MICROFINANCE INDUSTRY REPORT

Bangladesh

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Produced by The Banking with the Poor Network in collaboration with the SEEP Network
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Citi Foundation

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ii. Foreword

This assessment was completed as a Banking with the Poor Network (BWTP Network) activity of the Citi Network Strengthening Program, in collaboration with the SEEP Network and funded by the Citi Foundation.

The Citi Network Strengthening Program supports the development of Industry Assessments for national and regional level networks. The purpose of the BWTP Network Industry Assessments is to provide an overview of the microfinance sectors in which the BWTP Network operates. These assessments aim to extend beyond the performance of individual institutions, and focus on the development of the microfinance market as a whole by being both descriptive and analytical in nature. The aim of these assessments is to provide an outlook on each industry that is a valuable resource to the BWTP Network, its members and the wider microfinance community.

The 'Microfinance Industry Report: Bangladesh' is a review of the microfinance sector in Bangladesh, and constitutes a new contribution to the BWTP Network's Asia Resource Centre for Microfinance (ARCM).

The ARCM is based on dialogue and information exchange at national and regional levels in South and Southeast Asia, and aims to constitute a one-stop learning and information hub for BWTP members and other microfinance actors in Asia.

The ARCM promotes increased outreach and efficiency of financial services for the poor in South and Southeast Asia, services that are essential in the fight against poverty in the region, improving the lives of millions through asset building and increased income.

The ARCM has two main objectives:

- Firstly, the ARCM aims to encourage partnerships and cooperation in Asia, among microfinance providers and supporters, and between providers and financiers, in order to increase financial support for microfinance schemes and to increase peer learning.
- Secondly, the ARCM aims to build a knowledge management platform accessible to all microfinance actors in the Asia region, in order to increase institutional capacity, to increase the dissemination of innovations, and to develop regional and sub-regional standards in microfinance.

iii. Acknowledgements

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The Microfinance Industry Report: Bangladesh is also the result of a close and productive collaboration between Mr. Md. Abdul Awal, CEO, CDF, Bangladesh, the BWTP Network and the Foundation for Development Cooperation.

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iv. Acronyms

- **BWTP** Banking with the Poor Network
- **CDF** Credit and Development Forum
- **CGAP** Consultative Group to Assist the Poor
- **CIDA** Canadian International Development Agency
- **CSE** Chittagong Stock Exchange
- **DANIDA** Danish Agency for International Development Aid
- **DFID** Department for International Development
- **DSE** Dhaka Stock Exchange
- **ESSPS** Economic and Social Security Policy Scheme
- **GDP** Gross Domestic Product
- **GNI** Gross National Income
- **ICB** Investment Corporation of Bangladesh
- **IDB** Islamic Development Bank
- **INGO** International Non-Governmental Organisation
- **INAFI** International Network of Alternative Financial Institutions
- **IPO** Initial Public Offering
- **JBC** Jiban Bima Corporation
- **LCF** Livestock Compensation Fund
- **LNGO** Local Non-Governmental Organisation
- **LPRCP** Life and Property Risk Coverage Policy
- **MFI** Microfinance Institution
- **MRA** Micro credit Regulatory Authority
- **MSS** Manabik Shahajya Sangstha
- **NBFI** Non Bank Financial Institution
- **NCB** Nationalised Commercial Bank
- **NGO** Non-Governmental Organisation
- **NGOAB** Non-Governmental Organisation Affairs Bureau
- **PCB** Private Commercial Bank
- **PKSF** Palli Karma-Sahayak Foundation
- **PRSR** Poverty Reduction Social Responsibility
- **RLF** Revolving Fund
- **ROSCA** Rotating Savings and Credit Associations
- **SB** Specialised Bank
- **SBC** Shadharan Bima Corporation
- **SDC** Swiss Agency for Development and Cooperation
- **SEC** Securities and Exchange Commission
- **TMSS** Thengamara Mohila Sabuj Sangha
- **UNDP** United Nations Development Programme
- **USAID** United States Agency for International Development

1. Country Overview

Bangladesh has an area of 147,570 km surrounded by the Bay of Bengal on the south and sharing a border with India on the north, east and west, and a small border with Myanmar on the south-eastern edge. Located in one of the wettest regions of the world, Bangladesh has a tropical monsoon climate characterized by rain-bearing winds, warm temperatures, and high humidity. The country is subject to climatic extremities, including a dry summer and long and wet monsoon and is frequently affected by tropical cyclones, storms, and flooding that causes widespread damage to people's lives and livelihoods.

With a population of about 153 million Bangladesh is home to the ninth largest population in the world comprising of 87 percent Muslims, 12 percent Hindus and 1 percent from other ethnic groups. The country has multi-parliamentary form of democracy and the country is divided into six administrative divisions further divided into 64 districts.

Nearly 75 percent of the country's population is rural and engaged in agricultural and other related activities. Agriculture accounts for about 21.37 percent of Gross Domestic Product (GDP) and accommodates around 48.1 percent of the labour force. Almost half of the total population is still living below the poverty line - earning less than $1 a day. Per capita Gross National Income (GNI) in 2006-07 (provisional official statistics) was $520.

Bangladesh attained independence in 1971 after a violent war with Pakistan. As a result of the war, large numbers of people were displaced and left homeless or were living as refugees across the border in India. Millions of families were left without shelter and income, with a number of women headed households who had to provide for the young, elderly and infirm, with relatively limited skills and no resources. Those who had escaped death and physical injury had suffered in other ways. Thousands of women were raped and a many more suffered from psychological trauma.

The early years after independence were devoted to rebuilding the country, developing a governance structure and integrating into the international economy. Bangladesh received billions of dollars of donor aid from a number of international aid agencies. Aid supported the birth of a number of local Non-Governmental Organisation's (NGOs) and International Non-Governmental Organisation's (INGOs) programs focused on rehabilitation and reconstruction efforts.

The interventions of local and international development agencies over the past four decades have made significant contributions to the improvement of lives and livelihoods at the household and community levels. As Bangladesh makes the transition from a predominantly agrarian economy to an industrial and service economy, industrial policy reform has contributed to opening up the economy resulting in trade liberalisation and development, with the industrial sector focusing beyond the domestic market through a more open investment climate and continuing development of regional industrial centres, parks and special economic zones. In the last five years, the country has achieved a remarkable growth rate of more than 5 percent and is striving to upscale the economy to a mid level developed country. The promotion of certain sectors such as the garment and porcelain manufacturing sectors offer employment opportunities for millions of men and women who cannot be absorbed into the traditional sectors.

In spite of these efforts, various factors including dramatic increases in the cost of living, low income levels resulting in low nutrition, poor health, underemployment and unemployment and internal migration have contributed to the persistence of poverty. According to the United Nations Development Programme (UNDP) Human Development Report 2007-08, the Human Development Index for Bangladesh was 0.547 in 2005 resulting in an extremely low international ranking of 140th out of 177 countries.[1]

The country is one of the poorest in the world.

1 All efforts have been made to use the most recent data for this report. However, there is currently a dearth of up-to-date statistics on microfinance in Bangladesh and where necessary data from 2005/06 has been used.

The majority of the Bangladeshi population does not own homestead land or agricultural land. They do not earn enough to meet basic needs such as food, shelter and clothing, nor essential needs such as housing, education and health care. Although the government has provided free education, children are not able to complete their education as they are either forced to drop out in order to seek employment to supplement household income, or drop out because they do not have the sufficient support to perform. Lack of nutrition, education, opportunities and access to essential resources has contributed to the pervasive condition of generational poverty.

2. Microenterprise Development as a Poverty Alleviation Strategy

Lack of income security is one of the fundamental challenges for the poor in both urban and rural areas. While there are greater opportunities for employment in the urban areas than in the rural areas, the high cost of living makes it difficult for families to save. Wage differentials between the formal and informal sectors are significant with a majority of the poor engaged in the informal sector in both rural and urban areas. A relatively small percentage of the educated elite have access to salaried jobs and income security by gaining employment in the government and the private sector; however, income security and fair wages is a dream for the vast majority of the Bangladeshi population who rely primarily on daily or seasonal income from various types of economic activities in both rural and urban areas. In the rural areas, the poor who own agricultural land or are able to rent land for cultivation eke out a living with limited access to capital for purchasing essential agricultural inputs. The landless poor have to sell their labour and skills as agricultural workers in different types of farm and off-farm activities. The poor in urban areas are engaged in daily labour in the construction, transport, manufacturing, service and trading sub-sectors.

