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# Bangladesh Microfinance Review
## August 2011

**Report Prepared by**
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An Initiative of BRAC Development Institute, BRAC University

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# Preface

The microfinance sector in Bangladesh is one of the oldest and most mature. Some of the largest microfinance institutions in the world – BRAC, Grameen Bank, ASA – provide access to finance to nearly 20 million poor people here. Much has been written about these MFIs and many studies, primarily on outreach (specifically depth of outreach) and impact, have been conducted. However, critical issues pertaining to systemic concerns still need to be addressed. We need to develop models that can track household level financial flows and determine debt capacity. We need more sophisticated methods to predict systemic risks stemming from over-indebtedness. We need to assess market distortions due to interest rate caps. And a significant supply side analytical piece in these discussions pertain to transparency around MFI institutional performance. MFIs in Bangladesh, to be fair, do present their financial data to Credit Development Forum (CDF) and to the Microfinance Information exchange (MIX). But what is absent is an analytical assessment that allows us to draw conclusions on the dynamics of the sector. It is this piece that BRAC Development Institute has focused on.

The "Bangladesh Microfinance Review" presents a detailed overview of the sector -- its structure, outreach, efficiency, profitability, and portfolio quality – based on data from the ten largest MFIs. The study was conducted based on financial data for the year 2009. At that time this was the most recent data that was available. In fact, even now, financial data from 2010 is only just trickling in. The Review still provides an incisive understanding of the Bangladesh microfinance sector, for institutional policy alignment and for global comparisons. Indeed, this report will be circulated widely, especially to a larger global audience. We know this will fill an important void. We intend to bring this out annually. Along with similar reviews in India, Pakistan, and Afghanistan we will eventually be able to present an integrated picture of the South Asian microfinance sector.

We would like to thank M-CRIL and especially its CEO, Sanjay Sinha, for conducting the financial analysis and preparing this Review. We welcome your feedback and suggestions. We hope this BDI effort will contribute in some way to meeting the much larger challenge that we all face -- how best to make the financial sector more inclusive and democratic so that poor and low income households can cost-effectively access the range of financial services they require.

Syed M. Hashemi
Director, BRAC Development Institute
BRAC University

25th August 2011

## Executive Summary

### A "mature" industry whose role as global leader has been diluted

Bangladesh's microfinance industry is perhaps the oldest and, therefore, most mature microfinance sector in the world. On account of its pioneering role in developing a low cost model of microcredit delivery – known worldwide as the Grameen model – and in demonstrating its sustainability, Bangladesh has been referred to as "the birthplace (and sometimes as the 'mecca') of microfinance". In recent years, however, the pre-eminence of the country in the microfinance world has been diluted by the phenomenal growth of the Indian microfinance sector and by Bangladeshi MFIs' relatively slow adaptation of innovative microcredit products to serve the needs of clients more effectively. It has been slow to diversify product offerings away from credit, especially relative to markets such as Kenya and the Philippines in the case of payments and to South Africa and India in the case of microinsurance.

### ...while the domestic financial system has a dual structure with relatively few banks but over a thousand MFIs

With a population of 165 million and a density of 1,127 persons per square kilometre, Bangladesh is one of the most densely populated countries in the world. While it is one of the poorest countries in the world, Bangladesh has made significant progress in recent decades; achieving an 81% increase in its Human Development Index since 1980. The financial system of Bangladesh, summarized in the **figure** on the next page, has a dual structure with relatively few banks but over a thousand MFIs. Microfinance is provided overwhelmingly by NGO-MFIs with the Grameen Bank being the only exception in terms of institutional type. The NGOs not only offer microfinance services but also implement a wide range of other development programs aimed at poverty reduction.

### ...and the scope for further expansion is limited by the estimated 1.20 borrower accounts for each potential borrowing household in the country

For the purpose of determining microfinance coverage, the total number of households in Bangladesh has been calculated using an estimated household size of 5 persons resulting in 33 million households. Bangladesh Microfinance Statistics, 2009 indicates 27.05 million microfinance borrower accounts in the country at the end of 2009. Assuming every household below the poverty line is a potential microfinance borrower, the extent of microfinance coverage in Bangladesh would be 220% of all households below the upper national poverty line.

