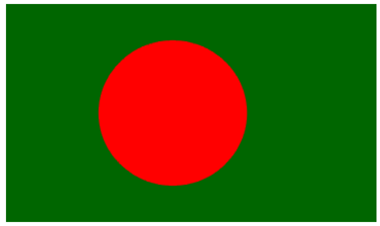

State of Microfinance in Bangladesh

Prepared for

Institute of Microfinance (InM)

As part of the project on
State of Microfinance in SAARC Countries

By

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Disclaimer

Any opinions expressed and policy suggestions proposed in the document are the author's own and do not necessarily reflect the views of Institute of Microfinance (InM). The report also does not represent the official stand of the Government of the countries studied.

List of Acronyms

ADB	Asian Development Bank
ASA	Bangladeshi NGO (formerly Association for Social Advancement)
BBS	Bangladesh Bureau of Statistics
BDT	Bangladesh Taka
BEES	Bangladesh Extension Education Services
BIDS	Bangladesh Institute of Development Studies
BKB	Bangladesh Krishi Bank
BMDA	Barind Multi-Purpose Development Authority
BRAC	Building Resources Across Communities (Largest NGO) [Formerly Bangladesh Rural Advancement Committee]
BRDB	Bangladesh Rural Development Board
BSBL	Bangladesh Sanchya Bank Limited
CARB	Center for Agricultural Research-Barind (a Bangladeshi MFI)
CBO	Community Based Organization
CBN	Cost-of-basic-needs
CDF	Credit and Development Forum
CFPR	Challenging the Frontiers of Poverty Reduction Programme
CIDA	Canadian International Development Agency
COSOP	Country Strategic Opportunities Paper (of IFAD)
CPD	Centre for Policy Dialogue
DANIDA	Danish International Development Agency
DFID	Department for International Development
DOL	Department of Livestock
DOF	Department of Fisheries
EC	European Commission
FSP	Financial Service for the Poorest
FSS	Financial Self-sufficiency
FY	Fiscal Year
GB	Grameen Bank
GDP	Gross Domestic Product
GOB	Government of Bangladesh
HCP	Hardcore Poor Program
HIES	Household Income and Expenditure Survey
IBBL	Islami Bank Bangladesh Limited
IFAD	International Fund for Agricultural Development
IGA	Income Generating Activities
IGVGD	Income Generation for Vulnerable Group Development
InM	Institute of Microfinance
JC	Jagorani Chakra (MFI)
LGED	Local Government Engineering Department
ME	Microenterprise
MFMSP	Microfinance for Marginal and Small Farmers Project

MFI	Microfinance Institution
MFTSP	Microfinance and Technical Support Project
MIDAS	Micro Industries Development and Assistance Society
MIDI	Micro Enterprise Development Initiative (of MIDAS)
MoF	Ministry of Finance
MOU	Memorandum of Understanding
MRA	Microcredit Regulatory Authority
MSME	Micro, small and medium enterprises
NCB	Nationalized Commercial Bank
NGO	Non-Government Organization
OSS	Operating Self-sufficiency
PDBF	*Palli Daridra Bimochan* Foundation (formally RD 12; CIDA-funded BRDB project)
PKSF	*Palli Karma-Sahayak* Foundation
PLDP	Participatory Livelihood Development Project
PMUK	*Padakhep Manobik Unnayan Kendra*
Proshika	A Bangladeshi NGO
PO	Partner Organization (of PKSF)
PRA	Participatory Rural Appraisal
RLF	Revolving Loan Fund
RNF	Rural Non-farm sector
ROA	Return on Asset
RRA	Rapid Rural Appraisal
SAARC	South Asian Association for Regional Cooperation
SB	Sonali Bank
SBL	Small Business Loan
SEL	Small Enterprise Loan
SDC	Swiss Agency for Development and Cooperation
SHG	Self-help Group
SME	Small and Microenterprise
SMF	Small and Medium Farmer
SM-PO	Small and Medium Partner Organization
SSS	Society for Social Services
TMSS	Thengamara Mahila Sabuj Shangha (an NGO)
URDEP	Upazila Resource Development and Employment Project (formerly TRDEP)
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WFP	World Food Programme

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Introduction and Background

Introduction

The Institute of Microfinance (InM), established in 2007 by the Palli Karma Sahayak Foundation (PKSF), has undertaken an initiative to publish the state of microfinance in the South Asian region. The institute has the mandate of offering short and long-term courses for human resources development for microfinance and allied sectors, working as knowledge manager, conducting research and providing technical assistance for development of training and research capacity in and for the microfinance sector. The publication will precede a conference on microfinance involving participants from all South Asian Association for Regional Cooperation (SAARC) member countries to be held in Dhaka and organized by the Institute. The publication is also to fill an apparent absence of any recent comprehensive report on the state of microfinance in Bangladesh and other SAARC countries.

This document reports the state of microfinance sector in Bangladesh. The sector has undergone tremendous transformation in all aspects over the last more than three decades following pioneering works of the Grameen Bank. The very visible changes are outreach and portfolio size, proliferation of microfinance through a large number of microfinance institutions, diversification of services, new regulatory regime, contribution in rural development, and recognition of microfinance and as a major contributor in poverty reduction. The methodology of Bangladeshi microfinance model has been replicated with or without variations in many countries and recognized as an excellent tool for poverty reduction. That has also brought international recognition in the form of Nobel Prize for Peace for Professor Mohammed Yunus and the Grameen Bank.

However, the sector is facing many challenges regarding institutional capacity, quality and diversity of services, fallout from political and macroeconomic factors and so forth. Above all, Bangladesh still remains a poor country with millions of her population living below the poverty line and facing many related challenges of livelihood and vulnerability. The country report discusses on all these issues to give an opportunity to the readers interested in microfinance, poverty reduction and development in general to reflect upon the status and future direction of the sector.

The sector review was undertaken in April-May 2009. The major topics discussed in this report are: evolution of microfinance sector, outreach of microfinance, market and products, financing of microfinance institutions, sustainability of micro-financial services and institutions, impacts of microfinance on poverty, regulatory regime, competition, challenges and future direction.

Objective

The overall objective of the review is to produce a comprehensive document reflecting on the status of microfinance sector of Bangladesh. The review has also reflected on the evolution of microfinance, sustainability of services, emerging issues and challenges.

Methodology

The review is primarily based on secondary and published information. The major sources of information are published research reports and papers, unpublished reports from reputable organizations, data from major institutions such as PKSF, InM, Microcredit Regulatory Authority (MRA), Grameen Bank, BRAC, ASA, some smaller but growing microfinance institutions, network agencies such as Credit and Development Forum (CDF), several international non-governmental organizations (NGOs) operating in the country, commercial banks, Bangladesh Bank (Central Bank) etc. Limited number of interviews has been conducted to develop a picture of the trends as well as challenges faced by the sector. Some anecdotal evidence and case studies are also included.

Data Limitation

A major challenge faced during producing such a report was absence of comparable and up to date data sets. Credit and Development Forum (CDF) used to publish a consolidated report on the sector but the latest published report presents data of 2006. Microfinance institutions also do not follow same reporting dates: some follow financial year and others calendar year. Definitions also vary, e.g. microenterprise loan of one MFI may be considered 'mainstream' microcredit in another MFI. Lack of availability of programmatic as well as financial information for individual financial product is a big challenge for analyzing viability of individual product. For example, hardcore poor and marginal/small farmers are merged with mainstream client groups in some MFIs whereas these are separate programs for others. Segregation of income and expenditure data according to product is rare. Therefore, data have been updated and segregated wherever practicable and estimated in other cases. Information about outreach, institutions, and or programs presented in this report should not be treated as exhaustive.

Organization of the report

The organization of the report is as follows:

Chapter 1 presents very brief background about the study and Bangladesh economy and poverty scenario to put the report as well as microfinance in perspective;

Chapter 2 traces back the historical development of informal loans, various loan programs for farmers and development of microcredit as we know today, the pioneering work of the Grameen Bank, and various lending techniques practiced in Bangladesh;

Chapter 3 provides analysis of present structure, progression of overall outreach and other common issues of the sector;

Chapter 4 reflects on financial market segments and products, and trends, prospects and challenges within each segment of microfinance market;

Chapter 5 deals with various financing arrangements for financing the expanding microfinance portfolio and possible strategy for future resource mobilizations;

Chapter 6 presents analysis on financial viability (sustainability) of sample major and smaller MFIs;

Chapter 7 reports on impact of microfinance on households and poverty as well as access to financial services, especially in rural areas. A brief literature review on effects and impacts of expansion of financial services on creating entrepreneurship and businesses has also been reported here;

Chapter 8 reviews the evolving regulatory regime in Bangladesh along with government role in support of the sector;

Chapter 9 deals with competition among MFIs, its effects and implications on the sector; and finally,

Chapter 10 presents the challenges faced by the sector and possible future direction and agenda for change.

National Governance

An elected government took office in January 2009 following the national parliamentary election held on December 29, 2008. Bangladesh has been facing political instability since late 2006 that followed declaration of state of emergency on January 11, 2007 and installation of a non-elected caretaker interim administration with a mission to introduce reforms in the electoral process and political system. The parliamentary election which was due on January 22 2007 was cancelled but later held on December 29, 2008. The declaration of state of emergency was preceded by a grave political crisis centering on the previously scheduled parliamentary election, with prolonged street violence, blockades and strikes led by the opposition political parties that crippled normal life and economy during late October 2006 to early January 2007. The state of emergency normalized economic life. However, Bangladesh suffered two major natural disasters: two successive floods and cyclone Sidr (November 15 2007) that caused major loss of life and property. Besides, world wide price hike of 2008 has caused severe social and economic hardships, especially for the poor. The politics and economy are still reeling from adverse effect of those events, which are now exacerbated by recession (see below for further discussion). The government is faced with many challenges that are expected to worsen in an environment of global recession. The public expectation from the government, which came to power by promising changes in political and governance culture, and social and economic life, is very high. The major challenges of the coming years will be maintaining political stability, undertaking programs for economic development, maintaining economic growth and keeping promises made during the election. However, the new government has already undone many reforms introduced in political, judicial, local government and economic areas by the preceding caretaker administration. These moves have received adverse criticisms from the press and other stakeholders.

Bangladesh Economy

A brief discussion on Bangladesh economy is presented in three parts: current Bangladesh economy under recession (2009 and onwards), economy under caretaker administration (2007-2008) when Bangladesh suffered from global price hike and natural disasters, and economy during 1990-2006 to reflect on past long-term performance.

World Economy in Recession: Impact on Bangladesh

Although in 2008 the government, banking sector and other stakeholders considered Bangladesh would be immune from US banking meltdown and economic downturn but the situation has become much clearer now in early 2009 that prompted the same stakeholders to change their views about the adverse impacts of global crisis on Bangladesh. The banking system has not been affected by US and European banking meltdown but the real economy has been showing clear signs of slow down. Bangladesh economy is being affected by several factors:

- The recession has hit non-garments exports first such as leather and leather goods, ceramic products and light engineering such as bicycle[1]. The garments industry is still growing but at a much slower pace compared to 2007-08 and price and profit margin have fallen significantly. Overall, the growth in export over the last nine months (July 2008 to March 2009) is 14.51% compared to the same period of last fiscal year.

- The investment in real economy has fallen in all sectors but the decrease is also due to political uncertainty, severe and unprecedented shortage of electricity and gas supply.

- The total flow of remittance has not fallen below last fiscal year but the rate of growth is much slower. There are signs of fall or total stoppage of new job opportunities for Bangladeshi workforce in the Middle-East and Malaysia. In additions, thousands of workers, especially in construction industry in the Middle-east, either lost their jobs or are not getting salaries on time. Many of them have either returned or are in the process of returning home. That will lead to loss of remittance as well as employment crisis in Bangladesh.

- The World Bank has projected GDP growth of Bangladesh between 4.5 to 5.5% in 2008-09. Similarly, the Asian Development Bank has forecasted GDP growth of Bangladesh at 5.6% in FY 2008-09 [ADB 2009]. But the Bangladesh Bureau of Statistics has projected a rate of 5.88%[2]. All figures are much lower than 6.2% growth of FY 2007-08. But the current projected rate is even lower than projected growth figure in national development strategy for FY09 to FY11 that assumed 6.5% growth in FY09, 7.0% for FY 10 and 7.2% for FY 11 [Bangladesh Bank 2008].

- The World Bank has predicted that additional 1% of population may slide below poverty line during the next two years due to worldwide recession[3].

However, pressure on macro-economic management somewhat has been released due to fall in international price of food items and fertilizer and dramatic fall of price of oil from USD 150 to below USD 50 per barrel (Bangladesh is fully dependent on oil imports) that will substantially reduce import bills and subsidy. In fact newspaper report suggested that the government had been making profits from oil imports and sale.

But the country is faced with different kind of problem due to fall in price of rice. The fall in price of rice and wheat has been welcome news for consumers but that has created adverse situation for about 6-7 million farming families because of fall of price of paddy in this (April-May 2009) *boro* (rice) harvest season. The price of paddy has fallen to about Taka 300-450 per *maund* (about 37.3 kg) in rural markets depending on variety compared to GOB procurement price of Taka 720 per *maund* during last season. The market price even climbed at times as high as Taka 900 per *maund*. Farmers made profit from rice production last season but reports[4] suggest expected loss to millions of farmers due to fall of price. GOB has declared procurement price of paddy as Taka 525 per *maund* but that assistance may not reach farmers in this season because the plan is to buy from millers rather than from farmers.

The private sector has been clamoring for assistance in the form of cash incentives. The government has responded by reducing lending rates of commercial loan (maximum of 13% except for consumer loans),

[1] The Daily Star (Star Business), January 25, 2009
[2] The Daily Star, April 26, 2009
[3] As reported in the Daily Prothom Alo, April 20, 2009
[4] The daily Prothom Alo May 10, 2009

subsidized sale of rice for garments workers, and rural infrastructure development for employment creation. Fiscal incentives and development programs are expected to be announced in the next national budget. The government on April 22, 2009 declared a stimulus package for assisting exports, agriculture, power sector, farm loan and social safe net in addition to what has been allocated by the former caretaker administration in FY2008-09 (July–June) budget (Table 1.1). The value of total additional assistance is Taka 3,424 *crores* that has brought the total allocation in these sectors to Taka 14,554. The garments sector though demanded cash incentive but the government wanted to give policy support and monitor any adverse impact on garments export. Overall, the additional support went 43% for agriculture, 18% for power, 15% for farm loan (recapitalization), 13% for export, and 11% for social safety (food). The challenge will be timely and speedy implementation of these plans. Overall Bangladesh is expecting to face slower economic growth, loss of overseas jobs and remittance, and rise of poverty in coming years.

Table 1.1: Stimulus package (Taka in *crores*)

Areas	**Existing support in FY2008-09 budget**	**Stimulus plan**	**% of total stimulus plan**	**Total**
Export	1,050	450	13	1 500
Agriculture	4,285	1,500	43	5 785
Power	600	600	18	1 200
Farm loan	1 000	500	15	1 500
Social Safety (food)	4 195	374	11	4 569
Total	11,130	3,424	100	14,554

Source: The Daily Star, April 22, 2009

Bangladesh Economy 2007-2008

Overall: The caretaker administration came to power on January 11, 2007. During the following two years the government had struggled to manage adverse impacts of floods, cyclone Sidr that devastated 12 southern districts and world wide price hike of food items and oil. During the two years economic growth declined from 6.6% in FY06 to 6.2% in 2007-08 though that was not bad given the world banking and economic crisis. The poor and middle income groups suffered due to price hike in 2008. A significant majority of households had to cut back on food intake, opt for lower quality of food or reduce spending on non-food items to respond to price hike [World Bank 2008]. An estimate by the Center for Policy Dialogue [CPD 2008] reported that 8.5% families (2.5 million) have fallen below poverty line compared to 2005 due to high inflation. GoB provided subsidized food and subsidy to farmers by heavily subsidizing fertilizer and diesel price, expanded food aid to the poor families and launched a 100-day guaranteed cash-for-work program that benefited 2 million poor (Taka 9156.8 million project). The progress made over the years by the poor due to economic growth, social programs and microfinance has eroded considerably due to floods, Sidr, price hike, macroeconomic and political problems. Bangladesh has started a new journey where the results seem to be uncertain largely depending on politics and outcome of recession. This was a period of high inflation: 7% in FY 07 and 10% in FY 08 (food inflation of 12.5%) [Bangladesh Bank 2008]. The growth in 2008-09 is expected to be below 6%. Table 1.2 provides comparative GDP growth between FY05 to FY08. Even with all political and structural odds FY 06 was the highest growth in Bangladesh’s history, 6.6%. Some unofficial estimate shows the figure even higher than 7%.

Table 1.2: Sectoral GDP growth (%)

Sectors	FY05	FY06	FY07	FY08
Agriculture	2.2	4.9	4.6	3.6
Industry	8.3	9.7	8.4	69
Services	6.4	6.4	6.9	6.7
Overall GDP (at FY96 constant market price)	6.0	6.6	6.4	6.2

Source: Bangladesh Bank Annual Report 2007-08

Structure: Major GDP breakdown in FY08 is as follows: 20.8% agriculture, 29.7% industry, and 49.4% services (see Table 1.3). The proportion of agriculture is in decline and industry and service are expanding their share. Still agriculture provides the majority of rural employment with an estimated 6-7 million farming families being the backbone of the rural economy. Agriculture is slowly diversifying from dependence on rice production, with the most rapid expansion being experienced in poultry and livestock and fisheries. Microfinance can legitimately take some credit for this expansion. There has been report of small export of fruits and vegetable that contributes to higher income to the rural families. Within industrial sector the garments sector provided the main growth. The service sector is predominantly whole and retail trade, urban and rural transport, construction, etc. This sector, especially small retail trade and rural transport, is a direct beneficiary of microfinance.

Table 1.3 Sectoral GDP Share

Sectors	FY05	FY06	FY07	FY08
Agriculture	22.3	21.8	21.4	20.9
Industry	28.3	29.0	29.4	29.7
Services	49.4	49.2	49.2	49.4
Overall GDP (at FY96 constant market price)	100.0	100.0	100.0	100.0

Source: Bangladesh Bank Annual Report 2007-08

Rural Income: The major sources of rural income are agricultural production and wage, retail/whole trade, rural transport, microenterprises of various types, and remittances (domestic and international). A country wide survey [MIDAS&ICG 2004] of micro, small and medium enterprises (MSMEs), including those with up to 100 workers, shows there are a total of approx six million such enterprises. About three-quarters of all MSMEs contribute half or more of the household income in both urban and rural areas and over three-quarters of all MSMEs are located in rural areas. In 2003, MSMEs contribute BDT 741 billion to GDP. Depending on how much of this is already included in the official statistics, MSMEs contribute anywhere from 20 to 25% of GDP in Bangladesh.

Increasingly MFIs are targeting microenterprises and farmers as potential customers Studies and anecdotal evidences show that a typical rural poor or near poor households have more than one sources of income: agricultural labour during planting and harvesting seasons, agriculture production in the form of rice/horticulture, poultry/livestock, petty trade and sometimes small production units. Microfinance has enabled expansion of existing income generating activities or starting of such activities that enhance income and diversify sources of income.

Positive Economic Trends of 1990s-2006

Overall: This discussion is to reflect on the overall performance of Bangladesh economy, which is also a period of expansion of microfinance sector in Bangladesh. The progress of Bangladesh has been mixed during the 1990-2006 years under democratic governments. There have been considerable positive changes in many social indicators, even in comparison to the country's better known neighbors. However, there have been disappointments on many fronts, with a failure to capitalize fully on all the opportunities in the social and economic arenas in order to achieve faster economic growth. Nonetheless in the economic arena Bangladesh did well even in an environment of confrontational politics. The estimated per capita GDP in FY 2006 was USD 514. The average GDP growth for 2002-2006 (4 years) was 6%, and year ending June 2006 had the best performance for the last 15 years. The major contributors were export growth in manufacturing, higher remittance growth from Bangladeshi workers, and growth in both agriculture and services. In FY 2006, growth in the industrial sector, agriculture and services was 9.6%, 4.5% and 6.5% respectively, the sectoral composition of GDP being: industry (29%), agriculture (22%) and services (49%). The classic long-term shift has been taking place with the move away from agriculture towards manufacturing and processing, and to services.

The domestic savings-GDP ratio rose from 20.0% in FY 2005 to 20.3% in FY 2006 and investment-GDP ratio rose form 24.5% in FY 2005 to 25% in FY 2006. Bangladesh has been able to attract important foreign investments but the future flow depends on political stability. The Government in 2006 was looking to a sustained 7% overall GDP growth rate from 2008 and onwards but as discussed above, that did not materialize.

Bangladesh exports experienced a 22% overall growth in FY 2005-06 reaching over USD 10 billion. The doomsday scenario of collapse in the garments sector due to the end of Multi Fibre Agreement (MFA) in 2005 was proven wrong. Export surged both in sewing (13.5%) and knitting segments (35.5%). Bangladeshi entrepreneurs and workforce had proven their resilience, acumen and efficiency. Remittances from Bangladeshi economic migrants through formal channels reached USD 4.8 billion in FY 2005-06, a 25% growth over the previous period; it was also estimated that a similar amount came in through informal channels.

Inflation: Bangladesh enjoyed a low inflation rate below 3% between 1990-91 to 2001-02 but the rate grew to 6.5% in 2004-05 and reached 7.2% in October 2006. This was due to internal demand, depreciation of Taka (8.5% in FY 2006) and increase in commodity prices in the world market, especially of oil. Being a fully oil importing country Bangladesh was hit hard; this led to an increase in transportation costs and agricultural inputs, especially diesel for irrigation. The government has responded by restrained monetary policy, tightening credit supply and an increase in interest rate.

Poverty declined: We mentioned above that the poverty is expected to rise by reversing a trend of 1990-2006. The Household Income and Expenditure Surveys (HIES) conducted in 1995/96, 2000 and 2005 using cost-of-basic-needs (CBN) method showed that poverty has been reduced across rural and urban areas: in 2005 about 40% of people lived below upper poverty line compared to 48.9% in 2000; and in 2005 about 25.5% lived below lower poverty line compared to 33.7% in 2000 (see Table 1.4). In CBN method two poverty lines are estimated: i) Lower poverty line and ii) Upper poverty line. There are two ways of defining these two poverty lines; food and non-food poverty lines. The food poverty line is determined by a) selecting a food basket of 11 items to meet the daily nutritional requirements of 2122 Kcal, and b) estimating the cost of acquiring the basket. A non-food poverty line is calculated by estimating the cost of consuming non-food goods by the households close to food poverty line. The lower poverty line represents extremely poor households whose total expenditures are equal to the food poverty line. The upper poverty line represents moderately poor households whose food expenditure is at the level of food poverty line.

Despite population growth (total est. 137 million in 2005) Bangladesh has experienced real growth and reduced poverty. For example, poverty shrank by 9% between 1991-92 and 2000, at the rate of 1% pa, and by 8.9% between 2000 and 2005, at the rate of 1.8% pa, and this reduction even touched the poorest of the poor. Extreme poverty has declined based on a headcount index using direct calorie intake method and nutritional indicators have improved. Both urban and rural poverty has declined though a huge disparity between rural and urban extreme poverty continues to exist (43.4% versus 28.4%) (see Table 1.5). Further, because of the population growth, the absolute number of poor has remained very high [World Bank 2002].

Table 1.4 Trends in Cost of Basic Needs (CBN) poverty measures

	Upper Poverty Line				**Lower Poverty Line**			
	1991-92	1995-96	2000	2005	1991-92	1995-96	2000	2005
HEAD COUNT RATE (Po):								
National	**58.8**	**51.0**	**48.9**	**40.0**	**42.7**	**34.4**	**33.7**	**25.5**
Urban	44.9	29.4	35.2	28.4	23.3	13.7	19.4	13.7
Rural	61.2	55.2	52.3	43.4	46.0	38.5	37.4	29.3
POVERTY GAP (P1):								
National	**17.2**	**13.3**	**12.9**	**9.0**	**10.7**	**7.6**	**7.3**	**4.6**
Urban	12.0	7.2	9.5	6.5	4.9	2.6	3.8	2.6
Rural	18.1	14.5	13.8	9.8	11.7	8.6	8.2	5.3
Total population (million)[5]	115.42	121.55	128.15	137.0	115.42	121.55	128.15	137.0
Population below poverty line (million) (Po)	**67.87**	**61.99**	**62.66**	**55.08**	**49.28**	**41.81**	**43.19**	**34.94**

Source: World Bank (2002) and HIES (2005) by Bangladesh Bureau of Statistics (BBS)

For the poor, agricultural labour is the main source of income (37% of households) followed by agricultural and non-agricultural self-employment which account for 28% and 26% respectively. There has been an overall rising trend in non-farm income, mostly in the self-employed category. Rising access of the poor to microcredit, rapid expansion of overseas workers remittances, and improvements in physical and social infrastructure all contributed to the sharp drop in poverty [ADB 2007].

Growing income inequality: Although GDP growth has been consistently around 5%, income distribution deteriorated both within rural and urban areas and between the rural and urban population, as reflected in worsening Gini coefficients (Table 1.5). A more recent study reports regional disparity between eastern and western part of the country [World Bank 2008].

[5] Source: projected from ADB, Key Indicators of Developing Asian and Pacific Countries. www.adb.org

Table 1.5: Trends in inequality: Gini Coefficients

	Upper Poverty Line				Lower Poverty Line		
	1991-92	1995-96	2000		1991-92	1995-96	2000
National	**0.259**	**0.302**	**0.306**		**0.272**	**0.315**	**0.318**
Urban	0.307	0.363	0.368		0.311	0.369	0.370
Rural	0.243	0.265	0.271		0.251	0.267	0.275

Source: World Bank (2002)

Nutrition status: Along with rising incomes there is evidence of an improvement in the nutritional standards of the overall population: consumption of fish, poultry, meat, and milk has increased across income groups, and in both urban and rural areas. Anthro-pometric data also suggest good progress on child nutrition. Nonetheless, with 50% of children under 5 years of age affected by stunting or underweight, Bangladesh still suffers one of the highest levels of malnourishment in the world, especially in its rural areas, and amongst the poorest, with the greatest concentration in coastal areas and northern districts[6].

Child mortality: Bangladesh has also made great improvements with respect to reducing child and infant mortality as well as fertility rates. Throughout the nineties the infant mortality rate decreased by 42%, while between the mid 70s to the 90s the total fertility rate dropped from 7 live births per woman to 3.3. The gap between the rural and urban areas persists, however, with rural areas suffering from higher rates of all indicators across the board. Although government and NGO managed health services have increased, access to health services is still a problem.

Girls exceed boys in school enrolment: Literacy rates improved from 1991 to 2000, but are still unacceptably low. About 59% of the rural population of 7 years and above are illiterate compared to about 72% in 1991; this compares with today's 33% in the urban areas. But Bangladesh can claim an overall success story in school enrolment of children in 6-10 and 11-15 age categories: overall 80.4% children of 6-10 age and 69.9% of 11-15 age attend schools. Urban areas fare slightly better than the rural areas. The gender gap has been eliminated, in fact reversed: more female children attend schools than male (81.3% compared to 79.5% in 6-10 age category and 74% compared to 66% in 11-15 age category) [World Bank 2007]. This is the result of proliferation of schools, free education for girls, motivational campaign to send children to schools, food/cash for education programs, and highest annual budgetary allocation for the education sector. But the drop-out rate is still high and the quality of education has been reported to be poor in rural areas.

Access to safe water: More than 95% people have access to safe drinking water (tube well water) but the surprising rise of arsenic in up to 300 feet of aquifer almost all over the country has created a tremendous problem. Access to sanitation has also improved.

[6] WFP, The Food Security Atlas of Bangladesh, p.17

Microfinance as Poverty Reducing Tool

The success of microcredit Bangladesh has led to using it as a major tool in national poverty reduction strategy by both the government and non-governmental organizations. The popularity of microfinance has made it the core activities of hundreds of microfinance institutions in Bangladesh. As we will see later in the report that due to support from the government and acceptance by people, microcredit has become the main form of rural finance. The case of microfinance in Bangladesh is a good example of non-government organization led operations where the government directly and indirectly provided major policy and material support to make it probably the largest microfinance sector in the world. We have also discussed the possibility of rising poverty in Bangladesh due to external factors and no fault of the poor. Microfinance may need to bear more responsibilities in this environment. Readers should look into the country report with this perspective in mind to appreciate the significance of microfinance.

Historical Perspective and Microcredit Modalities

Introduction

Microfinance refers to a range of financial services such as savings, credit and insurance for the poor. In 1980s and early 1990s, a more popular term was microcredit to emphasize the main service, i.e. credit to the poor though small savings has always been an integral part of microcredit programs. Although the practice of borrowing small amount of money for investment and consumption purposes has been common in Bangladesh but the modern organized, systematic, group-based and institutionalized microcredit operation is a Bangladeshi innovation pioneered by the Grameen Bank and replicated all over the world with local modifications and adaptations. The program has enjoyed explosive growth here and elsewhere and given hope to millions of poor women and men to generate income to rid of poverty. The microfinance management system has solved structural problems of targeting and delivering financial services to millions of poor people. It will be useful and important to briefly trace back the history of informal lending and other forms of small loans available mostly in rural areas to appreciate context and impressive changes that occurred due to micro-financial services offered by institutions.

The practice of giving and taking loan from informal sources is very old for purposes such as food consumption, medical treatment, festival, education, farming and other forms of investments. The informal sources include friends and relatives, neighbors, shopkeepers, and traditional moneylenders. Poor and not-so-poor people usually borrow under distress conditions. The loans may be interest free or with interest as high as 5-10% per month. The practice still continues even after massive expansion of microcredit in rural and urban areas for various reasons: demand for financial services by various groups of people/clients is too big to be handled by MFIs; mismatch between demand and supply in terms of timing and amount; MFIs are yet to meet the big demand from farmers who are the principal borrowers from moneylenders; failure of commercial banks to meet at least part of the demand. Informal money lending is expected to continue.

Commercial banks, agricultural banks, cooperative societies were the principal sources of small loans for various types of clients: farmers, traders and ‘cottage industries’ before the advent of the Grameen Bank and other MFIs. These institutions continue to provide some small loans to selected clients but not normally to the poor. The limitations of commercial bank loans were well-known: banks ask for collateral for disbursing loans and their branch networks were limited to urban centers. This was true before the independence of Bangladesh. After the independence the Nationalized Commercial Banks (NCBs) greatly expanded their branch networks in small towns and bazaars but their lending policies remained the same: they target the traders/businesses who could offer collateral. Although there have been many projects for NCBs for providing agricultural loans to the farmers the banks normally failed due to many institutional weaknesses. But the major issue remained that the expansion of branch did not help to bring the poor under financial services. NCBs tried to imitate Grameen Bank model to lend to the poor but did not succeed and changed strategy to become wholesale lenders to the MFIs working as retailers. The private banks have never been interested in small loans or poor people and the culture remains the same even today with the exception of Islami Bank Bangladesh Limited which has a large retail microcredit operations. Some private commercial banks have lately gone into wholesale lending (see Section 5 on wholesale microcredit operations of commercial banks). Agricultural Development Bank (later become Bangladesh Krishi Bank – BKB and Rajshahi Krishi Unnayan Bank- RAKUB) was the principal institutional intervention for supporting agriculture and farmers. BKB and RAKUB mainly targeted and still target the small, medium and large farmers who could offer land as mortgage. The performance of these two specialized banks has always been poor and largely avoid the poor and both are deeply insolvent [Ferrari 2008]. BKB and RAKUB also undertook many microcredit operations either directly managed by own staff members or through management of various donor funded projects, where the performance in terms of loan repayment was very poor mainly due to institutional weaknesses.

Cooperative societies tried to reach the small and marginal farmers in 1960s and 1970s as a follow on to the success of the Comilla model. Several distinctive features of Comilla model were as follows: targeting the farmers, especially the small farmers; introduction of technologies (HYV seed, chemical fertilizers, irrigation and new farm practices); loan was given to the farmers against land mortgage. In Comilla, farmers immensely benefited but the approach failed when copied nation-wide by the government under Bangladesh Rural Development Board (BRDB) [initially under a project called Integrated Rural Development Program]. Many reasons have been cited but the main reason was failure of government system to replicate a ‘movement’ under the leadership of Akhter Hamid Khan. The relevant issue here is that the Comilla cooperative system also could not organize the poor for delivering financial services. BRDB later introduced many microcredit projects funded by bilateral and multi-later donors with some initial successes but on the whole the programs should be termed as unsustainable (see Section 3 and Section 6 and also Khandkar and Khalily 1996). But some traditional cooperative societies have been found to be successful within trading communities (in urban and rural markets), within staff members of various organizations, various professional groups such as various vehicle workers and owners. They are known for investing in trading, real estate, vehicles and consumer loans but the poor are not their beneficiaries. There are examples where cooperative societies introduced microcredit for the poor. Reportedly the Cooperative law allows microcredit operations, however it is beyond the scope of this report to fully deal with financial services from cooperative societies.

Grameen Bank’s Breakthrough

What we find in all cases above, that is, informal loan, commercial banks (government and private), agricultural development banks and cooperative societies that none was designed to provide financial services to the poor, and policies, practices and human resources of these organizations either consciously or not were anti-poor. The Grameen Bank broke the barriers by developing a different kind of organization for the poor and to serve the poor with financial services. The story of Grameen is pretty known now in Bangladesh and elsewhere but is briefly presented here for completeness of the report as well as for understanding the basics of Grameen model and changes introduced over the years within the microfinance management system. The Bank started as project in 1976 and became a formal independent financial institute in 1983 under the Grameen Bank Ordinance 1983. Detail story of background and formation of Grameen Bank is available in (Counts 1996).

The Grameen approach has broken all barriers for reaching the poor with credit by introducing the following critical steps:

a) Target the poor people, mainly women who bear the burden of poverty. This has been made operational by accepting members/clients who own less than 0.5 acre of land (functionally landless). By targeting exclusively the poor the approach ensures services for the poor and eliminates possibility of enlisting rich people taking advantages of the service;

b) Accept primarily women as clients who repay loans on time, invest monies for productive purposes and spend income to improve the quality of life of family members; the process empowers them (women) as well;

c) Groups of 5 persons are formed and 30-50 members form a Kendra/centre, which is the organizational structure in a *para/*village where bank staff visits to make transactions;

d) Loans are collateral free; but to ensure repayment poor women are organized into groups to take responsibility of repayment (over the years it has been found that group responsibility has eroded considerably but still poor people repay more or less regularly);

e) Loans are small that is manageable by the poor and repayment are also small collected in weekly installments;

f) Instead of coming to the bank the approach takes financial service at the door of the poor; Bank's staff members collect supervise and take care of all management tasks similar to any commercial bank.

g) Procedures for loan applications and other administrative steps have been simplified to suit the poor.

h) All financial transactions are made in public to eliminate any possibility of corruption.

i) Experience shows that loan money is normally invested in commonly available activities such as livestock rearing, trading, agriculture production and small processing operations.

The Replication of Grameen Approach

But the main breakthrough was in the mindset of bankers and other people that the poor are bankable and they utilize loan and repay on time, lot better than commercial banks' wealthy borrowers. The Grameen experience by 1983 had proven that with right kind of savings and loan products, policies and management system and human resources, i.e., an appropriate institution with a mission to serve the poor could not only reach them but also make a viable financial institution. The simplicity of methodology developed by the Grameen Bank has inspired many non-governmental organizations to hurriedly replicate the model and offer similar financial services to the poor. The main incentives for NGOs which were normally involved in many social programs such as education, health, relief and rehabilitation to move quickly into microcredit were demand from the members, opportunity to become self-reliant (income covers expenses), and creating sustainable permanent institution, and career for staff members. The variations were in interest rate, savings and loan ceiling, size of groups etc not much on the fundamental structure of the model. Some of variations present today are summarized below:

- *Group formation:* The size may vary between 20 to 50 persons. MFIs do not strictly follow 5-member group structure of Grameen, instead they form one larger group called *samity* with women/men from the same neighborhood.
- *Savings policies:* The amount of savings may vary among members as well as organizations. Normally MFIs would lend only after deposit of several weeks or certain amount of money. Withdrawal of savings was restricted in earlier days is now lot more accessible. Still a few major institutions restrict withdrawal of savings to use the money as loan as well as cash collateral. Interest paid on savings may vary between 4 to 8.5% (Grameen Bank).
- *Loan policies:* Loan amount widely vary among MFIs; normally starts with small size and increase in successive loans. Interest rates vary between 20 to 30% per annum expressed in so called flat rate. Loans are collected in weekly installments but in some cases in monthly and one installment. Although in earlier

days clients were required to wait 1 to 6 months before receiving first loan but now a days due to competitive pressure first loan to a member may be disbursed within days of joining a group.

Prevailing Lending Modalities

Three different types of lending technologies are applied in Bangladesh:

- *Grameen styled group-based system*: Bangladesh microfinance sector for all practical purposes is dominated by basic group-based methodology pioneered by the Grameen Bank. The basic structure is as follows: Poor women and men are organized in groups or *samities* who meet once in a week to deposit small amount of savings to build their own capital. The Bank or MFIs lends one-year loan (some MFIs recover the loans within 43-46 weeks), which a borrower repays in equal weekly installments along with interest. Once a borrower repays one loan she is qualified to receive another loan normally of higher amount within the overall loan ceiling, which of course, is revised upwards with time. The technique has been found so robust and effective that almost entire industry follows this approach with minor adjustments in savings/credit policies such as interest on savings and loan, savings withdrawal rules etc. Currently nearly 33 million women and men transact every week by following this basic system. However, over time the Bank as well as other MFIs have changed their systems to offer more than one type of savings and credit products as the nature of demand has changed and MFIs have also learned to deal with more complex situations. Still we find basically two types of criticisms even against such a popular methodology: i) one group of critics/activists believes that the collection and management of savings should be job of the poor people. Loan should be made available to the members from the savings funds. But if they need additional funds that should be delivered from the formal financial institutions or in Bangladesh from an MFI, which has been organizing the so called ‘self-help’ groups in first place. Self-help groups should be treated as ‘people’s organizations’, which perform other social responsibilities in addition to providing financial services. ii) Another form of criticism is about the ‘rigid’ or ‘inflexible’ nature of group-based system. Critics feel that the weekly repetitive system does not match with poor people’s financial demand, therefore, the financial products should be ‘flexible’ or ‘demand driven’.
- *Self-help group system*: A handful of non-government organizations have tried and are still trying the so called self-help group approach of developing financial service delivery system. In this case, the promoter or the NGO organizes self-help groups with the objective of facilitating savings mobilization for the poor women/men from among themselves. If the participating members need loan they can borrow from their samity i.e. from their own savings funds. If the funds are not adequate, the self-help samities may try to borrow from banks or the NGO supplies the additional capital. The second option has been tried in Bangladesh but the first option has been found not realistic. All management responsibilities of savings and credit are expected to be taken care of by the leaders of the groups. But in real life often such educated leaders are not always available and in many cases NGO field officials perform this job. We do not find any reasonably large-scale financially viable operation that follows this approach. This type of community-based microfinance whilst popular in some countries has not been found to be successful in large-scale operation in Bangladesh. There have been some efforts from several NGOs (for example, Ashrai, Caritas, Concern Worldwide) and donor-funded projects to develop alternative systems but none could stand as a viable alternative. In general, this approach has failed to take off the ground to be considered as a serious alternative in Bangladesh. Self-help Groups (SHGs) or CBOs start with much enthusiasm but within a short period fail to continue due to many management problems. Some common problems are as follows: poor loan recovery rate; inability to keep proper accounts by illiterate people; poor management skills of SHG leaders/managers; often leaders do not give adequate time to keep the system running; misappropriation of funds by leaders and or influential individuals; maintaining funds in banks and dealing with banks; and inability to safe keeping cash balance in the village.

- *Individual lending system:* The central issue to developing individual system as opposed to group-based system is to offer flexible and demand-driven services to each client/borrower. Group-based system is viewed as 'one-size fits all' system. The individual lending technique, i.e. to offer savings and credit service to each individual according to the demand of that individual client. The flexibility may come in the form of amount and frequency of deposit of savings, loan amount and duration of loan, repayment of loan amount and frequency of installments (not having a predetermined schedule is considered flexible) etc. But lending to individual does not necessarily make it fully 'flexible'. For example, ASA and BRAC under their respective microenterprise loan program disburse loan to individual client but offer fixed one year loan and fixed monthly repayment system.

- Informal moneylenders are another traditional source of micro-loans that follows 'individual lending'. No rigorous up to date information and analysis are available about their operations. However, it is believed, based on anecdotal evidence and small studies that the rural poor do not have to depend on money lenders for small loans any more due to proliferation of MFIs. They have the opportunity to borrow for investments and in some cases consumption purposes as well, from one or more MFIs. Yet moneylenders can still be found lending for emergency loans to the poor and also for agricultural loans due to the absence of large-scale agricultural loan from MFIs.

