



Changing Face of Rural Finance in Bangladesh Achievements and Future Challenges



Bangladesh Bank

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BANGLADESH BANK

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Acronyms

ASA	Association for Social Advancement
ACD	Agricultural Credit Department
ATM	Automated Teller Machine
AML	Anti-Money Laundering
BB	Bangladesh Bank
BKB	Bangladesh Krishi Bank
BRAC	Bangladesh Rural Advancement Committee
BSEC	Bangladesh Securities and Exchange Commission
BBS	Bangladesh Bureau of Statistics
BRPD	Banking Regulation and Policy Department
CSR	Corporate Social Responsibility
CMSMEs	Cottage, Micro, Small and Medium Enterprises
CME	Cottage and Micro Enterprises
CFT	Combating Financing of Terrorism
CDF	Credit and Development Forum
CFT	Combating Financing of Terrorism
DTW	Deep Tube Well
DFS	Digital Financial Services
FYP	Five Year Plan
FY	Fiscal Year
FSP	Financial Service Providers
FCB	Foreign Commercial Bank
GNI	Gross National Income
GDP	Gross Domestic Product
HYVs	High Yielding Varieties
ICT	Information and Communication Technology
IDRA	Insurance Development and Regulatory Authority
JBC	Jiban Bima Corporation
KYC	Know Your Customer
LGIs	Local Government Institutions
MFIs	Micro Finance Institutions
ME	Medium Enterprises
MRA	Microcredit Regulatory Authority
MSMEs	Micro, Small and Medium Enterprises
MIC	Middle Income Country
NBFI	Non-Banking Financial Institution

NRB	Non-Resident Bangladeshi
NCBs	Nationalised Commercial Banks
NPL	Non-Performing Loan
NGO	Non-Government Organisation
NID	National Identity Card
PKSF	Palli Karma-Sahayak Foundation
PCB	Private Commercial Bank
RNF	Rural Non-Farm
RFM	Rural Financial Market
RAKUB	Rajshahi Krishi Unnayan Bank
RBCA	Risk Based Capital Adequacy
SB	Specialised Bank
STW	Shallow Tube Well
SBC	Sadharan Bima Corporation
SDI	Subsidy Dependence Index
SCB	State-owned Commercial Bank
SMESPD	Small and Medium Enterprises and Special Programmes Department
TFP	Total Factor Productivity

Executive Summary

A financial system that effectively moves money from surplus spending units to deficit spending units that are cash-strapped but have lucrative investment opportunities is essential to a robust, dynamic, and expanding economy. In the end, this boosts investments and quickens economic expansion. Rural finance refers to both large and small formal and informal financial institutions that provide small-scale financial services to farmers and underprivileged rural residents, as well as larger-scale financial services to agro-processing and other small and medium-sized rural enterprises. The wide category of rural finance also includes other financial organisations, such as microfinance institutions (MFIs).

Since the mid-1990s, Bangladesh's banking sector has grown dramatically. Despite the boom and government efforts to increase access, rural financial markets have, on average, shrunk. Financial resources are consequently scarce for the 'missing middle', which includes marginal small and medium-sized farmers and micro, small, and medium-sized enterprises. This is significant since, in terms of employment, GDP contribution, and expectations for future growth, these people are the primary forces behind rural Bangladesh's progress.

Changing profile of Bangladesh's rural economy

Key components of the dynamic setting of Bangladesh's rural economy over the last 54 years include the agriculture sector's shifting characteristics, rural economy's diversification, and rural household income's ongoing high susceptibility. Furthermore, during the past few years, Bangladesh agriculture has seen a noticeable change from an emphasis on food grains to commercial and horticultural crops. Therefore, in order to capitalise on the evolving agricultural landscape and support the shift towards increased production while simultaneously minimising risks in the most efficient and economical way, the rural financial market needs to be able to finance novel crops and technology.

Rural finance in the context of 'new agriculture'

Access to necessary financial services remains a challenge because rural finance's physical outreach has not been very successful in reducing poverty and increasing income thus far. According to estimates, MFIs have provided over 60 per cent of rural lending in recent years, followed by banks and other financial institutions at 10 per cent and non-institutional players at 30 per cent.

Managing risks and leveraging investments in the rural sector are significant problems for the policy agenda in the midst of Bangladesh economy's current rapid rural transformation. The great majority of small farmers face numerous dangers that deter them from making sufficient investments in agriculture. Sometimes, small farmers' inability to manage risks like livestock diseases and climate-related shocks makes them hesitant to borrow money for agricultural output. The ability of cottage, micro, small, and medium enterprises (CMSMEs) to expand their scale economies and productivity in the rural nonfarm sector is limited by their access to technology, business development services, finance, urban and external value chains, and marketing connections.

The framework in which Bangladesh agriculture needs to evolve will be significantly altered during the next 20-30 years by important demographic, social, environmental, and other issues. The size of the middle class will grow significantly, and urbanisation will accelerate. As the consumption of non-cereal, protein-rich, and processed foods increases and the consumption of rice and other staples declines, the dietary pattern and food expenditure will also shift. More unpredictable weather patterns will also result from climate change. Primary agriculture's GDP share will continue to fall, but the agroindustry's share, along with that of food distribution, logistics, and other services, will expand dramatically. Therefore, jobs and livelihoods in the rural economy will be significantly influenced by

the agro-food sector rather than primary agriculture.

Key challenges of rural finance

The new consensus that has evolved in Bangladesh suggests that many of the poor can and do save, invest, and repay their loans based on the experience of the majority of rural communities. In particular, they require access to financial services, including:

- Credit for funding their production/income-generating activities and for smoothing consumption;
- Deposit facilities with flexible rules and procedures tailored to their convenience for saving and accumulating savings for use in consumption smoothing and self-financing of economic operations; and
- Social Security, loan protection, and insurance services for risk reduction and crisis management.

While credit is crucial for engaging in relatively high return activities, savings are crucial for impoverished rural people to finance their own sustenance and low-return endeavours. In the future, it would be crucial to start the development of sustainable rural financial institutions and speed up the savings and credit cycle by making credit or savings the initial entry point when suitable.

Bangladesh Bank needs to strive to offer better financial and associated non-financial services in rural areas in order to support the national goals. All facets of the rural population must have access to an efficient network of rural financial institutions in order to achieve this. Bangladesh Bank will therefore need to create a systems approach to provide financial services in rural areas. In addition to increasing outreach to rural residents, particularly the impoverished, this will significantly push the boundaries of institutional sustainability for rural financial institutions.

In reality, different kinds of financial institutions and approaches are required in rural areas. Institutions must also be customised to meet the unique needs of their clientele as well as the possibilities of the area and cultural milieu. Home-based agriculture and low-return enterprises are more common in marginal and depressed areas (such as coastal belts, char areas, and haor regions). Small cooperatives or informal organisations that prioritise savings and run at low costs might be the best entry points in these areas.

High-potential regions with high-return agriculture, profitable rural microenterprise operations, credit-oriented MFIs/banks, and the required professional business development/management services and technical support facilities (which may be privately or community-owned) may be better suited for large financial cooperatives and commercial bank branches with individual or group technologies.

Depending on the circumstances, Bangladesh Bank could encourage diversity and competition rather than duplicate any one strategy in every rural area. This could include: (i) local financial institutions, such as informal/self-help groups and local cooperatives; (ii) mainstreaming savings and credit cooperatives; (iii) establishing formal cooperatives and their apex organisations; (iv) turning credit programmes into user-owned institutions; (v) connecting banks with MFIs and cooperative groups; (vi) promoting government-sponsored/commercially-operated apex organisations for refinancing MFIs and performing additional functions, such as credit rating, liquidity exchange, credit guarantees, and reinsurance; (vii) supporting institutional innovations, such as (micro-) leasing companies; and (viii) bolstering MRA's supervisory and monitoring capacity.

Promoting conducive policy and regulatory environment

Both inclusive rural development and an effective rural financial system depend on a favourable policy climate. The following factors are particularly significant in this context: (i) macroeconomic

stability; (ii) deregulated, effective, and flexible markets as determinants of interest rates, exchange rates, and agricultural prices; and (iii) a legal system that safeguards due process, financial institution and regulatory authority autonomy, and property and land-use rights.

For financial systems to develop and remain stable, prudential regulation and oversight of financial institutions are essential. Sustainable rural development is impossible without well regulated local financial institutions that draw in private resources and mobilise savings. The aforementioned calls for the establishment of self-regulatory organs of MFI networks, the adoption of appropriate legal forms of local financial institutions, and the adoption of prudential norms and standards as part of a delegated system of self-regulation and supervision under a central financial authority.

Issues and major recommendations

Bangladesh has gained valuable insights from its experiences in the financial industry over the years, and Bangladesh Bank has placed a high priority to sound financial governance, financial stability, and financial discipline. The goal of financial inclusion for the unbanked, primarily impoverished individuals -- who have been forced out of the financial mainstream despite having the potential to be bankable -- have also been adopted by the Bangladesh Bank. For MFIs and rural financial institutions, designing financial services and solutions that meet consumer requirements without sacrificing institutional sustainability and profitability has become more important. In order to establish prosperous rural banking and microfinance markets, the Bangladesh Bank, other authorities, and interested parties may consider the following priorities.

- In order to draw in productive investments, the emphasis would be on establishing enabling policies and regulations as well as on offering rural communities the support services they require, such as infrastructure like farm-to-market roads, irrigation, storage, and post-harvest facilities; research and development; training and extension; and marketing. These will reduce transaction costs, reduce risks, make it easier for money to move through the supply chain, and eventually boost value-added.
- Bangladesh Bank and other regulators need to keep working to create the required financial infrastructure, such as credit bureaus and liquidity facilities, and create more suitable regulatory and supervisory strategies for microfinance and rural financial institutions, like corporate governance and risk-based supervision of financial institutions.
- The government and other stakeholders could provide more support for rural financial and microfinance institutions to build their capacity. More specifically, they could support these institutions' efforts to organise small farmers, livestock rearers, and fisher folk and to facilitate direct and indirect linkages between these groups and supply or value chains. These actions will contribute to the creation of opportunities for agricultural produce and the outputs of other rural economic agents, such as micro-enterprises, to increase or create additional value. Financial literacy and numeracy, product development, risk management, enhanced credit analysis, loan delinquency management, bolstering loan portfolio quality, optimising operational processes, enhancing governance frameworks, strategic planning, and the ability to perform a better external environment are among the priority areas for capacity building.
- The construction of credit information systems, or credit bureaus, and performance requirements for MFIs and rural financial institutions (RFIs) could be the goal of the government, regulators, and other interested stakeholders.
- It makes sense to examine how heavily regulated interest rates affect rural financial markets and contrast their effects with those of a more market-friendly interest rate regime. The latter

makes it possible for banks to pay expenses and mitigate some of the risks associated with lending to rural and agricultural communities.

- The government, rural financial and microfinance institutions, and other stakeholders could keep redesigning policies like financial inclusion and regulations affecting the rural and microfinance markets in order to ensure the stability of rural financial systems and avoid disruptions in the delivery of financial services.
- It is desirable and could be encouraged for rural financial and microfinance institutions to shift their policy focus from merely granting loans to offering more comprehensive and long-term financial services. Achieving a sustainable capital base, enhancing cost recovery, and offering effective and responsive financial services ought to receive more attention.
- Within a prudential regulatory framework, financial institutions, particularly microfinance and rural financial institutions, could be allowed the freedom to pursue sound banking and financial operations. To achieve the desired results, appropriate regulators need to keep an eye on the lending institutions' credit policies.
- The financial and credit policies and procedures used by rural banking and microfinance institutions for credit analysis, loan screening, risk management, performance monitoring, and asset portfolio diversification could be strengthened. Building institutional capacity would be a top priority for rural financial institutions.
- Obtaining sufficient cash will enable rural banking and microfinance companies to have a strong buffer against financial stress and access additional domestic financing sources. As seen by the global financial crisis, a strong domestic deposit base and a local stock market can provide the capital needed for lending as well as help shield domestic financial institutions from currency volatility and capital flow reversals.
- By enabling rural banking and microfinance institutions to provide financial products and services that cater to the needs and preferences of their clients while always staying within the prudential bounds set by regulators, the recognition of financial inclusion as a worthwhile objective could be strengthened. The creation of a robust database on those not included in the formal financial system is one particular task that will need support from the government and donors. This is a crucial first step in developing client-responsive financial services and products.

Additionally, there are a number of areas where greater focused efforts may be made to develop the country's rural financial system into one that is more competitive and efficient. These include, for instance, a unified regulatory framework for banks, financing for MSMEs and cluster development, promoting technology-driven services and agent banking, promoting financing for agriculture and closing the gender gap, promoting the capital and bond market, the insurance industry and MFIs, and other related institutional framework.

Since Bangladesh gained its independence in 1971, the country's rural loan market has seen substantial structural transformation. Modern banking, such as agent banking and mobile financial services, has greatly expanded in rural areas in recent years. The rural financial sector is also home to specialised banks, cooperatives, MFIs, and other financial institutions in addition to commercial banks. In contrast to previous years, the majority of the credit demand in rural areas is currently met by lending from institutional sources. In this way, Bangladesh's rural areas are still primarily covered by institutional financing.

However, this oversimplified perspective just scratches the surface of the rural financial challenges.

Small/marginal farmers, micro/small nonfarm entrepreneurs, and the impoverished in rural areas seem to have access to financing primarily from a welfare perspective—more akin to a social obligation—rather than from the standpoint of feasible business models. In a similar vein, institutional credit has been viewed as serving only production purposes rather than a comprehensive livelihood strategy.

Adopting successful institutional finance business models that use poverty as an opportunity to expand the market's reach is essential to the rural financial sector's sustainable growth in Bangladesh. Product diversity, innovations in products and processes, and the growth of financial institutions' and customers' capacity are all crucial aspects of the country's rural financial development. In addition to embracing novel strategies like private equity capital, foreign capital, and other untapped sources, the problem of capital scarcity must be seen from a wider perspective. The rural financial sector, which includes all financial institutions, including MFIs, can undergo revolutionary changes through transparent and effective institution-borrower relationships, trust and transparent regulations.

1. Introduction

Bangladesh's financial sector has expanded over time in multiple ways, including the quantity of assets, financing options, and institutions. A bank-based system, which also includes cooperatives, capital market intermediaries, insurance companies, microfinance institutions (MFIs), and nonbank financial institutions (NBFIs), dominates the industry. A sizable informal financial sector, which includes unregulated lenders such as individual money lenders, associations, informal cooperatives, clubs, friends, neighbours, and relatives, does exist, despite the fact that not all financial institutions and market elements are subject to the same regulations.

The Bangladesh Bank (BB), the country's central bank, oversees and regulates the important elements of the financial industry, such as the banking system. Furthermore, because the capital market is still in its infancy, the banking sector provides a major portion of the economy's short- and long-term financing needs. BB is in charge of overseeing and controlling the financing operations and activities of banks and NBFIs, which are mostly associated with non-securities financial products and markets. The Bangladesh Securities and Exchange Commission (BSEC) oversees the capital market and the securities instrument-related activities of banks and NBFIs. The insurance industry is governed by the Insurance Development and Regulatory Authority (IDRA), while microfinance activities are governed by the Microcredit Regulatory Authority (MRA).

Because the formal financial institutions were nationalised and run under government supervision, the majority of Bangladesh's financial industry was under the public sector following the country's independence in 1971. The financial sector has been increasingly liberalised since the mid-1980s, and its structure has altered in terms of private ownership, number of institutions and branches, distribution in rural and urban areas, and volume of assets and advances. In the banking industry, the number of specialised banks (SBs) was decreased through mergers or adjustments to operational strategies, while new private sector banks began operations. In 2007, the commercial banks under government control were likewise corporatised and began to function as limited entities.

Two key concerns are necessary to ensure the linkages between the financial sector and inclusive and sustainable growth in a country like Bangladesh: (i) the ideal size and structure of the financial sector; and (ii) the regulatory obstacles to maximise the possibility of attaining financial stability while preserving inclusive and more sustainable growth.

The conventional positive relationship between a larger and deeper financial sector and long-term growth (e.g., Levine 2005) has been called into question in recent years, especially when it comes to the optimal size and structure of the financial sector (see, for example, Easterly et al. 2000). According to a recent perspective, financial depth—as indicated by the private credit to GDP ratio—reduces production volatility up to a certain degree but then actually raises it afterwards. More recently, it has been proposed that there is a negative correlation between the size of the financial sector and growth, particularly at a certain point of financial expansion (about 80–100 per cent of private credit to GDP ratio) (IMF 2012, Cecchetti and Kharroubi 2012).

But considering how crucial cottage, micro, small, and medium enterprises (CMSMEs) are to Bangladesh's job creation, their inability to obtain credit from the financial sector is a significant development barrier. Therefore, if done on sustainable grounds, at a fair price, and with proper regulation, facilitating CMSMEs' improved access to financial sources could support and accelerate growth. The primary challenges faced by CMSMEs in the domestic financial system centre on the absence of alternative funding sources and inadequate assistance from banking institutions. Therefore, if the financial market is successfully and consistently routed into CMSMEs, it may aid in the expansion of this sector.

In comparison to the size of its economy, Bangladesh's financial sector is small and straightforward, which gives the government more policy flexibility to shape the future structure and scope of the financial system. The main obstacle, however, is giving financial services to people who are excluded—such as a sizable section of low-income households and CMSMEs—and do not have access to formal financial products and services. In general, it is challenging to finance working capital and investments, particularly for CMSMEs (especially at low spreads and longer maturities), which are essential for expansion and job creation.

Furthermore, the structure of the financial industry is just as important as its size. It is crucial to have institutional mechanisms to close market gaps and institutionalise government actions to address market defects because the financial sector is rife with both. Furthermore, it is beneficial for the government to have organisations and processes to support the financing of the growth of specific sectors in order to carry out a particular development vision and strategy. Designing tools and organisations that can carry out these tasks is crucial in this situation.

Based on national experiences, there appears to be growing agreement that smaller, more decentralised banks are better suited to lending to CMSMEs in low-income countries like Bangladesh. This is partially because these banks are better able to understand their clients, which helps to reduce information asymmetries. Using the extensive network of MFIs to offer credit and financial services to CMSMEs and excluded households is another choice Bangladesh has. All things considered, a more diversified banking system—which includes both big and small banks, private and public development banks, MFIs, and other financial institutions—seems to offer the advantages of complementarity in serving various sectors and functions, competition for offering more affordable and suitable financial services to the real economy, and diversification, which reduces systemic risk.

Real Sector-Financial Sector Nexus: Theoretical Considerations

Growing emphasis has been placed in recent development literature on the role of the financial sector in social and economic development as well as on establishment of stable and profitable financial institutions, particularly in middle-income countries (MICs). According to Schumpeter, a well-developed financial system encourages entrepreneurship and innovation by reducing information asymmetry, improving risk management, mobilising productive savings, and allocating resources effectively (Schumpeter 1952). Endogenous growth theory also emphasises the significance of innovation and its drivers. Therefore, it is not surprising that contemporary research on the relationship between the financial and real sectors attempts to base its models on endogenous growth theory in addition to making explicit references to Schumpeter (e.g. King and Levine 1993).

Financial theory provides insights into the significance of the financial system and financial institutions for growth, which are then, transferred into the growth models that emphasise the financial system's growth-enhancing effects (see, for example, Bencivenga and Smith 1991; Greenwood and Jovanovic 1990; King and Levine 1993). In essence, increased marginal productivity of the invested capital is the cause of the positive relationship between economic growth and financial system development. Furthermore, countries with low or medium per capita incomes like Bangladesh can produce faster economic growth as a result of higher levels of financial asset formation.

Additionally, the research that is now available indicates that having access to financial services contributes to economic development, poverty reduction, and inequality reduction (Beck et al. 2000; Levine 2005). Financial development has an effect on reducing poverty through both growth and income disparity. (Beck et al. 2007).¹

¹ The decomposition of growth and inequality channels through which financial development impacts poverty reduction

The openness of the nation's financial system has a significant impact on how much economic growth contributes to the reduction of poverty and income inequality. When the financial system is inclusive and impoverished people have access to a variety of high-quality financial services, the growth effect of financial development turns into a pro-poor one (WB 2014). Use of banking services can be a key component of anti-poverty programmes because the expansion of banking services has a strong negative correlation with both poverty and inequality. Policies should focus on identifying ways to remove obstacles that prevent households and businesses from accessing banking services.

Five potential hypotheses can be used to categorise the relationships between the financial and real sectors in terms of causality: (i) no causal relationship; (ii) demand-following relationship; (iii) supply-leading relationship; (iv) negative causal link from finance to growth; and (v) interdependence. The five hypotheses can also be used to create a variety of syntheses, primarily in relation to evolutionary sequencing or various industry or enterprise needs. Lucas (1988) is the main voice for the belief that there is no meaningful correlation between the development of the financial sector and actual growth.

The claim makes sense in a neoclassical world with perfect knowledge and no transaction costs. According to the Modigliani-Miller theorem, institutions—especially financial institutions—do not matter in such a world (Modigliani and Miller 1958). This "irrelevance hypothesis" has drawn a lot of criticism for a number of reasons: (1) On the basis of informational and related arguments (such as agency problems, transaction costs, etc.), economists are increasingly disputing the existence of frictionless markets; (2) the significance of institutions is now generally acknowledged; and (3) numerous empirical studies provide compelling evidence for the relevance of finance for actual growth. "Finance follows where enterprise leads," according to Robinson (1952: 86), demonstrating a causal relationship between the real and financial sectors (demand-following finance). According to this theory, the actual economy or its demands determine financial development endogenously. This perspective is in line with the New Institutional Economics and the Coase theorem (Coase 1960), which contend that institutions maximise individual utility by adapting to market flaws. The "demand-following approach," on the other hand, is supported by actual data and is thought to be a short-term solution that might only last in certain situations, like the shift to a market economy.

According to McKinnon (1973) and Shaw (1973), finance is primarily supply-leading, meaning it has a positive impact on the actual economy. This is where the modern supply-leading finance arguments start. Another theory that suggests finance has a negative impact on an economy's actual growth is the risk of financial crises, which are frequently linked to speculative bubbles (Bhatt 1995) or, more generally, the concealment of the real economy's foundations, especially through capital market speculation.

Empirical research shows that there is a reciprocal causal link between finance and real growth, indicating the relevance of both supply-leading and demand-following finance theories. The impact might be used concurrently, implying that financial depth—that is, large financial markets—is what propels real growth as the growing financial sector satisfies the growing need for finance in the economy. Alternatively, an economy's overall level of development may determine whether its financial sector is supply-leading or demand-following. The most well-known assertion on such a sequential sequence of causality was made by Patrick (1966). Patrick argues that while demand-following finance is becoming more prevalent in wealthy economies, developing nations stand to gain significantly in terms of tangible benefits from expanding their banking industries (supply-leading finance).

shows that 40 per cent of the impact comes from reduction of inequality while the remaining 60 per cent is the result of growth effect. See Beck et al. 2007.

A financial system that effectively moves money from surplus spending units—those with extra money—to deficit spending units—those with less money but with good investment opportunities—is essential to a robust, dynamic, and expanding economy (Mishkin 2016). In order to lend to the borrowers, the financial sector might mobilise savings through banking and other financial organisations. In the end, this boosts investments and quickens economic expansion. Effective financial operations, for which regulations are required to strengthen the financial system, can reduce the existence of asymmetric information, which is linked to high transaction and information costs in the financial market.

The history of rural finance in Bangladesh can be explained in terms of subsidised credit as an agricultural input. However, within the environment of financial repression and easy money, the rural finance sector largely failed to recover the loans and the system was unsustainable. The rural financial market became grossly distorted while outreach stagnated. Over time, policy emphasis shifted towards rural financial system development, institutional diversity and sustainable access of the rural people to financial services. These efforts further require strengthening of sustainability of rural financial institutions, which in turn is related to the viability of the farm and non-farm enterprises of their clients.

Since the 1990s, strengthened macroeconomic stability and deregulation created a conducive policy environment for financial sector reforms. The government and Bangladesh Bank drew lessons from past experience and various notable new developments in rural finance for reforming the financial sector including the rural financial institutions.

A legal framework for the establishment of regulated microfinance institutions on a commercial basis has been made available by new laws for the establishment of the Microfinance Regulatory Authority (MRA) and the registration of MFIs. Additionally, this has opened doors for informal financial institutions to be mainstreamed and upgraded. As a result, more and more impoverished people can now use financial services. Nonetheless, there are still a number of issues with rural finance that necessitate targeted and well-coordinated initiatives.

Brief Review of Rural Finance Policy

The policy framework for the development of Bangladesh's agricultural and rural regions emphasises three crucial dimensions: (i) establishing a favourable legislative, regulatory, and incentive framework that enables private sector actors to make well-informed decisions; (ii) influencing the economic environment by making prudent use of government budget, particularly by providing and distributing public goods, such as infrastructure, marketing, extension, research, and other services; and (iii) providing farmers with essential inputs, such as credit, premium seeds, fertiliser, and other items to enable increased production.

Within the framework, increasing access to credit has been a key component of assistance programmes seeking to modernise agriculture since independence in Bangladesh. The country has committed substantial resources every year towards expanding agricultural and rural credit. Traditionally, these credit programmes featured subsidised credit with concessionary interest rates as their basic tenet for encouraging agricultural modernisation and confronting the causes of rural poverty. The urgent need to increase agricultural output has motivated this considerable effort. The formal agricultural credit system is under the overall guidance of the Bangladesh Bank (BB).

Rural financing is crucial to the country's overall growth, according to government objectives. It may be used more to achieve sustainable development methods and help pull rural residents out of poverty. It provides rural residents with access to banking and economic activities like savings,

payments, cash transactions, and credit. Having access to these services enables rural residents to improve their standard of living and economic activity.

Most of the impoverished people in Bangladesh live in rural areas. The collection of finances and cash payments to rural residents, particularly impoverished women, men, farmers, and small business owners, so they can continue their commercial endeavours and income-generating activities, is also referred to as rural finance. All sectoral and informal financial institutions that offer the rural poor various economic advantages as well as more substantial financial services to other small and medium-sized rural businesses and agro-processing businesses are included in the category of rural finance.

Additionally, disadvantaged people can get microfinance from microfinance institutions (MFIs) to help them with their income-generating endeavours and upward mobility. Reducing poverty, boosting the economy, improving people's quality of life, and advancing rural development all depend on rural financing. In order to raise the income and level of living of those who benefit from increased productivity and output predictability in rural regions, it is important.

Rural finance includes microfinance, MSME finance, and agricultural finance. Agricultural finance encompasses a range of financial services related to agricultural production, processing, and commercialisation, such as agricultural crop and animal insurance and short-, medium-, and long-term lending. Rural residents' livelihood, employment, and GDP contribution all depend on agriculture. Expanding food security, decreasing poverty, and promoting sustainable economic growth can all be achieved through expanding agricultural production.

Through loans, investment, and new start-up companies, rural finance in Bangladesh has a major impact on people's income growth, entrepreneurship, agricultural productivity growth, and agricultural diversity and commercialisation. In summary, the enormous expansion of rural finance through rigorous government efforts has been significantly responsible for the country's rural areas' remarkable development and beneficial changes in the way of life. Additionally, the development of non-crop agricultural sectors, the modernisation of agriculture, the enhancement of transportation and communication networks, and the growth of information and communication technology have all been important in this respect.

Under the direction of the Bangladesh Bank, the rural finance system's formal financial inclusion has enabled rural growth. Bangladesh Bank has focused more on the rural financing system over the years, which has been crucial to the country's overall development.

By offering financial services to impoverished women, men, farmers, small and medium-sized business owners, and small-scale business owners so that they can participate in income-generating activities, rural finance aims to reduce poverty. One development method for reducing poverty in Bangladesh is rural finance, which encourages women to work in rural regions and reduces poverty by creating immediate and noticeable effects.

Building on this foundation, rural finance provides access to financial services to enable rural residents escape the cycle of poverty. The majority of financial service providers have included rural finance into digital platforms and simplified the idea of rural financing. By enhancing the delivery of customer-focused financial services such as microcredit, microenterprise loans, microinsurance, savings, and other financial services, the NGO-MFIs have also helped to achieve significant progress.

Many local products are being created at the village level as a result of these rural-oriented initiatives. Additionally, rural poor people now have more job options and higher household and individual earnings. As a result, rural finance has had a variety of effects on rural residents, including poverty

alleviation, income generation, food and nutrition security, children's education, and overall health. The government and Bangladesh Bank are pursuing creative and more efficient steps to expand the frontier of rural financial services to everyone in the rural areas, with generally positive results. In order to help rural residents improve their living conditions and quality of life, banks and other financial institutions must be better able to offer loans and other financial services.

Within the strategic framework as spelled out under different policy documents of the government, BB formulates and implements specific rural credit policies and programmes for the farmers, small and medium enterprises (SMEs), and other rural inhabitants in order to streamline the credit flows to agricultural activities and the rural sector in general. Often special credit schemes are the primary means to channel funds to the rural areas. For ensuring effectiveness, such schemes carry preferential rates of interest for specific target borrowers. Under the BB authority, BKB, RAKUB and the commercial banks operate different special programmes covering a wide range of rural activities and borrower groups. For instance, special programmes include loans to small farmers, women, weavers, etc. and lending for specific activities such as pond fishery, irrigation equipment, grain storage, village mechanics, rural transport, power pumps, commercial livestock and poultry, rural housing and similar other activities. The major concern of these programmes is not only increasing the volume of credit to the rural sector but also creating opportunities for accumulation of savings that can finance new investments in prospective rural economic activities.

