

# A Microcredit Crisis Averted: The Case of Bangladesh

Bangladesh’s microfinance industry, which grew large in the 1990s, continued to expand well into the new century, adding 15–28 percent active borrowers annually from 2004 to 2007. Then in late 2007 microfinance institutions (MFIs) began to worry that continued rapid growth could have negative consequences. In 2007, Shafiqul Haque Choudhury, the founder and president of ASA, one of the largest MFIs, remarked, “Excessive lending into a saturated market could cause a ‘train crash’ that might cause great sector-wide damage and burden borrowers with debts they did not need.”<sup>1</sup>

Bangladesh’s microfinance was on the verge of a sharp change in direction. The country’s big four MFIs—ASA, BRAC, Buro, and Grameen Bank, which constituted two-thirds of microfinance supply for the past decade—in aggregate stopped adding branches and staff around 2008 (Figure 1). The change in course happened without notice or wider public discussion, and before microfinance crises in other countries, such as Nicaragua, Morocco, and India, came to light.

Soon, the aggregate number of borrowers also stopped growing (Figure 2). The active borrower totals contracted modestly as the sector pulled back, closed some ancillary

loan products, and completed other house cleaning. The number of borrowers has plateaued ever since.

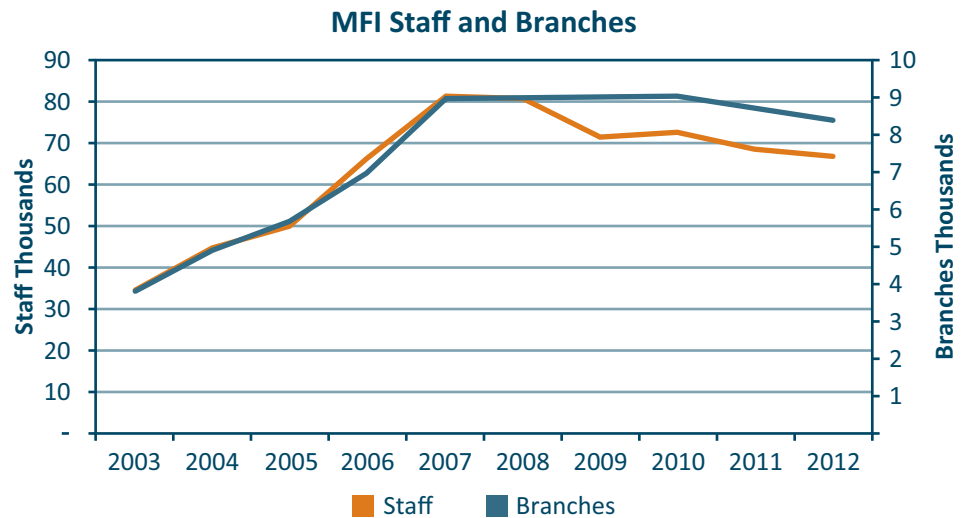
The slight contraction of branches and staff and the leveling off of customer numbers in turn affected the loan portfolios. Figure 3 shows their combined portfolio, and distinguishes the *microcredit* loans—to members of village groups—from *small enterprise loans* (SEL) to individual businesses. Interestingly, SEL rose from 10 percent of portfolio in 2003 to 30 percent by 2012, with the biggest shift happening during 2007–2008 just as microcredit lending slowed. Microcredit portfolios grew again in 2011–2012 as a result of a sharp increase in loan sizes, a step-change that is expected to level off, with loan sizes in the future stabilizing in line with inflation.

## The story behind the numbers

Why was growth so fast up to 2008? Why did the expansion of branches and staff suddenly stop in 2008? Why did the number of borrowers level off? How has the market adjusted? Was a crisis brewing but then averted?

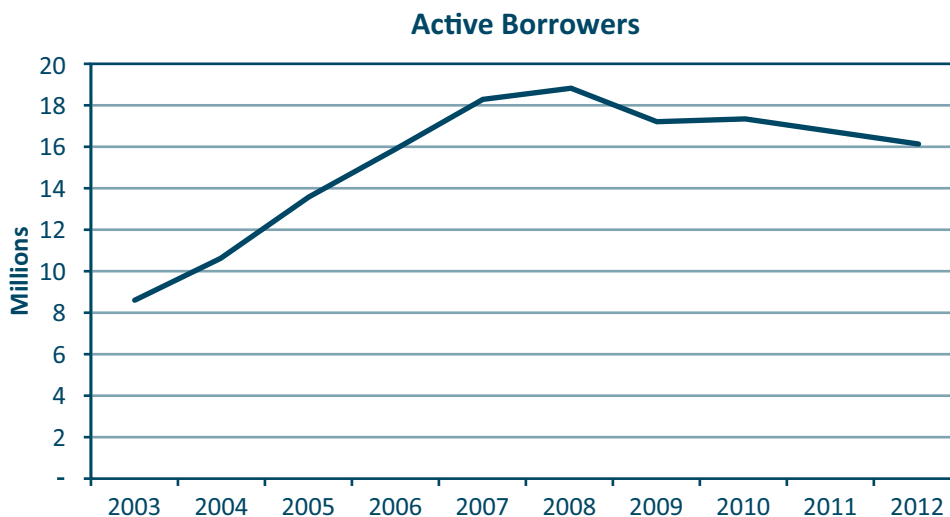
This Focus Note explores these questions. To see the full picture, we will describe not just how the

Figure 1. Staff and branch numbers, big four MFIs



<sup>1</sup> Stuart Rutherford interview with Choudhury in 2007.

Figure 2. Active borrowers, big four MFIs



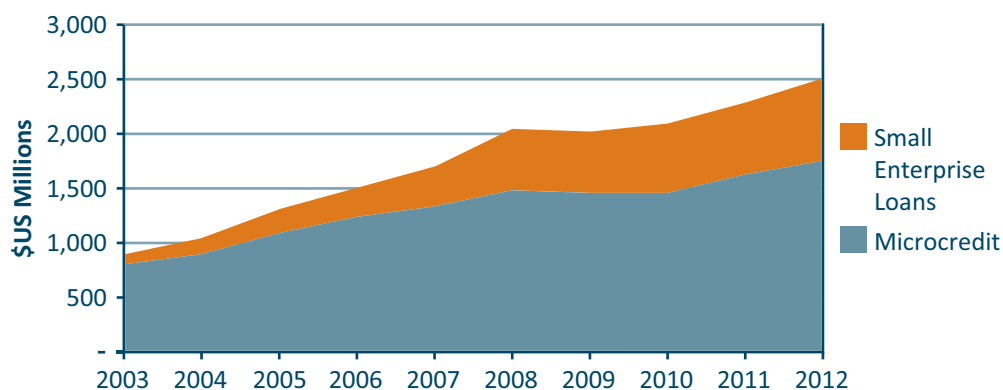
(Note: Aggregates borrower figures from all four MFIs and therefore double- or multiply-counts borrowers with loans from more than one MFI. Estimates indicate that borrowers with loans from more than one MFI are just over 30 percent nationally.)

MFIs behaved, but also compare the accounts given by MFI leaders with the views of their clients. Our aim is to describe the evolution of microfinance in Bangladesh over the past decade and to draw lessons from the sharp change in direction that began in 2008 as Bangladesh averted a crisis.

Our information comes from three sources. A decade's worth of financial and performance data were taken from audits and augmented by other

numbers provided by the four largest MFIs.<sup>2</sup> Several senior managers of each MFI were interviewed at length, and the MFIs also provided key internal policy documents. To add a demand-side perspective, 43 rural households were interviewed in depth during the first quarter of 2013 (summaries of each interview are available at <http://www.cgap.org/publications/household-interviews-bangladesh-2013>.) Combined these three sources of evidence provide a robust and balanced picture.

Figure 3. Gross loan portfolio, big four MFIs (constant 2012 \$US)



<sup>2</sup> The period 2003–2011 from audits, 2012 from provisional data provided by the MFIs.

