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Identifying the Critical Issues of Microfinance Institutions – Bangladesh Case

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Abstract: *Microfinance means providing financial services to low income group. This paper highlights an overview of Microfinance Programs and Microfinance Institutions in Bangladesh. In recent years, Microfinance Programs have attracted so many poor people in Bangladesh as they were not able to borrow money from the formal sector. There are some issues that have arisen recently regarding the microfinance institutions in Bangladesh. This paper identified those issues. It has been identified that there are some issues that could be managed only by the Government of Bangladesh and some issues which could be solved by the microfinance institutions themselves. In this regard some suggestions are given.*

1. Introduction

Microfinance means providing financial services to low income clients. These clients include general consumers and also self employed people. Micro credit means providing loans to low income micro enterprises. Poverty has different meanings. It is the subject of most concern for the whole world. According to 'World Bank' until 2005, there were 3 billion poor people in the whole world. Out of 3 billion, only 500 million poor people have the access to formal financial services. The residual people have to look for Microfinance Institutions (MFI) for getting the access to fund.

In 2005, World Bank estimated that there were 7000 MFIs, which were providing 16 million poor people with services in developing countries. MFIs have to provide the poor with credits as the banks are not encouraged to provide loans to that particular group. The concept of microfinance in Bangladesh was introduced in 1976 by Muhammad Yunus and Grameen Bank. For his contributions to this field, Muhammad Yunus was awarded the 'Nobel Peace Prize' in 2006. The target of this service is to generate income and wealth and to reduce poverty. Microfinance is considered unique development tool as it helps to reduce poverty and also helps to maintain a profitable business (Business Week, 2005).

2. Objective of the Study

The major objectives of this study are

1. To get a broad idea about the Microfinance industry in Bangladesh.
2. To identity the benefits of Microfinance Institutions in Bangladesh.
3. To identify the problems of Microfinance Institutions in Bangladesh.
4. To recommend the possible ways to face the problems of Microfinance Institutions in Bangladesh.

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3. Methodology of the Study

The mode of this study was descriptive. Considerable effort was given to develop the appropriate sample plan. The target population of the study was the executives of ASA, BRAC and Grameen Bank. The period of the study was three months. The extent of the study was the Metropolitan area of Dhaka city. The respondents were selected from Dhaka city. The survey was conducted in August 2009 with five respondents from ASA, BRAC and Grameen Bank.

Since the list of the target population was difficult to get, a non-probability sampling technique was applied. Thus, a convenience sampling procedure was followed to collect the data from the target population. The secondary information was collected from websites, different relevant journals from home and abroad, Associations for Social Advancement (ASA), Bangladesh Rural Advancement Committee (BRAC), Grameen Bank and Bangladesh Bank. A qualitative data analysis was applied for the elaboration of the study.

4. Literature Review

Different microfinance institutions are working in the informal sector for providing the poor with credits. The commercial banks feel hesitated for providing the poor with loans as they lack security. But MFIs deliver loans without security. They have introduced group lending where each member will be secured for the other one. In the past, Non-governmental Organization (NGO) was concerned about the income generation and development of the financial condition. Over the past decade there is an undeniable trend for NGOs to get on to the micro-finance bandwagon and move towards minimalism, while balancing sustainability and outreach (Dichter, 1999). A variety of studies have been done to get an idea about micro finance which have identified that micro finance programs can be an effective way to provide low cost financial services to poor individuals and families (Miller and Martinez, 2006; Stephens and Tazi, 2006). These programs have been shown to help the development process and growth of local economy by increasing the living standard and increase the disposable income levels of the poor. (Khandker, 2005)

Micro finance programs help not only to increase the income levels but also to improve health, nutrition, education, and so on. Women are given priorities under micro finance programs. The micro finance institutions are trying hard for empowering women in different levels by initiating different programs. These programs are considered an effective tool of poverty alleviation by the MFIs. Before micro finance programs, poor people had to borrow from their relatives or from moneylenders where the interest rate could be enormously high. Moneylenders tend to charge a very high interest rate to more poor borrowers than to less poor ones. As a result, the poorer people stay in a very risky position. This problem of poor people has been solved by the MFIs. Until now $ 25 billion has been distributed as micro finance loan throughout the world. It has been estimated that this industry needs $ 250 billion for all the poor people who need it across the world. This industry has been growing rapidly which is being a subject to potential risk unless it is managed carefully. According to ‘Micro Banking Bulletin’ at the end of

2006, there were 704 MFIs that were serving 52 million borrowers ($23.3 billion in outstanding loans) and 56 million savers ($ 15.4 billion in deposits). Of these clients, 70% were in Asia, 20% in Latin America and 10% in the rest of the world.

