SAARCFINANCE Governors' Symposium
on
Microcredit

Papers and Proceedings of the SAARCFINANCE Governors' Symposium on Microcredit Held in Dhaka, Bangladesh During February 15-16, 2006

SAARCFINANCE Cell
Research Department
Bangladesh Bank
Dhaka, Bangladesh

Preface

As per the decision of the 13th meeting of the SAARCFINANCE (Network of SAARC Central Bank Governors and Finance Secretaries) held in Washington DC, USA on September 25, 2005 Bangladesh Bank (Central Bank of Bangladesh) organized SAARCFINANCE Governors' Symposium on Microcredit during February 15-16, 2006.

The Governors, Deputy Governors and other senior officials of seven SAARC countries and Afghanistan attended the symposium. The local participants in the symposium were mainly from Bangladesh Bank, Nationalized Commercial Banks and Specialized Banks, different Ministries, Palli Karma-Shahayak Foundation, Credit and Development Forum, Grameen Bank, Islami Bank Bangladesh Ltd., Local Non-Government Organizations (NGOs), Bangladesh Academy for Rural Development and Social Development Foundation.

In the symposium, the participants from seven SAARC member countries and Afghanistan presented their country papers (excepting Bhutan) focusing experiences of microcredit operations of the respective economies. A keynote paper on "Microcredit: Banking With the Poor Without Collateral" was also presented at the symposium by Professor Muhammad Yunus, Managing Director, Grameen Bank. The proceedings and papers of the symposium are compiled in this book without peer reviewing and editing. I hope this will help the readers to understand the importance, achievements and challenges in the microcredit operations in the SAARC region.

I express my profound sense of gratitude to the Hon'ble Minister for Finance and Planning, Government of the People's Republic of Bangladesh Mr. M. Saifur Rahman who despite his busy schedule graced the occasion as chief guest and kindly inaugurated the symposium. I express my sincere gratitude to all participants of SAARC countries and Afghanistan for making the symposium successful. I am very pleased with thoughtful speeches by the sessions' chairmen. I am also very pleased with the lively interactions among the participants in the symposium. I acknowledge the excellent work that the officials of Research and other Departments of Bangladesh Bank have rendered for successful completion of the symposium.

August 27, 2006

(Dr. Salehuddin Ahmed)
Governor
Bangladesh Bank

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Summary of Proceedings

I. Background

In line with the main thrust of the Millennium Development Goals (MDGs), eradicating poverty from the SAARC region is one of the common priorities of the SAARC nations. Empowering the poor, women in particular has the most effective impact on poverty alleviation. In this regard, facilitating them with the adequate financial means and ways through microcredit is already a proven strategy for the policymakers in empowering the poor. Given the importance of microcredit in alleviating poverty from the SAARC region, Bangladesh Bank hosted the SAARCFINACE Governors' Symposium on Microcredit during 15-16 February 2006 as sequel of the decision of the 13th SAARCFINANCE Group Meeting held in Washington D.C. on 25th September 2005.

II. Inaugural Session

The inaugural session started with recitation from the Holy Quran followed by opening remarks of Dr. Salehuddin Ahmed, Governor, Bangladesh Bank and Chairperson SAARCFINACE. Professor Muhammad Younus, Managing Director of Grameen Bank, the pioneer of microcredit programme, presented a keynote paper in the session. The Hon’ble Minister for Finance and Planning, Government of the People's Republic of Bangladesh, Mr. M. Saifur Rahman attended the session as the chief guest.

In the opening remarks Dr. Salehuddin Ahmed (Governor, Bangladesh Bank) highlighted the gains in different aspects of the physical quality of lives in Bangladesh since 1971. He also mentioned that despite the impressive progress, however, poverty continues to be pervasive and poverty reduction is still the major challenge. As the rural poverty is closely linked to land ownership and the burden of poverty falls disproportionately on women, effective participation of the poor especially poor women in the growth process needs to be accelerated for rapid and sustainable poverty reduction. Microfinance is considered as one of the important tools for poverty alleviation as it can play a vital role in empowering the poor and in associating them with the growth process he added.

Dr. Ahmed then highlighted the role of financial institutions (Banks and Non-banks) and microfinance NGOs in approaching the poor. He mentioned in this regard that formal financial sector assets are heavily concentrated in the banking sector, with nationalized commercial banks accounting for about 40% of total banking sector assets. Despite the importance of banks to the general financial sector, commercial banks in the country serve no more than 25% of the population. At the same time a strong semiformal microfinance system comprising the Grameen Bank and hundreds of microfinance NGOs (MFIs) operating in rural areas, small towns, semi-urban areas, and increasingly, urban neighborhoods as well has emerged. The combined coverage of microfinance programs of Grameen Bank, and of the 1000 plus non-government microfinance institutions and of government-financed projects in Bangladesh is approximately 15 million households. He also added that the microfinance industry in Bangladesh has the potential of further expansion by increasing the outreach, and by expanding areas of service and types of products and services offered. He strongly supports the view that time has come for up scaling of microfinance into micro-enterprises and small enterprise, which lacks a proper regulatory framework.

Regarding regulatory framework of the microfinance industry, he mentioned that the Government has established "Microfinance Research and Reference Unit (MRRU)" in the Bangladesh Bank and constituted a Steering Committee under the chairmanship of the Governor of the Bangladesh Bank to formulate some policy guidelines and regulatory framework for this sector. Some progress has already been made in this regard. The Governor of the BB opined that in future the new law for semi-formal microfinance sector will change the scenario of rural financial market in Bangladesh. Because addressing the issues and innovations over the time would help develop microfinance sector in a sustainable manner and also help poor people to get access to credit from the institutional sources. Microfinance activities enable the poor to start with something to take a step forward to the prosperity. Since our aim is to eradicate poverty from the SAARC region, Dr. Ahmed added that our focus should be on SAARC Development Fund (SDF) and SAARC Poverty Alleviation Fund (SPAF) where making a proper interface between them is a major challenge. The Governor of the BB concluded his opening remarks by expecting that this Symposium could come up with some specific and pragmatic recommendations for consideration of the higher committee in eradicating poverty in the shortest possible time.

In his Keynote Paper Prof. Yunus pointed out that two thirds of the world population does not have access to financial services from the conventional financial institutions. He then highlighted how Grameen Bank provides banking services to the un-banked poor and how the bank extended un-collateralized credit service to the poor. In describing the up-dated activities of the Grameen Bank he mentioned that today the Grameen Bank is in a position where no external fund is needed to run it. Then he mentioned how the Grameen Bank is different from other financial institutions where the main objective is to bring financial services to the poor, particularly women and the poorest - to help them fight poverty, stay profitable and financially sound. It is a composite objective, coming out of social and economic visions. Among the various but unique features of the Grameen Bank he pointed out that

- It provides high priority to women
- There is no legal instrument and borrowers are never taken to the court
- Interest cannot exceed principal
- The bank provides scholarship and student loans
- It has launched loan scheme for the beggars
- No liability on dead people
- It provides telephone for ladies. It offers telecommunication services in nearly half of the village of Bangladesh

Prof. Yunus then described how the idea of Grameen Bank is used worldwide where the Grameen philosophy and methodology have spread notably. He mentioned in this regard that many global initiatives have been established to spread microcredit. Grameen Trust is an international wholesale fund that was created in 1989 to provide support to start Grameen replications in other countries. Grameen Trust started providing start-up money for projects all around the world since 1991. In a different type of program, Grameen Trust also goes into a country to create a microcredit program directly on the ground with experienced staff from Grameen Bank, under a Build-Operate-Transfer (BOT) contract.

In covering the impact of microfinance on poverty reduction he cited some studies that found strong evidence of positive impact. He emphasized on formulating legal framework for microcredit institutions. He argued that a friendly regulatory framework will enable the sector to mobilize deposits and reduce dependency on external resources. He also argued that adequate institutionalization of the sector through appropriate policy preparation is a very vital part of reaching the Millennium Development Goal (MDG) by 2015.

The chief guest of the inaugural session Mr. M. Saifur Rahman, the Hon’ble Minister for Finance and Planning, Government of the People's Republic of Bangladesh, in his speech remarked that the topic of the seminar was very appropriate and pragmatic in the present socio-economic background and perspective of the SAARC countries. He said that the poverty alleviation programs had got momentum in the SAARC region through the pro-poor growth strategies at different levels. According to him, the significance of microcredit in Bangladesh as also in other SAARC countries are extremely important for the welfare of poverty stricken people of these countries. Terming the microcredit operation as an important tool, the Hon’ble Minister mentioned that the concept has been well accepted by both developing and developed countries for its positive impact in reducing poverty. He completely endorsed the basic philosophy of the microcredit program in fighting poverty. He also added that the government of Bangladesh is committed to promoting microcredit activities for alleviating poverty from the country. He supported the view of collateral free banking along with the necessity of a critical minimum amount of credit, which is sufficient to generate effective income and output for the borrower. He mentioned some of the initiatives, such as food for education, free education and scholarship for girls, taken by his government to empower the poor, women in particular. The high enrolment rate of girls in school and colleges that helped to reduce gender disparity is because of these initiatives, he added.

Regarding the issue of loan defaults, the Hon’ble Minister explained his position and discussed various initiatives taken by his government against the loan defaulters. He mentioned in this regard that because of proper regulatory and legal changes initiated by his government, the tendency or propensity of not paying loans has somewhat declined in recent times. He also added that credit is inherent right of all individuals, which should not be the right of the rich people alone. He also expressed his observation that microcredit institutions in Bangladesh are doing great job in distributing credit to the poor and in eradicating poverty from the rural areas of the country. He urged other SAARC nations to spread the notion of microcredit program to fight poverty in their respective countries.

In explaining the role of his government in microcredit program, he mentioned that the efforts of the government of Bangladesh remained somewhat unnoticed where the government is relentlessly helping the microfinance activities in the country. Among the various initiatives of the government in microcredit, he mentioned about the targeted poverty reduction programs of the government and setting up of an NGO Foundation to finance our MFIs locally instead of foreign sources. Regarding the regulatory and legal framework in microcredit, he said that it has already been drafted and sent to the respective ministry for review hoping that the final form of the regulation would be in effect shortly.

III. Working Session I

Dr. Fakhruddin Ahmed, Managing Director, Palli Karma-Shahayak Foundation (PKSF) was the Session Chairman of the Working Session-1. The Theme Papers for this session were "Development of Microfinance and SME Lending in Afghanistan", "Microfinance in Bangladesh: Major Achievements and New Challenges," and "Up-scaling Micro Finance in India - Retrospect and Prospect."

III.1. Theme Paper 1: Afghanistan
"Development of Microfinance and SME Lending in Afghanistan"

Mr. Noorullah Delawari, Governor, Da Afghanistan Bank (the Central Bank of Afghanistan) presented the paper. The paper has described the emerging role of microfinance institutions in the regulated financial environment in Afghanistan given the importance of microcredit for the newly started but fully regulated economy. It also focused on some of the regulatory issues as well as the current activities of the microfinance institutions in the country. The Governor of Da Afghanistan Bank concluded his presentation by saying that the government of Afghanistan, together with its partners in the international community and relying on the enormous energy and nascent entrepreneurial talent of the private sector, is committed to creating an environment conducive to economic growth. He also added that, this country is emerging from 25 years of war, multiple regime changes, economic collapse, and a disintegration of the social fabric that is almost unprecedented in human history. Many more years of hard work will be required to rebuild the institutions of a stable, just, benevolent, and prosperous society.

III.2. Theme Paper 2: Bangladesh "Microfinance in Bangladesh: Major Achievements and New Challenges"

Khandakar Muzharul Haque, Executive Director of the Bangladesh Bank presented the theme paper titled "Microfinance in Bangladesh: Major Achievements and New Challenge" in the symposium. The paper has drawn attention to the fact that microfinance is currently at the center of policy discussions related to financial sector development and poverty alleviation. Microfinance experiences in Bangladesh have made important contributions to the emergence of this concept globally. It is important to analyze the experiences of microfinance as the exercise can lead to potential lessons for developing sustainable rural finance to eradicate rural poverty. Microfinance Institutions (MFIs) have managed to develop important innovations that enabled them to expand financial frontiers in developing countries such as Bangladesh. For the first time, large numbers of poor borrowers have access to financial services through formal type of institutions due to these innovations. It permitted these institutions to serve poor clients successfully without the collateral that is normally required by banks. The techniques that are used by the MFIs are in sharp contrast with the formal banks operating in the rural areas that require a conducive regulatory and policy environment for the development of this sector.

Development of the Microfinance Sector in Bangladesh

The institution that has shaped much of the modern-day microfinance is the Grameen Bank, which began in 1976 as an experimental Project and has been established as a formal bank for the rural landless in 1983 (by a separate Ordinance), a progress expedited by its success. For the last two decades Bangladesh has been drawing the attention of the world for its microfinance initiatives. The country experienced a massive expansion of microfinance activities during the 1990s with scaling up of existing providers, entry of new players and emergence of an apex funding institution like Palli Karma-Shahayak Foundation (PKSF).

Microfinance Programs of Different Types of Organizations

In Bangladesh, there are four main types of institutions involved in microfinance activities, such as (1) Grameen Bank (GB), a specialized institution, (2) Non-Governmental Organizations (NGO) like BRAC, Proshika, ASA 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 Bangladesh Rural Development Board (BRDB), Palli Daridro Bimochon Foundation (PDBF), Swanirvar Bangladesh, RD-12 and others which are run through several ministries.

Palli Karma Shahayak Foundation (PKSF): Apex Funding Organization

Palli Karma-Shahayak Foundation (PKSF) is the apex microcredit organization established by the Government in 1990. It also works for capacity building of the organizations. It does not directly lend money to the landless and the asset-less people but reaches its target groups through its Partner Organizations (POs). PKSF currently provides loanable funds to 233 POs at 4.5% interest to small and medium POs and 7% to large POs. The PKSF is also widely credited for sharpening the focus of many NGO-MFIs towards financial sustainability and also in setting appropriate standards that would ease the way for a strengthened regulatory structure for microfinance. Up to September 2005, PKSF has provided Tk. 23,291.74 million to its POs that enabled them to disburse Tk. 23,175.46 million to targeted poor.

Major Achievements of Microfinance in Bangladesh

Microfinance sector in Bangladesh could indeed take pride in its substantial achievements especially in terms of outreach, sustainability and its impact on the borrowers, within only two decades. Some of the significant features of achievements are as follow:

a. **Outreach or coverage:** The effective coverage of MFIs stands at 10.05 million, and that covers around 37% of all households in the country.

This covers more than 8 million poor households.

b. **Savings collected by the sector:** Till December 2004 Grameen Bank and NGO-MFIs had collected more than Tk. 30,384.99 million from over 14 million poor people.

c. **Sources of fund and financial sustainability:** 'Revolving Loan Fund' is financed with flow of funds from different sources. They are: (i) member savings; (ii) PKSF; (iii) Local commercial and Development Banks; (iv) International NGOs; (v) International donors; (vi) Local NGOs; (vii) Own Fund & Reserve; and (viii) Net revenue. Now the sector is accumulating more funds from local sources, i.e., members' savings and service charges; these two sources contributed more than 50 percent into the revolving loan fund in the year 2004.

d. **Impact on local economy:** There are a few studies that investigate the spillover effects of the program on local economies, thereby increasing welfare of the local villages. The results of the studies strongly support the view that microfinance facilitates aggregate welfare at village level.

Impact of Microfinance

- Impact on income and employment: The latest study mentions that the total household income has increased from 2.8 percent to as high as 12.2 percent per annum during 1997-2004.
- Social impact: Microfinance programs promote investment in human capital and contribute to increase awareness of reproductive health among poor families. Adult literacy rate is significantly higher among the eligible participants. Study also found that program participation increases the chance of both boys and girls to be enrolled in schools.
- Impact on local economy: There are a few studies that investigate the spillover effects of the program on local economies, thereby increasing welfare of the local villages. The results of the studies strongly support the view that microfinance facilitates aggregate welfare at village level.
- Impact on women empowerment in terms of:
  - Participation in household decision-making
  - Easy access to credit
  - They are able to stop domestic violence due to personal influence in income generation and through group action and
  - Active and vibrant participation in the local government.

Emerging Issues

Microfinance market in Bangladesh has come quite a long way. However, there are certain issues that need special attention. Stakeholders frequently talk about the following issues:

a. **Interest rate** -- The effective annual interest rate of microcredit usually varies between 20 to 30 percent. This rate apparently seems higher than the commercial banks' lending rate.
b. **Programs for the extreme poor** -- The extreme poor, who constitute about 15% of the total population of Bangladesh, have remained outside the traditional microcredit programs. PKSF, Grameen Bank and some other NGO-MFIs have recently taken some special programs to reach the excluded groups.
c. **Graduated borrowers and micro-enterprises** -- Some of the borrowers have become more skilled. Currently, many growing microcredit borrowers are attempting to become scaled-up micro-enterprises. MFIs are being encouraged to support these borrowers in order to help them generate additional income and employment.
d. **Commercial viability and self-reliance** -- Access to public deposits is still restricted. Without having access to public deposits MFIs need start up funds as grants or concession, which can often seriously damage their spirit of self reliance.
e. **Ownership and governance issues** --The issues of ownership and governance are not appropriately defined. The problems of governance are mostly due to the inadequacy of the existing laws and regulations and to lack of reporting, supervision and monitoring. At the same time the ownership structure of NGOs is not well organized. Both the issues are important, now that the sector has become institutionalized.
f. **Regulation and supervision** -- The issue of regulation and supervision has come to the forefront because MFIs are providing financial services and products to the poor, outside the formal banking system. NGO-MFIs should be subject to appropriate but a friendly regulatory framework.

Considering the above mentioned issues the paper pointed out that the government of Bangladesh established a unit namely "Microfinance Research and Reference Unit (MRRU)" in Bangladesh Bank and constituted a National Steering Committee under the leadership of the governor of the Bank to formulate a regulatory framework for this sector and to oversee the activities of MRRU. The Committee has prepared an operational guideline for MFIs which are now being implemented by the

MRRU. On the basis of this guideline MRRU is collecting information on this sector, analyzing them for policy inputs and publishing them to improve the transparency of this sector. The Committee has also prepared a draft law for setting up a separate regulatory authority for this sector and has already submitted it to the government for taking necessary action. The draft law has suggested an independent regulatory authority that would be responsible for providing license to the MFIs and monitoring their activities. It is expected that the proposed law will help build this sector on a solid foundation.

III.3. Speech by Mr. Daw Tenzin, Managing Director of Royal Monetary Authority of Bhutan

There was no discussion paper from Bhutan. However, Mr. Daw Tenzin, Managing Director of Royal Monetary Authority of Bhutan gave an informal speech in the symposium where he mentioned that the country is yet to have any formal microfinance activities. They are in learning process and they need to have regulatory framework before starting the microfinance activities in their country. In view of supporting development activities in the country, however, Bhutan Development Fund is doing an excellent job he added.

III.4. Theme Paper 3: India "Up-scaling Microfinance in India - Retrospect and Prospect"

Vishwavir Saran Das, Executive Director of RBI, India presented the theme paper titled "Up-scaling Microfinance in India - Retrospect and Prospect" focusing on the following points.

Development of Microfinance

As a large section of population in the unorganized sector particularly in the rural areas remained outside the formal financial structure, a need was felt for alternative policies, systems and procedures, savings and loan products, other complementary services, and new delivery mechanisms which would fulfill the requirements of the poorest, especially of the women member of such households. The emphasis, therefore, was on improving the access of the poor to microfinance.

Microfinance Models in India

a) The SHG-Bank Linkage Programme

In 1992, a pilot project of linking Self Help Groups (SHGs) with commercial banks was launched under the aegis of National Bank for Agriculture and Rural Development (NABARD), which is the apex bank for rural and agricultural credit in the country. The Government of India has also been supporting the SHG-bank linkage programme through budgetary announcements, inter-alia, regarding the number of SHGs to be linked to banks and other policy issues.

Three different models of linkage have evolved based on variations in the delivery mechanism. They are:-

- Model I : SHGs formed and financed by banks

  Under this model, banks themselves act as Self Help Promoting Institutions (SHPI), as at March 2005, 21 per cent of the total number of SHGs financed was from this category.

- Model II : SHGs formed by NGOs and other agencies but financed directly by banks

  Under this model, Non-Governmental Organisations (NGOs) and other agencies in the field of microfinance act as facilitators and banks in due course link the groups by directly providing loans to them. About 72 per cent of SHGs linked to banks as at March 2005 was under this model.

- Model III: SHGs financed by banks using NGOs as financial intermediaries

  In this model, NGOs take on the dual role of facilitators and financial intermediaries. The proportion of SHGs linked to banks under this model is relatively small, i.e., 7 per cent as at March 2005.

