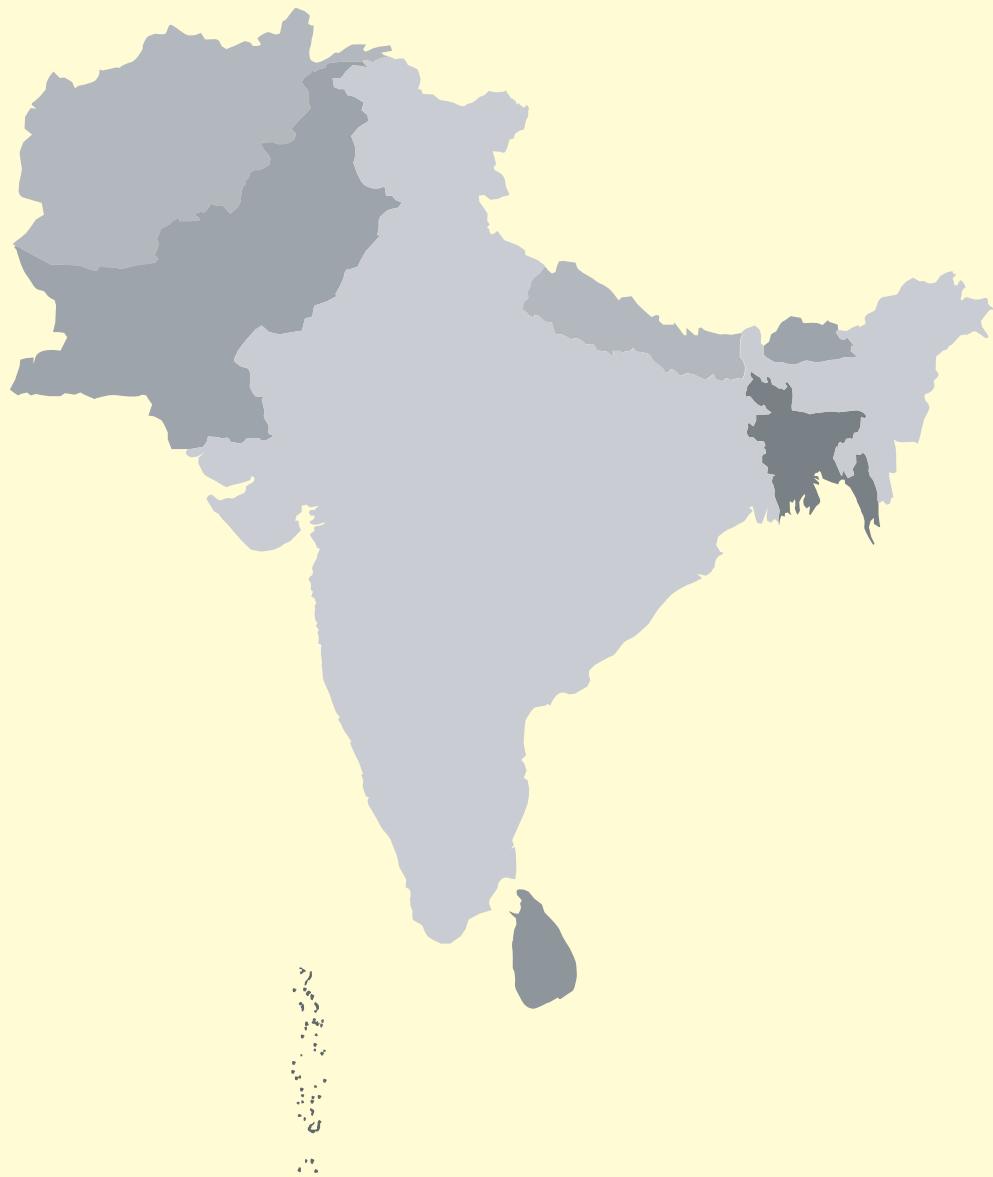


Microfinance in SAARC Countries



Microfinance in SAARC Countries

Overview Report

Acknowledgement

This overview report is mostly derived from the background State of Microfinance Reports from SAARC countries. Commissioned in 2009 by the Institute of Microfinance (InM) based in Dhaka, Bangladesh, the study was funded by UK aid, DFID under PROSPER Program. Baqui Khalily coordinated the preparation of the country reports. The country reports and their authors are as follows: Dewan A. H. Alamgir (Bangladesh), Anura Atapattu (Sri Lanka), Maliha Hamid Hussein (Afghanistan, Bhutan and Pakistan), Frances Sinha (India and Maldives) and Shankar Man Shrestha (Nepal).

Besides drawing up on the individual country reports, the overview report has also selectively used recent data and analyses wherever these were available and considered relevant for the overall purpose and framework of this report.

The overview report was prepared by Rashid Faruqee with contributions from Atonu Rabbani (Chapters 2 and 5), Kazi Iqbal (Chapter 1), Meherun Ahmed (Chapter 3), Tanweer Hasan (Chapter 4) and S. M. Rahman (Chapter 5).

S. Badruddoza, M. Alam, Faria Ahmad and N. Akhter provided competent support for preparing the report which also benefitted from the summaries from individual country reports prepared earlier under the guidance of Baqui Khalily.

The views and policy suggestions made in the overview report and country reports are those of authors' own and do not necessarily reflect the views of either InM or DFID.

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PREFACE

The idea of microfinance in its modern form is something for which South Asia can deservedly claim the intellectual property right. By developing innovative ways of reaching credit to the poor, the ‘microfinance revolution’, as it has come to be called, has seriously challenged many traditional assumptions about poverty reduction strategies on the one hand and financial markets on the other. Over the last three decades or so, the microfinance programs have rapidly increased their outreach across the South Asian countries under various institutional arrangements, ranging from the Grameen Bank model followed by NGO-MFIs to self-help organisations, savings/credit groups and co-operatives, and village banks. The varied and rich experiences gathered from these programs provide a unique opportunity for the countries of the region to share knowledge and revisit the idea of microfinance from various institutional and policy-making perspectives. This report represents a modest attempt to that end.

Microfinance represents an evolving and dynamic system that has shown its capacity to adjust to various socio-cultural settings and respond to the changing and varied needs of the poor. While this has encouraged new theorising about how microfinance works (almost all recent standard textbooks in development economics include a chapter on this subject), the practice of microfinance has itself evolved, often in unpredictable ways, outpacing the development of theory. A proper understanding of this evolution is essential both for meaningful theorising and for adopting policies that can better realize the full potential of microfinance. This is in part learning-by-doing, but also in part what can be better termed as a process of “learning-by-seeing-others-doing”. That is why, an exchange of ideas and experiences among countries is so important.

In spite of the rapid replication of microfinance programs and a proliferation of academic literature on the subject, there are many gaps in our understanding of how the microfinance market actually works. What, for example, motivate the borrowers to repay loans amidst a culture of widespread loan default by well-to-do borrowers of commercial banks? In this regard, by focusing mainly on group liability, the standard theorizing on microfinance may have missed other institutional features that may have a bearing on the success of the system: transparent transactions (as opposed to confidentiality maintained in traditional banking), close personal relationship between the lender and borrower, and the emergence of repayment norm through habit formation. In the mature microfinance systems where loan repayment norms are well established, the design of the programs can allow more flexibility to meet the varying needs of their members.

There are other issues surrounding microfinance that are often subjects of intense public debates. For example, how is the interest rate in the microfinance market determined? How can the financial viability of the microfinance programs be ensured? Should these programs be judged by their financial self-reliance and commercial viability, or by their effectiveness in helping the poor, even though by accessing subsidised funds from the government and foreign donors? A source of confusion may lie in not recognising the two separate roles of microfinance: to channel funds to the poor as an innovative banking operation, and to help poverty alleviation as part of social security or safety nets for the poor. There are

also underlying, and sometime quite overt, ideological differences arising from how these issues are addressed in competing alternative approaches to microfinance.

Can microfinance remove poverty? The additional family income generated by microfinance may be small to start with, but it often makes the difference between survival and destitution. The increased coping capacity of the borrowers at times of distress is well documented. There is also evidence that microfinance can help the poor families to break out of the poverty cycle through accumulation of physical and human capital; but there is a need to better understand these longer term impacts. This leads one to a much broader issue in the literature on economic development, namely, the linking of top-down development strategies aimed at creating opportunities for the poor with interventions for enhancing household capabilities, such as through skill training and access to credit.

In the wake of expansion and maturation of the first generation microfinance programs, a number of new issues and concerns are emerging. One set of issues relate to diversification, including micro-insurance, micro-enterprise loans to borrowers graduating from the mainstream programs, and extension of microfinance into agriculture. Other emerging issues include market saturation, overlapping credit from multiple providers with increasing competition among providers, and regulation of the microfinance sector. These second-generation issues will need to be addressed with the kind of ingenuity and creativity that have thus far driven the growth of this sector.

Lastly, let me express my sincere thanks and gratitude to the authors of this overview report and the background country reports. This project owes its success to their collective endeavour.

Dhaka
November 2010

Wahiduddin Mahmud
Chairman, Institute of Microfinance

List of Acronyms

1. ADB = Asian Development Bank
2. AFC = Agriculture Finance Corporation
3. AKRSP = Aga Khan Rural support Program
4. ALD = Agriculture Lending Department
5. APC = Association for progressive communication
6. ARMP = Afghanistan Rural Microcredit Program
7. ARTF = Afghanistan Reconstruction Trust Fund
8. ASA = Association for Social Development

9. BD = Bangladesh
10. BDFC = Bhutan Development Finance Corporation
11. BFIA = Busan Foundation for International Activities
12. BIDS = Bangladesh Institute of Development Studies
13. BMI = Berendina Microfinance Institute
14. BML = Bank of Maldives
15. BRAC = Building Resources Across Communities
[Formerly Bangladesh Rural Advancement Committee]
16. BURO-B= BURO Bangladesh

17. CBO = Community Based Organization
18. CFPR = Challenging the Frontiers of Poverty Reduction Program
19. CGAP = Consultative Group to Assist the Poor
20. CIDA = Canadian International Development Agency
21. CRB = Cooperative Rural Banks

22. EDA = EDA Rural System Pvt. Ltd.

23. FIA = Financial Intermediary Act
24. FINCA = Foundation for International Community Assistance
25. FMFB = First Micro Finance Bank
26. FSP = Financial Service for the Poorest
27. FSS = Financial Self-Sufficiency

28. GBB = Grameen Bikas Bank
29. GoI = Government of India
30. GoM = Government of Maldives

31. HDFC = Housing Developmetn Finance Corporation

32. IB = Individual Banking
33. IFC = International Finance Corporation
34. IGVGD = Income Generation for Vulnerable Group Development
35. INAFI = International Network of Alternative Financial Institution

36. MACS = Mutually Aided Cooperatives Societies

37. MF = Microfinance
 38. MFDB = Microfinance Development Bank
 39. MFI = Microfinance Institution
 40. MISFA = The Microfinancce Investment Support Facility for Afghanistan
 41. MIX = Microfinance Information Exchange
 42. MMA = Maldives Monetary Authority
 43. MoWASS= Ministry of Women Affairs and Social Security

 44. NBFC = Non-Bank Financial Company
 45. NCAER = National Council of Applied Economic Research
 46. NGO = Non Government Organization
 47. NPC = National Planning Commission

 48. OCT = Orangi Charitable Trust
 49. OSS = Operational Self Sufficiency
 50. Oxfam = Oxford Committee for Famine Relief

 51. PAR = Portfolio at Risk
 52. PKSF = Palli Karma Sahayak Foundation
 53. PMFB = Private Microfinance Bank
 54. PMN = Pakistan Microfinance Network
 55. POs = Partner Organizations
 56. PPAF = Pakistan Poverty Alleviation Fund
 57. PPP = Purchaing Power Parity

 58. RBI = Reserve Bank of India
 59. RGoB =Royal Government of Bhutan
 60. RMDC = Rural Microfinance Development Centre Limited
 61. RMA = Royal Monetary Authority
 62. ROSCA = Rotating Savings and Credit Association
 63. ROA = Return on Asset

 64. SAARC= South Asian Association for Regional Cooperation
 65. SAP = South Asia Partnership
 66. SBLP = SHG - Bank Linkage Program
 67. SEEDS = Sarvodaya Economic Enterprise Development Service
 68. SHG = Self Help Group
 69. SIDBI = Small Industries Development Bank of India
 70. SIL = Small Individual Loans

 71. TMSS = Thengamara Mahila Sabuj Shangha
 72. TUP = Targeting the Ultra Poor

 73. VSCO = Village Savings and Credit Organization

 74. WVI = World Vision International
 75. WWI = Women for Women International

Chapter 1:

Introduction and Background

This overview report is largely based on Microfinance Status Reports from eight SAARC countries commissioned by Institute of Microfinance (InM) based in Dhaka. The overall purpose of this overview report and the individual country reports is to review progress of microfinance programs in these countries, analyze lessons learned so far from the varied experiences, identify the challenges that are being faced now and are likely to become more pronounced in the future, and suggest directions for the future.

In SAARC countries, microfinance started at different points of time and pattern of evolution of these programs has not been uniform. There are some common features but some differences in models and approaches that were adopted. Modern microfinance system started in Bangladesh where it has also grown at an astonishing speed. In India, a substantial microfinance program based on self help groups has developed. Other SAARC countries started later and though most of them have now fully active microfinance programs, they vary in nature and depth of outreach. The varied experiences of these countries provide a unique opportunity to review and learn from each other experiences. This overview report attempts to do that.

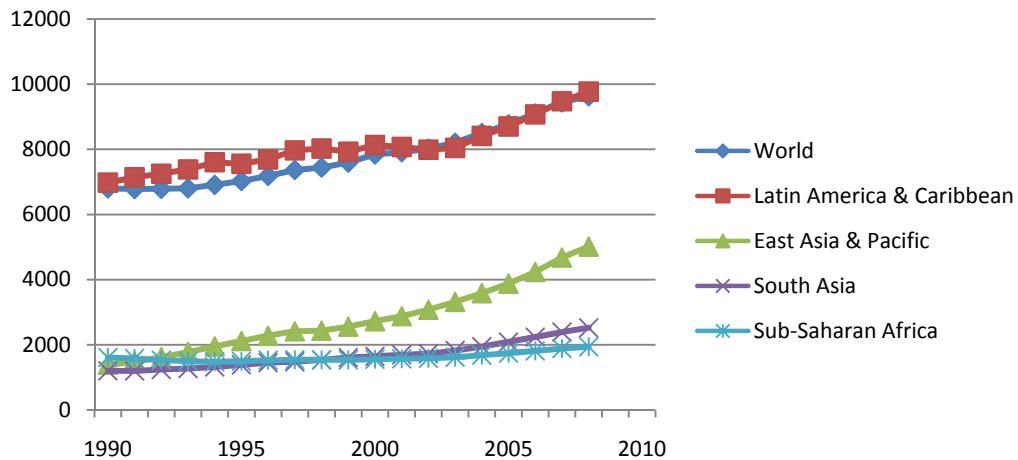
Issues of microfinance in SAARC countries cannot be studied without having adequate knowledge about the relevant countries. In order to put the role of microfinance in context, it is useful to have a picture of the macro economic situation of the SAARC countries. This chapter dwells on recent growth and inequality, extent of failure of the formal credit market to reach the poor, role of MFIs in filling the gap, and some basic outreach information of the MFI activities to set the tone for the whole report.

Growth Experiences of the Last Two Decades

South Asia is the home of 1.5 billion people which is about 20 percent of total population of the world. Yet only 2.5 percent of the world's output is produced in this region¹. Interestingly, the per capita GDP of South Asia was below Sub-Saharan Africa (SSA) in the first half of 1990 and gradually took off since 2000, leaving SSA behind (see Figure 1). While the per capita GDP of East Asia and Pacific (EAP) region was similar to South Asia in 1990, EAP maintained a steady and sharp increase over the last two decades, registering about 8.5 percent growth each year on an average. Currently per capita GDP of South Asia, adjusted for purchasing power parity (PPP), is \$2519 and the corresponding figure for low income countries is only \$1290.

¹ Besides the individual reports from SAARC countries, this chapter uses the data from *World Development Indicators* Online version, unless otherwise stated. See also Mahmud and Chowdhury (2008) for a recent comprehensive account of South Asian economic development.

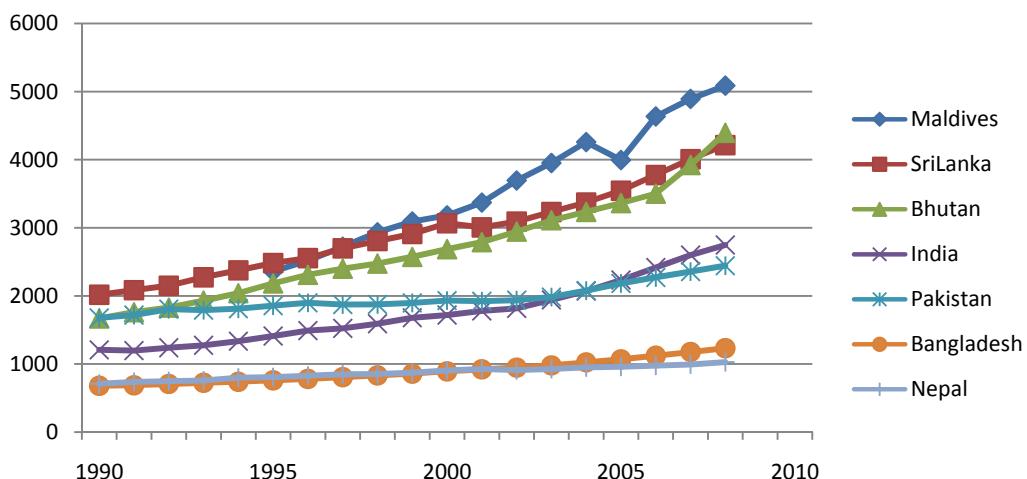
Figure 1: Regional Variation in Per Capita Income



Source: World Development Indicators, Online version.

Though South Asia has seen more than a decade of robust economic growth, the country growth experiences are not similar within the region (see Figure 2). One can readily identify three different clusters in 1990: (i) below \$1000 (Bangladesh and Nepal), (ii) between \$1000 and \$2000 (India), and (iii) around \$2000 (Bhutan, Maldives, Sri Lanka and Pakistan). Countries of the first group moved together all along during 1990-2008, with low per capita GDP growth. All the countries in the third group, except Pakistan, also moved together at a high per capita growth rate. Pakistan could not keep up the pace with other countries in the following year—countries that were in the same level in 1990. For the period 1990 to 2003, per capita GDP of this country was almost stagnant and fell below India. India, the lone country of the second group, experienced steady per capita growth, at about 6.3% each year, though GDP per capita remained well below group three and well above group one, maintained the same relative position as was in 1990.

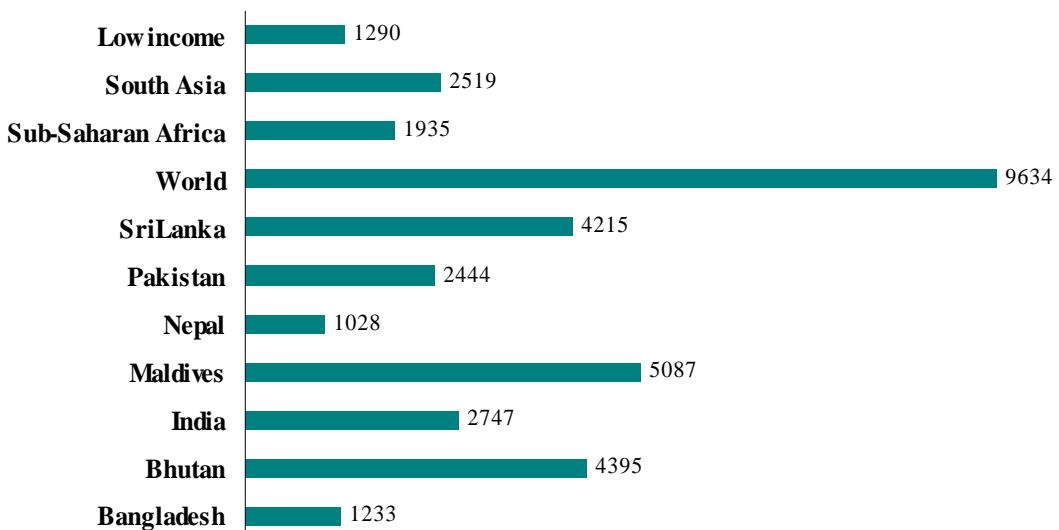
Figure 2: GDP Per Capita (PPP, Constant 2005 US \$)



Source: World Development Indicators, Online version.

The recent growth experiences of Maldives and Bhutan are particularly interesting. Maldives grew at a rate of about 8 percent per year over the last ten years and is currently a ‘middle income country’, thanks to the impressive sustained growth in manufacturing and tourism industry. Bhutan, once classified as the poorest country in the world in the year 1961, has moved well ahead of its other South Asian neighbors. The recent surge in electricity export, along with timber, cement and agricultural products have contributed to an average GDP growth of 8.5 percent over last ten years.

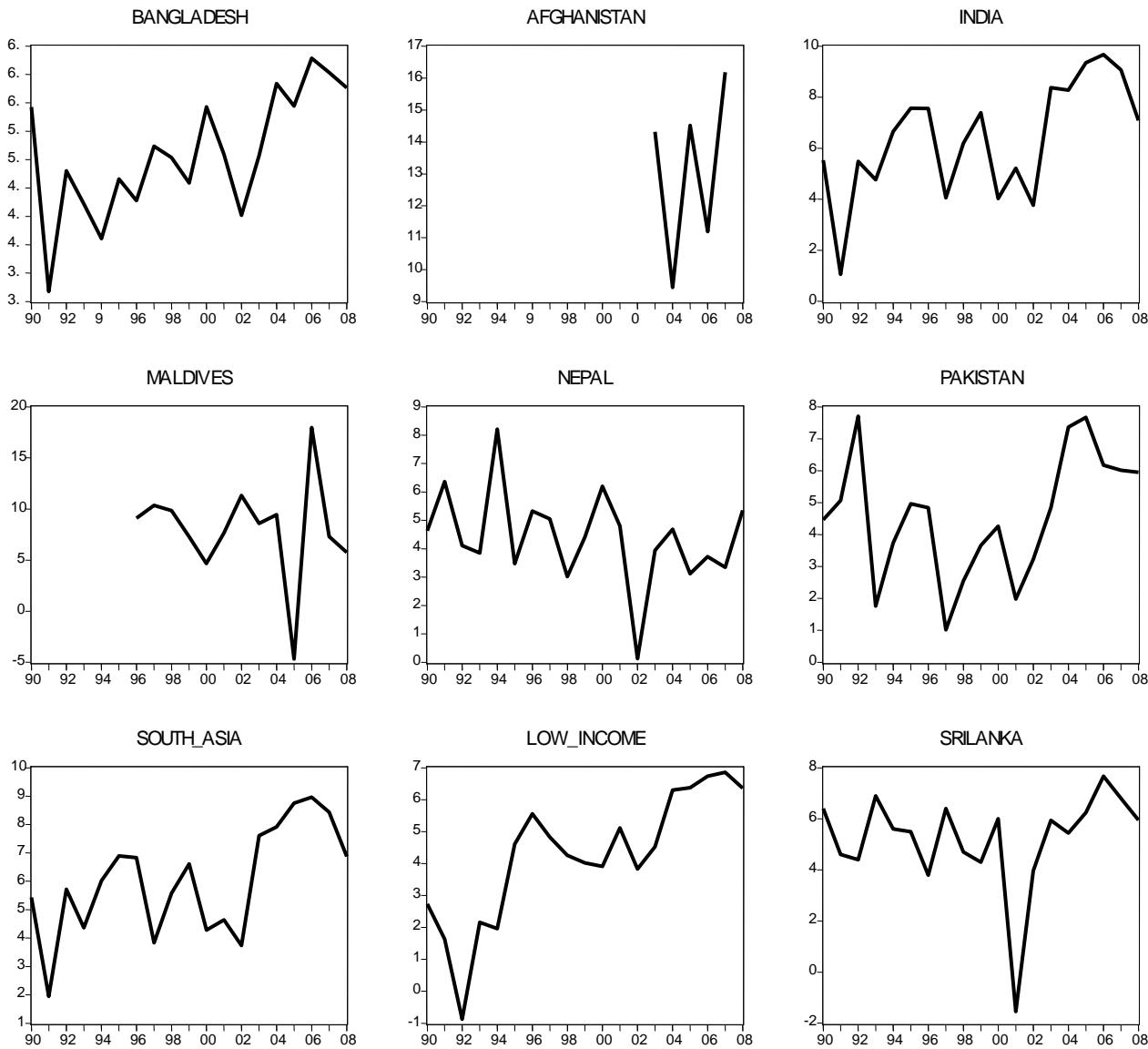
Figure 3: Per Capita GDP 2008 (PPP adjusted, US \$)



Source: World Development Indicators, Online version.

The growth experiences of the South Asian countries have not been a smooth ride without occasional jolts and hiccups. The recent global financial crisis (along with price-hikes in essential commodities) has also taken its toll on South Asian countries, especially countries which are more globally integrated through trade, finance and tourism (e.g. India). Figure 4 depicts GDP growth rate of South Asia dipped about 2 percentage points in 2006-08, with India and Maldives experiencing the biggest fall. Also, natural disaster such as Tsunami, cyclone (Sidr, Aila etc), earthquake, etc., war, political violence and terrorism have contributed to the volatility of the growth in this region.

Figure 4: GDP Growth Rates

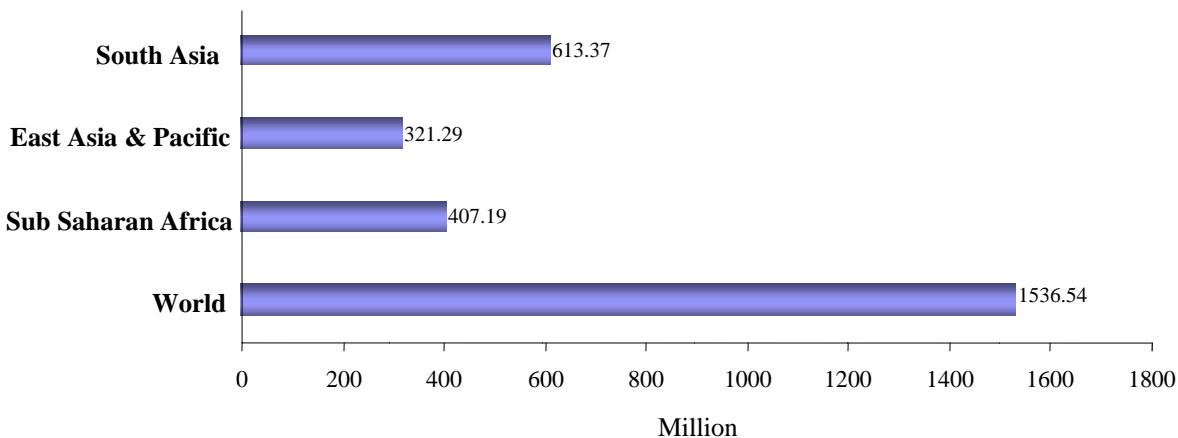


Source: World Development Indicators, Online version.

Poverty

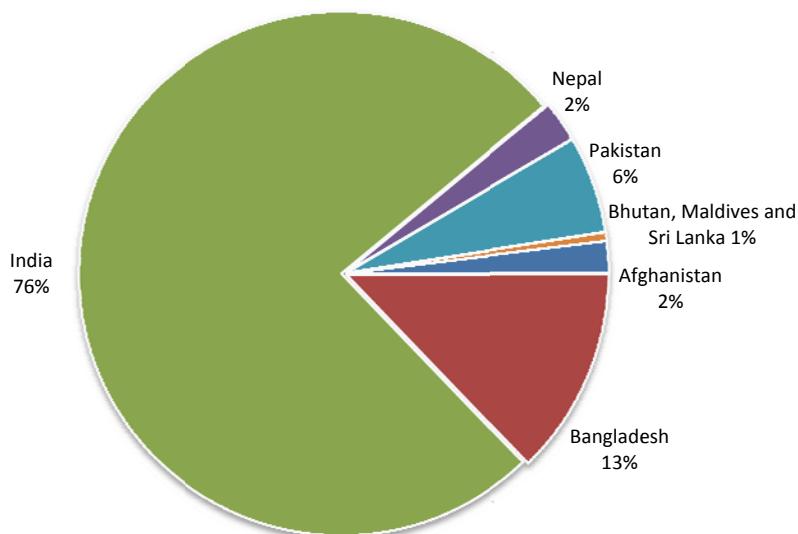
While 20 percent of total population of the world live in South Asia, more than 40 percent of the poor people of the world live in this region. There are 468 million poor people in India alone which accounts for about 75 percent of the poor of this region. Bangladesh (79 million) and Pakistan (37 million) together are the home of 19 percent of South Asian poor. Incidence of poverty is not uniform across this region. In Sri Lanka, Maldives, Bhutan and Pakistan, less than 25 percent population live below poverty line, whereas, more than 40 percent live below this line in India, Bangladesh and Afghanistan. However, it is 31% in case of Nepal. Incidence of poverty also varies across rural and urban areas as rural areas disproportionately have more poor than the urban areas (Figure 5).

Figure 5: Total Population below Poverty Line



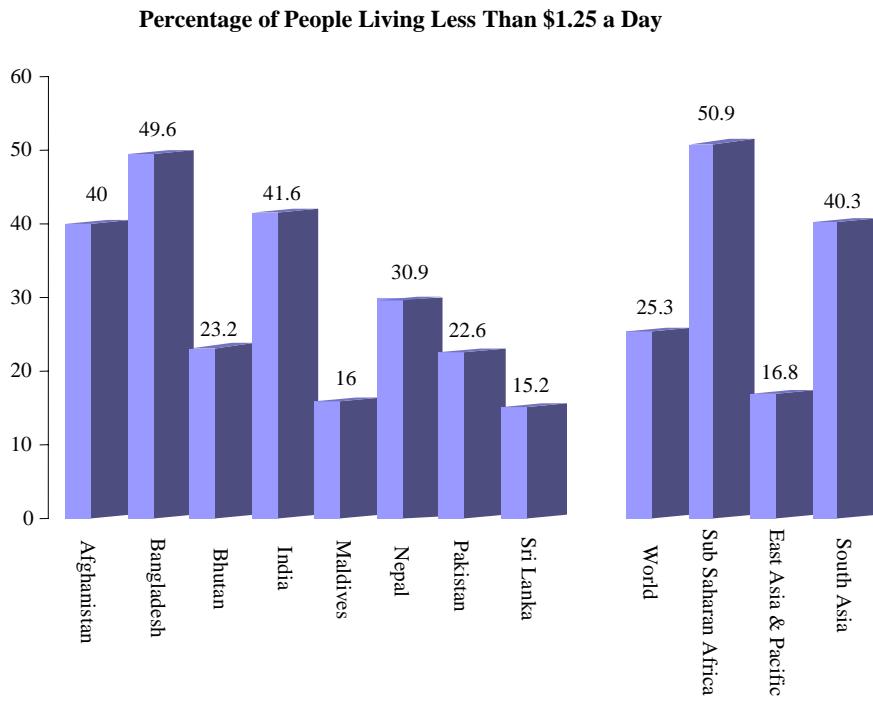
Source: World Development Indicators, Online version.