Development of Agricultural Policies: Broad Phases

Changes in limited rehabilitation programmes to the overall development of farmers were the first step in Bangladesh's steady shift in government policies towards agricultural development. Since the British colonial administration in the 1940s, the evolution of policies has undergone a transformative process that may be categorised into four major eras (Table 1.1).

Phase I: Adverse circumstances development policies (1870s to 1940s):

During the British rule, agricultural development strategies were designed to facilitate the efficient collection of land revenue. The government helped farmers who were severely impacted to oppose any peasant uprising. It supported agriculture by establishing a few institutions and taking a few actions. The Department of Agriculture's primary operation, which was funded solely by government grants, was the distribution of seeds. One could refer to this stage as the "adverse circumstances" policy phase.

Phase II: Supportive development policies (1950s – late 1970s):

During the period, agricultural development strategies were designed to facilitate the production of two major crops – rice and jute. The government helped farmers through establishing supportive institutions and provision of inputs including credit.

Table 1.1: Phases in development of agricultural policies in Bangladesh: Historical perspective

Phases of development policies	Objective of policies	Targeted farmers	Sources of expenditure	Establishment of institutions
Adverse circumstances development policies (1870s to 1940s)	Smooth collection of land revenue	Disaster affected farmers	Government only	A few for meeting critical needs
Supportive development policies (1950s –late 1970s)	A rise in the production of food	Forward-thinking, land-rich farmers	Government + donor support	Many for more support

Reform-embedded development policies (late 1970s - late 1990s)	Privatisation to cut back on government spending	No specific farmer group	Government; decreasing donor support	Reform of existing ones in viable sector
Collaborative development policies (late 1990s -2010)	Development involving the private sector	All farmers; emphasis on the land-poor	Government + limited donor support	Nil
Private sector led development with government's facilitative and supportive role (2010s – present)	Adoption of technology, inclusive structural change, and the rise of "new agriculture."	All farmers. Emphasis on small farmer development	Government + limited donor support + private and corporate sector	Reform of existing ones and institutional development of modern technology adaptation for new agriculture

Source: Journal of Rural Development, Vol. 28, No. 4, October - December: 2009; Authors' compilation.

Phase III: Reform-embedded development policies (late 1970s - late 1990s). Reforming input markets and other enabling institutions was the goal of agricultural policies in the late 1970s and early 1990s. In areas that were socially profitable, a few institutions were also established. Due to a fall in donor financing and pressure to cut government spending, development expenditures on agriculture fell. By the middle of the 1990s, the government had privatised all input markets, and the private sector and non-governmental organisations had taken over.

Phase IV: Collaborative development policies (late 1990s -present): From the late 1990s through the 2010s, agricultural policies sought to advance agriculture with private sector involvement. During this time, no new institutions have been founded. Due to a decrease in project financing from the donor agencies, development spending on agriculture kept declining. The policies made it possible for NGOs to cooperate with government development initiatives. The "collaborative" policy phase is the name given to this stage.

Phase V: Private sector led development with government's facilitative and supportive role (2010s – present): Agricultural policies since the 2010s till the present day are characterised by a broader pursuit of the collaborative policy phase along with refinement in in specific areas where gaps were identified. The focus has been more on research-extension linkages to expand the yield frontiers the major crops and introduction of new value added crops and non-crop agriculture to spread diversification and speed up the move towards 'new agriculture'.

Agricultural policies and documents of Government Ministries/Agencies

Numerous policy and strategy papers pertaining to Bangladesh's general agricultural and rural development, particularly those pertaining to agricultural and rural loans, are available. Table 1.2 provides a summary of the main aims and objectives of the key policies.

Table 1.2: Major agricultural and rural credit policies

Policies	Major goals	Implementing ministry
National Agriculture Policy 2018	To accomplish sustainable food and nutrition security as well as safe, lucrative agriculture.	Ministry of Agriculture
National Agriculture Policy (NAP), 1999	Integrated pest management (IPM), food security, profitable and sustainable production, income increases and land productivity, easy access to inputs, fair output pricing, improving marketing, lending, and agro-based enterprises, and protecting small farmers' interests	Ministry of Agriculture
Agricultural Extension Policy Manual 2020	To achieve safe, sustainable, diverse and profitable agriculture	Ministry of Agriculture
Agricultural Extension Policy Manual 1999	Annual crop planning, seasonal extension monitoring, participatory technology development and rural approval partnerships, technical audits, and studies of attitudes and practices.	Ministry of Agriculture
National Rural Development Policy 2001	Raising the incomes and employment of rural residents, ensuring their involvement in the development process, improving rural marketing facilities and infrastructure, local planning, educating women and young people, and developing underprivileged Hill Tract areas and small minority communities.	Ministry of Local Government Rural Development and Cooperatives
Agriculture and rural development , PRSP 2005	Fostering the development of non-crop enterprises like livestock, fisheries, and poultry; advancing the rural non-farm economy; diversifying into high-value non-cereal crops like fruits and vegetables; intensifying major crops like cereals; and developing future policies.	Planning Commission, Ministry of Planning
Seed Policy 1993	This includes breeding crop varieties that are suitable for high-input and high-output agriculture, multiplying quality seeds, developing balanced public and private sector seed enterprises, simplifying seed for commercial and research purposes, providing technical assistance and training in the production, processing, and storage of seeds, and monitoring, controlling, and regulating seed quantity and quality.	Ministry of Agriculture
Seed Rules 1997	Outlining the norms and regulations pertaining to the National Seed Board's evolving activities, seed certification, dealer registration, truthful label marking, and seed inspection procedures.	Ministry of Agriculture
SME Policy 2019	To carry out the government's development goals, the SME sector's GDP contribution is expected to rise from 25 per cent to 32 per cent by 2024.	Ministry of Industries

Source: Ministry of Agriculture, Agriculture, A SYNTHESIS OF AGRICULTURAL POLICIES IN BANGLADESH, Social Security Policy Support (SSPS) Programme <https://socialprotection.gov.bd/uploads/2017/06>

In the microfinance sector, Microcredit Regulatory Authority (MRA) as the regulator for monitoring and supervising microfinance operations of NGO-MFIs in the country has been guiding the sector towards creating an effective and favourable environment for employment generation, microenterprise development, poverty alleviation and ensuring better life of all citizens especially in the rural areas. Since the beginning in 2006, in addition to providing policy directions, MRA has been monitoring performances and analysing financial health of the licensed MFIs to undertake sustainable rural finance activities. In order to protect the interests of all parties involved, particularly the rural microfinance borrowers, it has also implemented a number of regulatory measures to improve the social benefits of microfinance, provide uniformity and discipline among practices, and raise transparency and responsibility. Obviously, MRA rules and regulations as well as off-and-on site monitoring have been creating successive impacts on the efficiency and effectiveness of rural

microfinance sector in the country.

In addition, PKSF has been working since 1990 as an apex organisation to facilitate the welfare of the poor by addressing the multi-dimensionality of poverty through combined access to education, health, shelter, income generating activities and other basic needs. All things considered, PKSF has expanded its scope of microfinance and embraced suitable financing as a useful instrument of rural finance. In keeping with its mission, PKSF has been working to reduce poverty by offering targeted financial services to underprivileged individuals in the country's impoverished regions. In order to address a variety of development issues linked to poverty reduction, including employment, rural microenterprise, environment and climate change, sanitation, low-income community housing, and others, PKSF has been implementing a number of core financial programmes (such as Jagoron, Agrosor, Buniad, and Sufolon) and various projects in recent years.

Numerous departments and agencies of various ministries are also implementing a number of projects and programmes to decrease poverty and increase rural residents' self-sufficiency through microfinance operations that boost employment, economic growth, and human resource development. For example, Rural Development and Cooperative Division (RD CD), Department of Cooperatives, Bangladesh Rural Development Board (BRDB), Bangladesh Academy for Rural Development (BARD), Rural Development Academy (RDA) Bogura, Palli Daridro Bimochon Foundation (PDBF), Small Farmers Development Foundation (SFDF), Bangabandhu Academy for Poverty Alleviation and Rural Development (BAPARD), Employment Programmes of Karmasangsthan Bank, Bangabandhu Youth Credit Programme, Microcredit Programme for Self-retired/Retrench Worker/Employees of Mills/Industries and Establishment, Credit Programme for Agro-based Industries, Microcredit Programme Monitoring through Microcredit Regulatory Authority (MRA), Micro Credit Fund for Women's Self-Employment, Microcredit Activities of Schedule Banks, Microcredit Programmes of Administrative Ministries/Divisions and similar other efforts reflect the wide range of activities undertaken by the government and BB to expand the coverage and strengthen the effectiveness of the rural finance sector in Bangladesh (MOF 2023).

Another important player in rural development and poverty reduction is the Bangladesh Rural Development Board (BRDB). By organising intensive training and motivation programmes, supporting capital accumulation, transferring productive assets and technology, disbursing micro and SME credit, and implementing product-based village development activities, BRDB is specifically helping small, medium, and marginal farmers, as well as assetless men and women in rural areas, to mainstream their livelihood activities. BRDB has successfully finished 118 projects and programmes across the country in recent years. Additionally, BRDB currently manages six programmes, including those that address poverty, empower women, and provide microcredit. The total amount of credit disbursed by BRDB as of February 2023 is Tk 21,810.45 crore. However, within the same time period, Tk. 19,731.18 crore was recovered in total (MoF, 2024).

As per the mandate of the central bank, BB has been formulating and implementing specific guidelines for the banks and relevant financial institutions and taking specific measures to achieve the overall goals and objectives of the agricultural and rural credit policies since independence, an integrated review of both government and BB (pursued by all relevant departments such as ACD, BRPD, EEFU, FID, MPD, SME&SPD, SSMSD Project, SFD and others) on important aspects of rural finance since independence has been provided in section 5. In the following paragraphs, some important policy announcements and guidelines over the last one and a half decade (2006-2024) are summarised (for details, see Annex 1). The purpose is to provide a broad view of the variety of measures undertaken by the BB to achieve the objectives of rural credit policies.

i. *Incentives during times of disaster and emergency situations*

- To combat the financial crisis, the agriculture sector has a unique incentive-based refinance programme (ACD, 14 September 2022).
- A credit guarantee programme for cottage, micro, and small businesses (CMSEs) to help them recover from the negative effects of the Covid-19 epidemic (SMESPD, July 27, 2020).
- The banks' BDT 50 billion loan disbursement at the customer level under the refinance plan was extended until March 31, 2021, to provide operating capital in the agriculture sector due to the Covid-19 outbreak (ACD, 29 December 2020).
- A special 200 billion BDT incentive programme for the Covid-19-affected cottage, micro, small, and medium-sized business (CMSMEs) owners.
- The Special Stimulative Refinance Scheme, a BDT 50 billion refinance programme for the agriculture sector brought on by Covid-19.
- Particular financial policy support for borrowers in the agriculture and small business sectors impacted by the 2018–2019 corrosion of the Padma River.
- A facility for agricultural loans to farmers impacted by the 2018–2019 Fani typhoon and the tidal bore that followed.
- Facilities for rehabilitation of agriculture sector in cyclone 'Aila' affected areas in 2009–2010.

ii. *Strengthening women focused SMEs*

- Create a Women's Entrepreneur Development Unit within financial institutions such as banks.
- In order to provide additional institutional loan facilities with favorable terms and conditions, Bangladesh Bank should set aside at least 10 per cent of its total SMEs fund for women entrepreneurs.
- A ranking system for SMEs has been implemented. The RBCA, December 2010 criteria have been amended for this purpose. Refer to BRPD Circular No. 35, which was issued on December 29, 2010.
- Opening of SMEs Service Centers in 2007–2008.
- In 2013–2014, changes were made to the "Bangladesh Bank Fund" small business refinance programme to encourage non-traditional and creative sectors.
- PFI will receive a 100 per cent refinance in exchange for the loans it makes to small and micro businesses.
- Micro and small businesses will receive financing from banks and NBFIs.
- It has been recommended that banks and other financial institutions make greater efforts to offer lending facilities to SMEs.

iii. *Management of fisheries resources*

- Banks are allowed to provide credit for the "Fish Cultivation in Cage" programme as a subsector of fisheries resources under the agricultural/rural credit policy and program. The

banks will choose the loan amount, length, repayment schedule, time of distribution, and security after consulting with local fish producers, fish specialists, and police.

iv. *Agriculture and rural development in ending poverty and boosting shared prosperity*

- Agricultural financing programs offering a 4 per cent concessional interest rate for salt production in the nation's coastal regions
- Set aside a part of the whole loan portfolio for financing to agriculture.
- All scheduled private and international banks in Bangladesh are required to engage in agricultural and rural lending activities.
- Short-term agricultural loans may be rescheduled for a maximum of two years from the date of rescheduling, contingent on the banker-customer relationship.
- The choice to offer agricultural credit facilities for salt production in the nation's coastal regions at a discounted interest rate of 4 per cent

v. *Access to financial institutions*

- Farmers 10 taka accounts (Ref: BRPD Circular No. 01 dated 17 January 2010)
- No bindings for maintaining minimum balance and banks shall not impose any charges/ fees on these accounts.
- Amended general provision for all unclassified credit (irregular and regular)
- A circular outlining the proper way to conduct rural and agricultural operations under agent banking.
- Interest rates for agricultural and rural loans can now be capped at 9 per cent instead of 10 per cent
- The BB revised the interest/profit rate on agricultural and rural loans and investments to a maximum of 8.0 per cent (BRPD, 22 April 2021).

The above shows the innovative and varied nature of efforts and policy directives that BB has been following over the years in relation to rural credit management for accelerating rural transformation in the country.

1.3 Main Objectives of the Present Report

This report's primary goal is to review and assess the government's policies and significant initiatives, both past and present, and the Bangladesh Bank's in particular, with regard to rural finance. It also identifies areas that require future focus in order to meet Bangladesh's more general national development objectives. Nonetheless, the following are the study's goals:

- To review and evaluate the past and current policies taken by the government and Bangladesh Bank in the context of rural finance;
- To give an overview of current situation of rural financial market in Bangladesh;
- To provide a detailed demand and supply side perspective analysis of the rural finance; and
- To provide future directions and recommendations.

1.4 Structure of the Report

This report is structured in seven sections. After this introduction, section 2 gives an overview of the country context and major issues, including the future dynamics of change in the rural economy of Bangladesh. The section's goal is to assess the present state of affairs in order to give a suitable backdrop for talking about the primary concerns. While Section 4 examines the demand side viewpoint of rural finance, Section 3 offers a thorough supply side examination of the expansion of the financial system with an emphasis on rural financing. In Section 5, the legislative and regulatory framework for rural finance during the last several decades is reviewed, along with the main strategies for reforming Bangladesh's rural financial sector. Strategic relevance is emphasised for future growth of financial services in rural regions. Future perspectives on rural finance policy are included in Section 6 along with a basic framework for reforms and next actions. Finally, section 7 summarises the main findings and major recommendations.

2. Country Context and Major Issues

According to BBS, 68.5 per cent of Bangladesh's population lives in rural areas, and the country's per capita income in 2024–2025 is \$2,820. Despite the widespread belief that rural society has not changed, the rural parts of the country today are very different from those of fifty-four years ago. Bangladesh's rural economy now differs greatly from that of the 1980s and 1990s due to the modernisation of agricultural activities and the emergence of new and diverse nonfarm enterprises. More shops and commercial establishments, paved roads, electricity, and concrete and pucca buildings are present, as are bKash, Rocket, Nagad, and other agents that assist with remittances through mobile phones, cyber shops, or info-ladies who travel on bicycles with laptops to provide services and information on legal rights, women's empowerment, family planning, health, and other social issues. Without a question, technology and infrastructure have brought about significant social and economic change in rural areas.

Among the main components of this dynamic rural context are (i) the rural economy's diversification, particularly the nonfarm sector's rapid growth; (ii) the rural household incomes' ongoing high vulnerability; and (iii) the agriculture sector's evolving character. Simultaneously, the banking industry in Bangladesh has experienced substantial change, and the organised (mostly urban) private sector is becoming more interested in conducting business in rural areas due to the current rapid spread of digital and mobile technologies. The country's rural finance industry has both an opportunity and a challenge as a result.

Since gaining independence in 1971, Bangladesh has experienced relatively rapid growth. Bangladesh has made remarkable progress in human development and economic growth over the past 54 years (Table 2.1). In the 1970s and 1980s, GDP grew at an average yearly rate of about 4 per cent, but in more recent years, it has climbed to over 6 per cent. According to the World Bank, Bangladesh's economy is one of the five fastest expanding in the world in 2019. At constant 2005-06 prices, the GDP per capita also rose, rising from Tk. 18,113 in 1975-76 to Tk. 68,739 in 2019-20.

Table 2.1: GDP growth rate, 1976-2025 (5 year intervals)

	GDP growth rate at constant market prices (Base: 2005-06)	GDP growth rate at constant market prices (Base: 2015-16)	Annual GDP per capita growth rate, constant 2006 prices, per cent	GDP per capita, Constant 2006 BDT
1976-1980	4.20	NA	1.40	18,293
1981-1985	4.28	NA	NA	...
1986-1990	3.76	NA	1.07	20,490
1991-1995	4.53	NA	NA	...
1996-2000	4.83	NA	2.62	25,346
2001-2005	5.09	NA	NA	...
2006-2010	6.07	NA	4.60	37,900
2011-2015	6.32	NA	NA	47,609
2016-2020	6.55	6.13	NA	62,517
2021-2022	NA	7.10	NA	177,186 (Base : 2015-2016)
2022-2023	NA	5.78	NA	188,409 (Base : 2015-2016)
2023-2024	NA	4.22	NA	NA
2024-2025 (P)	NA	3.97	NA	NA

Mote: NA = Not available; P= Provisional

Source: BBS

The relative importance of the various output sectors is explained by the GDP's composition. Agriculture has historically contributed the most to the GDP in the early phases of development. The industries and services sectors contribute more as the economy expands. The sectoral shift on the demand side can be explained by the comparatively low income elasticity of demand for agricultural items. Agriculture is vulnerable to the early application of the law of diminishing returns on the supply side because of its reliance on a fixed factor (land). The use of capital and technology in industry, particularly manufacturing, is practically limitless. The use of technology, particularly in contemporary service operations, presents numerous potential in the services sector. In Bangladesh, the industry and services sectors now account for a larger portion of the country's GDP than the agriculture sector, which has decreased to less than 12 per cent (Table 2.2).

Table 2.2: Average share (per cent) of value added by broad sectors, Bangladesh

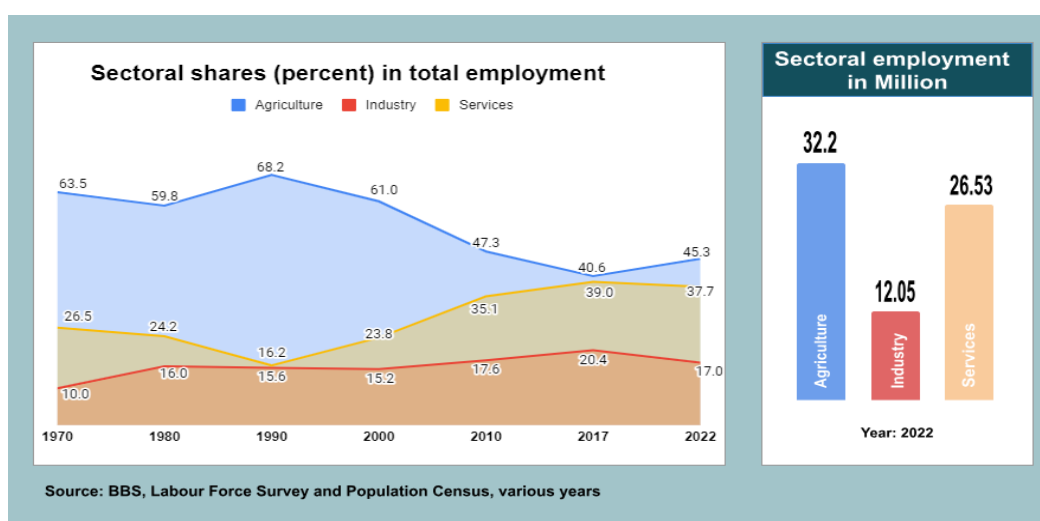
	Agriculture	Industry	Services	Total
1976-1980	43.75	10.88	45.37	100
1981-1985	31.6	11.59	56.81	100
1986-1990	28.99	12.8	58.21	100
1991-1995	26.92	14.33	58.75	100
1996-2000	24.52	15.91	59.57	100
2001-2005	22.66	16.44	60.9	100
2006-2010	20.37	18.2	61.43	100
2011-2015	16.45	27.87	55.68	100
2016-2020	13.08	31.01	55.91	100
2021-2024	11.28	33.94	54.78	100

Source: BBS, Statistical Yearbook of Bangladesh, various years and MOF, Bangladesh Economic Review, 2024.

Sectoral shifts in employment share are another crucial aspect of structural transformation, and Bangladesh has seen these shifts. Nonetheless, agriculture continues to account for a sizable portion of employment. Agriculture accounted for as much as 64 per cent of all jobs in 1970, but by 2022, that percentage had dropped to about 45 per cent (Figure 2.1). As a result, however slowly, the employment proportion in agriculture is decreasing. Additionally, the industry's employment share is not very significant. In 2022, 45 per cent of jobs are in agriculture, 38 per cent are in the services

sector, and the remaining 17 per cent are in the industry sector, particularly in manufacturing and construction. Due to the large prevalence of informal activities, the services sector mostly offers low-wage, low-productivity jobs.

Figure 2.1: Sectorial shares (per cent) in total employment



2.1 Dynamics of Agricultural Transformation

Moving labour from rural (such as agricultural) jobs to higher-productivity rural (as well as urban and overseas) nonfarm activities is the main characteristic of Bangladesh's rural transformation. Agriculture is primarily subsistence-oriented, thus when workers leave the rural areas, real earnings rise, which incentivises the adoption of machinery and new technologies to boost agricultural growth. Bangladesh's agricultural growth has seen a similar shift in recent decades. Policies also affected the flow of labour and other resources, causing them to support preferred activities or move in particular directions. Over the past 54 years, Bangladesh's agriculture has seen numerous changes of this kind.

Infrastructure and technology have undoubtedly been crucial in bringing about quick changes in rural areas, which have ultimately resulted in social and economic transformation. For instance, rural road development has, in a number of ways, given both men and women additional jobs and income-earning options. Road construction and maintenance jobs are open to the poor and landless, including impoverished women. Moreover, shorter commutes and easier access to employment outside of rural areas are the results of better roads. Improved infrastructure has also led to the growth of rural marketplaces and value chains that connect rural nonfarm products with agricultural inputs and outputs.

Private investments in stores, eateries, pharmacies, tea shops, saloons, beauty salons, and a variety of other businesses have given the rural populace wider job options. Additionally, the value of land has increased dramatically due to increasing linkages between rural and urban areas. Rural residents now have easier access to social services including health, nutrition, and education thanks to improved roads. Because of this, rural residents—women in particular—have more mobility when it comes to obtaining employment possibilities and maternal and child healthcare programmes. A significant number of rural schools, both public and private, have helped make education more accessible to rural youngsters, particularly girls.

The quick adoption of ICT and other technologies in rural regions has made it possible for farmers to use mobile services to obtain market information. Rural residents, including women, now have more options for a living thanks to the rapid growth of mobile-based services like mobile money, healthcare, education, information, and hotline services. Through access to technology and information flows, among other things, the expansion of NGO-MFIs' microfinance programmes in rural areas, where women make up the vast majority of members (about 90 per cent), raises household incomes, and promotes social empowerment. Specifically, education for girls has improved their career prospects (for example, in the RMG industries) and contributed to some aspects of gender equality, such as empowering them to make decisions and marrying at a later age. More use of maternal health care, better health outcomes, lower fertility, and better family nutrition have all been linked to women's education and information access.

Despite these changes, in many respects, rural Bangladesh continues to lag behind urban regions. Approximately 65 per cent of the population lives in rural areas, and as a result, there are significantly less economic and social prospects in rural than in urban areas. In fact, in every facet of Bangladeshi society, there appears to be a growing gap between rural and urban areas.

2.1.1 Tenorial Arrangements and Land Ownership Pattern

Rural land ownership has been changing slowly but steadily towards smaller land holdings due to generational fragmentation and other factors. The concentration of landless households is nearly 8 per cent in 2019 (Table 2.3).

Table 2.3: Farming, landless and agricultural labour households in rural Bangladesh

	1983-1984		1996		2008		2019	
	Total	%	Total	%	Total	%	Total	%
Rural households, million	13.82	N/A	17.83	N/A	25.36	N/A	29.75	N/A
Farming households, million	10.05	72.7	11.80	66.20	14.39	56.70	16.05	53.8
Agricultural labour households, million	5.50	39.8	6.40	35.90	8.85	34.90	9.04	30.3
Landless households, million	1.20	8.7	1.82	10.20	3.26	12.80	2.32	7.8

Ute: N/A means not applicable.

Source: Report on Agriculture Census 2019, October 2019, BBS, Dhaka.

This demonstrates how difficult it is to address the issue of these sizable sections of rural households' access to land through land reforms that prioritise tenorial arrangements. Tenant arrangements are also changing significantly in the meanwhile. About 41 per cent of land-holding households were cultivators, 47 per cent were owner-cum-renters, and the remaining 12 per cent were pure tenants in 1951. In 1978, comparable percentages were 65 per cent, 28 per cent, and 7 per cent, respectively. In subsequent years, these patterns persisted, with the shares rising to 61 per cent for owners, 38 per cent for owner-cum-tenants, and roughly 1 per cent for tenant farmers in 2008 (BBS 2014). As can be seen from the above, the proportion of owner farmers has grown over time, whereas the proportions of owner-cum-tenant and tenant farmers have decreased. The rise of agricultural productivity is positively impacted by these changes.

The distribution of the size of holdings has also undergone significant changes. The average size of a holding was 3.0 acres in 1960 which declined to 0.9 acre in 2008 (BBS 2014). In 2008, the number of holdings in rural areas of Bangladesh is estimated at 25.4 million, out of which 14.9 million are treated

as farm households.² Farm households in Bangladesh are divided into three major categories in terms of their size of holdings: small (0.05–2.49 acres), medium (2.50–7.49 acres), and large (7.50 acres and above). In 2008, the share of small farmers rose to 84 per cent and the shares of medium and large farmers declined to 14 per cent and less than 2 per cent, respectively.³

Additionally, the proportion of farmland under various farm sizes has varied. From 16 per cent in 1960 to 29 per cent in 1983–84 and then to almost 50 per cent in 2008, the area under small farms increased. However, the percentage of land covered by large farms fell from 38 per cent in 1960 to 26 per cent in 1983–84 and 12 per cent in 2008. The aforementioned modifications highlight two significant ramifications of Bangladesh's agrarian shifts. First, small farmers make up the majority of Bangladesh's agricultural sector. Second, most small farms are too small to produce enough income to cover even the average farm household's subsistence needs. Bangladesh's land usage pattern is still incredibly unequal, and as the agrarian structure continues to evolve, the pattern becomes increasingly unequal with time. However, it should be mentioned that even by the standards of other South Asian nations, Bangladesh's large farms—which are described as having roughly 3 hectares of land—are not particularly large.

When considering Bangladesh's natural and socioeconomic features, non-crop agriculture is quite important. The industry makes up approximately 43 per cent of the agriculture sector as a whole, or roughly 6 per cent of the GDP. The subsector of fisheries contributes approximately 4 per cent of the total GDP, whereas the livestock subsector contributes roughly 2 per cent. It should be emphasised that this subsector alone provides over 90 per cent of animal protein. This fast-growing, labour-intensive industry makes a substantial contribution to rural income growth and poverty alleviation.

2.1.2 Agribusiness and Value Chain Development

In Bangladesh, where a sizable portion of the rural population works in agriculture on dispersed land holdings, agribusiness development is a top priority in order to generate new growth prospects for the industry. Food with better quality and nutrition, longer shelf life, and with ease of preparation are becoming more popular in Bangladesh as the country's economy expands and urbanisation increases. This calls for an advanced agro-industrial system. Supermarkets and stop-and-shops are part of the intricate agri-food distribution chain that is already beginning to take shape in the big cities and urban areas.

The rapidly expanding middle class's purchase patterns are rapidly shifting, indicating increased competition from imported goods. Opportunities for rural expansion are still only partially fulfilled, and the linkages between rural and urban areas of the evolving agricultural system are reshaping as well.

The private sector Seed development, agro-processing, poultry, livestock, and the export of fresh and frozen fruits, vegetables, cut flowers, and decorative plants are all areas of agriculture that have experienced fast expansion in the last 20 years. The dairy industry, the poultry and feed industry, the fisheries subsector, the seed supply, and the condiment and spice industries are just a few of the other businesses that have seen improvements. As Bangladesh's agriculture grows more commercialised, it must provide a greater variety of goods for urban and peri-urban consumers. Because it provides a way to get goods from the farm gate to the customer's plate, the market is essential in this situation.