The SHG-bank linkage has shown significant growth in terms of number of groups linked to banks. Starting from only 255 SHGs linked to banks in the year 1992-93, the number increased to 0.5 million SHGs linked during the year 2004-05. Cumulatively, the number of SHGs linked to banks aggregated 1.6 million as at the end-March 2005. This translates into an estimated 24.3 million poor families brought within the fold of formal banking services. Ninety per cent of the groups linked with banks are exclusive women's groups. Cumulative disbursement of bank loans to SHGs stood at over Rs. 68 billion as on March 31, 2005 with an average loan of Rs. 42,600 per SHG and over Rs. 3,000 per member. A total of 573 banks including 47 commercial banks, 161 RRBs and 330 co-operative banks are now associated with the SHG-bank linkage programme. While 572 out of 603 districts of the country in 31 states/ Union Territories have been covered under this programme, the total number of NGOs presently involved in this linkage is around 4,500.

b) Bank-MFI Bulk Lending Model

An alternative delivery model for microfinance is the bulk lending model, where funds are placed at the disposal of NGOs or MFI for on lending.

c) The Bank-MFI Partnership Model

This model has been popularized by the new generation private sector banks in the country. Under this model, the MFI evaluates, recommends, originates the loans, helps in disbursal and subsequently tracks and collects the loans. However, the loans are accounted for in the books of the bank and not of the MFIs. This model has overcome the constraints of capitalization of the MFI.

d) Grameen Bank Model

Some NGO-MFIs in the country have adopted the Bangladesh Grameen Bank model for providing microfinance to poor women. Available data show that the outstanding loans given by these MFIs aggregated Rs. 5.1 billion as at the end of March 2005.

The Policy Framework for Microfinance

While there is no accurate data on MFIs in the country, the number of MFIs is estimated to be around 800, majority of which are operating on a smaller scale with clients ranging from 500 to 1,500 per MFI. An estimate from the largest association of MFIs indicates that on March 31, 2005, outstanding loans disbursed by their members amounted to Rs 10.63 billion. Micro finance institutions that are registered as companies come under the regulatory purview of RBI. Non-Banking Financial Companies (NBFCs) accepting public deposits are subjected to rigorous supervision by RBI, There are, however, only a few MFIs in the country that are registered as NBFCs. Further, companies which are engaged in micro financing activities, licensed as not for-profit companies and are not accepting public deposits, are exempted from the key regulatory/statutory requirements, viz., registration, maintenance of liquid assets and transfer of minimum percentage of profits to the Reserve Fund.

Reserve Bank of India has been striving to create an enabling environment for the growth of micro finance in the country. The pilot project of SHG-bank linkage launched by NABARD in 1992 received full policy support from RBI and it advised the commercial banks to actively participate in linkage programme which has since been extended to the regional rural banks and cooperative banks. The Reserve Bank set up four informal groups by in October 2002 to examine (i) structure and sustainability issues, (ii) funding issues, (iii) capacity building issues and (iv) regulatory issues relating to microfinance. The Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Vyas Committee) appointed by the RBI also examined various issues in microfinance.

Highlights of the circular/guidelines issued to banks in this regard incorporating the recommendations made by various committees are as under:

- Interest rates applicable to loans given by banks to micro credit organisations or by the micro credit organisations to Self-Help Groups/ member beneficiaries have been left to their discretion.
- Micro credit extended by banks to individual borrowers directly or through any intermediary is reckoned as part of their priority sector lending. Bank loans to SHGs are also treated as lending to the weaker sections.
- The banks may formulate their own model(s) or choose any conduit/intermediary for extending micro credit. It may be desirable for banks to deal with micro credit organisations having proper credentials.
- Banks may prescribe their own lending norms keeping in view the ground realities.
- Micro credit should also form an integral part of the bank's corporate credit plan and should be reviewed at the highest level on a quarterly basis.
- Banks should strive to remove all operational irritants and make arrangements to expeditiously sanction and disburse micro credit by delegating adequate sanctioning powers to branch managers. The loan

application forms, procedures and documents should be made simple.

- The group dynamics of working of the SHGs may be left to themselves and need neither be regulated nor formal structures imposed or insisted upon.
- The approach to micro-financing of SHGs should be totally hassle-free.
- MFIs would not be permitted to accept public deposits unless they comply with the extant regulatory framework of the Reserve Bank

Further, Foreign Direct Investment (FDI) has been allowed by the Government of India in the MFI sector subject to certain norms and NGOs engaged in microfinance have now been allowed to raise External Commercial Borrowing (ECB) up to USD 5 million during a financial year.

Expanding the Outreach of Microfinance

An Internal Group of RBI on Rural Credit and Micro-Finance (Khan Committee) had recently examined the issues relating to expanding the outreach of microfinance through linkage between banks and intermediaries from the formal, semi-formal and informal sectors and leveraging information and communication technology (ICT) for the purpose. On the basis of recommendations made by the Committee, banks have since been permitted to use the services of NGOs/SHGs/their federations, MFIs and other civil society organizations as intermediaries in providing financial services through the use of (i) Business Facilitator and (ii) Business Correspondent models.

Role of other Apex Level Institutions

a) NABARD

A Micro Finance Development Fund of Rs. 1 billion was established in NABARD in the year 2000-01 for (a) giving training and exposure to Self-Help Group (SHG) members, partner NGOs, banks and government agencies; (b) providing start-up funds to microfinance institutions and meeting their initial operational deficits; (c) meeting the cost of formation and nurturing of SHGs; (d) designing new delivery mechanisms; and (e) promoting research, action research, management information systems and dissemination of best practices in the microfinance sector. The corpus of the Fund has now been raised to Rs. 2 billion and it has been renamed as the Micro Finance Development and Equity Fund. The objective of the redesignated Fund is to facilitate and support the orderly growth of the microfinance sector through diverse modalities.

b) The Small Industries Development Bank of India (SIDBI)

The cumulative assistance of SIDBI's microfinance initiatives as at the end of March 2005 aggregated Rs. 4.2 billion through 209 MFIs, benefiting approximately 1.51 million poor, mostly women.

c) The Rashtriya Mahila Kosh (RMK)

The cumulative loan sanctioned by RMK stood at Rs 1.3 billion in respect of 749 NGOs and other agencies as at the end of March 2004.

Impact Evaluation

Impact evaluation studies conducted by NABARD and SIDBI point to positive results. The SIDBI study indicates that the microfinance initiatives have increased non-farm employment of the rural people and women in particular have been benefited in terms of economic and social empowerment, their ability to access loan, own productive resources, engage in income generating activities, decision making and increased mobility.

The Road Ahead - Issues and Challenges

1. Regional variations

Although more than 24 million poor families have been covered so far there is a need to upscale the number of SHGs, particularly in the Northern, Eastern and North-Eastern parts of the country where there is a dearth of good Self Help Promoting Institutions (SHPIs).

2. Cost of credit

Adoption of innovative methods and processes including low cost ICT solutions can be one way for reducing their transaction cost and, hence, the cost of credit to the borrowers.

3. Promotion of micro-enterprises

The average loan amounts per SHG and per member are about Rs.

42,600 and Rs. 3,000 respectively. The per member loan amount is too small for any meaningful business activity. The quantum has to be increased substantially when the SHGs go higher in the ladder to the level of micro-enterprises.

4. Regulation of MFIs

Major players undertaking microfinance activities in India (viz. banks and NBFCs) are well-regulated entities. The other types of organizations, such as, societies, trusts, etc. which do not accept public deposits are not regulated by the central bank. The Business Facilitator and Business Correspondent models suggested by the Khan Committee report will help forge NGO / MFI - bank linkages, leveraging the strengths of semi-formal and informal NGO-MFI sectors with the well regulated entities like banks. In the circumstances, a comprehensive regulatory framework for the large number of non-deposit taking organisations spread across the country may not be necessary for the present. Many experts have favored a self-regulatory system at the state level for MFIs, which do not fit into the existing regulatory framework. As regards SHGs, the group dynamics of working of the SHGs, whose strength lie in simplicity, informality and flexibility may be left to themselves and they need neither be regulated nor formal structures imposed upon them.

5. Funding support

The Micro Finance Development and Equity Fund established in NABARD is expected to play an important role in providing Equity Capital or Quasi Equity to enhance the capacity of the MFI to undertake financial operations. The banking sector also supports the "Fit and Proper" NGOs/ Self Help Promotion Institutions (SHPIs) in the formation and nurturing of SHGs and other microfinance initiatives.

6. Capacity building and other developmental issues

Efforts of NABARD, SIDBI and associations of the MFIs in this area need to be continued. The national level training institutions like the College of Agricultural Banking (CAB), Pune and the Bankers Institute of Rural Development (BIRD), Lucknow are also involved in the training of banks and MFIs. There is need for more stringent disclosure norms for MFIs/NGOs. In the interest of these organizations, proper accounting standards have to be developed and implemented. There is also a requirement of some form of credit information bureau on a localized basis to provide borrower information to banks and the MFIs.

7. Role of the corporate sector

Many corporate have realised that the people at the bottom of the pyramid can be brought into their business model and they can play a critical role in providing market linkage to the products of the rural areas and the informal sectors on a sustainable basis.

Finally, the presenter concluded his presentation saying that that we are committed to the philosophy of Financial Inclusion of the poor and the disadvantaged. In the fast changing socio-economic scenario, care is being taken to shape policies and adopt options based on continuous learning and feedback in this vital area critical to development with equity. With convergence of approach and appreciation of the issues among all the stakeholders, one can be confident of a bright future for the microfinance sector in India.

When the floor was opened for discussion, Mr. W. A. Wijewardena pointed out that the results of the studies related to microfinance activities are not unique- some come out with positive and some with negative impact of micro-finance activities on the overall economy. He also questioned the very high interest rates of lending in this sector. The Resident Economic Adviser (REA) of the Bangladesh Bank's recently launched Policy Analysis Unit (PAU) expressed his curiosity regarding the unique regulatory framework of the Afghan monetary sector. He also requested all other central banks to make the micro-finance data available for researchers. In response to question from the symposium participants, Mr. M. A. Raquib mentioned about a microfinance project of Islami Bank Bangladesh Limited based on Islamic Shariah by adopting Grameen Bank Model. In this regard, he proposed to the central bank to come forward to issue license for microfinance activities. He also endorsed the idea of credit for the beggars. While describing the experience of microfinance activities in Nepal, Mr. Bir Bikram Rayamajhi, Deputy Governor of Nepal Rastra Bank mentioned that initially they had faced problem with the Grameen Bank Model. He also added that the situation has already changed and they are in good shape now.

Dr. Fakhruddin Ahmed Managing Director of PKSF, the chairperson of the session made his remarks on the four important issues. Firstly, regarding the issue of cost of fund, he mentioned that our efforts are needed to make funds available for the poor at lower cost. Secondly, an effective regulatory framework is required for the development of this industry. Because, facilitation of the sector without regulation is difficult he added. Thirdly, he talked about the importance of the sources of fund, which very much related to increase the outreach as well as to the reduction of the cost of funds. Fourthly and finally, he raised the issue of hardcore poverty which is very important for Bangladesh where a large part of them is left out of the conventional credit program. All MFIs need to address this issue seriously, he added.

IV. Working Session II

Professor Wahid Uddin Mahmud, Department of Economics, University of Dhaka was the chairman of the session. The Theme Papers for this session were "Micro and Small Scale Financing: The Maldives Experience," "Microfinance Environment in Nepal," "Microfinance in Pakistan: the Policy Environment," and "Micro Credit Delivery System in Sri Lanka."

IV.1. Theme Paper 4: Maldives
"Micro and Small Scale Financing: The Maldives Experience"

Ms. Khadeeja Hasan, Managing Director of Maldives Monetary Authority presented the paper titled "Micro and Small Scale Financing: The Maldives Experience" with the following focal points.

Status and Situation Analysis of Micro and Small Scale Finance Providers

The Ministry of Finance and Treasury (MoFT) channels donor funds and provides credit out of budget to a number of ministries, enterprises and individuals. These funds are on-lent for a number of purposes that include electrification in islands, fishing boats, fish processing, and on-lending to women. The annual interest rate on these loans is 6-8 percent. There are no fixed terms for loan repayment by the participating ministries.

Fisheries Sector Micro and Small Scale Financing

A substantial allocation of funding, financed from donor funds and budget, has been made for fishing boats. The financing term is 10 years with bi-monthly payments calculated as a hire purchase arrangement. A review and analysis concerning loans made for boat purchase showed 90 percent of borrowers with overdue balances. No provision for loan loss was made in these programs. Loans at risk were over 90 percent of loans outstanding. Credit for fish processing has also been provided. Although loan size ceiling is Rf25, 000 most loans have been for less than Rf10, 000. Loan term for borrowers is two years including a six-month grace period. The interest rate is 7 percent. Loan disbursement is by check that is cashed in a Bank of Maldives (BML) branch. Loan Repayments, in cash, are collected through the Island or Atoll office. Administrative costs of the fish processing credit are high. No information is kept on the impact of the loans on the income of the borrowers.

Women Empowerment

Ministry of Gender and Family Development (MGFD) since March 2000 has had Rf1 million allocated out of budget for microcredit to disadvantaged.

Atoll Development Funds (ADFs)

ADFs are funded by the Government and UNDP. Four atolls are participating in ADFs: Nkoonu, Vaavu, Laamu and Shaviyani. These funds are earmarked for credit to individual borrowers and for community-service utilities. Without donor support, Government has no specific plans for extending ADFs to further atolls. Deposit mobilization is not an objective of the ADFs.

Key Issues and Challenges Regarding Micro and Small Scale Financing Programs

Government Credit Programs

Credit Programs through a number of ministries and donors have been developed as a response to perceived imperfections in the financial market. There is a Perception that the BML is unable or not willing to meet the credit needs of certain market segments mainly comprising disadvantaged women, fishermen and secondary businesses. Partly this is due to inability these borrowers to provide adequate of satisfactory forms of loan security, and partly because the bank does not regard their business activities as being sufficiently profitable to repay a loan.

Atoll Development Funds (ADFs)

Credits provided through the ministries and ADFs are competing with commercial lending of BML by using soft interest rates, by not charging their substantial administrative expenses to borrowers. Subsidized interest rates to borrowers are decapitalizing the funds. Effectively the existence of these soft credits makes it more difficult for the banking sector to expand and develop range of attractive financial service especially outside Male. These Programs do nothing to encourage deposit mobilization. There is substantial evidence that much of the credit, particularly in the service sector, merely facilitates entry of more entrepreneurs into market thereby reducing the market share of each business.

Legislative and Regulatory Environment

There is no appropriate regulatory framework for MFIs separate from banks that would allow MFIs to take in deposits. For MFIs to flourish as credit and deposit-taking institutions several changes in the banking regulations would be needed. In particular these relate to (i) a reduced capital requirement, (ii) modified minimum reserve requirements, (iii) modified standard financial statements, (iv) procedures for off-site and on-site inspections of MFIs, and (v) procedures for the audit of MFIs.

Lessons Learnt and Possible Next Steps

Government Credit Programs

There is a need to (i) review the criteria under which programs are justified, (ii) install a better system that provides a complete and current listings of all Government-financed programs, (iii) improve the presentation of the credit programs in Government expenditure accounts, (iv) improve the content and standardization of reports, (v) establish a system for monitoring of the sociological and economic impact of the programs, and (vi) provide for financial performance indicators and an evaluation system concerning the management of the loan portfolios.

Atoll Development Funds

In order to be sustainable, ADFs need to address the following concerns:

- Charge an interest rate on lending that completely covers the costs. This charge has to be an effective rate of approximately 20 percent.

- ❖ Change loan terms to match business investment needs and turnover. Working capital loan should be on a 6-12 month basis with renewal subject to satisfactory repayment.
- ❖ Limit lending for community utilities to not more than 20 percent of ADF borrowing and net worth and limit and individual loan size to not more than 15 percent of net worth.

IV.2. Theme Paper 5: Nepal

"Microfinance Environment in Nepal"

Mr. Bir Bikram Rayamajhi, Deputy Governor of Nepal Rastra Bank presented the paper titled "Microfinance Environment in Nepal" with the following major points.

Evolution of Micro Finance Sector in Nepal

Micro credit programs have been started in the country nearly three decades ago. Most of the micro finance programs implemented in the country have direct or indirect involvement of the government. Keeping in view the encouraging experiences of micro finance programs in other countries, the Nepal Rastra Bank (NRB) as a central bank has been making its efforts in creating environment to attract the private sector to the micro finance industry. As early as 1950s, first credit cooperatives were established as a means to provide credit to the farmers. Small Farmers Development Program (SFDP) is the first institutional microcredit program in the country, which was initiated in 1975 as a pilot project by the Agricultural Development Bank of Nepal (ADBN).

In 1982, His Majesty's Government of Nepal (HMGN) launched Production Credit for Rural Women (PCRW) program in collaboration with two public sector commercial banks. During 1992-1996, five regional rural development banks were established with a view to expanding micro finance services to a large number of poor households throughout the country. All of them have followed the operational modality of the Grameen Bank, Bangladesh, and they altogether have an outreach of about 150,000 poor households. In recent years, four non-government organizations (NGOs) having considerable experience in microfinance (MF) operation have transformed themselves into microfinance development banks (MFDBs). Most of these are following Grameen model of microfinance system with slight modifications. They have altogether served about 130,000 poor households. Majority of them belong to the poorest of the poor. The average loan recovery rate of the MFDBs is over 98%.

There are also a large number of NGOs, community based organizations (CBOs), and savings and credit cooperatives (SCCs) operating savings and credit activities as one of their major activities throughout the country. There could be over 2,000 SCCs, but only 34 SCCs have been able to get license from the central bank for limited banking operations. By the end of 2005 only 19 such SCCs are there and rest of them now operating outside of NRB regulation. In order to streamline the tiny but potential microcredit organizations scattered throughout the country, develop their institutional capacity for operating microfinance in a sustainable manner and provide them wholesale funds, the need of an apex microfinance organization in the country was greatly felt. Towards this end, RMDC was established in 1998 as a public limited company with the initiative of NRB and ADB.

Professionalization of Microfinance

In the past, microfinance was taken as a welfare program in the name of poverty alleviation. In recent years, professionalism in microfinance has been recognized as a major concern for sustainable development of microfinance in the country. The entry of private sector into the microfinance sector has been encouraged through policy instruments and directions from the central bank and the government. In this connection, a process has been started to privatize one of the five Regional Grameen Bikas Banks. Similarly, NRB has issued directives to MFDBs to adopt professional approach in their operations and to maintain minimum standards in the banks, such as minimum capital base, loan limit to a borrower, liquidity, recruitment of professional chief executive, proficient board, etc.

Sources of Funds for Microcredit

RMDC is a specialized institution for providing wholesale funds to MFIs for on-lending to the ultimate borrowers. There are a few other funds for micro credit programs. NRB requires commercial banks (CBs) to disburse at least 0.25%-3.0% of their total loan portfolio to the poor households directly or through MFIs. By the end of 2005 such investment was over Nrs 4370 million. NRB has a micro credit fund namely Rural Self-Reliance Fund (RSRF), which was created with a grant of Rs. 20

million from the government in 1991. This has been a source of small funds for rural cooperatives and NGOs for on lending to the poor households. Some projects or international NGOs are also providing small revolving funds to local self-help groups or community based organizations (CBOs) to support income generating activities of the poor families.

Regulation in Microfinance Sector

Since the last few years, NRB has been very proactive in bringing the microfinance institutions under regulatory framework through issuing directives and regulatory instruments. For the first time, the Financial Intermediary Act was enacted in 1998 in order to regulate microfinance operation of Non-Government Organizations (NGOs). NGOs were not allowed to accept savings deposits even from their members. After nearly two years, the Act was amended and the barriers were removed. A microfinance program has to get registered as a financial intermediary (FI) with NRB, and has to be renewed regularly. And only the registered FINGOs can have access to funds from formal financial institutions. Till mid July 2005, a total of 47 NGOs have been registered under the Act.

NRB has recently issued "Directives for Development Banks Undertaking Microfinance Program" to maintain standard practices in the Microfinance Development Banks (MFDBs). The directives focus on: (i) the requirement of minimum core capital and capital fund, (ii) the limitation on mobilization of financial resources, (iii) the maintenance of minimum reserves and liquidity, (iv) the requirement for the classification of loans and advances as per their overdue period, and the provision of loan loss, (v) the process of expansion in geographical areas and of opening branches, (vi) norms for corporate good governance, (vii) the loan limit to individual group members and (viii) setting interest rate and service charge. The directives have facilitated development of professionalism and helped maintain standards in the MFDBs.