Poor rural women either work as agricultural labour or do home-based income generation activities, including paddy husking, small livestock rearing, pond-fish farming or handicrafts depending on the income to invest in these activities. In urban areas, the vast majority of poor women are engaged as domestics in the homes of the upper middle class and the wealthy. The emergence of garment factories in cities such as Dhaka have provided employment opportunities for many women who face gruelling working conditions but are able to earn a living and save a small amount to send to their families.

Lack of employment opportunities and the inability to initiate economic activities in the rural hinterland force large numbers to migrate to the big cities, especially Dhaka. Seasonal migration is witnessed during low seasons when there is limited work available in the agricultural sector. After each flood or typhoon, families who have lost their meagre assets move permanently in search of employment to urban areas. Such migration puts tremendous stress on the scarce resources and infrastructure in the urban areas. Lack of adequate clean water, sanitation, electricity, police protection, and other essential support systems have led to unsafe conditions for the population in these slums.

In these circumstances, self-employment in one's own business activity or in a family business is an alternative for a poor household. These income generation activities may be initiated either as the primary or a supplemental source of income for the individual and household. The main constraint to self-employment in income generating activities that can be developed into microenterprises is the lack of capital for investment. The poor do not have adequate savings or productive assets that can be invested, nor do they have access to loans from the formal financial sector. While some borrow from moneylenders at high rates of interest, these borrowings are limited to essential needs and emergencies. Few are able to take the risk of borrowing from moneylenders for investment purposes.

Microfinance is therefore an essential instrument or tool for enabling the poor who have the confidence and risk to transform their skills and existing resources into sustainable income generating activities. They can either be developed as the primary source of household income, or contribute as supplemental or seasonal income.

3. Overview of the Financial Sector

The Bangladesh financial system is regulated by Bangladesh Bank, the country's central bank. The principle providers of financial services are the commercial banks including nationalised commercial banks (NCBs) and private commercial banks (PCBs); specialised banks (SBs); foreign banks; cooperative banks; non bank financial institutions (NBFIs), micro finance institutions (MFIs), insurance companies, credit rating agencies, and stock exchanges.

Currently all commercial banks are private, including the four nationalized commercial banks that have been privatized by the Government. As of December 2006, the four nationalized commercial banks hold about 35 percent of the total deposit, a decline from previous years as their shares of deposit have been decreased. Commercial banks and specialized banks have outreach all over the country and support development interventions with their existing resource endowments. Collectively they own a greater share of rural branches with the commercial banks owning more than 27 percent of the rural branches. The foreign commercial banks on the other hand are exclusively urban based. In spite of their vast infrastructure for outreach these commercial banks are conservative in their lending and do not serve the majority of the population in either rural or urban areas.

Specialized banks pursue industrial development through long term financial support and other imperatives of investment. They are refinanced by NCBs and some foreign banks to provide long term industrial financing and to encourage NBFIs to attach their resource endowments to industrial investment.

NBFIs are the most important service delivery outlets of financial resources in Bangladesh. The Financial Institutions Act 1993 regulates the operations of NBFIs. These institutions consist of, amongst others, investment, finance and leasing companies. As of 30 March 2007, 29 NBFIs are operating in Bangladesh. Of these one is government owned, 15 are local and the remaining 13 are chartered and instituted under joint venture with foreign investors. Bangladesh Bank has introduced a policy for loan and lease classification and provisioning from December 2000 on a half-yearly basis for NBFIs. In order to promote market dynamism 12 NFBIs have been listed on the stock exchanges to float their shares in the capital market. Four have already floated Initial Public Offering (IPO) to strengthen their financial capability and the rest are under process of enlistment. As of early 2009, NBFIs are permitted to borrow from overseas.

The capital market in Bangladesh is yet to play a potential role in financing long term investments. The Securities and Exchange Commission (SEC) regulates and supervises capital market under the SEC Act 1993. Bangladesh Bank, under the Financial Institutions Act 1993, also regulates the institutions engaged in financing activities including leasing companies and venture capital companies. The SEC so far has issued licenses to 27 non-bank institutions to participate in the capital market.

The Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE), the market players of secondary capital market were incorporated under The Companies Act. As of May 2007, the total number of enlisted securities with DSE stood at 326 of which 260 were listed companies, 14 mutual funds, 8 debentures and 44 treasury bonds.

The Investment Corporation of Bangladesh (ICB), a key institution of the capital market was established in 1976 with the objective of encouraging and broadening the base of industrial investment.

The insurance sector is regulated by Insurance Act, 1938. Currently 62 insurance companies are operating in Bangladesh, of which 18 provide life insurance and 44 are in the general insurance business. Jiban Bima Corporation (JBC) is the only state owned enterprise. Shadharan Bima Corporation (SBC) is the only statutory company owned by the government and delivers general insurance. A total of 32 insurance companies have been enlisted with the capital market, of which nine offer life insurance. Delta Life Insurance is the market leader among the private sector insurance companies.

In addition to these formal financial institutions, there are a large number of informal and semi-formal financial service providers. Informal financial service providers include moneylenders, pawn brokers and various rotating savings and credit associations (ROSCAs) that operate in both urban and rural communities. Semi-formal financial service providers include NGO microfinance programs, government microfinance programs as well as savings and credit associations.

Cooperatives form a significant part of the financial sector; although they are governed and supervised by the Registrar of Cooperatives. Some savings and credit cooperatives also offer micro loans and savings for their member base.

4. Evolution of the Microfinance Sector

The development of MFIs took place in several distinct phases over the last four decades. Micro credit was developed in the 1970s as a response to the relief and rehabilitation needs of post-independent Bangladesh when the government and private initiatives were focused on restoring livelihoods through income generating activities.

The development of the microfinance sector has undergone four distinct phases in the past four decades:

i. Action research phase in the 1970s
ii. Micro credit development phase in the 1980s
iii. Consolidation phase in the 1990s
iv. Expansion phase from 2000 onwards

In the 1970s, development organizations including local and international NGOs were involved in relief and rehabilitation. In addition to community development, health, literacy, agricultural sector development programs and food relief programs, some initiated income generation activities to help the landless poor, particularly women earn supplemental income. A major constraint faced by the population was the lack of access to capital for investment in income generating activities, so few could actually start enterprises.

In the mid 70s, Grameen Bank initiated its 'Jobra' experiment using the solidarity group-based credit delivery system using peer pressure and group guarantee to ensure timely repayment. The project achieved a high rate of success and it was formalized as Grameen Bank, with a special license obtained from the Bangladesh Bank. Grameen Bank remains the only bank with a poverty alleviation bank license. The license is of particular note as it allows Grameen as a licensed and regulated bank to mobilize savings legally, from members and non-members.

Also in the 1970's, the Bangladesh Bank initiated the Dheki Rin Prokolpa in collaboration iwth an NGO Swanirvar Bangladesh. Several other NGOs were also trying out various micro credit mechanisms and soon micro credit programs became a part of every social development NGO, even if it was not a major part of the program.

The 1980s is known as the period of microfinance program development. The success of Grameen Bank began to motivate social development NGOs to expand their economic development programs, with a particular emphasis on microcredit. The availability of donor grants resulted in the creation of revolving loan funds to make loans to NGO members for various income generating activities. NGOs began to expand their micro credit programs and some like ASA took a decision to shift focus from social and community development work to minimalist micro credit intermediation.

In the 1990's, the Palli Karma-Sahayak Foundation (PKSF) was established as the promoted apex wholesaler financed with government funds and the World Bank. As a result, NGOs providing financial services had the benefit of relatively low cost refinancing along with technical assistance to enhance their institutional infrastructure and management information systems to expand outreach, improve efficiency and increase self-sufficiency to reduce dependence on grant funds. The first NGO to achieve full operational self-sufficiency and financial self-sufficiency was ASA. In the late 1990s, ASA was able to move away from donor grants and operate its microcredit portfolio through earned income, savings, and equity converted from the grants received previously. ASA became the largest borrower of PKSF funds and was eligible for loans from commercial banks. Soon other NGOs like BRAC and Proshika began to scale up their micro credit programs, although their continued focus in their social and community development programs delayed their targets for financial self-sufficiency. Towards the end of 1990, the microfinance sector was well established with the "Big Four" namely, Grameen Bank, ASA, BRAC and Proshika who in turn promoted smaller NGOs providing refinancing as well as technical support in their respective development methodology and microfinance practices.

