Financial Inclusion Network Bangladesh

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Key Note Paper

Financial Inclusion in Bangladesh: Networking and Way Forward

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FINANCIAL INCLUSION IN BANGLADESH: NETWORKING AND WAY FORWARD

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01. Understanding Financial Inclusion

Financial inclusion, broadly understood to be financial services, is gaining greater importance to the policy makers worldwide mainly because of its appeal as a tool for sustaining economic welfare and also for reducing poverty. In addition it also supports economic and financial stability in the long-run by making the transmission of monetary policy more effective as it means more saving and investment at the bottom of the pyramid. Moreover, it produces legitimacy to the process of economic democratization pushed by most policy makers. The concept is gaining wider acceptance not only amongst international financial institutions but also by the standard setting bodies including Bank of International Settlement (BIS). Individual countries are also coming forward with many innovative ideas and policy interventions to enhance the level of financial inclusion. Bangladesh, surely, stands out to be a unique country which has been recently praised for its innovative financial inclusion strategy. The central bank of the country, Bangladesh Bank, has taken the lead in bringing motivational changes amongst bankers and others involved in the financial sector. Before we focus on the various initiatives taken by Bangladesh in enhancing financial inclusion in recent years let us look into this concept more in depth to know about the measures of financial inclusion. Fortunately BIS has recently published results of a survey conducted by the Irving Fisher Committee on Central Bank Statistics (BIS, 2016) which provides diverse measures of financial inclusion.

Figure 01: What is Financial Inclusion?

Access To	Finance	For All
Useful & affordable financial products and services.	Transactions Payments Savings Credit Insurance	Delivered in a responsible and sustainable manner.

The paper talks about various shades of definition, central bank mandates, policies and governance structures, data types and sources and finally international collaboration. It confirms that there is no standard, universally acceptable definition of financial inclusion. Some central banks have official definition of it typically including availability and use of financial services in addition to various other aspects. The challenge of clarification of the definition of SMEs (and distinguishing them from households) remains. Again some central banks have formal mandate for financial inclusion and some others have taken specific actions through regulations or directives in the areas of financial education and literacy by pursuing consumer protection, by designing and implementing onsite and offsite supervision of financial institutions and services. Though less recognized, the traditional role of central banks in pursuing price and financial stability also contributes towards financial inclusion. Also financial inclusion contributes to financial stability through expanding the base of deposit and lending. It should also be recognized that the domain of financial inclusion in many central banks remains decentralized as it may be routed through payment system, supervisory departments and, of course, targeted

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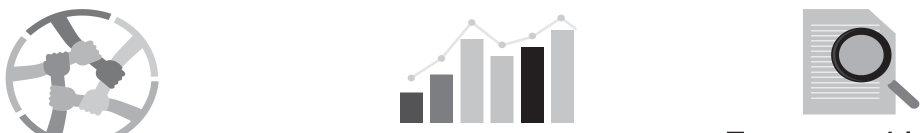
actions through departments of SME, agriculture, green finance etc. Some central banks like Bangladesh Bank have even a specific department of financial inclusion for coordinating and promoting financial inclusion activities within the central banks or outside. The financial services provided by commercial banks, development banks, non-bank financial institutions, micro-finance institutions, mobile financial service providers and even insurance companies etc. need to be coordinated and promoted. Some countries also have post offices, agent banking outlets provide inclusive financial services. These too deserve to be coordinated. Bangladesh Bank, in recent years, have been able to develop this role of coordination and for which it has been globally recognized.