Figure 6: Distribution of Poor People by Countries of South Asia



Source: World Development Indicators, Online version.

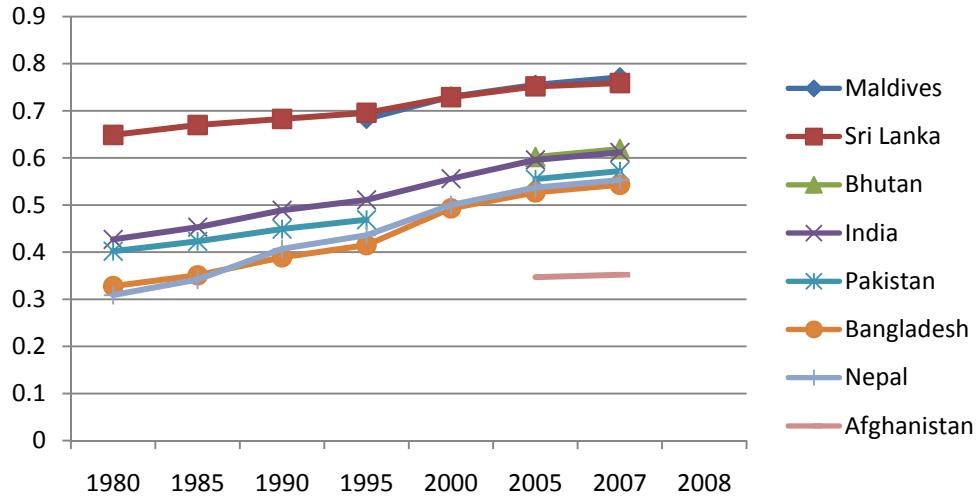
Figure 7: Percentage of Population below Poverty Line (2008)



Source: World Development Indicators, Online version.

Beyond Income: Trends in Human Development Index

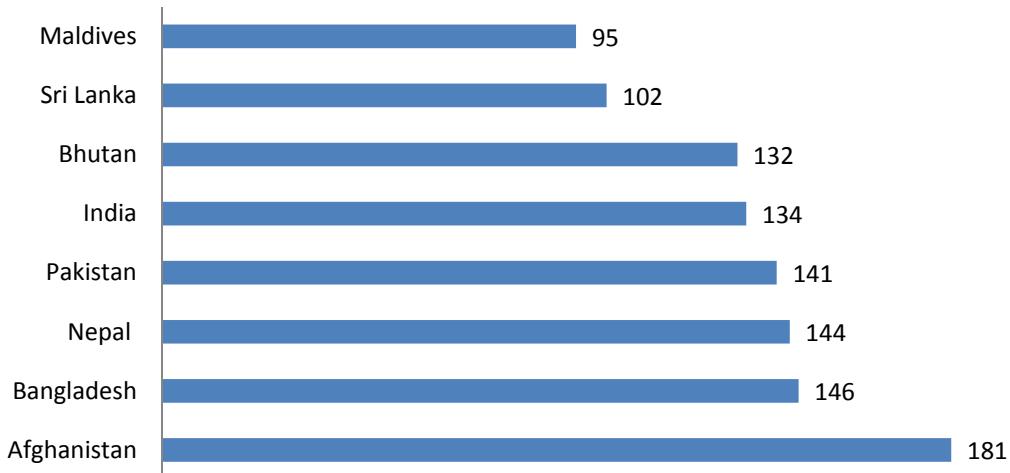
Figure 8: Trends in Human Development Index



Source: World Development Indicators, Online version.

Figure 8 depicts three distinct clusters in HDI trends. The leading group consisting of Sri Lanka and Maldives is way ahead of other major four countries - India, Pakistan, Bangladesh and Nepal. The lagging countries, however, show improvement in HDI index and are also tending to converge themselves over time. Afghanistan is alarmingly below all South Asian countries in this respect.

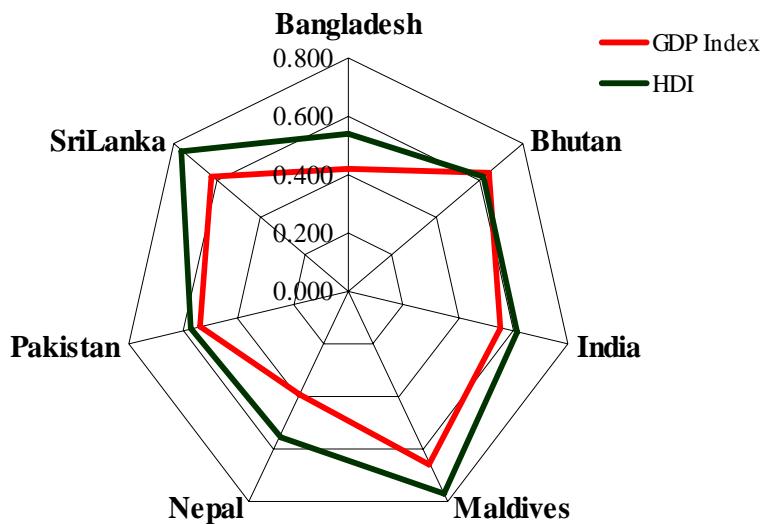
Figure 9: HDI Ranking



Source: World Development Indicators, Online version.

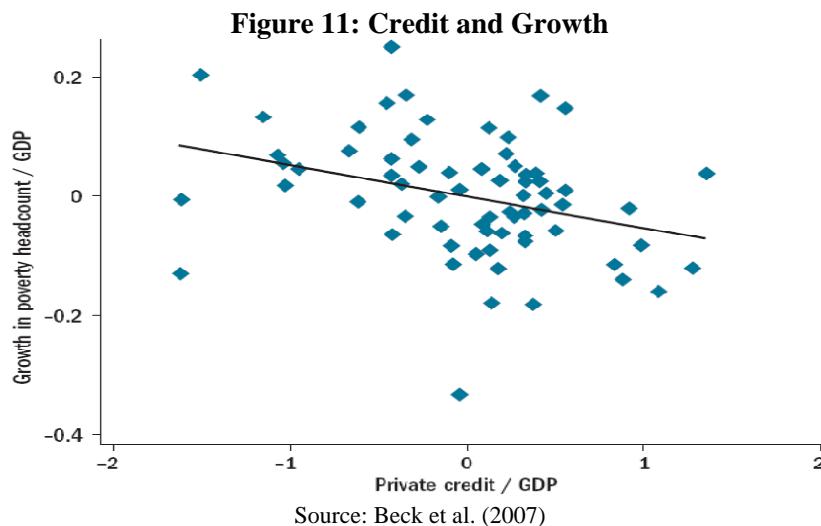
Interestingly, the relative positions of the countries remain similar in both income and non-income dimension, indicating that income growth has translated into progress in human development very strongly. This is also confirmed by the near overlapping heptagons of Figure 10. Sri Lanka has been known as an anomaly in South Asian region. Its high human and social indicators put it on a par with mid/high middle-income countries, despite its status as a low middle-income country. The only country that is ahead of Sri Lanka in South Asia is Maldives, the richest country in this region. Maldives ranked 95 whereas Sri Lanka was 102 in 2008 HDI ranking. Interestingly, despite extensive intervention of the government and NGO in social sector, Bangladesh still falls behind most of the South Asian countries, being only ahead of Afghanistan.

Figure 10: Income vs. Human Development



Source: World Development Indicators, Online version.

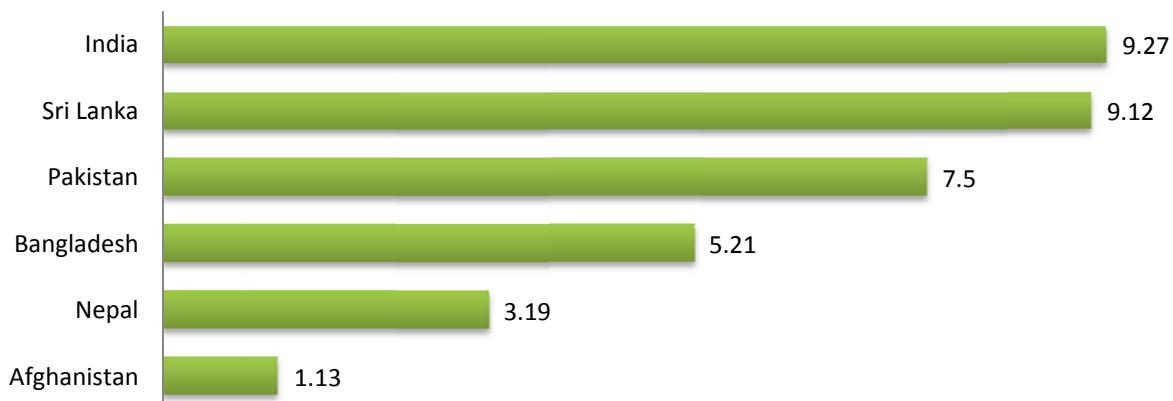
Access to Credit and Growth



Development in financial sector is expected to promote growth and reduce poverty by allowing the entrepreneur to have greater access to capital. Income of the people with greater access to credit is likely to grow faster than the people who have less access. If an unequal access to credit market exists, it creates income inequality in the society. Thus, greater outreach of the financial sector, inclusive of the poor people, is a precondition for sustained growth, poverty reduction and equitable income distribution in an economy. In the following section, we will discuss a host of country experiences regarding their early efforts in providing credit to the poor.

Banking sector has historically been the major source of capital in most of the countries in South Asia, though the role of non-bank financial institutions has been increased now-a-days. Figure 12 shows the commercial banks' branch per hundred thousand adults in six South Asian countries in year 2008. All the countries have less than 10 branches of commercial banks per hundred thousand people, India and Sri Lanka having the best figures, 9.27 and 9.12 respectively. Interestingly, the depositors save about 14 percent of their income in commercial banks in Bangladesh while this share is only 4.5 percent in India (see Table 1).

Figure 12: Commercial Banks' Penetration in South Asia



Comparable data on the expansion of commercial bank's branches in rural areas in South Asia is not readily available. But some anecdotal evidences suggest that private commercial banks' outreach is extremely limited despite increasing demand for credit in rural areas. For example, in Bangladesh private commercial banks have been increasing their presence in the rural areas, the state-owned ones account for 70 percent of total bank loans. Though the regulatory body requires banks to open one rural branch for every four urban branches, the extent of rural coverage of the banking sector is still very poor. A recent World Bank study shows that credit as a percentage of deposit has declined over time in rural areas, much faster than the urban areas. In the period, 1996-2005, agriculture loans fell from 17 percent to 10 percent of total bank lending (World Bank Report, 2006).

Table 1: Commercial Banks' Outreach in South Asia

Country	Accounts per thousand adults	Average value of account as a percentage of per capita income	Branches per hundred thousand adults
Afghanistan	3.98		1.13
Bangladesh	42.37	13.75	5.21
India	123.78	4.53	9.27
Nepal	38.27		3.19
Pakistan	47.10	8.89	7.50
Sri Lanka	487.03	1.11	9.12

Source: World Development Indicators, Online version.

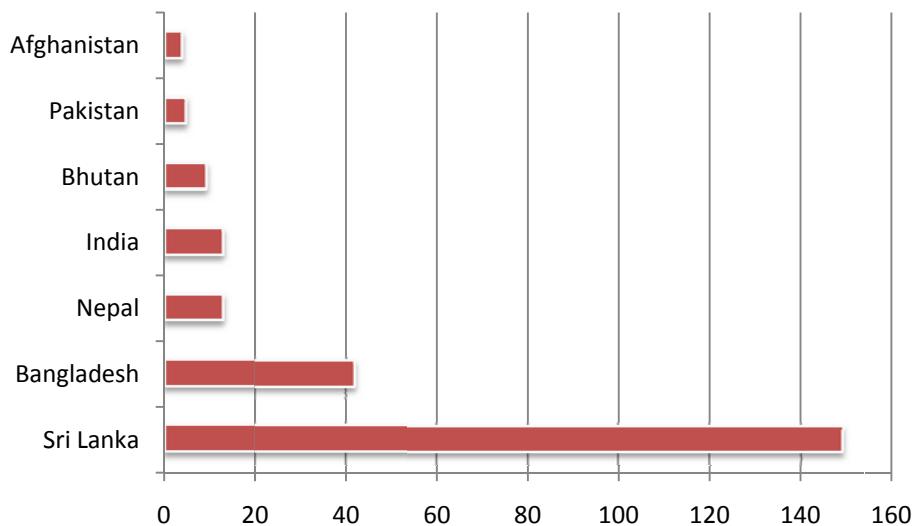
Informal Credit as a Source of Rural Finance

Even after growth of institutional loan facilities like MFIs, in many parts of South Asia, informal moneylenders still persist as source of credits at the time of need. It is difficult to quantify or assess to what extent the poor use such sources. However, it has been noted that moneylenders provide emergency loans at the time of need or large amount of agricultural loans because loans of such large scale for the purpose of agriculture may not be available from formal MFIs (see Bangladesh Country Report). As such informal credit has persisted in many parts of South Asia. There are many informal sources of credit such as family members, friends, shopkeepers and artisans (advanced sale of goods), landlords and moneylenders. The interest rates can be zero (in case of loans from a family member) to very high [as high as 10% per month] in case of borrowing from moneylenders (or so-called *mahajans*). It is difficult to get reliable statistics on informal credit market. However, it has been reported that 65% of the outstanding household debt in Pakistan was with the informal lenders in 2000 (see Pakistan Country Report). In country like Afghanistan, where formal microfinance industry is at a nascent stage and it is difficult to extend microfinance services, informal sector will probably continue to play a significant role in providing credit to mainly rural households. In other countries, informal sources will more likely to have a complementary role in provision of finance services to the poor.

Microfinance: Filling in the Gap

The failure of the commercial banking sector to reach the rural people as well as deteriorating performances of a number of early innovative experiments with cooperatives (e.g., Comilla model of Bangladesh) left a large population of this region with no access to formal credit market. In this backdrop, microfinance brought about a revolution in the credit market. The Grameen model, which started with a few members in Delduar Sub-District of Tangail, Bangladesh, has been replicated all over the world. The basic idea of substituting collateral by joint liability to overcome moral hazard and adverse selection has been the core of Grameen model. This report uses a wider definition of MFI and includes all types of credit or financial organizations that make small loans and/or provides financial services to a section of population (generally poor and mostly female) who do not have access to formal financial institutions.

Figure 13: Ratio of MFI Members to Total Poor (%)



Note: This bar chart would roughly reflect coverage of poor by broadly defined MFIs except for Sri Lanka where non-poor members feature prominently in the members of village-based cooperatives included in MFIs. Other countries in the chart have a provision of eligibility of membership, which makes the membership generally confined to poor people.

In Bangladesh about 33 million poor people (42 percent of the poor) are covered by microfinance industry.² There are 518 licensed (with Microfinance Regulatory Authority) MFIs operating their microfinance activities through more than 14 thousand branches. Interestingly, the ratio of MFI membership to total poor is about 150 percent in Sri Lanka because non poor are also eligible to get micro credit. If we take a narrow definition of MFI—membership confined to poor only—the percentage in Sri Lanka would come to about 7%. In India, Self Help Groups (SHGs), another of group lending model, dominates the conventional Grameen model³. There are about 450 million members of SHGs whereas MFI members are about 140 million. These two models of group lending cover about 13 percent of the poor in India and Nepal. In Bhutan, Pakistan and Afghanistan, the MFIs cover less than 5 percent of the

² Actual number of borrowers will be lower because of widely prevalent multiple membership.

³ Chapter 2 dwells in detail on various models of group based lending.

total poor. Maldives had 2 MFIs with 276,750 members. However, there is no data available on depth of outreach in terms of poverty levels of clients in Maldives.

The microfinance institutions in the SAARC countries have evolved over time in terms of coverage, product design, pricing and also source of finance. MFIs in these countries are now covering new regions and reaching new clients who were once left outside their programs. New and innovative variations in standard Grameen model have been introduced. New financial products (e.g., targeted customized credit products, micro-insurance, micro-leasing, remittance service, etc.) and non financial products (e.g., health, education, specialized training, advocacy, etc) have been designed. These products have also been tied up to create complex packages of credit and non-credit (e.g., tying credit with insurance), and financial and non financial (tying credit with training) products. Prices of these products have also changed significantly.

Issues of productive use of credit, multiple borrowing and indebtedness, structure of governance of the MFIs, monitoring and regulations, the tradeoff between sustainability and reaching out to the poor, etc. have again pushed microcredit to the forefront of policy debate in developing countries, especially in South Asia. This report is a fresh attempt to assess varied experiences of SAARC countries and draw lessons for the future.

The next chapter will begin with background information on the evolution of microfinance in SAARC region and then describe the current state of microfinance in SAARC region (provide description of number of MFIs, branches, members, borrowers etc.). It will describe the different models of or approach to microfinance and essentially describe how the MFIs are operating in different countries within the SAARC region, including new areas covered, innovations made, and experiments conducted.

Chapter 3 will present an analysis of the performance of microfinance institutions and impacts of these programs on households' development indicators such as income, consumption, wealth, savings, assets, education, nutrition and women empowerment. It will also analyze the state of competition among MFIs and the issue of overlapping loans that the borrowers take.

Chapter 4 will summarize the role of apex financing organizations and emerging patterns and effectiveness of the regulatory framework.

Chapter 5 will highlight key lessons learned from the varied experiences of microfinance in SAARC countries described in chapters 3 and 4. The chapter also discusses the challenges that have emerged including the question of long-term sustainability of MFIs, level of interest and fees charged, overlapping of their operations, and other issues that remain to be addressed for continued progress of programs of MFIs in this region.

The final chapter, chapter 6, will outline possible directions for policy and practice of MFIs in the future in the SAARC region.

Chapter 2:

Modalities & Outreach of Microfinance Institutions

Introduction

This chapter discusses the various models currently practiced in the different countries of South Asia. We have mostly used the country reports from SAARC countries supplemented by most current data available to show the extent to which different models of MFIs⁴ took shape in different countries of the sub-continent. While informal loans still constitute a large fraction in the total financial transactions for a typical rural household in South Asia (World Bank, 2006), MFIs have experienced an unprecedented growth in the last two decades in all South Asian countries. As the country reports suggest, the degree to which these MFIs are reaching the target population varies by country. However, this chapter will review the standard models of lending based on joint liabilities and group collateral (so called “Grameen” model) along with Self Help Groups (SHGs) linked with formal credit line and group motivated co-operatives regulated and aided by formal legal authority, which are becoming dominating models throughout South Asia and beyond.

South Asia is a special and interesting case to study outreach of MFIs for two main reasons. First, as we saw in Chapter 1, South Asia is the home to 40% of the poor people of the world poor (amounting to about 1 billion poor people living under \$2/day). Second, MFI experiments also took birth in this region. It has also been estimated that, despite impressive progress of microfinance, as of 2006, only a fraction of poor household’s financial needs were fulfilled by formal microcredit/microfinance organizations.⁵ In next couple of sections, we will outline the growth of microfinance outreach in the South Asian region, comment on loans recovered and outstanding member savings and its role as a source of funds for MFIs.

Emergence of Institutional Source for Microfinance

In almost all countries in South Asia, first institutional effort to deliver financial services to the poor was in the form of cooperative model. Government typically played important roles in encouraging this model among low-income groups while directly providing agricultural credit to the rural household. As early as late 19th century there were efforts to regulate and sanction agricultural loans to needy farmers. After emergence of nation-states in the region, similar models were followed in South Asia especially aiming to help and boost agricultural activities (ADBP in Pakistan; BKB and RAKUB in Bangladesh etc.). However, all these institutions performed very poorly as they were heavily dependent on government subsidy. There were also problems of very low loan recovery and high costs of credit delivery. Highly

⁴ In many contexts, microfinance institutes or MFIs refer to specific models of microcredit delivery and organization (generally the “Grameen” type models). In this report, these MFIs will be addressed as ‘NGO-MFIs’. These are usually stand-alone organizations (hence the prefix) that allow predominantly poor household to access financial services such as credit, savings and sometimes insurance. Because, we shall use the term MFI in a more general sense to incorporate models such as group liability models (i.e. Grameen type models), self-help groups (SHGs) linked with formal credit sources, village banks, co-operatives and savings and credit revolving models.

⁵ The figure is as high as 42% in Bangladesh to only around 4% in Afghanistan. The figure is particularly difficult to assess for Sri Lanka as borderline non-poor are included in microfinance program. See country reports.

subsidized loans were distributed to people who were politically connected and failed to reach the poor cultivators for whom the institutions were set up at the first place. All these problems faced by these credit programs were later solved by more decentralized and privately organized NGO-MFIs.

Commercial banks played a very limited role in the delivery of credit to the poor people (as noted in Chapter 1 above), especially to those who are residing in remote rural areas. There has been some exceptions to this such as Islami Bank Bangladesh Limited (IBBL)'s microcredit programs in Bangladesh among others. Commercial banks were plagued with some fundamental contract enforcement problems. The banks either could not or did not (possibly for political reason) ask for collateral from the poor clients. Adverse selection that involved giving loans to high risk clients and thus resulting in very high interest rates was another issue. Selective and intense monitoring is very costly for individual borrowers and inclusion of this cost in the operating expense results in very high interest rate even for modern MFIs.

Table 2: Different models of MFIs in South Asian Countries

	Afghanistan	Bangladesh	India	Nepal	Pakistan	Sri Lanka
NGO-MFIs	Dominant	Dominant	Emerging	Dominant	Dominant	
SHGs			Dominant			
Co-ops						Dominant

Source: Various Country Reports. NGO-MFI models are predominantly Grameen type models with focus on group-based liability and/or delivery and collection modes. In most cases, different MFIs use variations on this standard model.

The problem basically lied with the approach of lending that involved individual lending strategies and not utilizing the information that is embedded in the local communities but unavailable to the banks. The Grameen Bank approach has been so successful precisely because it targeted creditworthy poor through group formation. “Groups” play multiple roles in Grameen’s credit operation and probably have played an important role in the success of the model. Firstly, they reduce cost of targeting the appropriate people by imposing criteria to join a group. Secondly, they help the loan officers to accumulate the information about individual clients. Thirdly, they also reduce the cost of operations. Lastly, and most importantly, the Grameen model traditionally used group as a type of collateral as members of a group, who were liable for repayment of loans of other members. This peer pressure resulted in a very high repayment rate. It is worth mentioning that where SHGs are traditionally more prevalent, the “standard” Grameen model is gaining grounds in the recent time (e.g. India). But in many countries in South Asia, other variants of micro-credit operations such as village banking through revolving credit has remained dominant and likely to remain so (e.g. Sri Lanka).

Afghanistan

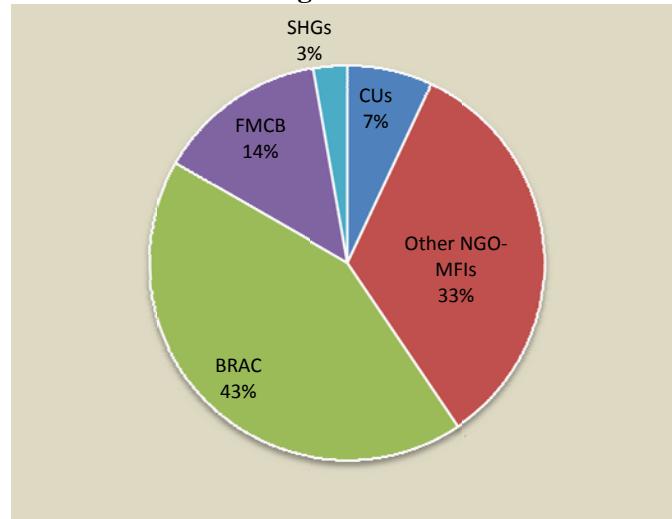
The emergence of MFIs in Afghanistan has occurred in an atypical way. As of 2001, the formal financial system was virtually non-existent because of years of war. According to World Bank estimate (cited in the Country Report) most of the economic activities in Afghanistan take place in the informal sector. There was no effective central bank, public banks were insolvent and private banks were virtually non-existent. As a result, all financial transactions in Afghanistan took place in the informal sector. Family, friends, moneylenders, traders and shopkeepers (through short-selling of commodities for cash loan, known as *Anawat* as well as commodity credit as delayed payment for purchased goods), landlords usually supply with credit which is very typical of almost all informal rural finance markets in South

Asia. Farmers (especially *Opium* growers) also use advance sales of their products for upfront cash receipt which is sometimes known as *Salaam*. MFI experiments were introduced in Afghanistan in the back-drop of this and knowledge and experience of MFIs elsewhere were imported with extension of international MFIs within the boundary of the country.

There are multiple modes of microfinance services in Afghanistan. The group lending method is the most common one. As noted earlier, group lending reduces the moral hazard through joint liability and also exploits the economies of scale through involving a group rather than an individual (see Afghanistan Country Report). The two biggest NGO-MFIs – BRAC Afghanistan (in terms of client size, it covers 43% of all borrowers in Afghanistan; see Figure 14) and First Microcredit Bank (FMCB) (in terms of loans disbursed) employ similar (group) approach for their loan product.

BRAC also employs a “holistic” approach to microcredit which involves training and investment in human capital. FMCB provides credit and savings product as well as payment and money transfer services both domestic and international in nature. Microfinance Investment Support Facility for Afghanistan (MISFA) works as an apex body for almost all MFIs in Afghanistan⁶ under the auspices of the World Bank’s Afghanistan Reconstruction Trust Fund (ARTF) which is now owned by Ministry of Finance and governed by an independent board of directors. There are also village banks, credit unions (through help from apex organization World Council of Credit Unions or WOCCU) and self-help groups (supported by Aga Khan Foundation and the Natural Resources Institution [NRIs]). As Figure 14 suggests, all these alternate models constitute a smaller part in the whole MFI landscape and these models are yet to be tested in the context of Afghanistan.

Figure 14: Market Share of Different MFIs in Afghanistan.



Source: Afghanistan Country Report. FMCB = First Microcredit Bank; SHGs = Self-Help groups; CU = Credit Union; NGO-MFIs = Non-Government Micro-Finance Institutions. BRAC implies BRAC Afghanistan. Data presented here is for 2008. The share is measured by number of active clients in different MFIs.

⁶ MISFA plays multiple roles in the development of microfinance sector in Afghanistan. It coordinates donor agencies’ effort in Afghanistan’s development projects and also provides the fledging microfinance sectors through provision of financial and technical help and monitoring. While there are some MFIs that get funding from developing partners (such as USAID) directly, the major share of the funding towards MFI sectors is channeled through MIFSA.

Bangladesh

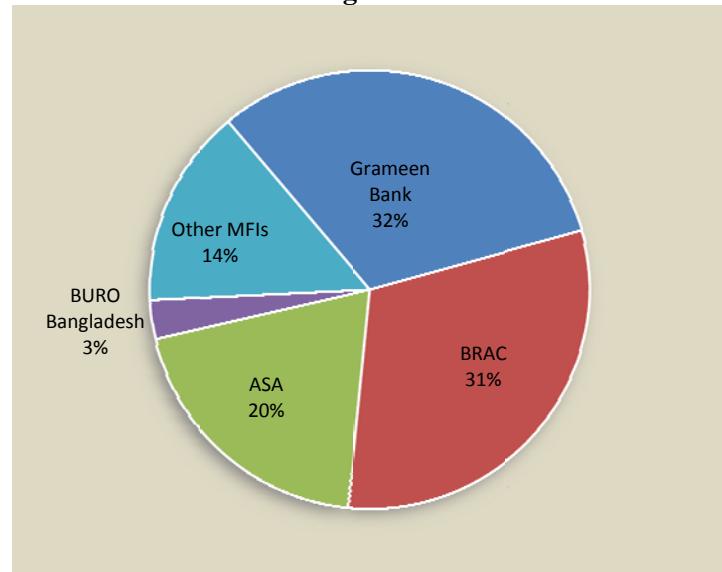
At present, the micro-finance sector (in both rural and urban sectors) is dominated by *Grameen*-type models of credit delivery often augmented by other financial (e.g. savings or insurance) and non-financial (e.g. training or knowledge gathering) services. Traditionally, informal lenders (such as friends and relatives, traders and moneylenders) had been the main source of credit to the rural population. The main purposes of these credits had been food consumption, medical, treatment, festival as well as economic purposes like procuring raw materials for making goods for the traders. While the interest rates for the loans from friends and relatives are typically zero, moneylenders (locally known as *mahajan*) usually charged monthly interest of 5-10% on average (sometimes payable in kind). These practices are still prevalent in the rural areas even after emergence of MFIs because of various reasons such as demand for large loans and temporary mismatch between demand for loans and supply of funds.

While limited in scope, commercial banks, specialized banks to support agriculture and cooperative societies provided banking services to the poor before the emergence and proliferation of NGO-MFIs as we know them today. Commercial banks had very limited role because of high cost of participation. Commercial banks usually ask for collateral which the many potential or asset deprived clients failed to provide and also had limited geographical access being mostly at the urban centers. In the 1970s, the nationalized commercial banks greatly increased their branches in the rural areas (mostly in small towns and *bazaars*) without providing any popular access to financial services. Among the private banks, only Islami Bank Bangladesh Limited had (and still has) a large retail microcredit operations.

Next set of experiments mostly revolved around supports for farmers and to enhance agricultural productivity. *Bangladesh Krishi Bank* (BKB, formerly known as Agricultural Development Bank) and *Rajshahi Krishi Unnayan Bank* (RAKUB) targeted farmers. However, these banks required land as mortgage, thus failed to reach the poor and were insolvent because of low repayment rates and inefficiency. There were also efforts to extend cooperative societies comprising of small and marginal farmers using the “Comilla Model” under the tutelage of Bangladesh Rural Development Board (BRDB), which also delivered the financial services to the poor but proved to be unsustainable.

Major breakthrough came from Grameen Bank and its now ubiquitous Grameen Model of lending through joint-liability and using group as collateral. As we see from Figure 15, the market is dominated by three large MFIs (namely, BRAC, Grameen Bank and ASA) that covered almost three-fourth of the

Figure 15: Market Share of Different MFIs in Bangladesh.



Source: MIX market data for 2009. The share is measured by number of active borrowers in different MFIs.

market in terms of borrowers. It should be noted that both BRAC and ASA differ substantially from the rudimentary Grameen Model.⁷ The rest of the market is dominated by MFIs of various sizes. Most of these MFIs received intermediate loans from *Palli Karma Sahayak Foundation* (PKSF, a semi-autonomous government body) at below market rate which they lend to both rural and urban clients. These smaller NGO/MFIs show widely diverge interest and innovation in their product designs (through introducing e.g. microinsurance, leasing practices etc.).

