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# Assessment of Enabling Condition of Rural Financial Services Development in Bangladesh

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# Assessment of Enabling Condition of Rural Financial Services Development in Bangladesh

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# Message

Over the years, we have witnessed the growing and improving condition of Bangladesh economy. Supported by very strong policies and development programs, Bangladesh is now recognized as one of the leading developing countries in terms of its support to its people especially in the rural areas to be more viable and vibrant.

In the rural areas, more and more organizations are taking an extra effort to address the living conditions of people while focusing on poverty, health and nutrition and economic activities. These are also the reasons why the financial sector is reinventing strategic innovations and developing appropriate products and services.

Several institutions from government and non-government organizations place financial support services their top priority in addressing the required needs of people engaged in farming, fishing, small businesses, enterprises not to mention the need for household expenses such as education and health services. Given these, the challenge of providing these services is the number one agenda of every Bangladeshi organization.

The commissioned assessment of Bangladesh financial condition is a welcome initiative for our institutions working on rural finance, social and economic development and policy advocacy.

This document will serve as a guide in making a change in our sector especially those who need it the most. We are thankful to the IFAD-APRACA FinServAccess Project through Dr. Marlowe U. Aquino, Project Manager for tapping a very strong research team led by Ms. Jovita M. Corpuz to assess the Bangladesh financial services and enabling condition to be improved further through the recommendations.

In APRACA together with the Bangladesh Bank we will work on the findings as an added reminder and basis to develop appropriate and strategic interventions for our people to enhance access to finance more effectively and efficiently. Also, may our other excellent researchers in rural finance and development sectors find this document relevant in expanding further the horizon of discovery for people and communities improved lives.

**SHITANGSHU KUMAR SUR CHOWDHURY**
APRACA Chairman
and Deputy Governor
Bangladesh Bank

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# Executive Summary

Bangladesh is one of the most densely populated countries, with 50 million Bangladeshis living below poverty line, 70% of which are in the rural areas. The economy is largely agricultural with more than 47% of the population directly employed in agriculture and 70% indirectly dependent for their livelihood. It has a growing service and manufacturing sectors, contributing at an average of 56% and 17% in the gross domestic product (GDP) of the country, respectively, for the last five years. Only natural crisis remains a major worry. However, people are very hard working and resilient.

Bangladesh has hosted a number of successful financing initiatives and breakthroughs, including green banking, mobile banking, and the internationally acclaimed microcredit initiatives. Furthermore, to foster a conducive environment for the achievement of financial inclusion, the Government of Bangladesh (GoB), through the Bangladesh Bank (BB), with its monetary and credit policy stance has been supporting the attainment of the government's inclusive growth and poverty reduction goals in line with the United Nations (UN) Millennium Development Goals (MDGs). The BB has been placing particular focus on the vulnerable sectors such as women, low income groups, small enterprises, the agriculture sector, and rural-based income generating activities.

However, in spite of numerous effort and initiatives to uplift the standard of living of the population through innovative financial services, poverty, particularly in the agriculture sector remains prevalent and credit, inaccessible. This study was conducted to assess and look into the gaps and enabling conditions of Bangladesh rural and agri-finance programs and initiatives.

The study collected and analyzed data using desk review and content analyses of existing literature including recent studies, papers, reports, articles primarily through internet searches and conduct of field visits to undertake: key informant interviews (KIIs) with selected financial service providers and relevant government financial and non-financial institutions, and one-on-one interviews with sample farmer-borrowers. A total of three microfinance institutions, three banks, four government institutions, and one international organization were visited and 64 sample farmer-borrowers were interviewed.

Bangladesh is part of the Next Eleven, also known as N-11 of emerging market of developing countries identified by Goldman Sachs investment bank and economist Jim O'Neill in a research paper as having a high potential of becoming among the world's largest economies in the 21st century and one of the Frontier Five comprising developing countries which are more developed than the least developing countries, but too small to be generally considered an emerging market.

The reforms towards a more market-based economy implemented during the 1980s and the process of trade liberalization that occurred in the 1990s have paved the way towards greater modernization of the Bangladesh economy. Eradication of extreme poverty and hunger by 2015 is one of the prime goals of the GoB as set out in the UN MDGs. Bangladesh is already ahead of many developing countries in terms of achieving the targets of MDGs. Palli Karma Sahayak Foundation (PKSF), various banks, and NGOs are collaborating with the implementation of programs of the government addressing poverty reduction. Various ministries including the Finance Division of the Ministry of Finance (MOF) have been relentless in implementing other programs along with microcredit programs.

Although Bangladesh is on track of becoming a Middle Income Country status by 2021, agriculture remains the largest employer in the country by far. Almost half (47.3%) of the population is directly employed in agriculture and around 70% depends on agriculture in one form or another for their livelihood. Agriculture is the source of food and feeds and the source of raw materials for industry, and timber for construction. The sector is a generator of foreign exchange for the country through the export of raw or processed agricultural commodities. It is the driver of the development of the agro-industrial sector including food processing, input production and marketing, and related services. As the main source of economic linkages in rural areas, agriculture plays a fundamental role in reducing poverty, especially in rural areas.

To sustain agricultural growth, the GoB is expanding its financing programs toward improving agricultural productivity and diversifying crops, and promoting the introduction of high yields and high market value crops. In addition to these programs, it provides more financing on agricultural activities, mainstreaming women in economic activities, adoption of innovative technology to improve banking experiences and institute agent banking.

The actual financing for agriculture is a mere 30% of the total demand (JICA, 2014), and the financing gap among small-scale and marginal farmers is particularly acute. While 90% of agricultural loans are provided by banking institutions, small-scale and marginal farmers cannot readily provide collateral, severely restricting their access to loans from banks which require a guarantee to secure the loan. Furthermore, as rural microfinancing is focused primarily on small loans for household financing, small-scale commerce and domestic industry, it does not suit the agricultural production cycle and cannot meet the needs for investments in agricultural equipment and supplies. As small-scale and marginal farmers lack agricultural technology, promoting new crop cultivation and the introduction of high-yielding varieties and agricultural equipment is a challenge both from a financing and a technical standpoint.

While informal sources of loans are prevalent in Bangladesh, the main sources of finance in agriculture are still the state-owned banks; BKB, RAKUB, and state-owned commercial banks (SCBs) are the major players in agriculture credit. In 2014, the BKB, RAKUB and SCBs disbursed nearly 60% (BDT 93.5 billion or USD 1.2 billion) of the total agricultural loans amounting to BDT 160.4 billion (USD 1.9 billion).

Rural finance in Bangladesh offers a variety of services which include, in addition to agricultural production credit, loans to rural households for non-farm activities, and other financial services such as rural savings and life and general insurance.

The financial system of Bangladesh is comprised of three broad fragmented sectors: the Formal Sector, Quasi-Formal Sector and the Informal Sector. The categorization is based on the extent of regulation in the sectors. The Formal Financial Sector is comprised of regulated institutions categorized under the Money Market and the Capital Market. The Quasi-Formal Sector is composed of institutions which are regulated but do not fall under the jurisdiction of financial regulators in Bangladesh. The Informal Sector, on the other hand, includes private intermediaries which are completely unregulated. This sector includes moneylenders and traders, village shopkeepers, landlords and rich farmers, as well as relatives and friends of borrowers.

Over the years, the GoB has implemented policies and programs to ensure inclusive growth in the country. In particular, financial inclusion is the fulcrum of its policies and programs. The BB defines financial inclusion as access to financial services from: (1) officially regulated and supervised entities such as Bangladesh Bank licensed banks and financial institutions, MRA licensed MFIs and registered cooperatives; and (2) official entities such as post offices offering savings, money transfer and insurance services, and national saving bureaus (Choudhry, 2014).

In terms of improving the access of the poor to agricultural credit, Dr. Yunus has established the Grameen Bank which can be considered today as the pioneer of microfinance. The Grameen approach has broken all barriers for reaching the poor with credit, especially poor women. The main breakthrough in the Grameen approach is its influence in convincing financial institutions that the poor are bankable, and that they utilize loan properly and repay on time. In 1983, the Grameen experience had proven that an institution with a mission to serve the poor, equipped with the right kind of savings and loan products, policies and management system and human resources, could effectively reach the poor and at the same time make a viable financial institution. The simplicity of methodology developed by the Grameen Bank has inspired many non-governmental organizations to replicate the model and offer similar financial services to the poor.

Today, the main incentives for NGOs which are normally involved in many social programs such as education, health, relief and rehabilitation to shift into microcredit Grameen style are demand from the members, opportunity to become self-reliant, and creating sustainable permanent institution, and career for staff members. Several variations of replications are made, mainly in terms of interest rates, savings and loan ceilings, sizes of groups, but not much on the fundamental structure of the model.

About 70% of households in Bangladesh have access to many kinds of financial services (savings, credit and/or insurance services in formal, quasi-formal and informal markets/), according to the Institute of Microfinance Access to Financial Services in Bangladesh Policy Brief. In terms of access to credit, about 54% have access to any source, with the biggest percentage (37%) obtaining credit from quasi-formal sources such as MFIs and cooperatives. Only 8% of households have access to formal credit market. Access to credit is higher among households living in the rural regions of Bangladesh, with 56% of households with access to credit compared to urban households with only 46% incidence. However, borrowing from non-formal sources is still prevalent among rural households with 44% incidence, as against the 17% prevalence among urban households.

The banking sector of Bangladesh is composed of four categories of scheduled banks namely, State-owned Commercial Banks (SCBs), State-owned Development Financial Institutions (DFIs), Private Commercial Banks (PCBs) and Foreign Commercial Banks (FCBs). Nine (9) newly licensed PCBs have started functioning in this year. The number of banks increased from 47 in 2012 to 56 in 2013 with a total number of 8,685 branches as of December 2013. The number of bank branches increased from 8,322 in 2012 to 8,685 in 2013 due to opening of new branches mainly by the PCBs, DFIs and SCBs during the year (Table 11). At the end of June 2014, the total number of bank branches increased further to 8,794, with total number of banks remained unchanged at 56.

The microfinance sector of Bangladesh has further improved its capacity to make its financial services more geographically accessible to the rural poor. The number of MFIs licensed by the Microcredit Regulatory Authority (MRA) increased from 419 in 2009 to 742 by the end of FY 2014. These licensed MFIs have a total of 14,730 branch offices all throughout Bangladesh employing 131,628 staff.

Furthermore, to ensure that the growth of the financial sector is balanced between urban and rural areas and between smaller and larger clients, the Government of Bangladesh (GoB) has introduced initiatives in facilitating rural credit. The government created Bangladesh Krishi Bank (BKB) in 1973 and Rajshahi Krishi Unnayan Bank (RAKUB) in 1987 to serve rural areas, and Bangladesh Small Industries and Commerce Bank Limited (BASIC) in 1988 to promote small industries in urban and rural areas. BKB and RAKUB play key roles in delivering financial services to rural households. In 2013, these banks (along with other specialized banks) accounted for 31% of bank branches in rural areas (Bangladesh Bank, 2014). With 1,029 branches now, BKB covers all of Bangladesh except the Rajshahi division—which is covered by RAKUB, with 377 branches. Both banks are entirely owned by the MOF, with state-appointed boards of directors and management. With 69 branches across the country, BASIC was created to be the main provider of credit to small industry in urban and rural areas.

Moreover, a recently introduced government policy encourages banks, especially private ones, to expand their activities in rural areas. The BB requires that banks have one rural branch for every four urban ones. While the GoB is committed to financial inclusion, many issues continue to impinge on its policies and programs in agricultural financing.

Based on this study, the following are the recommendations which the Bangladesh Bank (BB) and the Microcredit Regulatory Authority (MRA) may consider in designing the policies and programs for financial inclusion. Aside from these, both institution should work closely to establish strong partnerships with other national government agencies, non-government organizations including international development organizations which are working directly for smallholders and countryside development.

- Allow MFIs to accept deposits from the public
- Allocate New Funding for Agricultural Credit
- Enhance Policy and Coordination Structure
- Establish an Agricultural Insurance Program
- Create an Agricultural Guarantee Program
- Expand the Coverage of the Credit Information Bureau
- Evaluate the Impact of the Credit Subsidy
- Enhance Procedure for Loan Targeting
- Pilot Innovative Financing Schemes (IFS)
- Provide Institutional Capability Building (ICB) Support

# List of Acronyms

| | |
|---|---|
| ABL | Agrani Bank Limited |
| ACFID | Agricultural Credit & Financial Inclusion Department |
| AMP | Agricultural Microfinance Program |
| ARCPP | Agricultural and Rural Credit Policy and Programme |
| BASIC | Bangladesh Small Industries and Commerce Bank Limited |
| BB | Bangladesh Bank |
| BBS | Bangladesh Bureau of Statistics |
| BDT | Bangladesh Taka |
| BKB | Bangladesh Krishi Bank |
| BRDB | Bangladesh Rural Development Board |
| CBAP | Cooperative Bank Agri-lending Program |
| CBO | Community-Based Organization |
| CIB | Credit Information Bureau |
| CPI | Consumer Price Index |
| CRAR | Capital to Risk Weighted Assets Ratio |
| DFI | Development Financial Institution |
| DITF | Deposit Insurance Trust Fund |
| FCB | Foreign Commercial Bank |
| FGD | Focused Group Discussion |
| FSRP | Financial Sector Reform Program |
| FY | Fiscal Year |
| GDP | Gross Domestic Product |
| GNI | Gross National Income |
| GoB | Government of Bangladesh |
| HIES | Household Income and Expenditure Survey |
| IDRA | Insurance Development and Regulatory Authority |
| IFAD | International Fund for Agricultural Development |
| IPAP | Integrated Poverty Alleviation Programme |
| IRRI | International Rice Research Institute |
| KII | Key Informant Interviews |
| MDG | Millennium Development Goal |
| MFI | Microfinance Institution |
| MOF | Ministry of Finance |
| MRA | Microcredit Regulatory Authority |
| NBFI | Non-Bank Financial Institution |
| NCB | Nationalized Commercial Bank |
| NGO | Non-Government Organization |
| PCB | Private Commercial Banks |
| PEP | Productive Employment Programme |
| PKSF | Palli Karma Sahayak Foundation |
| PO | Partner Organization |
| PPP | Palli Progoti Prakalpa |

| | |
|---|---|
| PRDP-II | Participatory Rural Development-II |
| RAKUB | Rajshahi Krishi Unnayan Bank |
| RBL | Rupali Bank Limited |
| RLP | Rural Livelihood Project |
| RPAP | Rural Poverty Alleviation Programmes |
| RSBSA | Registry System for Basic Sector in Agriculture |
| SBC | Sadharan Bima Corporation |
| SCB | State-owned Commercial Banks |
| SEC | Securities and Exchange Commission |
| SHG | Self-Help Group |
| UN | United Nations |
| USD | United States Dollar |
| WD | Women Development |

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# CHAPTER 1
# Introduction

## 1.1 Background and Rationale

Formerly East Pakistan, Bangladesh gained independence from Pakistan in 1971 in the Bangladesh Liberation war. However, it was only in 1990 that democracy in Bangladesh was restored, after 15 years of military rule. Even then, the political scene remains volatile.

Bangladesh is one of the most densely populated countries, with 50 million Bangladeshis living below poverty line, 70% of which are in the rural areas. The economy is largely agricultural with more than 47% of the population directly employed in agriculture and 70% indirectly dependent for their livelihood. It has a growing service and manufacturing sectors, contributing at an average of 56% and 17% in the gross domestic product (GDP) of the country, respectively, for the last five years. Only natural crisis remains a major worry. However, people are very hard working and resilient.

Bangladesh has hosted a number of successful financing initiatives and breakthroughs, including green banking, mobile banking, and the internationally acclaimed microcredit initiatives. Furthermore, to foster a conducive environment for the achievement of financial inclusion, the Government of Bangladesh (GoB), through the Bangladesh Bank (BB), with its monetary and credit policy stance has been supporting the attainment of the government's inclusive growth and poverty reduction goals in line with the United Nations (UN) Millennium Development Goals (MDGs). The BB has been placing particular focus on the vulnerable sectors such as women, low income groups, small enterprises, the agriculture sector, and rural-based income generating activities.

However, in spite of numerous effort and initiatives to uplift the standard of living of the population through innovative financial services, poverty, particularly in the agriculture sector remains prevalent and credit, inaccessible. This study was conducted to assess and look into the gaps and enabling conditions of Bangladesh rural and agri-finance programs and initiatives.

## 1.2 Objectives of the Study

The general objective of the study is to analyze the present condition of Bangladesh towards responsive and innovative rural and agricultural finance development. Specifically, the study aims to:

(1) Determine the existing rural and agricultural development landscape of Bangladesh;

(2) Identify key factors towards rural and agricultural development highlighting innovations and approaches in the financial sector;

(3) Determine areas for improvement for more dynamic and responsive rural development;

(4) Critically analyze the issues and concerns including the constraints encountered by key players and stakeholders particularly on technological and financial access; and

(5) Recommend possible solutions and programs for collaboration, complementation and cooperation towards sustainable rural development.

## 1.3 Methodology

To gather the information required for accomplishing the objectives of the study, primary and secondary data collection methods were used, namely: (1) desk review of existing literature including recent studies, papers, reports, articles primarily through internet searches; (2) conduct of field visits to undertake: key informant interviews (KIIs) with selected financial service providers and relevant government financial and non-financial institutions, and one-on-one interviews with sample farmer-borrowers.

A total of three microfinance institutions, three banks, four government institutions, and one international organization were visited and 64 sample farmer-borrowers were interviewed. The field visit was conducted in Bangladesh from August 18-29, 2015.

## 1.4 Organization of the Report

The succeeding Chapters after the Introduction (Chapter 1) are organized as follows: Chapter 2 provides an overview of the socio-economic conditions in Bangladesh. Chapter 3 discusses the rural finance policy, structure, and regulatory framework. Chapter 4 presents the state of rural and agricultural finance and outreach of financial services to small agricultural households. Chapter 5 discusses the relevant issues and government initiatives to promote financial inclusion. Chapter 6 is the discussion on the major findings of the study including significant issues and challenges that may stymie the march to financial inclusion. Chapter 7 discusses recommendations for improving the rural and agricultural credit delivery system in Bangladesh. Finally, Chapter 8 summarizes and concludes the study.

# CHAPTER 2
# Socio-economic Conditions

Bangladesh is a developing country that is classified as a Next Eleven[1] emerging market and one of the Frontier Five[2]. The reforms towards a more market-based economy implemented during the 1980s and the process of trade liberalization that occurred in the 1990s have paved the way towards greater modernization of the Bangladesh economy.

## 2.1 Socio-economic Conditions

The economy of Bangladesh has been consistently growing, recording an average of 6.14% growth in the economy for the last five years. It continues to maintain its growth momentum in spite of the challenges emerging from the slow pace of global recovery and the destabilizing factors prevalent in the domestic front during the first half of the 2014 fiscal year (FY). For the previous fiscal year, GDP is provisionally estimated at 6.12%, slightly up from 6.01% in FY 2013. The growth is broad-based and well-supported by the three sectors of the economy: service, which has the biggest share (56.2%), followed by industry (27.9%), and agriculture (15.9%). The per capita national income reached USD 1,080 in FY 2014, up by USD 70 from USD 1,010 a year earlier. Inflation in 2014 stood at 6.2%, which is one percentage point lower than the previous year. Effective coordination between fiscal and monetary policy helped to maintain macroeconomic stability. Exports registered a growth rate of 6.3%, 3.8 percentage points higher than 2013. Inflow of remittances from overseas workers amounted to USD 14.2 billion, which is 1.61% lesser than the previous fiscal year due to the political turmoil and stagnant situation in manpower export (Dhaka Tribune, 2015). Despite the contraction of remittances inflow, the current account balance maintained surplus of USD 1,547 million (World Bank, 2014). As on 30 June 2014, foreign exchange reserve stood at USD 21,508 million, which is sufficient for about six months of import coverage. Exchange rate broadly remained stable during FY 2014. It is expected that the initiatives taken by the Government of Bangladesh (GoB) on fiscal and monetary fronts will help attain the desired growth targets. Population below national poverty line based on the 2010 is 31.5%. Incidence of poverty in rural areas is greater by 14 percentage points than in urban localities. Table 1 provides a summary of key socio-economic indicators of Bangladesh.

**Poverty**

Eradication of extreme poverty and hunger by 2015 is one of the prime goals of the GoB as set out in the UN MDGs[3]. The Millennium Development Goals Bangladesh Progress Report reveals that in terms of achieving Goal-1 along with some other important goals, the country has been achieving significant poverty reduction since 1990 (Table 2). The percentage of population under the lower poverty line, the threshold for extreme poverty, decreased by 25 percentage points from 56.7% in 1990. Poverty gap reduction has also been significant. From 17.2% during the baseline year (1991), poverty gap ratio went

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[1] Also known as N-11, are the eleven countries – Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, the Philippines, Turkey, South Korea and Vietnam – identified by Goldman Sachs investment bank and economist Jim O'Neill in a research paper as having a high potential of becoming among the world's largest economies in the 21st century.

[2] A type of developing country which is more developed than the least developing countries, but too small to be generally considered an emerging market.

[3] The Millennium Development Goals (MDGs) are the eight international development goals that were established following the Millennium Summit of the United Nations in 2000, following the adoption of the United Nations Millennium Declaration. All 189 United Nations member states at the time (there are 193 currently), and at least 23 international organizations, committed to help achieve the following Millennium Development Goals by 2015: (i) To eradicate extreme poverty and hunger, (ii) To achieve universal primary education, (iii) To promote gender equality, (iv) To reduce child mortality, (v) To improve maternal health, (vi) To combat HIV/AIDS, malaria, and other diseases, (vii) To ensure environmental sustainability, and (viii) To develop a global partnership for development.

**Table 1. Key Economic Indicators of Bangladesh**

| | |
|---|---|
| GDP, in billion USD (2014, World Bank) | 173.8 |
| GDP growth (2010-2014, World Bank) | 6.14 % |
| GDP growth (2014) | 6.11 % |
| Per capita GNI, atlas method, in USD | 1,080 |
| Per capita GNI, PPP method, in USD | 3,330 |
| GDP structure, at current prices (in %) | |
| Agriculture | 15.9 |
| Industry | 27.9 |
| Services | 56.2 |
| CPI (% change per year) | 7.0 (2000-2014) |
| Inflation (annual %) (2014) | 6.2 |
| Export of goods and services (annual %) (2014) | 6.3 |
| Import of goods and services (annual %) (2014) | (0.9) |
| Remittances | 1.61 |
| Unemployment rate, in % (2013, World Bank) | 4.3 |
| Labor force by sector, in % (2010, Bangladesh Bureau of Statistics) | |
| Agriculture | 47.3 |
| Industry | 17.5 |
| Services | 35.18 |
| Population (2014, World Bank) | 159. 1 million |
| Annual population growth rate (World Bank) | 1.2% (2010-2014) |
| Urban, in % of population | 34 |
| Rural, in % of population | 66 |
| Poverty Incidence, in % of population (2010, World Bank) | 31.5 |
| Urban, in % of population | 21.3 |
| Rural, in % of population | 35.2 |

Source: World Bank

**Table 2. Bangladesh Progress vis-à-vis MDGs**

| Goals, Targets and Indicators (revised) | Base year (1990/1991) | Status | Target by 2015 | Remarks |
|---|---|---|---|---|
| **Goal 1: Eradicate Extreme Poverty & Hunger** | | | | |
| **Target 1.A: Halve, between 1990 and 2015, the proportion of people below poverty line** | | | | |
| 1.1 Proportion of population below national upper poverty line (2,122 kcal/day), % | 56.6 | 31.5 (2010) | 29.0 | on track |
| 1.2 Poverty Gap Ratio, % | 17.0 | 6.5 (2010) | 8.0 | on track |
| 1.3 Share of poorest quintile in national consumption, % | 6.5 | 5.2 (2010) | n.a. | – |
| **Target 1.B: Achieve full and productive employment and decent work** | | | | |
| 1.5 Employment to population ratio, % | 48.5 | 59.3 (2010) | for all | not possible to achieve by 2015 |
| **Target 1.C: Halve, between 1990 and 2015, the proportion of people who suffer from hunger** | | | | |
| 1.8 Prevalence of underweight children under five years, % | 66.0 | 36.4 (2011) | 33.0 | – |
| 1.9 Proportion of population below minimum level of dietary energy consumption (2,122 kcal/day and 1,805 kcal/day), % | 28.0 | 19.5 (2005) | 14.0 | not possible to achieve by 2015 |

Source: Millennium Development Goals: Bangladesh Report 2012, Ministry of Finance Budget Report down to 6.5% in 2010. However, growth in employment is relatively slow especially in the formal sector because of the large share of the informal sector employment in total employment. Hence, the GoB is constrained to achieve its target of 100% employment in 2015. Also, the GoB has not been able to significantly decrease the proportion of population not having the minimum level of dietary energy consumption of 2,122 kcal a day. While reports indicate that the proportion of hungry people in total population of Bangladesh has declined from 34.6% in 1990 to 16.8% in 2012, the GoB has yet to achieve its target of decreasing its hungry population by 14% in 2015.