Achievements and Impact of Microcredit

So far, more than 750,000 families have received institutional microcredit services from different institutions. Four NGOs' microfinance programs have been transferred into private microfinance development banks. MFIs and their clients have shown that the poor are creditworthy without relying on physical collateral, if it is done with appropriate financial technology. Total savings collected by all micro finance institutions are stood as above Nrs 3400 million by the end of 2005. The success stories of microfinance clients, the number of poor household serve by MFIs and the total amount of savings collected show that there is a significant impact of micro credit in creating employment opportunities including self-employment and on the improvement of socio-economic standards of the clients of MFIs. They are also actively involved in making household decisions with their spouses. They are cautious about sanitation and safe drinking water, and are sending their children, including girl children to school.

Regulation and Supervision of MFIs

NRB is the only authority for regulating and supervising all financial institutions including the MFIs. We at NRB are determined to establish second tire institutions to regulate and supervise micro finance activities independently. In line with this RMDC, Sanakishan Bikash Bank and Sahakari Bikash Bank have already been established and started their operation.

Role of the Government

The Government of Nepal recognized Micro finance as an important activity in the national development plans as well. Since microfinance has proved to be a strong tool for poverty alleviation, the Government is serious to develop this sector, particularly on maintaining standards and creating conducive environment for the growth and sustainability of the sector.

Strategic Issues and Challenges

- Fixation of appropriate and acceptable interest rate.
- Limited institutional base.
- With the exception of a few, MFIs in Nepal have not been able to attain even operational self-sufficiency.
- Outreaching the poorest of the poor by the MFIs is still a major issue and a challenge in the country. MFIs in general do not focus on them because such an operation involves higher operating cost and lower loan volume per borrower.
- Governance and Management in MFIs is a major challenge. They lack professionalism in their approaches. The chief executive officer solely

formulates all policies and guidelines, using the committee or board as rubber stamps.

IV.3. Theme Paper 6: Pakistan
"Microfinance in Pakistan: The Policy Environment"

Mr. Tawfiq A. Husain, Deputy Governor of the State Bank of Pakistan presented the paper titled "Microfinance in Pakistan: the Policy Environment" with the following important points.

Microfinance Sector in Pakistan - An Overview

The history of microfinance (MF) in Pakistan has followed the conventional route. In the 60s, the focus was on agricultural credit, mostly for inputs, and the idea was that the poor primarily needed access to subsidized credit. In the 70s, there was a move to nationalize banks in the country and most of the credit provided to the small farmers was by government banks. During the 80s the Agha Khan Rural Support Programme (AKRSP) began its operations in the northern region of the country through Community Based Organizations (CBOs). The success of the AKRSP led to the gestation of several other RSPs in Pakistan, In the 80s and somewhat into the 90s the RSP methodology, dominated the microfinance scene in Pakistan. At the same time Pilot Project (OPP) had developed an individual lending approach targeting existing entrepreneurs in urban slums.

The millennium has seen some interesting developments: in addition to greater interest of the government in the sector by taking various initiatives, there have been innovations in the private sector. Some major initiatives include the setting up of an apex organization - Pakistan Poverty Alleviation Fund (PPAF), introduction of a comprehensive Microfinance Sector Development Program (MSDP), facilitation in establishment of Khushhali Bank, enactment of a law (MFIs ordinance 2001) and establishment of Pakistan Microfinance Network (PMN). Currently, the Microfinance sector players can be classified into three broad categories based on the criteria of their regulatory status. These are: (1) Microfinance Banks and Commercial Banks involved in Microfinance falling under the regulatory ambit of the State Bank of Pakistan, (2) Leasing companies involved in micro-leasing business regulated by the Securities Exchange Commission of Pakistan (SECP), and (3) Rural Support Programs, NGO/MFIs, Cooperatives, etc. which are generally self-regulated under

PMN framework of Disclosure on financial and operational performance. As per the above classification, under the first category, five Microfinance Banks have been licensed since 2000 whereas one more is in the process of getting a license. There are some commercial banks, which are involved in Microfinance (to a limited extent) but very few of them report segregated data on MF. The combined outreach of this category is 18,589 Active Savers, 193,547 Active Borrowers and PKR 1.9 billion Gross Loans Outstanding. Leasing companies are providing access to a number of clients but most of them do not provide segregated data on Microfinance. The third category comprises of hundreds of NGOs, a few Rural Support Programs and Cooperatives involved in Microfinance.

Policy and Regulatory Environment

Microfinance in Pakistan got due recognition since late 1990s when government initiated some very important Microfinance projects and adopted a Microfinance policy to promote and fuel growth in the sector. The policy recognized microfinance as an important poverty alleviation tool as well as an important component of country's financial system and encouraged private sector entry into banking with the poor. The existing policy and regulatory environment for MFIs in the country presents all the major features of a conducive and enabling policy environment for MFIs including sustained commitment and substantial investment by the government to help develop the sector, a responsive regulatory framework which allows institutional diversity and encourages both regulated and unregulated players to extend financial services to the poor while remaining in their respective domains, an apex institution to extend on-lending and institutional building funds to NGO-MFIs and growing trust between policymakers and practitioners to work jointly to develop the sector

Government's Initiatives: Apex Institutions- PPAF

Limited capital base and unstable sources of fund has been one of the major impediments in growth of the microfinance sector. Pakistan learning from the experience of Bangladesh, established PPAF in 1999 as a wholesale window for NGO-MFIs. The PPAF-1 valuing about US$ 100 million was completed well before the agreed time frame and World Bank appreciating the performance of the fund approved a much larger PPAF-II valuing more than US$ 250 million, formally launched in March 2004.It has been instrumental in building capacity of its partner NGOs and graduating some small NGOs to fairly large and matured levels.

Microfinance Sector Development Program (MSDP)

MSDP is another very significant policy and investment initiative of government of Pakistan to broaden and deepen the micro finance sector and align the policy and regulatory environment to achieve the desired sector development objectives. Most of the major developments in the sector during last four years including adoption of MF policy, enactment of separate legal and regulatory framework, mainstreaming of micro finance and establishment of Khushhali Bank etc. could largely be ascribed to MSDP, which the government launched in February 2001 with the financial assistance of Asian Development Bank (ADB).

New Bank Fund

The New Bank Fund (NBF) valuing US$ 15 million has been established at SBP to encourage emergence of new licensed MFIs at provincial and district levels through soft loans for institutional strengthening and developing institutional infrastructure for delivery of micro & rural finance services.

Legal Framework (MFIs Ordinance, 2001)

The enactment of separate legal framework for MFIs (MFIs Ordinance 2001) was one of the significant government initiatives, which led and steered most of the microfinance activity in the regulated microfinance sector.

Conducive Regulatory Framework

Since Government of Pakistan has identified microfinance as one of its major tools to eradicate poverty, State bank of Pakistan has been in consonance with the government to establish a responsive regulatory framework that allows and encourages the provision of financial services to the poor on sustainable basis. SBP envision Microfinance a growing sector and an effective instrument for increasing financial deepening. The crucial policy initiatives of SBP, since the inception of formal micro finance sector, are summarized as follows:

Licensing Criteria for Establishing Microfinance Banks

SBP, the regulatory authority, recognized the need for separately defining a set of parameters for the new entrants for establishing a micro finance bank and thus formulated licensing criteria for Micro Finance Banks. In addition to the licensing criteria, State Bank of Pakistan has also formulated a branch licensing policy to assist balanced growth of branches of MFBs.

Prudential Regulations for Microfinance Banks

State Bank of Pakistan, appreciating the evolving nature and characteristics of micro finance in Pakistan, has framed separate prudential regulations for micro finance banks in consultation with stakeholders. The Regulations interalia prescribe standards for different areas of operations of MFBs including capital adequacy ratio, maximum loan size, credit and operational risk and KYC etc.

Mobile Banking Guidelines

To facilitate State Bank of Pakistan has designed mobile banking guidelines to facilitate MFBs to penetrate their target market in a cost effective manner.

NGO/ RSPs /Cooperatives Transformation Guidelines

Transformation of microfinance institutions into microfinance banks. State bank of Pakistan has issued NGOs/RSPs/Cooperatives Transformation guidelines. The guidelines define and discuss various aspects of the transformation and prescribe minimum requirements to be completed for the transformation.

Fit and Proper Criteria

The quality of the Board Members and President/CEO to effectively undertake their respective responsibilities and functions in order to lead and steer the MFB as a socially conscious, pro poor and commercially viable financial institution.

Guidelines for Commercial Banks to Undertake Microfinance

With a view to enhance outreach of microfinance services to the poor, recently SBP has formulated the guidelines for Commercial Banks to undertake Microfinance which is in the final stage of consultation with stakeholders.

Other Support Structures/Systems: Pakistan Microfinance Network

It works as a representative body and focal point for MFIs, build MFIs' capacity through trainings & information dissemination, advocacy & dialogue with policymakers & government agencies and promote disclosures & transparency amongst its members.

Consultative Mechanism for Policy Formulation

It institutionalized the consultation mechanism for MF policy formulation and constituted a Microfinance Consultative Group having representation of State Bank of Pakistan, relevant government ministries, regulated MFBs, NGOs-MFIs and donor agencies to work as an advisory body for SBP in MF policy formulation process.

Capacity Building within the Central Bank (SBP)

SBP entered into a partnership with SDC to build the requisite capacities to play a proactive and effective role in development of a strong and vibrant micro finance sector in the country.

Conclusion

The paper concluded by noting that the Government of Pakistan and the State Bank of Pakistan are fully committed for growth and development of the Microfinance Sector on sound and sustainable basis. The policymakers' vision for the sector is to develop a conducive policy environment in which MFIs could establish, flourish, grow and provide a full range of financial services to the poor. A considerable development has already been made in this direction and further steps are being taken to make the policy environment more conducive for the sector. There are many challenges ahead that the sector faces today. Even with a conducive policy environment the fact remains that; the outreach has remained low (combined outreach of all MFIs around half a million loan clients is less than 10% of the demand). To fill this gap, there is still a need for the existing retail MFIs to rigorously work on building their capacity. They also need to work on pro-poor financial innovation by developing a range of products as per needs of the target market. Similarly, there is a need for innovative linkages between the formal financial sector and the NGO/MFIs to create synergies and enhance the outreach levels.

IV.4. Theme Paper 7: Sri Lanka
"Microcredit Delivery System in Sri Lanka"

Mr. W. A. Wijewardena, Deputy Governor of the Central Bank of Sri Lanka presented the paper titled "Microcredit Delivery System in Sri Lanka" with the following major points.

Sri Lanka - Institutional Network for Microcredit Delivery

A salient feature of Sri Lanka's financial system is the existence of a fairly large and a diversified network of financial service providers operating throughout the country. It was reported that 1038 units of community based lending societies by the name of "Samurdhi Banking Societies" (SBS) were in operation under the government sponsored poverty alleviation programme (Samurdhi programme) had been operating in the country as at the end of 2005. The network of financial service providers also included a very few (less than 5) NGO based microfinance institutions operating among the low-income segment of the population.

Lending by Formal Sector Institutions

According to a study conducted by ADB in 2000, the current supply of micro credit through the formal microfinance networks represents about 80 percent of the total potential demand for micro credit in terms of overall amount and number of micro loans. The formal sector financial (banking) institutions actively involve in the provision of micro credit for undertaking income generating activities, enhancement of scale of operations of existing economic activities, procurement of equipment and machinery, fulfillment of their working capital requirement etc. Further, it has been noted that informal sector providers are not capable enough to provide loans/credit with longer repayment periods and gestation periods required for the promotion of income generating economic activities. Their capital base is very limited and they tend to provide only short term consumption credit relying on the existing income of the borrowers for loan recovery.

Formal sector institutions have extended their services to cater to the consumption needs of the borrowers by establishing pawning units under their branches. People tend to borrow money by pawning their jewellery or other valuables to the pawnbrokers. In agricultural areas sometimes farmers pawn their valuables for obtaining money to meet the working capital requirements of their cultivations. Pawning loans are normally charged with higher interest rates both by formal and informal lenders. It has been observed that micro credit market saturation remains in a high degree in the country.

Central Bank's Participation in Microcredit

The Central Bank of Sri Lanka has continuously promoted the delivery of micro credit through formal sector institutions. The Government of Sri Lanka (GOSL) provides assistance to motivate the lenders to penetrate the micro credit markets with new innovations. The GOSL through CBSL provides assistance to the lending institutions to mitigate their risk, set off their losses and reimburse their cost with a view to creating an enabling environment to operate them in the micro credit market on a viable basis. The CBSL on behalf of the GOSL implements many development lending projects which include micro credit and poverty alleviation projects with the assistance of the GOSL and the donors. Terms and conditions of the schemes are also determined in consideration of a series of factors such as nature of economic activity undertaken, risk of the activities, yield levels, markets and other infrastructure available for sustainability and good income and low profitability etc. Loans are granted at concessionary interest rates with the interest subsidy support of the government.

Expansion of Outreach

In Sri Lanka, the government has committed to extend the micro credit delivery to a large number of low income households under different programs supported by the government and the donors. The Central Bank of Sri Lanka facilitates the stakeholders to develop more sustainable delivery systems through the existing institutional framework. The PFIs have extended their outreach year by year. Many PFIs have developed their own systems for mobilization of savings and promotion and delivery of their new loan products. Since a large number of formal sector banking institutions willingly participate in several micro credit programs at present, it has been observed that there is a greater opportunity to associate with such banks/institutions to increase the outreach. It is expected to introduce regulatory and supervisory mechanism for micro finance institutions, which are not regulated by the CBSL. With the implementation of the proposed regulatory mechanism it would be easier to screen out the fraudulent and illegal savings collectors operated in the name of micro-financing in the remote locations of the country. At the same time, it would be helpful for genuine MFIs to operate their financial services on a sustainable manner.

Microcredit Programs - Experiences

At present there are several micro credit schemes in operation in the country. All of the above mentioned formal sector institutions are participated on PFIs under such programs. Some of the programs are subsidized by the government while some are sponsored by the donor agencies. Apart from such programs some banks operate their own micro credit programs to serve the micro and small-scale enterprise sector in the country. The lending institutions have adopted many innovative approaches to reach effectively the target households and entrepreneurs at a minimum cost. They have adopted both direct lending and lending through intermediary organizations and have linked with grass root level organizations to deliver efficient services to the end borrowers. The collateral issue has been solved with the introduction of inter se guarantee under which borrowers can sign for each other as guarantors. In many instances group savings and group guarantees are accepted by the banks. Project loans are granted on project assets or the cash flow of the project.

Under some programs, PFIs provide wholesale lending to such CBOs, which have possessed a good track record in managing retail lending volumes among the individual micro borrowers. CBOs are also trained to handle retail lending activities and monitor end use of funds and recoveries in time. Group based micro lending was initiated in 1988 by one of the then Regional Rural Development Banks (RRDBs). Currently the group approach is widely adopted in many micro credit programs by numerous financial institutions and NGOs operated in different parts of the country. The CBSL in concurrence with the GOSL is currently in the process of strengthening the existing delivery mechanism with a view to achieving a sustainable outreach. In this process, attempts have been made to build up new and effective networks and linkages to integrate the cooperative mechanism (CRB network) with the formal banking institutions. Further, the CBSL with the assistance of the GOSL and the donors is in a continuous process to expand the existing programs to new areas and community groups in the country.

When the floor was opened for discussion, there were huge cross-cutting arguments and counter arguments on the various issues of microfinance among the participants of the symposium. The issue of regulation, high cost of funding and the issue of covering the poorest of poor including the issue of increasing outreach got upper-hand in the cross-cutting interaction among the designated participants of the symposium. Lots of queries and questions were directed towards Professor Dr. Muhammad Yunus, the father of microfinance in Bangladesh. Various designated participants wanted to know his explanation about the high interest rates in microcredit lending as well as the repayment schedule that starts right after the reception of the credit. Professor Yunus replied that the interest is fixed with the consensus of the both parties, the lender and borrower, in his microcredit program. Nothing is imposed forcefully. Regarding the repayment schedule, he added that the borrower starts to repay from their already savings plan without any difficulty.

In the concluding session, the Governor of the Bangladesh Bank, Dr. Salehuddin Ahmed started his remarks by focusing the significance of SAARCFINNANCE as important forum in sharing the country experiences regarding poverty alleviation. He mentioned, in this regard, that poverty is basically due to lack of access to loans and credit, lack of access to income and employment and lack of access to rights, education and health. He has mentioned that microfinance addresses not only the financial problems of the poor but also addresses the rights of the poor people, specially the women. He also added that MFIs are nothing but social capital, which could be effectively used for other important purposes of the country. He further mentioned that MDGs should not be forgotten where eradication of poverty is utmost priority. With a view to fight poverty in the SAARC region he reiterated the importance of SAARC Development Fund (SDF) with the three specific windows namely economic, social and infrastructure along with the SAARC Poverty Alleviation Fund (SPAF). He further added that transformation MFIs to commercial banks as in Afghanistan and introduction of microfinance bank as in Pakistan could be an interesting thing to follow for the other SAARC nations.

The chairperson of the session Professor Wahiduddin Mahmud made his remarks by pointing out that literature of microfinance/microcredit is expanding. It originated from low income country like Bangladesh. While conventional banking fails to offer credit to the ultimate poor MFIs are doing great job in providing credit to them. He added that microcredit activities can be seen as not only poverty alleviation program but also a social transformation program. He further mentioned that it's not just profit maximization it's something different. Finally, thanking everybody he concluded his speech and declared the closing of the seminar.

V. Some Strategic Areas for Future Actions/Cosiderations

Some of the challenges/strategic areas for future actions of the SAARCFINANCE forum as raised by Dr. Salehuddin Ahmed, the Governor of the Bangladesh Bank in his concluding remarks are:

* In line with the Charter of the SAARC Summit, the SAARC member countries should ensure inclusive financial systems where access to credit is opened to all individuals including the poor so that the process of poverty eradication from the SAARC region would be expedited.
* Up scaling of microcredit borrowers to micro and small enterprises is a growing demand.
* Finding alternative sources of foreign donor funding which is very important for the sustainability of the MFIs because of the fact that sustainability of the borrowers as well as institutions are important elements to run microcredit program in a productive way.
* The issue of high rate of the cost of fund should be resolved within the shortest possible time so that fund could be made available for the poor people at the lowest possible interest rates or service charges.
* More attention is also needed to focus on the regulatory framework of MFIs which is very important element of the microfinance program.
* With our vision we must go beyond microfinance that include health, nutrition and other financial services where the issue of microfinance should be dovetailed with the mission of SAARC Development Fund (SDF) and SAARC Poverty Alleviation Fund (SPAF) where the SDF has three specific windows namely economic, social and infrastructure.

Inaugural Session

1. Address *by* **Dr. Salehuddin Ahmed**, Governor, Bangladesh Bank

2. Keynote Paper on
   Microcredit: Banking with the Poor Without Collateral *by*
   Professor Muhammad Yunus, Managing Director
   Grameen Bank, Bangladesh

Address by **Dr. Salehuddin Ahmed**
Governor, Bangladesh Bank

Bangladesh has made great strides in improving the lives of its people since gainging independence in 1971, including raising literacy and school enrollment, reducing population growth and infant mortality rate, and improving health services. Despite the impressive progress, however, poverty continues to be pervasive and poverty is still the major challenge. More than 40 percent of the rural population lives below the poverty level. Rural poverty is closely linked to land ownership and the burden of poverty falls disproportionately on women. Therefore, progress in human development and effective participation of the poor especially poor women in the growth process needs to be accelerated for rapid and sustainable poverty reduction. Microfiance is considered as one of the important tools for poverty alleviation. Research findings also show positive impact of microfinance on the economic conditions of the households particularly on the income of the female borrowers.

Bangladesh's financial sector has assumed an important role in development in terms of the diversity and the reange of products offered by the financial institutions. The formal financial sector comprises mainly banks and non-bank financial institutions. Formal financial sector assets are heavily concentrated in the banking sector, with nationalized commercial banks accounting for about 40% of total banking assets. Despite the importance of banks to the general financial sector, commercial banks in the country serve no more than 25% of the population. Historically, the remaining populance has not had access to formal financial services. The sepecialized banks and natioanlized commercial banks with large branch networks have lent extensively even in rural areas, but yet a sizeable number of the poor do not have access to their services. Their lending is also based on traditional banking terms and the private commercial banks have generally stayed away from rural lending, although there are a few cases of small involvement in microfinance.

At the same time a strong semiformal NGO microfinance system has emerged in the country. The Grameen Bank and hundreds of NGO-MFIs operate in rural areas, small towns, semi-urban areas, and increasingly, urban neighbourhoods as well. Grameen Bank project was transformed into Grameen Bank by a separate Ordinance in 1983. The combined coverage of microfinance programs of Grameen Bank, and of the 1000 plus non-government microfinance institutions and of goverment financed projects in Bangladesh in approzimately 15 million households. By considering overlapping problems, which is about 33 percent, the effective coverage would be around 10 million households. Yet the microfinance industry in Bangladesh has the potential of further expansion by increaing the outreach, by expanding areas of service and types of products and services offered. Time has come for up scaling of microfinance into imcro-enterprises and small enterprises.

