A Comparative Review of Islamic Versus Conventional Microfinance In Bangladesh

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1. Introduction

Background

This paper presents a comparative review of Rural Development Scheme (RDS), i.e. microfinance operations, of Islami Bank Bangladesh Limited (IBBL) and financial services offered by traditional microfinance institutions (MFIs) in Bangladesh. The review was undertaken in July-August 2010. The major topics discussed in this paper are: evolution and structure of microfinance sector in Bangladesh including regulatory regime, management system of microfinance institutions and RDS, outreach of microfinance services, market segments and products of MFIs and RDS, financing of microfinance institutions, comparison of financial performance of some major MFIs and RDS, and impacts of microfinance on poverty.

Bangladesh is one of the poorest countries in the world in terms of income and other social and economic indicators. In 1990, approximately 58.5% of the population lived below the poverty line, which gradually improved to 40% in 2005. About 18% of population lives in absolute poverty who suffer from food insecurity coupled with illiteracy, lack of proper health and sanitation facilities.

The country's economy depends on agriculture with vast majority of the population living in rural areas but industrial sector, especially garments manufacturing, and service sector have significantly expanded. The agriculture sector is unable to create new opportunities for employment resulting in influx of rural population towards urban areas. Rural areas are characterized by almost stagnant agriculture and scanty industries. Underemployment and unemployment is a regular phenomenon particularly in rural areas. The vast human resources have remained unutilized due to lack of education, proper training and concerted efforts to help grow the rural economy.

But even with all structural odds, political instability, natural disasters and worldwide recession Bangladesh has maintained around 5% annual GDP growth over the last two decades and steadily reduced poverty except in 2007 and 2008 when sudden increase in prices have made poor people suffer. In 2010, the GDP per capita has exceeded USD 750. A number of factors contributed to these results: international remittance, labor intensive garments industry, some diversification within the agricultural sector, economic reforms, various poverty alleviations programs and microfinance. Microfinance institutions played a major role in the poverty alleviation, making access to savings and credit easily available at reasonable cost to more than 30 million poor and near-poor people. Besides non-government organizations (NGOs) contributed in spreading literacy and primary healthcare services.

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The microfinance sector, which is the focus of this paper, has undergone tremendous transformation in all aspects over the last more than three decades following pioneering works of the Grameen Bank. Following the success of Grameen Bank, many MFIs have proliferated throughout Bangladesh. The very visible changes are increases in outreach and portfolio size, proliferation of microfinance through a large number of microfinance institutions, diversification of services, new regulatory regime, contribution in rural development, and recognition of microfinance as a major contributor in poverty reduction. The methodology of Bangladeshi microfinance model has been replicated with or without variations in many countries and recognized as an effective tool for poverty reduction. That has also brought international recognition in the form of Nobel Prize for Peace for Professor Mohammed Yunus and the Grameen Bank.

IBBL, a leading private Islamic commercial bank, was founded with the major objective of establishing Islamic economy for balanced economic growth by ensuring reduction of rural-urban disparity and equitable distribution of income. Branches of the Bank have been encouraged to invest their deposits in their respective areas and in particular for the economic uplift of the rural people. In addition to its commercial banking operations, IBBL introduced its own version of microfinance called 'Rural Development Scheme (RDS)' in 1995 by practicing Islamic modes of finance to cater to the investment needs of agriculture sector and rural poor to generate employment opportunities, enhance income to alleviate poverty. As we will explain in details in this paper that RDS, a division of IBBL, is offering an Islamic alternative to microfinance services offered by traditional MFIs in rural Bangladesh.

Objective

The overall objective of the review is to offer a comprehensive analysis of RDS, and compare and contrast between RDS and microfinance services offered by MFIs, and performance of microfinance institutions of Bangladesh. In particular, we will compare financial performance of RDS with a reputed MFI, BURO Bangladesh, which is of similar size to RDS. The comparison covers outreach, products and market segments, management system, financing and financial performance. The review also covers evolution of microfinance and regulatory environment in Bangladesh.

Methodology

The review is primarily based on secondary and published information. The paper heavily draws on Bangladesh Microfinance Country Report prepared for the Institute of Microfinance (Alamgir 2009) for information and analysis on Bangladesh microfinance sector. The major sources of information are published research reports and papers, unpublished reports from reputable organizations, data from major institutions such as Palli Karma-Sahayak Foundation (PKSF), IBBL-RDS, Institute of Microfinance, Microcredit Regulatory Authority (MRA), Grameen Bank, BRAC, ASA, BURO Bangladesh, Credit and Development Forum (CDF) etc. We have also conducted a limited number of interviews.

The case of microfinance in Bangladesh is a good example of NGO-MFI led operations where the government directly and indirectly provided major policy and material support to make it probably the largest microfinance sector in the world. State-owned commercial banks although initially tried retail microfinance services but abandoned that after failure with the exception of RDS-IBBL. Readers should look into the paper with this perspective in mind the key differences and similarities between traditional microfinance and RDS-IBBL.

2. Bangladesh Microfinance Sector: Evolution and Current Structure

Definition and targeting

Bangladesh microfinance has earned world attention due to the pioneering role, enormous size, presence of famous institutions, and replication of its model or variants worldwide. The expansion and replication is going on and attracting many different types of people and institutions. The term microfinance is relatively new in Bangladesh. A more popular and practical term has been microcredit, which emphasizes the main focus of the various financial institutions involved, although small savings has always been a part of microcredit operations. Gradually, in response to demand, other services such as savings, insurance (life and non-life) and remittance services have been developed or being piloted and are now being bundled together under the term microfinance. Another important feature has been the focus on the poor. That focus very much remains but the MFIs have started to offer services to non-poor such as small farmers and micro-entrepreneurs. Therefore, the scope and target beneficiaries have evolved over time since the establishment of the Grameen Bank in 1983. In 2010 the term microfinance includes many financial products for both the poor and the near-poor.

The microcredit programs in Bangladesh rightly began by targeting the rural poor, especially women, as a development intervention strategy. Microcredit serves not only to meet financial needs but also contributes to other social and institutional development issues such as women's empowerment, bringing the rural poor into an institutional service network, and reducing the dependency on informal money lenders. The management system of microfinance programs has evolved over time but commonly have the following features:

- Women are the main recipients of microfinance services though many MFIs now have male members/clients;
- Group-based lending methodology is the main system of delivery of microfinance services, although commercial banks and a number of MFIs offer loans to individual clients. In early 1980s, especially in Grameen Bank, groups not only meant a collection of members for administrative purposes but also meant group liability. In case of loan default by a member, the group would take responsibility for the repayment of the defaulted loan. Now in 2010, the group-based system provides just a low-cost management structure, without any responsibility of repayment; that is the responsibility of the individual borrower. However, groups do serve another practical purpose, as a filter for screening individuals for membership;
- The microfinance sector in Bangladesh is now dominated by NGOs offering microfinance services, collectively known as NGO-MFIs, which offer financial services as 'private not-for-profit businesses' but strive to achieve institutional and financial viability as soon as possible;
- MFIs are diversifying into other target segments, including near-poor groups, by developing new financial products along with the traditional management system. This diversification strategy is not only helping portfolio growth and outreach but also transforming NGO-MFIs as permanent financial service providers for both the poor and the near-poor, amongst both the rural and urban populations. NGO-MFIs have now become a new class of financial institution in Bangladesh financial markets.

Target Groups: Aggressive expansion of microfinance in rural and urban areas by competing MFIs, i.e. Grameen Bank and the NGO-MFIs, has created a situation warranting a revised definition of target beneficiaries of microfinance programs. On paper the definition still remains ‘poor people’ having less than half an acre of land or some other income and employment criteria. In reality, women from so called ‘non-target’ groups, mainly from marginal farmer category, are joining in large numbers. The attitude about microcredit has changed over the time.

Over the last two decades, the Grameen Bank together with many NGO-MFIs now operating in Bangladesh have become permanent features of rural financial life and formal/institutional sources of loan with costs far lower than moneylenders’ rates. At the same time due to their contributions and national and international admiration, MFIs have achieved social recognition as well. That means, two compelling forces – the urge to expand services to maintain portfolio growth and the demand from former ‘non-target’ groups - have been contributing to the expansion of services as well as the need to redefine the ‘target group’ for microcredit.

