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# State of Microfinance in Bangladesh

## - What Do We Know?



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# Microfinance *for* Development

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- Microfinance is an innovative instrument targeted for:
  - Development of appropriate financial products for target population
  - meeting social objectives
  - aiming at poverty alleviation
  - promoting broad-based & inclusive growth

# Key aspects of MF development

- **Lack of physical collateral forces to introduce social collateral – a common theme**
- **Microfinance encompasses savings, loans, insurance, and transfer of remittance**
- **MF for the socially disadvantaged groups—clients need more than intermediation (skill training, marketing, etc)**
- **MF is largely donor-driven -- PKSF has emerged as an outlet for wholesaling**
- **Two types of MFIs emerged– microfinance only and microfinance plus.**

# MF for the poor and women

- **MF stands for financial intermediation targeted to the poor and women**
- **Bangladesh's experience with MF is for more than two decades– it is high time to take a stock of what we know and what we do not know**
- **A review is made here on 2 major themes– MF achievements and emerging issues concerning further development of MF**
- **First theme: MF's achievements as a financial intermediary and a development agent**
- **Second theme: Emerging issues for further development as a financial intermediary and a development agent**

## Step 1: Achievements as a financial intermediary

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- Outreach: membership growth
- Loan recovery rate
- Lending and savings mobilized
- Sectoral distribution of Portfolio
- Market share of rural financial intermediation
- Institutional sustainability: Subsidy dependency and market rate of interest

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## Step 2. Achievements as a development agent

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- Income, employment, and asset generation
- poverty reduction
- Empowerment and social development
- Contribution to local economy
- Borrowers' sustainability: Indebtedness and net worth growth

## Step 3: Emerging issues for further development of MF intermediation

- Managing rising material risk in loan default
- Promoting portfolio mix for higher growth and development
- Follow pathways to transform MFI into formal specialized financial institutions
- Promoting self-sustainable micro-banks

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## Step 4: Emerging issues for MF-driven results for sustainable development

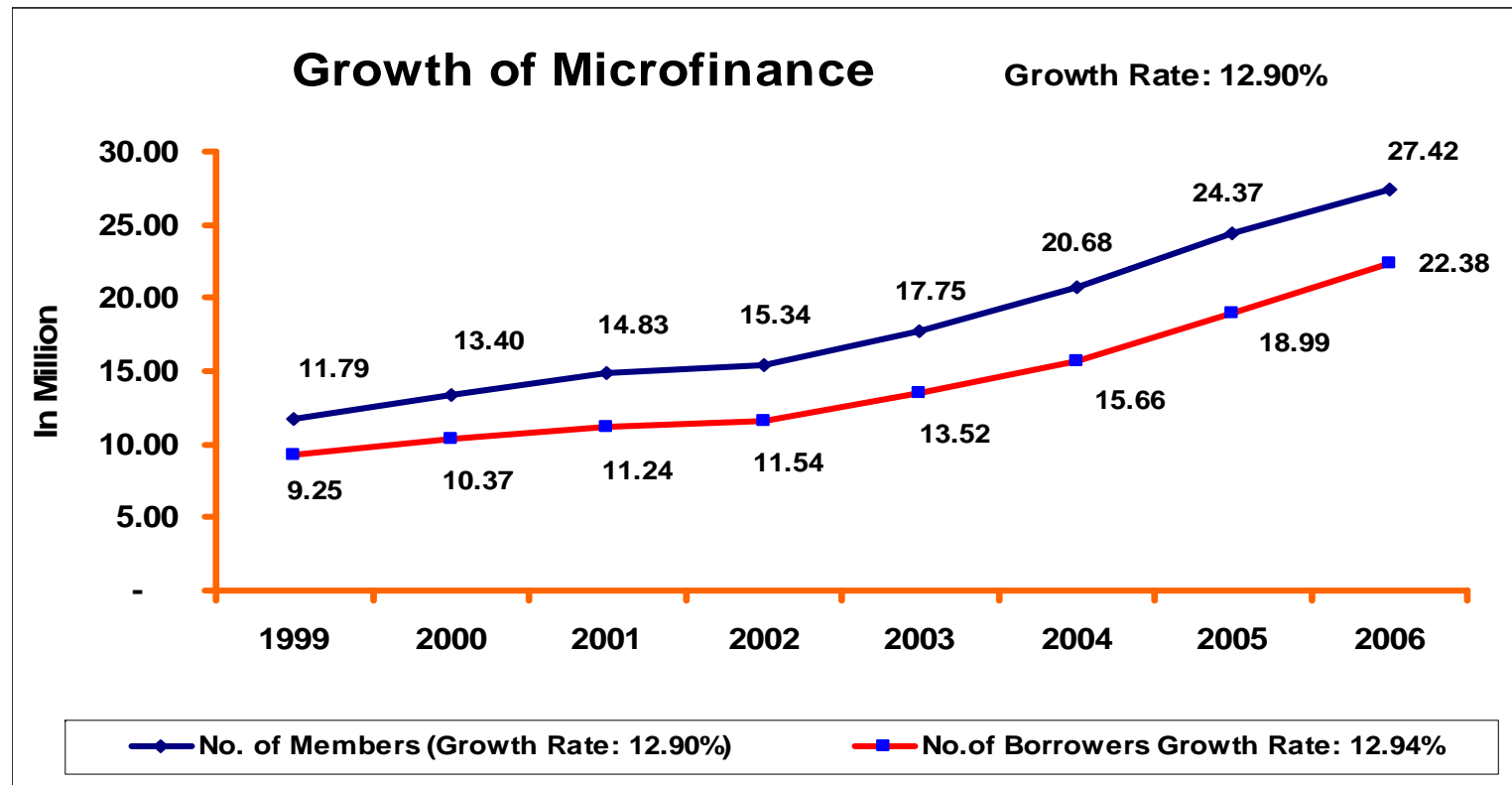
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- Are there declining benefits over time?
- Are there market saturation and diseconomies of scale?
- Is indebtedness rising?
- Is interest too high? Can it be reduced?
- Is micro-enterprise growing?