Bangladesh is already ahead of many developing countries in terms of achieving the targets of MDGs. Palli Karma Sahayak Foundation (PKSF), various banks, and NGOs are collaborating with the implementation of programs of the government addressing poverty reduction. Various ministries including the Finance Division of the Ministry of Finance (MOF) have been relentless in implementing other programs along with microcredit programs.

## 2.2 Agriculture Sector Profile

Although Bangladesh is on track of becoming a Middle Income Country status by 2021, agriculture remains the largest employer in the country by far. Almost half (47.3%) of the population is directly employed in agriculture and around 70% depends on agriculture in one form or another for their livelihood. Agriculture is the source of food and feeds and the source of raw materials for industry, and timber for construction. The sector is a generator of foreign exchange for the country through the export of raw or processed agricultural commodities. It is the driver of the development of the agro-industrial sector including food processing, input production and marketing, and related services. As the main source of economic linkages in rural areas, agriculture plays a fundamental role in reducing poverty, especially in rural areas.

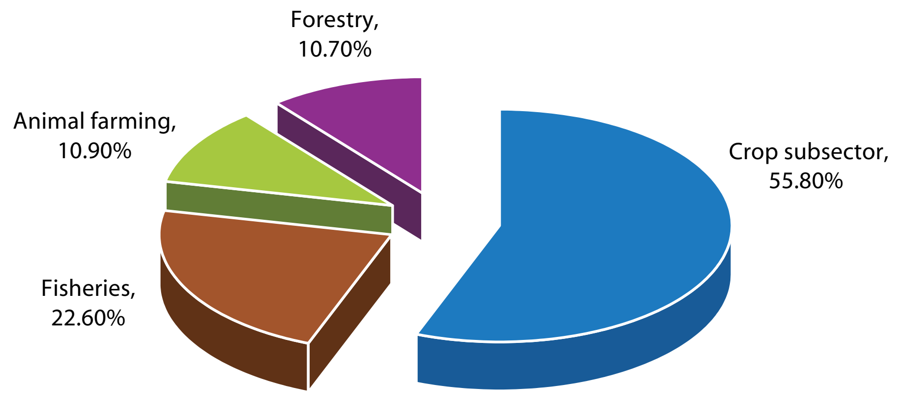
Agriculture is also fundamental in promoting nutritious diets, especially in the countryside where production and consumption patterns are closely linked. According to the Household Income and Expenditure Survey (HIES) 2010, 35.2% and 21.1% of the population in rural areas lives below upper and lower poverty line, respectively. The sector also plays a fundamental role in preserving and promoting the resilience to natural calamities and climate change of rural communities and agro ecological systems. However, as the Bangladesh economy and other sectors grow, the share of agriculture in GDP has naturally declined. During FY 2010-2014, the share of agriculture in GDP has been declining at an average of 0.5% per annum. In FY 2014, the broad agriculture sector contributed 15.9% to the total GDP, compared to its contribution of 16.3% in FY 2013.

Agriculture performance was up by 3.3% in FY 2014 after two consecutive years of lower growth, aided by good weather and continued government support. The crop and horticulture subsector, accounting for more than half (55.8%) of the agriculture sector, grew by 1.9%, an increase of 0.6% the year earlier. Non-crop subsectors (e.g. livestock and fisheries), which are crucial for generating rural employment, are also gaining momentum. Fisheries, which account for 22.6% of the sector, grew by 6.5%, 0.3 percentage higher than the FY 2013 performance. By comparison, animal farming, which accounts for 10.9% of the sector, rose marginally by 2.8%. Forestry, which accounts for 10.7% of the sector, posted an increase of 5.1%.

**Crop Subsector**

Like many South Asian nations, the crop subsector, cereals in particular, takes the biggest bulk of production in Bangladesh. Rice accounts for about 90% of the cereal production. About 70% of Bangladesh total arable land is dedicated to rice cultivation (Table 3). Of the total arable area of 7.7 million hectares (ha), about 5.4 million ha are used for rice production. Rice supply in 2015 is expected to be in the range of 31.2 to 35.2 million tons, and it is likely to grow to 39 million tons by 2030. It is projected that Bangladesh will be able to supply its own cereal grain at least until 2020. (Figure 2).

**Figure 1. Bangladesh Agriculture Sector Composition**



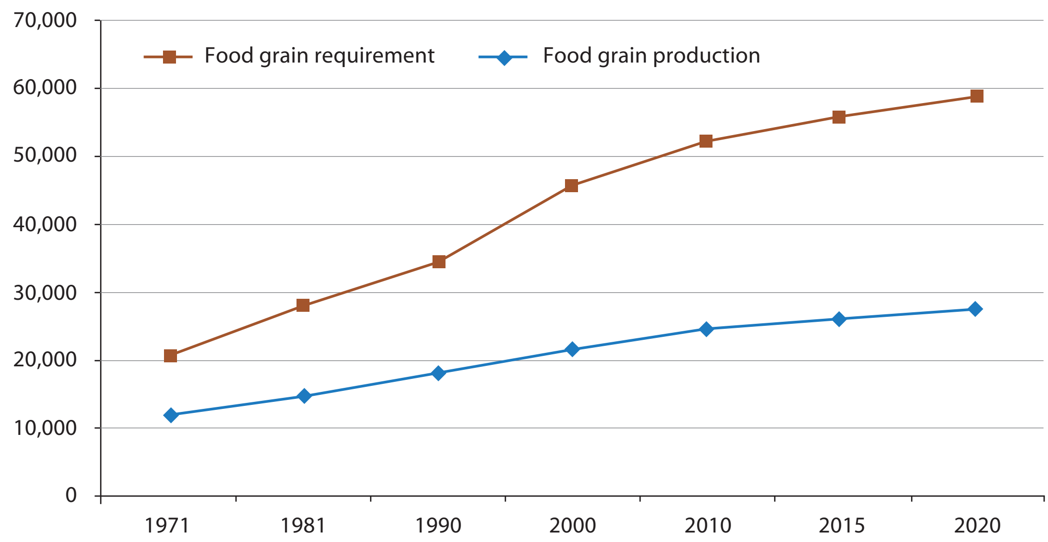

Source: World Bank & Bangladesh Bank

**Table 3. Bangladesh Land Area, Arable Lands and Area Planted to Rice, 2003-2012, in '000 ha**

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|
| Land area | 13,017 | 13,017 | 13,017 | 13,017 | 13,017 | 13,017 | 13,017 | 13,017 | 13,017 | 13,017 |
| Arable land | 8,228 | 8,143 | 7,911 | 7,880 | 7,816 | 7,803 | 7,796 | 7,741 | 7,628 | 7,675 |
| % of arable land to land area | 63.21 | 62.56 | 60.77 | 60.54 | 60.04 | 59.94 | 59.89 | 59.47 | 58.60 | 58.96 |
| Area planted to rice | 5,764 | 5,765 | 5,677 | 5,640 | 5,288 | 5,290 | 5,262 | 5,124 | 5,363 | 5,386 |
| % of area planted to rice to arable land | 70.05 | 70.79 | 71.76 | 71.57 | 67.65 | 67.79 | 67.50 | 66.19 | 70.30 | 70.17 |

Source: International Rice Research Institute

**Figure 2. Projected Food Grain Production and Requirement**




Source: Bangladesh Bureau of Statistics 2010

The GoB policy on rice production is articulated in the National Food Policy of 2006 and the National Food Policy Plan of Action (2008-2015). Historically, Bangladesh has emphasized self-sufficiency in rice, often at the expense of self-sufficiency in other non-cereal food products, such as pulses.

In 2014, Bangladesh produced an all-time record of 34.6 million tons of rice. Rice also accounts for 94% of the cereals consumed and constitutes 92% of the annual food grain production. Though Bangladesh

**Table 4. Domestic Production, Consumption and Import Status of Rice in Bangladesh**

| Year | Total import of rice ('000 MT) | Total domestic production ('000 MT) | Total domestic consumption ('000 MT) |
|---|---|---|---|
| 2010 | 1,308 | 31,700 | 32,400 |
| 2011 | 563 | 33,700 | 34,300 |
| 2012 | 35 | 33,820 | 34,500 |
| 2013 | 751 | 34,390 | 34,900 |
| 2014 | 600 | 34,600 | 35,300 |

Source: United States Department of Agriculture, USDA, http://www.indexmundi.com

has achieved significant progress in agriculture, especially with respect to rice production and yields, the demand for rice still outstrips domestic production (Table 4), and the country remains a net importer of rice.

To achieve and sustain MDG targets, and to turn Bangladesh into a middle income country by 2021, the Bangladesh economy has to grow at a minimum rate of 7% per year. To attain this, along with the population growth, agriculture should grow at a constant annual rate of 4-4.5%. There will be serious gap between demand and supply from domestic source if the current rate of production is not improved.

## 2.3 Role of Finance in Agricultural Policies and Plans

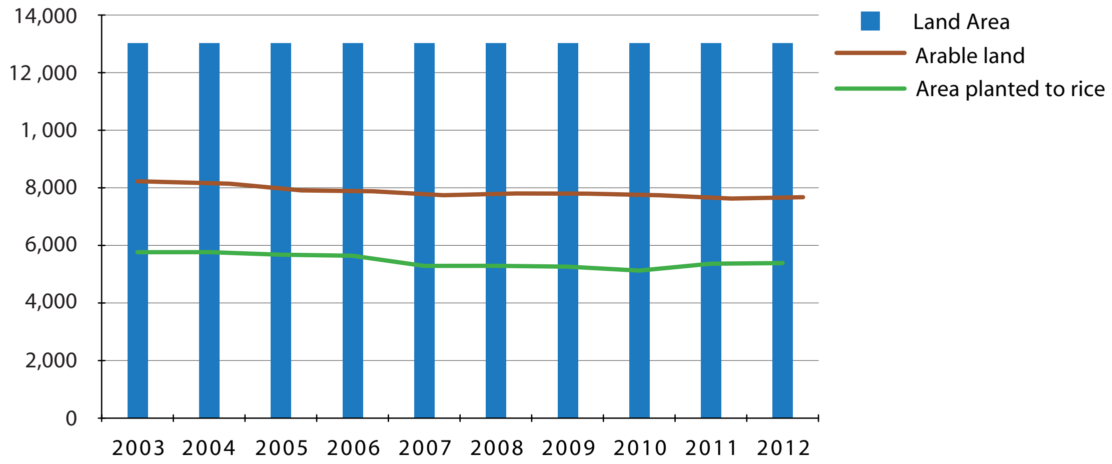
About 50 million people in Bangladesh still live in poverty, and 70% of them live in rural areas (World Bank, 2014). Nearly 70% of the rural population still depends on agriculture for their livelihood. While poor rural households have been proven efficient in farming, they need capital to upgrade farming practices and smooth out seasonal fluctuations in earnings (World Bank, 2014). Since cash flows and savings in rural areas for the majority of households are small, rural households typically tend to rely on credit for other consumption needs like education, food, housing, household functions, etc. Agricultural households need access to financial institutions that can provide them with credit at lower rates and at reasonable terms than the traditional money-lender and thereby help them increase their income and avoid threat of over indebtedness.

### Agricultural Credit

As mentioned earlier, agriculture accounts for about 16% of the GDP and 47% of the working population. The main agricultural producers are small-scale and marginal farmers[4] who comprise approximately 70% of all farming households and own about 50% of the total cultivated land. Arable land accounts for about 60% of the country's total land area. With an annual utilization rate of 190%, the country has nearly reached 100% rice self-sufficiency. However, the area of cultivated land is decreasing due to urbanization (Figure 3) while the food demand is expected to increase with the rising population. To sustain agricultural growth, the GoB is expanding its financing programs toward improving agricultural productivity and diversifying crops, and promoting the introduction of high yields and high market value crops. In fact, the GoB subsidizes agricultural credit through specialized banks: Bangladesh Krishi Bank (BKB) and Rajshahi Krishi Unnayan Bank (RAKUB) (Rahman, et al., 2011 as cited in Shameen & Chowdhury, 2013). Most of the agricultural subsidy is used for the purchase of fertilizers. For instance, the amount of subsidy for urea and non-urea fertilizer for the FY 2012-2013 is placed at BDT 48.24 billion (USD 621.3 million[5]) (FPMU & BER as cited in Hamid Miah, et al., 2014).

[4] Marginal farmers are those owning landholdings 0.21 to 0.5 ha, while small farmers are those owning landholdings 0.51 to 1 ha.
[5] BDT to USD conversion: USD 1 = BDT 77.64, based on World Bank Official Exchange Rate average for 2014.

**Figure 3. Bangladesh Land Area, Arable Lands and Area Planted to Rice, 2003-2012, in '000 ha**




Source: FAO & IRRI

The actual financing for agriculture is a mere 30% of the total demand (JICA, 2014), and the financing gap among small-scale and marginal farmers is particularly acute. While 90% of agricultural loans are provided by banking institutions, small-scale and marginal farmers cannot readily provide collateral, severely restricting their access to loans from banks which require a guarantee to secure the loan. Furthermore, as rural microfinancing is focused primarily on small loans for household financing, small-scale commerce and domestic industry, it does not suit the agricultural production cycle and cannot meet the needs for investments in agricultural equipment and supplies. As small-scale and marginal farmers lack agricultural technology, promoting new crop cultivation and the introduction of high-yielding varieties and agricultural equipment is a challenge both from a financing and a technical standpoint.

## Pattern and Trend of Agricultural Credit Disbursement in Bangladesh

Farmers in Bangladesh receive loans mainly for agricultural crop cultivation. Agricultural and rural credit programs in Bangladesh are categorized according to commodities and activities financed: (1) crops/food grains; (2) fisheries; (3) livestock; (4) agricultural equipment; (5) irrigation; (6) food grains storage and marketing; and (7) poverty alleviation and income generating activities.

Table 5 shows the amount of loans disbursed to the various commodities and agricultural activities for the last 10 years. The Bangladesh Bank (BB) target disbursement of agricultural credit has been increasing significantly, growing at an average of 12.5% annually for the last 10 years. This signifies that the GoB places importance in generating productivity and rural employment. Crop production has been getting the biggest share of disbursement with 47.6% in the FY 2015 alone. Figure 4 shows the proportion of loans disbursed to various commodities and activities for the last 10 fiscal years.

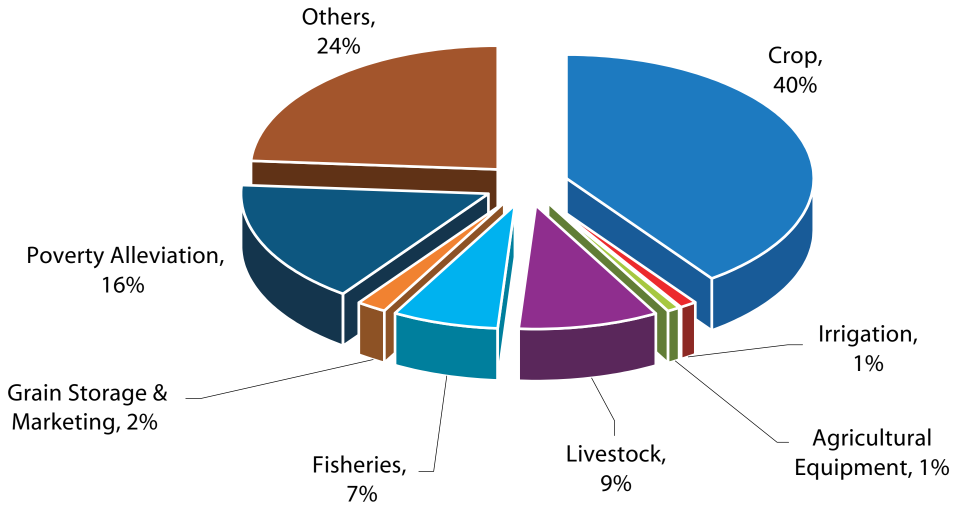
The targets for the agricultural financing against total disbursement for the period FY 2006-2015 are shown in Figure 5. Total disbursements for the period FY 2013-2015 have gone over the targets, compared to the previous fiscal years where the targets set were not met, especially in 2007 where the gap between target and actual disbursement is the biggest (amounting to BDT 10.6 billion or USD 136.5 million).

**Table 5. Trends in Agricultural Credit FY 2006-2015**

| | FY 06 | FY 07 | FY 08 | FY 09 | FY 10 | FY 11 | FY 12 | FY 13 | FY 14 | FY 15 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Program/Target (July-June)** | **55.4** | **63.5** | **83.1** | **93.8** | **115.1** | **126.2** | **138.0** | **141.3** | **146.0** | **155.5** |
| **Total Disbursement (in billion Taka)** | **55.0** | **52.9** | **85.8** | **92.8** | **111.2** | **121.8** | **131.3** | **146.7** | **160.4** | **159.8** |
| *Crop* | 22.3 | 22.9 | 25.8 | 30.8 | 38.2 | 43.7 | 53.6 | 64.3 | 71.3 | 76.0 |
| *Irrigation* | 0.1 | 0.1 | 0.1 | 1.0 | 0.4 | 0.0 | 0.8 | 0.8 | 0.8 | 0.8 |
| *Agricultural Equipment* | 0.2 | 0.3 | 0.4 | 1.1 | 1.5 | 2.1 | 2.6 | 2.0 | 1.6 | 1.6 |
| *Livestock* | 2.8 | 2.7 | 4.5 | 4.6 | 6.9 | 7.6 | 12.5 | 18.0 | 20.0 | 20.6 |
| *Fisheries* | 2.2 | 2.4 | 3.9 | 4.8 | 6.3 | 7.9 | 10.2 | 13.2 | 13.8 | 16.5 |
| *Grain Storage & Marketing* | 7.6 | 0.5 | 1.4 | 3.1 | 2.5 | 2.8 | 2.8 | 2.3 | 1.7 | 1.5 |
| *Poverty Alleviation* | 14.0 | 11.9 | 22.6 | 19.5 | 20.7 | 21.3 | 16.1 | 16.6 | 18.6 | 14.8 |
| *Others* | 8.7 | 12.2 | 27.0 | 27.9 | 34.7 | 36.2 | 33.0 | 29.5 | 32.6 | 27.9 |
| **Growth (in %)** | | | | | | | | | | |
| *Total Disbursement* | 12.4 | -3.7 | 62.2 | 8.2 | 19.8 | 9.6 | 7.8 | 11.7 | 9.3 | -0.4 |

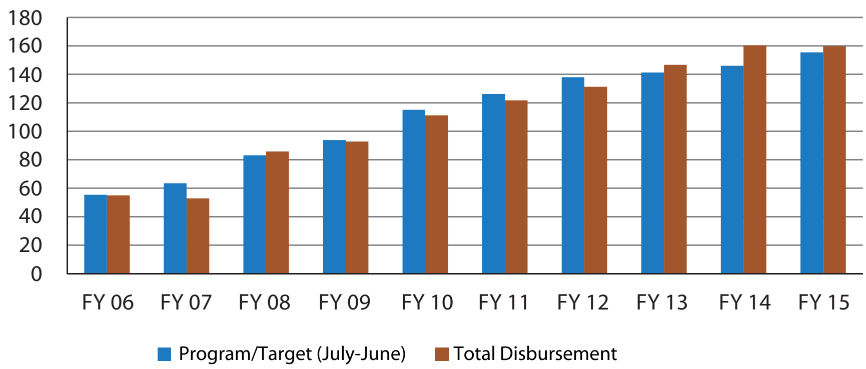
Source: Agricultural Credit Department, Bangladesh Bank (Bangladesh Bank Quarterly, April-June 2015, Volume XII, No. 4)

**Figure 4. Agricultural Loan Disbursements to Various Commodities and Activities, FY 2006-2015**




Source: Bangladesh Bank

**Figure 5. Agricultural Targets vs Total Disbursements, FY 2006-2015, In BDT Billion**




Source: Bangladesh Bank

While informal sources of loans are prevalent in Bangladesh, the main sources of finance in agriculture are still the state-owned banks (Table 6). BKB, RAKUB, and state-owned commercial banks (SCBs) are the major players in agriculture credit. For FY 2014, the BKB, RAKUB and SCBs disbursed nearly 60% (BDT 93.5 billion or USD 1.2 billion) of the total agricultural loans amounting to BDT 160.4 billion (USD 1.9 billion).

Data on past due loans indicate that private banks managed their loan collection better than state-owned banks, as they posted significantly lesser past due of 4% compared to the 26% past due of government banks.

**Table 6. Agricultural Credit Performance by Source FY 2014, Amount in BDT Billion**

| Source | Dis-bursement Target | Actual Dis-bursement | Recovery | Past Due | Out-standing | Past Due as % of Outstanding |
|---|---|---|---|---|---|---|
| **State-owned Banks** | | | | | | |
| State-owned Commercial Banks (SCBs) | 27.4 | 24.9 | 23.8 | 25.4 | 79.1 | 32.1 |
| Bangladesh Krishi Bank (BKB) | 46.0 | 54.3 | 65.8 | 33.1 | 157.9 | 21.0 |
| Rajshahi Krishi Unnayan Bank (RAKUB) | 14.5 | 14.3 | 16.8 | 14.8 | 41.6 | 35.7 |
| **Subtotal** | **87.9** | **93.5** | **106.4** | **73.3** | **278.5** | **26.3** |
| **Private Banks** | | | | | | |
| Foreign Banks | 4.3 | 5.9 | 4.6 | 0.0 | 3.8 | 0.0 |
| Private Commercial Banks (PCBs) | 53.7 | 61.0 | 56.4 | 2.8 | 64.0 | 4.3 |
| **Subtotal** | **58.0** | **66.9** | **61.0** | **2.8** | **67.8** | **4.1** |
| **Grand Total** | **145.9** | **160.4** | **167.5** | **76.1** | **346.3** | **22.0** |

Source: Bangladesh Bank Annual Report 2013-2014

The role of private domestic and foreign banks in agricultural lending has been increasing, with their share in the total agricultural credit disbursement growing at an average of 13% annually during the period FY 2010-2014 (Table 7). This may be attributed to BB's circular, mandating all local and foreign PCBs to invest in agriculture. On the other hand, government banks' share in the loan disbursement in the agriculture sector for the same period has been decreasing at an average rate of 5% annually.