The main players in the agri-food system, including producers, processors, distributors, and dealers, are progressively playing a significant role in the value chains that are characterising market development.

² In Bangladesh, holdings having land of less than 0.05 acre are considered as non-farm households and the total number of such households is estimated at 10.5 million in rural Bangladesh in 2008.

³ In 1960, small farms represented about 52 per cent of total farms while medium and large farms constituted 38 per cent and 10 per cent, respectively.

Making sure that impoverished people and small farmers are included in value chains to enhance their standard of living remains a significant challenge for Bangladesh.

To meet the challenges of agricultural transformation in the coming decades, Bangladesh needs to put in place a value chain management system that improves linkages among stakeholders, improves processing technologies, develops shared marketing systems, and improves quality control and assurance mechanisms.⁴ It would be essential to create a demand-driven framework to promote agribusiness connections among the stakeholders. These systems, which are based on the compatibility and features of the product and the market, include the supermarket supply chain model, the enterprise-market linkage model, the farmer-enterprise contract model, the big private firm model, and the farmer-market linkage model. In reality, improved value chain management will lead to the transition to commercial agriculture.

2.1.3 Commercialisation and Diversification of Agriculture

Over time, Bangladesh's agriculture has grown increasingly market-driven and commercial. In Bangladesh, high-value products have gradually been replacing conventional food grains as the main component of agricultural output. Agriculture is being driven by rising consumer demand for non-cereal crops such as fruits and vegetables, processed meals and beverages, and products from animals and fisheries. As a result, the production share of high-value commodities (fruits and vegetables, animal products, and fisheries) in total agricultural output has climbed from around one-third in the 1980s to over 45 per cent in recent years.

Additionally, the mix of the export trade is shifting away from traditional goods like tea and jute towards newer ones like processed products, livestock, and horticulture. The changes in the cropping pattern are further influenced by the diversification in the domestic food consumption basket, as well as the rising costs of fruits, vegetables, milk, eggs, meat, fish, drinks, and processed foods. Farmers' marketed share of agricultural output has also been increasing; in the 1950s, roughly 30–35 per cent of food grain output was marketed; today, that percentage is over 70 per cent. It goes without saying that the commercial crops have a larger percentage than the subsistence crops.

Additionally, the basket of foods consumed has grown more diverse (World Bank 2008). Cereal spending as a percentage of total food expenditure decreased from 39.0 per cent in 2005 to 25.9 per cent in 2016. According to the HIES 2016 data, the expenditure share of meat and eggs rose from 8.5 to 13.1 per cent, fruits and vegetables from 11.6 to 13.1 per cent, and fish from 12.2 per cent to 17.3 per cent between 2005 and 2016. Compared with rural areas, metropolitan areas have significantly bigger increases (BBS 2016).

Among other things, the introduction of new technologies, greater communication, and a decrease in the average household size have all contributed to these increases in land productivity. Nonetheless, medium-sized and larger landowner households are mostly responsible for paddy marketing (Hossain et al. 2009). A number of variables have combined to encourage small farmers to focus more on the market. Consequently, the agricultural industry has been increasingly diversified to include high-value commercial crops as well as fish and cattle products that are high in protein. The contribution of poultry to the livestock products has grown quickly.

Despite the technological, institutional, and infrastructure limitations that now define Bangladesh agriculture, these patterns show that even small farmers react to market signals rather quickly and

⁴ Although the terms value chain and supply chain are often used interchangeably, these are not the same. A value chain is related to linkages that generate value for the consumer. On the other hand, a supply chain deals with processes of moving/transforming commodities into products from producers to consumers. Thus, while the concern of a value chain is with generating value, a supply chain deals with logistics.

expand into high-value crops. In a similar vein, Bangladesh's agricultural exports have also shifted towards higher-value products, with a growing proportion of high-value crops (such as vegetables, fish, and shrimp) in overall agricultural exports.

Accelerating the expansion and diversity of agricultural production requires the creation of an effective marketing structure. While the private sector handles marketing for the majority of minor crops, the government directly intervenes for major items like wheat and rice. Poor market infrastructure dominates the country's agricultural commodity marketing, which necessitates large investments in institutions, technology, infrastructure, and management. These must prioritise building storage facilities, expanding the availability and quality of information services, enhancing market laws, granting access to institutional loans, and fortifying physical infrastructure.

Over the years, Bangladesh Bank (BB) has increased its focus on refinancing schemes for import substituting crops and future expansion of these activities. To give a boost to the cultivation and production of important import substituting crops (e.g. pulses, oilseeds, spices and maize) and to combat global price-hike resulting in higher import costs, these crops have been facilitated with agricultural credit at 4 per cent concessional interest rate at the farmers' level under interest subsidy facility of the government.

Under the agriculture and rural credit target, commercial banks and state-owned banks have been providing farm loans at a discounted 4 per cent interest rate supported by the central bank for import replacement items, according to the BB circular. Furthermore, banks are able to document the losses in their corporate social responsibility (CSR) records if they continue to experience interest losses.

According to the circular, more loans would be distributed through bank branches in all regions with high import substitution crop output. "A written banner should be displayed in areas where loans are disbursed at a 4 per cent interest rate. To find actual farmers, help from the local agricultural extension office should be sought if necessary," the BB circular continued.

Crop substitution and production intensification are two ways to accomplish diversification, even when there is little chance of diversification through expansion. With sufficient funding and assistance, intensification could be raised in practically every division—with the exception of Rajshahi. Potential investments will necessitate large expenditures in areas such as soil management, flood protection, irrigation and drainage, agricultural extension and research, and market access.

However, pumping costs and irrigation water availability in Dhaka and the northwest are being impacted by the diminishing groundwater supply. Closing the existing yield gap can lead to crop substitution diversification. Numerous studies indicate that there are significant differences between the agronomic potential yields in research and farm fields, with boro yielding 25 per cent and aus and aman paddy yielding 75 per cent (Gautam and Faruquee 2016; BARI 2016). Switching from boro paddy to other non-paddy crops would solve the problems of water pollution and groundwater depletion. Under its import substitution programme, the government has increased production of oilseed crops and pulses that use less water, and it has begun to encourage the switch from boro paddy to two-kharif paddy farming, which lasts for a shorter period of time.

Crops intended for use in animal feed are another potential sector. Bangladesh's livestock and fishery industries, which are flourishing and growing quickly, need supplemental feed, which is produced locally in factories using a combination of imported and locally farmed raw ingredients. Like rice, maize and soy beans are "field crops" that do not require a lot of additional management expertise, that is why they have been selected for additional research. In comparison with rice, maize has a shorter growing season. Additionally, they offer favourable import substitution potential.

Further, for ensuring efficient and profitable commercialization and diversification of agriculture, the system of agricultural marketing in Bangladesh has to be vastly improved. At present, there are several major problems that confront agricultural marketing in the country. These include, for example, lack of adequate facilities for proper cleaning and drying of agricultural produce; underdeveloped means of transportation hindering the movement of farm products and thereby making primary marketing costly through creating multiplicity of small dealers and middlemen and deterioration of quality and loss especially of perishable products like vegetables, tomatoes, pine apples, fruits, fish and the like; extremely limited availability of organized storage and warehouses (e.g. with credit facilities) for agricultural produce especially within the reach of the small farmers; multiplicity of Intermediaries (e.g. faria, bepari, aratdar, dalal or broker, stockist, wholesaler and retailer); and absence of adequate credit facilities from formal financial institutions to meet financial commitments during and after crop harvest forcing the growers to sell their produce immediately after harvest at very low prices and/or borrowing from private money lenders at excessively high interest rates.

Further, there are constraints related to lack of scientific grading and standardisation for most agricultural products creating constant tendencies for low quality products to drag down the prices of high and premium quality products especially through willful underestimation by the faria and other middlemen; inadequate processing and preservation facilities creating seasonal gluts of various agricultural commodities resulting in spoilage and forced selling at throw away prices especially of perishable products; prevalence of different kinds of fraudulent practices in agricultural marketing including 'use of false weights and measures' (e.g. multiplicity of weights and measures) and 'levying of a variety of charges' (e.g. aratdars, dalals and wholesalers levy a number of special charges, such as chalta which is an allowance in kind deducted in order to compensate the buyer for loss in weight resulting from assorting, bailing and transporting jute, kayali -- a cash allowance to cover weighing expenses, kabari -- a deduction made for the benefit of the buyer's staff, brittee elahi -- a cash market allowance deducted by the jute buyers at secondary markets intended for charity, iswar brittee -- deduction made in secondary market for religious and charitable institutions, and so on); and absence of cooperative marketing putting the small farmers at a great disadvantage since cooperative action of the growers is necessary to remove some of the defects prevailing in the marketing system in the country's overwhelmingly dominant small farmer agriculture.

2.1.4 Climate Change and Agriculture

Numerous crops in Bangladesh, particularly wheat, are susceptible to climate change, according to available studies using crop growth models. Among the irrigated rice types, boro rice—the nation's major crop—is more vulnerable to climate change than aman rice. The coastal region and the haor basin may become more vulnerable to climate change than the middle floodplain and the high barind area. Mango and other seasonal fruits, as well as mustard, onion, lentil, chilli, potato, peas, and many other winter vegetables, will also be more susceptible to climate threats. Even though climate hazards and their effects are more widespread, their negative effects are further amplified by other localised effects, many of which can be at least partially attributed to climate change. These include conditions that affect the nation's crop agriculture, such as flash floods, delayed drainage, hailstorms, coastal areas, salinity, cyclones, storm surges, tidal flooding, harsh weather, and water shortages for irrigation in barind areas.

Theoretically, there are several strategies that could be used to address climate change. For instance, retreat, accommodation, and protection may all be part of the coastal zone's climate change adaptation. In coastal areas, a retreat strategy entails moving residents to safer locations, whereas accommodation means that residents stay and adapt by turning their crops into fishponds, for

example. However, a protective strategy would entail safeguarding natural resources, economic activity, and sensitive places from climatic hazards by, for instance, constructing sea walls, embankments, and dykes along the coast.

2.1.5 Contract Farming

Alongside Bangladesh's fast economic development, the structure of agriculture and agricultural marketing techniques throughout supply chains are also changing quickly. One technique that is swiftly gaining popularity in Bangladeshi agriculture is contract farming for a variety of crops and other non-crop agricultural items. Developing it as an institutional tool to include small and impoverished farmers in contemporary market channels is a difficulty, nevertheless.

Interest in contract farming has grown as a result of structural changes in Bangladeshi agriculture, particularly in the food sector and rural-urban migration. Urbanisation increases the need for the transportation, storage, processing, and wholesale and retail distribution of different food product kinds. The pattern of food demand is also altered by migration, especially when household earnings in the country are gradually increasing.

When the buyers of the products furnish the inputs under the terms of the contract, contract farming often helps small farmers who have trouble acquiring high-quality farm inputs from the liberalised market. The emergence of supermarkets in the country's food retailing industry, particularly in metropolitan areas, has also contributed to the quick expansion of contract farming. It is probable that the contract farming system would improve small farmers' market accessibility and connect them to both domestic and international markets. Small and marginal farmers can gain from these new market prospects, especially as contract farming agreements sometimes involve the supply of inputs and technical support.

Integrating small farmers and businesses into contemporary markets is the main problem in the context of market liberalisation in Bangladesh agriculture. A number of areas require attention in order to support the successful and long-term growth of contract farming in Bangladesh. These include policies that support the development of healthy contract farming and improved communication and understanding between small farmers and buyers to guarantee dependable relationships and long-term collaboration. To increase the regulatory efficacy and efficiency of the contract farming system, the legal frameworks' enforcement should also be reinforced.

2.2 Rural Non-farm Sector

The rural non-farm (RNF) sector in Bangladesh encompasses a vast array of activities and is highly diversified. The incentives that are available and the ability of rural households to engage in nonfarm activities impact the nature and characteristics of the activities. Although there is a dearth of comprehensive data on the RNF industry's growth at the macro level, the evidence that is currently available indicates that the sector has been growing quickly in Bangladesh (Hossain 2004; Hossain and Bayes 2009; Balagtas et al. 2012). RNF operations made up 42 per cent of rural areas' income in the late 1980s, and by 2008, that percentage had risen to 57 per cent (Table 2.4).

Table 2.4: Sources of rural household income in Bangladesh, 1988–2008

	1988	2000	2004	2008
	Share in total household income, %			
Crop income	34	24	26	26
Income from rice crop	26	16	15	15
Non-rice crop income	8	8	11	11
Nor-crop agricultural income	11	13	12	11
Agricultural wage income	13	5	6	6
Total farm income	58	43	44	43
Trade/business income	9	21	19	15
Service income	18	17	16	10
Remittances income	5	13	14	23
Non-agriculture wage income	9	7	7	9
Total nonfarm income	42	57	56	57
Total household income	100	100	100	100
Total household income, in 2004 USD	1,105	1,325	1,395	2,062
Average income per capita, in 2004 USD	187	245	264	417

Source: Balagtas et. al., 2012

One key factor influencing the growth of the nonfarm economy in rural regions is worker productivity. Push forces would tend to increase nonfarm activities if the productivity of rural nonfarm labour exceeded agriculture earnings. Compared to other non-agricultural industries, agricultural labour productivity is often poor, according to labour productivity trends (Table 2.5). Transport driving has the highest productivity, followed by commercial, service, and nonfarm labour.

Table 2.5: Duration of employment and labour productivity in RNF occupations

	Employment duration, days per year			Labour productivity, USD per day		
	2010	2011	2012	2010	2011	2012
Agricultural labour	102	102	100	2.39	2.52	2.51
Non-agricultural labour	134	94	134	2.69	2.87	2.88
Business	204	210	214	3.50	3.45	3.48
Service	260	246	278	2.88	3.04	2.95
Transport driving	150	169	168	4.79	5.39	5.79
Other non-farm activities	192	165	174	2.20	2.54	2.52

Source: Pramanik et al, 2014

The manual labour-based RNF sector components in rural Bangladesh, such as transportation, construction, cottage industry, and nonfarm wage labour, are crucial because they allow the most vulnerable and impoverished groups to readily adapt to shifting rural dynamics. According to Tables 2.6 and 2.7, the RNF sector employs around 32 per cent of the rural labour force and contributes, on average, 56 per cent of family income in the country's rural areas. Compared with female household members, male household members participate in more nonfarm activities. Participation in RNF activities is positively correlated with average years of schooling, village infrastructure, and credit availability, but adversely correlated with land ownership, family size, and dependency ratio (Pramanik et al., 2014).

Table 2.6: Rural household income from farm and non-farm sources

	Annual income, current USD		Share of income %	
	2010	2012	2010	2012
Farm income	1,050	981	53.9	43.8
Crop	620	479	31.8	21.4
Livestock rearing	272	319	14.0	14.2
Fishing	84	121	4.3	5.4
Farm labour	75	63	3.8	2.8
Non-farm income	899	1,260	46.1	56.2
Business	229	218	11.8	9.7
Service	157	152	8.0	6.8
Remittances	330	568	17.0	25.4
Other occupations	11	11	0.6	0.5
Interest income	20	96	1.0	4.3
Other sources	151	215	7.7	9.6
Total	1,949	2,240	100	100
Income per capita	361	420	...	...

Source: Pramanik et al, 2014

Table 2.7: Distribution of rural population by employment type

	Primary occupation, per cent			Primary or secondary occupation, %		
	2010	2011	2012	2010	2011	2012
Agriculture	18.66	18.34	17.28	31.23	30.01	27.71
Farming	16.05	15.87	14.52	23.10	22.18	20.91
Agri-labour	1.97	1.84	1.99	4.41	5.20	4.86
Other agriculture work	0.64	0.63	0.77	3.72	2.63	1.94
Non-agriculture	26.79	26.76	27.10	30.84	30.90	31.51
Business	3.77	3.84	3.63	5.36	5.36	4.81
Cottage industry	0.48	0.37	0.36	0.69	0.79	0.67
Service outside village	4.52	4.41	4.35	4.52	4.41	4.35
Household help	0.11	0.21	0.15	0.11	0.21	0.15
Mechanics	1.22	1.42	1.48	1.33	1.68	1.79
Rickshaw/van pulling	1.33	0.95	0.92	1.38	1.06	0.97
Other transport	0.80	0.89	1.28	0.91	0.94	1.54
Service	11.37	11.61	11.71	11.70	11.82	12.07
Shop keeping	0.80	0.74	0.82	1.12	1.11	1.23
Non-farm labour	1.06	1.16	1.33	1.12	1.26	1.89
Other non-farm work	1.33	1.16	1.07	2.60	2.26	2.04
Non-remunerative activity	54.58	54.91	55.63	56.69	57.12	58.39
Homemaker	35.18	36.52	37.73	36.70	38.10	39.47
Student	12.01	12.77	13.45	12.60	13.40	14.47
Unemployed	7.39	5.62	4.45	7.39	5.62	4.45
Total	100	100	100	119	118	118

Source: Pramanik et al, 2014

2.2.1 Emerging Trends in the RNF Sector

Over the years, the contribution of the RNF sector to the rural economy is increasing rather rapidly.⁵ Currently, the RNF sector provides about half of all household incomes and more than 40 per cent of rural employment. Additionally, the sector has demonstrated remarkable vitality, with employment and income growing at higher rates (4.2 and 2.7 per cent, respectively) than agricultural income and employment (0.3 and 1 per cent, respectively). While some RNF operations are residual-type activities that augment agricultural employment and income, the majority of RNF activities are also more productive than agricultural employment. Specifically, RNF occupations yield larger returns than daily wage labour in agriculture (even when individual/location variables and educational disparities are taken into account).

Physical capital-intensive and human capital-intensive industries have the highest labour productivity in the RNF sector. Even working for self-employment in RNF activities is not considered a part-time job or a last-resort job. Furthermore, the majority of RNF businesses create steady jobs all year round.

The RNF sector in Bangladesh is undergoing structural change in addition to dynamism, which is making the productive segments more noticeable. Micro, small, and medium enterprises (MSMEs) with permanent locations are becoming more numerous, and their workforces are also often more productive. On the other hand, the number of cottage enterprises—home-based businesses that are less productive—has increased more rapidly than their employment. However, the manufacturing sector's home-based businesses have actually seen a fall in both employment and labour productivity.

According to recent developments in Bangladesh's rural economy, if proper policies are implemented, the RNF sector is set to embark on a new phase of faster growth. In agriculture, the RNF sector is expected to develop more quickly due to notable increases in crop yields and quicker growth in all non-crop subsectors. Furthermore, the demand for high-value agricultural products, processed foods, and RNF services—all of which have high income elasticity—is being stimulated by the fast growth in per capita incomes.

Furthermore, there is still a lot of untapped potential for both fresh and processed food exports. Where there are considerable intra-sector variances in labour productivity, there is also a great deal of room for productivity increase in RNF operations. The RNF sector's rapid growth also requires the necessary supply of trained labour, enterprise development and entrepreneurial skills, and funding.

The RNF sector spans a broad geographic region, including peri-urban areas, rural towns, and villages. Additionally, the RNF operations create various links by involving producers and consumers in each of these tiers as well as across them. Input-producing companies, agriculture-related and agro-processing industries, marketing and distribution of agricultural and RNF goods, specialised peri-urban manufacturing and services, and many other activities are all part of the RNF sector.

A number of key areas require attention in order to unleash the growth of RNF activities, including integrated agro-food supply chains, pro-poor RNF growth, policies to boost the economies of rural towns, smaller cities, and peri-urban areas, and the creation of an environment that is conducive to rural investment (World Bank 2004). The rural financial market in Bangladesh is still insufficient to satisfy the needs of the vast majority of RNF firms for financial services, even with the rapid growth of microfinance in rural regions.

The MSMEs' access to finance in rural regions has somewhat enhanced by the NGO-MFIs' recent

⁵ The contribution depends on the scope of the definition of the sector. Here, we take the RNF sector as consisting of all activities located in villages, rural towns, and peri-urban areas excluding the primary production of crops, fish, forests, and livestock.

growth of microenterprise lending. Compared with over 50 per cent of MSMEs in urban regions, nearly 60 per cent of MSMEs in rural areas obtain loans. Of the rural MSMEs that obtain credit, 37 per cent only borrow from informal sources (such friends and family), 42 per cent only borrow from formal sources (banks and MFIs), and the remaining 7 per cent borrow from both formal and informal sources. The NGO-MFIs are a major source of funding for smaller rural businesses; over 20 per cent of enterprises with less than three employees borrow from them, compared with 9 per cent with more than 20 employees (BBS, 2013). A sizable portion of small and middle-sized businesses continue to be neglected by the rural finance system (the so-called ‘missing middle’) since microfinance programmes primarily target the micro enterprises while larger businesses have easier access to bank loans.

Furthermore, effective and decentralised ways are needed to provide the necessary services to the rural entrepreneurs due to the variability and large spatial dispersion of RNF operations. Since there are many microbusiness owners spread out over vast geographic regions of the nation, supply-driven and top-down strategies are unlikely to adequately meet their demands in the RNF sector.

The NGO-MFIs have been one of Bangladesh's top suppliers of commercial and technical services to RNF enterprises in recent years. Through contract farming with smaller farmers, the Bangladesh Rural Advancement Committee (BRAC) continues to develop horticulture goods and has invested in their agro-processing.

Among others, the Association for Social Advancement (ASA), BRAC, and Grameen Bank offer financial services and technical support to MSMEs. Furthermore, effective decentralisation could be used to enhance the capacities of local government institutions, as many of the services needed by RNF enterprises fall under the category of public goods. The efficiency and efficacy of service delivery to rural enterprises may be greatly increased by fostering collaborations between the private sector, NGO-MFIs, and local governments.

To put it briefly, a two-pronged approach is required to promote the RNF sector: (i) enhance the investment climate in rural areas; and (ii) provide an institutional framework for effective provision of all services required by the RNF sector. Removing the anti-rural bias in current trade and macroeconomic policies, enhancing the physical and financial infrastructure, and putting in place an efficient regulatory framework for the growth of agri-food supply chains are the main areas for improving the investment climate. To strengthen financial intermediation in rural regions, more focus needs to be placed on mobilising savings, lowering transaction costs, and expanding microenterprise initiatives.

Intentional and purposeful government interventions are needed to support institutional and technological changes in order to modernise agri-food systems. The business development services must cover a wide range of topics, including training and extension, business development and counselling, marketing and information, business planning and management, technology development and diffusion, business linkages through subcontracting, franchising, and business clusters, among many others. To achieve the intended structural transformation in Bangladesh's rural economy, an integrated strategy is required to establish a positive feedback loop of farm and RNF growth.

2.3 Changing Profile of the Rural Economy

The rural economy's diversification, rural family income's ongoing high vulnerability, and the shifting nature of the agriculture sector are some of the major components of Bangladesh's rural economy's dynamic backdrop during the last fifty four years. As we have seen above, the proportion of agriculture in the overall GDP has rapidly decreased, and the RNF sector is contributing more to rural

GDP and employment. The pattern of land ownership in rural areas has been gradually shifting towards smaller farms due to generational fragmentation and other factors, and rural per capita income is increasing despite the decline in agricultural GDP. Given the comparatively high rate of rural poverty and the growth in rural per capita incomes, the rural banking sector must adapt to handle economic activity in rural regions outside of agriculture.

Furthermore, the income of rural households remains extremely susceptible, a stochastic phenomena primarily caused by agricultural hazards. Households in rural areas are especially susceptible to many hazards. While some of them, like illness of household members, occur often but have limited long-term effects; others, like floods and cyclones, might occur annually and have a significant impact. The latter need outside assistance, such as insurance payments or catastrophe relief, but the former may be managed most effectively by drawing on savings or borrowings. Additionally, idiosyncratic and covariant shocks can be distinguished. Idiosyncratic shocks may only affect a certain number of families, whereas covariant shocks, like drought, might impact every home in a community. Untimely mortality, health and accident risks, crop and livestock hazards, and other property risks outside of catastrophes are among the main risks.

Depending on the shocks' variability and intensity, rural families employ a variety of coping mechanisms. Self-insurance mechanisms for impoverished rural families include: (i) consuming less food grains; (ii) dropping out of school to save children's education costs; (iii) temporarily moving to urban and peri-urban regions for work; and (iv) diversifying sources of income. The household becomes more vulnerable if there are repeated droughts, floods, or family member disease episodes since some of the aforementioned measures make it harder to resist shocks in the future. Because of risk aversion, the impoverished are frequently forced to pass on potentially profitable new technologies, manufacturing options, and revenue streams. Therefore, one of the main causes of the poor health and ongoing poverty of small farmers and low-income participants in the informal agricultural economy in rural regions is the lack of appropriate risk mitigation methods. Therefore, risk must be addressed at the level of rural households as well as rural financial institutions in any attempt to restructure the country's rural finance system.

Furthermore, as previously noted, during the past few years, Bangladesh agriculture has seen a noticeable transition from a focus on food grains to one on commercial and horticultural crops. Produce such as fruits, vegetables, oilseeds, spices, and other minor or horticultural crops are becoming more and more important. The amount of land planted to crops other than food grains has been increasing continuously. Similar to this, the proportion of associated industries in agriculture—primarily dairying, fisheries, and poultry—is also rising quickly as a result of shifting dietary preferences.

The growing proportion of purchased inputs (such as water, fertiliser, hybrid seeds, etc.) in agriculture as opposed to owned inputs is another trend that is starting to emerge. This shows that agriculture is becoming more modern, which strengthens backward linkages. To take advantage of the growing demand for organic food, particularly in urban and external markets, some farmers are also embracing organic and green agricultural practices. There is a lot of room for expansion and scaling up these new trends.

Therefore, in order to capitalise on the evolving agricultural landscape and support the shift towards increased production while simultaneously minimising risks in the most efficient and economical way, the rural financial market needs to be able to finance novel crops and technology.

Farmers will also be able to produce crops in accordance with market demands rather than depending on the imperfect market and restricted pricing as a result of the rise and expansion of commodity future markets, which will also increase transparency in the price discovery process. However, further

work is required to guarantee the distribution of pricing information, the provision of storage facilities and warehouse receipt system, framework for financing against warehouse receipts, and similar steps in order for the farmers to profit from future trade.

Even though Bangladesh has made great strides since gaining independence, many rural residents still lack safe and dependable means of saving money, obtaining institutional credit, safeguarding and enhancing their assets, and transferring money. This is especially true for the most vulnerable populations, including women, young people, and the impoverished. Many rural populations still lack access to basic formal banking services. This complicated issue is exacerbated by inadequate infrastructure, financial service providers' restricted capability, and poor customer education levels.

Furthermore, access to necessary financial services remains a challenge because rural finance's physical outreach has not been very successful in reducing poverty and increasing income. Microfinance institutions (MFIs) are estimated to provide 60 per cent of rural lending in recent years, followed by banks and other financial institutions at 10 per cent and non-institutional players at 30 per cent. No formal financial institution lends much credit to the landless, who make up the majority of the rural poor. Although many MFIs are successful in helping the impoverished, their limited capacity to acquire funds in the absence of supportive rules prevents them from growing in size. The vulnerability of the rural poor is further increased by the near-complete lack of risk mitigation tools and processes, such as commodities derivative contracts to manage price risks and microinsurance for life, health, livestock, crops, and assets.

The enormous potential of rural finance to raise rural residents' standard of living is acknowledged in the country's policy agenda. As a result, rural livelihoods have been greatly impacted by the growth of financial institutions during the past 54 years. Financial services have expanded and grown thanks to innovative tools and creative institutions. Clients in rural areas may now access a greater variety of financial solutions thanks to technology. However, much more has to be done. Despite international financial crises, fluctuating food and agricultural commodity prices, and the dangers of climate change, inclusive rural banking is nevertheless a vital component of Bangladesh's rapidly evolving rural economy.

Managing risks and leveraging investments in the rural sector are significant challenges for the policy agenda in the context of Bangladesh economy's present fast rural change. The great majority of small farmers face several dangers that deter them from making sufficient investments in agriculture. Formal financial institutions are hesitant to lend money to small farmers and agribusinesses because they frequently view small-farmer-dominated agriculture as being too risky. Sometimes, small farmers' inability to manage risks like livestock illnesses and climate-related shocks makes them hesitant to borrow money for agricultural output. The ability of cottage, micro, small, and medium enterprises (CMSMEs) to expand their scale economies and productivity in the rural nonfarm sector is limited by their access to technology, business development services, finance, absence of linkages with urban and external value chains and marketing networks. To safeguard and fortify the rural economy and food production systems, all of these necessitate efficient agricultural and rural risk management in a comprehensive manner, particularly by utilising rural finance and investments in small farms and CMSMEs.

Adopting insurance (such as microinsurance) as a comprehensive risk management tool, where risks in agriculture and the rural nonfarm economy are evaluated, prioritised, and addressed in an organised manner, is the key to a sustainable and inclusive rural transformation in the Bangladesh economy. Insurance is a useful financial instrument for unforeseen risks that are unable to control otherwise. The focus in the agenda will be to shift from catastrophe response to intelligent risk management.