## Part 1: MF accomplishments: What do we know?

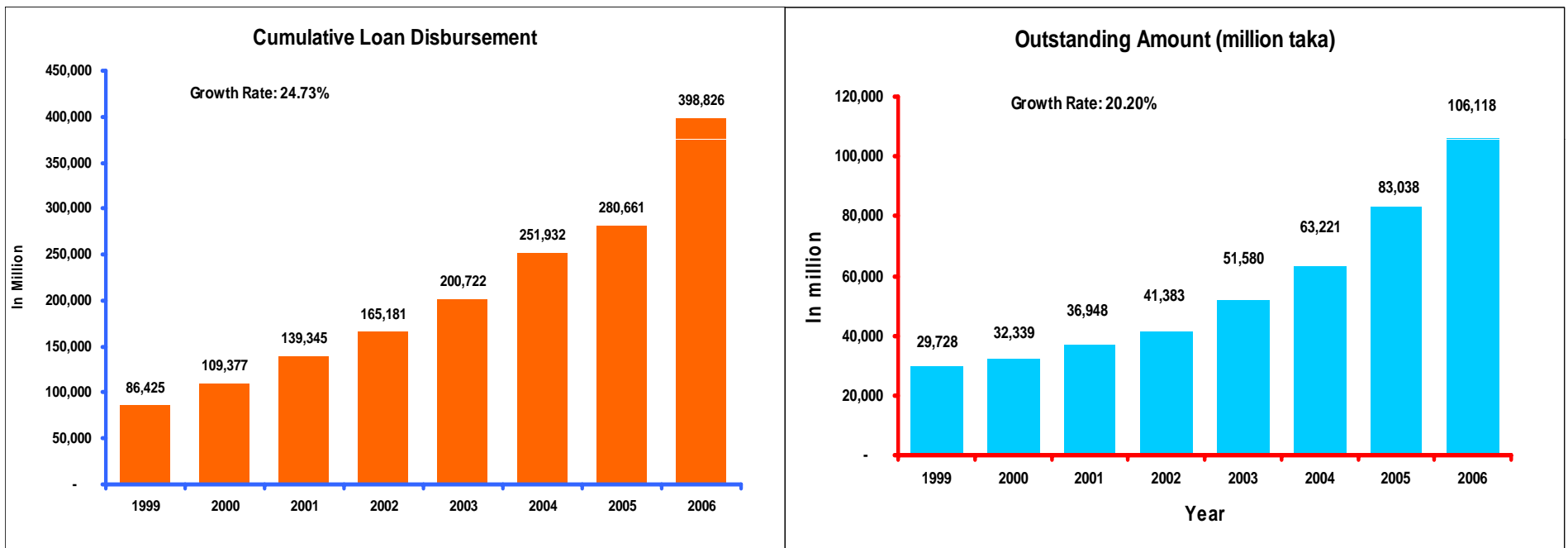
- Evidence on MFI accomplishments as financial intermediary
  - Outreach: membership growth
  - Annual disbursement
  - Loan outstanding
  - Savings mobilized
  - Membership growth
  - Interest rate structure

