Scaling microfinance is a prime need

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microentrepreneurs. This has also led MFIs to adopt two major mechanisms to deliver financial services to clients: (a) relationship-based lending to individual microentrepreneurs and small businesses; and (b) group-based lending under which several small borrowers come together to apply for loans and other services as a group. The group-based model represents an approach under which poor and near-poor households can have access to a range of appropriate financial services, including not just credit, but also savings, microinsurance, and fund transfers.

Some evidence shows that, for MFIs, the default rate is higher in relationship-based microenterprise lending than in group-based lending. Moreover, since the average size of microenterprise loans is much higher than in group-based loans, even a low default rate in the former loan causes a bigger liquidity constraint for MFIs. On the other hand, net returns are higher for microenterprise loans as these loans generally have low administrative and supervision costs. Thus, there is a dilemma, and the need for MFIs is to strike the right balance between the two types of loans and minimise the risks of microenterprise loan defaults. Additionally, while meeting the demands of these clientele groups comprising the "missing middle" is undoubtedly important, supporting excluded vulnerable and extreme poor households is also critical toward fulfilling MFIs' social mission.

Over the years, the interplay of both external and internal factors has motivated MFIs to develop innovative financial products and services to expand outreach and create internal capacities for delivering better microfinance services in Bangladesh. The government's policy and institutional reforms have also facilitated the development of innovative delivery techniques and appropriate products. Since its establishment under the Microcredit Regulatory Authority Act 2006, the Microcredit Regulatory Authority (MRA) has been working toward creating policy, regulatory, and institutional frameworks for the integrated development of the microfinance sector, which is both socially beneficial and profitable. In addition to traditional microfinance products, a wide variety of financial products and services is now available that are more accessible to the poor, better suit their cash flow challenges, and help address future spending needs.

The presence of a wide network of MFIs and other financial service providers (FSPs) has also created significant opportunities for increasing access to financial services in Bangladesh. Obviously, the gaps that presently exist in universal financial inclusion provide both a challenge and an opportunity to ensure effective access to and use of financial products and services by all residents of Bangladesh.

In fact, the double bottom line of fulfilling the social mission and providing financial services in a profitable and sustainable manner has been guiding the new generation activities of MFIs in Bangladesh. The MFIs are adopting more effective and innovative business models to ensure financial viability, supported by innovative loan collection techniques and monitoring and supervision methods.

In short, the operational characteristics of the microfinance market in Bangladesh show that: (i) around 58 percent of extreme poor households still do not have access to the microfinance market; (ii) around 53 percent of moderate poor do not access financial services of MFIs; (iii) female-headed households have lower access to microfinance services; and (iv) there seems to exist a recent trend of rising flows of credit to non-poor households who are graduating members and lateral entrants belonging to CMEs.

Considering these realities, three aspects of the financial operations of MFIs need attention in the coming years: (i) explore innovative and sustainable measures to ease binding financial constraints to provide financial services to target populations/business groups; (ii) develop appropriate financial products/services (including housing, business scaling-up and enterprise development, technology adoption, and emergency loan products) to meet the needs of different groups of excluded poor households/CMEs; and (iii) ensure more efficient and cost-effective MFI operations through the adoption of digital and modern technologies and resolve the asymmetric information problem of excluded households/enterprises.

In addition, capacity building of MFIs needs to be prioritised to meet the demands of different segments of targeted populations by addressing problems like lack of skilled and trained staff, inaccessibility to haor, hilly, and remote areas, limited access to technology and information, inadequate information flows to excluded households/enterprises, and limited financial education to manage financial resources more productively and efficiently.

Despite significant positive achievements, the challenge for MFIs is their high transaction costs needed to support a large number of small transactions, which are unique features of their operations. To overcome the challenge, the adoption of digital technology is a major enabler, which is proven, scalable, secure, cost-effective, and likely to be sustainable. Although MFIs still remain unchallenged in serving the poor and low-income segments, the urgent need is to dream for a digital future.

MFIs need to search for a roadmap towards that future, to grow and expand their mission to issues like supporting climate adaptation and mitigation efforts as well as in Bangladesh. The key is to learn how MFIs can leverage technology to grow their business, deliver value to their customers, and embark on a digital future. Although Bangladesh still has a long way to go to take full advantage of digital finance, the country is moving rapidly to build the required ecosystems and remove the barriers through creating an enabling policy and regulatory environment.