The paper is arranged in six sections.

- I. An update describing how modern microfinance operates in Bangladesh.
- II. Explanations of why growth was so aggressive from 2002 to 2007.
- III. The story of how MFIs sensed a looming crisis and how they reacted between 2008 and 2010.
- IV. A description of the kind of crisis averted by MFIs and their clients.
- V. A summary of the explanations of how the crisis was avoided.
- VI. Identification of five emerging trends in microfinance in Bangladesh following the marked changes in direction of the 2008–2010 period.

## I. Microcredit in Bangladesh

The story of microcredit can be fully understood only within the context of modern Bangladesh, where economic and social conditions have been improving. While income levels remain low, there has been steady growth of 5 to 6 percent for the past decade that raised incomes to \$1,700 (per capita gross domestic product [GDP] on purchasing power parity [PPP] basis) by 2012. Many rural households enjoy new income streams from family members working overseas, or in factory jobs in the rapidly expanding ready-made garments industry. Strong development fundamentals have positioned Bangladesh as one of the few low-income countries on target to achieve its Millennium Development Goals (MDGs) (The Economist 2012). Roads have been much improved, and telecommunications have undergone a mobile-phone revolution. There is little doubt that microfinance's growth has been aided by the improving conditions, rising incomes, and expanding markets, especially in rural areas. We also believe that microcredit has made a large contribution to the improving conditions, especially as a means of engaging women more fully in the economic and political life of the country. As S. N. Kairy, the chief financial officer of BRAC aptly summarized, "The lives of rural people in Bangladesh are totally different than 20 years ago."<sup>3</sup>

The term *microcredit* originated in Bangladesh and refers to the provision of small, one-year loans primarily to rural women organized in groups. These loans are repaid in frequent, regular installments, and there has always been a savings element. Today, just as they always have done, loan officers visit villages regularly to collect loan repayments and savings deposits. But these outward continuities belie underlying fundamental changes. Any obligation for group members to repay loans for each other (joint liability) has disappeared; it's up to the loan officer to collect. Loan and savings payments are still collected at a set time in each village but increasingly groups do not meet as a body. Some members send their repayments through a neighbor or simply wait for the loan officer to appear at their doorstep. Savings, which were once fixed in value and compulsory, have become largely voluntary and more flexible.

These changes reflect the long experience of clients who are deeply accustomed to the rules and rhythms of microcredit, and who can choose among several competing MFIs. These factors have reduced the importance of meetings and group cohesion that were once central to microcredit.

The 43 household interviews conducted as background for this paper were selected randomly and not because they were known to be MFI clients (Box 1). The interviews reveal how widely available microcredit has become. Twenty-seven of the 43 households were actively borrowing, and held among them 51 MFI loan accounts. Sixteen households were borrowing from more than one MFI. Any of the 43 households could have taken a loan from an MFI at any time.

The client interviews are a reminder that Bangladeshi microcredit functions in an environment where clients are well experienced with a service that has been widely available for over a generation. Many current microcredit users had mothers or even grandmothers who were MFI borrowers. The interviews also reveal how many borrowers carefully weigh the tension that comes from having to meet the regular, frequent repayments required of microcredit.

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<sup>3</sup> Unless otherwise noted, all quotations are from interviews with the authors conducted for this paper between January and May 2013.

### Box 1: Snapshots of Rural Households and Microcredit

To incorporate a client-side perspective on modern microcredit 43 rural households were interviewed in depth in the first quarter of 2013. Twenty-five are from central Bangladesh, which is more commercially active and highly competitive for microcredit; the rest are from southwestern Bangladesh, where MFI competition and economic activities are moderate.

Summaries of the interviews are available at <http://www.cgap.org/publications/household-interviews-bangladesh-2013>

The number of households interviewed was small, and the data obtained cannot represent Bangladeshi rural households generally, but the interviews do capture the feel and flavor of microfinance in this era. The individual households were selected by walking into random villages to find respondents. Homes that were obviously wealthy were bypassed, but other than that interviews were held with any household that was available and open to talk. The interviewers described themselves as researchers on rural livelihoods and did not mention microfinance until well into the interview. Afterwards, the respondents' verbal consent to use the interview and photos was obtained. Normally only one interview was taken in any one village; however, exceptions were made in two cases where there were particularly interesting and relevant respondents.

#### The households—basic demographics

Average household size was 5.4, adults had an average of 3.8 years of schooling, and almost all school-age children up to age 15 were in school. Nine households were headed by women: six of them were widows; three were deserted by husbands. Respondents were both Muslim and Hindu.

The households had an average of just under two active income earners each. Most employment was in daily and casual wage labor, small shops and businesses, farming and livestock rearing, and rickshaw driving. Most households had more than one source of income, though some were occasional or seasonal.

When asked to rank themselves 24 (58 percent) thought they were "middle income," 16 (37 percent) described themselves as "poor," and 3 (7 percent) thought of themselves as "very poor." Thirteen households had no land whatsoever. Of the remaining 30, nine had their own crop land and 21 had homestead-land only (of these, several farmed land that they leased or share-cropped). Ten households (23 percent) were getting remittance income from someone overseas or from a large city; several more were trying to arrange for someone to work abroad.

The households' relationships with MFIs are as follows:

<b>Households randomly surveyed</b>	<b>43</b>	
<b>Households with MFI membership/savings ever</b>	<b>41</b>	<b>(95%)</b>
<b>Households with MFI membership/savings at the time of the interview</b>	<b>36</b>	<b>(84%)</b>
<b>Households with a loan from one MFI</b>	<b>11</b>	<b>(23%)</b>
<b>Households with loans from two MFIs</b>	<b>11</b>	<b>(23%)</b>
<b>Households with loans from three or more MFIs</b>	<b>5</b>	<b>(7%)</b>

#### The households' use of financial services

All 36 current MFI users held savings at their MFIs, averaging about \$160 each. Three households held savings of more than \$500 (one had more than \$1,000). These larger savings are mainly held in the very popular commitment savings plans. Some held MFI savings only because they were required to. Few households reported anything more than trivial levels of savings in cash at home. Five households were using private saving clubs.

Three households held loans from formal banks, and five held policies with formal insurance companies (others had policies that had lapsed). Fifteen households held interest-bearing loans from private non-MFI sources, many others had done so in the recent past, and many of these loans were large relative to MFI loans. Several households were using MFI and private loans in combination (using MFI loans to pay off, bit-by-bit, large private loans, or using private loans to cover MFI repayments in times of stress). Almost everyone participated in the neighborhood-level exchange of interest-free loans—for day-to-day expenses (including paying MFI dues) or for small-to-medium scale expenditures. Some had borrowed large sums from relatives for purposes such as sending people overseas to work. Most borrowing and repayment is in cash, but some farmers use traditional "paddy loans"—borrowing in cash to buy inputs and repaying in paddy. Pawning jewelry and mortgaging land were also reported. The interviews confirmed what we are coming to know well: financial lives are complex, varied, and rich in the range of instruments used.

#### Three striking themes from the interviews

**Experience leads to more careful use of MFIs.** Many households reported that they had reduced the number of MFI accounts they held, or the number of loans, or both, saying that experience had

taught them to moderate their borrowing. MFI staff, several of whom we also interviewed, unanimously reported that their members have become steadily “more conscious”—meaning more judicious in taking and using loans, and are better able to manage repayments.

**Strong demand for savings services.** The percentage of members who want to use MFIs to save rather than borrow is growing. One regional MFI in central Bangladesh told us that “fifteen years ago members begged us for more loans: now we beg them to

take loans.” In his branch, less than 70 percent of members are borrowing.

**MFI borrowing can be stressful.** Many interviews described the tension involved in MFI loan repayments, and this was one of their main reasons for taking fewer or smaller loans. This stress is aggravated by the tenacious loan collection methods employed by most MFIs—especially afternoon or evening visits by motorcycle by loan officers working in pairs, who refuse to leave a late-payer’s home until at least a token payment is made.