Bhutan

Financial deepening in Bhutan is still very low and credit, in its modern format, is typically a new phenomenon. Bhutan has modernized its monetary system through proper regulation and policy in the early 1980s and since then the provision of credit to the rural population has also received its due attention. Historically the deferred payments were carried out through barter while later cash and paper based instruments dominated “credit” markets in both urban and rural areas. Informal sector (money lenders) provided much needed credit to the population with a monthly interest rate of 3% to 5% while it could be up to 10% in the urban areas like Thimpu (the capital of Bhutan). There are also demand-side constraints such as lack of profitable ventures so the market of borrowers is very thin and the financial sector is typified by high liquidity reserve and high Capital Adequacy Ratio. Weak financial intermediation has also led to high interest rate spread.

The financial markets in Bhutan have been dominated by two banks (Bhutan National Bank and Bank of Bhutan) and two non-bank financial institutions (Bhutan Development Finance Corporation, BDFC and Royal Insurance Corporation). After beginning of the modernization phase of the financial sector through establishment of Royal Monetary Authority (RMA) in 1982, BDFC was established in 1988 to help securing much needed credit services to the rural as well as urban areas to promote investment in productive purposes. It has since then been privatized in 1991 but is still supervised by RMA.

Before the advent of BDFC, informal moneylenders and monastic body provided credit services with interest rates between 15-25% per annum.⁸ Initially (in 1981), a Grameen type experiment was carried out through a government initiation by establishing a non-governmental organization called the National Women Association of Bhutan (NWAB). Microfinance was considered as a promotional instrument to reach the objective of creating awareness and promoting social mobilization for poor women when it was launched finally in 1991. After passing the NGO Act at the national assembly, several NGOs were formed in Bhutan but their combined efforts to provide loans to the general population have not reached any significant level.

Currently, only BDFC has the mandate to provide credits for small and medium sized enterprises and agricultural credit to the borrowers – especially those living in the rural areas. Besides the loan facilities carried out by the government, unlike other countries of the region, the eligibility criteria are also different than more traditional micro-credit programs. For example, in Bhutan, there are age limits to

⁷ BRAC takes more holistic approach toward development of their clients by embedding other development interventions within the credit services while ASA focuses on individual lending with group as an operational unit for loan disbursement, monitoring and collection.

⁸ Monastic institutions had access to fund through its revenue collection. These funds were then mobilized to provide credit to certain credit-worthy individuals and families.

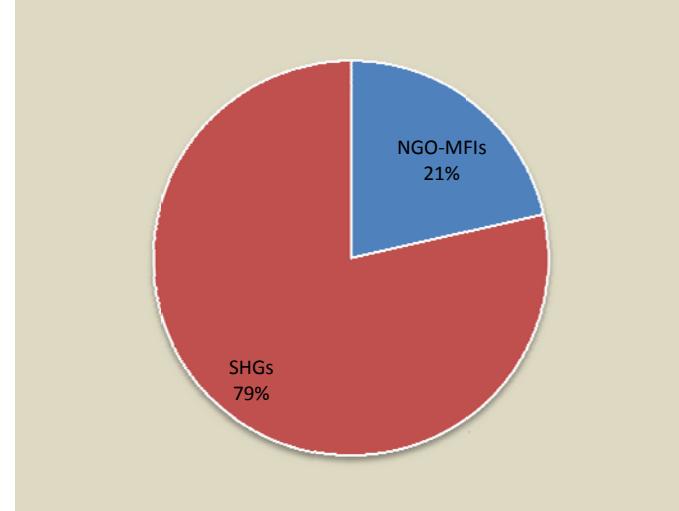
apply for credit⁹ and it is expected that the borrowers would have sufficient formal knowledge to carry out a business. While no formal collateral is required, all borrowers are required to have a guarantor or for the case of Group Guarantee Lending and Savings Scheme (GGLS), a group guarantee.

BDFC has different loan products and the delivery system also incorporates different modes including group based system and mobile banking. The decentralization efforts in the recent time have made it much easier and quicker to get a loan. The loan sizes vary. Higher loan sizes are disbursed by higher offices and the rate of interest is also increase with loan size. The average loan size is about USD 2,010 which is much higher than typical micro-credit loans in the South Asia. BDFC (under the Small Individual Loans or SIL) provide both seasonal and term loans. SIL is the main microloan products in Bhutan if consider loans below USD 2,040 as microloans. Total number of micro-loan clients (including GGLS) was 13,887 in 2010. The loan performance under GGLS is usually worse than individual loans. About 9,728 of these clients are also involved in micro-savings.

India

The MF industry in India is experiencing an on-going experiment as NGO-MFIs are gaining grounds in a country where SHGs model of cooperative groups are more common in practice. While largely organic in nature, the formation of the co-ops to provide loans of small sizes was facilitated by government policies from the very beginning. The targeting of the formal finance sector toward underprivileged population was initiated by the Cooperative Credit Societies Act of 1904 (see Country Report). The main goal of the act was to promote self-help groups and encourage savings or thrift among people in the lower income groups including farmers and artisans. This approach was later endorsed by nationalized banks in the 1960s and was reinforced by the establishment of Regional Rural Banks in 1976. However, these systems of banks were plagued with mismanagements and corruptions. Directed credit with restricted interest rate allowed allocation of funds through political connections and nepotisms. The effort largely proved to be unsuccessful and unsustainable without the support of public sector. Another attempt of poverty alleviation though provision of credit was through Integrated Rural Development Program (IRDP) which was dubbed as the largest microfinance program on earth. However, this also struggled with politically motivated lending and the repayment stood around one-fourth to one-third of the amount due from the borrowers. This discredited the viability for micro-borrowers to engage in a sustainable microfinance system with dynamic financial practice of engaging in productive economic endeavors, saving mobilization leading to self-funding and requiring minimum support from outside the system.

Figure 16: Market Share of Different MFIs in India.



Source: India Country Report. SHG = Self Help Group; NGO-MFI = Non-Government Microfinance Institute. The share is measured by number of members in different MFIs.

⁹ A female client has to be at least 16 and a male client has to be at least 18 to apply for a loan.

National Banks for Agriculture and Rural Development (NABARD) brought a seismic change to the MF landscape when it was established in 1982. NABARD acts as an intermediary between commercial banks and the SHGs through refinancing the commercial banks' loans to SHGs. This is largely done through SHG-Bank Linage Program (SBLP) initially started as a pilot project in Karnataka which is now expanded throughout the country. This approach has increased the outreach of microfinance network in India. Next set of innovations came from a number of important development organizations who relied on cooperative structure of microfinance models. The whole cooperative system was renewed with the emergence of "Mutually Aided Cooperatives Societies" or MACS. While historically lying outside the purview of state control, five Indian states have enacted MACS Acts and organizations under MACS Act have directly engaged in microfinance through SHGs of typically women members. Several hundred independent cooperative societies are now working in India along with two dozen finance companies to provide microfinance services to the poor.

At present SHGs are the most dominant models of providing financial products and services to the poor in India. As Figure 16 suggests, 79% of the total borrowers are involved in SHGs while the rest are now covered through NGO-MFI model.¹⁰ However, the later model is a more recent phenomenon (started as few pilot projects in the mid-1970s) and currently over 500 NGO-MFIs are working in all over India though there are some geographical concentration in the southern states. What NABARD did for SHGs in the early 80s, Small Industries Development Bank of India (SIDBI) did for NGO-MFIs in the late 90s. Formed in 1999, SIDBI Foundation for Micro-Credit (SFMC) promoted MFI model in India through providing financial access and credit and also helped NGO-MFIs in capacity building. The apex bodies such as NABARD, SIDBI and other organizations (e.g. *Rashtryia Mahila Kosh* [RMK]) have provided wholesale funding to the smaller SHGs and NGO-MFIs. These organizations also replaced the donor agencies as the principal source of funding and helped the MFIs to bridge the gap between public sector development finance organizations and retail borrowers (both groups and individuals) living in rural areas or urban slums.

Maldives

Maldives do not have NGO-MFIs as such and there is no particular model of MF delivery mechanism as in other countries of the region. There are some targeted credit schemes carried out by Development Banking Cell (DBC) of Bank of Maldives (the central bank of the country). The programs are targeted toward atolls that are distant from the capital and where the economic conditions are still not at par with the other parts of the country. DBC is mainly funded by UNDP and IFAD.

The ministry of Women Affairs and Social Security (MoWASS) started its own microcredit schemes in 2000 with providing loans to women to establish microenterprises and self-employment opportunity. One should note the sizes of loans in Maldives are about USD 1,175 which is quite high in comparison with loan sizes in other South Asian countries (smaller than only Bhutan). Other government ministries also started their own credit programs such as *agriculture revolving fund* (for agriculture, tailoring etc.), *credit to fisheries sector* (for boats and fish processing) and even *atoll electrification project* in the smaller islands. There are some differences among the loan disbursement procedures and credit delivery systems

¹⁰ This is probably an underestimated MFI membership because only a subset of MFIs was included in the survey. Personal communication with the authors of the country report suggests that these MFIs cover about 70% of total members with MFIs. Therefore, the actual figure may stand at about 27% of total SHG and MFI members in India.

in Maldives. Individual lending is the dominant method. However, several programs such as MoWASS's lending to women for establishing microenterprises gave credit to groups of borrowers. The interest rates also varied by characteristics of the projects for which the loan was disbursed.

Nepal

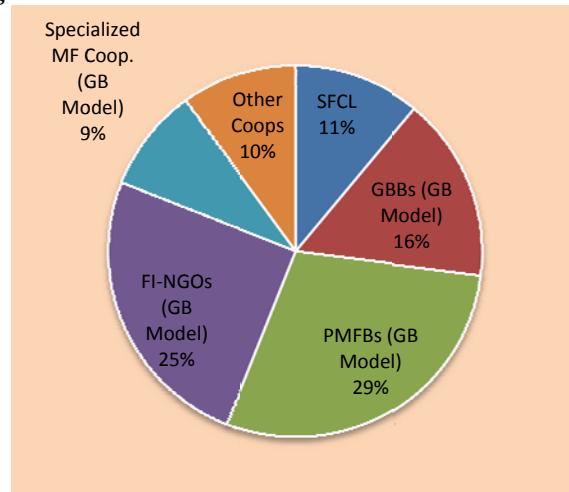
Grameen model of microfinance have been the most dominant model in Nepal (see Figure 17). In Nepal Grameen Bikas Banks (GBBs), Private Microfinance Banks (PMFBs), FI-NGOs and specialized microfinance cooperatives are following the Grameen model of microfinance. As of 2008, around 79 % of the MFI members are involved with MFIs following Grameen model. The MFIs following Grameen model are regulated by the Central Bank of Nepal, Nepal Rastra Bank (NRB) except some specialized microfinance cooperatives. Some cooperatives have also been licensed to carry out financial services to the nonmembers of the group of which most of the beneficiaries are non-poor. Savings and Credit Cooperatives (SCCs) are less regulated, often suffer from mismanagements and lack good governances. However, they provide a more flexible design and often function with a lower overhead leading to low interest rate which may be suitable for the poor people in the mountainous and hilly areas.

The Government of Nepal and *Nepal Rastra Bank* has initiated the *Grameen* model during the 1990s through establishing five regional Grameen Bikas Banks (GBBs). Two national NGOs also came up with their own brand of *Grameen* model at the same time. Such models have been mostly concentrated in the *tarai* area where communication is easier and economy is more solvent. In contrast to SFCLs, these models do not require security (the crux of *Grameen* model of financing) and use group as a guarantee for repayment. Some of the NGO-MFIs have shown innovation in savings schemes and through inclusion of microinsurance against various contingencies. Some also addresses social and other community issues to find solution that affect the member of its groups.

Most of the partner MFIs of RMDC which was established in 1998 as apex wholesale lending organization for microfinance have been following Grameen model and are successful in maintaining good portfolio quality and achieving operational self-sufficiency.

Small Farmer Cooperative Limited (SFCL) which was initiated by the Agricultural Development Bank Nepal (ADBN) also fell under the purview of cooperatives. This model also received considerable donor support from various organizations and has received considerable recognitions from abroad.¹¹ Recently, in 2001, an apex bank (*Sana Kisan Bikash Bank* or SKBBL) was established to provide wholesale loans

Figure 17: Market Share of Different MFIs in Nepal.



Source: Nepal Country Report. GBBs = Grameen Bikas Banks; PMFBs = Private Microfinance Banks; FI-NGOs = Financial Intermediary Non Government organizations; SFCL= small Farmer Cooperatives Ltd. The share is measured by number of members in different MFIs.

¹¹ SFCL model has received CGAP/IFAD Pro-poor Innovation Challenge Award in 2003.

to the affiliated SFCLs. Interestingly SFCLs require collateral security. Some of the SFCLs have grown very large and can sustain functioning even without loans from SKBBL. However, due to the collateral requirement of SFCL financing there are not pro-poor and most of their clients belong to small farmer category who can offer collateral security.

Unlike India, self help groups in Nepal are not tied with commercial banks. These groups, while largely informal in nature, play multiple roles, especially in the hill and mountainous regions of Nepal where more formal credit institutions find it hard to reach. They play more traditional role of saving mobilization for its members and provide credit to needy member of the group while at the same time involve themselves against social ill such as violence against women. These groups while organic in nature are often promoted by different agencies like UNDP and the World Bank. Like other groups, these SHGs, COs do not have legal status and are not considered microfinance institutions. Hence, their operations are not recognized as microfinance in Nepal.

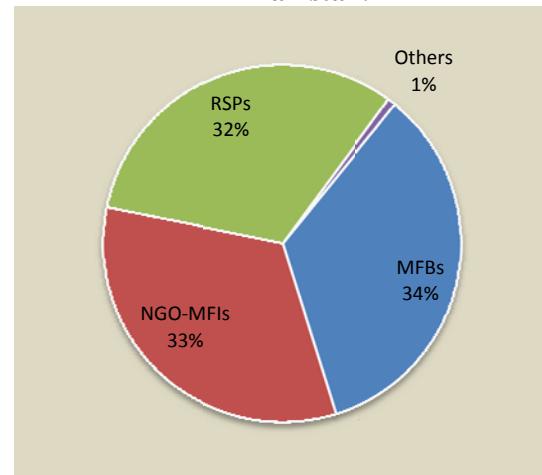
Pakistan

According to the most recent agricultural census (carried out in 2000), 65% of the credit in the rural areas of Pakistan is still under non-institutional informal credit system. As in other places, families, friends, landlords, money lenders, traders and commission agents constitute this informal sector. While it is true in most South Asian countries, if not regions around the world, microcredit and promotion of agriculture were inseparable from the public point of view in Pakistan. The early efforts of sanctioning and disbursing loans were very efficient but discontinued in the early 1990s.

Another typical effort to bring financial services to the poor was through the model of cooperatives. This was done at the federal level (through Federal Bank of Cooperatives or FBC) and also at the regional levels (through Provincial Cooperative Banks or PCBs). However, this effort was mired with uneven and/or limited coverage and poor professional and portfolio management. Weak monitoring by PCBs led to the limited scope for these organizations and also high interest rate to cover the subsidy they received from PCBs. There were also banks (such as Agriculture Development Bank of Pakistan or ADBP) targeted toward farmers providing fund at a below market rate.

There was couple of microfinance efforts which paved the way for later models based on which microfinance banking took strong hold in Pakistan. For example, Aga Khan Rural Support Program (AKRSP) experimented with both short and long term loans and developed what can be termed a “village bank” approach of mobilizing savings of the members to be managed by the same members entirely. The rural support programs which cover the one-third of all active borrowers in Pakistan are based on the rudimentary models of financing designed by AKRSP (see Figure 18).

Figure 18: Market Share of Different MFIs in Pakistan.



Source: Pakistan Country Report. RSP = Rural Support Program; MFB = Microfinance Bank; NGO/MFI = Non-Governmental Organization/ Microfinance Institution. The share is measured by number of active borrowers in different types of MFIs.

The fundamental change came when Kashf Foundation initiated the first specialized microfinance institutions facilitated by a grant from Grameen Foundation in 1996. This also pressured AKRSP to separate the microfinance operation into a separate financial unit.¹² In 2000, this was further enhanced by the government when it established the apex funding body (Pakistan Poverty Alleviation Fund, PPAF). This led to the growth of the overall microfinance sector and also helped to change the attitude toward microfinance business as the new generation of NGO-MFIs now take loans instead of grants to carry out their business, thus helping the industry to grow. The microfinance banks (MFBs) are now largely separate bodies mainly providing financial services to the poor while having only involvement beyond microfinance in socially engaging issues. Together, these NGO-MFIs and MFBs constitute about two-third of the total active borrowers in Pakistan (see Figure 18).

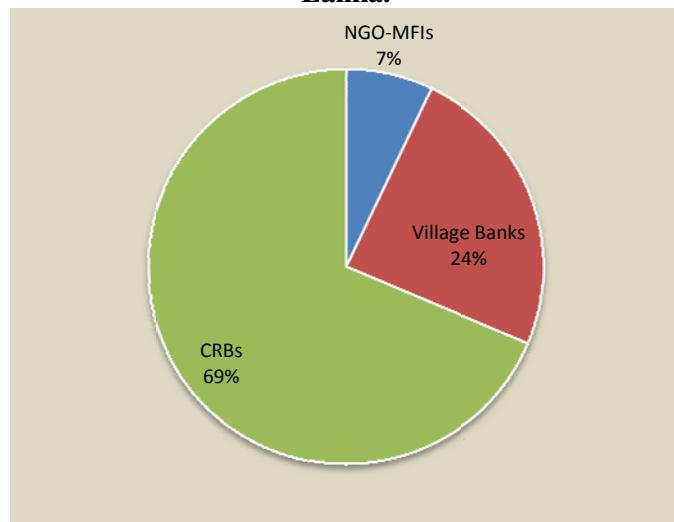
Sri Lanka

Until 1990s, the traditional credit cooperatives, community based organizations (CBOs) and village resolving funds were the most popular models of MFIs. Credit cooperatives were not very popular among rural poor until very recently. Village banks (comprising about one-fourth of total members in Sri Lanka) are community based banking organizations that usually start with savings. Initially providing small loans they gradually give bigger loans. Community members own these banks and make bylaws to govern the institutes. Usually they have holistic nature in operation and go beyond simple microcredit programs.

The typical MF models incorporate group collateral lending (the so-called *Grameen* model) and individual lending using group as a focal point of contact (dubbed ASA model because this was the approach successfully adopted by ASA, another large NGO in Bangladesh).¹³ However, MFIs following these models have so far limited coverage in Sri Lanka (only 7% of total MFI membership; see Figure 19). Another model, BRAC Sri Lanka, uses the similar model with only women participants, weekly participation by the members and explicit insist on geographic concentration by branch.

The most popular model in Sri Lanka is the credit union and cooperatives. About 70% of the total MFI clients fall into this category as participants. These are primarily member-driven, self-help financial institutions, entirely owned and conducted by the members of the institutions. Anybody can become a

Figure 19: Market Share of Different MFIs in Sri Lanka.



Source: Sri Lanka Country Report. CRB = Cooperative Rural Bank; NGO-MFI = Non Government Microfinance Institution. The share is measured by number of active borrowers in different types of MFIs.

¹² AKRSP eventually divested its microfinance subsidiary completely and founded a separate body to direct its microcredit interest through establishing First Microfinance Bank. With some exception, this independent body carries out the microfinance operations. See Pakistan Country Report.

¹³ Both these models had initiation in Bangladesh, which were replicated with some variation in Sri Lanka.

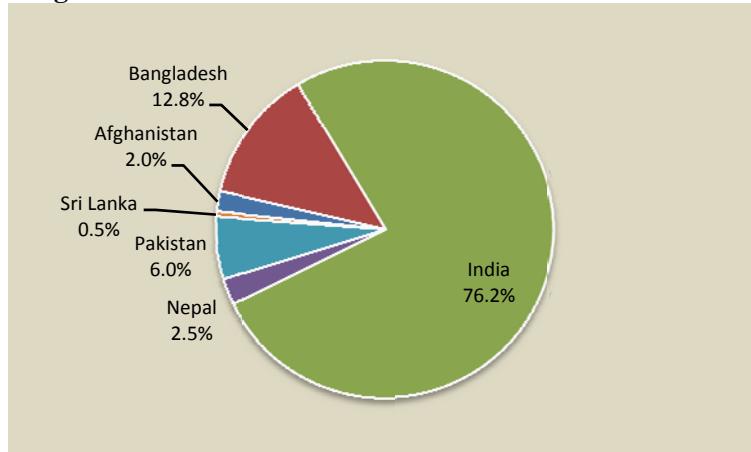
member as long as they belong to a pre-specified group. These totally member driven cooperatives or Cooperative Rural Banks are the most popular formats that are practiced in Sri Lanka. While not very popular, individual lending, Rotating Savings and Credit Associations (ROSCAs) and development banks are also prevalent to a limited degree here.

Selected Microfinance Statistics for South Asia

While Bangladesh and Sri Lanka exhibits a more mature microfinance sector (in terms of coverage), almost all countries in the South Asia experienced growth in their respective MF sector. This is even true for India where the SHG models have always been the dominant credit delivery system in terms of coverage or membership. The coverage and outreach by countries is very uneven within South Asia. For example, Bangladesh and Sri Lanka are home of 13% of poor people of the six countries included in Figure 20. However, 40% of MFI participants live in these two countries alone (see Figure 21).¹⁴

We see similar pattern while looking at the numbers of MFI branches by land area. Bangladesh and Sri Lanka have much bigger figures (110.9/thousand sq km and 22.7/thousand sq km respectively, see Table 3). Among other countries Nepal has 4.1 branches per sq km land area, most of which are concentrated in the *tarai* areas. However, both Nepal and Pakistan (which also has a smaller branch penetration) experienced high growth rates of 12% (which would effectively double these figures in every five years, see Table 3 for a growth in number of branches per thousand sq km). The MF

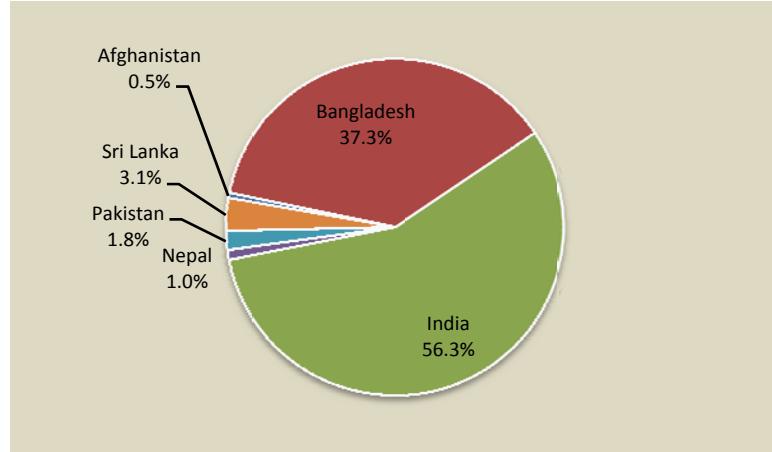
Figure 20: Distribution of Poor in South Asian Countries



Source: *World Development Indicators* online

However, 40% of MFI participants live in these two countries alone (see Figure 21).¹⁴

Figure 21: Distribution of MFI members in South Asian Countries



Source: Country Reports

¹⁴ For Pakistan, we included only numbers of active borrowers since corresponding client or membership figures were not mentioned in the country report.

experiment to eradicate poverty is a new endeavor in Afghanistan which started with the overall democratization effort there has a much smaller figure (about 0.4/thousand sq km).

Number of MFIs

The numbers of MFIs vary across different South Asian countries. It depends on many factors – the modes or delivery mechanism by which credit is disbursed to the potential clients, the degree of competition and institutional frameworks and the historical nature of the country. Some countries such as Bhutan have only experienced the microfinance phenomenon very recently and this sector is also dominated largely by the government as such the number of MFIs is very small (as a matter of fact BDFC is the only organization which has the mandate to provide small and medium sized credit; see Bhutan Country Report). Some countries show that more matured market and low barriers to entry have resulted in phenomenal growth of number of MFIs. Bangladesh probably epitomizes this situation. There are currently 518 NGO-MFIs registered with newly established Microcredit Regulatory Authority (MRA)¹⁵ and there are still many informal MFIs working in various corners of the country. These are mostly localized and small in size.

Number of NGO-MFIs (that is, MFI in the traditional sense of the word that exclude SHGs and Co-ops) can also be misleading in countries such as India and Sri Lanka, NGO-MFIs have minor share in terms of clients in these countries. In Sri Lanka, 60 local, national and international NGO-MFIs were registered with Lanka Microfinance Practitioners Association (LMFPA)¹⁶ and of which 32 delivered limited outreach data (Sri Lanka Country Report). On the hand, there are more than 7,000 village banks working in Sri Lanka in addition to 310 CRBs or multipurpose cooperative societies. Similarly, in India, there were 223 NGO-MFIs mentioned (see India Country Report). However, there were additionally 3.5 million SHGs linked with formal banking services. Counting the repeat loans to SHGs, there are probably 2.5 million distinct SHGs active in India.

The early effort of AKRSP has been complemented with the Pakistan Poverty Alleviation Fund (PPAF) which has been the main locomotive behind the microfinance industry in Pakistan. PPAF has disbursed loans through 71 partner organizations. Additionally the government of Pakistan established Khushali Bank to provide financial products to underserved population. State Bank (the central bank) also

Table 3: Number of MFI Branches by South Asian Countries.

	Number of Branches	Number of Branches per 1000 Sq Km Land Area	Average Annual Growth between 2006 and 2008 ^a
Afghanistan	283	0.43	6%
Bangladesh	14,441	110.94	5%
Nepal	590	4.13	12%
Pakistan	1,281	1.88	12%
Sri Lanka	1,465	22.67	1%

Source: Numbers of branches were collected from Country Reports. All figures are for 2008. Figures for land area were collected from *WDI Online*.

Note: total land area was instead of surface area. ^aAnnual growth rates for 2006/7 and 2007/8 were averaged using arithmetic mean.

¹⁵ See MRA website at www.mra.gov.bd. Accessed on August 18, 2010.

¹⁶ LMFPA is the network of NGO-MFIs in Sri Lanka.

encouraged more commercially oriented microfinance banks and 8 such banks are currently under operation.

Microfinance Investment Support Facility for Afghanistan (MISFA) works as the main conduit through which MFIs are funded in Afghanistan. The number of such MFIs has increased from only 3 in 2003 to 15 at the end of December 2008. MISFA's partners include 13 NGOs, one credit union and a microfinance bank. There are some smaller NGOs who have microfinance programs by getting direct financial support from international donor agencies. However, the total size of this section within the total microfinance industry is very small in Afghanistan.

Number of branches/units

MFIs as a mode of credit delivery mechanism have newly been introduced in Afghanistan and as of 2008 this delivery system has been working through only 283 branches of about 15 organizations. The geographic penetration of MFIs has also been very low with only 0.43 MFIs per thousand square kilometer. The annual growth rates between 2006 and 2008 were about 6%. Nepal also has a lower number of branches of only about 600. The branches are largely concentrated in the southern *tarai* areas (comparatively flatter regions).

Bangladesh has an astonishing number of branches of 14,441 in 2008 as such has the highest number of MFI branches in South Asia. Pakistan and Sri Lanka has similar number of branches at about 1,300 and 1,500 respectively while Sri Lanka shows higher concentration with higher number of branches per thousand square kilometer.

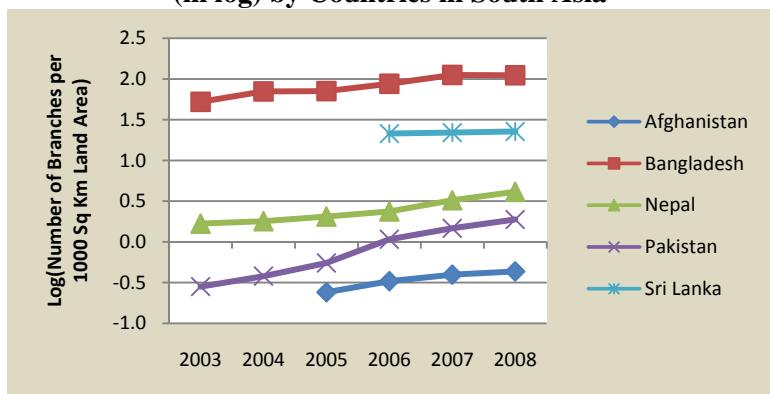
Figure 22 shows the dynamics of MFI branch penetration over time. Both Bangladesh and Sri Lanka show more matured MFI penetration rates. Not surprisingly, the growth rates for these countries exhibit lower rates compared to other South Asian countries at only 1% and 5% per annum in Sri Lanka and

Table 4: Number of Borrowers per thousand poor people by countries in South Asia and growth in 2007

	Borrowers per 1000 poor people	Growth (percentage change over 2006-2007)
Afghanistan	28.1	55.2
Bangladesh	305.9	15.1
India	33.9	18.4
Nepal	33.4	23.5
Pakistan	26.6	51.3
Sri Lanka	365.8	3.4

Source: Numbers for the borrowers are collected from individual country reports. Number of poor people for each country is estimated from total population and poverty rate. Except for Afghanistan, these figures were collected from *World Development Indicators Online* version. Data for Afghanistan were collected from *CIA World Factbook*. Poverty is measured as headcount ratio at \$1.25 a day (PPP) (% of population). Note: Percentage growth rate for India was measure over 2007-2008 because information on number of borrowers was not available for 2006.

Figure 22: Branches per Thousand Sq Km Land Area (in log) by Countries in South Asia



Source: *World Development Indicators online*

Bangladesh respectively. These rates are much lower than in countries such as Nepal and Pakistan where the annual growth rates of branches per unit area are as high as 12%. While the industry is newly introduced in Afghanistan, the growth rate is not as high as Pakistan or Nepal because of political instability and lack of economic activities in many parts of the country.

