

# INSIGHTS

## InM Newsletter

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## Do Microfinance Institutions Follow the Life-Cycle Theory?

Microfinance plays a major role in facilitating access to financial services by the poor and microenterprises that are usually under-served by the formal financial institutions in developing countries. Initially, the first generation microfinance institutions (MFIs) were largely funded by the public sector, i.e. by the donor agencies, governments and development organisations. They provided capital in the form of grants and subsidised loans to support the social mission of microfinance, i.e. reducing poverty and promoting women empowerment and social development.

However, since the early 2000s the funding base of the MFIs has widened substantially as private capital has also been attracted to the microfinance sector worldwide. This development is broadly in line with the life-cycle hypothesis (LCH) of MFI funding. The LCH broadly suggests that MFIs in the first stage of their life cycle, operate as small-scale, credit-granting NGOs, fund themselves predominantly by highly risk

tolerant public sector funds.

However, over time with gain in size, development of a track record of earning a surplus, and possibly transforming to quasi-regulated financial institutions, MFIs increasingly access private debt and equity markets.

Recent studies based on MFI-level datasets provide only limited support to the life-cycle theory as it is difficult to establish a clear link between the evolution of the capital structure of MFIs and their degree of maturity and size or profitability. One reason for this is the fact that the LCH portrays a rather simple picture of the MFI investor universe with only two players--risk-tolerant and development oriented public sector and risk-averse and return-oriented private investors.

However, many private investors, mainly in the form of specialised microfinance investment vehicles (MIVs) are also influenced by social and development objectives. Moreover, the original LCH

assumes that maturing and expanding MFIs increasingly tap local debt markets only, i.e. that MFI development and funding becomes a part of national financial development strategies.

In the real world, however, MFI funding has expanded substantially due to the emergence of a class of socially responsible private, foreign investors (SRIs), largely funding the above mentioned MIVs. These investors aim for a positive financial return but are also motivated by broader social or development goals. In addition, local governments have discovered MFIs as institutions they can use to channel funds dedicated to private sector development, notably in support of micro- and small businesses.

Finally, the original LCH is based on a narrative that MFIs start as NGOs, expand and mature, and then transform into licensed financial institutions. The empirical evidence, however, suggests that this narrative holds for a small minority of MFIs. Many of the MFIs operating today have never been NGOs but started as non-bank financial intermediaries, cooperatives or banks from scratch. As in particular the latter institutions take deposits, they might not need (large) support of public investors in the early days of operation and might be less inclined to take on private non-deposit debt when expanding operations.

In view of the above, probably the need is to modify the life-cycle hypothesis that reflects the changes in the MFI investor universe over the last few decades. The distinction between the behaviours of foreign and domestic investors is also important as foreign investors--private as well as public--might be driven by other investment motives than domestic investors.

## Research & KnM Highlights

### Ongoing Research Projects

#### **Strengthening Social Resilience Programme: Development of NFIS Implementation and Action Plan and Resource Plan of Bangladesh**

Financial inclusion has significant potential for improving the well-being of all citizens in society, especially for the participants in unserved and under-served financial markets who belong to the poor and marginalised groups, CMSMEs, small and marginal farm households, participants in informal sector activities, youth and women belonging to poor households, indigenous peoples, persons with disabilities, and other disadvantaged groups. The Government of Bangladesh (GOB) has adopted the National Financial Inclusion Strategy (NFIS, July 2021-June 2026) in 2021 as an effective tool to achieve the core objective to 'increase the level of financial inclusion (having at least one regulated financial service account) of all adults to 100 per cent by June 2026'. This strategy has established its linkages with the long-term Perspective Plan of Bangladesh (2021-2041), medium-term 8th Five Year Plan (2021-2025) and other relevant national strategies and policies. The government's priority to adopt the NFIS stems from a

number of considerations, including the potential of financial inclusion to reduce poverty and inequality, and promote financial stability, inclusive development and shared prosperity.

Under this ADB funded project, InM is developing the updated and detailed Implementation Plan including an Action Plan (July 2021 to June 2026) of NFIS. In addition, InM is preparing a detailed year-wise Resource Plan for NFIS which indicates the amount of additional financial resources that would be required to achieve the targets of NFIS. The analysis is being carried out in close collaboration with the NFIS Administrative Unit (NAU) of Bangladesh Bank and Financial Institutions Division of the Ministry of Finance and other relevant stakeholders.

## Comprehensive Rural Finance in Bangladesh

Under an agreement with Bangladesh Bank, InM is conducting a study on 'Comprehensive Rural Finance'. The study will undertake a comprehensive national household level field study/survey in the rural economy on the country's rural financial system (RFS) and collect sample data (both quantitative and qualitative) on financial products and services, such as savings, credit, payments, insurance, microfinance etc. from both formal and informal sectors of the rural economy.

Based on the survey outcomes, several policy papers will be produced by InM depicting future rural transformation and the role of Bangladesh Bank in ensuring inclusive transformation. In order to accomplish the broader goal of providing credible research support for designing rural finance policies and institutional reorganisation (as necessary) by the Bangladesh Bank and the national policy makers to support the long-term policy agenda of transforming Bangladesh to a high income country (HIC) by 2041, the study will undertake a number of specific tasks and perform several responsibilities in line with the Terms of References (ToR) of the study.