A new definition of ‘target recipient’ is now beginning to emerge: anyone in rural or urban areas who wants to take a small loan by accepting the institutional arrangements of the MFIs, i.e. group meetings, mandatory savings deposits and repayment schedule. Irrespective of actual economic conditions, such an individual is now a target recipient and includes nearly 90% of rural households. It only excludes the larger farmers and other richer families. It does not mean that microfinance now excludes the poor; far from it since the ongoing expansion thrust already includes most, if not all, of the potential moderately and hard core poor borrowers under one or more of the existing programs. The inclusion of former ‘non-target’ groups means simply broadening the outreach. In addition, there are two deterrents for richer borrowers joining mainstream microfinance: i) small size of loan; and ii) higher interest rate of microcredit (25-30%), which is almost two-three times the rate of commercial banks (10-12.5%), the normal sources of loans for richer borrowers.

Table 1 provides a classification of poverty groups and corresponding strategy followed by the microfinance sector to serve each group with financial and non-financial services. Each of these groups is then discussed further below.

Table 1: Common Microfinance Client Segments and Characteristics

Target Beneficiary Segments	Characteristics of Each Segment	Service Needs of the Beneficiaries (financial and non-financial services)	Common Strategy Followed in Bangladesh
Hardcore poor (Extremely poor or ultra-poor)	• Daily calorie intake: less than 1 800 • Land ownership: less than 0.15 acre • Food deficit status: Occasional to chronic deficit	Primarily savings services; Starts with food aid; skill training; and very small loans	Skill training Savings services Small amount of loan Food aid and asset transfer
Moderately Poor	• Daily calorie intake: less than 2 112 • Land ownership: less than 0.5 acre • Food deficit status: 30-40% above poverty line	Savings and credit services; Flexibility in services desirable; Selective productive skill training	Savings and credit services
Marginal farmers	Land ownership: less than 1.5 acre Food deficit status: break-even	Agricultural extension services; Selective training on non-crop income generating activities; Savings and credit services.	Limited number of NGOs is in this market segments; some marginal farming families included in regular microfinance groups. Savings and credit service
Small Farmers	Landownership: less than 2.5 acre Food deficit: Surplus Normally no-poor	Agricultural extension services; Training on diversification in farming and other areas and new farming technologies; Savings and credit (larger and seasonal loans); Access to market and farm inputs.	A few NGOs are involved; mainstream NGOs are yet to get involved in this market segment; limited savings and credit services.
Microentrepreneurs	Managed by owner; less than 10 employees Partly linked with mainstream market May possess capital machineries Investment normally higher than income generating activities; Need larger loans	Credit services (substantially larger: USD 500-10 000) Business development services including access to market and product development.	Credit service similar to regular microcredit with larger loan size.

Sources: As presented in Alamgir 2009; MIDAS and ICG (2004); Wright and Alamgir (2004); McKennie and Rahman (2003)

Evolution of Microfinance

Commercial banks, agricultural banks, cooperative societies were the principal sources of small loans for various types of clients: farmers, traders and 'cottage industries' before the advent of the Grameen Bank and other MFIs. These institutions continue to provide some small loans to selected clients but not normally to the poor. The limitations of commercial bank loans were well-known: banks ask collateral for disbursing loans, their human resources and management systems are not suited to the poor and their branch networks were limited to urban centers. Although state-owned expanded branch networks in rural areas, other limitations persist. Bangladeshi private banks have never been interested in small loans or poor people and the culture remains the same even today with the exception of Islami Bank Bangladesh Limited which has a large retail microcredit operations. Some private commercial banks have lately gone into wholesale lending to the MFIs. Two agricultural banks, BKB and RAKUB, mainly targeted and still target the small, medium and large farmers who could offer land as mortgage. The performance of these two specialized banks has always been poor and largely avoid the poor and both are deeply insolvent [Ferrari 2008].

Cooperative societies tried to reach the small and marginal farmers in 1960s and 1970s as a follow-up on to the success of the Comilla model. Several distinctive features of Comilla model were as follows: targeting the farmers, especially the small farmers; introduction of technologies (HYV seed, chemical fertilizers, irrigation and new farm practices); loan was given to the farmers against land mortgage. The relevant issue here is that the cooperative system also could not organize the poor for delivering financial services. Bangladesh Rural Development Board (BRDB) later introduced many microcredit projects funded by bilateral and multi-later donors with some initial successes but on the whole the programs should be termed as unsustainable (Khandkar and Khalily 1996).

Grameen Bank made the breakthrough to develop a management system to reach large number of poor with financial service. The Grameen Bank broke the barriers by developing a different kind of organization for the poor and to serve the poor with financial services. The story of Grameen is pretty known now in Bangladesh and elsewhere. The Bank started as project in 1976 and become a formal independent financial institute in 1983 under the Grameen Bank Ordinance 1983. Detail story of background and formation of Grameen Bank is available in Counts (1996). The features of microcredit mentioned earlier are basically developed by the Grameen Bank and later modified (mostly minor) by other MFIs to suit their purposes.

The Grameen experience had proven that with right kind of savings and loan products, policies and management system and human resources, i.e., an appropriate institution with a mission to serve the poor could not only reach them but also make a viable financial institution. The simplicity of methodology developed by the Grameen Bank has inspired many non-governmental organizations to hurriedly replicate the model and offer similar financial services to the poor. The main incentives for NGOs which were normally involved in many social programs such as education, health, relief and rehabilitation to move quickly into microcredit were demand from the members, opportunity to become self-reliant (income covers expenses), and creating sustainable permanent institution, and career for staff members. The variations were in interest rate, savings and loan ceiling, size of groups etc not much on the fundamental structure of the model. Some of variations present today are summarized below:

- *Group formation:* The size may vary between 20 to 50 persons. MFIs do not strictly follow 5-member group structure of Grameen, instead they form one larger group called *samity* with women/men from the same neighborhood.
- *Savings policies:* Amount of savings may vary among members as well as organizations. Normally MFIs would lend only after deposit of several weeks or certain amount of money. Withdrawal of savings was restricted in earlier days now lot more accessible. Still a few major institutions restrict withdrawal of savings to use the money as loan as well as cash collateral. Interest paid on savings may vary between 4 to 8.5% (Grameen Bank).
- *Loan policies:* Loan amount widely vary among MFIs; normally starts with small size and increase in successive loans. Interest rates vary between 20 to 30% per annum expressed in so called flat rate. Loans are collected in weekly installments but in some cases in monthly and one installment. Although in earlier days clients were required to wait 1 to 6 months before receiving first loan but now a days due to competitive pressure first loan to a member may be disbursed within days of joining a group.

Prevailing Lending Modalities

Three different types of lending technologies are applied in Bangladesh:

- *Grameen styled group-based system* is the dominant management system with features mentioned earlier. But critics feel that the weekly repetitive system does not match with poor people's financial demand, therefore, the financial products should be 'flexible' or 'demand driven'.
- *Self-help group system*: A handful of non-government organizations have tried and are still trying the so called self-help group approach of developing financial service delivery system. In this case, the promoter or the NGO organizes self-help groups with the objective of facilitating savings mobilization for the poor women/men from among themselves. If the participating members need loan they can borrow from their samity i.e. from their own savings funds. If the funds are not adequate, the self-help samities may try to borrow from banks or the NGO supplies the additional capital.
- *Individual lending system*: The central issue to developing individual system as opposed to group-based system is to offer flexible and demand-driven services to each client/borrower. Group-based system is viewed as 'one-size fits all' system. The individual lending technique, i.e. to offer savings and credit service to each individual according to the demand of that individual client. In case of microenterprise loans (i.e. larger loans) are offered by MFIs as individual loans.
- Informal moneylenders are another traditional source of micro-loans that follows 'individual lending'. No rigorous up to date information and analysis are available

about their operations. Even with the expansion of MFIs moneylenders can still be found lending for emergency loans to the poor and also for agricultural loans due to the absence of large-scale agricultural loan from MFIs.

Microcredit products and market segments

(a) Mainstream Microcredit (BDT 5,000-25,000, approx USD 70-350): The term ‘mainstream microcredit’ is the most commonly available financial service for the **‘moderately’** poor following the Grameen model of group-based lending. This category includes the common programs of NGO-MFIs serving the poor and moderately poor, which sometimes may include some not-so-poor members, especially marginal farming families. The current loan size varies between BDT 5,000 to BDT 25,000, which is normally invested in petty trades, poultry and livestock, fisheries, numerous small agro-processing activities and horticulture. Loans are for one year collected in weekly installments. The interest rate varies between 20-30% per annum. The main focus remains on poor women.