Although most central banks collect data on diversified financial inclusive services, specific gaps on the usage and quality of financial inclusion related services and infrastructure remain. The gaps normally are around exact number and distribution of SMEs, (including gender dimension), smaller retail bank accounts, mobile bank accounts, micro-finance accounts etc. These data, even if collected, are mostly estimates and not actual numbers. The non-bank financial accounts are not always rigorously supervised. Also there is no regular frequency of whatever data is collected. This can result into a financial instability as the challenge of shadow banking may not be adequately addressed. The BIS survey also confirms that a well-designed collaboration between central banks and interaction with international groupings (e.g. Alliance for Financial Inclusion) can indeed lead to effective exchange of views and best practices related to defining, measuring and analyzing financial inclusion. As expected, most respondents of the survey emphasized on international data-sharing and cross-country harmonization (not forgetting the national specificities). Furthermore, they opined for taking only those efforts to enhance data-sharing and harmonization which primarily leverage existing international collaboration initiatives.

02. Development Pathway of Bangladesh: Relevance of Financial Inclusion

In 1971, Bangladesh grew out of a strong national aspiration for freedom and equity. The dream of Bangladesh and the essence of the national spirit always embedded inclusiveness in it. The journey started beset many challenges. Out of these challenges emerged early inclusion efforts through microfinance, health, and other home-grown social innovations. Bangladesh has established a new development paradigm through its novel approach to socio-economic development. It is self-dependent yet collaborative, focuses on high growth while being inclusive, and respectful of heritage and yet opportunistic in use of new technology. A perspective plan (2010-2021) and two five year plans, 6th (2011-15) and 7th (2016-20) have moved the nation from investment-driven and resource dependent framework to a broader socio-economic transformation vision, unifying the various state and non-state actors with specific milestones and complementary roles. Macroeconomic achievements of the last decade has been especially commendable. For example, GDP rose from 72 billion USD in 2005-06 to 221 billion USD in 2016. The latest BBS estimates touches 250 billion USD by now. The structural transformation of the economy during this period has also been quite significant: 25 percent of GDP was from industrial sector in 2005-06 and now its 31 percent. Inflation has been reduced from 12 percent in 2007-08 to 5 percent now. Over 13 million jobs have been created in last 8 years. Export earning tripled from over 10 billion USD in 2005-06 to over 34 billion USD in 2015-16. Size of the ADP and revenue earnings have increased by 4.5 times and almost 4 times during the same period. In 2007, poverty rate in Bangladesh was 36.8% which has decreased over the years and became 23.2% in 2016. More importantly, extreme poverty rate was 22.6% in 2007 which decreased to 12.1% in 2016. Per Capita Income (USD) of Bangladesh has also increased steadily and in 2016-2017 it became 1,602 US Dollar. The latest BBS estimate puts it as 1,610 USD. In addition, overall consumption of Bangladesh has almost been tripled in the last decade. Overall investment quadrupled in the last decade (Rahman, 2017). Chief Economist & Senior Vice President of the World Bank Paul Romer has declared that Bangladesh now is capable of achieving more growth and more equality (Romer, 2016). He said in a workshop in Dhaka last year, “We know from the recent experience in Bangladesh that it is possible to have more growth and more equality.”

Figure 02: Relevance of Financial Inclusion in Bangladesh



Ensuring financial inclusion is pivotal to achieving the short- and long-term macroeconomic objectives. Inequality in access to opportunity is often a prime culprit- be it the opportunity of education, health, or financial services. Inequality is not just a moral issue- it is also a macroeconomic issue. Financial inclusion ensures broader social inclusion and fosters inclusive growth at the same time. Above all, it opens up blocked opportunities for the poor. It contributes positively to financial stability as well. More diversified funding and loan base, lesser reliance on unstable savings channel and political legitimacy are ensured through financial inclusion. These are the direct relationships between financial inclusion and financial stability. There are indirect relationships as well, e.g. promotion of stability as household levels, greater income equality, and improved transmission channels for better monetary policy implementation. Hence, financial inclusion in the context of Bangladesh and other similar emerging economies, is a critical tool for attaining macro-economic objectives.