In practice, since it is the $1.75 per day criterion that is most likely to represent the threshold for financial exclusion (while the bottom 10% of the population in Bangladesh is excluded by most MFIs), the size of the microfinance market is defined. Thus, for each potential microfinance borrowing household in the country, there is an average of around 1.45 loans outstanding. Feedback from some MFI managers, however, indicates an overstating of borrower accounts by around 15-20%, suggesting that loans per eligible client household are better estimated at 1.20 and the number of borrowers at around 18.5 million.

### Yet, despite the many MFIs, the provision of microfinance services is very concentrated

The largest 3 organisations service ~62% of all microfinance borrower accounts and ~69% of the sector's gross loan portfolio. After the largest 15 MFIs, the remaining 730 MFIs reporting their data service just ~19% of borrower accounts and 18% of the sector's portfolio.

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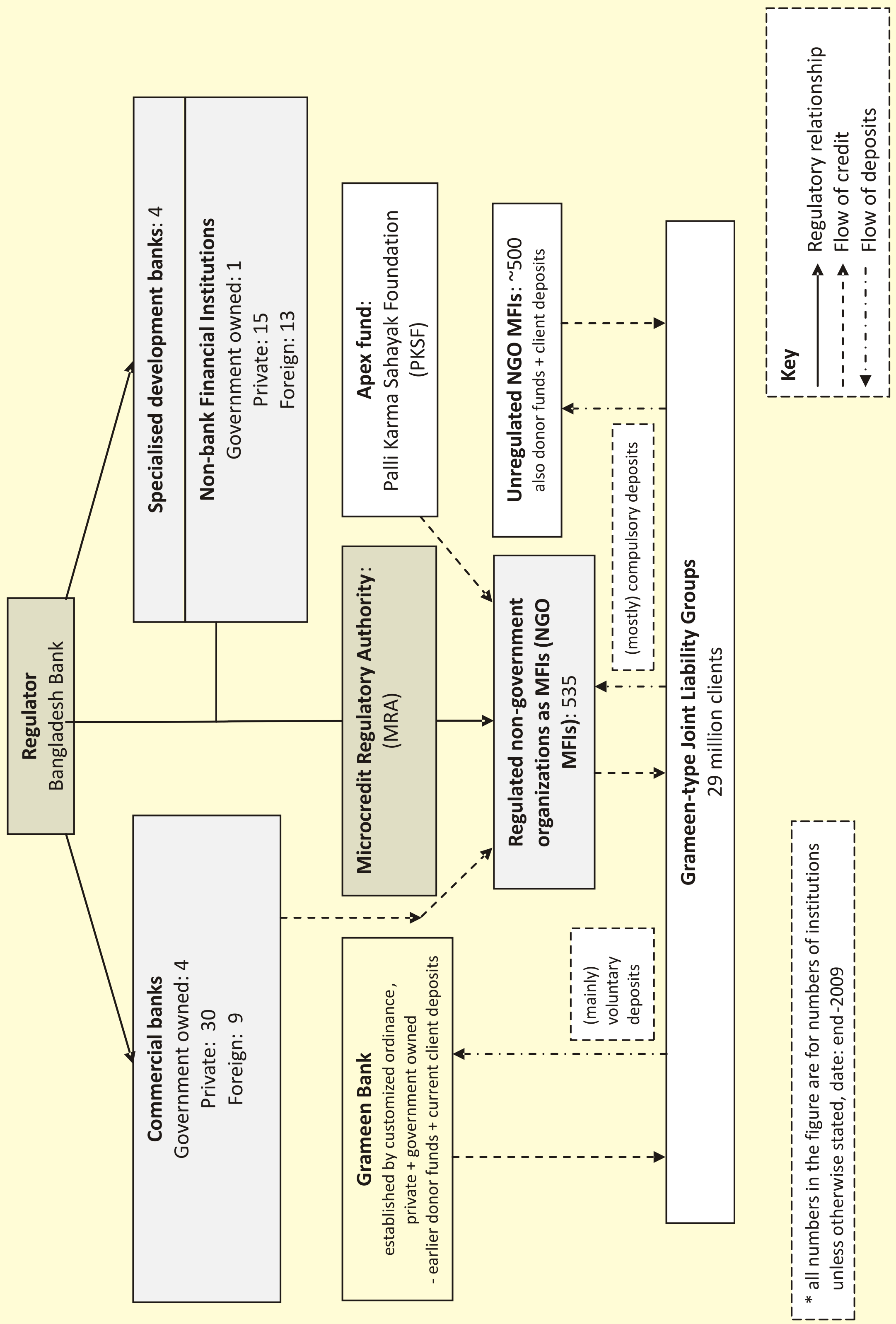
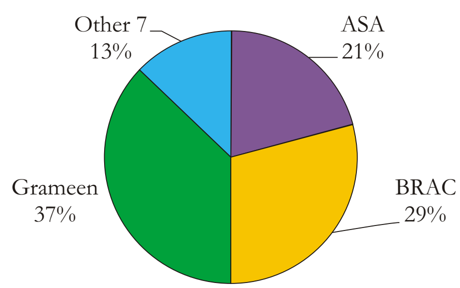
**Note:** All MFI financial data is for the year 2009. This was the latest data available at the time the study was conducted. Audited financial statements for 2010 for most MFIs had not yet been prepared. All financial data used in this report is from Credit Development Forum (CDF) and the Institute of Microfinance (InM).