In view of the history and operation of MFIs (most of which are NGOs), the conventional regulatory framework such as that of formal banks and financial institutions may not be appropriate for them. The goverment of Bangladesh is considering to bring microfinance institutions (MFIs) under a regulatory framework to ensure transparency and accountability of their operations. Government established "Microfinance Research and Reference Unit (MRRU)" in the Bangladesh Bank and constituted a Steering Committee under the Chairmanship of the Governor of the Bangladesh Bank to formulate some policy guidelines and regulatory framework for this sector. The Committee has prepared an operational guideline for this sector and drafted a law of an independent regulatory authority, for consideration of the government. MRRU in Bangladesh Bank is also doing the groundwork such as listing NGO-MFIs, collecting information on the sector, analyzing information for policy inputs, providing training to the personnel of NGO-MFIs on guidelines etc. to prepare the sector to come under the proposed regulatory authority.

It is expected that in future this new law for semi-formal microfinance sector will change the scenario of rural financial market in Bangladesh. However, there are many challenges such as reaching hardcore poor in an efficiant way, solving the problem of sustainability both at client level and institution level, increasing fair competion in the industry, providing more client oriented services at a reasonable price, developing effective and cost efficient monitoring and supervising tecnique for the sector. We hope that addressing the issue and innovations over the time will help to develop microfinance sector in a sustainable manner and also help the poor people to get access to credit from the institutional sources.

More than 200 years ago Adam Smith in his famous book *The Wealth of Nations* said that money makes money. When you have got a little, it is offten easy to get more. The great difficulty is to get that little. Microfinance enables the poor to take a leap forward to prosperity.

Microcredit : Banking With the Poor Without Collateral

Professor Muhammad Yunus

Unjust System

I have long argued that poor people remain poor not because of any fault of their own, but because we have designed institutions and policies that keep them poor. No matter how hard they try or how hard they work, they remain trapped in poverty because of these institutions and policies. A major example of this are the financial institutions that we have created all over the world - two thirds of the world's population do not have access to financial services from the conventional financial institutions. That we systematically exclude poor people from financial services, is tantamount to financial apartheid. By providing financial services to the very poor and poorest on terms that are suited to them, i.e. microcredit, in its essence, challenges this unjust system.

Grameen Bank

I became involved in the poverty issue not as a policymaker or a researcher, but because poverty was all around me. In 1974, I found it difficult to teach elegant theories of economics in the classroom in the backdrop of a terrible famine in Bangladesh and wanted to do something immediate to help people around me. That brought me to the issue of poor people's struggle and helplessness in finding microscopic amounts of money in support of their efforts to eke out a living.

I was shocked to discover a woman borrowing US $ 0.25 with the condition that the lender will have the exclusive right to buy all she produces at the price the lender decides ! I decided to make a list of the victims of this money-lending "business" in the village next door to our campus. When my list was done it had the names of 42 victims. Total amount they borrowed was US $ 27 ! I could not think of anything better than offering this US $ 27 from my own pocket to get the victims out of the clutches of the moneylenders. The excitement that was created by this action got me further involved in it. The question that arose in my mind was, if you can make so many people so happy with such a tiny amount of money, why shouldn't you do more of it ?

I have been trying to do just that ever since. First thing I did was to try to connect the poor people with the bank located in the campus. It did not work. The bank said that the poor are not creditworthy. After all my efforts over several months failed I offered to become a guarantor for the loans to the poor. I was stunned by the result. The poor paid back their loans every single time! But I kept confronting difficulties in expanding the programme through the existing banks. Several years later I decided to create a separate bank for the poor, to give loans without collateral. Finally in 1983 I succeeded in doing that. I named it Grameen Bank or Village bank.

Grameen Bank in 2006

Today, Grameen Bank is reaching 5.7 million poor borrowers, 96% of whom are women. The bank is owned by the poor borrowers. Grameen Bank has 1,736 branches working in 90 per cent of the villages in Bangladesh. Total staff is nearly 17,000. The total amount of funds disbursed is US$ 5.25 billion. Out of this, US$ 4.83 billion has been repaid. Current amount of outstanding loans stands at US$ 425 million. From January to December, 2005 Grameen Bank disbursed US $ 612 million. Monthly average loan disbursement over the past 12 month was US $ 51 million.

Projected disbursement for 2006 is US 821 million, i.e. monthly disbursement of US $ 68.40 million. End of the year outstanding loan is projected to be at US $ 600 million. The loan recovery rate is 99.01%.

No External Funds Needed

Grameen Bank finances 100 per cent of its outstanding loan from its deposits. Over 64 per cent of its deposits come from bank's own borrowers. Deposits amount to 113 per cent of the outstanding loans. If we combine both deposits and own resources it becomes 135 per cent of loans outstanding.

In 1995, GB decided not to receive any more donor funds. Since then, it has not requested any fresh funds from donors. Last installment of donor fund, which was in the pipeline, was received in 1998. GB does not see any need to take any donor money or even take loans from local or external sources in future. GB's growing amount of deposits is more than enough to run and expand its credit programme and repay its existing loans.

By the end of December, 2005 total deposit in Grameen Bank stood at US$ 481.22 million. Member deposit constituted 64 per cent of the total deposits. Balance of member deposits has increased at a monthly average rate of 3.83 per cent during the last 12 months.

Ever since Grameen Bank came into being, it has made profit every year except in 1983, 1991, and 1992. It has published its audited balance-sheet every year, audited by two internationally reputed audit firms of the country.

How is Grameen Bank different from other banks?

Grameen Bank methodology is almost the reverse of that of conventional banking. Conventional banking is based on the principle that the more you have, the more you can get. In other words, if you have little or nothing, you get nothing which is why more than half of the world's population has no access to financial services of the conventional banks. Conventional banking is based on collateral, Grameen system is collateral-free.

Grameen Bank starts with the belief that credit should be accepted as a human right, and builds a system where one who does not possess anything gets the highest priority in getting a loan. Grameen methodology is not based on assessing the material possession of a person, it is based on the potential of a person. Grameen believes that all human beings, including the poorest, are endowed with endless potential.

Conventional banks look at what has already been acquired by a person. Grameen looks at the potential that is waiting to be unleashed in a person. Overarching objective of the conventional banks is to maximize profit. Grameen Bank's objective is to bring financial services to the poor, particularly women and the poorest- to help them fight poverty, stay profitable and financially sound. It is a composite objective, coming out of social and economic visions.

High Priority to Women

Conventional banks focus on men, Grameen gives high priority to women. 96 per cent of Grameen Bank's borrowers are women. Grameen Bank works to raise the status of poor women in their families by giving them ownership of assets. It makes sure that the ownership of the houses built with Grameen Bank loans remain with the borrowers, i.e., the women. Conventional banks are owned by the rich, generally men. Grameen Bank is owned by poor women.

Grameen Bank branches are located in the rural areas, unlike the branches of conventional banks which try to locate themselves as close as possible to the business districts and urban centers. First principle of Grameen banking is that the clients should not go to the bank, it is the bank which should go to the people instead.

Grameen Bank's staff meet every one of the borrowers at their door-step spread out all over Bangladesh, every week, and deliver bank's service. Repayment of Grameen loans is also made very easy by splitting the loan amount in tiny weekly installments. Doing business this way means a lot of work for the bank, but it makes it very convenient for the borrowers.

No Legal Instrument

There is no legal instrument between the lender and the borrower in the Grameen methodology. There is no stipulation that a client will be taken to the court of law to recover the loan, unlike in the conventional system. There is no provision in the methodology to enforce a contract by any external intervention.

Conventional banks go into 'punishment' mode when a borrower is taking more time in repaying the loan than it was agreed upon. They call these borrowers "defaulters". Grameen methodology allows such borrowers to reschedule their loans without making them feel that they have done anything wrong.

When a client gets into difficulty, conventional banks get worried about their money, and make all efforts to recover the money, including taking over the collateral. Grameen system, in such cases, works extra hard to assist the borrower in difficulty, and makes all efforts to help her regain her strength and overcome her difficulties.

Interest Cannot Exceed Principal

In conventional banks charging interest does not stop when a borrower gets into trouble and cannot make the payments any more. (Sometimes exceptions are made only to some privileged loan defaulters.) As a result, interest charged on a loan can be a multiple of the principal, because the borrower has lost the capacity to repay the loan. In Grameen Bank this cannot happen. Charging interest will stop at a pre-determined maximum, if the borrower cannot pay back the loan. This maximum is equivalent to the principal amount of the loan. If the borrower has already paid it, no more interest will be charged. Interest on conventional bank loans are generally compounded quarterly, while all interests are simple interests in Grameen Bank.

Gives Scholarships and Student Loans

Conventional banks do not pay attention to what happens to the borrowers' families as results of taking loans from the banks. Grameen system pays a lot of attention to monitoring the education of the children (Grameen Bank routinely gives them scholarships and student loans), housing, sanitation, access to clean drinking water, and their coping capacity for meeting disasters and emergency situations. Grameen system helps the borrowers to build their own pension funds, and other types of savings.

In case of death of a borrower, Grameen system does not require the family of the deceased to pay back the loan. There is a built-in insurance programme which pays off the entire outstanding amount with interest. No liability is transferred to the family.

Lends to the Beggars

In Grameen Bank even a beggar gets special attention. A beggar comes under a campaign from Grameen Bank which is designed to persuade him/her to join Grameen programme. The bank explains to her how she can carry some merchandise with her when she goes out to beg from door to door and earn money, or she can display some merchandise by her side when she is begging in a fixed place. Grameen's idea is to graduate her to a dignified livelihood rather than continue with begging. To date, nearly 70,000 beggars have been reached. Such a programme would not be a part of a conventional bank's work.

Sixteen Decisions

Grameen system encourages the borrowers to adopt some goals in social, educational and health areas. These are knows as "Sixteen Decisions" (no dowry, education for children, sanitary latrine, planting trees, eating vegetables to combat night-blindness among children, arranging clean drinking water, etc.). Conventional banks do not see this as their business.

Housing and Microenterprise

Grameen Bank introduced housing loan in 1984. It became a very attractive programme for the borrowers. Maximum amount given for housing loan is US $ 249 to be repaid over a period of 5 years in weekly instalments. Interest rate is 8 per cent. 627,058 houses have been constructed with the housing loans averaging US $ 202. A total US $ 127 million has been disbursed for housing loans.

Many borrowers are moving ahead in businesses faster than others for many favourable reasons, such as, proximity to the market, presence of experienced male members in the family, etc. Grameen Bank provides larger loans, called micro-enterprise loans, for these fast moving members. There is no restriction on the loan size. So far 668,389 members took micro-enterprise loans. A total of US $ 235.00 million has been disbursed under this category of loans for purchasing a truck which is operated by the husband of the borrower. Power-tiller, irrigation pump, transport vehicle, and river-craft for transportation and fishing are popular items for micro-enterprise loans.

Scholarships and Student Loans

Scholarships are given, every year, to the children of Grameen members, with priority on girl children, to encourage them to get better grades in schools. Each year, about 9,000 children, at various levels of school education, receive these scholarships.

Students who succeed in reaching the tertiary level of education are given higher education loans, covering tuition, maintenance, and other school expenses. By December 2005, 8,926 students received higher education loans, of them 8,294 students are studying at various universities; 99 are studying in medical schools, 211 are studying to become engineers, 322 are studying in other professional institutions.

Telephone-Ladies

To-date Grameen Bank has provided loans to 187,187 borrowers to buy mobile phones and offer telecommunication services in nearly half of the villages of Bangladesh where this service never existed before. Telephone-ladies run a very profitable business with these phones and play an important role in the telecommunication sector of the country, while generating revenue for Grameen Phone, the largest telephone company in the country.

Progress in Bangladesh

In the last 15 years, Bangladesh has made significant achievements in terms of human, economic and social indicators. GDP growth has been over 5 per cent. Bangladesh birth rate has declined significantly. Fertility rate declined from 6.3 in 1975 to 3.3 in 1999 - 2000 reduced almost to half. Life expectancy of women in Bangladesh used to be lower than men, but is now higher.

Child and infant mortality have been falling at more than 5% a year, malnutrition among mothers has fallen from 52% in 1996 to 42% in 2002. In the past decade, Bangladesh reduced infant mortality by half ---- at a rate faster than any other developing country has done.

Primary school enrolment rates have reached 90%, up from 72% in 1990.

Enrolment in secondary education has been rising. Bangladesh has already eliminated gender disparity in primary and secondary school enrolment and has made remarkable progress in providing universal basic education.

Bangladesh has outstanding accomplishment in reducing child labour. According to UNICEF, percentage of child labour in Niger is the highest (66%). Bangladesh has one of the lowest percentages (7%). Nepal is 31%, India 13%.

Female labour force participation rate increased dramatically between 1983 and 2000, both for rural and urban, with sharper increase in rural, than in urban.

Bangladesh is cited as a success story in producing enough food to feed her people despite doubling the population in 35 years, remembered as the country which gave the world oral saline to combat diarrhea and internationally respectability by demonstrating her skill and efficiency in disaster management.

Not only is Bangladesh recognized as the birth-place of microcredit, it is also the home of the largest microcredit programs as well as the country with the largest number of such programs. Over 15 million poor borrowers are reached by microcredit in Bangladesh, representing about half of the country's population.

One of the reasons for this rapid expansion of microcredit in Bangladesh is due to the Palli Karma Shahayak Foundation (PKSF) which has financed microcredit programs throughout Bangladesh.

This progress has helped Bangladesh move steadily towards achieving Millennium Development Goals (MDG). According to data on current trends, Bangladesh has either met or is expected to meet most of the MDG targets. If right policies are pursued dedicatedly there is a good chance that Bangladesh will reduce poverty by half by 2015.

Microcredit Worldwide

Grameen philosophy and methodology have spread around the world. Microcredit Summit of 1997 set the goal to reach 100 million poorest families with microcredit by 2005. Although we do not have the final figures, obvious from the trend that we have crossed that number by the end of 2005.

Two new goals have been set by the Summit Campaign for phase II to be achieved by 2015, coinciding with the year set to achieve the Millennium Development Goals. First goal is to ensure that 175 million of the world's poorest families, especially the women of those families are receiving credit for self employment and other financial and business services by the end of 2015. With the average of five in a family, this would affect 875 million family members.

A second goal of the campaign is to ensure that 100 million of the world's poorest families move from below US$ 1 a day to above US$ 1 a day by the end of 2015. With an average of five per family, this would mean that 500 million people would have risen above US$ 1 a day, nearly completing the Millennium Development Goal on halving absolute poverty.

Grameen Trust for Grameen Replication Worldwide

Many global initiatives have been established to spread microcredit. Grameen Trust is an international wholesale fund that was created in 1989 to provide support to start Grameen replications in other countries.

Grameen Trust started providing start-up money for projects all around the world since 1991. Grameen Trust provided loan funds, operational funds, training, and technical assistance which enabled these projects to establish their programmes, build track records, and eventually source funds locally and internationally.

Funded by donors to-date, Grameen Trust has supported 137 programs in 37 countries in Asia and the Pacific, Africa, Latin America and Europe. GT has approved nearly US$ 21 million as loans to these partner organizations, who in turn have disbursed US$ 1.34 billion to more than 2.7 million poor borrowers, 99% of whom are women, in these countries. If we assume that each family has five members, then GT's support has impacted 13.5 million very poor people in these countries. Most of GT's partner organizations report near 100% repayment rates.

BOT Approach of Grameen Trust

In a different type of program, Grameen Trust also goes into a country to create a microcredit program directly on the ground with experienced staff from Grameen Bank, under a Build-Operate-Transfer (BOT) contract. Grameen Trust staff set up the program, recruiting and training local staff. This is a very efficient approach which shows good results very quickly. Lag time between a decision to start a program and implementation is minimal. Probability of success is also very high, as many risks and uncertainties can be bypassed under this arrangement. Donors and governments can try this arrangement whenever they are in doubt about the success of a their microcredit program. BOT approach can contribute to rapid expansion of microcredit in areas where it doesn't exist.

Grameen Trust set up successful BOT projects in Turkey, Myanmar, Kosovo and Zambia over the last nine years. This year it has embarked on such programs in Costa Rica and Guatemala. Negotiations on extending BOT programs in other countries in Latin America and Africa are currently underway.

Impact

Independent studies show that microcredit has a host of positive impacts on families that receive it. A World Bank study in 1998 reported that 5% of Grameen Bank, BRAC, and RD 12 of BRDB borrowers move out of poverty each year. A recent World Bank study by Shahid Khondkar (2003) shows that micro-credit programs operating in Bangladesh over a long period, have produced a greater impact on extreme poverty than on moderate poverty.

"The results of this study strongly support the view that microcredit not only affects the welfare of participants and non-participants but also the aggregate welfare at village level" ¾ Khondkar concluded.

Studies around the world have also shown that microcredit programs improve the coping mechanisms of the poor. This was demonstrated very clearly during times of disaster such as during the floods in Bangladesh in 1998. A large number of impact studies have been made on Grameen Bank from different perspectives. They all show significant impact on its members across wide range of economic and social indicators, including increased income, improved nutrition, better food intake, better consumption on clothing, better housing, lower child mortality, lower birth rate, higher adoption of family-planning practices, better healthcare, better access to education for the children, empowerment of women, participation in social and political activities.

56 Percent Crossed Over Poverty-line

According to Grameen Bank's own internal survey, 56% of its borrower families have crossed the poverty line by 2005, judging this on the basis of ten indicators (size of loan, amount of savings, housing condition, furniture in the house, provision of pure drinking water, sanitation and warm clothing, education of the children, etc.) set by Grameen Bank to track impact of its program on the poor families that it serves.

How to Expand the Outreach

There is no doubt that microcredit can contribute in significant way to poverty reduction. Although the expansion of microcredit to the poor is encouraging, there is still a number of constraints which prevent microcredit spreading even more quickly.

Bangladesh is still the only country where microcredit outreach is over 75% of the poor families. In most of the countries it has not even reached 10% of the poor families. To reach the Summit's phase II goal of 175 million poor families by 2015, and to ensure that 100 million of those who were below US$ 1 rise above it, each country must reach out to 50% of the poor families within that country. Therefore, there is a lot of catching up to do.

Two major issues are always discussed in connection with the institutionalisation of microcredit in Bangladesh and elsewhere. They are 1) financing of microcredit and 2) legal and regulatory framework for integrating microcredit with the national financial system. Both issues are inextricably connected with each other. If the issue of appropriate legal and regulatory framework for microcredit institutions is resolved, then the funding issue becomes much easier to address.

Enabling to Take Deposit is the Answer

Under the Grameen policies, branches are financed entirely with deposits mobilised within the locality served by the branch. A branch can mobilise more deposits than it needs to finance its loan operation, within the first month. A new branch becomes profitable within a year. Grameen Bank can mobilise deposits because it is a formal bank. NGOs cannot take deposits because NGO law does not support it. Microcredit can be funded locally at the village level, provided legal framework is created to allow microcredit programmes (MCP) to accept public deposits. If this legal framework is created, donor funding can be reserved for only start-ups, shoe-horning NGO-MCPs to graduate into microcredit banks, training, research and development, other technical support. This will give donor money more leverage than it currently gets.

There are many NGO-MCPs with over 100,000 microcredit borrowers in Bangladesh and around the world. It is not easy to run large microcredit programmes when the prime source of money is donor money. The paradox of the situation is that many of these NGOs operate within areas where there is plenty of money all around them. They can easily get to it if only they are allowed. Not only are they not allowed to take public deposits, in many countries they are not even allowed to take savings from their own borrowers. A legal framework to create enabling environment for the NGOs to convert themselves into microcredit banks will change the whole microcredit scenario.

I am strongly advocating that lawmakers pay serious attention to this issue in the context of reaching the Millennium Develop Goal of reducing poverty by half by the year 2015. This is one enabling step the lawmakers must take.

Creating Microcredit Regulatory Commission

By now all policymakers do recognise that microcredit needs different kind of banking format than conventional banking. Creation of separate legal framework, and a separate Microcredit Regulatory Commission will be the result of that recognition. Some countries (for example Philippines, Venezuela, Uganda) have already passed laws to create microcredit banks. But they closely followed the law that already exists for the conventional banks. I argue that we need to have sharper departure from the existing banking laws.

I am not aware of any separate regulatory commission for microcredit that has been created by any country. It will be an important initial step towards institutionalisation of microcredit. India has created separate regulatory body for rural finance. I see no reason why a separate regulatory body cannot be created for microcredit which can develop into a dynamic financial sector in any country with appropriate policy support. Central bank of the country can play an important role within the microcredit commission. Selection of the first chairman of the commission will be very critical. He or she must have deep understanding of microcredit, and patience and skill for creating an entirely new financial sector.