(b) Programs for the Hardcore Poor (BDT 500-5,000, approx USD 7-70): Two approaches have been adopted to redress the problem of meeting the needs of the poorest for financial services. The first is that ‘the very poor need to be prepared for microfinance’, usually by a combination of social and human development interventions. The second is that ‘microfinance needs to be prepared for the very poor’, i.e. that what is required is much greater flexibility and imagination in both the products offered, especially for savings, and in the manner in which they are offered. Improvements and innovations will be needed not only for serving various financial needs of the very poor but also to face competition. Examples of such programs are Building Resources Across Communities (BRAC)’s[4] Challenging the Frontiers of Poverty Reduction (CFPR) Programme; Grameen Bank’s Struggling Members’ Programme, and PKSF’s Hardcore Poor Programme. A number of programs even provide training, cash for work and productive assets to these groups.

(c)Microenterprise Program (BDT 25,000-500,000; approx USD 350-7,000): One relatively new frontier for the MFIs is loans for the development of microenterprises managed by ‘graduates’ from microfinance programs as well as millions of informal businesses operating throughout the country, which so far have been outside the MFIs traditional lending programs. This segment is significantly underserved, but potentially involves very large number of enterprises (more than 5 million) and opportunities for employment, including wage employment[5]. NGO-MFIs use both group-based (e.g. PKSF small and medium partner MFIs) as well as individual (e.g. ASA and BRAC) lending methodologies in case of microenterprise loans depending on whether they finance ‘graduate’ borrowers (e.g. PKSF partner MFIs) or new entrepreneurs (e.g. ASA and BRAC). In case of ASA and BRAC, most of the microentrepreneurs are men .Two features separate them from microcredit borrowers: larger loan amounts with longer

[4] Formerly Bangladesh Rural Advancement Committee (BRAC). BRAC has opened its operations in Sri Lanka, Afghanistan, and several countries in Africa.

[5] MIDAS and ICG (2004). National Enterprise Survey, MIDAS, Dhaka, Bangladesh

duration; and the need for non-financial services such as access to market, information and appropriate technology, assistance for product improvement and development, training for workers' skill development and management training for skill in financial and business management of the entrepreneurs.

(d) Microfinance for Marginal and Small Farmers (BDT 10,000-50,000; approx USD 150-700): So far only a small number of MFIs has ventured into this segment by following group-based lending techniques with limited outreach. PKSF with loan from IFAD has initiated Microfinance for Marginal and Small Farmers (MFSMF) project to reach 220,000 marginal and small farmers in 6 years. Sometimes seasonal loans with shorter duration (3-9 months) are disbursed and collected in one installment, for example after harvest. For this category, MFIs follow group-based lending system and cater mostly to women groups. But a number of MFIs have been lending to men's groups only with impressive success.

Microfinance Sector Structure

An estimated 33 million members and 26.78 million borrowers (81.1%) including multiple memberships or so called overlapping are served by the sector at the end of December 2008. A total of 14,441 branches serve these members/clients. The total estimated portfolio is Taka 158,807 million of which ASA (22.50%), BRAC (28.81%) and Grameen Bank (27.96%) account for about 79.26%. The rest 20.74% is under about 700 smaller MFIs that shows heavy concentration of portfolio in these three organizations. The important issue is that the three MFIs have become so big that microfinance sector can not afford any one of them to fail. Due to resource and management constraints the smaller MFIs are not expected to grow fast to increase market share. Such skewed structure is expected to continue.

Table 2: Aggregate time series data (Grameen Bank included)

Description	2003	2004	2005	2006	2007	2008
Branches (#)	6,837	9,165	9,253	11,368	14,577	14,441
Members (#)	17,754,747	20,681,349	24,373,389	27,420,570	31,367,009	33,018,926
Borrowers (#)	13,457,991	15,617,075	15,617,075	15,617,075	26,119,391	26,787,120
Portfolio (Taka mill.)	52,510	64,354	83,651	106,411	133,375	158,807

Source: Alamgir, 2009

In terms of memberships/clients (and consequently portfolio size) the structure of the microfinance sector is as follows:

- *Three very large MFIs*: Three very large organizations – ASA, BRAC and Grameen Bank- dominate the microfinance sector, each having more than 7 million members/clients in 2008 (ASA 7.28 million, BRAC 8.15 in March 2009 and Grameen Bank 7.67 million) all products combined (see Table 3). These three organizations had embarked a major lateral expansion beginning 2003/04 that led to doubling to tripling their sizes by 2008. These three MFIs have achieved spectacular lateral expansion, that is, to include new clients in same or new geographical areas by enhanced management efficiency, standardized management practices, products and policies, and mobilizing financial resources. The three combined has 8,547 branches, 19.16 million borrowers and loan outstanding of Taka 125,876 million at the end of December 2008 (ASA Taka 35,735 million, BRAC Taka 45,746 million in March 2009 and Grameen Taka 44,396.63 million). All three organizations have branch networks throughout the country except in a few remote char and coastal areas.

- *Large MFIs*: The sector has got a group of large MFIs whose memberships vary between 50,000 to one million. All of them are PKSF partner MFIs except BURO Bangladesh. Even within the group two organizations, TMSS and BURO-B separate them from the others and have expanded more than into 40 districts with their networks. Their expansion also came during 2005-2008 period and continues.
- *Medium Size MFIs:* Above two groups are followed by organizations with 5-50,000 members (3 to 30 branches) which are local or regional organizations mostly financed by PKSF.
- *Small MFIs:* MRA has a cut-off point of 1000 membership and Taka 4 million loan outstanding for receiving license. Several hundred such MFIs operate in the country although the exact number is not known.
- *Very small MFIs:* We see even smaller NGOs with very limited resources for loan disbursement, use mostly savings, are still operating which may face extinction for not qualifying for license.

Table 3: Structure of MFIs Sector

Indicators	ASA (Dec. 2008)	BRAC (Mach 2009)	Grameen (Dec. 2008)	Total
Member (Million)	7.28	8.15	7.67	23.10
Borrower (Million)	5.88	6.38	6.90	19.16
Loan outstanding (million Taka)	35,735	45,745	44,396	125,876
Savings balance (million Taka)	11,264	16,306	64,177	91,747
Branches	3,303	2,705	2,539	8,547

Source: Compiled by authors

Regulatory environment

Multiplicity of registering authority: The microfinance institutions of Bangladesh are registered under the following laws:

1. Social Welfare Act 1960
2. The Companies Act 1913 (revised in 2001) as non-profit company
3. The Trust Law
4. The Societies Act 1860
5. The Cooperative Societies Act

Interestingly none of these laws explicitly allows microfinance, especially the mobilization of savings, as all were drafted long before the advent of the present form of microfinance. All the laws do, however, allow ‘development activities’, ‘development of the poor’, ‘development of women and society’, ‘promotion of education, science and technology’ etc. NGOs did not start microcredit as their first activity but followed Grameen Bank’s success. Microfinance programs have been implemented as a ‘development’ activity in order to alleviate poverty. Critically, GOB, Bangladesh Bank and all the registering authorities responsible for the different laws cited above chose to ignore savings mobilization as a part of offering microcredit to the poor, though it was technically ‘illegal’. Bangladesh did not have any comprehensive law, or body of regulations or regulator for microfinance up to August 2006.

Microcredit Act: The Microcredit Act 2006 filled this gap with the following features:

a) MFIs legally created under any of the previous laws will receive licenses to offer microcredit subject to fulfilling criteria set by MRA;

b) The law created an independent regulator called Microcredit Regulatory Authority (MRA), with Governor of Bangladesh Bank as its Chairman, to issue licenses and supervise all MFIs;

c) The MRA has wide ranging powers to introduce regulations, set interest rates, revoke licenses, set standards etc.;

d) The microcredit programs of various government departments are not under the supervision of MRA.

In accordance with the new law, the MRA has now been set up. All members of the governing body are government officials except the managing director of PKSF, a private individual. The MRA has already started its functions and issued about 500 licenses. Although MRA has been issuing licenses but the body of regulation has not been introduced yet. MRA on its parts has developed a set of regulations but could not introduce them of its own without the approval of the Ministry of Finance, which is yet to give formal approval to the proposed regulations.

Tax free status: GOB has allowed the growth of the NGO-MFIs without either trying to contain that growth or seeking to collect tax from their operations. The tax free status has helped to build larger equity base that made them more stable and allowed them to borrow from commercial banks.

Interest Rate: Government of Bangladesh (GOB) did not decide or interfere in interest rates charged by the MFIs on their loan and paid on the savings products. Historically the rates were set by the large MFIs and followed by smaller MFIs as the going rate(s). However, there has been one exception where PKSF asked its partner organizations to reduce interest on loans from 15% (Flat) to 12.5% (flat) beginning July 2004 because it provides subsidized capital to the partner MFIs. Even with this rate its partners are found to be financially viable.

Legal Status of RDS: Since RDS is part of IBBL comes under the supervision of the Bangladesh Bank not under MRA and does not require license from MRA.

