2 Progress Toward Microfinance Commercialization

Social visionaries have led the rapid expansion of microcredit in Bangladesh, which began and continues to be strongly oriented toward serving the unmet or underserved demand of the poor for financial services. Dominated by the Grameen Bank and NGOs, microfinance has historically operated largely on a noncommercial basis, although two of the largest microfinance NGOs are commercially viable and currently reach about half the market. In addition, there are numerous poorly performing, subsidy-dependent microfinance NGOs and government microcredit programs. Many of these small NGOs and programs simultaneously operate (pre-microcredit) social mobilization efforts and (post-microcredit) business development services or "credit plus" activities that cloud their financial performance and hinder their ability to become financially viable. Given the level of subsidy dependence in microfinance, there is only a minute presence of private commercial banks as providers of microcredit.

Most of the MFIs are not financially self-sufficient and there will likely be a reduction, especially of small and medium-sized microfinance NGOs as competition increases and funding agencies tire of funding unsustainable institutions. Recently, many microfinance NGOs have begun to apply more commercial principles to their operations and have become more concerned about achieving financial self-sufficiency. However, there are still few commercial sources of funds. Also, the legal and regulatory framework is not supportive of movement toward greater levels of commercialization by microfinance NGOs. Nonetheless, as competition increases MFIs are becoming more responsive to client demand by diversifying their product offerings to include larger individual loans, leasing, savings products, and microinsurance. Those that can best satisfy client demand while ensuring financial self-sufficiency will be the most likely to survive.

This chapter discusses the historical development of the microfinance industry and evaluates its performance in terms of outreach and progress toward commercialization.

DEVELOPMENT OF THE INDUSTRY

The earliest providers of microfinance were cooperative societies that spread throughout the country before it gained independence in 1971 and that rapidly expanded into a nationwide network during the late 1970s and early 1980s.[30] The Bangladesh Rural Development Board (BRDB) promoted this growth by organizing the cooperative societies into a two-tier structure, with primary cooperatives at the local level and others at the subdistrict (*thana*) level. The BRDB helped to spread the cooperatives to most of the 460 *thanas* throughout Bangladesh but did not achieve the goal of making them self-sufficient. Although BRDB tried several ways to improve the financial performance of the cooperatives, the effort ultimately failed because of (i) inconsistent government policies that led to reduced support to the cooperatives; (ii) loss of traditional business, such as input supply and marketing, to the private sector because of the liberalization of agricultural markets; and (iii) tarnished reputation of cooperatives because of weak leadership, lack of appropriate staff incentives, staff disincentives, lack of internal controls, and massive deposit losses and loan defaults.[31]

Continued Influence of the Grameen Model

The institution that has shaped much of modern-day microfinance is the Grameen Bank, which Professor Muhammad Yunus began as an experimental project in 1976 to increase access of mainly poor rural women to microcredit. What has become well known as the Grameen model demonstrated that lending to the poor could be an economically viable activity. Its success led to the early establishment of other, similar microfinance programs by several other large multisectoral NGOs, such as the Bangladesh Rural Advancement Committee (BRAC) in 1972, Proshika in 1976, and the Association for Social Advancement (ASA) in 1978. Over the next 20 years, hundreds of specialized microfinance NGOs were created based on the Grameen model, either to provide microfinance services exclusively or to add microfinance to their menu of social services. Strong competition among microfinance NGOs has helped fuel growth in client outreach, especially in recent years (Table 2.1).

Two important lessons learned from the success of the Grameen model are that large numbers of poor can and will pay high interest rates (compared to the lending interest rates charged by private commercial banks) for access to timely and reliable sources of microcredit and that alternatives to traditional collateral, such as group liability and mandatory savings, can ensure high repayment rates. Participants at a March 2002 Women's World Banking consensus building seminar in Dhaka judged that successful development of the microfinance industry has also been because of the ability of MFIs to operate outside the strictures and traditional notions of the Government and international aid agencies. Over the last 20 years, Bangladesh government policymakers and regulators have allowed MFIs to grow, flourish, and innovate without government restrictions. The international development community has provided substantial support to microfinance, which in the early years was emphasized as a new approach to poverty alleviation.[32]

The success of the Grameen model and these external factors have led to outstanding achievements in outreach and consistently high repayment rates among the main providers. However, the approach has also led to a dearth of commercially viable MFIs and a lack of transparency in the microfinance industry because a high loan recovery rate has generally been treated as an adequate indicator of operational efficiency.