### ***Beyond Microcredit***

Within Bangladeshi microfinance, microcredit remains dominant. But new services are developing quickly. Some years ago MFIs became distribution networks for inward foreign remittances. The demand for savings, as indicated in Box 1, is growing, and MFIs are responding with a broader range of flexible short-term and disciplined long-term plans. On the credit side, the largest addition has been SEL, as Figure 3 revealed. In the 1990s, MFIs began to prioritize small enterprises as a way to promote off-farm businesses and rural value chain linkages that could generate larger income and more employment. Small enterprises are seen as a way to diversify local economic development beyond promoting the smaller activities at the household level that are the targets of microcredit (Wood and Sharif 1998).

Another new market segment arose in the 1990s from a realization that the very poorest households were not being reached by microcredit—the “bottom 20%.” To reach the destitute, wider livelihoods support strategies were developed. There are a number of ultra-poor programs, but the best known is BRAC’s Targeting the Ultra Poor (TUP) approach replicated in several other countries.<sup>4</sup> TUP couples access to savings with livelihoods development and safety nets.

One of the newest services in the microfinance industry is mobile phone banking offered by

commercial banks rather than MFIs. Because of the massive growth of mobile phone subscriptions, these services are increasingly available to the same market segments served by microcredit and SEL.

### ***Supply—highly concentrated in four providers***

There are well over 600 formal microfinance providers in Bangladesh licensed by the regulator, but the largest four dominate the market. Table 1 presents data on each individually and collectively as a proportion of the entire market. The big four make up one-half to three-quarters of microfinance supply. There are many regionally based MFIs that clients mention in field discussions, but these large four organizations have wide name recognition across Bangladesh.

These largest four have many similarities, including a deep grounding in promoting national development following the country’s independence struggle. Each has a strong nonprofit orientation,<sup>5</sup> and they all provide a similar group-based microcredit product as their primary service. At the same time, each has distinct features and backgrounds:

- **ASA** was founded by Shafiqul Haque Choudhury and a small band of colleagues as a nongovernment organization (NGO) in 1978 promoting the social and political empowerment of the poor. In 1991

<sup>4</sup> CGAP and the Ford Foundation have partnered to test adaptations to the BRAC approach in eight other countries and 10 pilot sites.

<sup>5</sup> Technically, Grameen Bank is a shareholding entity, but member-shareholders own a large majority, and it has typically had a return on assets lowest among the four.

**Table 1. Largest Four MFIs and the Microfinance Market (2012)**

	ASA	BRAC <sup>a</sup>	BURO	GRAMEEN	4 MFIs as % of All MFIs <sup>b</sup>
Loan Portfolio (\$US Millions)	636	750	110	997	65
Savings Deposits (\$US Millions)	262	311	42	1,628	86
Branches	3,025	2,120	625	2,567	49
Active Borrowers (Millions)	4.2	4.4	1.0	6.7	72
Microfinance Staff	20,969	17,700	5,447	22,621	53
Year of Launch of Microcredit	1991	1974	1991	1976	—

a. BRAC's figures include only full-time microfinance staff, though shared services staff (e.g., accounting and finance) would increase the full-time equivalent head count.

b. Percentages based on large four MFI figures for 2011 as a proportion of industry totals from Bangladesh Microfinance Statistics, 2011, Credit and Development Forum & Institute of Microfinance

it turned single-mindedly to becoming the world's most efficient MFI. In 2006 ASA launched ASA International, which now owns and operates affiliates in eight countries and is in the process of establishing several more.

- **BRAC** is one of the world's largest NGOs and was recognized by the *Global Journal* in 2013 as the top NGO globally. BRAC was founded by F. H. Abed in 1972 with a mission to fight poverty through large-scale basic health and education interventions, in addition to microfinance. In 2002 BRAC launched operations internationally, and today operates affiliates in 10 countries.
- **Buro Bangladesh** was founded in 1991 by a small group of people led by Zakir Hossain who had fought in Bangladesh's liberation war. It is the smallest of the four MFIs featured here, but has recently surpassed 1 million client members. It started as a regional player but now works at a national scale. Buro has a reputation for innovating flexible pro-poor savings services.
- **Grameen Bank** pioneered modern group-based microcredit in the late 1970s. In 1983 a unique ordinance established it as specialized bank for the poor. It was initially capitalized from government sources, and later primarily from shares of borrower-clients, or members. The Bank and its founder Muhammad Yunus won the Nobel Peace Prize in 2006. In 2010 Yunus fell into dispute with the Bangladesh Government and resigned from the post of managing director in May 2011.

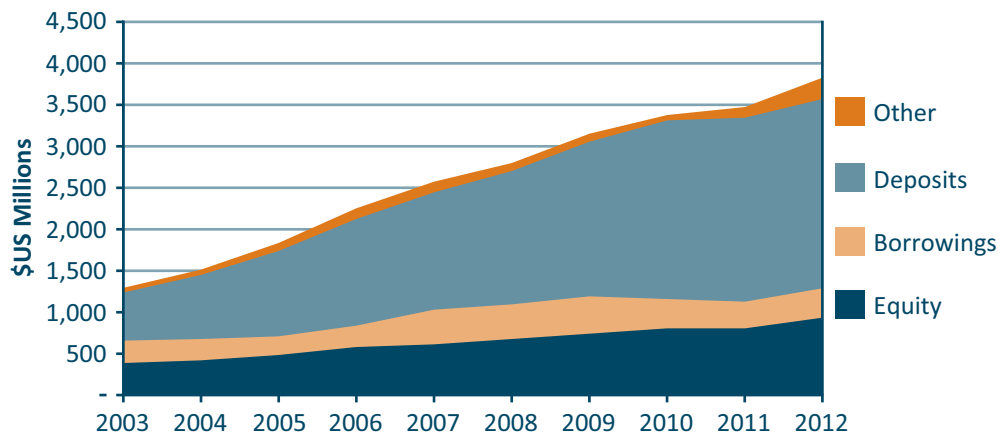
## II. Infectious Growth

By 2002 microcredit in Bangladesh was already two decades old, very large, and well-tested. Bangladesh had shown not only how to establish microcredit but how to scale it up. A number of set-backs had been overcome. In particular, disastrous flooding in 1998 and several years of injudicious ratcheting up of loan sizes had combined to damage the portfolio of the flagship program, Grameen Bank (Yunus 2002). But Grameen bounced back by 2002 with Grameen II, a redesign of its products that brought some welcome flexibility to its lending. ASA had grown to become one of the largest MFIs in Bangladesh with among the lowest costs anywhere. BRAC already had a large microcredit program and was expanding its SEL portfolio aggressively, alongside its large-scale health and education work. Buro was moving beyond its home district of Tangail to establish a wider national presence. Microcredit was in good shape, and a euphoric period of even faster growth set in between 2002 and 2007.

### To grow, MFIs had to raise new kinds of commercial capital

In the 1980s and 1990s international donors helped launch microcredit, often by funding poverty projects with grants. In 1990 the Government of Bangladesh set up Palli Karma-Sahayak Foundation (PKSF), an apex designed to wholesale funds to microcredit,

**Figure 4. Sources of funding, all four MFIs (constant 2012 \$US)**



Note: PKSF's loans to MFIs amounted to about \$400 million in 2011, PKSF Annual Report 2011.

and later the World Bank and other donors provided it with financing of over \$400 million (Forster, Duflos, and Rosenberg 2012). PKSF loans fueled the growth of many MFIs in the 1990s. Among the large four, ASA and BRAC borrowed from PKSF heavily while Grameen began with loans from other sources, such as IFAD.

But in the new century the growth ambitions of MFIs outpaced what PKSF or donors alone could provide. The four MFIs began to cultivate new sources of funding. Grameen II mobilized ample savings not just from borrowers but also from the general public, and today the Bank holds savings worth more than one-and-a-half times its loan portfolio. ASA demonstrated how cost-effectiveness can generate large surpluses, and by 2007 it was financing its loans almost entirely from retained earnings and deposits. BRAC also mobilized deposits from clients but began to command loans from domestic commercial banks in almost equal amounts. The funding vehicles became more sophisticated: BRAC, for example, opened a securitization window in mid-2006. Buro arranged a syndicated loan from a bank consortium to fund its national growth strategy.