**Table 7. Percent Share in Agricultural Loans Disbursement by Source, FY 2010-2014**

| | 2010 | 2011 | 2012 | 2013 | 2014 | Average increase/ decrease |
|---|---|---|---|---|---|---|
| **State-owned Banks** | | | | | | |
| State-owned Commercial Banks (SCBs) | 19.0 | 19.4 | 18.5 | 16.4 | 15.5 | -4.7 |
| Bangladesh Krishi Bank (BKB) | 43.7 | 45.8 | 36.0 | 31.3 | 33.8 | -5.4 |
| Rajshahi Krishi Unnayan Bank (RAKUB) | 10.1 | 8.8 | 8.8 | 9.1 | 8.9 | -3.0 |
| **Subtotal** | **72.8** | **74.0** | **63.3** | **56.7** | **58.2** | **-5.1** |
| **State-owned Banks** | | | | | | |
| Foreign Banks | 5.3 | 4.8 | 3.7 | 3.9 | 3.7 | -8.0 |
| Private Commercial Banks (PCBs) | 21.9 | 21.2 | 33.0 | 39.4 | 38.0 | 17.1 |
| **Subtotal** | **27.2** | **26.0** | **36.7** | **43.3** | **41.7** | **12.8** |
| **Grand Total** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | |

Source: Bangladesh Bank Annual Report 2013-2014

# CHAPTER 3
# Rural Finance Policy, Structure, and Regulatory Framework

Rural finance in Bangladesh offers a variety of services which include, in addition to agricultural production credit, loans to rural households for non-farm activities, and other financial services such as rural savings and life and general insurance. This Chapter focuses on the development of Bangladesh financial system, the current financial structure and regulatory framework, and the current policy environment particularly in agricultural finance.

## 3.1 Development of Bangladesh Financial System

Since it gained its independence in 1971, the financial system of Bangladesh has undergone three major phases. The first phase (1972-1982) was a period when the government focused on nationalization and reconstruction; the second phase (1983-1989) was when denationalization and privatization took place; and the third phase (1990-the present) was a period when the government began emphasizing financial liberalization through initiating a broad-based financial liberalization measure under the name of the Financial Sector Reform Program (FSRP) (Suzuki and Adhikari, 2009).

From 1972 to 1982, the Government of Bangladesh (GoB) exercised full control over its financial resources by nationalizing six commercial banks, then owned by Pakistanis, through the Bangladesh Banks (Nationalization) Order, 1972. The government then proceeded to revitalize the economy by expanding bank branches and extending credit to agriculture and state-owned enterprises. Catering to the financing needs of the rural population were the state-owned rural banks and cooperative societies, wherein microcredit was embedded in their services. In parallel with the government's efforts, some non-government organizations (NGOs) also supported rural development and poverty alleviation. However, while credit is part of their overall program, their main activities were mostly focused on creating awareness on managing their economic, social and political relationships and forging group solidarity.

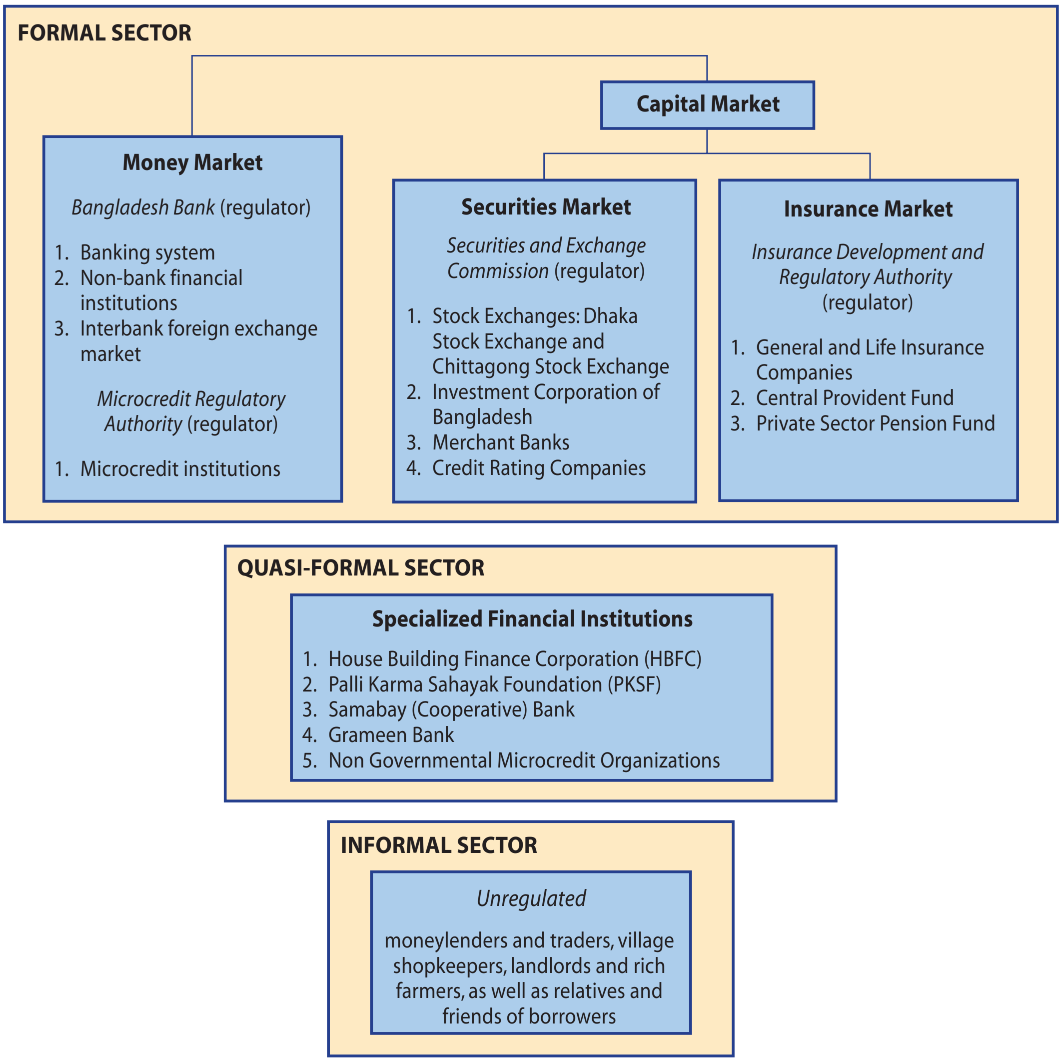
In the second phase, the government started denationalizing, starting with two nationalized banks, the Uttara and Pubali Bank, in 1983 and 1984, respectively, and eventually allowing the private sector to undertake financial intermediation. During this period, the government pursued policies that promoted private industrial growth by easing up credit disbursement both from the nationalized and private commercial banks. Priority sector lending policies continued during this phase, with the government mandating the remaining four nationalized commercial banks to finance state-owned enterprises. It was also during this phase that the Grameen Bank was established, to serve the section of society not served by formal banking institutions: the day laborers, traders, fishermen, and women who are virtually landless and eternally struggling to meet their basic human needs. Grameen Bank was legally mandated to provide credit facilities and other services to landless households in the rural areas. The success of Grameen Bank influenced the development thought of NGOs as a number began to replicate the Grameen Model on experimental basis.

The year 1990 marked the beginning of the third phase of the development of Bangladesh financial system, when the government initiated the FSRP, a broad based financial liberalization measure which brought about a number of developments in the banking system of Bangladesh. During the period, directed lending and priority sector lending were reduced and interest rates were liberalized. The policy on reducing priority sector lending affected the growth and flow of financial services, particularly to the rural poor. When rural and agricultural banks failed to reach the intended low-income households, alternative credit programs and institutions in Bangladesh evolved. As rural banks shift to a more commercial and market competitive environment, NGO-microfinance institutions (MFIs) began providing facilities exclusively to the poor landless households, thereby increasing credit flow to low-income households of rural economy. Within a very short span of time, NGO-MFIs began to enjoy a lion share of the rural financial market, and are considered to significantly contribute to the equitable growth of the Bangladesh Economy.

## 3.2 Financial Structure

The financial system of Bangladesh is comprised of three broad fragmented sectors: the Formal Sector, Quasi-Formal Sector and the Informal Sector. The categorization is based on the extent of regulation in the sectors. The Formal Financial Sector is comprised of regulated institutions categorized under the Money Market and the Capital Market. The Quasi-Formal Sector is composed of institutions which are regulated but do not fall under the jurisdiction of financial regulators in Bangladesh. The Informal Sector, on the other hand, includes private intermediaries which are completely unregulated. This sector includes moneylenders and traders, village shopkeepers, landlords and rich farmers, as well as relatives and friends of borrowers. Figure 6 illustrates the Financial System Structure in Bangladesh.

**Figure 6. Bangladesh Financial System Structure**



The establishment of the Dhaka Stock Exchange (formerly East Pakistan Stock Exchange) initiated the pathway of capital market intermediaries in Bangladesh. In 1976, the Investment Corporation of Bangladesh was formed and opened the door to professional portfolio management. The capital market of Bangladesh is subdivided into Securities Market, and Insurance Market. The Securities and Exchange Commission (SEC) oversees the operations for stock exchanges and of merchant banks. Established on June 8, 1993, SEC regulates the capital market intermediaries and issuance of capital and financial instruments by public limited companies and is attached to the Ministry of Finance (MOF). And by virtue of the Insurance Development and Regulatory Act of 2000, the Insurance Development and Regulatory Authority (IDRA) has supervision authority over the insurance industry.

The Money Market is composed of banks, non-bank financial institutions (NBFIs) and MFIs. The Bangladesh Bank (BB) is the central bank of Bangladesh and has regulatory and supervisory jurisdiction over the entire banking sector as well as NBFIs. The Bangladesh banking industry was initially composed of six nationalized commercial banks (NCBs), two state-owned specialized banks and three foreign banks. In the 1980s, during the second phase of its financial system development when private banks were eventually given freedom to undertake financial intermediation, the industry achieved significant expansion. As of to date, there are 56 scheduled banks[6] composed of: six state-owned commercial banks (SCBs), two specialized banks (SBs), 39 private commercial banks (PCBs), eight Islami Shariah based PCBs, and nine foreign commercial banks (FCBs); four non-scheduled banks[7] and 31 NBFIs.

The Microcredit Regulatory Authority (MRA) oversees the operations of MFIs. The MRA is mandated to ensure transparency and accountability of microfinance operations of MFIs as well as foster sustainable growth of this sector. The MFI sector has significantly grown since the 1990s and today, there are 742 licensed MFIs.

## 3.3 Policy and Regulatory Framework

### 3.3.1 Bangladesh Bank (BB)

Established on December 16, 1971 through the enactment of BB Order 1972-President's Order No. 127 of 1972 (Amended in 2003), the BB acts as the Central Bank of Bangladesh.

The general supervision and direction of the activities of the BB have been entrusted to a team of Board of Directors, composed of nine members, headed by the Governor who is the Chief Executive Officer of the institution as well. The BB has 45 departments and 10 branch offices.

The BB performs the following functions:

- formulates and implements monetary policy;
- formulates and implements intervention policies in the foreign exchange market;
- gives advice to the Government on the interaction of monetary policy with fiscal and exchange rate policy, on the impact of various policy measures on the economy and to propose legislative measures it considers necessary or appropriate to attain its objectives and perform its functions;
- maintains and manages the official foreign reserves of Bangladesh;
- promotes, regulates and ensures a secure and efficient payment system, including the issue of bank notes; and
- regulates and supervises banking companies and financial institutions.

[6] Scheduled banks are banks which are licensed to operate under Bank Company Act, 1991 (Amended up to 2013).
[7] Non-scheduled banks are banks which are established for special and definite objective and operate under the acts that are enacted for meeting those objectives. These banks cannot perform all functions of scheduled banks.

The core polices of the BB are discussed below:

*1) Monetary policy*

The main objectives of the monetary policy of Bangladesh Bank are (1) to stabilize both internal and external prices; (2) to promote sustainable growth and development; (3) to support achievement of high levels of employment; (4) to promote economic and efficient use of resources; and (5) to ensure stability of financial and payment system.

The tools and instruments for implementation of monetary policy in Bangladesh are Bank Rate, Open Market Operations, Repurchase agreements (Repo) and Reverse Repo, Statutory Reserve Requirements.

*2) Reserve Management Strategy*

The BB maintains the foreign exchange reserve of the country in different currencies to minimize the risks emerging from (1) widespread fluctuation in exchange rate of major currencies, and (2) very irregular movement in interest rates in the global money market. BB has established a Nostro account arrangements with different Central Banks. Funds accumulated in these accounts are invested in Treasury bills, repos and other government papers in the respective currencies. It also makes investment in the form of short term deposits with different high rated and reputed commercial banks and purchases high rated sovereign/supranational/corporate bonds. A separate department of BB performs the operational functions on investment which is guided by the investment policy set by BB's Investment Committee headed by a Deputy Governor. The underlying principle of the investment policy is to ensure the optimum return on investment with minimum market risk.

*3) Interest Rate Policy*

Under the Financial sector reform program, a flexible interest policy was formulated. According to program, banks are free to charge/fix their deposit (Bank/Financial Institutes) and Lending (Bank/ Financial Institutes) rates other than Export Credit. At present, aside from Pre-shipment export credit and agricultural lending, there is no interest rate cap on lending for banks. However, banks can differentiate interest rate up to 3%, with consideration on comparative risk elements involved among borrowers in same lending category. With progressive deregulation of interest rates, banks have been advised to announce the mid-rate of the limit (if any) for different sectors and the banks may change interest rates more or less than 1.5% of the announced mid-rate on the basis of the comparative credit risk. Banks upload their deposit and lending interest rate in their respective websites.

*4) Capital Adequacy for Banks and FIs*

Basel-III has been introduced to strengthen the capital base of banks with the goal of promoting a more resilient banking sector. The Basel-III regulation was adopted by phase starting January 2015, with full implementation of capital ratios targeted in the beginning of 2019. Since the start of its adaptation, scheduled banks in Bangladesh are required to maintain minimum capital of BDT 4 billion (USD 51.5 million) or Capital to Risk Weighted Assets Ratio (CRAR) of 10%, whichever is higher. In addition to minimum CRAR, Capital Conservation Buffer (CCB) of 2.5% of the total RWA is being introduced which will be maintained in the form of CET1. Aside from the minimum requirement, all banks have a process for assessing overall capital adequacy in relation to their risk profile and a strategy for maintaining capital at an adequate level.

For NBFIs, full implementation of Basel-II started in January 01, 2012 (Prudential Guidelines on Capital Adequacy and Market Discipline for Financial Institutions). Today, NBFIs in Bangladesh are required to maintain BDT 1 billion (USD 12.9 million) or 10% of Total Risk Weighted Assets as capital, whichever is higher.

*5) Deposit Insurance*

The deposit insurance scheme (DIS) was introduced in Bangladesh in August 1984 to act as a safety net for the depositors. All scheduled banks in Bangladesh are participants of this scheme, pursuant to Bank Deposit Insurance Act 2000. The objective of DIS is to help to increase market discipline, reduce moral hazard in the financial sector and to provide safety nets at the minimum cost to the public in the event of bank failure. A Deposit Insurance Trust Fund (DITF) has also been created for providing limited protection (not exceeding BDT 100,000 or USD 1,288) to a small depositor in case of winding up of any bank. The Board of Directors of Bangladesh Bank is the Trustee Board for the DITF. BB has adopted a system of risk-based deposit insurance premium rates applicable for all scheduled banks effective from January – June 2007. According to the new instructions on premium rates, problem banks are required to pay 0.09%, while private banks other than the problem banks, and state owned commercial banks are required to pay 0.07% where the percent coverage of the deposits is BDT 100,000 (USD 1,288) per depositor per bank. With this end in view, BB has already advised the banks for bringing DIS into the notice of the public through displaying the same in their display board.

### 3.3.2 Insurance Development and Regulatory Authority (IDRA)

The IDRA has been established to make the insurance industry as the premier financial service provider in the country. Its mission is to protect the interest of policy holders and other stakeholders under insurance policy, supervise and regulate the insurance industry effectively, and ensure orderly and systematic growth of the insurance industry.

### 3.3.3 Securities and Exchange Commission (SEC)

The Securities and Exchange Commission (SEC) regulates the capital market intermediaries and issuance of capital and financial instruments by public limited companies. It was established on June 8, 1993 through the Securities and Exchange Commission Act, 1993. SEC is attached to the MOF. Administering securities legislation is the directed by a five-member commission headed by a Chairman.

The SEC was created to protect the interests of securities investors, to develop and maintain fair, transparent and efficient securities markets, and to ensure proper issuance of securities and compliance with securities laws.

### 3.3.4 Microcredit Regulatory Authority (MRA)

The Microcredit Regulatory Authority was established to bring Non-government Microfinance Institutions (NGO-MFIs) under a regulatory framework. The MRA was created by virtue of the Microcredit Regulatory Authority Act of 2006.

The MRA is a statutory body having a board of directors with members as follows: Governor of Bangladesh Bank as Ex-Officio Chairman of the Board; six persons or government officials nominated by the government; an Executive Vice Chairman who shall, ex-officio, be the member-secretary. Generally, the nominated members will hold office for three years from the date of their appointment.

The mission of MRA is to ensure transparency and accountability of microfinance operations of NGO-MFIs as well as to foster sustainable growth of this sector. In order to achieve its mission, MRA performs the following functions:

- formulates and implements policies to ensure good governance and transparent financial systems of MFIs;
- conducts research on critical microfinance issues and provides policy inputs to the government consistent with the national strategy for poverty eradication;

- provides training to NGO-MFIs and linkage with the broader financial market to facilitate sustainable resources and efficient management;
- assists the government to build up an inclusive financial market for economic development of the country; and
- identifies the priorities in the microfinance sector for policy guidance and dissemination of information to attain the MRA's social responsibility.

Pursuant to the law, the MRA is responsible for (1) licensing of MFIs with explicit legal powers; (2) supervision of MFIs to ensure that they continue to comply with the licensing requirements; and (3) enforcement of sanctions in the event of any MFI failing to meet the licensing and ongoing supervisory requirements.

As of June 2015, MRA has sanctioned licenses in favor of 742 NGO-MFIs (45 are cancelled) and is still processing the flood of applications it received at its inception in 2006. The MRA initially received applications from more than 4,000 NGOs running microcredit operations before 2006. A large number of applications were cancelled due to the failure in meeting licensing criteria.

In processing license applications, MRA focuses its attention on four key areas of an institution; these are governance, management, financial transparency and operations at field. Governance includes formation of a general body, executive body, their tenure, frequency of meetings, and other activities. Under management, MRA considers human resources, organizational structure, flow of decision-making process, policies for management and operations. Financial transparency means adoption of standard accounting practices, appropriate disclosure, report generation, and external and internal audits, among others.

The MRA sets its supervising technique on the basis of type of institution; it also wants to minimize cost of supervision at the same time. It depends heavily on the output reports generated from the biannual reports submitted by the institutions and on the annual audit reports of the institutions. MRA has built up database of regular reports of information to understand trends of individual institutions as well as the sector as a whole, and their performances. MRA undertakes supervisory measures on the basis of the output generated from the system. It is also taking steps to ensure quality of audit reports and to improve supervisory tools.

## 3.4 Current Policy Environment

Over the years, the GoB has implemented policies and programs to ensure inclusive growth in the country. In particular, financial inclusion is the fulcrum of its policies and programs.

The BB defines financial inclusion as access to financial services from: (1) officially regulated and supervised entities such as Bangladesh Bank licensed banks and financial institutions, MRA licensed MFIs and registered cooperatives; and (2) official entities such as post offices offering savings, money transfer and insurance services, and national saving bureaus (Choudry, 2014).

Following the mantra of financial inclusion, the BB puts priority on the vulnerable sectors such as women, low income groups, small enterprises, the agriculture sector, and rural-based income generating activities.

### 3.4.1 Financing Agricultural Activities

Farmers growing priority crops such as pulse, spices, lentils, and oilseeds are given credit at concessional interest rates. The BB has also launched a refinance scheme, in partnership with Bangladesh Rural Advancement Committee (BRAC), worth BDT 5 billion (USD 64.4 million) for landless sharecroppers.

State-owned banks extend loans to sharecroppers, a considerable number of whom are women farmers. Private and foreign banks are also required to allocate at least 2.56% of the total loan portfolio of private and foreign banks' total credit to the agriculture sector, in partnership with NGOs or MFIs. Another important financial inclusion initiative is the introduction of a no-frills bank account for unbanked farmers[8]. In a circular, the Bangladesh Bank enable farmers to open a deposit account in any government-owned commercial and specialized bank branch with against his/her a National Identity Card, birth certificate or agriculture equipment assistance card issued by the Department of Agricultural Extension. No fees and charges are applied to the opening of these accounts with nominal initial deposits of as low as BDT 10 (USD 13 cents). Besides using these accounts as savings and premium medium, these accounts are being used by the account holders for receipt of agricultural input subsidies, social safety net payments, etc.

### 3.4.2 Mainstreaming Women in Economic Activities

The BB has mandated banks to allocate at least 15% of their loan portfolio to women entrepreneurs. Also, banks are required to have a 'Women Entrepreneur's Dedicated Desk' to be manned by competent and dedicated officials. Women entrepreneurs or enterprises with 51% women shareholders can borrow up to BDT 2.5 million (USD 32,200) from banks without collateral but against personal guarantee under BB refinance facilities. Interest rates are reduced to 10% per annum. Another policy followed by banks is group-based lending of at least BDT 50,000 (USD 644) for women micro entrepreneurs.

### 3.4.3 Adoption of Innovative Technology to Improve Banking Experience

The BB has been playing a notable role in maintaining smooth and secured e-banking operations. Banks have been provided online access to the Credit Information Bureau (CIB). The Bangladesh Automated Clearing House (BACH), Bangladesh Electronic Fund Transfer Network (BEFTN), and National Payment Switch (NPS) have been installed as well. Supervisory functions of the Bangladesh Bank have also been made efficient with the help of technology: guidelines on ICT Security and Mobile Financial Services for banking and financial institutions have been issued.

### 3.4.4 Agent Banking

To bring the unbanked people under the coverage of the formal financial sector, the BB is promoting the agent banking system. Agents are being used to extend formal financing services to the marginalized population of the society. MFIs, with 742 licensed nationwide have vast networks in different regions of the country. They have done a great job in providing small-scale financial services to these marginalized people, and effectively including them in the financial system. However, the MFIs lack the capacity to provide a wide range of financial services to customers which scheduled banks can provide. Agent banking aims to ensure easier access of the marginalized people to several financial services, especially in remote areas using the services of MFIs and others. Pursuant to the BB circular, eligible banking agents are NGOs and MFIs, cooperative societies formed under the Cooperative Society Act, 2001, post offices, registered courier and mailing services, registered companies, agents of mobile network operators, offices of rural and urban local government, union information and service centers and educated individuals. Agent banking hopes to stimulate financial inclusion and enhance financial activity in remote areas.

[8] Unbanked farmers are those who do not use banks or banking institutions in any capacity. Unbanked farmers generally pay for things in cash. Unbanked farmers also typically do not have insurance, pensions or any other type of professional money-related services.

## 3.5 The Role of Microfinance

In Bangladesh, a wide range of financial products are provided by formal financial institutions like government and private commercial banks, state-owned agricultural or rural development bank, savings and loan cooperatives, microfinance banks, leasing, housing and consumer finance companies. Financial services, although limited, are also offered by financial NGOs, self-help groups, small cooperatives, and credit unions.

Informal financing is still prevalent among rural households as it complements formal services such as microfinance. Microfinance emerged as a noble substitute for informal credit and is considered to be a powerful instrument for poverty alleviation among people who are economically active but financially constrained (Murdoch and Haley, 2002).