Impact of Microfinance

There have been many impact studies conducted on microcredit programs beginning mid-1980s through 1990s. The pioneering impact study on the microcredit program of the Grameen Bank was by Mahbub Hossain [Hossain 1988] who evaluated it using the indicators like reaching the target groups, size of loan disbursed, loan utilization, accumulation of capital, generation of employment, and income, and poverty status, and used 'before' and 'after' as well as comparison between borrowers and non-borrower control groups to see the impact of microcredit. This was conducted in a backdrop of skepticism about the success of Grameen Bank and whether the poor borrowers really invest the loan and actually earn enough to repay the loan as well as enhance family income. Methodologically this study was probably the most robust that used statistically valid sample as well as had an opportunity to compare with control group at a time when microcredit was not so widely available. The data were collected through field surveys in 1985 conducted in five selected project and two control villages in the area of operation of 5 branches of the Grameen Bank. The sample size consisted of 975 borrowers and census of all households in seven villages. An earlier study was done in 1984 [Hossain, Mahbub 1984]. The study [Hossain 1988] reported a number of concrete contributions of microcredit from the bank:

- Borrowers have increased their business capital by an average three times within a period of 27 months;
- Asset in the form of livestock increased by 26% per year;
- About one third of members who reported to be unemployed became self-employed after joining microcredit program of the bank;
- Grameen Bank members had incomes about 43% higher than target groups in control villages, and 28% higher the target group non-participants in the project villages. The enhanced income is from the income generating activities undertaken by using microcredit.
- The program is general enhanced overall income of households in the project villages: average household income is about one-sixth higher in project villages than in the control villages. Thus microcredit has reduced poverty.

Bangladesh Institute of Development Studies (BIDS) carried out a major comparative study of poverty alleviation programs in Bangladesh that included 10 programs of eight (8) organizations-both government and non-government [BIDS 1990]. The investigations were carried out in 30 villages covering nearly 6000 households that included household census and intensive sample surveys. The difference in this study is that it compared the same indicators for all programs to determine relative success or failure. As a part of the above analysis, comparative study was done to compare the credit programs of BRDB-RPP, BRAC-RDP and TRDEP [Bhattacharya 1990]. It reported success of all three programs in reaching the poor (a percent of non-target people was also found joining the microcredit groups), enhancing income and creating self-employment due to microcredit.

A number of important studies have been conducted on the programs of the Palli karma-Sahayak Foundation and its partner organizations (microfinance institutions that receive loan from PKSF to on lend to poor). We will discuss two studies Rahman (1996) and BIDS [2001]. Although the methodologies applied in these two studies are somewhat similar to other impact studies but the importance of the two studies is that both measured impact of microcredit from smaller microcredit institutions, which follow Grameen Bank model, to show that impacts of income and other indicators are similar. This shows robustness of the microcredit system that has been successfully replicated to reach millions of poor left outside the Grameen Bank or a few large organizations. The smaller MFIs replicated the management system and showed that if poor were reached with financial services they could use them efficiently irrespective of sources.

Rahman [1996] analyzed the impacts of microcredit using cross-sectional comparison of households who had borrowed and those had not. A stratified random sampling method was followed for selection of MFIs of different size: small, with less than 2000, medium with members between 2000 and 3000 and large with members above 3000. Eight (8) partner MFIs were randomly selected by allocating proportion to the number of partner MFIs in each three categories. For each selected partner MFIs, 40 households were randomly selected from the list of 3 types of members: the non-borrowers, those who borrowed only once and those who borrowed for more than once. Forty (40) households were selected to give a reasonable size of sample in each stratum and the total sample was 960. A survey was used among the selected households using a structured questionnaire. It was a preliminary study only after two years of PKSF's operations. The major findings of the study are as follows:

- Microcredit enhanced household income. Though the income increase was modest, this reduced food insecurity, and increased expenditure on clothing and human capital development.
- Income and awareness increase due to membership in MFIs led to better children's school attendance and immunization.
- Microcredit increased employment of both men and women in the form of self-employment; women participation in IGAs had increased.
- Women were found very active and enterprising when provided with opportunities for investment.

On the other hand, the study by Zahir et al [BIDS 2001] is more detailed and used panel data. The study area included 13 regions of Bangladesh, covering 91 villages spread over 23 sub-districts. Following a census of all households in the 91 villages during October 1997, the study administered three repeat surveys, on a matched sample of about 3000 rural households – during 1998, 1999 and 2000. Besides collecting information at household levels, separate modules were administered on MFI-members from these households and for village and samity-level information. Major findings are as follows:

- Microcredit from smaller MFIs supported numerous income-generating activities, mostly of self-employment nature. A proportion of microcredit recipients owned cattle, and control land ownership; the participants earned higher income from livestock than non-participants.
- Self-employment accounts for a higher share of (regular) program participants' annual income, compared to others. However, petty trading activities dominate, accounting for almost half the income earned from self-employment activities. While the direct and indirect impacts of microfinance have all led to increases in rural self-employment activities, it is primarily in the area of transport services where the programs have made significant contribution.
- Estimates on household income showed that self-employment activities were most severely affected by the flood. As a consequence, real income of poor households declined during the flood year, even though the average income of all sample households had increased. Participation in programs and access to credit had however helped in containing the negative effects of flood.
- Multivariate analysis in the study shows that there is significant positive effect of regular program participation on income and on average consumption of poor households. Particularly, increases in the consumption of pulse, fish and milk are more prominent among MFI borrowers, when controlled for land ownership.
- Both head-count and poverty gap measures show that regular participation registered a faster rate of poverty reduction than occasional participants, and reduction in poverty among the latter was faster compared to non-participants. A comparison across the first (1997-98) and the third (1999-2000) round shows the larger percentage of program participants tend to invest on both human and physical capital.
- Participation in MFI programs is found to have led to decline in gender gap in access to schooling and to modern health care.
- Generally, the study finds program participants to be less vulnerable to crises even though they face similar degree of crises as non-participants.

A summary of major quantitative impact studies has been presented by Rahman [2000] as reproduced below:

Table 4: Impact of microcredit on household income/expenditure

Source	Name of organization studied	Income or expenditure per annum (Taka)	Participants	Control (non-participants)	% change
Hossain 1984	GB	Income, per capita	1762	1346	30.9
Hossain 1988	GB	Income, per capita	3524	2523	39.7
BIDS 1990	BRDB	Income, per household	6204	4260	45.9
BIDS 1990	BRAC-RDP	Income, per household	2844	1560	82
IMEC 1995	Proshika	Income, per household	22,244	17,482	27.2
Rahman 1996	PKSF	Expenditure, per household	26,390	23,802	10,9
Khandakar 1998	BRAC	Expenditure, per capita	5180	4202	23.3
Khandakar 1998	GB	Expenditure, per capita	5050	4335	16.5
Khandakar 1998	RD-12	Expenditure, per capita	4931	4279	15.2
Halder 1998	BRAC	Expenditure, per capita	8244	6480	27.2
BIDS 1999	PKSF	Expenditure, per capita	36,528	33,732	8.3
IMEC 1999	Proshika	Income per household	48,635	43,584	11.6

Source: Rahman [2000]

The sector has observed gradual loss of interest for rigorous quantitative analysis for several reasons: high expenses; need for experienced expert human resources to conduct such studies; and on many occasions researchers reported difficulty of finding 'control groups' due to massive expansion of microfinance programs to make any meaningful conclusion about the impact of any particular program. Methodological innovations have been made to isolate impacts of overall microfinance program even if a particular borrower receives loans from many different sources. At the same time, researchers face challenges to isolate social and economic impacts of microcredit because such impacts are and can be derived from many different sources.

This has led to application of qualitative approaches of impact study emphasizing the views of the members/borrowers to determine impact of microfinance. This type of approach starts with the notion that the members/borrowers are in the best position to say whether they have benefited from the program. This approach is cost-effective, which also tries to bring out the various qualitative and social aspects of impact of microfinance as well as other development interventions.

3. Commercial Banks in Retail Microcredit

Commercial banks

The formal banking sector comprises four categories of organizations: the state-owned banks (nationalized commercial banks (NCBs)) namely Sonali, Agrani, Janata, and Rupali Banks; six specialized; private banks; and foreign (commercial) banks. Following the success of Grameen Bank the four NCBs and two agricultural banks started to offer retail microcredit by replicating group-based management technology, in addition to their individual small loans for agricultural as well as other purposes. Invariably all such group-based programs managed directly by the bank staff members have collapsed with huge default of loans. Currently NCBs have largely abandoned lending to group-based small loan programs but have maintained their original individual loan operations. Commercial banks, state-owned and private, are offering 'wholesale loans' to MFIs at interest rates varying between 10-15%. The exception is IBBL, which has large retail microfinance operations as described below in this paper.

