

Regulated Microfinance in Bangladesh: Prosper and Challenges

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Abstract:

Bangladesh is the founder of microfinance and have passed three decade of its success without any regulation. Microfinance Institution (MFI) becomes under regulation through act no 32 of 2006 as Microcredit Regulatory Authority (MRA) and already has passed six year. The article aims to know the opportunity and challenges of regulation in microfinance of Bangladesh. This is an analytical article based on secondary data from the different sources. Microcredit regulatory act 2010 is the main focus of the article. Some data has been analyzed using statistical method. The analysis has found that, regulation is very fruitful and effective for Bangladeshi MFIs. Regulatory body has addressed on the maximum area including governance, security of the depositors, monitoring and reporting also. But from the global experience we found here some probable area has not been addressed yet. Besides the fruitful regulation, few challenges are exist to overcome. Some initiative and policy be able to more strengthen the regulatory framework.

Keywords:

Microcredit Regulatory Authority (MRA), Governance, Microfinance Institution (MFI), Regulatory act, Policy

1. Preface:

Bangladesh is the pioneer of microfinance which helps the community moving to a poverty free world. Since inception, the tools become very useful to diminish poverty through asset buildup around the community. As the expansion of the program, it has been require a regulation from the different level of stake holder. This is condemnable that, in the year 2011 was a transitional period for microfinance in Bangladesh. Microfinance has been facing challenges, criticized and debate as founder and Nobel laureate Dr. Mohammed Yunus has been departed from Grameen Bank. Micro Credit Regulatory Authority (MRA of Bangladesh has been started it's almost complete regulation in this year. Regulation was essential to keeping everyone's rights. According to Peck Christen, R.Lyman and Rosenberg (2003) regulation refers to a set of enforceable bindings rules that govern the conduct of legal entities or individuals, whether they are adopted by legislative body or an executive body. Purpose of the prudential regulation is to ensure the financial soundness of financial intermediaries and try to prevent if not reduce financial system instability and loss of depositors money. In Bangladesh there are about five thousand MFI has been working which are small, medium and big. Besides the MFIs, thousands of other financial institution including cooperative, multipurpose and self help group (SHG) etc has been working in the same field. In fact, market failure of the formal financial institute has created MFIs and became praiseworthy. Credit unions and lending cooperatives have been around hundreds of years. However, the original of modern microfinance is often credited to Dr. Mohammad Yunus, who began experimenting with lending o poor women in the village of *Jobra*, Bangladesh during his tenure as a professor of economics at Chittagong University in the year 1970s. He would go on to found Grameen Bank in 1983 and win the Nobel Peace Prize in 2006. (<http://globalenvision.org>) In 1995, Government

has incorporated a cell named Microcredit Regulatory and Reform Unit (MRRU) under its central Bank. MRRU has had a great role in the field of microfinance through research, review and reform works which chronologically leads to a regulatory body. A full placed regulatory authority named **Microcredit Regulatory Authority (MRA)** has approved under MRA act 2006 (act no 32 of 2006) as the parliament approved the bill in 2006. To set up the activities and procedure, MRA has taken up the time up to 2010. In January 17, 2011 MRA has been declared a guideline and regulation named "Microcredit Regulatory Authority rule 2010" by a gazette notification. MRA has issued license to 698 MFIs by May2014 (www.mra.gob.bd) which are legal institutions for Microfinance operation. Besides these MFI more than 60 have temporary approval for operation. By this period the authority cancelled the license of 44 MFI for misconduct under the act. While MRA has taken initiative and issuing circular to introduce a uniform rules and regulation in the industry, the institution falling in different types of dilemma as they are different in size and nature. Few researches already have finished by the MRA on the regulation. A study conducted by Nuruzzamn (2010) shows that licensing MFI has two fold impact, first on beneficiaries and second on itself .In case of the beneficiaries of MFI 1) licensing exert the positive influence on client in building their confidence on MFI 2) Savings rate is higher than the licensed MFI than the unlicensed MFI and incase of MFI itself licensed MFI coverage, annual income and capital growth were significantly higher. Now this is a burning question to MFI that how smoothly the rules will be adaptable to the MFIs or they are capable enough. Definitely the regulation has more advantage but institutions have to manage challenges up to a certain time.