Among others, the study will provide a comprehensive review of the existing policies on rural finance introduced by the Government of Bangladesh and Bangladesh Bank and suggest new policies and amendments of existing policies, as needed. Further, the study will identify sector- and region-level potentials and occupational dynamics at the grassroots level of the rural economy and suggest policies to transit Bangladesh to a HIC by 2041. It will explore the financial-rural sector nexus in the rural economy and identify dominant rural growth drivers in support of rural transformation. It will also examine the extent, channels and other dimensions of net resource transfer from the rural to the urban areas through the financial sector institutions and assess their implications for rural growth and development.

Further, the study will assess the extent of availability of financial resources from different financial sources and the supply-demand gaps that exist for specific activities in both farm and nonfarm sectors in the rural economy and their development implications. The study will also examine the extent of penetration of digital (and other modern) financial services in terms of various household groups and enterprises in the rural economy and their implications for growth and development. In short, the study will provide evidence based inputs for framing effective policies by Bangladesh Bank for sustained and inclusive rural development in Bangladesh.

## Bangladesh Poverty Watch Report 2022

InM is currently preparing the Bangladesh Poverty Watch Report 2022 in collaboration with Center for Inclusive Development Dialogue (CIDD). The main objective of the Report is to ensure that grassroots voices of 'left behind' and extremely poor population groups are heard, and their voices are reflected in policies. The Poverty Watch Report 2022 summarises some current aspects of poverty including testimonies, reflections and 'stories' of individuals from selected 'left behind' population groups experiencing poverty in Bangladesh. As the Covid-19 pandemic is 'supercharging' existing poverty and inequalities, there are new and unequal risks for the poor and disadvantaged peoples of these groups in society. The Poverty Watch Report 2022 will specifically focus on selected plain land ethnic minority groups and transgender community.

The Report will also provide poverty dimensions in Bangladesh and how poverty is defined and measured globally and in Bangladesh including social exclusion, and some statistics related to poverty and deprivation at the national and regional levels in Bangladesh.

The analysis will bring out emerging priorities for policies as well as challenges faced by individuals experiencing poverty in Bangladesh. It will also cover best practices for reducing poverty and social exclusion, and recommendations for policy makers which will be intertwined throughout the Report emerging from testimonies, reflections, proposals and stories of persons experiencing poverty and exclusion.

## Completed Research Projects

### Bangladesh SDGs Progress Report 2022

Recently, InM has completed the 'Bangladesh SDGs Progress Report 2022' for the General Economic Division (GED) of the Bangladesh Planning Commission with support from UNDP. The Report gives an overview of the status of progress of SDG implementation in Bangladesh from 2015 till 2021. It also provides an assessment of the alignment of the SDGs with the national medium-term plan (8FYP) and evaluation of the existing gaps with the overall aim to speed up the implementation of SDGs in Bangladesh. The Report highlights goal-wise successes, constraints, and lessons learned to show where the gaps exist in terms of SDGs implementation in the country along with the impact of Covid-19 on the SDG implementation.

Among the 17 goals, Bangladesh is 'on track' on a few important goals such as 'no poverty' and 'quality education'. Bangladesh is also improving its performance against several goals including zero hunger; good health and well-being; gender equality; clean water and sanitation; affordable and clean energy; industry, innovation, and infrastructure; and sustainable cities and communities. On the other hand, more efforts are needed in areas like decent work and economic growth; life below water; peace, justice, and strong institution; and partnerships for the goals.

While the Bangladesh economy as well as the global economy was recovering strongly from the Covid-19 pandemic in 2021, the Russia-Ukraine war has posed a setback to the ongoing process of recovery. A rise in the global commodity prices and sluggish economic activities affected by the war induced supply chain disruptions across the world as well as in Bangladesh. Since the global macroeconomic prospects still remain uncertain due to the war induced crisis and fallout of the Covid-19 pandemic, future developments of the Bangladesh economy will significantly depend on the path of the pandemic, war situation, policy actions, evolution of financial conditions and commodity prices in the global economy, and the capacity of the domestic economy to adjust to the emerging impediments.

## Baseline Study on Piloting WaterCredit Adoption (WCAD) Programme

InM has successfully implemented the pilot phase of the WaterCredit Adoption (WCAD) Programme with support from Water.org that has created the scope of providing the poor households with access to small loans as a solution to affordable financing as well as access expert resources to make household water and toilet solutions a reality. The piloting was undertaken by InM in partnership with ten WCAD partner MFIs to the customers at the bottom-of-the-pyramid (BOP). The phase covered a period of 12 months; and, through the programme water supply and sanitation (WSS) loans were disbursed to people with improved water and/or sanitation and increased capital mobilisation.

Under the programme, InM conducted a baseline survey which has been used to assess the initial conditions; in addition, this has served as a benchmark to measure changes at the end of the pilot.

## Journal Publication

Mustafa K. Mujeri, Farhana Nargis, Nahid Akhter & Farah Muneer (2022).

### **COVID-19 Psychology and Financial Behaviour: The Urban Middle Class in Bangladesh.**

Indian Journal of Economics and Financial Issues, Vol. 3, No. 1, pp. 47-61.

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## InM Publications



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