With more capital raised from private savers and from bank loans, Bangladesh microfinance has become increasingly commercial. However, although

Grameen Bank has member-shareholders, none of the four MFIs has ever sold equity to outsiders, so management has never had to respond to the expectations or timelines of external investors. Thus, while Bangladeshi microcredit was able to grow large by tapping into commercial borrowings and savings, the four large MFIs retained a nimbleness that helped them to adapt quickly and avoid a crisis.

### **But, why did MFI management choose to grow so fast?**

Even though conditions were conducive and ample funding was found, there was no imperative for MFIs to continue to grow or to grow at a fast rate. MFI boards and managers controlled their own destiny, so why did they decide to grow so fast from 2002 to 2007?

#### ***Ambitious, intensely competitive institutions***

Many of Bangladesh's MFI leaders came to the fore following a bloody war of independence in 1971 and a famine in 1974 that left their country in chaos. Their sense that "something must be done for my country" went beyond do-gooder sentiment and drove an ambition to make a contribution at the national level. As F. H. Abed, the founder of BRAC, says, "Small may be beautiful, but large is necessary." The imprint of the founders' ambitions remains deeply embedded in their respective organizations.

Ambition is a large part of what makes these organizations so formidable and influential, and it fosters competition among them that has only intensified as each institution has grown. Sheer size—especially the number of clients—soon became the popular measure of inter-MFI rivalry. Buro, once a regional player, became determined to establish a national presence and measure itself against the giants. ASA was a late starter, having begun with an ideological preference for social over financial empowerment, but once it decided, in 1991, that microcredit was the most effective way to help millions of poor people, it grew fast. By 2002 ASA was snapping at the heels of BRAC and Grameen, and during the 2002–2007 “growth spurt,” it caught up with them, at least in terms of the number of its clients and branches.

MFI management knew that the industry was already large and that there would eventually be a ceiling to microcredit expansion: that sooner or later the market would peak and growth would slow. But that only intensified their efforts to claim market share before saturation was reached. It became a “race to the edge.” As Mosharraf Hossain, director of finance at Buro Bangladesh explained, “We continued to expand our operations rapidly from 2005 through 2010 to achieve our goal to be a nationwide microfinance organization. We knew that overlapping (multiple borrowing) was increasing but we felt that despite this that we were experienced and could handle things.”

#### **International encouragement**

The domestic ambitions of the MFIs fueled growth, but international encouragement greatly magnified it. In 2002 Bangladesh’s major MFIs were the world’s biggest, and among the most efficient. Their managers regularly showcased their work at international events. Their scale and efficiency were praised, promoted, and tracked by organizations such as the Microcredit Summit, CGAP, and MIX. The United Nations declared 2005 the Year of Microcredit. In 2006 Muhammad Yunus and Grameen

Bank won the Nobel Peace Prize, and in 2007 ASA was recognized by *Forbes Magazine* as the top MFI globally. Such attention naturally spurred the Bangladeshi MFIs to become even larger.

#### **New microcredit regulation**

Regulation also played an important, if unintended, role in accelerating growth. In 2006 Bangladesh’s parliament passed the Microcredit Regulatory Act, creating for the first time an independent authority to oversee all microcredit operators except Grameen Bank.<sup>6</sup> When the new Microcredit Regulatory Authority (MRA) began floating possible regulations in 2007, it proposed that MFIs would need MRA permission for each new MFI branch. The idea was later discarded, but by then it had provoked a reaction by MFIs who rushed to set up branches in advance of receiving their initial licenses. BRAC was particularly aggressive, leaping from 1,500 to 2,900 branches during the second half of 2007 just before it received its license in late November that year. Medium and small NGOs also set up additional branches in this period, and some NGOs turned to microcredit for the first time, in part to ensure themselves a source of income as a licensed provider. From the end of 2007 to the end of 2008 MRA licensed nearly 400 MFIs and would license more than 200 in subsequent years.

### **III. Reaching the Limits of Microcredit**

No one told Bangladesh’s biggest MFIs to stop the expansion of microcredit abruptly in 2008. There were no directions from regulators or government, nor recommendations from industry bodies. There were damaging cyclones in 2007 and 2009, but they were less severe than others in Bangladesh’s history, and their effect on microcredit was not serious enough to be part of decisions to slow growth. The dispute between Yunus and the government was still some years off and only came to the surface in 2011. Global encouragement was undiminished—internationally in 2008 growth remained the watchword, and this was the era that saw a rapid influx of new investment

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<sup>6</sup> This did not include Grameen Bank, which fell under its own ordinance.



vehicles for microfinance. Yet, Bangladesh microcredit began to slow well before microfinance problems in Bosnia, Morocco, Nicaragua, or India emerged. The Bangladesh slowdown also preceded the international financial crisis that began in late 2008.

Moreover, the slow-down was not coordinated among the big players, nor did they act at exactly the same time. For example, in mid-2007, just as ASA started to back-pedal, BRAC began the biggest branch expansion in its history. But by mid-2008 these late spasms of growth had ended, and aggregate branch and staff numbers stopped growing. Only Buro, which had taken on large bank debt and needed to deploy it quickly, bucked the trend, and did not slow growth until 2010.

MFIs slowed their own growth in reaction to two main problems:

- First, they began to sense the negative consequences of market saturation of the core microcredit market.
- Second, they became more aware of the management problems created by the rapid growth of 2002 to 2007.

### A crowded market

Market saturation occurs when the provision of a service reaches the limits of a targeted client segment's effective demand, but this concept is difficult to measure. In Bangladesh in 2007, MFIs had still not reached some villages in remote areas, and many of the poorest households were left out of microcredit. SEL lending and the ultra-poor programs were still well short of the total demands of these market segments. But the supply by MFIs to their core targeted client segment of basic *microcredit*—loans to women from low-income households in rural areas—had come very close to saturation. Nearly every target rural household who wanted a loan already had one or more than one. Nearly every household had been a member or borrower at some time in the recent past.

### Box 2. The Size of Bangladesh's Microcredit Market

The local microfinance industry body, the Credit and Development Forum (CDF), collected data from some 612 MFIs in 2008, and reported a total of 24 million borrowers.<sup>a</sup> After adjusting for estimates of multiple borrowing (clients with loans from more than one MFI), there were about 17 million unique individuals borrowing, from about 15 million households. By this estimate nearly half of Bangladesh's 33 million households had loans from MFIs. Since low-income households are the primary target, the level of coverage among that subgroup must have been even greater. In terms of the percentage of targeted borrowers reached, microcredit must surely have been very close to full saturation. Sanjay Sinha of MCRIL offers a very similar analysis based on 2009 data.<sup>b</sup>

a. Microfinance Statistics 2009, Institute of Microfinance and Credit and Development Forum, Dhaka

b. Bangladesh Microfinance Review, August 2011, BRAC Development Institute

Our random interviews of 43 low-income rural households in early 2013, when the number of borrowers was similar to 2008, showed that every household that wanted a microcredit loan either had one or could have easily have obtained one. Of the 43, only two households had never been MFI clients. Thirty-six households held MFI memberships (and therefore MFI savings) at the time of the interviews. Of these, 27 were borrowing and among them had 51 loans.

### *Differing views on the benefits and risks of multiple borrowing*

Multiple borrowing—borrowing simultaneously from two or more MFIs by a single borrower—had long been noticed in Bangladesh, where it is commonly referred to as “overlapping.” In 2001 Wright, Christen, and Matin noted that “[c]lients are now able to choose between as many as five or more MFIs in many villages, and multiple membership of MFIs has risen to unprecedented levels.”