2.4 Rural Transformation: Future Directions

Due mostly to restrictive land availability, area-driven expansion in Bangladesh agriculture is unlikely to continue in the future. The goal will have to be to increase agricultural intensity while preserving the condition of natural resources, particularly water and land. Furthermore, Bangladesh's agriculture is currently at a turning point. There is increasing competition for labour, land, and water in agriculture from nonfarm enterprises and other sectors.

The capacity of agriculture to compete as a low-cost producer of agricultural products is being hampered by rising labour costs along with extremely intensive production that uses purchased inputs and natural resources. Additionally, these negatively affect farmer profitability and the environment. The quick and dependable supply of food and associated goods, together with guarantees on quality, safety, and sustainability from farmers and businesses, are essential to Bangladesh's future competitiveness in both local and international markets.

The framework in which Bangladesh agriculture must evolve will be significantly altered during the next 20 years by important demographic, social, environmental, and other issues. The size of the middle class will grow significantly, and urbanisation will accelerate. As the consumption of non-cereal, protein-rich, and processed foods increases and the consumption of rice and other staples declines, the dietary pattern and food expenditure will also shift. More unpredictable weather patterns will also result from climate change. Primary agriculture's GDP share will continue to fall, but the agroindustry's portion, along with that of food distribution, logistics, and other services, will expand dramatically. Although the significance of seasonal and full-time employment in agriculture will fluctuate significantly throughout the country's regions, the agro-food sector—rather than primary agriculture—will therefore play a significant role in employment and livelihoods in the rural areas.

The organisation of production and value chains, as well as the utilisation of agricultural land, may also undergo substantial changes. It is probable that sizable tracts of land now used for rice production will be converted to other uses or ecological services. Aquaculture may be developed on cropland impacted by saline intrusion, and peri-urban land may be utilised for the production of vegetables or decorative plants. Land in environmentally vulnerable areas may serve several purposes, such as promoting ecotourism and maintaining biodiversity. Growth in total factor productivity (TFP) will inevitably accelerate agricultural transformation and growth. To bridge the gap between the labour-intensive manufacturing subsector and the agriculture sector, agricultural labour productivity will also need to rise. Furthermore, in order to satisfy the safety and quality requirements for a varied and nutritious diet, as well as the country's growingly varied food demands, agriculture will need to play a significant role.

Policies need to address a number of issues in order to ensure sustainable agricultural productivity growth and desired transformation. These include helping small farmers to take advantage of economies of scale, promoting diversification to meet new food demands and enhance income and job opportunities, encouraging broad-based innovations in the food and agriculture sectors, managing climate risks, creating inclusive and competitive value chains, enhancing public and private sector capacities to ensure and deliver safe food, and resolving the agriculture sector's long-term sustainability and competitiveness issues.

Crop diversification in favour of high-value crops and technical advancements would be the keys to increasing agricultural growth. This calls for sufficient funding for agricultural research and initiatives to increase its effectiveness, institutional changes to fortify the connections between research and extension, and investments in agri-infrastructure to capitalise on the possible returns on agricultural research funding. Given the enormous potential and the low yield advances thus far, horticulture crop

research deserves particular attention.

The primary forces for agricultural diversification in the future will be a steadily rising per capita income and a quickly growing urban population. Maximising the growth potential requires a number of measures, including infrastructure investments to reduce transaction and transportation costs, policies to attract private investment in cold storage, refrigerated transportation, agro-processing, and retail chains, measures to ensure farmers have access to technology, credit, inputs, information, and extension services, and policies that support institutional arrangements like contract farming and price risk mitigation.

3. Growth of Financial Sector: Supply Side Evidence

In general, all formal and informal financial institutions that offer rural families a variety of economic advantages as well as more substantial financial services to other MSMEs and agro-processing businesses in rural regions are included in the category of rural finance. Rural finance includes microfinance, CMSME financing, and agricultural finance, among others. Bangladesh has always made an effort to use its banking system to increase rural financing. In return for building more profitable urban branches, the nationalised commercial banks (NCBs) had to open branches in rural areas. Rural financing was particularly assigned to two agricultural development banks. Additionally, Bangladesh Bank rediscounted rural loans given to specific borrowers and established quotas for agricultural lending. Despite significant policy interventions, majority of the rural households in Bangladesh continued to remain excluded from formal financial markets and these excluded households are mainly the low income households.

Increasing farm production through modernisation of agriculture, use of modern inputs and adoption of new technology are at the root of establishment of development banks and introduction of subsidised targeted credit programmes. But these policies also had adverse impact on sustainability of the lenders and mis-allocation of resources. Further, the supply-leading finance strategy often excludes the poor for their lack of collateral and high transaction cost of lending. At the heart of the problem is the problem of asymmetric information. This has led to emergence of different types of institutions and lenders in different credit market with different loan production technology.

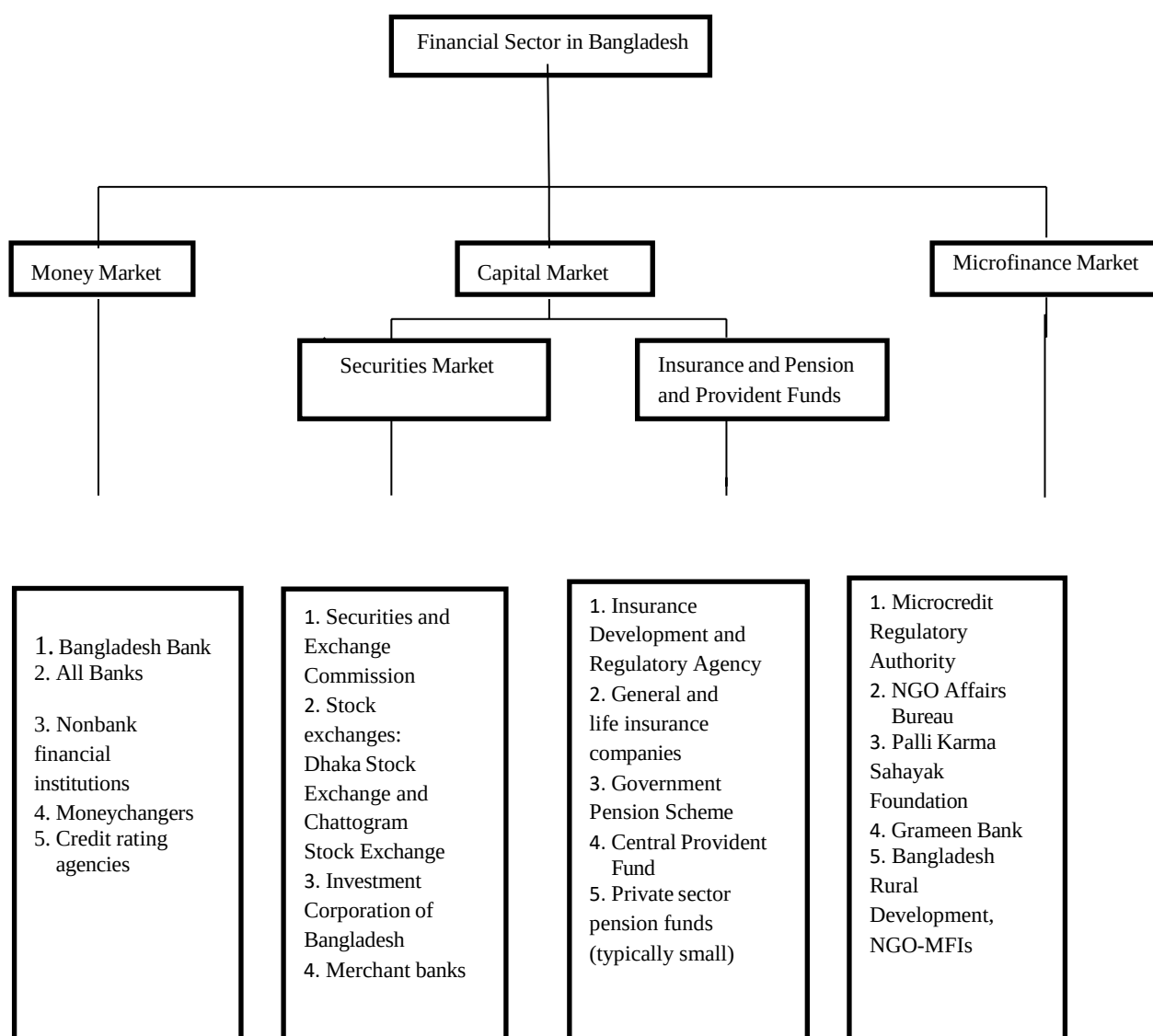
With decades of consistently high growth in financial resources, deposit liabilities, and loans, Bangladesh's financial sector is relatively sound and stable. Even though Bangladesh's financial architecture began to take shape in the public sphere following independence, the financial industry is currently dominated by new generations of private banks and financial organisations. In addition to state-owned and private commercial banks, specialised banks, insurance companies, and other nonbank financial institutions (NBFIs), Bangladesh has become the world leader in microfinance institutions (MFIs) throughout the years. ATMs, Agent Banking, and several multibank switches are examples of the alternative banking channels that the banks have developed. In this regard, mobile financial services (MFS) have become a viable option for expanding the availability of transaction sites and creating alternative banking channels.

Bangladesh's financial system has undergone significant changes over the years, particularly in reaction to the real economy's continuous development and shifting structure. Specifically, there have been notable advancements in the financial inclusion environment in recent years. The expansion of both formal (banks) and quasi-formal (NGO-MFIs, cooperatives) institutions, as well as the exploration of novel concepts, the utilisation of emerging technologies, and experience-based learning, have all contributed to the swift expansion of the country's financial institution network.

3.1 Overview of Current Landscape

Figure 3.1 depicts the overall organisation of the financial sector in Bangladesh as of right now. In recent years, Bangladesh's banking sector has flourished and developed a robust infrastructure. The Post Office, savings organisations, 17 life insurance firms, 191,396 cooperatives, 61 banks, 739 MFIs, 33 NBFIs, and other providers that cater to both individuals and businesses are included in Table 3.1. credit unions as well as several new suppliers of digital financial services (DFS). Big businesses and investors also use a variety of service providers that are rarely linked to financial inclusion but can be crucial. For instance, venture capital firms and capital markets provide a source of funding for significant, game-changing investments in infrastructure or businesses.

Figure 3.1: Financial Sector of Bangladesh



Source: Chief Economist's Unit, Bangladesh Bank

Banks rely nearly exclusively on deposits when it comes to liabilities. The Bangladesh Bank estimates that during FY 2021–2022, bank deposits were Tk 15,181.4 billion, of which 88 per cent were time deposits and about 20 per cent came from rural regions. Over time, the trend in the composition of deposits has stayed relatively unchanged. Over the past ten years, there has been a notable growth in the percentage of rural deposits. The total deposits in regions outside of municipalities and city corporations increased from Tk 1,610 billion at the start of 2016 to Tk 3,400 billion in June 2022, according to Bangladesh Bank. Since beneficiaries in rural areas get 90 per cent of the inbound remittances from overseas workers, remittance earnings are primarily responsible for the increase in rural savings (BB 2022).

Table 3.1: Overview of financial services landscape in Bangladesh

		Total number of institutions	Total number of branches	% of rural branches	Financial services provided			
					Savings	Credit	Payments	Insurance
Banks	State owned commercial banks	6	3,801	53.6	✓	✓	✓	
	Private commercial banks	43	5,421	36.6	✓	✓	✓	
	Foreign commercial banks	9	67	0.0	✓	✓	✓	
	Specialised banks	3	1,504	80.9	✓	✓	✓	
	Non-scheduled banks	5	3,441	NA	✓	✓	✓	
NBFIs	State owned NBFIs	5	NA	NA	✓	✓		
	Private NBFIs	30	NA	NA	✓	✓		
MFIs	MRA licensed MFIs	731	23,543	NA	✓	✓		
	Cooperatives	191,396	NA	NA	✓	✓		
Insurers	Life Insurance companies	18	NA	NA				✓
	Public sector life insurance	1	NA	NA				✓
	Non-life Insurance companies	44	NA	NA				✓
	Public sector non-life insurance	1	NA	NA				✓

Note: NBFIs are non-bank financial institutions. Two types of banks are recognised: scheduled banks, which can perform all types of banking functions; and non-scheduled banks, specialised banks with restricted functions.

Source: Bangladesh Bank, Microcredit Regulatory Authority, Ministry of Local Government, Rural Development & Cooperatives.

Furthermore, those who live in rural and isolated places may now access financial services and deposit their money into the banking system thanks to alternative transaction channels like agent banking and mobile banking. In July 2022, there were more than 180 million mobile bank accounts, surpassing the 165 million people who now make up the nation's overall population. Additionally, the Bangladesh Bank reports that 56 per cent of account holders are from rural regions.

Large deposits from rural regions have also been made into agent banking, the second rapidly expanding alternative banking channel. Rural regions accounted for 78 per cent of the Tk 280 billion in total deposits made through agent banking through June 2022. Rural deposits' percentage of total bank deposits rose from 20 per cent to 21.6 per cent throughout this time due to a rise in deposits by this client group as a result of urban residents' growing incomes (BB 2022).

The majority of financial sector entities in Bangladesh are distinguished by a combination of private and state ownership. Six state-owned commercial banks (SOCBs), three government-owned specialised banks—two of which are focused on lending to agriculture and rural areas—43 private commercial banks (PCBs), and nine foreign commercial banks (FCBs) comprise the banking sector, for instance (Table 3.1).

Thirty of the 33 NBFIs are privately held, while five are controlled by the government. Forty-four businesses offer general (non-life) insurance, whereas eighteen companies offer life insurance. The two sizable, state-owned firms that dominate the market are Jiban Bima Corporation (JBC) for life insurance and Sadharan Bima Corporation (SBC) for general insurance. Microfinance institutions (MFIs) have expanded quickly, and in Bangladesh, they, together with other formal financial institutions (SOCBs and specialised banks), specialised government agencies, and nongovernment organisations (NGOs), carry out microfinance programmes. In July 2006, the Microcredit Regulatory Authority Act 2006 was passed by the Bangladesh Government in an effort to increase accountability and transparency in the microfinance industry's operations. To carry out the Act and give the microfinance industry a complete regulatory framework, the Microcredit Regulatory Authority (MRA) was founded.

3.2 Growth of Rural Financial Sector

While general access to financial services has improved fairly marginally after independence, Bangladesh's financial industry has developed significantly. The rural financial market has shrunk in comparison, despite the government's attempts to improve access and the financial sector's explosive growth. Furthermore, rural farmers and business owners, particularly those operating CMSMEs, also referred to as the 'missing middle', continue to have restricted access to financing.

The primary measures of financial development show that Bangladesh's financial industry has been steadily expanding. In 2022, the broad money (M2) to GDP ratio, which measures the level of monetisation relative to the real economy, was 43.01 per cent (BB 2022). Increasing the number of bank branches typically intensifies financial services like deposits and advances. But despite policies prioritising financial inclusion, the distribution of branches remains highly skewed. Both the amounts of deposit and advances have increased over the years in the rural areas. But the banks are still concentrated in the urban areas while under-serving the rural population and the rural economy in terms of investment. In fact, the share of advances in rural regions has been declining over the past few years -- from 49.5 per cent in 2007 to 44 per cent in 2021. On the contrary, advances as share of deposits in urban regions have remained above 80 per cent till 2021. This shows that despite rising number of branches in rural areas, branches do not lend as much as the urban ones and tend to transfer resources to urban areas perhaps due to lower expected risk. However, although Bangladesh's ratio is relatively low in absolute terms, the continuously rising trend suggests that the financial sector has a growing capacity to channel surplus savings into productive investments. Despite the central bank's efforts to guarantee rural residents' access to financing, bank branches in rural regions have decreased by 11.5 per cent over the last 18 years compared with the metropolitan areas. According to a 2019 Bangladesh Bank report titled "Survey on Impact Analysis of Access to Finance in Bangladesh," there were 6,119 bank branches overall in 2000, with 2,460 (40.2 per cent) located in urban regions and 3,659 (59.8 per cent) in rural areas. However, in June 2018, the percentage of bank branches in rural regions fell to 48.3 per cent, while the percentage in urban areas rose to 51.7 per cent (Table 3.2). In 2018, the total number of branches rose to 10,114.

The distribution of bank branches between rural and urban regions suggests that the majority of the branches were located in the latter. In terms of profitability, an urban branch may turn a profit in as little as a year, whereas a rural branch may take three to five years to do so. The study identifies the

upgradation of rural areas into urban areas as a reason behind the decline in the ratio of rural branches against urban branches. Although the banks have started to expand branches in the rural areas afterwards, the ratio still remains poor. On the other hand, foreign banks have only a few branches in the rural areas.

Rural areas are also deprived in terms of getting advances or loans as banks disburse 10 per cent of their advances to the rural areas although these entities collect about 20 per cent of deposits from these areas. According to the BB study, banks received Tk 214,280 crore out of Tk 1036,640 crore of deposits from the rural areas whereas they disbursed Tk 86,310 crore out of Tk 847,020 crore of advances in the rural areas. The demand for finance of the small and cottage industries are mostly fulfilled by the microfinance institutions (MFIs) in the rural areas.

In December 2009, there were 4.98 bank branches per 100,000 people; by March 2018, that number had risen to 6.04. In addition to BB's efforts to guarantee rural communities' access to banking, agent banking, mobile financial services, and MFIs are also playing significant roles in this regard. Access to financial services is hampered from the customer's perspective by social exclusion, low income or assets, lack of understanding, and financial illiteracy. From a structural perspective, frequent grounds for exclusion include staff attitudes, inconvenient products and services, lengthy paperwork and other processes, branch timing, and distance from the bank branch. However, despite the fact that informal credit is more expensive than other forms of credit, its availability, flexibility, and other alluring qualities still keep it popular.

Table 3.2: Branches, deposits and advances in the banking system by rural and urban areas

Year	Number of branches			Deposits (billion BDT)			Advances (billion BDT)		
	Urban	Rural	Total	Rural	Urban	Total	Rural	Urban	Total
2000	2,460	3,659	6,119	160.6	549.2	709.8	100.1	493.5	593.6
2005	2,638	3,764	6,402	218.3	1,197.6	1,415.9	117.6	999.7	1,117.3
2010	3,265	4,393	7,658	436.9	2,942.3	3,379.2	206.9	2,367.5	2,574.4
2015	3,944	5,187	9,131	1,575.1	2,942.3	7,939.8	571.3	5,227.3	5,798.6
2018(June)	5,224	4,890	10,114	2,142.8	8,223.6	10,366.4	863.1	7,607.1	8,470.2
2022 (June)	5,324	5,639	10,963	3,395.3	12,343.0	15,738.3	1,460.2	11,526.4	12,986.6
2023 (June)	5,856	5,356	11,212	3,590.0	13,288.2	16,878.2	1,944.46	14,232.43	16,176.89

Note: Figures reported by Statistics Department are different from those of Department of Off-site Supervision due to different data collecting methods.

Source: Statistics Department, Bangladesh Bank

However, in terms of branch deepening, MFIs have made a significant progress and it is much higher than that of banks. From around 13 branches per 100,000 adult populations in 2004, MFI branches increased to over 27 branches per 100,000 adult populations in 2013. Compared with the banks, the depth of MFI branches per 1,000 square kilometers is even larger. In 2004, over 49 MFI branches were present per 1,000 kilometers but the number has significantly grown by 2013, reaching close to 118 branches per 1,000 kilometers (CDF, 2024). Even though cooperatives and credit unions surpass both of MFIs and banks in terms of density, but these are either societies or samities, which are not branches and formal institutions. Relatively speaking, the borrower density in MFIs is high although significant overlapping is also present. The broader and increasing outreach of MFIs plays a significant role in the amount of loans disbursed and number of outstanding borrowers. Both annual loan disbursement and number of outstanding borrowers have been on increasing trends. Total annual loan disbursed during 2020-2021 stood at Tk 1,618,850 million, disbursed by 502 MFIs during the year 2020-2021 while the number of outstanding borrower was 5,664 million. The amount of

loan outstanding followed similar pattern with nearly Tk 583 billion. Additionally, loan outstanding as a share of disbursement is relatively stable at around 60 per cent since 2010 (Source: CDF, Bangladesh Microfinance Statistics 2020-2021, Dhaka)

3.3 Status of Informal Credit Market

Along with accessing the bank and microfinance components of the rural financial market (RFM), individuals and enterprises also access the informal credit market as and when required. Although aggregate and precise information on informal credit market in Bangladesh is not readily available, the anecdotal and sketchy evidence on informal credit mostly based on micro studies indicates the important role of informal finance that it plays in RFM. Rahman et. al. (1989), using a major study on informal finance in Bangladesh, provide a focused analysis on the size of informal credit and associated terms and conditions. The study shows that informal credit market continues to exist despite wide expansion of the formal and microcredit market network. Some unique features and diverse products are the reasons behind its wide existence and popularity. Conventionally, informal finance has usually been looked from the perspective of exploitation, but its positive role in development and expanding financial services remains unrecognised (Rahman 1992).

4. Rural Finance in Bangladesh: Demand Side Perspectives

Nearly 69 per cent of the total population live in the rural areas (Report of the Bangladesh Population and Housing Census 2022) making the rural sector as the most critical to Bangladesh's development. However, the rural people are generally constrained in accessing appropriate financial services from the formal financial institutions (e.g. banks) for various reasons. The ratio of bank branches in rural and urban areas is now 48:52 (Branch Statistics, Bangladesh Bank, August 2022). In terms of deposit collection, around 20 per cent of the total deposits are gathered from the rural areas whereas only 10 per cent of advances are delivered to the rural areas. According to the aforementioned, metropolitan regions have a significantly greater bank density than rural ones, and rural families' and businesses' level of bank access has not kept up with that of their urban counterparts.

4.1 Access to Rural Credit Market – Available Options

In practice, rural households and enterprises can access three different segments of the rural credit market – formal bank credit, microfinance and informal credit. These three segments of the market are different in nature and characteristics. Generally, bank credit is offered from bank branches. Therefore, transaction cost (non-interest cost) of accessing bank's financial services, other things remaining the same, is relatively high. Bank credit usually requires collateral as security, and hence the banks are more inclined to provide services to enterprises and/or households with higher ability to provide collateral. Further, being profit maximisers, banks are more inclined to provide loan of relatively large size. As such, rural poor or low income households and rural cottage, micro, small and medium enterprises (CMSMEs) remain mostly excluded from the formal bank credit market.

In Bangladesh, in common with most developing countries, the majority of the rural people lack access to formal bank credit/financial services. People who cannot access formal services generally belong to low levels of income, as they are also extremely vulnerable to various idiosyncratic and covariate shocks (Binswanger and Rozenzweig 1986; Townsend 1994; Jalan and Ravallion 1999). In addition, lack of collateral and inability to save limits the poor to go to the formal banking system. Rural households and enterprises often do not use financial services from formal banks because the services are relatively more expensive and sometimes even unsuitable to serve their needs and demands (Claessens 2006). Many small borrowers do not apply for loan because of high transaction cost and incidence of high rejection rates. These costs can be considered as non-interest cost of borrowing. Due to high non-interest cost of borrowing, the low income groups are less keen to access credit from formal banks. Instead, they prefer to access informal and/or microfinance segments of the rural finance market (RFM).

Informal credit is generally segmented by localised levels of operation. Lenders include friends, relatives, neighbours, shopkeepers, professional moneylenders and suppliers of trade credit. Transaction cost of both lending and borrowing is relatively low because of minimum problem of asymmetric information and close monitoring. Long-term relationship forms the basis of informal credit. Lending interest rate is not necessarily always very high; but usually it is quite high (e.g. Khalily et al 2012; Hussain and Bayes 2009). The average annual interest rate is generally around 35 per cent in Bangladesh. Most importantly, loan products are diversified covering both economic and non-economic purposes. There is no rigid loan agreement; loan contracts are flexible in nature and it reflects individual status. Customer groups include both poor and non-poor. Given the resource constraint of the informal lenders, loan size is reasonably low but the lending is based on the intensity of risk (Adam et al. 1984; Aleem 1990; Udry 1990; Bardhan 1984). Informal market is flexible not only in terms of loan terms and conditions, but also in terms of providing credit for both economic and non-economic purposes such as consumption, social ceremony, migration etc. Formal market

does not provide loans for these purposes. As majority of low income people in rural areas are very prone to any kind of shocks, they need credit for non-productive purposes quite often. However, the informal market often fails to meet the credit demand of the rural poor to some extent. The formal money lenders (mahajans) of the informal market often provide small loans and charge high interest rate. These loans are very costly and often lead the rural poor to fall under the debt trap.

Microfinance institutions (MFIs) aim to address the failures of both formal and informal markets, and the microfinance market has emerged as the alternative market for the poor and low income households. The MFIs offer services to the poor or low income households with some distinct group-based, by and large, production technology featured by self-selection and joint liability (Jaffee and Stiglitz 1990; Matin 1997; Ghatak and Guinnane 1999). Consequently, the higher risk of lender-MFIs is reasonably low because of availability of more information and strict monitoring by both field level staff and joint monitoring by members of the group. Unlike the formal market, collateral is not required to receive loan from this market. Household level services make loan costly – high lending interest rate covers high transaction cost. But non-interest cost of borrowing for the borrowers is negligible. A close monitoring of field level staff reduces problem of moral hazard. However, the loan size is generally small.

In terms of cost, on an average, cost of informal loans, in most cases, is lower than bank credit and microfinance. On the other hand, the cost of bank credit is generally lower than microfinance, but the poor are excluded. Therefore, on the assumption of everybody having access to all segments of the rural credit market, potential rural borrowers will decide on access to different market segments based on the terms and conditions and non-interest cost of borrowing. The rural poor and low income households have limited choice as they can access only microfinance and informal credit markets.

Given the characteristics, as outlined above, of all credit market segments, what choices do the potential borrowers have? A number of factors influence the choice of credit market, including transaction costs, interest rates, contract flexibility, and the variety of loan products available. Based on an examination of a panel data set of 62 Bangladesh villages, Hussain and Bayes (2009) demonstrate that rural families have greater access to microfinance, with the percentage rising from 3.8 per cent in 1998 to 34.1 per cent in 2008. Meanwhile, the percentage of households who borrowed from informal sources (such friends and relatives) fell from 16.9 per cent in 1998 to 4.9 per cent in 2008. However, the informal market accounted for the largest portion of the overall loan supply. They contend that the demand for non-economic loans for things like social ceremonies, consumption, education, medical treatment, and home repair following natural catastrophes is what drives the majority of the informal lending industry. Conversely, they often take out loans from institutional sources and use the money for profitable endeavours like non-agricultural and agricultural enterprises. As a result, loan products have a significant role in determining the option of access to various credit markets. Khalily et al. (2012) also show similar results.

However, not all low-income households that borrow money are able to satisfy their entire credit needs through microfinance or informal lending. Borrowers often continue to be partially credit rationed in both formal and informal markets due to the intrinsic limitations of both markets, such as the informal credit market's cap on the size of individual loan funds and the microfinance market's loan size maximum. In light of the likelihood of credit rationing, terms and conditions are important when applying for loan. Nonetheless, it is true that a significant portion of rural impoverished households' funding comes from the informal credit market.

4.2 Microfinance in Bangladesh: An Overview

With a total of around Tk 1,717.07 billion in outstanding loans and a savings portfolio of approximately Tk 833 billion, the MFIs in Bangladesh offer credit, savings, and other financial and human development services to over 50 million low-income members and microenterprises (Table 4.1). Six categories include the credit services provided by the microfinance sector: (i) general microcredit for small-scale self-employment-based activities; (ii) microenterprise loans; (iii) loans for the ultra-poor; (iv) agricultural loans; (v) seasonal loans; and (vi) disaster management loans. Loans up to Tk 50,000 are often categorised as microcredit, whereas loans beyond that sum are categorised as microenterprise loans.

Additionally, around 65 per cent of microfinance operations occur in rural regions, and roughly 91 per cent of microfinance members are women (CDF, Bangladesh Microfinance Statistics 2020-2021, Dhaka). According to the Microcredit Regulatory Authority (MRA) Annual Statistics, June 2023, there were 728 licensed MFIs as of December 31, 2023, with 25,336 branches and 206,000 workers. In Bangladesh, the microfinance industry has a comparatively high concentration ratio, with the two biggest MFIs, BRAC and ASA, accounting for around half of all outstanding loans and deposits. Over four million microfinance borrowers are served by each of them. The two biggest MFIs control more than half of the clients and entire financial portfolios, while the top 20 MFIs own about three-quarters of the market share overall.

In order to provide broad and long-lasting development effects, the microfinance industry in Bangladesh has undergone tremendous change over the years, moving from group-based, small-scale microcredit operations to individual microenterprise operations. Over the years, microcredit has evolved from its primary function of assisting the impoverished with their basic necessities to fostering a wider range of agricultural and nonfarm endeavors as well as the microbusinesses of the microentrepreneurs and graduating microcredit borrowers. In Bangladesh, the MFIs have a rare chance to become significant development partners, particularly in trying times like the ongoing Covid-19 outbreak. The emphasis on ‘appropriate’ finance is the reason for this. It entails increasing credit to meet threshold levels of activities for creating sustainable livelihoods, focussing on remote and extremely poor areas, mobilising the poor to support social development, increasing awareness of health, education, women's empowerment, and other social issues, and giving them access to technologies and opportunities for earning a respectable living.