Types of Clients Targeted by MFIs

Indicators Used in Microfinance Programs

One of the contentious issues has been the definition of poor to include them under a microcredit program. The targeting of the poor is important to ensure that the loan reaches the poor not the wealthier families. Grameen Bank used a practical definition: land criteria, that is, members from a family owning less than 0.5 acres of land can join microcredit groups. Some earlier studies [BIDS 1990] reported about 30% non-target families mainly from the marginal farming families usually participate in the groups/samities. However, over time microcredit has expanded to capture other poor and non-poor groups as well. We will later discuss the concept of market segmentation to clearly indicate that new and finer definitions have emerged over time. We shall briefly describe some common indicators often mentioned in development and microfinance literature and their applications in the context of microfinance programs. It is often found that MFIs break-down those definitions into practically identifiable criteria to define market segments and corresponding financial products. Several examples follow:

- *Nutritional definition*: Often poverty, poverty line and poor people are categorized according to calorie intake, which is a good definition for analytical purpose. For example, a person's income to afford daily food consumption for at least 1800 Kcal is categorized as hardcore or extreme poor. But this definition has little application to a credit officer of an MFI who is interested to quickly identify such persons to include under hardcore poor financial services program. To circumvent the practical difficulties more operational but proxy indicators or criteria are devised that may approximately find the same group of people. For example, families without any homestead land or strong house, any male member or earning member, very irregular income, live on charity etc. may be used as working criteria for identifying such people. Not in every case these proxy indicators will identify the right persons but in most of the cases they do. Importantly the proxy indicators are very easy to apply at a low or no cost without requiring any additional formal research.

- *Land-based definition*: Microcredit programs in Bangladesh have traditionally used land ownership criteria to determine target group. The most common definition is landless and assetless people as the target population. Landless is defined as any person owning less than 0.5 acre of land. But sometimes MFIs also see the quality of land, that is, this definition is relaxed according to geographical areas. Similarly marginal, small, medium and large farmers have been defined according to land size. This definition can very easily be applied. However, it does not mean that credit officers go out to measure lands of potential clients. It is easy to learn in a village who are landless and who are landed families.
- *Housing characteristics*: Quality and size of house has been very popular criterion in microfinance sector to determine qualification of a person for regular microfinance program. House is a very visible asset.
- *Income criterion*: Often income criterion is mentioned in various documents as determining criteria for inclusion in or exclusion from a program. This is also not so practical criterion because of difficulty of income determination though sometimes credit officers informally check income levels of participating families.
- *Profession:* Profession-based indicators are easy to identify and apply such as small and marginal farmers, day labor, weavers etc.

Due to competition in the sector often MFIs do not strictly apply land or income criteria for selecting a member or customer. The current practice is to find out a more or less a homogeneous group of village women who are willing to take small loans, meet once a week and follow other rules and regulations. It boils down to accepting any woman who is happy to join a group and remain happy with small size loan. No formal selection process is applied or necessary. This is precisely the reason why researchers often find about 40% 'non-target' members in microcredit programs. However, exclusion criteria may be applied, i.e., hardcore poor women may be excluded from a regular microcredit program by other members and or by Loan Officers. That led MFIs to design separate programs for hardcore poor women who are then identified using more stringent targeting criteria and process.

Common Features of Poverty Groups

In the rural context, the following characteristics can be attributed to poverty groups:

- *Extreme/hardcore/very poor/ultra poor:* These terms are often interchangeably used by microfinance institutions for targeting the same category of the poor people. The most likely social indicators would be as follows: illiterate persons, no sellable skill other than manual labor, poor nutrition and health conditions, poor sanitary situation; may face food insecurity in 2-3 months of a year; may not have any influence in the village. Housing and other asset holding may be as follows: may or may not have own house; in case of own house it is expected to be made of cheap local materials; do not own any cultivable land. Income and employment characteristics are expected to be as follows: irregular small income often affected by agricultural seasonality; work as domestic help and day labor or live on charity; little household assets; may not have any livestock. An estimated bottom 10-15% of rural families may fall under this category.
- *Moderately poor*: The biggest segment of rural households will fall under this category. Most of the households are expected to have own small house, homestead land, small piece of agricultural land. These families are no more food insecure families. Adults are illiterate or some may have attended primary schools but children attend primary school. These families may have more than one sources of income such as crops, poultry and livestock, petty business and a portion of the families may have members having low paid jobs. Many marginal farming and share-cropper families are also in these categories. About 50% rural households may fall under this group.
- *Near poor or vulnerable non-poor*: This category in rural context is expected to have good strong house, agricultural land (1-2.5 acres), access to sanitation and safe water within the houses. Adults may be literate and may have high school or higher education, and children are expected to be better educated than their

parents. These families are expected to have more than one sources of income: crops from land, livestock and fisheries, shops and other businesses and in many cases family members will have jobs within the country and outside the country as expatriate workers. Remittance is an important source of income.

- *Wealthy families in rural context*: Invariably this category of families will have large chunk of land (may be leased out) (sometimes called medium and large farmers), good houses and access to all urban amenities. Normally these families will have several sources of income: land, commercial fisheries and livestock, jobs (within and outside the country) and large businesses in urban/peri-urban areas (shops and processing types). These rural elites who influence all important events of village life.

Terminologies and Targeting

Many different terminologies have been used in the literature as well as by institutions including the Palli Karma Sahayak Foundation (PKSF), Nongovernmental Organizations (NGOs), MFIs, and research organizations to indicate poverty category and corresponding financial market segments. For example, terms like microfinance for poor, moderately poor, very poor, extreme poor, hardcore poor, ultra-poor etc. are in abundance. The criteria for such definitions also vary such as calorie intake, land and other asset ownership, employment type and regularity, remoteness, marital status, nature of household heads etc. Institutions for various reasons use such terminologies and corresponding identification criteria. The reasons could be simply convenience or an attempt to precisely define target groups to deliver services, cost consideration, practical difficulty of applying some theoretically accurate but practically difficult criteria to apply in a real life situation. Or sometimes it may not be necessary to make any precise definition at all. People may generally understand from experience what is meant by certain terminology. Table 2.1 provides common classification of poverty groups and corresponding financial services needs. Note that Table 2.1 is a mix where in case of poverty groups the poverty criteria such as calorie and income are used as identification criteria. Whereas in case of farmers (who may or may not be poor) and microenterprises (generally non-poor) land and enterprise related criteria have been used.

'New' target groups for MFIs: Aggressive expansion of microfinance in rural and urban areas by competing MFIs, i.e. Grameen Bank and the NGO-MFIs, has created a situation warranting a revised definition of target beneficiaries of microfinance programs. In official documents the definition still remains 'poor people' having less than half an acre of land or some other income and employment criteria. In reality, however, field officials/credit officers of MFIs have little concern about the official definition. Women from so called 'non-target' groups, mainly from marginal farmer category, are joining in large numbers. The attitude about microcredit has changed over the time.

In earlier days, Grameen Bank was seen as 'Beggars' Bank. Rural elite and middle-class avoided microcredit because to borrow from MFIs they had to sit with poor women in the same groups, which went against their dignity/*samman*. Over the last two decades, the Grameen Bank together with many NGO-MFIs now operating in Bangladesh have become permanent features of rural financial life and formal/institutional sources of loan with costs far lower than moneylenders' rates. At the same time due to their contributions and national and international admiration, MFIs have achieved social recognition as well. That means, two compelling forces – the urge to expand services to maintain portfolio growth and the demand from former 'non-target' groups - have been contributing to the expansion of services as well as the need to redefine the 'target group' for microcredit.

A new definition of 'target recipient' has now emerged: anyone in rural or urban areas who wants to take a small loan by accepting the institutional arrangements of the MFIs, i.e. group meetings, mandatory savings deposits and repayment schedule is a 'member' or 'client'. Irrespective of actual economic conditions, such an individual is now a target recipient and includes nearly 90% of rural households. It only excludes the larger farmers and other richer families. It does not mean that microfinance now excludes the poor; far from it since the ongoing expansion thrust already includes most, if not all, of the potential moderately and hard core poor borrowers under one or more of the existing programs. The inclusion of former 'non-target' groups means simply broadening the outreach. In addition, there are two deterrents for richer borrowers joining mainstream microfinance: i) small size of loan; and ii) higher interest rate of microcredit (25-30%), which is almost two-three times the rate of commercial banks (10-13%), the normal sources of loans for richer borrowers.

Table 2.1: Microfinance Market Segments and Possible Product Features

Target Beneficiary Segments	Characteristics of Each Segment	Service Needs of the Beneficiaries (financial and non-financial services)	Common Strategy Followed in Bangladesh
Hardcore poor (Extremely poor or ultra-poor)	Daily calorie intake: less than 1 800 K calorie Land ownership: less than 0.15 acre Per capita annual income: Taka 3757 (1994) Food deficit status: Chronic	Primarily savings services; Starts with small loans; skill training; Food aid	Skill training Savings services Small amount of loan Food aid and asset transfer
Moderately Poor	Daily calorie intake: less than 2 112 K calorie Land ownership: less than 0.5 acre Per capita annual income: Taka 6287 (1994) Food deficit status: 30-40% above poverty line	Savings and credit services; Flexibility in services desirable; Selective productive skill training	Savings and credit services
Marginal farmers	Land ownership: less than 1.5 acre Per capita annual income: Taka 8368 (1994) Food deficit status: break-even	Agricultural extension services; Selective training on non-crop income generating activities; Savings and credit services.	Limited number of NGOs is in this market segments; some marginal farming families included in regular microfinance groups. Savings and credit services
Small Farmers	Landownership: less than 2.5 acre Food deficit: Surplus Normally no-poor	Agricultural extension services; Training on diversification in farming and other areas and new farming technologies; Savings and credit (larger and seasonal loans); Access to market and farm inputs.	A few NGOs are involved; mainstream NGOs are yet to get involved in this market segment; limited savings and credit services.
Microentrepreneurs	Managed by owner; less than 10 employees Partly linked with mainstream market May possess capital machineries Investment normally higher than income generating activities; Need larger loans	Credit services (substantially larger: $500-$10 000) Business development services including access to market and product development.	Credit service similar to regular microcredit with larger loan size.

Sources: IFAD COSOP 1999; MIDAS and ICG (2004); Wright and Alamgir (2004); McKennie and Rahman (2003); Analysis of various NGO and GOB projects by the author

Structure and Aggregate Outreach Analysis

Definition: Microcredit versus Microfinance

Microcredit versus Microfinance: The term microfinance is relatively new in Bangladesh. A more popular and practical term has been microcredit, which emphasizes the main focus of the various financial institutions involved, although small savings has always been a part of microcredit operations. Gradually, in response to demand, other services such as savings, insurance (life and non-life) and remittance services have been developed or being piloted and are now being bundled together under the term microfinance. Another important feature has been the focus on the poor. These focuses very much remain but the MFIs offer services to non-poor such as small farmers and microentrepreneurs. Therefore, the scope and target beneficiaries have evolved over time since the establishment of the Grameen Bank in 1983. In 2009 the term microfinance includes many financial products for both the poor and the near-poor.

The Grameen methodology has enjoyed explosive growth and given hope to millions of poor women and men seeking to generate income in order to rise out of poverty. Indeed the microfinance management system has solved many of the structural problems of targeting and delivering financial services to millions of poor people.

The microcredit program in Bangladesh rightly began by targeting the rural poor, especially women, as a development intervention strategy. Microcredit serves not only to meet financial needs but also contributes to other social and institutional development issues such as women's empowerment, bringing the rural poor into an institutional service network, and reducing the dependency on informal money lenders. The management system of microfinance programs has evolved over time but commonly have the following features:

- Women are the main recipients of microfinance services though many MFIs now have male members/clients;
- Group-based lending methodology is the main system of delivery of microfinance services, although commercial banks and a number of MFIs offer loans to individual clients. In early 1980s, especially in Grameen Bank, groups not only meant a collection of members for administrative purposes but also meant group liability. In case of loan default by a member, the group would take responsibility for the repayment of the defaulted loan. But now the group-based system provides just a low-cost management structure, without any responsibility of repayment; that is the responsibility of the individual borrower. However, groups do serve another practical purpose, as a filter for screening individuals for membership;
- The microfinance sector in Bangladesh is now dominated by NGOs offering microfinance services, collectively known as NGO-MFIs, which offer financial services as 'private not-for-profit businesses' but strive to achieve institutional and financial viability as soon as possible;
- MFIs are diversifying into other target segments, including near-poor groups, by developing new financial products along with the traditional management system. This diversification strategy is not only helping portfolio growth and outreach but also transforming NGO-MFIs as permanent financial service providers for both the poor and the near-poor, amongst both the rural and urban populations. NGO-MFIs have now become a new class of financial institution in Bangladesh financial markets.

Three categories of institutions offer micro-financial services: banks; non-bank government departments and agencies; and non-profit NGO-MFIs (in addition to Grameen Bank). The analysis and discussion below covers all three categories although the last category, the focus of this report, is the most dynamic and flourishing. The schematic table below gives the target market for each type of institutions:

Table 3.1: Market segments for microfinance

Market segment for credit	Notional Loan Size (Taka)	MFIs* [approx. 800]	Non- Bank Government Dept.	Banks[7] [47]
Hardcore poor	500-5,000	x		
Moderately poor	5,000-30,000	x	x	x
Small and marginal farmers	10,000-50,000	x	x	x
Microentrepreneurs	30,000-500,000	x		x

Source: Categorized by the author as per present policies of MFIs; * Not all received from MRA

Financial Services by Grameen Bank and other MFIs

Sector Structure

In terms of memberships/clients (and consequently portfolio size) the structure of the microfinance sector is as follows:

- *Three very large MFIs*: Three very large organizations – ASA, BRAC and Grameen Bank- dominate the microfinance sector, each having more than 7 million members/clients in 2008 (ASA 7.28 million, BRAC 8.15 in March 2009 and Grameen Bank 7.67 million) all products combined (see Table 3.2). These three organizations had embarked on a major lateral expansion beginning 2003/04 that led to doubling or tripling their sizes by 2008. These three MFIs have achieved spectacular lateral expansion, that is, to include new clients in same or new geographical areas by enhanced management efficiency, standardized management practices, products and policies, and mobilizing financial resources. The three combined has 8,547 branches, 19.16 million borrowers and loan outstanding of Taka 125,876 million at the end of December 2008 (ASA Taka 35,735 million, BRAC Taka 45,746 million in March 2009 and Grameen Taka 44,396.63 million). All three organizations have branch networks throughout the country except in a few remote char and coastal areas.
- *Large MFIs*: The sector has got a group of large MFIs whose memberships vary between 50,000 to one million. All of them are PKSF partner MFIs except BURO Bangladesh. Even within the group two organizations, TMSS and BURO-B separate them from the others and have expanded into more than 40 districts with their networks. Their expansion also came during 2005-2008 period and continues.
- *Medium Size MFIs:* Above two groups are followed by organizations with 5-50,000 members (3 to 30 branches) which are local or regional organizations mostly financed by PKSF.
- *Small MFIs:* MRA has a cut-off point of 1000 memberships, and Taka 4 million in loans outstanding for receiving license. Several hundred such MFIs operate in the country although the exact number is not known.

[7] Nationalized Commercial Banks (NCBs), Specialized Banks (BKB, RAKUB), private commercial banks, and foreign banks. Not all banks have microcrocredit (small loans) programs and not all offer loans to all market segments

- *Very small MFIs:* We see even smaller NGOs with very limited resources for loan disbursement, use mostly savings; are still operating, which may face extinction for not qualifying for license.

Table 3.2 Structure of MFIs Sector

Indicators	ASA (Dec. 2008)	BRAC (Mach 2009)	Grameen (Dec. 2008)	Total
Member (Million)	7.28	8.15	7.67	23.10
Borrower (Million)	5.88	6.38	6.90	19.16
Loan outstanding (million Taka)	35,735	45,745	44,396	125,876
Savings balance (million Taka)	11,264	16,306	64,177	91,747
Branches	3,303	2,705	2,539	8,547

Source: Compiled by author

Times Series Analysis of Outreach and Portfolio

An estimated 33 million members and 26.78 million borrowers (81.1%) including multiple memberships or so called overlapping are served by the sector at the end of December 2008. A total of 14,441 branches serve these members/clients. The total estimated portfolio is Taka 158,807 million of which ASA (22.50%), BRAC (28.81%) and Grameen Bank (27.96%) account for about 79.26%. The rest 20.74% is under about 700 smaller MFIs that shows heavy concentration of portfolio in these three organizations. The important issue is that the three MFIs have become so big that microfinance sector can not afford any one of them to fail. Due to resource and management constraints the smaller MFIs are not expected to grow fast to increase market share. Such skewed structure is expected to continue.

The aggregate time series data between 2003 and 2008 (see Table 3.3 to Table 3.6) shows that the sector has hugely expanded as reflected by memberships, borrowers and portfolio: membership has increased by 186%, borrowers by 199% and portfolio by 302.4%. The savings balance has also proportionately increased by 362%. Table 3.4 to Table 3.6 provides further insight about the growth pattern: the growth has actually come from the three very large organizations. Grameen has expanded 2.45 times in membership, 2.46 times in borrowers and 2.77 times in portfolio size. ASA has expanded 3.1 times in membership, 2.75 times in borrowers and 3.09 times in portfolio size. Similarly, BRAC has expanded more 2 times in membership, 1.82 times in borrowers and 2.77 times in portfolio size. The rest of the sector could only manage to grow by 1.2 times in membership, 1.52 times in borrowers and 2.44 times in portfolio. In all cases the average per capita loan size has increased. Overall the ratio between members and borrowers remained between 75 to 81% during 2003-2008. The average loan outstanding per borrower was Taka 3,902 in 2003 and Taka 5,928 in 2008, an increase of only 52%. That is, average loan disbursement per borrower was Taka 7,804 in 2003 and Taka 11,856 in 2008. That would mean the disbursement size did not really increase as one would have expected. Discussion with industry experts suggest that a number of factors have caused such situation: a) resource constraints of smaller MFIs; b) risk aversion attitude of staff members; c) low absorption capacity of borrowers; d) large number of young new membership or membership switching, that affects gradual growth of loan size because new members (although she/he has experience of borrowing from other MFIs) normally start with smaller loans.

Table 3.3: Aggregate time series data (Grameen Bank included)

Description	2003	2004	2005	2006	2007	2008
Branches (#)	6,837	9,165	9,253	11,368	14,577	14,441
Members (#)	17,754,747	20,681,349	24,373,389	27,420,570	31,367,009	33,018,926
Borrowers (#)	13,457,991	15,617,075	15,617,075	15,617,075	26,119,391	26,787,120
Portfolio (Taka mill.)	52,510	64,354	83,651	106,411	133,375	158,807

Source: Compiled by author

Table 3.4: Membership growth of MFIs

Description	2003	2004	2005	2006	2007	2008
ASA	2,341,819	2,996,660	5,988,134	6,455,979	6,663,734	7,276,677
BRAC*	4,065,957	4,858,763	4,837,099	5,310,000	7,370,000	8,150,000
Grameen Bank	3,123,802	4,059,632	5,579,399	6,908,704	7,411,229	7,670,203
Other MFIs**	8,223,169	8,766,294	7,968,757	8,745,887	9,922,046	9,922,046
Total	17,754,747	20,681,349	24,373,389	27,420,570	31,367,009	33,018,926

*data for 2008 are of March 2009; **CDF reported; in absence of up to date data for 2008, figure of 2007 has been repeated for 2008.

Table 3.5: Borrower growth of MFIs

Description	2003	2004	2005	2006	2007	2008
ASA	2,130,982	2,771,627	4,168,821	5,163,279	5,422,787	5,877,440
BRAC*	3,493,129	3,993,525	4,159,793	4,550,000	6,400,000	6,380,000
Grameen Bank**	2,811,421	3,653,668	5,021,459	6,217,833	6,670,106	6,903,182
Other MFIs***	5,022,459	5,198,255	5,613,209	6,382,901	7,626,498	7,626,498
Total	**13,457,991**	**15,617,075**	**15,617,075**	**15,617,075**	**26,119,391**	**26,787,120**
Borrower to member ratio (%)	75.8	75.5	77.8	81.4	83.2	81.1

*data for 2008 are of March 2009; ** Estimated: 90% of members;***CDF reported; in absence of up to date data for 2008, figure for 2007 has been repeated for 2008

Table 3.6: Portfolio growth of MFIs (Taka in million)[December]

Description	2003	2004	2005	2006	2007	2008
ASA	11,538	13,776	19,379	24,077	27,764	35,735
BRAC*	11,493	14,491	17,805	24,355	36,344	45,745
Grameen Bank	16,017	20,008	27,970	33,235	36,336	44,396
Other NGO-MFIs**	13,462	16,079	18,497	24,744	32,931	32,931
Total	52,510	64,354	83,651	106,411	133,375	158,807
Average per capita loan balance (Taka)	3,902	4,121	4,411	4,769	5,106	5,928

*data for 2008 are of March 2009; **CDF reported; in absence of up to date data for 2008, figure for 2007 has been repeated for 2008

Member Savings

Total savings balance in 2008 was Taka 104,590 million (see Table 3.7).The average savings balance per person did not register much growth because almost all MFIs except BRAC have made savings withdrawal easy. This is also reflected in the withdrawal rate: 70.85% withdrawal in 2007 (see Table 3.8). Besides, the average savings per week has not also increased much, varies between Taka 10-50 per week. MRA has stopped collection of time deposit, that is, deposit of small savings per week to receive a lump-sum at the end of 3 to 5 years. Whereas this type of savings in Grameen Bank, called GPS, is the most popular savings product among the members.

Table 3.7: Savings balance (Taka in million)

Description	2003	2004	2005	2006	2007	2008
ASA*	2,804	2,828	3,035	7,755	9,538	11,264
BRAC	6,285	7,657	9,159	10,595	13,467	16,306
Grameen Bank **	13,306	20,717	31,659	44,274	51,918	64,177
Other NGO-MFIs***	6,471	7,322	8,149	10,397	12,843	12,843
Total (Taka in million)	28,866	38,524	52002	73,021	87,766	104,590

*ASA: Includes security funds beginning 2006; **GB: Includes savings from non-members; ***CDF Reported and in absence of up to date data for 2008, the figure for 2007 has been repeated for 2008

Table 3.8: Savings growth (December) Excluding Grameen Bank

Items	2007 (N=535)	2006 (N=611)	2005 (N=690)	2004 (N=721)	2003 (N=720)
Net savings per member (Taka)	1,291	1,201	1,082	1,072	1,063
Savings withdrawal rate (%)	70.85	69.75	68	67	63

Source: CDF/InM

Key Performance

The aggregate portfolio quality has remained high till 2007 as indicated in Table 3.9. Although overall sector information at the end of 2008 is not available at the time of preparation of the report but information from major MFIs (ASA, BRAC, Grameen and a few other large MFIs) shows that the portfolio quality has remained good except in Sidr and severely poverty stricken districts. From 2005 onwards recovery has remained above 99% and the overdue as percentage of outstanding loan was 1.52% in 2007. Although no systematic study is available but practitioners in the sector reports that loan recovery in 2008-09 period is in decline and portfolio quality is under stress due to economic slowdown, reduced employment opportunities in rural areas, price hike of 2008 and probably institutional weakness created due to over-expansion. Overdue as percentage of loan outstanding has increased for ASA, BRAC and Grameen between 2006 and 2008 [Bangladesh Bank 2008].

Table 3.9: Performance Ratios (As of December)

Items	**2007 (N=535)**	**2006 (N=611)**	**2005 (N=690)**	**2004 (N=721)**	**2003 (N=720)**
Outstanding borrower per credit staff (No)	180	203	212	202	233
Loan portfolio per credit staff (Tk.)	889,772	920,874	846,656	748,947	798,510
Recovery Rate (%)	99.21	99.12	99.07	98.79	98.76
Overdue - Outstanding loan ratios (%)	1.52	1.63	1.89	6.25	3.63

Source: CDF/InM

Areas of investments

It is very difficult to know exactly the actual areas of investment because of two reasons: i) borrowers keep on changing IGAs within the year, and ii) often loan money is mixed with other family money. Table 3.10 presents areas of microcredit investments based on information from a large number of MFIs as mentioned in the loan application by the borrowers. The trend over the last five years has remained the same: trade and transportation (45.18% in 2007) topped the list followed by agriculture (24.85%). Within agriculture the highest amount went for livestock (11.85%), followed by crop production (9.89%), and fisheries (3.12%). In coming years, the crop sector is expected to grow larger because of expansion of microcredit in this sector. But one must be aware that the rural economy is not diversifying fast, which is precisely the reason of similar pattern of investment.

Table 3.10: Activities financed by microcredit (%)

	2007	2006	2005	2004	2003
Sectors	(N=475)	(N=370)	(N=283)	(N=379)	(N=442)
A. Productive Activities	**30.55**	**31.87**	**32.40**	**34.22**	**36.20**
A1. Agricultural Sector	**24.85**	**26.28**	**24.63**	**27.94**	**29.69**
a) Crops	9.89	9.84	7.57	10.25	9.08
b) Livestock	11.84	13.12	13.77	14.06	16.29
c) Fisheries	3.12	3.32	3.29	3.63	4.33
A2. Processing and Industries Sector	**5.70**	**5.59**	**7.77**	**6.28**	**6.50**
a) Food processing	3.71	3.71	4.78	3.40	3.60
b) Cottage Industries	1.99	1.87	2.99	2.88	2.90
B. Trade and Transport Sectors	**45.18**	**45.16**	**43.18**	**42.81**	**50.85**
a) Small business	42.42	42.65	40.47	40.61	48.60
b) Transport	2.76	2.51	2.71	2.20	2.25
C. Social Sectors	**1.81**	**2.02**	**2.15**	**1.70**	**1.58**
a) Health	0.53	0.73	0.77	0.44	0.45
b) Education	0.09	0.18	0.25	0.06	0.04
c) Housing	1.19	1.11	1.14	1.20	1.09
D. Others	**22.46**	**20.95**	**22.27**	**21.27**	**11.37**
Total (%)	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source: CDF/InM

Commercial Banks in Retail Microcredit

Formal Financial Institutions (Banks)

The formal banking sector comprises four categories of organizations: the state-owned banks (nationalized commercial banks (NCBs)) namely Sonali, Agrani, Janata, and Rupali Banks; six specialized banks including BASIC and the two agricultural banks, Bangladesh Krishi Bank (BKB) and Rajshahi Krishi Unnayan Bank

(RAKUB); private banks; and foreign (commercial) banks. Following the success of Grameen Bank the four NCBs and BKB and RAKUB started to offer retail microcredit by replicating group-based management technology, in addition to their individual small loans for agricultural as well as other purposes. Invariably all such group-based programs managed directly by the bank staff members have collapsed with huge default of loans.

Currently NCBs have largely abandoned lending to group-based small loan programs but have maintained their original individual loan operations. In addition, two of them (Sonali and Agrani Banks) and also one of the specialised banks, BASIC Bank, have opted for wholesale lending to NGO-MFIs. Interest rates vary between 10-15%, a lot higher than PKSF loans to NGO-MFIs. BKB and RAKUB follow individual lending techniques for their own operations and lend to groups organized by NGOs/projects. Private Banks, with the exception of Islami Bank Bangladesh Ltd (IBBL) which has a large and profitable retail Grameen styled loan operations with more than 589,000 clients in addition to its normal individual banking operations, opted for wholesale lending to MFIs. Foreign banks offer small loans to individual borrowers mainly in urban centres. The following paragraphs provide information on the status of small loan programs of banks.

Small loans (up to BDT 500,000) are available from two types of formal financial institutions: commercial banks and two specialized banks, BKB and RAKUB. Before the emergence of the vibrant MFI sector, these banks were the main sources of small loans, especially for agriculture and trade. Recently a number of private commercial banks have also entered in this segment in urban centers.

Table 3.11 below provides summary of borrower and loan outstanding information classified in terms of size of loans.

Table 3.11: Number of borrowers and loan outstanding from formal financial institutions as on September 2008

Loan Range From BDT	**To BDT**	**Number of borrowers**	**Amount** (BDT mill.)	**% of total borrowers**	**% of Total Amount**
-	5,000	735089	2,277	8.88	0.89
5,001	10,000	1803777	13,822	21.80	5.38
10,001	25,000	3729210	60,958	45.07	23.73
25,001	50,000	1207162	40,329	14.59	15.70
50,001	100,000	328064	22,602	3.96	8.80
100,001	200,000	207738	29,980	2.51	11.67
200,001	300,000	110103	27,219	1.33	10.60
300,001	400,000	88468	30,882	1.07	12.02
400,001	500,000	64583	28,779	0.78	11.20
Total		**8,274,194**	**256,848**	**100.00**	**100.00**

Source: Bangladesh Bank (Central Bank) Statistics, July-September 2008 Quarter

The following key inferences may be drawn from the status, trends, and performance of small loans (farm and non-farm) from banks:

a) The highest number of clients belongs to BDT 5,000 to 50,000 category representing 88% of borrowers and 55% of loan outstanding. Although the total number of clients is high (8.3 million), a significant number of them, especially those from the NCBs and specialized banks, are believed to be inactive due to high loan default.

b) Of the total small clients, 91% comes from NCBs and the specialized banks. This has been due to their wide branch networks in rural areas and mandate for disbursing agricultural credit to small holders. Private Banks are insignificant operators in this small business segment, limiting themselves in urban centers to serve large clients.

c) Agricultural credits top the list of outstanding loans followed by trade. There are two other formal institutions, BSBL and BRDB (state-owned), which are also active in this sector. But the disturbing issue is the very low rate of recovery of agricultural credits.

d) All formal banks require collateral to receive loans, especially for loans more than BDT 50,000. One of the main reasons for emergence of MFIs in Bangladesh is the dismal failure of NCBs, BKB and RAKUB to reach the poor who need small loans but cannot offer physical collateral.

Rural Development Scheme (RDS) [Microcredit] of IBBL

Islami Bank Bangladesh Limited (IBBL), the largest private bank in the country, deserves a special mention because it is the only commercial bank that offers Grameen styled retail microcredit to a large number of borrowers. The microcredit program known as ‘Rural Development Scheme’ was launched in 1995 as pilot program styled after the Grameen Bank model except that the scheme used Islamic modes of investment. The program runs side by side with the commercial banking operation of the bank and forms groups of women to provide small loans. As a bank it collects savings. But it shows lot more flexibility than MFIs in terms of duration of loans: one to five years depending on the type of investments. For example, housing loan is given for five years. The rate of interest is 10% (flat) [that is, 20%] but it gives rebate of 2.5% that makes it lowest in the sector, i.e. effective rate is 15% which is half of BRAC and ASA. Table 3.12 gives progress of the program. Until 2005 it was growing slowly but it has more than doubled its client base between 2005 and 2008. At the end of 2005, the membership was 217,445 which reached to 577,740 at the end of 2008 and to 589,280 at the end of March 2 009. Similar to MFIs, 92% of the members are women. Loan outstanding was Taka 3,204.13 million ($47.12 million) and repayment rate was 99%. It plans to enlist 1.2 million members by 2011. Although RDS is offered from its 136 branches in 61 district IBBL has recruited a separate cadre of officials to run the program. While NCBs left retail microcredit operations and other private banks opted for wholesale lending IBBL shows that a private commercial bank with proper management and motivation can profitably run microcredit operations as well.

Table 3.12 IBBL RDS (Microcredit)

Particular	2004	2005	2006	2008	2009 (March)
Villages	4,230	4,560	8,057	10,676	10,682
Members	163,465	217,445	409,575	577,740	589,280
% women clients	94	94	92	92	92
Investment Outstanding (Taka million)	789.97	1,106.47	2,242.21	3,011.72	3,204.13
Recovery rate (%)					

Source: RDS/IBBL 2009

GOB Owned MF programs (retail) and cooperative societies

Non-Bank Government Departments and Institutions

At one stage, as many as 17 GOB ministries and departments were engaged in either retail or wholesale microcredit operations for diverse groups of poor people. However, most of the projects collapsed or closed when donor funds ended. CDF reports that 13 GOB ministries and departments were still running microcredit program in 2005. Bangladesh Rural Development Board (BRDB) manages the largest of such operations. These are run as 'projects' without considering sustainability of the services and the 'projects'. Consequently the portfolio quality, loan recovery rates and financial viability are very poor. RD-12 used to be the better managed program, which enjoyed heavy subsidy [Khanddker and Khalily 1996]. GOB with the assistance from the Canadian International Development Agency (CIDA) converted RD-12 to Palli Daridra Bimochan Foundation (PDBF) to continue the retail services. PDBF received large amounts of grants from CIDA. But PDBF is struggling with 610,656 members and 451,570 borrowers of which 255,931 (56.7%) are defaulters[8]. BRDB is still continuing with several such unsustainable projects with poor portfolio quality and limited or no prospect of financial viability.

LGED – Cooperative Approach

Several other government departments such Local Government Engineering Department and Water Development Board construct water control, irrigation and drainage projects in different parts of the country. Both agencies, mostly LGED, have formed hundreds of cooperative societies by people living in the project command areas to take over the maintenance of water infrastructure. These cooperatives have undertaken savings and credit operation and even borrowed from a fund created by LGED. However, an assessment of sample cooperatives shows that the microcredit operations are either not functioning because of many management problems or not viable due to tiny portfolio size. In few cases where the cooperatives run irrigation projects (sell water for boro cultivation) and provide seasonal agricultural loan have shown success in loan recovery.

Cooperative Societies in Microfinance

No comprehensive study is available on microfinance programs run by cooperative societies within their shareholders or for outside borrowers. Although the cooperative law clearly permits savings and lending programs within the members (shareholders) of the societies but not clear about whether they can accept savings from and lend to non-members. But many market-based cooperatives reportedly are doing (should it not be extending in place of doing) microcredit to non-shareholders. But the quality and sustainability of such operations are not known.

Interest Rate

The rate of interest on loan product is a controversial issue in Bangladesh. Although the rate of interest of microcredit programs is expected to be higher than commercial bank's lending rate due to small size of loan and high delivery cost (service is delivered at the neighborhood of clients) but there is general public perception that MFIs charge 'excessive' interest on loan. Such views have been vented by high political and government officials in public forums. It would be useful to review the prevailing and past rates in the sector. Table 3.13 provides interest rates of prominent MFIs both on savings and credit products:

[8] Information received from CIDA

Table 3.13: Interest rate (May 2009)

Organizations	Interest on credit products (%) ['flat' rate]	Approximate effective rate on credit products (%)	Interest on savings (%)
ASA	14.4	28.8	<5%
BRAC	15	30	
Grameen Bank	10	20	Regular savings: 8.5 Time deposit:12.5
PKSF Funded MFIs	Hardcore poor:10 Others: 12.5	Hardcore poor: 20 Others: 25	4-5
Other MFIs	15	30	4-6
IBBL-RDS	7.5	15	>6%*

Sources: Respective organizations; * varies every year

The rate of interest on loans varied over the period of time. Grameen Bank used to charge 16% (effective rate) same as commercial banks' lending rate. But it then increased to 18% then to 20% to reflect its cost of operations and cost of fund. In both instances the bank revised its rate to compensate for pay increase to match with the government pay scale revisions. Incidentally Grameen's rate of interest on loan is the second lowest and interest paid on savings is highest in the sector. That has been possible due its economies of scale and higher average loan size due to long microcredit operations, longer than any other organizations (Grameen Bank began as bank in 1983 and ASA started in 1990-91).

Up to mid-1990s the interest rate in the sector was 20% (10% flat) which was later on revised upward to 25% then to 30%. Up to mid-1990s PKSF's rate of interest was 2-3% depending on the size of the organization. In 2003 PKSF conducted a study [Jashim Uddin 2003] to determine break-even rate of interest as well as the profitability of PKSF partner MFIs. On the basis of the study PKSF determined the ceiling of loan of its partner organizations to be 2.5% (flat) or 25% effective rate for mainstream microcredit. PKSF argued that since it provides subsidized loan at the rate of 4.5% for the smaller organizations and 7% for large organizations (ASA and BRAC) that allows partners to accumulate significant amount of equity and they also have become lot more efficient the benefits should be transferred to the microcredit borrowers. The effective way to do that would be to put a ceiling on interest rates for its partners. PKSF enforces this on its smaller partners but ASA and BRAC continued to charge 15% (flat) rate. But ASA and BRAC later reduced their rates to 12.5% for a short period but both moved to 15% in 2009 to reflect rising cost of operations (ASA) and cost of fund (BRAC).

A closer observation also reveals that poor people also prefer to maintain memberships with a number of NGO-MFIs at the same time, as their way of avoiding risk of not getting loan when needed. A small difference of rate is often ignored. Access to funds from different sources, including private moneylenders in all their various forms, often becomes more important than price.

The important issue is that NGO-MFIs have not used interest rate to compete with each other. So far they have been successful in deploying the available resources by maintaining the interest rate constant. It is unlikely that this practice will be changing in the near future. The main deterrent will be the threat to their financial sustainability if the interest rate goes down substantially. NGO-MFIs may find it self defeating to reduce current rate. One interesting case is ASA, which once reduced its rate from 30% to 25% and then again raised it to 30%.

ASA has been able to deploy the resultant higher net income to continue to expand its program with the current rate without much difficulty.

The following factors determine the rate of interest on loan, which have changed over the years:

a) *Cost of funds:* This is the weighted average rate of cost of different sources of capital such as grants, savings, concessional loan, and commercial loans. In early 1990s many small NGOs used to run their microcredit with savings by paying no or small interest and grants from donors. But now payment of interest on savings has become universal, grants have dried up, most small MFIs borrow from PKSF and many MFIs borrow from commercial banks at the rate of 12-15% interest. Grameen Bank fully depends on members and public deposits and pay competitive interests (commercial banks). CDF reports that in 2007 about 17% of total capital was provided by the commercial banks (two major clients are BRAC and BURO-B). PKSF has brought seven (7) more of its partner (excluding ASA, BRAC and Proshika) under BIPOOL window which charges 7% compared to 4.5% under OOSHA-window. In general, the cost of capital in the sector has significantly gone up.

b) Operating cost is the biggest component of MFI’s expenditure item comprising mainly of salary expenses. In general the average salary in microfinance sector has gone up and the salary gap at the field level between large and medium/small MFIs has also reduced due to increase in income, recently due to inflationary pressure, and demand for skilled staff members.

c) Cost of risk or loan losses is covered by keeping provision, which is, creating a reserve for future loss. PKSF ensures that loan-loss provisions are kept and MRA recommends also creating such reserve. The reserve is meant for routine business risks, which does not cover large loss of capital due to severe floods or cyclones such as Sidr.

d) Lending rate is also influenced by desire to make microfinance financially viable.

If the above factors are considered each MFI in principle should have different lending rate but in reality they all follow either 25% or 30% as the going rate in the sector. As we also mentioned that MFIs do not want to reduce rate as long as all available resources can be deployed. Currently, as response to mitigate the adverse impact of recession Bangladesh Bank has set ceiling for interest rate for commercial banks (ceiling 13%). But so far no such step is seen to put interest rate ceiling on microcredit though the Microcredit Act 2006 provides such authority to MRA.

Market, Product and Delivery System

Market Segmentation

We cursorily mentioned earlier that microfinance sector offers different types of savings and loan products to different groups of poor and non-poor clients. In this section we will investigate deeper into the operations of each market segment and their features and trends. Besides, we will discuss about savings as a separate financial product instead of a hidden component under microcredit. One of the main visible changes that evolved in microfinance sector is segmentation of markets in terms of poverty and professional groups and corresponding credit products to reasonably meet the demand of these groups. MFIs made some adjustments about savings as well. The very concept of product-market fit is often mentioned in microfinance literature and practitioners circles as designing and offering demand-driven financial products. In plain language it means two things: precisely determining the borrower groups (or client groups); and determining terms and conditions of savings, loans or insurance products according to the demand of the particular target group. We will call such categorization as 'market segment'. For example, if micro-financial products are designed for the 'hardcore poor' the concerned MFI should be defining who are the hardcore poor people, what are the nature of demands for financial services (savings, credit etc.) and the terms and conditions for each type of services to be offered by the MFI. We will discuss later in this chapter the criteria used by various institutions to define hardcore poor. Many different researches suggest that hardcore poor people can save but their savings will be very small and irregular and at the same time they would need money to meet various crises. That would mean a hardcore poor person is expected to withdraw savings at times. Therefore, if an MFI wants to offer savings service to the hardcore poor it would probably design the following terms and conditions for savings product; i) no minimum savings amount; ii) no conditions for depositing every week or month, i.e. a member will be allowed to deposit any time (i.e. daily, weekly or monthly); iii) she will be allowed to withdraw her savings any time she wants, if possible instantly either in the meeting place or at the office without prior notice. That also means that the MFI must empower its Credit Officers or branch managers to repay savings at the group meeting or office. The Management Information System (MIS) and accounting system must also be designed to reflect such transactions. Researches also suggest that the hardcore poor people have difficulty in managing large amount of loan, at least at the early days of association with an MFI, and sometimes she may even ask for consumption loans. It will be expected that she may skip repayment of some installments. That would mean that an MFI targeting and designing loan product for hardcore poor should not keep any lower limit for loans, should allow even consumption loan and be more tolerant about loan repayment. Similarly, the rules and regulations, MIS and accounting systems should be adaptive to these rules, if necessary (most of the time it wouldn't be necessary). Specially, the field officials need to be empowered to respond to the situation.