Since that 2001 report the industry had expanded massively, and by 2007 multiple borrowing almost certainly had increased, with some estimates indicating that just over 30 percent of borrowers had loans from more than one MFI (Khalily and Faruquee 2011).

Shafiqul Haque Choudhury, president of ASA, certainly thought so. Alerted by reports from his staff, he made an incognito visit to some ASA clients and found in his words a “horrifying situation”: some of them held loans from three, four, or even five MFIs. Choudhury took a straightforward view, “if borrowers take too many loans they will run into repayment problems, and would stop repaying me or someone else.”

Not everyone shared Choudhury’s fears. Shameran Abed, associate director of BRAC’s microfinance programs notes, “BRAC was sensitive to multiple borrowing, but we were also confident that our experience equipped us to manage this reasonably well.” Some in the industry noted that multiple borrowing has merits, arguing that it allows borrowers to better manage cash flows and it spreads repayment risk among the MFIs. Research shows that households need to form more than one lump sum each year, and therefore access to loans more than once a year can be helpful. Mosharoff Hossain of Buro notes, “We’ve long been aware of multiple borrowing, and have sent senior management teams out to see how many passbooks our borrowers keep. We determined that in most cases it was not risky and therefore carried on to reach our targets up through 2010.”

#### ***Collective action failed. . .***

ASA, however, remained anxious. In late 2007 ASA, BRAC, Buro, and Grameen Bank set up an informal discussion forum attended by senior managers.<sup>7</sup> The main agenda was how to manage multiple borrowing. ASA, motivated by its fear that over-supply could lead to a repayment crisis, argued for a division of territory, and suggested reciprocal closure of branches in over-served areas. This earned a tepid response. The others did not share ASA’s level of concern. Moreover, Grameen’s Mohammad Shahjahan says it has always been the Bank’s philosophy that “clients are better off if they have a choice between competing MFIs.” There was also a collective action dilemma—the fear by each MFI that if it were to close branches its rivals

might go back on their promises to do the same. The forum also discussed setting up a credit bureau, but this, too, failed to gain momentum at the time. The meetings were convened regularly for a year or more but were eventually quietly abandoned. Competitive rivalry dampened any potential collective response.

#### ***Instead, each MFI slowed growth in its own way. . .***

ASA was the first big MFI to take unilateral action. In mid-2007 it halted the growth of its branch network. The halt was ostensibly to allow time for new computerization to be embedded; but it was never reversed once that goal had been achieved. ASA’s branches peaked at 3,334 in 2007 and have declined slowly to 3,015 by the end of 2012. This decision was driven by ASA’s worries about multiple borrowing, but reinforced by a rise in delinquency ASA experienced late in 2007. The circular that ASA sent to its field staff announcing the cessation of any further branch openings also instructed branch managers to discourage multiple borrowing by cutting the number of clients per worker and to slow down client recruitment, “even if this means that total member numbers go down.” To provide added security against potentially delinquent loans, clients were to be told that they must open an additional commitment savings account if they borrowed more than \$200. Despite this decisive early action, ASA still had some doubts. Enamul Haque, then ASA’s executive vice-president of operations, recalls, “I felt that we were losing our edge when growth slowed and we could regain client and staff enthusiasm by resuming growth.” This view has almost won out as ASA has reconsidered its strategy periodically, but cooler heads have prevailed and the slowdown has remained in place.

Just as ASA put an end to the opening of new branches, BRAC was entering its final sharp growth spurt in advance of receiving its MRA license in late 2007. But shortly thereafter BRAC ran up against a clear sign of market saturation: word filtered back from the field in early 2008 that many of the newly opened branches couldn’t recruit enough clients

<sup>7</sup> This included key lieutenants from among the senior ranks of each MFI: Sushil Ray of ASA, Shabbir Choudhury of BRAC, Mosharoff Hossain of Buro, and Dipal Chandra Barua of Grameen Bank.

to achieve the minimum loan portfolio to reach breakeven. Kairy, BRAC's chief financial officer, recalls, "We were pushing to meet disbursement targets to achieve the necessary portfolio size, but some areas were simply not viable."

BRAC's growth spurt happened just as BRAC was expanding its international operations from one to eight countries, stretching senior management very thin. Within management ranks there were also increasingly divided views on the health of its microcredit operations. Some noted that those high growth figures temporarily masked underlying problems, and this concern gained traction when delinquency rose markedly in 2007 and 2008. By mid-2008 BRAC slowed growth but it was only by late 2009 that it made significant changes. Senior management installed a new and younger team to manage BRAC's microfinance operations and usher in a series of reforms. The reforms had many elements, but importantly BRAC scaled back from a peak of 2,900 branches in 2008 to fewer than 2,200 by the end of 2012.

For ASA, slowing growth also meant dropping a product. To boost its client numbers ASA had launched guardian loans in 2005—loans to the husbands or fathers of its female members, putting a second loan into borrowers' households. It found these loans hard to collect, and began to phase out the scheme in 2009, contributing to the slight decline in active borrower numbers.

By the end of 2008 Grameen Bank also slowed new branch openings, and its branch network has remained almost unchanged since then. Its managers did not share the same level of concern as those at ASA and BRAC. Grameen believed that multiple borrowing was moderate, with high levels confined only to a few districts. Its branch growth had been steadier than BRAC's in part driven by Grameen's savings products, which provided the resources to open new branches according to the steady rise in deposit levels. But like BRAC, Grameen saw reduced demand for group membership and microcredit, and began to relax the recruitment targets it gave its staff. Mohammad Shahjahan, Grameen's acting managing director, points out that the Bank's mission was always to

ensure that poor people got access to credit, so that "when we saw this ambition being fulfilled through our own work and that of other MFIs, we were happy to shift from fast growth to improving quality."

Buro, the smallest of the four, continued to grow until 2010. Its ambition was to achieve a national presence, but it was also obligated to grow due to the large bank loans it had taken. Buro's slowdown came by 2010, once its size targets had been achieved and in reaction to deteriorating performance.

### **Management problems in the wake of growth**

While market saturation was an important reason to slow growth, many of the problems that arose were caused not so much by saturation as by the torrent of growth from 2002 to 2007. As those problems emerged, the MFIs devoted much time to solving them, creating a second and more sustained phase of moderation. In particular, MFIs focused on re-establishing credit discipline, fixing staffing challenges, improving internal controls, and repairing their finances.

#### ***Re-establishing preloan credit discipline***

Credit discipline begins with attracting suitable borrowers. Bangladesh microcredit had always been focused on poverty alleviation, preferring to take on clients that matched a target poverty profile. This approach worked well enough when microcredit was in short supply and growth was moderate. But in the fierce competition of the years leading up to 2008, the pressure on staff to achieve recruitment and disbursement targets over-rode any doubts about whether they should take on this client or give a big loan to that one. Growth targets over-rode good judgment.

The first reactions to trouble focused on delinquency management. ASA hired a senior ex-police officer who called on his old colleagues in the districts to help staff bring pressure on bad payers, and he developed an intimidating-looking "contract" that overdue borrowers were asked to sign. All the MFIs appealed more strongly for help from community

leaders. BRAC formed a dedicated collection team to follow up on serious overdue payments. ASA emptied its executive floor in its Dhaka headquarters, sending all the directors to live in the field for months at a time, to lead the fight against delinquency.

These (*ex post*) measures to follow up on delinquency were only moderately effective, and it was fixing (*ex ante*) preloan checks on borrowers that repaired portfolio quality over time. From 2008 ASA told loan officers not to recruit clients who they knew to have loans from other MFIs, something they had turned a blind eye to in the past. BRAC developed new preloan documentation that required staff to more thoroughly investigate the livelihoods of would-be borrowers. Critically, the number of branches and branch targets were reduced, making it possible for staff to use more discretion in picking new borrowers.