Although the vast majority of NGOs adopted the Grameen style of group lending and focused on rural areas, there were some new initiatives. For instance, in the early 90s, an NGO named Shakti

Foundation took on the challenge of providing microfinance services to urban women living in the Dhaka slums who had limited literacy and numeracy skills and no permanent address, as slum evictions were common. The NGO Asharai promoted a savings based self-help group model of microfinance combined with community development services for tribal communities in the northwest part of Bangladesh. RDRS, an integrated service provider focused on micro credit initiatives along with agricultural interventions to increase the food sustainability of the drought affected population in the northern villages of Rangpur and Dinajpur districts. BURO Tangail, with its centre in the highly productive town of Tangail, started with a modified Grameen type methodology, but used action research and piloting of products to develop a range of credit and savings products, including flexible savings and term deposits. TMSS based in Bogra started with an integrated community development approach, using micro credit as a means to ensure sustainable development of the rural economy with a focus on social forestry, water resource management, agricultural and livestock management, fisheries and health, and now has grown into one of the top 10 MFIs in the country. Safe Save, a pilot project that took on the legal framework of a savings and credit cooperative started as a Lilliputian provider amongst the giants; however, has attained international fame for its success in innovating a savings based individual lending model in urban Dhaka, in contrast to the dominant Bangladeshi model of a credit-led group-based lending model for rural clients.

The fourth phase was one of professionalization and expansion of microfinance portfolios, and moving towards commercialized funds to enhance sustainability. In the late 1990s, with the increasing threat of declining donor funds NGOs began to experience the need to enhance management capacity and develop action plans to access loans in order to expand outreach to attain scale and sustainability. In the last decade a number of NGOs have experienced tremendous expansion, with at least a dozen succeeding in reaching over one million clients. Bilateral donors and international development agencies have contributed significantly to this growth in the sector by providing technical assistance support, financing technical support and institutional development and sponsoring training within and outside the country to introduce the sector to international experiences.

PKSF and a number of commercial banks have contributed to the expansion and outreach by refinancing microfinance portfolios to respond to increasing need for loan funds from existing and new customers. The support of action research and pilot testing of new products has added rigor and vitality to the sector. Expansion of microfinance portfolios has continued to the end of the 1990s and many MFIs are still experiencing high rates of growth with continued availability of commercial funds, increasing income from the loan portfolio, and member savings.

The current phase is formalization and transformation. The larger and medium sized NGOs will prepare to transform into formal financial institutions in accordance with the newly established Microfinance Regulatory Authority Act, with the objective of integrating into the formal financial sector to gain access to additional sources of capital and equity as well as mobilize savings from the public. Smaller NGOs that are unable to transform due to low levels of equity and inadequate scale or performance may consider mergers to consolidate portfolios and combine their strengths to overcome weaknesses.

Many of the smaller MFIs that have not been able to attain the adequate levels of sustainability and retain a committed customer base in competitive markets may be forced out of business. The sector will be faced with some new challenges, including intensified competition in some of the rural and urban markets where market saturation is already evident, and innovating mechanisms to service the markets that remain unbanked, including the extreme poor or "hard core poor" and the populations in remote areas that remain beyond the reach of either the formal banks or NGO MFIs.

5. The Microfinance Sector

The microfinance sector in Bangladesh consists of the following stakeholders who are categorized as the micro, meso and macro levels. The micro level consists of the existing clientele and the potential target client group who remain unserved or underserved. The micro level also consists of the different kinds of providers, including the formal, semi-formal and informal providers such as moneylenders, pawnbrokers and rotating credit and savings associations.

The meso-level consists of the financing partners, including donors, refinancing partners, development finance institutions, multilateral and bilateral aid agencies, commercial banks, specialized banks, development banks, as well as government agencies. Private investors are new comers in the meso-level providing equity and capital to MFIs. The meso level also includes technical support providers including training institutions, networking institutions, microfinance associations, rating agencies, audit firms, consulting firms, independent consultants and academic or research institutions.

The macro level consists of the regulatory bodies including the Central Bank or Bangladesh Bank and the Ministry of Finance. A principal player within the macro level is the NGO Affairs Bureau (NGOAB) which governs and supervises the NGO microfinance providers, including local and international NGOs with programs in Bangladesh.

About 62 percent of the borrowers live below the poverty line. The vast majority of these clients do not have physical collateral to secure loans and need alternative collateral mechanisms. The 2005 World Bank report states that a total of 9.6 million households are being served by MFIs. The total number of clients served by microfinance sector is approximately 24.25 million with effective coverage to about 17.32 million clients showing a substantial gap between demand and supply. Microfinance institutions, including Grameen Bank, collectively service more than 60 percent of the demand, with Grameen serving about 20 percent of the total. Women constitute 90 percent of the clientele. Average loan sizes are around Tk. 4000 (US$60). In 2006, micro credit loans constituted about 44 percent of the total disbursements in the credit sector.

The microfinance providers are primarily MF NGO and a few non-bank financial institutions (NBFIs), and one specialized microfinance bank, namely Grameen Bank. Some of the ministries or divisions of the Government of Bangladesh support large micro credit projects and some of the commercial banks have established windows for microfinance loans. Microfinance NGOs cover the largest share of the microfinance market. A report published by the Micro credit Regulatory Authority (MRA) reveals that up to June 30, 2006, states that the volume of loans outstanding for the 651 major NGO- MFIs is US $1105.86 million and CDF's statistics for 2006 show that up to December 2006, cumulative disbursement of 611 major MFIs was approximately US$8,171.71 million.

Grameen Bank is the only MFI with a specialized bank license. The MF NGOs are led by three very large organizations namely ASA, BRAC and Proshika which represent 94% of the total sector, in terms of numbers and more than 73% of the savings. The remaining part of the sector is comprised of 332 small & very small organizations. The Government of Bangladesh is a major stakeholder.

6. Microfinance Regulations

Most of the NGOs providing financial services were established as development organizations, and registered as LNGOs or INGOs. Most of the microfinance portfolios were grown on grant funds from foreign sources. With the increasing inflow of external resources, the government concerned with transparency and accountability created the NGO Affairs Bureau (NGOAB) in 1991. NGOAB played the role of the primary regulator of the development NGOs supported by foreign funds, providing microfinance services in the country.

The fact that MFIs remained unregulated for the past four decades has had an impact on their substantial growth in outreach and sustainability as well as promoted innovation. However, as the sector has acquired significant scale particularly in terms of deposits there is a concern regarding depositor security and the interests of poor clients. They can easily be exploited by microfinance providers, especially as many providers are motivated more by the potential for profit rather than to achieve social development objective.

Recent reform measures include the reformation of previous acts creating the Micro Credit Regulatory Authority Act 2006, building on the previous acts such as the Societies Registration Act 1860 (the same as in India) Companies Act 1913, Trusts Act 1882, Charitable and Religious Trust Act 1920 and Cooperative Societies Ordinance 1984 that have created the regulatory framework for the industry in the past. The Bangladesh Bank in coordination with NGOAB and in consultation with the microfinance NGOs represented by CDF and PKSF have established the Microfinance Regulatory Authority and created the Micro Credit Regulatory Authority Act 2006. All NGOs providing micro credit have to register with both the NGOAB if they are receiving foreign funds as well as the Microfinance Regulatory Authority if they wish to continue providing financial services. In time it is expected that all MFIs will apply for license, and be formalized and integrated into the formal financial sector.

There are some in the industry who feel that it is essential to have a regulatory framework to protect the sustainability of the sector, foster innovation and nurture growth, and most importantly to protect the interests of the clients while there are others who fear that regulation could strangulate growth and innovation.

The MRA Act requires all MFIs to register with the MRA in order to operate legally in the country in the provision of microfinance services. The MRA will issue and cancel licenses for micro finance operators, oversee, supervise and facilitate the entire range of activities of MFIs. The MRA will establish a depositor's insurance fund to ensure safety of the depositors and to secure all MFI deposits. All MFIs will be required to maintain a reserve fund which cannot be spent without prior permission of the authority. MFIs will not be allowed to take deposits from persons other than their members (i.e. no mobilization of deposits from the public who are not members of the MFI). MFIs that deviate from the norms will be subject to punishment of not more than one year of imprisonment or a fine of not more than Tk. 500,000 (US$ 7143).

Furthermore, the MRA will keep a watch over the MFIs in Bangladesh in order to safe guard the interests of microfinance clients, as well as ensure the protection of microfinance customers against overpricing. Price setting will be judged by the government in keeping with guidelines and regulatory provisions. Resources will be allocated from the commercial banks and formal financial sector to meet the demand for micro credit. The MRA will be responsible for monitoring and evaluation of performance.

The Act is a fairly recent intervention in a sector that has grown and developed and come of age over a period of four decades. It will take time for the stakeholders to get accustomed to the new regulatory framework and in turn for the regulatory authority to work out the existing areas of weakness or gaps in the Act and in the systems that are being established for registration, appraisal, licensing, monitoring and supervision.