Evidence of Market Saturation

The best available data on the current supply of microfinance are compiled by the Credit and Development Forum (CDF), a Dhaka-based microfinance NGO network. It produces a "CDF

Table 2.1: Growth of Microfinance NGOs, 1996–2001

Period	No. NGOs Reporting	No. Active Members (million)	No. Active Borrowers (million)	Outstanding Loan Portfolio (Tk million)	Cumulative Loan Recovery Rate (%)	Net Savings (Tk million)
end-1996	351	6.0	3.12	6,952	-	2,391
end-1997	380	6.7	4.26	9,564	-	3,382
end-1998	495	8.0	5.42	13,737	93.2	5,216
end-1999	533	9.4	6.89	18,692	95.0	6,922
end-2000	585	11.0	7.99	21,903	95.6	8,866
mid-2001	601	11.6	8.32	23,983	95.4	9,591

Note: Net savings is total savings deposited less withdrawals.
Source: Credit and Development Forum 2001b.

Statistics" booklet that presents self-reported and partially verified data from 585 microfinance NGOs.[33] The CDF Statistics include summary data for the three main types of microfinance providers–the well-known, large microfinance NGOs as well as data highlights for the Grameen Bank, hundreds of lesser-known small NGOs, and all government microfinance programs. As such, the CDF Statistics provide information on virtually all microfinance activity in the country.

Total membership of microfinance NGOs at the end of 2000 was 11 million, of whom 90% were women. The Grameen Bank has 2.4 million members. Also, there are 2.1 million members of five ongoing BRDB projects, many members of the Ministry of Youth and Sport's TharDEP project, and other government microfinance programs.[34] Total microcredit coverage appears to be about 15.5 million families (Table 2.2). However, as even casual observation in some of the more accessible and populated areas of Bangladesh shows, there is considerable double counting of membership (of the poor) in multiple organizations. Based on this and using the generally held assumption that only 70% of reported membership figures reflect active membership, it is unlikely that actual microcredit coverage is in excess of 10.8 million families.

Related to the issue of client double counting is the problem of client overlap (client borrowing from more than one creditor at the same time), particularly among the large NGOs and the Grameen Bank. Although the exact extent cannot be ascertained, overlap is seen by several leading practitioners to be a significant and a potentially dangerous trend for the microfinance industry. The general consensus from a March 2002 gathering of microfinance industry leaders in Dhaka sponsored by Women's World Banking was that the national average for overlapping was

Table 2.2: Microfinance Supply as of 31 December 2000

Large NGOs	No. Members ('000)	No. Active Borrowers ('000)	Outstanding Loans (Tk million)	Average Outstanding Loan per Member (Tk)	Net Savings (Tk million)
BRAC	3,410	2,993	7,706	2,575	3,538
ASA	1,205	1,129	3,986	3,531	1,607
Proshika	2,151	1,123	3,811	3,394	997
Subtotal of Large NGOs	**6,766**	**5,245**	**15,503**	**2,956**	**6,142**
Medium-sized NGOs[a]	2,025	1,465	3,198	2,183	1,161
Small NGOs	2,231	1,279	3,202	2,504	1,563
Subtotal of All NGOs	**11,022**	**7,989**	**21,903**	**2,742**	**8,866**
Grameen Bank	2,379	2,057	12,606	6,128	4,339
BRDB	1,243		1,659		
Ministry of Youth and Sports	318		310		
PDBF	330		816		
WEDP	177		130		
Total	**15,469**	**10,046**	**37,425**	**3,725**	**13,205**

BRDB = Bangladesh Rural Development Board; PDBF = *Palli Daridro Bimochon* Foundation; WEDP = Women Entrepreneurship Development Programme.

[a] Medium microfinance NGOs include the remaining "top 20" microfinance NGOs in terms of membership and more than Tk85 million ($1.5 million) in outstanding loans as of 31 December 2000.

Source: Credit and Development Forum 2001b.

about 15%, with much higher overlap in some rural areas (such as Tangail), ranging from 25% to 40%.[35]

The number of active borrowers gives a better estimate of market penetration. Adding 70% of the government microcredit program membership to the number of active borrowers of the microfinance NGOs and the Grameen Bank yields an approximate total of 11.5 million active borrowers. Reducing this figure by the estimated 15% incidence of overlapping yields 9.8 million active borrowers.