Number of members

Bangladesh, being the early adoptee of MFI in its standard format, has the biggest outreach in terms of number of members. As of 2008, there were about 33 million clients in the MFI industry as a whole (see Table 7). While this number may be a little misleading because of multiple membership to different MFIs (so called “overlapping”), microcredit industry probably caters to more than 20 million people in Bangladesh. India’s outreach probably indicates an untapped market for MFIs and it is generally observed that the microfinance sector in general is growing at a fast pace in India. For example, between 2007 and 2008, the membership has increased by 72%, according to the available statistics reported in the India Country Report. This is unprecedented and unmatched with any other South Asian country.¹⁷

Table 5: Loan Profile by South Asian Countries

	Afghanistan	Bangladesh	India	Nepal	Pakistan	Sri Lanka
2007						
Number of Borrowers (1000)	365.7	26,119.4	6,970.0	517.7	1,262.1	1,021.2
Borrower/member (%)	86.08%	83.27%	85.00%	79.66%	NA	37.81%
Total Loan Outstanding (in million 2007 Dollar)	102.93	5,554.06	1,753.87	191.74	588.86	364.77
Average Loan per borrower (in 2007 Dollar)	281.48	212.64	251.63	370.37	466.58	357.19
Average Loan per borrower as % of per capita GDP	NA	18.05%	9.68%	37.32%	19.79%	8.91%
2008						
Number of Borrowers (1000)	350.7	26,787.1	11,870.0	655.5	1,610.4	1,061.5
Borrower/member (%)	79.51%	81.13%	84.18%	77.84%	NA	38.13%
Total Loan Outstanding (in million 2007 Dollar)	106.37	6,123.26	3,639.05	245.10	726.27	367.36
Average Loan per borrower (in 2007 Dollar)	303.32	228.59	306.58	373.89	450.98	346.09
Average Loan per borrower as % of per capita GDP	NA	18.53%	11.16%	36.37%	18.45%	8.21%

Source: Country Reports. Numbers of members for Pakistan were not reported. Per capita income for Afghanistan was missing in *WDI Online* database. For better international comparison, all local currency figures were converted using Purchasing Power Parity (PPP) while correcting for inflation.

¹⁷ NGO-MFIs have mostly contributed to this growth rate in India.

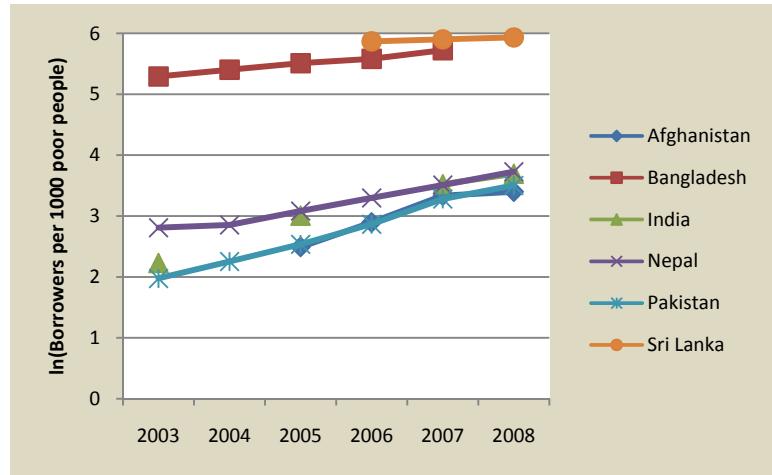
Sri Lanka perhaps reveals a more matured microcredit market with a robust membership number of 2.7 million. Both Nepal and Afghanistan have shown great potential in sizes of membership to MFIs to grow in the recent years with considerable hindrance of both geo-political and topographical natures. While microcredit organizations in Pakistan have managed to exhibit a very fast and robust growth in number of borrowers in the latter half of the decade 2010 (see Pakistan Country Report).

Number of borrowers

We also see a similar dichotomy in the intensity of penetration, if we look at the number of borrowers in different South Asian countries. Sri Lanka and Bangladesh again top the list by number of borrowers as a fraction of people living under poverty. In Sri Lanka, the ratio stood at about 366 borrowers per thousand poor people while the same figure was about 306 in Bangladesh (see Table 4).¹⁸ In other four South Asian countries, for which we have data available, the numbers of borrowers were around 30 per thousand poor people. These imply a well developed microfinance sector in Bangladesh and Sri Lanka where outreach of these programs was more extensive. Naturally, these countries also experienced the lowest growth rates in number of borrowers (3.4 and 15.1 percent respectively in Sri Lanka and Bangladesh). Both Afghanistan and Pakistan experienced the highest growth figures, well above 50% between 2006 and 2007 (see Table 4). India had only a modest growth in NGO-MFI borrowers (possibly because of having a tradition of self-help group models). While an annual growth rate of 24 percent is impressive by any standard, Nepal probably faces the geographic constraint of under reached mountain regions.

These findings are nicely complemented by the trend in penetration of MFI borrowings among poor people over time. Sri Lanka, while having a high penetration rate, shows the least growth rate over 2006-2007 periods at only 3.4% per annum. Similarly, Bangladesh has the next lowest growth rate at 15% which is still impressive given the more matured nature of the overall industry. Afghanistan and Pakistan have embarked on a high growth path of borrowers' penetration (more than 50% annual growth rates between 2006 and 2007). India and Nepal exhibited modest growth rates (about 20%) during this time.

Figure 23: Borrowers per Thousand Poor People by Countries in South Asia



Source: Numbers for the borrowers are collected from individual country reports. Number of poor people for each country is estimated from total population and poverty rate. Except for Afghanistan, these figures were collected from *World Development Indicators Online* version. Data for Afghanistan were collected from *CIA World Factbook*. Poverty is measured as headcount ratio at \$1.25 a day (PPP) (% of population).

¹⁸ In Sri Lanka, CRBs and other MFIs sometimes target households who are above the poverty line. Even in Bangladesh the microenterprise loans are also provided in larger quantities.

Loans recovered

High recovery rates and proper loan management is probably the heart of MFIs' success all over the world and particularly important in South Asia, being the breeding ground for modern microfinance revolution. Table 6 depicts overdue loans as percent of total loan outstanding. While it is possible to make comments on dynamics of overdue loans over time for a country, it is difficult to compare the figures across countries for the lack of consistent measures of loans overdue (for example, some countries reported portfolio-at-risk (PAR) more than 30-days while other countries consider loans overdue only if more than 60-days (e.g. India).

Table 6: Portfolio-at-Risk in South Asian Countries

	Afghanistan	Bangladesh	India	Nepal	Pakistan
2003	---	---	12.2	6.4	13.0
2004	---	3.6	---	7.4	9.3
2005	---	6.3	4.7	4.6	3.3
2006	1.2	1.9	---	5.0	2.3
2007	3.5	1.6	6.4	5.4	3.1
2008	10.5	1.5	2.9	4.1	1.7

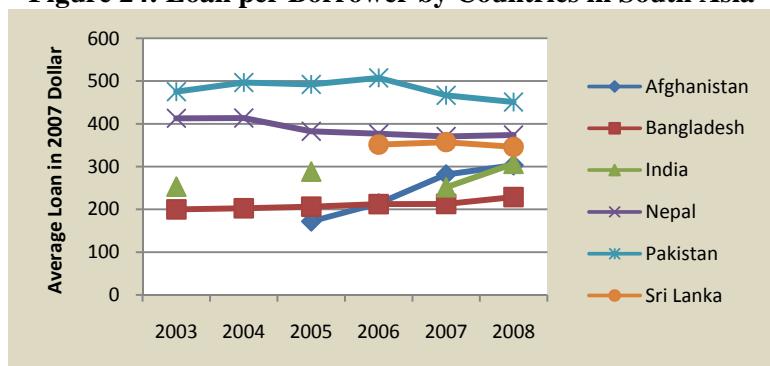
Note: The following metrics were used to measure portfolio-at-risk for different countries. Afghanistan: % Total loans > 30 days; Bangladesh: % Overdue - Outstanding loan ratios; India: % Portfolio at risk (>60 days), for 2008 the PAR is presented by PAR>30 days; Nepal: % loan overdue; Pakistan: % Portfolio at Risk > 30 days.

Loan outstanding

As we have seen, among all South Asian countries Bangladesh leads in number of borrowers. So it is not surprising that total amount of loan outstanding is also the highest in Bangladesh with almost 6 billion dollar (as measured in 2007 PPP¹⁹ values, see Table 7).

One can also see that 81% of the members borrowed money from NGO-MFIs. While the outreach in terms of coverage among people under poverty is the highest in Sri Lanka, fraction of members taking loans is quite low (38%) in the country. This can perhaps be explained by the particular types of institutions through which the credit is disbursed to the members of the organizations. Average loan size is also larger than that of Bangladesh.

Figure 24: Loan per Borrower by Countries in South Asia



Source: Total loan outstanding and number of borrowers were collected from country reports of Afghanistan, Bangladesh, India, Nepal, Pakistan and Sri Lanka. Except for Afghanistan, all loan outstanding figures were reported in local currencies. These nominal values were inflation adjusted using GDP deflator and then converted to US dollar using PPP for 2007. Loan figures for Afghanistan were reported in US dollar. GDP deflators and PPP figures were collected from WDI online database published by the World Bank.

¹⁹ Purchasing Power Parity.

Pakistan has the highest loan outstanding per borrower with \$451 in 2007 PPP dollar. Total loan outstanding in Pakistan was about 726 million dollar in 2007. Nepal has the second highest loan per borrower with 374 in 2007 PPP dollar with 78% of the members taking loans. This shows a much higher use of loans at both margins of members (bigger loan size) and institutions (higher percent of members taking loans). India and Afghanistan also show reasonably high level of active membership (i.e. members taking microfinance loans).

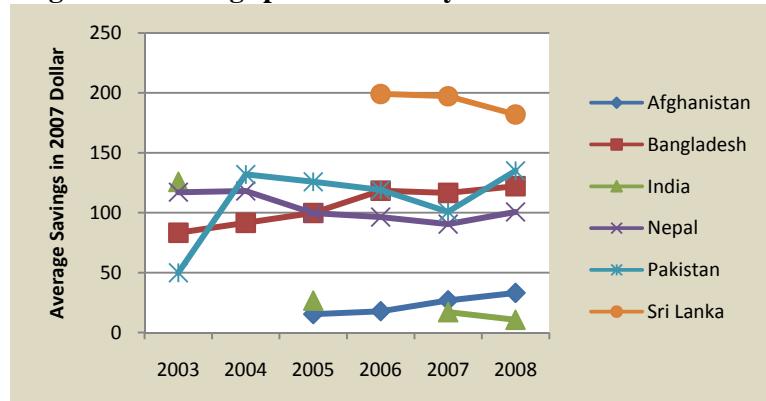
It is also useful to look at the average size of outstanding loan as a fraction of per capita income of the country to gain insight into the market of microcredit. Nepal has relatively large loan size as the average loan is about 36% of the country's per capita income (both measured in the same units). Bangladesh and Pakistan both have very similar loan size relative to average country income at about 18%. India and Sri Lanka have much lower relative loan sizes at 11% and 8% respectively. It is possible to look at the changes in the sizes of average loan outstanding over time and for countries like Bangladesh and Sri Lanka, the trends are somewhat flat. The dramatic increase in the loan sizes can be detected for the cases of Afghanistan and India. Pakistan has actually experienced decline in the average loan outstanding as programs in this country have extended to new borrowers.

Member savings

While it was easy to get information on total membership numbers for each country in South Asia it was more difficult to get information on total numbers of savers (see Table 7). However, available data also shows a wide divergence in saving behavior for the countries for which data is available. We found that for Indian NGO-MFIs, only 32% of their clients actually saved. This is very different from the more established SHGs in India suggesting specialization in financial products among different types of organizations. This also suggested relatively recent emergence of NGO-

MFIs in India as a credit delivery system based on standard model. The fraction actually fell from 32% in 2007 to 20% in 2008. This was caused by influx of members to emerging MFI sectors as the total number of savers actually went up in absolute amount (by about 200 thousand, see Figure 25).²⁰

Figure 25: Savings per Member by Countries in South Asia



Source: Total savings and number of members were collected from country reports of Afghanistan, Bangladesh, India, Nepal, Pakistan and Sri Lanka. Except for Afghanistan, all savings figures were reported in local currencies. These nominal values were inflation adjusted using GDP deflator and then converted to US dollar using PPP for 2007. Saving figures for Afghanistan were reported in US dollar. For Pakistan, numbers of active borrowers were used instead of number of borrowers because corresponding member figures were not reported. GDP deflators and PPP figures were collected from WDI online database published by the World Bank.

²⁰ The figure for Pakistan is not directly comparable to India since we only had active borrower number. The ratio of 116% suggests that emphasis on savings among the Pakistani MFIs (see Chapter 2).

In terms of total savings mobilized, Bangladesh leads among all South Asian countries with \$4 billion dollar followed by Sri Lanka with about 500 million dollar (see Table 7). The emphasis of savings has received attention in Bangladesh lately and it is somewhat evident in an upward trend in average member savings (see Figure 24). Sri Lanka, on the other hand has the highest savings mobilized by the NGO-MFI members (\$182 per member as of 2008) again highlighting prevalence of CRBs in the country. Bangladesh, Nepal and Pakistan has similar savings per member figures (however, it is likely that Pakistan's figure is a little overestimated as we used number of active borrowers rather than total membership or clients). Bangladesh and Sri Lanka also exhibited high ratios of average member savings to average loan outstanding (52-53%, see Table 7) suggesting higher amount of savings can be mobilized through own member savings.²¹

Table 7: Savings Profile by South Asian Countries

Country	Afghanistan	Bangladesh	India	Nepal	Pakistan	Sri Lanka
2007						
Total Members (1000)	424.80	31,367.01	8,200.00	649.93	1,262.08	2,700.65
Total Number of Savers (1000)	---	---	2,620.00	649.93	1,460.03	---
Savers/members	---	---	32.0%	100%	115.7%	---
Total Savings (in million 2007 dollar)	11.42	3,654.79	139.06	58.78	127.16	532.87
Average Savings per Member (in 2007 dollar)	26.88	116.52	16.96	90.44	100.75	197.31
Average Savings per member as % of per capita GDP	---	9.9%	0.7%	9.1%	4.3%	4.9%
Average Savings per member as % of Average Loan per Borrower	9.5%	54.8%	6.7%	24.4%	21.6%	55.2%
2008						
Total Members (1000)	441.09	33,018.93	14,100.00	842.21	1,610.41	2,783.53
Total Number of Savers (1000)	---	---	2,790.00	842.21	1,952.83	---
Savers/members	---	---	19.8%	100%	121.3%	---
Total Savings (in million 2007 dollar)	14.60	4,032.76	148.76	84.76	217.47	506.69
Average Savings per Member (in 2007 dollar)	33.11	122.13	10.55	100.64	135.04	182.03
Average Savings per member as % of per capita GDP	---	9.9%	0.4%	9.8%	5.5%	4.3%
Average Savings per member as % of Average Loan per Borrower	10.9%	53.4%	3.4%	26.9%	29.9%	52.6%

Source: Country Reports. Numbers of members for Pakistan were not reported. Per capita income for Afghanistan was missing in *WDI Online* database.

²¹ These average figures mask the wide heterogeneity in the individual firm's ability to finance their loans through mobilizing member savings. For example, Grameen Bank of Bangladesh, one of the largest MFIs in the country and forerunner of the MFI movement, had a total member savings of 64.1 billion Taka, suggesting a 1.4 Taka for each Taka loan outstanding in 2008 (see Bangladesh Country Report).

Concluding Remarks

Modalities of delivery and extent of outreach by MFIs vary a great deal across SAARC countries. Historically the households in the rural settings have been involved in borrowing in small amounts from relatives and friends and also from moneylenders. These informal sources of funding constituted the bulk of rural financing until very recent time despite (for the case of moneylenders) having very high cost of borrowing. With the advent of more formal sources of small borrowing (i.e. microcredit/microfinance) these changed fundamentally. One should also note the limited scope of commercial banks (of both private and public in nature) getting engaged in such financing practice. However, one can see more engagement of these institutions in the recent time in both rural and urban microfinance sectors.

The types of institution to deliver services include Grameen model, self-help group, cooperative programs, mixed models and rural support programs. Typically self-help groups through savings mobilization and later co-operative models were practiced in the sub-continent. SHGs are still dominant in India (having the bigger coverage) while co-operative models is the most important model of financial resource mobilization in countries like Sri Lanka where such programs, provide financial services to individual clients organized into credit and savings cooperation.

Grameen is the dominant methodology in Bangladesh and Nepal where nearly all the NGOs use delivery system similar to Grameen model. However, over time Grameen model itself has changed and many others in NGO-MFI system has changed along with it. Self-help groups are the dominant modality of delivery in India. Financial assistance from MFIs or Banks often supplements the resources for SHG and this model has the potential of accessing commercial sources for MFIs. Some models used for delivery seen to have combined the features of Grameen and SHG. Rural support program is another experiment mostly carried out successfully in Pakistan. The focus of rural support program is to organize the villages. The varied modalities and approaches by MFIs in the SAARC countries show various possibilities of growth and expansion of the programs.

While widely variant in terms of modes of operation and credit delivery system, joint liability models (ala Grameen and its variations and also, BRAC type models) in Bangladesh and cooperative type models in Sri Lanka have been very successful in mobilizing people to access credit and financing tools (e.g. savings). Other countries are yet to show this level of outreach. In India, the MFI models are gaining grounds in the southern parts (where the microfinance activities have been high historically) and currently in the northern states such as Bihar. The record on growth of MFI members, overdue loans, savings vary across the SAARC countries. For example, the record on savings by members shows that Bangladesh and Sri Lanka are ahead of others—the average savings per member as percentage of average loan per borrower show these exceed 50%. These two countries show that member savings could be a significant source of funding for MFIs in future. The experiences with MF sectors varied across countries (e.g. portfolio management and quality) and they had very different impacts on poor peoples' lives. We turn to these questions in the next chapter.

Chapter 3:

Performance and Impact of Microfinance Institutions

The previous chapter has outlined how microfinance has emerged as an effective and flexible instrument for providing a wide range of financial services including loans, deposits and payment services, insurance, to the segment of the poor population who are economically active but financially constrained and least likely to be served by the formal credit market. Some MFIs also combine their credit programs with other programs such as health, education, savings, technical training, etc.

This chapter will examine the performance of the MFIs using the indicators such as sources of fund, financial management and viability, operational efficiency and outreach levels. Later, the chapter examines the overall impact of MFI programs in the South Asian countries.

Performance of MFIs in SAARC Countries

MIX market data²² has been used to compare the performances of 6 South Asian countries, Afghanistan, Bangladesh, India, Nepal, Pakistan and Sri Lanka on six key indicators of financial viability, namely, cost per borrower, borrowers per staff, operational self-sufficiency, Portfolio at Risk (PAR) for 30 days, profit margin and return on assets over the period of 2002 to 2008. Data from Maldives and Bhutan were not available.

The cost per borrower graph indicates that Pakistan has a higher cost per each borrower. Other countries, particularly India, Bangladesh and Nepal have very similar numbers and trend over time. Staff productivity as measured by borrowers per staff is more or less equal in these countries except for Afghanistan where staff productivity is quite low. Pakistan and Afghanistan show greater volatility in terms of profit margin over the years and both these countries register sharp decline in return on assets in 2008. It is no surprise that Afghanistan is also struggling to achieve operational self-sufficiency. India is doing relatively well in recent time. Sri Lanka is showing a steep upward trend in 2008 both in Operational Self Sufficiency (OSS) and Portfolio at Risk (PAR). Performances of each of the countries are discussed in details below with particular focuses to the models of operation, foreign donation dependence and staff efficiency.

²² Microfinance Information Exchange (MIX) Market is a global, web-based, microfinance information platform. It provides information to sector actors and the public at large on microfinance institutions (MFIs) worldwide, public and private funds that invest in microfinance, MFI networks, raters/external evaluators, advisory firms, and governmental and regulatory agencies. MIX Market seeks to develop a transparent information market to link MFIs worldwide with Investors and Donors and promote greater investment and information flows. MIX Market currently provides data on over 1800 MFIs, over 100 investors and almost 200 partners.

Figure 26: Comparison of Financial Viability of MFIs in Six South Asian Countries

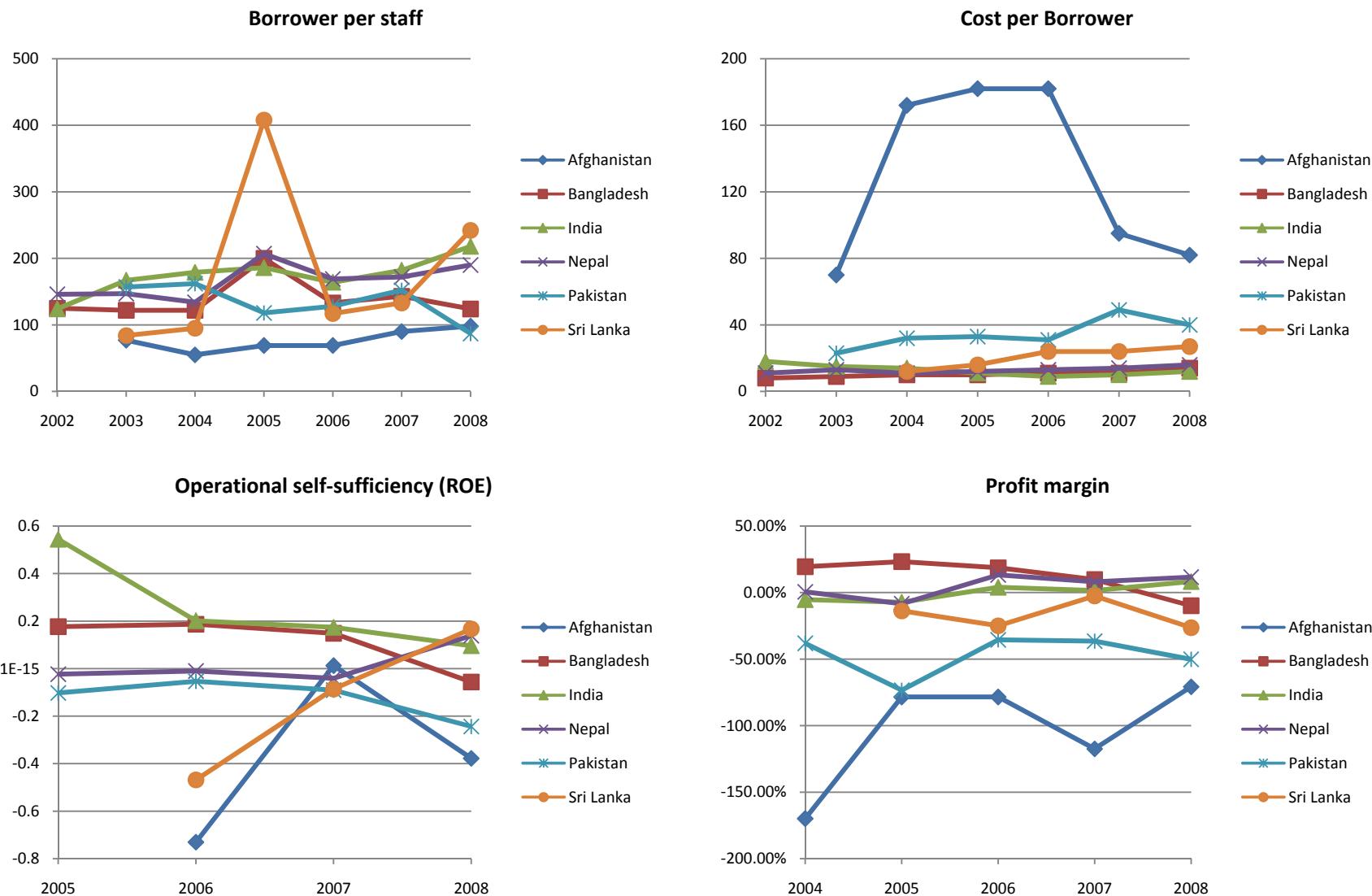
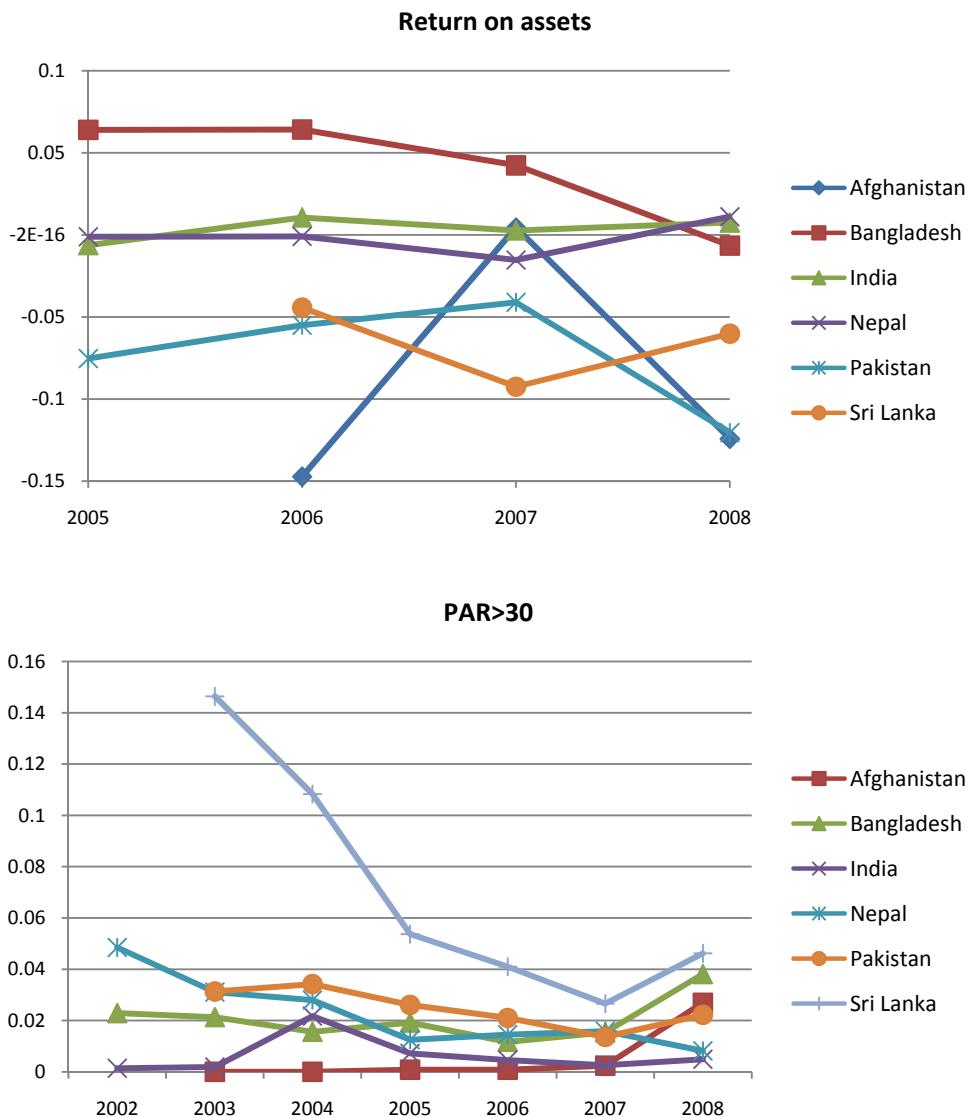


Figure 26: Comparison of Financial Viability of MFIs in Six South Asian Countries (Cont.)



Bangladesh

Consistent increase in average loan size, steady growth of borrowers contributed to increased income leading to financial viability of many MFIs in the recent history of MFI operations in Bangladesh. The growth in membership has been rather sharp, up to 25% for some MFIs since early 1990s. Membership of PKSF, the apex body, has also rose steeply enabling the partner organizations to vertically and horizontally expand their portfolio with increased fund availability from the apex institute. This trend is particularly stronger for smaller MFIs. Most of the smaller MFIs were financially self-sufficient as they could fully cover their operating and financial expenses. Subsidized capital from PKSF, low staff salary, staff efficiency, high loan recovery rate and overall economies of scale contributed to their satisfactory FSS and OSS.

Overtime staff productivity, as measured by members per credit staff, borrowers per credit staff has declined for most of the MFIs in Bangladesh. This is mostly due to competition among MFIs in the same geographic region; particularly smaller MFIs faced difficulty in recruiting new clients for their programs in the wake of intense competition from bigger MFIs. The recovery rate remains praiseworthy high, more than 99% since 2005. Overdue loans as a percentage of outstanding loans have steadily declined since 2004. This can be attributed to some extent to the sharp rise in portfolio size in recent years. The medium sized MFIs achieved almost 200% operating self-sufficiency. The Return on Assets (ROA) figure for Thengamara Mohila Sabuj Sangha (TMSS), one of the prominent medium sized MFIs, was almost 8% in 2004.

The performance of the MFIs also depends on the programs they run. Even with loans provided to poor and marginal farmers, MFIs stayed profitable due to low cost of funds and portfolio quality. The MFIs that provide seasonal and agricultural loans with various forms of repayment schedules, in-kind loans (fertilizers, pesticides, water etc.) and run hardcore poor program were not as profitable as the other MFIs. Studies have shown that PKSF partners of all sizes remained profitable even after the cap on the interest rate, reducing it to a flat rate of 12.5%.

The overall financial performance of the MFIs in Bangladesh in 2008 was impressive. The availability of highly subsidized funds is a key reason for such performances across various sizes and programs. Achieving full financial sustainability remains a challenge for many small and medium sized MFIs in the country in future, when they must cover operating costs from own sources of funds.

Maldives

The sustainability of the newly developed programs is hard to evaluate due to the lack of data. Bank of Maldives (BML) shows promise with reasonable staff productivity measured in terms of borrowers per staff and loans outstanding per staff in atolls. There is ample scope for improving outreach in atolls. With population size of 0.3 million spread across 120 islands in 20 atolls, majority of the population do not have access to any financial services. The GoM is keen on improving this situation, particularly in the remote atolls with a number of recent projects like mobile banking projects of the World Bank, credit bureau initiative of IFC, small and micro-enterprises promotion by ADB and low cost housing projects by HDFC.

Nepal

The top 20 MFIs in Nepal actually have the majority of the market share covering more than 90% of total borrowers. The 5 Grameen Bikas Banks (GBBs) covers 25% of total borrowers in the top 20 MFIs, while the shares of PMFBs is 42%, FI-NGOs serves 26% and Cooperatives covers 7% respectively. The Grameen model is successful in Nepal as it is in Bangladesh and the rest of the world. With a 25% share of total borrowers of the top 20 MFIs, the share of the total overdue loans of 5 GBBs stand at a staggering 72%.

In recent years the performance level of PMFBs, FI-NGOs and Cooperatives are almost at par. But this efficiency or productivity of staff and loan officers is much lower for Grameen Bikas Banks (GBBs). Even in terms of return on asset, GB's performance is way below that of the other MFI. Cooperatives, PMFBs and FI-NGOs have a much better chance for continued MFI operations compared to GBBs. This relative poor performance of GBBs is mostly because of excessive over-staffing and political interference in the management. The FSS numbers for these 4 types of MFIs show that the different modes of MFI operations have similar level of performance indicators except for GBBs. The GBBs are struggling to survive.