The present framework is a starting point. There will be modifications and amendments in the future. At present the legal frameworks do not include the option of a microfinance bank, as there is a fear of possible financial mismanagement resulting from limited controlling capacity of the newly formed MRA; however, in future this option may be provided based on the demand from MFIs for this particular legal framework and the capacity of the MRA to license and supervise these entities.

Another critical concern is the exclusion of foreign microfinance institutions that are promoted by international NGOs. Local MFIs are concerned that these provides will have an unfair advantage as they will have continued access to financial resources from external sources which could result in negative competition. Domestic MFIs feel strongly that the MRA should establish a policy that monitors the cash flow into foreign MFIs and closely monitors their expansion strategies.

Although insurance is an essential product to provide a social safety net to protect vulnerable populations from the impact of death, disease and other shocks and emergencies, the MRA has not included microinsurance as part of the products of MFIs. Insurance is a specialized financial product and is not within the purview of the Central Bank. At present, micro insurance products offered by both insurance providers and microfinance institutions are inadequate to meet the needs of microfinance customers. The sector will have to focus its efforts on action research and pilot testing with the government contributing to providing a social safety net for the vulnerable segments of the population.

7. Microfinance Institutions

The first generation MFIs that emerged in the 1970s had an explicit social agenda and their focus was on poor segments of the population particularly women. The geographic focus was primarily in the rural areas, but as migration created urban poverty, microcredit programs began to shift their focus to urban lending programs. While some NGOs offer an integrated development approach, including some community development, most NGOs have transformed into microcredit focused NGOs.

MFIs are categorized into four major groups, including NGO MFIs, which constitute the large proportion of MFIs, commercial banks with microfinance windows, and government line ministries that have promoted micro credit projects and programs. There is one specialized microfinance bank, namely Grameen Bank. The Grameen Bank established in 1983 under a special law with the initial support from the Bangladesh Bank is the only MFI that has been awarded a license to operate as a specialized bank for microfinance. All the other MFIs are NGOs that are registered with the NGOAB and now with the MRA.

The MFIs including Grameen Bank include the Big Four that have outreach to over 3 million clients. A handful of large MFIs reach over 1 million clients. Another 20 odd MFIs are categorized as medium sized institutions with outreach to less than 100,000 clients. The rest are small and very small MFIs, with about 20,000 clients. The smallest have less than 5000 borrowers. Most of these institutions operate in the rural areas, although several of the larger institutions are now lending in both rural and urban areas. A few institutions specialize in urban microfinance.

The Government promoted micro credit programs are substantially large. About thirteen ministries and fifteen divisions of the government of Bangladesh deal with microfinance activities with a cumulative disbursement of US$1238 million at the end of December 2006. The government programs are less efficient with recovery rates of about 84 percent as compared to the NGOs that have repayment rates over 90 percent.

The 2005 World Bank Report indicates that a total of 9.6 million (out of 14.3 million households) or 37 percent of all households in the country are currently served by microfinance services. The "Big Four" - Grameen, ASA, BRAC and Proshika - collectively account for 86 percent of the 14.3 million active borrowers. Collectively they have more than US$1249 million in loans outstanding and over US$402 million in savings.

8. Microfinance Delivery Mechanisms

Bangladeshi MFIs are best known for large-scale provision of microfinance services to the poor women using non-traditional collateral mechanisms. With more than 90 percent of clients being rural women, MFIs have demonstrated repayment rates of over 90 percent in comparison with the formal banking sector. The average loan size of MFIs is around Taka 4000 (US$60).

Microcredit is provided to poor or low income households through groups. Loan contracts are made in the name of individuals, but the group is an essential mechanism in the delivery and recovery process. Depending on the provider, the group performs different functions, including providing a cost-effective mechanism for client screening, loan appraisal, disbursement, collection, monitoring, supervision and the mechanism for delivering non-financial services. Some MFIs are now making loans to individuals as in formal banking practices, without requiring membership in a group.

The main feature of Bangladeshi microfinance is the provision of loans without demanding traditional collateral as security. The solidarity group concept is embedded in the social structure of Bangladesh which consists of closely knit groups at the village level who in the absence of external mechanisms provide essential social safety net for poor households. More importantly, the Bangladesh group model was developed according to the principles of group solidarity. An MFI organizes a joint liability group of up to 5 members who then form peer pressure groups of as many as 30 individuals or 6 joint-liability groups.

The primary use of the group in the Bangladesh microfinance model is to offer alternative collateral mechanisms for the target client group that is unable to offer physical collateral to secure loans. "Solidarity groups" provide group guarantee by using joint liability and peer pressure principles to enforce repayment from individuals within the group. In almost all the microfinance models, loans are further secured through the collection of compulsory savings that are deposited in a loan security deposit account. The loan security deposit helps when joint-liability and group guarantee mechanisms either are inadequate or fail.

Individuals come together to form a group that commits to taking on joint liability for the loans obtained and offer the support of guarantee to other members in case of problems that prevent timely repayment. In case of default, group members will make efforts to enforce peer pressure to enforce repayment or accept the consequences as a group. In the case of larger amounts outstanding, in case the client and the group are unable to pay, the MFI will negotiate with the individual and the group to identify secondary assets that can be liquidated to repay the loan; however, in principle no key assets such as homestead land or agricultural land are taken as lien for loans.

A few MFIs have developed other means of providing financial services to the poor. For instance, the NGO Swarnirvar plays the role of an organizer or promoter NGO, which organizes large groups of women and men into solidarity groups. After providing the groups with sufficient training in basic numeracy and financial management skills, and initiating savings activities to support regular savings habit to enable them to plan for the repayment of loans in instalments, the NGO links them to commercial banks and other formal sector financial institutions. The NGO supports the bank by conducting an initial screening of the clients and providing an institutional guarantee to motivate the bank to make the loans. Groups ensure repayment by individuals using the solidarity group approach, but collections are done either by office bearers of the groups, or direct deposits to the bank. Group leaders and NGO staff assist the bank in collection of bad debt. The promoter NGO providing bank-microfinance group linkages is not a common model in Bangladesh, as it involves substantial financial inputs to support the training and development of group members and groups and since the NGO does not earn the entire income from the loan portfolio, it is dependent on grants for non-financial inputs. Any shortfall in the provision of group and members training can result in arrears and default.

9. Microfinance Savings Products

Most MFIs in Bangladesh are MF NGOs and therefore were not under the regulatory authority of Bangladesh Bank until the recent establishment of the MRA. Bangladeshi MFIs are allowed to mobilize compulsory savings as loan security deposit and group savings fund from their members, but not allowed to mobilize savings from non-members or general public.

Although there was doubt regarding the savings capacity and willingness among the poor to save in cash with MFIs, there is evidence that the poor have a tremendous capacity and will to save if provided the opportunity and flexible products. The Bangladesh Bank Report (2005) observed that the total savings of the 352 major MF NGOs was $266 million with average savings per member of being US$18.5. However, only 20 of the MFIs mobilize 89 percent of the total savings in the sector. Of the 20, three of the largest institutions represent 1 percent of the total sector, covering 73 percent of the savings in the sector. Among the remaining MFIs, 332 small and very small organizations represent 94 percent of the total organizations, but mobilize only 11 percent of the total savings in the sector.

Microfinance products in the early phase of the sector were limited to savings products that were designed essentially to protect the MFI against losses due to arrears or default. Few MFIs considered the advantage of flexible savings products to benefit the clients, in case of emergencies or small cash flow needs. In such cases, it was assumed that the client would borrow, preferably from the MFI. In many cases, clients not only borrowed paying interest on loans from MFIs, but also borrowed from moneylenders, enhancing their liabilities and liquidating scarce assets for timely repayment.

Some MFIs with an interest in social and community development offered an additional savings product called group savings. Members of a group would deposit a certain amount each week or month towards a fund held at the group level which was managed by group leaders elected by the members. The fund would be used to issue small loans to meet essential household cash flow needs or finance emergencies at rates established by the group members based on their need and the rate they felt was necessary to ensure repayment but also growth of the fund. These group based loans were of critical importance as they were an essential alternative to borrowing from moneylenders at much higher costs.

Unfortunately, these group based loans would often create problems due to the eventual mismanagement of loan funds due to the lack of management capacity or the hijacking of loans by dominant members or group leaders, thus weakening the solidarity group structure. The erosion of group solidarity would affect the external loans from the MFI. Many MFIs who offered this additional product have since removed the product from their menu, in some cases designing loan products to substitute for those that were provided through the internal savings fund. Often clients continue to save individually at home as well as using traditional ROSCAs to meet their immediate cash flow needs or planned expenditures.

