Occasional Paper

MICROFINANCE IN BANGLADESH

Past, Present and Future

Institute of Microfinance (InM)

September 2011

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The authors thank Prof. M. A. Baqui Khalily for his valuable comments and suggestions.

This paper is an outcome of a desk study. This publication has been supported under the PROSPER (Promoting Financial Services for Poverty Reduction) Programme funded by UKaid, DFID. However, any opinions expressed in the document are the authors' own and do not necessarily reflect the views of either InM or DFID.

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Abstract

Bangladesh is rightly considered the pioneer of an innovative microcredit program, introduced by Professor Yunus through Grameen Bank, which earned him and his organization a Nobel prize in 2006. Although Grameen model is recognized world-wide and replicated in many countries, microfinance has existed in Bangladesh in some form or other for a long time.

At independence in 1971, Bangladesh had several organizations – commercial banks, agriculture banks and cooperative societies – which gave small loans to selected clients but not normally to the poor. A special model of cooperatives, Comilla model, pioneered loan and savings program for the poor. Its initial success was not sustained primarily because of escalating loan defaults. Comilla model provided a key lesson for late programs such as Grameen-that a cooperative system covering both poor and non-poor would be vulnerable to elite capture. Grameen targeted the poor people keeping out those who were not poor.

Despite spectacular growth of microcredit in Bangladesh and its replication around the world, the program has faced criticism here and abroad because of the high interest charged which some people fear may have led to over-indebtedness of borrowers. Some critics have also cited coercive tactics used by some microfinance institutions. Impact studies on microfinance abound in findings of positive outcomes, including empowerment of women here and in other countries. However, some methodological controversies persist in assessing the impact of microfinance programs on the poor. Because of these concerns and controversies, it is the right time to examine the entire program in a historical perspective and assess where the program stands now and which way it can go in future. This review paper does that by describing its evolution, assessing current status including its performance and impact, as well as by reviewing the challenges that microfinance faces now. Finally, it suggests possible strategies for the Government policy makers and microfinance practitioners to follow in future.

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A	AF	Anukul Foundation
	ASA	Association for Social Advancement
	ASAI	ASA International
	ASM	agriculture sector microcredit
	ASOD	Assistance for Social Organization and Development
B	BDT	Bangladeshi Taka
	BEES	Bangladesh Extension Education Services
	BIDS	Bangladesh Institute of Development Studies
	BIPOOL	Big Partner Organizations Operating in Large Areas
	BKB	Bangladesh Krishi Bank
	BMET	Bureau of Manpower Employment and Training
	BOESL	Bangladesh Overseas Employment and Services Limited
	BRAC	Building Resources Across Communities
	BRAC-RDP	BRAC Rural Development Program
	BRDB	Bangladesh Rural Development Board
	BSBL	Bangladesh Samabaya Bank Ltd
	BSCIC	Bangladesh Small and Cottage Industries Corporation
C	CARB	Centre for Action Research-Barind
	CARSA	Centre for Advanced Research and Social Action
	CDF	Credit & Development Forum
	CDM	Centre for Development Management
	CESLI	Community Empowerment & Strengthening Local Institutions
	CFPR	Challenging the Frontiers of Poverty Reduction
	CGAP	Consultative Group to Assist the Poor
D	DDJ	Dak Diye Jai
	DMF	Disaster Management Fund
	DSK	Dustha Shyastha Kendra
E	EFRRAP	Emergency 2007 Flood Restoration and Recovery Assistance Program
	Etc.	Etcetera
F	FCR	Financial Cost Ratio
	FSOEUP	Financial Services for the Overseas Employment of the Ultra Poor
	FSP	Financial Services for the Poorest
	FSS	financial self-sufficiency
	FSVGD	Microfinance Support Intervention for Food Security for Vulnerable Group Development
	FY	Fiscal Year
G	GB	Grameen Bank
	GDP	Gross Domestic Product
	GK	Grameen Kalyan
H	HRD	Human Resource Development
I	ICG	International Consulting Group
	ICT	information and communication technology
	IDF	Integrated Development Foundation
	IGA	Income Genrating Activity
	IGVGD	Income Generation for Vulnerable Groups Development
	IMEC	Impact Monitoring & Evaluation Cell
	InM	Institute of Microfinance
	IRDP	Integrated Rural Development Program
J	JCF	Jagoroni Chakra Foundation

L	LCG	Local Consultative Group
	LIFT	Learning and Innovation Fund to Test New Ideas
	LLR	Loan Loss Reserve
	LRP	Livelihood Restoration Program
M	ME	microenterprise program
	MENA	Middle East and North Africa
	MFIs	micro-finance institutions
	MFMSF	Microfinance for Marginal and Small Farmers
	MFTS	Microfinance and Technical Support
	MIDAS	Micro Industries Development and Assistance Society
	MIS	Management Information System
	MIX	Microfinance Information Exchange
	MRA	Microcredit Regulatory Authority
N	N	Number of observations
	NCBs	Nationalized Commercial Banks
	NFPE	Non Formal Primary Education Program
	NGO	Non Government Organization
O	OER	Operating Expense Ratio
	OOSA	Organizations Operating in Small Areas
	OSS	Operational Self-sufficiency
P	PAR	Portfolio at Risk
	PARD	Pakistan Academy for Rural Development
	PKSF	Palli Karma Sahayak Foundation
	PLDP-II	Second Participatory Livestock Development Project
	PMUK	Padakhep Manobik Unnayan Kendra
	POs	Partner Organizations
	PRIME	Programmed Initiatives for Monga Eradication
R	RAKUB	Rajshahi Krishi Unnayan Bank
	RDWF	Rural Development and Welfare Foundation
	RESCUE	Small Business & Livestock Enterprises
	RMC	rural microcredit
	RNPPO	Rehabilitation of Non-Motorized Transport Pullers and Poor Owners
	ROA	return on assets
	ROE	Return on Equity
S	SACP	Special Agricultural Credit Program
	SACP	Special Agricultural Credit Program
	SAHOS	Special Assistance for Housing of SIDR-affected Borrowers
	SHGs	Self-help Groups
	SL	seasonal loan
	SOJAG	Samaj O Jati Gathan
	SSS	Society for Social Service
	ST	Sangkalpa Trust
T	TMSS	Thengamara Mohila Sobuj Sangha
	TRDEP	Thana Resource Development and Employment Program
	TUP	Targeting Ultra Poor
U	UDDIPAN	United Development Initiatives for Programmed Actions
	UMC	urban microcredit
	UP	Ultra Poor
	UPP	ultra poor program
	USD	United States Dollar
V	Vs	Versus
W	WB	World Bank

Chapter 1: History of Microfinance Program in Bangladesh

INTRODUCTION

Bangladesh has played a pioneering role in microcredit movement and has shown the world that the poor are creditworthy and they can even do better than the rich in repaying the debt. This movement flourished for almost three decades and today it is no longer confined to only microcredit. More commonly it is now "microfinance", which includes more services than microcredit – such as microsaving, microinsurance and transfer services.

Microfinance thus far has reached numerous poor people across the world. Microfinance Institutions (MFIs) have become a dominant institutional form of finance for the poor who cannot access formal institutions of finance and now has an alternative to excessively costly informal loans. The development literature abounds in examples of many ways how microfinance has benefited the poor. That microfinance is empowering women is particularly well-recognized. However, microfinance has been criticized recently in various parts of the world, including Bangladesh, for high interest rates causing indebtedness of borrowers, and for using coercive tactics to collect loans.

So it is indeed the right time to take stock what has been achieved through microfinance so far in Bangladesh, where does the microfinance sector stand now and which course should it take for the future. This study purports to do that by reviewing evolution of the microfinance program, its performance so far and the challenges it now faces. Based on a review of past and present, the report suggests possible future strategies for microfinance practitioners to follow as well as the role that the Government policymakers can play.

Basic Concepts and Terms in Microfinance

Microfinance refers to the provision of financial services to poor or low-income clients such as loans, savings, money transfer services and microinsurance. People living in poverty, like everyone else, need a diverse range of financial services to run their businesses, build assets, smooth consumption, and manage risks. Microcredit is the main component of the microfinance services. Access to credit without collateral allows them to improve their well-being through augmenting their income and savings.

Generally microcredit bears a fixed rate of interest agreed upon by both parties. In microcredit program where all terms and conditions are more or less formalized, and receivers of credit services would know this before entering into a transaction.

MFIs usually lend to low-income clients who often have very few assets. Consequently, traditional collateral such as property, land, machinery, and other capital assets is often not available. Various innovative means of reducing the loan loss have been developed, including collateral substitutes and alternative collateral.

One of the most common collateral substitutes, therefore, is peer pressure, either on its own or jointly with group guarantees. In addition, there are other frequently used forms of collateral substitutes, such as savings, personal guarantees. Thus most MFIs facilitate the formation of groups whose members jointly guarantee each other's loans. Guarantees are either implicit guarantees, with other group members unable to access a loan if all members are not current in their loan payments, or actual guarantees, with group members liable if other group members default on their loans. In this connection, the related terms and concepts in microcredit are noted in Box-1.

Box-1: Related Terms and Concepts

Rural finance comprises formal and informal financial institutions, small and large, that provide small-size financial services to the rural poor, as well as larger size financial services to agro-processing and other small and medium rural enterprises. Rural finance also covers a wide array of micro-finance institutions (MFIs), ranging from indigenous rotating savings and credit associations and financial co-operatives to rural banks and agricultural development banks. Rural finance is a vital tool in poverty reduction and rural development.

Active members are the members of groups who attend the group meetings, deposit savings and repay the loan installments regularly following the rules and regulations of the institutions. In operational sense, an active member refers to a member who has saving with the institution and the institution did not cancelled `membership' of the person concerned for any reasons.

Group guarantee is also known as peer pressure. In this all the group members collectively guarantee each other's loans. Guarantees are either implicit with other group members unable to have access to a loan if all members are not regular in their loan payments, or actual guarantees, where group members are liable to repay loans of other members of the group.

Arrears represent the amount of loan principal that has become due and has not been received. The arrears rate provides an indication of the risk that a loan will not be repaid. The arrears rate is the ratio of overdue principal (or principal plus interest) to the portfolio outstanding:

$$\text{Arrears rate} = \frac{\text{Amount in arrears}}{\text{Portfolio outstanding (inclusing amount past due)}}$$

Overdue loan is the amount of loan that becomes due and has not been paid in time of loan term. Overdue may also be understood as the failure of making installment in time by the borrowers as per written or verbal agreement between the debtor and creditor.

Loan repayments can be made on an installment basis (weekly, biweekly, monthly) or in lump sum at the end of the loan term, depending on the cash patterns of the borrower. For most part interest is and principal are paid together. However, some MFIs charge interest up front (paid at the beginning of the loan term) and principal over the term of the loan, while others collect interest periodically and principal at the end of the loan term.

Portfolio at risk refers to the outstanding balance of all loans that have an amount overdue. Portfolio at risk is different from arrears because it considers the amount arrears plus the remaining outstanding balance of the loan.

The portfolio at risk ratio is calculated as follows:

$$\text{Portfolio at risk} = \frac{\text{Outstanding balance of loans with payments past due}}{\text{Portfolio outstanding (including amounts past due)}}$$

The portfolio at risk ratio reflects the true risk of a delinquency problem because it considers the full amount of the loan at risk - this is particularly important when the loan payments are small and loan terms are long.

Other Institutional Sources of Finance in Rural Areas

Besides MFIs, other sources of funds in the institutional part of rural finance markets are: (a) co-operatives that meet the needs of short, medium and long-term credit; (b) commercial banks cooperative and specialized banks; (c) agri-product marketing associations; and (d) land mortgage banks, and various government agencies including those established for agricultural development. The operations of financial institutions in formal rural financial markets are typically heavily regulated, and the nature and extent of formalities, as well as the interest rate structure, usually make access to credit from this market restricted to limited segments of the rural population.

Formal rural financial markets in Bangladesh comprise of rural branches of nationalized commercial banks, a sizeable number of private banks, cooperative banks and societies and specialized banks such as the Bangladesh Krishi Bank and the Rajshahi Krishi Unnayan Bank. Government institutions and programs such as the Bangladesh Rural Development Board (BRDB), Bangladesh Small and Cottage Industries Corporation, (BSCIC), Integrated Rural Development Program (IRDP), and the Swanirvar Bangladesh Program, as well as non-government organizations. Traditional sources like local moneylenders and friends and relatives constitute a significant source of informal rural finance in the country.

HISTORY

Microfinance has existed in this country in some form or other for a long time. We shall limit our discussion to the period since independence from British rule in 1947.

The practice of giving and taking loan from informal sources is very old for purposes such as food consumption, medical treatment, festival, education, farming and other forms of investments. The informal sources include friends and relatives, neighbors, shopkeepers, and traditional moneylenders. Poor and not-so-poor people usually borrow under distress conditions. The loans may be interest free or with interest as high as 5-10 percent per month. The practice still continues even after massive expansion of microcredit in rural and urban areas because some practices such as interest free loans from relatives for meeting unforeseen expenditure is a part of social network and is expected to continue. Other reasons for continued informal credit include: mismatch between demand and supply in terms of timing and amount of loans under microcredit program.

History of Rural Finance and Cooperatives

Finance is comparatively more in urban areas, which are full of banking and savings institutions. Rural economic activities, however, suffer a lot from lack of necessary funds. Although the supply of finance to rural areas is limited now and there is a general imbalance between supply and demand in rural capital markets at present, buyers and sellers of financial assets did exist in rural economies in the past. The market makers/intermediaries in rural financial markets are rural individuals, households, and farm and non-farm enterprises. Such classification of rural finance markets is based on the specific sources of funds, which have varied widely in organization, management, terms and conditions and lender-borrower relationships.

The non-institutional or informal rural finance

Informal rural finance markets enable flow of funds and transfer of rural financial assets through relatively localized transactions in money, and real goods and services among friends, relatives, kin-members, landlords, neighbors, shopkeepers, farmers, artisans, itinerant traders, marketing intermediaries, village *mahajans* (moneylenders), and other local income groups. Informal financial markets also exist in urban areas, but are more prominent in rural areas where institutional sources of finance are either absent or insufficient. The sources of informal rural finance in most developing countries include (a) professional moneylenders; (b) agricultural moneylenders; (c) commission agents; (d) relatives and friends, and different associations of rural professionals/self-help groups; (e) well-to-do rural people; and (f) shop-keepers, and marketing intermediaries and proprietors. Contrary to formal rural finance, the informal segment of rural financial markets is not subject to regulation.

For example, MFIs are yet to meet the credit demand of farmers who do not have access to formal market credit and who often have to finance by advance sales of products or suppliers' credit or by borrowing from moneylenders.

Formal rural finance

Formal financing through institutional sources evolved in Bengal during the British period. The Hindustan Bank was established in Calcutta in 1700. The Bengal Bank, established in 1784, is considered to be the first British-patronized modern bank in India to start trading in credit and money. The 14 prominent banks operating in Bengal during the British period were located in Dhaka, Chittagong, Rangpur, Chandpur, Mymensingh, Pabna, Dinajpur, Comilla, and Narayanganj. In addition to these bank offices, 17 loan offices were established which operated throughout the Bangladesh region between 1850 and 1894. These loan offices extended their lending activity to the rural areas and gave short, medium and long-term credits. Provincial co-operative banks were established in 1912 under the Co-operative Society Act that was passed and enacted in the same year. The Bengal Co-operative Societies Act 1940 was enacted to allow the formation of co-operative societies.

Following the partition in 1947, Pakistan inherited a banking and credit structure from the British regime consisting of 631 bank offices belonging to both local and foreign banks. Of these offices, only 159 were in rural areas. The State Bank of Pakistan, the central bank of the country, came into being in 1948 and attempted to strengthen the country's credit system through setting up new branches of commercial banks and other types of credit institutions in rural areas. In addition to the progress achieved in commercial banking, other credit institutions had also been established to satisfy the need for medium and long-term credits for rural trade, agriculture, industry, and housing in the 24 years between 1947 and 1971.

Among credit institutions, the Agricultural Development Bank of Pakistan had its branches in the rural areas of both the provinces.

The East Pakistan Provincial Government's loan for agriculture in East Pakistan was around Rs 30 million in early 1960s. *Taccavi*[1] loans for West Pakistan and Agricultural loans for East Pakistan constituted the operations of the government as a direct lender with no intermediate link between it and the agriculturists. Co-operative societies and organizations played a significant role in providing agricultural credit. Total credit disbursed by East Pakistan credit societies for agriculture was mostly Rs 30 million in late 1940s, came down to only Rs 4 million in 1959-60. Non-credit co-operative societies provided some loans (Rs 1.6 million in 1948-49 and Rs 0.5 million in 1959-60).

There were 8 land mortgage banks in East Pakistan at the end of 1959-60. These banks advanced Rs 0.63 million to farmers for redemption of old debts and permanent improvement of land. There were 83 central co-operative banks in East Pakistan in 1948-49. Together, they provided nearly Rs 30 million in 1959-60 to the agricultural sector. The Central Multipurpose Societies that existed in East Pakistan at that time often resorted to credit business in order to fulfill the requirements of areas which were not served by central co-operative banks.

Rural finance is often considered as an instrument to reduce poverty by financing income earning activities. But it is just one of the many important

[1] *Taccavi* an advance made to a raiyat by his superior tenureholder to enable him to recover the agricultural losses caused by natural calamities. The term taccavi is the combination of sanskrit 'taka' (money) and Arabic 'kavi', which means strength or strengthening. The Mughals and subsequently, the Company government used the term taccavi for repayable cash advance made to reinforce the cultivating strength of the raiyats in distress. The term lost its currency from the late nineteenth century when institutional agricultural credit was introduced by various cooperative societies, banks and other institutions. Because taccavi as a concept was associated with zamindari credit, the modern institutions called it krishi rin or agricultural loan.