Table 4.1: Features of microfinance sector in Bangladesh

	2023-24	2015-16
Reporting MFIs, number	505	530
No. of members/clients, million	50.61	37.66
No. of outstanding borrowers, million	38.45	30.61
Of which:		
Microcredit borrowers, million	30.80	27.36
Microenterprise borrowers, million	6.53	3.25
Others, million	1.12	...
Loan disbursement during the year, billion Tk	2,800.42	955.77
Of which:		
Microenterprise loan, billion Tk	1,058.87	277.88
Outstanding portfolio, billion Tk	1,717.07	611.62
Volume of member savings, billion Tk	832.68	294.11

Note: In 2023-24, out of a total credit disbursement of Tk 2,800.42 billion by the MFIs, Tk 1,676.19 billion (59.85 per cent) was microcredit, Tk 1,058.87 billion (37.81 per cent) was microenterprise loan while the remaining Tk 65.36 billion

(2.33 per cent) was credit for other activities, such as sufalan, moushumi, ultra-poor, disaster, social development and other purposes.

Source: CDF, 2024

In the rural economy, MFIs form a major source of rural finance especially in disbursing credit to small (especially cottage and microenterprises, CMEs), informal rural enterprises and farm households. According to the Credit and Development Forum (CDF), a network of MFIs in Bangladesh, the reporting MFIs (505 in number) disbursed a total of Tk. 2,800.42 billion in 2023-24 to 38.45 million borrowers in the country. Out of the total amount, the share of microcredit is 59.85 per cent while 37.81 per cent have been distributed as microenterprise loan and 2.33 per cent as loan under other special programmes (e.g. sufalan, moushumi, ultra poor, disaster, social development etc.). During the year, total savings of the members is Tk. 832.68 billion (CDF, 2024).

The broad sectoral pattern of loan disbursement is given in Table 4.2. It is seen that nearly 51.75 per cent of the loan have been distributed to agriculture, nearly 36 per cent to small business and industries sector and 1.84 per cent in social sector. Of the remaining amount, 3.26 per cent have gone to rural housing and the rest 6.88 per cent to other activities.

It is also seen that of the total amount of loan disbursed during the year, about 6.4 per cent have gone to remote areas (2.1 per cent in char areas, 1.3 per cent in haor areas, 0.8 per cent in hilly areas, and 2.2 per cent in coastal areas). In terms of the amount of borrowed fund by MFIs, the statistics shows that during 2020-21, a total of 258 MFIs borrowed Tk. 165.73 billion from the banks; on the other hand, 468 MFIs had term-deposits of Tk. 247.87 billion with the banks.

Table 4.2: Sector-wise MFI loan disbursement in Bangladesh, 2023-24

Sector	Disbursement of Loan (including ME & Others) (million Tk)	Share in total %
Agriculture sector*	1,449,162	51.75
Small business & industries sector**	1,015,534	36.26
Social sector***	51,527	1.84
Rural housing****	91,431	3.26
Others	192,762	6.88
Total	2,800,416	100

*All crops/Nursery, Irrigation assistance, Livestock, Animal husbandry, Diary, Poultry, Fishery, etc.

** All types of small trade & business, Small & cottage industries, Rural transport, Food & food processing, Electronics, T Parlor, Solar, Photostat, etc.

***Education, Health & medication, Rehabilitation of destitute, Disabled & Autistic, Rural infrastructure, etc.

**** Construction of rural housing & repairing works, etc.

Source: Credit and Development Forum (CDF), Bangladesh Microfinance Statistics 2023-24.

Many low-income individuals and microbusiness owners in Bangladesh depend on several financial services provided by MFIs, such as credit, savings, remittance transfers, loan insurance, etc. Prior to their engagement in the microfinance industry, the majority of these individuals were financially excluded. These changes have also led MFIs to add commercial and other sources of funding (like bank loans) to their own produced funding (like members' savings).

As a result, over time, the funding of MFI operations has grown to include loanable funds from a range of sources, including member savings, cumulative net surplus, commercial bank borrowing, concessional loans from a variety of sources, including the Palli Karma-Sahayak Foundation (PKSF), loans from large MFIs in the area, loans from non-institutional sources (like board and client members), reserve funds, staff security funds, loan loss provision funds, and other sources like

government funds, welfare funds, depreciation funds, emergency funds, and donations. Together, member/client deposits account for almost 43 per cent of MFIs' total funding, with cumulative net surplus coming in second at roughly 31 per cent and bank borrowings coming in third at 19 per cent. Furthermore, a significant source of loan funds for PKSF's partner organizations (POs) is the microfinance wholesale funding agency's (PKSF) subsidised loans, with the remaining sources being comparatively little (CDF, 2022).

MFIs have made significant contributions throughout the years to increasing low-income households' and the poor's access to microfinance services nationwide. In Bangladesh, microfinance for IGAs is largely seen as morally righteous and is recognised as beneficial in the country's attempts to combat poverty, particularly for impoverished women. Additionally, it is maintained that microfinance is a reasonably effective way to help the underprivileged (Becker and Posner 2009). However, these opinions have not gone uncontested. Even if microloan interest rates are somewhat high, this is seen to be a good way to limit the amount of microloan available to borrowers who can generate enough income to pay for it. Because the impoverished may borrow in an attempt to escape a vicious cycle of debt, this self-selection process is far from ideal in practice. Additionally, there can be issues with moral hazard (Banerjee and Jackson, 2017).

Although there is much debate on microfinance's ability to alleviate poverty in Bangladesh, a thorough evaluation of this sector's potential must use an economy-wide perspective. Microfinance is likely to be not a long-term solution to poverty, even if it can offer some short-term respite, particularly when impoverished households own little land or other productive assets.

Small farms are unlikely to fully utilise the robust positive economies of scale that exist in contemporary agriculture and reap the long-term benefits. Without robust general economic development and technical advancements, nonfarm economic options could likewise continue to be restricted. Since women in Bangladesh get the majority of microloans, microfinance's contribution to raising women's status and bargaining power within the family is more significant. Despite counter-evidence that suggests greater access to microfinance does not improve women's health and educational status, increase their access to consumer goods, or improve their role in household decision-making (e.g. Banerjee et al., 2015), these findings may be situational, context-specific, and contingent on the patriarchal nature of society. Microloans can be ineffective in empowering women if men maintain a firm grasp on the household resources. Overall, though, things are looking better in Bangladesh society, where a large number of women have gained confidence and succeeded as microbusiness owners by utilising microcredit as a springboard.

NGOs and civic organisations have collaborated with Bangladesh's local government institutions (LGIs) over the years to bring about revolutionary changes at the local level and establish connections with higher authorities, not only through government programmes but also by changing the fundamental attitudes and behaviours that support social development. When taken as a whole, these little initiatives have given Bangladesh a strong boost to produce quick social results that have accelerated social growth and change.

Furthermore, a sizable portion of low-income and vulnerable households—including those led by women and labourers—continue to be excluded from the financial services network. The adoption of suitable technology and the creation of a range of financial products are necessary for the financial inclusion of these marginalised groups in order to enable them to gradually overcome their current state of economic fragility and instability. This calls for both financial access and non-financial measures like training and capacity building to eliminate obstacles to financial services. Similar to this, low-income vulnerable poor households in locations that are comparatively harder to reach require particular policies that address a variety of topics, including governance, financial

infrastructure, laws, and funding availability. To ensure that credit rationing does not limit their ability to bring new low-income and vulnerable poor household groups into the financial network, MFIs must also properly balance funding microenterprises (MEs), financing the IGAs of disadvantaged and impoverished groups, and making larger loans.

In the framework of financial inclusion, MFIs could also endeavour to create fresh and creative financial services and products with terms and conditions better suited for the risk-averse and vulnerable segments of low-income families. These financial services and products most likely need to place more focus on diversifying sources of income, building up productive assets, and implementing risk-reduction strategies (like microinsurance) for risk-averse and vulnerable impoverished families. Evidently, it is necessary to determine the barriers preventing the expansion of MFI services to more low-income and vulnerable households as well as to less accessible and relatively susceptible locations. Then, in collaboration with other stakeholders, these barriers need to be removed. In less accessible locations, technologies such as ATMs, online banking, and mobile banking may open up new ways for lenders and borrowers to lower risks. Demand-side interventions are required in addition to suitable supply-side policies to guarantee that low-income and impoverished families are financially literate and capable of making effective and efficient use of the services.

4.3 Digital Financial Services and RFM

Increasing access to financial services, particularly for the impoverished in rural areas, is a top objective for RFM in order to assist them in embracing new and more efficient technologies and sources of income. Their prospects of escaping poverty will also be improved by this access, which will help them combat unanticipated dangers and personal financial difficulties.

In order to give impoverished households access to dependable and reasonably priced financial services, the government policy is to leverage the quick developments in digital payment systems and mobile communications. The policy initiatives emphasise how crucial it is to help impoverished families have more access to efficient digital financial services (DFS) for credit, insurance, savings, and payments, particularly in times of need. Financial services would help the impoverished find new and more productive employment, invest in new ventures, or effectively embrace new farming technology. At the same time, many individuals would be spared from reverting to poverty or becoming significantly poorer as a result of health issues, financial difficulties, and other shocks if they have access to DFS.

Thanks to MFIs and digital operators, a process that involves simple yet efficient advancements in the use of digital technology is already progressing swiftly in Bangladesh. This includes the launch of the digital wallet, an electronic prepaid card with mobile banking capabilities that makes use of mobile devices, ATMs, and other e-banking platforms. By lowering transaction costs to levels that potentially open the door to more efficient usage of financial goods and services that were unprofitable under previous technology, these advances help reach a larger proportion of the impoverished. Additionally, this might result in the development of savings products that are more affordable for the impoverished, better fit their cash flow issues, and assist with future spending requirements.

The Bangladesh Bank, the nation's mobile money regulator, has adopted the bank-led strategy and made significant new investments in innovation and technology. Mobile carriers have already provided a number of social VAS, but MFS providers have adopted a range of VAS in the mobile money environment. Digital initiatives in Bangladesh have progressed in two ways: (i) in the banking sector with the introduction of the internet, SMS, ATMs, and point-of-sale (POS)-based transactions; and (ii) at the mobile wallet/bank account level through MFS. Electronic fund transfers, national

payment switches, online credit and supervisory reporting, Bangladesh's automated clearing house, and real-time gross settlement systems are just a few of the enablement that Bangladesh Bank has put in place to support DFS.

In order to implement e-KYC, Bangladesh Bank is collaborating with the NID authorities to integrate NID with digital banking and the MFS system. Numerous projects have also been implemented, including Rural Savings Bank, Ektee Bari Ektee Khamar, Rural branches, POS, agent banking, union digital centres, and G2P payments connected to NID. There are several chances to expand access to financial services and products in Bangladesh due to the extensive network of MFIs and other FSPs. Similar to this, by expanding technology (such as mobile banking) and implementing regulatory and legislative efforts for FSPs, considerable progress may be achieved in creating inclusive financial institutions in unserved and unbanked areas as well as in regions susceptible to natural catastrophes. It goes without saying that the current gaps in universal financial inclusion constitute both a challenge and an opportunity to guarantee that all Bangladeshis have efficient access to and usage of financial products and services.

4.4 Current State of Rural Finance Market

Between 2005 and 2010, the country's banks saw a growth in the number of deposit and credit accounts per 1,000 people, from 242 to 333 and 51 to 63, respectively. While the number of credit accounts actually decreased from 53 in 2005 to 51 in 2010, the number of deposit accounts in rural regions increased from 127 to 189 during the same time period. This demonstrates that a sizable portion of Bangladesh's population—mostly the impoverished in both rural and urban areas—does not have access to established financial institutions. Bangladesh Bank needs to adopt and implement a thorough and complete guideline for establishing an inclusive financial system incorporating formal banks and financial institutions in order to promote access to financial services at the necessary pace and extent (Mujeri 2015).

Agriculture is essential to rural development in the rural sector. Due to particular barriers to serving rural and agricultural markets, financial services have historically been scarce or inadequate for rural inhabitants, small and marginal farmers, and other micro and small business owners. The lack of adequate financial services in these sectors will need to be addressed by policymakers if they hope to successfully advance agricultural and rural nonfarm development, or more generally, rural development.

According to some research, small and marginal farmers as well as other small business owners in rural regions typically lack access to suitable financial services from formal financial institutions, such as banks. As a result, MFIs ought to seize the opportunity to grow their rural businesses. Micro, small, and medium enterprise owners and household (group) borrowers are currently served by MFIs. MFIs employ group guarantees as collateral because they do not require any collateral from the borrowers. In this situation, microenterprise loans are typically granted to borrowers who have previously repaid a microloan or who are repeat borrowers with credit histories.

According to a survey conducted on rural MSMEs in the early 2000s, just 32 per cent of these businesses were able to borrow from banks in 2003–06, even though they made extensive use of bank services (45 per cent had an account and 75 per cent transferred funds) (Ferrari, 2008). Of these businesses, 44 per cent did not borrow at all during that time, while 16 per cent borrowed from MFIs and 8 per cent from informal sources, namely relatives and family. Their average loan amount while borrowing from banks was Tk 40,000, and when borrowing from MFIs, it was Tk 38,000. Just 33 per cent of these MSMEs financed new investments using borrowing. Numerous direct and indirect expenses were cited as the basis for not requesting credit. Interest rates and other transaction charges

are examples of direct costs. Long processing times and rigorous application procedures that need several meetings between banks and borrowers are examples of indirect expenses. On average, it took 40 days to obtain a loan from a bank and 28 days to obtain one from an MFI once all the necessary paperwork was filed. Furthermore, according to the survey, moveable assets make up 73 per cent of the average asset value of MSMEs, although banks typically need immovable assets as principal security in 86 per cent of cases (InM 2015).

Andrianaivo et al. (2018) estimate the overall demand for credit based on employment size and regional distribution using data from the 2013 Economic Census. An estimate of the overall loan demand may be obtained by multiplying the average loan demand by the number of businesses. A substantial funding shortfall of Tk 170 billion (about USD 2 billion) appears to be present. The poor and rural families have greater access to quasi-formal finance (52 per cent and 46 per cent, respectively), according to another InM research titled "Access to Financial Services" (A2Fs, 2010 and 2014). Conversely, urban families (54 per cent) and those who are not impoverished (44 per cent) have more access to formal financing. This is not unexpected given that MFIs primarily serve the impoverished in rural regions and that those who are not impoverished are better able to fulfill the standards for formal financing.

It is evident that while around 52 per cent of impoverished families have access to quasi-formal financing, 40 per cent of non-poor households have as well. Additionally, it is evident that the majority of rural families (56 per cent) are borrowers, whereas the majority of urban households (67 per cent) are savers. Higher penetration of the formal market in urban regions and a larger presence of the quasi-formal market in rural areas are associated with the urban-rural divide. The government's and NGOs' extensive coverage of poverty-targeted programmes and the growth of MFIs have undoubtedly increased the intensity of financial services access for rural households and the impoverished (See BB's July 2019 Survey on Impact Analysis of Access to Finance in Bangladesh).

As demonstrated by Hasan (2003), it is still difficult to provide microfinance to the most impoverished people in rural regions. While rural finance at present targets the impoverished on a large scale and shows that they are potential loan clients, but most of these exclusively serve the wealthiest members of rural society and offer restricted financial services with inflexible policies and processes that, in many respects, fail to meet the requirements of the most impoverished. Although microfinance has generally improved the lives of rural poor people, others contend that it has not been able to reach the poorest of the poor (Datta 2004).

A number of policy measures, such as the opening of bank branches, provision of novel and inventive deposit and credit products tailored to the requirements and preferences of particular groups, and other creative delivery and accessing systems for the country's banking system, are required to give rural areas the attention they deserve. There has already been some changes in the relevant rules and regulations by Bangladesh Bank such as: changing rules for bank branch opening from 5:1 to 1:1 (for opening 1 urban branch, 1 rural branch has to be opened instead of 1 rural for 5 urban branches); offering quality banking services to farmers by allowing them to open bank accounts with minimum initial deposit (Tk 10 only); issuing branch licenses to all SMEs/agriculture service centres; providing easy and effective access to banking services for physically challenged people, hard core poor, unemployed youth, freedom fighters and similar other priority categories; relaxing conditions of loan repayment and providing fresh facilities to natural calamity affected farmers; ensuring participation in agriculture/rural credit for all banks mandatory; providing agriculture credit to sharecroppers; formulating and implementing agriculture and SME credit policies and loan targets; putting emphasis on financing women entrepreneurs; arranging refinancing schemes for banks; developing ICT solutions (mobile banking, smart card etc.) for inclusive banking; encouraging formation of creative

partnerships between banks and MFIs; enacting policy guidelines for green banking and agent banking etc. (Bangladesh Bank 2019).

At the national level, access to the microfinance market has consistently been greater than that of the formal sector. The majority of the services offered in this industry are credit and savings. In terms of financial deepening, microfinance has outperformed the formal sector despite these fundamental services. According to a research conducted in 2014, 47 per cent of households have access to these services. The combined aggregate data shows that 61 per cent of families have access to the microfinance sector, which may not appear like a significant change from the previous figures (Table 4.3).

In terms of geographic locations, more than half of the households in the four divisions have access. Nonetheless, more families utilize microfinance services than banks or official institutions in districts like Khulna, Rajshahi, and Rangpur. However, residents in Chattogram, Dhaka, and Barishal have access to both sectors. Formal finance is a comparatively prominent industry, and the Sylhet division has the lowest percentage of households in the microfinance sector. The results of earlier studies showed that a much greater proportion of rural families than urban ones could be able to utilise microfinance services. Nonetheless, this report indicates that microfinance's reach in cities has increased. Though it is still less than in rural regions, over 45 per cent of urban families are able to access these services; still, the growth of the microfinance industry is noteworthy. The bulk of families using microfinance are impoverished, which makes sense given that microcredit programmes are aimed at the country's impoverished citizens. Although estimations show that there are more impoverished homes than there should be, there have also been a considerable number of non-poor households. This can be explained by the fact that a large percentage of impoverished families graduate and/or that non-poor households are mistargeted (see Access to financial services in Bangladesh, InM 2015).

Table 4.3: Distribution of access in microfinance market

	2014¹ Cross-Section (Past 3 years)	2010² Cross-Section (Past 5 years)	Aggregate³ (Past 8 years)
National	46.91	43.23	61.32
DIVISION			
Barishal	54.04	53.3	67.85
Chattogram	38.54	36.14	51.60
Dhaka	39.35	41.42	57.69
Khulna	57.48	35.35	65.10
Rajshahi	36.41	56.17	69.55
Sylhet	35.60	24.7	45.88
Rangpur	58.99	N/A	76.03
REGION			
Rural	47.34	46.39	63.90
Urban	45.43	30.88	52.41
POVERTY STATUS			
Non- Poor	45.72	39.67	59.93
Poor	50.57	51.7	65.58

Note:¹ Survey conducted in 2014, covering 2011-13. ² Survey conducted in 2010 covering 2005-2009. ³ Combined with survey conducted in 2010, covering 2005-2013 *Not a division in 2010

Source: Access to financial services in Bangladesh, InM 2015

5. Rural Finance Policy and Regulatory Framework

The manner in which the government has intervened in the rural financial sector has varied greatly during the years since independence. The goal of giving farm households access to affordable finance in order to boost output and guarantee larger agricultural investments has frequently served as the driving force for the intervention. The government gave subsidised credit to the targeted households, mostly in the 1970s and 1980s, using funds from the government budget and donor organisations. Interest rate regulation, lending quotas, directed and subsidised credits, special refinance facilities for agricultural lending, credit guarantees for small farmers, and the establishment and state funding of specialised agricultural development banks (such as Rajshahi Krishi Unnayan Bank, RAKUB, and Bangladesh Krishi Bank, BKB) were among the various government interventions.

However, as significant loan repayment issues and defaults resulted in significant write-offs of agricultural loans as well as the rehabilitation and recapitalisation of state-owned financial institutions, these strategies turned out to be mostly counterproductive. Furthermore, given the existence of ‘urban bias’ in development, many of these initiatives were carried out during periods when general macroeconomic policies, such as those pertaining to pricing, commerce, and foreign exchange, discriminated against agriculture and rural regions. However, more rural-friendly regulations have been established in recent years with the adoption of market-based development plans, and customers and financial institutions have been learning how to adapt to these new circumstances.

Some of the issues faced by rural financial institutions have been highlighted throughout time by the high transaction costs and hazards associated with providing financial services in these locations; however, these issues have also been exacerbated by unsuitable government policies and initiatives. Government actions in rural financial markets have occasionally resulted in distortions and deterrents for private financial institutions to participate. Due to significant economic ramifications, the massive loan subsidies also turned out to be onerous and unsustainable in hindsight.

At present, the main objective is to provide sufficient and sustainable financial services to the rural and farm sector in order to increase their productivity, with the added goal of promoting financial inclusion. In the past, the government's intervention in the rural credit market was justified by the policy to encourage the adoption of green revolution technologies, particularly by small farmers. Furthermore, the microfinance revolution since the 1970s has shown how effective it is to implement market-oriented policies and regulations and to let private institutions collaborate with the impoverished to create savings and loan products that meet their needs.

As a result, rural financial institutions have become increasingly receptive to the advantages of market orientation over time. Since the 1990s, in particular, the government has been creating regulations and policies that would support the rural financial sector without distorting it. In reality, since the 1990s, there has been a noticeable change towards policies that are better suited to rural areas and a market-based approach to the development of financial markets in order to tackle the problems of the twenty-first century. The primary obstacle in this situation, however, is the rural financial system's vulnerability, which is typified by its poor sustainability and restricted outreach, both of which were exacerbated by previous unfavourable policies and actions. Many rural institutions are still in poor shape and only exist as a result of government assistance and financing. Their financial infrastructure is unsupportive, they lack the technical know-how to assess credit risks, and government policies frequently fall short of the urgently needed extensive reforms of rural financial institutions.

5.1 Changing Face of Rural Finance

Post-independence approach to developing rural financial market

The post-independence (covering the 1970s and 1980s) approach to developing the rural financial market can be summarised in several trends:

- A major expansion in rural banking outlets;
- Rapid increases in agricultural loan disbursements;
- Different institutions providing loans often without collateral and some making long-term loans;
- Special food production programmes introduced providing subsidised credit and inputs to the farmers; and
- By enforcing credit quotas, establishing credit guarantees, and mandating the opening of rural bank branches in exchange for permission to create urban branches, the government pushed or required financial institutions to expand agricultural lending.

However, the policies created several problems as well:

1. Loan recovery emerged as a serious problem.
2. The farmers were typically charged cheap interest rates that did not account for the cost of loans. Large farms were frequently enticed to preempt the limited supply as a result.
3. Availability of medium- and long-term loans was limited, and the volume of agricultural credit often declined relative to funds allocated to manufacturing.

Furthermore, the small farmer credit programmes did not effectively serve the target demographics, despite the fact that the green revolution technologies raised the need for operations and investment credit. Credit usage could not be stimulated or directed in the proper direction by interest, input subsidies, or procedures to regulate input use. Either the demand or the institutions' ability to effectively manage loans was outpaced by the quick growth of credit institutions. Despite the enormous efforts made to institutionalise the provision of agricultural finance and establish rural organisations, many institutional problems remained unsolved. For a large portion of the 1970s and 1980s, officials pursued directed agricultural loans vigorously in spite of these issues. The overall strategy was distinguished by a number of characteristics:

- Generally, lending interest rates were subsidised and small farmer loans in particular were set at especially low rates. The government and donors were the main sources of funds and local savings mobilisation was largely ignored.
- In many cases, production packages were created with credit treated as an input like HYV seeds and chemical fertiliser. Credit was targeted for 'productive purposes' only, while loans for consumption and rural nonfarm enterprises were ignored. Many credit programmes specifically targeted small/marginal farmers and employed supervised credit through cooperatives/farmer groups to ensure proper use.
- Cooperatives were often the primary credit channels, while commercial banks and agricultural development banks also played important roles. The objective of government policy was to increase the supply of loans to the farmers with little attention paid to institutional sustainability of credit providing institutions. Several programmes broadened their target

groups to cover the rural poor as well.

- In providing and obtaining financial services, transaction expenses for both lenders and borrowers were mostly disregarded.

Rural finance policy after the 1980s

Despite the revealed weaknesses of the rural financial system and inadequate capacities of most institutions to channel 'good' loans and ensure timely recovery, subsidising borrowers continued to remain the primary objective of rural credit and sustainability of financial institutions remained a secondary goal after the 1980s as well. However, there was little proof that the subsidies actually reached the targeted borrowers or that the use of subsidised loans improved agricultural productivity and the adoption of new technologies. The principal issues were remarkably similar to those seen in the 1970s and 1980s, except a few notable exceptions:

1. Interest rates were often too low to cover the costs and risks of agricultural/rural lending. The MFIs usually set their rates high enough to cover most costs, but a combination of regulations and administrative pressures kept many agricultural lenders from raising rates to adequate levels.
2. The adoption of a market-oriented approach to rural finance was largely resisted. Targeted programmes, subsidised refinance funds, and restrictions on the clientele that could be served persisted although some of the repressive features of directed credit were eliminated.
3. Nonperforming loans in the banking sector posed a serious problem. Many rural financial institutions, especially the agricultural development banks, were weak and continued to perform only through fresh capital injection and subsidies from the government.
4. The focus of rural finance was primarily on agriculture and did not adequately cater to the broader demand for financial services by the rural nonfarm economy including the CMSMEs. Most rural financial institutions lacked the capacity to make long-term loans and utilise the explosion in new information and communication technologies (ICTs) used by the modern banking industry.

Box 1 : Impact of BB's agricultural credit refinance scheme for BKB and RAKUB

In order to increase agricultural and rural credit in the nation, Bangladesh Bank (BB) has been developing an annual Agriculture and Rural Credit Policy and Program since gaining independence in 1971. In order to improve the flow of credit to the rural economy, BB also offers refinance facilities to Rajshahi Krishi Unnayan Bank (RAKUB) and Bangladesh Krishi Bank (BKB). In order to assist BKB and RAKUB in carrying out the monetary policy, BB offers them refinancing facilities; the availability of refinance is contingent upon the monetary policy's flexibility and accommodating posture.

The net disbursement of agricultural and non-farm rural loans by NGO-MFIs is generally positive, which is optimistic for lowering the financial gap between rural and urban regions. When comparing the percentage of outstanding loans that are past due to banks, it is also evident that NGO-MFIs perform better. The big NGO-MFIs' effectiveness in client selection, loan collection, and field-level administration in providing agricultural and non-farm rural loans is demonstrated by the fact that, on average, 3.5 per cent of their outstanding credit is past due. In comparison, the average percentage of past-due loans for all banks, including BRDB and BSBL, was 22.6 per cent. As a result, NGO-MFIs in Bangladesh outperform BKB, RAKUB, and other banks.

The basic goal of the BB's re-finance scheme, which was to increase the production of agricultural commodities, including food grains, and to financially support the rural population in order to improve their economic conditions, has been accomplished. This is demonstrated by the comparison of the target and control groups in terms of asset, income, expenditure, and per acre production of agricultural commodities, as well as by the highlights of various qualitative assessments.

As this analysis shows that BB's re-finance scheme's fundamental goals have been met, BB should keep it going for BKB and RAKUB and increase its scope and institutional reach in accordance with the monetary policy's overarching goals. The study also shows that administrative and management limitations at the banks, not the borrowers' financial difficulties, are what hinder fast credit recovery and repayment to BKB and RAKUB.

Credit will be disbursed directly to the borrowers through the respective branch offices of BKB and RAKUB by opening a 10-Taka Account following a thorough review of the recommended lists of the NGOs/third parties. For proper loan administration, BKB and RAKUB may think about enlisting local NGOs or any other third party as partners to make recommendations for credit disbursement. At the conclusion of each month, the NGOs or third parties will also collect their portion of realized interest and follow up with borrowers to ensure they pay back their loans at the branch level on time. NGOs or other third parties may also be tasked with collecting deposits through the mobile banking system and recovering non-performing loans. In order to involve NGOs or other third parties in a few chosen branches, BKB and RAKUB may first implement test programs. Successful models can then be repeated in additional branches across the nation.

"Report on Impact Assessment of Bangladesh Bank's Re-finance Scheme for Financing Agricultural & Non-farm Rural Borrowers of Bangladesh Krishi Bank and Rajshahi Krishi Unnayan Bank," January 2015, Research Department, Bangladesh Bank

5.2 Review of Rural Finance Policies and Institutions

Outreach and self-sustainability are generally regarded as the two best ways to evaluate the effectiveness of rural financial institutions (Christen et al., 1995; Yaron, Benjamin, and Piprek, 1997). The level of market coverage for low-income populations that did not previously have access to formal financial services is referred to as outreach. It encompasses both the vertical (depth/level of client poverty) and horizontal (breadth of outreach/number of clients serviced) dimensions. Furthermore, it's crucial to take into account the range and kinds of financial services that are provided.