#### ***Shoring up staff capacity and compensation. . .***

The pace of growth also meant that MFIs found it harder and more expensive to recruit staff. In late 2007 BRAC grew its staff numbers by almost 50 percent and found it difficult to fill mid-level positions with qualified people. ASA, which had just added an extra staff member at each branch to run its new computers, also felt compelled to raise salaries, and its staff expense ratio surged. Investments in staff and training added to operating expenses. (See Figure 5.) These weakened financial performance in the short run, but were critical investments to re-establish the quality of operations.

#### ***Improving internal controls***

Grameen Bank also focused on improving its lending and recovery processes. Passbooks, for example, have fewer errors than they did four or five years ago. Similar improvements have been made by the other big MFIs. Buro says its passbooks used to be “messy”; now it has them reconciled in public, at the weekly meetings. BRAC was dismayed to find that an uncomfortably common practice of disbursing “ghost loans” had grown up among target-driven staff. Loans were “disbursed” to false names, so that their proceeds could be used to make up the overdue amounts of other clients. This practice manipulated repayment and disbursement targets. Shameran Abed of BRAC notes that “when we went to investigate we found that ghost loans amounted to less than 2% of portfolio, but more troubling than the amount of money involved were the signs of the pressures staff were under to meet targets, and our own lax oversight. Until we changed our attitude we were at risk of this problem growing worse.” BRAC tackled this problem by requiring branch accountants, who reported up a different chain of command than loan officers, to process loan disbursement paperwork and verify customers. At the same time it doubled its monitoring unit and filled many vacant positions in its internal audit unit. It also closed a loophole that let staff withdraw savings to make up for late loan repayments without having to get the consent of the client.

Buro found that some loans nominally disbursed to group members as individuals ended up in the

**Figure 5. Operating expenses as % of gross loan portfolio, all four MFIs**

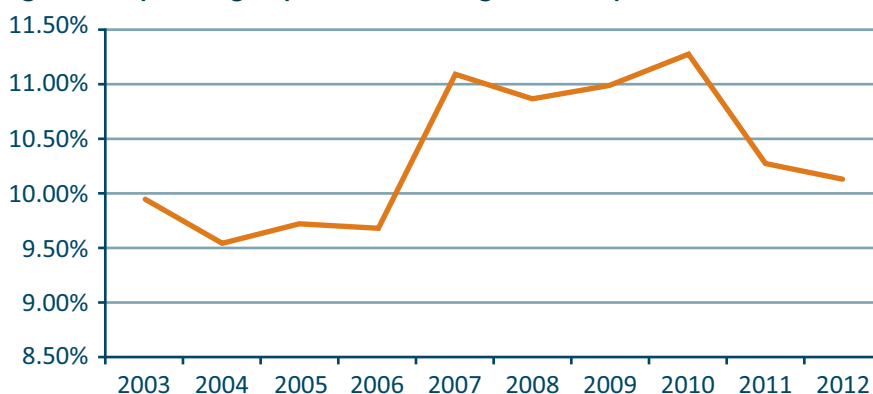
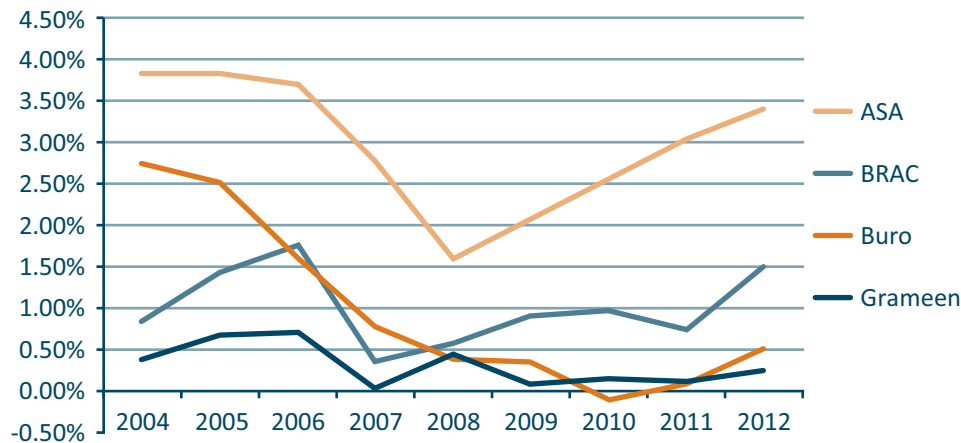


Figure 6. Return on Assets, big four MFIs



Note: Grameen Bank's loan interest rate has long been the lowest of the big four

hands of just one or two members, often from elite households. It stopped this practice by staggering disbursements and instituting pre- and post-loan checks on borrowers.

#### **Bracing for a financial hit**

MFIs in Bangladesh are not backed by deep-pocketed investors who can pump in cash on short notice, and therefore keep a very sharp eye on their finances. As they discovered and then set about correcting problems, MFIs braced themselves for a period of worsening performance. Each of the four organizations experienced a rise in its own delinquency measures.<sup>8</sup> For ASA it happened by end 2007; BRAC and Grameen Bank were affected during 2008. Buro's difficulties surfaced most visibly later in 2011, after it had achieved a national presence.

The MFIs took several measures to handle the financial downturn. All of them slowed the increase in loan size during 2009 and 2010, and pressured staff to increase deposits mobilized. Savings provide a buffer against default by allowing MFIs to adjust savings against loans that were overdue. MFIs also upped their provisioning to strengthen their loan loss

reserves. Attitudinally, they prepared themselves for the downturn. For instance, the managers of BRAC's microfinance program gave advance warning to senior leadership of a coming period of lower growth and poorer performance. Importantly, management of all the MFIs understood that a short dip in performance would be necessary to get them back onto stable footing over the longer term. In the end their performance did suffer, especially in 2008 and 2009, but by 2011 and 2012 the overall performance in the sector had been largely restored to solid footing.<sup>9</sup>

## **IV. What Kind of Crisis Was Averted?**

In hindsight, the signals of impending trouble were clear by 2007–2008. But signals that become obvious later are often invisible or overlooked or brushed aside at the time. Financial crises can take on unpredictable dynamics. A reaction by a market player may be misunderstood by others who may feel compelled to take action to protect themselves even at the expense of the wider public interest. There can be a precipitous loss of confidence by

<sup>8</sup> MFIs in Bangladesh each measure delinquency, but their systems for doing so are not uniform, making it difficult to offer comparable delinquency figures.

<sup>9</sup> A review of multiple years of loan delinquency measures, loan loss provisioning, and write-offs tells a consistent story about a rise in problems around 2008 and improvements since then.

borrowers or savers leading to a chain reaction of falling repayments or rapid savings withdrawals. Bangladesh was fortunate to avoid a descent into an unpredictable or spiraling deterioration. The improvements in portfolio quality and operations in 2011 and 2012, combined with the more optimistic views of managers today indicate that more serious problems were avoided. There was some damage from deteriorating performance for the four largest MFIs but this would have been several times worse had the trends seen in 2008 been allowed to fester.

MFIs may have avoided a crisis for themselves by putting their own houses in order, but where does that leave their clients? As the market expanded rapidly in the high-growth period, were clients dangerously over-indebted? To explore this question, we turn to our household interviews.

Over-indebtedness is tricky to measure. In some markets it can be seen in excessive “debt-service ratios”—that is, the borrower spends too big a proportion of income repaying debt. But where households have irregular income streams, as in rural Bangladesh, this definition is not always helpful, as the case of Mrs. MA (interview 006) shows:

Mrs. MA’s MFI loan repayments each month exceed her monthly income. However, she expects to be able to repay the loan because her son should soon reach Malaysia and start remitting money, and even if he is delayed she is confident of securing family loans, secured against future remittances, to tide her over.