Taccavi was an important agricultural institution during Mughal times. When agriculture was affected by any natural calamities such as flood, drought, and epidemics the Mughal government used to suspend or minimise revenue collections and furthermore, made taccavi advance towards reviving the farming strength of the peasantry. Its distributing agents were the zamindars and talukdars who were advised to lend taccavi to raiyats and make its necessary adjustment on account of public revenue. The taccavi advanced during the seasons of distress was collected during seasons of affluence. Such loan was always free from any surcharge like modern interest.

The taccavi system of agricultural credit as a state institution was abolished by the colonial government. An act of 1793 made it the responsibility of the zamindars and other landholders. Zamindars, however, continued the taccavi system of agricultural loan, because they were aware that without taccavi, raiyats would desert. Therefore, in their own interests, zamindars advanced taccavi loans to their raiyats at times of distress. But with the growth of population and consequent competition for land, zamindars discarded the taccavi credit from the early twentieth century.

ingredients into production. Its impact is fully felt only when conducive policies are in place, markets are functioning, and supporting services are available. The formal rural financial market in our country has been criticized for favoring the rich and for being used as political tools, not reaching poor households to meet their needs.

Rural Finance in Pre-Grameen Period

At independence in 1971, Bangladesh inherited a weak banking system, which had only 1,130 branches of 12 banks. Between 1971 and 1976, Bangladesh Krishi Bank (formerly the Agricultural Development Bank) and the co-operatives were the two institutions that were meeting the need of agricultural credit. To increase the flow of credit to agriculture, the government inducted the NCBs in the field of agricultural credit in 1976 under a new program called Special Agricultural Credit Program (SACP) which was designed to cater to all seasonal crop loans. Rural branches of NCBs were engaged in agricultural credit but only in a limited way. When the total disbursement by the banking system in 1976-77 was merely BDT 860 million, agricultural loans alone rapidly became BDT 3.75 billion in 1980-81, BDT 11.5 billion in 1984-85 and BDT 76.3 billion in 1999-2000.

After the independence, the Nationalized Commercial Banks (NCBs) greatly expanded their branch networks in small towns and bazaars but their lending policies remained the same–they targeted the traders/businesses who could offer collateral. Although there have been many projects for NCBs for providing agricultural loans to the farmers the banks normally failed due to many institutional weaknesses. But the major issue remained that the expansion of branch did not help to bring the poor under financial services. The private banks have never been interested in small loans or poor people and the culture remains the same even today with the exception of Islami Bank Bangladesh Limited which has a large retail microcredit operations. Some private commercial banks have lately gone into wholesale lending. Agricultural Development Bank (later become Bangladesh Krishi Bank–BKB and Rajshahi Krishi Unnayan Bank- RAKUB) has been the principal institution for supporting agriculture and farmers. BKB and RAKUB mainly targeted and still target the small, medium and large farmers who could offer land as mortgage. The 844 branches of Bangladesh Krishi Bank (BKB) and 301 branches of Rajshahi Krishi Unnayan Bank (RAKUB) have been engaged in providing agricultural credit.

The disbursements from BKB and RAKUB have been growing up over the years and they reached 52 billion and 10 billion, respectively, in FY2010-2011.

Other major institutions providing rural finance in Bangladesh are the Bangladesh Samabaya Bank Ltd (BSBL), the apex institution of all central co-operative societies, co-operative land mortgage banks, central sugarcane growers associations and *thana* co-operative societies. Any of the above societies can be a member of the Samabaya Bank Ltd, which had 511 members on 30 June 1999. Total loans and advances of the BSBL as of 30 June 2000 was BDT 27.43 million, of which BDT 25.94 million was distributed to the agricultural sector. The rate of interest charged by the institutions of the country's banking systems engaged in agricultural credit varied from 9.75 to 15.50 percent. The performance of these two specialized banks has always been poor and largely avoid the poor and both are deeply insolvent [Ferrari 2008].

Despite the significant increase in the amount of total agricultural credit in the country during the last two and a half decades, NCBs, BKB and the RAKUB together catered to only 50 percent of the total agricultural credit at present. A part of the rest is being provided by the informal system of suppliers' credit.

Commercial banks, agricultural banks, cooperative societies were the principal sources of small loans for various types of clients: farmers, traders and 'cottage industries' before the advent of the Grameen Bank and other MFIs. These institutions continue to provide some small loans to selected clients but not normally to the poor. The limitations of commercial bank loans were well-known: banks ask for collateral for disbursing loans and their branch networks were limited to urban centers. This was true before the independence of Bangladesh.

The Comilla Model

The Comilla Model was a rural development program launched in 1959 by the Pakistan Academy for Rural Development (renamed in 1971 the Bangladesh Academy for Rural Development). The Academy, which is located on the outskirts of Comilla town, was founded by Akhter Hameed Khan, the cooperative pioneer who was responsible for developing and launching the program.

The model has important implications for rural community development, particularly cooperative society based finance and microcredit development.

The Comilla Model was Akhtar Hameed Khan's reply to the failure of Village Agricultural and Industrial Development (V-AID) program, launched in 1953 in East and West Pakistan with technical assistance from the US government. The V-AID was a governmental level attempt to promote citizens participation in the sphere of rural development. Between 1954 and 1955, Khan worked as director of the Village Agricultural and Industrial Development (V-AID) Program. He was not satisfied with the development approach adopted in the program and established the Pakistan Academy for Rural Development (PARD) at Comilla in 1959 and was appointed as its founding director. He also laid foundations for the Comilla Cooperative Pilot Project in 1959.

Khan argued that for Comilla to develop rapidly, the farmers in its villages must be able to rapidly expand their production and sales. The main constraint they faced was inadequate local infrastructure–especially roads, drains, embankments and irrigation. But even if the government had the resources to build this infrastructure, Khan argued, the problem would not be solved. Once constructed, infrastructure must be regularly maintained. The benefits of it must be managed effectively based on rules that users would accept. In Khan's view it was essential to develop 'vigorous local institutions' capable of performing this type of local maintenance and management.

For this reason, the Comilla Model piloted a methodology for stimulating agricultural and rural development, based on the principle of grassroots cooperative participation by the people. Dr. Khan found inspiration for the cooperative development aspect of his Model from German cooperative pioneer Friedrich Wilhelm Raiffeisen, whose rural credit unions had been an early example of institution-building in predominantly non-literate communities.

After Khan's departure from Comilla, the cooperative's model failed in independent Bangladesh because only a few occupational groups managed to achieve the desired success. By 1979, only 61 of the 400 cooperatives were functioning. The model actually fell victim to the ineffective internal and external controls, and drastic fall in donor funds. This prompted the subsequent scholars and practitioners in microfinance, such as Muhammad Yunus of Grameen Bank and Fazle Hasan Abed of BRAC, to modify substantially the cooperative approach by adopting an informal cooperative (such as a group in Grameen) and by focusing on service structures to deliver small loans. The new strategy targeted the poorest villagers, while excluding the 'less poor'.

Implementation of the model

To simultaneously address problems caused by the inadequacy of both local infrastructure and local institutions, the Comilla Model integrated four distinct components in every *thana* (sub-district) where it was implemented:

1. Establishment of a training and development centre,

2. A road-drainage embankment works program,

3. A decentralized, small scale irrigation program, and

4. A two-tiered cooperative system, with primary cooperatives operating in the villages, and federations operating at *thana* level.

Considerable emphasis was placed on distribution of agricultural inputs and extension services, for example by helping farmers to grow potatoes in the sandy Comilla soil, and using cold storage technology.

In the villages, the Comilla Academy introduced a number of pilot projects beginning in 1959. These pilot projects were guided by two goals: first, to provide a real-life learning situation for its trainees; and second, to devise pilot programs and institutions which could serve as models capable of replication. In guiding and operating the projects, a set of principles and strategies were formulated as the bases for developing the pilot projects, resulting in a unique rural development approach.

Features

The main features of the Comilla Model were:

- The promotion of development and of refining of various institutions, both public and private, and establishing a system of interrelationships between them;
- Involvement of both public and private sectors in the process of rural development;
- Development of leadership in every village, including managers,

model farmers, women organizers, youth leaders, and village accountants, to manage and sustain the development efforts;

- Development of three basic infrastructures (administrative, physical and organizational);
- Priority on decentralized and coordinated rural administration in coordination with officials of various government departments and the representatives of public organizations.
- Integration and coordination of the various developing services, institutions and projects;
- Education, organization and discipline;
- Economic planning and technology;
- Development of a stable and progressive agriculture to improve the conditions of the farmers, and provide employment to rural labor force.

These features distinguish the Comilla Model from other rural development approaches, such as community development, the *target group* approach, and intensive area development.

Microfinance Element in Comilla Model

The initiatives were a network of interdependent programs that depended on community's will and intent to change their lives. They included the establishment of a training and development centre, a road drainage embankment works program, a decentralized, small scale irrigation program, and a two-tiered cooperative system with primary cooperatives operating in the villages, and federations operating at sub-districts (*thana*) level. It was expected that it would not be possible to form groups consisting of several villages and that because of factions not even all farmers of one village but only some of them could be organized. These village societies, with a membership of less than 50, were too small to be business cooperatives but were thought of as aid cooperatives helping the higher tier of the system to perform its functions. These outposts helped in the communication, distribution, collection of savings and extension of agricultural techniques from the central cooperative to the peasants.

Individual village cooperatives were united in the higher tier, which supervised the activities of the village cooperatives; such as saving, utilization of credit and division of profit into investment savings. The constant supervision of resource use, in particular, ensured the high investment rate. Besides, the Central Cooperative Association supplied all such services which cannot be organized at the village level, like machines, marketing, processing, etc. Kuhnen (1972) outlines some features of the activities of cooperative societies as discussed below.

Capital formation

In order to make the capital available, each member was required to save at least 50 paisas (Pak Rs 0.50) a week. This sum was collected at the weekly night meeting and deposited into the account of the Central Association.

Supervised credit

At least ten percent of the credit would be covered by savings and shares of the particular member. This determined the top limit of the credit to be granted. The credit, usually in kind, was made available at appropriate time and was issued to the societies and not to individuals. The societies remained responsible for proper use and repayment. The central cooperative charged six percent interest plus five percent for supervision expenses. The cost of supervision was rather high, but as a result of the strict supervision, the repayment rate was 99 percent. Repayment was made in cash or to a proportion of about 50 percent in kind.

Intensive training

A sort of farm leader school was established. The managers and model farmers of the village cooperatives assembled once a week for intensive training. Over the years, they received a continuous theoretical as well as practical training in the modern techniques of agriculture and were supposed to convey this knowledge to their fellow farmers at the weekly night meeting of village cooperatives. The teaching was done by the available staff of the departments at *thana* level. The process was supplemented by cooperative inspectors who were the technical representatives of the center in charge of a number of villages.

Difficulties Faced

For various reasons the *Comilla Model*'s initial success was not sustained and lost its preeminence. It had particular troubles with government relations and efforts to build strong cooperative institutions. According to Dr Khan:

"... in actual practice, the Comilla programs suffered from distortion, mismanagement, corruption and subversion. After Independence of Bangladesh, while the First Five Year Plan gave general endorsement, both theoretical criticisms and practical difficulties became more severe."

Escalating loan defaults became a particularly serious problem, undermining the hope that the cooperatives would become self-reliant and develop into strong institutions. Dr. Khan reported that influential local people had secured management positions in the cooperatives. "They are powerful and well informed. They know that the old sanctions (certificates, notices, pressure by officers) are now dead, and they can repudiate their obligations with impunity." In addition, the new government annulled loans issued by its pre-independence predecessor.

Chowdhury [1990] reports that by 1979 only 61 of the 400 cooperatives were only functioning. She attributes this result to four factors: fraud/lack of internal controls, stagnation, diversion of funds, and ineffective external supervision. The central problem of fraud and weak controls "was possible not only because of individual dishonesty, but because the people were not made aware of their rights, and were not in a position to voice their rights ..."

The main problem with the Comilla Model was that it neglected a key cooperative principle: independence from government. This neglect is clearly visible in the Khan's initial design of the Model, since the cooperatives were conceived of as an instrument for maintaining public infrastructure, and were dependent on the delivery of government extension services and credit for their success. Cooperatives however, have fallen prey to elite capture in many rural communities.

Lessons from the Comilla Experience

Comilla Model provided an experience to be profited by later practitioners. In the early years of BRAC (NGO) and Grameen Bank in the 1970s, both Muhammad Yunus and Fazle Hasan Abed tested cooperative approaches to delivering credit to poor people. They concluded that the cooperative strategy could not work in rural Bangladesh. Instead, both directly targeted the poor people, while attempting to keep out those who were not poor.

Dowla & Barua [2006] recently summarized the thinking at Grameen Bank:

A major reason for the prior failure of credit cooperatives in Bangladesh was that the groups were too big and consisted of people with varied economic backgrounds. These large groups did not work because the more affluent members captured the organizations.

Later cooperative development initiatives in Bangladesh, like Rural Development-12 (RD-12) and the Swanirvar ('self-reliance') Movement also adopted a targeting strategy.

Both Grameen and BRAC also attempted to catalyze collective enterprises that were locally owned and controlled. However, problems with internal control and elite manipulation continued, and by the 1990s Grameen and BRAC, along with all the main microfinance NGOs in Bangladesh, had abandoned cooperative approaches and developed highly centralized control and service delivery structures.

Grameen Bank's Breakthrough

One should recognize that, informal loan, commercial banks (government and private), agricultural development banks and cooperative societies only provide credit and no other financial services to the poor. The Grameen Bank broke away from the pattern and developed a different kind of organization to serve the poor with financial services. The origin of Grameen Bank (Village Bank) can be traced back to 1976 when Professor Muhammad Yunus, launched an action research project to examine the possibility of designing a credit delivery system to provide banking services targeted at the rural poor without any collateral. The action research demonstrated its strength in Jobra (a village adjacent to Chittagong University) and some of the neighboring villages during 1976-1979. With the sponsorship of the central bank of the country and support of the nationalized commercial banks, the project was extended to Tangail district (a district in northern Bangladesh) in 1979. With the success in Tangail, the project was extended to several other districts in the country. In October 1983, the Grameen Bank Project was transformed into an independent bank by government legislation. Today Grameen Bank is predominantly owned by the rural poor whom it serves. It has 2,565 branches all over the country (July, 2011).

The Grameen approach attempted to overcome all barriers for reaching the poor with credit by introducing the following critical steps:

- Target the poor people, mainly women who bear the burden of poverty. This has been made operational by accepting members/clients who own less than 0.5 acre of land (functionally landless). By targeting exclusively the poor the approach ensures services for the poor and eliminates possibility of enlisting rich people taking advantages of the service;
- Accept primarily women as clients who repay loans on time, invest monies for productive purposes and spend income to improve the quality of life of family members; the process empowers them (women) as well.
- Self-selected groups of 5 persons are formed and 30-50 members form a Kendra/centre, which is the organizational structure in a *para*/village where bank staff visits to make transactions;
- Loans are collateral free; but to ensure repayment poor women are organized into groups to take responsibility of repayment (over the years it has been found that group responsibility has eroded considerably but still poor people repay more or less regularly);
- Loans are small that is manageable by the poor and repayment are also small collected in weekly installments;
- Instead of coming to the bank the approach takes financial service at the door of the poor; Bank's staff members collect supervise and take care of all management tasks similar to any commercial bank.
- Procedures for loan applications and other administrative steps have been simplified to suit the poor.
- All financial transactions are made in public to eliminate any possibility of corruption.
- Experience shows that loan money is normally invested in commonly available activities such as livestock rearing, trading, agriculture production and small processing operations.

The Replication of Grameen Approach

The main breakthrough was that the Grameen experience by 1983 proved that with right kind of savings and loan products, policies and management system and human resources, i.e., an appropriate institution with a mission to serve the poor could not only reach them but also make a viable financial institution. The simplicity of methodology developed by the Grameen Bank inspired many non-governmental organizations to replicate the model. The main incentives for NGOs which were involved in many social programs such as education, health, relief and rehabilitation to move quickly into microcredit were demand from the members, opportunity to become self-reliant (income covering expenses), and creating sustainable permanent institution. The variations were in interest rate, savings and loan ceiling, size of groups etc not much on the fundamental structure of the model. Some of variations present today are summarized below:

Group formation: The size may vary between 20 to 50 persons. MFIs do not strictly follow 5-member group structure of Grameen, instead they form one larger group called *samity* with women/men from the same neighborhood.

Savings policies: The amount of savings may vary among members as well as organizations. Normally MFIs would lend only after deposit of several weeks or certain amount of money. Withdrawal of savings was restricted in earlier days but now it is a lot more accessible. Still a few major institutions restrict withdrawal of savings to use the money as loan as well as cash collateral.

Loan policies: Loan amount widely vary among MFIs; normally starts with small size and increase in successive loans. Interest rate is around 20 percent per annum expressed in so called flat rate. Loans are collected through weekly installments but in some cases in monthly and one installment. Although in earlier days clients were required to wait 1 to 6 months before receiving first loan but now a days due to competitive pressure first loan to a member may be disbursed within days of joining a group.

