Micro-finance in Bangladesh: Emerging policy issues

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THE micro-credit industry in Bangladesh has achieved a lot over the years. The number of clients reached by micro-credit in Bangladesh is the largest in the world, studies have shown that it has had a positive impact on improving social indicators and the industry is focused on achieving financial sustainability. Bangladesh is widely considered micro-finance's 'natural home' and it has helped boost the country's image abroad. However, there are currently a number of policy related questions that are being debated in Bangladesh regarding the future directions of micro-finance. This article seeks to contribute to the debate by addressing issues of appropriate interest rates, regulation, poverty impact and the role of apex organisations.

Several NGO's in Bangladesh are now financially sustainable in their micro-credit operations and many are moving in that direction. There are a number of factors that contribute to sustainability; a crucial one is the ability to set appropriate interest rates and this has become a charged issue in Bangladesh. The Bangladesh micro-finance industry has thus far been fortunate in being able to set appropriate interest rates. One of the views expressed in Bangladesh, however, is that interest rates charged by micro-finance institutions are "excessively high". The view is that poor people cannot afford these rates and will perpetually remain in a poverty trap if interest rates are not lowered. We think this view is incorrect. Let's start with the facts. Around 85 per cent of NGOs in Bangladesh charge between 11-15 per cent flat interest rate -- this compares with around 120 per cent charged by the village money-lender and around 27 per cent charged by the largest institution in another Asian country with comparable outreach, i.e., BRI in Indonesia. Micro-finance interest rates are higher than commercial bank rates because the transaction costs are much higher when dealing with small average loan sizes and taking financial intermediation directly into the village doorstep. If there is a surplus that is generated from these operations, they are revolved back through the loan fund in order to be able to service more clients and provide larger loan sizes.

Clearly, we are not saying that NGOs should become inefficient and pass on unnecessary costs to the poor borrower. Experience with the Palli Karma Shahayak Foundation (PKSF) and its partner organisations suggests that the majority of NGOs have lean operations with the appropriate staffing ratios that ensure high portfolio quality. If they are forced to lower interest rates, through some Government directive or through a cap in interest rates for instance, it will ultimately harm the poor borrower as some of these NGOs will not be able to sustain their operations given that donors are increasingly moving away from providing capital for credit funds as grants. The bottom line is that poor people value having access to credit much more than the rate of interest. Any measures to control interest rates by the State would only serve to undermine the sustainability of this source of financing for the poor.

It is clear, however, that the micro-finance industry is affected by the structure of interest rates and the overall macro-economic climate prevailing in the country. Sound macro-management entails maintaining fiscal restraint and avoiding excessive domestic borrowing by the Government in order to avoid upward pressure on interest rates. It also requires sound monetary management by the Central Bank in order for overall interest rates and inflation to remain at a reasonable level. An efficient banking sector is also essential in keeping interest rates competitive. Here, there is some way to go for Bangladesh -- large defaulters, loss-making branches of state-owned banks all contribute to high operating costs and sub-optimal interest rates. Financial sector reform is, therefore, essential in making Bangladesh's credit markets more efficient and contribute to the general reduction in interest rates in the economy.

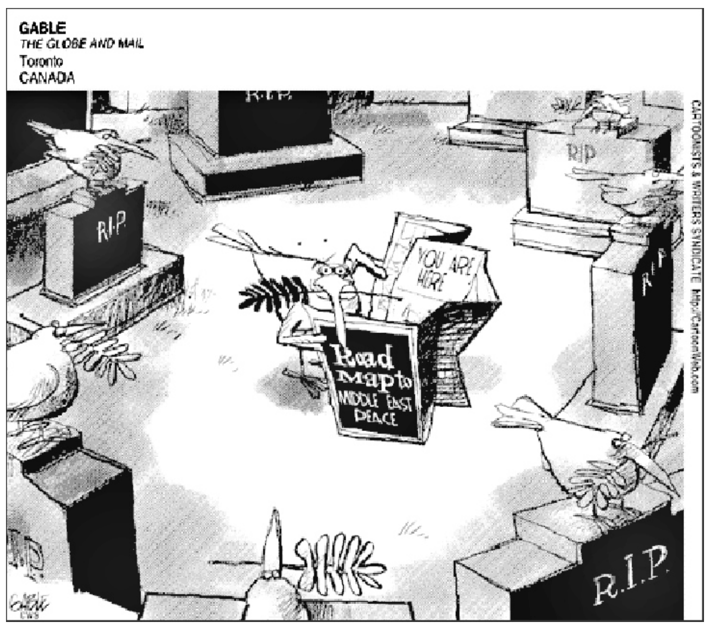
In order for Bangladesh to continue to remain at the cutting edge of this field both NGOs and the Government have to play their role. NGOs will need to continue to develop innovative financial and non-financial products for different client groups as is the case currently with the programmes for the extreme poor and for micro-credit 'graduates'...Correspondingly, the Government will need to assist NGOs in moving towards financial sustainability by enabling them to set interest rates that will cover costs and not establishing interest rate caps that will only ultimately lead to poor people having less access to credit.

