

**Project on: Microfinance in Bangladesh**

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**Introduction:** In Bangladesh there are mainly four types of institutions involved in micro-finance activities. These are 1) Grameen Bank (GB), a member owned specialized institution, 2) around 1500 Non- Governmental Organizations (NGO) like BRAC, Proshika, ASA, BURO-Tangail, BEES, CODEC, SUS, TMSS, Action- Aid etc. 3) Commercial and Specialized banks like Bangladesh Krishi Bank (BKB), Rajshahi Krishi Unnayan Bank (RAKUB) and 4) Government sponsored micro finance projects/ Programs like BRDB, Swanirvar Bangladesh, RD-12 and others which are run through several ministries viz., Ministry of Women & Children Affairs, Ministry of Youth & Sports, Ministry of Social Welfare etc. All the programs are targeted at the functionally landless rural poor. All the MFIs provide mostly small, un-collateralized one-year term loans to individuals belonging to jointly liable peer groups, and they use similar on-site loan disbursement and weekly collection methods by forming village organizations or centers. A research reveals that NGOs started credit program in mid eighties and their activities increased noticeably higher after 1990 (CDF, 2000). With the increasing number of collateral free micro credit disbursement by MFIs, some Nationalized Commercial Banks (NCBs), and Specialized Banks like BKB and RAKUBhave been encouraged to provide a considerable amount of their rural credit to the poor without security. However, the amount is much less compared to the deposit mobilization from the rural sector of the country. Today, some of the Private Commercial Banks (PCBs) have also started direct and linkage programs with NGOs. Total loan disbursement (cumulative) by these four kinds of institutions till December 2001 was taka 434.55 billion; of which disbursement under Government program was taka 37.77 billion (8.69%), Grameen Bank disbursed taka 154.11 billion (35.46%), other Banks and MF-NGOs disbursed taka 78.41 billion (18%) and taka 164.26 billion (37.80%) respectively (figure-1).

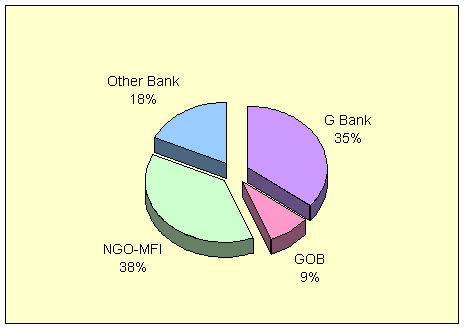


Figure-1: Institution-wise Cumulative Loan Disbursement.

All the non-government organizations are involved in micro-finance activity but they are not under the same regulatory authority / monitoring agency. Therefore, there is no single source of information about them. However, Credit and Development Forum (CDF) an NGO who collects information of MF-NGOs reveals that 629 MF-NGOs have mobilized about 13.85 million poor people (11.24% of the total population who are under absolute poverty[1]), among them 11.85 million are female and only 2 million are male. Out of 13.85 million of poor people near about 9 million are outstanding borrowers. About 90% of the borrowers of those MF-NGOs are from rural area and only 10% are from urban area. These MF-NGOs disbursed taka 164.26 billion with outstanding loan amount of taka 25.88 billion. The outstanding amount of micro-finance extended under government program is taka 7.46 billion, the outstanding balance of Grameen Bank is taka 12.73 billion and that of other banks is taka 7.55 billion. Grameen Bank, BRAC, ASA and Proshika are top four MFIs in terms of loan disbursement, outstanding loan and saving mobilization (figure-2). It has been seen that top 4 institutions including Grameen Bank served more than 70% of the market.

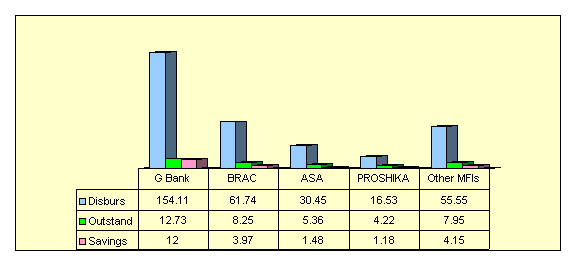


Figure-2: Top Four MFIs in terms of Disbursement, Outstanding loan and Savings in billion taka.