Growth of Other Large MFIs

Three very large organizations–ASA, BRAC and Grameen Bank- dominate the microfinance sector, having more than 18 million active borrowers/clients at the end of 2010 (ASA 4.53 million, BRAC 5.45 million and Grameen Bank 8.37 million) all products combined. These three organizations had embarked on a major lateral expansion beginning 2003/04 that led to doubling or tripling their sizes by 2009. This spectacular expansion was achieved by including new clients in same or new geographical areas and by enhanced management efficiency, and by introducing new products, adopting new and policies, and by mobilizing financial resources. The three MFIs have around 84 hundred branches (in April, 2011), more than 18 million active borrowers and gross loan portfolio worth more than BDT 2.28 billion (at the end of 2010). All three organizations have branch networks throughout the country except in a few remote *char* and coastal areas.

BRAC

In 1972, Fazle Hasan Abed, a professional accountant, established Bangladesh Rehabilitation Assistance Committee (BRAC)[2] began relief and rehabilitation operations in Sulla, Sylhet, following the end of Bangladesh's War of Liberation. In the next year, its activities transformed from relief and rehabilitation to long term community development and BRAC was renamed Bangladesh Rural Advancement Committee. In 1974, BRAC began microfinance activities. In 1977, targeted development commenced through the formation of Village Organizations and BRAC's Community Empowerment & Strengthening Local Institutions (CESLI) Program. In 1979, the Rural Outreach Program was initiated and the Rural Credit and Training Program. BRAC initiated Non Formal Primary Education Program (NFPE), Livestock Program, Rural Enterprise Project, and Income Generation for Vulnerable Group Development (IGVGD) program in 1985. Later it introduced the Child Survival Program and Human Rights and Legal Services program. In early 90's, BRAC established a Centre for Development Management (CDM) and Its Non Formal Primary Education Program was replicated in Africa. In 2000 to 2010, BRAC spread its development work to Afghanistan, Sri Lanka, Tanzania, Uganda, Haiti, India, Pakistan, Indonesia, Sierra Leone, Liberia and Southern Sudan. BRAC is operating 2,648 branches in Bangladesh (March, 2011).

ASA

ASA (Association for Social Advancement) was founded in 1978 by Md. Shafiqual Haque Choudhury with the aim of helping the poor organize & empower themselves so that they might establish their political and social rights for a just society.

ASA received formal registration from the government in 1979. To reach its goal of empowering the poor, ASA stressed the need for building people's

[2] Now the name has been again changed to 'Building Resources Across Communities' retaining the same acronyms.

organizations, or groups, through mobilizing landless rural poor. It undertook different programs including: awareness building for social action, legal aid and awareness build-up program, training program, communication support service program, training for rural journalists. In the second half of 80s, empowerment of numerous poor people was made by ASA through the improvement of health, nutrition, education, sanitation and by credit available to poor. The focus was shifted to women, who play an important role in the field of development.

After 1992, ASA started providing full microfinance package. The main elements of ASA approach are: savings and credit for income generation in a cost-effective manner and Member Security Fund (Mini Life Insurance) to shield member from unforeseen hardship. In 2001, ASA became financially self-sufficient and has not accepted any grants or donations from outside sources since then. ASA has 3,183 branches in Bangladesh.

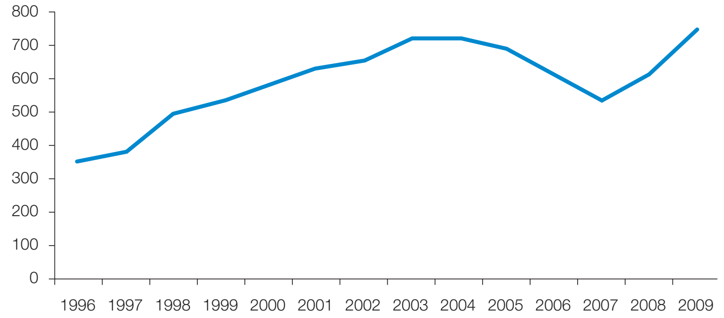
Being established in 2007, ASA International (ASAI) is currently establishing new MFIs in various countries like India, Nigeria, Pakistan, Sri Lanka, Philippines, and Ghana.

Other MFIs

The sector has got a group of large MFIs whose memberships vary between 50,000 to one million. All of them are PKSF partner MFIs except BURO Bangladesh. Even within this group, two organizations, TMSS and BURO-B separated them from the others and have expanded into more than 40 districts with their networks. These two groups are followed by organizations with 5-50,000 members (3 to 30 branches) which are local or regional organizations mostly financed by PKSF.

The number of NGO-MFIs was growing fast until 2003, after which it remained constant until middle of 2005 after the number declined a bit until mid 2007. After that the number grew fast again. This trend is captured in Figure 1. The Microcredit Regulatory Authority (MRA) has a cut-off point of 1000 memberships, and BDT 4 million in loans outstanding for receiving license. Several hundred such MFIs operate in the country although the exact number is not known. There even smaller NGOs with very limited resources for loan disbursement, and use mostly savings. They are still operating, but may face extinction for not qualifying for license.

Figure 1
Number of Reported NGO-MFIs



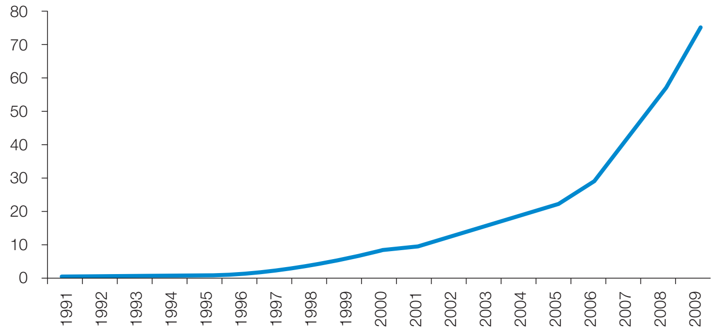
Source: Bangladesh Microfinance Statistics (1996-2009)

Two public institutions, Bangladesh Rural Development Board (BRDB) and Palli Daridro Bimochon Foundation (PDBF) have microcredit programs (with total loan outstanding of BDT 12 billion in 2009). Public commercial banks like Sonali, Agrani, Janata and Rupali have programs of retailing microcredit (about BDT 35 billion loan outstanding and Sonali Bank Limited alone contributed BDT 30 billion). Among three private commercial banks who supply retail microcredit, Islami Bank Bangladesh Limited is most prominent (BDT 3.7 billion loan outstanding in 2009). Ansar VDP Unnayan bank also have microcredit program.

Expanding Role of PKSF: An Apex Financing Agency

The Palli Karma-Sahayak Foundation (PKSF) or Rural Activities Support Foundation was established by the Government of Bangladesh in 1990 as the apex organization with the mandate to alleviate poverty with employment creation by providing subsidized fund to microfinance institutions (MFIs). PKSF disburses fund to MFIs who are its Partner Organizations (POs) to implement development programs designed for the poor of Bangladesh. At present PKSF has 257 MFIs as its PO providing financial services that have grown impressively. Through PKSF's widespread PO network, the organization has access to all districts in the country and a total sum of BDT 454.81 billion has been disbursed to 8.3 million borrowers so far at the end of June 2009 (Fig 2).

Figure 2
PKSF to PO Loan Disbursement in Million BDT



Source: PKSF Website (retrieved May 2011)

Features of Credit Activities

PKSF provides loans to three categories of POs – Organizations Operating in Small Areas (OOSA); Big Partner Organizations Operating in Large Areas (BIPOOL); and Pre-PKSF POs.

- PKSF charges 4.5 percent service charge per year to OOSA and Pre-PKSF category POs and 7 percent service charge per year to its BIPOOL category POs.
- Loans received by OOSA and Pre-PKSF category POs from PKSF are repayable within a period of 3 years. First 6 months are considered as a grace period and loans along with service charge are to be repaid in 10 quarterly installments within the rest 30 months.
- Loans received by BIPOOL category POs are payable in 4 years in 12 equal installments with a grace period of 12 months.
- The maximum and minimum loan fund is flexible in some programs.

Selection Process of POs

PKSF appraises various types of non-government, semi-government and government organizations, voluntary agencies, societies and local government bodies to select these NGOs as POs, which have gained experience and expertise or which have the potentials to operate a successful microcredit program for the landless and asset-less to achieve self-employment and income generation. In appraising an organization, PKSF follows a clear guideline which can be divided into the following areas: (1) Organization; (2) Organizer; (3) Management; (4) Good governance; (5) Human Resources; (6) Working Area; (7) Field Activities; (8) Past performance; (9) Management Information System (MIS) and (10) Accounting System.

PKSF's Operational Activities

PKSF comprises six core programs, eight projects and five special programs. Core programs are the driving force behind PKSF's expansion and growth. They include following programs with different functions implemented by POs, such as microcredit for rural areas-Rural Microcredit (RMC), for urban areas-Urban Microcredit (UMC), microcredit for entrepreneurship building-Microenterprise program (ME), microcredit for the poorest part of the society-Ultra Poor Program (UPP), for the development of agricultural sector-Agriculture Sector Microcredit (ASM), and for overcoming seasonal fluctuations in income-Seasonal Loan (SL).

The eight projects are Learning and Innovation Fund to Test New Ideas (LIFT), Programmed Initiatives for *Monga* Eradication (PRIME), Microfinance and Technical Support (MFTS), Microfinance for Marginal and Small Farmers (MFMSF), Second Participatory Livestock Development Project (PLDP-II), Disaster Management Fund (DMF), Livelihood Restoration Program (LRP), and Emergency 2007 Flood Restoration and Recovery Assistance Program (EFRRAP).

PKSF's Special Programs consist of five programs, namely Special Assistance for Housing of SIDR-affected Borrowers (SAHOS), Rehabilitation of SIDR-affected Coastal Fishery, Small Business & Livestock Enterprises (RESCUE), Microfinance Support Intervention for Food Security for Vulnerable Group Development (FSVGD) and Ultra Poor (UP) Beneficiaries program, Rehabilitation of Non-Motorized Transport Pullers and Poor Owners (RNPPO), and Financial Services for the Overseas Employment of the Ultra Poor (FSOEUP).

In the first decade, PKSF focused on strengthening program implementation and institutional development of its POs. In the second decade, PKSF has shifted gear to accommodate the economic and social change of Bangladesh. During this, PKSF integrated non-financial services such as skill development activities into the programs. PKSF's disbursement has grown steadily in the last two decades. In FY 2009, loan disbursement grew by 29 percent to BDT 18.17 Billion. Whereas POs on-lending to members have grown tremendously with grown spikes in the FY 2001 and 2006 and has a five-year growth average of 45 percent. Today, disbursement by POs has reached BDT 85.16 billion, a growth of 12 percent from last financial year.

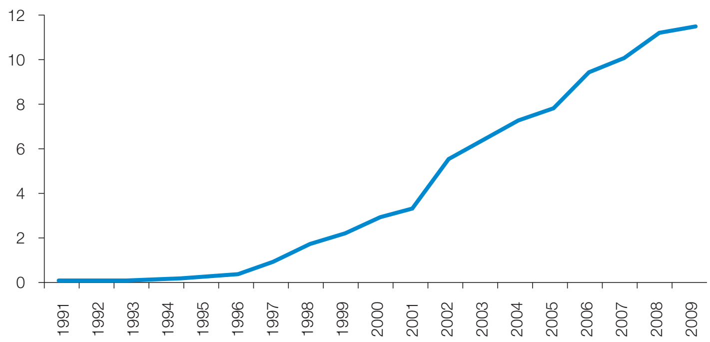
PKSF's loan outstanding, excluding institutional development loans, stood at BDT 28.98 billion in FY 2009. It grew by 19 percent from last year, having a five-year growth average of 24 percent. Whereas PO loan outstanding for FY 2009 is BDT 45.80 billion having a growth of 9 percent compared to last year and a five-year average growth of 21 percent.

From inception, PKSF's activities have mainly targeted women and hence majority of the members are women. Since FY 1991, when 77 percent of members were women, it has now reached to 90 percent in FY 2009 with 10.24 Million women as members. Even though growth of women members was only 2 percent from last FY, the five-year average growth is 11 percent (Fig 3).

Borrowers comprise of all members taking loan under various programs and projects. Total borrowers stood at 8.26 Million as of FY 2009 having a five-year average growth rate of 10 percent. Similar to proportion of women members, women borrowers account for 92 percent of total borrowers in FY 2009.

PKSF disburses Institutional development (ID) loans at a nominal service charge to the POs for capacity development activities. The activities include all form of institutional development such as enhancement of technology use, implementation of management information system; development of office building, training centers and procurement of office equipment among other things. ID loan disbursement peaked in FY 2007 and settled at BDT 24.7 Million in FY 2009.

Figure 3
Members of PKSF Programs (in Million)



Source: PKSF website (retrieved May 2011)

Eradication of Monga (Seasonal Hunger) by PRIME and Other Distinct Initiatives of PKSF

PKSF introduced Programmed Initiative for *Monga* Eradication (PRIME) as a pilot in Lalmonirhat (2006). PRIME is essentially a livelihood program having its own unique characteristics. The activities under PRIME are mainly of two types: activities throughout the year and special activities for lean season or *monga* (partial starvation) period. These broadly two type of activities include: Cash for Work for subsistence of the poor; creation of self-employment through the provision of microcredit; imparting training and providing technical support services; primary health care support and smoothing consumption through emergency/consumption loan are included. The program targets the ultra poor on the basis of specific criteria such as (i) landholding of households should not be more than 50 decimal; (ii) wage employment is the major source of income, (iii) monthly income should not exceed BDT 1,500. At present, PRIME is being implemented through 16 POs in 35 upazilas of greater Rangpur region.

As of June 2009, PRIME has organized 243,909 households who constitute 40 percent of the targeted 603,562 *monga*-affected households of greater Rangpur. Among the beneficiary households, 198,876 (82 percent of the organized beneficiary) have been brought under this program for the ultra poor.

To support the underdeveloped areas of the north having concentration of ultra poor families, PKSF started Financial Services for the Overseas Employment of the Ultra Poor (FSOEUP) program in 2008 to facilitate overseas employment. The program policy ensures that a person selected for overseas employment is a member of an ultra poor family in *monga* affected area. PKSF signed memorandum of understanding with the Bureau of Manpower Employment and Training (BMET) and the Bangladesh Overseas Employment and Services Limited (BOESL) to help smoothen cooperation and enhance progress of the program. As of June 2009, PKSF disbursed BDT 2.25 million under this program. POs disbursed BDT 0.25 million in the field. 27 people have been employed abroad through this program.

PKSF launched Learning and Innovation Fund to Test New Ideas (LIFT) program to support pro-poor ventures and innovations for poverty reduction through diversified use of microcredit. Under LIFT, PKSF has decided to provide both loans and grants separately or combined depending on the project considering the nature of expenditure in the project and for a long-term sustainability of the project. In FY 2009, PKSF disbursed BDT 53.32 million and cumulative disbursement amounted to BDT 74.75 million. Up to June 2009, LIFT supported 26 innovative ventures across the country. These ventures had generated employment opportunities for the poor with potentials for sustainability and replication elsewhere. Majority of these innovative ventures proved outstanding in promoting sustainable income and employment generation of the poor. Such examples include developing livestock (high yielding cross-breed dairy cow) by contract framing, developing microentrepreneurs in fish culture and operating up seed bank through tissue culture technology and rearing of Black Bengal goats at family-level farm.

Institutional Development

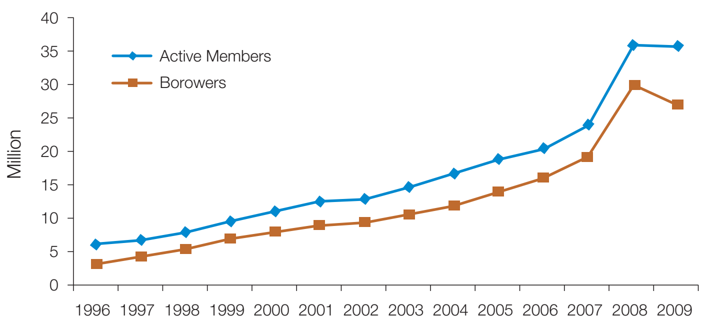
PKSF puts great emphasis on institutional development for itself as well as for its POs. Through such initiative PKSF is ensuring sustainability of itself and its POs. Institutional development has implications on a number of areas such as program outreach, absorption capacity of the POs, supervision and monitoring, financial management and control, personnel policy including human resource development (HRD), sustainability of microcredit program, etc.

RECENT TRENDS

Consistent increase in average loan size, steady growth of borrowers contributed to increased income leading to financial viability of many MFIs. The growth in membership has been rather sharp, up to 25 percent for some MFIs since early 1990s. Membership of PKSF, the apex body, has also risen steeply enabling the partner organizations to expand their portfolio vertically and horizontally.

Microcredit outreach has expanded tremendously over time. The microcredit member was 11.79 million in 1999 and reached 35.71 million in 2009, implying a consistent growth rate of around 12 percent over the years. Similar pattern of growth is also visible in case of microcredit borrowers. In 1999, the number of microcredit borrowers was 9.25 million and in 2009 it reached 27.05 million[3] (Fig 4).