RDS-IBBL

Islami Bank Bangladesh Limited was founded with the major objective of establishing Islamic economy for balanced economic growth by ensuring reduction of rural-urban disparity and equitable distribution of income. Islami Bank Bangladesh Limited (IBBL), the largest private bank in the country is the only commercial bank that offers Grameen styled retail microcredit to a large number of borrowers. The microcredit program known as 'Rural Development Scheme' was launched in 1995 as pilot program styled after the Grameen Bank model except that the scheme used Islamic modes of investment. The program runs side by side with the commercial banking operation of the bank and forms groups of women to provide small loans.

RDS caters to the investment needs of the agriculture and rural sector to create opportunity for generation of employment and raising income of the rural people with a view to alleviate poverty. Branches of the Bank are encouraged to invest their deposits in their respective areas and in particular for the economic uplift of the rural people.

Objectives: The main objectives of RDS are:

- To extend investment facilities to agricultural, other farming and off-farming activities in the rural areas.
- To finance self-employment and income generating activities of the rural people, particularly the rural unemployed youths and the rural poor.
- To alleviate rural poverty through integrated rural development approach.
- To extend investment facilities for hand tube-wells and rural housing, keeping in view the needs of safe drinking water and housing facilities of the rural dwellers.
- To provide education and Medicare facilities to the down-trodden people.

Area Selection: Initially RDS started as a pilot operation in the rural areas of several districts under the direct supervision of the nearby Branches of the Bank. At present, it is extended to all the 61 districts out of 64 districts of the country through 139 Branches of the Bank. The metropolitan areas and three Chittagong Hill Districts are kept outside of RDS.

Command Area and Baseline Survey: Each designated Branch selects villages within a radius of 16 km of the Branch. Following criteria are followed to select a village:

- Ease communication so that staff members can easily attend weekly meetings;
- Availability of agriculture and other off-farm activities; and
- Abundance of low-income people;

After primary selection of an area consisting of 4 to 6 villages, the Branch conducts detailed baseline survey to identify the target group people (clients/customers) and varieties of business opportunities in the area. The Branch has to ensure the availability of at least 400 target group people in the selected area.

Present operations: The present size of RDS is presented in the following Table 5.

Table 5: IBBL RDS (Microcredit)

Description	2005	2006	2007	2008	2009
# of branches offer RDS	101	118	129	136	139
Villages	4,560	8,057	10,023	10,676	10,751
Members/clients	217,445	409,575	516,725	577,740	492,475
Investment Outstanding (Taka million)	1,106.47	2,242.21	2884.66	3,011.72	3752.2

Source: RDS/IBBL 2009

4. Comparison of Financial Services: RDS versus MFIs

This section is devoted to present RDS is details in comparison with a typical MFI. In this connection we will mention various policies of RDS, Grameen Bank, ASA, BRAC and BURO Bangladesh, as appropriate to compare and contrast various issues. We follow a similar methodology of Hassan and Dewan (2002) to do this comparative analysis of Islamic and conventional microfinance institutions.

Target market or client groups

We mentioned that MFIs broadly offer financial services to four different segments: hardcore poor, moderately poor (mainstream microcredit), microenterprise and marginal and small farmers. However, not all MFIs offer services to all four segments. RDS basically offer services to all four segments, although the bulk of the investments is for moderately poor families. RDS defines its target population as follows:

- Physically fit and industrious rural poor within age group of 18-50 and permanently reside in command are of the branch;
- Farmers having cultivable land maximum 0.50 acres and or sharecroppers;
- Persons engaged in very small off-farm activities in the rural areas;
- Destitute women; but
- Persons with loan outstanding with other banks/institutions are not eligible for investment under RDS.

The target groups are similar to any other MFIs in the country and expected to be the same because MFIs and RDS-IBBL operates in the same geographical areas. In 2003 RDS introduced loan for microenterprises to offer larger loans to ‘graduated clients’.

Group management

RDS has literally replicated basic Grameen Bank’s group management system as its basic field structure as follows:

- Small Groups to be formed consisting of 5 members preferably of similar professions/ occupations.
- The members of the Group select their Group Leader and Deputy Group Leader to co-ordinate the Group activities. After formation of the Group, the Branch Manager visits the Group and has discussion with the Group members and then he gives formal recognition of the Group through issuance of Pass Books.
- A Centre is formed by minimum 2 to maximum 8 Groups. The group leaders under a particular centre select the Centre Leader and Deputy Centre Leader from amongst themselves to co-ordinate the Centre activities.
- The Centre has to conduct regular weekly meeting. The weekly meetings are to be organized in a particular place, day and time as decided in the meeting of the Centre.
- Centre meetings are recorded in a Resolution Book along with signature of the members (members who do not know signature must learn it). Attendance in the Centre meeting is the first requirement to become a dependable client member of the Scheme.
- The Centre meetings are conducted by the Field Officers with the following agendas: (a) Discussion on different Islamic topics, moral values, social rights & responsibilities, (b) Collection of Investment Installments, Personal Savings, Centre Fund etc., (c) Appraisal & approval of Investment proposals, etc.
- Investment client are selected in the Centre meeting and supplied with the application forms and other related papers. On finalization of the investment application, the list of the selected clients, supported by their applications, are

submitted to Branch Manager duly signed by the Group Leader, Centre Leader, Field Officer and Project Officer.

- Each member of the Group has to provide guarantee against investment of other members of his Group. If any member of a particular Group does not comply with the principles or rules of the Group, then other members make him compelled to observe Group discipline, otherwise they held responsible to recover the defaulted amount and/or loss, if any. Such defaulter member(s) are expelled from the Group for breach of Group discipline and will never be allowed any investment facility or any other benefit in future from the Bank.

Savings products and Policies

RDS' savings: As a commercial bank it can legally collect savings and offer different types of savings products. Basic savings systems are as follows:

- The members of the Group have to open Mudaraba Savings Account (RDS) in their individual names with the Branch from the very inception of the Group activity.
- This Mudaraba Savings Account is non-cheque account, which induces the clients to make a habit of compulsory savings.
- This savings may, however, be withdrawn by the member if he does not have any other liability with the Branch in any way.
- The weekly compulsory savings is minimum Taka10.00.

This seems more restrictive than savings products offered by the Grameen Bank and ASA, another leading MFI in the country.

Grameen's savings products: The Grameen Bank with permission from the government has devised several savings products for members (and some of them are also applicable for non-members):

- *Special Savings Account*: Mandatory weekly savings of minimum Taka 5 is accumulated in this account. In addition, 5% of loan is kept as mandatory savings of which 2.5% is accumulated in this account. Members have easy access to this account and do not have to maintain any minimum balance. The interest rate is 8.5%.
- *Special Savings*: The remaining 2.5% of the loan disbursement is kept as special savings, which earn 8.5% interest. Members can withdraw savings but have to maintain Taka 2000 as minimum balance.
- *Time Deposit (Fixed Deposit):* Members may deposit any amount for one, two or three years to earn 8.75%, 9.25% and 9.5% annual interest respectively.
- *Grameen Pension scheme (5 or 10 year period)*: The most popular savings scheme is GPS with options for 5 and 10 years, where members deposit Taka 50 or multiple of Taka 50 per month for a period of 5 or 10 years to receive a lump-sum at maturity. The interest rate is 10% and 12% compounded annually for 5 and 10 year option respectively. For borrowers with 'basic loan' more than Taka 8000 participation in

the GSP scheme at least Taka 50 per month is mandatory. External reviewer even goes to say this product may revolutionize savings and capital formation for the poor [Rutherford 2006].

- *Double in 7 Year Deposit:* Members may deposit Taka 10 000 or multiple thereof to receive double that amount in 7 year period. This is a long-term time deposit, which earns approximately 10.41% interest.
- *Monthly Profit Deposit Scheme*: Another form of time deposit with an option to receive monthly interest payment. The scheme has two options: 5 and 10 year and deposit should be a multiple of Taka 10 000. For Taka 100 000 deposit, the monthly interest payment by the Bank is Taka 800 and Taka 850 for 5 and 10 year option respectively. An estimated equivalent annual interest rate is 10.6%.

ASA's Savings instruments: ASA has also a variety of savings instruments including death benefits (termed as 'insurance'): mandatory savings, voluntary savings and long-term savings. Besides, it has introduced 'members security fund' in two forms: for women every member deposit Taka 10 per week (in case of Small Business Loan Taka 50 per month) where members receive a lump-sum at maturity or the nominee receive six times the saved amount in case of her death. Husbands or other male family members are also allowed to save in this fashion but the nominee receives three times the saved amount.