We therefore use “over-indebtedness” to refer to situations where clients have *ongoing* difficulty with loan repayments, and to measure the seriousness of the over-indebtedness by the extent to which it contributes to serious deteriorations in welfare, such as reduced consumption, poor health, loss of creditworthiness, or excessive stress (Schicks and Rosenberg 2011). Some clients accept repayment tension as a sacrifice worth making for the benefits of borrowing, so not all sacrifices made for loan repayments should be equated with a reduction

in overall welfare. The case of household 005 shows this:

Mr. MM’s household was landless, and years ago they borrowed heavily in the private market to secure a small piece of homestead land, which is now their one big asset. Mr. MM’s wife joined two major MFIs and year after year they have been using MFI loans to repay the private lenders. The MFI loans themselves are repaid through the strenuous work of their son ML who commutes two hours each day to the local town on his rickshaw, which he then rides for hire all day. Meanwhile, his father goes out begging to get their food. Mostly they eat twice a day, sometimes only once. But all three adults think their sacrifice is worthwhile.

Just how pervasive is over-indebtedness and how often does it lead to serious harm? The Institute of Microfinance released a paper in 2011 that presents evidence that over-indebtedness was low even at the height of the growth period (Khalily and Faruque 2011). The MFI managers we interviewed feel that high levels of harm have been avoided. Shafiqul Choudhury of ASA, who had been among the most vocal in warning of the dangers to clients of over-indebtedness now says that “the train crash was avoided.” On the whole, the evidence from our household interviews in early 2013 supports this conclusion. Twenty-seven of our respondents were holding MFI loans at the time of the interviews. Among them is one tragic case (interview 004) where a spiraling combination of business failure and multiple private and MFI loans resulted in a serious long-term drop in standard of living:

Mrs. MB (interview 004) joined six MFIs and borrowed from each of them to try to support a husband whose business failed and who had contracted loans from private moneylenders. In the end they sold virtually all their assets (including their land and home) to settle the debts. In the village, neighbors were more aware of Mrs. MB’s MFI debts than of her husband’s private ones, which were contracted in secrecy in the market. Mrs. MB reports that villagers say things like “MB has been finished off by the MFIs.”

Mrs. MB was the only one of our respondents who had themselves suffered catastrophic loss of assets, though we heard hearsay reports of similar cases. Some households reported long periods of reduced food intake, illness, and high levels of stress. Two of them (005 and 012) mentioned that they are eating less to find loan repayments, and one (002) was contemplating selling the household's rice stocks. Readers of the interviews may judge for themselves whether they indicate an acceptable or unacceptable incidence of harm.

Our opinion is that cases of the most serious kind of over-indebtedness, where there is a permanent drop in household welfare, are not common now, nor were they during the high growth period up through 2008 when microcredit volumes were similar to today. That said, the interviews reveal a level of stress that the microfinance industry would do well to take more seriously, and to seek ways to reduce still further, perhaps by relaxing the mantra of zero tolerance on loan repayment schedules so that repayments fit more comfortably with the often irregular and unreliable incomes streams of poor households.<sup>10</sup> The recent rise in nominal microcredit loan sizes, up from \$108 in 2008 to \$221 today, also deserves examination to ensure that the size of repayment obligations do not cause further stress, nor accelerate incidences of over-indebtedness, nor discourage poor but creditworthy households from borrowing.

This rise in loan sizes is a reminder that risk requires constant diligence. Bangladesh's big MFIs averted a crisis around 2008 but that doesn't mean that they are now immune from future ones. Analyses of Grameen's performance by David Roodman<sup>11</sup> show that the value of rescheduled loans in the bank's portfolio has been rising in 2011 and 2012. This change may not pose a serious risk to Grameen or the wider industry, but it does highlight how performance is always subject to dynamic change. Having averted a crisis before, the

industry will need to remain vigilant to steer past the potential pitfalls that lie ahead.

## V. How Was the Crisis Averted?

Senior management of the four large MFIs took decisions independently of each other beginning in late 2007—especially decisions to simply stop growing. There was no credit information bureau to provide reliable feedback on borrower indebtedness, nor were there any regulatory instructions to prompt them. While none of them was omniscient, and they were unable to agree on the nature, timing, or severity of the problems they saw, the MFIs were right to anticipate serious trouble. They pulled back and mended their systems. But why were the MFIs in Bangladesh—in contrast to those in some other markets—able to act in time to head off problems before they worsened?

### *Using experience to see through the "fog of growth"*

A well-known feature of Bangladesh microcredit is just how long the four largest MFIs have been operating—in each case over 20 years and in the case of BRAC and Grameen Bank for more than 30. Amid the "fog of growth" that enveloped microcredit up through 2007 there were many conflicting signals. Having already lived through many small difficulties and having survived some larger ones, their managers—many of whom had been in place since the founding of their institutions—knew that the underlying health of microcredit cannot be taken for granted. As S. N. Kairy of BRAC notes, "Growth in many ways made our numbers look better but we sensed potentially deeper problems." Their antennae were up and sensing something amiss.

### *Motivations to act—in it for the long-term*

While long years of experience helped MFI management sense problems brewing, it was their future expectations that compelled MFIs to act.

<sup>10</sup> See Sinha (2013).

<sup>11</sup> See his blog at <http://international.cgdev.org/blog/grameen-bank-portfolio-continues-deteriorating>

Each organization has staked its reputation on microcredit,<sup>12</sup> and their future viability depends on a healthy microfinance industry. The main stakeholders in MFIs are senior management, and for them there is no exit strategy, no personal shares to cash out—many count microfinance as a large part of their life's work. As F. H. Abed of BRAC notes, "Microfinance has made a big contribution to Bangladesh's development and we expect to continue to provide microfinance in the years ahead."

### ***Experienced clients helped, too***

A striking feature of our 2013 household interviews is the care with which potential borrowers approach the decision to take a loan. This comes out of long experience of working with MFIs and the basic microcredit product whose rules and rhythms they know well. Many of today's MFI borrowers are from households with three generations of exposure to microcredit. They are experienced in making judgments about the obligations and rules of loan agreements. Often this simply means not taking any more loans: the interviews show many such cases. Were the clients in Bangladesh less experienced, it is likely that many more of them would have borrowed injudiciously, creating much higher levels of over-indebtedness. The experience of clients likely muted some of the risks brewing in the rapid growth period. Zakir Hossain of Buro, commenting ruefully on his MFI's difficulties with recruiting and training good staff during the growth years, noted that "the borrowers were more experienced and knowledgeable than our staff."

### ***Promoting savings helped as a buffer in the MFI–client relationship***

Bangladesh microcredit has been coupled with savings from the very beginning, but during the era of rapid growth from 2003 to 2007, savings products proliferated and take-up multiplied, with short-term, open-access passbook savings and longer-term, disciplined commitment plans. This has proven to be a critical tool for managing credit risk for both clients and MFIs. For the clients their balances offer not only a cushion in times of need, but in case

of difficulty with their loans, they can also net off their savings against their debts and exit without the embarrassment associated with default. The interviews include many descriptions of clients who used their savings in this way.

For the MFIs, savings is both a growing source of funding necessary to maintain national scale and a vital device for maintaining strong credit discipline, offering a risk management tool that helps protect them. Savings provided extra resilience that helped the MFIs correct a deteriorating situation. This tool was not available in some other national markets where MFIs' ability to raise savings was more restricted, or banned outright.

### ***What contribution, if any, did the social goals of MFIs make to the change in course?***

In acting as they did, the MFIs were influenced by historical forces whose influence is large, if hard to measure. Bangladesh microfinance began soon after a brutal war of independence followed by a famine that left the country impoverished. The belief that microfinance exists primarily to draw people out of poverty is widely accepted, and microfinance is seen as a "movement" rather than as just an industry. This is not to say that Bangladesh MFIs are purely socially driven. MFIs take pride in the surpluses they generate, and a good year for many MFI managers often equates to a strong bottom line. The social commitment to poverty reduction didn't stop MFIs from undertaking reckless and potentially irresponsible growth up through 2007.