Access of small and marginal farmers to microcredit can help them get out of poverty. However, providers of microcredit have not generally addressed the credit need of small and marginal farmers because of some perceived problems, notably: (1) risk of investment in agriculture; (2) seasonality of agricultural production; (3) poor loan repayment performance of agricultural lending; and (4) technical nature of agriculture production system.

### 3.5.1 The Grameen Bank

To improve the access of the poor to agricultural credit, Dr. Yunus has established the Grameen Bank which can be considered today as the pioneer of microfinance. The Grameen approach has broken all barriers for reaching the poor with credit, especially poor women. The main features of the Grameen approach are:

1) *Targeting the poor people, mainly women who bear the burden of poverty*. This has been made operational by accepting members/clients who own less than 0.5 acre of land.
2) *Accepting primarily women as clients.* Empirical evidence shows that women repay loans on time, invest money for productive purposes and spend income to improve the quality of life of family members.
3) *Forming of groups of five persons and Kendra/center of 30-50 members*. This is the organizational structure in a para/village where bank staff visits to make transactions.
4) *Lending without requiring collateral*. To ensure repayment, poor women are organized into groups to take responsibility of repayment.
5) *Lending in small amounts*. Small loans are manageable by the poor and repayment is done on weekly installments so that paying their debt does not become a burden.
6) *Financial services at the door of the poor*. Bank's staff members collect, supervise and take care of all management tasks similar to any commercial bank.
7) *Simplifying procedures for loan applications*. Requirements for loan processing are easy to follow.
8) *Conduct of financial transactions in public*. This eliminates any possibility of corruption.

Experience shows that loan money is normally invested in livestock rearing, trading, agriculture production, and small processing operations.

### 3.5.2 The Replication of the Grameen Approach

The main breakthrough in the Grameen approach is its influence in convincing financial institutions that the poor are bankable, and that they utilize loan properly and repay on time. The Grameen experience in 1983 had proven that an institution with a mission to serve the poor, equipped with the right kind of savings and loan products, policies and management system and human resources, could effectively reach the poor and at the same time make a viable financial institution. The simplicity of methodology developed by the Grameen Bank has inspired many non-governmental organizations to replicate the model and offer similar financial services to the poor.

The main incentives for NGOs which are normally involved in many social programs such as education, health, relief and rehabilitation to shift into microcredit Grameen style are demand from the members, opportunity to become self-reliant, and creating sustainable permanent institution, and career for staff members. Several variations of replications are made, mainly in terms of interest rates, savings and loan ceilings, sizes of groups, but not much on the fundamental structure of the model. Some of variations present today are summarized below:

> *Group formation*. MFIs do not strictly follow the five-member group structure of Grameen. Instead, they form one larger group called "samity" with women/men from the same neighborhood.
>
> *Savings policies*. The amount of savings may vary among members as well as organizations. Normally MFIs would lend only after a member has made deposits for several weeks. Withdrawal of savings was restricted in earlier days, but is 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 four to 8.5%.
>
> *Loan policies*. Loan amounts widely vary among MFIs. Loan amount normally starts with small size and increases 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 or in one installment. Although in earlier days, clients are required to wait one to six months before receiving the first loan, the waiting time has been reduced due to competitive pressure from other MFIs.

## 3.6 Prevailing Lending Modalities

Today, there are three different types of lending technologies that are used in Bangladesh:

### 3.6.1 Grameen-style group-based system

The Bangladesh microfinance sector is dominated by basic group-based methodology pioneered by the Grameen Bank. The basic structure is as follows: poor women and men are organized in groups or samities who meet once in a week to deposit small amount of savings to build their own capital. Banks or MFIs lend one-year-term loans, which a borrower repays in equal weekly installments along with interest. Once a borrower fully repays the loan, he/she is qualified to receive another loan, normally of higher amount. The technique has been found so robust and effective that almost the entire industry follows this approach with minor adjustments in savings/credit policies such as interest on savings and loan, savings withdrawal rules etc. Currently, nearly 33 million women and men transact every week by following this basic system. However, overtime, banks, as well as other MFIs have eventually changed their systems to offer more than one type of savings and credit products as the nature of demand changes.

### 3.6.2 Self-help group system

In this approach, the NGO organizes self-help groups with the objective of facilitating savings mobilization. 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. The second option has been tried in Bangladesh but the first option has been found not realistic. All management responsibilities of savings and credit are expected to be taken care of by the leaders of the groups. In practice, however, such educated leaders are not always available and in many cases NGO field officials perform this job. This type of community-based microfinance while popular in some countries has not been found to be successful in large-scale operation in Bangladesh. There have been some efforts from several NGOs (e.g. Ashrai, Caritas, Concern Worldwide) and donor-funded projects to develop alternative systems but none could stand as a viable alternative. In general, this approach has failed to take off the ground to be considered as a serious alternative in Bangladesh. Self-help Groups (SHGs) or Community-based Organizations (CBOs) start with much enthusiasm but within a short period fail to continue due to many management problems. Some common problems are as follows: (1) poor loan recovery rate; (2) inability to keep proper accounts by illiterate people; (3) poor management skills of SHG leaders/managers; (4) lack of time by leaders in keeping the system running; (5) misappropriation of funds by leaders and or influential individuals; (6) maintaining funds in banks and dealing with banks; and (7) inability to safe keeping cash balance in the village.

### 3.6.3 Individual lending system

The objective of this approach 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 offers financial services, e.g. savings and credit service to each individual according to the demand of that individual client. The flexibility may come in the form of amount and frequency of deposit of savings, loan amount and duration of loan, repayment of loan amount and frequency of installments (not having a predetermined schedule is considered flexible) etc. But lending to individual does not necessarily make it fully 'flexible'. For example, ASA and BRAC under their respective microenterprise loan program disburse loan to individual client but offer fixed one year loan and fixed monthly repayment system.

Informal moneylenders are another traditional source of micro-loans that practice 'individual lending'. No rigorous up-to-date information and analysis are available about their operations. However, it is believed, based on anecdotal evidence and small studies that the rural poor do not have to depend on money lenders for small loans any more due to proliferation of MFIs. They have the opportunity to borrow for investments and in some cases consumption purposes as well, from one or more MFIs. Yet, 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.

CHAPTER 4

# State of Rural and Agricultural Finance

This Chapter presents the state of rural and agricultural finance in Bangladesh with focus on the performances of both banking and microfinance sectors and the outreach of financial services to small rural and agricultural households.

## 4.1 State of Rural and Agricultural Finance in Bangladesh

About 70% of households in Bangladesh have access to many kinds of financial services (savings, credit and/or insurance services in formal, quasi-formal and informal markets[9]), according to the Institute of Microfinance Access to Financial Services in Bangladesh Policy Brief.

In terms of access to credit, about 54% have access to any source, with the biggest percentage (37%) obtaining credit from quasi-formal sources such as MFIs and cooperatives. Only 8% of households have access to formal credit market.

Access to credit is higher among households living in the rural regions of Bangladesh, with 56% of households with access to credit compared to urban households with only 46% incidence. However, borrowing from non-formal sources is still prevalent among rural households with 44% incidence, as against the 17% prevalence among urban households (Table 8).

**Table 8. Access to financial services in Bangladesh, National, Rural and Urban Households**

| | Access to financial services (%) | Access to credit (%) | | | |
|---|---|---|---|---|---|
| | | Any source | Formal | Quasi-formal | non-formal |
| **National** | **76.8** | **54.1** | **8.0** | **36.6** | **21.8** |
| **Rural** | 75.5 | 56.2 | 7.6 | 39.1 | 43.8 |
| **Urban** | 81.9 | 46.1 | 9.6 | 27.0 | 16.8 |

Source: Access to Financial Services in Bangladesh, Institute of Microfinance Research Brief

In the latest Rural Credit Survey conducted by the Bangladesh Bureau of Statistics (BBS) in 2014, incidence of borrowing among rural households stood at 49% or 11.7 million households (Table 9), with 47% having outstanding loans by end of FY 2013. In proportion to the rural population 15 years of age and above, incidence of borrowing is only 19% (Table 9).

**Table 9. Number of Borrowing Rural Households and Individuals in Bangladesh in 2013**

| | Households | | Individuals | |
|---|---|---|---|---|
| | Number | Percentage | Number | Percentage |
| Borrowing | 11,721,656 | 48.7 | 13,479,904[a] | 19.4 |
| With Outstanding Loans | 11,319,603 | 47.0 | 13,017,544[a] | 18.7 |
| Total Rural | 24,083,945 | | 69,513,972[b] | |

[a] Multiplied by 1.15, which is the average number of loans per household based on the Bangladesh Bureau of Statistics Rural Credit Survey, 2014
[b] Number of Individuals age 15 years and above (66% of total population) based on the Bangladesh Bureau of Statistics Gender Statistics, 2011
Source: World Bank (2014 Household Population Estimates), Bangladesh Bureau of Statistics

[9] Formal sources of credit include banks and financial institutions; quasi-formal sources include MFIs and cooperatives, and informal sources include money lenders, friends, relatives, neighbors, landlords, suppliers of trade credit, savings club, etc.

Rural households borrow mainly from quasi-formal sources such as NGOs, cooperative societies/samity and government departments (72%), with NGOs dominating as disbursing source.

**Table 10. Distribution of Loans by Disbursing Source**

| | Household | Individual | |
|---|---|---|---|
| | Number[1] | Number | percentage |
| **Formal** | **1,963,784** | **2,258,352** | **17.1** |
| Banks | 1,963,784 | 2,258,352 | 17.1 |
| **Quasi-formal** | **8,250,921** | **9,488,559** | **71.7** |
| NGOs | 7,749,290 | 8,911,684 | 67.4 |
| Cooperative Society | 340,664 | 391,764 | 3.0 |
| Government Departments | 160,966 | 185,111 | 1.4 |
| **Informal** | **1,285,615** | **1,478,457** | **11.2** |
| **Total borrowing** | **11,500,320** | **13,225,368** | **100.0** |

[1] Data available is number of individual loans only. Number of household loans is derived by dividing the number of individual loans by 1.15, which is the average number of loans per household based on the Bangladesh Bureau of Statistics Rural Credit Survey, 2014

Source: World Bank (2014 Household Population Estimates), Bangladesh Bureau of Statistics

## 4.2 Performance of the Banking Sector

At the end of FY 2014, the banking sector of Bangladesh demonstrated considerable improvement in reinforcing resilience amidst political instability. Bangladesh Bank (BB) continues to focus on strengthening the financial system of the country.

### 4.2.1 Number of Bank Offices

The banking sector of Bangladesh is composed of four categories of scheduled banks namely, State-owned Commercial Banks (SCBs), State-owned Development Financial Institutions (DFIs), Private Commercial Banks (PCBs) and Foreign Commercial Banks (FCBs). Nine (9) newly licensed PCBs have started functioning in this year. The number of banks increased from 47 in 2012 to 56 in 2013 with a total number of 8,685 branches as of December 2013. The number of bank branches increased from 8,322 in 2012 to 8,685 in 2013 due to opening of new branches mainly by the PCBs, DFIs and SCBs during the year (Table 11). At the end of June 2014, the total number of bank branches increased further to 8,794, with total number of banks remained unchanged at 56.

**Table 11. Number of Bank Offices (As of 31 December 2013)**

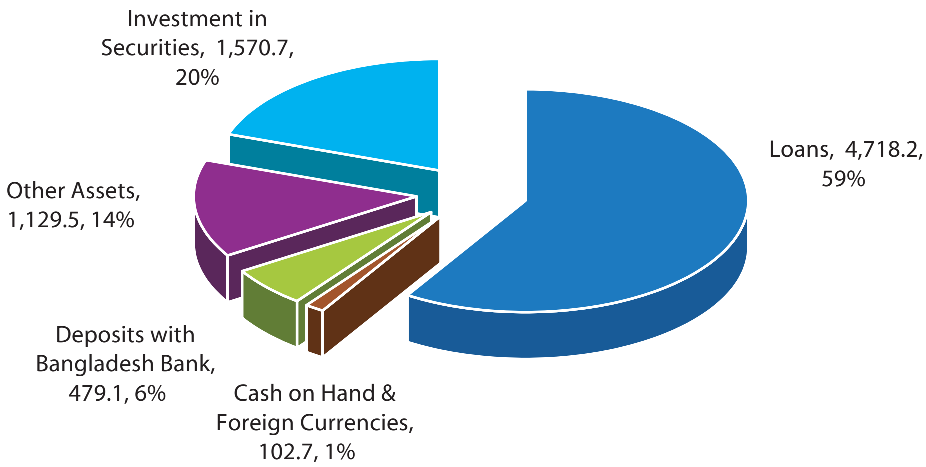
| Type of Bank | FY 2012 | | FY 2013 | |
|---|---|---|---|---|
| | Number of Banks | Number of Offices | Number of Banks | Number of Offices |
| SCBs | 4 | 3,478 | 4 | 3,520 |
| DFIs | 4 | 1,440 | 4 | 1,494 |
| PCBs | 30 | 3,339 | 39 | 3,602 |
| FCBs | 9 | 65 | 9 | 69 |
| Total | 47 | 8,322 | 56 | 8,685 |

Source: Bangladesh Bank

### 4.2.2 Assets

Total industry assets in FY 2013 posted an overall increase of 13.8% over FY 2012. During this period, the assets of SCBs and PCBs increased by 15.1% and 13.2%, respectively. Loans and advances of BDT 4,718.2 billion (USD 60.77 billion) constitute the most significant portion (59%) of the sector's aggregate assets of BDT 8,000.2 billion (USD 103.04 billion). Cash on hand including foreign currencies amount to BDT 102.7 billion (USD 1.32 billion); deposits with BB are BDT 479.1 billion (USD 6.17 billion); other assets are BDT 1,129.5 billion (BDT 14.55 billion); and investment in government securities amounts to BDT 1,570.7 billion (USD 20.23 billion) (Figure 7).

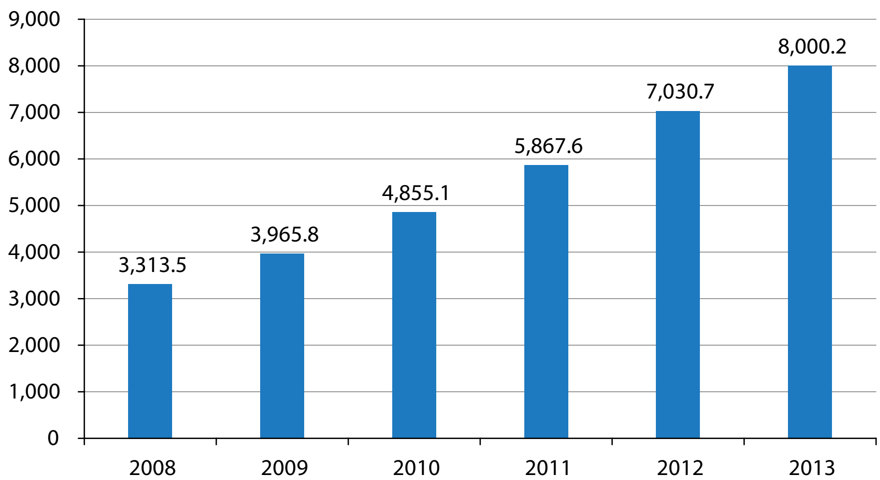
**Figure 7. Composition of the Aggregate Assets of the Banking Sector**
(As of 31 December 2013, in BDT Billion)




Source: Bangladesh Bank

Total assets of the banking sector have consistently increased since 2008, reaching BDT 8,000.2 billion (USD 103.04 billion) by the end of 2013 (Figure 8).

**Figure 8. Aggregate Assets of the Banking Sector (FY 2008-2013, in BDT Billion)**

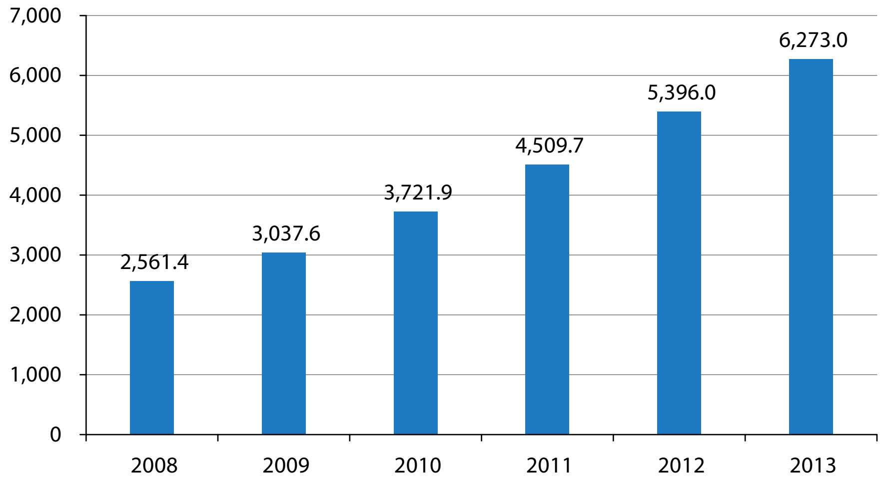



Source: Bangladesh Bank

### 4.2.3 Deposits

Deposits continue to be the main source of funds of the banking industry and constitute about 78.4% (BDT 6,273.0 billion or USD 80.80 billion) of the sector's aggregate liability and capital portfolio in 2013. Total deposits of the banks in 2013 rose to BDT 6,273.0 billion (80.80) from BDT 5,396.0 billion (USD 69.5 billion) in 2012. This is an overall increase of 16.3% compared to a 19.7% growth in 2012. As one of major services being provided by banks, total deposits in the banking sector generally follows the same increasing trend as aggregate assets and loans. Total deposits increased from BDT 2,561.4 billion (USD 32.99 billion) in 2008 to BDT 6,273.0 billion (USD 80.80 billion) in 2013 (Figure 9).

**Figure 9. Aggregate Deposits of the Banking Sector (FY 2008-2013, in BDT Billion)**

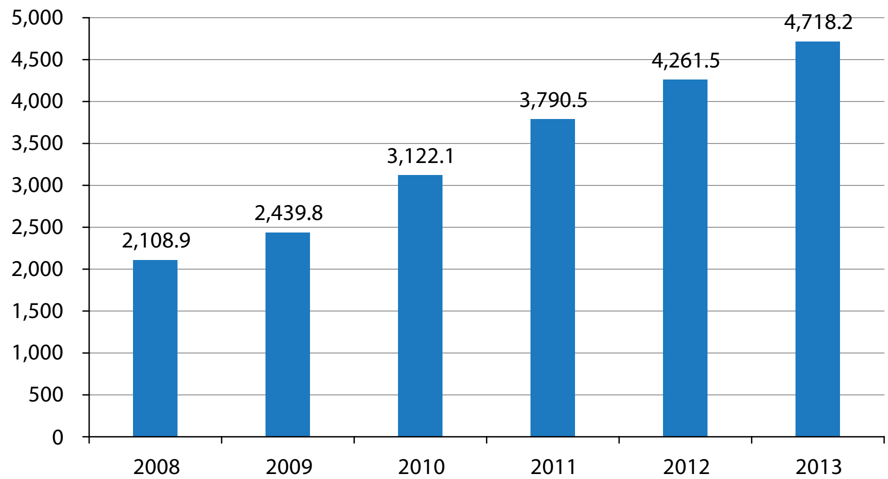



Source: Bangladesh Bank

### 4.2.4 Loans

Loans and advances are the major components in the asset composition of all commercial banks. Loans released by the banking sector have also been increasing since 2008, reaching BDT 4,718.2 billion (USD 60.77 billion) in 2013 (Figure 10). In spite of this increasing trend, growth in loans released has not been as consistent during the said period. From a 16% increase in 2009, credit growth rose to 30% in 2010 but went down to 21% in 2011, to 12% in 2012, and down to 10% in 2013.

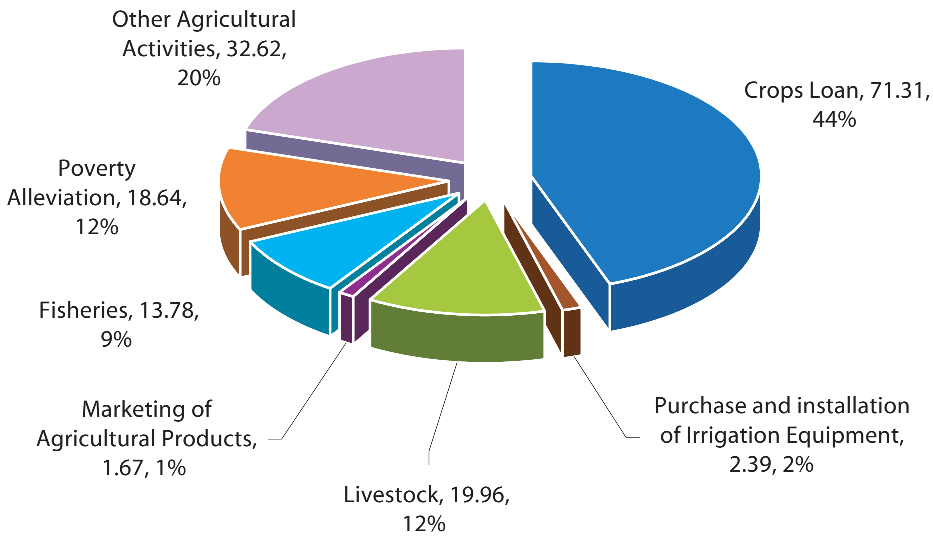
**Figure 10. Aggregate Loans Released by the Banking Sector (FY 2008-2013, in BDT Billion)**




Source: Bangladesh Bank

Loans to the agriculture sector was only about 7% (BDT 310.46 billion or USD 4.00 billion) of the total loans released by the banking sector by the end of FY 2013. For FY 2014 alone, a total of BDT 160.37 billion (USD 2.07 billion) was disbursed to the agriculture sector. Majority of these loans went to crops (44%), followed by other agricultural activities (20%), livestock and poverty alleviation (12%), fisheries (9%), purchase and installation of irrigation equipment (2%), and marketing of agricultural products (1%) (Figure 11). By the end of FY 2014, total outstanding agricultural loan of the banking sector amounted to BDT 346.33 billion (USD 4.46 billion) with past due loans of BDT 76.12 billion (USD 0.98 billion) or a past due rate of 21.98%.

**Figure 11. Agricultural Loans Released by the Banking Sector, Classified by Type of Loan**
(FY 2014, in BDT Billion)




Source: Agricultural Credit & Financial Inclusion Department, Bangladesh Bank

### 4.2.5 Other Accomplishment of the Banking Sector

In 1992, the Credit Information Bureau or the CIB was established. Its objective is to minimize the extent of potential loan defaults. One of the strategies of the CIB in attaining its objectives is the provision of online services for the financial institutions since July 2011.

The CIB online system plays an important role in maintaining a risk-free lending procedure in the banking industry. With the adoption of highly sophisticated ICT facilities, the performance of the CIB services has improved significantly in terms of efficiency and quality. It has also significantly reduced the time and physical movement of the banks in report generation which ultimately leads to the speedy processing of loans. The CIB database consists of detailed credit information of borrowers, owners and guarantors. CIB database covers the borrowers with outstanding loans amounting to BDT 50,000 (USD 644) and above. At the end of June 2014, the CIB database has recorded the profiles of 853,851 borrowers.

## 4.3 Performance of the Microfinance Sector

### 4.3.1 Number of Offices and Staff of MFIs

The microfinance sector of Bangladesh has further improved its capacity to make its financial services more geographically accessible to the rural poor. The number of MFIs licensed by the Microcredit Regulatory Authority (MRA) increased from 419 in 2009 to 742 by the end of FY 2014. These licensed MFIs have a total of 14,730 branch offices all throughout Bangladesh employing 131,628 staff (Table 12).