Essential Elements in Legal Framework for a Microcredit Bank

The law for creating a microcredit bank should have two things in mind. First, it should allow and encourage NGOs to convert one or more units of their microcredit operations into MCBs to test out the formal financial world. The law and the microcredit commission should make sure that the NGOs like the new experience. If NGOs convert more and more of their units into MCBs, this will be a testimony to the success of the new law.

Second, the law should encourage creation of start-up MCBs, without going through the process of being born as an NGO-MCP as a first step, and then converting it into an MCB as a second step.

There should be a clear definition of an MCB so that the law is not misused. The law should state clearly that an MCB is a bank which primarily serves bottom 50 percent (or bottom 25 per cent, as the case may be), or people earning less than a dollar (or less than two dollars) a day. There should be clear mention that MCBs would give preference to poor women. The law should be flexible enough to allow a part (say, 40 per cent) of the business of MCBs to go outside of strictly microcredit type banking, such as, providing credit for small businesses with or without collateral. The law should allow poor microcredit borrower to grow into borrowing larger loans as her business grows. No microcredit borrower should be forced to leave a MCB because her loan size has grown bigger over time.

Deposit Mobilization

MCBs should be allowed to take deposits from borrowers as well as from the public. The restriction on the amount that it can mobilize as deposit can be related to the amount of loans outstanding of the MCB. For example, the deposit mobilization may not exceed a maximum of twice the amount of the loans outstanding.

NGO MCPs and Deposit Mobilization

NGO MCPs that are not registered as MCBs should be allowed to mobilize deposits but only from their members and not from the general public. They may be allowed to take borrower deposits until the balance of deposits equals 75 per cent of their outstanding loans.

Deposit Insurance

It is necessary to protect the deposits of the poor against the risk of failure, fraud or mismanagement of MCBs. There should be some arrangement for deposit insurance for deposits mobilized by MCBs to protect the interest of the depositors.

Interest Rate

There should be no restrictive laws limiting the interest rate to be set for MCBs. MCBs may charge interest rate higher than the interest rate charged by commercial banks for their small loans. Microcredit interest rate should not be too far above the commercial bank interest rate.

As a thumb-rule I would say that an MCB should try to keep the interst rate within 5 to 10 percentage points above the commercial rate. If it goes above this limit, it would be entering money-lenders' world, leaving the microcredit world behind. In any case, there should be full disclosure to the borrowers and to the public, of the interest rates being charged and how it is calculated.

The Microcredit Commission should not rush to regulate and overregulate MCBs. As MCBs innovate and develop, they require a flexible and enabling regulatory environment. Keeping in mind that these programs are designed to help the poor, governments should not exert too much control which will discourage MCBs from expanding their operation.

Transforming NGO-MCPs into MCBs will be the only way for self-reliance for the MCPs. Creation of MCBs can strengthen the financial system of a country by filling in a vacuum left by the conventional banks, and give a boost to the emergence of a local level grass-root economy.

Conclusion

Next five years will be very critical in terms of making adequate institutional, financial, and policy preparations for reaching the MDG of 2015. We have less than ten years left for reaching the goal. If we fail to make appropriate preparations we'll fail to achieve the goal. Certainly we do not wish to accept the option of failure. Microcredit institutions, along with a whole generation of other social business enterprises, can play a vital role in attaining the MDG of halving extreme poverty by 2015. Issues raised in this paper needs to be seriously considered to get the world ready for successfully completing the most exciting task mankind ever embarked on. Let us not fail in this endeavour.

Session-I

Presentation of Papers

1. **Development of Microfinance and SME Lending in Afghanistan**
   by
   Mr. Noorullah Delawari
   Governor, Da Afghanistan Bank

2. **Microfinance in Bangladesh: Major Achievements and New Challenges**
   by
   Mr. Khandakar Muzharul Haque
   Executive Director, Bangladesh Bank

3. **Up Scaling Microfinance in India- Retrospect and Prospect**
   by
   Mr. V. S. Das, Executive Director, Reserve Bank of India
   Mr. H. R. Khan, Chief General Manager and Principal
   College of Agricultural Banking, Reserve Bank of India

Development of Microfinance and SME Lending in Afghanistan

Noorullah Delawari

The development of microfinance and lending to small and medium-sized enterprises (SMEs) in Afghanistan is proceeding hand in hand with the development of the financial sector in general. Therefore, this paper begins by reviewing overall financial sector developments since the establishment of the interim government in late 2001.

The development of Afghanistan's financial sector is currently guided by two basic laws that were both enacted in September 2003: the Law on Da Afghanistan Bank, also known as the Central Bank Law; and the Law on Banking in Afghanistan, also known as the Banking Law.

The Central Bank Law gives Da Afghanistan Bank (DAB, the central bank) the exclusive right and responsibility to license, regulate, and supervise several different kinds of financial institutions: commercial banks, branches of foreign banks, money service providers, foreign exchange dealers, payment systems operators, and securities service providers.

In addition to these current responsibilities, future legislation is expected to give DAB regulatory authority over non-depository credit institutions (such as finance companies, mortgage companies, and leasing companies), and perhaps private pension plans. (Insurance companies, which have yet to be established in Afghanistan, are an exception - they will for the time being be regulated by the Ministry of Finance under interim legislation.) This "unified regulator" approach, which is already practiced in many countries around the world, recognizes that there are some common elements in the supervision of many different kinds of financial institutions that call out for a consistent approach. Besides that, a unified regulator will be better able to handle ownership affiliations among different types of financial institutions, which will naturally arise as financial markets grow and develop.

Before the basic laws were passed in September 2003, Afghanistan's banking system consisted of six moribund state-owned banks. However, it was well known that there was substantial investor interest in creating new institutions to serve the expanding economy, and the legislation paved the way for the licensing of nine new banking organizations (four commercial banks and four branches of foreign banks) and the relicensing of three of the state-owned banks under tougher standards of condition and performance. Two or three more new banking organizations may join these 12 over the next couple of years, provided that they meet the licensing requirements.

The expansion of the banking sector in the since licensing began has been truly impressive. For almost two years now, banks have been supplying to DAB data on their condition and performance using international standards of accounting and reporting. These figures show that deposits have grown, since March 2004, at an annual rate of 240 percent and now stand at the equivalent of over USD 300 million. Although this is still very small, relative to the current level of economic activity, deposits are expected to grow to at least USD 600 million by the end of 2007.

A challenge facing policymakers in Afghanistan is to encourage the growth of deposits denominated in our local currency, the afghani, which was introduced successfully in late 2002. These deposits are growing at a 73 percent annual rate, but not as fast as US-dollar denominated deposits, which comprise 79 percent of the total.

DAB's regulatory functions have also been developing rapidly, to keep pace with emerging financial sector development. Since the passage of the Laws in 2003, DAB has set up and staffed its Financial Supervision Department (FSD) with 32 employees spread across four sections: Licensing and Corporate Activities; General Supervision (on-site examination and off-site monitoring); Accounting, Reporting, and Commercial Bank Audit; and Special Supervision (enforcement, conservatorship, and liquidation).

Technical assistance, primarily from the United States Agency for International Development but also from the U.K. Department for International Development, has helped DAB to build this capacity. Advisors work side-by-side with DAB examiners and analysts, teaching, training, helping to draft prudential regulations and policy statements, and assisting in organizing the FSD's work. Ten of the new financial sector supervisors have received training abroad, and more overseas training is planned for key staff in 2006 and beyond.

The Emerging Role of Microfinance Institutions in the Regulated Financial Sector

Microfinance institutions (MFIs) fit well into the expanding financial sector. From a regulatory point of view, there are two types of MFIs: those that accept savings deposits from their members, such as credit unions, and those that do not. It is clear that a more intensive regime of supervision is needed for the deposit-taking MFIs, and the Banking Law already authorizes DAB to apply whatever portions of the Law that are necessary to protect these MFI depositors. Accordingly, DAB is developing a "tiered" regulatory regime, in which the supervision becomes more "bank-like" as the MFI more resembles a commercial bank. Regulations have been drafted and are in the public comment stage to bring depository MFIs (DMFIs) fully into the regulatory framework, with internationally-accepted prudential standards of corporate governance, capital adequacy, liquidity, and loan-loss provisioning.

The proposed regulation embodies the concept that DMFIs should be oriented towards profit, although they may not necessarily be profitable. It also states that DMFIs must be "non-distributive corporations" - that is, corporations with shareholders who participate in losses of the DMFI, but cannot participate in any profits. All profits of the DMFI, if any, must be reinvested in the DMFI. If a DMFI with positive capital is liquidated, the net assets will accrue to another DMFI, not to the shareholders.

DAB recognizes that the differences between DMFIs and banking organizations in the nature and size of their business and the origin of their resources necessitates a simplified licensing, regulatory, and supervision regime. In particular, the restricted activities of DMFIs means that a variety of risks to which commercial banks are subject is not present. Accordingly, the following requirements are less severe for DMFIs than for banks:

Capital adequacy requirements : A DMFI needs only AFN 25 million in initial and ongoing financial capital, compared with AFN 250 million for a full-fledged commercial bank. The capital-to-asset ratio is a minimum 8 percent, compared with 12 percent for a bank.

Liquidity requirements : DMFIs are only subject to one minimum liquidity ratio: a ratio of liquid assets to customer deposits of 20 percent. Commercial banks are subject to two minimum ratios: the 20 percent "quick" liquidity ratio and the 15 percent "broad" liquidity ratio.

Reserve requirement for monetary policy purposes : DMFIs are not subject to the reserve requirement for monetary policy purposes.

Loan classification : For DMFIs, mandatory loan classification is based only on the past-due status of the borrower, not on his/her financial condition. This simplification facilitates the determination of the loan-loss reserve.

Some restrictions and requirements, however, are more severe for a DMFI than for a bank:

Loan-loss reserves for loans past-due by a certain number of days : Although the classification process is simpler than for banks, a higher loan loss reserve is required on certain loans that are past-due by more than certain thresholds. For example, DMFIs must establish a reserve equal to at least 25 percent on loans past-due 31 to 60 days, compared with 5 percent for banks (if there is no other negative information on the borrower). The required reserve rises to 50 percent on loans past-due 61-90 days, compared with 25 percent for banks; and then 75 percent on loans past-due 91-180 days, compared with 50 percent for banks. Once a loan reaches 181 days past due, however, the loan must be charged off - which is comparable to the 100 percent reserve required of banks.

The reason the minimum loan-loss reserve percentages for DMFIs is higher than for commercial banks is that microcredits rarely become past due, but when they do, the probability of total default is much higher than it is on a commercial bank loan.

Large exposure limitation : In granting loans to a single borrower or group of related borrowers, DMFIs are limited to 5 percent of regulatory capital, compared with 15 percent of regulatory capital for banks. This more severe limitation is in line with international practice.

Transactions with administrators : DMFIs may not grant loans or leases to administrators (defined as Councilmembers, the General Manager, Treasurer, and Compliance Officer). Banks may grant such loans, subject to various restrictions. The reasons for the more severe requirement on DMFIs are that the oversight of the administrators by the shareholders is not as close as it is for a commercial bank, and the DMFIs are located in more remote communities, where individuals who are powerful for other reasons may occupy these posts.

In addition, there are other types of prohibited transactions, the effect of which would, if permitted, enrich the administrator or his/her family at the expense of the DMFI. These transactions will also be prohibited for commercial bank administrators, as soon as the Banking Law is correspondingly amended.

Of course, MFIs that do not take savings deposits require less prudential supervision. Their supervision will be limited to a registration and reporting requirement, with periodic spot checks to ensure that they are not accepting deposits. Along with finance companies, mortgage companies, leasing companies, and other non-depository credit institutions, these MFIs will most likely be regulated by DAB under future legislation.

Current Activity of MFIs in Afghanistan

The motivation behind all of these legislative and regulatory efforts is that DAB regards MFIs as an integral part of the financial sector of Afghanistan, with a distinct emphasis on serving low-income and rural communities. And indeed they are: twelve MFIs currently have nearly 130,000 active borrowers throughout Afghanistan, with an average active loan size of $150. These outstanding loans currently represent over 13 percent of the total credit market in Afghanistan in monetary volume. In addition to that, 105,000 active savers have deposited a total of $2.6 million in the 5 MFIs that are currently functioning as credit unions.

Although MFIs in Afghanistan provide similar services to similar communities as MFIs in other countries, their organization and orientation are strikingly different. Because MFIs did not exist in Afghanistan under previous regimes, the advent of the new order of peace and stability in late 2001 gave policymakers and donors a "green field" on which to promote the growth of this activity in a relatively organized and controlled fashion.

There are some very distinctive characteristics of the MFIs that have sprung up in Afghanistan in recent years. First of all, MFIs supported by the major donor agencies through the Microfinance Investment Support Facility for Afghanistan (MISFA) are required to be organizationally distinct from the nonprofit associations (such as CARE and Mercy Corps) that set them up. This means that they are required to have their own corporate governance, own accounting, and own reporting.

Next, these MFIs are required to have an orientation toward profit. This does not mean that they will always be profitable, of course, but that they are expected to operate efficiently and prudently manage their risks. The fact that they are expected to account for and report on their activities separately from their founding organizations supports this goal, since it enables their performance to be measured against international norms and against the performance of other types of credit institutions, such as banks, finance companies, and leasing companies. It is worth mentioning, as an aside, that these expectations are the same that would be applied by any responsible bank supervisor to commercial banks.

It is recognized that the application of the "business model" to microfinance might strike some observers as inconsistent with the aim of microfinance, which is to help the poor. These observers may fail to see the merit of the cold-hearted application of allocated costs, loan-loss provisioning, calculation of rates of return on invested funds, and other concepts of sound financial management.

In Afghanistan, a different mode of thought is required. Afghanistan is one of the poorest countries of the world, and one of the largest per capita recipients of donor assistance. The policy of the Afghan government is that it is imperative that donor assistance, as well as the hard-earned savings of MFI members, not be squandered because of a lack of attention to risk, excessive costs, or improper or non-transparent transactions between the MFI and its founding or sponsoring organization.

And, if MFIs adopt this profit orientation early in their operations, it will help them grow in size and scope- may be even to the point where they would eventually qualify for a full-fledged commercial banking license. Indeed, there is already one commercial bank whose operations grew out of a previously-existing MFI. This bank has plans to expand to more provinces around Afghanistan, making larger loans to support small and medium-sized enterprises, without losing its original focus on microfinance.

To summarize, Afghanistan's relative inexperience with microfinance gives it an advantage - the nation can choose the best aspects of models that have been in place in other countries, while continuing to innovate on its own - as it has already done.

Lending to Small and Medium-sized Enterprises in Afghanistan

As in most very poor countries, commercial bank loans in Afghanistan comprise only a small portion of the total funds supplied to SMEs. Personal savings, family resources, and informal networks of traders and suppliers are more influential than the formal banking sector in Afghanistan's growing private sector.

Even so, the growth of outstanding loans by the 12 duly-licensed and permitted banking organizations since March 2004 is impressive, albeit from a very low base. Loans of all types have grown at an annual rate of 434 percent and currently stand at the equivalent of USD 130 million. Applying the Basel Committee's definition of SME lending (lending, other than microcredit, to enterprises with annual sales of under USD 60 million), it is clear that the bulk of commercial bank lending in Afghanistan is SME lending.

Because of SMEs' importance in job creation and the growth of the private sector generally, both the government and the donors have put a high and increasing priority on SME development.[1] And, many surveys of existing SMEs have identified lack of access to credit as an inhibiting factor in their development. The lack of access to credit, in turn, can be explained by two related factors: a reluctance by banking organizations to lend, and a lack of knowledge among SME managers about how to demonstrate creditworthiness through accurate measuring, monitoring, and reporting of cashflow, profits, turnover, and capital.

Reluctance by bankers to lend : The first factor - a reluctance by banking organizations to lend - stems primarily from the relative lack of a legal framework to protect creditors' rights. Up-to-date legislation on secured transactions, mortgages, collateral registration, and land titling does not exist. Even if it did, a corrupt and financially unsophisticated judiciary could not be counted on to enforce the laws or private contracts properly in a dispute between borrower and lender. Also, insurance is not available on collateral, further increasing uncertainty that values can be recovered. These problems are slowly being addressed, again with the help of donors, but progress is not as fast as the need for credit is growing. A central credit bureau would also help bankers identify reliable potential borrowers and have more confidence in the figures of total indebtedness reported by those potential borrowers.

Lack of knowledge about how to borrow : The second factor - a lack of knowledge about how to borrow - is also being addressed on a small scale, through various donor-financed training and outreach programs. These programs need to be significantly expanded, and spread throughout the country, into both urban and rural areas. Without their own ability to approach banks in a manner that builds trust, SME managers have to rely on personal connections to obtain credit. In addition, national standards of accounting and financial reporting need to be adopted, based on international standards, and used uniformly throughout the country. For the larger SMEs, a larger pool of trained accountants and auditors is required, to increase bankers' confidence in their financial statements. An appraisal profession also needs to be developed, so that collateralized lending can be based on more accurate measures of market value.

Other programs to address the need for funds by SMEs : Although commercial bank loans should be the primary sources of working capital and capital investment for SMEs in the future, they are not the only sources

1. By one estimate, there are between 250,000 and 750,000 SMEs in Afghanistan. The most promising sectors for SME development are considered to be horticulture, raisins, carpets, marble, poultry, cumin and saffron, wheat-based products, cashmere, construction and construction materials, and gems.

available today. Several development organizations, using donor funds, offer matching grants (mostly to agricultural SMEs), and an equipment leasing company has been set up to lease agricultural equipment. Based on favorable experience with these programs in agriculture, donors are considering setting them up to serve other sectors. In addition, donors are establishing partnerships with existing banking organizations in which potential SME borrowers are trained, and then credit by the banking organization is granted.

Other factors inhibiting SME development : The lack of a legal infrastructure negatively affects SMEs not only in their access to credit, but also in enforcing their own rights. Property rights and contract enforcement are weak, meaning that extra time and energy must be spent in verifying the reliability, fitness, and propriety of suppliers, distributors, landlords, and other partners. Establishing any business venture on land whose ownership is uncertain - due to imperfect land titling -- is extremely risky. SME managers also cite the prevalence of nuisance (and even illegal) taxes and fees charged, particularly during the shipment of goods, and confusion over business registration procedures as factors inhibiting their development.

In certain sectors, other deficiencies cause problems. For example, the lack of quality standards for building materials negatively affects the construction sector. The Afghan Builders' Association has attempted to remedy the situation by issuing its own standards. Construction is also hampered by municipal corruption in the issuance of building permits (a situation that is clearly not unique to Afghanistan but exists even in highly developed countries, as anyone trying to build or renovate a home in a major city will surely recognize).

Conclusion

The government of Afghanistan, together with its partners in the international community and relying on the enormous energy and nascent entrepreneurial talent of the private sector, is committed to creating an environment conducive to economic growth. Making that commitment is not easy. As you know, this country is emerging from 25 years of war, multiple regime changes, economic collapse, and a disintegration of the social fabric that is almost unprecedented in human history. With the help of the international community, Afghanistan is now stabilizing - but it is not yet stable. Many more years of hard work will be required to rebuild the institutions of a stable, just, benevolent, and prosperous society.

Appendix: Classifications of Credit Institutions in Afghanistan, January 2006

Total of nine separate official categories of credit institution and possible ownership structure for each

Type of institution	Number existing	Total loans outstanding (AFN millions)	% agg. loans	Required ownership structure
Commercial bank	7	5,759	77	Corporation registered in Afghanistan (actual)
Branch of foreign bank	5	743	10	Office of corporation registered in home country (actual)
Credit union (members are individuals and single proprietors, member-only savings deposits)	7	500	7	Non-distributive corporation (proposed)
Cooperative bank (mem bers are partnerships, organizations, and corporations, mem bers-only deposits)	0	0	0	Non-distributive corporation (proposed)
Finance company (including mortgage company and wholesale bank)	0	0	0	Corporation registered in Afghanistan
Leasing company	1	0	0	Corporation registered in Afghanistan
Class A microfinance institution (no savings deposits)	1	422	6	Non-distributive corporation (proposed)
Class B microfinance institution (no savings deposits)	0	0	0	Non-distributive corporation (proposed)
Class C microfinance institution (no savings deposits)	4	77	0	Non-distributive corporation (proposed -perhaps more flexibility)
Total		7,501	100	

Note: Data are as of 30 November 2005.