Let us move onto the issue of regulating micro-finance and supervising NGOs more generally. There has been a fair amount of thinking on this issue in Bangladesh and this area is still a work in progress. It is important that a balance be struck between excessive regulations that hinder the dynamism of the micro-finance industry and the need to safeguard the financial system and in particular poor people's savings. It is also clear that a 'one size fits all' type of regulation will not work since the type and scale of NGOs in Bangladesh varies widely. Hence, there should not be a 'rush to regulate' as once regulations are enacted they are often difficult to remove. One option that can be considered for micro-finance operations is a tiered regulatory structure where the extent of supervision varies according to the extent of savings mobilised and size of the organisation. Lessons from Indonesia and the Philippines where a tiered regulatory structure, catering to different types of institutions, is in place, may be useful. The development of a credit rating mechanism so that the public is aware of the credit-worthiness of the various NGOs could be used as an instrument of self-regulation for the micro-finance industry -- this could be an industry-wide extension of PKSF's current rating system for its Partner Organisations.

In Bangladesh, it will be important to pursue a highly consultative process involving various stake-holders to develop the relevant standards and regulations. As part of this process it will be important to assess the capacity of various entities who can potentially take on the role of supervising NGO functions. For example, if we take the case of local government, there needs to be much more emphasis on capacity building and greater experience with managing development projects before they are asked to supervise the operations of NGOs. Finally, on the issue of supervision and regulation, we also know from empirical work that the extent of corruption and the cost of doing business is related to the extent and complexity of regulation - hence whatever standards and regulations are drawn up they ought to be simple, transparent and without room for ambiguity and discretion.

What has been the impact of micro-finance in alleviating poverty in Bangladesh? Studies that have focused on micro-credit borrowers and compared them with non-borrowers with similar initial socio-economic characteristics have shown that micro-credit does contribute to reducing poverty and crucially to reducing vulnerability. This role of reducing vulnerability is often under-estimated and enough is not said about this role of micro-credit in social protection. Giving loans to poor people has been shown to smooth consumption, thereby limiting the amount of harm done in lean seasons or natural disasters. For instance a published paper by Jonathan Morduch shows that consumption variability is approximately 50 per cent less for Grameen and BRAC borrowers compared to comparable non-borrowers -- this consumption smoothing is driven by significantly lower labour supply variability for borrowers. We all also know that poverty is a multi-dimensional concept. The literature by and large argues that micro-credit has contributed to non-income dimensions of poverty such as children's education and nutritional status both through the impact of increased incomes and the social mobilisation messages delivered during group meetings.

For instance, nearly all girls in Grameen client households received schooling compared to 60 per cent of girls in non-client households. Fewer BRAC clients suffer from severe malnutrition compared to a comparable group of non-clients. Moreover, there is evidence that micro-credit in Bangladesh has contributed to female empowerment through, for example, greater decision-making power within the household, enhanced mobility and participation in local elections. However, there is still room for improvement in order to both document and enhance this impact particularly for the hard-core poor and for 'graduate' borrowers who require greater amounts of credit. This brings us onto our next point regarding the new directions for micro-finance in Bangladesh.



As impact analysis has shown there is need to be more innovative when designing interventions for the hard-core poor. These are households who are often severely undernourished, are marginalised in society and often ill or unable to work for various reasons. For some of these households, small amounts of credit can play a role in improving their socio-economic status, if it is delivered appropriately. The delivery mechanism will have to be more staff-intensive in order to motivate these households that it is worthwhile to borrow and the loan sizes are likely to start off smaller than the regular micro-credit loan. Moreover, credit alone will not be enough for this group of households -- the importance of skill training and social mobilisation activities are critical. PKSF is collaborating with the World Bank in a recently launched programme to experiment with different approaches of working with the extreme poor. This project will also look towards a good monitoring and evaluation of the various methods so that we know which approach works and which ones do not.

Another second generation issue is access to credit for the vulnerable non-poor and 'graduate micro-credit borrowers'. There are entrepreneurial households who require loans in excess of the average micro-credit loan in order to set up new small enterprises or expand existing ones. There are NGOs in Bangladesh who cater to this market and PKSF has also recently started financing this market segment through its partner organisations. A recent assessment using very basic data on fifty micro-enterprises in four districts confirmed that these borrowers are clearly better-off than the typical micro-credit borrower as around two thirds of the households own more than 0.5 acres of land and almost two-thirds had completed primary school. Around 40 per cent of these loans are for agricultural activities specifically poultry, livestock and fisheries; around the same proportion are for home-based production activities and around 20 per cent are for retail activities. However, what is most revealing is the analysis of these fifty enterprises which suggests that micro-enterprise loans typically finances the expansion of an existing business or contributes to the overall cash-flow of existing enterprises and in only a few cases is it used to start up a new business.

This is a sensible strategy at this initial stage of development of this new loan product as repayment rates need to remain high, credit managers deal with a new level of risk and there are viable existing businesses that can expand. Gradually going forward, it is important that the micro-finance industry consider how new businesses can also be financed and new borrowers can avail of these loans in order to generate further employment and growth.