2. Objectives of the article: To know the opportunity and challenges of regulated Microfinance institution in Bangladesh and suggest

a policy implication for more effective regulation.

3. Methods: This is an analytical article based on secondary data from the different sources. Microcredit Regulatory Act 2010 is the main focus of the article. Some data has been analyzed using statistical methods.

4. Major Regulation and Changes in Microfinance Industry of Bangladesh: Before 2010, there were no realistic regulations in Bangladesh microfinance sector. Many irregularities and inconsistent situation were making the field awful. Here product feature were different and overlapping, over debt were very untruthful. Now the government has incorporate many uniform rules for the licensed MFIs. Some of the major regulation and policy has been described below (*these are concise from rules and it's just reflect the meaning than original rules.*)

a) The licensed MFIs will not be able to run its microcredit activities outside the area of operation permitted by registration Authority. (rule 4 /C,2010)

b) The licensed MFI must provide all information as required by Authority and extend cooperation in carrying out any inspection and investigation (rule 4/G, 2010)

c) The Authority may cancel the license for violation of terms and conditions, liquidation of organization or closures of its activities, false or confusing information, running business that hamper the interest of depositor, any unlawful work and failure to comply with the directives (rule 6, 2010)

d) Every MFI will have a General Body comprise of minimum 15(fifteen) and maximum of 31(thirty one) member out of which at least 2(two) will be female members. A person will not be able to hold the membership of more than 5(five) MFI simultaneously.(rule 7,2010)

e) The tenure of Council of Directors will be three year and it will comprise of minimum of 5 and maximum of 10 members including 2 female. A

person will not be able to hold membership of Council of Director for more than three consecutive terms (rule 8, 2010)

f) Chief Executive Officer will not enjoy salary and benefit separately from various project of the institution. (rule 9,2010)

g) Parents, children's, spouse, and sibling will not be able to hold office of chairman and CEO at the same time. They also prohibited for joint-signatory of the same MFIs Bank account.(rule9,2010)

h)The MFIs will have an employee policy and pay-scale for its employee.(rule 12)

i) A least 70% of total Clients must be borrower in MFIs(rule 13,2010)

j) Client will have the right to know the condition, procedure, able the services, and interest on deposit amount. Recently interest on savings is 6% annually (rule 16,2010 and circular no 5)

k) Source of fund of MFI will be donation, borrowed fund (personal, institution, foreign), securitization or capital market subject to permission from Authority.(rule 18,2010)

l) Every MFI will create a reserve fund using its 10% (ten percent) of total income surplus. (rule 20,2010)

m)MFIs will disburse microcredit loan to member individually or in group and the size of Microenterprise loan will not greater than the half of total portfolio at any given time . (rule24, 2010)

n) MFI may offer insurance services to its client and the service details will inform to authority (rule 25, 2010)

o) The procedure and rate of service charge on loan must be set as the updated circular and guideline of government and the Authority. Recently the circular fixed the rate of interest is maximum 27% reducing balance method. (rule 26,2010 and circular 5,2010)

p) Loan period will be at least 46 week and first installment must be collect after 15 days from disbursement. (MRA circular no 8, June 0 8, 2011)

q) In case of prepayment of entire outstanding by any client a rational rebate must be allowed to respective client (rule 25/3, 2010)