Microfinance in Bangladesh : Major Achievements and New Challenges

Khandakar Muzharul Haque

1. Introduction

Microfinance is currently at the center of policy discussions related to financial sector development and poverty alleviation. Microfinance experiences in Bangladesh have made important contributions to the emergence of this concept globally. International agencies and development professionals have accepted microfinance as a tool for poverty alleviation although the models and the experiences are diverse. It is important to analyze the experiences of microfinance as the exercise can lead to potential lessons for developing sustainable rural finance to eradicate rural poverty. Microfinance Institutions (MFIs) have managed to develop important innovations that enabled them to expand financial frontiers in developing countries such as Bangladesh. For the first time, large numbers of poor borrowers have access to financial services through formal type (can be considered as semi formal) of institutions due to these innovations. It permitted these institutions to serve poor clients successfully without the collateral that is normally required by banks. The techniques that are used by the MFIs are in sharp contrast with the formal banks operating in the rural areas (Annexure-1). Therefore, we need to learn from this emerging sector and need to build up a conducive regulatory and policy environment for the development of this sector.

2. Development of the Microfinance Sector in Bangladesh

The institution that has shaped much of the modern-day microfinance is the Grameen Bank, which began in 1976 as an experimental Project and has been established as a formal bank for the rural landless in 1983 (by a separate Ordinance), a progress expedited by its success. For the last two decades Bangladesh has been drawing the attention of the world for its microfinance initiatives. Over the last 25 years, hundreds of specialized microfinance NGOs have been created mainly based on the Grameen model, either to provide microfinance services exclusively or to add microfinance to their main agenda of social services. Therefore, the country experienced a massive expansion of microfinance activities during the 1990s.

In the early 1990s, replication of the success of microfinance institutions in Bangladesh was one of the big challenges. Since then microfinance has seen a massive expansion all over the country with scaling up of existing providers, entry of new players and emergence of an apex funding institution like Palli Karma Sahayak Foundation (PKSF). Therefore, survival and expansion strategies for the microfinance sector discussed today are more in terms of vertical expansion through market segmentation and product diversification, providing more client-responsive services, establishing fair competition through a regulatory environment, ensuring accountability by a proper monitoring system, and linking microfinance with the mainstream financial market.

3. Microfinance Programs of Different Types of Organizations

In Bangladesh, there are four main types of institutions involved in microfinance activities. These are 1) Grameen Bank (GB), a specialized institution, 2) Non- Governmental Organizations (NGO) like BRAC, Proshika or ASA, 3) Commercial and Specialized banks, like Bangladesh Krishi Bank (BKB), Rajshahi Krishi Unnayan Bank (RAKUB), and 4) Government sponsored micro finance projects/ programs like Bangladesh Rural development Board (BRDB), Palli Daridro Bimochon Foundation (PDBF), Swanirvar Bangladesh, RD-12 and others which are run through several ministries. As of June 2003 the total coverage of microfinance in Bangladesh by different organizations is over 15 million households (Table-1). It is a sector that has created jobs for over 100,000 employees. Semiformal NGOs are the major players in the microfinance market in Bangladesh. A rough estimate finds that near about 60% of the total market is occupied by them.

Table-1: Coverage of Microfinance Program in Bangladesh (as of June, 2003)

Organizations	Borrowers
NGO-MFIs	8,894,969
Grameen Bank	2,786,748
BRDB	709,073
PDBF	272,349
Department of Youth Development	123,800
Department of Social Service	48,469
BSCIC	42,837
BARD	43,123
Sub Total	**12,921,368**
Nationalized Commercial Banks	2,159,927
Private Banks	117,954
Sub Total	**2,277,881**
Grand Total	**15,199,249**

Source: Maps on Microcredit Coverage in Upzilas of Bangladesh, June 2003, PKSF.

In the macro context, microcredit loans constitute around 5% of the total private sector credit in the economy. Table-2 shows a rising trend for the share of microfinance institutions in the total private sector credit. But in terms of the aggregate number of borrowers, the MFI sector may have a larger share than other private sector lending organizations. MFIs have nearly 15 million borrowers who had received only 5.30% of total private sector credit in the financial year 2004, while the private sector's borrowers number only 7.85 million (from the banking sector, the largest supplier of credit in amount).

Table-2: Microfinance as share of total private sector credit

Outstanding (in billion Takas)	FY 02	FY03	FY04
Banks	675.70	776.60	902.20
Non-banks	24.60	31.60	40.20
MFIs	36.30	43.10	53.00
Total	736.60	851.30	995.40
Microfinance as % of Private sector credit	4.90	5.10	5.30

Source: Bangladesh Bank.

Key Information of Different Types of Institutions are Given Below:

a. **Grameen Bank :** Grameen Bank is the pioneering institution in the country. It emerged as a specialized microcredit bank in 1983 by an Ordinance after years of experimenting. Over the past 23 years the bank has emerged as the largest MFI, attaining a network of 1,735 branches by the end of December 2005. By that time it had mobilized 5.58 million members with loans outstanding of Tk.27.97 billion. Along with the expansion of its network and loan disbursement, there has been an increase in savings mobilization from the members. The net members' savings balance till December 2005 was 20.14 billion, which is a little over seventy percent of the loans outstanding. Total savings from both members and non-members stood as Tk.31.66 billion by December 2005. Grameen Bank finances 100 percent of its outstanding loan from its own fund and savings from its depositors. Although the bank was subsidized in its initial years, its dependency on cheap funds has declined. This is evident from the contribution of its savings in loan financing. The bank has been operating profitably with a high degree of efficiency.

b. **Non-Government Microfinance Institutions (NGO-MFIs) in Bangladesh :** Non-government MFIs number over 1000. Of them 721 institutions (including all major players in this sector) had mobilized more than 14 million members, and loans outstanding of around Tk. 44 billion by the end of December 2004. The average loan is Tk.3,896 per borrower. Although players are many, top three - BRAC, ASA and

Proshika - dominate the sector. These three non-government MFIs mobilize 73.60% percent of the borrowers and account for about 77 percent of the loans outstanding (Figure-1). Next in line are only ten NGOs who have more than 50,000 borrowers followed by forty more whose borrowers number between 10,000 and 50,000. The rest, the overwhelming majority of the NGO-MFIs, are small, having less than 10,000 members.

NGO-MFIs also mobilize savings from their members. Their savings mobilization approaches vary from voluntary to compulsory. Till December 2004 these institutions mobilized Tk.17.29 billion from their members as savings. But average net savings per member is quite low. By end of 2004, it was only Tk. 1,200 per member. The top 20 institutions mobilize 89%, while the topmost trio (ASA, BRAC and Proshika) mobilize 73% of the total savings (Figure-2). Savings occupy a significant portion of the total loan-able funds of NGO-MFIs. At the end of December 2004, around 40% of the outstanding loan of NGO-MFIs had been financed by the savings collected from members.

Figure-1: Disbursement of Loan by NGO-MFIs

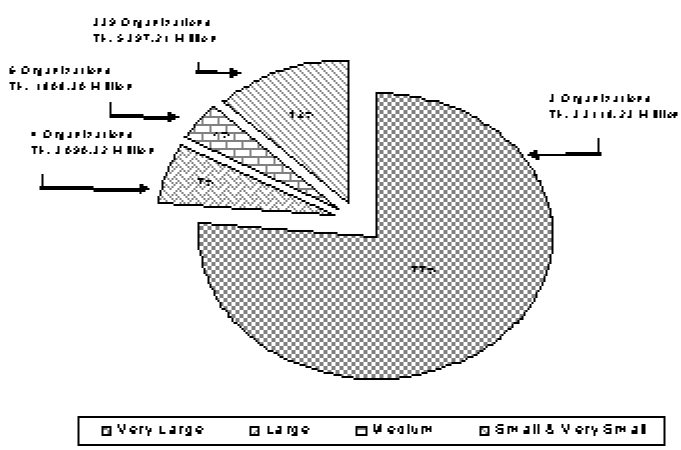


Figure-2: Savings Mobilization By NGO-MFIs

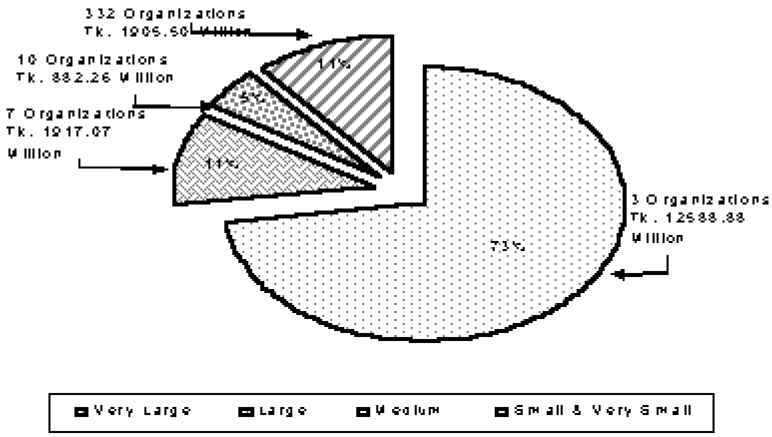


Table-3 gives a comparative picture of the MFIs (NGOs and Grameen Bank).

Grameen Bank and BRAC emerge as the largest MFIs in Bangladesh. BRAC is the largest in terms of membership while Grameen is the largest in terms of credit disbursement. By the end of December 2004, BRAC commanded around 23.99 percent of the total borrowers, while Grameen Bank's share was 20.04 percent. Grameen's share in credit disbursement, on the other hand, was 33.51 percent, while BRAC's was 24.27 percent.

Table-3: Market Occupied by Four Big MFIs

		Number of members (million)	Number of active borrowers (million)	Outstanding loan portfolio (million taka)	Member savings (million taka)
Four Big MFIs*					
	Grameen Bank	4.06	3.70	20,008.20	13,793.10
	BRAC	4.86	3.99	14,491.54	7,656.09
	ASA	2.99	2.77	13,775.62	2,828.24
	Proshika	2.75	1.54	4,851.07	2,103.56
PKSF's other partners		1.7	1.25	3,021.74	2,557.66
Other NGO-MFIs		3.9	0.8	3,561.43	1,446.34
Total		20.26	14.30	59,709.60	30,384.99
Big four as % of total		72.36%	85.66%	88.97%	86.82%

* Figures for the big four are for December 2004; figures for other NGO are for June 2004.

c. **Government Microfinance Programs in Bangladesh :** The government has been promoting public sector microfinance programs with financial support from international financial institutions or agencies. Seventeen departments of the thirteen ministries of the government of Bangladesh have poverty-alleviating microfinance programs (Table-4). The programs are implemented as projects. The government programs include any collateral free loan provided directly

Table-4: Microcredit Program of Different Ministries (As of December, 2003)*

Sl. No.	**Name of the Ministry**	**Cumu. Disbursement** (Taka in Million)	**Cumu. Recovery** (Taka in Million)	**Recovery Rate (%)**
1.	Ministry of Finance	1,359.90	1,106.30	81.35
2.	Rural Development and Cooperative	30,374.30	25,880.00	85-95
3.	Ministry of Women and Children Affairs	2,353.10	1,589.70	64-100
4.	Social Welfare Ministry	5,503.50	5,002.20	90.89
5.	Ministry of Labor and Employment	147.20	376.30 (past due)	255.64
6.	Cabinet Division	89.90	76.90	85.54
7.	Ministry of Fisheries and Livestock	1,567.80	1,055.50	45-77
8.	Ministry of Industry	1,968.20	1,747.60	69-91
9.	Ministry of Agriculture	2,673.10	1,914.30	71-98
10.	Ministry of Land	684.60	554.30	80.97
11.	Ministry of Local Government	561.80	237.50	42.27
12.	Ministry of Youth and Sports	5,331.70	4,365.30	81.87
13.	Ministry of Textile	262.30	89.20	34.01
	Total	52,877.50	43,990.60	83.19

* Bangladesh Economic Review, 2004, Ministry of Finance.

or through group approach to an individual. By the end of 2003, the total outstanding loan of these projects was about Tk.8.89 billion and their cumulative disbursement was Tk.52.88 billion. The program implemented by the BRDB under the Ministry of Local Government, Rural development and Cooperatives is the largest program run by the government. BRDB has disbursed Tk.34 billion to 102,342 cooperative societies/ groups comprising 3.6 million members. Palli Daridra Bimochon Foundation (PDBF) is another big program of the government. BRDB and PDBF together have achieved significant mobilization of members - over 3.95 million in number.

d. **Banks in microfinance--** The concept of microfinance is perceived a little differently by the nationalized commercial banks (NCBs), specialized banks and development banks (DBs). They consider any loan up to Tk.50,000 and extended without any collateral either based on 'individual' or 'group' basis as microfinance. This can be termed as small loans to encompass both micro and small loans. From this perspective, the NCBs and the DBs have been making very significant contributions to microfinance. By the end of June 2003, 12 banks disbursed a cumulative amount of Tk.99.35 billion among 10.80 million beneficiaries (Table-5). Bangladesh Krishi Bank (BKB) is one of the specialized banks that has been providing financial services largely in rural financial markets. It had disbursed Tk.9.5 billion by the end of December 2003.

Table-5: Microcredit disbursement by Banks as of December 2003*

Name of the Bank	Number of Beneficiaries	Cumu. Disbursement (in million Taka)	Recovery Rate (%)
Sonali Bank	4,302,144	46,937.70	98.87
Agrani Bank	3,073,802	14,338.10	99.47
Janata Bank	756,901	18,317.40	89.83
Bangladesh Krishi Bank	1,507,863	9,488.80	86.26
Rajshahi Krishi Unnayan Bank	183,975	1,691.70	77.55
Rupali Bank	32,546	254.70	85.00
Ansar-VDP Bank	632,222	2,835.70	98.43
Social Investment Bank	3,279	232.70	94.00
National Bank	14,473	93.70	95.00
Islami Bank	130,465	2,923.60	98.00
The Trust Bank Limited	30,000	1,564.90	95.00
Basic Bank Limited	159,576	673.30	98.00
Total	**10,827,246**	**99,352.30**	

*Bangladesh Economic Review, 2004.

e. **Palli Karma-Sahayak Foundation (PKSF): Apex Funding Organization --** Palli Karma-Sahayak Foundation (PKSF) is the apex microcredit organization established by the Government in 1990. It also works for capacity building of the organizations. It does not directly lend money to the landless and the asset-less people but reaches its target groups through its Partner Organizations (POs). It is getting financial support from the government and development partners. PKSF currently provides loan-able funds to 233 POs, at 4.5% interest to small and medium POs and 7% to large POs. PKSF is also widely credited for sharpening the focus of many NGO-MFIs towards financial sustainability and also in setting appropriate standards (Appendix-2) that would ease the way for a strengthened regulatory structure for microfinance. Up to September 2005, PKSF has provided Tk. 23,291.74 million to its POs that enabled them to disburse Tk. 23,175.46 million to targeted poor. Outstanding number of borrowers of the microcredit programs directly supported by PKSF stood at 5.68 million as on September 2005. Loan outstanding stood at Tk.10,947.76 million. Repayment rate is around 98 percent due to strict monitoring and incentives for POs to repay in order to access new loan trenches.

4. Major Achievements of Microfinance in Bangladesh

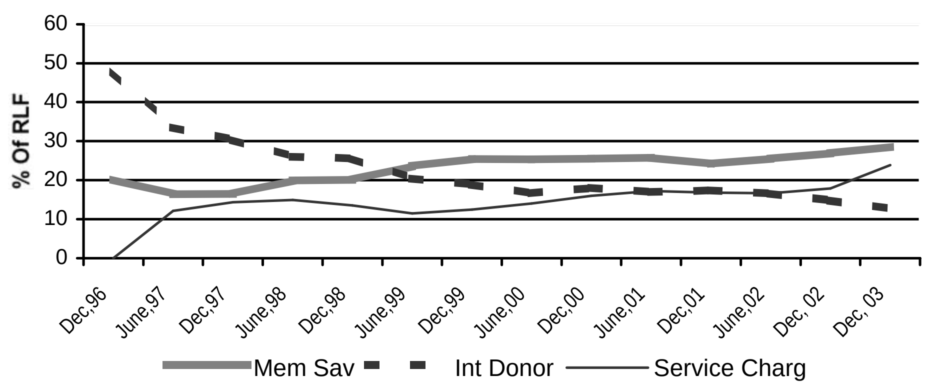
Microfinance sector in Bangladesh could indeed take pride in its substantial achievements especially in terms of outreach, sustainability and its impact on the borrowers, within only two decades. Some of the significant features of achievements are as follow:

a. **Outreach or coverage :** The growth in the MFI sector, in terms of the number of MFIs as well as outreach, was phenomenal during the 1990s and continues till today. The total coverage of microfinance programs in Bangladesh is over 15 million households (Table-1). A survey conducted by the PKSF (PKSF, October 2004) mentions that overlapping would be around 33%. After adjusting the overlapping the effective coverage of MFIs stands at 10.05 million, and that covers around 37% of all households in the country. If 80% of them are living below poverty line then it can be said that this program covers more than 8 million poor households.

b. **Savings collected by the sector :** Till December 2004 Grameen Bank and NGO-MFIs had collected more than Tk. 30,384.99 million from over 14 million poor people (Table-3) of rural Bangladesh as savings. This clearly indicates that the notion that poor people cannot and do not save is completely wrong. This means that there is a huge demand of savings in the rural Bangladesh, along with the demand for credit. This demand for savings product is not properly recognized by the banking sector operating there.

c. **Sources of fund and financial sustainability :** With the exception of Grameen Bank, no other MFIs are equity-based organizations. Although initially all MFIs were very much dependent on donor funds, different sources have emerged over time (Figure-3). In the initial years, commercial banks were not involved in micro-lending for poverty alleviation. PKSF emerged as an effective organization in the nineties for wholesale lending to its partner MFIs. Since MFIs are financial intermediaries, they mobilize resources from the members and raise funds from external sources for financing lending activities. 'Revolving Loan Fund' is financed with flow of funds from different sources. They are: (a) member savings; (b) PKSF; (c) Local commercial and Development Banks; (d) international NGOs; (e) International donors; (f) Local NGOs; (g) Own Fund & Reserve; and Net revenue. During the last few years there have been significant changes in the composition of revolving loan fund of the non-government MFIs. Now the sector is accumulating more funds from local sources, i.e., members' savings and service charges; these two sources contributed more than 50 percent into the revolving loan fund in the year 2004.

Figure-3: Sources of Revolving Loan Fund (RLF)



Local banks are now more responsive and they contributed more than 12 percent to the revolving loan funds of the MFIs in the year 2004. Because of the growing importance of PKSF and internal sources (net revenue and member savings) of finance, the share of international donors has declined from around 48 percent to around 10 percent over a span of eight years. These results do suggest an emerging role of PKSF and the internal sources. It has been observed that the sector has made impressive progress towards financial sustainability; MFIs in Bangladesh have been consistently covering cost of operation as well as cost of finance over the last several years. Smaller MFIs rely more on PKSF loan than savings, whereas big MFIs rely more on savings and accumulated surplus. An interesting research observation (Alamgir, 2004) is that MFIs can be profitable in every level of operations if they can appropriately match their income and expenses with their size of operation.

d. **Impact of microfinance :** A number of studies (Annexure-3) on the impact of microfinance highlight the fact that access to microfinance has resulted in an increase in employment and income. The most comprehensive and rigorous among them were carried out by the Bangladesh Institute of Development Studies (BIDS). Three important studies could be mentioned here --1) joint study of BIDS and the World Bank on the impact of group-based credit programs in Bangladesh (Pitt and Khandaker 1998), 2) survey report of BIDS on PKSF's Monitoring and Evaluation Systems (MES) (BIDS 2001) and 3) follow up study on PKSF's Monitoring and Evaluation Systems (MES) done by HB Consultants Limited (PKSF, 2005). Summary findings of these three are as follows:

   i) **Impact on Income and employment :** The programs do help poor in consumption smoothing, as well as in building assets. The average annual income of participant households is higher than that of non-participants. Self-employment activities had contributed more than 50% of the total income of the participants as against 43% in case of non-participants. Compared to non-participants the participants' households were better able to cope with flood, sustain their income, achieve higher purchasing power and consumption level. Wage and self-employment in non-agricultural sector is also higher for the participant households due to their access to microfinance program. The last study mentions that the total household income has increased from 2.8 percent to as high as 12.2 percent per annum during 1997-2004. Wage employment for women in participant has increased significantly between 1998 and 2004.

   ii) **Social Impact :** Microfinance programs promote investment in human capital (such as schooling) and contribute to increase awareness of reproductive health among poor families. Adult literacy rate is significantly higher among the eligible participants. The second study also found that program participation increases the chance of both boys and girls to be enrolled in schools.

iii) **Impact on Women empowerment :** Findings suggest that women do acquire assets of their own and exercise power in household decision-making. One of the most visible recent changes in the lives of rural women in Bangladesh has been a significant increase in their access to credit (Mahmud, 2004). In Bangladesh, in the last 15 years hundreds of thousands of women have become more visible through increased mobility. Microcredit programs make women come to the center meeting and that helps build their confidence. Microcredit allows a woman to handle money; she becomes a financial manager. Anyone can see this great transformation in Bangladesh. One simple example from Grameen Bank is its housing loan; there is a precondition that to take housing loan, the land has to be transferred to the woman's name. A great legal change is involved here! There are some evidences that members are able to stop domestic violence due to personal influence in income generation and through group action. In Bangladesh, microcredit programs have also increased women's participation in the activities of local government. Some women microcredit clients have been elected as Chairpersons and Members of various Union Parishads, the lowest and the most vibrant tier of local government.

iv) **Impacts on local economy :** The programs have spillover effects in local economies, thereby increasing local village welfare. The results of the studies strongly support the view that microfinance not only affects the welfare of participants and non-participants, but also facilitate aggregate welfare at village level.