The Government estimates that approximately 45% of the population, or some 12.2 million families, are poor[36] (based on a total population of 130.2 million, comprising about 27.1 million families with an average 4.8 persons per family).[37] If this estimate is correct, the microcredit market is largely saturated, with MFIs reaching slightly more than 70% of poor households (incorporating also the usual assumption that 10% of microcredit is borrowed by nonpoor clients).[38]

Saturation of the microcredit market "has led to many cases of over-indebtedness and appears to be undermining the primary incentive to repay … Increasingly, clients appear willing to default with one MFI safe in the knowledge that they can access financial services from one of its competitors if follow-on loans are not made available."[39] Indeed, for the first time in at least four years, repayment rates for microfinance NGOs are potentially declining (Table 2.1), and there have been recent repayment problems in several of the major MFIs. Switching costs incurred by clients when changing providers appear set to decline as competition increases and MFIs vie for clients by reducing the transaction costs of participation. While it is impossible to know how accurate the estimates of double counting and overlapping are, it is clear that these two factors are causing overstatement of total microcredit outreach figures.

It is important to note, however, that the high level of market saturation relates mainly to households with access to traditional Grameen-style microcredit and reflects the limited scope and provision of microfinance services, including microcredit (Box 2.1). The degree of market saturation noted in no way indicates fulfillment of the potential demand for microcredit on other terms (for example, individual lending, lending to men, or lending that is not tied to mandatory savings) or for other microfinance products, such as leasing, savings, and insurance. While the relative emphasis on credit and nonlending activities offered by each MFI varies, the key operational and financial features of the microcredit programs are generally quite similar.[40]

The present coverage of MFIs, about 70% of poor households, suggests little room for further growth in market depth through Grameen-style microcredit. However, there is potential to fuel further expansion of the microfinance industry by increasing the breadth of outreach, and by expanding areas of service and types of products and services offered. These approaches may be especially important for MFIs trying to make their operations commercially viable by exploring profitable market niches.

Opportunities for Expansion

While sustainability is an important goal, it depends on low overhead, adequate return on the loan portfolio, and high loan repayment rates, among other factors. This means that MFIs with a goal of sustainability would serve areas that are relatively easy and cheap to reach and would lend to sufficient numbers of clients having good repayment prospects. This would be the case at least until an MFI achieves full financial self-sufficiency, after which it may choose to cross-subsidize services to poorer people living in isolated areas and more vulnerable groups that are seen as more expensive to serve and pose greater credit risks. The costs of reaching more remote or poorer clients may exceed possible revenues. As such, complementary grant-based approaches or (cross-) subsidized microfinance services may be needed to reach much deeper, in terms of expanding the depth of outreach.

There may be viable options for increasing the breadth of outreach. There are still pockets of easily accessible, densely populated areas in

Box 2.1:

Elements of Traditional Grameen-style Microcredit

Typical microcredit lending in Bangladesh follows the traditional Grameen model: it is targeted at the landless/assetless; borrowers are part of a 15–20 person group, which meets regularly; women are given preference and make up 90% of the total borrowers; loans are collateral free and usually have a maturity of 50 weeks with weekly repayments; mandatory saving is an integral part of the program; and financial transactions are recorded in individual passbooks in the presence of the entire group to enhance transparency and self-monitoring. Microfinance institutions (MFIs) provide initially a small loan (about $25–75) and then follow-on loans of increasing amounts as long as repayment of the earlier loan is satisfactory. This stepped lending feature is essential to the excellent repayment performance (most MFIs report more than 95% cumulative repayment rates). The basic premise is that the poor need continuous access to credit for 8–10 years to accumulate enough savings/assets to escape poverty. MFIs usually have upper loan limits, but a few have a policy of "graduating" borrowers from their microfinance program to individual microenterprise loans, because clients who have been in the system for several years represent better credit risks despite the larger loan sizes. Borrowers are free to choose the activity financed by the loan. Activities are mostly rural and nonfarm in nature with short duration and daily sales, such as poultry farming, petty trade and shop keeping, cattle rearing, or handicrafts.

Source: World Bank 1999, p. 1.

rural Bangladesh where demand for more microfinance products may exist. These areas include the more remote tribal belts of Sylhet and Rajshahi, and the hill tract areas around Chittagong, where coverage is still relatively low in relation to estimates of the potential effective demand for microcredit.[41] There also may be market niches in urban areas, such as the smaller urban centers like Rajshahi, Jessore, and Comilla. Market penetration is lower in cities and towns; it is estimated that less than 25% of poor households in urban areas access credit services from MFIs.[42]

New Product Potential

There has been positive response to several recent innovations in tailoring various types of microfinance products and services to client needs, pointing to substantial potential demand that will enable further growth of the microfinance industry. Competition has arguably prompted the relatively recent tailoring of credit, leasing, savings, and insurance products to demand, as described below. Such developments also have the potential to expand access and relevance of microfinance to far greater numbers of poor and near-poor clients.