- r) According to the financial strength, deposit from member have classified in three class are compulsory, voluntary and terms deposit. For each type of savings collection, different condition has imposed in the rule. (rule 27-29,2010)
- s) Every MFI must maintain 15% liquidity fund of its entire savings fund (cash and bank) in a scheduled bank of branches office. rule 34,2010)
- t) All document, deed and records will preserve of its branch office for minimum 5 years and its head office for minimum 10 years.(rule 36,2010)
- u) Financial year of the MFI will be form July 1 to June 30. A detail budget approved in AGM must be sent to authority by first month of the financial year. (rule 39,2010)
- v) A unique and uniform register, record book and financial report (rule 41-43, 2010)
- w) MFI must carry out audit by chartered accountant firm enlisted by Authority (rule 47, 2010)

5. Global experience of Regulation: Global microfinance regulation experience almost positive especially in the African and Latin American countries. In the **Bolivia**, market transparency and consumer protection were strengthened with the regulation on interest rate. Here credit information bureau (CIB) has allowed regulated MFIs to access the credit information of non-regulated microfinance entities that helps them evaluate over indebt more fully. Challenges that are facing here are high cost of regulation, different nature from formal financial institution and require flexibility to adapt. National Bank of **Cambodia** (NBC) regulated their MFIs from different aspect. Their main focuses were on corporate structure and business with good governance, human resource development, source of fund and lending methodologies. In 2000 NBC firstly issued regulation on classification of MFIs in to three categories according to the level of operation and created criteria for licensing and registration. The biggest microfinance institution must be licensed from NBC .Regulation is very similar to

commercial bank except lower capital requirement. Medium sized required registration and smallest can operate freely. The purpose of the regulation is not to restrict their activities but to promote them. In the **Ethiopia**, before introduction of regulatory framework there was no formal financial institution to provide financial service to low income people. Regulatory framework has established MFI to offer many products such as credit, savings and money transfer.MFI mobilized saving from non loan clients and fund become available for loan. Regulation ensured consistency and transparency as MFI bound to submit report regularly. Here also facing challenges in the area of ownership and governance and competition with subsidized lending. Regulatory framework of **Tanzania** was issued in 2004 and included the licensing process. Central Bank evaluate the process to ensure adequacy of capital and verified that the microfinance company(MFC) are capable of practicing financial intermediation and engaging microfinance with high degree of prudence that is required by public interest. Adequate evidence should be provided to central bank to show that institution has successful experience in microfinance with the competent manpower at the top and medium level. In Tanzania new branch opening is subject to review process .Regulatory requirement for microfinance companies(MFC) of Tanzania addressed on minimum capital for nation wise or unit MFC ,lending limit ,capital adequacy ratio and loan loss provisioning .The regulatory and supervisory framework in **Uganda** is based on tiered approach. According to David D kalyango (2005) the tiered approach reflects microfinance as a line of business and it is conducive to the development of sound microfinance sector and its does not constrain the numerous valuable microfinance activity in the country. Tier regulatory frame work in Uganda divided the MFI in four categories and MFI graduated to first tier to next tier when they meet requirement. The field becomes more disciplined.

6. Opportunities and challenges for regulated

Microfinance in Bangladesh: This is condemnable that an aged microfinance program has made the demand for regulation from itself. More than three decade has been passed without any regulation and hence the operation in all over Bangladesh became very differential. To overcome the situation, the regulatory Authority has been established and started the monitoring and supervision. Consequently, the field of microfinance is becoming in a formal shape, but in fact it is highly challenging to adapt quickly.

6.1 Good governance and Organizational

sustainability: For last few decade nongovernment organizations (NGO) and MFI has been criticized for its transparency and accountability. Especially familiarity in governing body, relatives in high official, financial corruption and lack of accountability made the organizations controversial. Transparency International Bangladesh (TIB) has pointed out that, NGO governance system in Bangladesh has problem which are summarized below:

Problem area of governing system (each area had different sub area)	Percentage of problem in respective area
Role of governing body	85-100%
Decision making process	70-85%
Financial transparency	70-85%
Human resource development and grievance procedure	50-95%
Accountability to service recipient ,donor, government	45-65%

