credit operationally more effective		<ul style="list-style-type: none"> Some of the NGOs claim sustainability through dependence on own depositors' funds and low operational costs Repayment rules made somewhat more flexible than before 	<ul style="list-style-type: none"> Initiate further deepening of capital for credit operations Examine further reduction of interest rates and provide support to micro credit providers Initiate specialisation in credit delivery 	<ul style="list-style-type: none"> Extend and deepen the various initiatives taken during the rest of the PRSP period Establish a regulatory mechanism through coalition of GO-NGO-community organisations for stricter non-overlapping and savings and deposit management 	MoF, RDCCD, BRDB, NGOs, Private sector service providers

Literature:

- General sources: mixmarket, microfinance gateway, CGAP
- Povert Reduction Strategy Paper Bangladesh, 2005
- www.pksf-bd.org, website of apex organisation PKSF
- Year of MicroCredit, country report Bangladesh
- Hassan Zaman, 2004. The scaling-up of microfinance in Bangladesh: determinants, impact, and lessons. World Bank Policy Research working Paper 3398