# MF accomplishments: membership growth



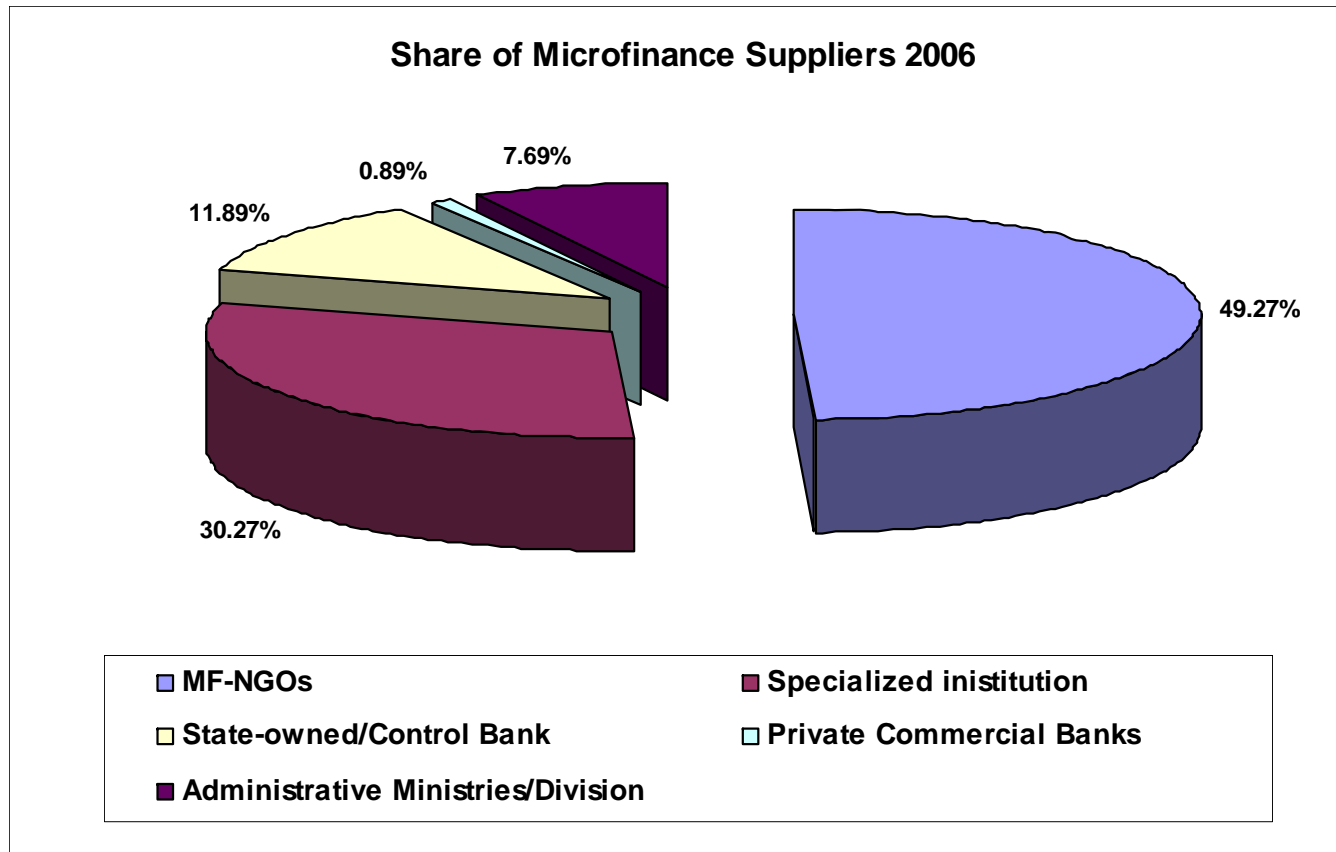
**Source: Institute of Microfinance**

# Disbursement and loan outstanding