Other MFIs: All small MFIs have mandatory savings and some offer additional 'voluntary savings' but in general the savings services are yet to develop fully to offer all poor members attractive savings services.

Centre Fund mandatory for RDS clients

Each member of the Group has to deposit minimum Taka2.00 per week in the Centre Fund. The fund is kept by opening a Mudaraba Savings Account in the name of the respective centre, which is utilized for the welfare of the members by way of Quard as per decision of the Centre in the weekly meeting. This refundable resource account is operated by Centre Leader & Deputy Centre Leader jointly.

Financial products and policies

Table 6 presents areas of investments, duration of investments and ceiling of RDS. It is apparent that most of the areas of investments are in agricultural sector. The loan ceiling and areas of investments are similar to typical MFIs. But one exception is that RDS may offer investment for more than one year whereas almost all loans from MFIs are for one year or less.

Table 6: Sector, Period and Ceiling of RDS investment

Sl.	Sector of Investment	Duration	Ceiling of Investment (Taka)
1	Crop Production	1 year	25,000
2	Nursery and commercial production of Flowers & Fruits	1 year	50,000
3	Agriculture Implements	1 to 3 years	50,000
4	Lives tocks	1 to 2 years	50,000
5	Poultry & Duckery	1 year	35,000
6	Fisheries	1 to 2 years	50,000
7	Rural Transport	1 year	20,000
8	Rural House Building	1 to 5 years	50,000
9	Off-farm activities	1 year	50,000

Source: RDS-IBBL, 2010

The members are provided investment maximum Taka 10,000 for the first time followed by larger investments subject to good performers. Investments allowed to an individual client in phased manner. Successful clients who utilized investments for production purposes consecutively for three years will be eligible to receive investment for housing purpose.

Rate of Return

The rate of return is determined by the authority from time to time, until march 2010 the rate used to 10% per annum (flat rate). At present, the rate of return is 12.5%. Timely repayment is encouraged by offering 2.5% rebate. Of the 12.5%, 1.5% is kept a welfare fund. Effective rate after rebate is 20% per annum, which is a major difference with typical MFIs. ASA, BRAC, BURO and many other MFIs effectively charge 30% interest per annum.

Collateral Requirements

Generally, collateral security is not required against investment under RDS. However, Group discipline should be strictly followed and complied with so that only the right persons are selected and included as members of the Group. But each member of the Group gives personal guarantee for other members of the same Group and the members are jointly and severally liable and responsible for payment of investment.

Modes of Investment

The Branch selects any of the following modes depending upon the sector and purpose of investment:

- Bai-Muajjal
- Hire-Purchase Shirkatul Meelk (HPSM) or Leasing
- Bai-Salam
- Murabaha

- Mudaraba
- Musharaka

Recovery of Investment

Usual practice is to collect investments in weekly installments for off-farm activities, especially in case of trading. For crop production investments installments are collected after harvest. For other agricultural activities, installments may be collected in quarterly basis. In case of MFIs, weekly collection is the main mode of collection. But monthly installments collection is practice for microenterprise loan and single installment collection system is practiced for crop loan.

Micro Enterprise Investment Scheme

To satisfy the demand for larger investments from the so called ‘graduated clients’ who already availed highest limit of investment under off-farm activities, a special scheme has been formed from Taka 50,000 to Taka 300,000, which has been introduced as Micro Enterprise Investment Scheme (MEIS). Local small traders may also be provided with investment facilities under this limit. This is similar to microenterprise loan offered by MFIs, which may offer loans up to Taka 500,000. In case of RDS, Field Officers and Project Officer explore the possibilities of investment in the area to recommend to the Branch. For MFIs, this segment is expanding fast and profitable because of larger loans size with same interest rate but same level of management efforts.

Management of Programs

All MFIs offer loans by opening branches all over the country. A typical branch will have 5-8 credit officers, a branch manager and an accountant. Various internal management systems such loan application, approval, disbursement, recovery, accounting and management information system are in place to manage microfinance operations. These are pretty much standard across MFIs. RDS also offer financial services from IBBL’s regular branches spread all over the country. It has also developed written policies, reporting forms and other formats to manage and control the program.

The investment under RDS is fully supervised. The Branch has the responsibility for the investment as well as recovery. To ensure 100% recovery the Field Officers make very close and intensive supervision over the clients. Moreover, the group approach is very helpful in this process. One Field Officer is appointed for 400 investment clients and one or more Assistant Officer/Officer is engaged in the Branch as Project Officer to supervise the activities of the Field Officers. One official from each Zone Office is assigned to supervise RDS activities of the Branches under the Zone. The Zone Officers visit the Branches at least twice in a year. Head Office Officials also visit the activities in the Branch level once in a year. Moreover, weekly, monthly, quarterly and annual statement of RDS activities of the Branches are prepared and sent to the higher authority to monitor and evaluate regularly.

Outreach of RDS

Since its beginning RDS has been steadily expanding the services of rural areas. Table 7 provides the information of last five years: By 2009 139 branches offered RDS and reached about 500,000 clients which makes IBBL one of the top 10 MFIs offering microfinance; IBBL reached about 11,000 villages (about 13% of total Bangladesh villages); and outstanding investments reached Taka 3752 million (USD 53.6 million).

Table 7: IBBL RDS (Microcredit)

Description	2005	2006	2007	2008	2009
Branches offer RDS (#)	101	118	129	136	139
Villages (#)	4,560	8,057	10,023	10,676	10,751
Members (#)	217,445	409,575	516,725	577,740	492,475*
Investment Outstanding (Taka million)	1,106.47	2,242.21	2884.66	3,011.72	3752.2

Source: RDS/IBBL 210; * non-participating members have been dropped

But unlike typical MFIs RDS has one critical bottleneck for expansion. MFIs in Bangladesh can open any number of branches without any permission from MRA that allows them to expand fast whenever they decide to do so. But RDS is offered from regular branches of IBBL. But IBBL can not open branches without the permission of Bangladesh Bank (the Central Bank), that is normally a slow process and needs to fulfill preconditions. Although demand for RDS is high in other parts of the country but RDS can be offered only where IBBL have rural branches.

Financing

The Bangladesh microfinance sector i.e. MFIs are broadly financed by the following types of resources: equity, that is, profit (surplus) and any grants that the concerned MFIs might have received from national and international sources; savings collected from clients, concessional loan received from sources such as PKSF and other similar agencies, and commercial bank borrowing. GOB has allowed mobilization of savings by MFIs from their members/clients even long before the Microcredit Act 2006 was enacted, which was single most important policy support for the sector although the laws under which NGO-MFIs were registered did not allow such collection of savings. We will use number of examples, BURO Bangladesh, Grameen Bank, BRAC and ASA to show the various in financing strategy of MFIs as opposed to RDS-IBBL.

Table 8 presents the comparative balance sheets of BURO (2006 and 2007). Balance sheets have been presented in two forms: actual Taka figures and assets as percentage of total assets and liabilities as percent of total liability. The second form reflects the importance of each asset and liability compared to total. The asset side of the comparative balance sheets provides interesting insights. As expected, BURO-B deploys about 85-88% of assets in loan program, the highest earning asset. It is unavoidable to have some cash and liquid investments (time deposits) since microfinance operations are managed through branch networks. But the percent also depends on fund management efficiency and good planning for the MFIs. Inefficiency and poor planning may lead to high cash balance in the banks. As MFIs grow big and accumulate profits, a part of the equity is converted into physical assets such as land and building, which is reflected as fixed asset. But our interest is how the loans are financed as will be seen by analyzing the liability side of the balance sheet.

Table 8: Balance sheet of BURO Bangladesh (2006-2007)

	Expressed in Taka in million		**Expressed as % of Asset and Liabilities**	
ASSET	**2006**	**2007**	**2006**	**2007**
Cash at hand and bank	27.31	123.35	1.57	5.54
Investment	60.00	69.46	3.45	3.12
Fixed asset	76.08	88.20	4.38	3.96
Other assets	32.67	50.22	1.88	2.26
Loan outstanding	1,541.70	1,894.43	88.72	85.12
Total assets	**1,737.76**	**2,225.66**	**100.00**	**100.00**
LIABILITY				
Loan	420.15	698.52	24.19	31.38
Members' savings	679.02	821.97	39.10	36.93
Other liabilities	47.09	52.73	2.71	2.37
Fund	590.50	652.44	34.00	29.31
Total liability	**1,736.76**	**2,225.66**	**100.00**	**100.00**

Source: Annual report BURO-B 2007 as presented in Alamgir, 2009

In 2007, 85% of its total asset is loan outstanding, which financed partly by equity/fund (29.31%), members' savings (36.93%) and loan from commercial banks and non-bank financial institutions (31.38%). The proportion of loan has increased compared to 2006 because BURO has financed its recent expansion mainly through commercial bank borrowing. Historically, BURO has been giving emphasis of savings which is 36.9% of liability and 43% of loan outstanding, a very important source of funds for microcredit operation. Since BURO has been a very profitable MFI 29% of total liability is basically accumulated profit that gives financial stability to its operations. The overall financing in case of BURO seems to be balanced divided into three sources. But increasing BURO is depending on commercial borrowing.