03. Development Role of the Financial Sector in Bangladesh

The recent global financial crisis in developed countries brought into focus the role of financial sector in general and the role of the central bank in specific. Due to lax regulations in the developed countries jobs were lost, asset value got wiped out and financial security shattered. At the same time, a quiet revolution of financial inclusion took place in many developing countries like Bangladesh. In these countries innovations ensured financial services for the previously excluded segments of the society. In case of the developed countries reform measures focused on helicoptering money to affected financial institutions. However, the broader response was visible in many developing countries including Bangladesh where newly created money was taken through ‘bullock carts’ to ground, and impacting real economy (both from demand and supply sides). These have brought in to light the developmental role of the central bank. The developmental central bank focuses on four core aspects, namely-

(i) Catalyzing innovation and efficiency of banks,

(ii) Coordinating role with private sector and across public sector agencies,

(iii) Setting examples of public sector innovation and reform,

(iv) Financial inclusion for social cohesion.

Figure 03: Philosophy of Developmental Banking.

In case of Bangladesh, during recent years the monetary policy mandate of the central bank has revolved around- maintaining price stability while supporting output and development; secondly instituting a new emphasis on the quality of monetary policy implementation; and thirdly prioritizing inclusive and environmentally sustainable growth. The focus has been on experimentation and implementation, while being mindful of what monetary policy can and cannot do. The core idea has been to combine short-term business cycle fluctuation management with long-term sustainability agenda. Areas emphasized are: technology and market infrastructure, regulatory framework, and refinancing initiatives. The overarching goals here are: (i) to improve monetary transmission channels; (ii) to promote macro-financial stability risks through inclusion, regulation, and supervision; (iii) to induce directional bias towards more productive and sustainable activities. Bangladesh Bank's inclusive financing thrust has thus been on output initiatives in-

- Agriculture supporting food security and food price stability
- SME financing promoting output, employment and income generation
- Green financing supporting environmental sustainability

Attaining these requires significant institutional changes, and Bangladesh Bank has responded to this call in a potent and efficient manner. The institutional changes ensured during recent years include the following;

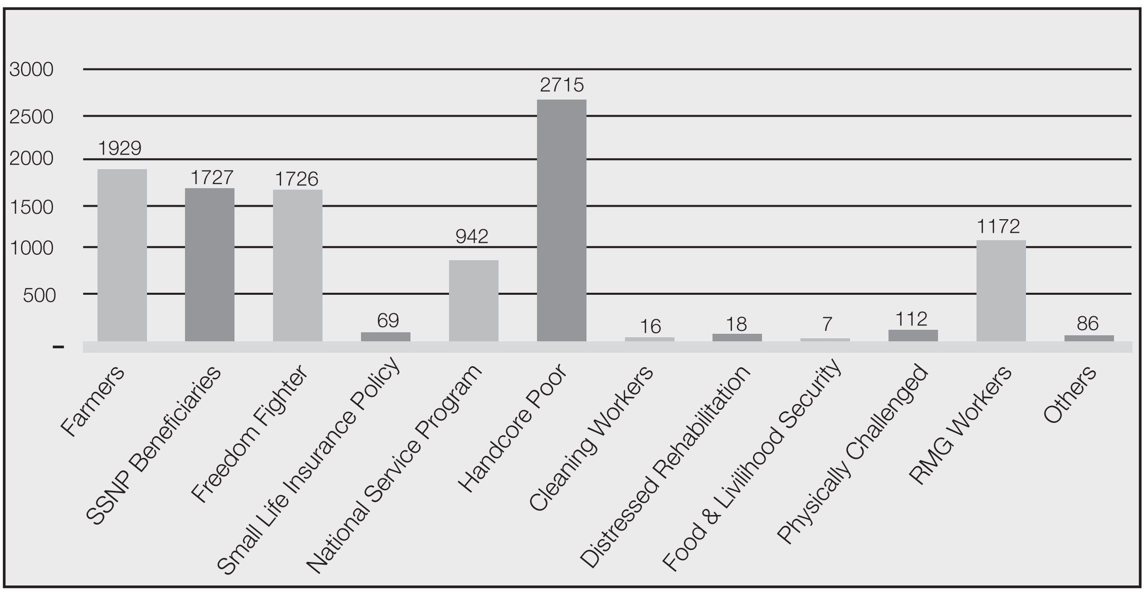
- Bangladesh Bank opened new departments (agri, SME, sustainable finance, CSR, financial inclusion) with a focus on financial inclusion.
- New thrust for opening more branches in the rural areas.
- Encouraging partnership between banks and MFIs to increase coverage in previously unreached areas.
- Similar partnership for quick disbursement of remittance to the recipients.
- Revamping CSR for reaching the extreme poor through scholarship and health programs.
- Motivating banks to provide loans to women entrepreneurs (at least one from each branch).
- A portion of the refinanced SME loans earmarked for the women entrepreneurs.
- Massive digitization of the payment system including development of national payment switch, MFS and electronic fund transfer.
- Consumer protection through Customer Interest Protection Center (CIPC) with a dedicated hotline.
- Providing better CAMELS rating, enhanced refinance, easier approval of new branches if banks excel in financial inclusion.
- Strengthening institutional capacity of the central bank for better supervision of the financial institutions engaged in financial inclusion.