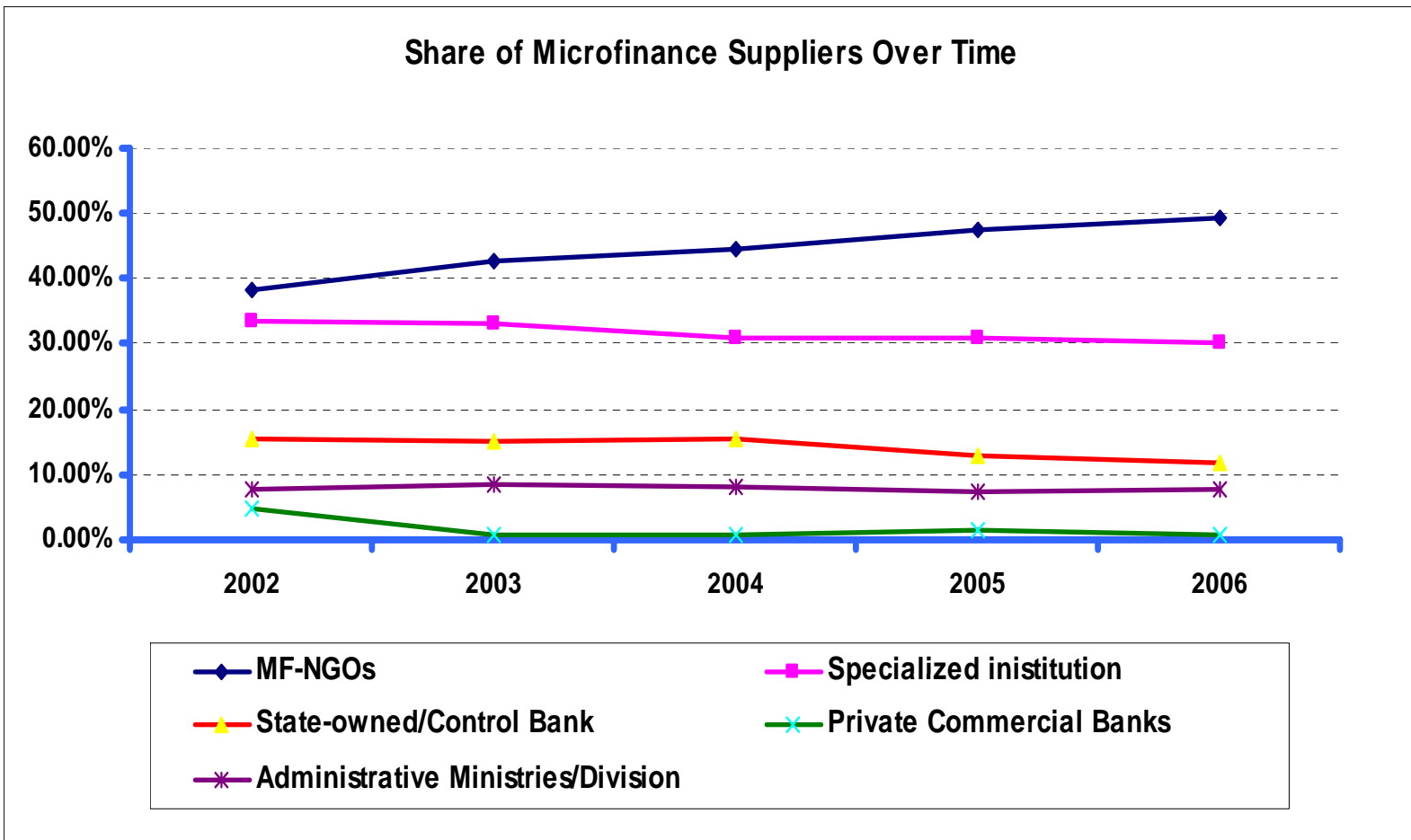
**Source: Institute of Microfinance**

# Who supplies what?



**Source: Institute of Microfinance**

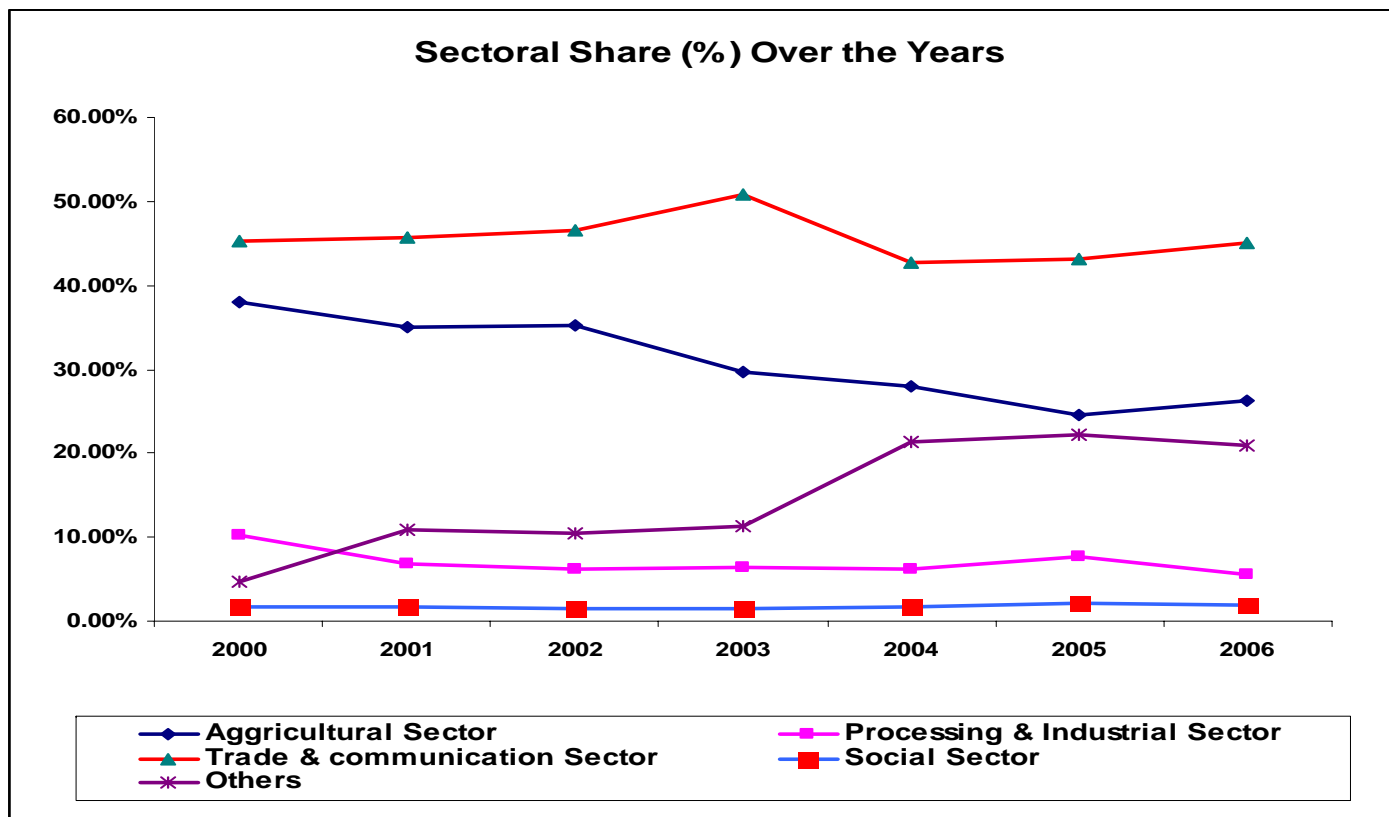