5. Role of Commercial Banks in Microfinance in Bangladesh

Commercial banks have different roles to play in an economy. They could be agricultural banks, development banks, export banks and so on. They have to consider interest rate ceilings, high reserve requirements and direct credit lines. For providing the clients with their services they have to think about high cost and high risk. Commercial banks also grant credit to their clients. In that case, they have to take collateral two or three times the value of the loan. Commercial banks do not concern with providing loans to the poor as they lack the traditional collateral to guarantee their loans. The commercial banks also do not have the appropriate lending methodologies to serve the poor clients. As commercial banks lack the expertise regarding providing the poor with loans, their cost is higher.

Again, the poor clients lack education and knowledge about the operations of commercial banks. They have fear about the formal banking system as the relationship between customer and supplier is not simple. The relationship is formal rather than informal. To offer the Micro Finance Programs (MFPs), commercial banks should have an organizational structure that allows MFPs to work independently and also allows the bank to work efficiently. The majority of commercial bankers perceive micro finance as risky, unprofitable and not appropriate with their core business. As the micro finance loans are small in size, their costs are higher than those of the traditional loans.

To provide micro finance loans, the commercial banks have to find strategies that will force banks to minimize processing costs, increase the productivity of staff and so on. Because of lacking of collateral most of the poorest people are not eligible for taking loans from major national and private banks in Bangladesh. They lack not only collateral but also knowledge, education and skills, which make them risky clients for the private banks. Where the private banks fail, Grameen Bank and other NGOs step forward to provide the poor with credit. Grameen Bank is the largest provider of micro credit in Bangladesh. The government also provides micro credit through its Pally Karma Sahayak Foundation (PKSF). It directly provides micro credit as well as funds to NGOs. In Bangladesh, commercial and specialized banks like Bangladesh Krishi Bank (BKB), Rajshahi Krishi Unnayan Bank (RAKUB) are involved in providing the poor with microfinance.

6. Role of Microfinance Institutes in Bangladesh

Muhammad Yunus introduced Microfinance in Bangladesh in 1976 with the establishment of Grameen Bank. This bank remains the largest provider of micro credit in Bangladesh. In Bangladesh, there are four types of institutions that maintain micro finance activities. These are Grameen Bank, NGOs like BRAC, Proshika, ASA etc, commercial and specialized banks (BKB, RAKUB) and government sponsored micro finance programs like BRDB, Swanivar Bangladesh and others. NGOs started credit program in mid eighties and their activities increased noticeably higher after 1990 (CDF, 2000).

With the encouragement of MFIs, some Nationalized Commercial Banks (NCBs) and Specialized Banks like BKB and RAKUB have started to grant credit to the poor without security. According to 'Bangladesh Bank' report in 2002, some of Private Commercial Banks (PCBs) have started to make direct and linkage programs with NGOs. For the SAARCFINANCE Seminar on Micro finance (held on December 2002), Bangladesh Bank reported that till December 2001, 8.69 percent of Cumulative loan disbursement for micro finance or micro credit was made under government programs. Grameen Bank disbursed 35.46 percent while other banks disbursed 18 percent and MFIs and NGOs disbursed 37.80 percent.

Table: 1 Cumulative Loan Disbursement in 2001

Under Government Program	8.69%
Grameen Bank	35.46%
MFI's & NGO's	18%
Other banks	37.80%