Nevertheless, there has been little work on the aggregate poverty reduction impact of microfinance at the local or national level in Bangladesh. A World Bank study (abridged version published in Grameen Dialogue in 2003) based on the 1991/92 household survey indicates that only about less than five percent of microfinance borrowers can lift themselves out of poverty each year, even if the estimated impacts on consumption are sustained over time (Khandker 1998). Such percentage represents only about 1 percent of the population; thus the aggregate poverty impact of microfinance programs was quite negligible in the period

1991/92 (Khandaker, 2003). The last study (PKSF, 2005) mentions that according to the most recent national estimates, absolute poverty declined by nine percentage points between 1991/92 and 2000 and 11 percentage points between 1998 and 2004. However, the moderate poverty declined by less than five percentage point between 2000 and 2004. The declining trend implies a positive and statistically significant effect of microfinance.

5. Emerging Issues

Microfinance market in Bangladesh has come quite a long way. However, there are certain issues that need special attention. Stakeholders frequently talk about the following issues:

a. **Interest rate :** The effective annual interest rate of microcredit usually varies between 20 to 30 percent (Table-6). Though apparently higher than the commercial banks' lending rate, it cannot be considered so from the perspective of sustainability approach. Considering the enormous effort needed in mobilizing the large numbers of poor borrowers and making financial services available at their doorsteps it seems really tough to keep the interest rate close to that of the commercial banks and make the institution financially sustainable. Lending interest rates probably will come down if MFIs operate efficiently in a competitive market. But this requires restructuring of MFIs and establishment of an appropriate regulatory agency. The interest rate is still a debatable issue among the policy makers and needs to be handled carefully.

Table-6: Interest rate structure of loan

Interest rate charged (Flat method) %	**Number of Institutions (among 664 MFIs)**
5-8	3
10	18
12-13	44
14	6
15	523
16	21
17-18	15
20	33
25	1
Total	**664**

Source: Steering Committee Report, MRRU, 2003.

b. **Programs for the extreme poor :** The extreme poor, who constitute about 15% of the total population of Bangladesh, have remained outside the traditional microcredit programs. Those deprived include beggars, slum dwellers, day laborers, bonded laborers, female headed households, physically disabled and elderly persons without a source of income. The current microcredit program design does not fit with the needs of these groups, who require different products with more flexibility. Though present day microcredit programs are characterized by predomination of a single loan product and one/two savings instrument, there are encouraging moves by MFIs to diversity their products in order to meet the varied needs of the poor people. PKSF, Grameen Bank and some other NGO-MFIs have recently taken some special programs to reach the excluded groups. MFIs are however yet to meet the challenge of diversifying their products adequately to meet the growing demand of the hardcore poor and microfinance needs to be prepared for the extreme poor.

c. **Graduated borrowers and microenterprises :** As borrowers have become more skilled the average size of the loans made by MFIs has grown. Currently, many growing microcredit borrowers are attempting to become scaled-up micro enterprises. Research shows that there has been a growing demand from microcredit borrowers for larger loans. MFIs are being encouraged to support these borrowers in order to help them generate additional income and employment. While not all MFIs are able to provide these borrowers with adequate funds, some are responding to their customers' needs. Unlike MFIs, banks have not traditionally provided smaller loans to poverty graduates or to other microentrepreneurs. In addition, bank credit is generally collateralized, which makes it almost impossible for microenterprises to qualify. Therefore, there arises a serious financial demand from these growing small and medium enterprises which needs to be met.

d. **Commercial viability and Self reliance :** Currently nearly half of the revolving loan fund of microfinance programs of MFIs comes from the interest earning and their members' savings. The rest is coming from subsidized sources, donors' fund and commercial lending. Access to commercial borrowing is still difficult for MFIs because of the legal system. Commercial borrowing is also very costly for them. Therefore, the question of commercial viability without subsidy is an important issue for them. It is true that access to public deposits helps Grameen Bank to reduce its dependency on subsidized fund. Without having access to public deposits MFIs need start up funds as grants or concession which can often seriously damage their spirit of self reliance.

e. **Ownership and governance issues :** As the existing legal framework to register the microcredit operating NGOs is inadequate, these organizations have been usually registered under different charters of the government of Bangladesh, where the issues of ownership and governance are not appropriately defined. Research findings indicate that governance and financial sustainability are closely interrelated. Weak governance and management characterize many microfinance NGOs in Bangladesh. The problems of governance are mostly due to the inadequacy of the existing laws and regulations and to lack of reporting, supervision and monitoring. At the same time the ownership structure of NGOs is not well organized. Both the issues are important, now that the sector has become institutionalized.

f. **Regulation and supervision :** The issue of regulation and supervision has come to the forefront because MFIs are providing financial services and products to the poor, outside the formal banking system. NGO-MFIs should be subject to appropriate but a friendly regulatory framework. Regulation would shield them from political interventions. It would enable MFIs to protect the interest of its members. It would also enable MFIs to grow and develop like financial intermediaries. If they operate under a proper regulatory authority, the monitoring system of MFIs will develop to comply with certain regulatory requirements.

Considering the above mentioned issues, the government of Bangladesh established a unit namely "Microfinance Research and Reference Unit (MRRU)" in Bangladesh Bank and constituted a National Steering Committee under the leadership of the governor of the bank to formulate a regulatory framework for this sector and to oversee the activities of MRRU (Annexure-4). The Committee has prepared an operational guideline (Annexure-5) for MFIs which are now being implemented by the MRRU. On the basis of this guideline MRRU is collecting information on this sector, analyzing them for policy inputs and publishing them to improve the transparency of this sector. The Committee has also prepared a draft law for setting up a separate regulatory authority for this sector and has already submitted it to the government for taking necessary action. The draft law has suggested an independent regulatory authority that would be responsible for providing license to the MFIs and monitoring their activities. It is expected that the proposed law will help build this sector on a solid foundation.

6. Future Challenges

Followings are the future challenges that the microfinance sector faces in Bangladesh as a new and growing industry:

a. **Sources of fund and the issue of sustainability :** It is clearly understood that donor funds for microcredit will diminish in near future, which means that the current operating spreads of MFIs will shrink and they will have to seek more commercial sources of funding. Hence, MFIs will need to balance greater efficiency and reduce fund for cross-subsidization of social programs that many NGO-MFIs operate. It is obvious that in future MFIs will have to prepare more efficient financial strategies for survival.

b. **Operational efficiency :** As the industry reaches the peak of its maturity it would face more competition. Therefore, MFIs will need to further refine the services / products that they offer and will have to identify market needs and design appropriate products accordingly to compete.

c. **Monitoring microfinance sector development :** Development of the microfinance sector requires both sustainable MFIs and a flow of information for comprehensive understanding. At least two agents are required for sound microfinance sector development: sustainable micro finance institutions, and appropriate regulatory framework for monitoring and supervision. In Bangladesh, efforts are underway to develop sustainable MFIs and a regulatory framework. Big MFIs have their own institutional arrangements for training, management information system, monitoring and research but small MFIs are unable to have institutional arrangements for monitoring and research. PKSF, however, provides technical support to its partner MFIs on a limited scale to build up their capacity. Much help is actually needed in this area.

d. **Regulation and supervision :** It has been mentioned earlier that currently MRRU in Bangladesh Bank is overseeing the sector in a non-prudential manner and the work would be under prudential regulation once the proposed law is enacted. However, many questions related to the regulation and supervision remain unsolved which will be solved by the future regulator. It is frequently asked that whether the same type of regulation and supervision would fit all types of NGO-MFIs and what would be the most cost effective technique to supervise some 1000 plus organizations? NGO-MFIs mainly operate in the rural areas, which sometimes are very difficult to reach in time; communication is generally poor in the rural sector. Considering all these problems and their nontraditional method of operation what kinds of supervision technique would be suitable for them?

e. **Developing comprehensive rural financial market :** Rural financial markets comprise formal, informal and semi-formal institutions. Public sector banks (PSBs) dominate formal financial market. These PSBs, are not able to reach all types of clients in the rural financial market, they are not also commercially viable. In such a situation, rural financial market can be more effective by making MFIs as the formal institutions. It will enable MFIs to expand their portfolio and exploit economies of scale. As such, MFIs would be able to improve their viability and offer financial services at relatively low interest rate especially for the poor people in the rural financial market.

7. Conclusion

Microcredit in Bangladesh has reached over one-third of all rural households in Bangladesh. Currently there are more than 1000 NGO-MFIs operating all over the country. In Bangladesh, mainly four big institutions including Grameen Bank dominate the market. Government programs and commercial banks' participation in microfinance are now considered valuable, they are also playing useful promotional and development roles in this sector. The important observation is that the microfinance operation is now more self-reliant than before; it has funded half of its operation from local sources that comprise members' savings and service charges on loan. However, the interest rate is still a debatable issue among the policy makers. The issue of regulating microfinance and supervising NGO-MFIs is being discussed more seriously among the policy makers, including the government and its development partners. In this context, PKSF is playing an important role in the development of a self-regulation process and in supervising its partner organizations, which would help build up a culture among the community. The government has established Microfinance Research and Reference Unit (MRRU) in Bangladesh Bank to develop some uniform policy guidelines and to formulate a regulatory framework for this sector. Recently, the government is considering enacting a law for the NGO-MFIs. Once the law is enacted many important issues of this sector could be resolved. Further, if the future challenges could be addressed successfully, then the microfinance sector would indeed have a bright future in the coming days.

Annexure-1

The Techniques Contributed to the Success of Microfinance

* Loan size- loans are small in size, and are made for only a few weeks or months to be used mostly for working capital purposes.
* Repeat loans- incentives are given to clients to maintain good repayment records by rewarding them with repeat loans.
* Loan repayment schedules- frequent payments are required, often weekly or monthly, to enable close monitoring of borrower performance.
* Interest rates- interest rates and fees are high, usually much higher than those charged by conventional lenders, and are usually positive in real terms.
* Loan officer efficiency- loan officers frequently handle 75 to 100 borrowers groups or 200 to 500 individual borrowers. Financial incentive schemes for employees stimulate high levels of efficiency.
* Loan collateral - many microfinance organizations use a lending technology involving peer group formation and peer monitoring as a substitute for conventional loan collateral to reduce transaction costs and risks.
* Decentralized lending procedures - the procedures for screening applicants and processing loans are simple, with considerable autonomy given to loan officers, who are required to maintain close contact with their clients.
* Loan delinquencies and losses- Systems are often used to produce daily repayment reports so loan officers can take corrective action at the first hind of unexplained delay in their clients' payments. Some organizations offer interest rebate fore on-time or early repayments.[1]

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[1]Source: Richard (2000)

Annexure-2

Developing Best Practices for Microcredit Sector by PKSF

PKSF, in the last decade, has prepared a number of policy guidelines and standards for its partner organizations (POs). Major policy guidelines and standards prepared by PKSF are:

1. Statement of Policy: Guidelines for selection of POs and borrowers of Rural, Urban, Hardcore poor and Microenterprise Credit Programs;
2. Guideline for Accounting;
3. Policy for Loan Classification and Debt Management Reserve;
4. Guidelines for Designing Internal Control System for POs or PKSF;
5. Guidelines for Management of Savings;
6. Guidelines for Management of Service Charge Earnings;
7. Guidelines for Avoiding Overlapping;
8. Management Information System;
9. Guidelines for Performance Standards and Categorization of POs;
10. Financial Ratio Analysis;
11. Policy for the Utilization of Disaster Management Fund;
12. Business plan for POs;
13. Guidelines for Management Audit of POs;
14. Guidelines for Internal Audit of POs;
15. Audit TOR for External Auditor of PKSF for Auditing PKSF;
16. Audit TOR for External Auditor of PKSF for Auditing POs;
17. Audit TOR for Auditors appointment by POs;
18. Policy for Loans for Institutional Development.

Annexure-3

Microfinance Impact Studies

Study	Coverage	Results
Rushidan Islam, 1994 BIDS	Partner Organizations of PKSF	Positive impact both on income and other aspects of lives observed
Alamgir, PKSF, 1994	Partner Organizations of PKSF	Strong positive impact on income observed.
Hulme and Mosely (1996)		Generally, a positive impact is found on borrower income of the poor with on average an increase to around 30% over the non-borrower.
Khandaker (1998)	Grameen Bank and BRAC	5% of participant households removed from poverty annually. Additional consumption of 18 taka for every 100 taka of loan taken out by women
Pitt and Khandaker (1998)	BRAC, BRDB, Grameen Bank	Positive impact of program participants on total weekly expenditure per capita, women's non-land assets and women's labor supply. Strong effect of female participation in Grameen Bank on schooling of girls. Credit programs can change village attitudes and other village characteristics.
BIDS, Study (2001)	Partner Organizations of PKSF	Positive impact on income of microcredit program participant in comparison to non-program participants. Other social indicators also revealed positive impact.
Amin et al. (2003)	Grameen Bank, BRAC, ASA	Members are poorer than nonmembers. Programs are more successful at reaching poor, but less successful at reaching vulnerable are effectively excluded from membership.
Khandker (2003)	Grameen Bank, BRAC, BRDB	Households who are poor in landholding and formal education tend to participate more Microfinance helps to reduce extreme poverty much more than moderate poverty (18 percentage points as compared with 8.5 percentage points over 7 years). Welfare impact is also positive for all households, including non-participants, as there are spillover effects.
Pitt et al. (2003)	BRAC, BRDB, Grameen Bank	Significantly positive effect of female credit on height-for- age and arm circumference of both boys and girls. Borrowing by men has either negative or non-significant impact on health of children.
PKSF (2005)	Partner Organizations of PKSF	Absolute poverty declined by nine percent points between 1991/92 and 2000 and moderate poverty declined by five percentage point between 2000 and 2004. Mobility of women in male dominated public places has increased remarkably.

Source: ADB, 2003 and PKSF (various publications)

Annexure-4

Terms of References (TORs) of the Steering Committee of MRRU

a. Formulation of policy guidelines to regulate the NGO-Micro-Finance Institutions (NGO-MFIs) and setting performance standard to ensure their qualitative improvement.

b. Preparation of uniform accounting guidelines for MFIs to ensure their transparency and accountability.

c. Monitoring the activities of the MFIs in compliance of the policy guidelines prepared by the Steering Committee.

d. Recommendations for preparing a legal framework in support of the Micro-finance Research and Reference Unit or a new regulatory authority for the MFIs.

Annexure-5

Developing Operational Guidelines for Microfinance Sector by MRRU

MRRU in the last few years has prepared some guidelines for NGO-MFIs and requested them to provide information to the Unit according to the instruction given. Guidelines contain;

a. MIS Format, which contains information on working areas, group and Member, savings, use of savings, credit disbursement and realization, income statement and balance sheet. Till now near about 700 institutions have reported to the Unit.

b. The Accounting manual contains of accounting policies, application of accounting standards, financial reporting, record keeping and reporting formats. It provides detail information regarding accounting practices with examples. It also provides methods to calculate financial ratio analysis of the institutions.

c. The guidelines also contain guidelines for Internal and external Auditors. The guideline for internal auditor mentions how to prepare management report, audit reports, and field inspection reports. The guideline for external auditors mentions that Audit firms should be enlisted with NGO Affairs Bureau, it would follow International accounting standard and it would also be based on the requirement of regulatory agency.

d. The guideline related to the performance indicators and standard discusses about program's viability of borrowers, institutional viability and financial viability. Different weights were given on these three areas of viability, institution would be considered viable if it can prove itself as a well performing institution in all areas mentioned above.

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Up Scaling Microfinance in India : Retrospect and Prospect

V. S. Das and H. R. Khan

It gives us great pleasure to be in the midst of this august gathering today deliberating on various issues relating to microfinance. We in the SAARC countries share the grave concern about the incidence of poverty in this region and the fact that in spite of actions initiated at all levels, it still remains a serious problem. About 900 million or 68 per cent of the world's poor live in Asia of which about 500 million live in South Asia. While each country has been dealing with the issue in its own way, there are some examples which stand out by virtue of their originality and effectiveness in addressing the problem. The experience of countries like Bangladesh has shown that given the right kind of resource support through credit and capacity building, the poor themselves can turn around their own situation. Microfinance plays a significant role in the overarching goal to reduce poverty, especially in the countries of the Asia-Pacific Region. Institutions such as the Grameen Bank have been instrumental in bringing about significant socio-economic transformation and it is only appropriate that all the world over the principles and practices of microfinance in Bangladesh are not only appreciated but also replicated.

Role of the Banking System

Rural credit policy in India had at its core the twin goals of bringing an increasing number of people within the formal financial system and using credit as an instrument of poverty alleviation and rural development in conjunction with other measures. The policy orientation was towards increase in supply of credit through expanding outreach of the banking system and adoption of lending policies aimed at facilitating flow of credit to the hitherto neglected sectors of the economy, called the "priority sectors". The Indian banking system has today an impressive penetrative outreach and there is now a bank branch fulfilling the need of every 16 thousand of the population. Although microfinance in the way it is understood today started in India in the early nineties, the banking sector in the country has been providing credit to the weaker sections of the society for productive purposes even earlier. The cooperative societies which were established since the early years of the last century have been providing credit mainly to the disadvantaged sections. The commercial banks have also been encouraged to extend credit to the weaker and disadvantaged sections. The Regional Rural Banks (RRBs) were set up in 1976 with a view to providing credit mainly to the weaker segment of the rural population. As a result of these initiatives, there has been a substantial broadening of the infrastructure for credit delivery resulting in increased outreach and reduction in the influence of informal agencies as evidenced by the increase in the share of institutional sources in the cash debts of rural households from less than 10 per cent in the early 1950s to more than 60 per cent in 1991.

The Quest for Financial Inclusion

In spite of the rapid expansion of the banking sector, there are still wide gaps in the availability of banking services in the rural areas due to several supply and demand side constraints. It is in this context, as a proactive measure, the Reserve Bank of India, in its Annual Policy Statement for the year 2005-06, urged banks to review their existing practices to align them with the objective of financial inclusion. In the Mid Term Review of the Policy (2005-06), with a view to achieving greater financial inclusion RBI exhorted the banks, to make available 'no frills' banking accounts either with nil or very minimum balances as well as charges that would make such accounts accessible to vast sections of the population. Further, in order to ensure that persons belonging to low income group both in urban and rural areas do not face difficulty in opening the bank accounts due to the procedural hassles, the Know Your Customer (KYC) norms for opening accounts has been simplified for those persons with balances not exceeding Rs 50,000 and credits in the accounts not exceeding Rs.1,00,000 in a year.

Development of Microfinance

As a large section of population in the unorganized sector particularly in the rural areas remained outside the formal credit structure, a need was felt for alternative policies, systems and procedures, savings and loan products, other complementary services, and new delivery mechanisms which would fulfill the requirements of the poorest, especially of the women members of such households. The emphasis, therefore, was on improving the access of the poor to microfinance.

Microfinance Models in India

a) The SHG-Bank Linkage Programme

Against this background, in 1992, a pilot project of linking Self Help Groups (SHGs) with commercial banks was launched under the aegis of National Bank for Agriculture and Rural Development (NABARD), which is the apex bank for rural and agricultural credit in the country. Subsequently, other categories of banks, viz., co-operative banks and the Regional Rural Banks (RRBs) also participated in delivery of micro finance services under the programme. During all the three phases of this programme, viz. pilot testing phase (1992-95), mainstreaming phase (1995-98) and the current expansion phase (1998 onwards) active policy support was provided by the Reserve Bank of India which allowed banks to open savings bank accounts by such informal groups and relax interest rate, margin, security, etc. norms wherever necessary for lending to the SHGs financed under the programme. Interest rates on loans by banks to micro-credit organisations and by micro-credit organisations to their members/beneficiaries were left to their discretion. Government of India have also been supporting the SHG-bank linkage programme through budgetary announcements, inter alia, regarding the number of SHGs to be linked to banks and other policy issues.