# Who supplies what?



**Source: Institute of Microfinance**

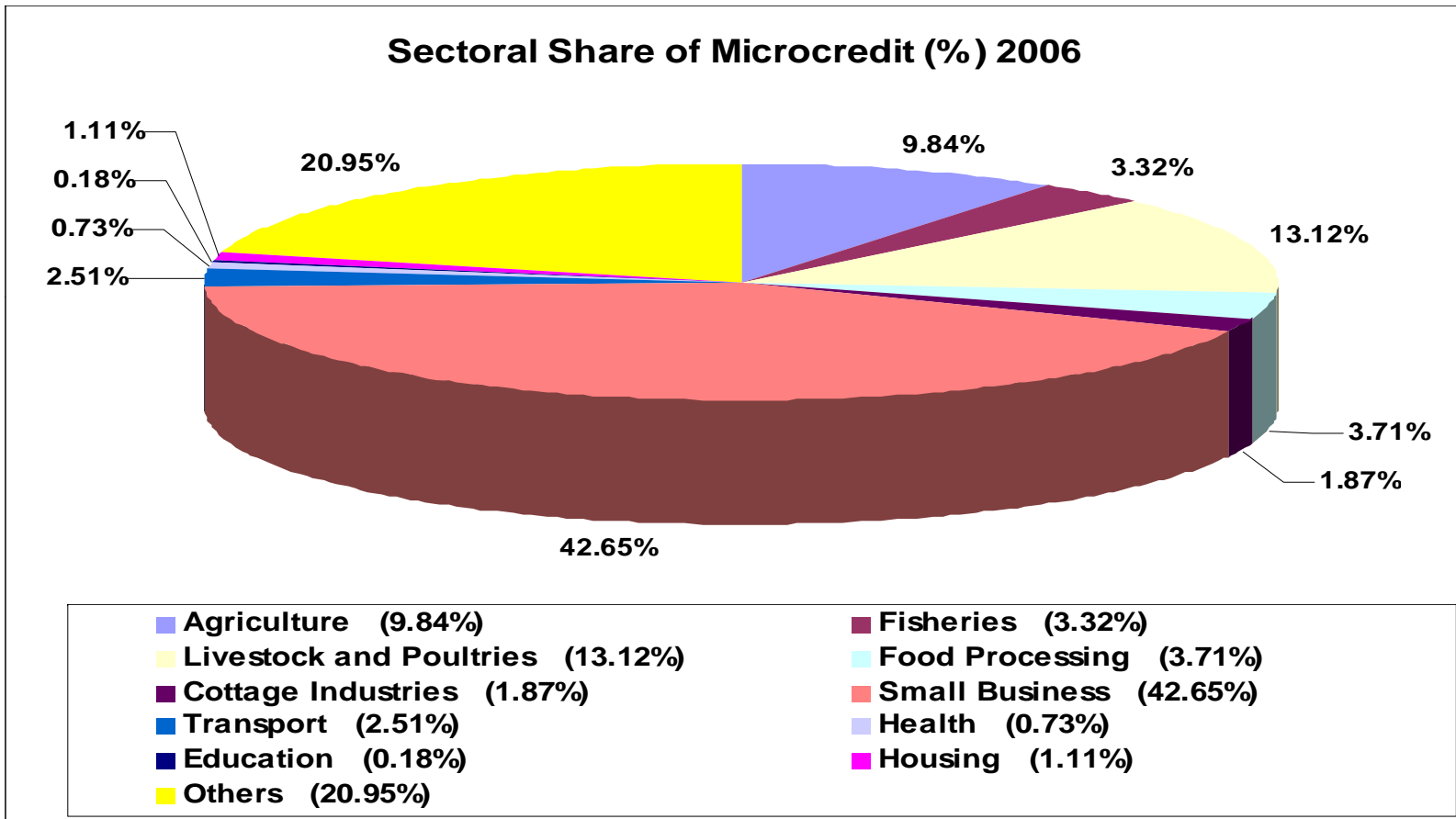
# Sectoral share of micro-lending (2000-2006)