Source: Bangladesh Bank

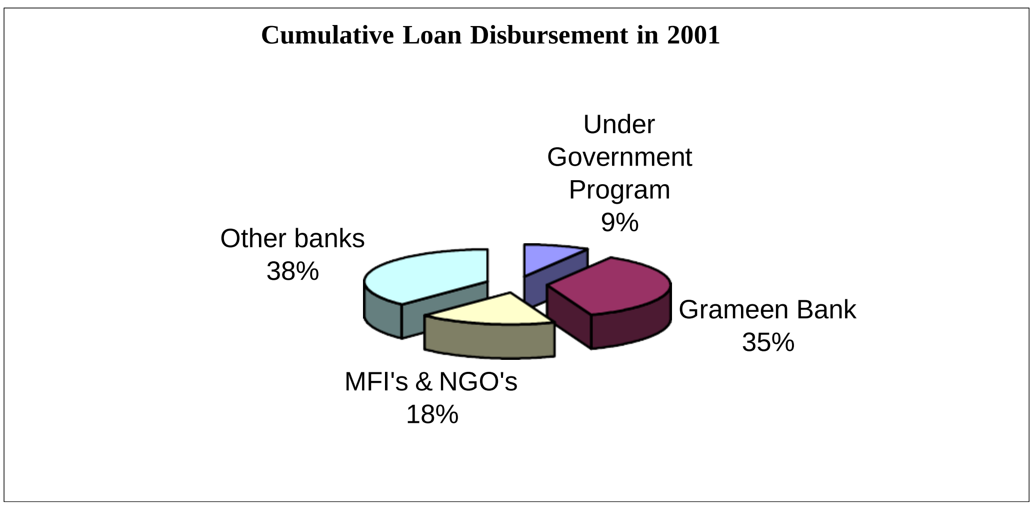

Figure: 1 Cumulative Loan Disbursement in 2001

The major objective of MFIs in Bangladesh is to reduce the poverty. Bangladesh is known as the birthplace of micro finance revolution towards fighting against poverty (Enamul, ASA, 2004). Up to 2002, the micro finance program covered nearly 67.7 million clients throughout the world and in Bangladesh, more than 15 million poorest would have reached the service of MFIs (ASA, Bangladesh). There are so many MFIs and NGOs working in this regard. From those, Grameen Bank, ASA and BRAC are considered to be the top three on the basis of outstanding loan and advances and savings mobilizations.

Table 2: Outstanding loans and advances (Amount in Taka)

MFIs & NGOs	2006	2007	2008
Grameen Bank	34,144, 897,122	37,546,479,706	45,786,957,884
ASA	24,077,000,000	27,764,118,831	35,573,964,723
BRAC	22,669,668,040	36,116,164,251	44,804,962,315

Source: Annual Reports of ASA, BRAC and Grameen Bank.

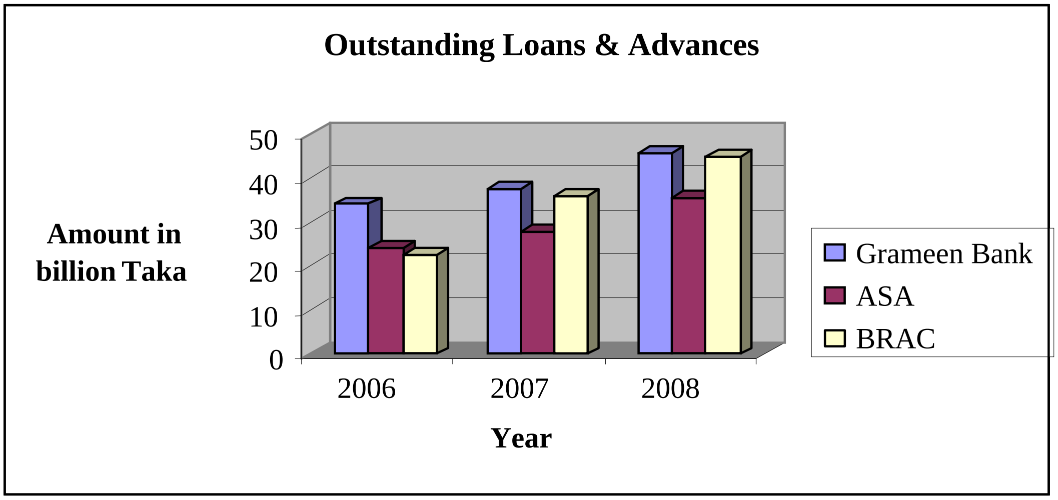

Figure 2: Outstanding loans and advances

From the given data, it can be said that Grameen Bank is the largest provider of micro loans to the poor clients. BRAC and ASA also disbursed significant amount of loans during that particular period to the poor. The MFIs should not be concerned about the loan disbursement but they have to be concerned about the savings to maintain sustainability. The savings of the members are the major source of fund for the MFIs as they are now not depending on donations in that portion. In this case, Grameen Bank again comes to the top position for mobilizing the savings.

Table: 3 Savings Mobilization (Amount in Taka)

MFIs & NGOs	2006	2007	2008
Grameen Bank	47, 650,702,448	55,640,755,203	68,314,322,203
ASA	3,647,000,000	4,468,526,623	6,217,652,649
BRAC	10,595,093,766	13,467,188,019	15,764,569,644

Source: Annual Reports of ASA, BRAC and Grameen Bank.