**Table 12. Aggregate Number of Licensed NGO-MFIs (As of FY 2014)**

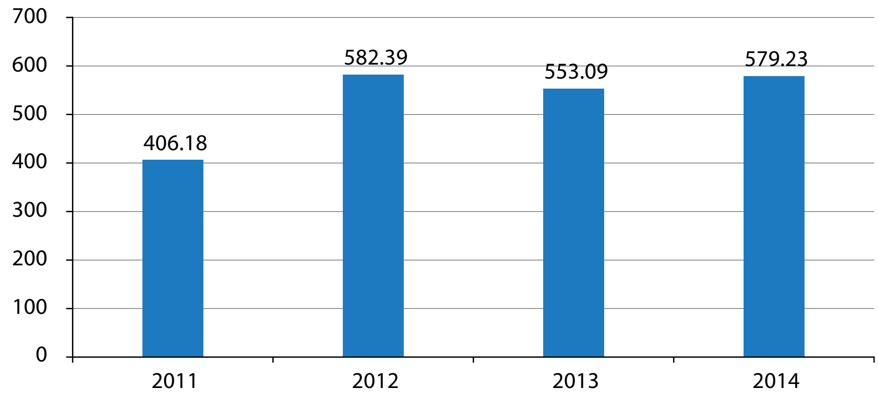
| Particulars | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|
| No. of Licensed NGO-MFIs | 419 | 516 | 576 | 590 | 649 | 742 |
| No. of Branch Offices | 16,851 | 17,252 | 18,066 | 17,977 | 14,674 | 14,730 |
| No. of Employees | 107,175 | 109,597 | 133,828 | 130,654 | 132,734 | 131,628 |

Source: MRA-MIS Database, 2014

### 4.3.2 Loans

Similar with the banking sector, loan disbursements by MFIs increased in the past four years. From BDT 406.18 billion (USD 5.23 billion) in 2010, loans released increased to BDT 579.23 billion (USD 7.46 billion) in 2014 (Figure 12).

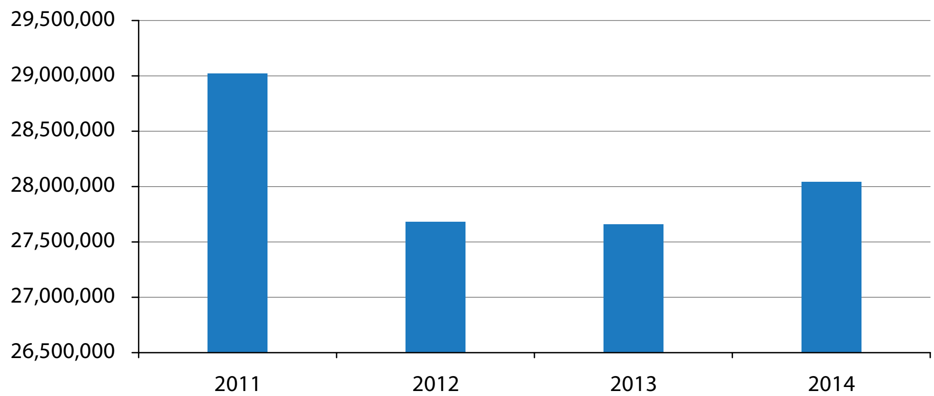
**Figure 12. Aggregate Loans Released by MFIs (FY 2011-2014, in BDT Billion)**




Source: MRA-MIS Database, 2014

The growth rate of loans released by MFIs has been inconsistent during the said period. From a 43% increase in 2012, credit growth went down significantly to 5% in 2013 and went up by 5% in 2014. There have been increases in loan size, as a consequence, while number of borrowers decreased from 29.02 million in 2011 to 28.04 in 2014 (Figure 13). It should be noted that 90% of borrowers are women (MRA-MIS Database, 2014) reflecting the original intent of microfinance to provide additional means of livelihood to households through women. Total outstanding loans as of FY 2014 amount to BDT 369.93 billion (USD 4.76 billion) with an average recovery rate of 95.64% (MRA-MIS Database, 2014).

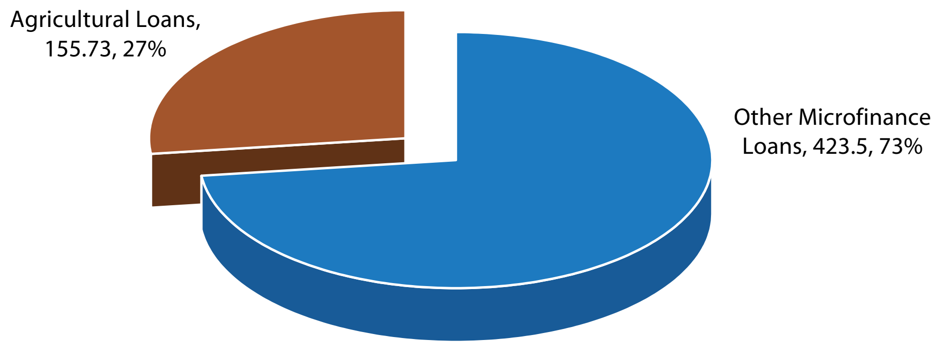
**Figure 13. Aggregate Number of Borrowers of MFIs (FY 2011-2014)**




Source: MRA-MIS Database, 2014

Compared to the banking sector, a larger portion of loans released by MFIs went to the agriculture sector (27% in 2014) (Figure 14) as against the 7% of total loan portfolio of banks going to agriculture.

**Figure 14. Proportion of Agricultural Loans to Total Loans Released by MFIs (As of FY 2014, in BDT Billion)**

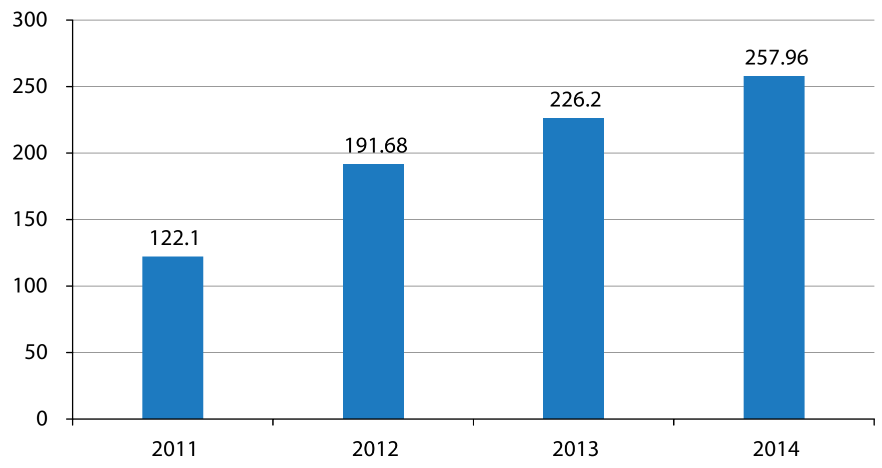



Source: MRA-MIS Database, 2014

### 4.3.3 Savings

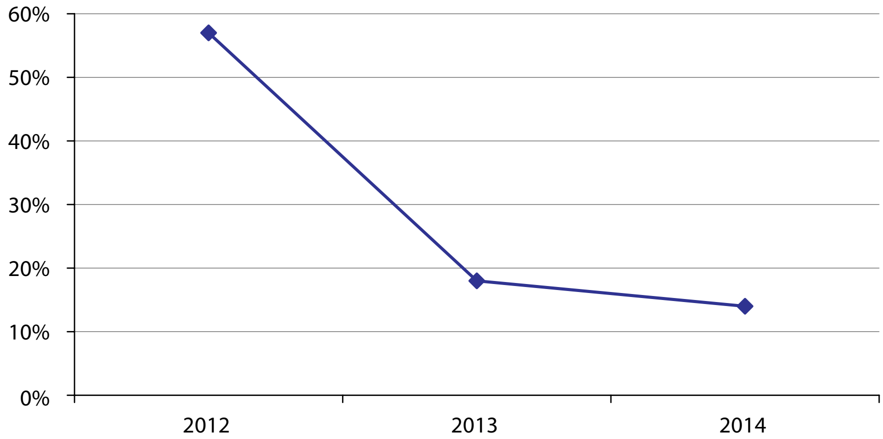
The savings generated by MFIs amounted to BDT 257.96 billion (USD 3.32 billion) in 2014 from only BDT 122.10 billion (USD 1.57 billion) in 2011 (Figure 15). The amount of savings generated has increased over the past four years but growth rate is not as consistent over the same period (Figure 16). Notwithstanding, this is still much lower compared to the total deposits generated by banks in the amount of BDT 6,273.0 billion (USD 80.80 billion) in 2013. It should be noted, however, that MFIs only collect savings from their members as prescribed by the MRA. The average amount of savings per client is BDT 4,349.00 or about USD 56.01 (MRA-MIS Database, 2014). As of end of FY 2014, the number of MFI clients reached 33.73 million, a 2% decrease from the total number of clients of 34.45 million in 2011 (Table 13).

**Figure 15. Aggregate Savings Generated by MFIs (FY 2011-2014, in BDT Billion)**




Source: MRA-MIS Database, 2014

**Figure 16. Aggregate Savings Growth in MFIs (FY 2011-2014)**




Source: MRA-MIS Database, 2014

**Table 13. Aggregate Savings and Number of Clients in MFIs (FY 2011-2014)**

| Particulars | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|
| Savings (BDT Billion) | 122.10 | 191.68 | 226.2 | 257.96 |
| Number of Clients (Million) | 34.45 | 33.01 | 32.99 | 33.73 |

Source: MRA-MIS Database, 2014

CHAPTER 5

# Relevant Issues and Government Initiatives to Promote Financial Inclusions

To ensure that the growth of the financial sector is balanced between urban and rural areas and between smaller and larger clients, the Government of Bangladesh (GoB) has introduced initiatives in facilitating rural credit.

## 5.1 Creating banks to serve rural areas

The government created Bangladesh Krishi Bank (BKB) in 1973 and Rajshahi Krishi Unnayan Bank (RAKUB) in 1987 to serve rural areas, and Bangladesh Small Industries and Commerce Bank Limited (BASIC) in 1988 to promote small industries in urban and rural areas. BKB and RAKUB play key roles in delivering financial services to rural households. In 2013, these banks (along with other specialized banks) accounted for 31% of bank branches in rural areas (Bangladesh Bank, 2014). With 1,029 branches now, BKB covers all of Bangladesh except the Rajshahi division—which is covered by RAKUB, with 377 branches. Both banks are entirely owned by the MOF, with state-appointed boards of directors and management. With 69 branches across the country, BASIC was created to be the main provider of credit to small industry in urban and rural areas. The by-laws of the bank require half of its loanable funds go to small-scale industries.

A recently introduced government policy encourages banks, especially private ones, to expand their activities in rural areas. The BB requires that banks have one rural branch for every four urban ones.

## 5.2 Promoting cooperative networks

The government has promoted two cooperative networks, covering both traditional cooperatives under the Registrar of Cooperatives and financed by Bangladesh Sambaya Bank Limited (BSBL) and two-tier cooperative systems under the Bangladesh Rural Development Board (BRDB). Cooperatives in the two networks are financed through Bangladesh's Bank agricultural refinance facility (for BSBL) and budget allocations (for BRDB).

Cooperatives under BSBL are organized in three tiers. BSBL is the apex cooperative bank, under which there are central cooperative societies and primary societies. BSBL on-lends to the central societies, which in turn on-lend to the primary cooperatives. BRDB, by contrast, organizes cooperative societies into a two-tier structure, with primary cooperatives at the local level and others at the than a level. Although allowed, in practice neither cooperative network takes deposits. Rather, both act as credit delivery mechanisms. The Department of Rural Cooperatives and Development oversees the activities of cooperatives.

## 5.3 Providing refinance facilities for agriculture

Through BB, the government provides refinance facilities to financial institutions interested in financing agriculture. The Agricultural Extension Department sets the terms and conditions for agricultural refinance loans between BB and participating financial institutions, and between these institutions and farmers (Box 1). BKB and RAKUB are the only active borrowers from the refinance facility. Although most of the outstanding amount is past due, BB continues to extend the facility because BKB and RAKUB's exposure is explicitly guaranteed by the MOF. BSBL and BRDB have outstanding (and past due) loans from the facility but have not been borrowing recently, as they have been unable to repay the amounts outstanding and have no government guarantee for these loans.

**Box 1. Terms and Conditions of Loans Refinanced under the Agriculture Refinancing Facility**

Bangladesh Bank provides a refinance facility for agriculture. At the beginning of each fiscal year, interested banks determine their goals for agricultural lending and submit applications to Bangladesh Bank. The limits for each participating institution are approved by Bangladesh Bank's Board of Directors, and repayments to the bank are guaranteed by the government. Between 1996 and 2005 annual disbursements from the facility ranged from 6 to 8 billion taka, while cumulative overdue loans increased from 7 billion taka in 2001 to 34 billion taka in 2005. Refinance facilities are offered for three types of loan products:

- Short-term loans (one-year maturities) to cultivate crops (aman, boro, sugarcane, wheat, oil seed, vegetables), jute, maize, cotton, tobacco, fisheries, and the like.
- Medium-term loans (five-year maturities) for livestock and poultry production (dairy, cattle, goat, buffalo, sheep, ducks), fisheries, nurseries, betel leaf cultivation, beef fattening, fruit gardening, and the like.
- Long-term loans (more than five-year maturities) for agricultural equipment, power tillers, deep and shallow tube wells, low lift pumps, hand tube wells, rubber cultivation, and the like.

The final annual interest rate is 8% for crop loans, 9% for other agricultural loans, and 11.5% for medium-size and large agricultural activities. Bangladesh Bank charges the participating financial institutions an annual interest rate of 5 percent.

Source: Bangladesh Bank

## 5.4 Providing crop insurance and waiving payments on small loans

In the late 1970s, the government designed the traditional multi-peril crop insurance scheme that was administered by Sadharan Bima Corporation (SBC), a state-owned insurance corporation. The program had to be ended in the early 1990s because the scheme was financially unsustainable, with claims 20 times higher than premiums. Since the program was discontinued, after natural disasters and before elections, the government had regularly waived interest, and sometimes principal, on agricultural loans below BDT 5,000 disbursed by BKB, RAKUB, BSBL, BRDB, and nationalized commercial banks. In theory, the MOF should compensate the financial institutions for half of the amount waived; in practice, this has almost never happened.

## 5.5 Programs of Bangladesh Bank

In spite of a large number of bank networks and microfinance institutions in the country, a large segment of the population particularly rural poor have limited access to formal credit. With this premise, BB, through the Agricultural Credit & Financial Inclusion Department (ACFID), is implementing several interventions to bridge the gaps in financial inclusion and has also started finding ways in making rural credit available to the common people. ACFID is entrusted to formulate and implement agricultural credit policy for the country. It formulates the policies relating to priority sectors of agriculture and rural credit. It monitors and ensures timely, adequate and transparent flow of credit to the rural people for agricultural activities and rural employment programs. ACFID also formulates policies and implements agricultural projects financed by development partners, GoB, and BB.

The BB, through AFCID, provides loan facilities to state-owned commercial banks (Rupali Bank, Sonali Bank, Janata Bank & Agrani Banks) and some specialized banks like Grameen Bank, Ansar VDP Unnayan Bank, Karmasangsthan Bank, among others, against government guarantee for extension of microcredit services to the rural people. The BB also mandates other private banks and foreign commercial banks to disburse at least 2.5% of their total loanable funds for the agriculture sector. The goal is to increase the disbursement of agricultural and rural credit by expanding banking services to rural areas, making the farmers accustomed to banking activities and to promote financial inclusion.

With the goal of ensuring food security and poverty alleviation, ACFID has formulated the Agricultural and Rural Credit Policy and Programme (ARCPP). This policy, which is being reviewed annually, aims to ensure the food security and nutrition for the people through establishment of profitable, environment-friendly and sustainable agricultural systems. Specifically, the policy is expected to help the farmers to achieve desired level of agricultural productivity and at the same time increase the credit supply in favor of the farmers, improve the living conditions of the rural people and ultimately alleviate rural poverty. Further, ARCPP is focused on policies relating to increasing the scope of agricultural and rural credit, refinancing scheme facility for farmers holding BDT 10-account, extra incentive to the cultivation of export oriented crops including potato, financing in vermicomposting, providing a wide list of environmentally sustainable crops to face the adverse effect of climate change, among others.

**Box 2. Some Features of the Agricultural & Rural Credit Policy & Programme**

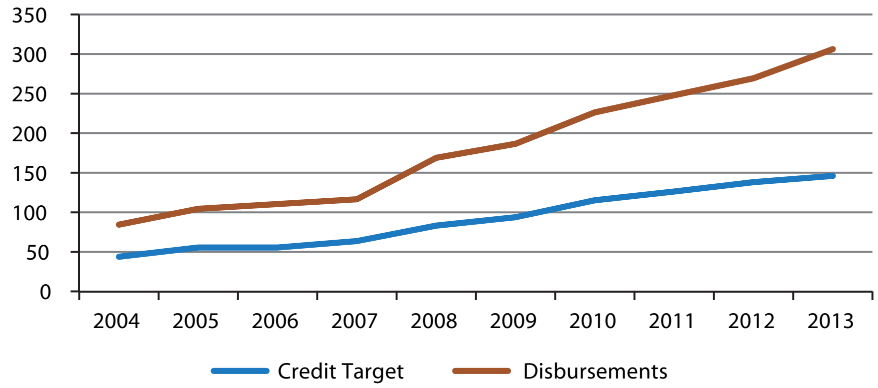
1. All private and foreign banks must disburse at least two and one half percent of their total loan and advance as agricultural loan to achieve their yearly target.
2. An agricultural loan application form has to be simplified and readily available to potential and eligible farmers.
3. Acknowledge receipt of the agricultural loan application form. If it is not possible to consider any application to grant a loan, the farmers need to be informed by a letter mentioning the reason for non-granting the loan and a copy of the letter will be preserved in a file.
4. For the sake of transparency in loan disbursement, disbursement of agricultural loan needs to be publicized at union level.
5. Banks have put in place an effective monitoring system to ensure timely and hassle free disbursement of necessary loans to real farmers and to achieve the targeted agricultural credit.
6. Credit has been made available as required to establish solar energy driven irrigation pumps.
7. Banks have followed the directions to conduct the agricultural credit operations in partnership with Microfinance Institutions (MFI's) approval by Microcredit Regulatory Authority (MRA).
8. Achievement of the agricultural and rural credit target of banks will be considered to determine CAMELS rating.

Source: Bangladesh Bank

With ARCPP, the amount of agricultural credit disbursed to farmers has increased subsequently over the period FY 2004-2013 (Figure 17). In FY 2013, the government set a target for agricultural credit disbursement of BDT 145.95 billion (USD 1.88 billion) as compared to BDT 138.00 billion (USD 1.78 billion) in FY 2012. There is a 3.29% increase in targeted agricultural credit disbursement. For FY 2012, the percentage increase in target setting was 9.35% whereas the percentage increase in actual credit disbursement for the fiscal year was 7.80%. This scenario reveals a situation where the target of credit disbursement is not attained for most of the fiscal year. Hence, farmer's credit needs are not met.

There were some gaps in the target setting and actual disbursement of credit during FY 2004-2007 and FY 2009-2012, which may have restrained farmers in getting agricultural credit (Table 14). However, actual credit disbursements to agriculture sector in FY 2008 and FY 2013 have reached more than 100% of the target. This accomplishment against the target can be attributed to the participation of private sector banks through linkages with MFIs.

**Figure 17. Aggregate Agricultural Credit Target & Disbursement Agricultural Credit & Financial Inclusion Department, Bangladesh Bank (FY 2004-2013, Amount in BDT Billion)**




Source: Bangladesh Bank

**Table 14. Gap in Agricultural Credit Target and Disbursements (FY 2004-2013, Amount in BDT Billion)**

| Fiscal Year | Program Target | Disbursement | Gap | Percentage Gap in Target Achievement |
|---|---|---|---|---|
| 2004 | 43.8 | 40.7 | 3.1 | 7.08 |
| 2005 | 55.4 | 48.9 | 6.5 | 11.73 |
| 2006 | 55.4 | 55.0 | 0.4 | 0.72 |
| 2007 | 63.5 | 52.9 | 10.6 | 16.69 |
| 2008 | 83.1 | 85.8 | (2.7) | (3.25) |
| 2009 | 93.8 | 92.8 | 1.0 | 1.07 |
| 2010 | 115.1 | 111.2 | 3.9 | 3.39 |
| 2011 | 126.2 | 121.8 | 4.4 | 3.49 |
| 2012 | 138.0 | 131.3 | 6.7 | 4.86 |
| 2013 | 145.9 | 160.4 | (14.5) | (9.9) |

Source: Statistical Department, Bangladesh Bank

## 5.6 Programs of Government Agencies

In general, the major roles played by the Government of Bangladesh with regard to rural and agricultural development include: (1) provision of an enabling policy and regulatory environment conducive for private sector investment; (2) infrastructure development such as farm-to-market roads, irrigation, and other agricultural facilities; (3) provision of support services such as capacity building (e.g. training on new production technologies, other alternative livelihood opportunities), agricultural research and extension, and market support/linkage, among others; and (4) fund mobilization from both local and foreign donors in support of priority development programs and projects. Key government agencies include the Ministry of Finance (MOF), Ministry of Agriculture (MOA), and Bangladesh Rural Development Board (BRDB) under the Local Government Ministry.

With financial support coming from the government and international financial institutions, the Government of Bangladesh through its various ministries and departments has been promoting microfinance in support of its poverty alleviation program. Table 15 shows disbursements and recovery amount under the poverty alleviating microfinance program of the Government of Bangladesh. As of end of FY 2014, the cumulative disbursement through various ministries and departments of the government stood at BDT 1,223.80 billion (USD 15.76 billion) of which BDT 1,117.26 billion (USD 14.39

billion) were recovered with an average recovery rate of 91%. In order to sustain the microcredit programs for poverty reduction, the Government of Bangladesh emphasizes on developing small entrepreneurs. The Finance Division in cooperation with the other Ministries is working together in this endeavor.

The BRDB, a specialized government agency under the local government ministry has been extending its activities through microcredit operations, imparting training, mobilizing capital, transferring technology, empowering women, accelerating family planning and reproductive health services, improving public health and sanitations for poverty alleviation in line with the Government strategies. Since inception, BRDB has so far implemented various projects and programs many of which are poverty focused and microcredit based. Presently, the ongoing projects and programs of BRDB are concentrated mostly on poverty reduction and human resource development. These include: (1) Rural Livelihood Project (RLP); (2) Rural Poverty Alleviation Programmes (RPAP); (3) Productive Employment Programme (PEP); (4) Palli Progoti Prakalpa (PPP);(5) Integrated Poverty Alleviation Programme (IPAP); (6) Participatory Rural Development-II (PRDP-II); (7) Productive Employment Awareness Raising Programmes for the Rural Women; (8) Women Development (WD); and (9) Employment Guarantee Scheme for the Hard Core Poor of the Northern Region. BRDB works for agricultural development by organizing and providing credit and other agricultural services to small and marginalized farmers.