Source: Institute of Microfinance



- Agriculture includes crops, Livestock, Fisheries.
- Processing & industrial Sector includes Food Processing and Cottage Industries.
  - Trade and Communication includes Small Business and Transport.
  - social Sectors includes Health, Education, Housing.

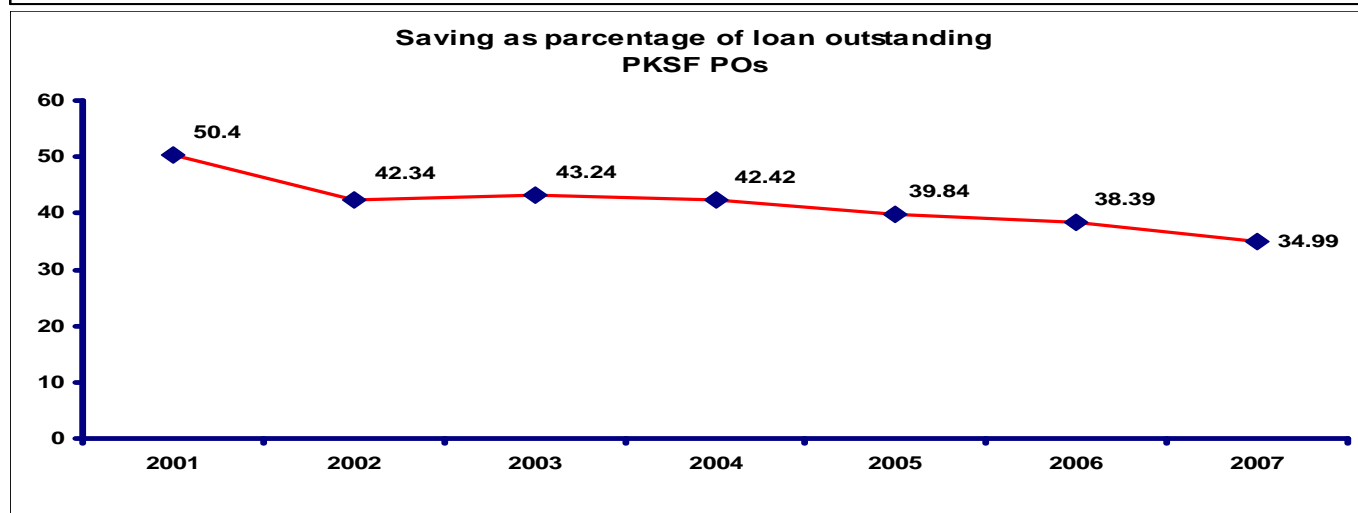
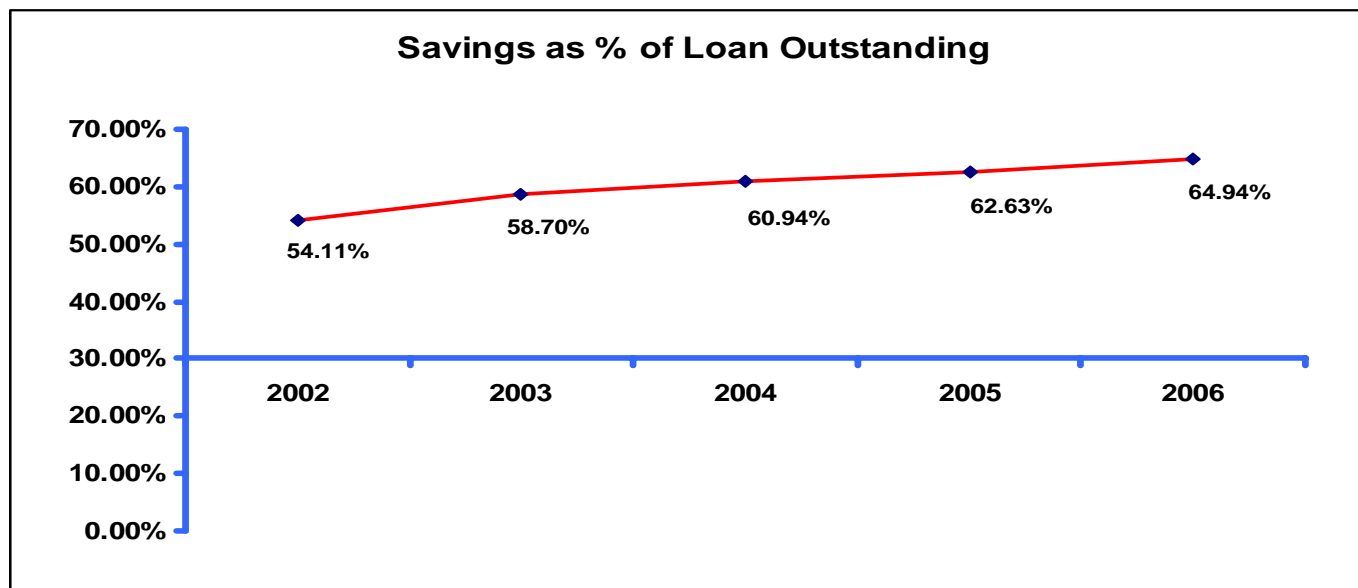
# Sectoral distribution of micro-lending (2006)