Breaking Away from the Traditional Grameen Model

Microcredit innovations through promotion of individual lending, expanding lending to men, and increasing access to those clients caught in the "missing middle"[43] hold promise to be the largest areas of potential demand. Over time, credit products have diversified. Today, there exist more than 15 credit products including daily credit, leasing loans, and housing loans. Normally, the loan ranges from Tk1,000 to Tk15,000 for one year. The average loan size is Tk3,500 ($70). Organizations providing loans higher than Tk3,000 are very few. Only a handful of MFIs can adequately support the real needs of their clients. The clients opine that the credit given falls far short of actual needs. This means that the market can absorb more .[44]

Introducing Leasing Services

Leasing was first introduced by Grameen Bank in 1992 on an experimental basis by leasing power looms to weavers in the Ariahazar area of Dhaka District. Now, most of the activities funded by Grameen's leasing programs are related to the small manufacturing and service industries. One of Grameen's most successful leasing programs has been the Village Phone (Box 2.2). Most of Grameen's leasing programs target experienced borrowers, who can handle loan sizes larger than Grameen's traditional microcredit products, and their family members. A member who possesses some skill in a certain technology for production of goods and services can buy the required equipment or any other items under this program. The rate of interest or leasing fee is 20% (on a declining basis), the same as in Grameen's basic loan product. There is no upper limit on size. Grameen has leased items as high as Tk1.2 million, such as a transport vehicle. The lease period is a maximum of three years. By December 2000, Grameen had provided 21,973 leasing loans totaling Tk33.54 million. The activities included services (67%), processing and manufacturing (21%), livestock and fisheries (12%), and trading (just under 1%).

Leasing, however, is yet to become popular in the sector. The Shakti Foundation for Disadvantaged Women (SHAKTI) is the only microfinance NGO that has developed substantial leasing operations. SHAKTI introduced equipment leasing in December 1999. Members in their third general loan cycle can access this service. A maximum of Tk30,000 is provided with 15% interest (flat) per year. The lease period is a minimum of 100 weeks.

Leasing (including both financial and operating leases) appears to have good market potential as evidenced by the Grameen Bank experience. The more established large and medium-sized microfinance NGOs may consider offering this product as their clients gain more experience handling loans and their businesses require larger amounts of credit.

Box 2.2:

Grameen Bank's Village Phone Leasing Product

Grameen Bank began its cellular phone leasing program in 1997 in response to high demand stemming from low telephone density in Bangladesh. Bank members leasing the phone, popularly known as "telephone ladies," sell services to earn additional income, which Grameen estimates is almost four times higher than the national average per capita income. In collaboration with Grameen Telecom, the Bank had disbursed 3,085 cellular leasing loans by the end of 2000, amounting to Tk55.53 million, with an average loan size of Tk18,000. During 2000 alone, 823 leasing loans were made, totaling Tk16.6 million.

Source: Grameen Bank 2000, p. 22.

Mobilizing Voluntary Savings

The microfinance market is largely oriented toward microcredit. Practically all clients have taken loans; savings are often on a forced rather than a voluntary basis, following the Grameen model. Nevertheless, savings play a central role in the economic lives of all households and microenterprises. Whether families use traditional assets (such as livestock or gold) or bank accounts, the purpose is the same: to build a material cushion of security. These savings are perhaps the most important factor in creating the domestic investment needed for sustainable economic growth. As indicated in Table 2.3, the savings market is virtually captured by the top 20 microfinance NGOs. Given the large number of microfinance NGOs in the country, growth in savings mobilization points to the potential for mobilizing massive amounts, should the legal framework allow this in the future.

Savings have shown spectacular growth both in absolute terms and share in the total revolving loan fund (RLF), which also rose over the last few years (Table 2.3). Yet, the scope of savings mobilization is very limited. A handful of organizations have introduced flexible savings among their members. ASA and the Bangladesh Unemployed Rehabilitation Organization (BURO) Tangail introduced flexible savings, term deposits, and time deposits among their "associate members" (nonmembers) with good

Table 2.3: Microfinance NGO Savings Mobilization

Period	Total Net Savings (Tk million)	Net Savings of Top 20 NGOs (Tk million)	Share of the Top 20 NGOs of Total Net Savings (%)	Total Revolving Loan Fund (RLF) (Tk million)	Share of Net Savings in the Total RLF (%)
end-1998	5,216	4,578	88	18,164	29
end-1999	6,922	5,941	86	24,096	29
end-2000	8,866	7,505	85	29,873	30

Source: Credit and Development Forum 2001b, p.5–12.

response, but these savings services to associate members were later discontinued following a notice by the Bangladesh Bank in the national daily newspapers in September 2000, prohibiting such services (Box 2.3). The notice reprimanded all organizations (not only NGOs) taking deposits without a license from the Bangladesh Bank. BURO Tangail has continued offering flexible savings services, but only within its membership.