Figure 4
Growth of MFI Members and Borrowers

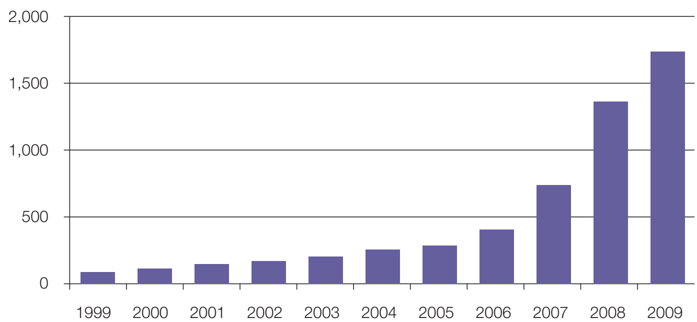


Source: Bangladesh Microfinance Statistics (1996-2009)

[3] These numbers seem to suggest all the poor households in Bangladesh village are covered by the microcredit program, which is not borne out by household surveys conducted by InM. These surveys suggest that about 50% of the poor households have been covered so far. It is possible that reported number of active borrowers may include multiple borrowers and non-poor borrowers. Also, MFIs may not have used the same definition to describe members and borrowers.

After 2008, number of active members remained almost the same but number of borrowers declined. This may reflect some corrections in multiple borrowings. However, loan disbursement has increased throughout the period. Overall, the sector achieved a commendable increase in cumulative loan disbursement to the individual household borrowers (Fig 5).

Figure 5
Cumulative Loan Disbursement in Billion BDT



Source: Bangladesh Microfinance Statistics (2009)

As per survey, cumulative disbursement of loans to borrowers stood at BDT 1790 billion up to December 2009.

The average annual growth rate in the microfinance sector in Bangladesh over the five years 2003-2008 was 23 percent. It is expected to reach 25 percent annually over 2009-2012 as a result of growing demand for larger loan sizes. Despite its significant outreach–estimated at 60 percent of all Bangladeshi households–microfinance assets remain less than 2 percent of GDP, having increased only marginally relative to GDP since 2001.

CONCLUSION

The modern microfinance movement has come a long way to reach its current position. A kind of microcredit program existed in Bangladesh for a long time. The Grameen type of microfinance started in Bangladesh in 1979 and radically changed the conventional thoughts and approach to rural finance. The establishment of Grameen Bank was a major breakthrough in prolonged practiced rural individual lending and group lending. Later, the Grameen model became prominent and widely implemented by many NGOs in both Bangladesh and other countries.

Chapter 2: Current Microfinance Program and Its Impact

PROFILE OF CURRENT MICROFINANCE PROGRAMS

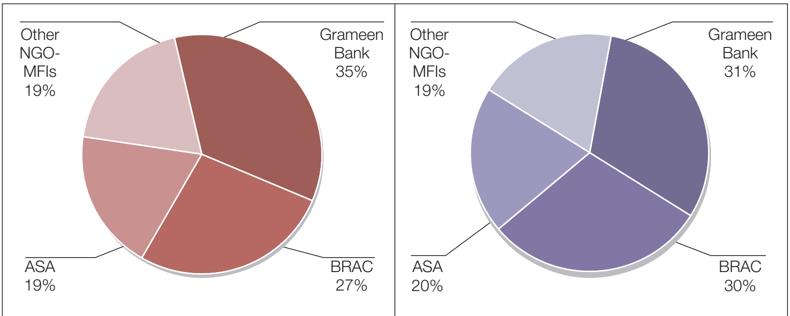
Microfinance is an innovative tool targeted for developing appropriate financial products for target population to achieve poverty alleviation, through broad-based, inclusive growth. In a developing country like Bangladesh, the vast majority of the poor have no access to a banking system, which deprives many extremely hard working people to realize fully their income earning potential.

The microcredit program, pioneered by the Grameen Bank started as a project in 1976 and became a formal independent financial institute under the Grameen Bank Ordinance in 1983. Although the practice of borrowing small amount of money for investment and consumption purposes has been common in Bangladesh but the modern organized, systematic, group-based and institutionalized microcredit operation is a Bangladeshi innovation and replicated all over the world with local modifications and adaptations. The Grameen experience by 1983 had proven that with right kind of savings and loan products, policies and management system and human resources, i.e. an appropriate institution with a mission to serve the poor could not only reach them but also make a viable financial institution.

The simplicity of methodology developed by the Grameen Bank has inspired many non-governmental organizations to replicate the model and offer similar financial services to the poor. The microfinance sector (in both rural and urban sectors) is now dominated by NGOs collectively known as NGO-MFIs, which offer financial services as "private not-for-profit business". The three large MFIs (namely, ASA, BRAC and Grameen Bank) cover almost three-fourth of the market share (Fig 6). At present, microfinance services are provided by a range of NGO-MFIs, microfinance banks, government programs, nationalized commercial banks, and private commercial banks.

Bangladesh Microfinance Statistics (2009) reports there are 745 NGO-MFIs (including Grameen Bank) in Bangladesh with 17,407 branches. These branches employed more than 242 thousand staff, of whom 57 percent are credit staff. Number of active groups reached almost 2.6 million with 35.7 million active members. Top ten MFIs enjoyed 3.84 percent growth in 2009, which is the lowest of past five years. There are 553 licensed MFIs under Microcredit Regulatory Authority (MRA) as of 16 March 2011.

Figure 6
Gross Loan Portfolio and Number of Active Borrowers (2009)



Note: Based on the data of 28 largest MFIs that covers more than 90% of the market
Source: www.mixmarket.org (retrieved in May 2011)

Cumulative savings deposit became BDT 368,941 million in 2009, with the highest growth rate of 25.53 percent in past five years. Cumulative loan disbursed stood at BDT 1,731,465 million with overdue amount of BDT 6,016 million only. All these MFIs benefited a cumulative total of about 67 billion borrowers, of whom about 40 billion fully repaid the loan.

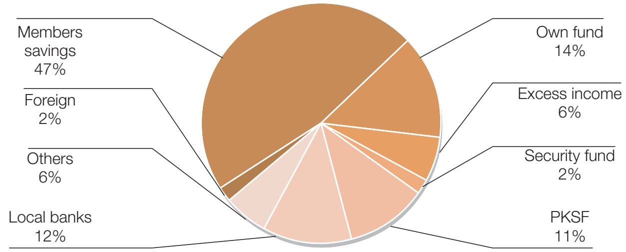
According to the survey, 97.72 percent of 744 NGO-MFIs followed the flat method in calculating interest on loans to the borrowers in 2009. The survey also finds that, out of 744 MFIs, 708 do not follow declining method of interest rate. More than half of those MFIs charge a flat rate of 15 percent, and 38 percent of MFIs charge 12.5 percent–which is delimited by PKSF for its POs.

Figure 7 provides reader with the distribution of revolving microfinance program by sources of fund in 2009. The highest source of fund in 2009 was savings generated from members (47 percent). Own fund of MFIs, borrowing from local banks and PKSF financing occupy the next three positions respectively.

Figure 8 shows utilization of microcredit by sector in 2009. Among all uses, small trade tops with its share of 31 percent. The rest 69 percent of credit usage goes into versatile sectors-of which only agriculture holds considerable share (24 percent).

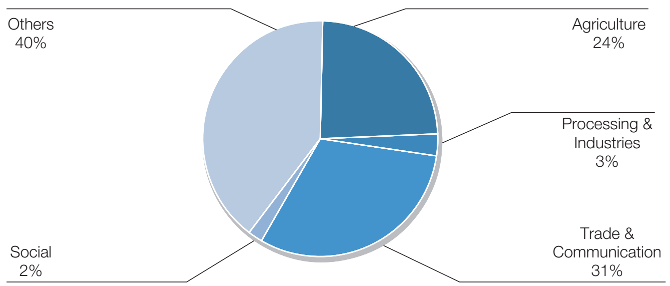
The average size of loan per borrower was around BDT 26,588 in 2009 compared to BDT 23,081 in 2008. On the other hand, loan recovery rate of the 126 NGO-MFIs have been consistently staying between 96 and 99 percent. There was not much difference observed in the trend of loan recovery rate in past five years.

Figure 7
Distribution of Revolving Microfinance Program by Sources (2009)



Note: Based on 679 MFI survey, Source: Bangladesh Microfinance Statistics (2009)

Figure 8
Utilization of Microcredit by Sector (2009)



Note: Based on 679 MFI survey, Source: Bangladesh Microfinance Statistics (2009)

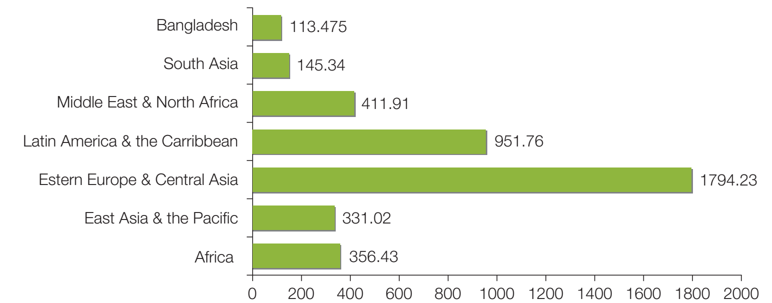
Data of 73 Bangladeshi NGO-MFIs collected from MIX market[4] website shows recent statistics of microfinance for 2009. Gross loan portfolio became 2.3 billion of 2009 USD, where the number of active borrowers was 20.6 million. Average loan balance per borrower was 115.6 USD, which was lower than all the regions of the world. Average deposit was estimated at 1.8 billion USD from some 27.8 million depositors. Total assets of those NGO-MFIs were worth 3.5 billion USD (Fig 9).

In case of performance, microfinance institutions of Bangladesh are doing moderately (See Figure 10). MIX market data shows that the return on

[4] 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.

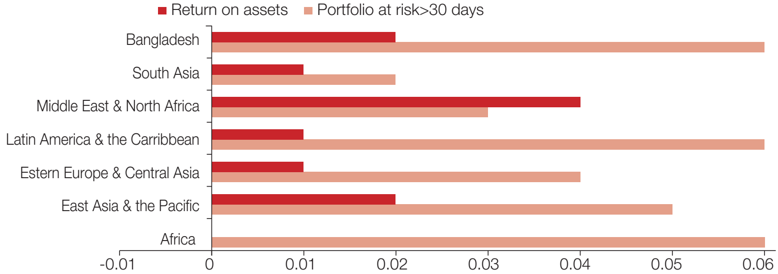
assets (ROA) is the second highest compared to all regions of the world, simultaneously standing with East Asia & the Pacific region. ROA is at its highest in Middle East and North Africa (MENA) region (0.04). ROA in Bangladesh is even higher than its regional average (0.01). ROA in South Asia coincides with Latin America & the Caribbean and Eastern Europe & Central Asian regions (0.01). As the data shows, MFIs of Africa have no ROA.

Figure 9
Average MF Loan Balance Per Borrower in USD (2009)



Source: www.mixmarket.org (retrieved in May 2011)

Figure 10
Comparison of MFI Performance in Bangladesh & Other Regions (2009)



Source: www.mixmarket.org (retrieved in May 2011)

On the other hand, Portfolio at risk (PAR>30) in Bangladeshi MFIs are similar to the Latin America & the Caribbean and African MFIs' (0.06). It is even higher than South Asian average of 0.02. PAR>30 respectively declines from 0.05 to 0.02 among East Asia & the Pacific, Eastern Europe & Central Asia (0.04), Middle East & North Africa (0.03), and South Asia. The data agrees on our previous understanding about Bangladeshi MFIs that they are performing well but sustainability still remains as an issue.

Competition among MFIs

An InM study "Strategic Behavior of NGO-MFIs" conducted by Iqbal (2011) shows that MFI coverage has increased over time. One reason for this higher concentration of MFIs is that MFIs tend to locate their branches closer to other MFIs to take advantage of information and externalities the incumbents have already created. Other signs for competition for market share-greater number of products, more relaxed terms and conditions of products and lower nominal interest rates were also found. In short, results indicate that MFIs compete in all three spaces - location, product and price and this gives a borrower wider range of products to choose from larger number of MFIs with lower nominal price and more lenient terms and conditions.

Figure 11 provides reader with a general idea on the concentration of MFIs across Bangladesh. The mapping is district-wise. So the higher the number of NGO-MFIs in a district, the darker it appears on the map. It shows that the density of MFIs is comparatively higher in Western and North-western parts of the country than the rest of it. The capital, Dhaka has the most population of NGO-MFIs. Greater Dhaka region, north-western part, Jessore, Khulna, Barisal and Chittagong follow Dhaka. Aside from the north-western region, where seasonal poverty is rampant, other regions have the common characteristic of better communication and population density.

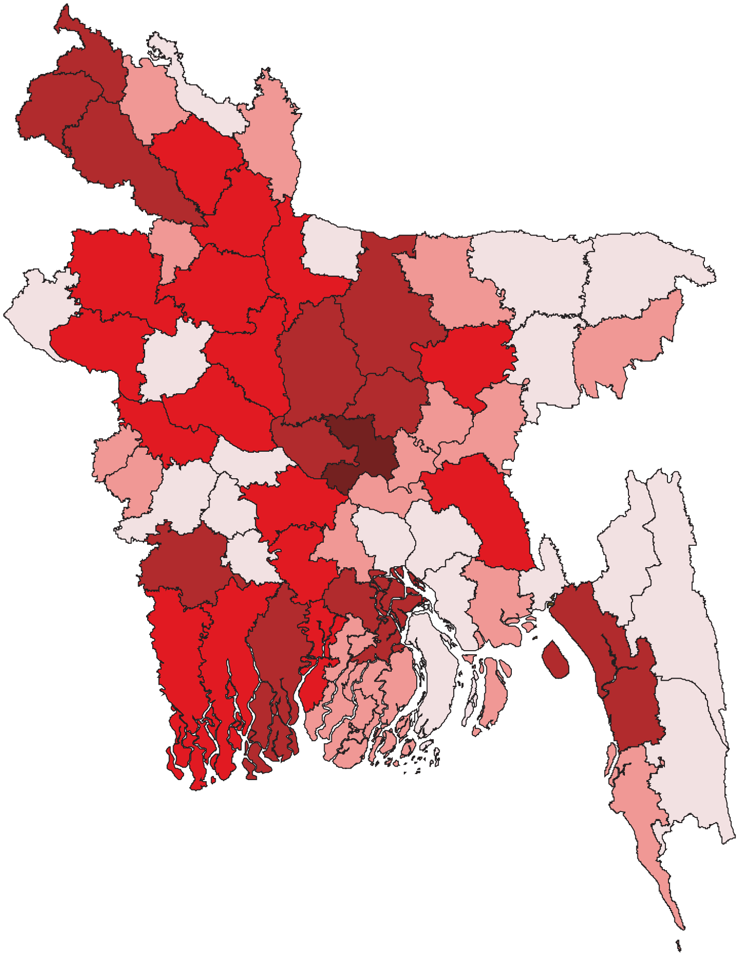
Prevailing Lending Modalities

Three different types of lending technologies are used in Bangladesh:

Grameen styled group-based system: Bangladesh microfinance sector for all practical purposes is dominated by basic group-based methodology pioneered by the Grameen Bank. The basic structure is as follows: Poor women and men are organized in groups or *samities* who meet once in a week to deposit small amount of savings to build their own capital. The Bank or MFIs lends one-year loan (some MFIs recover the loans within 43-46 weeks), which a borrower repays in equal weekly installments along with interest. Once a borrower repays one loan she is qualified to receive another loan normally of higher amount within the overall loan ceiling, which of course, is revised upwards with time. The technique has been found so robust and effective that almost entire industry follows this approach with minor adjustments in savings/credit policies such as interest on savings and loan, savings withdrawal rules etc.

Figure 11

Density of MFIs by Districts across the Country (2009)
(the darker the region, the higher the number of NGO-MFIs)



Note: Based on PKSF Partner Organizations. Source: PKSF website (retrived in May 2011)

Currently nearly 33 million women and men transact every week by following this basic system. However, over time the Bank as well as other MFIs have changed their systems to offer more than one type of savings and credit products as the nature of demand has changed and MFIs have also learned to deal with more complex situations. Still we find basically two types of criticisms even against such a popular methodology: i) one group of critics/activists believes that the collection and management of savings should be job of the poor people. Loan should be made available to the members from the savings funds. But if they need additional funds that should be delivered from the formal financial institutions or from an MFI in Bangladesh, which has been organizing the so called 'self-help' groups in first place. Self-help groups should be treated as 'people's organizations', which perform other social responsibilities in addition to providing financial services. ii) Another form of criticism is about the 'rigid' or 'inflexible' nature of group-based system. Critics feel that the weekly repetitive system does not match with poor people's financial demand, therefore, the financial products should be 'flexible' or 'demand driven'.

Self-help group system: A handful of non-government organizations have tried and are still trying the so called self-help group approach of developing financial service delivery system. In this case, the promoter or the NGO organizes self-help groups with the objective of facilitating savings mobilization for the poor women/men from among themselves. If the participating members need loan they can borrow from their samity i.e. from their own savings funds. If the funds are not adequate, the self-help samities may try to borrow from banks or the NGO supplies the additional capital. The second option has been tried in Bangladesh but the first option has been found not realistic. All management responsibilities of savings and credit are expected to be taken care of by the leaders of the groups. But in real life often such educated leaders are not always available and in many cases NGO field officials perform this job. We do not find any reasonably large-scale financially viable operation that follows this approach. This type of community-based microfinance whilst popular in some countries has not been found to be successful in large-scale operation in Bangladesh. There have been some efforts from several NGOs (for example, Ashrai, Caritas, Concern Worldwide) and donor-funded projects to develop alternative systems but none could stand as a viable alternative. In general, this approach has failed to take off the ground to be considered as a serious alternative in Bangladesh. Self-help Groups (SHGs) or CBOs start with much enthusiasm but within a short period face many management problems and often fail to continue. Some common problems are as follows: poor loan recovery rate; inability to keep proper accounts by illiterate people; poor management skills of SHG leaders/managers; often leaders do not give adequate time to keep the system running; misappropriation of funds by leaders and or influential individuals; maintaining funds in banks and dealing with banks; and inability to safe keeping cash balance in the village.