Sources of Fund and Financial Sustainability: Initially foreign donation was the major source of fund for these organizations, contribution of which stood to near about 50% of the total fund until 1996. But after 1996 it had declined sharply and became only 17% of the total fund in December 2001 (Figure-3). With the declining trend of foreign donation, the MF-NGOs have concentrated on accumulating funds from internal sources such as saving mobilization from their members. Therefore, it has been seen that members' saving has increased over time and in December 2001 it has contributed 25% of total Revolving Loan Fund. The contribution of service charge in Revolving Loan Fund has also increased with the decreasing rate of foreign donation. Now the contribution of service charge in Revolving Loan Fund in terms of percentage is same as that of foreign donation.

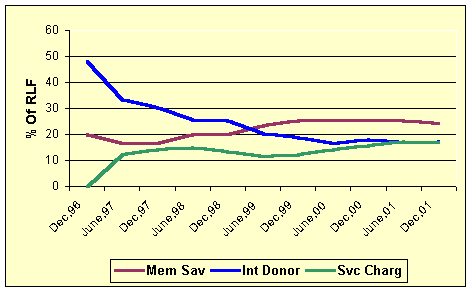


Figure-3: Trends of Sources of Fund over the Time.

At present, one of the major sources of funds of the NGO-MFIs is the savings of its members. They do not accept deposits from the general public like that of formal financial institutions. The interest rate they offer to the members for saving mobilization is less than the interest rate offered by government and commercial banks. In spite of that as of December 2001, the major sources of fund of 629 MF-NGOs were members' savings and that was 24.13% of the total RLF; PKSF[2] supplied 23.49% and direct foreign donation was 17.36% (Figure-4). However, a significant portion of the funding (16.76%) was actually generated from service charges. Service charges vary from 8% to 37% depending on the method followed by the MFIs.

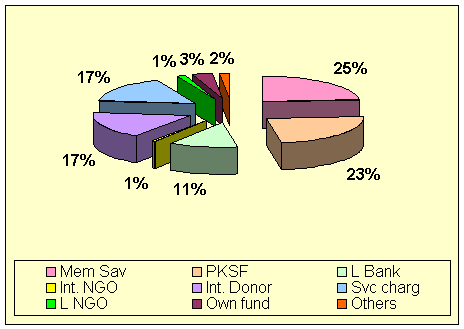


Figure-4: % of Revolving Loan Fund

Though direct donation from international donors comprise only 17.36% of total Revolving Loan Fund (RLF), MF-NGOs are getting soft loan and subsidies from other sources like GOB, PKSF and other big national and international NGOs/banks. Their members' savings, service charges and own fund (3%) comprise only 44.14% of the RLF that does not seem enough to make up the cost of their loan operation which is about 50% of their total expenditure. Therefore, it is obvious that this sector is highly subsidized by different donor and sympathetic groups. It is also widely believed that the large MF-NGOs are also engaged in other profitable businesses from which they earn handsome profit and also use a part of it for cross subsidization of their micro finance activities. Annual financial reports of Grameen Bank and some other NGO-MFI show that their program is not financially sustainable without subsidized loan or donation. Actually the issue of sustainability in this case is very much related to the following questions;

� Whether these MF-NGOs are business institutions or charity organization?

� Can they be the bankers and social workers at the same time?

NGOs who are serving in the market of micro-finance should be clear about their identity by asking themselves these questions. Whether they are business organizations and therefore should they be under the law of business and follow the rules of business. One may also question whether NGOs run business should ask for subsidy to be sustainable or if the NGOs claim to be charity or service oriented voluntary organizations then they may not bother about service charges, compulsory saving mobilization etc. But they must be very careful about the administrative cost, which is generally met from the soft donations/grants/charity given for the poor.

The MF-NGOs of Bangladesh, especially the bigger ones are generally pursuing multiple ventures and their legal identity is often mixed: social organization � bank- business enterprise- all. That is why recently these questions have been raised and they may merit attention

Impact of Micro-finance Services on Borrowers and on the Economy

The impact of micro-finance at macro level is not still clear (CPD, Task force Report, 2001), even though it has some impact at micro level on the society both in terms of economy and social value. There are a few studies on this impact assessment of micro-finance, findings of those studies are as follows:

1. The dependency of poor people on the moneylender or richer people has been reduced substantially in the society and people are getting access to institutional sources for credit. Even the formal sectors have been keeping confidence on the poor for lending money, which is a qualitative change in the rural society due to micro-finance intervention.