We can give another example where an MFI may be interested to finance small and marginal farmers for rice production. Some MFIs try to provide regular microcredit with weekly repayment to finance this market segment when ideally the farmers should be able to repay after harvest, that is, in one installment. It is understood that MFIs design such product and insist on weekly repayment for fear of loan default. But that is a sub-optimal solution, i.e. not a demand driven product. A natural demand-driven product would be a seasonal loan for 4-5 months, and farmers would repay in one installment. In such a situation, MFIs will need to develop different management system (such as selection of borrowers, awareness building, supervision and monitoring, staff training) to ensure full repayment of loan.

The distinctive market segments in today’s Bangladesh microfinance sector are as follows:

(a) Mainstream microcredit (BDT 5,000-30,000, approx USD 70-425): The term ‘mainstream microcredit’ is the most commonly available financial service for the ‘moderately’ poor following the Grameen model of group-based lending. This category includes the common programs of NGO-MFIs serving the poor and moderately poor, which sometimes may include some not-so-poor members, especially members of marginal farming families. The current loan size varies between BDT 5,000 to BDT 30,000, which is normally invested in petty trades, poultry and livestock, fisheries, numerous small agro-processing activities and horticulture. Loans are for one year collected in weekly installments. The interest rate varies between 20-30% per annum. The main focus remains on poor women.

(b) Programs for the hardcore poor (BDT 500-5,000, approx USD 7-70): Two approaches have been adopted to redress the problem of meeting the needs of the poorest for financial services. The first is that ‘the very poor need to be prepared for microfinance’, usually by a combination of social and human development interventions. The second is that ‘microfinance needs to be prepared for the very poor’, i.e. that what is required is much greater flexibility and imagination in both the products offered, especially for savings, and in the manner in which they are offered. Improvements and innovations will be needed not only for serving various financial needs of the very poor but also to face competition. Examples of such programs are Building Resources Across Communities (BRAC)’s[9] Challenging the Frontiers of Poverty Reduction (CFPR) Programme; Grameen Bank’s Struggling Members’ Programme, and PKSF’s Hardcore Poor Programme.

(c)Microenterprise program (BDT 25,000-500,000; approx USD 350-7,000): One relatively new frontier for the MFIs is loans for the development of microenterprises managed by ‘graduates’ from microfinance programs as well as millions of informal businesses operating throughout the country, which so far have been outside the MFIs traditional lending programs. This segment is significantly underserved, but potentially involves very large number of enterprises (more than 5 million) and opportunities for employment, including wage employment[10]. NGO-MFIs use both group-based (e.g. PKSF small and medium partner MFIs) as well as individual (e.g. ASA and BRAC) lending methodologies in case of microenterprise loans depending on whether they finance ‘graduate’ borrowers (e.g. PKSF partner MFIs) or new entrepreneurs (e.g. ASA and BRAC). In case of ASA and BRAC, most of the microentrepreneurs are men .Two features separate them from microcredit borrowers: larger loan amounts with longer duration; and the need for non-financial services such as access to market, information and appropriate technology, assistance for product improvement and development, training for workers’ skill development and management training for skill in financial and business management of the entrepreneurs.

(d) Microfinance for marginal and small farmers (BDT 10,000-50,000; approx USD 150-700): So far only a small number of MFIs has ventured into this segment by following group-based lending techniques with limited outreach. PKSF with loan from IFAD has initiated Microfinance for Marginal and Small Farmers (MFSMF) project to reach 220,000 marginal and small farmers in 6 years. Sometimes seasonal loans with shorter duration (3-9 months) are disbursed and collected in one installment, for example after harvest. For this category, MFIs follow group-based lending system and cater mostly to women groups. But a number of MFIs (e.g. Sojag) have been lending to men’s groups only with impressive success.

[9] Formerly Bangladesh Rural Advancement Committee (BRAC). BRAC has opened its operations in Sri Lanka, Afghanistan, and several countries in Africa.
[10] MIDAS and ICG (2004). National Enterprise Survey, MIDAS, Dhaka, Bangladesh

Market Segmentation by ASA, BRAC and BURO Bangladesh

ASA's Target Market and Financial Products: As one of the largest and most famous MFIs in Bangladesh, ASA targets several market segments with corresponding financial products (not all mentioned in Table 4.1). We see it uses gender and land criterion as indicators of poverty, and income and enterprise type criteria to segment the financial market and design various financial products. It uses land and income criteria for its main loan product, small loan (women), which is again solely targeted to women. Interestingly, it has added a new loan product for men, which does not need additional criterion other than the fact that the men should be from the same families of the members of women groups. Similarly, we see nature of business as the primary criterion for small business loan (shop owners) and small entrepreneur loan (production type enterprises).

We see an attempt by ASA to develop a product-market fit in its design features for financial products. For example, attendance in group meeting is central to the small loan (women) program whereas 'individual loan' and 'no attendance in meeting' are two important design features of Small Entrepreneur Loan (SEL) program. Similarly, the size of loan is very distinctively determined with demand and nature of loan.

BRAC's Market Segmentation: BRAC very clearly categories the poverty groups that it targets to reach by its financial products, which is followed by operational features to identify the actual persons. Its five financial products target three poverty groups, extremely poor, moderately poor and vulnerable non-poor. Two products target the first category, one is basically asset transfer and training, and the other is food aid, training and financial services. It is evident from Table 4.2 that an effort has been made to make poverty group and identification criteria as distinct as possible to ensure effective targeting.

BURO Bangladesh: Similar effort is also clear in case of BURO-B which offers several loan products: general loan to moderately poor, microenterprise loan, agricultural loan, disaster loan and water and sanitation loan. The last two loans are for special purposes that can be taken in addition to another loan. BURO-B has a separate hardcore poor program. Each financial product with unique features in terms of target groups as well as terms and conditions defined in such a way that field officials clearly and easily implement programs.

Table 4.1: Summary of Credit Products of ASA

Name of the product	Target Groups	Members [December 2008]	Samity size (#)	Samity Meeting	Loan Size	Repayment	Insurance Coverage	Duration of Loan	Interest rate
Small Loan (women)	Poor women having less than 0.5 acre land and Taka 5,000 monthly income.	5,086,342	15-30	Weekly	1st cycle 4000-10,000; increased max. of Taka 3000 every successive loan	Weekly	Yes	43 weeks	14.4% (flat)
Small Loan (men)	Husband or adult male from women's families [introduced in 2005]	1,655,425	Individual loan.	No meeting	1st cycle 1000-3,000; increased max. of Taka 1,000 every successive loan	Monthly	Yes [not mandatory]	5-10 months	14.4% (flat)
Small business loan	Men (shop owners, traders) and successful women Small Loan borrowers ('graduate' borrowers)	393,006	10-15	Weekly	1st cycle 15,000-50,000; increased max. of Taka 5,000 every successive loan	Weekly	Yes	12 months.	14.4% (flat)
Small entrepreneur loan (SEL)	Microentrepreneurs [normally for production type enterprise]	83,584	Individual loan.	No meeting	1st cycle 30,000; Next cycle: depends on feasibility study but maximum of Taka 200,000.	Monthly	No	Max 24 months	14.45% (flat)
Hardcore Poor (HCP)	Poorest people in remote and poverty stricken areas.	52,062	5-20	No meeting	1st cycle: max 5,000; increased max. of Taka 2,000 every successive loan	Weekly	Yes	3-12 months	14.4% (flat)

Source: ASA AT A GLANCE 2008

Table 4.2: Targeting by BRAC

Poverty Group	Components	Definitions of Target Groups	Outreach [March 2009]	Product details
Extreme Poor	CFPR-Targeting the Ultra Poor (CFPR-TUP)	• Depends upon female domestic work and begging • Owns less than 10 decimals of land • No adult active male member in the household • No productive asset in the household	Phase I: 100,000 Phase II: 181,461	• Asset transfer and subsistence allowance • Enterprise development training • Social development training • Essential Health Care Service • No loans provided. After two years under CFPR, members can access IGVGD loan products
	CFPR-OTUP	• Households owning no more than 30 decimals of land • Women who are divorced, separated or have disabled husband, aged between 18-49	Phase I= 1.3 million	• Livelihood training input support • Social development training • Starting loan size: Approx. USD 20 • Interest rate: 15% (flat) • Repayment: 46 weekly installments within one year (national holidays and festivals excluded)
Moderately poor	DABI	• Own up to one acre of land including homestead, sell manual labor for living	Member: 6.67 m Borrowers: 5.32 m	• Loan size: Taka 3,000-30,000 • Interest rate: 15% (flat) • Repayment: 46 weekly installments within one year.
	UNNATI	• Own more than one acre of land and involved in farm and non-farm enterprises	Member: 1,232,786 Borrower: 817,846	• Loan size: Taka 15,000-50,000 • Interest rate: 15% (flat) • Repayment: Monthly installments within 12-18 months
Vulnerable non-poor	PROGOTI and WEDP	• BRAC and non-BRAC microentrepreneurs to develop and finance own business • Both men and women clients	Borrowers (Progoti): 242,513	• Loan size: Taka 50,000-300,000 (now Taka 50,000-500,000) • Interest rate: 15% (flat) • Repayment: Monthly installments within 12-24 months

Source: BRAC Annual Report 2005; IGVGD: Income Generation for Vulnerable Group Development

Savings Products

We will deal with a number of issues related to savings: access to savings, variations of savings products of major organizations and regulation.

Savings as Important Financial Service

Grameen's savings products: The Grameen Bank with permission from the government has devised several savings products for members (and some of them are also applicable for non-members):

- *Special Savings Account*: Mandatory weekly savings of minimum Taka 5 is accumulated in this account. In addition, 5% of loan is kept as mandatory savings of which 2.5% is accumulated in this account. Members have easy access to this account and do not have to maintain any minimum balance. The interest rate is 8.5%.
- *Special Savings*: The remaining 2.5% of the loan disbursement is kept as special savings, which earn 8.5% interest. Members can withdraw savings but have to maintain Taka 2000 as minimum balance.
- *Time Deposit (Fixed Deposit):* Members may deposit any amount for one, two or three years to earn 8.75%, 9.25% and 9.5% annual interest respectively.
- *Grameen Pension scheme (5 or 10 year period)*: The most popular savings scheme is GPS with options for 5 and 10 years, where members deposit Taka 50 or multiple of Taka 50 per month for a period of 5 or 10 years

to receive a lump-sum at maturity. The interest rate is 10% and 12% compounded annually for 5 and 10 year option respectively. For borrowers with ‘basic loan’ more than Taka 8000 participation in the GSP scheme at least Taka 50 per month is mandatory. External reviewer even goes to say this product may revolutionize savings and capital formation for the poor [Rutherford 2006].

- *Double in 7 Year Deposit:* Members may deposit Taka 10 000 or multiple thereof to receive double that amount in 7 year period. This is a long-term time deposit, which earns approximately 10.41% interest.
- *Monthly Profit Deposit Scheme*: Another form of time deposit with an option to receive monthly interest payment. The scheme has two options: 5 and 10 year and deposit should be a multiple of Taka 10 000. For Taka 100 000 deposit, the monthly interest payment by the Bank is Taka 800 and Taka 850 for 5 and 10 year option respectively. An estimated equivalent annual interest rate is 10.6%.

*ASA’s Savings instruments***:** ASA has also a variety of savings instruments including death benefits (termed as ‘insurance’): mandatory savings, voluntary savings and long-term savings. Besides, it has introduced ‘members security fund’ in two forms: for women every member deposit Taka 10 per week (in case of Small Business Loan Taka 50 per month) where members receive a lump-sum at maturity or the nominee receives six times the saved amount in case of her death. Husbands or other male family members are also allowed to save in this fashion but the nominee receives three times the saved amount.

Other MFIs: All small MFIs have mandatory savings and some offer additional ‘voluntary savings’ but in general the savings services are yet to develop fully to offer all poor members attractive savings services.

Access to Savings

Small amount of savings has always been an integral part of microcredit programs. Usual practice was not to allow any member to withdraw any savings unless a member decided to leave an organization. This practice helped to use savings as a major source of finance. But members’ dissatisfaction and competition have improved the situation that MFIs provide limited access to savings such as a member can withdraw once in a year, 50% of savings and so forth. The most liberal savings policy among the large three organizations is practiced by ASA which used to follow the rule that members can withdraw all their savings in excess of 10% of loan outstanding at any point in time. It has further liberalized the savings rules: i) members having loan outstanding should maintain Taka 50 per Taka 1000 loan as balance and may withdraw any amount above that; ii) members without any loan outstanding may maintain only Taka 100 as minimum balance. Still ASA has a healthy balance of savings—20.26% of total loan outstanding at the end of 2008. Average savings balance for per member varies between Taka 854 to Taka 1929 depending on type of borrowers.

The most ‘open access’ policy is practiced by BURO Bangladesh where savings and loans are separate ‘products’. Members can withdraw all savings from ‘general savings account’ even having loan outstanding. However, to borrow again she has to save every week for 3 weeks before qualifying for a loan.

BRAC’s savings policies are as[11]:

- Own savings: On an average, members are required to save a minimum of Taka 5 every week.

[11] Source: BRAC 2004 Annual Report. Members with no loan oustanding can withdraw savings; and with loan oustanding can withdraw in case of emergency only.

- Compulsory savings: Five percent (5%) of loan amount is deposited into savings account, which bears 6% interest and normally allows withdrawal at anytime.
- Current account savings: BRAC has recently introduced Current Account Savings that bear no interest but allow unlimited withdrawal.

Smaller MFIs also try to match rules regarding access to compete with other MFIs. However, it is often hampered by shortage of capital. PKSF's small and medium Partner NGOs also follow some kind of 'access to savings' policy. Although the rigid policies have contributed to the mobilization of savings as a significant source of fund but with some negative consequences for the poor borrowers: i) it denies the use of savings at times of need; ii) may discourage additional savings; iii) does not encourage to develop 'savings' as a separate financial service; and iv) effective rate of interest goes up because it may require a borrower to borrow extra money at the rate of 20-30%, whereas she earns only 4-5% on her savings. A national policy regarding access to savings in line with some of the best examples in the country may be introduced, which would strike a balance between savings mobilization for financing microcredit programs and poor people's right to access their savings. This could be most effectively done by the Microcredit Regulatory Authority (MRA) in consultation with NGO-MFIs. But the Microcredit Regulatory Authority instructed all MFIs to stop such long term savings and return the amount to the clients. This has been done to reduce the risk of the savers from weak organizations. It is reported that some MFIs have stopped the products and either repaid the savings or merged it with their regular savings accounts. But the move has practically stopped development of savings as a separate product. A more pragmatic step could have been to allow selected MFIs that meet certain criteria (to be developed by MRA) to offer long-term savings.

To summarize, we see the following trends within MFIs in the savings area:

- *Mandatory weekly savings with or without withdrawal facilities*: All microcredit programs collect mandatory weekly savings as a condition for microcredit provisions. But various 'flexibilities' have been introduced in terms of accessing savings deposited by the members. For example, BURO Bangladesh allows 100% withdrawal of savings at any time irrespective of size of loan outstanding. Smaller NGOs have chosen a variation of the above, where they allow access either after a certain period or above or below a certain amount of money IBBL being a bank opens individual regular savings account in the name of each member where members can deposit any amount and withdraw whenever she likes.
- *Additional savings account*: BRAC allows opening up savings bank account where members may transact according to their will.
- *Time deposit:* An amount of money kept for a fixed time for higher interest for example by ASA and Grameen Bank.
- *Small regular savings to get a lump-sum after a fixed period*: This type of savings has been most successfully introduced by Grameen Bank.
- *Savings from Public*: Only Grameen Bank can and has legally offered this service.

Credit Products Offered by MFIs

Mainstream Microcredit

The mainstream loan product or microcredit for the moderately poor people, the original product introduced by Grameen Bank, has become most common or routine loan product in the market. All MFIs offer this almost on same terms and conditions: one year loan, weekly repayment, interest rate may vary between 20 to 30% per annum. But the loan ceiling may vary among MFIs. One change first introduced by ASA in mid-1990s was 46 installments to collect the loan instead of 50 equal installments. . All MFIs including Grameen followed suit because that solved the problem of holidays that may fall on a loan collection days and members could skip a few weeks still showing 100% repayment. ASA again has changed the number of installments to 37 but recovered in 43 weeks. That allows a few holidays. The main motivation for this change is to increase cash flow by increasing the size of installment within shorter period. The interest rate is 14.4% (flat). BURO-B has changed to 41 installments that show its interest rate as 14.8% (flat).

The microfinance industry is dominated by the group-based original Grameen Bank model (Grameen II or GB2 has introduced significant flexibility) with variants of various rules and regulations introduced by each MFI. However, the model remains the same, with loan for one year, weekly installments and primarily targeting women. Table 4.3 provides the memberships microfinance sector for 2001-2008. The total memberships as on December 2008 are 31 million. In absence of up to date data for 'other NGOs' we kept the same figure of 2007, which will not make any big change due to its small size compared to the overall sector. The sector is dominated by three MFIs, Grameen, ASA and BRAC. Taken together they have more than doubled their combined memberships since June 2003, with ASA the most rapidly growing among the three. These organizations are expected to continue to expand, creating further concentration in an already heavily concentrated market. Despite this, many small and medium MFIs are nonetheless looking to expand their outreach, trying out new and different types of savings and credit products.

Table 4.3: Memberships of mainstream microcredit Product (Million)

Name of MFIs	2003	2004	2005	2006	2007	2008
ASA	2.34	2.99	5.98	6.46	6.66	6.74
BRAC*	4.06	4.86	4.84	5.31	6.3	6.67
Grameen Bank	3.12	4.06	5.58	6.91	7.41	7.67
Other MFIs**	8.22	8.77	7.97	8.75	9.92	9.92
Total (in million)	**17.74**	**20.68**	**24.37**	**27.43**	**30.29**	**31.0**

Source: Compiled by the author from MFIs, CDF Statistics and other secondary sources; * borrowers of Dabi =5.5 m in 2007 and 5.32 million in 2009 (March); ** Same figure used for 2007 and 2008

The ways in which the sector can further grow are as follows: a) the same individual borrowing from more than one MFI for the same or a different purpose; b) bringing in more people from outside the target groups; c) increasing average loan size; and, d) 'formally' including men as target beneficiaries (ASA has started this strategy by lending to the male members of its existing women clients' families). Multiple memberships are certainly increasingly common in various regions of the country. However, there are no detailed studies of the effects of this important phenomenon although a study by PKSF in 2007 shows that the overall multiple memberships are about 30%. But industry experts and microfinance practitioners feel that multiple memberships have increased a lot. Two opposing views prevail about the impact of overlapping and the further planned expansion of the large NGO-MFIs. Generally, the latter see competition as beneficial. However, the small and medium NGO-MFIs feel just the reverse. Small and medium MFIs are clearly at most risk in such a competitive situation. Survival will depend very much on the ability to mobilize additional capital resources and maintain strong management. The impact of such growth on portfolio quality and on the overall sustainability of microfinance has not been properly studied.

The main trends in this segment are:

- Gradual increase in loan size and ceiling due to inflation and enhancement of capacity;
- But at the same time multiple memberships have become very common. Although the recovery rate has remained good but the impact on indebtedness and utilization of loan has remained mostly unknown;
- The area of investment has remained the same. Many NGOs with external assistance sometimes provide training. Unless new areas of investment opportunities are opened the concentration of investments are expected to remain the same (Trade, livestock, agriculture etc).

Programs for the Very Poor

We have given considerable importance to new markets segments such as microfinance for the very poor and discussed below in great length about this product. It has been a great challenge to devise and offer financial services to the very poor people and remains a challenge. We hope to highlight the recent programs for this market. This is relatively a new program and MFIs employ considerable time and efforts to ensure correct target as the product is often coupled with subsidized non-financial services.

Box 4.1

Profile of Target Population for Ultra-poor Programs

- Families with food shortage; malnourished people both in urban and rural areas.
- Families with irregular income from manual (adult) labor; families depending on child labor
- Poor families with irregular employment and income
- Poor people living in disaster prone areas
- Families of infra-structurally poor and inaccessible areas such as *chars* and isolated places.
- Disabled people and HHs with chronic health problems
- Poor women headed HHs
- Families with very poor housing conditions
- Households without homestead and agricultural land

Definition and features

This segment will include the bottom 10% of the population in terms of economic conditions, often characterized as families with very low and irregular income, poor women-headed households, food insecure families, families with members with chronic disease, people without homestead and/or any agricultural land and poor housing conditions, and people living in very difficult geographical conditions (chars, low lying areas, severely flood affected areas, extremely infra-structurally poor areas etc.). The service delivery could be group-based or otherwise, which depends on the concerned NGO-MFIs. The characteristics of hardcore poor are summarized in Box 4.1.

Techniques to Identify the Poor

There has been great emphasis of reaching the hardcore or very poor with microfinance over the last 5-7 years. It came mostly due to the criticism that microcredit did not reach the hardcore poor although it has great success with moderately poor people. Larger MFIs such as ASA, BRAC and Grameen Bank, apex organization such as PKSF with the funds from the government and some donor agencies are actively financing programs supporting microfinance and associated non-financial programs for the hardcore poor. Much importance has been given to selecting the hardcore poor members to make sure they are enlisted and because the programs often come with some additional free services such as training and asset transfer. In this report we have used two terms, hardcore poor and ultra-poor, interchangeably to refer to the same group of people (discussed above). The definition used here is for operational purpose, that is, to precisely identify the persons to include them in the proposed program. But some MFIs may use ultra-poor to mean destitute who may be receiving food aid and other assistance, and who may not be considered able to participate in a financial services program. For example, PKSF for its hardcore poor program uses the following criteria to identify hardcore poor: families not having any homestead or agricultural land (in this case Financial Services for Vulnerable Group Development (FSVGD) project less than 0.15 acre land); women headed poor households, beggars, widow or divorced, day laborer, domestic help, families having no earning male member etc. These will be the features for referring hardcore (ultra) poor. But BRAC in the Challenging the Frontier for Poverty Reduction- Targeting the Ultra-Poor (CFPR/TUP) program defines ultra-poor as destitute who qualify for asset transfer and free skill development training but not for microcredit.

The identification becomes very important if the programs are for the extremely/hardcore poor where specially designed programs are implemented, which may include training, food aid and asset transfer etc. Otherwise the very purpose of design special program becomes meaningless. But the precise targeting also means additional time, efforts and cost. We will discuss examples and process of low cost targeting methods applied by MFIs and other agencies for poverty targeting.

Use of secondary information/maps for geographical targeting

One easy step is undertaken to identify large number of hardcore poor is to use poverty map because a large number such people live in several districts and geographical pockets in addition to those spread in every village. The Social-Economic Infrastructure Division of the Planning Commission [Ministry of Planning, Government of Bangladesh (GOB)] and the World Food Program have jointly developed poverty map to identify food insecurity areas based on the following indicators[12]:

- Vulnerability to natural disasters like floods, river erosion and cycle
- Deficit or surplus of food grain
- Rate of agricultural wages
- Proportion of households not owning agricultural land
- Proportion of unemployed persons
- Proportion of widowed, divorced and separated women
- Proportion of literate women

[12] Source: The World Bank (2005d). Targeting Resource for the Poor in Bangladesh, The World Bank Office, Dhaka, December, 2005

This map will give general intensity of poverty level, which can be used to develop a geographical focus of a specially designed microfinance program. PKSF and a number of on-going programs use more target and practical indicators to determine geographical focus of poverty such as river char areas, low lying and water logged areas (Sunamganj *haor* areas, coastal areas etc), infrastructurally poor areas etc. Once such focus is determined other household level criteria may be applied to identify individual beneficiaries for a particular program. For urban areas it is easy to identify slums and poor neighborhoods to finalize geographical focus.

Low cost identification techniques

Usually participatory rural appraisal techniques such as social mapping and wealth ranking are of low-cost and easy to apply techniques, which are practiced by a number of programs. Usually MFI staff members with the help of village participants (men and women of various profession and social groups) develop a map of the target village indicating location of all important infrastructures such as houses, educational and religious institutions, markets, water points, roads, rivers/canals, ponds etc. This is followed by developing a wealth rank of each household based on a number of indicators such as income, occupation, land ownership, asset ownership, housing characteristics, jobs/business etc. Villagers have common understanding of who are hardcore poor, poor, middle income and wealthy people in the village. The appraisal meeting can develop ranks of all households or classify them into the above categories. Depending on the objectives and resource base households or group of households can be included under a program.

Targeting Process in Very Poor Program of PKSF

We see techniques described above are applied in the microfinance for hardcore poor (HCP Program) to deliver savings and credit services to hardcore poor program. At the beginning, the program started with geographical focus (later expanded to all over the country), mainly in North-western districts to target the hardcore poor of those districts. The Partner Organizations of PKSF (i.e. MFIs) applied wealth ranking technique as well as explicit criteria determined by PKSF to identify the hardcore poor for this program. The criteria include landless families (non agricultural land, destitute, women headed poor households, day labor, domestic helps, beggars etc.) to be included under this program. The partner MFIs either opened separate branches, or formed separate groups, or included the hardcore poor under existing groups depending on the situation after identification.

Targeting by BRAC/CFPR-STUP program

BRAC has been implementing Specially Targeted Ultra-Poor program for the last several years, which includes skill training and asset transfer to enhance livelihood conditions of the ultra-poor beneficiaries. This project with a very narrowly defined target group requires extra-caution to identify the ultra-poor beneficiaries. The following broad steps in the targeting process [World Bank 2005]:

- *Rapport building*: As a first step in Participatory Rural Appraisal (PRA) technique the program undertakes rapport exercise with the community to determine the target area, select venue for a PRA session and invite community members to attend PRA session.
- *Participatory Rural Appraisal Meeting*: A PRA meeting is held to develop a village map showing distribution of households; and rank the households by wealth. Households are categorized in several poverty categories.

Poor are considered to be landless, own only homestead, work as day labors, small traders or beg for living, not own any livestock, and live in thatched houses.

- *Survey for Preliminary Selection*: PRA session is followed by household survey to pin down potential beneficiaries. Table 4.4 summarizes 'inclusion factors' and 'exclusion factors' for the program. These factors are proxy indicators for determining poverty level.

Table 4.4 Criteria for Preliminary Selection of STUP Beneficiaries

Inclusion factors	Exclusion factors
• Not having a Vulnerable Group Development (VGD) card (VGD card holders already receive food aid) • Not being member of any MFI or NGO • Being the head of a female-headed household and being able to work • Having a sick husband (who is unable to work) • Being a woman living with her father • Being widowed or divorced • Gathering and selling fuel wood • Domestic help • Living in poor housing conditions • Having low level of income (if any)	• Being a member of any NGO • Holding a VGD card • Not being able to work • Being in comparatively good economic conditions • Having repaid a loan/credit but still having savings with an NGO • Receiving assistance from others • Economically active husband • Being too old • Having tin-roofed house • Possessing luxury items, e.g. radio

Source: The World Bank (2005)

- *Final Selection*: Senior officers from the program make final determination by verifying information gathered through the survey as well as comparing them with program-set criteria (see Table 4.5).

Table 4.5 Program-Set Criteria for CFPR/STUP

Inclusion factors	Exclusion factors
• Owning less than 10 decimals of land including homestead • No adult male income earner in the household • Having school-age children who are working • Women of the household work outside the household • Owning no productive asset	• The household is borrowing from an NGO-MFI • The household is a current cycle recipient of government or non-government benefits (e.g, under VGD program) • There is no adult women in the household who is physically able to contribute labor towards assets transferred

Source: The World Bank (2005)

Services for the Very Poor

Under normal circumstances, MFIs and their client groups (*samities*) exclude the hardcore poor from microfinance programs for fear that they (hardcore poor) may not be able to invest and repay loans, may not follow rigid rules of microcredit programs and hence the programs would not be viable. There have been some remarkable changes in program design, and special efforts have been taken to take microfinance to the hardcore poor. Currently several large programs are underway to serve the hardcore poor, for example, PKSF funded microfinance for hardcore poor program (HCP). A deeper look into the economic and skill issues show that the hardcore poor need more than one service:

- *Access to financial services*: This issue has two sides: beneficiaries need flexible financial services to suit their specific social and economic situation; and MFIs have to reach a financially viable program within a reasonable time frame. The flexibility issue has been dealt with earlier, that is, the hardcore poor need easy savings schemes with withdrawal facilities, and the loan amount should be relatively small (gradually increasing) at a reasonable cost. The participating MFIs of PKSF lend at 10% (flat rate) under the hardcore poor program and do not take any insurance premium to cover death risks of the clients (which varies between 0.5 to 1% of loan under mainstream microcredit program). MFIs earn less due to lower interest rate and smaller portfolio compared to mainstream microfinance. Currently PKSF provides interest rate subsidy (lend at 1%) and partner MFIs cross-subsidize HCP from other programs, especially the PKSF-funded rural microcredit (RMC) program, the largest and profitable program. MFIs need skilled human resources to manage the program.
- *Poor human resource skill of beneficiaries*: It has been established that skill and managerial training enhances capabilities of hardcore poor people to manage income generating activities and consequently larger loan to come out of poverty. The training issue has several dimensions: i) affordability of training; ii) quality of contents and delivery methods; iii) dependence on NGO and GOB staff members to deliver training; and private sector training providers have not been pooled and strengthened; and iv) training tends to be concentrated on farm related activities only. The focus of all on-going programs is on poultry and livestock and it is based on the need to provide opportunities to women that are close to the homestead.
- *Access to market and business services*: This category of problems relates to: i) accessing business and technological information; ii) accessing market, which has become especially important with expansion of poultry, livestock and horticulture production. Special efforts will be needed to establish linkage of milk and horticulture producers to main processors and markets; iii) accessing other business services such as vaccination, design and development of products.
- *Access to wage employment:* The problem has a number of dimensions: i) direct investment in rural areas is low due to a host of problems such as infrastructure, market, lack of skilled labor; ii) private investments are clustered around urban centers with no linkage with rural areas negating any opportunity for the rural poor to get wage employment; iii) marketable skills as demanded by the private sector are not always readily available from the ultra-poor; iv) No organized campaign by the local authorities or NGOs or any group to encourage private sector to establish linkage with the rural economy, not just as an input supplier but to participate in the production process.

The design of any ultra-poor poverty reduction program becomes very complex if all issues related to the ultra-poor families are addressed. The views are normally polarized into three groups: i) ultra-poor people need wage-based jobs not credit and other non-financial services to come out of their current extreme situation. The rural road maintenance under food-for-work programs as well as other subsistence programs is the result of this view. ii) A more pragmatic view is to combine food aid and other non-financial services with microfinance, and bring the very poor population under regular microcredit programs with certain changes (e.g. smaller loan size at the beginning). iii) Design simple program with financial services only appropriate for the very poor. The participants of the same set of consultation identified various elements of such holistic programs, which reflect views of all the three camps (Box 2). Grants often dominate as major instrument to finance the non-financial part of such programs.

All three approaches have been tried in Bangladesh. In cases of financial services two approaches have been adopted to redress the problem of meeting the needs of the poorest for financial services. The first is that ‘the very poor need to be prepared for microfinance’, usually by a combination of social and human development interventions. The first approach prepares the women through training and food aid to reach such a level that they could participate in regular microfinance programs. Another variation is to give productive asset to the ultra-poor to raise income generating status, which will be later followed by financial services, for example, CFPR/TUP of BRAC.

The second is that ‘microfinance needs to be prepared for the very poor’, i.e. that what is required is much greater flexibility and imagination in both the products offered, especially for savings, and in the manner in which they are offered. Improvements and innovations will be needed not only for serving various financial needs of the very poor but also to face competition. The second approach is to design a special program with the flexibilities suitable for the ultra-poor, for example, the HCP and FSP of PKSF. The features of such programs are as follows: women are encouraged (not necessarily made obligatory) to put aside small savings; the savings can be withdrawn any time; the loan amount is smaller (as small as Taka 200) than regular microcredit. Evidence suggests that training may play a complementary and significant role to prepare these women to take on income generating activities. In this approach the training is very much dependent on the availability of resources and training can be provided at any time not necessarily before the first loan.

Outreach of Very Poor Program

Table 4.6 to Table 4.8 provides details of memberships, borrowers and outstanding of such programs. The microfinance for very poor programs started small but eventually expanded to become reasonably large initiatives. At the end of 2008, the memberships have reached to 1.388 million. Since this type of program is implemented in phases (3 years or so) then merged with mainstream microcredit operations the memberships decline after each phase. These types of programs are seen essentially as social programs with substantial elements of subsidy such as in interest rate (Grameen’s program is interest free). They are characterized by smaller loan size, flexible savings deposits, and flexible repayment schedule; combined with substantial parallel investments in human development, notably free skill training and food aid for members. PKSF’s Hardcore Poor Program is managed through those of its partner organizations which can cross-subsidize the hardcore poor program. The programs are expected to expand substantially because of the need, support from PKSF and other donor agencies, and the opportunity to design special financial services for the very poor.

Table 4.6: Memberships of hardcore poor Program (2006-2008)

Name or groups of MFIs	2006	2007	2008
ASA [HCP]	198,417	171,807	52,062
BRAC [CFPR]*	1,400,000	132,500	305,614
Grameen Bank [Struggling members]	79,847	86,017	91,452
PKSF- SM POs [HCP] [95 partner MFIs in 2008]	668,987	850,506	939,185
Total	**2,347,201**	**1,240,830**	**1,388,313**

Source: Compiled by the author from MFIs, and other secondary sources;* combined data for CFPR/STUP and CFPR/OTUP; Phase I CFPR ended in 2006; Phase II (2007-11) started in 2007 with a target of 863,000 (STUP: 363,000 and OTUP: 500,000); Number of women trained has been used as members in BRAC/CFPR.

Table 4.7: Borrowers of the very poor programs (2006-2008)

Name or groups of MFIs	2006	2007	2008
ASA	187,398	178,141	95,417
BRAC/CFPR*	1,400,000	82,679	181,461
Grameen Bank [Struggling members]	79,847	86,017	91,452
PKSF- SM POs [HCP] [95 partner MFIs in 2008]	548,507	675,223	722,077
Total	**2,215,752**	**1,022,060**	**1,090,407**

Source: Compiled by the author using data from respective organizations *Phase I ended in 2006 and Phase II (2007-11) is under implementation

Table 4.8: Loan outstanding in hardcore poor program [Taka in million]

Name or groups of MFIs	2008	Deporting date
ASA	100	December 2008
BRAC/CFPR	n.a	
Grameen Bank [Struggling members]	33	December 2008
PKSF- SM POs [HCP] [95 partner MFIs in 2008]	2,126	December 2008
Total	2,259	

Brief Description of Very Poor Programs

A brief description of prominent programs such as BRAC's CFPR program, Grameen Bank's struggling members' (beggars') program, PKSF's Hardcore Poor Program (HCP), and ASA's hardcore poor loan program will illustrate the approaches and differences of hardcore poor program.

BRAC's Challenging the Frontiers of Poverty Reduction Program (CFPR) is the most comprehensive of all programs where many of the critical challenges faced by the ultra-poor people have been addressed by a number of program elements. CFPR works with two groups of people: specially targeted ultra poor (criteria are given in Table 4.5) and other targeted ultra poor (OTUP). OTUP are better-off than STUP category of ultra-poor. BRAC follows two approaches: grant-based and grant plus loan based interventions. The program is based on long experience of working with extremely poor people. During Phase I (2002-2006) 100,000 STUP participants received asset such as chicken, goats or cows, (though other types of asset purchases are possible), a subsistence allowance, and 1-on-1 as well as group enterprise training support. All of these participants have successfully graduated to regular microfinance operations. Another 1.3 million participants received subsistence allowance, enterprise training and soft and regular loans. All these participants have also graduated to BRAC's regular microcredit program The Phase II (2007-2011) seems to be more comprehensive where 863,000 (STUP: 363,000 and OTUP: 500,000) are expected to participate from 40 districts. Asset transfer, subsistence, essential health care, community support through community support group and soft loan are elements of the program [BRAC 2007]. But this is a resource heavy approach since it involves asset transfer and subsistence allowance.

Grameen Bank provides credit and guarantee services to participants of its ultra-poor program [Struggling members/Beggars' program]. Participants receive interest free loans for mainly petty trading. An excellent innovation is to provide guarantee to a shop owner to give goods of maximum of Taka 2000 on credit to a poor woman to sell door-to-door in villages. The poor woman will pay the shop owner after selling her goods and Grameen stands guarantee of the payment. This approach does not require any loan disbursement.

ASA has two different policies: a) include very poor families in its normal credit groups; b) establish separate organizations to implement 'flexible' financial services for the very poor people. Under the separate program, ASA has opened 38 branches. Loan ranges between Taka 1000 to 3000 and any repayment schedule is acceptable but monthly repayment is desired. The interest rate is 14.4% per annum (flat rate). ASA offers rehabilitation loan to poor people affected by any natural disaster. The loan is interest free to be repaid within one year.

Microfinance for Hardcore Poor (HCP) of PKSF: HCP has been designed by PKSF based on the successful experience of FSP-PKSF program for the ultra-poor. This special program is to target the bottom 15% of the rural populations who have been excluded by the mainstream microfinance programs. HCP is the largest microfinance program for the hardcore poor. The goal of the program is to reduce the poverty of hardcore poor and improve their quality of life.

Some key issues of this targeted program will be useful as explained below[13]:

- *Definition of hardcore poor*: The hardcore poor under the program are those who are unable to i) arrange three meals a day, ii) ensure the quality of food, especially for elderly, lactating and expecting mothers, iii) ensure minimum housing and clothing, iv) ensure their health care, v) establish rights of access to common resources, and vi) establish their [strong] existence in the society.
- *Target group of HCP Program*: To make the above definition operational the following groups are included under the program: i) landless people; ii) day labors and unskilled labors; iii) domestic helps; iv) beggars; iv) women headed poor households; v) slum dwellers; vi) families with irregular income; vii) seasonal labors affected by river erosion; viii) char dwellers; ix) poor ethnic minorities and x) other vulnerable groups.
- *Strategy for effective targeting of the program:* The Partner organizations of PKSF use three complementary strategies to ensure proper targeting of the program:
    a) Strategy to determine the location of the hardcore poor- PKSF and POs use GOB/WFP prepared poverty map to identify the Upazilas and char areas to identify for including them under this program. The focus

[13] This section is based on PKSF document 'Microcredit for the Hardcore Poor- PKSF's Initiative' (December 2005).

of the program is the North-western districts although it is gradually expanding to other poor Upazilas (sub-districts) and geographical pockets of the country.

b) Strategy to make microfinance attractive to the hardcore poor: This strategy is to make program features flexible/suitable with the economic conditions and capability of the target group.

c) Strategy to exclude/discourage the non-HCP from the program; The POs use wealth ranking technique as well as targeting criteria mentioned above to include the correct groups and exclude the non-target population from the program.

- *Group Management for HCP Program*: Some extra-steps are taken to manage the groups under HCP program: i) a profile format is filed in; ii) wealth raking technique is used to determine membership; iii) group size varies between 10-30 depending on the availability of hardcore poor in a village; iv) no multiple membership is allowed; v) flexibility in group meeting; and vi) no extra fees both in time of admission and subsequent loan disbursement.
- *Savings policies under HCP program*: i) small amount of savings determined by the members; ii) members may skip some weeks; iii) members may withdraw savings as and when necessary; iv) no link between savings and loan disbursement, especially for the first loan.
- *Credit policies under HCP Program*: i) small loan size as determined by the individual member (maximum amount of first loan is Taka 4000); ii) maximum rate of interest charged by the POs to the beneficiaries is 10% (flat rate); iii) flexibility in repayment of loan; iv) encourage beneficiaries to invest the monies in income generating activities but consumption loan may also be given in Monga areas; v) PKSF charges subsidized interest (1% per annum) to the POs.
- *Management Information System and Accounting Practices*: i) maintain profile of beneficiaries in designated format; ii) separate MIS for HCP program; iii) separate Head of Accounts in ledger, cash book and other registers/formats; and iv) create loan-loss provision as per PKSF's policy.
- *Training under HCP Program*: i) POs impart training to the members on social issues, environment, health care, sanitation, safe drinking water etc.; ii) POs organize training on savings and credit management, confidence building for IGA selection; iii) PKSF and POs organize training and workshop for staff members.
- *Additional services*: i) Create emergency funds so that short-term loan or grants can be given in emergency situation; ii) provide beneficiaries with additional services such as health, sanitation, education etc.

The HCP program has experienced rapid growth because of special impetus by PKSF and 95 partner MFIs and the numbers of beneficiaries have reached 939,185 by December 2008. Although this program is funded by GOB budget support, PKSF views HCP as a core program because of its size and its mandate of poverty reduction. PKSF will continue to fund this program from its own sources in case GOB does not add new finance. This is important for sustainability of the program. As complementary activities, PKSF advocates proper distribution of GOB safe net benefits to the ultra-poor, establishing linkage of poorer areas with export business, crop diversification, expansion of non-farm activities etc.