The ability of a financial institution to continuously pay costs while providing financial services without the need for outside subsidies is referred to as sustainability. The Subsidy Dependence Index (SDI) can effectively be used to evaluate the degree of subsidisation of a financial organization (Yaron, 1992). Sustainability is advantageous for two primary reasons: firstly, while short access to loans yields some benefits, establishing a long-term sustainable financial connection is more beneficial as it facilitates potential for future gains. A lasting institution will serve more clients than

one that initially experiences rapid growth but subsequently fails. Second, if borrowers make timely repayments, they may anticipate long-term access to services since a sustainable organization is not financially dependent on the government or donors. This promotes the expansion of institutions and offers some defense against noneconomic meddling.

But in the case of MFIs, some academics worry that outreach and sustainability may have to be sacrificed (e.g. Hulme and Mosley, 1996). Instead of providing modest loans to newly impoverished consumers, MFIs aiming for self-sustainability may attempt to cut expenses by offering bigger repeat loans to existing clients. Although attaining greater outreach depth may compromise sustainability if the expenses and risks of lending are not offset by interest income, establishing economies of scale through expanded outreach might enhance sustainability as per-unit lending costs diminish with increased loan volume.

Box 2 : Bangladesh Bank sets farm loan disbursement target at Tk 309 billion for FY2022-23

Bangladesh Bank's Agricultural and Rural Credit Policy and Programme for FY2022-23 published in July 2022 has raised the agriculture and rural loan disbursement target by nearly 8.9 per cent to Tk. 309.11 billion compared with the disbursement target of Tk283.91 billion for FY2021-22. The disbursement target for state-owned and specialised commercial banks has been set at Tk 117.58 billion, while the aim for private and foreign commercial banks is Tk 191.53 billion, in light of the rising demand for agricultural and rural loans. All scheduled commercial banks disbursed Tk 288.34 billion in agricultural and rural loans during FY2021-22, exceeding the target of Tk 283.91 billion. A total of 3.31 million borrowers obtained the agricultural and rural credits, with 1.80 million of them being women who received Tk 108.29 billion. Additionally, several banks gave 2.50 million small and marginal farmers about Tk 201.82 billion. Additionally, Tk 195.90 million was distributed to 4,073 farmers in the country's less developed regions, including Char and Haor.

One of the main engines of Bangladesh's economy is agriculture. In light of the recent global food crisis and the Covid-19 epidemic, the significance of agriculture is becoming increasingly apparent. Bangladesh Bank is providing the required funding to support the growth of the agriculture industry. Additionally, Bangladesh Bank's annual Agricultural and Rural Credit Policy and Program for FY2022-23 aims to mobilise and ensure the necessary credit flows to the rural areas in order to accomplish the government's three main SDGs: eradicating poverty, ensuring safe and nutritious food, and ensuring good health and well-being.

A number of new provisions have been added to this fiscal year's agricultural credit policy in order to guarantee food security for everybody and create a sustainable agricultural credit system. These include adding credit standards for raising ducks under the poultry subsector, adding credit standards for growing chia seeds, teen fruit and sugar bits, adding credit standards for growing Vietnamese hybrid coconut, coffee and sweet corn, adding credit standards for growing seaweed, adding credit standards for growing lobster under the fisheries subsector, adding group loan disbursement to easily increase the credit limit per acre for crop cultivation and more.

Source: Bangladesh Bank, Annual Agricultural and Rural Credit Policy for FY2022-23

Obviously, better performance of rural financial institutions depends on a host of factors, but a few systematic factors may be identified that influence the success of these institutions. They can be summarised within a three-pronged analytical framework: policy environment, financial infrastructure, and institutional development.

Policy environment

There are many policy issues that influence the prospects for developing sound rural financial market in the country. Two important issues are: interest rates and client selection.

Interest rates: The primary issue is that interest rates for agricultural loans are frequently regulated. Nevertheless, interest rates must be sufficiently elevated to enable financial institutions to generate interest margins that will offset operational expenses and losses. In order to encourage savers to

deposit money for lending, they need to have positive returns in real terms. Additionally, banks need to make enough money to cover reserves, reinvest in future development, and provide a fair return on capital. In order to cover expenses and risks, institutions must be allowed to set their own prices for loans and other services. Bangladesh implements well-meaning interest rate limits for certain industries or customer groups, but this compromises sustainability. Low interest rate policies are meant to help borrowers, but they also make financial institutions—particularly state-owned ones—more dependent on government subsidies.

The second issue is that institutions that are market-oriented—that is, privately owned—need to compete with those that receive subsidies. Subsidised credit harms other rural financial institutions, therefore this might become a major issue. Since these loans may be viewed as subsidies, the lenient terms and lax enforcement practices linked to special subsidised programmes might threaten the payback culture. For this reason, networks other than financial institutions could be used to distribute emergency aid.

Client selection: The ability to choose clients freely is frequently associated with the ability to establish interest rates. Programmes for subsidised credit typically have limitations about the target population. The likelihood that the lender may be compelled to invest in an undiversified, hazardous portfolio increases with the specificity of the target group (small/marginal farmers, for example). Furthermore, the possibility of noneconomic intervention in the distribution of credit increases with the size of the subsidy.

Because this will limit portfolio diversity as a safeguard against systemic risks, focused programmes that are limited to serving a certain group or kind of customer could be avoided as much as feasible. Instead of being singled out by a particular programme, customers could choose to use the items provided by particular institutions. Client and institutional freedom of choice enables the development of a banking relationship in which clients know that financial services are provided because they are regarded as valued customers.

Financial infrastructure

The financial infrastructure required to facilitate financial intermediation is one of the elements of the rural financial market that is frequently disregarded. Since infrastructure has an impact on all financial institutions' costs, it is significant.

Legal and regulatory framework: Building solid financial institutions requires a sufficient legal and regulatory environment. For the time being, the MFIs can sidestep certain issues that banks face, such as difficult legal processes for loan collection. Peer pressure and the availability of fresh loans may encourage consumers to repay, making the legal system less significant. However, when more conventional means of contract enforcement are needed for bigger loans, issues may arise.

Information systems: By facilitating better access to information on the legal status of land pledged as collateral, efficient and trustworthy land titling lowers transaction costs for lenders. As financial markets become more complex, effective methods are needed to provide information on borrowers' debt and repayment history. To find out whether loan applicants have outstanding loans elsewhere, lenders want easy access to up-to-date, reliable information. In order for all institutions to be aware of a borrower's debt position, regulated institutions are often required to disclose the names of delinquent borrowers; non-regulated institutions typically do not have this information.

Institutional development

A thorough institutional development approach that takes into account the intricate relationships between the institution's architecture, administration and governance, incentive structures, human capital development, and other elements can help rural financial institutions become more successful.

Design of products and services: Two goals need to be taken into account when financial organisations create certain products and services. The first is anticipated customer demand, taking into account conflicting formal and informal sources. The second is the capacity to make money while covering expenses, either through one transaction or several throughout the course of the customer relationship. Financial institutions can successfully develop products and technology for short-term working capital loans without official security, but they may not be able to effectively compete with the informal sector in providing extremely modest, emergency loans. The organisations may test and modify their products to meet customer needs through pilot projects, test marketing, and market research. Additionally, the institutions are able to lend for a variety of purposes because they understand that customers often know the best way to use their loans, but they still demand full payback regardless of how the money is spent.

Loan recovery: Recovery of loans frequently determines whether financial institutions succeed or fail. Repayment rates are influenced by several factors. First, profitable banks create products that improve borrowers' capacity to pay back, such as modest loans with repayment plans tailored to borrowers' cash flow. The MFIs adopt a weekly payback plan that allows for regular customer interaction and makes each payment minimal. Dropping clients might indicate that new technology and products are needed. One reason may be that the loan products, repayment plans, and savings criteria are too strict and could be more tailored to the needs of the customers.

Second, there are two ways that institutions might boost borrowers' desire to repay. Repayment of joint-liability loans may be encouraged by peer pressure among group members. Even more crucial is the favourable perception of businesses looking to build lasting relationships with their customers, which encourages excellent payback by raising the prospect of future loans with better terms and conditions.

A third aspect influencing repayment is timely client information. Because of the institutions' effective internal information systems, loan officers are able to promptly notify clients when loans are past due, follow up with them, and make arrangements for repayment. The open weekly meetings of MFIs, when savings deposits and loan payments are processed, give consumers a clear method to see who is behind on payments and put a lot of social pressure on past-due borrowers.

Management and governance: Large organisations with hundreds of outlets and thousands of employees are difficult to manage in remote locations with inadequate communication infrastructure. The institutions ought to gain a reputation for having competent administration and a great deal of autonomy in their daily operations.

Staff incentive systems: The majority of successful organisations use performance-based incentive programmes for both management and employees. Bonuses can be given based on an employee's efficiency or the overall success of the organisation. Because their pay is greater than that of some comparable positions in the public or private sectors, employees want to stay with their current employer. Loan officers are encouraged by incentives to handle a sizable portfolio and service a lot of clients. Social commitment and teamwork may be leveraged to improve employee performance.

Human capital development: To find top talent, organisations can apply a variety of hiring and recruitment strategies. The institution's mission can be instilled and specialised skills taught through

intensive training programmes. New personnel may be designated as trainees or apprentices prior to their employment as permanent staff. Loan officers may get more loan approval power with experience, and the decentralisation of decision-making is facilitated by investments in human capital development.

Despite the inadequate condition of rural finance, a vigorous microfinance movement arose, encompassing the specialist Grameen Bank and several NGOs that provided microcredit to the impoverished, predominantly in rural regions. These micro-lenders attained considerable breadth (clientele size) and depth (clients' poverty levels) of outreach, but with a substantial reliance on subsidies. Most also circumvented the adverse debt phenomenon that afflicted the banks. As a result, bank and cooperative lending diminished relative to agricultural GDP, although the aggregate quantity of loans from banks, cooperatives, and NGOs increased.

Regarding the future of rural finance, there was also a great deal of uncertainty. Although the NGOs were able to take a more market-oriented stance than the banks, they were unable to fully cover the costs and risks associated with lending. For their existence, they continued to rely on erratic government and donor funding.

Since some NGOs started actively mobilising voluntary deposits, regulation of NGOs was also starting to become a significant problem. Additionally, some started to provide more accommodating loan terms and conditions than were customary in the early phases of an NGO's development. A number of institutions' portfolio quality was impacted by some borrowers' excessive debt as a result of the NGOs' increasing competitiveness.

To enable the rural financial sector to meet policy targets and withstand both internal and external shocks and crises, the government and Bangladesh Bank have been working to establish a sound financial infrastructure, including regulatory and policy frameworks covering pro-rural policies and improved supervision of financial institutions, despite the obstacles.

The government began concentrating on developing an enabling policy and regulatory environment for a sound rural financial market, which includes the microfinance sector, as a result of the microfinance sector's maturity and the proven feasibility and viability of lending money to low-income borrowers. In order to improve the regulatory and supervisory frameworks, the Microcredit Regulatory Authority (MRA) was established in 2006. This, among other things, forced all financial institutions to improve their risk and liquidity management. Since the 1990s, financial sector reform initiatives have been put into place, which are necessary for a market economy to function. Although financial institutions are now able to charge market-based interest rates thanks to partially deregulated financial laws, the government nevertheless offers subsidised loans to specific targeted industries (such as CMSMEs and agriculture).

Bangladesh Bank has grown increasingly conscious of the significance of prioritising more robust bank supervision that is based on risk exposure management and the decrease of non-performing loans, in tandem with the financial sector's deregulation and related reforms. In order to strengthen local capacity for effective financial intermediation, there has also been a greater focus on institution construction. In the case of microfinance, the MRA has acknowledged the unique characteristics and quirks of the industry, established laws that are suitable, and implemented supervisory procedures that are sensitive to the demands of the delivery of microfinance services and products.

Understanding how crucial financial inclusion is and in order to guarantee financial inclusion for all adults of the country, Bangladesh has adopted the five-year National Financial Inclusion Strategy (NFIS) in 2021. The provision of a broad variety of financial services, including credit, insurance, savings, remittances, and payment services, particularly to the underprivileged and impoverished who

have historically been unable to engage in the formal financial system, is known as financial inclusion. The fundamental strategy is to increase the number of impoverished individuals who have access to the financial system by means of extensive and pervasive delivery channels (banks and non-bank entities), which may be tailored to more efficiently serve those who are financially excluded.

Financial innovations, which give the impoverished improved access to financial services in the context of poverty and exclusion, can help advance financial inclusion. The development of solutions allowing the unbanked to access and participate in financial markets is greatly aided by modern information and communications technologies (ICTs). In order to solve the issue of the poor remaining unbanked despite the advancements in financial reforms, Bangladesh has become a leader in the use of agent banking and mobile financial services (MFS) technology. Rural financial institutions, such as MFIs, have begun to use mobile communications technologies to provide traditional banking services like deposit taking, savings withdrawal, payment transactions, and more, capitalising on the increasing use of mobile phones by a large portion of the population.

Although Bangladesh's microfinance and rural financial sectors have been growing and developing, there are some new issues that have surfaced. Stakeholders in the dynamic and rapidly evolving microfinance sector have also seen shifts in how they view risk. Some detrimental effects of increased competition may have been observed in recent years. With the possibility of potentially significant loan losses for MFIs, the rivalry for clients is likely to promote 'bad' lending practices and dwindling business, which would contribute to the pervasive issue of excessive debt.

The incapacity of MFIs to keep track of their clients' debt levels exacerbates the issue. Lending officers frequently pay less attention to client screening because they are too preoccupied with lending quotas or targets, which are based on profitability and performance goals. Highly indebted clients might not allow the scope to access more liquidity by adopting processes such as: they might take out another loan to pay back debts that are about to mature or just spend the extra loan for consumption. The likelihood of the loans not being repaid becomes actual throughout this procedure. This might indicate that the microfinance market has become 'saturated' due to inadequate governance and systemic elements as well as unfavourable regulatory actions.

Concerns have also been raised about the MFIs' lack of necessary institutional strength. For these institutions, corporate governance and management quality are two of the biggest risk factors. Although the MFI sector has grown quickly in terms of expanding access and developing novel products, microfinance runs the danger of falling short of one of its goals if excessive debt and the issues that go along with it are the result.

Main objectives

Generate tangible and long-lasting social and economic benefits for underprivileged and low-income groups. Rural financial institutions, including banks, specialised banks, and other financial institutions, MFIs, cooperatives, finance companies, and other rural organisations, have been able to respond to market opportunities provided by a permissive but prudential regulatory environment thanks to the rapidly evolving policy and regulatory frameworks in the rural finance sector. The government continues to interfere in the rural financial sector through subsidised credits, loan quotas, controlled interest rates, and other measures, even though it has been enacting market-friendly changes in this area.

As a result, Bangladesh still uses a variety of institutions for rural finance and microfinance delivery, such as government and commercial banks, specialised banks (such BKB and RAKUB), NBFIs, cooperatives, NGO-MFIs, self-help organisations, and other grassroots organisations. The predominance of specialised banks and MFIs as formal loan providers is a shared trait. The country

has embraced and created a broad spectrum of public and private financial institutions or intermediaries over the years that are best suited to offer microfinance and rural finance services in various local financial and economic contexts.

5.3 Conclusions and Implications

To address the difficulties of the upcoming decades, the rural financial market in the country needs to undergo significant developments in several strategic directions.

Government policies are inadequately helpful at present, financial infrastructure is unsupportive, and many institutions lack the technical expertise to assess credit risks. Financial markets are undergoing a transformation because of the rapid development and availability of new information and communication technologies, but rural financial institutions remain mostly isolated from these advancements. The first indicator of growing financial dualism is the disparity in access to financial services between rural and urban people and businesses. The ‘digital divide’, which divides those who use modern computers and communication technology from those who do not, is a second aspect of financial dualism.

A new paradigm utilising a more market-oriented strategy has arisen, whereas policymakers in the past have used the directed lending method to create the rural financial market during the last few decades. Using this new paradigm may be the reason for the relative success of many microfinance programmes. The rural financial market might not be able to succeed in serving rural regions if it continues to operate under the outdated paradigm.

Important issues in the rural financial sector are identified by the core analytical framework, which consists of the regulatory environment, financial infrastructure, and institutional development. All three areas require improvement. For rural finance to be successfully reformed, the failed institutions—particularly agricultural development banks—need to be adequately restructured. A few flagship financial organisations are available that can act as examples for other institutions.

Furthermore, if given the opportunity, freedom, and funding, the country's highly skilled workforce, although very few in number, might still manage institutions and develop innovative financial technologies. The government's responsibilities include establishing institutions, investing in infrastructure that supports them, and fostering a positive atmosphere. The government needs also to acknowledge the contribution of the private sector to the financial system and refrain from actions that jeopardise the stability of institutions, such as attempting to address social issues by directing subsidised loans via financial institutions. Bangladesh has the capacity to establish robust rural banking systems that are focused on the market. To make the required adjustments, the critical issue is to possess the vision and the will. It needs to be acknowledged that the rural elite profits from the status quo, while the poor suffer as a result.

Serving the country's rural clients is undoubtedly difficult given the enormous number of rural poor people and low availability of required resources, as well as the high frequency of natural catastrophes and the negative effects of climate change.

Serving rural and agricultural communities undoubtedly entails significant risks and expenses’, thus extending the formal financial frontier goes beyond merely repeating microfinance. Furthermore, merely adhering to the outdated rural finance model will not be sufficient to address the complex issues of current rural dynamics of development. When the right policies and institutional architecture are implemented, Bangladesh could create and duplicate successful flagship institutions that have the potential for significant outreach and sustainability.

6. Rural Finance Policy: Future Perspectives

Rural finance is an essential instrument for guaranteeing Bangladesh's future rural development, which will support and advance the country's longer-term journey towards becoming a high income country. One of the main challenges for rural finance is to ensure that two target groups—small and marginal farmers and the rural nonfarm sector, which includes CMSMEs—have access to financing for productive activities with drastically differing potentials emerging from the country's rapid structural transformation in a globalised world. Designing and operationalising a comprehensive framework for rural finance, as well as implementing actual standards and regional plans that allow for both innovation and the consolidation of successful practices, would be the next step.

It needs to be acknowledged, nonetheless, that rural finance is not a cure-all. It is one of many crucial areas for action, and its full impact will only be achieved when sectoral and macro policies are supportive, modern technologies are available and innovations are encouraged, markets are active, market linkages are robust, and nonfinancial and business development services are offered. Furthermore, it could be necessary to directly promote microbusinesses and revenue-generating ventures, income transfers, safety nets and social security, as well as better infrastructure and human development services, in order to more successfully reach the underprivileged and impoverished segments of rural population. Realising that a policy cannot address every area that requires intervention and policies should not be imposed from above is crucial. In addition to providing room for local modifications and financial innovations, it must be tailored to the unique socioeconomic context of each community and location.

A wide range of financial service providers (FSPs), including MFIs, financial cooperatives, and other nonbank financial institutions, need to be accommodated in addition to the traditional commercial banks because of the large number and diversity of stakeholders in rural areas and the need for multiple financial products and services that meet the needs and demands of each stakeholder. Additionally, new and expanded channels for the effective delivery of rural financial services could be made possible by technical advancements such as digital and mobile financial services. The reality is that without effective institutions, rural finance would move through ineffective channels of interconnected cash or in-kind transactions, including credit from suppliers, processors, and dealers. Table 6.1 summarises the key aspects of recent advancements and the main issues with rural finance in the present times, based on this current review.

Table 6.1: Recent developments and major shortcomings of rural finance in Bangladesh

Area	Recent developments	Major shortcomings
Policy environment	Macroeconomic stability; financial sector deregulation; ease of setting up banks or branches; digital/mobile banking and technological innovations in financial sector; bringing MFIs under regulation; government emphasis on financial inclusion and adoption of National Financial Inclusion Strategy (NFIS).	Inadequate policy, regulatory and legal environments. Protracted execution of deregulation; insufficient property rights and sluggish legal processes.
Specialised rural (agricultural) development banks	Reforms aimed at enhancing autonomy, viability, and self-reliance without resorting to privatisation.	Administrative/external interference in performance of activities; lack of financial viability; inadequacy and absence of effective mechanisms in meeting the demands for credit and other financial services especially to the low income segments and CMSMEs.
Rural and agricultural finance	Gradual replacement of borrowings from money lenders by self-financing from profits and savings as well as commercial credit from banks and MFIs.	Inadequate availability of self-financing and commercial credit to meet the demand for short and long-term finance; own savings mobilisation is insufficient.
Microfinance institutions (MFIs)	Regulatory/legal framework available for commercially-operating MFIs; privately financed start-ups; availability of a number of self-sustaining 'large' MFIs.	Inadequate availability of funds for microfinance/microenterprise operations; bottlenecks in adopting new technologies to reduce operational costs; danger of 'mission drift' and potential conflict between social mission and financial sustainability.
Non-formal financial institutions	Framework accessible for advancement to formal tiers and for financial market integration	Upgrading potential of informal financial institutions remains largely untapped
Nongovernment organisations (NGOs)	Innovative approaches available for social development and poverty alleviating lending in rural environments especially for left behind communities; possibility of successful conversions to formal intermediaries exists.	High dependence on donor support and external financing limit autonomy and sustainability, low focus on mobilising domestic resources and in striving for self-reliance.
Access of the poor and left behind communities to financial services	Outreach of MFIs (including banks) to the poor rising along with innovative programmes	Vast majority of the poor people, including members of left behind communities particularly in marginal areas, lack access to savings, credit and other financial services.

6.1 Key Challenges of Rural Finance

From the experience of the vast majority of the rural communities, the new consensus that has emerged in Bangladesh and other developing countries indicates that many of the poor can and do actually save, invest and repay their loans. They need access to financial services, particularly:

- Deposit facilities that allow them to accumulate and safely store money for use in self-financing economic operations and consumption smoothing, with flexible regulations and processes tailored to their convenience;
- Credit for funding their production/income-generating activities and for smoothing consumption; and
- Insurance services for crisis-coping and risk mitigation, social security and loan protection.

For the poor rural households, savings are important for financing of own subsistence and low-return activities while credit is important for undertaking relatively high return activities. For the future, it would be important to accelerate the savings and credit cycle by enhancing savings or credit as the first entry point as appropriate and initiate sustainable rural financial institution-building.

The only financial institutions that can consistently deliver sufficient financial services and broaden their reach to the impoverished are those that are viable. Financial institutions are strong because they can lower transaction costs, manage risks, distribute limited resources effectively, and make their resources increase dynamically. Therefore, for rural financial institutions, there are five principles of sustainability.

1. Viability: Ensure the coverage of costs at the margin.
2. Self-reliance: Build capacity to mobilise own resources.
3. Financial self-sufficiency: Activities should be profitable with ability to preserve the value of the resources of the enterprise.
4. Outreach: Enterprise should acquire the ability to continually broaden the services demanded by the poor.
5. Impact: The activities undertaken should help the poor to help themselves.

To sustainably offer the range of financial services required by various household groups and business types, the rural financial sector needs to have a diversity of financial institutions operating under solid principles and in a supportive legislative and regulatory framework. Each of these organisations serves as the foundation for a successful rural banking system. Outreach and institutional sustainability may be made compatible and reinforce one another with the right strategies. But there can be short-term trade-offs between them that call for further context-specific investigation. To effectively influence rural households and businesses, a functional system of nonfinancial services—such as business development, technology and innovation, marketing, supply and extension, and others—is required in addition to finance.

Bangladesh Bank needs to strive to offer better financial and associated non-financial services in rural regions in order to support the national goals. All facets of the rural population must have access to an efficient network of rural financial institutions in order to achieve this. Bangladesh Bank will thus need to create a systems approach to provide financial services in rural areas. In addition to increasing outreach to rural residents, particularly the impoverished, this will significantly push the boundaries of institutional viability for rural financial institutions.

Own resource mobilisation is essential as a foundation for the dynamic expansion of institutional self-reliance and self-financing among microentrepreneurs and small farmers. However, the majority of rural people and businesses often lack the personal savings and household resources necessary to take full advantage of the economic prospects. Therefore, credit lines are required to cover the gap. Financial institutions that provide a wide variety of financial services while also generating personal savings are necessary for rural households, particularly those with low incomes. The key to success will be to: (i) create a unique rural financial infrastructure using a variety of strategic approaches; (ii) improve institutional sustainability by reaching out to the rural poor; and (iii) encourage a favourable regulatory and legislative climate.

6.2 Building Rural Financial Infrastructure

In reality, different financial institutions and approaches are required in rural regions. Institutions must also be customised to meet the unique needs of their clientele as well as the possibilities of the area and cultural milieu. There are marginal and depressed locations (e.g. haor regions, char areas, coastal belts etc.) with predominance of home-based agriculture and low-return activities. In these locations, small cooperatives or informal groups, which are savings-oriented and operate at nominal costs, may be the most suitable entry points.

Financial cooperatives and commercial bank branches employing individual or group technologies may be more appropriate in high-potential regions characterised by high-return agriculture, profitable rural microenterprise activities, and credit-focused microfinance institutions or banks, complemented by requisite professional business development, management services, and technical support facilities, which may be privately or community-owned.

Bangladesh Bank should promote variety and competition rather than replicate any single model at all rural locations depending on specific situations. This may include: (i) local financial institutions (e.g. local cooperatives/informal/self-help groups) including financial grassroots organisations; (ii) mainstreaming savings and credit cooperatives; (iii) supporting networking and apexing among MFIs; (iv) establishing formal cooperatives and their apex organisations; (v) transforming credit programmes into user-owned institutions; (vi) linking banks with MFIs and cooperative groups; (vii) promoting government sponsored/commercially-operated apex organisations for refinancing MFIs along with performing additional functions e.g. liquidity exchange, credit rating, credit guarantees and reinsurance; (viii) supporting traders, processors and suppliers' credit and promoting their access to refinancing institutions;⁶ (ix) promoting institutional innovations, such as (micro-) leasing companies; and (x) strengthening microfinance supervisory and monitoring capacity of MRA.

Grant assistance may be necessary for social intermediation via training, capacity and institutional development, as well as for action research to evaluate novel methodologies and disseminate findings. Numerous regions at the rural grassroots level can be identified:

- Modernising and mainstreaming local financial institutions: Particular focus should be placed on modernising and mainstreaming local financial institutions, such as self-help organisations and informal cooperatives. Although there are self-help organisations and financial cooperatives, they are often tiny and remote. Incentives for joining a network, including training and advisory services, liquidity exchange, refinancing, and

⁶ Traders, processors and suppliers may act as important channels of credit, particularly in the absence of a functioning local financial system. These channels tend to be less sustainable than institutions and less efficient in terms of transaction costs, but may provide interim solutions in the process of building up small entrepreneurs' assets and rural financial systems.

accreditation, should be utilised to encourage mainstreaming and advancement to higher legal forms.

- Networking among MFIs and facilitating the formation of apex services is a crucial strategy for enhancing the rural financial system by expanding rural financial services and institutions. Interest expression, policy discussions, training, consulting, self-regulation and oversight, bank connections and liquidity exchange, research and development, information sharing, and donor connections are a few examples of apex services. Instead of being provided by outside organisations, network apex must provide professionally managed services as a component of a legally defined sustainable structure. Subsidiaries may offer non-financial services. Until the network and its peak are completely self-sufficient, the appropriate government organisations and non-governmental organisations may serve as facilitators.
- Connecting banks with regional financial entities, including microfinance institutions and local cooperatives or self-help groups: The strategy of connecting banks with microfinance institutions and local cooperatives comprises three separate phases: (i) improve the access of rural people to credit from commercial sources through local intermediaries; (ii) integrate local financial institutions into national financial markets; and (iii) enable banks to reach out to unbanked rural population groups and micro entrepreneurs as a new market segment. This is a strategy of reaching the poor and the unbanked in a cost-effective way, in both high-potential and marginal areas. Linkage banking is becoming increasingly successful in many developing countries. It requires banks with an effective rural delivery network and local MFIs/self-help groups with sustainable operations. For success, linkage programmes may be established to strengthen the capacity of all linkage partners, bridge shortcomings in resources for refinancing, and share successful linkage lessons.

6.3 Promoting Conducive Policy and Regulatory Environment

Both inclusive rural development and an effective rural banking system depend on a favourable policy climate. The following factors are particularly significant in this context: (i) macroeconomic stability; (ii) deregulated, effective, and flexible markets as determinants of interest rates, exchange rates, and agricultural prices; and (iii) a legal system that safeguards due process, financial institution and regulatory authority autonomy, and property and land-use rights.

For financial systems to develop and remain stable, prudential regulation and oversight of financial institutions are essential. Sustainable rural development is impossible without well regulated local financial institutions that mobilise savings and draw in private resources. As part of a delegated system of self-regulation and supervision under a central financial authority, the aforementioned requires the adoption of prudential norms and standards, the formation of self-regulatory organs of MFI networks, and the adoption of suitable legal forms of local financial institutions.

6.4 Innovations in Rural Finance: Achievements and Possibilities

Wide-ranging developments in Bangladesh's rural financial sector have been spurred, particularly in recent years, by the dangers and difficulties presented by the shifting global real and financial environment, climate change, and fluctuating and frequently rising food costs. Reducing credit risks and high transaction costs, improving the poor's and unbanked peoples' access to financial services, particularly for the entrepreneurial poor, facilitating the inclusion of those who are financially excluded in financial systems, and other similar goals are the main goals of many product and process

innovations. These innovations include the creation and implementation of new financial products, new methods, new delivery systems, institutional adjustments, and other risk-reduction techniques.