**Source: Institute of Microfinance**

# Savings as percentage of loan outstanding

Source: Institute of Microfinance



# Institutional Sustainability

- Subsidy dependency and market rate of interest

Source: Institute of Microfinance

## Subsidy as % of Loans Outstanding

Variable	BURO	TMSS	BRAC	ASA	GB
Income Subsidy	0.00%	10.41%	0.00%	0.00%	0.00%
Subsidy from Borrowings	2.32%	5.68%	3.46%	0.55%	0.54%
Grant Subsidy	0.90%	0.00%	0.81%	0.00%	0.15%
Total Subsidy	3.22%	16.09%	4.27%	0.55%	0.70%
Net Subsidy	-3.00%	8.12%	-3.10%	-12.99%	-3.40%

## Nominal Interest Rate

Variables	Very Small	Small	Medium	Large	Very Large
Borrowing Interest Rate	2.45%	3.18%	3.28%	4.96%	6.77%
Lending Interest Rate	13.17%	13.06%	13.11%	13.33%	16.67%
Savings Interest Rate	5.33%	5.16%	5.00%	4.50%	6.17%

## Part 1: MF accomplishments: What do we know?

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### Conclusions:

MF has created not only its market niche but also managed to maintain good financial performance over the years...

But are these achievements sustainable?  
Are there sustainable benefits accrued by participants and the society?

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## Part 2: MF driven results for development – what do we know?

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### ■ **2.1. Assessing MF development impacts: The key issues are:**

- ❑ **Are the program impacts really identifiable?**
- ❑ **If MF's emphasis is lending, impacts of borrowing are identifiable, provided liquidity constraints are binding**
- ❑ **Impact evaluation (IE) is not a comparison of benefits between program and non-program villages**
- ❑ **Similarly, IE is not also a comparison among participants and non-participants**
- ❑ **Program placement and participation are not random**

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## Part 2: MF driven results for development: What do we know?

### 2.2. IE means counterfactual comparison...

- Impact assessment involves a counterfactual comparison (i.e., what would have happened to a participant had he/she not participated?)
- In practice we do not observe the same person in two scenarios at the same time
- Finding a creditable counterfactual is required and it is the challenge of MF program evaluation

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## Part 2: MF driven results for development – what do we know?