Anecdotal evidences show that the women mobilized belong to the target population and women are borrowing and repaying regularly. The loan amounts are sometimes as small as Taka 200. A part of the loan is allowed for consumption, which is an important consideration in running a microfinance program for the hardcore poor. The successful expansion of access to microcredit to the hardcore poor depends on three major factors: willingness and ability of MFIs to include the hardcore poor; financial and managerial support of PKSF in the form of loan capital and policy guidance; and ability of the hardcore poor to increasingly borrow money for investment purposes.

Box 4.2: Hardcore Groups by TMSS

Manikala women samity (29 members), Naogaon: No member of this samity has any agricultural land; the whole para (part of a village) is located on *khas* (government owned land) land for more than three decades. The main profession of the male members of the families is agricultural labour. A number of families are involved in petty trade (*ferri*), production of *chun* (calcium oxide) and rickshaw pulling. Two members (widows) are VGD cardholders who receive monthly food aid for two years. Three of them are involved in road maintenance of Local Government Engineering Department. The main problem faced by the group is drinking water. The whole para collects water from *indara (dug well).* The range of loan is Taka 1000-4000. The members invested in poultry and livestock, ferri and *chun* making. The possible areas of training are poultry and livestock rearing and tailoring. It seems the group is short of ideas what can be done in such places.

Ghatal para (27 members), Naogaon: The whole *para* has been a new settlement by migrant families from Chapai Nawabganj who lost their houses due to river erosion. They also live on *khas* land. The main sources of income of these families are day labor, petty trade, ferri, masonry etc. The main criteria applied by TMSS while forming the HCP samity is landlessness-- no family has got any agricultural land and one of them is a beggar. Two widows have VGD cards. The range of loans is Taka 200-4000. The weekly savings is taka 10 and can be accessed if needed. This group has good skill in weaving *nakshi khatha* and embroidery (former profession) who strongly feel that training and marketing assistance could help them earn additional income. The samples shown are of good quality but may not be trendy. Design and marketing assistance would definitely help produce good quality stuff.

Box 4.3: Hardcore Poor Groups in Rangpur, Lalmonirhat and Kurigram districts

ASOD Samity in Sadar Upazila: The samity of 38 women lives in *char* areas (former river banks and the river has shifted some distance now). Most of them are former members of Rural Road Maintenance Program. Targeting is very good because of the 38 members, eleven families do not have homestead, 4 are widows, 4 are abandoned and no family has got any agricultural land. The women and their husbands are mostly day labor. Children attend school and there is a GOB clinic nearby but service is known to be very poor. Group members primarily want employment. Some of them would like to get some training on poultry and livestock rearing, sewing and bamboo products making. Loan money from HCP has been mainly invested in livestock.

TMSS (Lalmonirhat) has mobilized under Belabari (Aditmari Upazila) branch some 549 members under 33 samities in 21 villages where RDRS does not have HCP. RDRS and TMSS have demarcation of working area. TMSS has introduced two types of savings products under its HCP branch: i) Taka 5 per week mandatory savings (Taka 2 for beggars); and ii) Taka 10 voluntary (Monga) savings, which members can withdraw any time. The target for TMSS is to mobilize 1500 beneficiaries under this branch. The loan range is Taka 600-4000. Most of the loans are for goat and poultry rearing, rickshaw van etc. The samities are smaller due to stringent selection criteria. A significant percentage (approximately 40%) of loan goes for consumption. The area in general is very poor where labor wage is very low. The main produces are rice, groundnut, tobacco and vegetable.. Poor people want relief (food aid during monga), sanitation, and training on useful income generating activities. In Falibari Sramajibee Mahila Samity (17 members) it was found that all members have homestead but no agricultural land.

Solidarity (a Kurigram based partner organization of PKSF) in Kurigram also implements HCP of PKSF. In addition to the savings and credit for the hardcore poor Solidarity has been active to highlight the monga and acute poverty in the district through print and electronic media. This NGO has conducted short poverty investigation and supplied them various newspapers. In addition it has been campaigning for wage employment, food for work and increased investment and infrastructural development in the district.

Summary of Experience from all Targeted Programs

The experience from various programs can be summarized as follows:

a) *Targeting and beneficiary selection*: Clear definition of target groups and operational criteria are needed to target and ensure inclusion of the hardcore poor under microfinance program. PKSF's hardcore poor program conducts wealth ranking exercises and uses clear criteria for identifying the hardcore poor. This process has been found to be useful and successful in including the correct beneficiaries. When left alone not all ultra-poor will join microfinance programs, even after receiving food aid and training, or MFIs will take them into their regular program without the right incentives.

b) *Financial services*: The financial services should be 'flexible' to meet the needs of the hardcore poor. The main flexible terms and conditions are as follows: savings deposits should be small and should be accessible at any time; loan amount should be small and according to the need of the borrowers; a part of the loan should be allowed for immediate needs including purchase of food (consumption) etc. The HCP program meets these criteria.

c) *Graduation*: Access to microfinance has to be sustained for a long time. Anecdotal evidences suggest that a significant number of ultra-poor gradually become members of regular microfinance program and come out of poverty.

d) *Training:* Targeted training prior to engaging in income generating activities, especially in poultry and livestock rearing, has been very beneficial for enhancing feed management, reducing mortality and gradually expanding the activities. Such training needs to be demand driven rather than giving everyone the same type of training. The training should be prior to engaging in the activity. In cases where a member cannot take the training her family members may also be included in the training. The main positive impact of effective training is the enhanced capacity to manage income generating activities. PKSF preferred package for the hardcore poor is a combination of flexible savings and credit service, and skill and managerial training.

e) The vaccination of poultry and livestock is crucial for success of the income generating activities.

f) *Marketing of produces*: Increasingly access to market has become crucial for various farm and non-farm products. The poultry sector has developed a good chain in marketing eggs and birds/meat but milk marketing may not be so simple. In some areas private processors such as Milk-vita, BRAC and *Pran* have set up chilling/collection centers.

g) *Linkage with private sector*: The ultra-poor women often ask for wage employment in addition to financial services for self-employment. Not all hardcore poor will or can borrow to become self-employed. Many projects in the past provided wage employment. There have been some evidences in the garments sector where the large entrepreneurs from Dhaka get a part of manual work (e.g. embroidery) done in rural areas. The poor women get wage employment. This type of work should be promoted by the NGOs to bring more and more private sector involvement in the rural areas. In addition to actively promoting linkage, the poor women will need to diversify skill training to perform a quality job.

Core Strategy and Competition

There is not much competition found in this segment of the financial service market. In many cases the very poor programs are cross-subsidized. Most of the programs, especially the non-financial services, are fully subsidized. Programs are either receiving interest or administrative grants to cover cost. The lending interest rate is either same as the normal microcredit programs or slightly less. For example, BRAC charges regular interest rate. On the other hand, PKSF funded ultra-poor program for Monga areas (North western Bangladesh) charges 20% per annum. Grameen Bank's struggling members' program is interest free.

Financing of Very Poor Program

Current finance for the very poor programs comes from PKSF, GOB, savings funds and donors. The RLF comes in the form of loan (lower interest rate) and non-financial services come from donors such as WFP, DFID-led consortium of donors etc. GOB in FY 2005 has provided Taka 1000 million to PKSF to provide microcredit to the very poor people in Monga affected districts.

Trends and Challenges

The current trends are to:

- Expand the outreach of the programs to include larger number of the very poor people;
- Absorb the very poor members within the mainstream
- Develop more and more demand-driven services; and
- Attain financial sustainability.

The obvious challenges are to:

- Attain sustainability of the programs;
- Gradually improve the conditions of the participants to 'graduate' into mainstream microcredit programs; and
- Develop more innovative products (Savings, credit and insurance) to attract the very poor and serve their financing needs.

Microenterprise Loan Program

Microenterprise loan has become another distinctive market segment being served by the MFIs. This has been due to several factors: demand from better performing ('graduating') borrowers for larger loans compared to loans normally given under 'mainstream microcredit'; demand from small enterprises throughout the country, which are not the members of microcredit groups but willing to take loans for running or expanding businesses; small enterprises that do not qualify for receiving loans from commercial banks but need capital for running a larger business; MFIs are also actively seeking to expand portfolio (and income) by serving this group. Another reason for devising loan product for this group is that microenterprises create wage employment for poor people in addition to self-employment for the owners.

Box 4.3

Profile of microenterprise financed by MFIs

- Both 'graduates' of mainstream microfinance programs as well as informal businesses employing less than 5 persons excluding family labor.
- 'Business' with a minimum working capital of Taka 30,000
- Enterprises with prospect for employment generation
- Informal (without legal registration) and formal businesses should be included.
- Micro-entrepreneurs and microenterprises with successful track records
- Families able and willing to take risk to expand current income generating activities
- The program should include all profitable businesses.

Definition of Microenterprise

In Bangladeshi context, there is no uniformly understood definition for microenterprise. The term is used to indicate that they are larger than income generating activities financed by microcredit programs. One definition use employment criteria. An estimated more than 5 million informal businesses operate all over the country, which employ less than 10 persons [MIDAS&ICG 2004]. These are bigger than the millions of family-managed income generating activities financed by microfinance programs all over the country. Although there is no acceptable uniform definition, the following characteristics may be used to develop a profile of such ventures: employ less than 10 persons; employ capital machineries in case of manufacturing units; capital is between Taka 20,000 to 1,000, 000; sells within the local as well as distant markets. In case of financing, the borrowers may be 'graduates' of microcredit programs or existing microenterprises managed by 'near poor' or non-poor who are given individual loans. The loans could be given for any farm and non-farm business including agro-processing and larger scale poultry, livestock and fisheries. The defining characteristics would be loan amount; i.e. the loan amount is between Taka 30,000 to Taka 500,000. The program is also separately identified and managed within the MFIs.

Consultations with MFIs and existing microenterprise borrowers describe the profile of microenterprises as presented in Box 4.4. Development and promotion of large-scale microenterprise program needs several assistances (Box 4.5). Unlike the mainstream microfinance, ME development program needs both financial and non-financial services. Both long-term project finance and working capital finance have been identified as crucial. In addition, non-financial services in the form of assistance for accessing market, information, technology, and management and technical training have been identified as priority areas.

Box4.5
Services for ME Development

- Credit for customers (working capital and long-term project finance)
- Savings services
- Linkage with financial institutions and insurance companies
- Professional management and production technology related skill development training
- Access to market in the form of information and contact with buyers, especially exporters and larger companies
- Assistance for product development and improvement
- Improved system of information dissemination about technology, transfer of technology, management, markets, and finance
- Product and management skill development training for entrepreneurs and employees
- Business counseling
- Access to business and agricultural insurance

The current lending techniques are more or less similar to the microcredit lending except that loans are given to individual clients without group formation by some MFIs such as ASA and BRAC. On the other hand small and medium MFIs that finance the graduates of microcredit program use group lending method. The consultation suggested the following features are appropriate for the segment of the market, although the participants wanted more innovations in credit methodology to reach this segment of the market:

- Loans for individual microentrepreneurs, partnerships and small groups;
- Loan amount, repayment conditions (repayment installments) and duration according to the nature of business
- Both working capital and long-term project loan facility
- Lower interest rate compared to microcredit (interest rates similar to commercial banks)
- Insurance assistance probably through establishing linkage with insurance companies

Coverage and industry structure

The relatively new frontier for NGO-MFIs is lending for expansion of microenterprises managed by 'graduates' from microfinance programs as well as millions of informal businesses throughout the country, which so far are living outside the NGO-MFIs lending programs. This segment is significantly underserved, but potentially involves very large number of enterprises and opportunities for employment, including wage employment. Two features separate them from microcredit borrowers: larger loan amounts with longer duration; and the need for non-financial services such as access to market, information and appropriate technology, assistance for product improvement and development, training for workers' skill development and management training for skill in financial and business management of the entrepreneurs. PKSF and the commercial banks should be major potential sources of funds. The more challenging area will be how the necessary non-financial services can best be provided in the most cost-effective manner and at an affordable price to microenterprises. Some commercial banks have started small lending windows to reach the small borrowers with loan range from Taka 50,000 to 500,000 (for example, BASIC, Agrani Bank, Islami Bank, Prime Bank). But compared to NGO-MFIs commercial banks are more experienced and reached more clients than NGO-MFI programs. A similar trend is visible in lease finance sector where leasing companies are reaching out smaller clients. MIDAS Limited is the pioneer in this segment of the market. The borrowers are very small entrepreneurs from urban and semi-urban areas. In this segment also the growth rate is slow and it is of the recent phenomenon. Table 4.9 summarizes microenterprise loan programs. ME loan program has also started slowly but has reached significant size in 2008: 2.4 million clients with Taka 22,197 million outstanding loan. Slowly smaller MFIs are also entering this segment.

Table 4.9: Borrowers of microenterprise programs (2006-2008)

Name or groups of MFIs	**2006**	**2007**	**2008**	**Loan outstanding (Dec 2008) [Taka million]**
ASA	241,556	301,901	445,236	7657
BRAC	113,551	199,442	242,512	2462
Grameen Bank [cumulative]	1,016,495	1,271,660	1,643,775	8236
PKSF- Small Partner Organizations* [132 Partners in 2008]	131,065	144,116	102,377	3842
Total	1,502,667	1,917,119	2,433,900	22,197

Source: Compiled by the author using data from the respective organization;
* Decline of ME in 2008 was due to exclusion of BRAC clients.

Brief Descriptions of Prominent Programs

A brief description of on-going prominent ME development programs would highlight the current structure and practices:

- Grameen Bank: Grameen Bank provides larger loan amount to microenterprises for 1 to 3 years. The cumulative number of borrowers is 1,643,775 (up to December 2008) with outstanding loan of Taka 8,236.68 million [Grameen Bank 2008].

- BRAC- *Progoti*: The Progoti program (formally known as MELA) established in 1996 currently serves two types of clients both in rural and urban areas: ‘graduates’ of microfinance program, and the non-poor microentrepreneurs. Loans are provided to individuals ranging Taka 50,000-300,000 for 12-18 months at an interest of 30% and paid in monthly installments. Progoti does not ask for any matching funds from borrowers but requires collateral from the non-poor, but not from poverty graduates, whose loans may be secured by personal guarantees, and hypothecation of assets. Loans are primarily used to finance working capital, and occasionally for the acquisition of fixed assets. At the end of December 2008, Progoti had 242,512 borrowers with average loan size of more than Taka 110,000. The loan outstanding at the end of 2008 is Taka 2462 million [BRAC 2009]. In general, 70% go to the trading sector, 10% to manufacturing, and 20% to other sectors; loans are generally given in 20 specific sub-sectors. Progoti has separate management structure to manage the program. The program is profitable and is expected to expand fast, provided necessary loan capital could be mobilized.
- Small Enterprise Loan (SEL) of ASA is targeting microenterprises for ‘productive purposes’ (for example, manufacturing and processing), that is, ASA under this program avoids traders. The loan range is Taka 30 000 to Taka 300,000 and interest rate is 28.8% per annum. Loans are for 12, 18 or 24 months collected in monthly installments. SEL had 83,584 borrowers at the end of 2008 with Taka 3,296 million in loan outstanding.
- Under Small Business Loan program ASA lends between Taka 25 000 to 50 000 to shop owners in rural market places to finance inventory. The interest rate is similar to the mainstream microfinance, i.e. 28.8% per annum. The outreach reach is 393,006 members with loan outstanding of Taka 4,361 million (December 2008).
- ME-PKSF funded NGOs: PKSF under a separate lending window provides loans to its partner organizations to finance microenterprises of ‘graduates’ of microcredit programs. The terms and conditions are as follows: Loan range Taka 30,000 to 300,000; duration 12-24 months; interest rate 25% per annum; and repayment is in monthly installments. Up to December 2008, 132 SM-POs have 102,377 borrowers and Taka 3,842 million outstanding loans. PKSF is expected to expand this program.
- The Micro Enterprise Development Initiative (MIDI) is a special credit program of MIDAS Financing Limited, non-bank financial institution provides loans to small entrepreneurs, especially among women, with the following terms and conditions: Loans range from Taka 50,000-500,000, with an allowable debt-equity ratio of 80:20; interest rate is 14.5% (declining method); loan duration 12-36 months; collateral is not required for loans but must be secured by the personal guarantee of the sponsor or a third party. MIDI only lends to enterprises having as legal entity (a proprietorship, partnership, or private limited company).
- *Commercial banks:* There has been a visible trend in the private and nationalized banks to try to reach out the microenterprises. For example, Islami Bank Bangladesh Ltd., Prime Bank, Mercantile Bank, Agrani Bank, Sonali Bank etc. have introduced lending schemes to meet the demand of smaller borrowers. The features of these loan products are more or less similar: loan range Taka 50 000 to 500 000; duration 12-24 months; interest rate similar to other commercial loans; monthly repayment; Collateral and or personal guarantees are required. Discussions with officials reveal that banks find this segment profitable. But private banks suffer from limited outreach of branch network except IBBL. But NCBs find limited human resources as the main bottleneck because the small loans need stronger supervision and monitoring.
- *Leasing companies*: Although leasing companies are not in a big way in this segment but increasingly some leasing companies are getting involved in small leases. They are the biggest borrowers of Bangladesh Bank managed SME Fund, which targets Taka 200 000 to Taka 5 million range. But it appears from discussion with participating leasing companies that they are targeting top end within the band from cost and management consideration.

Core Strategy and Competition

The strategy under the segment is yet to become clear. MFIs and banks are still in experimental mode regarding lending to this segment. Although the loan range is between Taka 30,000 to 500,000 but the average loan size is still around Taka 100,000, which indicates a cautious approach by the MFIs. They are targeting the lower end of the segment. The present coverage compared to the potential size is small. Therefore, unlike the mainstream microcredit this is a virgin field with limited competition. But with appropriate initiatives the growth in this segment may make huge impact on employment and poverty.

Management of Microenterprise Program

A World Bank study [Alamgir, 2007] based on case studies of ASA, BRAC *(Progoti)* and PKSF microenterprise program shows the following:

- *Loan range:* The loan range is similar for all three MFIs, similar between Taka 20,000 to 200,000 (very recently BRAC has changed to Taka 50,000-500,000 and PKSF has a limit of loans made by partner organizations (POs) of Taka 30,000-300,000). The first loan is normally on the lower end of the range. Subsequent loans are disbursed on the basis of a feasibility report, not automatically increased as is often the case with MFI loans to the poor.
- *Disbursement:* Large loans are disbursed through an account payee check, which is considered additional proof of disbursement. Sometimes opening a bank account can be problematic for borrowers due to non-cooperation of commercial bank branches.
- *Duration and repayment:* Although the written policies for ASA, BRAC and PKSF allow loans of more than one year, in practice most loans are made for one year. Field managers prefer one year loan, which, they feel, ensures better repayment due to the expectation of repeat loans of larger amounts. ASA and BRAC collect loans in equal monthly installments, which is a preferred system by borrowers as compared to a weekly system. PMUK, a partner of PKSF, collects weekly installments, a practice replicated from the standard group-based microcredit system.
- *Areas of investment:* Any profitable legal business can be financed under this program. Experience shows that about 70 percent of the borrowers operate some kind of trading business.
- *Interest rate:* The interest rate for BRAC is 15 percent (flat) per annum whereas PMUK charges 12.5 (flat). ASA charges 14.4% (flat).
- *Processing Fees:* The loan appraisal and processing and documentation fee varies between the programs. PMUK does not have any loan appraisal fee, but ASA and BRAC charge 0.2 and 0.5 percent of the loan, respectively, as an appraisal fee, and collect the fee before the disbursement of loan. Additional processing expenses are incurred by the borrowers such as documentation, application fees, etc. For example, BRAC's borrowers pay documentation expenses of Taka 435 irrespective of loan size. This expense excludes the expenses for the borrowers to prepare any legal papers related to the land mortgaged to BRAC as collateral.
- *Guarantor:* All three MFIs require loan repayment guarantees from a guarantor in case of default. This practice has become an industry norm.
- *Collateral:* Only BRAC requires land as collateral. It does not registry the mortgage deed but get the deed notarized by a 1st Class magistrate or GOB-nominated lawyer. BRAC's approach to the use of collateral is similar to the commercial banks.
- *Documentation requirement*: All MFIs require extra documentation in the form of a signed agreement on a non-judicial stamp along with guarantor's signature, promissory note and application form. BRAC requires additional documentation related to land mortgages.

- *Management system:* As indicated above, group-based as well as individual lending systems are practiced. ASA and BRAC follow an individual lending system. All PKSF partner-MFIs lend through their existing groups that hold weekly meetings. Since borrowers of SEL/ASA and Progoti/BRAC are spread over a large area (50 to 100 borrowers per branch), it is less feasible to organize groups and conduct monthly meetings. Borrowers either repay their loans at branch offices on the repayment date or loan officers visit the borrowers to collect the installments.

Conditions for Successful Replication and Scaling Up

The study finds the following factors important for scaling up of microenterprise loan:

- *Strong microfinance program:* An essential pre-condition for replication of the models used by these case study institutions is that the MFIs must operate strong microfinance programs. This will demonstrate that they have managed to resolve basic product design and management issues, recruit and train staff, develop a branch network, and attract and retain a portfolio of member borrowers. Their existing branches can be used to launch new products, their current borrowers are a good source of information about potential new clients, and their most successful microcredit borrowers represent a pool of potential candidates for ME loans. They can select existing staff for additional training as loan officers for the new products and, with training, their branch managers can learn to assist with appraising prospective borrowers and monitoring the performance of the new products.

- *Product design and pilot testing*: MFIs that have successfully designed and launched new products are the best sources of information for other MFIs about the changes required to successfully serve new market segments. Prior to any large scale roll out of new products, each new entrant into the market segment needs to develop its own products and carefully conduct small-scale pilot tests including the training of staff, making adaptations to internal management, control and MIS, and monitoring the performance of the products.

- *Managing risks*: MFIs can employ several techniques to help minimize risks as they begin to serve MEs. First, consistent with their standard policies for MF lending, they can slowly increase loan size so through repeat loans they can evaluate the debt repayment capacity of borrowers. MFIs should proceed slowly to test their designs and methodologies with this new market segment and keep a balance between these loans and other types in their portfolios.

- *Human capital:* The relatively low education levels and skills of most MFI staff are adequate for Grameen style group lending based on making and recovering small loans using a lending technology that uses simple repetitive manual transactions. But greater analytical skills are required for loan officers and branch managers who must conduct more sophisticated credit analysis, make lending decisions, and monitor borrowers with larger agricultural and non-agricultural loans. Therefore, a major upgrading of employee skills is a fundamental requirement for MFIs that seek to grow by entering these market niches. An important feature of successful MFIs in competitive environments is a speedy approval process for loan applications, which requires a considerable degree of decentralization of credit approval authority.

- *Financial resources*: ME loan program needs significantly enhanced resources base of MFIs since the average loan size is about 6 to 10 times of mainstream microcredit.

CASE 1: Small Business and Small Entrepreneur Loan of ASA

ASA is one of the MFIs that have a large-scale microenterprise program: one for the small businesses (shop owners and traders) and one for the production type enterprises. Within each branch's operational areas there are small bazaars full of shops in permanent and semi-permanent structures. Besides, a percentage of women clients do better than the other group members who need larger loans than small loans. These two groups are now included under the new Small Business Loan (SBL) program. To give exclusive focus on 'production oriented' enterprises ASA began the Small Entrepreneur Loan (SEL) program initially in some selected areas and is gradually incorporating them under its regular branches. These two loan products have targeted more enterprising groups who are normally bypassed by commercial banks because of small size and lack of collateral and by regular microcredit programs because of demand for relatively large loan. ASA's strategy of diversification fulfills this unmet demand. The SEL client group has the potential of creating wage employment for the poor people but SBL may not have the same opportunity.

The identification and assessment process is reasonably elaborate for this type of relatively large loans:

- *Identification of potential Clients*: A Loan Officer makes reconnaissance visits within his/her working area to find out various farm and non-farm enterprises. Often the members from ASA's regular groups provide information. Since these types of businesses are not in large numbers it is not difficult to locate them. Loan officers explain ASA's program to potential customers during their visits and in the process learn about the businesses and entrepreneurs. Brief notes about the program are also distributed to the businesses. This process generates a list of potential clients in the area.
- *Assessment Process*: ASA follows two stage assessment processes in case of SEL: i) A potential borrower fills in a simple application form with desired loan amount and basic information amount about his/her business such as type of business, location, monthly family income etc. Then the Loan Officer follows prescribed 'feasibility appraisal' process developed by staff members. ii) The District Officer checks the feasibility report by verifying the information gathered and analysis is done by the Loan Officer.
- The feasibility study investigates (all information are recorded in a prescribed form) all aspects of the business such as: i) marketing: main customers, location, monthly sale etc; ii) technology involved in the business; ii) management capacity of the owner and the technical skill of the workers; and iii) determine total assets; total capital and source of capital; profitability of the project by determining income and expenses and nature of cash flow. The analysis leads to the determination of the size of loan. However, often the cash-flow may not match with the monthly loan repayment scheme so the loan officer determines the other sources of income of the entrepreneur to ensure monthly repayment.
- The loan approval is delegated to the District Officer who after his own verification by visiting the business approves or rejects the loan;
- If approved, a formal loan agreement is signed.
- *Group Management and Policies:* The two products have two systems. The small business loan requires formation of groups of 10-15 clients in the bazaar (for the shop owners) or any other convenient place. Unlike the group meeting of regular microcredit (small loan) groups, the group meeting for SBL is just a transaction place where the clients appear at a designated time to repay the installments. This is to reduce transaction costs of ASA. On the other hand the SEL is an individual loan and no group meeting is organized. The clients pay in check, or cash at the ASA office or the Loan Officer collect installments from the clients' premises. The summary of savings and loan policies are already discussed above. The outreach of ASA's program is given below.

Microcredit for farmers/seasonal loan

Introduction and product design

This is a new frontier for MFIs. Earlier days microcredit used to be disbursed for non-farm activities in most cases trading and businesses so that borrowers can regularly make week repayments. But even in earlier days a significant part (about 30-40%) of microcredit was disbursed for livestock rearing, one of the most popular activity for poor rural households. Borrowers used to repay loan from other sources of family income. Since microcredit mainly targeted functionally landless and marginal farmers, microcredit was disbursed to cater to the needs of these groups of people. Farming families were consciously avoided as non-target groups although sometimes as high as 30% members were found non-target. In addition, about 90% members are women whereas, by definition farmers mean men MFIs by and large avoided this segment and to some extent are reluctant to go into agriculture (crops and horticulture) for fear of loan default although the need and demand from this segment has been well recognized. Traditionally this segment has been the territory of agricultural credit programs of nationalized commercial banks, BKB and RAKUB. But the quality and outreach of the banks' programs are very poor.

Similar to microenterprise segment some MFIs are gradually moving into directly financing crop sector. Selected Partner MFIs of PKSF under four (4) projects and BRAC are leading in this segment. In this section, we deal with these specialized programs although many marginal farming families are already participating in mainstream microfinance programs. Two types of loan come under this category: loan given to small and medium farmers for agriculture whether as one year loan or as seasonal loan (5-6 months) and loan given to any borrower for seasonal agricultural activities such as crops/horticulture, fisheries, and livestock.

The main features of this product are:

- *Target group*: small and medium farmers and loans are mainly for field crops and horticulture. Seasonal loans are also mostly for crop production but may include agricultural activities;
- *Loan range*: Taka 10,000 to 50,000 but sometimes linked with size of land in case of crop production
- *Duration*: 5-6 months and one year
- Repayment: weekly, monthly or lump-sum at the end of the specified period (harvest or sale of livestock)
- *Interest rate*: 10-15% (same as mainstream microcredit)
- Lending technique: Group method

Aggregate Analysis of Microcredit to the Farmers

Table 4.10 and Table 4.11 present memberships (2006 to 2008) and loan outstanding (2008) of prominent programs for marginal and small farmers respectively. A total of 2.263 million members/clients are under this segment with loan outstanding of Taka 11,137 million. MFIs are slowly entering this segment.

Table 4.10: Members under microfinance for small and marginal farmers

Organizations/programs	**2006**	**2007**	**2008**
BRAC*	n.a	666,000	1,232,786
PKSF-partners (MFSMF)	71,363	117,383	162,162
PKSF-Seasonal loan	35,382	65,398	68,578
MFTSP	255,910	250,370	252,525
PLDP-II	408,276	478,994	547,564
Total	770,931	1,578,145	2,263,615

Source: Respective organization; *BRAC 'At a Glance March 2009'

Table 4.11 Agricultural Loan Program [2008]

Programs	Participating MFIs (#)	Loan Outstanding (Taka in million)	Members (#)	Borrowers (#)	Reporting date
PKSF-MFMSF	25	939	162,162	120,981	December 2008
PKSF-Seasonal Loan	97	571	68,578	68,578	December 2008
PKSF-MFTSP	24	1255	252,525	181,547	December 2008
PKSF-PLDP-II	15	1957	547,564	371,618	December 2008
Total		4722	1,030,829	742,724	
BRAC (Unnati)*	1	6,415	1,232,786	817,846	March 2009
Total		11,137	2,263,615	1,560,570	

Source: Respective organization; *Data reported in 'BRAC At A Glance' March 2009

Brief Description of Prominent Programs

We will discuss four PKSF projects and BRAC's agricultural loan program:

Microfinance and Technical Service Project (MFTSP): PKSF implements this program through 25 partner organizations. This project focuses on poultry sector where loan, training and technical assistance are provided to the borrowers. Besides, 'poultry chain' is developed as a part of poultry development program. As many as 25 MFIs are involved in this project. They have organized 252,525 members of which 181,547 are borrowers with loan outstanding of Taka 1255 million (December 2008). The interesting aspect of the program is the combination of financial services and training on poultry and livestock production. The difference in this project is that each borrower qualifies to receive a training of their choice, normally before taking on an income generating activity. The training is demand driven. The priority has been on poultry and livestock development. The contents of the training course include introduction on various breeds, feed management, disease prevention and cure, costing and pricing, and awareness about marketing. Specialized long-term (28 days) training is offered for hatchery development and management. The training methodology gives emphasis on effectiveness of keeping in mind the capacity of the ultra-poor. The training program is backed by follow-up support by dedicated staff members and credit for undertaking the income generating activities. Initial experience has been very positive, which shows that trainees have been successful in employing their new skills to start new and/or expand existing businesses. For example, ultra-poor families have gone into chick rearing, production of fertile eggs, chick rearing for eggs, rearing goats and cattle etc. As a part of supporting the whole poultry development some poor families have been trained in chicken hatchery development, and in many villages they have actually started chick hatchery to supply day-old chicks to chick growers. In addition, poultry workers (vaccinators) and egg traders have also been developed within the samity members. The process has developed the full chain of production, rearing, marketing and support service within the village and within the access of the ultra-poor. The training program is managed by the participating POs by recruiting trainers from staff members, the private sector, individual trainers, and GoB departments.

Participatory Livestock Development Project –Phase II (PLDP-II): This special credit and capacity building project with heavy emphasis on production/technological training funded by PKSF with loan from the Asian Development Bank that targets the moderate poor with poultry and livestock rearing and related businesses is the main focus of the loan program. Fifteen MFIs are involved in this program which has organized 547,564 members and the number of borrowers is 371,618 with outstanding loan of Taka 1957 million (December 2008). Loans are given for one year. The training to the potential borrowers has been used as a pre-requisite for receiving loan. The project has separate management office, which facilitates all training courses in collaboration with the participating Partner Organizations. The training has been found to have built confidence among the poor, assisted them to undertake and expand the income generating activities enhanced livestock feed management and reduced mortality rates. The program has also ensured vaccination using local vaccinators and establishing linkage with the local Department of Livestock Services office. Some efforts have also been taken to market the products though more organized facilitation accessing market, benefiting the beneficiaries. The challenge remains to make the training courses more effective by revising contents and improving delivery system. In addition, the dependence on NGO and GOB trainers may be reduced by promoting private training providers.

- *Microfinance for small and marginal farmers*: This is an exclusive project to address the needs of small and marginal farmers. A total of 25 MFIs are implementing program with a target of reaching 220,000 farmers by 2010. Current (December 2008) membership is 162,162, borrowers 120,981 and loan outstanding is Taka 939 million. MFIs form separate groups for receiving crop and other loans. Loan is repaid either in weekly or monthly installments. A number of MFIs are practicing single installment repayment.
- *Short-term seasonal loans* have been offered by 97 MFIs to 68,578 borrowers with loan outstanding of Taka 571 million. These loans were made for terms of 3 to 6 months with disbursements in one or two installments. Seasonal loans are repaid in one or more installments at the end of the season.
- Other MFIs: BRAC has launched *Unnoti* for small agricultural producers. The loan range is Taka 10-50,000 depending on the size of farm. At the end of 2008, the *Unnoti* has1.23 million members and 817,846 borrowers.

Management of Agricultural Credit: Cases Studies

An estimated 6-7 million households are regularly engaged in agriculture (field crop). That means a very small percent of total demand is currently met by MFIs because they still consider agricultural loans are risky and farmers, being men, are risky borrowers as opposed to women borrowers. But slowly MFIs are accepting men as their clients for agricultural and seasonal loans. The discussion below is based on a World Bank study [Alamgir, 2007] based on three partner MFIs of PKSF who are engaged in agricultural credit: i) Sojag which disburses loan to men (farmers) during two main production seasons (mainly for *amon* and *boro* production of rice) and collect it in single installment after harvest; ii) BEES extends agricultural loans through women groups from small farmer families and use weekly collection system; and iii) CARB used to give in-kind loan (inputs such as fertilizer and water) to men and collect loan in cash after harvest. However, CARB has failed as an organization because of governance issue that was nothing to do with the microcredit program. On the basis of the success of seasonal loan of Sojag, PKSF has expanded the program throughout the country.

Introduction to three sample MFIs

BEES is a small to medium sized MFI operating in 28 districts through 83 branch offices that supplied microfinance to over 96,000 women and men as of June 2006. Ten of its 83 branches specialize in delivering credit to small farmers under two IFAD funded special projects channeled through PKSF. The Microfinance and Technical Support Project (MFTS) provides training, technical assistance and finance for poultry and livestock development in eight branches. Two branches offer microcredit designed for marginal and small farmers (MFMSF). Together these two projects accounted for loans to about 11,400 farmers in FY 2006 (12 percent of total borrowers) with total disbursements of 72 million Taka, representing 13 percent of BEES' total disbursements for the year.

CARB was registered in 1998 as an NGO to conduct agricultural development activities in NW Bangladesh in the Barind Tract. It is a semi arid region that requires irrigation water for cropping during the November to April dry season. Water is supplied by thousands of deep tube wells drilled by the Barind Multi-Purpose Development Authority (BMDA) of the Government of Bangladesh (GOB). CARB implements a variety of development activities aimed at improving farm production, promoting the use of hybrid seeds, and environmental protection. It began offering crop credit only in 1999 with funds supplied by the National Bank and PKSF. Funding for its other components comes from a variety of donors. The number of loans disbursed per year has grown from just over 100 in 1999-2000, to almost 20,000 in FY 2006. Disbursements in FY 2006, mostly to men, totaled over 87 million Taka in three production seasons. The in-kind lending program of CARB is unique among MFIs., Farmers within the command area of a deep tube well are organized into a borrowing group of 15-30 members. Loan officers, referred to as Farm Managers, prepare crop budgets for the individual farmers who can acquire in-kind production inputs during the production season within the overall limits of their budgets. For each purchase, the farmer travels to the CARB branch to receive a delivery order that is taken to an authorized input supplier who supplies inputs in the form of seeds, fertilizer, pesticides, or irrigation water. The farmer may obtain as many delivery orders per season as he/she chooses. About 49 percent of the credit disbursed has reportedly been used for fertilizer.

Sojag is the smallest of the three MFIs. It was established in 1985 in Sailan village in the Dhamrai sub-district located just 50 kilometers north of Dhaka. It is a low lying area but has not been flooded in the past several years. Its' Grameen style Credit Plus programs were started in the early 1990s by organizing farmers around deep tube wells and using tube well managers to disburse and recover loans. That initiative failed and a second was launched with a DANIDA funded three year project (1999-2001) that provided credit, training for farmers, and extension services supplied by project and GOB staff to expand the adoption of a high yielding rice variety. Its success led to it negotiating a special seasonal credit line from PKSF in 2004 to expand lending. PKSF has now expanded its Seasonal Loan window for its partner organizations. Microcredit has grown to be the largest program in Sojag in terms of members, staff members and resource allocation. Other programs include fisheries and livestock development, social forestry, non-formal education, and disaster management. In addition to offering seasonal crop loans, three other credit products are offered similar to many other MFIs that receive PKSF support: rural microcredit, microenterprise credit, and credit for the hardcore poor. Marginal and small farmers are targeted for seasonal crop loans and membership in the program has grown steadily from about 2,000 in 2002 to over 7,700 in June 2006. As of June 30, 2006, the 4,300 crop loan borrowers with outstanding loans represented 43 percent of Sojag's total borrowers and their 21 million Taka in outstanding loans represented 37 percent of the total portfolio. However, data at the June cutoff date for the fiscal year are not an ideal indicator of relative importance because many crop loans have been repaid by that date. Using crop loan disbursements during FY 2006 as the indicator, the importance of crop lending rose to 46 percent of Sojag's total annual disbursements.

Comparative analysis of performance

Characteristics of loan products: The loan products of the three MFIs are summarized in Table 4.12 and the differences in lending technology are obvious. The BEES loans are essentially an adaptation of the standard Grameen style Credit Plus group lending technology applied to agriculture. Cash loans are made to poor SMF households, primarily to women, engaged in a variety of farming activities payable in a year in 45 weekly installments. Similar to its other credit products, BEES forms groups or samities composed of 15-40 women that meet weekly for 45-60 minutes to engage in financial transactions and to occasionally receive other services such as a monthly health check up of women and children by paramedics who visit the groups. Weekly savings are required which earn an annual rate of interest of 5 percent.

CARBs use of in-kind lending is a throwback to techniques used years ago by many state agricultural development banks that attempted to channel funds to specific targeted purposes. In-kind lending was designed to control the diversion of funds to unauthorized uses. CARB loans are designed to assist marginal, small and medium farmers who have access to two important inputs for dry season cropping, namely land for cultivation and water for irrigation. Farmers within the command area of a deep tube well are formed into samities of 15-30 mostly men farmers but they meet only at the beginning of the season to determine farm budgets and at the end of the season to determine loan repayment dates. A credit committee is formed of 3-5 borrowers to identify and recommend the selection of farmers for loans, and to accept informal responsibility for recovering loans. The farmers obtain delivery orders for use in acquiring water and complementary inputs of seed, fertilizer and pesticides. Input suppliers or dealers for these inputs are screened and pay a fee of Taka 10,000 as security money to guarantee a supply of inputs for participating borrowers. The dealers are paid on a weekly or fortnightly basis for the delivery orders they submit to CARB. Branch managers collect and record input prices daily from the dealers and periodically post the borrowers' purchases to their accounts.

CARB's lending methodology imposes large administrative costs on the MFI that may discourage other lenders from adopting it. Although CARB's annual effective interest rate of 29.2 percent (Taka 0.80 charged per day per Taka 1,000 borrowed) is the highest of the three MFIs, the farmers find it attractive and are willing to accept the transaction costs of obtaining multiple delivery orders because interest is charged only for the actual purchases from the date of purchase to the date of repayment. Most farmers try to minimize interest charges by getting delivery orders for only those inputs that are immediately used rather than getting fewer orders for larger quantities and storing the extra inputs until needed.

Table 4.12: Comparison of SMF Loan Products

MFI	Target clients	Loan range (Taka)	Interest rate (Flat rate) (%)[14]	Group based versus individual management	Collateral requirement	Guarantor	Group meeting	Duration of loan and installments
BEES	Poor women from SMF households farming 0.5 to 2.5 acres engaged in crop, livestock and poultry activities in NW Bangladesh	12,000 to 25,000 Taka in cash loans	12.5 % with weekly payments, annual effective rate of 25%	Group based, loans to individuals	None	No	Weekly meetings for financial transactions and delivering other services	One year, 45 weekly installments
CARB	Poor SMFs using deep tube wells in Barind Tract, NW Bangladesh. Loans made largely for rice production	In-kind loans covering production inputs <2,000 to >10,000 Taka, ave. 4,410 Taka in 2006	Interest charged on each purchase order until repayment at Taka 0.80 per Taka 1,000 for annual effective rate of 29.2%	Groups based on using the same well, loans made to individuals	None	No	None	Production season of 5-8 months, paid in one or two installments after harvest

[14] Several MFIs express their rate of interest as a "flat rate", i.e. the total interest due is calculated as a flat percent of the loan amount and added to the principal. The total principal and interest is then amortized over several weeks or months. The annual effective rate becomes roughly double the quoted rate. The Grameen Bank, commercial banks, and leasing companies quote actual rates.