The interest rate charged by the MFIs is not unique. It may vary. Grameen Bank sometimes charges interest rate almost 20 percent whereas BRAC charges interest rate ranging from 12.5 percent to 15 percent. For the year 2006, ASA charged 15 percent interest rate for Business Loans and 12 percent for Hardcore Loans. With the realization that these interest rates on loans were high, ASA in 2007 decided to reduce the interest rate for Business Loans from 15 percent to 12.5 percent and for hardcore loans from 12 percent to 10 percent. Where the MFIs charge high interest rate on loans, they do not provide high interest on savings. Grameen Bank considered 10 percent to 12.5 percent on savings deposits for the year 2007 whereas they gave 8.5 percent to 10 percent in the year 2006.

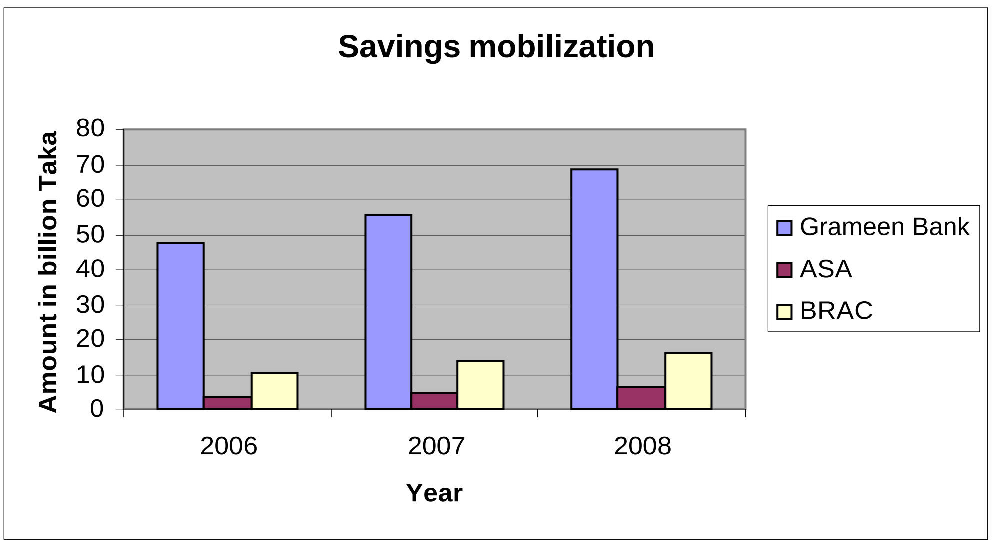

Figure: 3 Savings Mobilization

Microfinance Institutes are established for poverty alleviation. But the impact of micro finance programs at macro level is not still clear (CPD, Task force Report, 2001). Some impact shows that before MFIs the poor were dependent on the local moneylenders and rich relatives for getting credit. Now a days, they do not have to go to moneylender for credit, rather they can get credit from MFIs. According to MFIs, the eligible poor clients have now more opportunities to get employment as they could be self-employed. MFIs provide the poor with loans without security. Their main clients are women as according to them women are more disciplined and organized. Women are now getting credit from MFIs, which make them more valuable in the family. They now get the voice in the family and also have the power and confidence to make decision within the family and in the society. Women now move outside of their home. They now go to offices, banks, markets and other places without a male company (Khandakar, Rashid, 2002).

7. Critical Issue of Microfinance Institutions of Bangladesh

The main objective of MFIs is to reduce poverty. According to CPD Taskforce Report 2001, MFIs' impact on macro level is not clear. MFIs might reduce the dependency of the poor on moneylender or relatives or they might be able to empower women but there are some major and critical issues regarding MFIs. These issues are as follows:

- Though MFIs claim that micro finance helps to poverty alleviation, the poverty rate of Bangladesh is not decreased significantly in the past years. MFIs might reach the poor but they could not reach the poorest people of a country. There might be success of micro finance at the micro level but that does not show the significant impact on macro level. In the recent literature, it is often mentioned as the problem of Macro-Micro Mismatch (Sen, 2001).
- The policy of MFIs is to provide the poor people with credit so that they could invest and earn cash flows to repay the loan in time. But the main problem is that the poor people generally use the maximum portion of loans for consumption which they are receiving from the micro finance institutions for investment. The very poor people have a limited capacity for handling loans. The poor women often become burdened by the repayment obligation, especially as they use credit primarily for consumption (Hulme and Mosley, 1996).
- There are limitations in regulations to monitor the activities of MFIs in Bangladesh. As a result, NGOs are in uncertain position and they are not able to take risk. NGOs are sometimes confused about their role in this case. They sometimes work like voluntary organizations and sometimes like business organizations. They have no clear idea in which group they belong to. If they belong to voluntary organization, then questions arise about their service charges, compulsory savings mobilizations and so on (Khandakar & Lila, 2002).
- Different MFIs and NGOs are charging different interest rates and service charges. The interest rates vary from 10 percent to 20 percent and service charges vary from 8 percent to 37 percent. As there are no specific ceilings imposed by the Government of Bangladesh to charge interest rate and service charges, variations in charges arise among different institutions. As a result, the poor clients are being discriminated by the MFIs and NGOs.
- According to Professor Abul Barkat (Economist of University of Dhaka), micro credit system with unrealistic interest rates will not lead to any human development. In his study, Mr. Barkat found that 80 percent of women beneficiaries of Grameen Bank had got themselves into debt traps and for that he identified the high rate of interest (25 percent to 65 percent in some cases) as the key reason for the failure.
- MFIs provide the clients with loans in small amount. This is a major problem of MFIs as the clients cannot use this small amount for productive purpose. Sometimes the clients use the entire amount for consumptions rather than for investment. 30 percent to 40 percent of loans given by MFIs are used for consumption (Rahman, 1999). As a result, the policies of MFIs are appeared to be failure in poverty alleviation.
- Another issue arises about the MFIs regarding the savings interest rate. Most of the NGOs provide 6-7 percent interest on savings, which is lower than commercial banks savings rate. As a result, the poor clients are getting fewer benefits from MFIs and it also fails them to generate large volume of cash flows to pay back the loan.

- Overlapping is a critical problem for the micro finance institutions in Bangladesh. Recent studies showed that most of the poor clients are taking additional loans to repay the previous loan. Some identified that these problems of overlapping arise because of high interest rate on micro credit. The poor clients are being forced to take addtional loan as the MFIs are charging high interest rate and service charges. Because of the high service charge, the amount of actual loan disbursement reduces and the poor clients do not get the desired amount. MFIs have to constantly monitor and compare their products, prices and other related issues with other MFIs, which increase their cost.
- MFIs' main focus group for providing loan is women. They provide women with loans to empower them within family and also in society. But the women in rural area basically lack skills, education and experiences. As a result, they might fail to make profitable investment and the ultimate result of this failure would be non-repayment of loans.
- Though the MFIs provide women with loans, most of the time they do not have control over those loans as the male member force them to make choice. As a result, the women lose their power over credit and they also lose the voice within their family. But they have to take the burden as they have to repay the loan in time. The women lose their power in the family though they have to take the responsibility for the repayment in a Bangladesh Programme (Goetz and Gupta, 1995). A study of women borrowers in Grameen Bank shows that up to 10 of 40 women in the sample were passing out on all or most of their loans to male family members under circumstances that gave them little control over the use of this capital (Todd, 1996).
- Studies have shown that there are low repayment rates in comparison with traditional financial institutions (Miller and Martinez, 2006; Stephens and Tazi, 2006). In addition, there have been reports of the use of harsh and coercive methods to push for repayment and excessive interest rates (Business Week, 2005; The Financial Express, 2005).

8. Findings from the Survey of Microfinance Institutions in Bangladesh, 2009

While preparing this article, face to face interview was conducted in different micro finance institutions (ASA, BRAC etc.) to get an idea about the recent issues on Microfinance in Bangladesh. Discussions were made on the interest rate, overlapping problems, regulations and so on. While doing so, it has been identified that the micro finance institutions, in reality, are charging high interest rates to the beneficiaries. They are charging an interest rate greater than that charged by the commercial banks. The micro finance institutions are charging a high interest rate on loan on the ground of high operating cost incurred by the micro finance institutions. For the high operating costs, they are claiming that their officers have to go to the doorsteps of the micro clients for motivating the clients to repay the loan. They have to continuously force their clients to make the repayment of the loan amount. As a result, the operating and monitoring costs become very high. It has also been identified that though Bangladesh government passed the Micro credit Regulatory Act (MRA) in the year 2006, to ensure transparency and accountability of micro finance institutions in Bangladesh's growing microfinance industry , it would be difficult for the government to control them. The government can not force all the micro finance institutions to charge the same interest rates on loan as there are differences existing in the capital levels and costs levels of the micro finance institutions. Government can not set different limits on interest rates for different micro finance institutions. To sustain in the long run, some of the micro finance institutions have to charge high interest rates on loans.