**Table 15. Microcredit Disbursements of Various Ministries/Departments**
(FY 2014, Amount in BDT Billion)

| Ministry/Division | Disbursements (BDT Billion) | Recovery (BDT Billion) | Recovery Rate (%) |
|---|---|---|---|
| 1. Ministry of Finance | 4.22 | 3.33 | 79 |
| 2. Rural Dev't & Cooperative Division* | 112.51 | 100.52 | 89 |
| 3. Ministry of Women and Child Affairs | 1.62 | 1.20 | 74 |
| 4. Ministry of Social Welfare | 4.92 | 4.08 | 83 |
| 5. Ministry of Industries | 2.10 | 2.22 | 106 |
| 6. Ministry of Agriculture | 1,080.84 | 990.83 | 92 |
| 7. Ministry of Land | 1.26 | 0.95 | 75 |
| 8. Local Government Division | 3.60 | 3.25 | 90 |
| 9. Ministry of Youth and Sports | 12.59 | 10.72 | 85 |
| 10. Ministry of Textile and Jute | 0.08 | 0.14 | 167 |
| 11. Ministry of Liberation War Affairs | 0.06 | 0.03 | 57 |
| **TOTAL** | **1,223.80** | **1,117.26** | **91%** |

* Includes disbursements of BRDB
Source: Bangladesh Bank & Concerned Ministry/Department

## 5.7 Palli Karma-Sahayak Foundation

The Palli Karma-Sahayak Foundation or PKSF is an apex development organization established by the government of Bangladesh in May 1990, with mandate for sustainable poverty reduction through employment generation. Among its major objectives are to: (1) provide financial assistance and institutional development support to appropriate organizations for implementing sustainable inclusive financial programs for reduction of poverty through creating productive employment opportunities for the moderate and ultra-poor, small and marginal farmers and micro entrepreneurs; (2) support, promote, develop and identify sustainable employment opportunities for the moderate and ultra-poor, small and marginal farmers and micro entrepreneurs; and to provide them assistance including education, health, training and risk reduction services as may be necessary for enhancing their capacity; (3) build and strengthen the institutional capacity of the POs (partner organizations) and enhance their ability to provide various financial and non-financial services to the poor on a sustainable manner; (4) support, promote and sponsor innovative programs and suitable projects for improving the quality of life of the poor and enabling them to lead a dignified life; and, (5) help the poor to diversify and strengthen their livelihood strategies, enhance their security, give them access to assets and rights, and augment their self-respect by providing them greater choices and independence.

At the early stage of its operation, PKSF set the goal of creating self-employment opportunities in the rural off-farm sector and adopted the strategy of promoting a credit program for attaining its goal. Launched for the rural moderate poor, its credit program has been diversified over time in accordance with the changing needs of heterogeneous poverty-stricken segments of society and has gradually evolved into an "inclusive financing program". PKSF's present financing program includes the moderate poor of both urban and rural areas, ultra-poor, micro entrepreneurs, marginal and small farmers; members of these poverty groups are offered customized services. Enabling the poor to come out from the low productivity trap, PKSF has integrated capacity building, technology transfer, value chain development and other technical services in its development program.

The PKSF, since its inception in 1990, has been making significant contributions in alleviating poverty through the provision of microfinance services to the poor through its Partner Organizations (POs) in order to achieve the goal of poverty alleviation. In support of this endeavor, PKSF has created Special Fund and Programme-Support Fund with its own fund to enhance the capacity of the poor. Besides, PKSF has established Livestock Unit with a view to ensuring adequate financial services, disseminating of appropriate technology, building up capacity of borrower and establishing value chain and marketing system for the livestock products and by-products.

The PKSF sources its funds from the Government of Bangladesh, grants and donations from private institutions local and abroad, uses of which are consistent with its purposes and objectives. Among PKSF's fund sources are: World Bank, Asian Development Bank, Department of International Fund, European Union, International Fund for Agricultural Development, and Kuwait Goodwill Fund.

At the end of FY 2014, PKSF has disbursed at total of BDT 188.33 billion (USD 2.43 billion) to its 273 POs. Revolving this amount, these organizations have disbursed BDT 184.60 billion (USD 2.38 billion) to the poor borrowers while maintaining a recovery rate of more than 98.85%. Total number of borrowers stood at 8.13 million of which more than 91% are women. Recovery rate at the borrower level is maintained at 92.57% at end of FY 2014. The status of PKSF's microcredit program is shown in Table 16.

**Table 16. Status of Microcredit Program of PKSF**

| Particulars | Cumulative as of FY 2014 |
|---|---|
| Amount Disbursed to POs (BDT Billion) | 188.33 |
| Number of POs | 273 |
| Amount Recovered (BDT Billion) | 151.29 |
| Recovery Rate (PO level) | 98.85 % |
| Amount Disbursed to borrowers (BDT Billion) | 184.60 |
| Amount Recovered (BDT Billion) | 170.88 |
| Recovery Rate (borrower level) | 92.57 % |
| Number of Borrowers | 8.13 million |
| Female | 7.42 million |
| Male | 0.71 million |

Source: Bangladesh Bank, PKSF

## 5.8 Role of Financial Institutions in the Delivery of Financial Services to the Rural Poor

### 5.8.1 Banking Sector

With growing demand of agricultural credit for sustainable agricultural production, Bangladesh Bank requires all scheduled banks (SCBs, SBs, PCBs and FCBs) to mobilize credit into agricultural sector. These financial intermediaries have offered short and long term credit according to the purposes of agricultural activities. According to BB recent report, about 63% (BB Annual Report FY 2014) of credit disbursed as short-term lending and the rest 37% as in the form of long-term loans. Long term loans are used for purchasing irrigation equipment, agricultural machinery, livestock, horticultures, fisheries, and establishment of agro-based industries etc. Typically, short-term loans are provided for seasonal agricultural production activities. Nevertheless, performance of agricultural credit is measured based on credit disbursement and recovery situation overtime. More precisely, credit performance is evaluated from two angels-credit performance; one from the lenders 'point of view, and second, the credit performance from the perspective of specific agricultural sub-categories.

Accessibility of banking services to small and marginal farmers is necessary to keep smooth growth of the agricultural sector. Hence, the banking sector is playing a vital role particularly state-owned banks (SBs) are dominating the agricultural credit market. They distribute agricultural credit through their branch network and in collaboration with NGO-MFIs. Presently, specialized banks, like Bangladesh Krishi Bank (BKB), Rajshahi Krishi Unnayan Bank (RAKUB), BASIC Bank and other scheduled banks, Sonali, Janata, Islami and others, have their own microcredit based programs such as agricultural credit, livestock credit, fisheries credit, handloom credit, among others. Others have microcredit programs through linkage with other NGOs. However, direct involvement of banking sector in this field is not well defined as some banks claim their agricultural or small loan programs as microcredit (Rahman & Rashid, 2011). Therefore, there are doubts in statistics regarding microcredit operations of the banking sector. Based on available figures, 10 banks composed of five commercial banks and five specialized banks have disbursed (Table 17) a total of BDT 452.35 billion (USD 5.83 billion) to the microcredit sector mostly as wholesalers to the NGOs. Sonali Bank, the largest state-owned commercial bank, has partnership with 63 NGOs and BASIC Bank, a specialized bank, has partnership with 68 NGOs. Among them, two banks have retail microcredit program. Recovery rate is maintained at an average of 92% at the end of FY 2014. These banks, further, have reached about 3.3 million borrowers.

**Table 17. Status of Microcredit of the Banking Sector, Cumulative as of FY 2014**

| Name of Bank | Disbursements (BDT Billion) | Number of Borrowers | Recovery Rate (%) | Type |
|---|---|---|---|---|
| 1. Sonali Bank | 122.99 | 262,149 | 98% | Wholesale |
| 2. Agrani Bank | 51.37 | 132,317 | 99% | Wholesale |
| 3. Janata Bank | 55.90 | 548,134 | 78% | Wholesale |
| 4. Bangladesh Krishi Bank | 16.35 | 14,919 | 86% | Wholesale |
| 5. Rajshahi Krishi Unnayan Bank | 4.21 | 10,480 | 79% | Wholesale |
| 6. Rupali Bank | 1.94 | 15,849 | 88% | Wholesale |
| 7. BASIC Bank | 4.25 | 370,618 | 98% | Wholesale |
| 8. Ansar VDP Unnayan Bank | 20.01 | 979,511 | 97% | Wholesale |
| 9. Islami Bank Limited | 87.55 | 899,237 | 99% | Retail |
| 10. National Bank Limited | 87.78 | 32,853 | 95% | Retail |
| **TOTAL** | 452.35 | 3,266,067 | | |

Source: Bangladesh Bank, Concerned Bank

### 5.8.2 Microfinance Institutions

The member-based MFIs constitute a rapidly growing segment of the Rural Financial Market in Bangladesh. Microcredit programs in Bangladesh are implemented by various formal financial institutions (i.e. nationalized commercial banks and specialized banks), specialized government organizations and NGOs. In spite of more than a thousand institutions operating microcredit programs, only 10 large MFIs and Grameen Bank account for 87% (Alauddin & Biswas, 2014) of total savings of the sector and 81% of total outstanding loan of the sector. Through the financial services of microcredit, the poor people are able to engage in various income generating activities and around 30 million poor people (Alauddin & Biswas, 2014) directly benefit from microcredit programs.

Microfinance services of this sector can be categorized into six broad groups: (1) general microcredit for small-scale self-employment based activities, (2) microenterprise loans, (3) loans for ultra-poor, (4) agricultural loans, (5) seasonal loans, and (6) loans for disaster management. As of June 2015, about 742 institutions have been licensed by MRA to operate Microcredit Programs. Grameen Bank is out of the jurisdiction of MRA as it is operated under a distinct legislation-Grameen Bank Ordinance, 1983.

**Table 18. Basic Statistics of MRA-Supervised NGO-MFIs, As of June 2014**

| | |
|---|---|
| Number of Licensed NGO-MFIs* | 742** |
| | 147*** |
| Number of Branches | 14,730 |
| Total Employees | 109,628 |
| Total Clients | 25.11 million |
| Total Borrowers | 19.42 million |
| Total Savings Balance | BDT 106.99 billion |
| Loan Outstanding | BDT 282.21 billion |
| Cumulative Surplus | BDT 99.94 billion |
| Loan Disbursement | BDT 462.00 billion |
| Total Asset | BDT 334.50 billion |
| Maximum Rate of Interest | 27% (Diminishing Method) |
| Minimum Interest Rate on Saving | 6% |

* Excluding Grameen Bank; ** 45 cancelled licenses; *** with temporary approval
Source: MRA-MIS Database, 2014

Loan amounts up to BDT 30,000 are generally considered as microcredit while loans above this amount are considered microenterprise loan which can be as high as BDT 500,000. An increasing trend in microenterprise loans has been observed; however, loan size indicates that less than 30% of total loans were disbursed to the microenterprise sector (Credit and Development Forum Statistics). This has been further validated among 65 borrowers of Grameen Bank interviewed, of which only 15 borrowers have loans of more than BDT 30,000.

On interest rate of microcredit, NGO-MFIs usually charge 12% to 15% interest on loans at a fixed rate for a year-long loan which would be around 24 to 30% per year when calculated on a diminishing balance. Under the fixed rate method, MFIs charge a single rate for the total amount at the beginning of the loan disbursement and prepare a repayment schedule of equal installments. However, the real or effective rate could be higher depending on the terms and condition of the loan, such as upfront deduction on the loan, number of installments, and mode of payment, among others. Usually, loans for a one-year term are repaid back by 45-46 weekly installments. Some loans are repaid by monthly installments and some by just one installment. A survey by MRA on 50 institutions (MRA Survey, 2010) shows that if other terms and conditions are not considered, the effective rate of interest on general loans ranges from 25 to 33% (Table 19). Among them, the range for 75% of the institutions falls under 28 to 30% and the modal value is 29%.

**Table 19. Interest Rate of Microcredit on Different Types of Loan**

| Types of Loan | Effective Interest Rate (usual range) | |
|---|---|---|
| | After considering deductions for savings and insurance during loan disbursement (%) | Without considering any deduction during loan disbursement (%) |
| General Microcredit (Rural & Urban) | 28-70 | 25-33 |
| Microenterprise Loan | 28-65 | 26-40 |
| Ultra-poor Loan | 22-28 | 22 |
| Agricultural Loan | 28-65 | 22-33 |
| Seasonal Loan | 28-55 | 26-33 |
| Disaster Management Loan | 2.46-21 | 2.46-21 |

Source: MRA-MIS Database, 2014

In terms of savings, not like banking institutions, NGO-MFIs are not legally permitted to receive savings or deposits from the general public. Instead, these MFIs generate savings from their members/clients under various names or categories as follows: (1) compulsory savings, linked to loans; (2) voluntary savings of flexible amount; and, (3) long term savings. Compulsory savings are tied to the loan taken. However, voluntary savings could be any amount saved by the beneficiaries of microcredit on a voluntary basis. Long term savings are also offered, features of which are similar to that offered by banks. Savings account for over 30% of outstanding credit. The amount of savings collected by MFIs, including Grameen Bank, indicates that poor people can save money from their small income if the right kind of savings instrument are available to them, thus there are demands for these services. Insurance services are also provided by limited number of MFIs under which borrowers mainly get exemption from repayment of loan in case of death. In this type of insurance, borrowers do not need to pay regular premiums as required by traditional insurance services. Rather, it is one-time payment during the disbursement period. In most cases, the insurance payment depends on the loan size.

The cost structure of NGO-MFIs depends on their efficiency and composition of fund sources. Costs include administrative costs, financial costs, and cost of loan loss. Administrative expenses generally consist of over 60% of total expenses. An analysis on 50 institutions done by MRA shows administrative cost of this sector varies widely ranging from 10% to 30% of loans outstanding. Inherent causes of this variation of operational costs is not yet understood, which perhaps depends on many factors including areas of operation, pay structure of the organization, nature of the organization, organization's intention to provide subsidies to other development programs, inefficiency in management and operations, among others.

Although a large number of NGO-MFIs are operating their microcredit activities in Bangladesh, only the top five licensed MFIs (BRAC, ASA, PROSHIKA, TMSS, Buro Bangladesh) as well as Grameen Bank cover the maximum share of the total loan outstanding and savings of the sector. At the end of FY 2014, overall MFI sector disbursement has increased by 7.7% as compared to FY 2013. Recovery increased by 12.6% in FY 2014 as compared to 50% increase in FY 2013. Past due as a percentage of outstanding loans stood at 2.5% in FY 2014 from 3.3% in FY 2013. Total loans granted by PKSF to its 273 POs amount to BDT 188.3 billion (USD 2.43 billion). The table below shows the status of microcredit operations among the major MFIs in Bangladesh, as of FY 2014.

Further, MFIs are now categorized as transmission channel of monetary policy. The microfinance sector has a vital role in financial deepening (Rahman & Rashid, 2014), one of the targets of the monetary policy pursued by the Bangladesh Bank to help poverty reduction through availability of money in the informal sector especially in the rural sector. Generally, an expansionary monetary policy contributes to higher monetization in the informal sector through the activities of the MFIs. Further, private MFIs are also now being considered as one of the vehicles for prompt delivery of remittances by Bangladeshi overseas workers to their beneficiaries at home. Partnership among banks and MFIs, for efficient and swift delivery of payments and other financial services to population segments in dispersed and remote locations, is now being encouraged by the Bangladesh Bank.

**Table 20. Microcredit Operations of Major MFIs in Bangladesh, As of FY 2014**

| Name of MFI | Disbursement (BDT Billion) | Outstanding Loans (BDT Billion) | No. of Borrowers (Million)* | | | Recovery Rate (%) |
|---|---|---|---|---|---|---|
| | | | Total | Male | Female | |
| Grameen Bank | 117.23 | 87.73 | | | | 98 |
| BRAC | 133.87 | 81.17 | 5.60 | 5.00 | 0.60 | 97 |
| ASA | 102.60 | 59.29 | 1.00 | 0.70 | 0.30 | 97 |
| PROSHIKA | 2.22 | 1.94 | 0.11 | 0.08 | 0.03 | 87 |
| TMSS | 18.64 | 10.57 | 0.56 | – | – | 96 |
| Buro Bangladesh | 23.63 | 13.72 | 0.89 | – | – | 97 |
| **TOTAL** | **398.19** | **254.42** | | | | |

* The exact number could be less if overlapping numbers are counted. Overlapping rate is 40% per PKSF Survey in 2005.

Source: MRA-MIS Database, 2014 & Bangladesh Bank

## 5.9 Developments and Experiences of Selected Financial Institutions

Based on the interviews conducted with key officials of selected financial institutions and secondary data provided by the same institutions, the following sections present the highlights of developments and experiences of each institution in relation to its contribution to poverty reduction by way of providing credit and other services to the small and marginalized farmers in Bangladesh.

### 5.9.1 Bangladesh Krishi Bank

Previously known as Agricultural Development Bank of Pakistan, the Bangladesh Krishi Bank (BKB) was established in 1962. Derived from the Bengal word "Krishi" which means agriculture, BKB functions as the agriculture bank of the country mandated to modernize agriculture to increase agricultural production, diversify agricultural activities, and improve farmers' income. The primary function of BKB is to provide credit facilities to the farmers for the development of agriculture i.e. crop production, fish culture, and animal husbandry, among others. But this bank had its branches mostly in urban areas to finance largely tea and jute trading. Ultimate growers of crops were least benefitted (Khalily, 2015).

Following the independence of Bangladesh in 1971 and greater emphasis by the then government on agricultural development, BKB was more focused on financing different farm and off-farm economic activities in rural areas. In order to encourage flow of credit for agricultural development, several policy measures were taken during the period 1970-1990: (1) refinancing of credit; (2) targeted credit program with credit ceiling; and (3) subsidized credit policy with low interest rate (Khalily, 2015). Being the specialized agricultural financing lending institution, BKB was more directed towards lending rather than deposit mobilization. As such, it has remained more or less dependent on subsidized funding from Bangladesh Bank and/or government.

Administratively, it was difficult for this bank to uniformly finance agricultural sector throughout the country, thus, the government of Bangladesh in mid-1980s split BKB into two – RAKUB and BKB. The RAKUB operates in the north-western region of the country, and BKB continues to operate in rest of the country. Because of regional split, no competition exists between these two banks.

The BKB operates its function through its 1,029 branches (except Rajshahi Division). It has 16 foreign exchange (Authorized dealer) branches. At the field level, BKB has 9 divisional, 29 chief regional and 24 regional offices for close supervision of the branch activities. For smooth operation, as a part of internal control and compliance system, the bank has also 63 field level audit offices of which 9 at divisional and 54 at regional levels. The existing strength of BKB's manpower is 9,430.

The BKB finances activities under the seven priority sub-sectors, namely, crop, fisheries, livestock, farm and irrigation equipment, agro-based industrial project, SME, continuous loan (working capital and cash credit), and microcredit or small loan. Out of total annual allocation of BKB's loan portfolio, 60% is allocated for crop financing. This credit facility covers all the seasonal crops produced in the country. The loan is disbursed per standards set by the Bangladesh Bank. The rate of interest for this sector is 11%. The rate of interest may however, vary from time to time. The target borrowers for this facility are landowners, sharecroppers, and marginal farmers. BKB does not require collateral for borrowers with land holdings of five acres and below. At the end of FY 2014, total loan disbursements for the microcredit sub-sector amount to BDT 16.35 billion (USD 0.21 billion) benefiting 14,919 borrowers. Recovery rate stands at 86% (BB Annual Report, 2014).

### 5.9.2 Rupali Bank Limited

Established in December 1986, Rupali Bank Limited (RBL) is a commercial bank that emerged from a nationalized commercial bank constituted with the merger of three commercial banks (Muslim Commercial Bank Ltd., Australasia Bank Ltd., and Standard Bank Ltd.) operated in the then Pakistan on March 26, 1972 under the Bangladesh Banks (Nationalization) Order 1972 (P.O. No. 26 of 1972), with all their assets, benefits, rights, powers, authorities, privileges, liabilities, borrowings and obligations.

The principal activities of the bank are banking and related activities such as accepting deposits, personal banking, trade financing, SME, trade and services, cash management, treasury, securities and custody services, and remittance services, among others. With a large geographical coverage, RBL has well distributed network of branches in rural and urban areas of Bangladesh. As of the end of FY 2014, there are 535 RBL branch offices, of which 293 are situated in the urban areas and 242 are in the rural areas with a total number of employees of 5,914 (RBL Annual Report, 2014).

The bank extends rural loans and small credit to farmers through its 242 branch network in the rural areas. The bank has taken initiatives to provide loans among the entrepreneurs who want to rear cows to increase milk production. The bank also provides loan for fishery, shrimp cultivation, goat/sheep rearing, poultry, microcredit for handicapped, and tree plantation. These loan facilities are accessed through bank-NGO credit facility. To comply with the Agricultural and Rural Credit Policy and Programme or ARCPP of Bangladesh Bank, RBL has disbursed a total of BDT 1.94 billion (USD 24.98 million) which benefited a total of 15,849 borrowers as of the end of FY 2014 (BB Annual Report, 2014).

### 5.9.3 Agrani Bank Limited

The Agrani Bank Limited (ABL) was incorporated as a state-owned commercial bank on 17 May 2007 under the Companies Act 1994. ABL emerged as a nationalized commercial bank following the Bangladesh Banks (Nationalization) Order 1972. ABL took over the business, assets, liabilities, rights and obligations of Agrani Bank through a vendor's agreement signed on 15 November 2007 between the MOF of the People's Republic of Bangladesh and the Board of Directors of ABL with effectivity from 1 July 2007. Operating with 921 networks of bank offices in the entire country (mostly urban areas) with a total manpower of 13,414, the major business activities of ABL include finance and insurance, consumer and corporate banking, and investment and management (ABL Annual Report, 2014).

With a view of widening the access to finance of the poor and ultra-poor community, ABL has been financing NGOs since 1997 of various categories and capacities at privileged rates of interest. ABL has been in a unique position to providing credit facilities to the farmers at a lower rate of interest (currently at 8%). A huge amount of foreign currency is spent in every year to import pulse, oil seeds, ginger, spices, maize etc. In order to save foreign currency, the Government of Bangladesh encourages the farmers to boost up the production of above crops by introducing rebate rate of interest at 4% which is considered as the lowest rate of interest among any credit facilities.

The ABL has been financing the agriculture sector with the broad objective of integrating rural people with the mainstream development activities and tap unutilized sources in order to boost growth in agriculture including livestock, fishery, and other off-farm activities. Poverty alleviation through income generating activities is one of the strategies which the Bank employs to make financial resources available to the rural poor to break poverty cycle and stimulate growth. Large number of targeted programs with loan amount to BDT 5,000-100,000 and interest rate of 8% to 10% are being undertaken to reach the rural landless, marginal farmers, small entrepreneurs, and distressed women. No collateral security is required for loan up to BDT 100,000. As of the end of FY 2014, a total of BDT 51.37 billion (USD 0.66 billion) has been disbursed for this purpose which benefited 132,317 borrowers (BB Annual Report, 2014).

### 5.9.4 Grameen Bank

In August of 1976, Dr. Muhamnad Yunus developed the principles of the Grameen Bank (literally, "Bank of the Villages" in Bengali) from his research and experience and started a project called Grameen Bank Project to test his method for providing credit and banking services to the rural poor. Proving successful, the project, with support from Bangladesh Bank, was extended in 1979 to the Tangail District (to the north of the capital, Dhaka). In October 1983, Grameen Bank was established as an independent bank. Today, Grameen Bank is operating all across the country and the Grameen approach has been replicated in more than 100 countries of the world.

The bank has gained its funding from different sources, and the main contributors have shifted over time. In the initial years, donor agencies used to provide the bulk of capital at low rates. By the mid-1990s, the bank started to get most of its funding from Bangladesh Bank. More recently, Grameen has started bond sales as a source of finance. The bonds are implicitly subsidized, as these are guaranteed by the Government of Bangladesh, and still these are sold above the bank rate. In 2013, Bangladesh parliament passed 'Grameen Bank Act' which replaces the Grameen Bank Ordinance, 1983, authorizing the government to make rules for any aspect of the running of the bank.