MFI	Target clients	Loan range (Taka)	Interest rate (Flat rate) (%)[14]	Group based versus individual management	Collateral requirement	Guarantor	Group meeting	Duration of loan and installments
Sojag	Poor men on SMFs cultivating 0.5-2.5 acres, especially rice, in Dhamrai Sub-district, north of Dhaka	Linked to amount of land cultivated. Up to a max. of 9,000 Taka	Annual effective rate of 15% paid in one installment	Group-based, loans to individuals	None	Yes	Monthly meetings; priority for attending at the beginning of the cropping season and at harvest	Production season of 5-6 months; paid in one installment after harvest

Sojag uses a variation of its group based methodology. Most borrowers farm one to 2.5 acres of land and normally have other sources of income. Samities are formed with 15-30 male members and hold monthly rather than weekly meetings for financial transactions including savings. This adjustment in meeting frequency fits the reality that many male members are reluctant to attend meetings. Even so, meeting attendance is only 50-60 percent and is especially low during planting and harvesting periods. Members deposit a fixed amount of Taka 40 per month in savings for as long as they are members. These savings earn 5 percent annual interest. They can be withdrawn in case of emergency, for important occasions, or if they leave the MFI. Between meetings, the loan officers visit the borrowers and provide some technical assistance on seed selection, use of fertilizer, irrigation management, and pest control.

Loan sizes are largely determined by the amount of land operated by the borrower with a maximum of Taka 9,000 in 2006. Two seasonal disbursements are made per year. The rule of thumb is Taka 2,500 to 3,500 per third of an acre (*bigha*) cropped depending on season of the year. Rice is the most important crop financed. No collateral is required but the samity leaders are held responsible for repayment. The loan term is approximately six months and payments are made in one installment. The loan officers along with the samity leaders determine the repayment dates which are set to fall within one month of harvest. Repayment dates are adjusted so that not all samities in the same village have the same repayment date. Simultaneous dates could cause liquidity crises in villages because villagers are known to borrow from each other to meet payment deadlines.

Profile of clients: The BEES clients are exclusively women drawn from poor families with an acre or two of land. Paddy, jute, fruit and vegetable are the primary crops for which loans are borrowed. Usually the family has another source of income so there are overlaps because family members may participate in more than one type of BEES group and borrow through each group. For example, they may borrow seasonal crop loans while participating in other BEES programs from which they borrow for diverse non-agricultural activities such as grocery stores, rickshaws, and other small enterprises.

CARB borrowers are exclusively farmers with access to land and irrigation water. Over 40 percent of the borrowers were found to be essentially landless farmers who cultivate less than 0.5 acres of land, while roughly 22 percent are marginal farmers who cultivate 0.5 to 1.5 acres. Small farmers cultivating 1.5 to 2.5 acres constituted almost 20 percent, medium farmers with 2.5 to 5.0 acres represented about 12 percent, and large farmers represented five percent. Medium and large farmers may have access to bank loans but prefer the collateral free system of CARB. Many borrowers also have other sources of income but CARB only finances crops. Almost all the borrowers are men because they typically cultivate land and make cropping decisions, and the tube wells are also normally operated by men. Women tend to be involved in seed processing and the post harvest activities of drying, storing and husking of paddy.

The borrowers of seasonal crop loans from Sojag tend to be marginal (0.5 -1.0 acres of land) and small (1.0 – 2.5 acres of land) farmers that own, rent or sharecrop land. A sample of samities revealed 28 percent landless, 19 percent marginal farmers and 47 percent small farmers. Men are targeted as they are most of the paddy farmers. There is considerable overlap as nearly 40 percent of the borrowers are from families that participate in other Sojag loan programs. Members are accepted into samities that are directly involved in farming, are known as someone with a good transaction history, is considered to be “polite” and easy for a loan officer to work with, and with access to irrigation water for dry Rabi season (November – February) cropping. People not directly involved in cropping, large farmers, and people with bad repayment records are excluded.

Customer satisfaction: The BEES borrowers reported that they appreciated loans being available with a minimum of delay between successive loans, and there is no uncertainty about the next loan if the current one is repaid promptly. Processing fees are low (Taka 40 per loan), and loans are available for both agricultural and non-agricultural activities. Non-financial services in the form of training in crop production and periodic medical checkups are also valued. The primary complaint is that loan sizes are too small.

CARB borrowers also appreciated the minimum in delays, the rapid processing of delivery orders, low interest rates compared to moneylenders, low loan processing fees (Taka 35), and lump sum payments scheduled a month after harvest allowing for commodity price appreciation. The lack of loans for livestock production is the primary complaint.

The borrowers of Sojag liked the availability of loans at the beginning of the season, short processing times, interest rates lower than other NGO loans, no deductions for service fees, lump sum payments scheduled a month after harvest allowing for price appreciation, and information provided at the beginning of the season about good production practices. The most frequent customer complaint is the lack of loans for other activities and the inability to borrow larger amounts.

Non-financial support services: The three MFIs provide limited amounts of non-financial services in addition to financial products. In typical Grameen Bank fashion, BEES organizes women and children into groups to facilitate the delivery of its various products. Group meetings are used to conduct training; disseminate technical information on crop production, raising poultry and livestock, and feed making; distribute vegetable seeds twice per year; and conduct monthly medical checkups. Likewise, CARB provides technical information on crop production in the meetings held at the beginning of each growing season. Its loan officers disseminate technical advice when they visit farmers during the growing season. It offers soil testing for Taka 100 per sample, promotes the growing of green manure crops, and provides training to power tiller drivers.

Under earlier projects, Sojag provided more services in the form of promoting high yielding varieties, use of organic fertilizers, crop diversification, and soil conservation. Loan officers now receive training in rice production and offer suggestions to farmers during farm visits. The management believes that more technical assistance would be helpful to both the success of the program and to the clients but cannot provide it due to a shortage of funds.

Financial and productivity measures: Generally the three MFIs are financially sustainable because their FSS values are greater than 100 percent, and they generally reported a positive, but low, return on assets. The loan portfolios are also in good condition as measured by a high rate of loan recovery. The obvious weakness revealed in these performance data is the comparatively small number of active borrowers and outstanding loan portfolio per loan officer. This could be the result of a slow buildup in the agricultural portfolio after hiring loan officers to market the loans, or the seasonal nature of agricultural lending, or lending technologies and management systems that are not conducive to high levels of staff efficiency. All three MFIs offer limited non-financial services to their borrowers and this may also absorb some of the time that loan officers could otherwise devote to managing more borrowers and a larger portfolio. Efficiency and profitability are areas that clearly need to be improved over time in these MFIs and fortunately the trends have been positive in recent years.

Challenges Replication of Agricultural Credit: For the MFIs to successfully expand outside their traditional scope of lending and begin to offer products especially for small and marginal farmers they must deal with several challenges. The most important are:

- Learning how to serve a new sector or sub-sector. Traditionally, the MFIs have performed well in using a Grameen style methodology to serve female clients capable of generating regular cash flows needed for weekly payments. This meant that loan portfolios were dominated by borrowers engaged in small-scale trading, poultry and milk production. This methodology does not require that loan officers must be well trained to evaluate their borrowers' businesses. However, offering loans for larger crop, poultry or livestock operations require more business and technical knowledge. It also requires that loan officers represent a social and economic status roughly similar to their borrowers.
- Serving male borrowers. Most MFIs largely lend to women because they are more amenable than men to attend meetings, to accept responsibility for the repayment of loans for defaulting group members, and to meet other responsibilities of membership. However, crop farming and larger scale trading and production activities are largely dominated by men. Therefore, when lending for these activities, MFIs must decide how to adjust their lending technology to directly lend to the men who operate the farms.
- Making seasonal and larger size loans. Together with lending to men, serving crop farmers means that the MFIs must deal with the additional problem of weather risks. To minimize this risk, some MFIs choose to lend only to rice farmers using irrigation. They must also adapt to the liquidity management problem caused by the seasonal demand for loans. Financing crops implies a large outflow of funds to meet loan demand at the beginning of the planting season, followed by several months of low inflows when the borrowers have limited capacity to pay unless they have other sources of cash income. Then at harvest time borrowers generate income and prefer to pay their loans in one lump sum. The resulting large flow of funds into MFIs may accumulate and then largely sit idle until the beginning of the next crop season. Moreover, crop lending introduces a large seasonality in loan officer work loads so MFIs may need to adjust employee compensation levels, offer compensatory time off in slack periods, and utilize technological innovations to accelerate data processing. ME loans, whether made to graduates of standard microfinance programs or to entirely new clients, by definition will be larger on average than MF loans which raises the risk of potentially larger losses for the MFIs in case of default. Borrowers with small farm and non-farm businesses tend to have diverse sources of income but larger firms tend to be more specialized and earn a larger proportion of their incomes from one or a few sources. Loan repayment, therefore, is likely to be more dependent upon the success of the business being financed rather than from multiple sources of income typically earned by poorer households. This implies that evaluating applications for larger loans demands a greater capacity to gauge risks and the probability that business income will be large enough to meet loan repayment obligations.

*Opportunities for replication and scaling up***:** Even though the opportunities for continued horizontal expansion of MF lending are limited because of rapid MFI growth during recent years, the market for SMF loans is far from saturated; therefore there appears to be opportunities for growth by both scaling up operations for these innovative MFIs and be other MFIs replicating their experiences in serving these two market segments. The experiences of the MFIs studied suggest there may be considerable opportunities for many of the remaining 200 or so MFIs financed by PKSF to follow a similar evolutionary growth process and begin to serve the new market segment.

Some of the funds that the MFIs now lend in their MF programs are used for agricultural purposes such as for poultry or livestock. Therefore, the second logical evolutionary step will be for them to begin to explicitly lend to successful women MF borrowers specifically for agricultural activities, including cropping, recognizing that sometimes the funds will be used by male members of the households who are employed in such enterprises. Initially, to reduce credit risks the same general MF terms can be retained as a way of limiting the loans to borrowers with other sources of income to use in paying weekly loan installments if they borrow for cropping or other agricultural enterprises that do not generate regular cash flows.

The third step, which represents a more fundamental change, is for the MFIs to begin to lend directly to men for cropping and other agricultural enterprises. This will require adapting the standard MF loan terms and conditions to the seasonality and other characteristics of the agricultural enterprises financed. It will also require recognizing the subtle differences in techniques that loan officers must employ in dealing with men who are less inclined than women to be threatened by social pressure and lack of access to future loans. Risks can be minimized by limiting this type of expansion to the geographic areas where the MFIs currently have operations and have already accumulated considerable knowledge and understanding about the population and local economic activities. Existing female group members can be tapped as a source of information about prospective borrowers. Many of the borrowers will likely to have family members who participate in other MFI programs so they will be a source of information about the repayment performance of fellow household members.

*Advantages of Replication and Scaling Up***:** Besides the obvious economic and social benefits to farmers of expanding financial services, there are four main advantages for replication and scaling up. First, it will contribute to a growth in the size of MFI portfolios and possibly help them to realize economies of scale and reduce per unit operating costs. Second, MFI efficiency is likely to rise through increasing average loan volumes per loan officer. Third, overall MFI profitability and self-sustainability should improve provided that credit risks can be controlled. Finally, improvements in efficiency and profitability, along with greater competition among MFIs on the ground, may help clients through reduced interest rates charged on loans and/or higher rates of interest paid on savings.

Conditions for Successful Replication and Scaling Up: Similar to microenterprise loan program we see several conditions for successful replication and scaling up of agricultural credit: presence of strong and viable mainstream microfinance program; product design and testing; management of risks; specialist human resource with knowledge of agriculture and capacity to deal with male borrowers and larger loans, and provision for extension services by the MFIs or by establishing linkage with GIB or private extension service providers.

Financing of Microfinance Sector

Introduction

This section analyzes the financing strategy of microfinance institutions and sources of finance. The microfinance sector of Bangladesh has transformed itself over the last two decades from grant-based small operations to loan-based large operations reaching more than 33 million poor men and women, which would not have been possible without a loan-based more commercial type financing structure. The transformation is continuing where increasingly the major organizations are moving towards commercial type sources as well as depending on internally generated funds and funds that are more reliable and predictable.

The sector is broadly financed by the following types of resources: equity, that is, profit (surplus) and any grants that the concerned MFIs might have received from national and international sources; savings collected from clients, concessional loan received from sources such as PKSF and other similar agencies, and commercial bank borrowing. GOB has allowed mobilization of savings by MFIs from their members/clients even long before Microcredit Act was enacted, which was the single most important policy support for the sector although the laws under which NGO-MFIs were registered did not allow such collection of savings.

For understanding the financing strategy of MFIs we will do the following:

- Analyze comparative balance sheets of three of very large institutions: ASA, BRAC and Grameen Bank, which will give the opportunity to look into the difference of financing strategies between each of these very large organizations;
- Analyze balance sheets of sample MFIs: BURO Bangladesh from large category, SSS from medium category, and 14 other MFIs from very small and small category by quoting from an earlier study, which will provide insights into the financing of smaller MFIs; and
- Analyze aggregate data to analyze overall financing situation of the whole sector excluding the Grameen Bank using CDF compiled data. This analysis will show importance and transformation of each sources of finance.
- The above analysis will be followed by brief discussions on functioning of wholesale lending institutions and commercial banks' entry into financing microcredit programs.

Financing Strategy of Small, Medium and Large Organizations

Deployment of asset: Table 5.1, Table 5.2 and Table 5.3 present the comparative balance sheets of BURO (2006 and 2007), SSS (2004-2006) and 14 smaller MFIs categorized in three sub-groups (2004) respectively. Balance sheets have been presented in two forms: actual Taka figures and assets as percentage of total assets and liabilities as percent of total liability. The second form reflects the importance of each asset and liability compared to total. The asset side of the comparative balance sheets provides interesting insights. As expected, MFIs deploy about 70-85% of assets in loan program, the highest earning asset. It is unavoidable to have some cash and liquid investments (time deposits) since microfinance operations are managed through branch networks. But the percent also depends on fund management efficiency and good planning for the MFIs. Inefficiency and poor planning may lead to high cash balance in the banks. Besides, in case of PKSF partners (all sample MFIs in very small,

small and medium size category) a part of savings and various reserve funds are kept aside as investments. As MFIs grow big and accumulate profits, a part of the equity is converted into physical assets such as land and building, which is reflected as fixed asset. But our interest is how the loans are financed as will be seen by analyzing the liability side of the balance sheet.

Table 5.1: Balance sheet of BURO Bangladesh (2006-2007)

	Expressed in Taka in million		Expressed as % of Asset and Liabilities	
ASSET	**2006**	**2007**	**2006**	**2007**
Cash at hand and bank	27.31	123.35	1.57	5.54
Investment	60.00	69.46	3.45	3.12
Fixed asset	76.08	88.20	4.38	3.96
Other assets	32.67	50.22	1.88	2.26
Loan outstanding	1,541.70	1,894.43	88.72	85.12
Total assets	**1,737.76**	**2,225.66**	**100.00**	**100.00**
LIABILITY				
Loan	420.15	698.52	24.19	31.38
Members' savings	679.02	821.97	39.10	36.93
Other liabilities	47.09	52.73	2.71	2.37
Fund	590.50	652.44	34.00	29.31
Total liability	**1,736.76**	**2,225.66**	**100.00**	**100.00**

Source: Annual report BURO-B 2007

Table 5.2: Balance sheet of SSS (2003-2006)

	Expressed in Taka in million				Expressed as % of Asset and Liabilities			
ASSET	**2003**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
				107.8				
Cash at hand and bank	24.8	63.6	44.8		6.28	10.32	5.15	7.43
				168.2				
Investment	35.0	45.7	112.7		8.85	7.42	12.96	11.60
				51.2				
Fixed assets	55.6	46.6	50.3		14.04	7.56	5.78	3.53
				97.6				
Other assets	54.1	84.3	87.6		13.68	13.67	10.07	6.73
				1,025.8				
Loan outstanding	226.1	376.0	574.5		57.15	61.02	66.05	70.71
Total assets	**395.6**	**616.2**	**869.8**	**1,450.6**	**100.00**	**100.00**	**100.00**	**100.00**
LIABILITY								
				470.2				
Loan	158.5	280.0	433.4		40.05	45.44	49.83	32.42
				370.3				
Deposits	103.1	171.8	118.0		26.07	27.88	13.57	25.53
				346.7				
Other liabilities	45.2	84.0	128.6		11.41	13.63	14.78	23.90
				263.3				
Capital and reserves	88.9	80.4	189.8		22.47	13.04	21.82	18.15
Total liabilities	**395.6**	**616.2**	**869.8**	**1,450.5**	**100.00**	**100.00**	**100.00**	**100.00**

Source: Institute of Microfinance

Table 5.3: Financing the very small, small and medium MFIs

[Assets and liabilities are expressed as percent of total assets and liabilities respectively]

	V. Small MFIs	Small MFIs	Medium MFIs
As on	June 2004	June 2004	June 2004
Number of MFIs in the group	4	8	2
ASSETS			
Cash at hand and bank	9.25	8.22	8.25
Investment	10.28	12.68	11.39
Fixed asset	3.34	6.29	3.25
Other asset	0.88	4.36	8.21
Loan outstanding	76.25	68.46	68.90
Total (100%)	**100.00**	**100.00**	**100.00**
Liabilities			
Loan	48.94	41.86	32.25
Savings	22.48	32.48	31.79
Other liabilities	4.95	3.11	12.54
Fund[15]	23.61	22.56	23.42
Total (100%)	**100.00**	**100.00**	**100.00**

Source: Alamgir [2005]

Financing the Loan Operations: Table 5.1 presents balance sheet of BURO Bangladesh. In 2007, 85% of its total asset is loan outstanding, which is financed partly by equity/fund (29.31%), members' savings (36.93%) and loan from commercial banks and non-bank financial institutions (31.38%). The proportion of loan has increased compared to 2006 because BURO has financed its recent expansion mainly through bank borrowing. Historically, BURO has been giving emphasis on savings which is 36.9% of liability and 43% of loan outstanding, a very important source of funds for microcredit operation. Since BURO has been a very profitable MFI 29% of total liability is basically accumulated profit that gives financial stability to its operations. The overall financing in case of BURO seems to be very balanced divided into three sources. But increasing BURO is depending on commercial borrowing. SSS is also a regional MFI. About 71% of its total asset is loan outstanding, which is financed by funds from three sources: loan (32.4%), savings (25.5%) and equity (18%). But the important difference between BURO and SSS is that the latter borrows from PKSF not from any commercial bank so that cost of capital of SSS is much lower than BUOR-B.

Alamgir (2005) analyzed 14 small MFIs, all PKSF partners, that also shows similar trends and the summary of 2004 balance sheets is presented in Table 5.3. In case of very small MFIs, which primarily depends on PKSF for financing the percent of loan is much higher than larger MFIs. Although savings is comparatively low but still is about one third of total liability. About 20% of finance comes from accumulated surplus. This also indicates that even smaller MFIs are also profitable.

[15] Fund includes grants, profits and reserves

A number of other insights can be gained from these figures:

- The capital structure and consequently the financing strategy of very small, small and medium size MFIs are somewhat similar. All these MFIs depend on three sources: loans from PKSF and other sources; members' savings; and own funds, accumulated profit now being an increasing proportion of this element. The loan figure is basically loan from PKSF for smaller MFIs. They do not have loan from commercial banks.
- Very small and small MFIs are more dependent on loans from PKSF than other categories of MFIs. Their share of savings as a source of finance is smaller than loan. For medium MFIs, loans and savings provide similar level of financing.
- The present composition of the capital structure of the smaller MFIs is expected to continue for sometime. They may become more dependent on loans as they launch new credit products. That will need wholesale sources like PKSF to expand their lending operations in order to meet demand. As we will see later that over the last 2 to 3 years commercial banks are increasingly financing microcredit operations of MFIs.

Financing Strategy of Very Large Organizations

Grameen Bank: The capital structure of the Grameen Bank is unique, that is, similar to that of a commercial bank, which currently fully depends on deposits to finance its loan program. Of the total liability in 2007, 80.7% is deposits from members and public, only 2.6% is institutional borrowing and 8.51% is capital and reserves. It has a small loan amount, which is residual of former loans whereas the MFIs discussed above have more than 30% institutional borrowing. This structure has been possible due to its legal coverage as a bank to raise savings as well as additional permission from the government to offer various savings services. The deposits of the bank come from members' savings (various short and long-term deposits), deposits of staff members and deposits from other sources. No other MFI in the country has such legal basis, array of savings services as well as dependence on deposits to finance microfinance operations. That is, 88.13% of total liabilities come form savings and own funds. This situation has dramatically eliminated dependence on external institutional resources (from within and outside the country). Additional insights can be obtained from Table 5.4 below which provides comparative balance sheet of Grameen Bank for 2004 to 2007 [Grameen Bank 2007]. At the end of 2007, the total deposit is 148% of loan outstanding, and deposit and capital combined is 163% of loan outstanding. These figures are 145% and 158% respectively at the end of December 2008 [Grameen Bank 2008]. That is, the bank is financed from internally generated resources. Grameen Bank has benefited enormously from its legal position compared to other MFIs, being the only MFI legally able to offer long-term savings products to its members and to take savings from the public. Besides, not many MFIs give the poor people access to their savings and pay good interest on savings other than Grameen Bank.

Table 5.4: Comparative balance sheet of Grameen Bank

	Expressed in Taka in million				Expressed as % of Asset and Liabilities			
ASSET	**2004**	**2005**	**2006**	**2007**	**2004**	**2005**	**2006**	**2007**
Cash at hand and bank	798	980	900	936	2.37	2.20	1.52	1.36
Investment	7,226	9,987	19,744	24,466	21.47	22.38	33.25	35.48
Fixed assets	906	955	1,045	1,115	2.69	2.14	1.76	1.62
Other assets	3,877	3,805	3,549	4,890	11.52	8.53	5.98	7.09
Loan outstanding	20,846	28,897	34,145	37,546	61.94	64.76	57.50	54.45
Total assets	**33,653**	**44,624**	**59,384**	**68,954**	**100.00**	**100.00**	**100.00**	**100.00**
LIABILITY								
Loan	2,896	1,917	1,855	1,793	8.61	4.30	3.12	2.60
Deposits	20,833	31,771	47,651	55,641	61.91	71.20	80.24	80.69
Other liabilities	3,566	3,382	3,766	5,654	10.60	7.58	6.34	8.20
Capital and reserves	6,358	7,554	6,111	5,866	18.89	16.93	10.29	8.51
Total liabilities	**33,653**	**44,624**	**59,384**	**68,954**	**100.00**	**100.00**	**100.00**	**100.00**

Source: Grameen Bank Annual Reports various years

ASA: The capital structure of ASA is unique in another sense. In 2005, the largest figure in the capital structure was capital fund (i.e. small amount of grants and accumulated profits) (55.28%) followed by savings (32.69%). The accumulated profit has been the result of efficiency of ASA. Another factor that has also contributed to the profit is the rate of interest compared to the Grameen Bank, ASA charges 12.5%-15% on loans and Grameen Bank charges 10% [all flat rates]. However, no other MFI even with 15% interest is as profitable as ASA. The loan component as percent of total liability is also low (10.45%), which has been declining (loan amount is primarily from PKSF). ASA has not been borrowing from PKSF since 2005. ASA seems to be an MFI financed by equity. Its savings mobilization aspect also needs some explanation. ASA follows so called open and flexible deposit system, i.e. members have ready access to savings funds. But ASA has launched an interesting savings product which combines savings with ‘insurance’ element called Security Fund. This product with its long-term features has attracted significant resources to finance microcredit operations. Table 5.5 provides an additional insight of ASA’s financing strategy: equity is 65.4% of loan outstanding, and equity and savings combined is 104% of loan outstanding. That is, similar to Grameen Bank, ASA is also financed by internally generated resources, though the composition of sources is different.

Table 5.5: Comparative balance sheet of ASA

	Expressed in million Taka		Expressed as % of total asset and liability	
ASSET	**2004**	**2005**	**2004**	**2005**
Cash at hand and bank	1,137	997	7.15	5.17
Investment	2,944	1,011	18.51	5.24
Fixed asset	206	382	1.29	1.98
Other assets	186	593	1.17	3.08
Loan outstanding	11,428	16,303	71.87	84.53
Total assets	**15,901**	**19,287**	**100.00**	**100.00**
LIABILITY				
Loan	3,112	2,016	19.57	10.45
Members' savings	4,453	6,306	28.00	32.69
Other liabilities	493	303	3.10	1.57
Fund	7,844	10,662	49.33	55.28
Total liability	**15,901**	**19,287**	**100.00**	**100.00**

Source: ASA Annual Report 2005

BRAC: More than 80% of BRAC's total asset is loan outstanding. We see a different liability structure in case of BRAC compared to Grameen Bank and ASA. At the end of 2007, BRAC has three important components: Savings (31.83%), fund (20.65%) and loan (46.59%) [see Table 5.6]. The loans are mainly from commercial banks and a small amount from PKSF. Increasingly BRAC is financing its microcredit program using expensive commercial bank loans. BRAC raised funds from a consortium of commercial banks and through securitization instrument. BRAC has increased its members by 39% between 2006 and 2007. Loan outstanding from institutional sources has also increased by 269% and portfolio by 149%. But this approach is expected to have adverse impact on profitability. However, the need for external resources depends on many factors including portfolio growth, profitability and savings policies. Grameen Bank and ASA's ability to introduce savings instruments as well as efficiency have reduced both institutions' dependency on external resources. On the other hand, BRAC seems to be increasingly depending on commercial loans for its huge expansion. The case of Grameen shows the importance of legal back-up and savings mobilization for financing microcredit operations. This illustrates a case which the sponsor of the very large MFIs and policy makers should seriously consider for developing appropriate legal option and mobilizing savings to finance microcredit operations.

Table 5.6: Balance sheet of BRAC

	Expressed in Taka in million				Expressed as % of Asset and Liabilities			
ASSET	**2004**	**2005**	**2006**	**2007**	**2004**	**2005**	**2006**	**2007**
Cash at hand and bank	868	714	1,265	2,301	5.09	3.37	4.66	5.44
Investment	1,052	1,884	844	3,318	6.17	8.90	3.11	7.84
Fixed assets	1,449	1,417	1,388	1,346	8.50	6.69	5.11	3.18
Other assets	404	555	981	1,354	2.37	2.62	3.61	3.20
Loan outstanding	13,280	16,596	22,670	33,986	77.87	78.41	83.51	80.34
Total assets	**17,053**	**21,165**	**27,148**	**42,305**	**100.00**	**100.00**	**100.00**	**100.00**
LIABILITY								
Loan	3,943	5,371	7,327	19,710	23.12	25.38	26.99	46.59
Members' savings	7,657	9,159	10,595	13,467	44.90	43.28	39.03	31.83
Other liabilities	299	378	1,201	391	1.75	1.79	4.43	0.92
Fund	5,154	6,257	8,024	8,737	30.22	29.56	29.56	20.65
Total liability	**17,053**	**21,165**	**27,148**	**42,305**	**100.00**	**100.00**	**100.00**	**100.00**

Source: BRAC Annual Report 2005, 2006 and 2007 and recast by the author

Aggregate Financing Position

Over the years the financing of microfinance programs witnessed significant structural changes. In its early days, the sector primarily depended on donors' grants but by late 1990s the primary sources of funds were members' savings, and loans from PKSF. In 2009, commercial banks are also participating in microcredit operations through BRAC and some other large and medium MFIs with good management and financial performance. Other contributions come from retained earnings (accumulated surpluses). For larger and efficient NGO-MFIs accumulated surplus has become an important source of funding. Table 5.7 provides summary information about the source of finance of the sector since 1996. The data from 2004 to 2007 will provide recent situation.

Table 5.7: Sources of Revolving Loan Funds of NGO-MFIs

Date	Members Savings %	PKSF %	Local Banks %	International Donors/ NGOs	Own fund %	Other %	Total (No. MFI-NGOs)	Total Taka in Billion
Dec. '96	20	10	2	48	0	20	100 (351)	8
Dec. '98	20	19	12	26	25	3	100 (495)	15
Dec. '00	25	23	10	19	20	3	100 (585)	30
June '02	25	24	9	17	22	3	100 (681)	37
Dec. '02	27	22	9	15	24	3	100 (656)	39
Dec. '03	23	25	3	10	24	15	100 (777)	36.08
Dec'04	37.35	16.70	16.70	13.99	5.74	3.93	100 (721)	43.97
Dec'05	40.12	22.76	22.76	10.64	5.30	3.07	100(690)	53.07
Dec'06	39.14	18.86	24.00	8.16	6.17	3.68	100 (611)	67.53
Dec'07	27.08	20.13	30.92	6.32	7.10	8.45	100(535)	95.00

Source: CDF Statistics

Members' savings is an important source of capital. Although the restrictive rule provides cheap source of finance for the NGOs, it has several negative impacts on the poor: savings has not developed as a separate service; poor people do not have easy access to their own savings at times of needs; the policy effectively increases interest on loan from the NGOs because members earn very low rate (3-5%) on their savings whereas pay 25-30% on loans. A sector-wide policy/regulation in favor of easy access to savings would have resolved the issue. We would like to make the following observations from Table 5.7:

a) Savings as percent of total capital have steadily grown up to 2005 but declined in 2006-2007 comprising the second largest contribution to revolving loan funds. The decline could be because of easier access so that clients regularly withdraw funds, or may be because of data of fewer MFIs included in the Table, or dramatic increase of commercial bank loan reduced the percent of savings.

b) PKSF's share of revolving loan funds has remained around 20% and continues to rise substantially in Taka but commercial banks have exceeded PKSF since 2005.

c) Donor/iNGO funds and grants have practically dried up; the amount reported is probably the residual amount of past contribution.

d) The commercial banks have entered with significant resources since 2004 and became the largest source (31%). But the commercial banks' loans are limited to a several BRAC and larger MFIs and cost is very high (10-15% per annum).

Wholesale Funding Sources

The wholesale lending to microfinance institutions has been instrumental in expanding microcredit operations in Bangladesh. It comes in two different forms: concessional loans from specialized institutions such as PKSF, which has been set up exclusively for this purpose, and loans from commercial banks. Unlike commercial banks, institutions like PKSF assist their partner MFIs to strengthen institutional capacity. We will briefly discuss about examples of wholesale lending agencies and commercial banks' loans to MFIs.

Palli karma Sahayak Foundation (PKSF)

PKSF leads the wholesale funding segment of the market. PKSF is primarily a long-term wholesale portfolio lender with two main objectives: expand outreach to reach the poor with financial services, and assist MFIs to achieve institutional and financial viability for sustainable service provision to both rural and urban poor. The Palli Karma Sahayak Foundation (PKSF) [Rural Employment Support Foundation] was set up by the Government of Bangladesh (GOB) in 1990. The overall objective of PKSF is to alleviate poverty and improve the quality of life of the poor by providing them with resources for creation of self-employment. It finances the microcredit programs of government and non-governmental organizations, called the Partner Organizations (POs). PKSF also provides technical assistance and advisory services to them for institutional development. It is a '*company limited by guarantee and not for profit*'. Instead of becoming a microcredit provider, it has capitalized the capacity of locally based organizations to reach the poor.

It now lends to almost all prominent MFIs in the country through its two lending windows: *Bipool (window for large MFIs)* and Oos*a (window for small MFIs).* PKSF distinguishes MFIs according to their size and capability, and lends at 4.5% and 7% to *Oosa* and *Bipool*[16] partners respectively. The selection criteria remain distinctly different for these two groups of partner organizations. At the end of 2008, PKSF has 197 active partner MFIs which have mobilized 11.35 million (PKSF-funded part) members, that is, about one third of the whole sector. Loan outstanding of its partner MFIs is Taka 44,231 million.

Table 5.8: Loan program of PKSF

Indicators	2006	2007	2008
Number of MFIs [active]	186	196	197
Memberships	8,689,138	10,542,632	11,354,105
Borrowers	6,460,965	7,925,591	8,291,829
Loan outstanding (Taka in million)	30,171	38,907	44,231
Savings balance (Taka in million)	10,390	13,275	14,558
Loan outstanding of PKSF to its partners (Taka in million)	16,518	23,204	27,727

Source: PKSF

PKSF also provides long-term institutional development assistance to its partners embedded within its loan program, which has benefited all partner-MFIs and immensely contributed to the institutional strengthening and sustainability. In addition, PKSF has developed several training modules for the POs and provides training to their staff members in collaboration with its Partners and other training providers. The emergence of the Palli Karma-Sahayak Foundation (PKSF) as the main source of finance and institutional development assistance for the microfinance sector has been the most significant development of the last decade. PKSF has contributed

[16] Oosa: Small and medium size partners; Bipool: Large NGO partners.

immensely to expand the outreach as well as to help many MFIs to achieve financial viability and to set the informal norms and standards for the sector. PKSF is expected to continue to influence positively the financial service sector for the poor and other small borrowers. Over the time a different set of issues has emerged, which will influence the future growth and direction of the sector. PKSF's role and its position in the sector can play a crucial role to determine the future path. Currently the financial product segments funded by PKSF are as follows: a) Rural Microcredit, b) Urban Microcredit [Up to 2005 PKSF did not finance microcredit in six divisional cities, which has been revised in 2006], c) Microenterprise loan, d) Microcredit for small and marginal farmers, and e) Microcredit for hardcore poor. Besides it implements number of projects for promoting access to technology and markets by the poor, farmers and microentrepreneurs.

Anukul Foundation of CARE Bangladesh

CARE Bangladesh has established Anukul Foundation after completion of its INCOME III project to continue lending to urban MFIs and institutional development activities, mainly training for partner MFIs as well as others for a fee. During the project period it had given loans to 32 partner NGOs and assisted in capacity building through staff training, and system development. The partner organizations mobilized 102,446 poor men and women and reached 76,346 with loans (December 2005) (Table 5.9). The members have also accumulated savings of Taka 208 million. INCOME used to charge 8% on its loan. Currently Anukul Foundation has 13 partner NGOs which has reached 69,193 members and 54,754 borrowers (Table 5.9). The interest rate is 8% and loan is repaid in 3 years.

Table 5.9: INCOME-funded MFIs (2005) and Anukul Foundation (2008)

Indicators	INCOME- funded (December 2005)	Anukul Foundation (December 2008)
Number of MFIs	32	13
Memberships	102,446	69,193
Borrowers	76,346	54,754
Loan outstanding (Taka in million)	361.64	475.75
Savings balance (Taka in million)	208	163.71

Source: CARE-INCOME and Anukul Foundation

Grameen Trust

Grameen Trust is an international wholesale lending agency and technical assistance provider. It has small lending operations in Bangladesh for MFIs operating in urban areas and replicating Grameen Bank model.

Stromme Foundation

The Stromme Foundation (SF) has been operating in Bangladesh for the last several years with a focus on poverty alleviation through implementing microfinance and education programs. Under its microfinance (not all in urban areas) SF provides loans to Non-governmental Organizations (NGOs) and/or Microfinance Institutions (MFIs) to run microfinance and microenterprise programs, mostly in rural and peri-urban areas. Currently, SF has 9 Partner

MFIs with SF's outstanding loan of approximately Taka 407 million. The partners have organized 135,019 members and disbursed loans to 113,569 borrowers. Current loan outstanding is Taka 679 million (March 2009). SF will be expanding the microfinance program to reach more poor people of Bangladesh by injecting new capital every year. It has another program with a regional NGO CODEC which acts as lender to the small local NGOs operating in southern coastal region.

Table 5.10: Wholesale loan operations of Stromme Foundation

Indicators	Figures (as of March 2009)
Number of MFIs	9
Memberships	135,019
Borrowers	113,569
Loan outstanding (Taka in million)	679.00
Savings balance (Taka in million)	229.19
Loan outstanding of SF to its partners (Taka in million)	407

Source: Stromme Foundation 2009

Credit and Development Forum

Credit and Development Forum (CDF) is primarily active in capacity building of NGO-MFIs and advocacy activities. But it has a small lending/facilitation activity for very small NGO-MFIs, which can not get access to PKSF or commercial bank directly. The lending/facilitation work is managed in three different modes:

- Partnership with commercial banks where CDF makes assessment of potential small MFIs and recommends to commercial banks for lending to the MFIs. In this program CDF has MOUs with seven commercial banks. Under this system seven commercial banks have given loan to 75 very small MFIs. The loans are for 3 years repaid in quarterly installments with interest rates varying between 13-14%. CDF adds additional 2% for its assessment, supervision and monitoring services. Total loan disbursed from commercial banks (two state owned and 5 private) is Taka 87.5 million.
- CDF has a small capital fund from which it has disbursed Taka 35.8 million to 49 very small MFIs. The program is suspended now.
- CDF managed a project of assisting community-based organizations (CBOs), some of which were later registered under the Department of Social Welfare as NGOs. Fifteen (15) such CBOs have been assessed by the Mutual Trust Bank for funding their microcredit operations, eight of them have received Taka 4 million and others are in the process of receiving another Taka 5.5 million.

Table 5.11: Lending program of CDF [December 2008]

Indicators	CDF-Bank partnership	CDF direct lending	CDF-Bank- CBO partnership
Number of MFIs	75	49	15
Memberships	17,517	-	n.a
Borrowers	17,517	-	n.a
Disbursement from banks/CDF (Taka in mill.)	87.5	35.8	4*
Loan outstanding (Taka in million)	17.9	3.7	-

* 9.5 million approved fro 15 CBOs and 4 million disbursed to 8 CBOs

Commercial Banks

Commercial banks have been providing loans to MFIs in mainly three different modes: a) individual bank develops its own policies and programs and lends to individual MFIs; b) syndicated loan where a number of commercial banks band together led by one bank to finance microcredit operations of one of the MFIs; and c) securitization. All three modes have been applied in Bangladesh market. A number of private and state-owned banks have been lending to MFIs since mid-nineties but in a limited scale. BASIC Bank was one of the early entrants in this business. State-owned commercial banks such as Sonali Bank and Agrani bank have given loan to MFIs under different projects (not for urban programs). Pubali Bank and BRAC Bank have on-going wholesale lending program for selected NGOs. Recent trend is to provide large amount of loan through syndication. BRAC and BURO Bangladesh have received large sums of loans through syndication. In one case in 2007, BURO Bangladesh received Taka 500 million for a period of 5 years at an interest rate of 14.5% per annum. The deal was led by BRAC Bank in association with another eight commercial banks. The loan will be repaid in quarterly installment beginning second year (one year moratorium). Similarly, BURO-B is in the process of receiving another loan of Taka 1250 million for five years at a rate of 13% per annum (highest rate currently fixed by the government). This deal is being led by CitiBank N.A. No physical collateral is required for this loan. A group of banks also provided a syndicated loan for Taka 100 crores (Taka one billion) to BRAC's microfinance program. The limitations of these initiatives are high rate of interest (12-14.5%). BRAC also received fresh cash by securitizing its loan portfolio. Currently more than 20 commercial banks are involved in financing microcredit operations.

However, it will be difficult for any MFI to heavily depend on commercial loans due to high cost of borrowing without adversely affecting profitability: borrow at 12-14.5% and lend at 30% given high management cost of microcredit operations. Commercial loans may be a very small percent of the capital funds and short term in nature. The more sustainable strategy is that of the Grameen Bank with its private ownership (Grameen Bank is owned by borrowers) and being a bank it could raise savings from members, and public to finance its loan operations. Large MFIs such as ASA and BRAC should be following similar strategy.

Sustainability of Microfinance Institutions

Introduction

This section presents a review of financial viability studies beginning mid-1990s to very recent times of microfinance institutions of various sizes: very small to very large organizations. Although the viability of the system also includes viability of borrowers but this section deals only with the financial sustainability of microfinance institutions and borrowers' viability issue is presented in Section 7. No study is available that does full sustainability analysis by taking a large number of MFIs of various sizes. We, therefore, have to depend on studies with limited number of sample MFIs to draw conclusions. The review will highlight the changes of viability of MFIs over times and factors that influenced such changes. The focus of analysis of financial viability has been to determine whether the MFIs are able to cover (a) operating expenditure and (b) financial cost from interest income. A few studies also attempted to see whether MFIs could cover the opportunity cost of fund from the income (mainly interest income) of microcredit program. The outreach, operating efficiency, portfolio quality and profitability of each PO when taken together determine its financial viability. We, therefore, will examine four sets of indicators related to (a) outreach, (b) operating efficiency, (c) portfolio quality and (d) profitability, to determine the viability of MFIs in each of these studies. We have chosen findings of some earlier studies as well as analysis conducted at the time of preparation of the report to gather insights about issues related to financial viability of MFIs.

Operating Efficiency of MFIs

We will briefly discuss operating efficiency indicators of MFIs collectively (excluding the Grameen Bank) using data collected by CDF. Table 6.1 presents a number of outreach data and operating efficiency indicators. In absence of detail information we can only use member per credit officer, borrower per credit officer and portfolio per credit officer to discuss about the trends in efficiency. We will complement this shortcoming by analyzing several MFIs in details later in this section that will provide further insights about operating efficiency. It appears during 2003 to 2007 period the overall operating efficiency of the sector as a whole declined (see Table 6.1): members per credit officer have declined from 320 to 221; borrowers per credit officer have declined from 233 to 180; and portfolio per credit officer has remained almost the same in nominal terms, increased slightly from Taka 798,510 to Taka 889,772. This has been mainly due to rapid horizontal expansion, that is, enrollment of 'new' members/clients in new geographical areas. Branches were opened in new areas and staff recruited who took time to form groups and achieve desired level of membership. It became more difficult for smaller MFIs to find new members because very large and small MFIs all followed same strategy during this period. The loan portfolio per credit offer and average loan outstanding per borrower remained almost same because MFIs start with small loans for new members. Since a large portion of total memberships was new members the average outstanding per borrower remained small. This has impacts on overall profitability of MFIs as well.