Sri-Lanka

The performances of the MFIs in Sri Lanka have been mixed. The more commercialized, larger and established MFIs like SEEDS, Lanka Praja Sanwardana Mandalaya, Janashakthi and Arthacharya Foundation showed solid performance in all dimensions in a consistent manner. The MIX market study "Performance and Transparency" (2006) found that average Sri Lankan MFI spent US\$ 16 per borrower – just two thirds of what it cost the average South Asian Institutions. Moreover it only costs 19 cents to maintain each dollar in loans outstanding, compared to 22 cents across South Asia. The country report of Sri Lanka reports that among the leading MFIs, only Janashakthi has FSS over 100% and both Janashakthi and Sarvodaya Economic Enterprise Development Service (SEEDS) report positive return on assets. The number of borrowers per staff member has been very low in almost all MFIs compared to all the neighboring countries. This constitutes a major reason for low profitability and un-sustainability of the MFIs. The credit plus and other non financial services of MFIs is one of the major reasons for a low case loads of MFIs in the country.

Bhutan

Bhutan is the only country in South Asia where formal microfinance is provided solely by the government. The Bhutan Development Finance Corporation (BDFC), a non-bank financial institution, deals with both commercial lending and subsidized micro lending. This organization, by structure is totally dependent on government grants and external assistance. Sustainability is a major concern for this bureaucratic, statist, subsidized credit provider. Its rural credit program has high operating costs and mostly sustained by the institute's commercial and industrial lending operations. The overall quality of loan portfolio of Agricultural Lending Department (ALD) is rather dismal. The recovery rate of loans outstanding is quite low compared to the neighboring countries. Consequently, the arrears rate is very high. The average arrears per borrower has remained unchanged despite write offs and rescheduling.

Pakistan

The overall Operational Self Sufficiency (OSS) and Financial Self-Sufficiency (FSS) levels were more or less stagnant in the last five years. This is mostly because of the rapidly shifting individual MFI ratios. The sector was at 89% OSS and about 74% FSS at the end of 2007. Some MFIs struggled with financial sustainability as there was a mismatch between the expansion of their activities and the associated costs.

Donor funds and interest incomes resulted in a steady flow of funds but in the absence of a sound accounting system and a clear understanding of the costs incurred with rapid expansion, led to a reduction in the revenues and hence they faced difficulty in achieving self-sufficiency. This is true even for some organizations who have achieved self-sufficiency in the early years of operation. One of the major problems in the industry is that the MFIs are in constant pressure from the Government, elected representatives and the press to reduce the interest rate. The World Bank report notes that the average interest rate is significantly lower than Bangladesh and other neighboring countries. This leads to a lower yield on gross portfolio and making it difficult for MFIs to cover their costs.

Afghanistan

Microfinance programs in Afghanistan by the end of 2001 had a very limited outreach serving approximately 10,000 clients with weak institutional structures. There were about 500 NGOs working in Afghanistan at that point and 4%-5% of those were providing some kind of credit services and these programs were not designed to be sustainable²³. After the creation of the Microfinance Investment Support Facility for Afghanistan (MISFA) in 2003, there has been a steep rise in outreach and portfolio outstanding. In terms of operational self-sufficiency (OSS), most of the leading MFIs in Afghanistan reported satisfactory performances. The following figure gives the OSS for the main MFIs in the country. The operating costs tend to be relatively high in Afghanistan due to security expenses, small sized loans, low population density, poor infrastructure, high costs of some services and hiring of expatriate staff. Loan outstanding per branch has a steady upward trend and each branch on average was handling an outstanding loan. Staff member productivity almost doubled in the last four years. Each staff was managing a portfolio of US\$ 22,200 at the end of December 2008. However, active borrowers per staff member had remained more or less stagnant in the last four years in the range of 70-83 and had even showed a decline between 2007 and 2008. Data on loan per borrower indicates that loan size has increased by almost 80% in last four years. The average portfolio yield in Afghanistan is about 27% and has a wide variance. It ranges between 4% (Sunduq) to 38% (Women for Women International [WWI]). In general interest rates on loan products, depending on terms and type of the product, range from 1.4% – to 2% flat per month or 17% to 24% flat per annum. Even with the pressure on MFI to charge lower interest rates, they have remained more or less steady. The deteriorated portfolio quality is a major concern in the microfinance sector. The PAR (>30 days) increased dramatically within a very short period of time from March 2007 to end of December 2008. The steeply increasing delinquency is a result of both external and internal factors. Deterioration in the security situations, drought conditions prevalent in many parts of the country, losses in business, frauds, weak managements, lack of human resources, inflations, migrations, etc. had affected the repayment of loans.

India

As noted in the previous chapter, there are several models of MFI operations in India similar to Nepal. The Grameen Bank model is quite successful in India. Staff productivity which measures human resources utilization shows that it has improved in a consistent manner over the last seven years making

²³ Source of data: The State of Microfinance in Afghanistan, 2009.

India one of the most efficient in the region. The Grameen model in India is most efficient in terms of number of borrowers served per staff member, at 252 in 2008 followed by SHG serving 175 clients per staff. Over the last 7 years, the efficiency of the Grameen Bank models in terms of staff productivity increased significantly and made Grameen type the most competitive MFI in India. Indian MFIs were able to maintain a good portfolio quality in 2008 after a setback in 2007. Performances of Grameen organizations have been excellent with PAR of 2.1% in 2008 while Individual Banking (IB) had somewhat riskier portfolio with PAR at 8.7%.

Analysis of OSS and FSS indicates that Indian MFIs have become more sustainable with improved financial viability overtime and have good profitability. Interest rates charged by MFIs have seen considerable decline since 2005. Across various models, Grameen Bank and IB MFIs charge higher interest rates than SHGs. This is mainly due to the legal nature of their operations: while SHGs are mostly non-profit entities, GB and IBs run their operations for profit. Also lower cost per borrower and lower operational costs enables SHGs to charge relatively lower interest rates. Most of the MFIs faced losses in 2007 but recovered in 2008 and became profitable. 72% of the organizations have an average Return on Asset (ROA) within the range of 0 to 3%.

The MFIs are performing well overtime in terms of OSS and FSS. There has been a marked improvement in 2008 from the OSS and FSS numbers in 2007. The Grameen and IB models have OSS and FSS greater than 100 implying their viability. SHG organizations however operationally are not self sufficient even though they improved their overall performances in 2008 from previous years. The FSS ratio continues to be low indicating SHGs are not able to cover their costs without subsidies. There are regional variances in the financial performances of the MFIs. The MFIs in the East and West have achieved self sufficiency and the MFIs in the South have either achieved or close to achieving self-sufficiency. The MFIs located in the Northern regions are still struggling with financial viability but have made significant progress in 2008 compared to previous years.

A consolidated report on the performance of South Asian countries in comparison with Latin America and East Asia are presented in Table 8.

Table 8: Performance Indicators of MFIs in South Asia compared to Two Other Regions of the World, 2008

Institutional characteristics	EAP	LAC	SouthAsia	Afghanistan	Bangladesh	India	Nepal	Pakistan	Sri Lanka
Number of MFIs (covered)	155	328	188	16	28	79	27	12	8
Return on assets	2.09%	1.84%	-0.31%	-12.42%	-0.65%	0.75%	1.11%	-12.04%	-6.02%
Return on equity	13.31%	7.63%	0.89%	-37.76%	-5.62%	9.61%	13.89%	-24.35%	16.72%
Financial self sufficiency	113.29%	107.76%	98.41%	58.83%	91.02%	108.17%	113.21%	58.93%	79.18%
Revenues									
Financial revenue ratio	28.51%	28.31%	19.19%	19.02%	20.19%	20.35%	14.72%	16.18%	21.93%
Profit margin	12.13%	6.94%	-1.62%	-70.80%	-9.87%	8.29%	11.67%	-50.14%	-26.34%
Yield on gross portfolio (nominal)	34.74%	33.70%	23.46%	31.80%	23.39%	22.30%	18.17%	32.60%	24.12%
Yield on gross portfolio (real)	27.12%	26.66%	14.00%	16.61%	13.09%	14.97%	11.38%	23.23%	7.15%
Expenses									
Total expense/ assets	26.99%	26.32%	20.86%	28.26%	23.86%	18.54%	12.50%	27.23%	27.76%
Operating expense/ assets	17.60%	15.88%	9.75%	20.65%	12.46%	8.74%	6.81%	15.78%	17.72%
Efficiency									
Operating expense/ loan portfolio	20.01%	22.26%	14.15%	38.79%	18.25%	10.78%	10.48%	24.84%	12.14%
Cost per borrower	68	180	15	82	14	12	16	40	27
Cost per loan	73	167	15	79	12	12	17	37	26
Productivity									
Borrowers per staff member	97	107	162	98	124	218	190	87	242
Loans per staff member	100	113	169	98	125	228	226	67	159
Risk and liquidity									
Portfolio at risk > 30 days	1.56%	4.27%	1.59%	2.69%	3.81%	0.49%	0.82%	2.22%	4.62%
Write-off ratio	0.73%	2.36%	0.55%	0.30%	1.55%	0.06%	0.67%	0.93%	0.00%

Source: Compiled from country reports, www.mixmarket.org and WWB – APU for Janashakthi

Impact of MFI Services

The success stories accompanying Microfinance (MF) were so graphic and spectacular that, for a considerable time, repayment alone was considered an adequate test of benefit. And it is a valid indicator—but covering only one aspect—namely financial viability of the transactions. Because individuals freely engage in them, these loans can be presumed to be beneficial. But it does not tell us whether poverty has been lowered or GNP increased or if the quality of life and human development indicators have moved up at all. Many Microfinance Institutions (MFIs) felt that since they had repeat borrowers and since their programs were expanding, MF must be filling a social need. MF achieved much of its initial fame because of its impact on empowering women. These social changes are very much part of the manner in which MF has changed the map of development. However, to evaluate the contribution of microfinance to the economy and society, one needs to analyze its impact on income and other economic and social welfare indicators.

The first step in analyzing MFIs contribution is to get numerical measures of impacts and for this we need to use the empirical estimation strategy of double difference²⁴. In this estimation strategy, one needs to compare the change in economic and social indicators of MFI users with that of MFI non-users. This difference in change in outcomes between MFI users and non-users yield an estimate of the impact of MFI, given that we hold everything that may have affected MFI participation decisions constant across MFI users and non-users. However, not all of the estimates of impact stated here use this strategy; hence not all the estimates mentioned can be called causal effect of MFI's. Those studies that do not use this estimation strategy of double difference merely show the association of MFI with poverty indicators.

We begin by focusing upon the economic impacts of MFI activities on income and asset growth. This is usefully divided into two parts, the impact upon the poor and that upon the very poor (also called the hardcore poor). In this report, we refer to impacts as that which happens to an individual or household in terms of quality of life mainly due to increase (or decrease) of income from investments in income generating activities. Common indicators are impact on income, food, clothing, housing, health, schooling, water and sanitation, building of assets, empowerment etc. We compiled impacts analysis from eight countries in the SAARC region- Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. The impacts, although positive in almost all countries, varies to a great extent across countries, as demonstrated below.

²⁴ The simplest set up is one where outcomes are observed for two groups (one group that uses MFI (treatment group) and the other control group that does not) for two time periods (one period when neither MFI users nor control group has access to MFI and another period when MFI users have access to MFI). Treatment group members i.e. MFI users are exposed to micro-loans in the second period but not in the first. The control group (non-MFI users) is not exposed to micro-credit during either period. Because the same households within control group are observed in each time period, the average gain over two periods in the control group is subtracted from the average gain in the MFI users. This removes biases in second period comparisons between the treatment and control group that could be the result from permanent differences between those groups, as well as biases from comparisons over time in the treatment group that could be the result of trends.

For Bhutan, there are only summary statements by Bhutan Development Finance Corporation (BDFC) on the positive impacts of MF on the incomes and qualities of lives of rural farmers, but with no numerical basis given for the judgments provided. Similarly, for Maldives also there is very limited information on impacts. There is only one 1999 study for Maldives that mentions that the incomes of members increased by 138% on average or by 76% at the median. These impressive gains would be more useful to our analysis if we had also been told of the increase in income of non-members during this period so that we could employ the double difference estimation strategy to obtain the proper estimates of the MFIs. There is very limited data on MFIs in Afghanistan as well, although there is a BRAC report that shows that impacts of MFIs in Afghanistan are positive but meager. Hence, it is evident that impacts analyses of MF studies are still at an early stage in these three countries.

Nepal provides three evaluations: (a) National Planning Commission (NPC) [2004], N=479; (b) SAP-INAFI [South Asia Partnership - International Network of Alternative Financial Institution] (2006), N= Not available; and (c) RMDC [Rural Microfinance Development Centre Limited] (2008), N=192. In 2004, MF covered some 35% of the poor of Nepal and the poor constituted about 69% of all MF borrowers. Only a small proportion, 24.4%, reported an improvement in their social and economic situation. There was an unspecified increase in assets and a move away from agriculture towards petty trading. In 2006 study, it was found that 56% of the respondents increased their incomes even though 36% of the loans were used for consumptive purposes. There was even further improvement reported in 2008, when after three years of MF operations, incomes increased by 250% and savings by 286%, with comparable increase in assets like livestock and household goods. Even landholdings increased in both sizes and values, by 61% and 86%. Since no appropriate method of data analysis was used, we do not know how much of these changes should be attributed to MF. It may be noted in passing that all the countries with lower levels of commercialization and economic development indicate strong positive responses to MF. Nepal, in particular, shows signs that the impacts of MF is increasing with time; whether it reaches a maximum level or not is yet to be seen.

With Sri Lanka, we enter the complex terrain where the impacts of MF are hard to tell because the results are so mixed. One study conducted by Dulan de Silva and Sunimal Alles (2008), found that 71 % of borrowers reported an increase in sales or profits, but two other studies undertaken by: (i) Tilakaratna, Wickramasinghe & Kumara (2005) and (ii) Outreach of Financial Services (OFS) (2008) reported 44.2% and 37% increase in income respectively. In more poverty prone districts, Colombage (2004) found no real differences between the income increases of clients and non-clients. The Silva and Alles study provided the interesting statistic that 117 jobs were created by the MF investments of Rs.2.56 million, thus making the investment per job equal to 2.56m/117. When we consider loans to extant micro enterprises, we find that 37% of Samurdhi clients and 73% of Sarvodaya Economic Enterprise Development Service (SEEDS) clients had an increase of profits, with those getting larger loans having more success. As we consider this mixture of results we have to ask, why are the success rates for increasing incomes or profits so low compared with the fabulous repayment rates? Why do they fluctuate so much from study to study? Is the main impact of MF is to save people from falling into a poverty trap? These questions can be explored further by discussing findings from India, Pakistan and Bangladesh.

India has better data on MFI compare to Afghanistan, Bhutan and Maldives. The most comprehensive data for the impacts of MF in India comes from two studies, National Council of Applied Economic

Research (NCAER) and by Small Industries Development Bank of India (SIDBI): NCAER (2006) for a sample of SBLP [SHG - Bank Linkage Program] clients and was based on recall, while SIDBI provided before (2002-03) and after (2005-06) data of a sample of clients from 25 MFIs. Neither study is quite adequate to gauge the impacts of MF due to their incorrect study designs. Therefore the results can only claim to show associations not causations. NCAER data show a reduction in the proportion of SHG - Bank Linkage Program (SBLP) client households below the national poverty line from 58% to 33%, after an average of 5 years in the SHG - Bank Linkage Program. For MFIs, on the other hand the Agriculture Finance Corporation (AFC) study indicates a more modest reduction, from 38% poor households to 30% after 2-5 years. It is worth remembering that a substantial proportion of clients, whether of SBLP or of MFI, remain in poverty. Nevertheless, both studies reported an increase in household incomes, expenditures and assets: NCAER data shows an increase in average household net incomes, and in average household expenditures on major consumption items - at a very modest real rate of growth of 1%-2% per annum. For MFIs, all wealth ranks showed an increase in income. Compared with the control group, poorer households did significantly better (a difference of 23%) than non-poor households (a difference of 7%). Overall, half of client households reported an income increase in the previous two years, compared to 38% of non-client households.

Data for MFI clients shows higher level of acquisition of productive assets, mainly in the Grameen and IB and a significant difference with non-clients, particularly with reference to productive assets. As with the case of income, the differences between client and non-client households were found to be significantly higher for poorer households. These figures are a little odd for the MFIs at least, since the data also shows that the poor use less of their loans for productive investments than the non-poor (approximately 50% for poor versus 70% for non-poor).

As with other SAARC countries other than Bangladesh, evaluations of MFI impacts became a serious issue only after year 2000. In Pakistan, while some NGO's like Orangi Charitable Trust (OCT) and Kashf had conducted regular impact studies, extensive studies began after 2002 when the Pakistan Poverty Alleviation Fund (PPAF) surveyed 1800 households in 2002 and then 3000 households in 2005. The PPAF study uses proper double difference estimation strategy to find not very encouraging results in Pakistan. The difference in the mean incomes of the two groups (group of clients and group of non-clients) is not statistically significant. This finding is true for both personal and for household incomes.

However, smaller NGO studies in Pakistan appear to indicate significant benefits of MF. A Kashf study reports an increase of real income of 15% and that some 73% for its clients compared with only 23% for non-clients. Kashf impact surveys indicate strong results; in 2004, not only did the average income of its clients increased by 30%, almost one-third of its clients moved above the poverty line in one year! Other effects are more standard; borrowers are seen to earn more from enterprises, with the rate of return on loans being estimated by PPAF at an average of 30% per annum. The limited income gains, despite these rates of return, are not entirely, surprising since the same studies indicate that a significant portion of the loans, as much as two-thirds in any cases, are used for consumptions. Assets of borrowers also tend to be higher, particularly of livestock, though the significance has not been tested. As may be expected with such loans and the textbook belief in diminishing returns, poorer borrowers gain relatively more. It may be noted that Pakistan is different in that the large sample studies how much less impacts than the small ones get. Hence, we shift our focus to the more thorough studies done on impacts of MFIs in Bangladesh.

As Bangladesh is the motherland of MF, it is only to be expected that the most extensive testing and evaluations have gone on in Bangladesh. Hence Bangladesh deserves a more extensive treatment in this review. The pioneering study on the impact of micro credit was a study of the Grameen Bank by Mahbub Hossain [Hossain 1988]. This was conducted in a backdrop of skepticism about the success of Grameen Bank. Methodologically, this study broke new ground by using a statistically valid samples and comparing borrowers with a control group. The data were collected through field surveys in 1985 of five Grameen Bank projects and two control villages. The sample size consisted of 975 borrowers along with a census of all households in seven villages. It found that, within 27 months, borrowers tripled their business capital on average, and their livestock increased by 26% per year. About one third of the unemployed members became self-employed after joining microcredit programs of Grameen Bank; average household income was about one- sixth higher in project villages than in control villages and due to the income generating activities undertaken by using micro credit, Grameen Bank members had incomes significantly higher than comparable groups either in control or project villages. Thus microcredit has reduced poverty. Many subsequent studies confirmed the increased incomes and reduced vulnerability of MFI members as compared to non-borrowers; this was true in large samples and for programs administered by lesser known, smaller MFI's.

Table 9: Impact of Microcredit on Household Income/Expenditure

Source	Name of organization studied	Income or expenditure per annum (Tk.)	Participants	Control (non-participants)	% change
Hossain 1988	GB	Income, per capita	3524	2523	39.7
BIDS 1990	BRDB	Income, per household	6204	4260	45.9
IMEC 1995	Proshika	Income, per household	22,244	17,482	27.2
Rahman 1996	PKSF	Expenditure, per household	26,390	23,802	10.9
Khandakar 1998	BRAC	Expenditure, per capita	5180	4202	23.3
Khandakar 1998	GB	Expenditure, per capita	5050	4335	16.5
Halder 1998	BRAC	Expenditure, per capita	8244	6480	27.2
BIDS 1999	PKSF	Expenditure, per capita	36,528	33,732	8.3
IMEC 1999	Proshika	Income per household	48,635	43,584	11.6

Another study by Zohir et. al [BIDS 2001] on Bangladesh, using proper study design conduct multivariate analysis, find that there was significant positive effect of regular program participations on income and on average consumptions of poor households. Both head-counts and poverty gaps measures show that regular participation registered a faster rate of poverty reduction than occasional participants, and reduction in poverty among the latter was faster compared to non-participants. Analysis also shows that

program participation is associated with greater investments on both human and physical capitals. Generally, the study finds program participants to be less vulnerable to crises even though they faced similar degree of crises as non-participants. A summary of major quantitative impact studies has been presented by Rahman [2000] as reproduced in Table-9.

Unlike the earlier quantitative study on Bangladesh mentioned above, Alamgir (1996) used a qualitative measurement strategy of asking participants about their perceptions of changes due to MFI participations, and evaluated the impacts of micro credit programs of PKSF and its partner organizations. The survey involved 7,041 members of 297 groups/societies from 20 Partner Organizations (POs or MFIs). Interviews as well as in-depth discussions revealed that about one third of the unemployed members became self-employed after joining microcredit programs of the bank. Average household income was about one-sixth higher in project villages than in the control villages and due to the income generating activities undertaken by using micro credit, Grameen Bank members had incomes significantly higher than comparable groups either in control villages. Thus microcredit has reduced poverty. At least 85% reported an increase in family income, improvement in productive employment, and an overall improvement in their quality of life due to the loan.

Along with studies that report significant impacts of MFIs on the poor, there are also studies in Bangladesh indicating positive impacts on the hardcore poor.²⁵ Significant early findings were obtained by studies of Financial Services for the Poorest (FSP) and BRAC (CFPR/TUP). The FSP results (PKSF 2005) showed a modest gain in income and expenditure but provided the important finding that the extremely poor people can borrow, invest, enhance income and repay loans on time. The findings from the BRAC CFPR/TUP [Challenging the Frontiers of Poverty Reduction Program/ Targeting the Ultra Poor] show major improvements in many aspects of quality of life, reduction in vulnerability and improvement in assets. For example, although starting worse-off compared to non-participants, the BRAC participants now have deposited considerable savings, taken loans, increased their assets in the form of lands and furniture, have larger incomes, fewer food shortages, and can spend more for medical needs.

A comparative study by Nath [Nath 2005] on the impacts of four microfinance programs targeting the ultra-poor/hardcore poor: (1) CFPR/TUP program of BRAC, (2) Financial Services for the Poorest of PKSF implemented through a number of partner MFIs (FSP-PKSF), (3) Struggling Members Program of Grameen Bank, and (4) the Financial Service Program for very poor of Plan Bangladesh were studied. The study analyzed data from 263 households randomly selected from 67 villages and compared that with control village data and conducted regression analysis to estimate impacts on the hardcore poor.

Results show that, FSP-PKSF and Grameen give emphasis on credit and Plan Bangladesh emphasizes on saving aspects. BRAC's clear advantage is food aid and in case of CFPR/TUP, transfer asset in the form of poultry and livestock to the ultra-poor families. Grameen bank provides interest free loans, life insurances and loan insurance services to the beggars in order to help them to find out a dignified livelihood, send their children to schools, and graduate them for becoming regular GB members. FSP-

²⁵ Hardcore poor under FSP-PKSF is defined as one who is landless or holds up to 10 decimals of land, is unemployed or earns less than a dollar a day or dependent on temporary jobs, has no assets and no place to sleep, is deserted or separated women headed household member, disabled and elderly, parents of child laborers, seasonal workers or day laborers.

PKSF and BRAC (Income Generation for Vulnerable Group Development - IGVGD) have extended some features of regular microfinance with some flexibility in terms and conditions, but the programs of Plan Bangladesh and Grameen Bank are entirely flexible. For the hardcore poor, all programs except Grameen Bank's charge interest rate similar to their regular programs.

There has been significant increase in assets of hardcore poor among BRAC participants (Taka 6300) followed by hardcore poor participants of Plan Bangladesh (Taka 5700) and Financial Service for the Poorest (FSP) (Taka 4600). Grameen hardcore poor borrowers, being at the lowest strata of the society, have formed assets to the extent of Taka 1400. The assets are primarily livestock, followed by rickshaws and improved housings. Participants of all these four programs have also been able to increase agricultural and homestead lands.

Among the hardcore poor participants of the four programs mentioned above, there has been an increase in self-cultivations, non-agricultural labors, petty businesses, nursery managements (plant sapling productions) and livestock rearing as well as a decline of tenant farming, agricultural labors, low paid service labors and rickshaw pulling. About 66% beneficiaries indicated enhanced work incomes new occupations for 10%, increased working hours for 22% and income increase 27%. The changes were more among Financial Service for the Poorest - Palli Karma Sahayak Foundation (FSP-PKSF) and Grameen members.

Following increase in employment, one can expect increase in both income and consumption, which have been reported to have increased in the participating households. The average income for participants in the four programs varies between Taka 11,984 (Grameen) to Taka 32,679 in Income Generation for Vulnerable Group Development (IGVGD) to Taka 34,471 in FSP-PKSF and Taka 38,483 in Plan Bangladesh. The average change has been between 18%-27%. Relative change of per capita income has been much higher than that in control households. Food deficit among control households is much higher than program participating households. Control households have the highest food deficits and Income Generation for Vulnerable Group Development (IGVGD) the lowest. Over time, chronic food deficit and occasional food deficits have declined and households with surplus food have increased, implying that food security has improved after the program interventions. However, food insecurity remains still an acute problem in a sizable number of households. Along with increase in incomes, there has been positive savings in households involved with MFI programs and the value of program participants' assets has substantially increased.

On the front of improvement in health and social benefits of the hard core poor, the MFI programs contributed greatly. The main social benefits are manifested in better sanitary and health condition and the increased empowerment of women, as seen in their increased health consciousness and freer movement and participation in family and societal affairs. There have been positive attitudinal changes among the households regarding the rights' of women.

Despite all the benefits that the hardcore poor avail through associations with MFI participations as mentioned so far, poverty remains acute within the participating families, since 99.6% of the participating households are below the poverty line, although 31% have risen above extreme poverty. Clearly available evidence shows that microcredit programs had a strong positive effect on ultra poor.

MFIs in most south Asian countries –notably in Bangladesh, India and Sri Lanka—have mainly targeted women and have definitely empowered them. Generally speaking women have been found more amenable to thrift and repayment discipline. Providing women –and not men – access to financial services is by itself empowering women, who are otherwise at a disadvantage state in South Asian society. Women are also seen as more likely than men to use their earnings for the benefit of households.

Several studies have focused on the impacts of financial services on South Asian women, although with varying interpretations. Indicators such as self confidence, status in the family, and role in decision making are positive but difficult to assess in practice, being subjective and liable to change age and family status. Other indicators appear to be more objective, for example, “control” over the loan and ownership of assets, but these indicators reflect a more individualized notion of women’s empowerment and have less positive results in much of South Asia where a strong patriarchal culture limits women’s roles.

Studies in Bangladesh have documented a positive impact for women. Generally speaking, a woman’s contribution to household incomes and ownership of assets has been a significant contributing factor toward her increased self worth and improved family status. Studies of Grameen and BRAC borrowers suggest that even if women do not have control over the loan amount, they are still “more empowered” than women who have not borrowed at all.

In India, studies of the SHG-bank link programs report an increase in the self-confidence and decision-making ability of women after participation in group credit and saving activities. A study from Nepal also found similar results of SHG approaches under the Women’s Empowerment Program (WEP), which combined savings led microfinance with a strong literacy curriculum. Overall, evidence supports the conclusion that microfinance is contributing to some increase in women role with existing patriarchal limits.

General Effects

One could make a distinction between ‘impact’ and ‘effect’. By impact, we define the changes in the personal and household level leading to changes in quality of life mainly due to the change in income from investment in income generating activities. By effect, we mean many different services and benefits that have emerged with the proliferation of microfinance. Therefore, the effects are no less important than the direct impact of services on quality of life. For Bangladesh, following can be considered as direct broader effects of massive proliferation in microfinance sector:

Access to market information has improved in the sense of the interactions of members within the groups provides opportunities for informally receiving market information such as price of various inputs, commodities and production levels. Hence, social and marketing network are more established.

These MFIs created access to essential training services for the poor. Many government and donor agencies and NGOs provided millions of man-days of training on numerous topics mostly for free. These topics included awareness building on social issues, poultry and livestock rearing, fisheries, health and family planning, vegetable and crop production, tailoring, business management, accounting, etc.

With the huge growth of MFIs in Bangladesh, access to technological information and demonstration of production technologies have benefited the participants of microfinance programs.

To conclude, available evidences from SAARC countries show that microfinance programs have had positive impacts on the economic status of households—increasing money assets and saving of households, smoothing consumptions and improving diets of households, reducing households' dependency on moneylenders and finally reducing overall incidences of poverty and extreme poverty.

Similarly, microfinance programs have had a positive impact on the social status of households' particularly in increasing decision making role of women , increasing participation of women in own or household enterprises and increasing spending on health care. Also enterprises supported by microcredit have clearly gained in productive assets, increased employment and made more profits.

Beside above specific impacts, there are some significant general effects of microfinance—creating access to market information for clients, providing training to members and creating access to new technologies for members.

Chapter 4:

Regulatory Bodies and Apex Financing Organizations

This chapter delineates the regulatory environment relevant to the microfinance sector in each of the eight SAARC member countries: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. A review of the individual country reports reveals a lack of holistic regulatory policy for the microfinance sector in all member countries and the regulatory environment varies by the country depending on the stage of the development of the microfinance sector. The process of regulating this important, dynamic and emerging sector seems to be evolving with the changing nature and scope of the microfinance sector in all SAARC member countries. In some of the member countries, specifically Bangladesh and India, the microfinance movement has reached a point where the policymakers see the need for a comprehensive policy and eventually integrate some portions of this sector into the framework of regulated financial services. Wholesale suppliers of microfinance funds and/or apex financing organizations seem to exist in all SAARC member countries except for Bhutan and Maldives. In the absence of a formal and adequate regulatory environment, apex financing organizations and/or wholesale suppliers of microcredit funds often work as effective standard setters and key policy influencers of the microfinance sector in the member countries. Therefore, a brief overview of these apex organizations and/or suppliers of wholesale microcredit funds in each member country is also included in this chapter.

Afghanistan

As noted earlier, microfinance services are currently provided by three sources (i) formal institutions such as banks, (ii) semiformal institutions such as NGOs and (iii) informal sources such as moneylenders and shopkeepers. As Afghanistan did not have any specific regulation to address microfinance activities up until very recently, diverse laws applied to the different providers of microfinance services and these include the Central Banking Law and the Commercial Banking Law which were promulgated in September 2003. The June 2005 Law on NGOs provided a new legal framework replacing the Regulation for the Activities of Domestic and Foreign NGOs enacted in 2000. Most MFIs registered as NGOs now operate under this new legal framework. Finally, in July 2006 the Legislative & Regulatory Division of the central bank, Da Afghanistan Bank (DAB), announced Article 12: Licensing, Regulation, and Supervision of Depository Microfinance Institutions (DMFIs). A DMFI is defined under this article as a legal entity that accepts voluntary savings deposits only from a membership defined by a common bond, such as employment at the same legal entity or defined groups of entities or in the same occupation, or residence within the same delineated community, and grants microcredit only to that same membership. Microfinance institutions (MFIs) that accept only mandatory deposits from members are not considered to be DMFIs but yet retain the option to be licensed by the DAB and can be subjected to this same regulation as DMFIs.