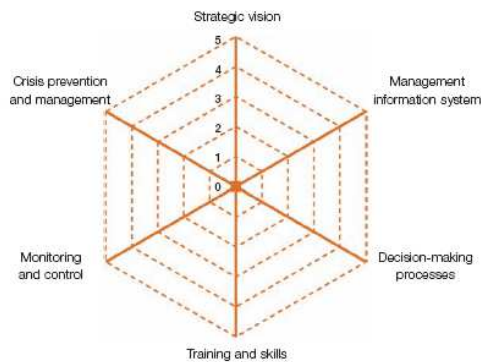
Source: Role of Governance in NGO sector: The Way out, Transparency International Bangladesh

Newly established regulatory Authority has addressed the issues to make the organization accountable and transparent through its act and rules. There are many rules which are positive for

good governance. Among these few are, 1. Chief Executive Officer will not enjoy salary and benefit separately from various project of the MFI 2. Retirement age for CEO and other 3 Parents, children's, spouse, and sibling will not be able to hold office of chairman and CEO at the same time. They also prohibited for joint-signatory of the same account 4. Council of Directors is allowed for three consecutive tenures 5. Body member are not illegible for loan.6.Restriction on usages of fund 7.Employee policy and its well functioning and no paid employee of MFI shall be a member of general body or Council of Directors, etc. Before 2010, there were no realistic regulations in Bangladesh microfinance sector. These types of rule indicate the opportunity for new leader in microfinance organization, reduced malpractices, dictatorship and financial transparency. But the MFIs are not a profit oriented organization like other financial institution and the leadership in any misery situation may faces a challenges due to lack of ownership. Celle Lapenu and Dorothee Pierret (2006) Shows that the institution should be made up of six fundamental elements for good governance which are 1. Shared strategic Vision 2.Reliable and quick management information system to makes decision and monitoring of the organization 3. Decision making processes that are clear, well- adapted and coherent with the governance structure 4. A level of staff training, capacity and involvement that ensure decision are executed.5.An efficient monitoring system 6.Ability to prevent and overcome internal and external crisis. Here evaluation of the good governance for Microfinance Institute has been designed with the following (Diagram -1). MRA rule addressed it's all the part gradually. But recently MRA has taken initiative to capacity building of the institution and its employee.

Diagram: 1

Diagram for evaluating the governance of a MFI



(Source: Celle Lapenu and Dorothee Pierret (2006), Hand book for analysis for Governance of Microfinance Institute, IFAD, P. 31)

6.2 Security and safety for stakeholder and confidence buildup

All initiatives of the regulatory body strongly addressed the security and safety and they aimed to keep their rights. According to the microcredit regulatory Authority act 2006, no private organization (NGO-MFI) is permitted to operate microfinance activities in Bangladesh without obtaining license from authority. Here the regulatory body has ensured the safety of the beneficiaries or member, right to get the interest on savings and minimum service charge or interest payment in maximum period. Increasing savings rate reflect the improved confidence on MFI. The

Authority shall form and maintain a fund to be called Depositor Security Fund in (DSF) order to secure depositor. (Act 19/2006).MRA already developed a policy framework for DSF which is to be called Microfinance Deposit Trust Fund (MDTF) in Bangladesh. Moreover Authority has the rule to postponement or cancels the licenses for business against the interest of depositor (rule 6, 2010). At the same time the rule ensured the service with appointment letter, salary structure and even a declared policy for its employee part. According to notice in website the Authority has cancelled some licensed of MFI under the act and rules. (June 2012).

6.3 Unique and uniform rule

Up to August 2012, MRA has issued 651 licenses to operate the microfinance and some other are now under consideration and process. Before MRA, microfinance industry in Bangladesh has practiced many types of rule and policy in case of product, interest, monitoring, reporting etc. But the rules impose the same policy for all in terms of the operation and reporting. The rule 2010 has a prescribed MIS and FIS format to provide report regularly. The interest rate or service charge became a unique digit. But there is no probation for charge interest on overdue loan amount if it is reducing balance up to single year. In this case it may be challenging to MFIs in case of high overdue rate and bad debt.