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- **2.3. Key is to determine a counterfactual through two alternative ways:**
  - Randomized or experimental design
  - Quasi- or non-experimental design

Among the non-experimental methods,

- propensity score matching (PSM)
- Instrumental variable (IV) method
- Regression discontinuity (RD)
- Difference-in-difference (DD) method

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## Part 2: MF driven results for development – what do we know?

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### ■ 2.4. Which method to use?

- ❑ Findings are sensitive to the method applied
- ❑ No wonder controversies arise about the extent of program benefits
- ❑ No method is perfect and beyond doubt
- ❑ Alternative methods are to validate results
- ❑ Careful studies are hardly available
- ❑ No randomized evaluation of MF is done in BD
- ❑ Quasi-experimental designs are therefore used

## Part 2: MF driven results for development – what do we know?

### ■ 2.5. Development impact results

- At WB, we cross-examined the results using alternative non-experimental methods; PSM, IV, and DD methods with correction of time-varying heterogeneity.
- *Results suggest the following:*
- MF benefits borrowers in terms of income, employment, and hence poverty reduction
- MF has helped increase women's assets and household net worth
- MF contributes to social development by reducing fertility, increasing contraceptive use, and increasing human capital investment through higher school enrollment of boys and girls and better nutrition of children

## Part 2: MF driven results for development – what do we know?

### ■ 2.5. Development impact results (Contd...)

- MF helps empower women
- MFI driven results are more pronounced for women than for men
- Non-credit inputs are also helpful – for certain outcomes, impacts are even more pronounced for non-credit than for credit, given access to borrowing
- MF impacts are sensitive to resource endowments of borrowers, i.e., not all borrowers will benefit from microfinance equally.

## Part 3: Challenges for further development of MF sector— what we do need to know

- **Hard-core poor are hardly reached:**  
Not more than 20 percent of borrowers are hard-core poor—new interventions are introduced— we do not know much about their long-term impacts
- **Overlapping membership growth:**  
12 % from BIDS-WB study in 1997/98; 39% in 2006 from PKSF mapping study—rising competition among lenders— is market saturated? Or a way of risk diversification for lenders or an indication of easing credit constraints or a case of indebtedness?
- **Managing rising credit risk – (behavioral versus material risk)—**  
Flood, cyclone and other environmental shocks increase the material risk and hence, loan default rates and indebtedness are perhaps on the rise? How MFIs handle this rising material risk?

## Part 3: Challenges for further development of MF sector -- what we do need to know (contd.)

- **Micro-enterprise and agriculture loans are on the rise**

yet trade and trade-related sectors dominate the MF portfolio—is it problem of market demand or lack of skills and other inputs necessary for dynamic portfolio growth?

- **Interest rate too high?**

What is the break-even rate of interest rate? Is demand for MF interest sensitive? If so, how much sensitive? Can open competition among lenders help promote cost efficiency, which may help reduce the interest rate charged by MFIs?

- **Regulating and promoting micro-banks:**

A regulatory body is set up to regulate the MF industry and protect members' savings. The Regulatory body has licensed already 200 MFIs. The question is—how to promote these MFIs to become self-sustainable micro-banks that can service the target groups in an effective manner.

## Part 4: Challenges for MFI-led development— what we do need to know

- Declining benefits over time? Returns to borrowing have declined over the years—18 percent in 1991/92 to 12 percent in 1997/98. Is it an indication of diminishing returns to scale of operation of MF industry as a whole or by only participant level?
- Market saturation and diseconomies of scale?
  - returns to late entrants are lower than those of their counterpart early entrants;
  - returns to borrowing are lower in villages with higher aggregate amount of borrowing

## Part 4: Challenges for MFI-led development— what we do need to know

- **Rising indebtedness? InM study shows that some 12% of borrowers were indebtedness (defined as those who used rescheduled loan to repay the loan)—the reason was mainly for lumpy expenditure incurred. Average loan size/loan outstanding is higher over the years. Is it an indicator of indebtedness?**
- **What is important is to find out whether household net worth is increasing as well.**
- **In fact, estimates show that net worth of program participants grew at a rate of 15 percent per year during 1991/92-97/98 (WB study) and 8 percent per year during 2005-2007 (InM study).**
- **Yet growing income via micro-enterprise growth is a way for upward mobility**
  - Do not know how much income and employment growth is taking place in the micro-enterprise sector supported?
  - Can micro-enterprise loan be an engine of growth?

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## Part 5: A research agenda

- Structure of market demand and supply of microfinance
- Interest rate structure for financial sustainability of both lenders and borrowers
- Hard-core poverty and MF interventions
- Coping with rising material risk in MF
- Micro-enterprise growth and upward mobility
- Monitoring poverty and other indicators
- MF regulation and supervision: How to manage financial discipline for MF transformation

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# Thank You