The Microfinance Investment Support Facility for Afghanistan (MISFA) was established by the government of Afghanistan (GoA) as an apex institution in 2003 to coordinate donor financing, encourage international and local NGOs to enter the microfinance sector and to help meet the growing demand in the sector. MISFA was recently transformed from an entity within a government program to an

Afghan company with limited liability. Now, it is a non share holding company owned by the Ministry of Finance and governed by an independent Board of Directors. This provides MISFA with more autonomy to attract new donors and to retain the involvement of those that continue to provide funding directly to government for microfinance activities. The objectives for which MISFA was created included the following: (i) coordinate donor funding (ii) help young MFIs scale up rapidly by offering performance based funding for operations and technical assistance; and (iii) build systems for transparent reporting and instill a culture of accountability.

While most donor agencies providing financing to the sector channel their funds through MISFA, there are some like the USAID and a few others who are providing direct funding to some MFIs. However, the volume of direct financing to MFIs is small and most of the donor agencies prefer to go through MISFA. MISFA is currently the main source of financing for the microfinance sector in Afghanistan. The number of MFIs supported by MISFA has grown from only 3 in 2003 to 15 at the end of December 2008. MISFA's partners include 13 NGOs, one credit union and a microfinance bank.

Bangladesh

Up until recently MFIs in Bangladesh were able to register under several laws: i) Social Welfare Act 1960, ii) The Companies Act 1913 (revised in 2001), iii) The Trust Law, iv) The Societies Act 1860, and v) The Cooperative Societies Act. Interestingly, none of these laws explicitly allows microfinance, especially the aspect of savings mobilization, as they were drafted long before the advent of microfinance in the present form. However, all microfinance programs in Bangladesh always had a built-in mandatory savings component and consequently, all NGOs involved in microfinance ended up mobilizing savings. The GOB, central bank (Bangladesh Bank) and all the registering authorities responsible for the different laws cited above chose to allow savings mobilization by NGO-MFIs under the clause 'development activity' to alleviate poverty and thereby, provided legitimacy to MFI and NGO-MFI operations.²⁶ This important policy support, along with the granting of tax free status to MFIs and NGO-MFIs, contributed to the rapid proliferation of microfinance in Bangladesh as there is no bar for any NGO registered under any law to get involved in the microfinance sector.

As noted earlier, the main players in the microfinance sector at the retail level are (a) individual MFIs/NGO-MFIs, (b) government departments and agencies, (c) commercial banks, (d) nonbank financial institutions (e) cooperatives, and to a smaller extent, (f) finance and leasing companies. Commercial banks, both nationalized and private (local as well as foreign), have been involved in microfinance for a while now. Currently, more than 20 commercial banks are involved in financing microcredit programs in Bangladesh. Commercial banks have been providing loans to MFIs in three different modes: a) retail as well as wholesale lending (where individual bank develops its own policies and programs and lends to individual MFIs), b) syndicated loan where a number of commercial banks band together led by one bank to finance microcredit operations of an MFI; and c) securitization. These commercial banks, obviously, fall under the purview of the central bank, Bangladesh Bank.

²⁶ Mobilization of savings here refers to mandatory small savings and other forms of savings instruments that MFIs have designed to mobilize savings from their borrower members and not from the general public except for Grameen Bank.

Bangladesh did not have any comprehensive law, or body of regulations or regulator specifically designated for the microfinance sector up to August 2006. The need for a proper legal basis for NGO-MFIs to offer financial services has been felt since mid-nineties when NGO-MFIs began to grow fast, mobilize large amount of savings and own a large portfolio partly financed by savings.

Microcredit Regulatory Authority (MRA) was established by the Government of Peoples' Republic of Bangladesh under "Microcredit Regulatory Authority Act, 2006" to bring Non-government Microfinance Institutions (NGO-MFIs) into a regulatory framework, with a view to ensuring transparency and accountability of microcredit activities in the country. The act basically covered licensing prerequisites, rights, responsibilities, operational requirements and governance of MFIs. It also covers specifications on illegal activities and penalty. MRA is empowered and responsible to implement the act. Its vision is to create a conducive and healthy environment for microfinance sector in the country which will ultimately foster sustainable development of the country. MRA is now the central body to monitor and supervise microfinance operation of Non-government organizations of Bangladesh. License from the Authority is mandatory to operate microfinance operation in Bangladesh as an NGO. There are 518 licensed MFIs under MRA as of 22 July 2010.

According to the Act, the MRA will be responsible for the three primary functions that will need to be carried out, namely: (1) licensing of MFIs with explicit legal powers; (2) supervision of MFIs to ensure they continue to comply with the licensing requirements; and (3) enforcement of sanctions in the event of any MFI failing to meet the licensing and ongoing supervisory requirements.

The wholesale lending to microfinance institutions has been instrumental in expanding microcredit operations in Bangladesh. Wholesale comes in two different forms: concessional loans from specialized institutions such as Palli Karma Sahayak Foundation (PKSF), which has been set up as an apex financing body exclusively for this purpose, and loans from the commercial banks. But, unlike commercial banks, institutions like PKSF assist their partner MFIs, called Partner Organizations (POs), to strengthen institutional capacity. Several other specialized organizations are involved in supplying wholesale funds to the MFIs in Bangladesh – Anukul Foundation of CARE Bangladesh, Grameen Trust, Stromme Foundation, and Credit & Development Forum (CDF).

PKSF leads the wholesale funding segment of the microfinance sector in Bangladesh. PKSF is primarily a long term wholesale portfolio lender with two main objectives – (a) expand outreach to reach the poor with financial services, and (b) assist MFIs to achieve institutional and financial viability for sustainable service provision to both rural and urban poor. As noted earlier, PKSF was set up by the GoB in 1990 and lends through its two lending windows: *Bipool* (window for large MFIs) and *Oosa* (window for small MFIs). PKSF distinguishes MFIs according to their size and capability, and lends at 4.5% and 7% to *Oosa* and *Bipool* partners respectively. In 2010, PKSF has 194 active partner MFIs which have mobilized 10.9 million (PKSF-funded) members, that is, about one third of the whole microfinance sector. PKSF also provides long term institutional development assistance to its partners embedded within its loan programs, which has benefited all POs and immensely contributed to the institutional strengthening and sustainability. In addition, PKSF has developed several training modules for the POs and provides training to their staff members. The emergence of PKSF as the main source of finance and institutional

development assistance for the microfinance sector has been the most significant development of the last decade. PKSF has contributed immensely to expand the outreach as well as help many MFIs to achieve financial viability and set the informal norms and standards for the sector. Currently the various segments funded by PKSF are as follows: a) rural microcredit, b) urban microcredit (as revised in 2006), c) microenterprise loan, d) microcredit for small and marginal farmers, and e) microcredit for hardcore poor. Furthermore, it implements number of projects for promoting access to technology and markets by the poor, farmers and micro entrepreneurs.

Credit and Development Forum (CDF), primarily active in capacity building of MFIs and relevant advocacy activities, has a small lending/facilitation operation targeted to very small NGO-MFIs which cannot get access to PKSF or commercial bank directly. CDF also makes assessment of potential small MFIs and recommends them, if satisfied, to a selected group of commercial banks for funds. CDF currently has MOUs with seven commercial banks - two nationalized and five private commercial banks. As of December 2008, these seven commercial banks have given loan to 75 very small MFIs. The loans are for 3 years repaid in quarterly installments with interest rates varying between 13% and 14%. CDF adds an additional 2% for its assessment, supervision and monitoring services. Total loan disbursed from these commercial banks is Taka 87.5 million. Furthermore, CDF managed a project of assisting community-based organizations (CBOs), some of which were later registered under the Department of Social Welfare as NGOs. Under the CDF-Bank-CBO Partnership program, fifteen (15) such CBOs have recently been assessed by the one private commercial bank, Mutual Trust Bank, for funding their microcredit operations. Eight (8) of them have received Taka 4 million and others are in the process of receiving another Taka 5.5 million.

Bhutan

As noted in chapter 2, the financial sector in Bhutan is very small and comprised of four major financial institutions. There are only two commercial banks - Bhutan National Bank (BNB) and Bank of Bhutan (BOB), and two non-bank financial institutions - Bhutan Development Finance Corporation (BDFC) and Royal Insurance Corporation of Bhutan (RICB). The Financial Institutions Act and the Company Act govern financial institutions. The Royal Monetary Authority of Bhutan (RMA) supervises the financial system and fulfils the role of a central bank. Among its initial duties was the administration of financial assistance for rural development. Microfinance, as we know it, in Bhutan featured only in the recent past. Unlike other countries in South Asia, microfinance in Bhutan is managed by the public sector institutions and not by NGOs.

A development bank in Bhutan, Bhutan Development Finance Corporation (BDFC) was established in 1988. BDFC was registered under the Company's Act of Bhutan enacted in 1989 and subsequently, privatized in 1999. The BDFC board and management were to pursue efforts (along with the RGoB and RMA) with the objective to encourage establishment of appropriate legislations and a regulatory framework for the rural banking sector. Initially BDFC was subjected to the same regulations as commercial banks even though it was a non-bank institution. It was therefore felt that the RMA should adopt a more lenient approach towards BDFC, with regard to its prudential requirements, also taken into account its specific social mandate. In addition, it was viewed that BDFC should have autonomy in

setting the interest rates at levels that would enable it to become self-financing. Given that BDPC is not a deposit taking financial institution, the RMA takes a relaxed approach with respect to supervision and the regulations on collateral are not stringently applied. Also other regulations with respect to provisioning are broadly adopted. However, the non-bank financial institutions are still subject to the same regulations as commercial banks. With support from technical assistance of the ADB, RMA is now actively working to further develop the regulatory framework and other measures required to increase the integrity and development of the microfinance sector.

India

India is a relatively unique case when it comes to microfinance regulation and supervision. The Indian financial sector is comprised of banks, non-bank finance companies (NBFCs), cooperatives/credit unions and non-profit institutions. Many of these are involved in providing microfinance services with a varying degree of focus. Institutions involved in the Indian microfinance sector have a variety of legal forms. Microfinance was taken up in India primarily as a development initiative in the early 1990s. The NGOs that took up such activities were registered as Societies or Trusts (NGO-MFIs) as Section 25 non-profit companies. Some cooperatives and one cooperative bank were also engaged in providing microfinance to the targeted people. The involvement of the commercial banks in the financing of the MFIs is much stronger in India than anywhere else. This was facilitated by the advent of microfinance rating and the central bank's circular recognizing wholesale lending by banks to MFIs as part of their priority sector lending requirements (40% of all loans). This has stimulated and accelerated the transformation of NGO-MFIs to non-bank finance companies (NBFCs) since banks are more comfortable with the latter institutional form. The result is that there is *de facto* regulation of microfinance institutions through the central bank, Reserve Bank of India (RBI). However, since RBI does not recognize microfinance, NBFCs are a separate category and cannot create separate prudential and non-prudential regulations that would facilitate the provision of microfinance services and safeguard clients. It shall be noted that the unrated NBFCs in India are not allowed to offer deposit services. Societies, trusts and cooperatives are regulated by their respective Registrars and Acts specifically formulated for them. However, when it comes to financial intermediation the RBI supersedes any norm under these Acts to protect the rights of clients. Among all the other legal forms of institution NBFC and non-profit companies make up over 75% of the sector in terms of their portfolio and 70% in terms of total number of borrowers.

In 1982 the microfinance sector in India gained real impetus with the establishment of the National Bank for Agriculture and Rural Development (NABARD). NABARD is a government of India (GoI) owned apex refinance (wholesale loan) institution with a combination of promotional, supervisory, and refinance functions for retail institutions like rural branches of commercial banks, regional rural banks, and cooperative banks. As noted in earlier chapters, NABARD's well known SHG (Self Help Group) Bank Linkage Program (SBLP) sponsored and has now expanded throughout the country. NABARD refinances commercial bank loans to SHGs to facilitate relationships between the banks and poor borrowers. The SHG-linked bank groups are under the indirect supervision of RBI as the norms of SHG lending have been designed by RBI. Also the banks with whom these SHGs are linked are governed by prudential and other regulations that emanate from the Banking Regulation Act which, in turn, gives the RBI the supervisory responsibility. The bank-SHG linkage program has greatly increased the outreach of the

banking system to otherwise unreached households (specifically to women as SHG members) and initiated a change in the outlook of banks towards low income families from beneficiaries to customers. Similarly, all 7,000+ NBFCs in the country are directly regulated by RBI.

A high-powered Task Force on Supportive Policy and Regulatory Framework for Microfinance was set up by NABARD per directives from the RBI in November 1998. The objectives of the Task Force were to come up with suggestions for a regulatory framework that brings the operations of the MFIs into the mainstream, assess the possible role of self-regulatory organizations and explore the need for a separate legal framework for the microfinance sector. The Task Force made a number of recommendations, one of which was a common definition of microfinance.²⁷ Partly as a result of the Task Force recommendations, GoI established a Rs. 500 *crore* Microfinance Development and Equity Fund (housed at NABARD) to support the growth of the sector and the RBI issued a circular to the commercial banks requiring them to lend 40% of their total loan portfolio to the priority sector via MFIs.

Considering that microfinance is practised differently from the conventional banking system, in 2005, the Government of India recognized the need for a Microfinance Act for India. The Bill was introduced in the parliament as the Micro Financial Sector (Development and Regulation) Bill, 2007 on 20 March 2007. The draft Microfinance Bill would empower NABARD to regulate the microfinance sector in India. NABARD may grant approval to MFIs (called microfinance organizations, MFOs, in India) to collect deposits if it has been in existence for at least 3 years, has net own funds of at least Rs. 5 *lakhs* and if NABARD is satisfied about the ‘general character’ of the management of the MFIs. Every MFI granted approval to offer thrift (deposit) services would be required to create a reserve fund out of transfers to the fund of not less than 15% of its net profit or surplus every year and would need to prepare year-end financial statements in such form as may be specified, to be audited by an approved auditor. Although the Bill proposes to cover the regulations for the NGOs and cooperatives offering microfinance services, it does not cover the microfinance operations of the NBFCs. The regulatory stance of protecting savers from systemic and institutional risk has been taken as an overarching consideration under the Bill. Since it is difficult to regulate a large number of small deposit taking institutions, the Bill attempts to ensure that these institutions will have strong systems, adhere to prudential practices and bring in a reasonable minimum of quasi-equity capital. Apart from providing these prudential norms, the Bill requires the regulators to achieve much broader non-prudential objectives. This would be done by promoting orderly and ensuring greater transparency, effective management, and good governance in microfinance sector.

Another objective of the Bill is consumer protection where the powers would be given to a Microfinance Ombudsmen to redress grievances. The Bill propagates the creation of a national database in the public domain and dissemination through national dissemination network. This would be done with MFIs submitting their accounts and duly audited returns at the end of each year. This will apply to all organizations providing microfinance services, thereby falling under the purview of the Bill. The Bill also provides for setting up a Micro Finance Development Council to advise the regulators on policy formulation, schemes and other measures required for the establishment of orderly growth and development of the sector. Furthermore, the Bill calls for the continuation of the Microfinance

²⁷ Microfinance is defined as: “Provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards”.

Development and Equity Fund which will receive grants and donor funds to on-lend to MFIs in the form of equity and quasi-equity. Finally, in order to legitimize the operations of MFIs, the Bill would enhance the legal status of NGO-MFIs and would in effect protect them from arbitrary state government action. The Bill, however, would not protect the MFIs from action under the state-level Usurious Money Lending Acts.

Cooperatives (not registered as banks) are included in the Bill and are defined to include all cooperatives except those engaged in agriculture operations. India has had a large thrift cooperative movement which at one time was one of the strongest in the world. Mutual organizations in the form of cooperatives are allowed to accept savings from their members.

It is now over three years since the Micro Financial Sector (Development and Regulation) Bill, 2007 has been in the public domain and there has been no consensus in terms of what needs regulations, who should regulate and how it shall be done. Consequently, the Bill is still waiting to be introduced in the Indian Parliament. Meanwhile, the microfinance network, Sa-Dhan, who also propagates self-regulation to its MFI members, has formulated a code of conduct that lays down core values and fair practices for MFIs to provide services in a manner that benefits and respects clients. The core values include:

Integrity: To serve low income clients and their families in providing short and long term access to financial services that are client focused, designed to enhance their well-being and delivered in a manner that is ethical, dignified, transparent, equitable and cost effective.

Quality of services: Clients deserve fair and efficient microfinance services provided in a convenient, participatory and timely manner.

Transparency: Provides clients with complete and accurate information and educate them about the financial services offered.

Fair practices: Not to provide unethical and deceptive services to clients and provide microfinance services including lending and collection of dues, committed to fair practices, which balance respect for client's dignity and an understanding of a client's vulnerable situation, with reasonable pursuit of recovery of loans.

Privacy of client information: To safeguard client information and not disclose details for information exchange.

Integrating social values into operations: Provide high standards of governance, participation, management and reporting while working with low income clients.

Feedback mechanism: Provides clients channels for formal and informal feedback to improve services.

MFIs are expected to sign up to these core values through a compliance agreement. Sa-Dhan has a compliance mechanism whereby MFIs are required to adhere to the values or face a variety of penalties.

But Sa-Dhan's compliance mechanism is still in the process of being activated and the code is yet to acquire any real momentum.

Maldives

There are no MFIs in Maldives. In 1990 the Government of Maldives and the Bank of Maldives (BML), initiated a development banking project in atolls and to implement this project, a Development Banking Cell (DBC) with a separate entity and financial autonomy was established within the BML. Ever since its inception, the DBC has played a pivotal role in providing and promoting many development banking activities in Maldives. Credit provided under DBC programs are categorized as targeted credit. Prior to 2006, various Government ministries were also allowed to undertake financial intermediation (for credit programs) directly. However, the Finance Act 2006 has restricted this and now any financial intermediation has to be done through the banking system. Following the Finance Act, 2006, the DBC manages the credit component of all international as well as bilateral programs in Maldives.

There are no separate regulations/norms for regulating the microfinance activities in Maldives. All financial institutions in Maldives are regulated under the guidelines of the Maldives Monetary Authority (MMA) Act, 1981 which requires all local and foreign financial institutions to obtain a license from the MMA. The license shall indicate the type of banking business licensee is authorized to do and are regulated as per the guidelines for that particular type of institution. The Credit and Bank Supervision (CBS) division under Financial Sector Division (FSD) of MMA is responsible for supervising banks.

Nepal

There was no stated policy of the government on microfinance prior to the promulgation of the National Microfinance Policy, 2008 by the Ministry of Finance of the Government of Nepal (GoN) in 2008. This policy was developed on the advice of the Nepal Rastra Bank (NRB). NRB is the regulatory body for all types of commercial banks/financial institutions and Financial Intermediary NGOs (FI-NGOs). Non Bank Financial Institution Supervision Department of NRB is supposed to monitor and supervise the operations of the Microfinance Development Banks (MFDBs) and other forms of MFIs. However, owing to the lack of adequate manpower and trained staff it has not been able to discharge these responsibilities effectively and many MFIs are short of complying with the requirements of the NRB Directives.

NRB classifies banks as Class 'A', Class 'B', Class 'C' and Class 'D' banks under the BFIA 2006 and require them to lend a specific percentage of their loan and advances to the deprived or priority sector based on this classification. These banks could either provide loans directly to the poor and low income people or they could pass on this amount to the MFIs for on-lending to their clients. The category 'A' (commercial) banks are required to lend 3% of the loan and advances to the deprived sector. But the category 'B' (development) banks and category 'C' (finance) companies are also required to lend out 1.5% and 1% of their loan and advances to the deprived sector, respectively. This umbrella Act has a provision for even a foreign bank or financial institution, in joint collaboration with a Nepalese organization or citizen or through its subsidiary organization having its full share, can provide microfinance services in the country with the permission from NRB and the GoN. Under this act, NRB

has the responsibility to supervise, warns the Board of Directors and even takes over management in case some wrong things happen to a bank and also initiates actions for liquidation if required by circumstances. MFDBs, FI-NGOs and Cooperatives licensed by NRB are required to report to the Financial Institutions Regulation Department. Failure to comply with the prudential norms of reporting or late reporting may result in penalties per the BFIA, 2006.

The Financial Intermediary Act (FIA) 1998 was designed to regulate the FI-NGOs. According to this Act, FI-NGOs are required to obtain license from the NRB and maintain a minimum of Rs. 100,000 as their capital to be eligible for license. After receiving license from NRB, the FI-NGOs can apply for funds from the wholesale lending/apex institutions.

After the promulgation of Financial Intermediary Act 1998 (subsequently amended in 2001) the NRB introduced Financial Intermediary Regulation in 1999. This regulation was also subsequently amended in 2003 - NRB Directives for Microfinance Institutions, 2003. This regulation has specified the documents to be submitted by an NGO to the NRB for obtaining a financial intermediary license. As per the regulation, it has to be renewed every two years. The FI-NGO has to classify outstanding and overdue loans in four categories such as good, sub-standard, doubtful and bad, and creates a reserve for loan loss provision. This regulation also restricts the FI-NGOs from purchasing shares and debentures, giving loans to the board and their family members and purchasing fixed or movable property for commercial purpose without NRB permission.

In 1991, the GoN enacted the Cooperative Societies Act 1992. Under this Act, a group of 25 people from a community can form a cooperative by registering it with the Department of Cooperatives, Ministry of Agriculture and Cooperatives. These autonomous institutions are entitled to formulate their own bylaws or operational procedures through their General Assembly (GA) meetings. Each cooperative will have a Board of Directors and an Accounts Committee (AC) consisting of members duly elected through GA using one-man one-vote principle. The Board appoints a management team or prescribes other body to carry out the day-to-day activities of a cooperative.

In order to make provisions for wholesale credit to qualified Savings and Credit Cooperatives (SCCs) and NGOs the GoN created the Rural Self Reliance Fund (RSRF) within the NRB in 1991. The objective of RSRF is to assist the rural poor to get out of poverty by making provision of microfinance services through local NGOs and Cooperatives. It is managed by NRB. However, RSRF has not been able to make much progress. Its outreach of client numbers 14,862 in a period of about 17 years is very low.

Rural Microfinance Development Centre Ltd. (RMDC), the second and the major wholesale lending organization in microfinance sector in the country, was established in 1998. RMDC provides support for strengthening the institutional capacity of the partner organizations. As a result of adhering to the set criteria for lending and having a good supervision system, RMDC has been able to demonstrate the best performance among the wholesale lending institutions in Nepal.

The third wholesale lending institution, Sana Kisan Bikas Bank Limited (SKBBL), was established in July 2001 with an objective to provide the needed loans to the Small Farmers Cooperative Limited

(SFCL). SKBBL, besides providing wholesale funds to SFCL, monitors the POs as per the guidelines provided by NRB and provides technical assistance as well.

Pakistan

Regulation of the microfinance sector is a relatively new phenomenon in Pakistan. MFIs registered as Microfinance Banks (MFBs) are regulated by the central bank, State Bank of Pakistan (SBP). The nonbank MFIs largely remain unregulated and consequently, are prohibited from providing a full range of financial services.

The Microfinance Institutions Ordinance 2001 provides the regulatory framework for the microfinance sector in Pakistan. The Ordinance defines the scope of business for a MFI, the paid-up capital and liquidity requirements, licensing policies for such institutions, the basic structure of its management and administration, and SBP's powers for supervision purposes. The MFI Ordinance has helped re-define microfinance as a core financial sector activity with not only social implications but also commercial opportunities. Since the promulgation of the MFI Ordinance, a number of supportive regulations have also been issued by the central bank including: (1) Prudential Regulation for Microfinance Banks, 2003; (2) Guidelines for Mobile Banking Operations, 2003; (3) Guidelines for NGOs Transformation, 2005; (4) Fit and Proper Criterion for CEOs/member of Boards of MFBs, (5) Prudential Regulations for Commercial Banks to undertake Microfinance Business, 2006; (6) Guidelines for Commercial Banks to undertake Microfinance Business, 2006; and (7) Branchless Banking Regulations, 2008.

The 2001 Ordinance allows for setting up of four types of MFBs: (i) District Level MFB: licensed to operate only within the prescribed district and the minimum paid-up capital requirement to set up such a bank is Rs. 100 million; (ii) Regional Level MFB: licensed to operate within five adjacent districts within the same province and the minimum paid-up capital requirement to set up such a bank is Rs. 150 million; (iii) Provincial Level MFB: licensed to operate only within the prescribed province and the minimum paid-up capital required to set up such a bank is Rs. 250 million and (iv) National Level MFB: licensed to operate anywhere in the country and the minimum paid-up capital required to set up such a bank is Rs. 500 million. Other than the difference in capital requirement, all types of MFBs face the same prudential regulations and can offer the same range of services to their clients. The Ordinance has been very important for encouraging the entry of private sector players into the microfinance sector in Pakistan. However, some additional measures have been suggested for improvement of operational efficiency of the MFBs: (i) reduce the infrastructure requirements stipulated for bank branch offices (ii) enhance the scope of mobile banking, (iii) strengthen the on-site inspection capacity of SBP, (iv) lower the minimum capital, reserve and provisioning requirements, etc.

An apex funding body, the Pakistan Poverty Alleviation Fund (PPAF) was established in 2000. The role of PPAF is to act as a wholesaler and intermediary of funds, while its Partner Organizations (POs) perform the actual retailing function of loaning funds and implementing projects on the ground. PPAF provides its partner NGOs three types of facilities which consist of (i) extending lines of credit for expansion of poverty targeted microcredit programs (ii) grants for Community Physical Infrastructure

(CPI) schemes and social sector services on a cost sharing basis and (iii) grants to strengthen the human and institutional capacity of POs.

The establishment of PPAF and its financing of NGOs provided a real impetus to the growth of the sector. In last eight years from 2000 to 2008, PPAF has established itself as one of the main players in the development sector in Pakistan. Prior to PPAF, none of the NGOs had ever taken loans to finance their operations. PPAF thus brought about a significant shift in the institutional mindset of these organizations. This change entailed a complete transformation in organizational culture, appraisal criteria, staffing pattern, financial management and monitoring and evaluation criteria. The leading microfinance practitioners are all beginning to transform their microfinance programs in Pakistan. They all have either already separated their microfinance programs from other services or are in the process of doing so. PPAF now requires its POs to prepare separate audited accounts for their microfinance operations.

Sri Lanka

There is no separate regulation or law which specifically addresses microfinance activities in Sri Lanka. Organizations involved, fully or partially, in microfinance business seem to have a variety of legal form of incorporation. As noted earlier, microfinance in Sri Lanka, in the retail level, is administered by various types of institutions that includes: (1) local, regional and national level MFIs, (2) village banks (CBOs, Sanasa Societies, etc.), (3) cooperative rural banks (CRBs), (4) development banks (regional development banks and Sanasa development bank), and (5) commercial banks. The level of involvement in the microfinance business varies among these institutions. Given the diverse type of institutional forms involved in the sector, different legislative enactments as listed below may apply, in some form or other, to the MFIs operating in the country: (1) Money Lending Ordinance, (2) Pawn-brokers Ordinance, (3) Companies Act, (4) Banking Act, (5) Finance Companies Act, (6) Finance Leasing Act, (7) Exchange Control Act, (8) Cooperative Societies Act, (9) Societies Ordinance, (10) Voluntary Social Service Organizations Act, (11) National Housing Act, (12) Mortgage Act, (13) Debt Recovery Act/ Debt Conciliation Ordinance/Recovery of Loans by Banks Act, and (14) Inland Revenue Act/ Value Added Tax (VAT) Act.

Majority of the organizations providing microcredit are registered under Companies Act and Societies Ordinance. This, in turn, implies that organizations registered under these two Acts are not entitled to accept/mobilize deposits. In 2006-2007, the Government of Sri Lanka developed a draft of Microfinance Act. However, this draft Act has been put on hold by the government for the last 3 years. Once operational, this draft Act would, among other things, (i) allow NGOs and NGO-commenced MFIs to accept deposits and (ii) require NGOs to separate microfinance work from other activities of the organization. To ensure/spur growth of microfinance activities in Sri Lanka a few additional regulatory challenges need to be addressed in the near future. The two most important, among others are related to restrictions on foreign investment (Exchange Control Act prohibits foreign entities/persons from investing in the shares of companies carrying on the business of money lending) and foreign loans in MFIs (there are very stringent regulations on repatriation of funds abroad including remittances of loan repayments which discourage many overseas based international agencies from investing in the microfinance sector in Sri Lanka).

Most MFIs in Sri Lanka depend on National Development Trust Fund (NDTF), a government owned Apex which provides wholesale to 189 partner MFIs (POs). The funds made available to the POs for retail lending are meant only for income generation purposes. The Poverty Alleviation Microfinance Project (PAMP), managed by Central Bank of Sri Lanka, also disburses wholesale funds to MFIs and has disbursed Rs. 514 million during 2008. The funds made available by PAMP are also for income generation purposes only. PAMP funds are disbursed through regulated banks such as regional development banks and selected partner commercial banks as participatory financial institutions. Stromme Micro Finance Institute (SMFI) is another wholesale lending institute similar to NDTF which also provides technical assistance. It has 40 NGO partners. Two other notable smaller suppliers of wholesale funds in the microfinance sector are Ecumenical Loan Fund and Rabo Bank Foundation.

To sum up, microfinance regulation in SAARC countries has different forms and characteristics. Some countries (Bangladesh, Nepal and Pakistan) have a microfinance regulation already in place, some (India and Sri Lanka) are considering a draft law and some (Afghanistan, Maldives and Bhutan) have developed special regulations under existing banking law and framework. While the need for regulation is clear, overregulation may prove counterproductive. The challenge is to design microfinance banking regulation that will scale up outreach, not slow down, and help in introducing a wide range of microfinance services. Since having an appropriate regulatory framework is an emerging issue, this topic will be revised in next two chapters as well.

The experience of SAARC countries also show that microfinance apex institutions have played a significant role in the development of the sector.

Chapter 5: **Lessons Learned and Emerging Challenges for the Future**

The microfinance industry varies in maturity across SAARC countries. Countries like India, Bangladesh, Pakistan, Nepal and Sri Lanka are more mature, while Afghanistan, Bhutan and Maldives are relatively new and fledgling.²⁸ So the lessons learned and the challenges faced are very different. This chapter outlines the lessons learned in terms of issues like targeting the poor, product diversifications, models of operations or approaches, program impacts, competition and overlapping, interest rate issues, restrictions on deposit services, resource mobilization, reliance on the donors, regulation and portfolio quality. In addition, the chapter also outlines various emerging challenges for the microfinance sector in SAARC countries that are being faced now and likely to continue in future. Major emerging challenges include: sustainability of MFI programs and then possible scaling up, new product development, improving MFI regulations, strengthening institutional & HR development, and extending applications of IT knowledge by MFIs.