2. Employment opportunities of the poor have increased to a great extent in terms of both longer working hours and new employment. The targeted households that are eligible for participation in micro-finance programs have a higher probability of being self-employed than their counterparts in non-program villages.

3. The labor force participation rate (LFPR) for more employment opportunity of the participants was found higher than the non-participants. Before nineties the wage rate for women labor force did not get importance because of social backwardness, women labor was sold at a very low non-bargaining rate. This was equally true in case of male labor force before the eighties. But with time passing situations have changed noticeably; it is recognized that there is now a days a serious scarcity of labor in rural areas, especially in the peak season and this shortage even hampers agricultural production. The intervention of micro-finance in the rural market is one of the main reasons for this change. Therefore, the labor force of rural areas now has the ability to influence rural wage rate.

4. As the main target group of micro-finance is women, they have gained a special financial power over men. Though women are dominated by men culturally, their access to get credit and do their own business has increased their confidence on their own ability. This is especially true for the rural poor women of the country. Now more and more rural women move outside their home after joining micro-finance program. They now go to office, banks, market and other places without a male company. This is a positive indicator of women empowerment.

5. There is a controversy about the impact of micro-finance on poverty alleviation. The poverty rate of the country did not decrease significantly in last few years. It did not increase though. The main focus of micro-finance is to alleviate poverty, but it could not reach the poorest of the poor till now. One of the reasons might be the failure to reach the hard-core poor by these programs. Now MF-NGOs are seriously thinking about this issue and have started some programs to solve this problem. But it is a challenging work to do, because this group of the population first needs money for consumption. Without solving these problems they are not able to invest credit for cash flow, which they need to repay the loan in time. Therefore, it has been seen that there are big successes of micro-finance at micro level that do not show any significant impact at macro level. In the recent literature it is often mentioned as the problem of "Macro-Micro Mis-match" (Sen, 2001).

To know the real extent and to quantify the impacts of micro-finance mentioned above thorough study is needed, which is time consuming and costly. However, government needs to do that to make a correct decision. There is another problem to assess the real net positive impact of micro-finance program, which is again impossible without assessing the real cost involved in operating this financial service. Different MF-NGOs are charging different interest rates but none is based on rational cost involved. A real positive impact of micro-finance program can be measured if and only if the recipients of this facility pay the full cost of the services they receive.

**Regulatory Framework:**

Two big provider of micro-finance are Grameen Bank and MF-NGOs. Grameen Bank follows the Grameen Bank Ordinance, 1983 and MF-NGOs register under any of the following acts of the Government of Bangladesh :

. Societies Registration Act of 1860

. Voluntary Social Welfare Agencies (Registration and Control) Ordinance of 1961

. Companies Act of 1994

. NGOs who are accepting grants/donation are required to take a certificate of permission from the NGO affairs Bureau.

There is nothing in the registration act of any NGO/MFIs that prohibits them to undertake micro-finance activities with the member clients. Therefore, there are two types of MF-NGOs operating in the field of micro-finance. One type of them are those who have started their organization with a single objective of micro financing, and the others are NGOs who have other objectives in addition to micro-financing. A large number of NGOs did not start the organizations with a view to perform micro financing activities, but later on they either shifted to or have added micro financing. However, they need formal and legal permission from the Government in the form of a special licence for carrying out the micro-finance activities with the ultimate objective of poverty alleviation. In spite of that, there is no single authority that provides licence/ permission and keep the information of all organizations involved in micro financing.

In this context, many agencies like GOB, donor agencies and policy makers of the country feel that there is a serious need to monitor the activities of MFIs in Bangladesh. Since, members' savings is most important source of fund (near about 25%) of MFIs, which also is increasing as a percentage, therefore, there is a need to protect the interest of small savers. In addition to that, without a formal legal entity the sustainable growth of the NGO-MFIs would be hampered seriously in a number of ways. Among those, the most important is the lack of access to formal sources of national and international fund for effectively carrying out micro-finance program for poverty alleviation on a sustainable basis. Therefore, there is an obvious need for certain form of compatible and user's friendly prudential norms/indicative guidelines in the shape of a concrete code of norms/conduct for making this sector more institutionally organized and sustainable with a specific legal identity.