Grameen Bank is owned by the borrowers of the bank. The main goal is to make credit available to the rural poor, mostly women, in struggle against poverty strictly following the Sixteen Decisions of Grameen Bank (Box 3). In doing so, borrowers are given loans for income generating purposes and housing. All loans are given without collateral and without legal instruments. Grameen Bank loans are repaid on a weekly basis.

The Bank continues to expand across the entire nation. At the end of FY 2015, Grameen Bank has 2,568 branches, 268 area offices, 40 zonal offices, and 40 zonal audit offices. Through 142,223 centers, spread over 81,390 villages, over USD 17.42 billion have been disbursed to nearly 8.68 million member-borrowers, 97% of which are women and with a recovery rate of 98.33% (Grameen Bank Monthly Update, July 2015). Savings balance of the borrowers stands at USD 1.38 billion.

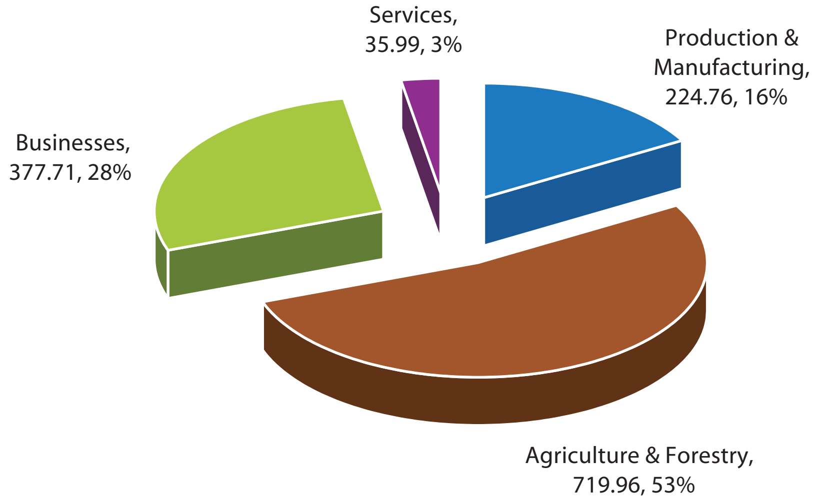
The proportion of loan disbursement per loan type is shown in Figure 18. It is worth noting that 53% of the cumulative loan disbursement went to agriculture sector. This is further validated during the conduct of focused group discussion in two separate center meetings at Rai Dhakin Village, Manikganj District in Dhaka. Interviewed 36 Grameen Bank borrowers, majority of these borrowers are engaged in agricultural activities: 12 said they are into cow rearing, 5 are into milking cow, 8 are into poultry raising, and the remaining 11 borrowers are into microenterprise. Loan sizes vary from BDT 6,000 to a maximum of BDT 300,000 with loan term of one to two years. Loans are repaid in weekly installments. Majority of the borrowers interviewed said that late payment is not an issue because installment due not paid on time is automatically deducted from the borrower's savings account with Grameen Bank. In addition to the interviews, the houses of seven borrowers were visited and these authors were happy to note that the borrowers satisfied the 10 Indicators of Poverty Alleviation for Grameen Bank Members (Box 4). The houses visited have tin roofing, with decent beds, sanitary latrines, and access to purified water, among others.

**Box 3. Sixteen Decisions of Grameen Bank**

1. We shall follow and advance the four principles of Grameen Bank: Discipline, Unity, Courage and Hard work – in all walks of our lives.
2. Prosperity we shall bring to our families.
3. We shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest.
4. We shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus.
5. During the planting seasons, we shall plant as many seedlings as possible.
6. We shall plan to keep our families small. We shall minimize our expenditures. We shall look after our health.
7. We shall educate our children and ensure that they can earn to pay for their education.
8. We shall always keep our children and the environment clean.
9. We shall build and use pit-latrines.
10. We shall drink water from tube wells. If it is not available, we shall boil water or use alum.
11. We shall not take any dowry at our sons' weddings; neither shall we give any dowry at our daughters' weddings. We shall keep our center free from the curse of dowry. We shall not practice child marriage.
12. We shall not inflict any injustice on anyone; neither shall we allow anyone to do so.
13. We shall collectively undertake bigger investments for higher incomes.
14. We shall always be ready to help each other. If anyone is in difficulty, we shall all help him or her.
15. If we come to know of any breach of discipline in any center, we shall all go there and help restore discipline.
16. We shall take part in all social activities collectively.

Source: Grameen Bank

**Figure 18. Cumulative Loan Disbursement, By Loan Type, (As of FY 2015)**




Source: Grameen Bank

**Box 4. Ten Indicators of Poverty Alleviation for Grameen Bank Members**

1. The members and their family who are living with dignity in a tin roofed house or having a house with a worth of Taka 25,000 only and the family members have the arrangement to sleep on cots or beds instead of floor.
2. Use water from tube wells installed individually or jointly with others in the absence of tube well water ensure safe water by wat or boiling or purifying it with alum, bleaching powder or water purifying tablet.
3. All children of the members, who are at the age of six and above and are physically and mentally fit, go to school.
4. The members whose minimum weekly loan installment is Taka 200 or more.
5. All the family members use hygienic and sanitary latrine.
6. The family members have sufficient clothings for daily use. Have the winter clothes like kantha, wrapper, sweater, quilt, blanket, etc. to protect them from cold and have mosquito net to protect them from mosquito menace.
7. Have arrangements for growing vegetables or plantation of trees etc. in the homestead for earning additional income to improve economic condition of the family and the same time enable them to pay their loan installments from these incomes.
8. The members should have savings deposit in bank at least on average of Taka 5,000 round the year.
9. Has the ability to feed the family members three square meals a day throughout the year i.e. no food crisis exists in the family.
10. All family members are conscious about the health issues. Have the ability to tale immediate actions for proper treatment including defraying of medical expenses in the event of illness of any member in the family.

Source: Grameen Bank

### 5.9.5 BRAC

Formerly known as the Bangladesh Rehabilitation Assistance Committee and then as the Bangladesh Rural Advancement Committee, BRAC, as an acronym currently does not represent any particular meaning. Established in 1972, BRAC is an international development organization based in Bangladesh, and is now considered as the largest NGO in the world in terms of in terms of number of employees as of June 2015. BRAC is present in all 64 districts of Bangladesh as well as other countries in Asia, Africa, and the Americas. It employs over 100,000 people, roughly 70% of whom are women, reaching more than 126 million people. BRAC considers itself to have a unique philosophy towards eradicating poverty, bringing together the poorest people in the poorest countries and teach them to read, think for themselves, pool their resources, and start their own businesses. Mobilizing the isolated poor or the ultra-poor, including women and girls, has been the strong focus of BRAC's anti-poverty approach.

BRAC has various economic development programs which include microcredit. Aside from its active participation in poverty alleviation, health, education, and social development initiatives, BRAC is considered as the largest NGO microcredit provider. BRAC provides collateral-free credit using a solidarity lending methodology, as well as obligatory savings schemes through its Village Organizations. Reaching nearly 4 million borrowers, Village Organizations provide loans to poverty groups. BRAC has reached out to those who, due to extreme poverty, cannot access microfinance. BRAC defines such people suffering from extreme poverty as the ultra-poor, and has designed a program customized for this group that combines subsidy with enterprise development training, healthcare, social development, and asset transfer, eventually pulling the ultra-poor into its mainstream microfinance program.

BRAC typically provides loans to the poor to start raising chickens for eggs and meat. Aside from lending money to a loanee, BRAC also teaches the loanee on how to care for and raise the chickens. The uniqueness of BRAC is its hand in self-empowerment, even in lending programs. BRAC's microcredit program has given over $1.5 billion in loans over the past thirty years. Ninety percent of BRACs microloans have gone to women, which is astounding given the very traditional and passive roles women typically have in Bangledashi culture. Repayment of the loan is over 98%. This is a testament to the success of BRACs microcredit program.

In addition to microfinance, BRAC provides enterprise training and support to its member borrowers in poultry and livestock, fisheries, social forestry, agriculture and sericulture. It provides inputs essential for some enterprises through its 'Programme Support Enterprises' that include Poultry farm and disease diagnostic laboratory, Bull Station, Feed Mill, Broiler Production and Marketing, Seed Production, Processing, Marketing and Soil Testing, BRAC Nursery, and Fish and Prawn Hatchery.

Over the last four decades, BRAC microfinance program has become one of the world's largest financial services to the poor, providing tools that enable the financial inclusion of millions of people across the nation. In 2014, the credit and savings services of BRAC reached 5.5 million clients, 95% of whom are women. The microfinance program disbursed over USD 1.9 Billion in loan. Recovery rate on loans stands at 97% (Bangladesh Bank). The loan portfolio of BRAC has increased by 18% from USD 928 million to USD 1.2 billion.

In the Tepil Bare Village, situated at the nearby district outside Dhaka, a focused group discussion with 22 women and 6 men (borrower-members of BRAC) was conducted to gather some information regarding their experiences as beneficiaries of the microfinance program of BRAC. With loan sizes ranging from a minimum of BDT 20,000 to a maximum of BDT 60,000, majority said they were able to support their financing needs for their agricultural activities. Eighteen borrowers said they are engaged in dairy while the other 10 grow vegetables. Each loan is charged with an annual interest rate of 18% (declining method) without having to provide any collateral, of which they find it very convenient. With these loans taken from BRAC, these borrowers were able to improve household income and were able to sustain daily subsistence of food and other household expenses. At least four borrowers said they were able to sell some surplus of their produce in the nearby local market. Others said their produce are just enough for consumption. With regard to BRAC's loan processing, based on the interview, processing of new loans take one month while loan renewal only takes one week, of which these borrowers find it acceptable and they are all satisfied with the services BRAC provides. However, all borrowers said they need more funds in order for them to expand their livelihood activities that would in turn provide them more income.

### 5.9.6 ASA

The association was established in 1978 by Md Shafiqual Haque Choudhury and a team of people with the founding framework aimed at empowering rural landless villagers from the "bottom up" through people's organizations. ASA has currently over 5.3 million members forming different groups with special emphasis on saving practice and 21,477 employees engaged in disbursing and collecting loans and savings deposits.

Since its inception, ASA sought to combine social development (in health, education, nutrition, and sanitation) with credit provision. In 1991, however, ASA started to solely focus on microcredit operations, staying away from being donor-dependent and become specialized and financially self-sufficient. Since then, ASA offers financial services including microcredit, small business credit, regular weekly savings, voluntary savings and life insurance with the aim to follow a simple, standardized, low-cost system of organization, management, savings and credit operations.

Initially, the microcredit operations of ASA was funded by donors, then some small commercial bank loans, then low-cost loans from a subsidized wholesaler, and finally from client deposits and retained earnings. The core service has remained the low-value year-long weekly-repayment loan. Also, savings from clients are used to provide security against default by protecting the small loan portfolio, instead of being used in more risky ventures like raising capital.

The philosophy of ASA is to provide small and medium size loan to the poor and low income people with soft and friendly obligations so that they can use such loans in various income generating activities which eventually would incorporate them in the mainstream economic processes of the country. Loans offered are completely collateral free. This helps reduce their poverty and provides them access to manifold socio-economic opportunities. Presently, ASA uses two types of loan products: one is 'Primary Loan' and another 'Special Loan'. Primary Loan has a maximum tenure of 12 months with a loan ceiling of BDT 70,000. The organization disbursed Primary loans amounting to BDT 81.96 billion (USD 1.054 billion) in 2013. Meanwhile, special loan has a maximum tenure of 30 months and provides an amount ranging from BDT 71,000 to BDT 300,000. Both the loan products have flexibility in respect of repayment and are provided at the interest rate of maximum 27% in declining mode. ASA disbursed loans amounting to BDT 17.99 billion (USD 0.23 billion) in 2013.

ASA maintains savings programs enabling the poor to absorb unexpected shocks of calamities/disasters. Members are allowed to withdraw their savings whenever they require and interest is provided on their deposits. By the end of 2013, the savings balance (regular, LTS & capital build up savings) of ASA's clients is BDT 26.16 billion (USD 0.34 billion). Table 21 presents "ASA at a glance" by the end of FY 2015.

**Table 21. Status of Microfinance Operations of ASA, As of FY 2015**

| Particulars | Data as of FY 2015 |
|---|---|
| Total Number of Branch Offices | 2,932 |
| Total Number of Villages | 63,859 |
| Total Number of Members | 6,313,359 |
| Total Savings | BDT 37.24 billion |
| Total Loan Outstanding | BDT 96.63 billion |
| Recovery Rate | 99.67% |
| Portfolio-At-Risk (1 day) | 2.66% |
| Total Number of Staff | 22,927 |

Source: ASA Quarterly Progress Report

## 5.10 Outreach and Extent of Coverage of Selected MFIs

Compared to banks, microfinance providers in Bangladesh have the capacity to expand outreach of financial services to a larger segment of the poor residing in rural areas. The three sample MFIs interviewed provide financial services up to the union level, the smallest administrative unit in the country. BRAC has the most number of offices/branches with 3,028 spread all over the country. ASA is the second the second largest MFI interviewed in terms of coverage. Its 2,932 offices cover all 64 districts in Bangladesh. On the other hand, the 2,568 branches of Grameen Bank covers 81,390 villages also covering all district in the country (Table 22).

**Table 22. Extent of Coverage, Number of Offices and Staff of Selected Financial Institutions in Bangladesh (FY 2014)**

| Name of FI | Type | No. of Offices | No. of Staff |
|---|---|---|---|
| Bangladesh Krishi Bank | Specialized Bank | 1,029 | 9,430 |
| Rupali Bank Limited | Commercial Bank | 535 | 5,914 |
| Agrani Bank Limited | Commercial Bank | 921 | 13,414 |
| Grameen Bank | NGO-MFI | 2,568 | no data |
| BRAC | NGO-MFI | 3,028 | 115,000 |
| ASA | NGO-MFI | 2,932 | 22,927 |

Source: Various reports from concerned institutions

## 5.11 Loans Outstanding and Beneficiary Outreach of Selected MFIs

Among the selected financial institutions, Grameen Bank has the highest loans outstanding with BDT 87.33 billion followed by BRAC with BDT 81.17 billion, and ASA with BDT 59.29 billion. In terms of beneficiary outreach, Grameen Bank has the most number of borrowers with 8.7 million. Estimating the average loan size based on loans outstanding and number of borrowers, the Grameen Bank and BRAC have the lowest average loans at BDT 10,038 and BDT 14,495, respectively. Bangladesh Krishi Bank has the highest average loan size at BDT 1.1 million followed by Agrani Bank BDT 388,234 and Rupali Bank with BDT 122,405 (Table 23).

**Table 23. Loans Outstanding and Number of Borrowers of Selected Financial Institutions in Bangladesh (FY 2014, Amount in BDT Billion)**

| Name of FI | Type | Loans Outstanding | No. of Borrowers |
|---|---|---|---|
| Bangladesh Krishi Bank | Specialized Bank | 16.35 | 14,919 |
| Rupali Bank Limited | Commercial Bank | 1.94 | 15,849 |
| Agrani Bank Limited | Commercial Bank | 51.37 | 132,317 |
| Grameen Bank | NGO-MFI | 87.33 | 8.7 million |
| BRAC | NGO-MFI | 81.17 | 5.6 million |
| ASA | NGO-MFI | 59.29 | 1.0 million |

Source: Bangladesh Bank & concerned MFIs

## 5.12 Issues and Constraints to Credit Access

Empirical evidence proves that credit plays an important role in increasing agricultural productivity. Timely and easy access to credit enables farmers to purchase the required inputs and machinery for carrying out farm operations and increase production.

Like many developing countries, the GoB provided subsidized agricultural/rural credit through specialized banks such as the BKB and RAKUB. Unfortunately, the outcomes were very unsatisfactory, with huge default rates, poor performance of specialized banks, and mismatched credit targeting. Factors that contributed to unsuccessful subsidized agricultural lending are the following: (1) instead of the marginal and small farmers accessing credit, only the large landowners are able to borrow; (2) a culture of non-repayment fosters because debts were forgiven due to political favor (Nagarajan and Meyer, 2005); and (3) institutions become unsustainable because of subsidized interest rates (Christen and Douglas, 2005; Nagarajan and Meyer, 2005; Khandker and Faruqee, 1999; Harper, 2005).

The failure of subsidized agricultural/rural credit triggered Bangladesh Bank (BB) to shift its agricultural/rural credit policy through incorporating all scheduled banks (including PCBs and FCBs) and NGO-MFIs under an agricultural/rural credit program. Under this credit policy, banks are encouraged to forge partnership agreement with the NGO-MFIs to make use of their extensive network and branches, especially in the rural areas as banks have fewer or no rural branch offices. In addition, a new system been introduced in 2009 to disburse agricultural credit at Union level openly i.e., disbursing on field or in union parishad office rather than in banks, so that only true farmers can get the credit. Coupled with this strategy is the 'Agricultural Credit Monitoring System', developed and maintained by the BB.

While the rural finance situation of Bangladesh continues to progress, a number of issues continue to beset the smooth flow of credit to the rural poor. Some of these are briefly discussed below.

### 5.12.1 Insufficient bank branch offices in the rural areas

Only SBs have rural branch offices at village level while SCBs have branch offices at upazilla level. Hence, farmers are reluctant to handle the application and other formalities at upazilla level having their extreme business during peak season of agricultural farming. On the other hand, PCBs do not have adequate branches in rural areas while FCBs do not have any rural branch offices to expand their rural or agricultural credits which tend to reduce the business scale and performance.

### 5.12.2 Perceived bias on the selection of farmers by banks

Bangladesh Bank has encouraged all scheduled banks to collect farmer information from department of agricultural extension to identify the real farmers. However, selection bias still prevails as bank officers give special priority to their relatives, friends, and those maintain good relation with bank personnel in selecting the borrowers (Rahman, 2009).

### 5.12.3 Collateral requirements by banks

Typically, farmers have to keep some of their assets as mortgage for obtaining loans from scheduled banks. Even the formalities and procedures are complex and they require longer time for processing loans. As most of the farmers are illiterate, they are intimidated by these formalities that they eventually lose their interest to borrow from formal banks. In spite of recent initiative for extending credit to marginal and small farmers through guarantee of land owners or responsible person from the village, these have not gained much success as small and marginal farmers find difficulty in accomplishing the requirements.

### 5.12.4 Recovery of agricultural credit

Generally, farmers are enthusiastic to borrow from formal lenders particularly from specialized banks (BKB, RAKUB) due to lower interest rates. However, most of the farmers face difficulties to borrow from them due to collateral requirement, complex application procedures, claim on bribe, lack of required amount of credit and in timely fashion etc. (Rahman et al., 2011). Hence, they prefer to borrow from NGO-MFIs as easily accessible to them and require less formality. There are concerns that NGO-MFIs are little shy to lend to farmers in absence of a real group model, potential of credit risk due to natural calamity, government pressure on subsidized interest rate for agriculture sector etc. (Bayes, 2011). So, it is quite challenging to strike a balance between farmer preference and the reality of agricultural credit market.

### 5.12.5 Interest rate and repayment scheme

Generally, farmers have to pay higher interest rates for the loans that they borrow from NGO-MFIs. The concern is that the credit becomes costly for the farmers to have their production profitable. This is because the NGO-MFIs borrow their funds from PCBs/FCBs at high interest rate. After adding their cost, the mark-up interest rate is 20-22%, which is well above the market rate of interest available for agricultural credit (CDF, 2006). So, the higher interest rate may shirk the market access of PCBs and FCBs. Generally, NGO-MFIs provide credit for short period of time and ask for weekly repayment which may not be suitable for agricultural sector.

### 5.12.6 Uneven distribution of agricultural credit

Within agricultural credit allocation among sub-categories, the livestock and fisheries sub-sectors were neglected (Rahman, 2011). Even, the target attained was only between 50-70%, while other sub-categories almost reached their settled target even exceeded the defined target.

### 5.12.7 Inadequate credit supervision and monitoring

In spite of the central bank initiatives, there is still lack of supervision and monitoring services from lenders side particularly it is true for SCBs and SBs. Hence, farmers are transferring agricultural credit to non-farm or business purposes as farming is more risky compared to non-farming activities (Miah et al., 2006). To reduce such deviation of agricultural credit there is nothing better than proper monitoring and supervision.

### 5.12.8 Absence of Risk-Mitigating Mechanism

In Bangladesh, the agricultural insurance system has not yet been developed (Rahman, 2009). The earlier initiative on crop insurance failed due to lack of government patronization, and lack of interest from insurance companies due to higher risk in agricultural farming. Also, there is no guarantee program that would protect financial institutions from defaults.

### 5.12.9 Credit Pollution

Credit pollution or borrowing from multiple sources is a long-standing issue in agricultural finance in Bangladesh (MRA, 2014). Poor farmer borrowers, who typically avail themselves of microcredit from MFIs do not receive the required amount of money they need to finance their production requirements from one source. Hence, they need to borrow more from other sources. Some banks and MFIs are therefore very cautious in lending to borrowers who may just use the loans to pay existing debts. However, the operationalization of the credit information bureau in 1992 is only expected to minimize the extent of potential loan defaults of borrowers. While this helps maintain the loan portfolio quality of lenders and keeps the financial system healthy, borrowers with loans from multiple sources find it even more difficult to borrow.

### 5.12.10 Some Required Interventions from Government

The following are some interventions required from the government based on the interviews with key officers of selected banks, MFIs, and other key institutions from the private sector:

(1) Provide market for farmers' produce and make market information (prices of produce) available to farmers. The government should provide farmers the necessary information on what to produce and what agricultural commodity/product is commercially viable and profitable;

(2) Provide guarantee for agricultural commodities and invest more in value chain activities;

(3) Improve viability of agriculture sector to encourage more financial institutions to lend to farmers. Intensify support services such as infrastructure, new farm technologies, automation, processing/post-harvest facilities, farm equipment should also be provided;

(4) Provide more capacity building for farmers;

(5) Encourage more MFIs to lend to the agriculture sector by providing incentives such as subsidy for rebates.

(6) Bangladesh Bank to intensify policies on programs for financial inclusion; to influence more banks to open branches in rural areas under the new branching policy; and

(7) MRA to address the issue on credit pollution especially with small borrowers in the rural areas

# CHAPTER 6
# Discussion

The Bangladesh economy has grown considerably over the years. The Government of Bangladesh (GoB) has aimed to reach the status of a Middle-Income Country by 2021 but the goal was already realized in 2014. With an average GDP growth of 6.2% per annum since FY 2010, per capita income rose to USD 1,080 in FY 2014, higher than the middle-income-country threshold of USD 1,046 (World Bank, 2015).

To sustain and accelerate economic growth, the GoB aims for a 7% GDP growth in FY 2016. The World Bank believes that the realistic growth would be around 6.5%. This is relatively high, considering the fact that the two biggest economies in the world, i.e., USA and China, moderately grew in the past years. For instance, the GDP of the USA posted an average growth of 3.24% from FY 1947 to FY 2015. By comparison, the economy of China expanded by an average of 1.9% for the period FY 2010 – FY 2015 (US Central Intelligence Agency).

The biggest contributors to the Bangladesh GDP are the services and industry sectors. Still, the agriculture sector continues to be significant as it is the biggest source of income and livelihood of 70% of the country's population of 160 million.

The arable land of Bangladesh is decreasing at a rate of 1% per year (Alauddin & Biswas, 2014). Cropping intensity is about 190% which is rather high. The source of agricultural growth will therefore come from increased productivity in the factors of production.