04. Financial Inclusion Efforts in Bangladesh: Innovation and Networking

Bangladesh Bank has brought in a number of innovations in formulation and implementation of monetary policy. Elaborate stakeholder consultation has become hallmark of formulation of participatory monetary policy. As a result the central bank can get advance suggestions from the stakeholders about their demands. Once a monetary policy is launched based on those suggestions the transmission mechanism becomes smooth and well understood by them. In deed such an approach has helped the central bank to establish one theme: as a developmental central bank Bangladesh Bank believes that societies and pyramids are as strong as their bases. With such base the country's macro-financial and price stability ought to be stable. And that's exactly what has happened in case of Bangladesh. The inclusive finance initiatives in Bangladesh have covered wider segments: agriculture, MSMEs, Green Products. The agriculture finance includes some unique initiatives:

Annual Agriculture Policy:

Figure 04: Total Outstanding Balance (in million BDT) of NFAs for Farmers and other than Farmers as of June 2016.



Source: Bangladesh Bank

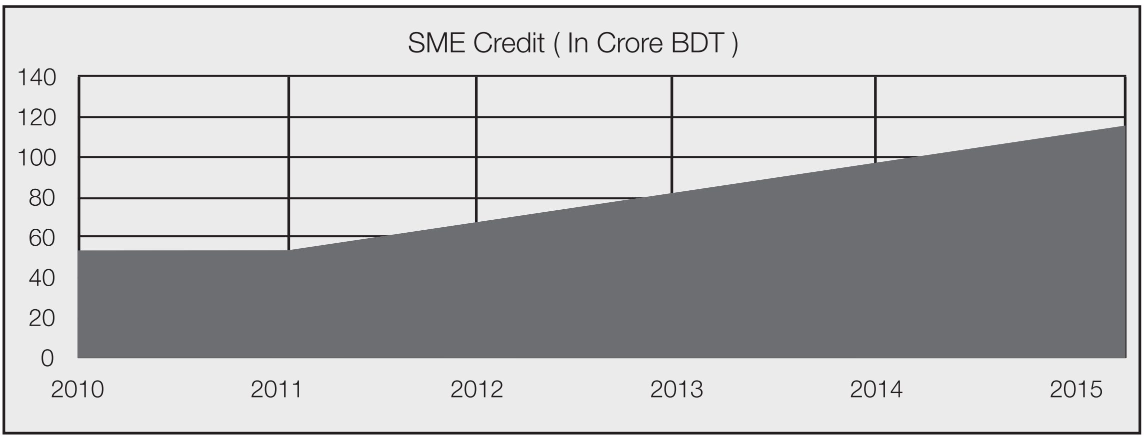
The MSME financing includes initiatives:

- 20 % of the total credit should go for MSMEs.
- 10 % of MSMEs credit should go to women entrepreneurs.
- All banks and nonbank financial intuitions must set up dedicated desks for women entrepreneurs
- Area approach and cluster based financing.
- Dedicated Refinance Schemes.