Three different models of linkage have evolved based on variations in the delivery mechanism. They are:-

❖ **Model I : SHGs formed and financed by banks**

Under this model, banks themselves act as Self Help Promoting Institutions (SHPI), i.e., forming and nurturing the groups, opening their savings accounts and providing them bank loans. As at March 2005, 11 per cent of the total number of SHGs financed were from this category.

❖ **Model II : SHGs formed by NGOs and other agencies but financed directly by banks**

This appears to be the most popular model amongst the bankers. Under this model, Non-Governmental Organisations (NGOs) and other agencies in the field of microfinance act as facilitators and banks in due course link the groups by directly providing loans to them. About 72 per cent of SHGs linked to banks as at March 2005 was under this model.

❖ **Model III : SHGs financed by banks using NGOs as financial intermediaries**

In this model, NGOs take on the dual role of facilitators and financial intermediaries. They help in formation of SHGs, nurturing them, training them in thrift and credit management and then approach banks for bulk loan assistance for on-lending to these SHGs. The proportion of SHGs linked to banks under this model is relatively small, i.e., 7 per cent as at March 2005.

The SHG-bank linkage has shown significant growth in terms of number of groups linked to banks. Starting from only 255 SHGs linked to banks in the year 1992-93, the number increased to 0.5 million SHGs linked during the year 2004-05. Cumulatively, the number of SHGs linked to banks aggregated 1.6 million as at the end-March 2005. This translates into an estimated 24.3 million poor families brought within the fold of formal banking services. Ninety per cent of the groups linked with banks are exclusive women's groups. Cumulative disbursement of bank loans to SHGs stood at over Rs. 68 billion as on March 31, 2005 with an average loan of Rs. 42,600 per SHG and over Rs. 3,000 per member. A total of 573 banks including 47 commercial banks, 196 RRBs and 330 co-operative banks are now associated with the SHG-bank linkage programme. While 572 out of 603 districts of the country in 31 states/ Union Territories have been covered under this programme, the total number of NGOs presently involved in this linkage is around 4,500.

The advantage of the linkage programme is that it enables the banks to externalize part of their credit cycle of identifying the borrowers and also helps in recovery of loans with the on-time repayment reported at over 95 per cent. Impact evaluation of the programme by NABARD has shown that it has benefited the group members both financially as well as socially, and has resulted in a general increase in the level of their self-confidence. An impact assessment study conducted by the Small Industries Development Bank of India (SIDBI) has also shown that micro finance has supported increased non-farm employment and access to micro finance has had a significant positive impact on women's economic and social empowerment in terms of ability to access loans, own productive resources, engage in income generating activities, decision making and increased mobility.

b) Bank-MFI Bulk Lending Model

An alternative delivery model for microfinance is the bulk lending model, where funds are placed at the disposal of NGOs or MFI for on-lending. SIDBI, Friends of Women's World Banking (FWWB) and the Rashtriya Mahila Kosh (RMK) have followed this route along with some private, foreign and public sector commercial banks. The on-lending could be to SHGs or groups in Grameen model or even to individuals.

c) The Bank-MFI Partnership Model

This model has been popularized by the new generation private sector banks in the country. Under this model, the MFI evaluates, recommends, originates the loans, helps in disbursal and subsequently tracks and collects the loans. However, the loans are accounted for in the books of the bank and not of the MFIs. This model has overcome the constraints of capitalization of the MFI and the double exposure that the banks are exposed to. For the services that the MFIs provide a service charge is collected from the borrowers by the MFI. It also provides First Loan Default Guarantee (FLDG) to the bank to a certain extent (8 - 15 per cent) of the limit sanctioned in the form of a security deposit with the bank so as to maintain its stake in the loan portfolio. Since MFIs find this deposit amount too large to mobilize, further innovation by providing the FLDG amount as an overdraft limit to the MFI has also been tried out.

d) Grameen Bank Model

Some NGO-MFIs in the country have adopted the Bangladesh Grameen Bank model for providing microfinance to poor women. Available data show that the outstanding loans given by these MFIs aggregated Rs 5.1 billion as at the end of March 2005.

The Policy Framework for Microfinance

Under the multi-agency system existing in India, different types of institutions are at present engaged in delivery of micro credit. These include, apart from the banking institutions, microfinance institutions (MFIs), such as, non-banking finance companies (NBFCs), co-operative societies and other entities set up as societies and trusts. While there is no published data on MFIs operating in the country, the number of MFIs is estimated to be around 800, an overwhelming majority of which are operating on a smaller scale with clients ranging between 500 to 1,500 per

MFI. An estimate from the largest association of MFIs indicates that as on March 31, 2005, outstanding loans disbursed by their members amounted to Rs 10.63 billion.

While the commercial banks are regulated by Reserve Bank of India, the cooperative societies, which are not banks, are regulated by the concerned State Governments under the provisions of the respective State Cooperative Societies Act. Micro finance institutions which are registered as companies come under the regulatory purview of RBI. While Non-Banking Financial Companies (NBFCs) accepting public deposits are subjected to rigorous supervision by RBI, those not accepting public deposits are regulated in a limited manner. There are, however, only a few MFIs in the country that are registered as NBFCs. Further, companies which are engaged in (i) micro financing activities (with credit cap of Rs. 50,000/- for a business enterprise and Rs. 1,25,000/- for meeting cost of a dwelling unit), (ii) licensed under Section 25 of the Companies Act 1956 (i.e., not for-profit companies), and (iii) which are not accepting public deposits are exempted from the key regulatory/statutory requirements, viz., registration, maintenance of liquid assets and transfer of minimum percentage of profits to the Reserve Fund.

Reserve Bank of India has been striving to create an enabling environment for the growth of micro finance in the country. The pilot project of SHG-bank linkage launched by NABARD in 1992 received full policy support from RBI and it advised the commercial banks to actively participate in linkage programme which has since been extended to the RRBs and cooperative banks. The progress of SHG linkage was reviewed in 1995 by a Working Group set up by RBI, based on which guidelines were issued to banks in April 1996 for financing the SHGs beyond the pilot phase. Based on the report of the Micro-credit Special Cell which was set up in the RBI pursuant to the Monetary and Credit Policy announcement in April 1999 and the Task Force on Supportive Policy and Regulatory Framework for Micro finance, set up by NABARD, in February 18, 2000 RBI issued a comprehensive circular to banks to initiate steps for main-streaming micro-credit and increasing the outreach of micro credit providers. Micro credit was defined as the provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standards and the micro credit institutions as those which provide these facilities. The Reserve Bank set up four informal groups in October 2002 to examine (i) structure and sustainability issues, (ii) funding issues, (iii) capacity building issues and (iv) regulatory issues relating to microfinance. The Advisory Committee on Flow of Credit to Agriculture and related Activities from the Banking System (Vyas Committee) appointed by the RBI also examined various issues in microfinance.

Highlights of the circular/ guidelines issued to banks in this regard incorporating the recommendations made by various committees are as under :

- Interest rates applicable to loans given by banks to micro credit organisations or by the micro credit organisations to Self-Help Groups/ member beneficiaries has been left to their discretion.
- Micro Credit extended by banks to individual borrowers directly or through any intermediary is reckoned as part of their priority sector lending. Bank loans to SHGs are also treated as lending to the weaker sections.
- The banks may formulate their own model(s) or choose any conduit/intermediary for extending micro credit. It may be desirable for banks to deal with micro credit organisations having proper credentials.
- Banks may prescribe their own lending norms keeping in view the ground realities.
- Micro credit should also form an integral part of the bank's corporate credit plan and should be reviewed at the highest level on a quarterly basis.
- Banks should strive to remove all operational irritants and make arrangements to expeditiously sanction and disburse micro credit by delegating adequate sanctioning powers to branch managers. The loan application forms, procedures and documents should be made simple.
- The group dynamics of working of the SHGs may be left to themselves and need neither be regulated nor formal structures imposed or insisted upon.
- The approach to micro-financing of SHGs should be totally hassle-free.
- MFIs would not be permitted to accept public deposits unless they comply with the extant regulatory framework of the Reserve Bank

Further, Foreign Direct Investment (FDI) has been allowed by the Government of India in the MFI sector subject to certain norms and NGOs engaged in microfinance have now been allowed to raise External Commercial Borrowing (ECB) up to USD 5 million during a financial year.

Expanding the Outreach of Microfinance

Following the Finance Minister's Budget Speech for the year 2004-05 stating, inter alia, that commercial banks may consider adopting 'agency model' by using the Civil Society Organisations (CSOs) and others to expand their outreach in the rural and farm sectors and appointing Micro Finance Institutions (MFIs) as "banking correspondents" to provide transaction services on their behalf, an Internal Group of RBI on Rural Credit and Micro-Finance (Khan Committee) set up by RBI recently had examined the issues relating to expanding the outreach of microfinance through linkage between banks and intermediaries from the formal, semi-formal and informal sectors and leveraging information and communication technology (ICT) for the purpose. On the basis of recommendations made by the Committee, banks have since been permitted to use the services of NGOs/SHGs/their federations, MFIs and other CSOs as intermediaries in providing financial and banking services through the use of (i) Business Facilitator and (ii) Business Correspondent models.

The Business Facilitators will provide non-financial services to the banks, such as, identification of the borrowers and fitment of activities, collection and preliminary processing of loan applications including verification of primary information/data, creating awareness about savings and other products and education and advice on managing money and debt counseling, processing and submission of applications to banks, promotion and nurturing Self Help Groups/ Joint Liability Groups, post-sanction monitoring, monitoring and handholding of Self Help Groups/ Joint Liability Groups/ Credit Groups/ others, and follow-up for recovery. In addition to activities listed under the Business Facilitator Model, the scope of activities to be undertaken by the Business Correspondents will include (i) disbursal of small value credit, (ii) recovery of principal / collection of interest, (iii) collection of small value deposits (iv) sale of micro insurance/ mutual fund products/ pension products/ other third party products, and (v) receipt and delivery of small value remittances/ other payment instruments. Thus, the emphasis has been on provision not only of credit but also of the entire gamut of financial services at the doorsteps of the poor through these agencies.

Role of other Apex Level Institutions

a) NABARD

Apart from being the pioneer in the field of microfinance in India under the SHG-Bank Linkage Programme, NABARD has been promoting the idea of organising thrift and credit groups among the NGOs and encouraging their linkage with banks, providing inputs in capacity building for banks and NGOs, and providing funds to banks and financial support to eligible MFIs to ease the fund flow position to the sector. A Micro Finance Development Fund of Rs 1 billion was established in NABARD in the year 2000-01 for (a) giving training and exposure to Self-Help Group(SHG) members, partner NGOs, banks and government agencies; (b) providing start-up funds to micro finance institutions and meeting their initial operational deficits; (c) meeting the cost of formation and nurturing of SHGs; (d) designing new delivery mechanisms; and (e) promoting research, action research, management information systems and dissemination of best practices in the micro finance sector. The corpus of the Fund has now been raised to Rs 2 billion and it has been renamed as the Micro Finance Development and Equity Fund. The objective of the redesignated Fund is to facilitate and support the orderly growth of the microfinance sector through diverse modalities for enlarging the flow of financial services to the poor particularly for women and vulnerable sections of society consistent with sustainability. (e.g. SHG -Post Office linkage, promotion of Joint Liability Groups, marketing of SHG products).

The mainstream SHG movement has been able to promote the philosophy of financial inclusion to a large extent as 121.5 million poor have been linked to the formal financial institutions. More than 4300 NGOs and other agencies and the entire banking industry in the country are partners in the movement. Other important initiatives taken by NABARD include putting in place innovative projects with active support from NABARD, conducting various studies in the field of microfinance and developing a rating model for MFIs in association with CRISIL, a leading credit rating agency.

b) The Small Industries Development Bank of India (SIDBI)

The Small Industries Development Bank of India (SIDBI) has also been supplementing the efforts at providing microfinance in the country through its SIDBI Foundation for Micro Credit (SFMC) launched in January 1999. The objective is to create a national network of strong, viable and sustainable MFIs from the informal and formal financial sectors to provide micro finance services to the poor, especially women. The cumulative assistance of SIDBI's microfinance initiatives as at the end of March 2005 aggregated Rs. 4.2 billion through 209 MFIs, benefiting approximately 1.51 million poor, mostly women.

c) The Rashtriya Mahila Kosh (RMK)

The National Credit Fund for Women or the Rashtriya Mahila Kosh (RMK), an agency of the Government of India, provides funding assistance to NGOs and SHGs exclusively for benefit of women living below the poverty line. The cumulative loan sanctioned by RMK stood at Rs 1.3 billion in respect of 749 NGOs and other agencies as at the end of March 2004.

Impact Evaluation

Although a large scale evaluation of the impact of microfinance initiatives on the poor, particularly their sustainable livelihood is not available, some preliminary studies by NABARD and SIDBI point to positive results. NABARD study, with refeference to SHG-bank linkage programme, revelals that the group members have been benefited both financially as well as socially and it has resulted in a general increase on the level of confidence of the group members, who are mostly disadvantaged women. SIDBI study indicates that the microfinance initiatives have increased non-farm employment of the rural people and women in particular have been benefited in terms of economic and social empowerment, their ability to access loan, own productive resources, engage in income generating activities, decision making and increased mobility.

However, given the degree and dimension of poverty in a country of continental size, we still have a long way to go. Against this background, let me now briefly touch upon the issues and the challenges we face in upscaling the microfinance for the financial inclusion of the uncovered and under-covered poor of our country.

The Road Ahead - Issues and Challenges

Regional variations

Although more than 24 million poor families have been covered so far since the pilot project for financing of SHGs was launched in the early nineties, vast segment of the population are still to be covered and wide regional variations exist in spread of SHGs in the country. Thus, there is a need to upscale the number of SHGs, particularly in the Northern, Eastern and North-Eastern parts of the country where there is a dearth of good Self Help Promoting Institutions (SHPIs). In some cases, the SHGs have started federations at the District/ Taluka levels and the role of such federations in intermediating between banks and SHGs will have to be watched in the next few years.

Cost of credit

The issue of high interest rates charged by the MFIs is often raised in various forums. In this context, the MFIs' contention is that their cost of operations is quite high due to higher intensity of follow-up and need for continuous contact with the borrowers. Adoption of innovative methods and processes including low cost ICT solutions can be one way for reducing their transaction cost and, hence, the cost of credit to the borrowers.

Promotion of micro-enterprises

Though the SHG-Bank Linkage programme was intended to provide sustainable access to the unbanked poor, the question often being posed by different stakeholders is 'what next'? Under the SHG-Bank Linkage Programme, the average loan amounts per SHG and per member are about Rs 42,600 and Rs 3,000 respectively. The per member loan amount is too small for any meaningful business activity although often such small doses of finance help the poor household in consumption smoothing. It is imperative that the quantum has to be increased substantially when the SHGs go higher in the ladder to the level of micro-enterprises. More importantly, the members of the groups need to have access to information and knowledge about appropriate economic activities that can be undertaken by them as well as the various backward and forward linkages available for sustaining such activities.

Regulation of MFIs

As regards regulation of micro finance institutions, it has to be kept in mind that major players undertaking micro finance activities in India (viz. banks and NBFCs) are well regulated entities. The other types of organizations, such as, societies, trusts, etc. which do not accept public deposits are not regulated by the central bank. The Business Facilitator and Business Correspondent models suggested by the Khan Committee report will help forge NGO / MFI - bank linkages leveraging the strengths of semiformal and informal NGO-MFI sectors with the well regulated entities like banks of the formal financial system. The use of MFIs and other intermediaries to accept small deposits at the doorstep of the people on behalf of the banks based on certain norms of due diligence and rating would ensure safety of poor people's funds on the one hand and provide comfort to lenders, donors and other stakeholders in dealing with such MFIs. In the circumstances, a comprehensive regulatory framework for the large number of non-deposit taking organisations spread across the vast country may not be necessary for the present. Otherwise, many experts have favoured a self-regulatory system at the state level for MFIs which do not fit into the existing regulatory framework. Such SROs may be engaged in evolution of code of ethics, uniform standards of accounting and disclosures, empanelment and training of auditors, capacity building, etc. As regards SHGs, we believe that the group dynamics of working of the SHGs whose strength lie in simplicity, informality and flexibility may be left to themselves and they need neither be regulated nor formal structures imposed upon them.

Funding support

While talking of MFIs, existence of a proper funding mechanism for such organizations is also important. The Micro Finance Development and Equity Fund established in NABARD is expected to play an important role in providing Equity Capital or Quasi Equity to enhance the capacity of the MFI to undertake financial operations and enhance the comfort level of the lenders, particularly in areas where the penetration of microfinance movement is still low. There is also support available from SIDBI Foundation for Micro Credit (SFMC) as well as the Rashtriya Mahila Kosh. The banking sector also supports the "Fit and Proper" NGOs/ Self Help Promotion Institutions (SHPIs) in the formation and nurturing of SHGs and other microfinance initiatives. Hence, funding and facilitation support in an environment of good governance and transparency among the NGOs/MFIs/SHPIs may not be a major constraint.

Capacity Building and other Developmental Issues

Capacity building is going to be essential for the large number of

NGOs/MFIs that may be required to be promoted to expand the geographical coverage of the financial services. Efforts of NABARD, SIDBI and associations of the MFIs in this area need to be continued. The national level training institutions like the College of Agricultural Banking (CAB), Pune and the Bankers Institute of Rural Development (BIRD), Lucknow are also involved in the training of banks and MFIs. However, there is still a lot of ground to be covered. While accounting systems of MFIs are fairly well developed, there are no prescribed standards of accounting for SHGs and NGOs. Further, there is need for more stringent disclosure norms for MFIs/NGOs. In the interest of these organizations, proper accounting standards have to be developed and implemented. Product innovation, particularly by harnessing information and communication technology (ICT), will go a long way in improving the efficiency of the microfinance institutions. At present, there is no proper database of MFIs in the country and simultaneously, there is also a requirement of some form of credit information bureau on a localized basis to provide borrower information to banks and the MFIs. In this regard, the Khan Committee's recommendation on a Micro Finance Information Bureau is worth consideration. Long term sustainability of the SHG model, particularly when the number of groups expands rapidly, may require a federal structure without severing the linkages that the SHGs have with bank branches. Such federations, besides providing specialized services like rural housing loans and micro insurance, would improve the quality of the SHGs by tying with common service providers for accounts, human development, capacity building, marketing and other linkages and facilitate credit linkages with banks.

Role of the Corporate Sector

Corporate India has, of late, shown keen interest in microfinance, as it provides an alternative business opportunity for them besides being a means to actualise its corporate social responsibility objectives. As the poor move from subsistence living to higher standards of living, their demand for newer goods and services besides the traditional items like agri-inputs implements and household consumables grows rapidly. Many corporates have realised that the people at the bottom of the pyramid can be brought into their business model and they can play a critical role in providing market linkage to the products of the rural areas and the informal sectors on a sustainable basis.

Beyond Microfinance

Lastly, an important issue that needs to be looked into is the provision of microfinance, rather than microcredit, that is the availability of other financial services, such as, insurance and remittance to the members of SHGs. The need for development intervention for the poor would not be met unless access is provided to some type of insurance against loss of life or property. Looking still ahead, one can perhaps say that there is a case for going beyond microfinance itself. This will mean provision of comprehensive livelihood support to the poor not only through financial services but also institutional development services, infrastructure development and other facilities, such as, health and nutrition, education, etc. There is also a need for much better convergence of various programmes of the government agencies and the non-government sector to bring about the necessary synergy in the development process.

In conclusion, we would like to assure that we are committed to the Philosophy of Financial Inclusion of the poor and the disadvantaged. In the fast changing socio-economic scenario, care is being taken to shape policies and adopt options based on continuous learnings and feedback in this vital area critical to development with equity. With convergence of approach and appreciation of the issues among all the stakeholders, one can be confident of a bright future for the micro finance sector in India.

Session-II

Presentation of Papers

1. **Micro and Small Scale Financing: The Maldives Experience**
   by
   Ms. Khadeeja Hassan, Managing Director,
   Maldives Monetary Authority

2. **Microfinance Environment in Nepal**
   by
   Mr. Bir Bikram Rayamajhi, Deputy Governor, Nepal Rastra Bank
   Mr. Gyanendra Prasad Dhungana, Deputy Director,
   Financial Institution Supervision Department, Nepal Rastra Bank

3. **Microfinance in Pakistan: The Policy Environment**
   by
   Mr. Tawfiq A. Husain, Deputy Governor, State Bank of Pakistan
   Mr. Muhammad Ashraf Khan, Director,
   Small & Medium Enterprises Department, State Bank of Pakistan

4. **Microcredit Delivery System in Sri Lanka**
   by
   Mr. W. A. Wijewardena, Deputy Governor, Central Bank of Sri Lanka
   Mr. W. M. Karunaratne, Director of Regional Development,
   Central Bank of Sri Lanka