Lessons Learned

Various country studies establish that the poor people are indeed bankable and creditworthy. Micro loans were found making big differences to the poor. Group approach emerged as a cost effective vehicle for delivery of micro loans. Unlike most commercial banks, micro loans are provided without any collateral, yet the performance is much more satisfactory. Micro loans and savings services are interlinked and go hand in hand. Women are proved to be the effective channel of microfinance operations and microfinance has also proved to be an effective instrument of women's economic and social empowerment. Microfinance institutions can be viable and sustainable only with appropriate rate of interest on their loans. Institutional development of MFIs is also a prerequisite for the growth and expansion of microfinance services. Some of the key lessons learned from experience of MFIs in SAARC countries are noted below.

Targeting the Poor

To whom MFI services are targeted? How successful are the MFIs in targeting the poor? Target groups for microfinance include very poor, moderately poor, near poor or vulnerable poor and some non-poor families in rural areas. As noted in Chapter 1, the coverage of poor by MFIs varies a great deal among countries; it is only 4% in Afghanistan, 4% in Bhutan, around 13% in India and Nepal, 5% in Pakistan and 42% in Bangladesh (see Figure 13). Comparable figures are not available for Sri Lanka and Maldives because of including of non-poor in the broadly defined MFIs in those countries.

A general understanding in India is that all microfinance programs are for the poor and members involved with the program are primarily in the “low income” category. In Bangladesh, the biggest segment of rural households falls under moderately poor category. About 50% rural households may fall under this group²⁹. In Nepal, many NGOs, international NGOs (INGOs), and government agencies have formed

²⁸ As one should note in Chapter 2 that Bhutan and Maldives have very distinct MF sectors as they are largely dominated by public provision, which is very different from other SAARC countries.

²⁹ Dewan A H Alamgir (2010), State of Microfinance in Bangladesh, InM, Dhaka

groups for different development activities. However, the MF activities have been largely concentrated in the southern *tarai* regions and most MFIs do not feel comfortable to launch services to the deprived groups of the far flung areas in the country. As a result, the poorest of the poor and the vulnerable groups of hills and mountains have not been benefited from the services of MFIs. There is no microfinance program or model as such in Maldives and no designated microfinance institutions.

Targeting new clients while retaining the existing ones are important in countries where MF industry is already matured (e.g. Bangladesh and India). Due to resource and management constraints, the smaller MFIs are not expected to grow fast to increase their market share.³⁰ Such skewed structure is expected to continue. In countries the MFIs have started expanding the market to include previously precluded groups like ultra-poor households by designing special programs.³¹ The MFIs (in Bangladesh and elsewhere) are also scaling up by identifying and delivering bigger loans to individuals with more entrepreneurial capacity.

The overall outreach of microfinance in India is estimated at approximately 50 million people (around 45 million households) including 19.1 million borrowers by end of March 2008. About 10% of clients are assumed to belong to common households. While SBLP accounts for around 72% of the total estimated outreach in terms of members covered, the MFI model has a higher coverage of total borrowers at around 62%. One of the reasons for this anomaly is the more aggressive approach of the MFIs in lending in comparison with the banks. In India, MFIs are catering to clients from a range of income levels including both poor and non-poor. Moreover, some MFIs do not have an orientation to target the poor, but serve non-poor groups with lending to small enterprises.

There is significant divergence regarding estimates about the extent to which micro-finance actually reaches the poor in Pakistan (see Pakistan Country Report). Some justifiably assert that most MFIs do not reach large numbers of very poor people. Some studies show that there are limits to the use of credit as an instrument for poverty eradication, including difficulties in identifying the poor and targeting credit to reach the poorest of the poor. Added to this is the fact that many people, especially the poorest of the poor, are usually not in a position to undertake an economic activity, partly because they lack business skills and even the motivation for business.

The GTZ demand side survey (2008) in Sri Lanka found that 80% of Sri Lankan households, which has borrowed from institutional sources had borrowings below Rs. 100,000. In the urban areas, 67.9% households, which took loans below Rs. 100,000, whilst in rural areas it was 100% for borrowing households. This shows that Sri Lanka is primarily a microfinance market, but the program seems to have served many non-poor households.

³⁰ The smaller new entrants are also facing first mover advantage enjoyed by the bigger and older MFIs.

³¹ BRAC the largest NGO in the world, introduced programs targeting, very clearly categorized the poverty groups offering distinct financial products, which is followed by operational features to identify the actual persons. Its five financial products target three poverty groups; extremely poor, moderately poor and vulnerable non-poor. Two products target the first category; one is basically asset transfer and training, and the other is food aid, training and financial services.

The country reports clearly show that microfinance programs have been able to target the poor though in some cases, near poor and some non-poor households in the rural areas are also served by microfinance programs. The coverage of the poor varies widely and in some countries (Bangladesh and Sri Lanka) the coverage of the poor by the existing program may have reached near saturation.

Product Diversification and Scaling-Up of Microfinance Programs

Product diversification and scaling-up issues have gained in importance considerably over the years in the SAARC regions. Generally loan sizes are expected to grow for continuing clients. Offering of pre-determined small size loans have been considered a deterrent for the MF market to grow and MFIs are taking this into considerations. Now, special micro-enterprise and agriculture loans are available for eligible clients. As one of the largest and most famous MFIs in Bangladesh, ASA targets several market segments with corresponding financial products. Interestingly, it has added a new loan product for men, which does not need additional criterion other than the fact that the men should be from the same families of the members of women groups. ASA has thus attempted to develop a product-market to respond to market demand. For example, attendance in group meeting is central to the small loan (women) program whereas ‘individual loan’ and ‘no attendance in meeting’ are two important design features of Small Entrepreneur Loan (SEL) program. Similarly, the size of loan is very distinctively determined with demand and nature of loan. Only a few MFIs are lending for microenterprise development, the lessons and experiences of which will have relevance for other SAARC countries.

In Nepal, lack of market for products and very limited economic activities due to low density of population have posed problem to the financial institutions to expand their operations in the remote hills and mountains. Likewise, low level use of suitable agriculture technology is another problem in promoting microfinance in the geographically remote areas. In Sri Lanka, the most prominent loan products available from SEEDS, Sanasa, Samurdhi and such initial microfinance projects and programs was an income generation loan. Some of them have been diversifying their products but found them to be inadequate. The range of financial products in Pakistan offered by most MFIs is limited and until now most do not offer the full spectrum of services, such as savings, micro-insurance and remittances. The loan amount, repayment schedule and duration of loan does not generally meet the requirements of the clients. In terms of loans, most MFIs offer only one or two loan products, which generally consist of group guaranteed working capital loans. There are only two services provided by the MFIs in Afghanistan; credit and savings. ARMP and OXUS are providing agricultural credit. The main loan product offered by the largest MFI, BRAC-Afghanistan is based on a solidarity group methodology with groups of four or five clients, primarily women. One or two MFIs, such as FINCA have recently introduced non-interest bearing Murabaha Islamic loans or contracts where sellers declare their cost and profit.

Deposit services constitute the neglected part of financial services because of the sustained discrimination against and frequent disregard for the need for such services, despite their productive roles in financial services. This is evident from different nomenclature used at both the international and national levels where credit is emphasized. Savings services can be a useful entry point for the un-banked. With the greater spotlight on knowing the customer and the fact that poor households do not have a salary slip, utility bills, clear land titles or unique identity papers, a regular savings record could be the first building

block to membership of the formal financial sector. What is more, with savings services, poor customers need to trust the financial institution and not the other way round.

The Indian microfinance sector is tilted towards credit and other aspects of financial services provisions and does not feature prominently. Although there are institutions which are innovating and experimenting with insurance products through MFIs as a delivery channel, deposit services remain a distant dream for the practitioners. The SHG-Bank linkage program has made some progress in providing poor clients an opportunity to save and, as women form the majority of the client base, the initiative also supports their empowerment.

In Sri Lanka, all of the major players have had significant portfolio growth in the recent past. The market is mainly limited by the availability of financial resources than the demand for credit. Therefore the competition is mainly centered on deposit mobilization. In addition to micro credit providers the National Savings Bank and all commercial banks are aggressively mobilizing savings from the microfinance market which affect the availability of deposit resources for micro credit providers to provide credit services to much needed microfinance clients.

The lessons learned from the studies of SAARC countries clearly show that as MFIs gather more experience; these can and may diversify products and services and include such an important fence as deposit.

The overall lesson learned from the experience of eight SAARC countries is that there is considerable variation in microfinance products and some countries have advanced much more than others indicating that there is good room for scaling up. The prospect for scaling up MFI lending is borne out by the evidence of continued role of the informal sector in almost all the SAARC countries. (see Chapter 1)

Varied Models /Approaches of MFIs

As one should note from Chapter 2, countries in the SAARC region follow a wide variety of models and delivery mechanism to reach clients from various strata of the society and this diversification is also observed within a single country. For example, in India, there are the government run SHG Bank Linkage Programs and the MFI models, which is privately managed by independent civil society institutions with some of them regulated by the Reserve Bank of India (RBI). The MFI model uses a variety of methodologies ranging from the very popular SHG methodology traditionally pursued in the country with Grameen and joint liability groups, as well as individual banking arrangements. Over the years, through an ongoing process of experimentation and innovation undertaken by Indian MFIs, many now largely follow a mixed approach customised to their target segment and area of operation. However, all the fastest growing MFIs in India follow the Grameen methodology.

In Sri Lanka, there are many models being practiced by MFIs. One of the biggest problems that Sri Lanka faces is the weakness of the most prevalent model which is the “Community Banking Model”. Sri Lanka commenced serious microfinance program expansions, such as SEEDS, ISURU, TCCS and Janasaviya as early as mid 1980's. However, countries that began much later, such as Pakistan, have qualitatively much better MFIs. Also, the simple group or cluster approaches followed by most Bangladeshi MFIs, including

ASA, BRAC and Grameen Bank have seen better results during last 2-3 years. While the society or community based models can bring social and economic empowerments, they also introduce restriction on how the organizations can behave making them inflexible. A few Sri Lankan MFIs have started following this model and this includes Ceylinco Grameen, BRAC Sri Lanka, Lak Jaya and Berendina Micro Finance Institute. Both Lak Jaya and Ceylinco Grameen at present are facing problems but these are not due to the issue in the model but are related to the governance related issues.

In Nepal, there are quite a few prominent models of microfinance. These include Cooperative model, Small Farmers Cooperatives Limited (SFCL) model, Grameen Bank model, and Community based organizations (COs) or Self-Help Groups (SHGs) model. In addition, Production Credit for Rural Women (PCRW) and Village Banks are also considered separate programs/models of microfinance in Nepal. Programs like Decentralized Local Governance Support Program (DLGSP), Poverty Alleviation Fund (PAF) and some other rural development programs have also included microfinance as a component following the SHG model. Each model has its historical background and modus operandi of its own.

Most of the microfinance institutions (MFIs) in Nepal are concentrated in areas, which have easy access to markets and also have high density of population. They have not been able to build up right approach to outreach the neediest downtrodden masses in remote areas. Often they have the tendency to serve households that are neither poor nor vulnerable. The institutions do not have the right culture and mindset to serve the poorer first.

In Afghanistan, the predominant models combine the group lending approach with individual lending. Some also use the solidarity group lending model. While one or two organizations have experimented with Self Help Group models, these have not really taken off in Afghanistan. The membership approach is being used in the establishment of member owned credit unions. However, this membership model is being used in a limited manner. Most MFIs are attempting to use the group methodology and within that the solidarity group, such as BRAC or village organizations, such as the Afghanistan Rural Micro-Credit Program (ARMP).

Another important lesson from various MF practices in the SAARC countries is that public sectors played important roles in carrying out microfinance services (e.g. Bhutan and Maldives) and/or facilitating the industry as a whole (through apex wholesale loan providers such as PKSF in Bangladesh among others). Microfinance in Bhutan began only in 1980. Unlike in other countries in South Asia microfinance in Bhutan is being managed by public sector institutions and not by NGOs. The Bank of Bhutan (BoB), which is mandated to give 20% of its loan portfolio as rural credit did not lend even 1% of its loan portfolio. The principal reason for this was that BoB's loans were highly secured. The microfinance sector of Bhutan uses both the individual and group lending methodology. However, it has not had much success with its group approach.

The microfinance sector in Pakistan consists of a diverse range of institutions and the products that they offer do not vary significantly. Despite the purpose for which the loan is taken, the loan amount and repayments are not structured to reflect their use and individual demand. Thus most people who are using micro-loans are borrowing from other sources as well. Some private sector leasing companies are offering various types of equipment on lease. A few MFIs have introduced Islamic products but these have not

really reached any significant scale. In spite of wide variety of microfinance providers in Pakistan, the lending methodology is surprisingly uniform. The group lending methodology uses both the community group and the solidarity group approach. While the RSPs use the broad based village, community or women's³² organization as the group through which they provide financial services, the MFIs generally use the solidarity group lending model. Kashf Foundation, in particular, follows the Grameen Approach of solidarity group lending method.

Three different types of lending technologies are being applied in Bangladesh that includes Grameen styled group-based system, self-help group approach and individual lending. Bangladesh microfinance sector for all practical purposes is dominated by basic group-based Grameen methodology with some modifications. A handful of non-government organizations have tried and are still trying the self-help group approach of developing financial service delivery system. This type of community-based microfinance whilst popular in some countries has not been found to be successful in large-scale operation in Bangladesh. The central issue to developing individual system as opposed to group-based system is to offer flexible and demand-driven services to each client/borrower.³³

In the light of the foregoing, it is evident that Bangladesh microfinance industry is dominated by Grameen styled approach, which is a group approach indeed. Except the Grameen Bank, there is no legal provision for setting up "for profit" MFIs in Bangladesh and there is no graduation process of MFIs either. To the contrary, India, Sri Lanka and Nepal abound with various models/approaches in microfinance. Each of these countries has established microfinance non-banks as well as banks. As cited in the foregoing, many MFIs in India now largely follow a mixed approach customised to their target segment and area of operations. In addition, despite wide variety of microfinance providers in Pakistan, the lending methodology is surprisingly uniform. About 92% of the borrowers have been provided funds through the group lending methodology. The group lending methodology uses both the community group and the solidarity group approach. In Afghanistan most are following group methodology within the solidarity group. Overall, Grameen approach is popular in the regions. Except Bangladesh, ultra poor seems to be generally bypassed in most of the countries in terms of intervention as well as methodology.

Competition and Overlapping

All countries in the SAARC region have faced increased competition in the microfinance market. There have been new entrants in the industry and this has shifted the landscape of the industry to further outreach and product diversification. However, the issue of overlapping has also received much attention. The impacts and roles of competition in terms of increment of number of MFIs are somewhat mixed and yet to be assessed fully. For example, in Sri Lanka increase in number of MFIs has not have much impact on MFIs' profitability or interest rates. However, clients now have wider microfinance products to choose from. In Nepal, competition among MFIs has led to wrong targeting and borrowing from multiple MFIs.

³² Sununtar Setboonsarn, Ziyodullo Parpiev. Microfinance and the Millennium Development Goals in Pakistan: Impact Assessment using Propensity Score Matching Discussion Paper No: 104. ADB Institute. 18 April 2008.

³³ There have been some efforts from several NGOs (for example, Ashrai, Caritas, Concern Worldwide) and donor-funded projects to develop alternative systems but none could stand as a viable alternative. ASA and BRAC and many others disburse loan under their respective microenterprise loan programs to individual clients but offer fixed one year loan and fixed monthly repayment system.

In Sri Lanka, in general the competition is good for the clients where they will get more to choose from and improved services due to competition. The competition is supposed to reduce the market interest rate as service providers compete for the clients. However, there has not been any significant change in the market interest rates of the major players as a result of competition. Contrarily, there has been an upward trend in the interest rate charge in the NGO-MFI sector. This may mean that despite competition a good part of microcredit market demand is unmet.

The issue of competition and overlapping is particularly important in Bangladesh as the number of NGO-MFIs is large (about 1000 though not all of them are registered with the MRA) and most of them are working in an already saturated field. While the industry is dominated by top three MFIs, locally all of them compete with other players for clients, resulting in overlapping.

With an increasing number of MFIs mushrooming in the Indian microfinance space and with the high growth rates of the large MFIs, there is an increased incidence of client over-indebtedness on account of multiple lending. Although there has not been enough research on the direct relationship of competition and over-indebtedness, it has been observed that the same clients are members of more than one MFI in many parts of the country. This could be leading to clients accessing more debt funds than they have the capacity to repay. Such observations have been made mostly in urban areas where there is a high density population and MFIs are able to achieve economies of scale. There is another aspect of efficiency in tracking loans, which is linked to competition and over-crowding. A key finding of the diaries is that many households were borrowing systematically from several MFIs and SHGs. In the sample, more than 90% were indebted to more than 2 MFIs/SHGs and 50% were indebted to more than 4 MFIs/SHGs. About 70% of the households also had loan repayments to finance companies, chit-funds and money-lenders. As microfinance has expanded, the sector has begun to see evidences of overlap and competition. Overlap between SBLP and MFIs has emerged mostly strong in the two southern states of Andhra Pradesh and Tamil Nadu, which are the leading states in terms of number of clients under both models. Direct competition between MFIs is emerging in certain areas, particularly the southern states of Andhra Pradesh and Karnataka, and the eastern state of West Bengal, in both rural and urban areas. The M-CRIL social ratings cover microfinance overlap and early ratings found overlap on average of 7% of households covered in the rating sample. In certain areas, the overlap goes much higher – up to 30%.

In Nepal, the RMDC study (unpublished) show that some overlapped members used loan from one MFI to repay loans from others. Over indebtedness of clients caused by overlapping of programs or overcrowding of MFIs in a few easily accessible areas with well developed market is yet another challenge to this sector. MFIs' tendencies to snatch away each other's clients have caused misuse of loans and financial indiscipline among borrowers. Some racketing was also noticed by vested interest groups by taking advantage of undue competition among MFIs.

Overall, competition is good for extending outreach. An important effect of competition is greater choice for clients. When clients have more bargaining power, they ask for products and services that meet their needs more effectively and microfinance institutions do respond. Competition among MFIs would take place if they are aiming to reach the same group with similar loan products. If the MFIs demonstrate areas of operation or provide different types of products, the MFI would then complement each other. To create competition on a level playing field, transparency and easily accessible information to clients would be

necessary. Overlapping, in the sense of borrowing from multiple MFIs, has not been a problem until now. However, increasing use of regulatory framework and technical tools would be desirable.

Interest Rate Issue

The interest rates on the microfinance loans and deposits are largely market determined and generally it is expected to be higher than the rates charged by the commercial banks. This reflects the fact that the loan sizes are small and average operating costs for disbursement and recovery loans of such small sizes usually entails higher cost. Moreover, the interest charged by the MFIs allows them to cover cost and build equity due to efficiency gained over time and economies scale (large portfolio). However, in many parts of the SAARC regions the alleged high interest rates charged by the MFIs are matter of great debate. Countries like Bangladesh has engaged in a debate whether such high interest rates should be controlled by a central authority or not.

Historically in Bangladesh, the rates were set by the large MFIs and followed by smaller MFIs as the going rate(s). The apex wholesale loan provider PKSF asked its partner organizations to reduce interest on loans from 15% (flat) to 12.5% (flat) beginning 1, July 2004 because it provided subsidized capital to the partner MFIs. Even with this rate its partners are found to be financially viable. Grameen Bank has been charging at 10%, which is the lowest in the industry. The important issue is that NGO-MFIs have not used interest rate to compete with each other. So far they have been successful in deploying the available resources by maintaining the interest rate constant. It is unlikely that this practice will be changing in the near future. The main deterrent will be the threat to their financial sustainability if the interest rate goes down substantially. However, there is general public perception that MFIs charge ‘excessive’ interest on loan. Such views have been vented by high political and government officials in public forums. Government has tentatively fixed a flat rate of 15% and effective interest rate of 30% as ceilings.

MF experiments, as noted earlier, in Afghanistan are new and the interest rates are determined on an assessment of the delivery and financial costs that MFIs incur. MFIs also take into consideration the clients’ willingness to pay for the loans, the overall welfare enhancing activities of the NGO/MFIs and sector averages the international MFIs charge elsewhere in the world. In justifying their interest costs, some of the MFIs in Afghanistan maintain that the interest rates and charges reflect the costs of doing business in an environment of high security risk, scattered population, high wage and food inflation and of adopting an Islamic approach which entails higher costs due to the fact that female loan officers require Maharams and the Murabaha transactions have higher administrative costs, etc. A key factor which has influenced the interest rate policy of MFIs in Afghanistan is the availability of grants for operational costs and subsidized loan funding from MISFA.

In Nepal the Cooperative Society Act 1992 allows cooperatives to fix and apply their own interest rates on the loans extended to their members and the deposits collected from them. Similarly, Financial Intermediaries Act 1998 allows the FIs to fix interest rates on loans and deposits on their own. The NRB Directives, 2003 also provide freedom to Microfinance Development Banks (MFDBs) to fix and apply interest rates of their own on loans to, and saving deposits from, their members. However, the NRB Act, 2002, in case of the Rural Self-Reliance Fund (RSRF), has specified the interest rates for its borrower

cooperatives and NGOs, which are far below the market rates. This has to some extent distorted the market interest rates.

One of the key challenges in the microfinance sector of Pakistan is that most MFIs in Pakistan do not charge their clients interest rates that are high enough to enable them to cover their costs. A look at the average operating expenses of the Pakistan Microfinance Network (PMN) members compared with the revenues generated from the loan portfolio (yield on portfolio) suggests that MFIs are not pricing their loans appropriately.³⁴ PPAF has allows POs to charge its clients interests rates that fully cover its costs and fix rates that are not less than the long-term deposit rates. A historical review of interest rates in the micro-finance sector shows that interest rates have moved from an average of about 3% to 30% today. Thus it is anticipated that in the next few years the pricing structure of most of these organizations will shift towards sustainability. In fact, it is already beginning to happen, with for example, the National Rural Support Programme (NRSP), the largest supplier of micro-credit in rural areas, now starting to raise its interest rates. On one hand, the average operating expense ratios of the leading MFIs are basically in line with the region's overall low ratios at 22.4 percent compared with 22.8 percent for all of Asia. Again, the revenues generated from the loan portfolio (e.g., the yield on portfolio) are low at 18.8 percent for the leading MFIs compared with 30.7 percent in Asia on an average.

Interest rate settings by MFIs in India for lending have always been based on covering the operational costs. Interest rates have seen a significant decline since 2005. The weighted average APR dropped from 30.1% in 2003 to 26.1% in 2007. In 2005, the interest rates have been higher mainly because of the higher operational costs as the sector had started to grow and there were inefficiencies in the MFI systems. SHGs usually have lower operating costs thus charge lower interest rates in general, compared to the more standard Grameen type models. MFIs have been lowering their interest rates in the recent time because of further efficiency gains in operations and also political pressures.³⁵ Legal provision of allowing Grameen type models to operate as for-profit organizations also allowed higher interest rates for such organizations. It is expected that as the MFIs grow further and gain more experience, with better economies of scale and improved operational efficiencies the interest rates would further come down in years to come.

Pakistan Poverty Alleviation Fund (PPAF) currently has a differentiated interest rate policy with regard to its Partner Organizations. It charges the NGOs an interest rate of 8 percent and has fixed an interest rate of 10 percent for private sector leasing companies and microfinance banks. PPAF has linked its interest rates to the inter-bank rate in order to gradually move the sector towards sustainability—as far as the interest rate policy of its partners is concerned PPAF mandates.

There are number of wholesale funding or refinancing schemes in Sri Lanka, which provide loans to MFIs at subsidized interest rates. NDTF provided at 9% declining balance and it is scheduled to be further reduced to 7% from July 2009. Poverty Alleviation Microfinance Project (PAMP) provides funds to Rural Development Bank (RDB's) at 4.5% interest rate which goes to end clients at 16%.

³⁴ The Pakistan Micro-Finance Network.

³⁵ The enforcement of Moneylenders Act in some states on a few institutions on interest rates related issues also has some impact in reduction of interest rates in some regions.

In general, the MFIs in Nepal are free to charge any rate of interest on loans to their clients. The regulation does not cap the ceiling. In other words, interest rate is deregulated by the Nepal Rashtra Bank (NRB). Some Financial Intermediary NGOs (FI-NGOs) are charging as low as 18% per annum, while others are charging interest between 20 to 25% per annum. The government owned Grameen Bikash Banks (GBBs) are charging 20% interest rate per annum on the loans to their clients. Four out of five GBBs have now been privatized. The private microfinance development banks are charging interest on loans to their clients at a range between 20%-25% per annum. The rate of interest charged by the Nepalese MFIs is lower compared to the rates charged by the MFI in India, Bangladesh, the Philippines and Indonesia, etc.

The review of experience of SAARC countries about interest rate shows that it varies a great deal and achieving an overall reduction in interest rate in microfinance is accepted as desirable, but this cannot be effectively or efficiently accomplished by imposing interest rate caps. However, there is room for giving relief on interest rate to most borrowers by increasing efficiency of its operations and by introducing variations in pricing. There is also a need for transparency and clarity in fixing interest rate charges for better understanding of poor borrowers.

Resource Mobilization

It is difficult to assess the utilizations of internal financial resources of the existing MFIs. In India, microfinance institutions have relying heavily on debt; about 72% of the financing came from debt. Savings from clients and grant components have been declining as well. With improved profitability and financial sustainability, retained surplus is becoming an increasingly important source of funds now contributing 7.9% of total funds in 2008 compared to its negative 4.2% contribution in 2003. However, with the current financial crisis and increasing financial cost ratio, it would be interesting to see if MFIs are able to sustain the increase in retained surplus in the coming years. In Bangladesh, the NGO/MFIs can collect deposits from the members only, while for the major ones subside credits from PKSF which is an important source. Traditionally grants and donations have also been major sources of funds. As per rule of the central bank deposit taking from the public without license is prohibited. However, the Grameen bank can mobilize deposits from both members and the general public.

There is thus extensive variation in the methods in which resources are mobilized by MFIs in SAARC countries. India and Bangladesh seem to be most successful in mobilizing funds and their examples are worth emulating by other SAARC countries. In India, microfinance is clearly experiencing a surge of interest from the private sector, which needs to be encouraged and expanded. In Bangladesh, savings from members provide a useful source of funds for lending, but careful prudential regulation will have to be put in right place.

Portfolio Quality

This is an important element in assessing sustainability of MFIs, which is a key emerging challenge for the future (described next). Database analysis indicates that the Grameen organisations in India have been the best performers with Portfolio at Risk (PAR₆₀) in the previous years, except in 2007 when PAR₆₀ rose to 8.4% owing to the political problems that occurred in South India. The portfolio quality based on analysis of PAR₃₀ of the sample MFIs in 2008 stands at 2.1%. This shows a significant improvement from 2007. This better performance of Grameen organisations is attributed to the small 5-member group structure and to better group discipline maintained through deployment of significant resources by the

MFI and strong delinquency management efforts. Hence, this good portfolio quality was often maintained at high cost (typical OER 19.4%). Looking at the sample information across various institutional types, NBFCs and Sec-25 companies are among the best performers (PAR_{30} of 3.2% and 2.1% respectively) as most of them follow the typical Grameen Bank methodology with enforcement of greater credit discipline among the clients by the field staff.

In Bangladesh, the portfolio quality of very large and other smaller MFIs has been declining over the last 2-3 years. Interviews with key individuals and field level staff members reveal some pattern: (i) fast expansion without giving due consideration about selection of members/borrowers (field officials try to reach targets); (ii) economic slowdown, price hike and impact of natural disasters in some geographical areas; (iii) de-emphasis on groups system and meetings which might have improved efficiency and reduced transaction time for the borrowers but field officials may be now missing important client information to assess risks; (iv) multiple borrowing without proper investment opportunities; (v) part of loan diverted to various consumption purposes; and (vi) lack of capacity of the respective MFIs to manage large program that expanded too fast.

In Sri Lanka, the weak portfolio quality has been an issue in the industry for many years. The concern over portfolio quality was built up in the industry in the recent past. The issues are lack of understanding on importance of portfolio quality, lack of appropriate loan tracking mechanisms and cultures within MFIs to ensure on time repayments. The culture among clients for delayed payments aggravates the issue even for MFIs having proper systems and procedures regarding portfolio quality to implement them in the field.

A major area of concern in the microfinance sector in Afghanistan is the portfolio quality of the sector which has deteriorated quite significantly in the recent time, with the PAR (>30 days) increased from 1.9% in March 2007 to 10.2% in March 2008 and to 9.4% at the end of September 2008 and 10.5% at the end of December 2008, the steepest increase in the last 18 month period. The official reports of PAR (> 30 days) of 36% may under-report the actual figures of 55% coming from independent private review of MFIs.

In Bhutan, the overall quality of the group loan portfolio is poor and they vary a lot across branches. The total number of loans in arrears as a percentage of total loans outstanding increased from 20 percent in 1999 to 25.6 percent in 2001. This is despite the fact that many borrowers had loans with a grace period of one year. With respect to the portfolio quality of all loans outstanding of the Agriculture Lending Department, the recovery rate is also poor. The arrears rate is very high. The aging report shows that there is virtually no improvement in portfolio quality management over time for loans with arrears less than 12 months.

The Pakistan Microfinance Network (PMN) monitors the portfolio at risk in the sector. Apart from a few outliers this has generally remained at acceptable levels in the past. In 2005, PAR was reported to be 9% for loans overdue for more than 90 days. In 2006 the PAR was 5.2% for the sector as a whole for loans overdue for more than 30 days and in 2007, it was further reduced and reported to be 3.1% for loans overdue by more than 30 days. The PAR for the last few years in Pakistan, however, does not reflect the accurate figures in the sector and MFIs maybe under reporting on issue.

Emerging Challenges for Future

Microfinance is now globally recognized as an effective tool for reduction of poverty. It has shown positive results in many countries. However, microfinance services have not yet deepened down to reach the neediest poor. There are still huge masses of people who are deprived of financial services in a number of developing countries. At the same time, there are a number of challenges facing the microfinance industry. The review of experiences and lessons from country report throw up some key challenges for microfinance programs in the future.

Sustainability of MFIs

Operational Self Sufficiency (OSS) measures the ability of an MFI to meet all its operational and financial costs out of its income from operations. Financial Self Sufficiency (FSS) measures the extent to which its income from operations covers operating costs after adjusting for all forms of subsidy, loan loss provisioning and the impact of inflation. The FSS is an approximate indicator of the impact of subsidies on an organisation's sustainability.

Indian MFIs have become increasingly sustainable over the years. It is evident from the data that the weighted average OSS and FSS of the Indian MFIs have increased significantly to 122.4% and 115.4% respectively as compared to 92% and 87% respectively during 2007. The OSS and FSS for the typical MFIs have also improved in the last two years, owing to better management of operating and other expenses by the large and relatively young organizations. Over the last two years, the Indian microfinance industry has gained experience and has become more commercially oriented. The presence of a large number of professionals joining the sector has also made a difference. In the recent past, many start-ups have been established by professionals rather than by development practitioners.