The Green Finance initiatives include:

- Taka 2 billion Annual Refinance Scheme.
- USD 50 million Fund from ADB
- USD 200 million Fund for Green Transformation of the textile and leather sectors.
- 50 green products for finance and refinance in 11 categories.
- Annual consultation with banks and NBFIs for setting targets.

Figure 05: Credit Flow to Promote SMEs.

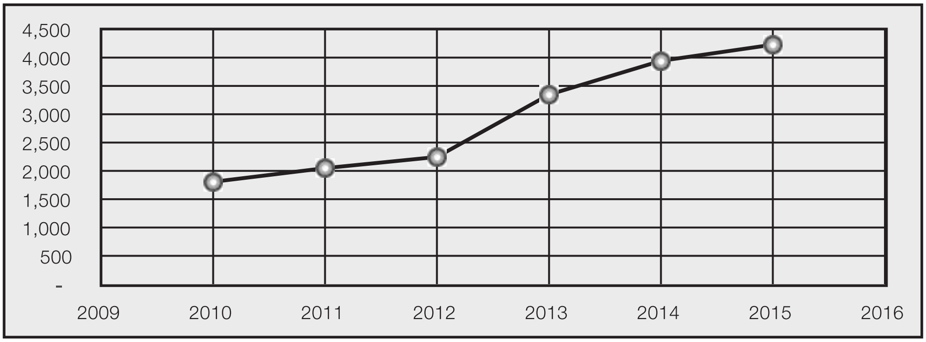


Source: Bangladesh Bank

Amongst the innovative financial inclusion products and services the followings are impo

- No frill (ten Taka) accounts for the farmers and the disadvantaged
- Banking services for the physically challenged
- Banking for the school students and street children
- Refinance schemes for
- No-frill account holders
- Residents of enclaves who have been newly annexed to Bangladesh
- Third gender

Figure 06: Credit Disbursed (in Crore BDT) to Women MSMEs.

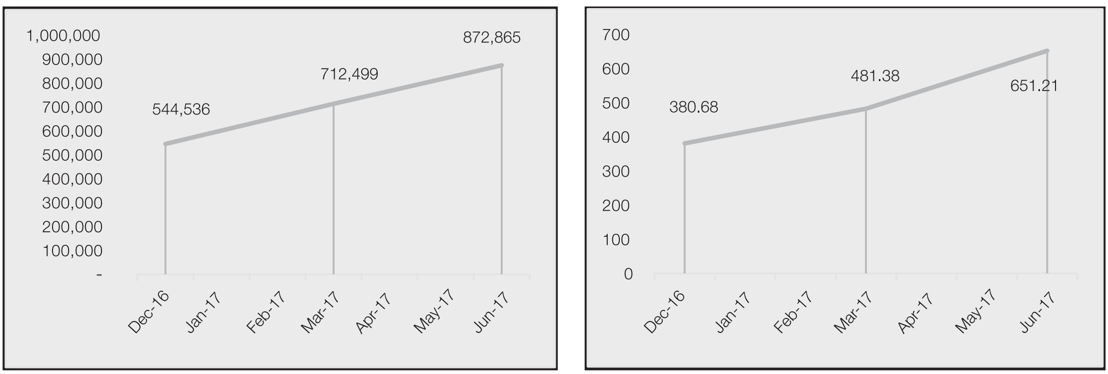


Source: Bangladesh Bank

A number of initiatives have been taken to diversify the service delivery channels:

- Banks must establish at least 50 % new branches in the rural areas.
- Banks must go for agent banking where branch banking is not viable.
- Online banking/ internet banking.
- NGO-MFI-Bank linkage programs for loan disbursement and remittance distribution.
- The digital financial services through mobile agents, post offices and mobile financial service providers like bKash (indeed total mobile financial service accounts have gone up to 35 million by 2015.).

Figure 07: Agent Banking is Flourishing as a Cost Saving Approach to Reach the Unbanked.