But those who work in Bangladesh microfinance argue that their nonprofit character makes a difference. S. N. Kairy of BRAC remarks, "External investors are not interested in the same development goals as NGOs." Choudhury of ASA shares the same sentiment about his Bangladesh operations, "Commercially driven private equity would have made the situation worse leaving us unable to quickly correct the problems that emerged." Whether these beliefs hold true is debatable, but they underscore

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<sup>12</sup> Although BRAC is perhaps better known for its public health and primary education work.



a common Bangladeshi view about microfinance. It is true that while Bangladesh microfinance is increasingly commercially funded, management has not ceded governance control. We cannot say what would have happened had more outside investor interests played a role. There are countries where external investors and commercialization have built responsible microfinance sectors. But it would be defying the obvious to ignore the development roots and founding visions in motivating MFIs to pause and reconsider their growth trajectory. Efforts to remain true to their professed beliefs in development helped shape behavior during this critical change in direction in Bangladesh.

## VI. The Road Ahead: Five Trends for Bangladesh

The shifts that began in 2008 mark a turning point for microfinance in Bangladesh. As traditional microcredit, which until then had dominated the growth of the industry, began to plateau, other parts of it—notably small enterprise lending and savings—have accelerated, and new possibilities in the shape of mobile services have emerged. As of 2013, five trends stand out.

### 1. The core microcredit product is holding steady and evolving incrementally

Microcredit will serve a stable rather than expanding number of clients. Change will come from incremental product refinements. MFIs are already moving toward disbursing bigger loans. Loan sizes saw an upward shift in 2011 and 2012 across all four of the big MFIs. This was done in part to keep up with inflation, but as Mosharoff of Buro notes, “The loan size increase was primarily driven by the introduction of the interest rate cap of 27 percent by MRA in 2011.” BRAC no longer gives loans of less than US\$ 125 to microcredit borrowers. The loan size increase is a cause of concern. F. H. Abed of BRAC notes, “We are worried about leaving out poorer clients and

must figure out a way to reach back out to those who require smaller loans.”<sup>13</sup>

Other changes are underway. Grameen Bank has already introduced the option to top-up loans to their full disbursement value part way through the term, and reschedules delinquent loans into a flexible repayment plan. BRAC has adopted the top-ups and is experimenting with loan rescheduling and refinancing. Other product refinements under consideration include loan terms other than the year-long standard and more flexible loan repayment schedules to better match customers’ cash flows. BRAC is shifting some loan repayments from weekly to monthly. Grameen has introduced a new “young entrepreneur’s loan” aimed at the sons and daughters of Grameen members, youngsters who have enjoyed better education and have brighter horizons than their mothers and need “something extra” to attract them into the Grameen fold.

### 2. Lending to small enterprise will remain a significant market segment

The most marked development since 2007 has been the step change in the value of SEL lending. Bangladeshi MFIs recognized that some of their group members had the capacity to take and repay bigger-than-average loans that they would invest in (or repay by means of) larger standalone enterprises, usually retail stores, small-scale manufacturing, construction and transport services (interview 039), or intensive food production.

Of the four big MFIs, BRAC is the only one that has separated its SEL line of business (which it calls *progoti*, meaning progress) from its microcredit. Progoti often operates out of newly established branches (usually in the market town area rather than the village) and employs separate, specially trained staff. It lends mostly to men, as individuals, and loans are repaid in monthly rather than weekly installments. The other three MFIs have not separated their SEL to this extent and are more cautious. Nevertheless,

<sup>13</sup> Traditionally, microcredit borrowers were supposed to own no more than half an acre of cultivable land or its equivalent in other assets. When we asked an MFI field worker what he looked for these days when recruiting members for the microcredit groups, he told us he preferred clients with “good assets”—such as an acre or more of farm land, plus homestead land big enough to grow trees and vegetables.

SEL is likely to remain an important and growing portion of microfinance operations.

### **3. Client demand for savings services is increasing; but is inadequately met**

Studies consistently show that, even in the absence of formal services, poor people seek ways to save and will tolerate the risks of using informal tools to satisfy this need. As incomes rise and poverty recedes, populations become more future-orientated, more inclined to worry about providing for tomorrow as well as for today, and therefore ever more interested in saving. Bangladesh, with its reductions in poverty, is no exception. The household interviews suggest that the awareness of and desire for savings are high. Even insurance agents now find it worth their while to visit quite modest homes to sell policies (often 10-year endowment savings).

Mrs. KA (interview 007) has been using MFIs since before she was deserted by her husband. When he was still around, they managed MFI loans reasonably well from his income. Now she is on her own she has found that saving is a better way to help her secure the future of her children. She has left two of her MFIs and is now in just one friendly local one that doesn't insist on her taking a loan.

Mr. ABS and his wife Mrs. MB (interview 016) head a modest farming family. Mrs. MB has two insurance policies to help the couple as they age. One is a 10-year endowment savings plan, and she pays 100 taka (\$1.28) a month into it, sourced from selling eggs and saving on the housekeeping. The other is a 15-year term life policy. This requires an annual payment of 5,077 taka (\$65)—quite a large sum. To raise this sum on time each year Mrs. MB borrows from an MFI.

Many MFIs assume that their clients want to, and should, borrow continuously. One of our interviewed households (003) describes this attitude as “clumsy,” and several others (like Mrs. KA in the box above) would like to see MFIs become more willing to allow their members to enjoy ongoing savings services without being obliged to borrow. But the general

MFI inclination to push borrowing is only reinforced by the MRA regulator, which has regulations that restrict savings offerings.<sup>14</sup>

Savings had always been linked to the core microcredit product, but in recent years the service has become increasingly flexible. Now, as we can see in the interviews, almost every MFI offers passbook (that is, unrestricted withdrawal) savings and commitment savings (in one form or another). Almost everyone we spoke to knows what these instruments are, even if they don't have one themselves.

It was the expansion of savings under Grameen II that made a big difference. Grameen's Pension Scheme, a long-term commitment savings product that safely collects regular deposits and pays a good rate of interest for terms of five or 10 years, has proved attractive for accumulating large sums. Grameen Bank's savings balances today are by far the largest of any of the MFIs and provides evidence that demand could be much better met if other MFIs achieve a similar scale, but for this to happen the regulation of MFI NGOs would need to adapt. This is the main point of trend four.

### **4. There is growing momentum to create a special category of deposit-taking MFIs**

Licenses have now been extended to some 600 or more MFIs, but the regulations remain based on a microcredit approach that prioritized credit and de-emphasized savings.<sup>15</sup> Regulators must protect depositors' funds, so caution is warranted for a large majority of the 600 licensed MFIs. But applying restrictive rules to all MFIs indiscriminately misses the opportunity to offer more conducive regulations for a small number of MFIs that are strong enough to operate under a different regulatory approach. There is increasing discussion in Bangladesh of creating a new class of microfinance deposit-taking institution and extending licenses to perhaps five to 10 organizations. These MFIs could be given greater flexibility to mobilize deposits, particularly if critical

<sup>14</sup> Microcredit Regulatory Authority unofficial translation of regulations: [www.mra.gov.bd](http://www.mra.gov.bd)

<sup>15</sup> There are limits, for example, governing the ratio of deposits held to loans outstanding.

organizational standards are met. Views appear to be swinging favorably in this direction: the chairman of the MRA (the governor of Bangladesh's Central Bank) remarked in April 2013 that MFIs should "begin to think about setting up MFI Banks."<sup>16</sup>

### 5. Mobile phone payments services are developing rapidly

Several new mobile-phone-based deposit and payment services are growing rapidly across Bangladesh, including one from Dutch Bangla Bank and another, bKash, a service provided by a subsidiary of BRAC Bank.<sup>17</sup> By the end of April 2013 these services have more than 5 million accounts and 80,000 agents, and these numbers are growing fast. This has put the opportunity to open a basic mobile-phone-based account or accessing an agent within reach of millions. It is not yet clear what impact this might have on microfinance; but by reaching many of the same clients mobile phone based accounts and payments introduces a potentially dynamic new force on the scene.

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<sup>16</sup> Daily Star, 4 April 2013

<sup>17</sup> BRAC Bank does not work in microfinance, but its primary promoter is the NGO BRAC. *bKash* the mobile banking service is a subsidiary of BRAC Bank.

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