The majority of NGOs continue to provide only compulsory savings which include personal savings, group fund savings and loan security deposit. These are deposits that clients make as a requirement for loan eligibility that contribute to loan security in the event of default. These deposits are not accessible to the client unless the client either quits the program or is expelled for bad debt or other reasons. Deposits earn dividend and all dues are deducted and funds are distributed to the client.

On average NGO-MFIs offer mostly 5 to 6 percent interest on deposits from members, but a few offer more than 7 percent. In order to encourage savings in rural areas, MFIs are initiating term deposits with higher rates of interest. For instance, GB offers attractive interest rates for deposits ranging from 8.5 to 12 percent.

The NGO MFI BRAC, for instance provides three types of accounts, including the traditional compulsory savings (loan security deposit), personal savings, and current account savings which are accessible to the borrower. Grameen Bank has introduced many savings products since its inception in the early 70s, when the product range was limited. The current product menu includes personal savings, special savings (for specific purposes), the Grameen Pension Scheme, time deposits, (a savings scheme in which the amount deposited doubles in seven years) and fixed deposits with monthly income. The offering of various products has helped GB increase its total net savings to more than 56 percent of the total net savings of microfinance institutional savings. As it is a regulated institution, GB can also mobilize deposits from non-members and about 23 percent of GB's net savings comes from non-members.

In some cases, during periods of flooding and other natural disasters, MFIs have offered more flexibility in their savings policies, including the offering of a temporary cessation of repayments and allowing clients to withdraw savings from their savings accounts to cope with essential expenditures. Once the crisis period is over the MFIs resume their normal credit policies regarding savings and begin collection of instalments.

Over the past decade MF NGOs have piloted and promoted a range of savings products other than the traditional products such as compulsory savings (loan security deposit), special savings, contractual savings to include time deposits and daily savings. MF NGOs like BURO and ASA have introduced a number of flexible savings products that enable members to withdraw savings in time of need.

Savings mobilization is an essential aspect of ensuring the long-term financial sustainability of MFIs. MFIs invest a large share of the deposits as sources of funds for micro loans, thereby reducing their cost of funds by borrowing from commercial sources and enhancing self-reliance by reducing dependence on donor grants from foreign agencies. The establishment of the MRA in 2005 is having an impact on savings mobilization, and is expected to provide greater security for the depositor, enhance self-sustainability among microfinance institutions and promoting product innovation.

10. Microfinance Loan Products

The traditional microfinance loan product is usually called the "General Loan." This is a small loan with a ceiling that is under US$100 (at present the average loan size is US$60). Loan ceilings are based on the expressed demand from members as well as the fund availability the MFI to meet the demand for loans. When members reach the maximum loan size, they have the option of applying for a larger enterprise loan if the MFI offers this product at different rates and repayment terms and conditions, or has to consider moving to another provider that offers the desired product.

The General Loan is provided in cycles of up to 12 months with about 45 monthly instalments consisting of equal amounts of principal and interest. Loan instalments are calculated based on the average household income of the target client group, allowing the vast majority of clients to repay without undue stress; however, most clients find repayment during the early years a struggle given their lack of adequate income and financial management capacity, and clients taking larger loans can also find instalments difficult to handle if household income is not sufficient to manage essential expenditures.

Interest charged by MFIs varies and is calculated on a flat or declining basis depending on the operational efficiency, cost of funds, inflation and other factors specific to the institution such as fees to cover non-financial inputs to the business or social development services.

Upon the successful repayment of a loan, the client is eligible to apply for a larger loan in the next cycle, where the ceiling is increased automatically by Tk.500 (US$7). Currently, loan ceilings for the General Loan are as high as Tk.50,000 (US$700). Clients can borrow as much as they want within the ceiling of their loan cycle. In principle there is no pressure for clients to borrow the maximum amount and can opt to take smaller amounts based on their need and their repayment capacity. In case of arrears MFIs have policies regarding penalties. In case of default, the client is closely monitored and there is some grace period to recover outstanding amounts over the subsequent instalments. In case of a loan default, the MFI follows its recovery procedures, depending on the terms and conditions specified in the loan contract.

In the case of collecting bad debt, the first step is to work with the group members of the joint-liability group to analyse the reasons for default in consultation with the client and the family and identify options for recouping the loan outstanding. The next step is to discuss the situation with the larger peer group to identify the best strategy to recoup the loan. Depending on the situation, either the client will take responsibility to repay the entire amount or in other cases, the group members will help by contributing from the group fund to repay the outstanding amount to keep the group in good standing with the MFI. In situations where the client is not at fault, and the reasons for default is due to death, illness or business failure due to external factors, the interest may be waived, the entire loan may be rescheduled or even waived and covered by the loan loss reserve fund of the MFI.

As microfinance loans increase in size, the exposure to risk inhibits group guarantee through the group fund as a reliable or viable means of recovering losses. Therefore, in the case of larger loans, a client is eligible for larger micro enterprise loans, but must maintain membership in the group and comply with all the group requirements, including regular meetings, compulsory deposits, and deposits in the voluntary savings account. Although the group must continue to assist in the collection of bad debt, the loans are secured through the loan security deposit of the individual client as well as the attachment of secondary assets that the client can liquidate if faced by income loss causing repayment problems.

In a few cases, such as ASA, loans are being made to individuals outside the group mechanism to attract a different target group of clients, including men and women with established microenterprises who are not interested in group mechanisms but are interested in borrowing from an MFI as they are not eligible for commercial bank loans.

The General and Micro Enterprise Loans are generally provided for many different purposes including investment in business activities including investment in productive assets such as agricultural land, equipment, machinery, electricity connection and inventory. Microfinance clients can obtain sector programme loans for micro enterprise development in areas such as trading, service sector, food production, poultry, livestock, agriculture, sericulture, fisheries and social forestry. Some NGOs offer clients enterprise development training, technical assistance for specific sub-sectors as well as marketing inputs.

General loans are provided for any profitable and socially acceptable income generating activities such as: rural trading; rural transport; paddy husking; food processing; small shops and restaurants, etc. Although diversion of loans for household consumption needs is not encouraged, there is an understanding that money is fungible, and what is important is that income levels within the household enable a client to repay her instalments regularly and continue to remain a customer in good standing. General loans usually range between USD$15 and USD$160. Members are eligible to apply for larger amounts once they have repaid their outstanding loan in full and as per the terms and conditions specified in the loan contract.

The micro-enterprise loans are larger than general loans, and can be borrowed both at the group level and also as individuals directly, but with more rigorous credit appraisal including a thorough household and business appraisal to assess risk and potential for repayment. The clients are usually graduates who have successfully repaid several general loans and are committed to transforming small income generating activities into sustainable micro enterprises that will provide the primary income for the household.

Some MFIs offer agricultural loan products that have different terms and conditions for repayment depending on the agricultural cycle. Repayments are made with monthly instalments of interest and a payment of the principle amount in one or more instalments depending on the cash flow of the household.

MFIs also offer loans for other purposes, including asset creation, housing improvement, house construction, purchase of homestead land, as well as education of children. Several MFIs offer loans for repair of their homes, upgrading and in some cases actual construction of home or purchase of homestead land. Bangladesh Bank now offers house-building loans to MFIs at the rate of 1 percent per annum to finance the demand for housing loans from MFI clients. The average loan size is typically USD$310.

In addition to these productive or investment loans, MFIs also provide other loans for emergencies, disaster mitigation, sanitary latrines and tube wells. Due to the fact that Bangladesh is often affected by natural disasters including floods and typhoons, MFIs often provide emergency loans and disaster loans to help clients cope with the loss of income and assets as a result of a disaster.

Box 1: Typical microfinance loan products

1. General Loan
2. Micro enterprise Loan
3. Agricultural Loan (for cultivation purposes)
4. Housing Loan or House Improvement Loan
5. Education loan
6. Emergency or Disaster Loan
7. Tube well loan
8. Sanitary latrine loan

11. Microinsurance

The insurance sector is relatively undeveloped in Bangladesh in contrast to the need for social security and social safety net in one of the poorest countries in the world where the population is greatly exposed and vulnerable to shocks. The common types of insurance products in Bangladesh are health insurance, life insurance, credit insurance, property insurance and crop insurance. However, not all these products are currently available to microfinance clients.