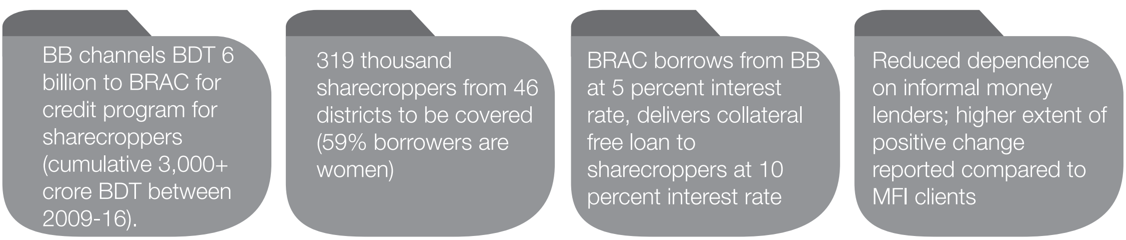


No. of Accounts

Total Outstanding (in Crore BDT)

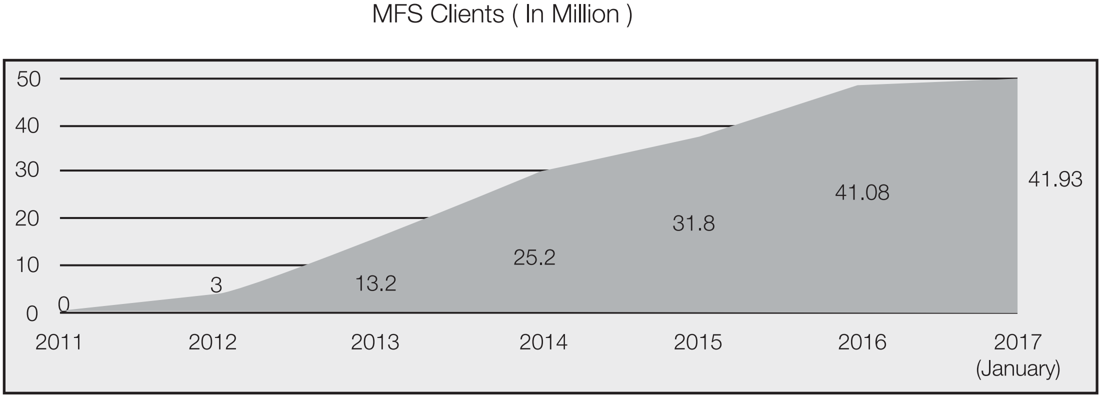
Source: Bangladesh Bank

Figure 08: Loan to Sharecroppers is Another Innovative Initiative Promoting Bank-MFI Partnership.



Source: Bangladesh Bank

Figure 09: Mobile Financial Services Expansion in Bangladesh.



Source: Bangladesh Bank

Consumer protection and financial literacy using a dedicated hot line for resolution of customer grievances and various digital communication services have helped cement the idea of effective financial inclusion.

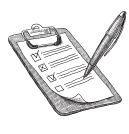
Corporate Social Responsibility programs initiated by banks and central bank have been helping in improving the standard of living for the unserved and underserved segments of the population. It may be noted that by 2015 grants were given to 70 projects from Bangladesh Bank's own CSR fund for disaster management, health and culture. The banks were also enthused to provide support to the third gender and other neglected segments of population. There was nearly tenfold increase in the total expenditure on projects supported by the CSR fund of the financial sector during 2009 to 2015.

05. Way Forward

It must be noted that the financial sector alone will not be able to attain the overarching goal of financial inclusion. Central bank and financial service providers require support from the entire eco-system. Three fold role of public finance is crucial, namely- financial support, market development, and rules and regulations. Coordination and capacity building of the policy ecosystem is crucial.