Financing Strategy of Very Large Organizations

Grameen Bank

The capital structure of the Grameen Bank is unique, that is, similar to that of a commercial bank, which currently fully depends on deposits to finance its loan program. Of the total liability in 2007, 80.7% is deposits from members and public, only 2.6% is institutional borrowing and 8.51% is capital and reserves. It has a small loan amount, which is residual of former loans. This structure has been possible due to its legal coverage as a bank to raise savings as well as additional permission from the government to offer various savings services. The deposits of the bank come from members' savings (various short and long-term deposits), deposits of staff members and deposits from other sources. No other MFI in the country has such legal basis, array of savings services as well as dependence on deposits to finance microfinance operations. That is, 88.13% of total liabilities come form savings and own funds. Additional insights can be obtained from Table 9 below which provides comparative balance sheet of Grameen Bank for 2004 to 2007 [Grameen Bank 2007]. At the end of 2007, the total deposit is 148% of loan outstanding, and deposit and capital combined is 163% of loan outstanding. These figures are 145% and 158% respectively at the end of December 2008 [Grameen Bank 2008]. That is, the bank is financed from internally generated resources. Grameen Bank has benefited enormously from its legal position compared to other MFIs, being the only MFI legally able to offer long-term savings products to its members and to take savings from the public. Besides, not many MFIs give the poor people access to their savings and pay good interest on savings other than Grameen Bank.

Table 9: Comparative balance sheet of Grameen Bank

	Expressed in Taka in million				**Expressed as % of Asset and Liabilities**			
ASSET	**2004**	**2005**	**2006**	**2007**	**2004**	**2005**	**2006**	**2007**
Cash at hand and bank	798	980	900	936	2.37	2.20	1.52	1.36
Investment	7,226	9,987	19,744	24,466	21.47	22.38	33.25	35.48
Fixed assets	906	955	1,045	1,115	2.69	2.14	1.76	1.62
Other assets	3,877	3,805	3,549	4,890	11.52	8.53	5.98	7.09
Loan outstanding	20,846	28,897	34,145	37,546	61.94	64.76	57.50	54.45
Total assets	**33,653**	**44,624**	**59,384**	**68,954**	**100.00**	**100.00**	**100.00**	**100.00**
LIABILITY								
Loan	2,896	1,917	1,855	1,793	8.61	4.30	3.12	2.60
Deposits	20,833	31,771	47,651	55,641	61.91	71.20	80.24	80.69
Other liabilities	3,566	3,382	3,766	5,654	10.60	7.58	6.34	8.20
Capital and reserves	6,358	7,554	6,111	5,866	18.89	16.93	10.29	8.51
Total liabilities	**33,653**	**44,624**	**59,384**	**68,954**	**100.00**	**100.00**	**100.00**	**100.00**

Source: Grameen Bank Annual Reports various years

ASA

The capital structure of ASA, one of three very large MFIs mentioned earlier, is unique in another sense. In 2005, the largest figure in the capital structure was capital fund (i.e. small amount of grants and accumulated profits) (55.28%) followed by savings (32.69%). The accumulated profit has been the result of efficiency of ASA. Another factor has also contributed to the profit is the rate of interest compared to the Grameen Bank, ASA charges 12.5%-15% on loans and Grameen Bank charges 10% [all flat rates]. The loan component as percent of total liability is also low (10.45%), which has been declining (loan amount is primarily from PKSF) ASA has not been borrowing from PKSF since

2005. ASA seems to be an MFI financed by equity. Its savings mobilization aspect also needs some explanation. ASA follows so called open and flexible deposit system, i.e. members have ready access to savings funds. But ASA has launched an interesting savings product which combines savings with 'insurance' element called Security Fund. This product with its long-term features has attracted significant resources to finance microcredit operations. Table 10 provides additional insights of ASA's financing strategy: equity is 65.4% of loan outstanding, and equity and savings combined is 104% of loan outstanding. That is, similar to Grameen Bank, ASA is also financed by internally generated resources, though the composition of sources is different.

Table 10: Comparative balance sheet of ASA

	Expressed in million Taka		**Expressed as % of total asset and liability**	
ASSET	**2004**	**2005**	**2004**	**2005**
Cash at hand and bank	1,137	997	7.15	5.17
Investment	2,944	1,011	18.51	5.24
Fixed asset	206	382	1.29	1.98
Other assets	186	593	1.17	3.08
Loan outstanding	11,428	16,303	71.87	84.53
Total assets	**15,901**	**19,287**	**100.00**	**100.00**
LIABILITY				
Loan	3,112	2,016	19.57	10.45
Members' savings	4,453	6,306	28.00	32.69
Other liabilities	493	303	3.10	1.57
Fund	7,844	10,662	49.33	55.28
Total liability	**15,901**	**19,287**	**100.00**	**100.00**

Source: ASA Annual Report 2005

BRAC

More than 80% of BRAC's total asset is loan outstanding. We see a different liability structure in case of BRAC compared to Grameen Bank and ASA. At the end of 2007, BRAC has three important components: Savings (31.83%), fund (20.65%) and loan (46.59%) [see Table 11]. The loans are mainly from commercial banks and a small amount from PKSF. Increasingly BRAC is financing its microcredit program using expensive commercial bank loans. BRAC raised funds from a consortium of commercial banks and through securitization instrument. BRAC has increased its members by 39% between 2006 and 2007. Loan outstanding from institutional sources has also increased by 269% and portfolio by 149%. But this approach is expected have adverse impact on profitability. However, the need for external resources depends on many factors including portfolio growth, profitability and savings policies. Grameen Bank and ASA's ability to introduce savings instruments as well as efficiency have reduced both institutions' dependency on external resources. On the other hand, BRAC seems to be increasingly depending on commercial loans for its huge expansion.

Table 11: Balance sheet of BRAC

	Expressed in Taka in million				**Expressed as % of Asset and Liabilities**			
ASSET	**2004**	**2005**	**2006**	**2007**	**2004**	**2005**	**2006**	**2007**
Cash at hand and bank	868	714	1,265	2,301	5.09	3.37	4.66	5.44
Investment	1,052	1,884	844	3,318	6.17	8.90	3.11	7.84
Fixed assets	1,449	1,417	1,388	1,346	8.50	6.69	5.11	3.18
Other assets	404	555	981	1,354	2.37	2.62	3.61	3.20
Loan outstanding	13,280	16,596	22,670	33,986	77.87	78.41	83.51	80.34
Total assets	**17,053**	**21,165**	**27,148**	**42,305**	**100.00**	**100.00**	**100.00**	**100.00**
LIABILITY								
Loan	3,943	5,371	7,327	19,710	23.12	25.38	26.99	46.59
Members' savings	7,657	9,159	10,595	13,467	44.90	43.28	39.03	31.83
Other liabilities	299	378	1,201	391	1.75	1.79	4.43	0.92
Fund	5,154	6,257	8,024	8,737	30.22	29.56	29.56	20.65
Total liability	**17,053**	**21,165**	**27,148**	**42,305**	**100.00**	**100.00**	**100.00**	**100.00**

Source: BRAC Annual Report 2005, 2006 and 2007 and recast by the authors

RDS-IBBL

Since RDS is part of a commercial bank it does not have a separate capital structure. However, its source of funds, as expected, is from IBBL resources, which in turn public deposits as for all commercial banks. RDS members also save, which is recycled as loan. As of July 2010, total savings balance from RDS members is Taka 1427.67 million, which is 32.5% of investment outstanding of Taka 4388.5 million. It seems that RDS' members' savings is similar to typical MFIs. The rest of resources come from IBBL mainstream deposits of IBBL.

5. Comparative Financial Performance: RDS-IBBL versus MFIs

We use four sets of indicators such as (a) outreach, (b) operating efficiency, (c) portfolio quality and (d) profitability to determine the viability of MFIs. We have used comparable data and indicators to analyze RDS as well. Table 12 presents the findings. As mentioned in the methodology section that BURO Bangladesh, a reputed MFI of comparable size with RDS, will be compared to reflect on the financial performance of RDS.