There are two major limitations for the successful provision of microinsurance. Firstly, while it is a financial product, insurance is a specialized financial product requiring different expertise and mechanisms for design, implementation and management. Furthermore, unlike loans and savings, marketing insurance products to the poor is a challenge. The poor prefer to have whatever cash they have available to invest in their household or income generating activities. They are often not willing to contribute to monthly or annual premiums for unexpected shocks to the business or to household due to events such as death, disease, accidents and unexpected hospitalization. MFIs that wish to offer insurance products as part of their financial services therefore, must work with partners who are insurance providers and have the core experience and competence. They also will have to invest in research and development, as well as piloting products to assess the demand and potential for making insurance products a viable part of their product menu in the long-term. Substantial inputs will be required in terms of research, the establishment of a specialized team to manage insurance products as well as the training of the personnel and establishment of systems and infrastructure for product delivery and management of information.

In the past decade some MF NGOs have been piloting insurance products in collaboration with insurance companies. Grameen Bank introduced one of the earliest insurance products in the sector, including health insurance through Grameen Kalyan. It had potential but did not become a successful long term product. The MF NGO BRAC partnered with the market leader in insurance, namely Delta Insurance to offer life insurance. The product offers US$77 to the family in case of death of a member to cover funeral expenses and contribute to the repayment of remaining liabilities. Members do not have to pay a regular premium for the life insurance facility.

Proshika has the most diverse range including a Life and Property Risk Coverage Policy (LPRCP) for its group members. Proshika's Economic and Social Security Policy Scheme (ESSPS) covers housing, education, health and some other facilities for the group members who are the regular savers. Its Livestock Compensation Fund (LCF) pays for the loss caused by the sudden death of farm animals and poultry.

Microfinance NGOs in Bangladesh are gradually becoming interested in offering insurance products. MFIs over the years have offered various kinds of insurance products like health insurance, life insurance, credit insurance, property insurance and crop insurance but have experienced difficulties in attracting clients and maintaining the sustainability of the product. Having realized the importance of creating social safety nets to support their loan investments and limit the erosion of client savings and assets for meeting unplanned expenditures and sudden shocks, several MFIs are currently working in collaboration with action research partners such as the International Network of Alternative Financial Institutions (INAFI) Bangladesh to adapt field based research and piloting for the design of viable insurance products.

12. Remittances and Money Transfer

Most Bangladeshis have family members who have left the village or even the country to work as migrant labourers. In order to serve these migrant workers and their families, MFIs are now offering money transfer services in collaboration with commercial bank and money transfer companies such as Western Union.

With an increasing number of migrants, both rural-urban and international, money transfer is becoming more important. Because of their extensive outreach, both geographically and membership base, some of the MFIs are in a strong position to provide money transfer services to their members. In a tripartite service provision, BRAC, BURO Bangladesh, TMSS, BRAC Bank and Western Union Money Transfer have been extending money transfer services to even the remotest areas in Bangladesh since 2004. Currently about 50,000 transfer transactions are made per month by BRAC Bank alone, while other MFIs are providing the similar services on this front.

13. Financing Microfinance

In the early years of the sector, the major source of loan funds included compulsory savings and donor grant funds. Since most of the MFIs rely on the funds coming from foreign grants, the government, in consideration of keeping proper accounts and utilization, is accountable for those grants. To undertake this task, NGO Affairs Bureau (NGOAB) was established in 1991. NGOAB is regarded as the primary regulator of development NGOs supported by foreign funds. NGOAB's activity spectra entails the areas like- NGO registration, approval of project proposals, releasing funds and monitoring NGO projects, etc.

As the portfolio size expanded MFIs were able to allocate larger proportion of earned income from the portfolio towards the loan fund, if they had been able to achieve economies of scale in terms of outreach and managing the operational expenditures. As they attained operational efficiency MFIs were able to attract commercial funding from financial institutions at both soft rates as well as commercial rates of interest. ASA and Shakti Foundation were the first MFI NGOs to attract loans at market rates of interest from commercial banks, including Agroni and Sonali Bank. Since then more than 70 MFI NGOs have leveraged commercial loans from various commercial banks in the past decade.

The credit for enabling the scaling up of the microfinance sector goes undoubtedly to the efforts of the Palli Karma-Sahayak Foundation (PKSF), a specialized institution that was established in 1991 to refinance MF NGOs. PKSF was established by the Government of Bangladesh for refinancing the NGOs providing microcredit services to the poor in rural areas. Once it was established, PKSF was refinanced by government funds as well as funds from the World Bank to continue to meet the growing financing needs of the sector. Most of the current market leaders in the MF industry have established their scale of operations and achieved financial self-sufficiency through their collaboration with PKSF. PKSF is part of the success of MFI giants such as ASA and now BRAC, as well as TMSS. It has helped various small MFIs to achieve high levels of operational efficiency whereby they can enhance their financial self-sufficiency and leverage funds from the commercial banking sector in future. The efforts of CDF's Bank MFI Linkage Program that linked relatively small and medium MFIs to banks, using loan guarantee and guarantor mechanisms is also notable.

Currently, the major sources of loan funds for Bangladesh MFIs are member savings, interest income and service charges from the loans, and loans from financial institutions including PKSF and commercial banks. Over the years, reliance on grant funds from external sources is declining. The external source contribution to fund decreased from 30.4 percent in 1997 to 7.9 percent of total revolving fund (RLF) in 2005. In turn the revolving funds have increased from 35.7 percent to 59.5 percent.

14. Non-financial Services

The vast majority of MF NGOs were established as social development organizations. Micro credit provision was not a core function of the organization until later in their development. Therefore, a large number of MF NGO continues to provide non-financial services along with financial services. These services primarily include different types of training on enterprise creation, business skill development, sub-sector specific technical inputs, financial literacy and financial management training. A few MFIs have also included health support programs to ensure the wellbeing of clients and their families, legal and political awareness to promote a better understanding of their rights and promote political participation among women. The most notable institutions that provide enterprise development services are Grameen Bank, BRAC and TMSS.

NGOs such as Proshika, BRAC, TMSS, MSS and Uddipon are also providing other non-financial services to their clients including legal aid, adult and child literacy programs, community health programs, maternal and infant care, non-formal primary education, and various community development programs, including safe water, sanitation, waste management, ground water management. Some like BRAC have established schools in slums and villages, and TMSS has established a full-fledged hospital.

15. Technical Assistance and Support

Bangladesh has the largest number of microfinance clients among the leading microfinance countries of the world. The sector includes the four nationalized banks, specialized banks, government organizations, and over 1000 MF NGOs, in addition to a number of informal sector microfinance providers.

The growth of the sector is attributed to late interventions of formal regulation allowing more than three decades of unrestrained growth and innovation. The efforts and contributions of the NGO Affairs Bureau (NGOAB) established in 1991 must be noted. NGOAB played the role of the primary regulator of the development NGOs supported by foreign funds, providing microfinance services in the country. NGOAB was in charge of functions such as NGO registration, approval of project proposals, releasing funds and monitoring NGO projects, etc. The growth in the MFI sector, in terms of the number of MFI as well as total membership, was proliferated by high voice of poverty alleviation in the government's Poverty Reduction Social Responsibility (PRSR) initiative which allocates public sector resources to facilitate rapid expansion of microfinance resulting in outreach to approximately 24.25 million borrowers.

The microfinance sector was nurtured and supported by several bilateral donors and foundations that forged long-term partnerships with the first generation MFIs and continued to support MFIs in the 1990s. The contributions of the United States Agency for International Development (USAID), Department for International Development (DFID), Canadian International Development Agency (CIDA), SDC, The Dutch Government, Norwegian Government, as well as foundations such as Ford Foundation are notable. International development agencies such as Action Aid UK, CARE and Oxfam have also made substantial contributions to the sector, in terms of grants, technical assistance, and financing research and documentation to promote knowledge creation and dissemination of experiences internationally.

In recent years, given the rapid growth of the microfinance industry and the concerns regarding microfinance operations particularly safety of deposits, BB has taken certain financial reform measures to measures that not only support a dynamic commercial banking sector to accelerate development of the economy, but also ensure depositor security among microfinance clients. Policy measures include improvements in the functioning of the NCBs, including the privatization of the four nationalized commercial banks. Improved monitoring by Bangladesh Bank and the professional upgrading of management and governance to improve efficiency and productivity will contribute to enhanced support of the MF sector through refinancing and linkage initiatives and other partnerships.

Although PKSF is essentially an apex wholesaler, it has played a significant role in the microfinance sector, including contributions to policy advocacy, networking and the provision of institutional development inputs to partners, to enhance their sustainability and core competence in managing sustainable commercially viable microfinance programs without losing mission drift and focus on the poor.

Development oriented NGOs, including those providing financial services, were originally associated under the auspices of ADAB, the Association of the Development Agencies of Bangladesh. However, as the microfinance sector evolved and many NGOs began to focus primarily on microfinance activities, these specialized MFIs established the Credit and Development Forum in 1992, as an association or network of MF NGOs.