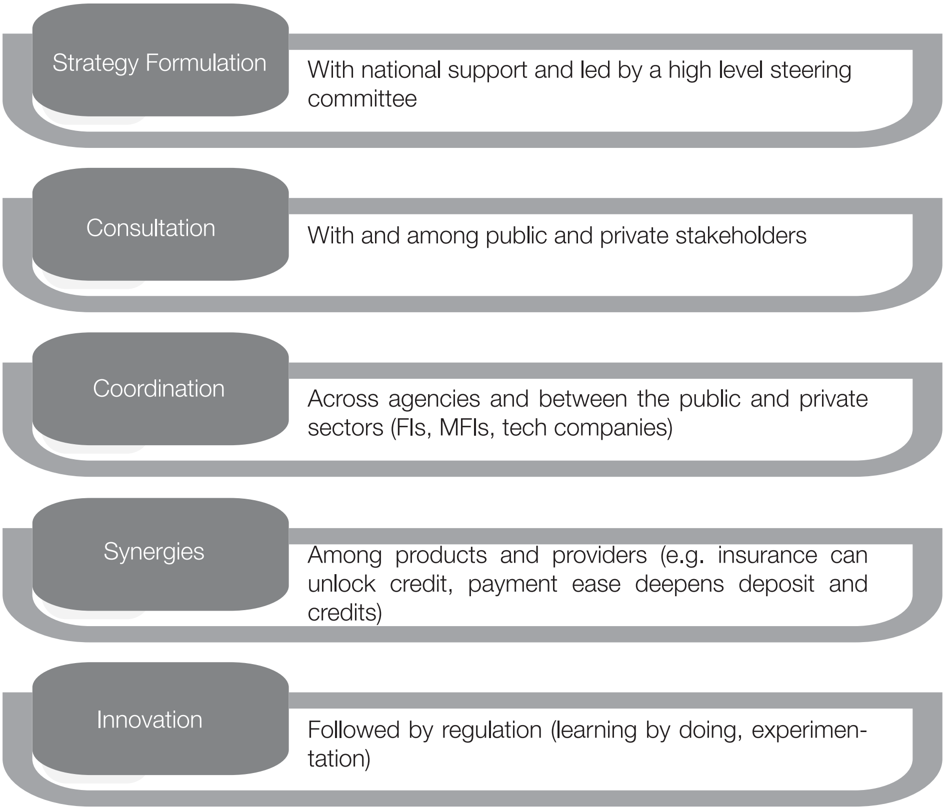

Financial Support


Market Development


Rules and Regulation

Regulatory framework has a profound impact on inclusion the poor and MSMEs. Regulators struggle to keep abreast of new technologies and business models. Digitization needs to be strategically leveraged and managed to increase efficiency, market gaps, and price discovery- Standard Setting Bodies (SSBs) need to stress a risk-based approach to balance financial stability/integrity with financial inclusion. With an enabling policy environment together with technology-driven innovations, alternative Financial Service Points(FSPs) and delivery channels can become effective ways to access and use different financial products and services. Peer learning through various platforms (AFI, IFC GPFI etc.) plays a critical role in helping countries to implement balanced regulatory frameworks.

Figure 10: Guiding Principles for Broader Financial Inclusion Strategy



Economies like Bangladesh are undergoing complex simultaneous transitions in the fields of demography, industrialization, urbanization, and technology. Inclusion is imperative for navigating domestic and external shocks thrown out by the above transitions. The above discussion on financial inclusion clearly indicates that the central bank of a developing country like Bangladesh has gone a long way in complementing the inclusive development strategy of the government through its innovative toolkits of financial inclusion. The advanced countries' central banks have created tons of money to buy government debts and hence created risks of financial instabilities. On the contrary, the central bank of Bangladesh has motivated the entire financial sector to put the money to productive unserved sectors like agriculture, MSMEs, green products, CSR support for the disadvantaged and also ensure consumer protection and financial literacy. The end result has been unprecedented stability of the macro-economy despite some governance challenges and enhanced participation in the financial sector by all the stakeholders. This indeed has been a new kind economic democratization bringing in the unbanked and underserved into the financial world.

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