Table 6.1: Operating efficiency and portfolio quality of MFIs (2003-2007)

Items	2007 (N=53)	2006 (N=611)	2005 **(N=690)**	2004 **(N=721)**	**2003 (N=720)**
a) Outreach indicators					
Active members (#)	23,955,780	20,511,866	18,793,990	16,622,047	14,630,945
Outstanding borrowers (#)	19,449,285	16,096,180	13,941,823	11,963,407	10,647,170
Borrower-member ratio (%)	78.55	76.92	74.18	71.98	72.80
Loan portfolio (Taka in million)	97,039.04	73,176.37	55,681.21	44,346.65	36,493.53
Overdue amount (Taka in million)	1,464.32	1,193.23	1,051.28	2,772.12	1,323.59
Total credit staff (#)	108,081	79,464	65,766	59,215	45,702
Average outstanding loan size (Taka)	4,947	4,546	3,994	3,707	3,427
b) Operating efficiency indicators					
Members per credit staff (#)	221	258	285	280	320
Borrower per credit staff (#)	180	203	212	202	233
Loan portfolio per credit staff (Taka)	889,772	920,874	846,656	748,947	798,510
c) Portfolio quality indicators					
Recovery Rate (%)	99.21	99.12	99.07	98.79	98.76
Overdue as % of Outstanding loan (%)	1.52	1.63	1.89	6.25	3.63

Source: InM/CDF

Portfolio Quality of MFIs

Table 6.1 also provides two indicators related to performance portfolio: loan recovery rate (%) and overdue as percentage of outstanding loan. A better indicator would have been to first classify the loan portfolio (aging report) and estimate portfolio at risk (PAR). In absence of PAR, we can make some intelligent guess about quality of portfolio from other indicators. The recovery rate of loan has remained high, more than 99% since 2005. Similarly, overdue has declined as a percentage of outstanding loans since 2004. However, the decline could be because of sharp rise in portfolio size between 2004 and 2007. As we mentioned, the portfolio quality in more recent times has actually declined.

Viability of Small MFIs: Early Results

21-MFIs Study

The emphasis on achieving financial viability has begun sometime in mid-1990s. Early status of viability has been reported in Alamgir (1999a) about the financial viability of 21 small MFIs (highest membership 15,000 in 1999), which were borrowing from PKSF to run microcredit programs (see Annex 1 for the list of 21 MFIs reported in this study). The performance of microcredit program is ultimately reflected in partner organizations' (POs, i.e.

MFIs that borrowed from PKSF) financial viability. As above, four sets of indicators – outreach, operating self-sufficiency, financial self-sufficiency, and economic sustainability, have been used to determine the financial viability of MFIs. Summary of findings are as follows:

Outreach: Beginning early 1990s, POs have opportunities for horizontal growth (inclusion of new members). Of the 21 POs, 10 POs had less than 5000 borrowers and the remaining 11 had more than 5000 borrowers. During FY98, 4 POs registered more than 25% growth in membership compared to FY97. Similarly, 6 POs have registered more than 25% increase in borrowers compared to FY97. Others also had registered positive growth in membership and borrowers. Increase in average loan size and improvement in member to borrower ratio contributed to increase in income and to improve viability. With the increase in borrowers, the average loan size of the POs has consistently increased over the period of time, i.e. POs have also been vertically expanding by increasing their portfolio due to availability of fund from PKSF. This ensures sustained increase in income. During FY98, 12 POs disbursed, on an average, more than Taka 5000 per loan and the remaining 9 POs disbursed between Taka 2250 to 5000 per loan. Of the 21POs, 15 POs could provide microcredit to more than 70% of their members (see Table 6.2).

Table 6.2: Outreach of 21 Partner Organizations

Sl. No.	Indicators	Range	Number of POs
1	Small POs	< 5000 members	7 (33.33%)
	Medium POs	>5000 members	14 (66.67%)
2	# of POs having borrowers	<5000 borrowers	10 (47.62%)
		> 5000 borrowers	11 (52.36%)
3	Annual growth of members	> 25%	4 (19.05%)
		< 25%	14 (66.67%)
		(negative growth)	3 (14.28%)
4	Annual growth of borrowers	>25%	6 (28.57%)
		< 25%	12 (57.14%)
		(negative growth)	3 (14.28%)
5	Borrower/Member ratio	>70%	15 (71.42%)
		<70%	6 (28.57%)
6	Average loan size	> Taka 5000	12 (57.14%)
		<Taka 5000	9 (42.86%)

Source: Alamgir (1999a)

Operating efficiency: The POs had been successful in improving their operating efficiency by increasing the ratios of (a) members/borrowers to credit officer by increasing membership, and (b) portfolio to credit officer by disbursing larger loans to increased number of borrowers. This had consequently reduced 'cost per Taka lent' and 'cost per loan'. In case of 12 POs, a credit officer on an average supervised more than 200 borrowers whereas in 9 POs workers supervised on an average less than 200 borrowers (see Table 6.3). Three hundred (300) borrowers per credit officer used to be considered as industry standard. The portfolio per credit officer was more than Taka 500,000 in 9 POs, and less than Taka 500,000 in 12 POs. On an average, the portfolio per credit officer could go as high as Taka 750,000 if the ratio of borrowers to members could be raised to 90% and the loan size was approximately Taka 6,000 per loan. The cost of lending Taka 1000 to a borrower was less than Taka 100 in 16 POs.

Table 6.3: Operating efficiency of Partner Organizations (21-PO study)

Sl. No.	Indicators	Range	Number of POs
1	Members per worker	>200 members	12 (57.14%)
		<200 members	9 (42.86%)
2	Borrowers per worker	>200 borrowers	6 (28.57%)
		<200 borrowers	15 (71.43%)
3	Portfolio per worker (Taka)	> Taka 500,000	9 (42.86%)
		< Taka 500,000	12 (57.14%)
5	Cost per 1000 Taka lent	>Taka 100	5 (23.81%)
		<Taka 100	16 (76.19%)
6	Cost per loan	>Taka 250	18 (85.71%)
		<Taka 250	3 (14.29%)

Source: Alamgir (1999a)

Portfolio Quality of POs: The quality of portfolio is very critical for sustainability of microcredit program. The indicators used to assess the quality of portfolio are: rate of recovery of loan, amount of overdue as % of outstanding loan, and the bad-debt reserve against the overdue. All POs except one could maintain rate of recovery more than 98% in FY98. Except in cases of 3 POs, the overdue was less than one percent of the outstanding loan. The POs had created adequate amount of reserve according to the Debt Management Reserve policy of PKSF (see Table 6.4).

Table 6.4: Portfolio quality of POs

Sl. No.	Indicators	Range	Number of POs
1	Rate of recovery of microcredit	> 98%	20 (95.23%)
		= 98%	1 (4.76%)
2	Overdue as % of loan outstanding	< 1%	18 (85.71%)
		> 1%	3 (9.52%)
3	Defaulters as % of borrowers	> 5%	2 (9.52%)
		< 5%	19 (91.48%)
4	Reserve as % of loan outstanding	> overdue	18 (85.71%)
		< overdue	3 (14.29%)

Source: Alamgir (1999a) (21-MFI study)

Financial Viability: The study reports that except for one MFI all other could cover operational expenses from income as early as 1997. Similarly, 18 out of 21 MFIs were financially self-sufficient, that is, 18 organizations could fully cover their operating and financial expenses (interest on members savings at the rate of 6% per annum, cost of borrowing from PKSF at 3-4.5%, provision for bad-debt) (see Table 6.5). Three (3) small MFIs were in the process of becoming financially viable. However, it should be noted that the viability was achieved due to subsidized cost of capital from PKSF and relatively low level of staff salary in these smaller MFIs. Other factors that contributed to this performance are operating efficiency achieved by the staff members, high loan recovery and overall economies of scale. An analysis has been done to assess the economic viability of these MFIs assuming an interest rate of 16% (commercial bank lending rate at that time) where none of the MFIs could cover full cost at this rate of interest.

Table 6.5: Financial viability of 21-POs

Sl. No.	Indicators	Range	Number of POs
1	Operating self-sufficiency	> 100%	20 (95.23%)
		<100%	1 (4.77%)
2	Financial self-sufficiency	> 100%	18 (85.71%)
		<100%	3 (14.29%)
3	Economic sustainability	>100%	0 (0%)
		< 100%	21 (100%)

Source: Alamgir (1999a)

14 MFI Study

With time small MFIs expanded operations with important impact on financial viability, which has been captured in another study [Alamgir 2005] conducted by the World Bank using information of 14 partner MFIs of PKSF of various sizes: four very small MFIs (membership maximum 10,000), eight small MFIs (membership between 10,001 and 50,000) and two medium MFIs (membership between 50,001 to 500,000). Data for 2001-2004 were used for this study. Conclusions of the study are presented below.

Sustainability of very small MFIs

Outreach: The sample has four very small MFIs having members between 3,000 to17,000 (see Table 6.6). These local MFIs had one to less than 5 branches and took several years to reach present state. The important indicator is that they reached more than 70% of members with loan at any given time. The average loan size was more than Taka 7000 in 2004. The high loan size and high member/borrower ratio has enabled them to reach financial viability.

Operating efficiency: The operating efficiency indicators of the very small MFIs are similar to larger MFIs but considerably vary within the group: Member per credit officer varied between 240 to 325; borrower per credit officer varied between 180 to 250; cost per 1000 Taka lent varied between Taka 77 to 100; cost per loan varied between Taka 642 to Taka 930; and portfolio per credit offer varied between Taka 0.63 million to Taka 1.133. The last indicator depended on many factors such as availability of resource, average length of memberships etc. The cost factors were influenced by salary structure, overhead, staff efficiency, and other costs.

Portfolio quality: The loan recovery rate of two MFIs was below industry standards (below 98%) and so was the overdue rate.

Financial viability: All four MFIs enjoyed nearly 200% operating self-sufficiency (i.e. income was nearly double than the operating expenses; RDWF and DDJ more than 200%; and CARSA and ST 183%). Similarly, all four organizations enjoyed very high financial viability ratio (FSS between 140 to 172%) because of the low financial costs compared to income. All four MFIs borrowed at the rate of 4.5% from PKSF and paid 5% on members' savings. The yields on RLF were quite high for RDWF and ST, 30.37% and 27% respectively in 2004. Combining all income and expenditure factors the very small MFIs were profitable as indicated by FSS and also high return on asset (5.87% to 11%). To achieve high profitability reflected by financial self-sufficiency and return on asset (ROA) MFIs should have a) high borrowers to members ratio (>80%), high average loan size, high portfolio per credit officer, high deployment of asset in loan (i.e. ratio of loan outstanding to asset), high recovery rate and god portfolio quality, reasonable salary structure, relative low cost of capital and efficiency in capital deployment. Some of the indicators mentioned here are dependent on others. To estimate more realistic indicators of profitability a revised set of FSS and ROA was computed by assuming cost of borrowing at 10% (Commercial bank's lending rate to NGOs at that time) and by reflecting rate of inflation. Although these two adjustments reduce the values for OSS, FSS, and ROA but the four MFIs remain profitable and financially viable.

Table 6.6: Sustainability Parameters for Very Small MFIs (2004)

Sustainability indicators	**RDWF**	**ST**	**DDJ**	**CARSA**
1. Outreach indicators				
Members (#)	2,897	12,159	16,181	16,680
Borrowers (#)	2,227	10,115	11,587	12,800
Ratio of borrowers to members (%)	76.87	83.19	71.61	76.74
Average loan size (Taka)	10,672	7,376	7,236	7,294
2. Operating efficiency indicators				
Members per credit officer (#)	322	253	257	242
Borrowers per credit officer (#)	247	211	184	186
Portfolio per credit officer (Taka in mill.)	1.133	0.848	0.632	0.63
Cost per 1000 Taka lent (Taka)	77.7	93	97	100
Cost per loan (Taka)	830	642	699	573
3. Portfolio quality indicators				
Annual recovery rate (%)	100	99.77	93.83	97.0
Overdue as % of loan outstanding (%)	0	0.92	3.49	4.68
4. Profitability Indicators				
Yield on RLF (%)	30.37	26.93	25.83	23.77
Cost of borrowing (%)	5.84	4.09	3.86	4.06
Operating self-sufficiency (%)	234	183	219	183
Financial self-sufficiency (%)	172	141	160	140
Return on Asset (%)	11.00	6.73	7.07	5.87

Source: Alamgir (2005); 14-MFI study

Sustainability of Small MFIs

Outreach: The sample has eight (8) small MFIs having members between 15,000 and 45,000 (see Table 6.7). These local MFIs had more than 5 branches and took several years to reach present state. The important indicator was that they reached more than 70% of members with loan at any given time and in two cases more than 90%. The average loan size varied considerably: between Taka 3,396 to Taka 17,649 but in most cases around Taka 7000. The high loan size and high member/borrower ratio had enabled them to reach financial viability.

Operating efficiency: The operating efficiency indicators of the small MFIs are similar except in one case (AF): Member per credit officer varied between 121 (in case of IDF which operates in hilly region) to 330; borrower per credit officer varied between 113 (IDF) to 297; cost per 1000 Taka lent varied between Taka 28 to 146; cost per loan varied between Taka 496 to Taka 873; and portfolio per credit offer varied between Taka 0.389 million to Taka 1.03. The last indicator depended on many factors such as availability of resource, average length of memberships etc. The cost factors were influenced by salary structure, overhead, staff efficiency, and other costs.

Portfolio quality: The loan recovery rate was reported high (96 to 100%). But overdue of loan of AF was unacceptably high.

Financial viability: All eight sample small MFIs enjoyed nearly 150-200% operating self-sufficiency (i.e. income is nearly double than the operating expenses) with the exception of ASOD for 2004 when the operating self-sufficiency exceeded 300%. Similarly, the financial self-sufficiency ranged between 135 to 165%, except for AF, which had financial self-sufficiency of 110% in 2004. Its poor performance could be explained by three factors: below average loan size (Taka 3000), high overdue (13.5%), and low deployment of capital in loan program (53%). But other well-managed MFIs enjoyed relatively high return. The yield on RLF varied between 25 to 33% that indicated presence of MFIs which actually charged more than 30%. The ROA within these eight MFIs varied between 2.16 and 19.92% (see Table 6.7). Similar to the Very Small MFIs a set of adjusted FSS and ROA was computed for the eight MFIs assuming 10% rate of interest that reduced FSS and ROA but seven out of eight MFIs remained profitable and financially viable.

Table 6.7: Sustainability Parameters for Small MFIs (2004)

Profitability parameters	DIP	GBK	IDF	WAVE	CCDA	SDC	ASOD	AF
1. Outreach indicators								
Members (#)	28,383	15,289	42,342	45,566	25,456	19,733	16,446	30,332
Borrowers (#)	25,523	13,374	39,675	35,222	19,801	14,269	13,539	23,647
Ratio of borrowers to members (%)	90	87	94	77	78	72	82	78
Average loan size (Taka)	17649	5119	16202	6363	7475	7341	7000	3396
2. Operating efficiency indicators								
Members per credit officer (#)	330	212	121	257	210	274	358	261
Borrowers per credit officer (#)	297	186	113	199	164	198	294	204

Portfolio per credit officer (Taka in mill.)	1.03	0.401	0.475	0.728	0.79	0.781	0.823	0.389
Cost per 1000 Taka lent (Taka)	28.31	117.74	27.67	113.7	76.3	92	125	146
Cost per loan (Taka)	499.74	602.7	705	723.3	570.4	678	873	496
3. Portfolio quality indicators								
Annual recovery rate (%)	100	99	100	96.98	100	99.02	99	98.92
Overdue as % of loan outstanding (%)	0.04	4.6	0.25	1.0	0	0.87	9.4	13.5
4. Profitability indicators								
Yield on RLF (%)	28.89	33.45	25.13	25.47	28.19	27.48	27.99	28.06
Cost of borrowing (%)	4.41	3.3	3.22	3.82	4.21	2.8	4.63	4.11
Operating self-sufficiency (%)	221	166	170	153	213	184	282	157
Financial self-sufficiency (%)	165	136	136	119	158	152	225	116
Return on Asset (%)	9.86	4.97	6.04	3.24	7.92	5.95	19.92	2.16

Source: Alamgir (2005); 14-MFI study

Sustainability of Medium MFIs

Outreach: Two medium-size MFIs (JC and TMSS) were separately studied (see Table 6.8). Similar to smaller MFIs, JC and TMSS also reached more than 80% of members with loan at any given time. The average loan size was not much different: slightly higher than Taka 6,000.

Operating efficiency: The operating efficiency indicators of these two much larger MFIs were similar: Member per credit officer varied between 295 to 306; borrower per credit officer varied between 235 to 264; cost per 1000 Taka lent varied between Taka 94 to 97; cost per loan varied between Taka 576 to Taka 634; and portfolio per credit offer varied between Taka 1.24 million and Taka 1.3 million. The last indicator depended on many factors such as availability of resource, average length of memberships etc. The cost factors were influenced by salary structure, overhead, staff efficiency, and other costs.

Portfolio quality: The loan recovery rate was reported high: more than 99% in both cases. Overdue loan was also similar.

Financial viability: JC and TMSS in 2004 as well as over the last 4 years had achieved more than 200% operating self-sufficiency (i.e. income is more than double than the operating expenses). Similarly, JC and TMSS had an average financial self-sufficiency (FSS) of 150% except in 2004 for JC where the self-sufficiency ratio suffered. This was due to appropriation for various reserves. The ROA for TMSS was much higher (7.87% compared to 3.68% of JC) possibly because of higher yield on portfolio.

Table 6.8: Sustainability Parameters for JC and TMSS (2004)

Profitability parameters	JC	TMSS
1. Outreach indicators		
Members (#)	102,769	297,833
Borrowers (#)	81,828	256,904
Ratio of borrowers to members (%)	79.62	86.26
Average loan size (Taka)	6493	6085
2. Operating efficiency indicators		
Members per credit officer (#)	295	306
Borrowers per credit officer (#)	235	264
Portfolio per credit officer (Taka in mill.)	0.87	0.93
Cost per 1000 Taka lent (Taka)	97.7	94.7
Cost per loan (Taka)	634.5	576.5
3. Portfolio quality indicators		
Annual recovery rate (%)	99.76	99.79
Overdue as % of loan outstanding (%)	1.24	1.3
4. Profitability indicators		
Yield on RLF (%)	25.32	27.28
Cost of borrowing (%)	3.83	3.84
Operating self-sufficiency (%)	202	206
Financial self-sufficiency (%)	122.69	160.82
Return on Asset (%)	3.68	7.87

Source: Alamgir (2005)

Viability of MFIs: More Recent Results

More recent data (2002-2006) have been used by Alamgir (2006) and Alamgir (2007) for five small and medium MFIs to investigate financial viability. Alamgir (2006) reports detail analysis of two MFIs, SKS and GUK, which managed large hardcore poor programs and had operations in char areas. The results were found similar to other MFIs discussed earlier where both MFIs gradually improved their financial viability.

Table 6.9 and Table 6.10 present four sets of indictors for 2002 to 2005 for SKS and GUK respectively: outreach, operating efficiency, portfolio quality and profitability. The total microfinance program of SKS was marginally profitable nevertheless profitable during 2002-04 but could not cover cost in 2005 without subsidy from PKSF. SKS received management cost as subsidy under its (PKSF) FSP program, which is incidentally managed in char areas. The Adjusted FSS (i.e. removing management subsidy received from PKSF) was below 100% (92.79%) in 2005 (see Table 6.9). The low level of profitability was due to income factors: low average loan size, smaller number of borrower per credit officer and lower borrower/member ratio. Similarly, GUK shows viable microfinance operations (see Table 6.10).

Table 6.9: SKS: Critical indicators for assessing financial viability

	Total Microfinance			
INDICATORS	**2002**	**2003**	**2004**	**2005**
1.Extending Outreach				
Members (#)	5,923	9,729	15,978	33,008
Borrowers (#)	3,077	5,850	10,491	25,116
Ratio of borrowers to members (%)	52	60	66	76
Annual growth of members (%)	n.a	39.1	39.1	51.6
Annual growth of borrowers (%)	n.a	47.4	44.2	58.2
Average loan size of the year (Taka)	5,154	3,849	5,938	4,042
2. Operating Efficiency				
Members per worker (#)	370	270	291	308
Borrowers per worker (#)	192	163	191	235
Portfolio per worker (Taka)	509,614	331,292	394,725	555,292
Cost per 1000 Taka lent (Taka)	140.62	173.90	105.32	103.10
Cost per loan (Taka)	724.80	669.28	625.37	416.71
3. Portfolio Quality				
Annual rate of recovery of loan (%)	100	100	100	100
Bad debt reserve to Loan outstanding (%)	0.98	0.79	0.78	1.04
4. Profitability Analysis				
Operating self-sufficiency (%)	133.22	153.63	155.19	131.05
Financial self-sufficiency (%)	105.45	120.36	127.54	109.31
Adjusted ROA (%)	n.a	3.25	3.03	(1.42)

Table 6.10: GUK: Critical indicators for financial viability

INDICATORS	2002	2003	2004	2005
1.Extending Outreach				
Members (#)	4,467	5,184	6,475	14,222
Borrowers (#)	3,203	4,637	5,363	11,624
Ratio of borrowers to members (%)	71.70	89.45	82.83	81.73
Annual growth of members (%)	n.a	13.83	19.94	54.47
Annual growth of borrowers (%)	n.a	30.93	13.54	53.86
Average loan size of the year (Taka)	4,959	9,181	6,715	6,383
2. Operating Efficiency				
Members per worker (#)	372.25	225.39	231.25	215.48
Borrowers per worker (#)	266.92	201.61	191.54	176.12
Portfolio per worker (Taka)	819,322	555,787	641,150	918,849
Cost per 1000 Taka lent (Taka)	150.85	59.84	119.04	83.94
Cost per loan (Taka)	748.01	549.43	799.28	535.76
3. Portfolio Quality				
Annual rate of recovery of loan (%)	99.99	99.99	99.99	99.97
Bad debt reserve to Loan outstanding (%)	0.74	1.09	0.83	0.52
4. Profitability Analysis				
Operating self-sufficiency (%)	257.42	202.64	219.82	164.29
Financial self-sufficiency (%)	158.90	163.59	186.03	134.40
Adjusted ROA (%)	n.a	8.81	15.43	4.25

Alamgir (2007) presents analysis of financial viability of three MFIs (BEES, CARB, Sojag) having significant (in case of CARB 100%) seasonal and agricultural loan portfolio using 2005-2006 data. Profitability and operating efficiency indicators for three MFIs are presented in Table 6.11. BEES follows Grameen styled group system to lend to small and marginal farmers but gives annual loan and collects in weekly system. Sojag on the other hand provides loan to men (farmers) at the beginning of two agricultural seasons and collects in one installment after harvest. CARB at the time of the study provided in-kind loan (fertilizer, water, pesticides) through registered dealers to farmers during boro season. Besides, BEES and Sojag had also hardcore poor program. All three are profitable but not as profitable as the other MFIs reported above. The main reason is small portfolio per credit officer (see Table 6.11)

Table 6.11: Financial Viability Indicators for BEES, CARB and Sojag (Various years)

	BEES (June)	BEES (June)	CARB (June)	CARB (June)	Sojag (June)	Sojag (June)
Profitability Indicators	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**
Operational self-sufficiency (%)	121.9	124.5	85.4	132.6	151.1	175.4
Financial self-sufficiency (%)	100.4	101.3	74.9	106.8	99.4	120.8
Return on assets (%)	0.01	0.06	(3.23)	0.70	(0.19)	0.25
Operating efficiency Indicators	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**
Number of clients per loan officer	177	266	205	185	269	382
Number of borrowers per loan officer	142	220	205	185	134	227
Average loan size (Taka)	6,666	6,149	3,965	4,410	7,527	7,111
Portfolio per Loan officer (Taka in million)	0.56	0.94	0.22	0.34	0.73	1.36
Loan recovery rate (%)	99.0	99.0	100	100	99.93	99.78

Note: These indicators are for the entire portfolio of the MFI, not just for their special agricultural loans.

We would like to go back to performance of smaller MFIs financed by PKSF. A 2003 PKSF study (Jashim Uddin 2003) showed that PKSF-Partners of all sizes were profitable and could actually reduce interest rate to 12.5% (flat rate). That was the basis for reducing interest rate of PKSF partners from 15% to 12.5% (flat). They enjoyed high Return on Asset (ROA) and Return on Equity (ROE) even with 25% lending rate. The profitability of MFIs is crucial for long-term sustainable services for the poor. This is very important for PKSF as well since the result shows long-term sustainability that is also linked with sector's sustainability.

Financial Viability of Large and Very Large MFIs

Three MFIs- BURO-B (2005-2008), ASA (2002-2008) and BRAC (2004-2007), have been analyzed using published data that show their viability and impacts of many factors. Table 6.12 presents the same four sets of indicators for BURO-B a most prominent MFI in Bangladesh which has been expanding fast over the last several years and continues to do so. The operating indicators are more or less similar to other MFIs. The total microfinance program of BURO-B was profitable during 2005 to 2008. In fact it was one of the most profitable MFIs and emphasized viability since its inception in early 1990s. But the profitability has significantly declined over the years: OSS was 163% in 2005 but reduced to 118 in 2007 and 109 in 2008; FSS was 136% in 2005 but reduced to 107% in 2007 and 104 in 2008; return on total asset has declined from 10% in 2005 to 2% in 2008. The decline in profitability has been due to cost factors: productivity has declined due to rapid expansion, loan portfolio has increased, more importantly cost of fund has increased. BURO-B depends very much on high cost commercial bank borrowing to finance its portfolio.

Table 6.12: BURO-B: Financial Viability Indicators

INDICATORS	2005	2006	2007	2008[17]
1.Extending Outreach				
Active customer (#)	273,286	331,329	376,710	602,273
Active borrowers (#)	209,808	263,503	354,020	496,603
Borrowers/Customer ratio (%)	77	79	94	82.45
Average loan size of the year (Taka)	6,375	7421	8416	9,035
2. Operating Efficiency				
Loan officer productivity (#)	318	213	206	242
Portfolio per Loan Officer (Taka)	1,347,714	1,006,335	1,062,208	1,347,787
Cost per 1000 Taka lent (Taka)	50	60	70	70
3. Portfolio Quality				
On time recovery rate (OTR) (%)	98.07	98.17	98.07	98.05
Portfolio at risk (>60days) (%)	1.69	1.73	2.89	2.47
Write off ratio (%)	0.14	0.24	0.33	0.60
4. Profitability Analysis				
Operating self-sufficiency (%)	163	136	118	109
Financial self-sufficiency (%)	136	122	107	104
Return on Total Asset (%)	10	6	3	2

Source: Annual reports of BURO-B: 2006, 2007; data for 2008 are not audited

[17] Figures of 2008 have supplied by BURO-B but not yet audited

ASA and BRAC are two very large MFIs in Bangladesh each serving more than 7 million clients all over the country. But when it comes to profitability ASA is more profitable due to management efficiency. A set of critical indicators for ASA - operating efficiency, portfolio quality and profitability- is reproduced in Table 6.13. ASA makes high profit as indicated by Operational Self-sufficiency (OSS), Financial Self-Sufficiency (FSS) and Return on Asset (ROA). The superior financial performance of ASA is mainly due to its efficiency. The number of clients and portfolio per loan officer figures are unmatched in the industry. At the same time ASA has maintained high portfolio quality. But Table 6.13 shows a marked gradual fall in profitability: gradually reduced OSS, FSS and ROA compared to 2002. OSS, FSS and ROA figures were 230%, 154% and 9.05% in 2002 respectively which became 143% (37% drop), 114.3% (26% drop) and 3.02% (only one third of 2002) in 2008 respectively. The main reason is fast rise of operational expenses with expansion. At the same time portfolio at risks has risen from 0.33% in 2002 to 4.99% in 2008.

Available data shows that BRAC has been improving profitability since 2001 but significantly declined in 2007 (see Table 6.14). OSS was 229% in 2006 but fell to 184% (drop of 20%) in 2007. Similarly, FSS was 137% in 2006 but became 106% (22.6% fall) making microfinance operations marginally profitable. ROA was 7.03% in 2006 which became 1.47% (79% drop from previous year) in 2007. The reasons are two folds: increase in management cost between 2006 and 2007 when BRAC expanded its membership by 39%; and the massive expansion was financed by expensive commercial bank borrowing.

Both the case of ASA and BRAC shows gradual decline in efficiency and increase in cost and decline in profitability. It seems that there is link in both cases between falling performance and rapid expansion: in case of ASA increase of operational cost and in case of BRAC increase of financial cost.

The case of another giant, the Grameen Bank, was first studied by Khandkar and Khalily (1997). The study showed although Grameen was profitable it had enjoyed built in subsidy in the form of low cost funds. But the situation has changed now (2005-09) because the bank fully depends on deposits from the members and public. The rates on deposit scheme as discussed earlier are very competitive with commercial banks. The financial reports of 2006 and 2007 show Grameen Bank profitable by having almost 100% commercial sources of funds.

Summary

The discussions and example above reveals several key points:

- With the passage of time smaller MFIs have expanded their operations and reached financial viability. The factors that made most contributions are economies of scale (expanding portfolio), staff efficiency (management cost control) and reasonable cost of capital, especially subsidized funds from PKSF and low cost savings.
- Even with loan for hardcore poor and small and marginal farmers MFIs were able to stay profitable because of low cost of fund and excellent portfolio quality.
- The very large and large MFIs have been historically very profitable but recent signs are cause for concern. In all three case (ASA, BRAC and BURO-B) the profitability has declined dramatically that can be linked with massive expansion financed by high cost loan (BRAC and BURO) and increase in management cost (all three cases).
- Portfolio quality also seems to be in decline as reported by ASA and BURO and other sources (Bangladesh Bank 2008).

Table 6.13: ASA: Critical Financial Viability Indicators: Overall MF

Important indicators	2002	2003	2004	2005	2006	2007	2008
Profitability indicators							
Operational self-sufficiency (%)	230.8	265.5	244.6	275.2	238.1	187.1	143.6
Financial self-sufficiency (%)	154.9	175.1	158.5	169.7	155.2	127.7	114.3
Return on assets (%)	9.05	11.45	9.57	10.71	9.36	5.7	3.02
Operating efficiency indicators							
Number of clients per loan officer	448	461	430	631	558	451	504
Number of borrowers per loan officer	414	419	397	441	446	367	412
Average loan size	7507	8603	7517	7129	7430	7868	9039
Portfolio per Loan officer (Taka million)	1.7	1.97	1.72	1.78	1.81	1.67	2.14
Portfolio quality							
Portfolio at risk > 30 days as % of total portfolio	0.33	0.45	0.69	1.22	1.85	3.36	4.99

Source: ASA 2008

Table 6.14: BRAC: Critical Financial Viability Indicators of Microfinance Program

Important Indicators	2001	2002	2003	2004	2005	2006	2007
Operational Self-sufficiency (%)	167.31	184.84	198.51	207.10	196.13	229.4	184.4
Financial Self-sufficiency (%)	112.53	117.98	126.80	116.75	130.65	136.88	106.6
Return on Total Asset (%)	n.a	3.26	4.73	3.39	5.80	7.03	1.47
Return on Equity (%)	n.a	10.43	14.98	10.95	19.43	23.86	6.08
Loan Recovery Rate (%)	98.85	99.27	98.04	99.32	99.49	99.52	99.54

Viability of Specific Program/Product

Sustainability of Very Poor Microcredit Programs

Studies analyzing various components of loan programs are not available. In case of microfinance for hardcore poor programs start with high level of subsidies in the form of lower cost of capital (e.g. PKSF charges only 1% to MFIs for hardcore poor component), administrative subsidies such as donor funded projects. The main reasons for operational loss is smaller loan size leading to smaller portfolio and smaller group size for same level of management cost. But with increase in loan size, the cost of operation is expected to be covered. An independent hardcore poor program branch reaches viable level within three years period compared to one year for a mainstream branch.

Viability of farmer and microenterprise program

Since the loan size of these types of product is much higher than mainstream microcredit the profitability is higher but segregated financial data are not available to study profitability of each product separately.

Effect and Impact of Microfinance

Introduction

We have distinguished two terms - 'effects' and 'impacts' of microfinance in Bangladesh. By impact we define the changes in the personal and households level leading to changes in quality of life mainly due to increase (or decrease) of income from investment in income generating activities. Common indicators are impact on income, food, clothing, housing, health, schooling, water and sanitation, building of assets, empowerment etc. By effect we mean many different services and benefits that have emerged with the proliferation of microfinance such as decline in dependence on moneylenders, enhancement of business skills, expansion of non-farm businesses, easier access to financial services, access to better market information, access to training and social development services and so forth which would not have been otherwise available to the poor. The effects are no less important than the direct impact of services on quality of life.

Effects of Proliferation of Financial Services

The following can be considered as the direct broader effects of massive proliferation of microfinance in Bangladesh:

- Access to savings and credit services from formal (licensed) organizations: Aside from impact due to increase in income the proliferation of MFIs (now most of them have received license from MRA) has allowed people to transact with formal financial institutions. We can say 33 million poor have savings account with accumulated savings of Taka 91,747 million. At no time in the history of the nation so many poor people had access to formal institutions, be it for savings or for loan. It is an achievement by itself that formal institutions are reaching the poor with professional financial services and poor people in their life have access to them.
- Decline in dependence on moneylenders (undignified borrowing): The above phenomenon has helped to reduce dependence on moneylenders who would only lend to a few of their choice, of course at an exorbitant rate (120% per annum). Besides, such personal lending-borrowing relationship creates an undignified situation where lender may take other advantages.
- *Access to market information*: The interaction of members within the groups provides opportunities for informally receiving market information such as price of various inputs, commodities, and farm produces.
- *Access to training services*: Many government and donor agencies and NGOs provided millions of man-days of training on numerous topics mostly for free. Most common training courses are awareness building on social issues, poultry and livestock rearing, fisheries, health and family planning, various agricultural products such as vegetable and crop production, tailoring, business management, accounting etc. However, these supply-driven training courses may not be always effective but over a long period of time and long association with NGO-MFIs has enhanced skills, confidence as well as technological skills of millions of poor.
- *Access to technological information*: Access to technological information and demonstration of production technologies have benefited the participants of microfinance programs but may not be always physically visible.

- *Access to social and marketing network*: Poor people through groups/samities have also developed social and marketing networks.
- *Employment generation and development of professional human resources*: MFIs are one of the largest employers for education among men and women. An estimated 171,599 persons are directly employed by the MFIs excluding the Grameen Bank.
- *Expansion of service providers (e.g. training)*: Individuals and private institutional providers have emerged to provide management and technological training to the group members as well as to MFIs (staff members and organizations).
- *Extension and other services through MFIs and groups*: MFIs and groups have also participated in other programs such as health, family planning, renewable energy promotion etc where microcredit groups have been used as platform for dissemination of information and ideas.
- *Expansion of non-farm businesses*: Main recipients of microcredit are trading, shops and small processing/manufacturing, repairing and many other services (rural transport). This has enabled millions of households to access capital to develop and earn from non-farm sources that has reduced pressure on agriculture for creating new jobs. Besides, the poultry, livestock and fisheries sector, that is, non-crop agricultural activities got serious boost due to microcredit creating employment and generating income from these sub-sectors. That is, the process has enabled diversification within broad agricultural sector. However, this is not to mean that only microfinance contributed to this situation. Other business services have also proliferated to aid the situation.

Impact of Microfinance

There have been many impact studies conducted on microcredit programs beginning mid-1980s through 1990s. The objectives were to clearly and verifiably prove the financial and economic impact of microcredit programs on the lives of the poor as well as level of reduction of poverty. However, later on it has been taken for granted that if poor people can be reached with financial services, especially credit, they will prudently utilize the monies for investments and other purposes to uplift their poverty situation. We see major variations in methodological approach and scope of studies conducted over more than two decades. The studies may be grouped into the following categories, of course not mutually exclusive: (a) evaluation or impact of microcredit, (b) comparative evaluation of more than one programs, (c) research on a particular issue, (d) sustainability analysis, (e) evaluation of performances of different organization, (f) studies on management systems and human resources of organizations, and (g) macro-policy studies. We will focus on studies that dealt primarily with impact of microcredit on quality of life. However, it is beyond the scope of this review to discuss numerous studies conducted over the years. We have selected substantive researches that include researches of various periods, variety of methodologies, scope of work, and answer relevant questions. We will briefly report on methodologies employed and major findings.

The pioneering impact study on the microcredit program of the Grameen Bank was by Mahbub Hossain [Hossain 1988] who evaluated it using the indicators like reaching the target groups, size of loan disbursed, loan utilization, accumulation of capital, generation of employment, and income, and poverty status, and used ‘before’ and ‘after’ as well as comparison between borrowers and non-borrower control groups to see the impact of microcredit. This was conducted in a backdrop of skepticism about the success of Grameen Bank and whether the poor borrowers really invest in the loan and actually earn enough to repay the loan as well as enhance family income. Methodologically this study was probably the most robust that used statistically valid sample as well as had an opportunity to compare with control group at a time when microcredit was not so widely available. The data were collected through field surveys in 1985 conducted in five selected projects and two control villages in the area of operation of 5 branches of the Grameen Bank. The sample size consisted of 975 borrowers and census of all households in seven villages. An earlier study was done in 1984 [Hossain, Mahbub 1984]. The study [Hossain 1988] reported a number of concrete contributions of microcredit from the bank:

- Borrowers have increased their business capital by an average three times within a period of 27 months;
- Asset in the form of livestock increased by 26% per year;
- About one third of members who reported to be unemployed became self-employed after joining microcredit program of the bank;
- Grameen Bank members had incomes about 43% higher than target groups in control villages, and 28% higher than the target group non-participants in the project villages. The enhanced income is from the income generating activities undertaken by using microcredit.
- The program in general enhanced overall income of households in the project villages: average household income is about one-sixth higher in project villages than in the control villages. Thus microcredit has reduced poverty.

A follow-up study was done on Grameen Bank [Rahman, Atiur 1986] that reported similar increase in income of the borrowers and found that borrowers selling marketable goods faced no problem of demand constraints. Besides, it reports that “with the expansion of Grameen activities, the rural economy is getting commercialized and more people, especially the borrowers are becoming job-specific.”

A less robust but with similar objective of proving the impact of microcredit was done on 200 randomly selected borrowers out of 1500 borrowers of four branches of ASA who received three successive loans reported improvement in income and in other social indicators of beneficiaries due to availability of microcredit [Keyamuddin 1992]. Another study using Rapid Rural Appraisal (RRA) and social evaluation techniques on one of the Grameen replicators, Thana Resources Development and Employment Project (TRDEP), reported increase in income of borrowers, especially those of repeat borrowers [Department of Youth 1994].

BIDS carried out a major comparative study of poverty alleviation programs in Bangladesh that included 10 programs of eight (8) organizations-both government and non-government [BIDS 1990]. The investigations were carried out in 30 villages covering nearly 6000 households that included household census and intensive sample surveys. The difference in this study is that it compared the same indicators for all programs to determine relative success or failure. As a part of the above analysis, comparative study was done to compare the credit programs of BRDB-RPP, BRAC-RDP and TRDEP [Bhattacharya 1990]. It reported success of all three programs in reaching the poor (a percent of non-target people was also found joining the microcredit groups), enhancing income and creating self-employment due to microcredit.

A number of important studies have been conducted on the programs of the Palli Karma-Sahayak Foundation and its partner organizations (microfinance institutions that receive loan from PKSF to lend on to the poor). We will discuss two studies Rahman (1996) and BIDS [2001]. Although the methodologies applied in these two studies are somewhat similar to other impact studies but the importance of the two studies is that both measured impact of microcredit from smaller microcredit institutions, which follow Grameen Bank model, to show that impacts of income and other indicators are similar. This shows robustness of the microcredit system that has been successfully replicated to reach millions of poor left outside the Grameen Bank or a few large organizations. The smaller MFIs replicated the management system and showed that if poor were reached with financial services they could use them efficiently irrespective of sources.

Rahman [1996] analyzed the impacts of microcredit using cross-sectional comparison of households who had borrowed and those who had not. A stratified random sampling method was followed for selection of MFIs of different size: small, with less than 2000, medium with members between 2000 and 3000 and large with members above 3000. Eight (8) partner MFIs were randomly selected by allocating proportion to the number of partner MFIs in each three categories. For each selected partner MFIs, 40 households were randomly selected from the list of 3 types of members: the non-borrowers, those who borrowed only once and those who borrowed for more than once. Forty (40) households were selected to give a reasonable size of sample in each stratum and the total sample was 960. A survey was used among the selected households using a structured questionnaire. It was a preliminary study only after two years of PKSF's operations. The major findings of the study are as follows:

- Microcredit enhanced household income. Though the income increase was modest, this reduced food insecurity, and increased expenditure on clothing and human capital development.
- Income and awareness increase due to membership in MFIs led to better children's school attendance and immunization.
- Microcredit increased employment of both men and women in the form of self-employment; women participation in IGAs had increased.
- Women were found very active and enterprising when provided with opportunities for investment.