Other regulatory issues related to savings mobilization by microfinance NGOs are discussed in Chapter 3.

Currently, the savings products available in the microfinance NGO sector (for members only) include mandatory savings, special savings, forced savings/group savings, contractual savings, time deposits, and daily savings. Very few organizations in urban areas are providing daily savings services. However, an experimental project operated by SafeSave since 1996 in the slums of Dhaka, demonstrates that strong demand exists for voluntary open-access savings among the very poor, and the poor are motivated and capable of saving when offered savings opportunities that feature safety and flexibility.[45]

The Grameen Bank has many savings products that include personal savings, special savings, Grameen Pension Scheme, time deposits, a savings scheme in which the amount deposited doubles in seven years, and fixed deposits with monthly income. As a bank, it is authorized to mobilize voluntary savings from the public (members and nonmembers alike). The Grameen Bank's total net savings now constitute 56% of total microfinance NGO net savings deposits (with 23% of Grameen Bank's net savings coming from nonmembers).

Box 2.3:

Bangladesh Bank Notice That Ended Voluntary Deposit Mobilization by NGOs from "Nonmembers"

Warning Notice

It has recently been observed that several unauthorized organizations/persons in different parts of the country are collecting money from the public in the name of savings/deposits/investment by alluring them with unrealistic and abnormally high interest rates. A good number of reports have appeared in the newspapers about persons who were cheated or adversely affected in the hope of making a large profit. The members of the general public are hereby advised to remain cautioned not to deposit any money with any such unauthorized organizations/persons. Bangladesh Bank is initiating legal steps against persons/organizations accepting savings/deposits as banks or financial institutions without being licensed by Bangladesh Bank.

Source: Published in Bangla in "The Daily Star" on 3 September 2000.

Experimenting with Insurance

Microfinance NGOs in Bangladesh are gradually becoming interested in offering insurance products, particularly life insurance, to their existing credit and savings clients. Interest has been generated following the successful microinsurance experiences of a private sector provider, Delta Insurance (Box 2.4). A sample of 528 microfinance NGOs by CDF in December 1999 showed that 76 (15%) had some kind of insurance products, indicating that MFIs could possibly serve this market.

To date, provision of insurance by NGOs may still be regarded as being experimental. The premiums are calculated using rule of thumb rather than actuarial data or financial analysis. Most of those sampled by CDF charged 1–2% of the original loan amount; others charged Tk1 per week; and still others charged on a monthly or yearly basis.

In introducing this practice, microfinance NGOs are presumably following both a social agenda and a commercial one. The social agenda shows increased recognition of poor households' needs for protection against risk. Insurance reduces the vulnerability of households and increases their ability to take advantage of economic opportunities. Also, insurance reduces the impact of households' losses that could exacerbate their poverty situation. The commercial agenda assumes that insurance enhances the stability and profitability of poor households. It reduces the impact of client risk on loan and savings portfolios, generates additional revenue, and enhances services. Insurance supports risk management, reducing clients' vulnerability to economic stresses. Additionally, insurance is helping to build up a source of funds for the microfinance NGOs–a zero cost funding source because pay-outs are still very rare. Overall, this concept is giving the providers of this service the opportunity to cross-sell their clients other services.

The Grameen Bank also has a quasi-insurance product for its members called a loan insurance savings account. On the last day of each year, the borrower is required to deposit a small amount of money, 2.5% of the outstanding loan, into this account. In event of the borrower's death, the outstanding loan is waived and the premium paid is returned along with savings.

Box 2.4:

Delta Insurance's Microinsurance Product

Gono Bima (Popular Insurance) is a subsidiary of Delta Insurance, a private insurance company in Bangladesh. It markets a life insurance product that has been designed to reach many of the poor and has clearly benefited from the experience of MFIs like the Grameen Bank. The product itself is simple. It is a 10-year contractual savings account with fixed monthly premium payments leading to a one-time lump sum payment at maturity, with accumulated interest. The insurance element is provided by the guarantee that a full pay-out will be made if the insured person dies during the term.

The delivery mechanism is equally simple. There are no medical examinations and only minimal application procedures. *Gono Bima* rents simple office space in rural and urban centers, staffed by field workers who collect premium payments from groups of customers in villages and slums. The smallest monthly premium accepted is about $2.00. The office then relends the premium income to its customers in microloans with terms similar to those of the Grameen Bank.