Table 1: Rate of interest on savings and service charge on loan practiced and MRA rule

Savings			Credit			
Interest rate(%) in the market	% of NGO MFI Practiced	MRA rule	Service charge in the market (before regulation)	Method	% of NGO MFI practiced	MRA rule
Up to 5	24.6	6% yearly	Up to 10 % (flat)	Flat	3.5	Maximum 27%
6-7	56.55		11-15 % (flat)	Flat	85.1	
8-10	17.10		16 to 20% (flat)	Flat	11.2	
11-15	1.30	Monthly calculation	21-25% (flat)	Flat	0.16	Declining method
16-20	.32			Only 5 MFI practiced declining		
Total	100 (n=617)	All refund with interest			100 (n=624)	Rebate on advance payment

6.4 E Regulatory system: From April 2012 MRA launched online based regulatory system. The system is to facilitate the licensed MFIs to submit periodic required data online as a part of compliance to regulatory reporting. It is very effective to reduce reporting time and off-side monitoring.

6.5 Reduced overlapping, over debt and Credit Information Bureau (CIB)

One of the most common and critical challenges of Microfinance in Bangladesh is overlapping. The issue of the competition is a particularly in Bangladesh as the number of the NGO/MFI is large (about 1000 though not all of them are registered with MRA) .Most of them are working in already saturated area and all of them compete for client,

resulting in overlapping (*overview report 2010, Microfinance in SAARC countries, Institute of Microfinance, Dhaka*).Currently overlapping is assumed to be 40%(*Maps of Microcredit coverage in Upazilla of Bangladesh, PKSF, October 2006*)

Table 2: MFI branch and client increasing trend

A) Total reported MFI 482

Particular/Year	2005	2006	2007
No of Branches	7733	12156	11461
Client (Million)	18.82	22.89	20.83

Source: NGO-MFI in Bangladesh, Volume 6, June 2009, Microcredit Regulatory Authority, Dhaka

B) Total Reported MFI 524

Particular/Year	2008	2009	2010	2011	2012
No of Branches	15077	16851	17252	18066	17977
Client (Million)	23.45	24.85	25.28	26.08	24.64

Source: NGO-MFI in Bangladesh, Volume 9, June 2012, Microcredit Regulatory Authority,

Table-2A shows that number of branches has increased 48.20% over the three years where number of client has increased only 11%. So the MFI has covered the same beneficiaries resulting overlapping and to somewhere over debt. But regulation commendably has been reducing the problem which is shown in table-2 B. Here the rate is 19% and 11% in 2011 and more lower for 2012. Being a central leader and regulator of the industry MRA has the scope to develop Credit Information Bureau like central bank on borrower to reduce the overlapping and to find the actual demand of loan. Moreover the CIB will reduce the risk of portfolio also. International Alternative Financial Institute (INAFI) Asia chapter in Bangladesh already has proposed for a Credit Information Bureau (CIB) with a view to develop a central credit data base for microfinance sector in Bangladesh. Objectives in details are reducing overlapping, avoid unhealthy

Table: 3 Market shares of different types of MFI

Category	Number of Borrower	Number of MFI	Share in Outstanding of Loan %	Share in Total Savings %
Very Small	Up to 10,000	440	4.30	4.99
Small	10,001-50,000	107	11.28	10.90
Medium	50,001- 1,00000	20	6.88	6.83
Large	100000 to 1000000	21	24.44	26.70
Very Large	>10,00,000	2	53.08	50.50
Total Reported MFI		590	100	100

Source: NGO-MFI in Bangladesh, Volume 9, June 2012, Microcredit Regulatory Authority, Dhaka

competition, avoid oversized loan, maintain quality portfolio, increase in outreach, development AIS and MIS, ensure transparency and accountability etc. (*Project concept Note on Microfinance and Technology, INAFI Bangladesh, September 2010*). Recently authority has been working with DFID fund to established a CIB.