As a member based network the Credit and Development Forum (CDF) offers a common platform for lateral learning, information exchange and practitioner led innovations in technology and good practices. CDF has also played a significant role in lobbying for the interests of microfinance providers, with particular emphasis on the small and medium MFIs to influence the establishment of a favorable regulatory environment and policies that allow sustainable growth and development of different types of microfinance institutions with different scale of outreach. CDF offers institutional development training programs, technical assistance on site as well as refinancing through its own fund channeling commercial bank funds to small MFIs and also forging linkages between small and medium MFIs and commercial bank partners.

While there are other networks in the microfinance sector, CDF is recognized as the largest of the microfinance networks and the national level network or association of microfinance practitioners. In addition to its strong networking in Bangladesh, CDF has also forged good linkages with international bodies such as CGAP and other microfinance networks such as the SEEP Network, INAFI International, Micro Save Africa, Women's World Banking, and the Banking with the Poor Network.

INAFI is a global network of the development practitioners promoting financial and non-financial services with the aim of enhancing the lives and livelihoods of the poor in all developing regions of the world. INAFI is a member based network of more than 300 MFIs worldwide. INAFI Bangladesh is focused on capacity building of the sector through MFI partners in collaboration with CDF and PKSF. The primary areas of focus are identifying opportunities for management training of MFI senior management, credit rating, credit scoring, action research on various thematic issues and product innovation in micro insurance, micro remittances, and other pro-poor products. INAFI Bangladesh also contributes to the policy advocacy initiatives of CDF and informs policy advocacy efforts in the sector through its research and data provided by members. INAFI Bangladesh advocates for pro-poor financial services, increased transparency and accountability, and self-sufficiency of MF NGOs. The INAFI Asia network office is located in Dhaka Bangladesh linking Bangladesh to the international network office in Senegal, regional chapters in Africa and Latin America, and national chapters in India, Nepal, Philippines and Sri Lanka.

16. Key Achievements

No other country can boast the size and scale that Bangladesh has achieved in the microfinance sector. While other countries like Indonesia have one or two large providers, Bangladesh has an estimate of more than 3000 providers of which 1500 providers report their information to CDF. Among these 200 are considered significant. The "Big Four" namely Grameen Bank, ASA, BRAC and Proshika, dominate the sector, followed by TMSS, Swarnirvar, BURO Bangladesh, MSS, and other medium sized operators.

MFIs in Bangladesh have demonstrated several areas of strength. Over the past two decades the target population has achieved tremendous social acceptance. Low income households have recognized the advantages of microfinance programs and have taken advantage of the services offered. The participation level among poor women is particularly notable. The poor in Bangladesh are now in a better position for accessing loans for various household and enterprise purposes, given the large number of MFIs in the country as well as the outreach of some MFIs through expansive branch outreach structures. Clients now have various options of products and delivery mechanisms and have the opportunity to select. Waiting times for accessing credit have been substantially reduced from the earlier periods.

High on time repayment rates demonstrate the establishment of a strong culture of credit discipline that is to a great extent a result of the sound monitoring and supervision of microfinance institutions and client responsive design of products, including small instalments that allow clients to make regular repayments.

While the General Loan and compulsory savings remain the dominant products in the sector, many MFIs have expanded their menu of product offerings to include enterprise loans and loans to meet various business and household needs, and cope with emergencies. Several MFIs have also introduced flexible savings accounts as well as term savings to meet the regular and long-term financing needs of clients.

Increasing demand for new loans from existing customers and new clients is evidence that there is a market for microfinance loans for investment in businesses as well as creation of assets, including education of children and health.

The sector has demonstrated the capacity of the poor to save as most MFIs are financing their loan portfolios through internal savings. MFIs have also demonstrated their ability to manage operating costs efficiently ensuring profit margins so that they can contribute towards the loan fund and invest in expanding outreach through branches.

Gradual increase in voluntary savings accounts is evidence that micro finance has economic impact as poor households are able to put aside small amounts from their income to ensure long term security and plan ahead to meet planned expenditures and cope with shocks.

Almost all Bangladeshi MFIs have shown an increase in outreach to larger geographic areas. A large number have expanded beyond their original areas of operation to reach district and sub-district levels, and more than half a dozen are offering services at the national level. Scale and operational efficiency has resulted in MFIs showing larger amounts of profit from their portfolio enhancing financial self-sufficiency. MFIs in Bangladesh have achieved high levels of financial self-sustainability by leveraging performance to attract loans from the formal financial sector including soft loans from PKSF as well as loans from commercial banks. Grants from external sources decreased from 30.4 percent in 1997 to 7.9 percent in 2005. MFIs own resources have increased from 35.7 percent to 59.5 percent.

Sector wise figures show that savings and interest from the loan portfolio constitute more than half of the loan funds. PKSF accounts for over 14 percent of the loan funds. Loans from commercial banks have increased in recent years from 8.3 percent in 2003 to about 16.9 percent by the end of 2005. The figures indicate that overall the Bangladesh microfinance sector is gradually moving towards self-sustenance, with variation from institution to institution.

Although there is tremendous competition within the industry, especially among the key players, there is a degree of collaboration and cooperation when it comes to policy impact to protect the greater interests of the sector, as well as the promotion of awareness creation and knowledge enhancement through member based associations and networks. In recent years, there has been considerable activity in terms of action research at the institutional and sector level to influence product innovation as well as measuring financial performance and social impact on clients.

The key donors in the microfinance sector currently are the multilateral development banks, namely the World Bank and the Asian Development Bank who support refinancing initiatives rather than direct support to individual MFIs.

Bilateral donor agencies such as the United Kingdom DFID, CIDA, and the Danish Agency for International Development Aid (DANIDA) and the more recent entrant, namely the Islamic Development Bank (IDB) are supporting non-financial services as well as technical and institutional development initiatives in individual MFIs. Donor aid is currently moving into the support of small and medium enterprise initiatives to promote backward and forward linkages for comprehensive economic development within the enterprise sector. Collaborations between Bangladesh Bank, World Bank and Asian Development Bank have created refinancing facilities within several commercial banks and NBFIs that have supported more than 6000 small and medium enterprises as of late 2007.

17. Future Challenges

Although there are more than 25 NGOs that have achieved a degree of scale and sustainability to ensure long-term viability, the vast majority of MFIs are not able to move efficiently towards commercialization, due to a lack of adequate human, financial and technical resources. Most MFIs are too small and are unable to achieve the levels of operational efficiency required to assure financial self-sufficiency and leverage funds from the commercial sector to maintain sustainable growth. These MFIs often lack the technical expertise and experience required in the governance and management structures. They either lack links with technical service providers or are unable to finance their technical assistance needs.

The increasing scale and performance of the sector however has now attracted the private financial institutions, including some commercial banks. There is a risk that banks and other opportunity seeking financial service providers may start attracting the senior most clients of MFIs. Cherry picking will result in the loss of good customers, but also deposits that contribute to the sustainability of the MFI.

MFIs are fuelling their growth and expansion through risk management and high profits. As competition increases, and the pressure intensifies, some MFIs may not enforce good screening and either push larger loans into the hands of clients who are unable to manage repayment, creating debt burdens on clients and using unfair means to collect repayment, or exclude extremely poor households and vulnerable clients using screening criteria such as land holding, minimum family size and marital status to minimize risk due to exposure rather than use household income and expenditure analysis and cash flow analysis to approve loans.

The exclusion of the poorest and the lack of penetration in remote areas remains a concern. The figures show that the coverage of micro credit operations is absent in the more remote and less populous districts of the country's north and southwest where reduced population density and lack of markets and other essential infrastructure increases the cost of operations for MFIs. A recent mapping exercise conducted by PKSF found that a significant number of highly poor districts, particularly in the northwest, have relatively few MFIs operating and consequently a lower number of poor borrowers compared to better-off parts of Bangladesh is addressed. In recent years, some efforts have been taken to reach the households excluded from the MF interventions by offering more flexible support. It is important to note that more than 80 percent of the MF-NGOs have less than 5 branch offices and about half of them do not have any branch office at all.

In addition to internal challenges, Bangladeshi MFIs have to overcome many external challenges. A major constraint is the economic, social and natural environment in which they operate. The country is one of the poorest in the world, with the vast majority of the client base living either just above or well below the poverty line. Many regions of the country are vulnerable to regular flooding or typhoons leaving millions of households without homes and means of employment. Political instability and frequent strikes have in the past affected markets in urban and rural areas. Lack of adequate infrastructure such as roads, bridges and communications as well as the absence of backward and forward linkages have also slowed down the growth potential of the enterprises in these areas thus impacting the growth and sustainability of the microfinance institutions that finance these enterprises. In addition these internal constraints, the economy of Bangladesh relies heavily on global export markets as well as the inflow of remittances from the large numbers of migrant workers working in countries outside Bangladesh. Fluctuations in the global markets have an almost immediate impact on the economy of the country, including financial flows in the microfinance sector.