Started in 1994, the *Gono Bima* service had reached many villages by 1997, when its premium income topped $4 million, and represented more than one fifth of Delta's total premium income. At the end of 2001, there were more than half a million microinsurance clients and more than 100,000 microcredit clients in the program, more than 50% of whom were women. However, poor repayment rates experienced with their microlending program raise questions about its viability.

Sources: Women's World Banking 2001; Matin, Hulme, and Rutherford 1999, p. 20.

COMMERCIALIZATION OF MICROFINANCE PROVIDERS

Dominance of Microfinance NGOs

The microfinance market is dominated by three large NGOs–BRAC, ASA, and Proshika. They account for 71% of the total amount of outstanding loans made by all microfinance NGOs and 41% of the entire microfinance industry (Table 2.2). Also, although more than 585 microfinance NGOs report to CDF (as at the end of 2000), the top 20 institutions account for 87% of the total amount of outstanding loans made by all such NGOs and 51% of the total amount of outstanding loans in the microfinance market.

The Grameen Bank and government programs are the other two major suppliers of microfinance. The Grameen Bank alone provides about one third of the total amount of outstanding microloans. Established as a bank by special charter, Grameen enjoys the ability to mobilize deposits and accounts for around one third of total savings mobilized by microfinance providers. In addition, 18 separate microcredit programs are carried out by as many as 13 government ministries and divisions. Membership in these government microfinance programs is estimated at about 15% of the total.

It is difficult to estimate the extent of private sector commercial bank involvement in microfinance but it is widely perceived to be quite low. Although a few banks may be anxious to reclassify much of their small loan portfolios as microfinance for public relations purposes, most would not qualify as such in the definition used in this report. Some short-term crop financing in amounts below Tk30,000 ($526) might qualify, but there are no reliable data on what proportion of such credit is accessed by the poor. For the most part, the banks shy away both from lending directly to the poor and from making wholesale loans to MFIs. The profit potential of microfinance is as yet unclear and the predominance of noncommercial MFIs undermines the incentives for private capital to enter the market. In addition, little competitive pressure exists in the formal banking sector for banks to begin microfinance operations. One exception is a microcredit program being run by the Islami Bank Bangladesh, Limited (Box 2.5).

Few Commercially Viable MFIs

Despite the outstanding achievements in outreach, few MFIs have achieved full sustainability, often equated with financial self-sufficiency. However, the two MFIs known to be financially self-sufficient have large outreach, totaling 4.6 million members and accounting for about one third of the total amount of outstanding microcredit. Based on year-end 2000 data compiled by the MicroBanking

Box 2.5:

Microcredit Program of Islami Bank Bangladesh, Limited

Islami Bank Bangladesh, Limited (IBBL) has a microcredit wing undertaking a rural development program for poverty alleviation. IBBL uses the basic Grameen model but, as its name implies, uses Islamic banking concepts that require it to invest through methods such as leasing and hire purchase rather than cash lending. There are mandatory savings of Tk5 per member per week. Loan repayments are in weekly installments, in terms of cost plus mark-up (12% on a declining basis, compared to the 14–16% declining rate of interest it charges on its more traditional loans), and the loan period is from one to three years. IBBL's microcredit lending program has grown rapidly in the last three years reaching 76,266 members (94% of whom are women) with outstanding loans of Tk332.0 million ($5.8 million) at the end of June 2001. The reported (cumulative) repayment rate on its microcredit program loans was 99%. However, it is unclear whether or not IBBL's microcredit activities are sustainable.

Source: Credit and Development Forum 2001a.

Bulletin and published by the MicroFinance Network with its members' permission, both ASA and BRAC have achieved full financial self-sufficiency (Table 2.4). The operational self-sufficiency (OSS)[46] and financial self-sufficiency (FSS)[47] ratios for ASA were steady at 134% and 120%, respectively (and expected to continue to rise, to 146% and 129%, respectively, by the end of 2001). Similarly, BRAC achieved an OSS of 111% and FSS of 104% (with both ratios expected to register 1–2% increases in 2001). Such achievements in sustainability are in large part the result of extreme cost efficiency and relative inflexibility with which both institutions operate. MicroBanking Bulletin data on BURO Tangail, a medium-sized NGO, indicate that for 2000 and several previous years, this institution has also been hovering around full OSS and about 80% FSS.