6.6 Incorporation the same rule by very large and small MFI

Microcredit Regulatory Authority has divide the NGO/MFI depending on its borrower in five categories are 1) very large 2) Large 3) Medium l 4) Small. 5) Very small .Out of 590 MFIs only 2 MFI has covered its more than 50 % of market share in term of disbursement and savings collection. (Table 3).More than 74% MFIs has only share on 4-5% savings and loan.

As the MFI has a difference in terms of size and coverage, they are not equally sustainable in

financial and nonfinancial areas. Now this is challenging to the some small MFIs to maintain the same rule because of inefficient human resource, source of fund, return on asset, equity and even

outreach and sustainability. The summary of sustainability, cost and profitability comparison is as below in table- 4

Table- 4: Comparison of Sustainability and Cost of NGO- MFI in Bangladesh

Type of MFI	Return on Asset(ROA)	Operational Self Sufficiency(OSS)	Portfolio Yield	Total Operating Cost (per 100TK)
Average of Top 10 MFI	3.73	113.89	25.72	21.28
Average of 576 MFI	1.18	102.88	20.33	19.58

ROA=Net profit/Average total asset *100

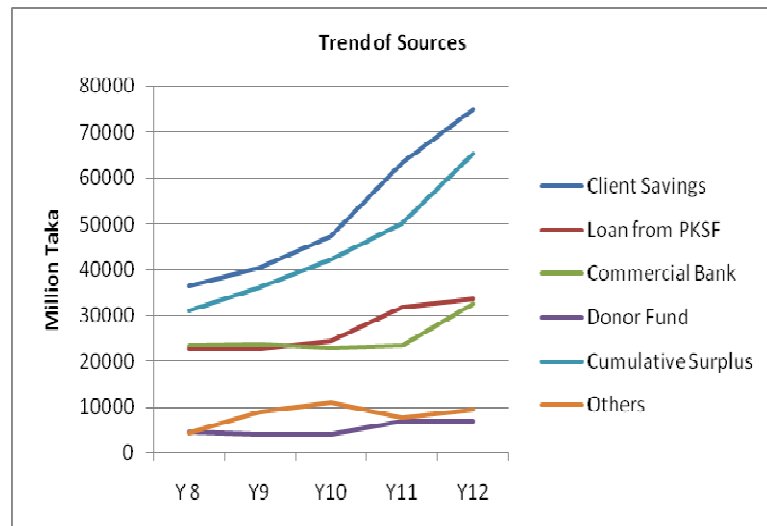
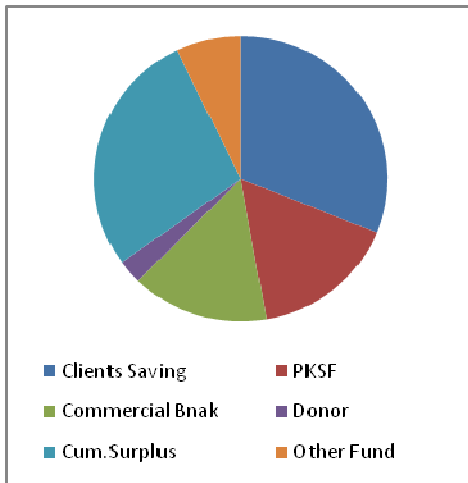
Portfolio yield=Total interest income/Average loan outstanding*100

6.7 Market segmentation and uneven competition with unregulated player: The market for microfinance is not well segmented here (table 3). Though 77% market is covered by only twenty three large MFI, this is very critical to compete them with the rest 23% by all other. On the other hand NGO MFI is not only provider of microfinance but lot of multipurpose and cooperatives are working here whose are out of regulation. Most of the cooperative and multipurpose has been working as like as microfinance institution and compete with very low procedure but high interest rate. In most cases they overlapped the MFIs client also.