From the survey, it also has been identified that overlapping remains as a critical problem for the micro finance institutions as this problem could not be solved in a short period of time. As there is no established mechanism for monitoring the clients, the problem of overlapping could not be solved. The micro finance institutions in Bangladesh do not have collaboration to each other. As a result, it becomes difficult for the micro finance institutions to get information about the clients from other micro finance institutions. The clients in this field are not optimistic to disclose the information about their several borrowings from different micro finance institutions. The clients do not have transparency in this regard. So, the micro finance institutions have nothing to do about this issue and one day the beneficiaries find themselves into a debt trap without prior notification. The micro clients use a part of the loan amount for the consumption and the micro finance institutions can not force the clients to make any particular type of investment. The micro finance institutions have limitations in giving suggestions about the use of loan amount because if a recommended business of the client fails then he or she will blame that particular institution for the failure. Again, most of the time the clients do not use the loan amount according to the suggestions of the micro finance institutions. They sometimes do not like the direct interventions of the micro finance institutions. There are issues also about the amount of the loans given by the micro finance institutions. Sometimes, different NGOs provide larger amount of micro loan to the clients without notifying that the clients might not be able to handle the loan carefully. This situation happens because of the lacking of their (NGOs) proper training and also because of their inexperienced role in this field. Because of this situation, the clients have to face problems. They can not utilize the loan amount effectively and ultimately fail to repay the loan.

9. Recommendations Regarding the Services of Microfinance Institutions in Bangladesh

The current problems of micro finance institutions have been pushing the government and others to think carefully about these issues so that necessary actions or steps can be taken to get the ultimate benefit of micro finance institutions in Bangladesh. There are some suggestions stated below

- MFIs should have clear visions about their duties. They should carefully recheck their operations. This industry should not be controlled instead of the supplier of the found by the user of the fund.
- All the MFIs and NGOs should be concerned about the interest rate they are charging for the loans. The high interest rate charged by them cannot bring the success to the clients. For the betterment of the clients, MFIs should decrease their interest rate so

that the poor clients will be able to repay the loan and also get the ultimate benefit of micro credit.

- The savings interest rate applied by the MFIs is very low. They should give high interest on savings so that the poor clients will be able to generate greater amount of money and be able to overcome their financial problems.
- Micro finance industry should be strengthened by making channels with formal economy sector. The government should emphasize on creating the proper regulations for this sector.
- MFIs should have proper accountability and transparency about their operations. They should make investment in profitable business so that high costs could be managed without charging high service charges.
- MFIs should ensure the employment of the poor clients to maintain long-term financial viability of the clients. They should provide not only the financial support but also the mental support to the clients. The clients should be given proper advice by the MFIs about the use of the loan.
- The MFIs should provide the clients with proper training. The women's skills and knowledge should be developed to empower them for making financial decisions within family and also in the society. Proper education should be ensured for the children and also for the old ones.
- The provider of micro credit should be flexible in terms of interest rate, service charge and other charges. The poor clients should be given longer time to repay the loan. There should be back up plan for the non-repayment of the loan. Their behavior with the clients should be much easier so that the clients do not feel hesitated about their services.

10. Concluding Remarks

Micro finance industry has been established to serve the poor and to overcome the crisis of providing the poor with loans. The MFIs provide the poor with loans without security. Where the commercial banks fail to provide service because of lack of organizational structure, MFIs come forward to provide the proper services. Though MFIs have been cheered for successful repayment rate, they have been recently criticized for charging high interest rate on loans. In recent times, they have been even held responsible for charging high interest rate by the Government of Bangladesh. Grameen Bank has landed poor communities in a perpetual debt trap (Sharma, 2007). Some beneficiaries committed suicides for being unable to repay the loan to the MFIs. Questions also arise about the recovery rate of MFIs. Critics also argued that there is no evidence created by the MFIs proving that the women in Bangladesh have been empowered and the rate of poverty has been reduced. To make MFIs viable and to sustain in the long run, they should address these problems. They should be more concerned to resolve these issues so that the poor people could get the benefits of micro finance services in Bangladesh. The micro finance institutions should have collaborations to each other and they should consider their roles in this field. They should always keep in mind that their clients are poor household or bottom line people. The micro finance institutions should be rational about their clients and also should take initiatives to eradicate these critical issues.

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