Finally, it is important to talk about the role of PKSF in the development of micro-finance in Bangladesh. A recent cross-country study by the Consultative Group to Assist the Poorest (CGAP) raised doubts about the effectiveness of apex institutions in many countries. One of the main reasons is that in many countries apexes were set up but the retail capacity to absorb these funds was missing. Another key factor was that political pressure adversely affected funding decisions. The example of NDTF in Sri Lanka is a classic example of both these factors at play; heavy political intervention resulted in funding unqualified MFI's that didn't meet the apex's own minimum criteria.

However, it is clear that in Bangladesh, the apex institution, PKSF, has been a success. PKSF has benefited from an existing critical mass of retail capacity and has successfully managed to expand the outreach of micro-finance while ensuring a strong focus on financial sustainability. It has also gradually moved into second generation issues in micro-finance and has recruited and retained high quality staff. However, while the reasons for this success are several there is arguably one key factor that is crucial and that is the lack of political interference in the management of PKSF. The risk with public-private partnerships is that this delicate relationship is often jeopardised through politicised appointments or direct interference in the running of the entity. Thus far, the changes in Government and in personnel at the concerned ministries in Bangladesh, have not seriously affected the independence and professionalism of PKSF. However, it is absolutely crucial that it continues to be the case if PKSF is to maintain its high standards and if PKSF-type institutions are to be replicated in other sectors in Bangladesh as a novel method of delivering services to the poor.

In summary, the following are our main points. The scale, outreach and professionalism of the micro-finance industry in Bangladesh are truly impressive and are something that micro-credit practitioners around the world admire and would like to learn from. It is a justifiable source of pride for Bangladesh. The impact of micro-finance on household income, vulnerability and non-income dimensions of poverty has also been positive. In order for Bangladesh to continue to remain at the cutting edge of this field both NGOs and the Government have to play their role. NGOs will need to continue to develop innovative financial and non-financial products for different client groups as is the case currently with the programmes for the extreme poor and for micro-credit 'graduates'. NGOs will also need to maintain their lean structures in an effort to reduce donor dependence and also stay away from partisan politics. Correspondingly, the Government will need to assist NGOs in moving towards financial sustainability by enabling them to set interest rates that will cover costs and not establishing interest rate caps that will only ultimately lead to poor people having less access to credit. It is also critical that the tradition of sound macro-economic management continues and that financial sector reforms take place in an effort to further lower market interest rates. The Government should also not be in any 'rush to regulate' but ought to strengthen depositor protection by absorbing the lessons of 'tiered regulation' in other countries, strengthen self-regulation through the development of a credit rating body and ensure that supervision responsibilities are given to entities that have the capacity to do so effectively.

Finally, it is crucial that the lessons from the failures of several apex organisations worldwide are kept in mind, the main one being that political interference in the management of an apex body can have seriously adverse consequences -- hence we hope that the trend of positive Government involvement in PKSF's governance continues into the future.

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MUHAMMAD HABIBUR RAHMAN

The road map to peace, but nowhere to go!

The road map to peace is not a chart of a cartographer
It is not drawn on scales or lines, and neither
On projections of Lambert, Mercator or Miller.
It is a diplomat's document full of double entendre leanings
Each word having at least two directly opposite meanings.
The road map to peace is full of duplicity and evasion
It may serve as a guise for another war or an invasion.

These days when a sovereign state suffers an outrage
It is euphemistically called a regime change.
The makers of the road map to occupation
Also call it euphemistically the road to liberation..

The road map to peace is a very intricate maze
Unlike a children's game of cat and mouse
The elders find it very difficult to engage.
It may endlessly bungle and end up in rat's nest
It may get lost in the jungle and end in a snake's pit.
The road map for peace may lead to a labyrinth
Where over their kills
The depressing dragons like to drink their absinth.

All roads now no longer lead to Rome,
For want of a destination aimlessly we roam.
With no particular mission to perform
With no particular objectives to conform.
Maps are often drawn and redrawn
And on, and on and on .

The road to Jerusalem, Golgotha and Calvary
Was the road map to treason and treachery
To Hiroshima and Nagasaki road to atomic fission
Was the road map to total annihilation.
To Auschwitz, Belsen or Buchenwald for mass execution
Was the road map to holocaust, the "Final Solution"
These maps of destruction worked without any fail.
The road map to the moon also worked well.
While the soft landing on the moon was easier
The road map for peace on earth is, however, heavier .
.
If the new map is drawn on the old beaten path
It may lead us back to the old war path
With the recurrence of usual bloodbath
And it may yield only the grapes of wrath.
If the maker of the road map to peace is a psychopath,
Let the psychiatrist prescribe for him a bubble bath.

The road map to peace should be like the road to chivalry
Where the combatants did nobly forget their rivalry.
No one asserted his right on the basis of might.
No one asked another to renounce his right.
No one was worried of a loss of face.
No one intended the other to disgrace.
Where no one felt himself a loser,
And no one claimed himself to be a winner.
Very exceptional? Exceptional, indeed!
Peace itself is exceptional, indeed!

If the road map to peace is just a mere bon mot
Then it would be a cul-de-sac, nowhere, nowhere to go.

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