Table 12 presents the same four sets of indicators for BURO-B, one of the most prominent MFIs in Bangladesh which has been expanding fast over the last several years and continues to do so. The corresponding indicators for RDS, computed by the authors from data supplied by RDS, are also presented in Table 12. We will focus on i) Operating Self-sufficiency (OSS) defined as total income divided by total operating expenses and ii) Financial self-sufficiency defined as total income divided by total expenses including financial expenses. The microfinance program of BURO-B was profitable during 2005 to 2009. Note that the profitability has significantly declined over the years: OSS was 163% in 2005 but reduced to 107 in 2009; FSS was 136% was in 2005 but reduced to 102% in 2009. The decline in profitability has been due to cost factors: productivity has declined due to rapid expansion, loan portfolio has increased, more importantly cost of fund has increased. BURO-B depends very much on high cost commercial bank borrowing to finance its portfolio.

If we compare RDS with BURO-B we see that OSS is far superior in case or RDS: 206% in 2005 and 181% in 2009; the corresponding figures of BURO-B is 163% and 107% respectively. This can be explained by higher staff productivities of RDS reflected by number of members supervised by one loan officer and amount of portfolio per loan officer. In 2009, loan officer productivity of RDS is 326 compared to 209 of BURO-B. Similarly, portfolio per loan officer of RDS is Taka 2.48 million compared to Taka 1.13 million of BURO-B. The average loan size of RDS is slightly higher. We should also note that interest rate of BURO-B is 30% compared to 15% rate of return of RDS, which is half compared to BURO-B. If the interest would have been same RDS' performance would have been much superior. The FSS of RDS is higher (109%) compared to 102% of BURO-B. In other years FSS is somewhat similar. It seems that cost of fund of RDS is higher for RDS that reduces its FSS compared to its very high OSS. Another reason could be that it is not included overall IBBL's overhead cost in its expenditure data. Nevertheless it is clear that with half of the rate of return RDS could do as similar financial performance due to better operating efficiency.

Table 12: Financial Performance Indicators: BURO-B and RDS

	BURO-B					RDS				
INDICATORS	**2005**	**2006**	**2007**	**2008**	**2009**	**2005**	**2006**	**2007**	**2008**	**2009**
1.Extending Outreach										
Active customer (#)	273,286	331,329	376,710	602,273	746,938	217,425	409,575	516,725	577,740	492,475
Active borrowers (#)	209,808	263,503	354,020	496,603	621,391	164,116	295,012	350,278	321,484	312,036
Borrowers/Customer ratio (%)	77	79	94	82.45	83	75.48	72.03	67.79	55.65	63.36
Average loan size of the year (Taka)	6,375	7421	8416	9,035	9,999	10,178	10,731	12,139	13,963	18,800
2. Operating Efficiency										
Loan officer productivity (#)	318	213	206	242	209	250	299	300	357	326
Portfolio per Loan Officer (Taka)	1,347,714	1,006,335	1,062,208	1,347,787	1,133,317	1,270,000	1,640,000	1,670,000	1,860,000	2,480,000
Cost per 1000 Taka lent (Taka)	50	60	70	70	70	n.a	n.a	n.a	n.a	n.a
3. Portfolio Quality										
On time recovery rate (OTR) (%)	98.07	98.17	98.07	98.05	98.15	99	99	99	99	99
Portfolio at risk (>60days) (%)	1.69	1.73	2.89	2.47	3.34	n.a	n.a	n.a	n.a	n.a
Write off ratio (%)	0.14	0.24	0.33	0.60	1.32	n.a	n.a	n.a	n.a	n.a
4. Profitability Analysis										
Operating self-sufficiency (%)	163	136	118	109	107	206	197	213	163	181
Financial self-sufficiency (%)	136	122	107	104	102	120	122	115	100.2	109

Source: Annual reports of BURO-B: 2006-2009 and RDS-IBBL; n.a= not available

We would also like to discuss financial performance of ASA and BRAC, two very large MFIs in Bangladesh each serving more than 7 million clients all over the country. But when it comes to profitability ASA is more profitable due to management efficiency. A set of critical indicators for ASA - operating efficiency, portfolio quality and profitability- is reproduced in Table 13. ASA makes high profit as indicated by Operational Self-sufficiency (OSS), Financial Self-Sufficiency (FSS) and Return on Asset (ROA). The superior financial performance of ASA is mainly due to its efficiency. The number of clients and portfolio per loan officer figures are unmatched in the industry. At the same time ASA has maintained high portfolio quality. But Table 13 shows a marked gradual fall in profitability: gradually reduced OSS, FSS and ROA compared to 2002. OSS, FSS and ROA figures were 230%, 154% and 9.05% in 2002 respectively which became 143% (37% drop), 114.3% (26% drop) and 3.02% (only one third of 2002) in 2008 respectively. The main reason is fast rise of operational expenses with expansion. At the same time portfolio at risks has risen from 0.33% in 2002 to 4.99% in 2008.

Available data shows that BRAC has been improving profitability since 2001 but significantly declined 2007 (see Table 14). OSS was 229% in 2006 but fell to 184% (drop of 20%) in 2007. Similarly, FSS was 137% in 2006 but became 106% (22.6% fall) making microfinance operations marginally profitable. ROA was 7.03% in 2006 which became 1.47% (79% drop from previous year) in 2007. The reasons are two folds: increase in management cost between 2006 and 2007 when BRAC expanded its membership by 39%; and the massive expansion was financed by expensive commercial bank borrowing.

Both the case of ASA and BRAC shows gradual decline in efficiency and increase in cost and decline in profitability. It seems that there is link in both cases between falling performance and rapid expansion: in case of ASA increase of operational cost and in case of BRAC increase more in financial cost. If we compare RDS with ASA and BRAC we can conclude that RDS has similar financial performance with half the interest rate charged by ASA and BRAC.

Table 13: ASA: Critical Financial Viability Indicators: Overall MF

Important indicators	2002	2003	2004	2005	2006	2007	2008
Profitability indicators							
Operational self-sufficiency (%)	230.8	265.5	244.6	275.2	238.1	187.1	143.6
Financial self-sufficiency (%)	154.9	175.1	158.5	169.7	155.2	127.7	114.3
Return on assets (%)	9.05	11.45	9.57	10.71	9.36	5.7	3.02
Operating efficiency indicators							
Number of clients per loan officer	448	461	430	631	558	451	504
Number of borrowers per loan officer	414	419	397	441	446	367	412
Average loan size	7507	8603	7517	7129	7430	7868	9039
Portfolio per Loan officer (Taka million)	1.7	1.97	1.72	1.78	1.81	1.67	2.14
Portfolio quality							
Portfolio at risk > 30 days as % of total portfolio	0.33	0.45	0.69	1.22	1.85	3.36	4.99

Source: ASA 2008

Table 14: BRAC: Critical Financial Viability Indicators of Microfinance Program

Important Indicators	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Operational Self-sufficiency (%)	167.31	184.84	198.51	207.10	196.13	229.4	184.4
Financial Self-sufficiency (%)	112.53	117.98	126.80	116.75	130.65	136.88	106.6
Return on Total Asset (%)	n.a	3.26	4.73	3.39	5.80	7.03	1.47
Return on Equity (%)	n.a	10.43	14.98	10.95	19.43	23.86	6.08
Loan Recovery Rate (%)	98.85	99.27	98.04	99.32	99.49	99.52	99.54

6. Conclusions

We can make several observations from the analysis of RDS and MFIs presented in this paper. The following will be important in the context of Bangladesh:

- IBBL is the only commercial bank now offers microfinance to the poor directly whereas state-owned and all other private banks have abandoned the poor. This has been possible due to its commitment and its management system where the bank has created a separate division along with appropriate human resources and management system similar to MFIs.
- As we have seen that the savings and investment policies of RDS-IBBL, especially areas of investment, ceiling of investments, collection policies are similar to those of the Grameen Bank and other MFIs. The group-based microcredit management system developed by the Grameen Bank has been successfully replicated by IBBL.
- But IBBL has been successfully applying Islamic modes of investments for small investments that itself a success and can be used for further expansion.
- Another very important difference beneficial to the poor is the rate of return, currently 20% per annum after rebate (used to be 15% until March 2010), is two-third of large MFIs (30% per annum).
- Although the demand for Islamic microfinance is huge, IBBL finds it difficult to expand RDS because of small number of branches. MFIs do not face that constraint as they do not need permission MRA to open new branches.
- Financial performance is comparable, if not superior to MFIs of similar size and large MFIs, even with its lower rate of return (should be interpreted as rate of interest for MFIs) (15% RDS versus 30% of MFIs). Apparently this has been due to better operating efficiency.

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