In Nepal, most MFIs have been running at profit and have achieved operational self sufficiency (with an average OSS of 120%). They are geared up towards attaining financial self sufficiency as well. But they heavily depend on external sources such as RMDC and commercial banks for financial resources to meet the loan demands of their clients. They receive wholesale loan from commercial banks (CBs) under deprived sector allocation. However, in case the deprived sector is phased out, they may not receive loans from them at lower rate. Hence, it is a challenge for them to identify and tap financial recourses that would be regularly available to meet their needs.

In Pakistan, sustainability is an important issue in the sector. There is a heavy reliance on donor financing in the sector. Despite the exponential growth in the NGOs providing micro-finance services in the last few years, the sector lags behind most countries. There are also concerns that the growth rate of the last few years may not be sustained. Only four MFIs had reached OSS by the end of December 2008. While the Pakistan microfinance sector has among the lowest cost of delivery, its yield on portfolio is low compared to other countries. Many attribute this to interest rates which do not cover costs of delivery. This represents a real challenge to the sector as many MFIs are charging interest rates between 20% and 35%. While some of the factors are beyond the control of the microfinance practitioners such as low population density, other cost cutting measures are well within the reach of the providers.

The overall operational self-sufficiency of the leading MFIs in Afghanistan was reported to be 80% at the end of December 2008.³⁶ Currently, only two MFIs in Afghanistan, the Children's Fund for Afghanistan and the First Microfinance Bank of Afghanistan report an operational self-sufficiency ratio of more than 100%. The operating costs are very high in Afghanistan due to expenses incurred on security measures, small sized loans, low population density, poor infrastructure, high costs of some services and hiring of expatriate staff. Lack of sustainability in MFIs is noticed in Sri Lanka. Out of a total 20 MFIs studied, only 7 MFIs have had operating profits in 2008. There are few MFIs that calculate and report their operational Self-sufficiency. In Sri Lanka, widespread involvement of public sector with heavy subsidy on operational costs specially Samurdhi where all staff and administration costs are subsidized by government. This is a major challenge and many Banks and more in the private sector have not commenced microfinance programs due to this challenge of competing with subsidized programs of the government. NGO MFIs and co-operatives are working amidst this type of challenge as Samurdhi is a huge program which covers every single Grama Niladari division (lowest administrative division) and is a sizable competitor for all MFI's in the country. Fortunately some of the stringent policies adopted by Samurdhi still leave space for others to compete successfully. Based on the lessons learned, the sustainability issue appears to be a formidable challenge and this is why it is dealt as an emerging issue in the future.

In Bangladesh, the emphasis on achieving financial viability began sometime in mid-1990s. Early status of viability has been reported in Alamgir (1999a) about the financial viability of 21 small MFIs (highest membership 15,000 in 1999), which were borrowing from PKSF to run microcredit programs. The performance of microcredit program is ultimately reflected in partner organizations' financial viability (MFIs that borrowed from PKSF). The study reports that except for one MFI all other could cover operational expenses from income as early as 1997. Similarly, 18 out of 21 MFIs were financially self-sufficient, that is, 18 organizations could fully cover their operating and financial expenses (interest on members savings at the rate of 6% per annum, cost of borrowing from PKSF at 3-4.5%, provision for bad-debt). The viability was achieved due to subsidized cost of capital from PKSF and relatively low level of staff salary in these smaller MFIs.

Appropriate Microfinance Regulation

Regulation in Pakistan is a relatively recent phenomenon and only applies to MFIs registered as banks. The non-bank MFIs largely remain unregulated and for this reason are prohibited from providing a full range of financial services. The central bank has encouraged these institutions to transform into MFBs if they wish to offer services such as savings to their clients and other market segments. The Microfinance Institutions Ordinance 2001 provided the regulatory framework for the microfinance sector in Pakistan. The Ordinance defined the scope of business for a microfinance institution, the paid-up capital and liquidity requirements, licensing policies for such institutions, the basic structure of its management and administration, and SBP's powers for supervision purposes, etc. A number of amendments have been made to the Ordinance since 2001 in consultation with the sector stakeholders to make the framework more conducive and rational. The enactment of the MFI Ordinance has had positive effects on the

³⁶ Monthly Progress Report. MISFA. December 2008.

microfinance sector in the country. It has helped to re-define microfinance as a core financial sector activity with not only social implications but also commercial opportunities.

In Bangladesh, microfinance is now regulated under the Microcredit Act 2006 and enforced by the Microcredit Regulatory Authority (MRA). As high as 432 MFIs have already received license and more MFIs are expected to receive license. This is the first step toward formally recognize and legitimize microfinance under licensed organizations. But MRA is yet to introduce the body of regulations that are supposed to actually guide the MFIs. The situation poses two issues: (i) the actual scope and authority of MRA which currently cannot independently and professionally function without the approval of MoF that makes MRA more of a weak recommending body only; and (ii) delay in introduction of regulations essential for regulating MFIs. MRA is a new organization with limited capacity that will have serious difficulties to meaningfully regulate several hundred financial institutions.

NABARD in India has been entrusted with the regulation of the microfinance sector under the draft Microfinance Bill. NABARD is also an implementer even though it does not directly finance clients under SBLP; the regulatory responsibility will still entrust it with the dual functions of implementer and regulator, leading possibly to a conflict of interest. A larger concern is of leaving a large part of the microfinance sector (serviced by NBFCs and Section-25 Companies) uncovered by microfinance regulation. This will not allow these MFIs to provide deposit services to clients for their savings. Savings services are not only essential for the clients but also a very important source of financing for MFIs. This becomes more relevant in today's times of recession when commercial borrowings have become more limited.

In Sri Lanka, MFIs operate within number of legal frameworks. The savings is a strong capital base for MFIs. Although the Acts of parliament within which most of the MFIs are registered do not provide legal power, savings mobilization were promoted among MFIs by donors as well as government managed poverty alleviation projects.³⁷ The government failed to offer no clear legal path for those institutions subject to prudent supervision. In the recent past, due to the failure of certain private sector as well as NGOs and CBOs to honor the withdrawal of deposits by savers, the government is now attempting to strictly control and prevent savings by MFIs not authorized to do so. The microfinance Act, which was drafted and was on discussion for last 2 to 3 years from time to time has not come out so far. As this is a serious challenge, some MFIs are pursuing the option of licensing as finance companies or development banks. Only very few can pursue these options as they are costly and need specific capital requirement and changing legal status as public companies, etc.

The formal microfinance sector emerged in Afghanistan in 2002 as part of the rehabilitation process to provide social protection and alternative means of livelihoods to the poor. While there is no special microfinance legislation in the country, the existing policies are such that microfinance banks committed to microfinance feel they can enter the market.³⁸ The Government of Afghanistan has taken other measures to support the fledgling microfinance industry. In 2006 the central bank published the "Deposit Taking Microfinance Institutions" regulations under the Banking Act that will allow MFIs to eventually

³⁷ Such as NDTF (then called JTF) and small landless farmers credit (ISURU) project.

³⁸ The First Microfinance Bank, Afghanistan was the first licensed microfinance bank in Afghanistan which has been incorporated as a full service commercial bank with microfinance being its main area of focus.

transform into specially-regulated deposit-taking microfinance institutions, and from there to full commercial banks should they wish.³⁹

The history of microfinance in Nepal is over three decades old. However, there was no stated policy of the government on microfinance prior to the announcement of the microfinance policy by the Ministry of Finance of the Government of Nepal in 2008, on the advice of the Nepal Rastra Bank (NRB). Such policy was expected to do away with the problems related to organizational and legal issues with a view to smoothly providing microfinance services in the rural areas, increasing the access of the destitute class to such services, creating a healthy and competitive atmosphere among MFIs, and encouraging the private sector to get involved in the task of providing such services on a sustainable basis, and to boost up microfinance industry as a whole. It also has envisaged establishing a regulatory and supervisory body for regulating and supervising the MFIs in the country as such that they discharge their services effectively and efficiently. In addition, NRB is solely responsible for supervising MFDBs, FI-NGOs and Cooperatives with limited banking licenses and Cooperatives which are the borrowers of RSRF. NRB supervises these institutions only once every three years, which is quite inadequate to keep these institutions on right track in their operations and financial management.

In most of the SAARC countries, regulation is yet to be enforced by the respective governments. Regulation is being talked about everywhere. Nevertheless progress has been made in some countries, though. There has to be a transformation process of the MFIs into graduated legal entities, which is still lacking in these countries. This issue has emerged as challenge to be dealt with in future.

Institutional and HR Development

MFIs in Nepal still lack a matching pool of knowledge and skills required for running MFI programs as business. MFIs often charge low rate of interest on their loans that may cause them losses. Most MFIs do not have business plans and lack strategies to achieve sustainability in their operations. Further, there is also a serious shortage of institutions that can provide capacity building training to the MFIs. Hence, developing professionally managed capable MFIs is also a challenge to this sector.

Microfinance sector in Bangladesh is a mix bag of institutions in terms of institutional and human resources capacity. Over the years significant progress has been made in many areas such as management of MFIs, accounting and financial reporting, etc. However, the complexity of serving different clients groups and increased size of organizations poses major challenges for top and mid-level human resources. So far numerous but ad hoc in-house on the job training and donor and PKSF-funded training courses have been the main mode of human resources development. Due to breakneck expansions in microfinance programs in recent years, there is a dearth of skilled microfinance staff which is affecting the quality of the microfinance programs of most MFIs.

In India, capacity building and improving understanding of techniques for improving microfinance management is the key to effective microfinance operations and eventually for achieving the prime objective of financial inclusions. In the recent past, capacity building and investment in human resources in India have increased but the quality and quantity of such services does not necessarily match the current requirements of the sector. The effective bridging of capacity building gaps requires regular

³⁹ IDA. 2007.

interventions in a number of areas like keeping paces with the fast growths of the sector, geographical spreads and diversity and local language constraints. Capacity building service providers must also cope with issues like relevance of contents, the subsidy orientations of some service providers and the high attrition rates of MFI staff. In spite of high personnel allocation ratios MFIs continue to limit their investments in their own staff capacity. Some of the current capacity building gaps are in the areas of governances, human resource managements, risk managements and social performance managements. There is also the lack of specialized low cost agencies for providing customized capacity building to the field staff of MFIs. Field staff requirements have grown manifold due to the growth of the sector in recent years. The MFIs have, so far, relied on in-house and on-the-job training methods for this purpose but in the long run this may not be cost effective.

In Pakistan, the sector suffers from serious capacity constraints. Several donors such as the Swiss Development Cooperation, the Department for International Development (DFID-UK), USAID, the Asian Development Bank and the World Bank have been providing support for the sector and have helped to build the capacity through specially tailored programs for the institutions. The PPAF and the Pakistan Microfinance Network (PMN) have played a positive role in helping to strengthen the sector institutions, enhance industry standards, improve transparency and performances. In the initial years many of the governance systems were dominated by family members and friends. There is now a growing trend to replace the members of the Board with professionals and independent individuals with experience and capacity to provide real leaderships.

In Sri Lanka, another major factor affecting the sector is lack of competent staff. Due to the paucity of training programs in this sector there are very few trained and experienced staff. At senior level such as Managing Director or Operations Director, it is extremely difficult to recruit staff due to lack of experienced senior staff in the sector. However, there are few recent initiatives such as provisions of CGAP microfinance training in local languages, microfinance diploma programs offered by Colombo University and Institute of Bankers to address this issue.

The capacity building of MFIs is needed from two standpoints – one is staff capacity and another is institutional development in terms of policies, practices, methods, procedures, etc. Capacity building is a continuous process. Investment in human resources (HR) and institution developments need increased attentions to enhance the productivity of staff and effective functioning of the systems. Adequate quality institutions for capacity building are yet to be developed in these countries. It has therefore become a defining challenge to cope within the days ahead.

Increasing Use of IT in Managing MFI Programs

The use of IT is very limited in microfinance among the SAARC countries. The progress is occurring at very slow pace in very few countries. In Bangladesh, applications of information and communication technology (ICT) in management of MFIs are limited. A few large MFIs have, however, introduced accounting and MIS software at the branch levels but the management system remains largely manual. MFIs will find it difficult to manage diversified products and effectively control internal management without deeper applications of ICT.

In Sri Lanka, as in other MFIs, an important challenge faced by the sector is automation. Most of the MFIs, both large and small, moved for automation in the recent past. GTZ- ProMiS supported 8 MFIs including 3 RDB's with the banking software called 'Micro-Banker'. Other locally developed banking software such as SENOVA, SOTFWATCH and RAJEEEDA are also used by many small and medium sized MFIs. While this effort has improved the efficiency of MFIs, it is noted that there are large number of known and unknown issues faced by the users. The major reason is inadequate microfinance related technical know-how within the MFIs as well as with the software developers. Lack of understanding on MFIs' accounting principles and practices and needs of loan tracking systems by the software producers have resulted in poor quality products. If these concerns are not addressed immediately, there is a danger in managing inaccurate financial and Management Information System among the Sri Lankan MFIs.

In Bhutan, the present IT capacity base and resources within the financial sector are inadequate and the sector is overly reliant on manual systems and procedures, there is an urgent need to strengthen and enhance the financial system operations through a modern, harmonized and properly networked, user-friendly IT system. The Royal Monetary Authority (RMA) envisages the future introduction of a common platform for the IT bases of all financial institutions to standardize accounting systems, interest calculations, and data reporting which would contribute to reliable, prudent and efficient supervisions of the sector and the compilations of monetary statistics.⁴⁰ The World Bank is assisting the RMA to introduce IT systems in the country.

The needs for IT in the microfinance sector cannot be overemphasized. To make microfinance services faster and reliable, there is no alternative to make it IT based and fortunately technologies are available to transform microfinance. The process of using available technologies has begun in some countries but it has to be accelerated. In the long run, this system will help reduction of costs. Right at the moment, this has emerged as an important issue which calls for immediate attention.

⁴⁰ Third United Nations Conference on the Least Developed Countries. Country Presentation. Bhutan. 2001. Brussels, 14-20 May 2001. Presentation of the Royal Government of Bhutan. Action Programme for the Development of Bhutan, 2001-2010.

Chapter 6:

Directions for Future

The reviews of experiences of 8 SAARC countries clearly show that microfinance programs in these countries have come a long way. In particular, Bangladesh has made most impressive progress. The Grameen Bank started in Bangladesh with a mono-lending product (i.e. general loans) with required savings in small amounts. Over time, Grameen Bank has developed more flexible products, such as open passbook savings and commitment savings accounts, to better meet the various financial-services needs of the poor. The Grameen Bank's original vision was access to simple loans that can help the poor build small businesses. But introducing more flexible financial products has helped address a broader set of critical needs, including managing cash flows, coping with risks, and accumulating large sums over time. Sri Lanka and India have also done well going somewhat in different routes. Other countries are in different stages of progress and the reviews clearly establish that microfinance even in the country where it has progressed most—in Bangladesh, there are still rooms for further progress and in other countries microfinance can, of course, do much better and advance forward.

Ensuring Sustainability of MFIs

One key lesson from South Asian experience is that dependence on subsidized funding will have to end someday and it would be vital to worry about sustainability of the MFIs in future after the support that these have had received in the early stages are no longer available. As stressed in 2006 World Bank report, in a favorable environment and with appropriate leadership an MFI is most likely to become profitable after some 3 years' operations, serving some 20,000 clients and having a portfolio between \$2 and \$3 million. The overall performances of MFIs in the region are improving as the needs and awareness about sustainability of MFIs are becoming pronounced. But the speed of improvement varies among SAARC countries, as this review paper has shown. The factors that have affected the speed of improvement are regulatory framework and political environment. The awareness and understanding about good practices also contribute to the speed of improvement.

Looking at the possible sources of funding for MFIs, commercial sources, including deposits, will provide significant funding for MFIs in future. Commercial banks already have access to plentiful sources of funds through deposits and the capital markets; as their roles in microfinance grows they will draw on these resources for financing. Some specialized microfinance providers have made great strides in accessing the capital markets to fund their portfolios in Latin America and to a limited extent in India. Experiences elsewhere also show that some advanced microfinance institutions fund their loan portfolio mainly with saving deposits. We can expect that these institutions and others will develop additional savings products geared to the general public, which will not only increase their access to funds but will also improve their standing in their countries as trustworthy and financially viable organizations. A logical next step in this regard is to have large MFIs turn into micro-banks, which is happening in limited way in South Asia, but in a more extensive manner in Latin America.

We can thus expect that additional ways of accessing the capital markets will develop, creating additional resources for MFIs. We have already seen the first steps into securitizing microfinance, with private

placements and wholesale purchases of microfinance portfolios taking place in India. The recent BRAC issue of securities in Bangladesh has advanced microfinance securitization because the securities did not remain with the sponsored bank, as in previous issues in India, but were passed on to other investors. We can expect more such instruments to develop, making securitization a standard tool for raising funds in microfinance. Once these tools are developed, capital will flow from both local and international markets and will integrate whole new groups of investors into microfinance.

Financial sustainability of the MFIs will depend on their ability to improve their overall efficiency in management, enhance their portfolio quality, and cut down on the operating costs. Most MFIs in South Asia are still dependants on the external sources of funds, subsidy from foreign donors (Afghanistan, Pakistan and Bangladesh) and from Governments (Sri Lanka, India, and Bhutan). The MFIs must try to generate their own funds and build up their equity if they want to remain in the industry and become financially viable. One success story in this respect is of the pioneer MFI Grameen bank of Bangladesh. It was heavily subsidized by foreign funds in the past but under the Grameen II model, the MFI is running their operations completely from their own funds generated from the deposits of its members and the public. It is a profitable concern with complete commercial sources of funds. The MFIs in South Asia also need to focus on service delivery, staff management, staff productivity and operational costs in order to attain self-sufficiency.

Scaling up Microfinance and Catering to Needs of Poor More Comprehensively

Going beyond sustainable positions, the MFIs of Southwest need to worry about making further progress. Although the microfinance movements in South Asia has already changed the nature of financial sector and has succeeded to provide services to poor who were excluded until now from coverage. However, many more poor people are still excluded from the coverage. Recent research shows that MFIs have taken rather small proportions (15 percent) of the microfinance businesses of households and the shares of high-cost informal sectors are still substantial (see Chapter 1). There is thus a substantial shortfall in the availability of microcredit in the region in reaching to demands. Other countries fall in between with Pakistan—reaching about 10% and India and Nepal reading about 15%. The proportion of the poor households covered so far ranges from 4% (Afghanistan) to 45% (Bangladesh).

In the future, MFIs must aim at providing universal financial services, encompassing all financial services on a daily basis, flexibility in loan repayment (not always forcing businesses to take micro-loans if not desired), and better management of cash-flow problems and risks. The hope is that, once the set of flexible “core services” is in place, better specialized savings, loans, and insurance services may be developed. The financial services should respond to the demand for products for home improvements, medical and educational expenses, and pensions, as well as micro enterprises. Innovations must be the rules of the game in changing the environment.

The available evidences show that poor people do indeed manage their money; but the portfolios they manage are often fragile and incomplete. We need to determine how a high-quality, basic financial services could be made available to the poor on a near-universal basis. In this way, providing universal micro-banking could perhaps become an indicator of broad-based development and poverty reductions. In essence, this would mean that the poor would need reliable access to three key services: (i) day-to-day

money management, (ii) building of long-term savings, and (iii) general-purpose loans. These three features of financial services would then constitute the basic financial service. The challenges would be how to develop and provide frameworks that give the poor chances at better access to financial services to improve their lives.

Extending Beneficiary Targets and Development of New Products and Services

Going beyond poor and ultra poor, its outreach of MFIs can expand to include near poor. It is encouraging to observe that a new definition of ‘target recipient’ is now emerging—anyone in the rural or urban areas who wants to take a small loans by accepting the institutional arrangements of the MFIs—group meetings, mandatory savings deposits and repayment schedules—can be a ‘member’ or ‘client’. Irrespective of actual economic conditions, such an individual is now a target recipient and would include nearly 90% of rural households. It only excludes the larger farmers and other richer families. The ongoing expansion thrust already includes most, if not all, of the potential moderately and hard core poor borrowers under one or more of the existing programs. The inclusion of former ‘non-target’ groups mean simply broadening the outreach.

In the expanded outreach programs, microenterprise developments would feature prominently. Enterprise developments will boost the growths of rural economy and thereby alleviate poverty. Unlike the mainstream microfinance, microenterprise development programs will have a growth inducing effects and would need both financial and non-financial services. Both long-term projects finance and working capital finance have been identified as crucial. In addition, non-financial services in the form of assistance for accessing markets, information, technology, and managements and technical trainings have been identified as priority areas. Assistance suggested for this aspect is as follows: (a) credits for customers (working capitals and long-term project finances); (b) savings services; (c) linkages with financial institutions and insurance companies; (d) professional managements and production technology related skill development trainings; (e) access to markets in the forms of information and contacts with buyers, especially exporters and larger companies; (f) assistance for product developments and improvements; and (g) improved systems of information disseminations about technology.

Some of the most useful new products and services would include:

1. Remittance Service: This is important for the poor families when family members travel all over the country for work and live in different places and some even go abroad. The present practices are to carry home money, to send it via friends and relatives or in some cases to use the postal services. In Bangladesh, for example, it is estimated that between 40-60% of total remittances of overseas workers come through informal channels: *hundi/hawala*, friends and relatives or hand carried by the visiting workers [Bangladesh Bank, 2006]. MFI workers could be effectively utilized to transfer funds to the rural poor with the help of information and communication technology. This has already started in Bangladesh, where some partner organizations of PKSF have begun providing remittance services for funds sent from within the country. Recently some NGOs in Bangladesh have linked up with a commercial bank to provide remittance services for funds sent from abroad. The experience in Bangladesh and elsewhere show that to provide remittance services the following steps will be needed: develop an electronic payment system

involving participating MFIs; computerization of accounting and MIS of MFIs (branches and Head Offices) and interconnecting the branches with the applications of information and communication technologies; and examinations of applications of anti-money laundering laws. Once successful the payment system can even be linked with commercial banks to link with international remittance transfer systems. A number of commercial banks have engaged MFIs as their agents to distribute remittances. The whole domestic and international remittance services could be commercially viable if appropriate policies were introduced and the necessary technological resources deployed.

2. Micro-Insurance: Insurance services are another major area where experimentations have begun and further work is required. A number of MFIs are experimenting with life, health and cattle insurance services. The experiences of MFIs have clearly established that vulnerability of the poor borrowers is a recurrent problem and therefore credits with some micro insurance would help the borrowers to overcome shocks such as caused by crops failures, grave illnesses, and social obligations of major expenditures. So a credit plus insurance can bring substantive improvement in the income status of borrowing households. Innovation of products, development of service delivery systems and support from insurance regulator and MRA will be essential for development of insurance services along with credits. MFIs directly, or possibly by setting up insurance companies, and/or in collaboration with other private providers should be encouraged to experiment and allowed to develop and offer such insurance services.

Linking with Formal Financial System

So far microfinance has provided most of the access to financial services available to low-income people in South Asia, but it is still largely separate from the overall financial systems. There are only few examples of direct service provisions to the poor by mainstream commercial institutions. There is growing support for developing a seamless inclusive financial sector and this is not happening yet. Only in India are there significant examples of bank involvements in microfinance. This includes the link models with MFIs, the large and growing bank-SHG links, and involvements in the markets of several large commercial banks. Several local and international social investment funds offering debt and equity products are active in India, something that has not taken off elsewhere in the region. But even in India, aside from the bank-SHG models, evidences of mainstreaming are still limited to a relatively small part of total outreach.

In some of the SAARC countries, major impediments need to be removed before an inclusive financial sector can develop. In Sri Lanka especially, the dominating presences of very large government subsidized microfinance programs impede the growths of well managed MFIs and commercial banks that want to enter the sector.

In Pakistan, most NGO-MFIs and microfinance banks are not profitable and do not charge interest rates that would support profitable operations, largely because they still receive significant donor and government funded subsidies. Recently in India, competitions between subsidy-oriented government programs and MFIs have resulted in a state government placing pressure on financially sustainable MFIs to lower their interest rates to unsustainable levels. This would give a cautionary signal to banks that

might otherwise consider retailing products of microfinance. Reforms are needed to remove impediments before a healthy and inclusive financial sector will emerge.

The microfinance movements of past few decades have fundamentally changed the financial sector, and this change process is gathering momentum. Now there are opportunities to take the microfinance move to the next stage of its development—a stage in which a more inclusive financial sector can be shaped to better serve the needs and interests to the poor.

It is experienced that for the next few years at least, most of the growths in microfinance will come from a few large, profitable, specialized institutions that might in some way rival smaller banks in their respective countries. Bangladesh is an example where strong, growing institutions primarily focusing serving the poor has been achieved, and there are signs of similar development in Pakistan and India. Such institutions will be able to gain greater legitimacy by having well-managed efficient and profitable operations; and some of these would become micro-banks, which will be regulated and will be able to forge links with mainstream commercial institutions.

Furthermore, such large institutions will offer more flexible loans and deposit services, will add to other financial services such as insurances and money transfers, and will have the strengths to reach out to poorer people, including links with safety net programs, and more remote regions.

The dominant institutions those are likely to emerge over the next few years will have access to and make more uses of commercial sources of funding. Links with commercial banks and social investors will become increasingly important, not only affording these institutions, a source of fund to support their donor-or-government-dependent growths, but also bringing more discipline, transparency, and accountability to their operations. At the same time, the development of enabling regulatory environment should allow good MFIs to increasingly mobilize deposits from their members as well as others. This is beginning to happen in Bangladesh and such opportunities should expand to other countries as well. By putting substantial resources into improving the management capacity of MFIs, they can increase their efficiency and reduce their costs. In SAARC countries, this could lead to the costs of microfinance to the client settling at an effective rate of 21 to 24 percent per year and outreach throughout the region expanding to 50 to 60 percent to the poor in less than a decade. Bangladesh has made considerable progress in this regard and its examples are worth emulating in other SAARC countries.

Improving Regulatory Frameworks

Greater interests in regulation hold out the prospects of increasingly mainstreaming microfinance within the larger financial sector. This involves improving existing regulations, advocating for or creating new regulations, setting up new regulatory bodies, and improving transparency and self-regulations. Although there are many activities, more experience and clear thinking are needed to channel these efforts in ways that will lead to good enabling environment. One of the most constructive regulations initiatives has been adopted in Afghanistan, where microfinance is in its infancy, Bangladesh, has so far only gone part way to create an environment that will enable the sector to make an even greater contribution. Regulatory changes such as the recent approval by the RBI to allow correspondent banking relationships and the interests in several countries to allow mobile telephone banking are examples of initiatives that could help

commercial banks downscale their services and become more active in bridging the gaps between commercial banking and microfinance.

Microfinance can only progress if the enabling environment is supportive. The policy and regulatory environment will determine which regions and countries will close the credit demand gaps most successfully. The progress in policy and regulatory environment have until recently come from movements from state-controlled and distorted financial markets toward more liberalized financial markets, and this has been good for microfinance. Microfinance has flourished in settings where the government did not follow directed credit policies, allowed interest rates to be market-determined, kept credit allocation separate from politics, and was not itself involved in direct lending. In some countries, special microfinance regulatory frameworks have been very helpful, supporting the particular needs of microfinance institutions in countries like Indonesia and Bolivia.

Increasing Use of New Technologies

New technologies promise new ways to improve efficiency and expand outreach faster. Already, some MFIs are using ATMs and handheld computers, but more significant changes might become possible as mobile telephones outreach and internet access expand more widely and become less expensive. This could lead to new kinds of microfinance service providers that are based on mobile banking or online transactions with MFIs.

Fortunately the technologies to transform microfinance already exist. Among the available technologies are magnetic stripes and chip (smart) cards, points of sale devices, ATMs, cell phones, satellite communications, the internet, credit scorings, data mining, biometric recognitions and more. These technologies will require microfinance institutions to redesign their business models and educate their employees and customers to master new ways to deliver and receive services. Such changes will not always be easy, but the benefits will be dramatic. They include greater convenience and lower costs for customers, ability to reach more remote customers, and increased security. Innovations in technology will occur in three main areas: payments, credit underwritings and back end systems. And even while we work to apply existing technologies to microfinance, those technologies will themselves evolve, changing the way the financial system operates and making things possible that we cannot even envision at present.

Creating Favorable Political and Social Environment for Expansion of Microfinance

A critical step in the region's financial liberalization could occur if the wider political and social environment changes to recognize that economies of scale exists in financial service delivery—cost is inversely proportional to the size of accounts. Central banks and finance professionals including researchers will need to take the lead to urge politicians and media to help change the conservative economic environment relative to the poor. Without such liberalizations, the processes of microfinance evolutions are likely to slow down as it hits the barrier of sustainability, particularly if the formal sector reaches a point at which the marginal return to corporate social responsibility falls below the losses associated with microfinance service providers and low-income clients. South Asia has not yet reached that except for India, where some banks are testing the limits. So there is scope of much progress and the

progress will be more if microfinance programs are developed as a sustainable commercially viable model and not as a matter of social responsibility.

Countries where microfinance is developing actively, governments should provide at least some of the ground rules that favor financial sector development and microfinance. In those countries, where there is consensus that the government should be a facilitator but not a participant in the financial sector. The principles that credit decisions must be made without political interferences are fundamental. Governments refrain from using the financial sectors as means of financing their own spending. Financial sector must recognize property rights, and court system must uphold secured transactions. The financial sector has to be overseen by a strong and independent bank regulatory and supervisory authority. Most of the countries that have liberalized their financial systems during the past decades have established these conditions, or are well on their way to do so.

The best enabling environment exist in those countries that have taken a proactive approach to microfinance, while adopting best practices. In those countries, there is a consensus to provide broad access to financial services as a key goal of financial sector policy. These governments have entered a dialogue with the microfinance providers in their countries to chart pathways for development while maintaining high prudential standards. Their banking authorities have invested in learning about how microfinance works. So far this is happening only in a limited way in India and Bangladesh. Much more remains to be done and hopefully the SAARC countries will benefit from the lessons of each other and the policy makers in these countries would ensure the most supportive environment for continued growths of microfinance and expansion of the outreach of MFIs.

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Microfinance in SAARC Countries

This overview report is the synthesis of individual country reports on State of Microfinance in SAARC Countries. Commissioned in 2009 by the Institute of Microfinance (InM), the study was funded by UK aid, DFID under Promoting Financial Services for Poverty Reduction (PROSPER) Program. The overall purpose of this overview report and the individual country reports is to review progress of microfinance programs in these countries, analyze lessons learned so far from the varied experiences and identify the challenges.

In SAARC countries, microfinance started at different points of time and pattern of evolution of these programs has not been uniform. There are some common features but some differences in models and approaches that were adopted.

The diversified experiences of these countries provide a unique opportunity to review and learn from each other. This overview report attempts to do that.

The Institute of Microfinance (InM) is an independent non-profit organization established primarily to meet research and training needs of national as well as global microcredit program. It is principally funded by UK aid, Department for International Development (DFID) through its Promoting Financial Services for Poverty Reduction Program (PROSPER).



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