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

Operating Efficiency of MFIs

We will briefly discuss operating efficiency indicators of MFIs collectively (excluding the Grameen Bank). Table 1 presents outreach data and selected indicators on operating efficiency. In absence of detail information, we can only use member per credit officer, borrower per credit officer and portfolio per credit officer to discuss about the trends in efficiency. We will complement this shortcoming by analyzing several MFIs in detail later that will provide further insights about operating efficiency. It appears that during 2003 to 2009, the overall operating efficiency of the sector as a whole declined. Members per credit officer declined from 320 to 258; borrowers per credit officer declined from 233 to 195; and portfolio per credit officer increased from BDT 798,511 to BDT 1,365,308. This has been mainly due to rapid horizontal expansion, that is, enrollment of 'new' members/clients in new geographical areas. Branches were opened in new areas and recruited staff took time to form groups and achieve desired level of membership. It became more difficult for smaller MFIs to find new members because very large and small MFIs all followed the same strategy during this period. The loan portfolio per credit offer and average loan outstanding per borrower became almost double because MFIs start with more loans for new members. This has impacts on overall profitability of MFIs as well.

Table 1
Operating Efficiency and Portfolio Quality of MFIs

Year	2009	2008	2007	2006	2005	2004	2003
Number of MFIs observed	**745**	**613**	**535**	**611**	**690**	**721**	**720**
a) Outreach indicators							
Active members (in thousand)	35708	35905	23956	20512	18794	16622	14631
Outstanding borrowers (in thousand)	27054	29797	19449	16096	13942	11963	10647
Borrower-member ratio (%)	75.76	82.99	81.19	78.47	74.18	71.97	72.77
Loan Portfolio (billion BDT)	189	171	97	73	56	44	36
Overdue amount (million BDT)	6017	4298	1464	1193	1051	2772	1324
Total Credit staff (in thousand)	139	137	108	79	66	59	46
Average outstanding loan size	6996	5741	4989	4546	3994	3707	3428
b) Operating efficiency indicator							
Members per credit staff	258	262	222	258	286	281	320
Borrowers per credit staff	195	218	180	203	212	202	233
Loan portfolio per credit staff (in thousand BDT)	1365	1250	898	921	847	749	799
c) Portfolio quality indicators							
Recovery Rate (%)	98.17	97.87	99.21	99.12	99.07	98.79	98.76
Overdue as % outstanding loan (%)	3.18	2.51	1.51	1.63	1.89	6.25	3.63

Note: Figures are rounded for convenience.
Source: Authors' calculation from Bangladesh Microfinance Statistics

Portfolio Quality of MFIs

The Table also provides two indicators related to performance portfolio: loan recovery rate (%) and overdue as percentage of outstanding loan. A better indicator would have been to first classify the loan portfolio (aging report) and estimate portfolio at risk (PAR). In absence of PAR, we can make some intelligent guess about quality of portfolio from other indicators. The recovery rate of loan has remained high, around 98 percent. Similarly, overdue as a percentage of outstanding loans remains around 3 percent. However, the interim decline could be because of sharp rise in portfolio size between 2004 and 2007.

EFFECTS OF PROLIFERATION OF FINANCIAL SERVICES

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

Access to savings and credit services from formal (licensed) organizations: Aside from impact due to increase in income the proliferation of MFIs (now most of them have received license from MRA) has allowed people to transact with formal financial institutions. We can say 33 million poor have savings account with accumulated savings of BDT 91,747 million. At no time in the history of the nation so many poor people had access to formal institutions, be it for savings or for loan. It is an achievement by itself that formal institutions are reaching the poor with professional financial services and poor people in their life have access to them.

Decline in dependence on moneylenders: The above phenomenon has helped to reduce dependence on moneylenders who would only lend to a few of their choice, of course at an exorbitant rate (as high as 120 percent per annum). Besides, such personal lending-borrowing relationship creates an undignified situation where lender may take other advantages.

Access to market information: The interaction of members within the groups provides opportunities for informally receiving market information such as price of various inputs, commodities, and farm produces.

Access to training services: Many government and donor agencies and NGOs provided millions of man-days of training on numerous topics mostly for free. Most common training courses are awareness building on social issues, poultry and livestock rearing, fisheries, health and family planning, various agricultural products such as vegetable and crop production, tailoring, business management, accounting etc. However, these supply-driven training courses may not be always effective but over a long period of time and long association with NGO-MFIs has enhanced skills, confidence as well as technological skills of millions of poor.

Access to technological information: Access to technological information and demonstration of production technologies have benefited the participants of microfinance programs but may not be always physically visible.

Access to social and marketing network: Poor people through groups/samities have also developed social and marketing networks.

Employment generation and development of professional human resources: MFIs are one of the largest employers for education among men and women. An estimated 171,599 persons are directly employed by the MFIs excluding the Grameen Bank.

Expansion of service providers (e.g. training): Individuals and private institutional providers have emerged to provide management and technological training to the group members as well as to MFIs (staff members and organizations).

Extension and other services through MFIs and groups: MFIs and groups have also participated in other programs such as health, family planning, renewable energy promotion etc where microcredit groups have been used as platform for dissemination of information and ideas.

Expansion of non-farm businesses: Main recipients of microcredit are trading, shops and small processing/manufacturing, repairing and many other services (rural transport). This has enabled millions of households to access capital to develop and earn from non-farm sources that has reduced pressure on agriculture for creating new jobs. Besides, the poultry, livestock and fisheries sector, that is, non-crop agricultural activities got serious boost due to microcredit creating employment and generating income from these sub-sectors. That is, the process has enabled diversification within broad agricultural sector. However, this is not to mean that only microfinance contributed to this situation. Other business services have also proliferated to aid the situation.

POVERTY IMPACT OF MICROFINANCE

There have been many impact studies conducted on microcredit programs beginning mid-1980s through 1990s. The objectives were to clearly and verifiably prove the financial and economic impact of microcredit programs on the lives of the poor as well as level of reduction of poverty. However, it has been taken for granted that if poor people can be reached with financial services, especially credit, they will prudently utilize the monies for investments and other purposes to uplift their poverty situation. One sees major variations in methodological approach and scope of studies conducted over more than two decades. The studies may be grouped into the following categories, of course not mutually exclusive: (a) evaluation or impact of microcredit, (b) comparative evaluation of more than one microfinance programs, (c) research on a particular issue related to microfinance programs impact on poverty, (d) sustainability analysis, (e) evaluation of performances of different microfinance organization, and (f) studies on management systems and human resources of organizations.

This paper focuses on studies that dealt primarily with impact of microcredit on quality of life. However, it is beyond the scope of this review to discuss numerous studies conducted over the years. The paper has done a selective, but not exhaustive, review of researches conducted in various periods, using various methodologies, to answer relevant impact questions. Below is a brief report on methodologies employed and the major findings.

The pioneering study on the impact of micro credit was a study of the Grameen Bank by Mahbub Hossain [Hossain 1988]. Methodologically, this study broke new ground by using a statistically valid sample 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 program 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 or project villages.

According to these early studies, microcredit 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 MFIs.

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

- There is significant positive effect of regular program participation on income and on average consumption of poor households.
- Both head-count and poverty gap measures show that regular participation registered a faster rate of poverty reduction than occasional participants, and reduction in poverty among the latter was faster compared to non-participants. A comparison across the first (1997-98) and the third (1999-2000) round shows the larger percentage of program participants tend to invest on both human and physical capital.
- Generally, the study finds program participants to be less vulnerable to crises even though they face similar degree of crises as

non-participants.

A follow-up study was undertaken by Atiur Rahman et. al. (2005) to assess the impact of microfinance programs of PKSF in reducing poverty, socio-economic status of the borrowers, and women's empowerment. In particular, the impact was assessed mainly in terms of economic well-being of borrowers, coping with risk and insecurities, reducing poverty, and enhancing women's empowerment. The survey was carried out on the same households as in the previous survey round by BIDS. Total 7,541 respondents were interviewed involving household heads and members, village elites and head of POs.

The study found that the household income had a secular trend of growth, ranging from initial 2.8 percent to 12.2 percent per annum between 1997 and 2004. Although non-participants of microcredit programs had the highest average household income at the beginning, they were gradually surpassed by the regular participants.

PKSF panel household data showed that, by and large, absolute poverty declined from 74.7 percent in 1998 to 63.9 percent in 2004. Similar declining trend was also observed in case of households participating in microfinance programs over the period. Moreover, the study established that the economic base of the participant households had already been strengthened enough to withstand crisis from the flood in 1998.

The most comprehensive impact study of microfinance, a joint research project of the Bangladesh Institute of Development Studies (BIDS) and the World Bank, finds strong evidence that the programs help the poor through consumption smoothing and asset building (Khandker 1998; Pitt and Khandker 1998). The findings support the claim that microfinance programs promote investment in human capital (such as schooling) and raise awareness of reproductive health issues (such as use of contraceptives) among poor families. The studies also shed light on the role of gender-based targeting and its impact on household and individual welfare, finding that microfinance helps women acquire assets of their own and exercise power in household decision making.

The research project estimates that the marginal impact of microfinance on consumption was 18 percent for women and 11 percent for men (Pitt and Khandker 1998). The study finds that some 5 percent of borrowers may lift themselves out of poverty each year by borrowing from a microfinance program, if the estimated impacts on consumption continue over time (Khandker 1998). But even if this does happen, microfinance could lift less than 1 percent of the population out of poverty because it reaches only a quarter of the population. If this rate were sustained given the level of poverty among program participants in 1991/92, this could have led to an estimated 5 percentage point reduction in poverty for participants and a 1 percentage point reduction for the village as a whole over the program period.

Morduch (1998) found either small or non-existent program effects using the same 1991/92 BIDS-World Bank survey data. However, this study applied the difference-in-difference technique, which is suitable only for a randomized experimental study, whereas the BIDS-World Bank survey is of the quasi-experimental type and hence endogeneity of program participation is a serious issue. Morduch also pointed out that because of mistargeting (about 25 percent), the impacts shown in Pitt and Khandker (1998) were upper bound. However, a reexamination by Pitt (1999) showed that mistargeting was a nonissue in the estimated impacts and reconfirmed the earlier findings in Pitt and Khandker (1998), even after relaxing the targeting criteria and excluding mistargeted households from analysis.

Another important study by Khandker and Pitt (2003) examined the impacts of microfinance using a number of outcomes using panel household data from Bangladesh. More specifically, they considered such issues as whether the effects of microfinance are saturated or crowded out over time, whether programs generate externalities, and whether the estimated impacts of microfinance found earlier with cross-section data analysis can be corroborated using an alternative method. They found a declining long-term effect of microfinance as well as the possibility of village saturation from microfinance loans. Microfinance continues to reduce poverty among poor borrowers and within the local economy, albeit at a lower rate. It raises per capita household consumption for both participants and nonparticipants. The average returns to cumulative borrowing for female members of microfinance programs are as much as 21 percent in 1998/99, up from 18 percent in 1991/92. Despite higher returns to cumulative borrowing, the impact on poverty reduction among program participants was lower in 1998/99 (2 percentage points) than in 1991/92 (5 percentage points). This is due to diminishing returns to additional borrowing, so that despite the increase in the stock of borrowing by female members, the resulting increases in consumption were not large enough to reduce poverty as expected.

The positive effect of credit on poverty has, however, been questioned by several studies like Zaman [1999]. The study found that the effect of access to credit on level of poverty could vary significantly, depending on the initial income level of the recipient and also on the size of the loan. The study found that the largest effect of microcredit on poverty was achieved on moderate poor. The study also sought that the use of credit for non-investment purposes would only bring a short run impact on income and consumption level but could not bring any substantial change in the level of poverty.

Khandker and Pitt (2003) study as well as other studies have shown that some of the microfinance borrowers are using their funds to lease in land, especially from larger farmers, many of whom either find wage labor too expensive or are moving out of agriculture altogether. The other possibility is the flow of remittance in the rural economy-both foreign and domestic remittance, but especially the former-that finances self-employed farmers.

A comparatively recent study by Q. K. Ahmad (2007), based on interviews with randomly selected 2,500 micro-borrowers from across Bangladesh, looked at both socio-economic and indebtedness-related impacts of microcredit in Bangladesh. The survey was conducted in early 2006 and the results were published in January 2007. Some of its major findings are:

a) Some of the micro-borrowers in Bangladesh have benefited in certain respects. A lot of them are struggling under the stringent terms of credit including high cost of borrowing and a weekly repayment schedule starting a week after a credit is taken. Many have gone further into indebtedness and face a bleak future. The micro-borrowers face the threat of expulsion and confiscation of their assets when they fail to pay up weekly installments; and some have in fact had their meager assets confiscated when they failed to pay up.

b) A large majority of the micro-credit households have remained condemned to a lowly and subservient state of living. The main culprits for this state of affairs include the glaring and accentuating socio-economic disparity and worsening wrong power relations in the country, neither of which is addressed or even recognized by the micro-credit institutions. (Qazi Kholiquzzaman Ahmad (2011); Microcredit: A Panacea or A Villain)

Regarding empowerment of women micro-borrowers, the study reports that women borrowers by and large do not control the money they borrow. Only about 10% of the female respondents have indicated that they are in full control of and manage the economic activities undertaken with micro-credit. It would appear that they are often simply the conduit for some money coming into the family. However, women micro-borrowers are now generally more aware of things as they go about their work at home and outside; and many are consulted in the process of important family decisions being made. Moreover, tyranny of dowry has increased with respect to the marriage of women belonging to microcredit receiving households.

It may also be noted that the study has found that while the benefits enjoyed by most of the borrowers are uncertain and many face setbacks, the MFIs have generated for themselves large surpluses through high actual interest rates and other charges and burgeoning credit creation through a continuous process of loan collection and lending/relending.

Contrary to Q. K. Ahmad study, another recent study by Imai and Azam (2010), "Does Microfinance Reduce Poverty in Bangladesh? New Evidence from Household Panel Data" uses some recent statistical techniques to correct self-selection bias in estimating real impact and find a strongly positive impact of microfinance programs.

Hossain and Bayes (2009) also show a very upbeat picture regarding the role of microfinance in rural poverty reduction. According to this study, MFI member households experienced faster poverty reduction by nearly 7 percentage points compared to the non-member households from the same landholding "target" group during the period between 1987 and 2007.

Table 2 presents summary of major quantitative impact studies up to 2010. The table reproduces Rahman [2000] and it is extended beyond 2000 using recent studies.

Thus the impact studies mostly show that microcredit has generally helped the poor by raising consumption and income, and empowering women borrowers. There are some studies that particularly show that microcredit has helped in smoothing consumption, particularly to withstand shocks. Pitt and Khandker (2002) clearly establish that microcredit program has helped in smoothing income and consumption. Household consumption may vary over the seasons both as a result of an inability to smooth the predictable component of seasonal income and of seasonal income shocks. Micro credit helps smooth seasonal consumption by financing a new productive activity whose income flows and time demands do not seasonally co-vary with the income generated by existing activities of households. In rural Bangladesh, male household members are typically engaged in agricultural pursuits. The weather-induced seasonality of the crop cycle is therefore the largest source of seasonality in income flows. Agricultural households wishing to reduce seasonal fluctuations in income trees to diversify into non-agricultural activities that are less tied to seasonal weather patterns. It is found that the majority of borrowers use their loans to finance nonfarm activities, because the self-employed activities that are financed are likely to generate income streams that will not co-vary with income from agricultural pursuits.

Table 2
Impact of Microfinance on Household Income/Expenditure

Source	Name of organization studied	Income or expenditure per annum (BDT)	Participants	Control (non-participants)	% difference
Hossain 1984	GB	Income, per capita	1762	1346	30.9
Hossain 1988	GB	Income, per capita	3524	2523	39.7
BIDS 1990	BRDB	Income, per household	6204	4260	45.6
BIDS 1990	BRAC-RDP	Income, per household	2844	1560	82.3
IMEC 1995	Proshika	Income, per household	22,244	17,482	27.2
Rahman 1996	PKSF	Expenditure, per household	26,390	23,802	10.9
Khandker 1998	BRAC	Expenditure, per capita	5180	4202	23.8
Khandker 1998	GB	Expenditure, per capita	5050	4335	16.5
Khandker 1998	RD-12	Expenditure, per capita	4931	4279	15.2
Halder 1998	BRAC	Expenditure, per capita	8244	6480	27.2
BIDS 1999	PKSF	Expenditure, per capita	36,528	33,732	8.3
IMEC 1999	Proshika	Income, per household	48,635	43,584	11.6
Zohir 2001	PKSF	Wage income, per capita	5858	5559	5.3
Hossain 2002	GB	Income, per household	18134	14204	27.7
Khandker 2003	GB, BRAC, RD-12	Expenditure, per capita	3923	3838	2.2
Rahman, Atiur 2005	PKSF	Annual Income, per household	58109	38968	49.1
Khalily 2010	PRIME-2 of PKSF	Annual income, per household	53394	48505	10.1
Rabbani 2011	PRIME-3 of PKSF	Annual Income, per household	61530	45680 (benchmark)	34.7
Khalily 2011	FSVGD & UP of PKSF	Monthly Income, per household	5224	4463 (early dropouts)	17.0

Source: Rahman [2000] & the authors

Recent Findings of InM

Two recent nationally representative studies of InM (2010) by Khalily et. al. and Osmani et. al. brought interesting results. By filling up the gap between demand for financial services and supply offered by the formal banking sector, MFIs contribute significantly to help people out of poverty. Such contribution is generated both in terms of credit and savings. Holding other things constant, a 1 percent increase in MFI credit would reduce probability of poverty by 6.7 percent. Both quasi-formal credit and savings have significant negative correlation with poverty and a percentage increase in total MFI credit would reduce the likelihood of poverty by 8 percent and the corresponding figure for quasi-formal savings is about 4 percent.