Grameen Bank performance details are indicative of most of the microfinance industry. At the end of 2000, the Grameen Bank had total outstanding loans of Tk12.6 billion (with 2.4 million members) and reported a profit of Tk11.1 million for the year, but only after taking into account grants worth Tk19.2 million. This suggests a net operating loss in 2000 of Tk8.2 million.[48]

Despite Grameen Bank's claims to the contrary, it is clear that if international accounting standards were applied, including adjusting for loan loss provisions and accounting for soft loans, the institution would be operating at a loss. As with most MFIs in the country, the Grameen Bank is dependent on foreign grants and soft loans and receives domestic subsidies (see also Table 2.5). In recent years, government-guaranteed bonds have become a relatively large share of its overall resources. These grants and soft loans include borrowings of Tk942.5 million from the International Fund for Agricultural Development at 2–3% interest per annum, and purchase by nationalized commercial banks of Tk6.5 billion and Tk2.0 billion worth of government-guaranteed, 4–10% interest-bearing bonds in 1994 and 1999, respectively. By imputing values to all the subsidies received by Grameen, it has been estimated that it would need to raise the nominal interest rate on its general loans from 20% per annum to 33% (both on a flat basis) in order to break free from subsidies.[49]

Despite widespread subsidy dependence of the microfinance industry, good performance by a few MFIs indicates the potential for a larger number of MFIs to move toward greater sustainability. The difficulty of raising lending interest rates in areas where competition for microcredit clients exists, however, means that most MFIs will need to find ways of improving operational efficiency in order to become more financially self-sufficient.

COMMERCIALIZATION OF FUNDING SOURCES

Increasing Reliance on Savings

The latest available data indicate that the largest sources of funds for microfinance NGOs are now member savings (25%), followed by soft loans from PKSF (23%), foreign donations (18%), service charges (16%), and local banks (10%) (Table 2.5).

The importance of savings is growing rapidly. Microfinance NGOs' income from interest included in service charges is also increasing and borrowing loan funds from commercial banks for onlending is also on the rise, albeit at a slower growth rate. These trends represent a shift away from grants to use of savings and other sources of funds, pointing to gradual commercialization of microfinance funding sources (Figure 2.1).

Limited Access to Commercial Funding Sources

There are few commercial sources of funds for MFIs other than client savings. Most MFIs are still heavily dependent on donor support. Neither the Grameen Bank nor the NGOs can access lines of credit from the central bank. Commercial banks are reluctant to lend to most microfinance NGOs mainly because of the latter's lack of a clear ownership structure, the perception that loans to the poor are inherently

Table 2.4: Selected MicroBanking Bulletin 2000 Indicators

	ASA	BRAC
OUTREACH AND INSTITUTIONAL INDICATORS		
Age of Institution (years)	22	26
Number of Offices	825	1029
Number of Active Borrowers	1,128,693	2,992,674
Women Borrowers (%)	94	100
PROFITABILITY		
Adjusted Return on Assets (AROA) (%)	3.7	0.9
Adjusted Return on Equity (AROE) (%)	10.5	2.6
Operational Self-Sufficiency (OSS) (%)	134.3	111.0
Financial Self-Sufficiency (FSS) (%)	120.4	104.3
EFFICIENCY		
Total Admin. Exp./Avg. Gross Loan Portfolio (%)	9.0	16.1
Salary Exp./Avg. Gross Loan Portfolio (%)	7.5	11.6
Other Admin. Exp./Avg. Gross Loan Portfolio (%)	1.5	4.5
PRODUCTIVITY		
Average Salary (multiple of GNP/Capita)	2.7	4.0
Cost per Borrower ($)	5.8	8.0
Staff Productivity	211.1	279.4
Loan Officer Productivity	323.4	336.3
PORTFOLIO		
Portfolio at Risk > 90 days (%)	0.5	2.0
Average Loan Balance ($)	65.0	49.0
Depth (Loans as a % of GNP/Capita)	17.6	13.2

Notes: $\text{Average Salary} = \dfrac{\text{Average Personnel Expenses + In-kind Donations}}{\text{GNP per Capita}}$

$\text{Cost per Borrower} = \dfrac{\text{Administrative Expenses + In-kind Donations}}{\text{Average No. Active Borrowers}}$

$\text{Staff Productivity} = \dfrac{\text{No. Active Borrowers}}{\text{No. Staff}}$

$\text{Loan Officer Productivity} = \dfrac{\text{No. Active Borrowers}}{\text{No. Loan Officers}}$

Source: MicroBanking Bulletin 2000 Statistics shared by ASA and BRAC.