Modern technology – the use of high-yielding varieties, balanced used of fertilizers, superior animal breeds, feeds and medicines for livestock and poultry, proper cultural practices, etc. – is necessary in attaining optimum farm production. The problem is that most Bangladeshi farmers are resource-poor and they do not have the wherewithal to purchase farm inputs. This is where the importance of credit and related financial services come to the fore.

It is estimated that about 96% of farmers require financing in various forms (Alauddin & Biswas, 2014). However, only 17% of the farmers requiring agricultural credit have access to institutional loans. This, in spite of the Bangladesh Bank (BB) policy that banks including foreign-owned should allocate 2.5% of their loan portfolio to agricultural production loans. As of date, only 7% of the loanable funds of banks are disbursed to the agriculture sector.

Government efforts to increase access of poor borrowers to agricultural finance have had mixed results. Lending in rural areas has increased although at a much slower rate than in urban areas. The importance of banks and cooperatives has been declining, while the importance of microfinance institutions (MFIs) has increased. Bank intermediation in rural areas remains limited, with banks transferring BDT 0.5 to urban areas for every BDT 1.0 in deposits collected in rural areas.

Nonetheless, the banking industry is robust, with total assets and deposits increasing over the years. Loans released to the agriculture sector have also increased. State-owned banks account for 60% of the total agricultural loans. In FY 2014, the total outstanding agricultural loans was USD 4.46 billion.

In similar vein, the total assets of MFIs have expanded with a corresponding increase in loan disbursements to the agriculture sector. The total outstanding agricultural loans of MFIs stood at USD 4.76 billion in FY 2014.

The performance of some private banks (PCBs and FCBs) is impressive in terms of credit recovery even if they are only in agricultural lending operation for three years. Past due loans are on a declining trend for all lenders although the past due rates (PDR) of state banks are higher than those of private banks and MFIs. The PDR of government banks is 26%, on the average, while private banks have a PDR of 4%. This situation implies that the private banks are more efficient in managing their loans compared to the government banks.

Understandably, private banks and NGO-MFIs should be prudent in their financial decisions if they want to survive. Government banks may not be as prudent since they are subsidized by the government. Besides, some studies indicate that the evaluation of loan applications is loose. Some bank officers favor friends and relatives although they do not qualify for a loan. Also, it is reported that before or after national elections, interests, penalties, and sometimes even the loan principal are condoned by the government. Government banks are not also keen in collecting loans because the Ministry of Finance is supposed to refund half of the default but it is claimed that this is more anecdotal than real.

Government banks should improve their PDR since most of the money that is used for agricultural loans came from deposits. If they don't, they may face a bank run and eventually will go bankrupt.

The quest for inclusive growth through financial inclusion has generated a number of government programs with credit component. And as a pioneer of microfinance, i.e., the Grameen Bank approach, Bangladesh can teach the world about microfinancing in agriculture to help the poor and the ultra-poor. Mainstreaming of poor women in the credit market is something worth emulating. Agent banking and group lending are innovations that bring credit to the rural poor.

It is also worthy to note that the Bangladesh Bank (BB) has green financing program to promote good agricultural practices. And to top it all, BB has already a credit program that addresses climate change.

Nevertheless, there remain many issues and challenges that may stymie the march to financial inclusion. Some of the significant ones are discussed below.

## 6.1 The Issue of Interest Rate

Access of small borrowers to agricultural credit is a function of affordability of interest rates, the ease of accomplishing the documentary requirements, ability to satisfy other loan requirements like collateral, the viability of projects where the loan is going to be used, and the availability of credit funds.

About 54% of households have access to all types of lenders. Of those borrowing, 37% obtain loans from quasi-formal institutions like the NGO-MFIs and 8% borrow from formal sources. A bigger number of borrowers (44%) get loans from non-formal sources like friends, relatives, and traditional money lenders.

Even if interest rates from informal sources are higher than the interests charged by the quasi and formal lenders, many borrowers still use them because except for character reference, there are almost no other requirements in order to get a loan.

Loans from informal sources are not bad per se because the money is readily available when it is needed. However, because informal credit lenders tend to operate locally, funds fail to flow across regions or groups of individuals.

The interest rate of government banks for special agricultural programs ranges at 6%-10% per annum. By comparison, the interest rate of NGO-MFIs is 12%-15% per annum, but when this is computed on a diminishing balance, effective rate is around 24%-30% per annum. A recent survey of the Microcredit Regulatory Authority reveals that Effective Interest Rate is even higher at 25%-33% per annum.

The administrative costs of NGO-MFIs is about 60% of the total expense incurred in the processing of loan. This is relatively high. In the Philippines, the transaction costs of MFIs is estimated to be around 6-8% of total expenses.

High administrative costs would push interest rates upward and this does not bode well for poor farmers. Since landholding is very small (about 0.2 ha to 1.0 ha per farmer), net income from production may be minimal that after paying their loan there is hardly any money left to finance subsequent farm operations. Thus, they have to borrow again, leaving the poor in the quagmire of poverty. The government must therefore help the MFIs in bringing down the interest rates of agricultural loans. The GoB can look into the possibility of allocating funds to the MFIs that are financially trustworthy. This can be in the form of loan but interest rate should be lower than the interest rate of the capital market. Another field for possible assistance is in capacity building with the aim of increasing the efficiency of MFIs in processing loan allocation, office management, creation of management information system, field monitoring, among others.

Transaction costs can also be reduced if MFIs have access to data and information pertinent to the borrowers. The current data base of the Credit Information Bureau (CIB) covers farmers with outstanding loans amounting to BDT 50,000 (USD 644) and above. Even with increasing loan sizes, many of the loans disbursed by MFIs are on average, BDT 30,000 (USD 386) and below. It is likely then that borrowers in this category are not in the database of CIB.

On the other hand, credit subsidy for fertilizers may be justified on the ground that because of poverty, farmers need the credit subsidy. This can be considered as a transfer of government resources to the poor sector of the society. However, this policy should be reexamined because experience in other countries in extending credit subsidies to the poor had poor results. If credit subsidy is needed to attain certain short-term goals like self-sufficiency in rice, it should be time-bound because subsidies are costly propositions. The money for the credit subsidy may as well be used for building infrastructure in the rural areas.

## 6.2 Issue of Collateral and Risk-mitigation

The main reason why farmers get loans from quasi-formal and informal sources is simply because they do not have the collateral required by banks to cover their loans.

The availability of risk-mitigating mechanisms like agricultural insurance and credit guarantee can encourage banks to waive their collateral requirement. Insurance protects the income of farmers from weather shocks and pests and diseases, and hence, they are able to repay their loans. Credit guarantee, on the other hand, insulates financial institutions from defaults as unsecured loans are covered by the guarantee.

The experience of the GoB in agricultural insurance through the Sadharan Bima Corporation (SBC), a state-owned insurance corporation, is not good. Indemnities were 20 times higher than the premiums that in the end SBC went bankrupt and its operations stopped. Today, there is no nationwide agricultural insurance program of the government. Neither there is one from the private sector.

These authors believe that what happened to SBC is a problem of management and governance. Because of the importance of insurance, the GoB should learn from the lessons of SBC and consider the creation of another government entity for agricultural insurance. Similarly, a credit guarantee program should be established so that farmers with no collateral can obtain loans from banks.

The GoB can also develop innovative financing schemes that suit the credit needs of farmers with no collateral. For example, a credit program can have loans for agricultural production coupled with another loan for livelihood projects. With this scheme, there is no diversification of loans between equally important projects.

The Philippines is one of the countries that replicated the Grameen Bank approach in order to increase the flow of credit to the countryside. Two programs that are administered by the Agricultural Credit Policy Council (ACPC) do not require collateral for agricultural loans. The only requirement for loan approval is for borrowers to submit a promissory note (PN) that bears the amount of loan and period of repayment. These programs are the Cooperative Bank Agri-Lending Program (CBAP) and the Agricultural Microfinance Program (AMP). The CBAP is an agricultural loan program that covers priority commodities of the Department of Agriculture (DA). It is implemented by cooperative banks. On the other hand, AMP extends microfinance loans to families engaged in agriculture for livelihood projects to diversify their income. The partner institution of ACPC for the AMP is the People's Credit and Finance Corporation (PCFC), a government-owned corporation.

Another ACPC program that does not require collateral is the Agri-Fisheries Financing Program (AFFP). The AFFP is a credit facility intended to serve as an alternative to the rigid and stringent credit windows provided by banks. The AFFP requires no collateral for farmers and fishers to avail themselves of loans under the AFFP. The only requirement is for borrowers to be listed in the Registry System for Basic Sectors in Agriculture (RSBSA).

The RSBSA is a nationwide database of information on farmers, farm laborers, and fisherfolk including their basic profile. The RSBSA is used by all government agencies in carrying out the delivery of basic services and other government interventions necessary in the development of the agriculture and fisheries sector.

Perhaps the Bangladesh state-owned banks can come up with similar programs that do not require collateral. Hence, more poor farmers can access their loans.

## 6.3 Capitalization of MFIs vs. Credit Demand

Gone are the days when microfinance in Bangladesh was subsidized by donations coming from international development agencies. The major MFIs – Grameen Bank, ASA, and BRAC – have to internally generate funds. Some of them even borrow from the capital market to meet loan targets.

Although data show that MFIs are able to meet their loan targets, the decreasing number of borrowers belies adequacy of credit funds for lending to agriculture. It is alleged that the decreasing number of borrowers is due to increasing loan sizes. But why should there be lesser borrowers with increasing loan sizes if the purpose intended for the loan is viable? Bigger loan sizes should not diminish the number of borrowers. This is an indication that MFIs loanable funds are inadequate to meet credit demand.

MFIs have a client base of about 34 million. And with their vast network, they are a potent force in delivering credit and related services to the rural poor. Their failure in meeting the growing demand for credit would push borrowers to obtain loans from the informal sector which usually charges higher interest rates. In fact, credit pollution or multiple borrowing is reported to be a problem in Bangladesh.

MFIs can only accept deposits from its members. The GoB should assist MFIs in increasing their fund base if it wants to sustain the viability of these institutions. A related issue is how loan targets for MFIs and banks are set. Some reports claim that there is inequity in the allocation of credit funds. For example, the crops subsector accounts for 55.8% of total loans extended to the entire agriculture sector. Loan targeting should be demand-driven, and not because the Government tells banks to do so or there is strong lobby from some people of influence. In addition, borrowers should be profiled because different economic profiles would require different government intervention. Insofar as agricultural lending is concerned, different economic profile would translate to different types of loans in varying sizes. Under this scenario, it is likely that the estimates for loan targets would change.

## 6.4 Who is In-charge?

The playing field for agricultural lending is huge as 80% of the farm population are small and marginal farmers. In addition to the banks and MFIs, a number of government agencies run their own credit programs.

MFIs are regulated by the Microcredit Regulatory Authority while banks are supervised by the Bangladesh Bank. But which agency supervises the credit programs of the government ministries? Is there coordination among government agencies, on one hand, and the government and private sector, on the other? From the perspective of efficiency, it is important for the different government agencies with credit function to have a coordinating mechanism so that credit resources are used according to government policy. That is, all players would move as one in attaining financial inclusion for inclusive economic growth.

# CHAPTER 7
# Recommendations

While the GoB is committed to financial inclusion, many issues continue to impinge on its policies and programs in agricultural financing. This chapter discusses some options that the Bangladesh Bank (BB) and the Microcredit Regulatory Authority (MRA) may consider in designing the policies and programs for financial inclusion.

## 7.1 Allow MFIs to accept deposits from the public

In order for MFIs to increase their fund base, the top performing MFIs, namely, the Grameen Bank, ASA, and BRAC, should be authorized by the BB to collect deposits from the public. This has been done in Cambodia and there are success stories of MFIs that were converted into MDIs – microfinance deposit-taking institutions. In the Philippines, the law has authorized cooperative banks to accept deposits from the public. Cooperative banks, which are composed of primary cooperatives, are now partners of the Philippine Government in implementing credit programs for the rural poor.

To protect the depositors, the BB and the MRA should set the criteria for selecting MFIs that will qualify to become public depositor-taker. Moreover, the protocols for supervision and monitoring should be established, and the ceiling as to the proportion of the deposits that can be used for agricultural lending should be defined.

## 7.2 Allocate New Funding for Agricultural Credit

Mandating banks to allocate 2.5% of their total loan portfolio to agricultural credit is not enough. It should be coupled with the infusion of additional funding from the GoB.

While there may be an existing window at the BB from which banks and MFIs can borrow for agricultural lending, its requirements may be stringent that only a few can access it. It is therefore important that a fund that is solely dedicated to agricultural credit and related services be made available to augment the supply of credit for the rural areas.

The Ministry of Agriculture (MA) and the Ministry of Fisheries and Livestock (MOFL) should articulate the need for the GoB to allocate an amount in the National Budget for agricultural and fisheries credit purposes. The fund can be released as a lumpsum or in tranches.

The credit program that will arise from this new money will focus on small and marginalized farmers including poor women. Let the formal financial institutions (FIs) take care of agricultural borrowers who can satisfy the required collateral and other documentary requirements.

The credit fund can be used to support projects on crop production, livestock and poultry, fisheries, farm equipment and machinery, and marketing, among others. A certain portion of the fund can also be allocated for capacity building of bank and MFI officers and staff on subject matters that pertain to agricultural financing.

Since the development of the agriculture sector is the main concern of the MA and the fisheries sector belongs to the MOFL, the new credit fund should be allocated between agriculture and fisheries. The proportion of the fund going to each sector will depend on the demand for credit of agriculture and fisheries. However, the ministries only administer the credit funds. Banks and MFIs will become partners in the extension of loans to poor borrowers. Funds will be given to banks and MFIs in the form of loans at agreed terms between the Ministries of Agriculture and Fisheries and Livestock, and the FIs.

The target borrowers of the new program are the high-risks and the unbankables. It is suggested that loans under this proposed credit facility will be treated as "off-books" by the FIs so that their past due ratio (PDR) will not be affected.

## 7.3 Enhance Policy and Coordination Structure

There should be synergy among the different programs of various government agencies that are involved in agricultural development. To attain optimum delivery of financial services, a formal mechanism for policy setting, allocation of credit resources, and coordination should be established by the GoB through the Ministry of Finance.

The Ministry of Finance can study the possibility of creating a National Credit Council (NCC) that will take charge in determining the policy direction for rural finance, allocate credit resources, and coordinate rural credit programs of the Government. The NCC will be an autonomous government entity with its own budget and it may be attached to the Ministry of Finance.

The NCC will have a Governing Council (GC) composed of Ministers of relevant agencies like the Ministry of Finance, Ministry of Agriculture, Ministry of Fisheries and Livestock, Ministry of Planning, Ministry of Budget, and the Governor of the Bangladesh Bank, among others. The GC will be chaired by the Minister of Finance.

The NCC will have a Technical Secretariat which will implement the policies and programs of the GC.

## 7.4 Establish an Agricultural Insurance Program

Even if its experience in agricultural insurance is not good, the GoB may again try to come up with an agricultural insurance program if it wants to improve the bankability of the rural poor.

The Gob can create an insurance corporation with initial funding from the government. The insurance corporation will have a Board of Directors coming from relevant government agencies, representative from the private insurance industry, and representatives from farmer/fisher groups.

The insurance corporation is envisioned to be self-sustaining so the premium rates for different products should be set according to actuarial studies.

## 7.5 Create an Agricultural Guarantee Program

Another important risk-mitigating tool is the provision of government guarantee to the unsecured loans of rural borrowers. A government corporation should be created for this purpose, with initial funding to be provided by the government. Eventually, like the proposed Agricultural Insurance Corporation, the Guarantee Corporation will be self-sustaining.

The proposed Agricultural Guarantee Corporation will have a Board of Directors composed of representatives from relevant government agencies, and representatives from the private banks.

## 7.6 Expand the Coverage of the Credit Information Bureau

One way of reducing transaction costs is to minimize the cost of credit investigation of loan applicants. Financial institutions can make use of the database of the CIB if they want to shorten the period of credit investigation.

Currently, the database of CIB contains the profiles of borrowers of BDT 50,000 and above. Most of the MFI loans fall within the range of BDT 30,000 and below. The CIB should therefore increase its coverage to include borrowers whose loan sizes are below BDT 50,000.

## 7.7 Evaluate the Impact of the Credit Subsidy

A cost-benefit analysis should be conducted to evaluate the impact of the agricultural credit subsidy. Do the benefits to society of the fertilizer subsidy warrant the continuation of the subsidy? How much longer should the subsidy be carried out? These are questions that only an independent impact evaluation study can answer.

The results of the impact evaluation will provide a guide to policy-makers as to whether or not the credit subsidy should continue.

## 7.8 Enhance Procedure for Loan Targeting

Loan targets for each FI and across commodities should be based on credit demand. In this regard, the BB should make an estimate of the annual credit demand for agriculture and fisheries sectors. The credit demand will serve as a guide in setting loan targets and in defining strategies to attain objectives under the Agricultural and Rural Credit Policy and Programme. The same will also serve as a baseline for measuring the accomplishments in credit delivery to agriculture and fisheries.

Corollary to the estimation of credit demand is the creation of a socio-economic profile of rural borrowers. As mentioned in Chapter 6, different profiles would require different government programs, and hence, different credit requirements.

## 7.9 Pilot Innovative Financing Schemes (IFS)

The BB should initiate the design and piloting of innovative financing schemes that will increase the flow of credit to poor rural borrowers. IFS may address the issue of collateral and the various risks that banks and MFIs face. Examples of such schemes include value chain financing where the credit need for each link in the supply chain is available. That is, rural borrowers can access loans from the financial institutions for production, post-harvest, and even for marketing and trading purposes.

In this context, the BB should allocate fund for innovative financing schemes. It may also consider having a Registry System of farmers, livestock and poultry growers, and fisherfolk who may possibly be the beneficiaries of IFS.

## 7.10 Provide Institutional Capability Building (ICB) Support

Aside from credit funds, the BB should also provide funding support for institutional capability building activities geared towards strengthening both the individual farmers and the credit providers, the MFIs in particular.

For MFIs, a wider scope of ICB activities should be promoted to help MFIs improve their efficiency and viability as credit providers for the sector. This should involve, among others, monitoring, training and education, exposure visits for experimental learning, seminars on credit portfolio management, capital-build-up or savings mobilization, accounting books preparation, mentoring and coaching, business plan preparation, and credit discipline.

For individual farmers, capability building activities to support new production technologies and efficient farming practices should be considered to help increase agricultural productivity. Further, it is also important to develop the necessary values, attitude, and discipline through social preparation and value formation activities, for a farmer to be able to assume the responsibilities and accountabilities of a borrower. Learning the right things can spell success for farmers.

# CHAPTER 8
# Summary and Conclusion

Empirical evidence proves that credit plays an important role in increasing agricultural productivity. Timely and easy access to credit enables farmers to purchase the required inputs for carrying out farm operations to increase production and income. To uplift the standard of living of the population through innovative financial services, Bangladesh has hosted a number of successful financing breakthroughs, including the internationally acclaimed microcredit. However, poverty, particularly in the agriculture sector remains prevalent and credit, inaccessible.

The study reveals issues and challenges that deter the flow of credit to the agriculture sector that at the same time hinder the march to financial inclusion. Among the significant findings include the issue of interest rate, the issue of collateral and risk-mitigation, capitalization of MFIs vs. credit demand, and the question of who is in-charge of the credit programs of the government ministries.

The study prescribes courses of actions that can be adopted to increase the small and marginal farmers' access to credit and ultimately unlock the potential of the agricultural sector as a driver of growth of the economy of Bangladesh. The study recommends to:

(1) Allow MFIs to accept deposits from the public;
(2) Allocate new funding for agricultural credit;
(3) Enhance policy and coordination structure;
(4) Establish an agricultural insurance program;
(5) Create an agricultural guarantee program;
(6) Expand the coverage of the Credit Information Bureau;
(7) Evaluate the impact of the credit subsidy;
(8) Enhance procedure for loan targeting;
(9) Pilot innovative financing schemes; and
(10) Provide institutional capability building support.

Some of the recommendations may be done immediately while the others need legislation and new fund allocation from the GoB. While the proposed National Credit Council is not in place, the Ministry of Agriculture and the Ministry of Fisheries and Livestock should take the cudgels in convincing policy makers and legislators to allocate new credit funds for farmers, fisherfolk, and livestock and poultry growers.

Also, credit cannot work alone. For financial inclusion to truly succeed, the GoB should continue improving the physical and information technology infrastructure of the country. It must also enhance its Land Use policy to arrest the conversion of its arable lands for industrial purposes.

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# LIST OF INSTITUTIONS INTERVIEWED

| Name of Institution | Department/Branch | Person(s) Interviewed/Position |
|---|---|---|
| Bangladesh Bank | Agricultural Credit & Financial Inclusion Department | Provash Chandra Mallick<br>General Manager |
| | Agricultural Credit & Financial Inclusion Department | Md Shahid Reza<br>Joint Director |
| Bangladesh Krishi Bank | Office of the Deputy Managing Director | Ghandi Kumar Roy<br>Deputy Managing Director |
| | Loans & Advances Department-1 | Bashir Ahmed<br>Deputy General Manager |
| | Branches Control & Business Development Department | A.R.M. Anisuzzaman<br>Deputy General Manager |
| | Audit & Internal Control Division | Md Firoze Khan<br>General Manager |
| Rupali Bank Limited | Rural Credit Division | A K M Shamsuddin<br>Deputy General Manager |
| Midland Bank | Emerging Corporate & Special Programmes | Mohammad Iqbal<br>Executive Vice President |
| Agrani Bank Limited | Gulshan Branch | Shahinur Sultana<br>Assistant General Manager |
| Grameen Bank | International Program Department | Golam Morshed Mohammed<br>Senior Principal Officer |
| | Joymontop Branch | Delowas Hossain<br>Branch Manager |
| BRAC | Microfinance | Md Alamgir Hossain<br>Senior Programme Manager |
| | Finance Department | Md Abdus Satter Sarker<br>Head of Finance |
| | Agriculture and Food Security | Md Sirajul Islam PhD<br>Programme Head |
| | Agriculture and Food Security | Md Julfiker Rahman<br>Agronomist |
| | Accounts | Mrinal Kanti Biswas<br>Head of Accounts |
| ASA | Agriculture Department | Kbd. M.A. Salam<br>Director |
| | Agri. Business Development Project | Md Hamidul Islam<br>Deputy Director |
| | ASA Central Office | Subeg Das<br>Account Officer |
| Palli Karma-Sahayak Foundation | Audit Department | Md Hasan Khaled<br>General Manager |
| | Operations Department | Tanvir Sultana<br>Manager |
| | Developing Inclusive Insurance Sector Project | Hasib Ahmed<br>Deputy Project Coordinator |

| Name of Institution | Department/Branch | Person(s) Interviewed/Position |
|---|---|---|
| Ministry of Finance-<br>Microcredit Regulatory Authority | | Md Shazzad Hossoin<br>Director |
| | | Muhammad Shahidul Islam<br>Deputy Director |
| | | Jinat Aman Banna<br>Senior Assistant Director |
| Ministry of Agriculture | Office of the Additional Secretary | Mohammad Nazmul Islam<br>Additional Secretary |
| | Department of Agricultural Extension | Kbd. K.M. Shaiful Islam<br>Deputy Director |
| | Bangladesh Agricultural Research Council | Dr. Md Mosharraf Uddin Molla<br>Principal Scientific Officer |
| International Fund for Agricultural Development (IFAD) | IFAD Country Office (Bangladesh) | Nicolas Syed<br>Country Programme Officer |

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