Nearly 70 percent of rural households have taken some sort of loan in 2007-2009. Almost half the households have taken microcredit and a similar number have borrowed from the informal sector (friends, relatives, moneylenders, traders, etc.). About 6 percent of rural households have taken loan from the formal sector. The relevant duality is now between informal and microcredit sectors in rural Bangladesh, with microcredit having a slight edge as the leading sector.

About 40 percent of those who ever took microcredit stopped taking it at some point in life. Of them, 16 percent returned at a later stage, but the rest didn't. Those who stopped taking microcredit at some point in life cited varied reasons. The most important reason (36 percent) was that they found it difficult to maintain regular repayment for one reason or another. About half as many stoppers (18 percent) did so because they found new sources of raising the level of their incomes that made borrowing redundant. Only 2 percent of the stoppers (and less than 1 percent of borrowers) cited high interest rate as a reason.

Some 45 percent of the rural households have never taken microcredit and almost 95 percent of them declared that they had no interest in taking it. For those who claimed to be not interested, the single most important reason (31 percent) was that they thought it would be difficult to maintain the strict regime of weekly repayment. Thus, there may still be considerable scope for expansion provided the MFI can find new products with more flexible repayment conditions.

A large proportion of target groups (landless and functionally landless) still remain out of reach–37 percent in the case of landless and 46 percent in the case of functionally landless. On the other hand, the non-target groups have also come to enjoy significant access to microcredit. As against 62 percent of the poor who have had access to microcredit, as many as 50 percent of the non-poor also had similar access.

Impact on Hardcore Poor

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

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

As expected, the interim results (PKSF 2005) showed a modest gain in income and expenditure but it was an important finding that the extremely poor people could borrow, invest, enhance income and repay loan on time. Table 3 shows changes of household income and expenditure compared to baseline (2002). The extremely poor households moved from lower income and expenditure brackets to higher brackets. The mean annual household incomes before and after project interventions (2 year period) were BDT 15,805 and BDT 18,946 respectively. More importantly, the extremely poor families could increase savings and improve health and hygiene, access to safe water, sanitation, food intake etc.

Table 3
Interim Impact of Microcredit in FSP Project

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

Source: PKSF 2005

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

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

- Household income is also found to have grown more in the beneficiary households compared to that of control group. The average household income for the beneficiary from 2005 to 2007 increased by more than 110 percent from BDT 18,986 to BDT 39,939 and on the other hand, the increase of incomes in the control group was 83 percent from BDT 21,156 to BDT 38,907. The major sources of household income for the beneficiary were IGAs undertaken through FSP credit.

- During the project period, not only household income but also household expenditures of the beneficiary households increased by 180 percent from BDT 13,890 to BDT 35,529, on average (thanks to the price hike in the country.) For the control group, the average expenditures increased by 22 percent from BDT 26,661 to BDT 32,466. The major expenditure categories such as food consumption remained the same but the relative share of food as a portion of household expenditure declined.

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

Comparative Impacts of Hardcore Poor Programs: PKSF sponsored a comparative study by Nath [Nath 2005] on the impacts of four microfinance programs (two of them have additional non-financial features) targeting the ultra-poor/hardcore poor: CFPR/TUP program of BRAC, Financial Services for the Poorest of PKSF implemented through a number of partner MFIs (FSP-PKSF), Struggling Members Program of Grameen Bank, and the financial service program for very poor of Plan Bangladesh implemented through three partner MFIs were studied. All these programs are innovative in terms of features of financial services, delivery methods, and combination of financial and non-financial services. The review by Nath (2005) focused primarily on two aspects: a) delivery system of financial services to the hardcore poor; and b) social and economic impacts of the programs. The study followed the following methodology: a) analyzing features and design of each program delivery system; b) analyzing 263 households randomly selected from 67 villages and comparing that with control village data; and c) conducting regression analysis for reaching conclusion.

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

The lending techniques of the four programs also vary. Grameen Bank's regular microcredit operation is based on groups. But it has made an exception for the program for ultra poor; where it follows individual lending technique. Plan also follows individual lending techniques where FSP-PKSF and BRAC follow group lending methodology. Plan Bangladesh provides door to door service to the individuals on daily basis.

Flexibility in savings and credit operation also vary. FSP-PKSF and BRAC (IGVGD) have limited flexibility in terms and conditions, but the programs of Plan Bangladesh and Grameen Bank (Struggling Members Loan Program) are entirely flexible. Grameen program provides interest free loan without any time limit of repayment. Plan Bangladesh shows maximum flexibility in terms of size and time of savings, grace period and repayment of loan money and about holding of weekly or monthly meetings.

As for selection of clients and targeting, all four MFIs follow very stringent criteria and undertake elaborate steps (BRAC, FSP-PKSF, and Plan) to identify the hardcore poor and beneficiary of the programs. Plan Bangladesh accepts the poorer families within a village. For BRAC or FSP-PKSF also most of the beneficiaries belong to the poor echelons of the village society. Grameen Bank targets the beggars under struggling member program. BRAC has been implementing IGVGD program by targeting the hardcore poor with VGD card holders. Hardcore poor under FSP-PKSF is defined as one who is landless or holds up to 10 decimals of land, is unemployed or earns less than a dollar a day.

Except Grameen Bank all three programs charge interest rate similar to their regular programs. For these programs the loan size, especially the first loan is small, as small as BDT 500. BRAC and FSP-PKSF follow weekly repayment, and the other two programs do not have any repayment schedule. Savings deposits are encouraged and withdrawal is relatively easy (Table 4).

InM Study on FSVGD & UP Project of PKSF

Microfinance Support intervention for Food Security for Vulnerable Group Development (FSVGD) and Ultra Poor (UP) is a project implemented by Palli Karma-Sahayak Foundation (PKSF) through its 31 POs in 19 districts of Bangladesh. PKSF at first piloted the Financial Services for the Poorest (FFSP) Project in 2002 and later on, PKSF launched Microcredit for Ultra Poor or UP Project in 2004.

PKSF, towards accommodating the FSVGD beneficiaries in its microcredit project for the ultra poor modified its components and termed the project "FSVGD and UP Beneficiaries Project". The overall goal was to facilitate access to financial services for the FSVGD members and the rural ultra poor, and to extend training and other capacity building support so that they develop and implement income activities in a sustainable way. Along with this, assistance for capacity building of staff of PKSF and its partner MFIs to delivering services to the beneficiaries effectively was accepted as a project component.

Table 4
Comparative Analysis of Performance of Different Programs on Hardcore Poor

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

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

The target beneficiaries of the project include the following categories of ultra poor – (i) dependent female headed households, (ii) landless, day laborers and other unskilled workers, (iii) bonded labor and domestic helps, (iv) poor households forced to sell their standing crops for subsistence; (iv) laborers, who sell labor in advance for managing present subsistence; (v) helpless people in the households having no able earning members; (vi) people who are physically or mentally retarded members of poor household; and (vii) other ultra poor deemed deserving candidates to receive support of the project.

The impact study based on a sample survey of 3,245 households; including 2,984 participating households and 261 control households. Of the participants, 1,990 were continued participants, 994 drop-out households (including 279 early drop-out participants). The early drop-out participants are those who had taken at best one loan. Therefore, impact is assessed comparing outcomes of (i) early drop-out and continuing participants, (ii) control and participant households. A short questionnaire was prepared for benchmark survey, and quite a modified version was prepared for impact survey in follow up. InM evaluated impact using both panel and cross-sectional data sets.

The panel data show that the participants are better off than the early drop-out households. Only the statistically significant results are reported as follows:

First, monthly nominal income of the participant households increased from 1711 BDT to 5224 BDT, while monthly nominal income for the drop out-group increased from 1738 BDT to 4804 BDT. The gain in monthly nominal income is higher (by over BDT 750) than the early drop out group.

Second, expenditure of the participant households has significantly increased from the benchmark period to the follow up period compared to the drop out-group. Such increase in expenditure is economically plausible because the marginal propensity of spend is positively associated with increase in income. Monthly food expenditure for the participants was higher by BDT 276.

Third, the proportion of income that has spent for monthly non-food expenditure has increased than the portion spending for food. It was higher by BDT 377.

Fourth, the difference between income and expenditure, economically termed as savings of the participant households remarkably has increased from the base period to the follow up period and this finding is verified by the descriptive and the econometric analysis. Net annual savings was higher by BDT 2609 for the participant-households compared to the early drop-out.

Fifth, the number of cows of the participant households in the follow up year has increased significantly compared to the early drop out households, which is validated by the significant asset score differences.

Major findings derived from the cross-sectional analysis are as follows:

Participants are better off compared to the early drop out households in the program villages in terms of household average monthly nominal income. Average monthly nominal income of participant was BDT 4921 as against BDT 3818 for the early drop out group in program village. The difference was statistically significant.

Average savings of participants was BDT 2705 compared to average savings of in control village was BDT 1051 and the difference was statistically significant.

Mean monthly expenditure of participant was BDT 4460 compared to BDT 4320 of drop out households in program village and compared to BDT 3251 of the non-participant in the control village. Food expenditure is a function household income.

Mean non-food expenditure of participant group is found statistically high compared to other two groups.

Mean number of cattle of the participants is higher than mean number of livestock of early drop out households in program village. The difference is significant at 1 percent level.

Mean number of house of participant was found statistically higher than that of early drop out households and control households.

From the endogenous switching regression we find that the participant household would have lower income, expenditure and saving if they would not take part in the program (counter-factual). Monthly income would have reduced by around 8 percent; food expenditure would have declined by around 3 percent. There could have been substantial fall in non-food expenditure. It would have reduced very substantially, by almost 100 percent.

The review so far has focused on the impact of microcredit on poor and ultra poor in respect to income, consumption, food security and asset formation including increase in land holding. The impact could also be assessed by examining some selected aspects of the impact.

InM Study on Impact of PRIME (Special Program for Ultra-Poor)

Seasonal food deprivation, locally known as *monga*, has been a critical problem in the north-western Bangladesh, especially in Greater Rangpur region. To understand *monga*, identify its causes and consequences, and evaluate the effectiveness of various policies and programs, InM and PKSF Jointly conducted the baseline survey. The first phase was completed and the report was submitted in December 2007. The study implies that, microfinance and the government social safety net programs are needed to be expanded for most vulnerable poor. Microfinance should be focused more on vulnerable poor. MFIs should be involved in different program designs.

InM, jointly with PKSF, also undertook a study on "Impact of Cash for Work Programme under PRIME in Lalmonirhat District" to evaluate the effectiveness of the PRIME's (Programmed Initiatives for *Monga* Eradication) "Cash for Work Programme" in Lalmonirhat district. The initial study on Impact of PRIME was confined to Lalmonirhat district. Later, the programme was extended to other districts of Greater Rangpur region as the scope of services also increased.

The study found a greater net gain in consumption ordering of the participants compared with the non-participants. Rise in income, shift from wage employment to self-employment, increase in borrowed amount and savings due to program participation appeared to have contributed to their larger net gain in consumption ordering. Econometric analysis also showed that the probability of being worse off in subsequent *monga* is quite low. The rate of decrease in wage employment and consequent rise in self-employment is higher for the participants than for the non-participants.

Major positive change is found in reduction in the percentage of households in occasional starvation in *monga*. Consequently, there is also a change in consumption rationing. It increased by three percentage point from pre-PRIME level.

In the third phase of the PRIME, the program design has included enhanced supplies and services, which may have measurable impact. The study found that, non-participants of any kind of microfinance are more likely to be female headed households in char areas and engaged in agricultural activities; have no electricity, education and sanitation. The PRIME participants with less than a year in the program and the benchmark group – who did not participate in any PRIME programs – were found to be similar. There were significant differences in savings and expenditure – higher for PRIME participants.

Further, several positive outcomes were found while assessing the impacts in context of participation in PRIME programs. As duration of membership increases, members were found to have more meals a day – both in normal and *monga* time (mid-August to mid-November). Cross-sectional and panel analyses also showed higher percentages of total land holding, livestock, income, expenditure and self-employment for older PRIME members.

Taking Operational Self-sufficiency (OSS) into account, it was found that as the duration of operating PRIME programs increases, OSS of pre-existing MFI branches that are implementing PRIME falls and branches established through implementing PRIME rises.

Employment

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

The aforementioned study by Atiur Rahman (2005) found that non-participating households lost the self-employment opportunities leaving ways to the participants of microfinance programs.

InM Poverty Dynamics Survey leaded by Osmani (2010) shows more recent picture. Almost 33 percent of borrowers' labor time is devoted to self-employment in non-agriculture compared to 23 percent for non-borrowers. Borrowers in general have lower levels of productivity in self-employment and salaried work, but not in wage employment. Poor borrowers who did not use credit for productive purposes may not have gained directly in terms of income, but they did gain from consumption smoothing. Many of the poor borrowers are gradually climbing out of the asset trap that history had set up for them, those among the poor non-borrowers who did not have access to foreign remittance are still caught in that trap.

Social Benefits

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

Seasonal Migration and Microcredit

An important determinant of seasonal migration could be the role of microcredit in influencing the decision regarding migration. Micro-credit provided by micro-finance institutions (MFIs) is a recent policy development in developing countries in relation to poverty alleviation. It is argued that if given access to relatively small credits, entrepreneurs from poor households will find opportunities to engage in viable income-generating activities, often secondary to their primary occupation, and thus alleviate their poverty by their own.

Individuals can use micro-credit during the productive part of the year and use the increased income to address their consumption and income shortfalls during the lean season. However, the major drawback of the micro-credit framework is the rigid loan repayment rule where nearly all contracts are fixed in their repayment schedules, which entails constant equal weekly payments with a high effective interest rate (usually more than 20 percent). One option to meet such strict loan repayment rule is to by combine both migration and micro-credit where the credit is received by the female member of the household but is used by the male member who migrates to the urban areas during the lean season and sends remittances to repay the loan (Rahman & Hossain, 1991). However, not everybody in the population has capable family members to take the loan and there exist a sizable number of female headed households, elderly people and disable people who will be restricted to migrate if taken credit and may not like to access micro-credit. Moreover, the amount of loan available through micro-credit is also very limited which is based on the borrowers' ability to repay in their worst week (Karlan and Mullainathan, 2009). Therefore, the impact of having prior access to micro-credit on seasonal migration has important policy implication for the poor people who are affected with the seasonality in the agricultural sector. Rahman & Hossain (1991) found that poor individuals prefer seasonal migration to accessing microcredit.

To sum up, the reviews of empirical studies show that so far we know that there are sizable effects of microfinance on poverty, especially in the short run. The empirical evidence on long-run sustainability of the effect is not so clear-cut. This effect becomes weak over a longer period. Most importantly, it is established that microcredit has helped the poor households to smooth consumption and avert devastating effect of calamities (flood, cyclone and death of income earner) or major expenditures (social obligation or illness). The positive effects are deepened using additional programs with microcredit. The long run sustainability of the benefits over time is not always certain in the same form and size as found in the short run.

Incidence of Poverty and Graduation Out of It

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

CONCLUSION

The above review covers studies conducted on programs of major organizations in the country over more than two decades applying both quantitative as well as qualitative methods on impacts of microcredit for the poor and extremely poor. In all cases, the findings show that microcredit increases employment and income of households that leads to improved quality of life as indicated by reduced food insecurity, improved housing, health, sanitation and education and formation of assets in many different forms.

The very visible changes are outreach and portfolio size, proliferation of microfinance through a large number of microfinance institutions, diversification of services, new regulatory regime, contribution in rural development, and recognition of microfinance and as a major contributor in poverty reduction. The changes come over a period of time that needs continued access to finance. However, it should be noted that finance alone did not lead to such changes but other developmental and macro-factors have definitely contributed positively or negatively.

On the whole the researches have proved the positive impacts of financial services for the poor. Bangladesh microfinance sector now has passed beyond doubt the era where studies were conducted to prove its effectiveness but now faces new challenges of other emerging issues such as continued vulnerability of poor due to external factors, overlapping of microcredit services, impact on microfinance in an era of slow or no growth of economy, and lack of new and more demand-driven products etc.

Chapter 3: Current Concerns and Challenges

Microfinance sector in Bangladesh, however, is facing many challenges regarding institutional capacity, quality and diversity of services, fallout from political and macroeconomic factors and so forth. Some political leaders in Bangladesh have publicly criticized the practices of MFIs to charge high interest rate leading to high indebtedness of borrowers and for using coercive loan collection tactics. Above all, some policy makers have remarked that microcredit has not made any dent on poverty level. Bangladesh still remains a poor country with millions of her population living below the poverty line and facing many related challenges of livelihood and vulnerability. This section discusses all the critical concerns, criticisms and challenges faced by microfinance program in Bangladesh.

INTEREST RATE

Right from the start of microcredit program in late 1970s, there has been a strong criticism of high interest rates charged by MFIs. This criticism has actually intensified lately and the subject has drawn considerable attention from political leaders to general public. In Bangladesh, top political leadership as well as key policymakers have expressed concern for the substantially higher interest rate charged by MFIs than the rate that commercial banks charge for the rich, while MFIs claim to help the poor. Different methods of calculating interest rate are noted in Box-2.

ifferent Methods of Calculating Interest Rate

Lending Interest is interest paid by the clients on loans amount borrowed from the MFIs. In microfinance there are various ways to calculate lending interest by the borrowers. Two methods are popular: flat method and declining balance method. There are diversified rates of lending interest, ranging from 10 percent to 20 percent in flat method, while in declining balance method the MFIs generally charges 20 percent.