On the other hand, the study by Zahir et al [BIDS 2001] is more detailed and used panel data. The study area included 13 regions of Bangladesh, covering 91 villages spread over 23 sub-districts. Following a census of all households in the 91 villages during October 1997, the study administered three repeat surveys, on a matched sample of about 3000 rural households – during 1998, 1999 and 2000. Besides collecting information at household levels, separate modules were administered on MFI-members from these households and for village and samity-level information. Major findings are as follows:

- Microcredit from smaller MFIs supported numerous income-generating activities, mostly of self-employment nature. A proportion of microcredit recipients owned cattle, and control land ownership; the participants earned higher income from livestock than non-participants.
- Self-employment accounts for a higher share of (regular) program participants' annual income, compared to others. However, petty trading activities dominate, accounting for almost half the income earned from self-employment activities. While the direct and indirect impacts of microfinance have all led to increases in rural self-employment activities, it is primarily in the area of transport services where the programs have made significant contribution.
- Estimates on household income showed that self-employment activities were most severely affected by the flood. As a consequence, real income of poor households declined during the flood year, even though the average income of all sample households had increased. Participation in programs and access to credit had however helped in containing the negative effects of flood.
- Multivariate analysis in the study shows that there is significant positive effect of regular program participation on income and on average consumption of poor households. Particularly, increases in the consumption of pulse, fish and milk are more prominent among MFI borrowers, when controlled for land ownership.

- Both head-count and poverty gap measures show that regular participation registered a faster rate of poverty reduction than occasional participants, and reduction in poverty among the latter was faster compared to non-participants. A comparison across the first (1997-98) and the third (1999-2000) round shows the larger percentage of program participants tend to invest on both human and physical capital.
- Participation in MFI programs is found to have led to decline in gender gap in access to schooling and to modern health care.
- Generally, the study finds program participants to be less vulnerable to crises even though they face similar degree of crises as non-participants.

A summary of major quantitative impact studies has been presented by Rahman [2000] as reproduced below:

Table 7.1: Impact of microcredit on household income/expenditure

Source	Name of organization studied	Income or expenditure per annum (Taka)	Participants	Control (non-participants)	% change
Hossain 1984	GB	Income, per capita	1762	1346	30.9
Hossain 1988	GB	Income, per capita	3524	2523	39.7
BIDS 1990	BRDB	Income, per household	6204	4260	45.9
BIDS 1990	BRAC-RDP	Income, per household	2844	1560	82
IMEC 1995	Proshika	Income, per household	22,244	17,482	27.2
Rahman 1996	PKSF	Expenditure, per household	26,390	23,802	10,9
Khandakar 1998	BRAC	Expenditure, per capita	5180	4202	23.3
Khandakar 1998	GB	Expenditure, per capita	5050	4335	16.5
Khandakar 1998	RD-12	Expenditure, per capita	4931	4279	15.2
Halder 1998	BRAC	Expenditure, per capita	8244	6480	27.2
BIDS 1999	PKSF	Expenditure, per capita	36,528	33,732	8.3
IMEC 1999	Proshika	Income per household	48,635	43,584	11.6

Source: Rahman [2000]

The sector has observed gradual loss of interest for rigorous quantitative analysis for several reasons: high expenses; need for experienced expert human resources to conduct such studies; and on many occasions researchers reported difficulty of finding ‘control groups’ due to massive expansion of microfinance programs to make any meaningful conclusion about the impact of any particular program. Methodological innovations have been made to isolate impacts of overall microfinance program even if a particular borrower receives loans from many different sources. At the same time, researchers face challenges to isolate social and economic impacts of microcredit because such impacts are and can be derived from many different sources.

This has led to application of qualitative approaches of impact study emphasizing the views of the members/borrowers to determine impact of microfinance. This type of approach starts with the notion that the members/borrowers are in the best position to say whether they have benefited from the program. This approach is cost-effective, which also tries to bring out the various qualitative and social aspects of impact of microfinance as well as other development interventions.

Alamgir (1996) followed a low-cost method, that is, qualitative measurement of impact of microcredit program of PKSF and its partner organizations. Two objectives of the study were to ascertain whether partner organizations of PKSF had reached the poor and whether borrowers had benefited from this program. A survey has been conducted among the members (7,041 members) of 297 groups/societies of 20 Partner Organizations (POs or MFIs). Several factors, such as the year of enlistment, membership, amount of loan disbursement, legal identity and geographical location have been considered in selecting the sample POs. A comparison of social and economic status has been made between non-borrower members and members who received loans for 4 times or more. A total of 600 borrowers from 12 POs were studied and compared with another set of non-borrower members.

Nearly 6000 borrowers of the 297 groups (centers) gave their opinion about the impact of credit from POs. Their opinions were gathered using different indicators related to quality of life. Besides, in-depth discussions were held with the groups to get their impression about impact of credit program as well as the need for the continuity of the program. The highest number of members (87.58%) reported increase in family income followed by improvement in productive employment (87.03%) due to loan. Women worked for additional income of the family, thus contributed to the improvement of family. The next important impacts were improvement in food (79.68%), child education (83.48%) and health care (77.03%). The members perceived the increase in health care spending as the direct benefit of the program. The least number of members (57.14%) reported improvement in housing conditions. Usually it takes longer time for families to spend any significant amount for improving houses. Programs of POs were relatively new and they did not provide housing loan. Therefore, the improvement in housing must come from family savings, which is usually slow at the early years. Nearly 6000 (86.25%) members reported overall improvement in quality of life (Table 7.2).

Table 7.2: Comparison of the quality of life before and after taking loan

Serial No.	Indicators	Decreased		Same as before		Improved		Total	
		#	%	#	%	#	%	#	%
1	Family income	42	0.71	697	11.71	5211	87.58	5950	100
2	Quality and quantity of food	43	0.72	1166	19.60	4741	79.68	5950	100
3	Clothes	32	0.54	758	29.55	4160	69.92	5950	100
4	Health	58	0.97	1309	22.00	4583	77.03	5950	100
5	Child education	21	0.35	962	16.17	4967	83.48	5950	100
6	Housing condition	18	0.30	532	42.55	3400	57.14	5950	100
7	Productive employment of family members	7	0.12	765	12.86	5178	87.03	5950	100
8	Overall quality of life	26	0.44	792	13.31	5132	86.25	5950	100

Source: Survey, 20 POs reported in Alamgir (1996)

The four times or more repeat borrowers and the non-borrowers evaluated the overall conditions of their families. This approach has been used as complementary indicator to assess impact of microcredit. Status of the members had been classified into 6 categories. Out of the 602 borrowers, none was reported to have “chronic deficit” throughout the year, only 16 (2.66%) borrowers reported “occasional deficit”. The remaining 586 (97.34%) either have no deficit or are better off, that is, they can generate some surplus. But in case of the 593 non-borrowers, 28 (4.72%) reported “chronic deficit” and 98 (16.53%) reported occasional deficit. Majority (54.89%) of non-borrowers are in “no deficit” category whereas this is only 20.76% in case of borrowers. It appears that the overall impact of credit program is a gradual shift in status of members upwards (see Table 7.3).

Table 7.3: Self-Evaluation of Borrowers and Non-Borrowers about Family Condition

Serial No.	Evaluation status	Borrowers		Non-borrowers	
		#	%	#	%
1	Chronic deficit throughout the year	0	0	28	4.72
2	Occasional deficit	16	2.66	98	16.53
3	No deficit	125	20.76	343	54.89
4	Adequate	302	50.17	109	18.38
5	Surplus for children education and other expenses	104	17.28	9	1.52
6	Surplus for investment after covering all expenses	55	9.14	6	1.01
Total		602	100%	593	100%

Source: Survey, 12 POs

A similar study with much smaller sample size was conducted to ascertain the impact of long-term association with microfinance institutions, i.e. repeat borrowers by Alamgir (1999b). Twenty six (26) small and medium Partner Organizations (SM-POs) of the Palli Karma Sahayak Foundation (PKSF) were selected out of 143 active POs to investigate the impact of microcredit on the socio-economic conditions of the borrowers. A total of 675 borrowers, 25 borrowers from each of the POs, who received loans for 4 times or more were interviewed to gather their opinions related to various socio-economic issues. All 675 sample borrowers are women and married. On an average these members have been associated with POs for at least 6 years. The sample borrowers received an average of 4.61 loans. Forty two percent (42%) of the sample borrowers received more than 4 loans. At the beginning borrowers usually received small loans and gradually received higher loans. The average value of first loan was Taka 2,188 and 61% of the borrowers received up to Taka 2000 as their first loan. But with successive loans, the size increased and the loan size at the time of the study, on an average, was Taka 7472 and 30% of the borrowers received loan more than Taka 8000. Only less than 1% (6 out of 675) of the borrowers still received loan of Taka 2000.

The areas of investment by the borrowers had been observed to be more or less same over the time. The most common area of investment had been petty trade, about 34.81% of borrowers invested in small business (petty trade and shops), this was marginally lower (33%) in case of first loan. The second preferred investment in case of first loan was poultry rearing. There has been slight shift in investment activity. Currently, cattle fattening has been the second choice investment followed by leasing of land and improvement in housing.

The study assessed in the following manners: firstly, to study the impact of microcredit opinions of borrowers were gathered regarding the benefits or contributions of microcredit on: (a) the income of the family, (b) the nutrition, clothes, housing conditions, sanitation, and (c) the land ownership; secondly, the borrowers were asked to categorize the conditions of current housing and that of before joining PO and the contribution of microcredit on the change; thirdly, borrowers evaluated their overall current family status and compared that with the status before joining the PO; and finally, an attempt was made to estimate the value of assets formed by the borrowers after joining the PO based on their opinions and compared that with their current debt to find their net worth. Note that qualitative information was mainly gathered in the study. At the same time all the positive impacts mentioned by the borrowers may not be entirely attributed to microcredit because the families have other sources of income. However, borrowers believe that net positive benefits were derived from microcredit and it opened up the opportunity for them to accumulate some assets.

The assessment of impact of credit program by sample borrowers is as follows (see Table 7.4):

- income has increased for 97.93% of borrowers and 1.78% reported no change. Only 2 borrowers (0.34%) reported fall in income; .
- improvement in quality and quantity of food intake by the family members have been reported by 88.59% of borrowers;
- improvement in clothing has been reported by 87.85% of borrowers;
- improvement in housing conditions has been reported by 75.26% of borrowers ;
- improvement in child education has been reported by75.41% of borrowers;
- improvement in sanitation condition has been reported by 68.74% of borrowers; and
- improvement in quality of life has been reported by 94.96% of borrowers.

Table 7.4: Impact of microcredit on repeat borrowers (4 times or more)

	Indicators	Improved	Same as before	Decreased	Total
1	Family Income	661	12	2	675
	%	97.93%	1.78%	0.30%	100.00%
2	Quality and quantity of food	598	77	0	675
	%	88.59%	11.41%	0.00%	100.00%
3	Clothes	593	82	0	675
	%	87.85%	12.15%	0.00%	100.00%
4	Housing conditions	508	162	5	675
	%	75.26%	24.00%	0.74%	100.00%
5	Children education	509	101	13	675
	%	75.41%	14.96%	1.93%	100.00%
6	Sanitation	464	210	1	675
	%	68.74%	31.11%	0.15%	100.00%
7	Overall improvement in quality of life	641	33	1	675
	%	94.96%	4.89%	0.15%	100.00%
8	Land ownership	192	482	1	675
	%	28.44%	71.41%	0.15%	100.00%
9	Average size of land acquired (decimal)	30.56			

Source: Alamgir (1999b)

An important indicator of improvement in economic conditions of a poor family is increase in land ownership: 28.44% of sample borrowers reported that they could increase their land ownership. They acquired on an average 30.56 decimals of land, significant for a poor family. Nationally, 55.23% of rural households own less than 49 decimal of land and 36.46% own land between 5-49 decimals[3]. More than 28% borrowers could bring themselves within this group of rural population by acquiring on an average 30.56 decimals of land.

A significant improvement in quality of housing of borrowers' had been reported. Housing conditions have been classified in 4 categories: (a) thatched house (jhupri), (b) house with wall and roof made of sub-standard materials, (c) house where wall is made of sub-standard material and roof with CI sheet and (d) wall and roof both made of CI sheet. Ownership of categories (a) and (b) has decreased from 36.7% to 4.6% and 30.4% to 15% respectively, represents a marked improvement in quality of living conditions of the borrowers. As a result, the ownership of the houses of categories (c) and (d) has increased from 25.6% to 44.3% and 7.3% to 36% respectively. The housing characteristics of the borrowers were better than the national housing characteristics in rural areas at the time of survey. Nationally in rural areas, 75.2% households have jute/bamboo/mud (sub-standard material) as wall material and 31.8% households have similar sub-standard material as roofing material. But in case of borrowers, only 15.11% households have such materials for roof and wall. Nationally only 12.2% households have tin as wall material whereas the 36.00% borrowers have tin as wall and roof, significant improvement than the national characteristics[4] .

Table 7.5: Housing conditions of borrowers

	Classification of housing conditions	Current Housing conditions		Before joining PO	
		# borrowers	%	# borrowers	%
1	Jhupri (Thatched house)	31	4.59	248	36.74
2	Wall and roof with sub-standard material	102	15.11	205	30.37
3	Wall with sub-standard material, tin roof	299	44.30	173	25.63
4	Tin wall, tin roof	243	36.00	49	7.26
	Total	675	100.00%	675	100.00%

[3] Household Expenditure Survey 1995-96 (Summary Report)
[4] Demographic and Health Survey 1996-97.

Self-evaluation of family conditions: Microcredit interventions have been able to significantly reduce food deficit of the borrowers. This has been assessed based on self-evaluation made by the surveyed borrowers. The number of families having food deficit (and other incidental expenses) has been reduced from 82.22 to 9.63% over a period of 5 to 6 years. This was evaluated by seeking information on their family conditions based on six (6) categories: (a) Chronic deficit throughout the year (b) occasional deficit, (c) no deficit (d) adequate, (e) surplus for children education and other purposes, (f) surplus for investment after covering all expenses. Only 0.59% and 9.04% reported that they had chronic and occasional deficit during the year respectively. But these figures were 38.07% and 44.15% before joining the PO. On the other hand, for 77.33% [summation of categories of (d), (e) and (f)] the families have either 'adequate' or better situation compared to 4.75% before joining the PO. These indicate that microcredit has contributed in reversing chronic food deficit of the borrowers.

Table 7.6: Self evaluation of borrowers about family conditions

	Description of status	Current Status		Before joining PO	
1	Chronic Deficit Throughout the Year	4	0.59%	257	38.07%
2	Occasional Deficit	61	9.04%	298	44.15%
3	No Deficit	88	13.04%	88	13.04%
4	Adequate	106	15.70%	24	3.56%
5	Surplus for Children Education and Other Purposes	173	25.63%	7	1.04%
6	Surplus for Investment After Covering All Expenses	243	36.00%	1	0.15%
	Total	675	100.00%	675	100.00%

Borrowers perceived that accumulation of family assets largely attributed to the surplus of income from microcredit. About 87% borrowers formed some kind of physical asset while the remaining 13% borrowers reported that they could not form any asset after joining the PO. The average value of asset per person was Taka 30,934. But the average value of current debt per borrower is Taka 4,140, i.e. average net worth of Taka 26,794 (see Table 7.7). These 584 borrowers formed 1154 types of assets, i.e. each borrower could form more than one type of assets. The average value of different types of asset is Taka 11,916. The most common asset was livestock as reported by 316 borrowers (54.1% of borrowers who could form physical assets and 27.38% of total number of assets). The second type of asset was the purchase of land as reported by 171 borrowers (29.28% of borrowers and 14.82% of total assets). This was followed by construction/improvement of house as reported by 156 (26.71%

and 13.52% of total assets) borrowers. Other types of asset were poultry birds, agricultural equipment, sewing machine, rickshaw/van etc. representing 44.28% of total number of assets.

Table 7.7: Current indebtedness and value of asset formed after joining the PO

	Value of asset/indebtedness (Taka)	Loan		Asset formed after joining the PO	
		#	%	#	%
1	None	0	0	91	13.48
2	up to 5000	448	66.37	81	12.00
3	5001 - 10000	206	30.52	125	18.52
4	10001 - 15000	14	2.07	71	10.52
5	15001 - 20000	5	0.74	62	9.18
6	20001 +	2	0.30	245	36.30
	Total	675	100.00%	675	100.00%
	Average (Taka)	4,140		30,934	

Table 7.8: Types and value of assets formed

	Type of asset	#	%	Average
1	Purchase of land	171	14.82	50,959
2	Lease of land, pond etc.	48	4.16	18,593
3	Poultry birds	145	12.56	1,576
4	Livestock	316	27.38	8,317
5	Rickshaw/van/boat	87	7.54	7,475
6	Agricultural equipment	15	1.30	6,820
7	Repair of house/purchase of CI sheet	156	13.52	15,218
8	Sewing machines etc.	23	1.99	5,000
9	Cash savings	142	12.31	24,198
10	Others	51	4.42	26023
	Total	1154	100.0	11,918

All studies reported above followed similar approach, either using quantitative (income or expenditure) or qualitative household information, to determine the impacts of microcredit on income and consequently on other quality of life indicators. Alamgir [1994] followed a different approach to indirectly measure the impact on income by measuring profitability of individual income generating activities financed with microcredit by partner organizations of PKSF. Besides, estimating profit the objective was to see whether the borrowers were able repay loan even after payment of interest at the rate of 30% per annum. In this context, the main objective of this study was to assess the level of income accrued to the rural poor after the payment of principal and nearly 30% interest on loan. A total of 460 borrowers were selected from 14 organizations and in-depth discussions were carried out to estimate the revenue, expenses and profit (loss) of each micro–business ventures Of the 14 organizations, 12 were Partner Organizations (POs) of PKSF and one branch from the Grameen Bank and BRAC. Note that there are some shortcomings in the methodology: small number of borrowers were interviewed; revenue expenses were based on recall method and there was always a risk of over or understatement of profits (loss) but the findings can be treated as indicative of the situations; women borrowers do not normally consider their own labor cost as the activities are done as part-time and shared by other family members. The major findings are:

- Borrowers' earnings depended on the amount of money invested and the nature of business they undertake.
- All respondents reported net positive income from micro businesses. The net income to the families increased with the greater amount of loan and longer duration of membership.
- Even after payment of principal amount of loan and a high rate of interest, a significant amount of income was accrued to each borrowing family. The total income as percentage of average loan ranges between 108.5% to 962.8%. The income mainly depended on the nature of the micro businesses undertaken by the borrowers and the amount of money invested.
- The total interest paid as a percentage of net income (after full payment of loan with interest) was estimated. It ranged between 1.5% to 13.83% for 1st, second and third time borrowers, the total interest paid as a percentage of net total income varied between 1.56% to 13.83%, 2.5% to 8.1% respectively. Apparently the variations decreased with successive loans.
- There were significant improvements in social indicators such as the use of sanitary latrines, increase in awareness regarding family planning the use of safe drinking water, child education, etc.

Another study [Alamgir 1999c] was conducted to estimate the contribution of microcredit on family income by estimating income from micro-investment and estimating return on investment. Because of small size of sample this can be considered as an anecdote. But the profitability of common investment can be calculated using this approach. The study calculated annual inflows to family to estimate contribution of microcredit. Microcredit has two inflow items in the form of income: net profit from an activity and income earned as a labor of family members who usually run the activity. An analysis of 85 microcredit investments was conducted to determine the rate of return of each of the activities. Each activity was analyzed to develop an income expenditure profile by deducting all expenses including family labor from revenue of the activity. First of all, revenue and expenses were determined for one cycle of business and then annualized to determine annual profit. Sample activities studied from five broad categories: petty trade, poultry and livestock, agro-processing, rural transport and services.

All 85 families included in the study generated or are expected to generate surplus (receipts minus payments) during the year. This was considering the loan repayment already made to the PO and micro-investment made during the year. Since the families will be generating surplus, it is expected that they will be able to repay the remaining loan installments as well. The contribution of microcredit to family income has been found to be significant. On an average it contributes Tk.37,833 per year as additional income in the form of family labor and profit. The proportion of contribution from microcredit to total family income is also very significant and has been found to be sometimes as high as 98% (see Table 7.9)

Table 7.9: Contribution of Microcredit on Family Income

Type of activity	Number of cases	Average annual surplus generated by the family (TK.)	Average annual contribution from micro-investments (Tk.)	PKSF's contri-bution (TK.)	Average income from micro investments as % of total family income %
Tailoring	2	37,195	96,351	20,396	56.6
Rickshaw/van	3	24,496	62,816	21,763	46.3
Scooter (motorized 3 wheeler)	1	68,245	109,900	12,988	36.3
Paddy husking	3	30,442	86,619	56,844	80.2
Grocery shop	9	41,408	99,759	23,338	68.0
Small trading	24	32,027	80,287	28,825	69
Milk cow	6	20,028	41,457	6,064	31.3
Broiler/cattle fattening	7	33,826	124,268	11,820	34.1
Chick rearing/poultry	2	11,143	41,482	8,303	21.3
Fish farming	2	30,594	78,976	22,484	35.4
Furniture making/ bamboo products/pottery	6	37,989	87,690	35,653	58.7
Handloom/ embroidery	3	27,123	71,216	30,027	65.7
Restaurant/ sweet shop	4	56,345	99,389	33,014	58
Veg./agro-processing/nursery	9	19,599	65,777	16,990	40.6
Services (painter/ welding shop/blacksmith	3	28,784	99,028	53,200	98.4
Total	85				
Average		**37,832.6**	**83,001**	**25,447**	

Source: Alamgir (1999c)

Average value of investment varied between TK.6,000 and TK.28,000 (in one case TK.80,000) and the equity contribution was about 58%. PKSF's average loan size was about TK.8,400 (see Table 7.10). All microcredit investments studied produced profits. The rates of return varied between 36 to 226%, which was expected in case of such family managed micro-investments. The overhead cost and hired labor in most of these investments were zero, leading to a very high rate of return. It had been observed that activities with short business cycles, where money could be revolved over and over within the year (e.g. trading, grocery shops, and restaurants) had very high returns. On the other hand, activities having long business cycle such as poultry, fish farming, and cattle fattening had relatively low rates of return. Importantly, the rate of return in all cases was found to be higher than the effective rate of interest on micro credit.

Table 7.10: Rate of Return of Microcredit Investment

Type of activity	Number of cases	Average Equity (TK.)	Average PKSF Loan (TK.)	Average Investment (TK.)	Average Annual Rate of Return (%)
Tailoring	2	7525	5500	13,025	196
Rickshaw/van	3	1000	6667	7,667	135
Scooter (motorized 3 wheeler)	1	70000	10000	80,000	36
Paddy husking	3	2000	9000	11,000	415
Grocery shop	9	19611	8556	28,166	164
Small trading	24	12104	8792	21,250	188
Milk cow	6	16700	9333	26,037	51
Broiler/cattle fattening	7	32757	11000	43,757	63.6
Chick rearing/poultry	2	1750	5000	6,750	112
Fish farming	2	5000	11500	13,000	64
Furniture making/bamboo products/pottery	6	4417	8167	11,583	191
Handloom/embroidery	3	4667	8333	13,000	221
Restaurant/sweet shop	4	9000	10250	19,250	167
Veg/agro-processing/nursery	9	3014	7278	10,125	126
Services (painter/welding shop/black smith)	3	14000	7667	21,666	226
Total	**85**	**12,729**	**8,402**	**21,751**	

A completely different type of study has been conducted by Mohiuddin Alamgir [1998] to estimate contribution of the Grameen Bank on GDP of Bangladesh in 1994-1996. The author estimates the figures as 1.5%, 1.33% and 1.1% respectively.

Impact of Hardcore Poor Programs

A considerable amount of efforts has been given over the last 6-7 years to reach the extremely/ultra-poor with appropriate financial services on the backdrop of severe criticism that microcredit has served only the moderately poor, and either group members and field staff members deliberately keep them out of the system or they (ultra-poor) exclude themselves because the service does not suit them. Several important initiatives have been undertaken, e.g. by PKSF (Financial Services for the Poorest, and Hardcore Poor microcredit program), BRAC (CFPR/TUP) and the Grameen Bank by introducing appropriate terms and conditions in savings/credit component and adding some non-financial services as well. This section will discuss the impacts of such programs that will also give us an opportunity to review the very recent (2007-2008) impact studies conducted in the country.

Impact of FSP

One of the early project implemented by PKSF through its 19 partner organizations in 19 sub-districts with a target to reach 57,000 (at the rate of 3000 per sub-district) extremely poor people with financial services. The project started in 2003 and reached highest number of target beneficiaries in June 2006 (64,725 members and 58,505 borrowers). Two studies were conducted to measure the impacts: interim assessment in 2004 (PKSF 2005) and final study in late 2007 (PSKF 2008). In both studies samples were taken from each sub-district; a total of 1900 respondents were (1425 participants and 475 control households) studied. The project defined ultra-poor family with daily income less than USD 1 or families having less than 3 decimals of land.

As expected the interim results (PKSF 2005) showed a modest gain in income and expenditure but it was an important finding that the extremely poor people can borrow, invest, enhance income and repay loan on time. Table 7.11 shows changes of household income and expenditure compared to baseline (2002). The extremely poor households moved from lower income and expenditure brackets to higher brackets. The mean annual household incomes before and after project interventions (2 year period) were Taka 15,805 and Taka 18,946 respectively. More importantly, the extremely poor families could increase savings and improve health and hygiene, access to safe water, sanitation, food intake etc.

Table 7.11: Interim impact of microcredit in FSP project

Income/expenditure brackets [Taka]	**Percent of households in this income bracket (%)**		**Percent of households in this income bracket (%)**	
	Before (baseline)	After	Before (baseline)	After
5,000-10,000	20	5.3	27.9	19.8
10,001-15,000	32.2	26.7	43.6	42.2
15,001-20,000	25.7	29.8	17.1	23.4
15,001-20,000	10.6	19.4	3.8	7.0
20,001-25,000	11.5	18.8	7.6	7.6
Total	100	100	100	100

Source: PKSF 2005

The same number of beneficiaries and control families from the same villages were studied in later 2007 that showed the following important impacts (PKSF 2008):

- FSP has increased the employment position of the beneficiaries and their household members. The incidence of migration from beneficiary households has declined, although it found a rise in the control households

- Household income is also found to have grown more in the beneficiary households compared to that of control group. The average household income for the beneficiary from 2005 to 2007 increased by more than 110% from Taka 18,986 to Taka 39,939 and on the other hand, the increase of incomes in the control group was 83% from Taka 21,156 to Taka 38,907. The major sources of household income for the beneficiary were IGAs undertaken through FSP credit.
- During the project period, not only household income but also household expenditures of the beneficiary households increased by 180% from Taka 13,890 to Taka 35,529, on average (thanks to the price hike in the country.) For the control group, the average expenditures increased by 22% from Taka 26,661 to Taka 32,466. The major expenditure categories such as food consumption remained the same but the relative share of food as a portion of household expenditure declined.

Impact of CFPR/TUP

CFDP/TUPis one of the systematically targeted ultra-poor program implemented by BRAC. The program includes temporary cash stipend, asset transfer, skill training, savings and after 18 months of asset transfer microcredit for income generating activities. An impact study (Mehnaz, Rabbani et at, 2006) using panel data of 2002 (before program implementation) and 2005 (after 3 years of program implementation) has been conducted to document the overall impact of the program. A total of 5,288 participants were interviewed. Comparison has been made with non-selected ultra-poor. The findings report major improvement in many aspects of quality of life, reduction in vulnerability and improvement in assets. For example, although starting with a worse-off position compared with non-participants the participants have deposited considerable savings, took loans, increased assets in the form of land and furniture, and participants have larger income and fewer food shortages, and spend more for medical needs.

Comparative Impacts of Hardcore Poor Programs

PKSF sponsored a comparative study by Nath [Nath 2005] on the impacts of four microfinance programs (two of them have additional non-financial features) targeting the ultra-poor/hardcore poor: CFPR/TUP program of BRAC, Financial Services for the Poorest of PKSF implemented through a number of partner MFIs (FSP-PKSF), Struggling Members Program of Grameen Bank, and the financial service program for very poor of Plan Bangladesh implemented through three partner MFIs were studied. The study had been timely when large-scale microfinance programs were launched targeting the hardcore poor. All these programs are innovative in terms of features of financial services, delivery methods, and combination of financial and non-financial services. The study has focused primarily on two aspects: a) Analysis of delivery system of financial services to the hardcore poor; and b) Social and economic impacts of the programs. The study followed the following methodology: a) Analyzed features and design of each program delivery system; b) Analyzed 263 households randomly selected from 67 villages and compared that with control village data; and c) Conducted regression analysis for making conclusion. The study used the following indicators for impact evaluation (see Table 7.12):

Table 7.12: Indicators for Impact Evaluation of four hardcore poor programs

Types	Indicators
Income	Total Household income and Income from different sources
Expenditure	Food, Non-Food Expenditure such as clothing, transport etc., Household durables, Productive expenditure.
Assets	Land owned, Non-Land Assets, Market value of household durables and Saving
Employment	Status of employment
Distress sale of assets	Disposal of asset in case of emergency need.
Housing condition	Types of houses including types of roof and wall
Consumer utilities	Water supply facilities, Sanitation facilities and Main energy sources for cooking and lighting
Income based Food security	Surplus, Occasionally deficit and Chronically deficit
Mobility	General mobility of Women and Occupational mobility
Participation	Participation in family decision-making and Participation in local level decision-making
Education	Educational level, literacy, enrolment of Children

A comparative analysis of the four programs is useful (see Table 7.13) to interpret the findings:

Credit plus program: All four programs have savings and credit products although they vary on degree of emphasis. FSP-PKSF and Grameen give emphasis on credit and Plan Bangladesh emphasizes savings aspects. BRAC and PKSF combine skill training while DSK, a partner of Plan Bangladesh, has additional primary health services. BRAC's clear advantage is food aid, and in case of CFPR/TUP, transfer asset in the form of poultry and livestock to the ultra-poor families. Grameen Bank provides interest free loan, life insurance and loan insurance services to the beggars in order to help them to find out a dignified livelihood, send their children to school, and graduate them for becoming regular GB members.

Group versus individual lending technique: Grameen Bank's regular microcredit operation is based on groups. But it has made an exception for this program where it follows individual lending technique. Plan also follows individual lending techniques where FSP-PKSF and BRAC follow group lending methodology. Plan Bangladesh provides door to door service to the individuals on daily basis.

Flexibility in Savings and Credit Operation: FSP-PKSF and BRAC (IGVGD) have extended some features of regular microfinance with some flexibility in terms and conditions, but the programs of Plan Bangladesh and Grameen Bank (Struggling Members Loan Program) are entirely flexible. Grameen program provides interest free loan without any time limit of repayment. Plan Bangladesh shows maximum flexibility in terms of size and time of savings, grace period and repayment of loan money and regarding the holding of weekly or monthly meeting.

Selection and Targeting: Unlike regular microcredit programs, all four MFIs follow very stringent criteria and undertake elaborate steps (BRAC, FSP-PKSF, and Plan) to identify the hardcore poor and beneficiary of the programs. Plan Bangladesh accepts the poorer families within a village. For BRAC or FSP-PKSF also most of the beneficiaries belong to the poor echelons of the village society. Grameen Bank targets the beggars under struggling member program. BRAC has been implementing IGVGD program by targeting the hardcore poor with VGD card holders. Hardcore poor under FSP-PKSF is defined as one who is landless or holds up to 10 decimals of land, is unemployed or earns less than a dollar a day or dependent on temporary job, has no assets and no place to sleep, is abandoned or separated women headed household member, disabled and elderly, parent of child labor, seasonal worker or day laborer.

Product features: Except Grameen Bank all three programs charge interest rate similar to their regular programs. For these programs the loan size, especially the first loan is small, as small as Taka 500. BRAC and FSP-PKSF follow weekly repayment, and the other two programs do not have any repayment schedule. Savings deposits are encouraged and withdrawal is relatively easy.

Table 7.13: Comparative Analysis of Performance of Different Programs on Hardcore Poor

Items	Grameen Bank	BRAC	PKSF (Wholesaler)	Plan Bangladesh(Wholesaler)
Name of The Project/Program	Struggling Members Program	Income Generating Vulnerable Group Development Programme (IGVGD)	Financial Services to the Poorest (FSP)	i) Dustha Shasthya Kendra (DSK) ii) Come to Save (CTS)
Life of the program		20 years during 1985-2005	3 years during 2002-2005	Three Years during 2002-2005
Services delivered	Loan	Food, Training, Loan and Savings	Awareness, Training, Savings, Loan	Visit by the Field Visitor-Awareness-Savings-Loan
Procedure followed for beneficiary composition	Random selection of able bodied beggars	Selection of Holders of VGD Card	Selection of Hardcore Poor by Observation and Screening Life Style, Wealth holding and occupation	Selection of Hardcore Poor (D and E categories) on the basis of Wealth ranking by the community classification of households into five classes: A, B, C, D and E.
Lending technique	Individual	Group	Group	Individual
Loan Sequence Ist loan 2nd Loan 3rd Loan	 658 346 13	 2713 3766 2905	 1882 3609 2872	 2000 2200 2728
Interest Rate on Loan-Flat Rate (On Reducing Balance)	0	15% at flat rate (30% P.a.)	12.5% per annum (p.a.) at flat rate (25% p.a.)	13% p.a. at flat rate (20% p.a. on monthly repayment)
Mode of repayment	Flexible as per wish of Borrower	46 Weekly	46 Weekly	Flexible as per ability and wish of Borrower
Recovery Rate	NA	99.5%	100%	98.5%
Total Number of beneficiaries of the Programme	52000	292200	57000	17500
Savings Programs/ Procedure	No compulsion, but motivation is there	Compulsory weekly saving of Taka 10 and above in addition to savings of 5% of loan disbursed at the time of disbursement	Compulsory weekly saving of Taka 10.00	Flexible Savings-Immediately after application and any amount of Savings acceptable at any time
Average Savings		Taka 1102	Taka.339 (ASPADA)	Taka.356 (CTS)
Interest on Savings	8%	6%	6%	8%
Withdrawal of Savings	Flexible as per wish	Difficult	Difficult	Flexible but Difficult if there is loan
IGA Training	No	Yes	Yes	No
Food Assistance	No	Yes	No	No
Health Service	No	Yes	Sometime	Yes

Source: BIDS (2005), PKSF. ASPADA is a PKSF partner organization and CTS is a Plan Bangladesh partner organization

The summary of findings of economic and social impacts is as follows:

Asset formation: Across all four programs beneficiaries have been able to increase assets in the form of livestock, rickshaw, and improved housing. The findings on asset formation have been very much expected because the focus of training program has been on livestock. A hardcore poor woman finds it convenient and profitable to go into livestock rearing in addition to what she has been doing before joining the group. She is also responsible for household chores. Livestock rearing is a part-time work and leads to new asset formation. The study shows the value of asset is significant: IGVGD-BRAC (Taka 6300) followed by Plan Bangladesh (Taka 5700) and FSP (Taka 4600). Grameen borrowers being at the lowest strata of the society have formed assets to the extent of Taka 1400.

Occupation Pattern and Employment: With training and credit it is normally expected that majority of trained beneficiaries as well as others will have opportunities to enter into new income generating activities, increase present work and or expand existing activities. The process leads to changes in occupational pattern, temporary or permanent, depending on success and length of association with the MFIs. In case of the four MFIs we see a familiar pattern. There has been increase of self-agriculture, non-agricultural labor, petty business, nursery management (plant sapling production) and livestock rearing due to program inputs. There has been report of decline of tenant farmers, agricultural labor, low paid service and rickshaw pulling. About 66% beneficiaries indicated enhanced work in the form of new occupation (10%), increased working hours (22%) and income increase (27%). The changes were more among FSP-PKSF and Grameen members. However, the members still report uneven employment throughout the year, especially the lean months. This indicates still the members depend much on agricultural production cycle. The livelihood of hardcore poor in these months depends upon borrowing or previous savings, credit purchase or by less spending or advance sale of labor. Though it needs further investigation to determine the causes but it may so happen that financial services alone may not be the only response to seasonal employment.

Land ownership: One important impact of financial services program is increase in land-ownership, especially for the hardcore poor families many of whom even do not have homestead land. With financial services participants of all four programs have been able to increase agricultural and homestead land. Over the same period, average land ownership has decreased in control households. Other forms of productive assets have also increased substantially compared to the control households except in case of Plan international.

Income, Consumption and Food Security: Both income and consumption have increased in the participating households. The average income for the four programs varies between Taka 11 984 (Grameen) to Taka 32 679 in IGVGD to Taka 34 471 in FSP-PKSF and Taka 38 483 in Plan. The average change has been between 18-27%. Relative change of per capita income has been much higher than that in control households. There has been considerable food deficit among the households. In the control households food deficit appears highest. IGVGD has the lowest food deficit .There is no household with surplus food in Grameen and control households. Over time, chronic food deficit and occasional food deficit have declined and households with surplus food have increased implying that situation of food security has improved after the program intervention. However, food insecurity remains still an acute problem in sizable number of households (45%) varying from 17% in IGVGD to 24% in FSP, 43% in GB, 57% in Plan and 84% in Control groups. *Srabon, Bhadra, Ashwin, Kartik and Chaitra* are the months (Bangla calendar) of severe food deficit when work is not easily available.

Savings and household assets: There has been positive savings in all the households whether program or control. Highest level of savings belongs to IGVGD followed by Control and FSP households. Household assets in terms values have substantially increased, the most important items across all programs are cot, quilt, sweater and new saree.

Social Benefits: The main social benefits are manifested in better sanitary and health condition and increased empowerment of women, their increased health consciousness and freer movement and participation in family and societal affairs. There has been positive attitudinal change among the households regarding the rights of womanhood.

Incidence and Graduation of Poverty: Poverty remains acute within the participating families, 99.6 % of the households are below this poverty line. But the study reports reduction in all the programs by -8.2% of poverty for all the households. Extreme poverty gap has declined still greater. On the basis of ranking of extreme poverty gap the study reports upward shift of 31% of households. Distribution among co-sharers, river erosion, death of husband, loss of property due to natural calamities etc are the main causes of falling in severe poverty. Death of father at younger age, lack of assistance from children in the old age, sickness of family members, abandonment by husband and selling of land by father for health care are among others the important factors causing poverty. Participants perceive that getting land, livestock and or money for business as per need and adequate training facilities are the main ways of getting rid of poverty. In general poor households suggest credit, technical facilities, employment, savings, training and marketing assistance will lead to poverty reduction.

Conclusions

The above review covers studies conducted on programs of major organizations in the country over more than two decades applying both quantitative as well as qualitative methods on impacts of microcredit for the poor and extremely poor. In all cases, the findings show that microcredit increases employment and income of households that leads to improved quality of life as indicated by reduced food insecurity, improved housing, health, sanitation and education and formation of assets in many different forms. The changes come over a period of time that needs continued access to finance. However, it should be noted that finance alone did not lead to such changes but other developmental and macro-factors have definitely contributed positively or negatively. On the whole the researches have proved the positive impacts of financial services for the poor. Bangladesh microfinance sector now has passed beyond doubt the era where studies were conducted to prove its effectiveness but now faces new challenges of other emerging issues such as continued vulnerability of poor due to external factors, overlapping of microcredit services, impact on microfinance in an era of slow or no growth of economy, and lack of new and more demand-driven products etc.

Policy Support, Legal and Regulatory Environment

Government in Microfinance Sector

Microfinance has been at the center of development strategy of Bangladesh implemented through non-governmental and government agencies over more than three decades. It came to prominence and took the centre stage as a poverty reduction strategy in 1990s although the role of GOB has not been articulated with total clarity but evidences suggest continued support for microfinance. The proliferation and growth of outreach and portfolio can be to some extent credited to active as well as indirect support of all successive governments. Political governments changed but the support to the sector remained same and evolved overtime. Government of Bangladesh acted in different forms such as provider of resources, implementer of microcredit programs through various agencies, facilitator and regulator. Successive governments in Bangladesh have accorded top priority to the poverty alleviation through promoting overall growth, employment generation through human development, education and other social services and infrastructure development. Macro-economic stability and small-scale rural infrastructural development have also supported rural economic growth.

We will briefly discuss the important actions taken by the government over the years and their impacts, and legal and regulatory environment for the microfinance sector. The new regulatory environment emerging after introduction of the Microcredit Act 2006 may have far reaching implications for the sector.

The Grameen Bank

To understand evolution of microfinance in Bangladesh and elsewhere it would be important to learn the role of government in supporting the Grameen Bank in its early stage as well as various policy and material support it received from the government. The major policy and material support can be summarized as follows:

- Professor Yunus's Jobra project was expanded as project of the Bangladesh Bank (Central Bank) in collaboration with another state owned bank.

- The project was later converted into a specialized bank by the government by enacting the Grameen Bank Ordinance 1983. Initially 60% of the share of the bank was owned by the government and 40% by the borrowers, which is now owned 94% by borrowers and 6% by the government. The bank received unique legal coverage which no other MFI has received.