One significant novelty, for instance, is that mobile phones may be used to assist transactions because many unbanked people are impoverished and mobile technology provides the potential to both alleviate financial exclusion and enhance the financial lives of consumers. By inputting a code that moves money from a personal account to the bank's account, customers may use their phones to repay loans.

Some examples of innovations

Product innovation: In recent years, several new products have been experimented and implemented by the rural financial (including microfinance) institutions in Bangladesh. These include: (i) micro-agriculture loans; (ii) housing microfinance loans; and (iii) microinsurance products.

Loans for small or marginal farming households' agricultural endeavours are known as micro-agriculture loans. MFIs often permit a one-time payment in addition to smaller, recurring installments from revenue earned from non-farm sources. Collateral may not be required and small/marginal farmers only have to accomplish simple documentation. Micro-agriculture loans are different from the regular and traditional agricultural loans of banks where payments are usually made after harvest and collateral (usually agricultural land) is required.

Existing microfinance clients as well as additional low-income and impoverished households who are unable to get traditional housing financing for home building, renovation, or acquisition are given credit through housing microfinance loans. This innovative loan product is thought to be a means of improving the living conditions of low-income households and the impoverished, which in turn improves their quality of life, productivity, and health. The justification is that low-income clients have a high demand for small loans for incremental housing repair, but this demand has not been met because banks typically offer loans for the purchase of an existing housing unit or for the purchase of a residential lot and the construction of a house.

Many MFIs have expanded their portfolios to include microinsurance due to the perceived need for social safety among low-income households. Every time a disaster strikes, such as the loss of the primary provider, floods or droughts, crippling illnesses that prohibit family members from earning a living, and other calamities, rural households are all too frequently thrust into a crisis and further into debt and poverty. The majority of MFIs include two microinsurance products in their microcredit packages: (a) health insurance, which helps the impoverished deal with crippling illnesses, improves health in low-income households, and lowers mortality; and (b) life insurance, which lessens the financial shock caused by the death of a household's primary provider. Repayment of existing debts becomes a challenge for households when the primary breadwinner passes away or suffers from a crippling disease.

Innovations in delivery mechanisms/channels: Financial services may be made accessible even in remote locations with lower transaction costs and less risk by using innovations in delivery methods or channels. Among the innovations are: (a) programmes that connect formal and informal financial intermediaries, or the use of grassroots organisations as a direct line of communication with the impoverished; (b) large banks' wholesale lending strategy; and (c) the use of information and communications technology (ICT), such as digital and mobile financial services.

Banks can expand their reach at a reduced cost by establishing connections between official and informal financial intermediaries. The informal associations are responsible for coordinating rural borrowers and clients, monitoring their development, enforcing discipline among members, notably

regarding credit utilisation and loan repayment, and marketing savings and other non-credit financial services provided by the bank. They offer training and technical support for company growth and link loans and clients to potential markets across the supply chain. The banks provide the capital for loans.

It is possible to identify several instances of delivery method advances. To reach more impoverished customers, a lot of banks collaborate with MFIs that cater to people and microbusinesses. By partnering with MFIs that have a competitive advantage in serving rural customers, pilot programs are being implemented to provide insurance services in rural regions.

By offering wholesale loans to MFIs or other organisations, commercial banks serve the retail segment of the credit markets, which entails lending directly to consumers or businesses. In this instance, wholesaling encompasses not just the supply of capital but also additional support services meant to assist retail organisations, such as cooperatives, in becoming sustainable financial intermediaries. In addition to managing and lending money, support services provide chances for capacity growth that let retail financial institutions deploy deposits. The benefit of the wholesale-retail lending approach is that the banks that route the loan money through qualified retail conduits or channels do not provide the end-borrowers with their loans directly. The drawback is that the extra layer this lending structure creates—that is, retail lending to end-borrowers following a wholesale loan—may result in interest rates for end-borrowers that are higher than what would have been charged if there had only been one lender.

Banks and MFIs are using information and communication technology (ICT) more and more to improve their business operations (such as loan monitoring and evaluation) and to connect with customers. For instance, mobile and agent banking has emerged as a way to more effectively and economically serve a huge number of potentially bankable but unbanked consumers, particularly those in remote and difficult-to-reach places. Serving all income levels, including those with low incomes, the mobile phone business offers tremendous opportunity for the integration of mobile technology, electronic money, and conventional brick and mortar networks, as well as for the development of strategic alliances between banks and non-banks. To assess the risks of lending to low-income, independent contractors, computerised credit-scoring algorithms are being tried.

Innovations in new methodologies/approaches: Value chain financing is becoming more and more popular as a way to lower loan rates to farmers, mitigate risks, and eventually receive official funding to the industry. The term "value chain" refers to a sequence of actions that enhance a final product, starting with production and continuing through processing or further development, and concluding with marketing and sale to the customer or end-user. Value chain finance, which may or may not involve assistance from official financial institutions, is the term used to describe the flow of credit or other financial services through participants along these networks. By guaranteeing a market for the produce, the value chain lowers commercial risk and makes it simpler for chain participants to secure bank and other official funding.

Effective value chain finance is crucial to the agriculture sector as it may assist small- to medium-sized farmers, merchants, and processors in optimising financial investment, resource allocation, and capacity expansion. The three predominant value chain financing alternatives are trader finance, contract farming and out-grower programs, and warehouse receipts.

Buyers and sellers of inputs and goods exchange short-term or seasonal loans (or advances) as part of trade finance, which is usually offered in commodity value chains. Typically, loans are given based on personal connections that have been made. Loans for out-grower programs and contract farming are linked to purchase agreements. The buyer and sellers have a more official or captive relationship, with the buyer committing to supply extra services like technical support and technology.

On the other hand, non-perishable commodity depositors receive warehouse receipts for keeping their goods in safe, secure warehouses, which enables banks to use the deposited inventory as collateral. Farmers and dealers who deposit their grain supply can get warehouse receipts from recognised warehouse operators, who can then apply for loans from an approved bank.

Innovations in risk-reducing mechanisms: Apart from microinsurance, there are additional instruments that seek to directly lower the risk of lending to the rural poor or agriculture, which benefits banks as well as farmers or producers and, as a result, promotes investments in these sectors. These are the weather insurance and guarantee systems that are based on indexes.

For agricultural risk management, index-based insurance products offer a compelling substitute. The viability and cost of such items have been demonstrated via pilot projects. Estimates of financial losses in index-based weather insurance contracts are derived from an index, or proxy, rather than from each policyholder's actual losses. Variables including regional rainfall, wind speed, temperature, regional area yields, and regional animal fatality rates might serve as the basis for the index.

The insurance provider starts compensating policyholders for losses when the index passes a predetermined critical threshold. Payments increase incrementally as the index deteriorates, and policyholders receive the maximum amount possible when a predetermined upper limit is reached. Experiments and pilot studies in this area are still continuing but there are a number of studies which show that weather index insurance can work and that some programmes demonstrate real capacity to scale up.

Conversely, loan guarantee programs are comparable to insurance products in that they distribute the risk of lending among the borrower, guarantor, and lender. Usually, up to 85 per cent of the bank loans made to the target customers—typically marginal farmers—are guaranteed by a government organisation or agency. According to proponents of loan guarantee programs, there are a number of circumstances that make this kind of intervention appropriate: (i) when lenders give special consideration to collateral when making lending decisions, and the majority of small agricultural entrepreneurs lack the conventional collateral to provide; (ii) when the high fixed cost of due diligence (in relation to loan size) renders it unfeasible for lenders to offer small loans; and (iii) when it is a great chance for cooperation or partnership between the public and private sectors. The loan guarantee system is not completely new, but it has been reintroduced in a number of nations with new characteristics to entice banks and encourage their use.

Financial Inclusion

Poor individuals can engage in the formal economy and enhance their socioeconomic well-being through financial inclusion. It is generally known that the only alternative available to low-income individuals or households is the costly informal money-lending industry, which is still quite prevalent in rural regions and is outside the purview of official financial institutions. In response, rural institutions and policymakers have used contemporary technology to give the unbanked access to financial services. Making innovative use of technical advancements has made it possible for the impoverished to participate more fully in the mainstream rural financial system.

The National Financial Inclusion Strategy (NFIS), adopted in 2021, is being implemented by the Bangladesh Bank. Creating and maintaining "an integrated financial system supportive to rapid and inclusive development of the country's potential sectors, be accessible and responsive to the needs of the population such that they can regularly use financial products and services to manage their cash flows and needs of livelihoods, and mitigate shocks as needed at individual, household, and enterprise levels" is the strategy's overarching goal. Three essential components that are essential to the Strategy complement the NFIS vision:

- Every adult has a personal, fully functional, secure, and regulated financial service account, made possible by modern technology;
- Every account holder has access to electronic financial service locations that are reasonably close by and offer safe, affordable, and secure cash deposit, withdrawal, and transfer services; and
- Comprehensively regulated (i) a complete spectrum of credit and other financial services and products; (ii) suitable deposit and investment products; (iii) a variety of insurance (including microinsurance) and risk management products; and (iv) legally safeguarded rights to access appropriate financial products and services from providers, as well as the right to make informed decisions, are all readily accessible and affordably priced for all households and businesses, including overseas migrant workers, their families, and Non-Resident Bangladeshis (NRBs).

To realise the established vision, the principal considerations of NFIS-B are to (i) capitalise on emerging opportunities and the collective vision of universal financial inclusion; (ii) implement evidence-based policies and credible measures that address key constraints; (iii) replicate successful practices with an emphasis on fostering a more integrated, efficient, and accessible financial sector; (iv) embrace innovations in financial inclusion and new technologies, particularly in the digital domain; (v) establish a system for providing incentives while mitigating risks and transaction costs; (vi) balance demand and supply side issues concerning product suitability, affordability/transaction costs, and alternative options. (vii) foster confidence and trust; and (viii) guarantee effective coordination and collaboration among policymakers, regulators, service providers, and other stakeholders.

7. Conclusions: Issues and Recommendations

Bangladesh has gained valuable insights from its experiences over the dynamics of financial sector over the years, and Bangladesh Bank has placed a high value on sound financial governance, financial stability, and financial discipline. The objective of financial inclusion for the unbanked, primarily impoverished individuals who have stayed out of the financial mainstream while having the capacity to be bankable, has also been adopted by Bangladesh. The creation of financial products and services that satisfy customer requirements without compromising institutional sustainability and profitability has been a growing priority for MFIs and rural financial institutions.

Financial regulators view microfinance as an important part of the country's financial infrastructure because they recognise the important contribution the microfinance industry is making to financial inclusion by helping poor and low income households better manage their household finances, which enables them to accumulate assets, smooth consumption, and insure against risk. Along with implementing market-friendly laws and regulations, Bangladesh Bank is also taking a number of steps to establish a regulatory structure and policy climate that support rural finance and microfinance. Both rural finance and microfinance institutions have responded by increasing outreach while closely monitoring profitability and sustainability when the legislative and regulatory climate is prudential and market-friendly.

The financial sector has made it possible for private lending organisations like banks, MFIs, cooperatives, and others to participate more actively in the thriving rural finance sector thanks to market-oriented reforms. Reaching target customers through government and specialised banks has continued to be a crucial part of the strategy for financing agriculture, particularly small farmers and CMSMEs. Naturally, this means giving such banks substantial subsidies so that they may offer policy loans that satisfy specific socioeconomic goals set by the government. The main takeaways, however, emphasise the need of combining prudent institutional design that prioritises financial sustainability with market-friendly financial laws and regulations. The main takeaway is that eligibility for government subsidies could be linked to specific, well-defined goals and quantifiable performance metrics.

The following are additional issues that could be resolved to guarantee sufficient and long-lasting financial service delivery in rural regions, particularly for the underprivileged:

- The rural financial system needs continuous efforts and policy measures to strengthen and develop in consistency with the rapidly changing and dynamic patterns of the rural economy.
- Excessive indebtedness might lead to significant credit risk and pose a serious danger to MFIs and the rural finance industry. Since excessive interest rates are seen as unethical, this problem may encourage lenders to conceal fees and interest rates, making the actual cost of borrowing for customers unclear or opaque.
- Flooding, drought, and other natural disasters are becoming more common as a result of climate change and environmental degradation. The majority of microfinance and rural institutions are ill-equipped to handle significant systemic risks, which can result in client deaths, worsening of clients' ability to earn income and repay loans, and a decline in the vibrancy of the local economy.
- Most rural areas have poor transportation and communication infrastructure, which makes it prohibitive and expensive for rural and microfinance institutions to provide poor residents/businesses in remote and far-flung areas with financial services.

Policymakers and interested stakeholders may want to take into account the following factors in light of the experience with thriving rural financial and microfinance markets.

1. To attract productive investments, the government should focus on implementing supportive policies and regulations, while providing rural communities with essential services, including infrastructure such as farm-to-market roads, irrigation, storage, and post-harvest facilities; research and development; training and extension; and marketing assistance. These will diminish transaction costs, mitigate risks, facilitate the flow of financing across the supply chain, and ultimately enhance value-added.
2. Alongside formulating more appropriate regulatory and supervisory frameworks for rural financial and microfinance institutions, including risk-based supervision and corporate governance, Bangladesh Bank and other regulators should continue their endeavours to establish essential financial infrastructure, such as credit bureaus and liquidity facilities.
3. The government and other stakeholders could provide more support for rural financial and microfinance institutions to build their capacity. More specifically, they could support these institutions' efforts to organise small farmers, livestock rearers, and fishermen and to facilitate direct and indirect linkages between these groups and supply or value chains. These actions will contribute to the creation of opportunities for agricultural products and the outputs of other rural economic agents, such as CMSMEs, to increase or create additional value. Financial literacy and numeracy, product development, risk management, enhanced credit analysis, loan delinquency management, bolstering loan portfolio quality, optimising operational processes, enhancing governance frameworks, strategic planning, and the ability to perform an external environmental scan are among the priority areas for capacity building.
4. The creation of credit information systems, or credit bureaus, and performance benchmarks for MFIs and rural financial institutions (RFIs) could be the goal of the government, regulators, and other interested parties.
5. It makes sense to examine how heavily regulated interest rates affect rural financial markets and contrast the results with those of a more lenient, market-friendly interest rate policy. The latter makes it possible for banks to pay expenses and mitigate some of the risks associated with lending to rural and agricultural communities.
6. To avert interruptions in the provision of financial services and ensure the stability of rural financial systems, the government, rural financial institutions, microfinance entities, and other stakeholders should persist in deliberating policies related to financial inclusion and regulations affecting rural and microfinance markets.
7. Rural banking and microfinance institutions could be encouraged to provide more comprehensive and sustainable financial services rather than only lending. This change in policy emphasis is desired. Achieving a sustainable capital base, enhancing cost recovery, and offering effective and timely financial services ought to receive more attention.
8. Financial institutions, including rural financial and microfinance institutions, should be given the autonomy to pursue sound banking/financial practices within a prudential regulatory framework. Loan forgiveness may be well-intended but detrimental for the long run and tends to create significant damages to financial institutions and creates unhealthy expectations on the part of the clienteles.
9. The financial and credit rules and procedures used by rural banking and microfinance

institutions for credit analysis, loan screening, risk management, performance monitoring, and asset portfolio diversification could be strengthened. Building institutional capacity could be a top priority for rural financial institutions.

10. To establish a resilient buffer against financial pressures and secure supplementary domestic financing sources, rural banking and microfinance institutions should amass sufficient capital. A local stock capital and a strong domestic deposit base can provide the necessary funds for lending and help safeguard domestic financial institutions against currency volatility and capital flow reversals, as seen by the global financial crisis.
11. By enabling rural banking and microfinance institutions to provide financial products and services that cater to the needs and preferences of their clients while always staying within the prudential bounds set by regulators, the recognition of financial inclusion as a worthwhile objective could be strengthened. The creation of a robust database on those not included in the formal financial system is one particular task that will need support from the government and donors. This is a crucial first step in developing client-responsive financial services and products.

Uniform regulatory framework for banks

It is well-known that a fair and competitive environment improves efficiency in the financial market and facilitates optimisation of service quality and overall financial sector outcomes. For example, in the banking industry, the SCBs do not enjoy a uniform regulatory and governance environment relative to the PCBs/FCBs to operate and compete with these market players on a level playing field. The SCBs have been supported with capital injections using taxpayers' money to overcome distress and are often engaged in non-profit-making activities assigned by the government in the name of the public interest. Moreover, in a number of cases, the SCBs are required to offer services to the government free-of-charge. However, for the sake of transparency, these services should be priced to unearth the true financial status of the SCBs and actual levels of financial losses and recapitalisation need. It is probably unfair to compare the performance of SCBs with that of PCBs/FCBs since these two groups of banks work under dissimilar regulatory and governance environments. Nevertheless, the corporate governance and leadership practices of SCBs require greater attention for streamlining sound banking practices in the country.

Cluster development and SME financing

Inadequate financing is a critical bottleneck in the rural financial market, especially for micro, small, and medium enterprises (MSMEs). Evidence shows that SME clusters are useful in handling asymmetric information and other related problems in an effective manner and can make a difference in efficiency in SME financing. As a financing approach, banks/NBFIs in Bangladesh in most cases do not make any distinction between individual SME financing and SME financing in a cluster. In general, banks/NBFIs do not follow a cluster approach to financing of SMEs. In the case of agriculture and green financing, several encouraging efforts are present in the renewable energy sector. The development of collaborative and sustainable clusters may be pursued as a means to stimulate innovations, manage resources more efficiently, and help address environmental and social challenges. It is well-known that a generic SME strategy is not likely to perform well in the case of sustainable cluster development since identification of clusters based only on geographical proximity may not reveal the true nature and characteristics of clusters. What is important is to undertake an in-depth and integrated analysis of relevant information on SME clusters in the country to identify effective cluster development strategies and adopt the cluster approach to SME financing.

Promoting technology-driven services and agent banking

The country's rural financial sector and related development initiatives have already seen a significant transition thanks to mobile banking and technology-driven products and services offered by banks and NBFIs. Banks and NBFIs need to embrace innovation and contemporary technologies to be competitive and meet upcoming challenges. Specifically, the new and creative banking channels—mobile banking and agent banking—are successful in providing banks with efficient and economical service delivery in both urban and rural areas. By guaranteeing larger deposits and providing access to additional financial services for the low-income rural population, this is already strengthening the country's financial inclusion initiatives. Agent banking is a crucial issue that comes with challenging rules for both mobile and agent banking. Choosing and keeping an eye on the appropriate agents is essential to guaranteeing efficacy and safeguarding against money launderers abusing the platforms. Enforcing a thorough and suitable AML/CFT (fighting the financing of terrorism) regulatory framework is crucial when it comes to assessing and keeping an eye on agents using mobile and agent banking channels. Data and drives could be divided into three categories: credit access, deposit inclusion, and payment inclusion in order to guarantee the transparency and reliability of financial inclusion initiatives.

Promoting agricultural financing and reducing gender gap

Given that a sizable section of the population still relies directly on agriculture, there are enormous opportunities to develop and market credit and insurance products specifically aimed at this sector. The implementation of a warehouse receipt system, which is currently in its early stages of development, is a priority in order to guarantee sustained financial inclusion and sufficient finance flows to the farm sector. It is necessary to take the initiative and implement lobbying efforts in order to establish a regulatory body that will oversee the development of warehouse receipt systems and commodity exchange agreements for the country's agricultural marketing system. Currently, Bangladesh's agricultural commodity markets are only supported by a few dispersed and fragmented efforts.

A national agricultural commodity exchange could be established, government warehouses could be built up or private warehouses could be licensed, local service points could be established with the current telecom networks, and an efficient warehouse receipt system could be designed and implemented. When all these activities are combined, the country may develop a sophisticated commodities market for efficient financing of agriculture. IDRA and Bangladesh Bank may work together to provide customised insurance solutions for micro, small, and agricultural businesses. To close the gender gap, women entrepreneurs and depositors could be given extra encouragement.

Promoting capital and bond market, insurance sector and MFIs

Bangladesh's financial system needs efforts to lessen its excessive reliance on the banking industry. For the country's banks to operate sustainably, the growth of other financial institution segments is important. Banks and NBFIs only use a small number of deposit products since the bond and capital markets are still in their infancy. In reality, a major flaw in the liability portfolios of both banks and NBFIs is their excessive reliance on deposits alone. For the bond market to grow, the government needs to assist the financial sector in preserving a competitive interest rate structure that is focused on the market. Policy and regulatory support is necessary for venture capital financing and funds to encourage innovative businesses. A financial market's strength is, in fact, the interdependence and relationships among its reliable players. The banking industry can help advance all other areas, but not at the expense of depositors' interests. Banks and other institutional investors ought to be drawn to the capital market as well. The recent launching of bank-insurance products aimed at the country's

enormous untapped insurance market can bring a noticeable change, and banks and NBFIs can create an efficient cooperative strategy with MFIs for credit linkage in certain locations. To build trust among the general public, insurance operations require more regulatory oversight and controls. More financial literacy related to capital market and insurance services has to be provided by the government and regulators.

Since Bangladesh gained its independence in 1971, the country's rural credit market has undergone substantial structural change, as the current research indicates. Modern banking, such as agent banking and mobile financial services, has greatly expanded in rural regions in recent years. The rural financial sector is also home to specialised banks, cooperatives, MFIs, and other financial institutions in addition to commercial banks. In contrast to the previous years, the majority of the credit demand in rural regions is being met by lending from institutional sources. In this way, Bangladesh's rural areas are now mostly covered by institutional financing.

However, this perspective also conceals important limitations of rural financing. The access to finance by small/marginal farmers, micro/small nonfarm enterprises, and the impoverished in rural regions is still primarily seen from a welfare perspective—more akin to a social obligation—rather than from the standpoint of feasible business models. In a similar vein, institutional credit has been viewed as serving production purposes alone rather than a comprehensive living strategy.

Adopting successful institutional finance business models that use poverty as an opportunity to expand the market's reach is essential to rural financial sector's sustained growth in Bangladesh. Product diversity, innovations in products and processes, and the growth of financial institutions' and customers' capabilities are all crucial aspects of the country's rural finance development imperatives. In addition to embracing novel strategies like private equity capital, foreign capital, and other untapped sources, the problem of capital shortage could be seen from a wider perspective. The rural financial sector, which includes all financial institutions, including MFIs, may undergo revolutionary transformations through transparent and effective institution-borrower interactions and laws.

Annex A

Bangladesh Bank's Selected Policy Guidelines, Circulars and Directives on Agricultural Credit and SMEs Financing, 2006-2022

FY 2022

September 2021 • In continuation of the previously adopted incentive packages, BB established the "Special Incentive-based Refinance Scheme in Agricultural Sector (Phase II)" with a BDT 30.0 billion investment from its own funds to offer low-interest loans to various agriculture sectors for dynamic and vibrant activities and to protect against the financial crisis caused by the COVID-19 pandemic. Under the initiative, participating banks will get a refinancing facility at 1 per cent interest/profit, with interest/profit at the farmers' level being limited to 4 per cent at a basic rate that applies equally to new and current borrowers. The refinance facility was made available till 30 June 2022. (ACD, 14 September 2022)

April 2022 • For a maximum of three years, including a six-month grace period from the date of rescheduling, scheduled banks were instructed to reschedule short-term agricultural credit (including previously rescheduled agricultural credit) with a lenient down payment requirement, sometimes without a down payment, depending on the banker-customer relationship. Furthermore, loans under certificate cases must be stopped or resolved via compromise prior to rescheduling, and new loans will be approved to borrowers following rescheduling without requiring a new deposit. (BRPD, 19 April 2022)

FY 2020

July 2020 BB introduced a credit guarantee programme for cottage, micro, and small (CMS) businesses in an effort to recover the negatively impacted CMS industry from the COVID-19 epidemic. Scheduled banks and other financial institutions were protected against their investments in the CMS industry and loans without collateral by this program. Through the credit guarantee scheme (CGS) unit set up at BB's SME and Special Programme Department, the coverage will be offered. Only working capital loans and investments made in the CMSME sector that were made possible by the BDT 200.0 billion stimulus package are eligible for the aforementioned program. It was suggested that interested scheduled banks and financial institutions sign a five-year Agreement of Participation with BB's CGS subsidiary in order to receive the advantage. As per the agreement, the CGS unit provides a guarantee against the CMS portfolio. The government and BB work together to finance the necessary funds for the program. CMS businesses are limited to a maximum of 70.0 per cent in the manufacturing and service sectors and 30.0 per cent in the trade sector. (SMESPD, 27 July 2020)

September 2020 • It was determined that, even in the event that the standard deteriorate, the loan/investment classification status that was in place on January 1, 2020, could not be negatively categorised until December 31, 2020. However, by the time a loan or investment's categorisation status is improved, it will be included by adhering to the appropriate standards. Furthermore, from January 1, 2020, the due payment or installments of the current term loans (including microcredit and short-term agricultural loans) might be considered postponed for the specified duration. Beginning in January 2021, the amount and number of installments may be changed. The same number of installments might be added to the number that was past due from January 1, 2020, until December 31, 2020, when the number of installments is re-fixed. Even if one or more installments were past due during the specified time frame, the borrowers could not be classified as defaulters. (BRPD, 28 September 2020)

December 2020 • Due to the COVID-19 outbreak, the banks' deadline for customer-level loan distribution under the BDT 50.0 billion refinancing plan for working capital in the agriculture sector was extended to March 31, 2021. (ACD, 29 December 2020)

April 2021 • The interest/profit rate on agricultural and rural credit/investments was redesigned by BB to a maximum of 8.0 percent, from the previous maximum of 9.0 per cent, in light of the COVID-19 pandemic and the importance of the agriculture sector to our national economy. (BRPD, 22 April 2021)

June 2021 • In light of the Covid-19 pandemic, BB has loosened its requirements for accepting down payments. In the event that a down payment is not received, short-term agricultural loans may be rescheduled for a maximum of two years from the date of rescheduling, depending on the banker-customer relationship. This is done in an effort to boost agricultural production by guaranteeing a continuous supply of credit and lowering the number of non-performing loans in the agricultural sector. Additionally, farmers may reschedule and get new short-term agricultural loans. In this instance, rescheduling might result in a new loan facility without requiring a new deposit. (BRPD, 01 June 2021)

April 2020 • The government of Bangladesh launched a special incentive package of BDT 200 billion to help the cottage, micro, small, and medium-sized business owners who have been severely impacted by the COVID-19 outbreak. Banks and other financial institutions will provide working capital loans and investment facilities to entrepreneurs. The package will have a maximum interest rate of 9 per cent for the facility, of which 4 per cent will be paid by the borrower and the remaining 5 per cent will be subsidised by the government to the relevant bank or financial institution. The package has a three-year tenure established.

April 2020 • In order to counteract the likely losses in the agriculture sector resulting from the COVID-19 epidemic, a refinancing plan worth BDT 50 billion is being built to provide working capital in the horticulture, pisciculture, poultry, dairy, and cattle sectors. The fund in question will be funded entirely by Bangladesh Bank's own resources. "Special Stimulative Refinance Scheme in Agriculture Sector" will be the scheme's title. Bangladesh Bank will provide participating banks with a 1 per cent refinancing facility, while the customer-level interest rate will be 4 per cent.

June 2020 • Declassification of any loan or investment standard occupied on January 1, 2020, is prohibited for scheduled institutions until September 30, 2020. Nonetheless, if any loan or investment quality improves over time, such requirements may be categorised in accordance with the appropriate criteria. All term loan installments made between January 1, 2020, and September 30, 2020, including those for investments, microcredits, and agricultural, will be regarded as delayed. In October 2020, the payment amounts and sizes will be adjusted. Any loan or investment payments that are not paid or made on time by the borrower will not be regarded as defaulted.

FY 2019

October 2018 • Decisions have been made to offer specific financial policy support to borrowers in the agriculture and SME sectors who have been impacted by the recent corrosion of the Padma River in some Upazilas of the Shariatpur district. Under the assistance, borrowers and entrepreneurs in the agriculture and SME sectors who experienced significant losses are permitted to reschedule their outstanding loans based on the banker-customer relationship. In certain situations, a down payment relaxation is permitted, along with a maximum grace period of six months. Rescheduled loans allow impacted borrowers to access new funds without compromising their existing balance. Access to financing for import substitution crops at a concessional rate of 4 per cent has also been given priority. In order to comply with the ministry of finance, the banks must simultaneously take the

appropriate steps to waive interest to the impacted parties. To prevent ongoing loans from being scrapped or terminated, banker-customer relationships have been promoted and new certificate cases and litigation have been discouraged. Lastly, it has been recommended that ongoing attention and the growth of the banker-customer connection be implemented in order to prevent harassment while obtaining new loans.

December 2018 • Under a banker-customer relationship, a small-term agricultural loan can be rescheduled with a loosened down payment requirement and, in some cases, without one. Following the rescheduling, borrowers without collateral or new deposits may also be eligible for new small-term agricultural loans. Subdued Certificate suits must be dropped or resolved via negotiation in order to reschedule debts.