Different methods of calculating Interest Rate

The Flat Method calculates interest rate as a percentage of the initial loan amount rather than the amount outstanding (declining) during the loan term. Using this flat method means that the interest is always calculated on the total amount of loan initially disbursed, even though periodic repayments cause the outstanding principal to decline. Often, but not always, a flat rate will be stated for the term of the loan rather than as a periodic (monthly or annual) rate.

$$\text{Total amount of interest} = \frac{\text{Principal loan amount x Rate of interest}}{100}$$

The Declining Balance Method calculates interest as a percentage of the amount outstanding over the loan term. Interest calculated on the declining balance means that the interest is charged only on the amount that the borrower still owes. The principal amount of a one-year loan, repaid weekly by installments of principal and interest, reduces or declines every week by the amount of principal that has been repaid. This means that borrowers have use of less and less of the original loan each week, until at the end of the year when they have no principal outstanding and have repaid the whole loan (assuming 100 percent repayment).

$$\text{Total interest} = \frac{\text{Outstanding principal loan x Rate of interest}}{100} \times \frac{\text{Due days or Payable days}}{365}$$

MFIs justify their position showing the high cost of funds, operating expenses and risk of defaults. It is true that transaction costs for microloans (about 70 percent of the cost) are much higher than for those administered by formal financing institutions. However, some MFIs receive subsidized fund from an intermediary agency such as PKSF and argument of high cost would not be valid for those. Also some MFIs, such as Grameen Bank, have access to funds received from depositors who are paid an interest rate of 8 percent.

InM is preparing a policy note highlighting interest rate and suggested options addressing it [Faruqee, 2011]. It shows several factors that determine the actual cost of borrowing, or the effective interest rate. First and foremost is the stated interest rate. Second, the method used to calculate the interest rate-simple versus compound will be an important element. Third, the method in which the principal of the loan is treated in calculating the interest rate will matter. For instance, a declining balance method uses the loan balance that remains unpaid as the basis of calculating interest rate. Fourth, the payment schedule will also matter. Normally the loans from MFIs are paid back over a year in 44 installments. The rate would vary if the installments are different and if grace period is allowed in paying back the loan. Finally, effective interest rate also depends on other charges and fees (such as insurance or forced savings, application fee, loan processing fee etc.).

Taking all these factors in the calculation of effective interest rates paid by clients–the effective interest rates charged by MFI vary a great deal across different loan products. Partner organizations (POs) of PKSF charge an effective annual interest rate of 24 percent to 32 percent on average. It can be as wide as 22 percent to 110 percent for MFIs outside the POs (taking all deductions into account). The effective interest rates generally charged by MFIs are expected higher (because of much higher transaction costs) than rates charged by formal institutions. The Government (Microcredit Regulatory Authority) has now set an interest rate cap at 27 percent on a declining balance method (That is equivalent to 14.5 percent flat method, according to one calculation). The effective interest charged by some MFIs are definitely higher than the cap.

MULTIPLE BORROWINGS (OVERLAPPING) IN MICROCREDIT

Rapid expansion and diversification of microcredit programs have been accompanied by borrowing of the same individual from several microfinance institutions (MFIs). This has led to a phenomenon of multiple borrowing sometimes referred to as overlapping. According to Consultative Group to Assist the Poor (CGAP), multiple borrowing means that an individual client or household borrowing from more than one microfinance institution for the same or similar purpose. The term is used to indicate multiple microfinance membership at the level of individual or household. Any household with more than one membership is termed as 'household overlapping', and any individual member having membership with more than one institute is referred to as 'membership overlapping'.

Borrowers taking loans from several MFIs might end up with increasing indebtedness. Indebtedness itself is not bad, unless the degree of indebtedness is such that it puts a financial burden on the borrowing client.

From the client's perspective, multiple borrowing takes place because of several reasons: (a) the client's business/consumption needs exceed the loan offered by a single MFI, (b) different rates of interest, (c) client's credit needs are not met by one MFI's product ranges, (d) emergency need of cash, (e) the client is defaulter and needs second loan to repay the first.

On the contrary, there are several potential ways for multiple borrowing to happen from the MFIs' perspective: (a) MFIs' aggressive growth plans force poaching the existing clients of other MFIs, (b) clients do not reveal their borrowings/membership with other providers, (c) loan sizes are based on cycles rather than cash flow, (d) different members from the same family or household take loans, (e) borrowers avail multiple loans by using multiple spellings/names on multiple identity cards.

However, in a recent study of InM carried out by Khalily et. al. (2011), no evidence of growing indebtedness for the overlapping households is found so far. Despite the fact that only 70 percent of the loans are generally utilized for financing enterprises, overlapping has not contributed to growing indebtedness. Overlapping households with continuous decrease in net worth over time will be considered as indebted households. Researchers found that the net worth grew for both overlapping and non-overlapping households.

Self employment days are higher for the overlapping households. The non-overlapping households had an average 168 person days of self-employment compared to 217 person days for the households with three multiple memberships and 237 person days for the households with five or more memberships. Number of earning members was also found higher for the households with multiple memberships. Thus, there is positive impact of overlapping found on the whole.

OVER-INDEBTEDNESS

As in any growing market, the success of microcredit has attracted new entrants and there has been mushroom growth of microcredit institutions in many developing countries. As noted, microcredit clients in those countries not only have access to credit from one single institution, but can choose from a number of lenders. Thus, some microcredit markets have become overextended. Borrowers have taken on too much credit that they eventually cannot repay. Such borrowers may end up "over-indebted". Possible drivers of over-indebtedness in a microcredit market are the facts that informal sources of financing as well as consumer lenders are widespread, credit bureaus are not in place or not functioning well and some microfinance institutions (MFIs) follow aggressive growth or do not customize their products to actual demand.

As a result, microcredit program in recent years has come under growing criticism scrutiny because of causing alleged debt trap for borrowers. The phenomenon of over-indebtedness is not new to microcredit as the risk is, to a certain extent, linked to market development itself. Over-indebtedness of microcredit borrowers however can, in the first place, be detrimental due to the material psychological and social consequences of being unable to respond to repayment obligations. Second, over-indebtedness can hamper financial sector development by harming the trust relationship between (financially inexperienced) microcredit borrowers and MFIs. Third, over-indebtedness is a great risk to the quality of the loan portfolio of MFIs, and subsequently constitutes a risk for investors in microfinance. Due to the detrimental impact over-indebtedness can have, all possible efforts should be undertaken to prevent markets from overextended, without holding back the desired market development in general. This is a key challenge to the entire microcredit industry.

So the relevant questions to ask are: How sever is the indebtedness of microcredit borrowers? Does indebtedness imply microcredit's failure to substantially impact welfare in a positive way? Or is indebtedness due to economic, political or environmental factors producing low returns to micro-investment? Are the terms and conditions of microloans stringent enough? Even if microfinance generates benefits over a short period of time, are there accrued benefits unsustainable in the long run for other reasons? For example a lack of entrepreneurial skill combined with insufficient product demand, may lead to diminishing returns on micro-investment. When realized returns fall short of expected ones, micro-entrepreneurs may be more likely to depend on repeated loans, creating a vicious cycle of micro-debt dependency.

Growing debt may not be alarming if a household's net worth (the value of assets net of liability from all sources including microfinance) is growing along with rising loan portfolio, even with membership from multiple programs. The research suggests that households who accumulate borrowing either from a single source or multiple sources are not necessarily over-indebted because the rising net worth of their portfolio is keeping pace with rising indebtedness; however, this is not the case for all borrowers. Widespread indebtedness should be major concern for microcredit borrowers and their lenders.

By the end of 2009, individual membership overlapping was estimated at 31.02 percent. If adjusted for overlapping, actual number of individual members mobilized by the end of 2009 would be 24.63 million, not 35 million.

Individual membership overlapping is a manifestation of the competition in micro credit market. It may be caused by flexibility in loan contract and/or loan ceiling. Often it can be attributed to demand for lumpy expenditure and enterprise failure. Ahmed (1996) argues that the micro finance sector took off from the mid 90s, and the program deepening has been increasing at a faster rate. In the process of such deepening, because of concentration of

MFIs in accessible areas, as Ahmed argues, this has contributed to individual membership or overlapping had been growing at an increasing rate.

In 2000, the individual membership overlapping rate was around 8.58 percent, and it increased to around 31 percent in 2009. Average annual rate of growth in individual membership overlapping during the period was 15.35 percent, but the percentage of single membership has been declining at an average annual rate of around three percent.

Not every individual had same number of memberships. It varied; it was as high as 9, i.e., some individuals had membership with nine MFIs. Although lower percentage of individuals have memberships with more than three or four, average annual growth rate is increasing with different level or intensity of overlapping. However, it should be noted here that only around one percent of the members had multiple memberships of five and more.

Geographical characteristics might induce overlapping. Individual membership overlapping varies by division. Barisal and Dhaka division have the highest individual overlapping rate of around 40 percent in 2009 - nine percentage points higher than the mean rate of 31 percent. Barisal had overlapping rate of around 22 percent even in 2001. The Microfinance Mapping of MFI operations by PKSF in 2006 reported that intensity of coverage was 100 percent. Like the individual membership overlapping, the household overlapping rate is very high in the Barisal and Dhaka division. In both the division, the overlapping rate was around fifty percent in 2009.

During the past decade, household overlapping has increased enormously. Average annual growth rate was estimated at 13.8 percent. It has been growing at a decreasing rate, evident from the 3-year annual average growth rate.

The highest growth rate is observed for the household overlapping of more than four memberships, and the lowest for two memberships. This suggests that deepening of overlapping has been increasing. We call it higher deepening of overlapping implying increasing growth in the higher number of multiple memberships.

Overlapping of Microcredit Lending and Over-Indebtedness

Households go for multiple memberships or overlapping if there is any excess demand for credit, and when the households become more vulnerable. If any household is in need of fund for lumpy expenditures, the household will have fewer funds available for enterprise financing. Therefore, it is rationale to expect that overlapping may cause over-indebtedness, defined as increasing loan burden and declining net assets or net worth. Khalily and Faridi (2010) showed overlapping households have higher net assets over time despite increase in loans outstanding. That means, the households have higher ability to pay for loan liability.

This suggests that with higher amount of borrowing, net worth of the overlapping households did not decrease. In fact, it increased. Therefore, one could conclude that overlapping did not contribute to over-indebtedness.

SUSTAINABILITY AND FINANCIAL VIABILITY OF MFIs

This section presents a review of sustainability studies beginning mid-1990s to very recent times of microfinance institutions of various sizes: very small to very large organizations. The review highlights the changes of viability of MFIs over times and factors that influenced such changes.

The focus of viability analysis has been to determine whether the MFIs are able to cover (a) operating expenditure and (b) financial cost from interest income. A few studies also attempted to see whether MFIs could cover the opportunity cost of fund from the income (mainly interest income) of microcredit program. The outreach, operating efficiency, portfolio quality and profitability of each PO when taken together determine its financial viability. We examine four sets of indicators related to (a) outreach, (b) operating efficiency, (c) portfolio quality and (d) profitability, to determine the viability of MFIs in each of these studies.

It is worth noting that, 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.

Khandker et. al. (1996) assessed the sustainability of a Government targeted credit program RD-12. They found the recovery rate for RD-12 as high as the rates of Grameen Bank and BRAC. RD-12 placement was found to be sensitive to area characteristics implying the endogeneity of program placement. The program depended on grants to operate at the thana level. In fact, 93 percent of the thana-level central cooperative societies were profitable in 1993 only if the head office grant was included as part of their revenue. Economic subsidy for RD-12 was calculated to be USD 7.5 per member in 1991. However, given that the program provided resources to generate income, skill, employment and other human development inputs to improve the living standard of the rural poor, especially women, that subsidy was judged to be worth spending.

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

A research of Quayes and Khalily (2010) shows that the size of the MFIs matters and larger MFIs are more efficient than smaller MFIs. Amongst the big three, Grameen Bank and ASA are very close to the efficient frontier. As smaller MFIs survive and grow they undergo the process of learning efficiency. There is also some evidence of learning by all MFIs over time. On an average, PKSF partners are more efficient than those who are not PKSF partners. The efficiency of PKSF partners can be attributed to their uniform disclosure and organizational practice. There is a tradeoff between depth of outreach (inverse of average loan balance per borrower) and cost efficiency.

A 2003 PKSF study (Jashim Uddin 2003) showed that PKSF-Partners of all sizes were profitable and could actually reduce interest rate to 12.5 percent (flat rate). That was the basis for reducing interest rate of PKSF partners from 15 percent to 12.5 percent (flat). They enjoyed high Return on Asset (ROA) and Return on Equity (ROE) even with 25 percent lending rate. The profitability of MFIs is crucial for long-term sustainable services for the poor.

Status of viability has been reported in Alamgir (2010) about the financial viability of 21 small MFIs (highest membership 15,000 in 1999). Ten POs had less than 5000 borrowers and the remaining 11 had more than 5000 borrowers. During FY98, 4 POs registered more than 25 percent growth in membership compared to FY97. Six POs have registered more than 25 percent increase in borrowers compared to FY97. Others also had registered positive growth in membership and borrowers. Increase in average loan size and improvement in member to borrower ratio contributed to increase in income and to improve viability. During FY98, 12 POs disbursed, on an average, more than BDT 5000 per loan and the remaining 9 POs disbursed between BDT 2250 to 5000 per loan. Of the 21POs, 15 POs could provide microcredit to more than 70 percent of their members.

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

All POs except one could maintain rate of recovery more than 98 percent in FY98. Except in cases of 3 POs, the overdue was less than one percent of the outstanding loan. The POs had created adequate amount of reserve according to the Debt Management Reserve policy of PKSF.

The study reported 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 percent per annum, cost of borrowing from PKSF at 3-4.5 percent, provision for bad-debt). Three small MFIs were in the process of becoming financially viable. However, it should be noted that the viability was achieved due to subsidized cost of capital from PKSF and relatively low level of staff salary in these smaller MFIs. Other factors that contributed to this performance are operating efficiency achieved by the staff members, high loan recovery and overall economies of scale. An analysis has been done to assess the economic viability of these MFIs assuming an interest rate of 16 percent (commercial bank lending rate at that time) where none of the MFIs could cover full cost at this rate of interest.

Another study was conducted by Alamgir in 2005, using information of 14 POs of PKSF of various sizes: four very small MFIs (membership maximum 10,000), eight small MFIs (membership between 10,001 and 50,000) and two medium MFIs (membership between 50,001 to 500,000). Data for 2001-2004 were used for this study.

The very small MFIs had one to less than 5 branches. The important indicator is that they reached more than 70 percent of members with loan at any given time. The average loan size was more than BDT 7000 in 2004.

The small MFIs had more than 5 branches. They reached more than 70 percent of members with loan at any given time and in two cases more than 90 percent. The average loan size varied considerably: between BDT 3,396 to BDT 17,649 but in most cases around BDT 7000. The high loan size and high member/borrower ratio had enabled them to reach financial viability.

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

The operating efficiency indicators of the small MFIs are similar except in one case (AF)[5]: Member per credit officer varied between 121 (in case of IDF which operates in hilly region) to 330; borrower per credit officer varied between 113 (IDF) to 297; cost per 1000 BDT lent varied between BDT 28 to 146; cost per loan varied between BDT 496 to BDT 873; and portfolio per credit offer varied between BDT 0.389 million to BDT 1.03. The last

[5] AF: Anukul Foundation, IDF: Integrated Development Foundation, RDWF: Rural Development and Welfare Foundation, DDJ: Dak Diye Jai, CARSA: Centre for Advanced Research and Social Action, ST: Sangkalpa Trust, ASOD: Assistance for Social Organization and Development. All are MFIs operating in Bangladesh.

indicator depended on many factors such as availability of resource, average length of memberships etc. The cost factors were influenced by salary structure, overhead, staff efficiency, and other costs.

The loan recovery rate of two very small MFIs was below industry standards (below 98 percent) and so was the overdue rate. That rate of small MFIs was reported high (96 to 100 percent). But overdue of loan of AF was unacceptably high.

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

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

Two medium-size MFIs (JC and TMSS) were separately studied. Similar to smaller MFIs, JC and TMSS also reached more than 80 percent of members with loan at any given time. The average loan size was slightly higher than BDT 6,000.

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

The loan recovery rate was reported high: more than 99 percent in both cases. JC and TMSS in 2004 as well as over the last 4 years had achieved more than 200 percent operating self-sufficiency (i.e. income is more than double than the operating expenses). Similarly, JC and TMSS had an average financial self-sufficiency (FSS) of 150 percent except in 2004 for JC where the self-sufficiency ratio suffered. This was due to appropriation for various reserves. The ROA for TMSS was much higher (7.87 percent compared to 3.68 percent of JC) possibly because of higher yield on portfolio.

Three MFIs- BURO-B (2005-2008), ASA (2002-2008) and BRAC (2004-2007), have been analyzed using published data that show their viability and impacts of many factors.

The operating indicators are more or less similar to other MFIs. The total microfinance program of BURO-B was profitable during 2005 to 2008. In fact it was one of the most profitable MFIs and emphasized viability since its inception in early 1990s. But the profitability has significantly declined over the years: OSS was 163 percent in 2005 but reduced to 118 in 2007 and

109 in 2008; FSS was 136 percent in 2005 but reduced to 107 percent in 2007 and 104 in 2008; return on total asset has declined from 10 percent in 2005 to 2 percent in 2008. The decline in profitability has been due to cost factors: productivity has declined due to rapid expansion, loan portfolio has increased, more importantly cost of fund has increased. BURO-B depends very much on high cost commercial bank borrowing to finance its portfolio.