- The bank received long-term as well as short-term loan from the government. GOB had also guaranteed Taka 650 crore bond issued by the bank;

- Finally, the government has allowed the bank to mobilize savings from the public as well as to offer long-term savings products to its members/clients. It was a unique opportunity for the bank. The deposits come from members' savings (various short and long-term deposits), deposits of staff members and deposits from other sources. No other MFI in the country has such a legal basis, array of savings services as well as dependence on deposits to finance microfinance operations. Total deposit is 145% of loan outstanding at the end of 2008 that has dramatically eliminated its dependence on external institutional resources (from within and outside the country and relieved it of resource constraints to fuel its recent expansion.

The effects are open for all to see. Since 1983 the bank kept expanding and has become truly an enormous organization which has had major impact on poverty reduction not only in Bangladesh but also worldwide. The total current number of members, at the end of 2008, was over 7.67 million from 83,566 villages (almost all villages of the country) spread out all over Bangladesh. Cumulative disbursement of the bank is Taka 418 billion and the current amount of outstanding loans stands at Taka 44.39 billion.

NGO Affairs Bureau

GOB established the NGO Affairs Bureau to facilitate foreign funds to NGOs, which actively promoted microcredit projects. During 1980s and 1990s many donor agencies provided grants money to NGOs to try out microcredit with grants funds as seed capital since savings funds were not adequate. Numerous donor-funded development projects facilitated by NGO Affairs Bureau had complementary microfinance programs.

Government Agencies in Microcredit

GOB's recognition of microcredit as a poverty alleviation tool is also reflected in its support for direct implementation of microcredit projects by government agencies. At one point 17 ministries used to run microfinance under various projects (although many of them were not sustainable and in fact after such huge success of MFIs GOB agencies should no longer continue to be unsustainable microcredit programs).

8.5 Multiple Laws for NGO Registration and Savings Mobilization

The microfinance institutions of Bangladesh are registered under several laws: i) Social Welfare Act 1960; ii) The Companies Act 1913 (revised in 2001) as non-profit company; iii) The Trust Law; iv) The Societies Act 1860; and v) The Cooperative Societies Act. Interestingly none of these laws explicitly allows microfinance, especially the mobilization of savings, as all were drafted long before the advent of the present form of microfinance. All the laws do, however, allow 'development activities', 'development of the poor', 'development of women and society', 'promotion of education, science and technology' etc. NGOs did not start microcredit as their first activity but followed Grameen Bank's success. Microfinance programs have been implemented as a 'development' activity in order to alleviate poverty. Critically, GOB, Bangladesh Bank and all the registering authorities responsible for the different laws cited above chose to ignore savings mobilization as a part of offering microcredit to the poor, though it was technically 'illegal'. The main arguments to ignore the legal shortcomings have been as follows:

a) Microcredit is believed as benefiting the poor and is one of the best instrument to assist them;

b) Although savings from members have been mobilized, the amount of savings is much smaller than the credit supplied by the NGO-MFIs to their members as a result of receiving funds from outside sources. Consequently, poor people would not normally lose money in case of failure of an NGO-MFI;

c) GOB has been one of the principal supporters of microcredit and many GOB agencies and departments have been implementing the programs through NGO-MFIs without amending the relevant laws. This explicit support has provided legitimacy to the NGO-MFIs;

d) There has not been any major failure or fraud that led to substantial loss of savings, even without the direct supervision of a regulator. (Some NGO-MFIs which were against formal regulations had argued that since the sector was running so well that there was no need for regulation, and government regulatory intervention would only stifle the growth of the sector).

The above view of allowing microfinance to be introduced by any NGO registered under any law has contributed significantly to the rapid proliferation of microfinance in Bangladesh. NGOs active in other sectors simply added microfinance as a new activity without requiring any permission from any authority. Approval from the NGO Affairs Bureau to use foreign grants for microcredit programs, finance from PKSF and other domestic sources directly contributed to the expanded access to credit and provided indirect legitimacy. At the same time registering an NGO under any of the above law is very easy, only a matter of days. Since microcredit programs in Bangladesh always have a built-in mandatory savings component, all NGOs ended up mobilizing savings without legal permission. This implicit 'permission' and the positive views of GOB and other government agencies have helped more than 1,000 NGO-MFIs to start and grow with financial services, though not all have been successful and grown at the same speed. Any NGO anywhere in the country could on its own start offering microcredit as long as it could convince poor women/men to join its credit groups.

The single most important policy support in Bangladesh by the Government is to allow the NGO-MFIs to mobilize savings from their members. These are the mandatory small savings and other forms of savings instruments that MFIs have designed to raise savings from their borrower members but not from the public. Bangladesh Bank stopped any savings mobilization from the public, except for the Grameen Bank which was given special permission to mobilize savings from the public. This ability by the NGO-MFIs to mobilize savings has resulted in two very positive effects: the provision of savings services for the poor provided they are members of an NGO-MFI; and the provision of substantial capital to the NGO-MFIs for making loans to members, currently nearly 30% of outstanding loans are funded from savings. This, therefore, opened up the opportunity for the local financing of the NGO-MFIs without any demand on GOB budget and for the provision of sustainable services for the poor. This has had a tremendous impact on the financing, sustainability and expansion of outreach of microfinance throughout the country.

Over many years and through a number of political changes the Government has implicitly allowed the NGO-MFIs to implement a massive and ongoing expansion of their operations. This silent laissez faire policy may not be as visible as, for example, the creation of PKSF or the introduction of the Microcredit Act 2006 but it is important to recognize its significance and consequences. That has created several large organizations in the country as discussed in Section 3 and Section 4.

Tax free status

GOB has allowed the growth of the NGO-MFIs without either trying to contain that growth or seeking to collect tax from their operations. The tax free status has helped to build larger equity base that made them more stable and allowed them to borrow from commercial banks. One can only conclude that it is recognized within GOB, explicitly or implicitly, that the NGO-MFIs, especially the biggest players as BRAC and ASA, are genuinely serving the interests of poor people.

Palli Karma Sahayak Foundation (PKSF)

One of the most significant institutional interventions in microfinance sector after establishing the Grameen Bank was setting up of the Palli Karma Sahayak Foundation (Rural Employment Support Foundation) by the Government. We have discussed functions of PKSF earlier. The important point to note that although the government has established PKSF and provided huge resources directly and by borrowing from international development lending agencies but the governing structure allowed it to operate independently. Both the Governing Body and the management have remained independent in devising policies and programs and managing day to day operations of PKSF. The independence is considered one of the most critical reasons behind its success.

Aside from providing sustained financing to its partner MFIs PKSF provides long-term institutional development assistance. This has benefited all partner-MFIs and immensely contributed to the institutional strengthening and sustainability. In addition, PKSF has developed several training modules for the partner organizations (POs) and provides training to their staff members in collaboration with its partners and other training providers. Occasionally, PKSF conducts research by its staff members as well as in collaboration with research organizations. In absence of a formal regulator PKSF used to work as standard setter and key policy influencer of microfinance sector.

PKSF has attracted resources from the government and international sources that include grants from GOB, USAID, DFID and EC, and substantial loans from the World Bank, ADB, and IFAD via the government. PKSF has contributed immensely to expand the outreach as well as help many NGO-MFIs to achieve financial viability and set the informal norms and standards for the sector. PKSF is expected to continue to influence positively the financial service sector for the poor and other small borrowers. Over time a different set of issues has emerged, which will influence the future growth and direction of the sector.

Interest Rate

GOB did not decide or interfere in interest rates charged by the MFIs on their loan and paid on the savings products. Historically the rates were set by the large MFIs and followed by smaller MFIs as the going rate(s). As we have discussed earlier that the interest charged by the MFIs allows them to cover cost and build equity due to efficiency gained over time and economies scale (large portfolio). However, there has been one exception where PKSF asked its partner organizations to reduce interest on loans from 15% (Flat) to 12.5% (flat) beginning July 2004 because it provides subsidized capital to the partner MFIs. Even with this rate its partners are found to be financially viable.

The Microcredit Act 2006

Bangladesh did not have any comprehensive law, or body of regulations or regulator for microfinance up to August 2006. The need for a proper legal basis for NGO-MFIs to offer financial services has been felt since mid-nineties when NGO-MFIs began to grow fast, mobilize large amount of savings and own a large portfolio partly financed by savings but without proper legal basis. Early discussions were informal and among key stakeholders such as PKSF, large MFIs, government and donor agencies. At one stage ADB even drafted a microfinance law but the initiative did not go far as the government and NGO-MFIs were not enthusiastic. Microfinance II project of PKSF funded by the World Bank had some allocations for conducting studies related to regulations. There have been many discussions for and against introducing a law specifically for microfinance. The pro camp finally won the argument that the sector has become too big to be left to its own devices and needs a formal regulator, which will set standards and regulate the sector. Since GOB (Ministry of Finance) did not have the capacity to draft the desired microfinance law, in July 2000 it created the Microfinance Research and Reference Unit (MRRU) under the Bangladesh Bank to start the work of a de facto regulator by first collecting data and providing guidance to the NGO-MFIs. An 11-member national committee was created, with representation from across the microfinance sector including PKSF, Grameen Bank, BRAC, ASA, CDF and MRRU to draft a law for the sector. This high-powered committee later formed a Technical Committee actually to draft the law by consulting with NGO-MFIs, researchers, academics and other stakeholders. The Technical Committee did this by pooling knowledge within the industry, reviewing the laws of other countries and organizing several consultative meetings with NGO-MFIs.

The result was a detailed draft law which proposed the following key features:

a) MFIs legally created under any of the previous laws would receive licenses to offer microcredit;

b) It would allow the setting up of shareholder owned microfinance banks of various classes in terms of size (capital requirements) and area of operation ranging from Union (cluster of villages) to national level operations, i.e. very small to very large operation;

c) It would create an independent regulator called Microcredit Regulatory Authority (MRA), with Governor of Bangladesh Bank as its Chairman, to issue licenses and supervise all MFIs;

d) The MRA would have wide ranging powers to introduce regulations, set interest rates, revoke licenses, set standards etc.;

e) The microcredit ‘programs’ of the various government departments would come under the supervision of MRA.

The national committee submitted the detail draft law to MRRU, which in turn submitted it to the Ministry of Finance in 2004. A shorter version of the above mentioned draft was passed in the by dropping many key elements such as the creation of microfinance banks, MRA jurisdiction over the microfinance programs of government departments and many detail issues regarding composition and governance of MRA. The revised law, without these elements, was later adopted by Parliament in August 2006.

In accordance with the new law, the MRA has now been set up. All members of the governing body are government officials except the managing director of PKSF, a private individual. One of the Executive Directors of the Bangladesh Bank, who was earlier in charge of the MRRU, has been appointed as the Vice-Chairman and Chief Executive. The MRA has already started its functions with limited number of staff and invited applications from NGO-MFIs for licenses which the law makes mandatory for all NGO-MFIs. MRA has decided to issue licenses to MFIs which have more than 1000 clients and minimum loan outstanding of Taka 4 million, subject to meeting other institutional requirements. MRA has already issued 432 licences (up to mid-June 2009) but the body of regulations has yet to be published. A more important issue is the scope of license. The same license is provided irrespective of size and capacity.

A few observations can be made about the present regulatory and supervisory situation after setting up of MRA:

- *Long-term savings:* Other than issuing licenses to MFIs, MRA has taken one important decision regarding long-term savings products offered by MFIs. MRA has ordered to discontinue long-term savings and return the savings to members. Long-term savings have been found to be very popular among poor savers/borrowers. Even before the Grameen Bank introduced such products a number of leading MFIs successfully introduced them. Many smaller MFIs by following steps of larger counterparts have also offered them. Most common product was to collect small weekly/monthly deposit to be repaid with (higher) interest after a period of 3 to 5 years. The product had given opportunity to the savers to build capital and the MFIs to develop a stable base of local resources. However, there is a legitimate concern that long-term savings are risky for the savers if the MFIs fail to keep their promise of returning the savings at maturity. Instead of a blanket order to stop and return the savings a more pragmatic step would have been to allow selected MFIs to offer long-term savings.

- *Scope of the law:* The Act allows that cooperative societies registered under the Cooperative law can also offer microcredit and in principle receive license from MRA. But there are too many cooperative societies (more than 200,000), which do some kind of savings/lending business. MRA will be simply overwhelmed to do the gigantic job. MRA has proposed to amend the Act and leave cooperative societies outside the scope of the Act.

- *Regulations*: Although MRA has been issuing licenses but the body of regulation has not been introduced yet. MRA on its parts has developed a set of regulations but could not introduce them of its own without the approval of the Ministry of Finance, which is yet to give formal approval to the proposed regulations. It appears that the Act 2006, in practice, has made MRA a recommending body only in case of introducing regulations although members of governing council are all top civil servants including Secretary, Ministry of Finance as member and the Governor of the Central Bank as the Chair. The clause that weakens MRA and gives power to the Ministry of Finance (as super regulator) is ***Clause 51: To achieve the objectives of the Act the Authority (MRA) may introduce regulations <u>subject to prior approval of the government</u> and by government gazette notification***. The Act elaborates functions and responsibilities of MRA but practically takes away its power of doing the main job of regulation by one simple clause.

- *Capacity of Supervision*: MRA has already issued 432 licenses and is expected to issues to a total of 600 plus MFIs. The main concern for the future will be its ability to effectively monitor, supervise and enforce future regulations. It will need to devise an effective system for timely information gathering, analyzing, and using them for management decisions. On-site verification and supervision will also be important.

- *Wholesale lending*: The Act is silent about the wholesale lending operations (lending to MFIs) by not-for-profit organizations. It seems to be an omission that can be corrected by introducing appropriate amendments.

Competition in Microfinance Market

The microfinance sector has grown up from one organization (Grameen Bank) sector to about several hundred large and small microfinance institutions although we earlier mentioned that three institutions dominate the market. We often hear about intense competition among MFIs to attract borrowers and offer financial services but the nature of the competition is not fully understood. We need to understand the nature of competition by market segments. Practically there is no competition to reach the extremely poor households because this category of people is perceived as risky and does not borrow large loan that may lead to unviable programs. Special programs with subsidies in the form of subsidized interest rate on, grants for non-financial services and assets are provided to MFIs to reach this market segment.

The main competition among the MFIs is seen in the 'mainstream' microcredit segment of the market where the number of client and consequently, the size of the portfolio is large. The viability of an MFI depends on its success in this segment. The main urge of competition from MFIs is to maintain financially viable operations. Medium and large organizations have laterally expanded by recruiting 'new' clients who create demand for increasing amount of loans. MFIs on their part have mobilized resources and try to maintain client base to maintain its disbursement targets. The process has led to clients borrowing from multiple sources. This may be manifested in various forms: the same person borrowing from multiple sources or multiple family members become members of same or different organizations. Many different reasons have been put forward by the clients: i) inadequacy of loan from one MFI encourages the members to borrow from other sources to fully finance her/his intended IGAs; ii) Clients need loans for different purposes throughout the year. Since an MFI only provides loan once in a year clients also borrow from more than one sources to meet consumption and investment needs; iii) part of the borrowing is sometimes for settling other loans or for meeting emergency purposes; and iv) Clients also tend to preserve access to multiple sources.

The intensity of competition has led to improved services for the clients: a) prompt disbursement of loan within days; b) easier access to savings; c) sometimes higher interest on savings; d) 'flexibility' in loan repayment (clients skip/delay some installments if needed); e) good and friendly behavior from the part of staff members; and f) larger loan size.

Although the competition from MFIs to get good clients has become intense but that has not led to reduction of interest rather the interest rate has gone up lately from 12.5% flat to 15% for larger organizations such as ASA and BRAC. It appears that demand for loan remains high, so whatever the level of loan funds MFIs can disburse that at the going interest rate. It has been observed, irrespective of size of NGO-MFIs, that interest rates have not been used as a weapon for competition. Normally it might be expected that, when the products are similar, with increased competition price becomes probably the main weapon for competition in the commercial world. The process leads to some winners after the 'price war' and they capture bigger market share at the expense of others. This phenomenon has not yet been observed in the microfinance industry in Bangladesh. The large NGO-MFIs normally set the price (a price that makes them financially viable) and others simply follow the 'going rate'.

NGO-MFIs use other methods to keep clients and continue to expand the portfolio such as:

a) *Larger loan size*: Normally large NGO-MFIs with better resource base use loan size as competitive edge compared to small and medium NGO-MFIs.

b) *Shorter waiting period*: Resource rich MFIs usually disburse loan quicker than the small and resource poor NGO-MFIs. Normally waiting period between two loans are shorter for resource rich NGO-MFIs.

c) *Flexibility:* A number of NGO-MFIs are trying to differentiate their credit products by introducing small flexibility in terms and conditions.

d) *Savings:* Ease of access to savings is being used as a competitive edge to maintain loyal member base. Many NGO-MFIs in the past did not allow withdrawal of savings and some of them still continue to practice with some access to savings. This is a direct result of increased competition. But BURO-B, for example, allows total withdrawal of general savings even by members having outstanding loans.

e) *Local flavour:* Often small local NGO emphasize their local root as a way of promoting trust. On the other hand, large NGO emphasize their size as means of establishing presence.

f) *Additional services:* Some NGO-MFIs often use additional services such as education, health, training, and extension services to maintain a loyal customer base.

But the real impact of multiple borrowing is not known. No systematic study has been done to investigate the reasons of multiple borrowing or overlapping, impacts (positive or negative) of such practice on the clients' economic life, and to understand the need for developing appropriate loan products. The effect could be positive due to adequacy of resources to fully finance IGA, owning multiple IGAs, or grabbing emerging opportunities throughout the year. It could be negative if it leads to indebtedness, which may lead to loss of asset and pauperization, adverse impact on the MFIs in terms of portfolio quality if loan is not repaid.

Competition for disbursing loans to small farmers is practically not existent. Only a handful of MFIs are in this segment of the market and they tend to hand pick their clients to ensure full loan repayment. But some competition has been reported in microenterprise loan. In this segment, large MFIs and commercial banks with microenterprise loan program tend to compete for good clients. The main advantage for commercial banks is rate of interest, which is less than half of MFIs. But banks require collateral and takes long processing time to approve loans. On the other hand, microenterprise loan from MFIs are more attractive because of quick appraisal and approval of loan application and no requirement of collateral.

The main challenge for the sector regarding competition is the lack of knowledge and understanding about the financial market, customer needs and behavior and innovation of products to exactly suit their needs.

Challenges and Future Direction

Challenges

Reducing vulnerability

Throughout the report we have mentioned that microfinance over the years has made significant contribution in all strata of poor people- ultra poor to vulnerable non-poor and farmers. All studies and anecdotal evidences point to the facts that millions of participating households have increased income and assets and improved quality of life slowly over a period of several years. This achievement has happened in an era of [1990-2006] when Bangladesh even with all its confrontational politics maintained above 5% growth and reached almost 7% in 2006, enjoyed low inflation and maintained stable other macroeconomic indicators. We have reported poverty reduced at a rate of 1.8% annually. During the same period MFIs enjoyed an unprecedented growth reaching 33 million poor and near-poor clients, and maintained financially viable operations. But the scenario has changed to threaten the gain attained by the poor but because of no-fault of the poor. The unprecedented price hike of food and other essential commodities in 2007-08 have wiped out much of gains. During this period poor people curtailed consumptions and were forced to sell asset: CPD study reports 2.5 million people forced go below poverty line. Following the price hike came the recession. The World Bank predicts that 1% people will go below poverty line during next two years. Besides, Bangladesh face natural calamities every year: floods and cyclones that result loss of lives, properties and livelihoods and create more poor. The devastating cyclone Sidr in November 2007 destroyed lives, property and livelihoods of the poor built over many years, if not decades. Although relief and grants from local and foreign sources mitigated suffering and helped o build life again but it wiped out the gain of many years. It seems microcredit and other programs help people's life but such uncontrollable shocks wipe out many years of gain.

These external events, macro-economic instability or natural calamities, have serious implications on the management and viability of microfinance institutions. Several national and regional MFIs were forced to suspend microfinance operations (recovery and disbursement) that led to loss of income and portfolio. Some large MFIs have declared writing off loans but smaller MFIs could not afford to do so. There is no systematic study to assess the adverse impact on loan repayment rates in Sidr affected areas but field officials and beneficiaries report that they are having serious difficulties in maintaining high repayment rates even of new disbursements. Similarly, wide spread adverse impact has fallen on portfolio quality due to price hike when poor borrowers/poor had to spend more on family consumption. MFIs are yet to recover from that situation which is now followed by recession. The apprehension is that the impact may be even greater and prolonged. The response against such wide spread and deep problems are not really known. Earlier limited scale floods were individually faced by some MFIs by suspending loan collection for a few weeks, scheduling loans, allowing withdrawal of savings and providing emergency loans. Routine reserve against loan loss, creation of reserve for disaster management are some mitigating steps but these are not enough to meet the depth and breadth of problems due to massive natural disaster, recession and sudden high inflation leading to large loss of portfolio. The sector seems yet to fully understand the dynamics and depth of the problem and devise response against such situation. Individual MFIs try to maintain its own portfolio quality by pressuring borrowers, adjusting with savings and (allegedly) by disbursing larger loans (if fund is available). However, an industry wide systemic problem may not be solved by routine day-to-day steps. The situation simply highlights the linkage of Bangladesh microfinance sector with broader economy and negates the view that microfinance can continue to perform well and stay in isolation.

Economic Growth and Microfinance Sector

Microcredit provides capital to the poor and near poor for investing in various farm and non-farm income generating activities. The implicit assumption is that there are millions of such profitable investment opportunities and increasingly created in the rural economy so that more and more people with larger investment funds (large loans are given in successive years) can profitably invest. This is only possible when these sectors are growing at reasonable rate. As mentioned earlier, Bangladesh economy has grown at a rate more than 6% during 2001-06 when microfinance sector had its unprecedented growth expanding from 17.75 million (2003) clients to 33 million clients (2008). Some specific examples of linkage between microfinance sector and growth can be visualized. One of the major areas of investment is poultry rearing for eggs and meat. Investment portfolio in poultry expanded with expansion of the sector. The eggs and meat produced by microcredit borrowers are sold not in rural areas but in urban centers. After the bird flu attack purchase fell, farmers lost money and thousands of farmers closed poultry farms, and MFIs faced huge loan default. Due to rise of price of paddy in 2007-2008 farmers invested in rice production but are counting loss due to fall of paddy [in 2008 it was as high as Taka 800 per *maund* (approximately 37.5 kg)] to Taka 300-450 per *maund* in April-May 2009 harvesting season. Many of the farmers have borrowed from MFIs may now have problems of repayment and MFIs face poor portfolio quality. Good harvest and good price leads to high income and good repayment of loans and vice versa.

There is no systematic study to show link between *monga* and microcredit repayment but staff members of MFIs operating in north-western part of Bangladesh report serious strain on repayment during *monga* period. Before considering any good package of response we need to acknowledge and understand the linkage of economic growth and microfinance sector. Poor people make profit and get more opportunities for investments in an era of growth. Therefore, higher growth is very much important for the poor and microfinance sector. Economic growth allows higher investments in microenterprises that again contribute in GDP. Slow growth in rural economy is expected to have adverse impact on microfinance.

Policy and the Producing Class

Government economic policies have direct implications on profitability of income generating activities, and consequently on poverty and portfolio quality of the MFIs. One such example is milk sector. About one third of microcredit goes to livestock rearing, mainly for milk production, which is a profitable, traditional and convenient income generating activities for the rural households. The price of one liter of milk was Taka 50-70 in various urban/peri-urban areas in 2008 but that has gone down to Taka 25-30 in 2009. The reduction of price has been due to government reduction of import duty on powdered milk to please urban consumers. This action has made powdered milk lot cheaper than fresh milk that prompted sweet producers and milk processors to use imported powdered milk instead of local fresh milk. One policy has put the whole sector along with financing MFIs in trouble, which exemplifies linkage of government policies with production, profitability, portfolio quality and poverty. Similar examples of anomalies in policies can be found in other sectors that directly affect the poor.

Microcredit and Consumption Loans

Over the years MFIs have relaxed or simply stopped the practice of verification of utilization of loan money. In early days Grameen Bank and other NGO-MFIs used to pay post-disbursement visit to the client to verify whether loans have been used for the purpose mentioned in the loan application: buying cow, increasing inventory of shop, starting a poultry or fishery business etc. The intent was to ensure loan repayment and stopping diversion of loan to other purposes, especially consumption or non-productive purposes. But gradually the practice has been stopped due to many reasons:

- Increased supervision cost for the MFIs;
- Each loan officer looks after 300-450 borrowers that makes it very difficult to check loan utilization after completion of loan collection (3 samities per day) and accounting works;
- Borrowers often repay from sources other than the IGAs so MFIs are happy as long as installment is repaid on time;
- Loan money is often mixed up with family cash flow so it is impossible to track actual use of loan;
- Clients borrow from more than one sources (3-4 sources are very common) that makes it more difficult to track whose money is used for which purpose; and
- Borrowers within the year changes IGAs depending on opportunities.

Interviews in many groups show that a) purpose of the loan mentioned in the application has little link with the actual IGAs being run, and b) borrowers use loan money for various purposes building house, sending sons/daughters to overseas, paying old loan and various other consumption. There is no systematic study to show actual complex use of loan money along with family finance. All these factors have opened up opportunities for diversion of funds for many consumption purposes. If the borrowers have many different sources of income and total annual debt is within the serviceable limit than it may not be difficult to keep all repayments on time. A good percentage of the borrowers are doing that. At the same time a good percentage of poor are defaulting (and some even leave the areas) due to over borrowing and not investing for the purpose the loan was borrowed. The cause of concern is if a large percent of loan is going for consumption not for investment, especially in a slowly growing economy or downright recession there is a risk of system wide loan default making many MFIs insolvent. The economic prediction for next 2-3 years is slow growth. The basic issue here is that the sector as a whole expanding blindfolded without really knowing actual demand for loan, utilization of loan, linkage between economic growth and performance of MFIs and borrowers etc.

Institutional Preparedness Offer Demand-driven Products

The sector is diversified according some broad product-market segments. Not much of a difference is seen between microcredit of one MFI than the other; or for that matter microenterprise loan of one MFI than the other except for a few procedural differences. The products are still standardized and uniform that does not reflect the need and cash flow of individual clients. The real diversification will need cash-flow based lending and adopting appropriate management system to handle such lending product, especially in case of larger loans. The assumption behind such approach is that clients are homogeneous and need similar services. But even within the hardcore poor category we do see diversity such as mobile hardcore, hardcore core poor that lives in urban areas, rural areas, char and costal areas and hardcore poor with or without some endowment and hardcore poor with some education etc. Besides, to ensure sustainability MFIs are very cost conscious and try to offer standardized products. Some MFIs are trying to move into other services such as micro-insurance (life and non-life) but that would require research and innovation in product development as well as management system. Notwithstanding exceptions the main bottlenecks are lack of institutional capacity to develop and offer such diverse services and willingness of doing so.

Research and Innovation

Bangladesh microfinance sector depends on the innovation of only a few organizations. The basic Grameen model was widely replicated by all. The next innovation in the form of flexible microfinance for the very poor, microenterprise loan or seasonal loan for farmers have been started by only a handful of MFIs and later replicated by many with encouragement from PKSF and demand from clients. Most of small and medium MFIs either do not have the capacity or willingness to take the risk of trying out new things. This approach of replication limits innovation and competition.

The sector also lacks resources and wiliness to undertake research related to microfinance. Only BRAC has in house capacity to conduct research. Bangladeshi universities and research agencies do not regularly produce useful research findings. Occasionally some donor funded projects do some research that can be at best called anecdotes. CDF produces an annual report on microfinance statistics which will be now produced in collaboration with InM. The major weakness in the system is that MFIs, PKSF, MRA and other policy makers do not have necessary up to date research results to make policy decisions. InM, PKSF, MRA, other national research institutions such as BIDS and capable MFIs should lead in research and knowledge-based leadership in the sector.

Resource Mobilization

PKSF, several commercial banks and two much smaller apex organizations are providing wholesale fund for mainstream microcredit and other loan products. But demand for finance from BRAC and other larger MFIs, if they want to reach farmers and microenterprises, will be much greater than these institutions can supply. The most practical solution is savings mobilization using various types of short and long term instruments. Two large MFIs may like to take clue from the effects of savings mobilization on the Grameen Bank that is now fully financed by members' and public savings. By converting a few large institutions into member/privately owned microfinance banks is expected to reduce pressure for resources from PKSF and high cost borrowing from commercial banks. In addition, some capable MFIs with right amount of equity base, strong governance and management capacity, strong internal control, superb portfolio, and good policies and practices should be allowed to offer long-term savings products.

Regulatory Environment

Microfinance is now regulated under the Microcredit Act 2006 enforced by the Microcredit Regulatory Authority (MRA). Four hundred thirty two (432) MFIs have already received license and more MFIs are expected to receive license. This is first step to formally recognize and legitimize microfinance under licensed organizations. But MRA is yet to introduce the body of regulations that are supposed to actually guide the MFIs. Although it has produced a set of draft regulations but that has not been approved by the Ministry of Finance (MoF) reportedly due to protest from the leaders of the sector. The situation brings up two issues: i) the actual scope and authority of MRA which currently can not independently and professionally function without the approval of MoF that makes MRA more of a weak recommending body only; and ii) delay in introduction of regulations essential for regulating MFIs. So far MRA has issued licenses, collected some basic data and conducted several training courses on accounting and reporting system. But the sector needs a full body of regulations that would ensure good governance and transparency, protect the savers and borrowers, and encourage long-term sustainability of MFIs but discourage excessive risk-taking for short-term gain by the MFIs.

A number of areas of regulations will be critical: savings mobilization, use of and access to savings; pricing of savings and loan products (after many years the Central Bank has set up cap on commercial banks loan products to mitigate effects of recession on the economy); governance of MFIs; accounting and financial policies and reporting. In principle MFIs needs to prepare themselves to comply with the regulations. The uncertainty about the time and scope of regulations will delay professional growth of microfinance sector, especially in governance.

On the other hand, it is also important to recognize that MRA is a new organization with limited capacity that will have serious difficulties to meaningfully regulate several hundred financial institutions. It is of critical importance that the capacity of MRA be significantly enhanced accompanied by right tools to collect and analyze information and data for enforcing rules and regulations.

Institutional and HR development

Microfinance sector is a mix bag of institutions in terms of institutional and human resources capacity. Over the years significant progress has been made in many areas such as management of MFIs, accounting and financial reporting etc. However, the complexity of serving different clients groups and increased size of organizations poses major challenges for top and mid-level human resources. So far numerous but ad hoc in-house on the job training and donor and PKSF-funded training courses have been the main mode of human resources development. The sector needs more sustainable supply of short and longer-term training and other institutional services from private and public institutions.

Portfolio Quality

Portfolio quality of very large and other smaller MFIs have been declining over the last 2-3 years. Although the exact reasons have been thoroughly studied, analyzed and understood but interviews with key individuals and field level staff members reveal some pattern: a) fast expansion without giving due consideration about selection of members/borrowers (field officials try to reach targets); b) economic slowdown, price hike and impact of natural disasters in some geographical areas; c) de-emphasis on groups system and meetings which might have improved efficiency and reduced transaction time for the borrowers but field officials may be now missing important client information to assess risks; d) multiple borrowing without proper investment opportunities; e) part of loan diverted to various consumption purposes; and f) lack of capacity of the respective MFIs to manage large program that expanded too fast. It seems the sector as a whole, at least the major players, may need to undergo a period of consolidation of their mainstream microcredit product.

Application of ICT

Application of information and communication technology in management of MFIs is limited. A few large MFIs have introduced accounting and MIS software at the branch level but the management system remains largely manual. MFIs will find it difficult to manage diversified products and effectively control internal management without deeper applications of ICT. Overall ICT can be used by MFIs, PKSF, and MRA to improve efficiency, ensure transparency, improve monitoring and internal control, disseminate accurate information and offer better services to respective clients and other stakeholders.

Support for Business Expansion

Microfinance has eased supply of resources to the poor and near-poor for investments. But the expansion of actual IGAs as seen by the limited growth of loan size has been limited not because of lack of supply of money but because of other non-finance factors such as limited growth of demand, access to market, limited access and application of technology etc. Major challenges for the clients will be to have these services and for the MFIs and other stakeholders to provide or facilitate them. The activities and interventions in these areas are still in pilot or rudimentary stage. Although private sector providers are supposed to respond to demand for such services but that is not automatically happening. There is a case for support for expansion of non-financial services for the borrowers of MFIs.

Future Direction

Diversification and Growth in Specific Market Segment

The review shows that two distinct market segments, small/marginal farmers and microentrepreneurs, are still at the early stage of development: small number of clients and small portfolio compared to potential size of market, small loan size and cautious expansion of programs. Product innovations, strengthening of human resources skills within the MFIs, and access of the retail MFIs to substantial additional financial resources will be critical to capitalize the potential.

Two strategies will be important for financial services targeting the hardcore/extremely poor: merger of existing borrowers with mainstream microcredit after 3-4 years of association with special programs that offer finance and non-finance services, and expansion of hardcore poor program to take care of vulnerable people. Success of current initiatives is encouraging further expansion of such targeted programs. Graduation of hardcore poor out of acute poverty using food aid, asset transfer, training and increased income from investments from loans has been demonstrated by current programs. The graduation process may be faster due to other development interventions, especially in rural areas, such as agricultural diversification, wage employment and development of rural infrastructure, expansion of health services etc. Early skepticism whether the hardcore poor would be willing and able to borrow and use loan monies for investment purposes has been proven wrong. Targeting of financial services for the extreme poor people is expected to remain a policy and development agenda for PKSF, GoB and many development agencies.

The microfinance industry is expected to witness sharper market segmentation due to demand to meet more and specific financial services needs. To meet such demands MFIs are expected to design products, i.e. offer terms and conditions to win over competition. In the process, the financial market for the poor and near poor is expected to become further segmented.

Consolidation of Mainstream Microcredit

The mainstream microcredit segment will need a period of consolidation, which is being observed in some organizations. This may take place in different forms: recovery of bad loans, dropping out of non-performing borrowers, stringent selection criteria, restraints on disbursement, stronger monitoring on the part of MFIs, emphasis on group meetings and strengthening skills of field officials.

Additional Services/Products

Domestic Remittance: Domestic remittance service is important for the poor families when family members travel all over the country for work and live in different places. The present practice is to carry home money, to send it via friends and relatives or in some cases to use the postal services. MFI networks could be effectively utilized to transfer funds to the rural poor with the help of information and communication technology. To introduce this service the following steps will be needed: develop an electronic payment systems involving participating MFIs; computerization of accounting and MIS of MFIs (branches and Head offices) and interconnecting the branches with the application of information and communication technologies; and examination of application of anti-money laundering law. Once successful the payment system can even be linked with commercial banks to link with international remittance transfer system.

International remittance: Millions of Bangladeshi workers live outside Bangladesh who value safe and secured transfer of their hard earned money. International remittances are largely handled by commercial banks but they do not have good networks in rural areas. As a result, it is estimated that between 40-60% of total remittances of overseas workers come through informal channels: hundi/hawala, friends and relatives or hand carried by the visiting workers [Bangladesh Bank 2006]. A number of commercial banks have engaged MFIs as their agents to distribute remittance. The whole domestic and international remittance service could be commercially viable if appropriate policies were introduced and the necessary technological resources deployed.

Micro-Insurance: Insurance services are another major area where experimentation has begun and further work is required. A number of MFIs are experimenting with life, health and cattle insurance services. Innovation of products, development of service delivery systems and support from insurance regulator and MRA will be essential for development of such services. MFIs directly, or possibly by setting up insurance companies, and/or in collaboration with other private providers should be encouraged to experiment and allowed to develop and offer such insurance services.

Management and Application of Technology

Application of information and communication technologies by MFIs for managing complex operations involving many different types of products and customer groups, and for internal control will be essential. MFIs need to be proactive to embrace technology to improve efficacy and better serve their clients.

Financial Resources

The expansion of outreach of financial services programs for farmers, microenterprises and hardcore poor will require significant resources. A significant amount of resources (capital fund) at relatively low cost and or at no-cost (for non-financial service components) will be needed for hardcore poor microfinance programs coupled with non-financial components. Competent MFIs subject to stringent criteria and strong supervision by MRA should be allowed to offer long-term savings products. A bolder strategy would be to allow microfinance banks and convert a few existing MFIs into microfinance banks.

Regulatory Environment

Body of Regulation: A full body of regulations that is expected to ensure good governance and transparency, protect the savers and borrowers, and encourage long-term sustainability of MFIs but discourage excessive risk-taking for short-term gain by the MFIs should be quickly introduced and enforced.

Long-term savings products: Introduce regulations by MRA permitting long-term savings products by selected NGO-MFIs, the latter to be selected through predetermined criteria developed by MRA. Ensure proper supervision by MRA and reporting by the NGO-MFIs. For additional safety, mandatory savings insurance policies may be introduced.

Microfinance banks: Introduce a new law or extend the microcredit law to allow a few of the large NGO-MFIs to convert into microfinance banks under the supervision of the Central Bank or MRA. This would enable them to enhance their capital resources substantially and potentially by offering appropriate long-term savings products to their existing members/clients; offering a full range of savings products & services to the wider public; and attracting additional (equity) investment. Careful consideration would have to be given to the issue of taxation, notably on the profits of such banks.

Wholesale lending: Introduce amendments in Microcredit Act 2006 to accommodate wholesale lending operations of not-for-profit organizations.

Scope and capacity of MRA: Appropriate amendments should be introduced to clarify the scope of MRA and strengthen its capacity to perform regulatory and supervisory functions. Steps should be taken to recruit and to train adequate number of human resources, and to devise and install monitoring system for effectively enforcing regulations. Application of information and communication technology will be very helpful for this purpose.

Capacity Building

One of the bottlenecks to further expansion, and innovation and effective management of the microfinance sector is the limited capacity of the human resources at all levels. Constant and further training of the staff of the NGO-MFIs is required if the financial services provided are to be enhanced and expanded. That will require proactive steps from the part of management of each MFI to systematically improve human resources capacity, invest a part of the income for human resources development, increase supply of related services, and strengthening public, private commercial and private non-profit providers of various types of human resources development services e.g. short- and long term training course, specialized degrees etc. The new Institute of Microfinance may in time be able to help in correcting this situation.

Research, Innovation and Information

Research, innovation and dissemination activity is one of the weakest area in the sector. One important area of research will be operations research in areas such as product development, system improvements, analyzing costs and benefits of different savings credit products, the extent and consequences of multiple membership of NGO-MFIs, new technologies for remittance transactions, the impact of regulations on access to financial services, and the employment effects of loans to microentrepreneurs and small/marginal farmers etc. This could be coupled with active dialogue and dissemination of the results that could provide valuable information to MFIs and policy makers, and help to form opinions about future direction.

Application of ICT

It will be critical for MFIs, wholesale lending agencies and regulators to take advantage of information and communication technologies to manage internal operations and interact with their clients. Immediate importance will be to computerize accounts, MIS and other internal control systems and interconnect all branches of each MFI.

Non-financial Services

MFIs are expected to expand and offer larger loans to microentrepreneurs and small/marginal farmers. Borrowers will require non-financial services for expanding their businesses. Whether this is to be provided by the NGO-MFIs or from external sources, probably commercial sources, such support will be essential in order to ensure that borrowers are successful in their ventures.

Annexure

List of Partner Organizations included in the sustainability study

Sl no.	Name of the PO	Members (#)	Year of enlistment	Area of Operation (District)
1	Annesha Foundation	4,759	1992-93	Barisal
2	Dak Diye Jai	6,188	1993-94	Pirojpur
3	Associatio of Rural Advancement in Bangladesh (ARAB)	4,923		Manikganj
4	Society Development Committee (SDC)	8,956	1991-92	Faridpur
5	Palli Mangal Karmasuchi	11,280	1993-94	Manikganj
6	Paribar Unnyan Sangstgtha (FDA)	2,759	1991-92	Bhola
7	Thengamara Mahila Sabuj Sangha (TMSS)	85,377	1990-91	Bogra
8	Eco-Social Development Organization (ESDO)	9,659	1991-92	Thakurgaon
9	Nowabenki Bazaar Cooperative Society	7,526	1992-93	Sathkhira
10	Solidarity	3,736	1994-95	Kurigram
11	Samaj Kallyan Sangstha	1,772	1995-96	Gaibandha
12	Program for People’s Development (PPD)	2,702	1994-95	Sirajganj
13	Uddipan	21,473	1993-94	Kushtia
14	Gana Kallyan Trust (GKT)	15,269	1992-93	Manikganj
15	SPUS	8,077	1990-91	Manikganj
16	Social Upliftment Society (SUS)	3,740	1991-92	Dhaka
17	Rural Reconstruction Centre (RRC)	11,112	1991-92	Jessore
18	Srijani	6,556	1992-93	Jhinaidha
19	Gram Unnayan Sangstha (GUS)	9,164	1992-93	Panchgarh
20	Palli Pragati Sahayak Samity (PPSS)	10,786	1992-93	Faridpur
21	Sajag	3,656	1992-93	Dhaka

Source: Alamgir (1999)

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