6.8 Source of fund and its usage: Source of fund for microfinance in Bangladesh is very much limited. Member's savings, PKSF, Commercial

Bank, Local NGO and donor were the only fund provider .PKSF is the only apex organization to provide loan to MFIs with lower interest rate. In figure 1 it is shown that for last few years' (2008-2012) donor funds, commercial bank fund is decreasing or remaining stable and clients savings and surplus income used is increasing. Regulation brings a positive result on surplus generation and savings accumulation efficiently. MRA has opened the door for fund from more sources including capital market (rule 18, 2010) which maybe more viable for large organization and will reduce the cost of fund. Recently MRA tried to make linkage in between bank and MFIs to ensure low cost fund. Consequently it is little bit increased in 2012. Authority has been imposed the restriction to usage of the fund to control misuse also.

Figure 1: Source of Revolving Loan Fund (RLF) and its trend



Data Source: NGO-MFI in Bangladesh, Volume 9, June 2012, Microcredit Regulatory Authority, Dhaka

6.9 Opportunity of funding small MFI by large one:

Recently MRA opened the door to funding MFI itself through issuing a guideline (*MRA/Regulation-9(14)2014*). This is very commendable decision from MRA as the authority made more scope for very small MFI addressing the real funding crisis in the field and experience.

6.10 Addressing the Ultra poor, Women empowerment and Disaster:

The act and rule has been indicated to use MFIs profit for poverty reduction through other intervention, but no specific area has identified. Increasing environment degradation and climate change areas that faced in frequent natural disaster in the past may experience more flood, drought, and hurricane. Unprotected clients and MFI divested by single crises. Generally, the step should be taken to protect and MFI are

- identifying the potential client in the area and make financial projection for them
- update and store duplicate client record at safe area
- make a disaster fund
- disaster policy and procedures
- create a disaster realization team
- develop and internal and external disaster communication strategy
- train staff who can efficiently handle
- pre relationship for emergency fund
- liaison with early warning system and relief organization.

(www.mip.org/pub/mbp-def.htm) MRA hopefully addressed the fund and other initiative is necessitate

here. (MRA advised MFIs to disburse loan to disadvantage people, disable and tribal. And use a portion of its excess of income over expenditure for health service and training of its women clients. (*Circular no 6, 2010-2011*).

6.11 Financial Inclusion and its effects on Microfinance:

Last few years, MFI and financial institutions are trying to increasing financial inclusion and retention rate. Consequently, to serve the poor and mass people with more service, most of the commercial bank making partnership with licensed MFIs. Now MFIs client are not limited to savings and credit only and they are enjoying insurance and remittance also. MRA is concerned with the issues. Recently MRA conducted a study on remittance titled' *Remittances and its Utilization through MFIs' Intermediation in Bangladesh: Potential and Realities*'. They study found a positive scenario of remittance activities like quick delivery with lower cost.

7. Conclusion and policy implications:

Age of regulation in Bangladesh microfinance sector is not longer. The regulator has tried to ensure and establish a well-designed microfinance through prudential regulation. If the regulation has been made an as usual shake to the sector but the result is very positive. Considering with global experience

and local situation the, result of regulation in Bangladesh is highly praiseworthy as the sector gaining a good shape quickly. To enhance the success of regulation we have some policy implications that are as below:

v.

- i. Microcredit Regulatory Authority should introduce the tier approach in law, at least in the area which depends on institutional capacity for very big and small MFIs.
- ii. Should address and take more necessary step to stop the uneven competition between MFI and others that serving microfinance.
- iii. Microcredit Regulatory Authority may take more initiative to enhance the Institutional capacity and staff development. A common and generally

accepted human resource policy may develop to introduce similarity in operation and management.

Authority should incorporate more details regarding social performance and disaster management in the law as the MFI has social commitment.

A Credit Information Bureau (CIB) which is under process should establish quickly to reduce over debt and protect portfolio.

All other financial service including remittance, insurance and mobile banking may include lawfully with proper guideline

As the service charge of loan is reducing balance method and advance payment required rebate then it is considerable to impose charge on late payment and bed debt.

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