The Government of Bangladesh has formed a committee named 'Micro-finance Research and Reference Unit (MRRU)' in 2000, which includes 11 members from different sectors who are involved in this program to formulate a uniform policy for this sector. Ensuring transparency and accountability of MF-NGOs would be the main objectives of this policy. This committee has also given emphasis on observing uniform accounting policy and auditing, governance structure of MFIs, policy on savings and investment, rational interest rate, credit rating etc of the MF-NGOs. The committee is also discussing the issue of licencing to those MF-NGOs who are accepting deposits up to a certain amount from non-members or general public

**Challenges for MF-NGOs and for the Government:**

The current challenge of MF-NGOs is whether they could run the program without subsidy, because the flow of donor fund is declining over the years. Since the main objective of micro-finance is to alleviate poverty, the question is whether they would be able to charge real cost of service on the recipients. If it charges full cost, what would happen to the other objective of outreaching the poorest of the poor? On the other hand if full cost is not charged, would they be financially sustainable in the long run? And the challenge for the government is to bring this huge unorganized industry under a uniform umbrella where this industry would get proper direction and support to run the business and at the same time serve the people who are the target group in such a way that they would be benefited in the long run and would be able to overcome their financial backwardness. Ultimately these institutions would become autonomous players in the main-stream economy.

**Suggested Reforms To Face The Future Challenge:**

Since NGO-MFIs have to face the realities of declining subsidized fund, they should take effort to reduce administrative and transaction cost which seems very high. Most of them do not practice proper bookkeeping and accounting policies, lack professionalism in financial transaction, therefore, training and capacity building in accounting and financial management plus greater transparency in their operation is essential not only to make them attractive to the donors but also to enable them to tap commercial markets and banks.

Formal commercial banks lack experience and expertise to operate in this market; they can overcome this problem by linking them with NGO-MFIs who already have a ready set up of operation and experience. This linkage program on one side can reduce operational cost of commercial banks and on the other side can reduce the financial problem of NGO-MFIs. Especially, smaller NGO-MFIs could be encouraged strongly to play the role of brokers between the banks and the borrowers. Here the banks bear the credit risk by lending directly to the borrowers and share a part of its spread with the NGO-MFIs. The NGOs will receive a commission for identifying borrowers and ensuring repayments. Large NGO-MFIs can also be integrated into this program of poverty alleviation by encouraging them to establish themselves as banks.

Present legal framework of formal financial institution can be changed in favor of the rural poor. Under this framework moveable property, accounts receivables, credit history or good previous repayment performance etc. are not useable as security to access credit. But most of the rural poor people have only these things to offer as security. These realistic changes in the legal framework can help poor people to enter into the formal financial market easily.

Therefore micro finance sector will have to develop a concrete long run vision of a flexible, self-sustainable, well-regulated and pro-people micro finance industry capable of facing all these challenges. That means the industry will:

� Design its product according to the market need - what kind of loan poor people really need and which terms and conditions are applicable to them. They should not just follow Grameen Bank model, rather they should be innovative in product designing,

� Diversify its loan portfolio, not just depending only on the agricultural sector for investment,

� Identify the exact cost involved and find out reasonable service charge for each product offered,

� Apply internationally accepted accounting policy,

� Formulate transparent policy for the stakeholders,

� Acquire a corporate legal identity owned by the clients themselves or focus on a single activity with corresponding single legal identity.

On the other side the government and the donors should try to help the industry to be sustainable by developing infrastructure needed, providing training and technical assistance, providing correct guidelines and regulation, offering proper incentive for positive contribution and punishment for the opposite.

**Conclusion:**

It is expected that with the fulfillment of the above vision this service sector would contribute to our economy by alleviating poverty in real sense. It would help to generate permanent employment, remove over dependency on agriculture and help people by eliminating their dependency on the moneylenders and informal credit suppliers. Poor people would be able to take care of their health and education by getting the benefit from this service and they would also help MFI to be sustainable by paying their due on time. It is also expected that since members' savings is becoming the main capital of this business, therefore the representative of the members should have a say in the decision making process of the MFIs for the long run benefit of the industry.

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[1] Intake of less than 2122 Kcal per capita per day

[2] A government initiated apex body, receives fund from both GOB and donor agencies and provides loan facilities to its partner organization