The vast majority of the Bangladeshi population remains unreached by MFIs. Out of a population of approximately 153 million of which 40 percent (approximately 61 million) lives below the poverty line and has no access to formal financial services. Currently microfinance services cover only about 17.32 million indicating a big demand and supply gap. The extent to which micro finance programs can reach this population of the extreme poor (poorest of the poor) remains an open debate. It is well understood that while the economically active poor have the will and ability to save and to repay loans, they may not be able to participate in microfinance programs as they either are screened out of groups by other members of the community who see them as high risk, or they themselves opt out of participation as they lack the confidence. Many may not have sufficient income due to lack of full or regular employment to fulfil the conditions of compulsory savings and other conditions.

The hard-core poor have to be addressed through specialized programs with separate teams trained to deal with their specific issues, concerns and needs, as they are screened out of mainstream microfinance programs by other better off members of the community or screen themselves out of these programs. Only MFIs that have the social mission to reach these underprivileged groups and design responsive mechanisms, products and services will be able to succeed. The effort of BRAC's "Hard Core Poor" initiative is a notable example.

While many MFIs have been able to expand outreach, they have not been able to increase lending to borrowers, either in terms of loan amounts or actual borrowing. Overall borrower to member ratio for the industry is 78 percent with percentages varying from organization, but some have member ratio below 40 percent. Such institutions are not really focused on microfinance intermediation, they are essentially moneylenders or transferring funds from depositors to other interventions.

Another fact is that average loan sizes in the industry have remained rather low. The average loan per borrower is $60 and the typical size of loan per borrower ranges from $46 to $80. Nine institutions out of 352 have loans per borrower below $8, which is too small a loan for investment in revenue generating activities. If loans are being used for cash flow, then these are not institutions that are contributing to economic development and income sustainability. While MFIs have made significant contribution to the reduction of total household unemployment, in most cases the income generating activities that were financed were not large enough to ensure income sustainability and remained part-time or seasonal self-employment initiatives.

The challenge of maintaining high levels of productivity and profit, while maintaining competitive rates of interest on their loan products and sufficient levels of profit to cover losses is a constant one for MFIs. Cost of funds when borrowing from commercial banks and income to cover the cost of essential infrastructure and development of an efficient and productive human resource base needed remains a concern for those institutions that are graduating from a NGO grant subsidy approach to a commercially oriented approach. Achieving the right mix of earned income, borrowed funds from commercial banks and adequate levels of deposit mobilization from members is not always feasible. Raising interest rates on loan products to clients is also not an option given the competitive environment and the potential for clients to opt for other choices. MFIs are forced to ensure high rates of efficiency and productivity, while retaining good clients and attracting new clients in a highly competitive environment.

At the sector level, outreach in both numbers and volume of loans outstanding is dominated by four very large institutions, and another dozen large and medium sized institutions. The remaining institutions are relatively small both in terms of outreach and volume. Lacking access to external sources of financing given the decline in grants and their inability to attract commercial sources of loans, limit them to internal income from the portfolio and member savings which limits their growth and outreach and impacts future sustainability and competitiveness.

The absence of innovation in savings products has deterred the financial sustainability of some MFIs. Institutions like Grameen Bank, ASA, and BURO Bangladesh that have been able to mobilize larger amounts of savings from their clients by offering both compulsory savings as well as voluntary savings products have been able to increase their income from deposits as well as attract clients for loan products.

While PKSF is a ready source of loan funds for the MFI sector, and a significant number of MFIs have availed of PKSF loans to grow their portfolios and expand both outreach and financial self-sufficiency, there are others that are not eligible for PKSF loans. Until recently PKSF did not lend to MFIs with operations in urban areas and to institutions that did not follow the Grameen type lending methodology. During this period, these MFIs were forced to rely on grants and equity, member savings, income from the portfolio, and borrowing from commercial sources at higher rates of interest. Reliance on significant volumes of commercial funding puts tremendous pressure to maintain operational efficiency and competitive interest rates.

The vast majority of MFIs have weak governance and management structures or lack the information management systems to ensure efficient and productive portfolios. Technical assistance inputs are limited to institutions that have partnerships with donors who cover their costs of training staff and who support their technology needs. Most MFIs do not have such donor partners and are not able to afford their technology and technical assistance needs.

The limited number of competent professionals in finance, accounting and banking, who also have the commitment to field based development initiatives like microfinance creates a high level of competition for management with vision and leadership ability as well as committed and efficient field staff. Larger and medium sized MFIs that are growing at a rapid pace often succeed in attracting the best staff from smaller MFIs as they are able to offer greater job security and better compensation packages.

Most MFIs also need to develop good governance by creating awareness among existing board members as well as recruiting new blood who can both balance the need to maintain focus on the original mission, but also contribute the technical competence to guide the MFI through existing and potential challenges. Governance and senior management must work together efficiently and effectively to review and modify institutional and program policies and procedures that ensure sustainable growth and development, long term financial self-sufficiency, protect the MFI against risk of exposure and fraud, and focus on the needs of clients as well as ensure social impact. There is a need to move away from subsidy and charity driven visions that do not allow clients to develop self-reliance and sustainable approaches to livelihood creation. There is a need to continue the work of maintaining credit discipline, but also protect clients and MFIs against the danger of debt mismanagement.

Bangladesh MFIs have to also contend with the fact that while the microfinance sector has evolved and matured, it remains dependent and reliant on a strong social and human development sector. Loss of income and business failure is often due to the lack of adequate social security, particularly to cover the cost of essential health care and to protect families against the expenditures related to unplanned health emergencies. The cost of quality education and appropriate vocational skill training limits the potential of the human resource base.

While the country has made tremendous growth in education and literacy rates, the lack of literacy, technical and professional skill sets, and adequate exposure to business and financial management continue to hinder the growth of a sustainable micro enterprise sector. Continued support from both government and private sector to nurture and foster micro enterprise development with the provision of suitable policies as well as technical and infrastructure inputs is essential for the sustainability of the enterprises and the sector.

Coordination at the national level to continue to influence microfinance sector policies and protect the interests of both microfinance institutions as well as the clients they serve and who contribute to the sustainability of the sector is essential. Over time, MFIs have to collaborate to protect their institutions against common threats, and ensure that there is sharing information to protect against fraud and to promote higher levels of transparency and accountability to the public.

18. Conclusion

Clients of microfinance institutions have demonstrated both through the increasing demand for new loans and repeat loan requests that there is a continued demand for microfinance services. While there is evidence of market saturation in some parts of the country, there is also evidence that there are pockets of the population that remain unbanked by microfinance institutions or are not completely served. MFIs in Bangladesh have individual experiences and the benefit of collective expertise in the sector to develop appropriate products and mechanisms to manage the high cost of delivering financial services to those who remain unbanked.

Government and central bank policies and incentives have encouraged and motivated commercial banks to refinance the MFI sector to meet the need for capital. Those who are not eligible for direct negotiation with commercial banks can benefit from the refinancing facility established by CDF that both channels commercial funding to MFIs that are not able to attract funds directly and also provides guarantor facilities through referrals. PKSF remains a reliable source of refinancing for the MFI sector, having sufficient funds to meet the refinancing needs of the sector.

The establishment of the Bangladesh Microfinance Regulatory Authority and the MRA Act will first help to consolidate the industry and continue to foster the growth and development of a sector that is sustainable and safe for the provider and the client, with a focus on transparency, accountability and sound principles of governance.

Credit for the success of the Bangladesh microfinance sector must be first given to the Bangladeshi people, the clients of microfinance providers. The credit culture, discipline, and commitment towards maintaining regular repayment and compliance with microfinance provider norms in the face of volatile economies is subject to both human and natural disasters are commendable. The character and resilience of the Bangladeshi people along with the innovation of alternative collateral to secure loans has led to the success of the Bangladesh microfinance sector, making it one of the world's greatest success stories in development interventions.

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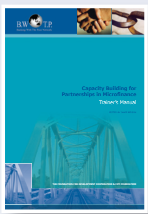

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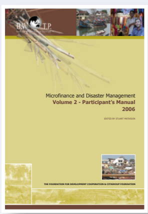

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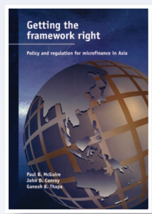

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