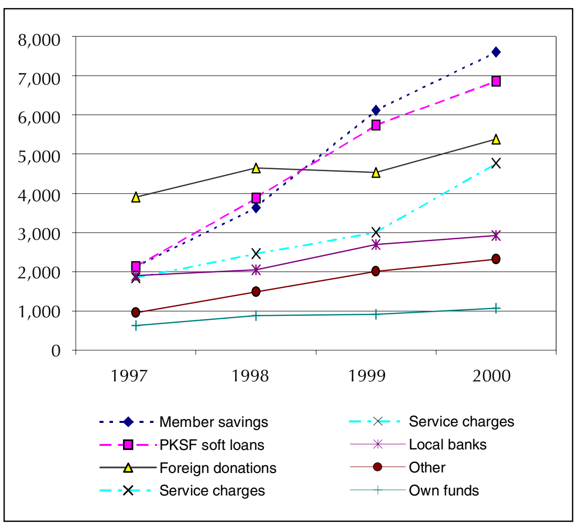
Table 2.5: Sources of Revolving Loan Funds[50] for Microfinance NGOs (Tk million)

Period	Number of NGOs	Grants	PKSF Soft Loans	Member Savings	Own Funds	Service Charges	Others[a]	Total RLF
end-1996	351	3,888	769	1,656			1,804	8,117
		(48)[b]	(10)	(20)			(22)	(100)
end-1997	380	3,907	2,128	2,126	627	1,853	2,228	12,869
		(30)	(17)	(17)	(5)	(14)	(17)	(100)
end-1998	495	4,644	3,83	3,637	888	2,48	2,654	18,164
		(26)	(21)	(20)	(5)	(13)	(15)	(100)
end-1999	533	4,534	5,738	6,114	913	3,004	3,793	24,096
		(19)	(24)	(25)	(4)	(12)	(16)	(100)
end-2000	585	5,384	6,863	7,607	1,067	4,768	4,184	29,873
		(18)	(23)	(25)	(4)	(16)	(14)	(100)

[a] Includes funds borrowed from commercial banks, ASA, BRAC, Proshika, and other sources.
[b] Numbers in parentheses are percentages representing the proportion of each type of source of revolving loan fund per year.

Source: Credit and Development Forum 2001b.

Figure 2.1. Trends in Sources of Revolving Loan Funds for Microfinance NGOs (Taka million)



Source: Credit and Development Forum 2001b, and previous years.

risky, and the lack of familiarity with NGOs' modes of operation. These factors result in banks' lack of confidence in assessing MFI creditworthiness.[51]

A few of the largest NGOs, however, have borrowed money from commercial banks at competitive interest rates and been able to run their microcredit programs at a profit. Enamul Haque, General Manager of ASA said that "Besides PKSF, we have also taken loans from other financial institutions like Agrani Bank and BASIC…We paid 9% interest to Agrani and 7% to BASIC. But this did not affect our financial health. This proves that it is sustainable to tap into the formal money market to help the poor." Agrani Bank is one of the seven national commercial banks. However, its Tk10 million loan to ASA was fully secured by ASA's headquarters building.[52] Aminul Alam, a Deputy Executive Director at BRAC, noted, "BRAC has also taken loans from banks. From Janata bank we had taken funds at 11% interest and from IFIC Bank at 9%. And we are planning to take fresh loans from AB Bank at a 9% interest rate. We have already repaid our loans to Janata." These statements indicate that perhaps with better MFI performance and greater transparency, commercial sources of funds for MFI onlending may become more available.

Support organizations such as CDF and the INCOME Project Phase III of CARE/Bangladesh, are helping this trend through the development of formal-semiformal financial linkages. The CDF is very actively involved in the process of linking its partner microfinance NGOs with commercial bank credit. It also provides referral services by sending the names of capable NGOs to PKSF for financial assistance. The focus of CDF's capacity building is indeed commercialization; it stresses operational and financial sustainability, product pricing/costing, cost efficiency, productivity, and eventually linking its partners with commercial sources of funds. The CARE INCOME Project component on building financial linkages focuses on creating linkages between microfinance NGOs and the commercial banks so that small and medium-sized NGOs are not forever reliant on funding agencies. CARE INCOME attempts to remove the obstacles that prevent mutually beneficial business relationships between these NGOs and commercial banks. CARE has approached Sonali Bank, Janata Bank, and BASIC Bank regarding this linkage and all the banks have shown willingness to cooperate. A credit guarantee will be the core business under this component.

The Grameen Bank's access to commercial sources of funds is the result of a provision to the Grameen Bank Ordinance added by the Bangladesh Bank in 1990, allowing Grameen to issue bonds and debentures guaranteed by the Government of Bangladesh. In 1995, Grameen floated $1.25 million of bonds in 3-, 5- and 10-year tranches, which were sold to four commercial and two private banks and guaranteed by the Government.[53] As noted earlier, Grameen Bank's ability to mobilize voluntary deposits legally from nonmembers allows the institution to grow while reducing its dependence on grant and other subsidized funding sources.