ASA and BRAC are two very large MFIs in Bangladesh each serving more than 7 million clients all over the country. But when it comes to profitability ASA is more profitable due to management efficiency. ASA makes high profit as indicated by Operational Self-sufficiency (OSS), Financial Self-Sufficiency (FSS) and Return on Asset (ROA). The superior financial performance of ASA is mainly due to its efficiency. The number of clients and portfolio per loan officer figures are unmatched in the industry. At the same time ASA has maintained high portfolio quality.

OSS, FSS and ROA figures were 230 percent, 154 percent and 9.05 percent in 2002 respectively which became 143 percent (37 percent drop), 114.3 percent (26 percent drop) and 3.02 percent (only one third of 2002) in 2008 respectively. The main reason is fast rise of operational expenses with expansion. At the same time portfolio at risks has risen from 0.33 percent in 2002 to 4.99 percent in 2008.

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

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

Alamgir (2007) presents analysis of financial viability of three MFIs (BEES, CARB, Sojag) having significant (in case of CARB 100 percent) seasonal and agricultural loan portfolio using 2005-2006 data. BEES follows

Grameen styled group system to lend to small and marginal farmers but gives annual loan and collects in weekly system[6]. Sojag on the other hand provides loan to men (farmers) at the beginning of two agricultural seasons and collects in one installment after harvest. CARB at the time of the study provided in-kind loan (fertilizer, water, pesticides) through registered dealers to farmers during boro season. Besides, BEES and Sojag had also hardcore poor program. All three are profitable but not as profitable as the other MFIs reported above. The main reason is small portfolio per credit officer.

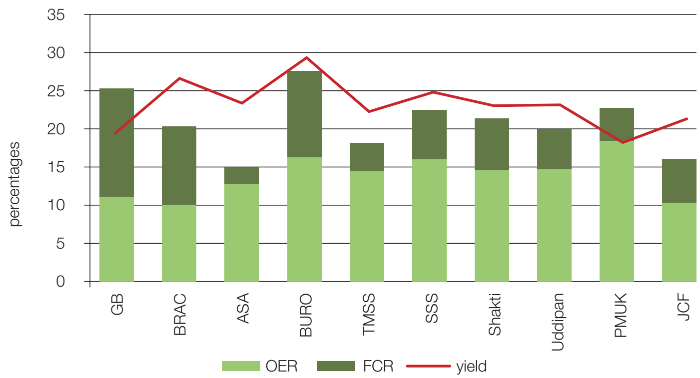
Microfinance Review by BRAC

In Bangladesh Microfinance Review (2011), BRAC analyzed performances of the largest ten microfinance institutes. Three of them: Grameen Bank, BRAC and ASA are very large (L-3), and other seven (O-7) come afterwards: BURO Bangladesh, TMSS, SSS, Shakti Foundation, Uddipan, PMUK and JCF. It found the Portfolio at Risk (PAR) 6.6 percent and 4.9 percent respectively for L-3 and O-7. Generally, Loan Loss Reserve (LLR) is supposed to be at 75 percent of PAR to cover all possible risks including both the risk posed by natural calamities and the risk of over-indebtedness resulting from multiple borrowings. The review found that in 2009, those MFIs have reserves that either exceed or nearly equal to their PAR. The ROA was 4.2, 3.9, 0.4 and 2.3 percent respectively for ASA, BRAC, Grameen Bank and O-7 in 2009, while Bangladeshi Banks have 1.37 percent. In case of ROE, the review paper found that, ROEs are 7.1, 10, 5.7 and 16.1 percent for ASA, BRAC, Grameen Bank and O-7, respectively. ROE is 21.7 percent for Bangladeshi banks.

Figure 12 is generated from the report which shows cost and returns of ten largest MFIs of Bangladesh. Yield rate exceeds Operating Expense Ratio (OER) and Financial Cost Ratio (FCR) for all of them except Grameen Bank (GB) and PMUK. The gap is highest for ASA (8.5 percent).

[6] BEES: Bangladesh Extension Education Services, CARB: Centre for Action Research-Barind, and Sojag: Samaj O Jati Gathan, TMSS: Thengamara Mohila Sobuj Sangha, SSS: Society for Social Service, PMUK: Padakhep Manobik Unnayan Kendra, JCF: Jagoroni Chakra Foundation, UDDIPAN: United Development Initiatives for Programmed Actions. All are Bangladeshi MFIs.

Figure 12
Costs and Returns of 10 Largest MFIs in 2009



Source: Bangladesh Microfinance Review (2011)

Viability of Specific Program/Product

Sustainability of Very Poor Microcredit Programs:

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

Viability of farmer and microenterprise program:

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

SOCIAL VERSUS COMMERCIAL ORIENTATION OF MICROCREDIT

The theory and practice of social safety net and microfinance clearly show that there is a good deal of overlap between the two. It is, therefore, extremely important to identify the areas of overlap and areas of difference so that separate norms and approaches could apply to those programs and appropriate policy for each can be formulated.

Bangladesh Government runs about 30 social safety net programs and at least 13 ministries are engaged in planning and implementation of the projects. Involvement of the ministries has caused considerable overlaps in programs and administrative which stretch the administrative and resource capacity of the country. Most of the existing programs are ex-post coping initiatives expected by a few ex-ante preventive programs. The social safety net program is weak and most attention goes to support ex-post coping programs.

Major safety net programs in Bangladesh can be divided into conditional and unconditional transfers. Unconditional transfer programs mainly include food and cash, while the conditional programs involve credits too. Existing social safety net programs do not provide a sufficient basis to cope with the magnitude of extreme poverty. Given this, there is increasing reliance on microcredit to fill in the gap created by non-existing or weak social safety net programs.

APPROPRIATE MICROFINANCE REGULATION

In Bangladesh, microfinance is now regulated under the Microcredit Act 2006 and enforced by the Microcredit Regulatory Authority (MRA). Around 550 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 to 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.

Bangladesh is, however, ahead of other countries in the SAARC region. 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.

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.

INSTITUTIONAL AND HR DEVELOPMENT

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 contrast to Bangladesh experience, India's program has considered capacity building and better understanding of techniques for improving microfinance management as 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 increased but the quality and quantity of such services did not necessarily match the current requirements of the sector.

Experiences of both countries show that effective bridging of capacity building gaps requires regular 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.

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.

CONCLUSION

Microfinance is now globally recognized as an important 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 throw up some key challenges for microfinance programs.

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 percent per annum, cost of borrowing from PKSF at 3-4.5 percent, 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.

The discussions and examples above reveal several key points:

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

Chapter 4: Future Direction

Bangladesh has made the most impressive progress in microfinance program. 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. Although microfinance progressed most in Bangladesh, there is still room for further progress.

Addressing the Key Concerns and Creating Favorable Political and Social Environment for Expansion of Microfinance

High Interest Rate

Rather than attacking microcredit program for high interest rates, a more appropriate policy response would be to identify the reasons for high rates and find ways how to reduce them. So the critical challenge for the Government and regulating agency is that how can an enabling environment be created through which the MFIs who are operating efficiently and providing useful services to clients can go forward unhindered by regulation or policy. At the same time, the outliers (charging much higher than average effective rate of interest) are forced to shape up or go out as a result of competition. This objective can be achieved through multipronged approach that would involve the following principles and actions:

First, MFI interest rates must legitimately cover operating costs, but those costs should be as efficient as possible. Therefore focus should be on increasing MFI efficiency. Second, setting interest rate caps is advisable only when there is clear evidence of market failure. Keeping in mind the cases of donor funds (at subsidized interest rate), a better approach would be capping the spread between cost of services and interest rate and various fees charged by MFIs. Third, transparency and some kind of uniformity in interest rates charged for similar type of loan and use of declining balance method in calculating interest rate would be highly desirable. Here a regulatory framework can play a vital role. Fourth, transparency should be required in financial reporting. It enables stakeholders to understand the revenues and costs of an MFI. It also improves performance by challenging MFIs to compare themselves with their peers and find ways to improve efficiency. Fifth, industry infrastructure (e.g., credit bureaus, auditor's training) will have to be developed and supported. Last, different type of institutions associated with MFIs (e.g., NGOs, credit unions, microfinance banks) will have to be supported and promoted. All stakeholders interested in bringing down the costs of microfinance to borrowers should consider what actions and interventions will be most beneficial to support competition and help in the development of natural market mechanisms that will effectively respond to the diverse consumer demand for financial services in developing countries.

Overlapping

Multiple borrowing may be caused by the nature of credit need and inherent terms and condition of microcredit. For example, if the credit is far agriculture crop and the size of the loan is tented by the return of microcredit program, the borrowers may have to turn to several provides for loan.

Other reasons for multiple borrowing are: default in repaying existing loans, economic recession requiring additional loans by borrowing households, and overlapping jurisdiction of MFIs can by definition lead to overlapping. In Bangladesh one survey shows that 95 percent of the villages survey actually overlapped in areas covered.

As for the future, certain steps may be taken to direct overlapping to a constructive and productive route. Credit bureau or clearing houses may be set up to avoid or minimize overlapping, MFI credit policies need to be adjusted in a manner that allows minimum of overlapping. For example, microcredit for agriculture needs to adjust to size and repayment provide in a manner that is suitable for agriculture. MFA need to take some actions to minimize overlapping or direct this to a productive route. Information sharing between MFIs would help in minimizing the overlapping in lending to microcredit to members of MFIs.

Indebtedness

Responsibility for avoiding over-indebtedness rests with both clients and institutions. For clients, this means making prudent decisions and judging their repayment capacity. For institutions, this means carefully assessing a client's ability to repay.

Consumer loans are still frequently identified as a potential source of over-indebtedness as they do not provide debtors with returns for repayment. However, researchers increasingly point out the valuable contribution of consumer loans to consumption smoothing and risk management and recommend that the industry should not deprive the poor of this valuable tool by overemphasizing the myth of poverty alleviation from investment credit (Adler 2009; Collins et al. 2009; Guérin et al. 2009a; Morduch 1995; Rahman 1999). Microloans for consumptive purposes do bear risks, but they can also have positive social impact and to many poor borrowers are more important than investment loans. It is therefore important to offer both types of microloans but tailor loan decisions and products better to the various loan uses, avoiding investment loans where investments do not create sufficient returns and consumer loans where they are not justified by a specific need.

An important reason for the over-indebtedness of borrowers is that the consequences of taking a loan are simply hard to understand. Lenders can exploit this challenge, promoting a loan's upsides and trying to downplay or hide the cost of credit. In microfinance pricing, there are numerous means for MFIs to obscure the actual cost of their products to clients. Among the most common MFI techniques to reduce pricing transparency are the introduction of fees to increase income without stating higher interest rates, the communication of monthly instead of annual interest rates, and the application of interest to a constant instead of declining balance.

MFIs should take the challenges of their customers with regards to budgeting and time related information processing seriously and adapt their customer communication accordingly. If the terms and conditions are presented in a way that is not suitable for the borrowers' mental representations, they may not understand the implications of taking a loan and may over-indebt themselves. From a customer protection perspective, MFIs should therefore aim at the right balance between transparency and understandability, providing an easy to grasp overview of their loan costs that focuses on the information psychology has shown to be easiest to process.

Lending in a highly competitive microcredit market, MFIs often fail to avoid client over-indebtedness even though after recognizing that a risk for the client is also a risk for the institution. To mitigate these risks, MFIs should perform rigorous credit analysis of its clients before issuing a loan and follow up with audits to verify proper staff behavior and discover why clients are not able to meet their obligations. Proactive measures like financial-literacy programs and client-loyalty efforts complement analysis and audits can be taken to create a robust system to avoid client over-indebtedness.

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 changes 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 other 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.

Easing Loan Repayment Process Using Information & Communication Technology

The use of IT is very limited in microfinance programs in South Asian 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.

The needs for ICT in the microfinance sector cannot be overemphasized. To make microfinance services faster and reliable, there is no alternative to make it ICT 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.

Easing Loan Recovery Method

Loan recovery methods should be made easy and convenient for the poor. In India, microcredit industry has boomed in the past few years but has become increasingly marred by coercive loan practices, which the state government is blaming for the increase in the number of suicides in the area. The state government has then adopted a new law that, observers note, has brought the entire industry to a halt. Coercive loan recovery can also be found in Bangladesh. More frequently, coercive maintenance of membership happens. Borrowers often forced to take another loan, regardless of their demand for the loan and/or capacity of repayment. In contrast to microcredit schemes that could offer only financial inducements for repayment, the Grameen Bank initiated to practice social coercion. The meetings are designed to develop peer pressure to ensure compliance. Failure of blocking coercive borrowings will eventually hurt both lenders and borrowers.

Ensuring Sustainability of MFIs

One key lesson 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 South Asia are improving as the needs and awareness about sustainability of MFIs are becoming pronounced. But the speed of improvement varies among the countries. 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.

Thus there are additional ways of accessing the capital markets, creating additional resources for MFIs. It is already evident that 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 Not Covered Yet

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 only covered 43 percent of rural households and the shares of high-cost informal sectors are still substantial (23 percent). 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 percent and India and Nepal reading about 15 percent. The proportion of the poor households covered so far ranges from 4 percent (Afghanistan) to 45 percent (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.

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 percent 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.

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.

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 percent 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 dearly 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.

   Microinsurance in Bangladesh did not grow like microcredit in spite of the fact that the implicit risk premium associated with informal or self-insurance can be exorbitant. The problem may be that the products typically on offer are not of much interest to the poor.

   InM study conducted by Ahsan (2009) shows that in spite of 25 percent of surveyed households being covered by the Grameen Kalyan plan; none reported utilizing it when met with health shocks. Thus, self-insurance means are too inadequate to prevent vulnerability to poverty. According to WHO (2010), 150 million people face catastrophic health expenses worldwide. InM data (2009) showed that 4011 households and 19424 persons reported 1186 events of health shocks over a two year period; of whom, 1457 missed work over the preceding 12 months, 462 cases involved loss of up to 5 days and 219 remained absent more than 31 days.

Health shocks occurring to earner or non-earners appear to reduce household per capita consumption significantly. Among costs of shocks those related to death of a non-earning member, health shocks on the part of both earners and non-earners were significant. Negative consequences of asset depletion and using-up of savings as means of coping with a shock were evident.

So far, research on microinsurance in Bangladesh gives the following results: (a) No health insurance product is currently available in Bangladesh, (b) Life insurance is very costly–but a few people take the insurance, (c) Insurances do not cover the vulnerability, rather cover only shocks like death, (d) There are some insurance available for livestock losses, (e) Microfinance institutes seem do not have the apparatus to reach the poor on this purpose, (f) Some NGOs provide their so called health insurance for the poor, which is in fact, discounted charge for basic health treatment, (g) This type of health insurance was not successful to drag clients' attention.

The broad understanding is that, while low cost insurance can be, and indeed is being implemented around the world, the process is hard and challenging. Not only groups of large numbers need to be enrolled so that the cost of risk is minimized, but at the same time the actual scale cannot be overwhelming. It is imperative to provide some services in a local environment that is adequate, timely, and cost-efficient.

Financial subsidy regimes ought to be fully integrated into the insurance design so that long-run sustainability can be ensured. Most low-cost products marketed en masse appear to be those intermediated by MFIs, SHG collectives or credit/saving cooperatives, and depending on the mode of delivery, may also utilize registered risk carriers to shift the risks. When microfinance institutions and like organizations are involved in local delivery of insurance services, it is to be kept in mind that insurance is separate from credit, and accommodating groups of non-borrowing members is vital to the success of the plan.

Linking with Formal Financial System

So far microfinance has provided most of the access to financial services available to low-income people, 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 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.

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 South Asian countries, this could lead to the costs of microfinance to the client settlings 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.

Strengthening Microcredit Regulatory Authority (MRA): Facilitation Vs Regulations

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.

CONCLUSION

Because the large majority of microcredit is awarded to women under the pretense of ensuring their empowerment, several improvements must be made to the distribution of microcredit in relation to women.

Many scholars and practitioners suggest an integrated package of services ('a credit-plus' approach) rather than just lending out money. When access to credit is combined with other services, such as additional financial services (voluntary savings facilities, non-productive loan facilities, insurance), enterprise development (production-oriented and management training, marketing support) and welfare-related services (literacy and health services, gender and social awareness training), the adverse effects discussed above will be diminished. However, the role of microcredit programs in development process should be reviewed as a key measure to open doors of economic opportunity to the poor by helping them to overcome the critical credit constraint to realize fully their entrepreneurial potential. It may also help the poor to avoid sale of assets during hardships. Microcredit program should not be viewed as the only means to help the poor climb out of poverty. Overall economic growth must accompany any microcredit program to achieve significant and lasting poverty impact.

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The Institute of Microfinance (InM) is an independent non-profit organisation established primarily to meet the research and training needs of national as well as of global microcredit programmes. Initiated and promoted by Palli Karma-Sahayak Foundation (PKSF) on 1 November 2006, the Institute is principally funded by UKaid, Department for International Development (DFID) through its Promoting Financial Services for Poverty Reduction (PROSPER) Programme. InM has an excellent team of professionals in research, training and knowledge management. InM draws research scholars from reputed universities here and abroad. The major services that InM provides are research on poverty, microfinance, enterprise development, impact assessment and evaluation of microfinance programmes. Beside research, InM provides microfinance related training, capacity building support and knowledge management services to microfinance institutions and other development organisations.

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