May 2019 • Bangladesh Bank has made the decision to offer agricultural credit facilities to farmers who have been impacted by the recent storm and the tidal bore that Fani generated. Banks are advised to bolster and increase agricultural loan disbursements to the impacted areas in order to expedite the decision. Additionally, they are directed to ease the down payment requirements for rescheduling prior loans, stop and postpone debt recovery from the impacted farmers for a year, and provide new loans without harassment as soon as feasible.

FY 2018

September 2017 Bangladesh Bank has modified the general provision for all unclassified credit (both regular and irregular) under short-term agricultural and microcredits in order to promote the involvement of scheduled banks in the distribution of agricultural and microcredits. According to this modification, all scheduled banks will now hold a general provision of 1 per cent against all short-term, unclassified agricultural and microcredits, rather than 2.5 per cent.

October 2017 Bangladesh Bank has revised the provisions for loans and advances issued by all private and foreign commercial banks in the agriculture and rural sectors, taking into account the demand for credit at the grassroots level, the aggregate loans and advances of the banks, the objectives set for the preceding year, and the capacity and efficacy in disbursing credit within these sectors.

November 2017 • With funding from the Asian Development Bank and the People's Republic of Bangladesh, a refinancing plan of USD 240.0 million has been established with the goal of improving financial services for cottage, micro, small, and medium-sized businesses.

FY 2017

July 2016 • In addition to their regular agricultural credit disbursement procedure, scheduled banks are able to offer agricultural and rural credit through agent banking. A circular outlining the procedures for conducting rural and agricultural operations under agent banking has been released.

July 2016 • When agricultural and rural credit is disbursed through an agent banking system, the interest rate cap of Bangladesh Bank's agricultural and rural credit policy will apply.

April 2017 • In light of the actual demand and loan distribution prioritising Robi grain and import-substituting crops (pulses, oilseeds, spices, and maize) under concessional interest rates, new loans should be allocated for Ropa-Amon cultivation as well as other crops and the aquaculture sector to sustain agricultural production in flood-affected regions.

June 2017 • Considering the downward trend in lending and deposit interest rates, Bangladesh Bank has reduced the maximum ceiling of interest rate on agricultural and rural credit to 9 per cent from 10 per cent effective from 1 July 2017.

FY 2016

June 2016 • Given the declining trend of interest rates on advances and deposits, the maximum interest rate for agricultural and rural loans has been recalculated to 10 per cent from 11 per cent.

FY 2015

November 2014 • All scheduled banks have been directed to set aside 2.5 per cent for all unclassified credits (irregular and regular), 5 per cent for "sub-standard" and "doubtful" credits, and 100 per cent for "bad/loss" credits in order to promote bank participation in the distribution of agricultural and microcredits.

December 2014 • Given the declining trend of interest rates on advances and deposits, the maximum interest rate for agricultural and rural loans has been recalculated to 11 per cent from 13 per cent.

February 2015 • BB instructed all scheduled banks and financial institutions to set up a "Women Entrepreneur Development Unit" in order to provide a variety of services to women entrepreneurs, prioritise lending to small and cottage women entrepreneurs in the manufacturing and service sectors, and carry out development activities while encouraging the cluster of women entrepreneurs to participate in loan activities more accurately and efficiently. It has been suggested that the proposed unit keep an eye on the branch-level operations of the dedicated desk/help desk for women entrepreneurs. The "Women Entrepreneur Development Unit" has prioritised the appointment of female officials. Within 15 days of the circular's release, all scheduled banks and financial institutions are encouraged to establish the aforementioned unit within their own organisations and notify BB of the change.

February 2015 • The following decisions have been made regarding the rescheduling of such loans in light of the agricultural sector's critical role in the expansion and stability of the Bangladeshi economy, as well as the government's farmer-friendly policy to increase agricultural production and recover agricultural credit:

- Depending on the banker-customer relationship, the need of a down payment may be loosened in the event of rescheduling short-term agricultural loan. Such credits may occasionally be rescheduled without a down payment.
- Following a rescheduling, new short-term agricultural credit can be issued. In this situation, a new credit facility can be granted without requiring a payment deposit.
- After withdrawing or resolving certificate cases by mutual agreement (solenama) with the client, credit may be rescheduled if any cases have already been submitted within the trial period.

FY 2014

January 2014 • The 'Credit Rating Methodology for Small and Medium Enterprises' that BB has created will guarantee consistency and higher degrees of transparency in external credit evaluation, thereby establishing credit discipline in the banking sector by determining the relative creditworthiness of entities in this segment. In this manner, BB has launched SME ratings for banks in Bangladesh (Ref. no: BRPD Circular No. 35 dated 29 December 2010). For this purpose, amendments have been made to the guidelines on RBCA, December 2010.

November 2013 • Some changes have been made to the small business sector refinancing programme "Bangladesh Bank Fund" with the goal of encouraging non-traditional and innovative industries. (Reference: SMESPD Circular No. 02 dated 04 September 2011).

- Subject to funding availability, PFI will get a 100 per cent refinancing against the loans it has made to micro and small businesses involved in the publishing and marketing of knowledge-based and creative writing books. At the client level, the appropriate interest rate will not exceed 10 per cent (bank rate + 5 per cent). Writings that violate a nation's culture, traditions, or history, or that are offensive to any race, religion, or clan, or that cause harm to any group of people, will not be considered creative works for this reason.
- Micro and small businesses will be financed by banks and NBFIs, who will treat them as creative publishers in the banker-customer relationship. Publishers who are members of the "Bangladesh Gyyan or Srijonsil Prokasok Somity" or any other legally established organisations, or who are regarded as such by the relevant banks and NBFIs, shall be the creative publishers.

January 2014 • The 'Credit Rating Methodology for Small and Medium Enterprises' that BB has created will guarantee consistency and higher degrees of transparency in external credit evaluation, thereby establishing credit discipline in the banking sector by determining the relative creditworthiness of entities in this segment. SME ratings for banks in Bangladesh have been introduced by BB in this way (Ref. no: BRPD Circular No. 35 dated 29 December 2010). The RBCA, December 2010 criteria have been amended for this reason.

FY 2013

July 2012 • If the short-term agricultural loan or microcredit is not paid back within the allotted period, it will be deemed "overdue" six months after the expiration date.

November 2012 • Following decisions have been made with a view to making farmers' Taka 10 accounts effective through transaction (Ref: BRPD Circular No. 01 dated 17 January 2010):

- A 1-2 per cent higher interest rate than a standard savings account can be taken into consideration in order to boost transactions in farmers' Taka 10 accounts.
- Bank head offices must establish an annual goal for their branch chiefs to maintain farmers' Taka 10 accounts open.
- When working at the field level, field supervisors and helpers must motivate farmers who own Taka 10 accounts by discussing the advantages of these accounts with them.
- A promotional campaign on the advantages of transactions through farmers' accounts started with Taka 10 might be set up at open loan disbursement, loan fairs, or other agriculture-related fairs.
- The possibility of offering a loan facility with reduced interest rates up to 90 per cent of the savings held in farmer accounts that were created with Taka 10 may be taken into consideration.
- Farmers' accounts initiated with Taka 10 cannot be rendered dormant.
- Farmers with Taka 10 accounts must be informed and motivated to utilise these accounts for remitting funds to their children studying in various locations throughout the nation.
- Farmers who have Taka 10 accounts should be encouraged to use them to send money to their children and relatives who live overseas.

- It is required that farmers with Taka 10 accounts conduct transactions by putting funds from crop sales or cash on hand into their accounts.
- These accounts are free of fees and charges, and the remaining amount up to Taka 1 lakh is exempt from excise duty. To persuade farmers to save and trade in these accounts, this issue has to be communicated to them through a marketing effort.

December 2012 • Loans under the "Special Mention Account" and "Sub-Standard" that are not short-term agricultural or microcredit loans shall not be considered defaulted loans for the purposes of section 27KaKa(3) [read with section 5(GaGa)] of the Bank Company Act, 1991. For the same reason, however, fixed-term loans in the "Sub-Standard" category up to Taka 10.00 lacs will also be considered defaulted loans.

March 2013 • Concerning loan categorisation and provisioning, it has been determined that short-term micro-credit encompasses all micro-credits not surpassing Taka 50,000 and due for repayment within twelve months (Refer to section 1(d) of BRPD Circular No. 14 dated 23 September 2012).

May 2013 • Section 2.d) of the circular will be replaced as under:

Time limit for rescheduling for short-term agricultural and micro-credit: In case of rescheduling of any classified short term agricultural and micro-credit, 6 months may be added with following time-limit from the day after the expiry date/repayment date of last installment to determine the repayment schedule which will be started from the date of rescheduling.

FY 2012

September 2011 • It has been determined to amend, modify, or remove a few of the following clauses from the Bangladesh Bank fund's policy guidelines under the small business refinancing scheme: The application of cottage and microbusiness refinancing will now be taken into consideration, much as small business.

- Only entrepreneurs in the manufacturing and service sectors operating cottage, micro, and small businesses will be eligible for a 100 per cent refinancing facility against issued loans, subject to sufficient funds, with the exception of women.
- The refinancing limit has been raised from Taka 10,000 to Taka 5,00,000 for cottage industries and from Taka 20,000 to Taka 10,000 for microbusinesses.
- The cap for small businesses will stay at Taka 50,000, with a maximum of Taka 50,000,000.

September 2011 • Under the agricultural/rural credit policy and programme for FY12, banks are permitted to offer credit on the "Fish Cultivation in Cage" programme as a subsector of fish resources. In consultation with local fish farmers and fish specialists, as well as officers, the banks will determine the loan amount, length, repayment schedule, and security.

March 2012 • The 'Agricultural Credit and Financial Inclusion Department' has been established by restructuring the 'Agricultural Credit Department' to enhance the dynamic of Corporate Social Responsibility (CSR) initiatives and financial inclusion efforts. The activities of the CSR within the Department of Offsite Supervision will be governed by the newly established Agricultural Credit and Financial Inclusion Department.

FY 2011

September 2010 • BB has taken a number of steps to improve the financial stability of the nation's female entrepreneurs and to boost the flow of institutional loans to them. The lower ceiling for loans to small business owners was recently lowered by BB from Taka 2,000,000 to Taka 50,000. However, it was noted that bankers do not heed to female entrepreneurs who want bank financing for less than Taka 50,000. In order to eliminate this barrier to women entrepreneurs' access to financing, BB directed all banks and financial institutions to notify women entrepreneurs who require less than 50,000 Taka each to form a group in order to apply for a SME loan. Banks and financial institutions may then provide credit facilities to this group. Additionally, group-based SME credit will be refinanced under BB's refinance program, with an interest rate of no more than 10 per cent (bank rate plus 5 per cent). Depending on the bank's own policies and the connection between the banker and the consumer, the number of group members, loan amount, and other credit standards may be decided.

September 2010 • It has been decided to offer agricultural loan facilities for salt farming in the nation's coastal regions at a concessional interest rate of 4 per cent. The loan facility would be available to legitimate salt producers on an individual or collective basis for the cultivation of salt on 0.5 bigha to 2.5 acres of land. The involved banks will determine the reasonable maximum credit limit for salt cultivation per acre, taking into consideration factors like land leasing or rent, polythene costs, and embankment costs. Farmers who grow salt on their own property, however, will not be eligible to receive the rent or lease payment. In the event that a farmer is found to have misused the loan, the standard interest rate will be applied rather than the 4.0 per cent concessional rate. Within a month after the end of the corresponding year, banks will submit an application to Bangladesh Bank for interest loss compensation at 6.0 per cent against recovered/adjusted loan accounts financed at 4.0 percent.

June 2011 • The SME/agricultural branches that will be established or open will be environmentally friendly, with options for using renewable energy, natural light, energy-efficient bulbs, other equipment, and water that is both efficient and purified. In order to receive a licence for branches that have been granted authorisation in principle, these branches will need to guarantee in their application that a solar system is installed in the branch.

FY 2010

July 2009 • Banks have been instructed to provide new agri-loan options for the recovery of the agricultural industry in regions impacted by Cyclone "Aila." The hurricane "Aila" has caused a one-year delay in the realisation of agricultural credits for the impacted farmers. Banks will step up their oversight to ensure that impacted farmers may obtain financing as quickly and safely as possible.

December 2009 • Rescheduling of Short Term Agricultural Credit may take place by imposing required down payment as per clause 1.02 of BRPD circular No. 01/2003.

January 2010 • In light of the farmers' contributions to economic activities, particularly in agriculture, it has been determined that a farmer may establish a deposit account at any state-owned commercial or specialised bank using a national ID card, birth registration card, and agricultural equipment assistance card issued by the Department of Agricultural Extension. No minimum balance requirements will be enforced on the specified account, and banks shall not levy any charges or fees associated with these accounts.

February 2010 • The Bangladesh Bank operates the "Refinancing scheme for small entrepreneur" to guarantee balanced industrial growth and to facilitate small and medium-sized business owners' access to institutional loans. Instead of 0.02 million and 0.01 million, respectively, the lowest limit of

the loan under the plan outlined in section-2 of ACSPD circulars no. 01/2004 and 01/2007 is set at Taka 50,000.

May 2010 • The abrupt flood in the North-East area has had a significant impact on the "Boro" crop, and farmers there have struggled to repay their agricultural loans. To lessen the hardship of the impacted farmers, it has been decided to extend the loan payback period by more than a year from the date the loan originally expired. In order to guarantee prompt loan approval free from harassment, the monitoring and supervision mechanism will also be reinforced.

June 2010. The district agricultural credit committee (DACC) is essential to the implementation and coordination of agricultural operations in the lead bank system. According to that arrangement, a commercial or speciality bank branch is already designated for the distribution of agricultural loans at the union level. DACC's primary responsibilities include keeping an eye on and coordinating the credit situation (disbursement and recovery) between local government and banks. The committee's head is the Deputy Commissioner (DC), and the main bank in the relevant district serves as the secretary by holding monthly meetings to keep an eye on all agricultural loans through DACC. Private commercial banks have limited banking networks at the district level. Private and international banks currently provide agricultural and rural lending through their own branches or through Micro Finance Institutions (MFIs) that have been authorised by the Micro Finance Regulatory Authority (MRA). Representatives from private and international commercial banks must be included in the DACC due to the involvement of all banks. The inclusion of representatives from private and international commercial banks has been decided. In addition to notifying the corresponding lead bank and BB's Agriculture Credit Department, private and international banks will designate their representatives in the DACC.

June 2010 • Currently, all scheduled private and international banks in Bangladesh are required to engage in agricultural and rural lending activities. Under the agricultural/rural credit policies of FY10, banks who lack or have insufficient branch operations in rural regions now have the possibility to participate in agricultural/rural lending activities through partnerships with MFIs certified by MRA. The following are some decisions that have been made to highlight coordination and monitoring:

The banks that partially or totally distribute agri-credit through partnerships with MFIs must make sure that the borrower has received the loans. A detailed work plan and monitoring mechanism must be in place at the concerned banks and MFIs. However, it will be the involved bank's responsibility to provide BB with all necessary data and statements.

- A credit proposal submitted by the MFIs that clearly outlines the loan amount, likely borrower-level loan size, number of borrowers, tenure, sector/sub-sector, applicable borrower-level interest rate, project area (district/upazilla), etc. will be taken into consideration by the banks in order to grant the credit line to the MFIs.
- Upon disbursing the initial loan installment, MFIs must provide banks with comprehensive financing details, including the number of borrowers, loan tenure, sector/sub-sector, applicable borrower interest rates, and project zone (district/upazila). For subsequent installments, MFIs are required to submit a certificate confirming that the prior loan has been appropriately utilised for agricultural or rural credit activities.
- In accordance with the Bank-MFI relationship, BB will only consider the funds that the bank releases to MFIs as agricultural or rural credit once they have been disbursed to farmers or borrowers.
- . In accordance with policy guidelines, banks that partially or wholly disburse agri/rural

credit through MFIs must guarantee that 60 per cent of the target amount is disbursed as crop loans. In order to do this, the MFIs must provide crop loans in addition to income-generating and poverty-reduction initiatives.

July 2008 • For the fiscal year 2008-2009, the Agricultural Credit and Special Programs Department (ACSPD) of Bangladesh Bank developed credit standards for several crops based on crop production standards created by the Ministry of Agriculture's Directorate of Agricultural Extension. Depending on the real credit demand, banks may raise or lower the loan amount by up to 10 per cent. Banks will create their own agricultural credit programme by establishing the goal based on the real demand for credit and taking the required steps to ensure that credit is disbursed on schedule. In order to make credit rules more realistic, the credit limit has occasionally been raised by 20 per cent to 30 per cent for certain crops in light of the rise in production costs in the agricultural sector. There will be no changes to the other rules developed for agricultural lending. If reasonable and required, banks can alter the rules to support the growth of the agricultural sector and the extension of agricultural credit.

September 2008

- The following actions have been made to improve agricultural productivity and increase the distribution of agricultural loans and advancements in order to guarantee food security.
- All scheduled banks operating in Bangladesh, including foreign and private banks, are required to take part in agricultural lending initiatives.
- A percentage of each bank's overall loan portfolio will be set aside for agricultural financing. Banks will set a reasonable goal at the start of the fiscal year and notify Bangladesh Bank. In order to meet their yearly goal for agricultural lending, banks will make sure that appropriate oversight is in place.
- Banks that failed to set an agricultural loan disbursement goal for the 2008–09 fiscal year will do so right away and notify Bangladesh Bank of their decision.
- If Bangladesh Bank determines that the bank's aim is unrealistic, BB will instruct the bank in question to re-fix the target.
- By prioritising crop cultivation according to location and crop type—that is, which region is ideal for growing a given crop—agricultural credit should be distributed using the "area approach."
- Banks that lack branches in rural areas or have insufficient branches will use NGO connections to provide agricultural finance.

September 2008

To facilitate efficient agricultural credit operations, therefore simplifying access for farmers and ensuring a consistent flow of credit at the farmer level, BB has implemented a "Revolving Crop Credit Limit System (RCCLS)" with duration of three years. This system will adhere to the following guidelines:

- Farmers that produce crops continuously will be permitted to use the RCCLS facility.
- The farmer will get a subsequent loan or renewal without re-documentation following the realisation of the prior loan (principal and interest accrued thereon).
- Every piece of paperwork will be made as simple as feasible.

- The branch manager should be given the authority to approve loans.
- Any modifications to production scheduling and credit requests would need further bank support after the payment is received.
- The bank itself will decide on the specifics of the new plan, such as the credit limit, mortgage, interest rate, etc.
- This mechanism will encourage farmers to apply for loans.
- Banks will keep a careful eye on things to make sure farmers are receiving the aforementioned facilities.

October 2008

Guidelines have been released that contain, among other things, the following in order to ensure food security, streamline the agricultural credit disbursement system for sharecroppers, and take into account their significant contribution to agricultural growth and the national economy:

- In accordance with these regulations, sharecroppers who actively participate in agricultural production will be qualified to receive agricultural credit.
- In order for a bank branch to grant agricultural credit, sharecroppers must be a permanent resident of the jurisdiction.
- Sharecroppers must possess a farmer's or national identification card.
- The concerned bank branch that disburses agricultural loans is in charge of determining who is a legitimate sharecropper.

April 2009

- In light of the current rate of inflation and the state of the world economy, the interest rate on loans for trade, housing, large and medium-sized business loans, term and working capital loans, and agricultural loans has been reduced and set at a maximum of 13 per cent.

FY 2008

February 2008 • Because agricultural input prices have been rising, the Agricultural/Rural lending Program's lending requirements have been loosened. Generally speaking, banks will adhere to credit standards when deciding on loan amounts, loan disbursements, and loan repayment plans. However, they may raise or lower the amount of loans set aside for certain crops by up to 20 per cent rather than 10 per cent in light of farmers' real credit needs.

September 2008 • It has been recommended that banks and other financial institutions make more efforts to offer loan facilities to small and medium-sized businesses (SMEs). Under these conditions, it has been recommended that banks and other financial institutions use their extra liquidity to invest in a variety of new and profitable SME sectors, particularly those run by women entrepreneurs.

November 2008 • The recent catastrophic cyclone and tidal surge in the nation caused extensive damage to the agriculture sector. In this context, the following measures have been implemented to alleviate the hardships of the impacted farmers concerning agricultural credit operations.

- In regions impacted by cyclones, agricultural credit disbursement operations had to be reinforced.

- By easing the requirements for the down payment of past-due loans, impacted farmers should get new loans as soon as feasible following the rescheduling of their previous loans.
- The concerned bank's top executives will visit the impacted areas to guarantee that credit is disbursed correctly.
- Bangladesh Bank should be notified every two weeks on agricultural credit disbursement activities; the banks would set up appropriate monitoring to ensure that any impacted farmers are not harassed or have their loan applications delayed.

February 2008 • Because agricultural input prices have been rising, the Agricultural/Rural lending Program's lending requirements have been loosened. Generally speaking, banks will adhere to credit standards when deciding on loan amounts, loan disbursements, and loan repayment plans. However, they may raise or lower the amount of loans set aside for certain crops by up to 20 per cent rather than 10 per cent in light of farmers' real credit needs.

March 2008 • Some changes have been made to the refinancing plan for women entrepreneurs in the Small and Medium Enterprises (SMEs) sector in order to give them access to additional institutional and financial facilities on favourable terms and circumstances.

- Banks and other financial institutions must receive and process all loan applications from small and medium-sized female entrepreneurs with the utmost attention.

May 2008 • Bangladesh Bank has taken a decision in principle to accord permission for opening SME Service Centres. These Service Centres will be allowed to perform the following functions:

- The SME Service Centres will solely provide banking services to the SME sector for loan applications, disbursements, monitoring, and recovery.
- The SME Service Centres will have the authority to receive foreign remittances and provide them to the relevant payees in their home currency.
- To provide women entrepreneurs who are actively promoting the Small and Medium Enterprise (SME) sector priority, the SME Service Centres will be permitted to set up a dedicated desk.
- It is recommended that scheduled banks doing business in Bangladesh submit applications to the Banking Regulation and Policy Department of Bangladesh Bank in order to build a restricted number of SME Service Centres, exclusively in regions of the country where the bank does not already have any branches. It is recommended that scheduled banks apply for the opening of the aforementioned centre by June 15, 2008, for the year 2008, and for the year 2009, together with the application for the opening of bank branches.

May 2008 • To strengthen SMEs, some instructions are given to banks/financial institutions for their compliance.

- The target percentage of loans to be issued in the SMEs sector out of the total amount of disbursable loans for the year would be communicated to Bangladesh Bank.
- A minimum of forty per cent of the capital designated for SMEs must go to small business owners, with the remaining portion going to medium-sized business owners.
- A desk specifically for the SME sector will be set up. The amount of loans given to small businesses and their percentage in accordance with the stipulated form must be included in the information that is delivered to Bangladesh Bank on a quarterly basis.

May 2008 • The Refinance Scheme for Women Entrepreneurs of Small and Medium Enterprises (SMEs) of Bangladesh Bank has increased the amount of funds allocated to women entrepreneurs from 10 per cent to 15 per cent in order to increase the number of women entrepreneurs who can access credit for starting businesses and conducting business operations, as well as to increase their involvement in the nation's industrial development. Forty per cent of this fifteen per cent grant will go to tiny female businesses.

May 2008 • In order to lower the supervisory costs associated with loan disbursement and recovery, banks and other financial institutions have been recommended to enlist the help of non-governmental organisations (NGOs) in the selection of borrowers, credit disbursement, and credit recovery processes. This is in an effort to increase credit availability in small and medium-sized businesses. By rescinding all previous directives, the medium-term loan duration for medium-sized businesses has now been extended from three to four years. All refinanced loans must be repaid in seven equal half-yearly installments within four years of the loan's receipt date, including a six-month grace period.

June 2008 • For the necessity of strengthening, encouraging and expanding SME sector, fund for "Refinance Scheme for Small Enterprise sector" has been raised from Taka 300.00 crore to Taka 500.00 crore with effect from 12 June 2008.

FY 2007

July 2006 • Based on crop production standards created by the Directorate of Agricultural Extension under the Ministry of Agriculture, the Agricultural Credit and Special Programs Department (ACSPD) of Bangladesh Bank developed credit standards for several crops for the 2006–07 fiscal year. Generally speaking, banks will adhere to these rules while assessing borrowers' eligibility, credit amount, and repayment schedule, as well as when utilising the appropriate passbook. The standards are used to establish the loan amount, taking into account the farmers' real credit need. However, depending on each borrower's unique credit needs, banks may raise or lower the loan amount by up to 10 per cent. Banks create their own agricultural lending programs by establishing goals based on real credit demand and taking the required steps to ensure timely loan disbursements.

February 2007 • It has been decided to set aside at least 10 per cent of the total fund of Small and Medium Enterprises (SMEs) offered by Bangladesh Bank for women entrepreneurs of SMEs in order to provide more institutional credit facilities with favourable terms and conditions, with the goal of ensuring balanced and organised industrial development in the nation.

FY 2006

July 2005 •

Effective July 1, 2005, the FY06 annual agricultural credit/rural credit programme began, and it will conclude on June 30, 2006. In light of the real credit demand, concerned institutions will design their own agricultural loan programs and make the required preparations to ensure prompt credit distribution. Given farmers' real demand for agricultural credit, the guidelines' recommended credit level may be reduced or raised by up to 10 per cent.

June 2006 • Bangladesh Bank has periodically updated its prudential rules for loan classification and provisioning in an effort to improve credit discipline and align the classification policy with global norms. In order for the banks to have all of the current instructions on the topic in one location, a Master Circular was released on June 5, 2006, as part of the process. A few new guidelines and updated loan categorisation and provisioning formats are also included in this circular. By raising the cap from Taka 10,000 (ten thousand) to Taka 25,000 (twenty-five thousand), more attention has been paid to short-term microcredit. To increase the transparency of OBU transactions for EPZ (Export

Processing Zone) businesses, banks with an offshore banking unit (OBU) have been placed under the purview of loan classification and provisioning. As a result, they must report to Bangladesh Bank's CIB and BRPD for cross-informational purposes.

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Annex 1

List of Reports under the Comprehensive Rural Finance Study

Sl. no	Title	Reference No.
Analytical and Survey Report		
1.	Reshaping Rural Finance in Bangladesh: Key to Building Prosperous, Equitable and Inclusive Rural Society	Study Completion Analytical Report: Summary Results and Major Recommendations
2.	Pathways To Smart and Inclusive Rural Bangladesh: Key Recommendations for Reshaping Rural Finance	Comprehensive Summary of Major Recommendations
3.	গ্রামীণ বাংলাদেশে অন্তর্ভুক্তিমূলক উন্নয়ন প্রসারে আর্থিক খাতের সমস্যা ও চ্যালেঞ্জ: ভবিষ্যত যাত্রা পথের জন্য কৌশলগত সুপারিশের সারসংক্ষেপ	Analytical Summary Report in Bangla: Major Findings and Recommendations
4.	Bangladesh: Report of the Rural Finance Survey 2023	National Survey Report
Policy Paper and Policy Brief		
1.	BANGLADESH: Review of Rural Finance System and Policy Implications	Policy Paper No. 2025-01
2.	Access to Finance: The Smart Vehicle of Empowerment for Vulnerable Communities in Bangladesh	Policy Brief No. 2025-01
3.	Dynamising Rural Enterprises in Bangladesh: Access to Finance is the Key	Policy Paper No. 2025-02
4.	Financing Industry Based Clusters in Rural Bangladesh	Policy Paper No. 2025-03
5.	Rural Women Entrepreneurship and Access to Finance: Challenges and Opportunities in Bangladesh	Policy Paper No. 2025-04
6.	Access to Finance of Rural Farming Households in Bangladesh: Challenges and Opportunities	Policy Paper No. 2025-05
7.	বাংলাদেশের গ্রামীণ নারী উদ্যোক্তাঃ সফলতার পথে চ্যালেঞ্জ এবং অর্থায়নের ভূমিকা	নীতি সংক্ষেপ ২০২৫-০১
8.	বাংলাদেশে গ্রামীণ কৃষি পরিবারের অর্থায়নঃ সুযোগ, চ্যালেঞ্জ ও সম্ভাবনা	নীতি সংক্ষেপ ২০২৫-০২
Background Report		
1.	Changing Face of Rural Finance in Bangladesh: Achievements and Future Challenges	Background Report No. 2025-01
2.	Financial Needs of Selected Marginalised and Vulnerable Communities in Bangladesh	Background Report No. 2025-02
3.	Access to Finance for Rural Entrepreneurs in Industry Based Clusters of Bangladesh	Background Report No. 2025-03
4.	Access to and Use of Financial Services by Rural Entrepreneurs in Bangladesh	Background Report No. 2025-04

5.	Access to Financial Services by Rural Women Entrepreneurs in Bangladesh	Background Report No. 2025-05
6.	An Overview on Rural Finance in Bangladesh Structure, Policies and Priorities	Background Report No. 2025-06
7.	Supply Side Analysis on Comprehensive Rural Finance	Background Report No. 2025-07
8.	Access to Finance of Farming and Non-farming Households in Rural Bangladesh	Background Report No. 2025-08
9.	Penetration of Agent Banking and Mobile Financial Services in Rural Areas of Bangladesh	Background Report No. 2025-09
10.	Regional Variation in Access to Finance by Rural Households in Bangladesh	Background Report NO. 2025-10

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