**Figure** Structure of the financial system and microfinance delivery mechanism in Bangladesh



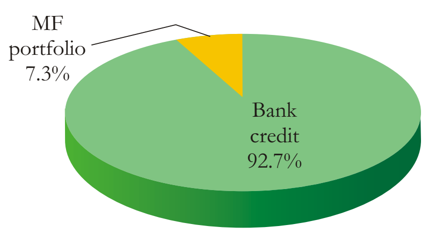
The group of institutions used for this analysis is comprised mainly of the largest 10 MFIs[1] (L-10), each with more than 200,000 active borrower loan accounts. The ten MFIs chosen for this study are not only amongst the largest 10 Bangladeshi MFIs in terms of borrower accounts but also in terms of the gross loan portfolio according to data reported by them to the MIX. Even amongst these ten, concentration is substantial with the largest three (L-3) accounting for over 70% of the total microfinance portfolio in Bangladesh (**Exhibit 1**) and 87% of the portfolio of the L-10 MFIs.

**Exhibit 1** Distribution of outstanding portfolio, 2009




**Active borrower numbers and portfolio size have increased steadily over time** at an average annual growth rate of 11.6% from 2005 to 2008. There was a spurt from 2003 to 2007 and a slowdown to 3.7% in 2008. This was followed by a decline of 9.5% in the number of borrower accounts serviced by the largest 3 MFIs (L-3) in 2009. The greatest fall in the number of active borrower accounts took place at ASA, which exhibited a drop of 32% between 2008 and 2009 as they undertook an effort to establish the real number of unique clients in their portfolio. The other two large MFIs, Grameen and BRAC, also reported minor changes in their client numbers in 2009.

**Exhibit 2**
Microfinance as part of the financial system

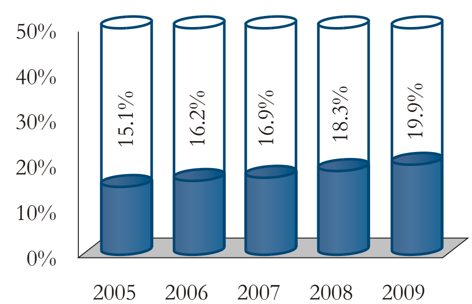



**...and their contribution to financial inclusion is substantial**

The microfinance industry has $2.72 billion of credit outstanding, which amounts to 7.33% of the $37.1 billion outstanding in the country's entire financial system (**Exhibit 2**). The is significant relative to the equally large Indian microfinance sector, which contributes just 0.64% to the Indian financial system (albeit through 40% of all small borrower accounts below Rs25,000 or $550).

**Average loan balance has increased in real terms** from $71 per borrower in 2005 to $115 in 2009, increasing from 15% of GNI per capita in 2005 to 20% in 2009. This suggests that loans today are making a greater contribution to the economic lives of their clients than five years ago (**Exhibit 3**). However, the savings balance per depositor has, until recently, been very low (less than 8% of GNI). Over the past couple of years, however, deposits at Grameen Bank have grown to $152 per depositor, whereas average **deposits** in the other sample MFIs have actually decreased from $44 in 2005 to $31 in 2009.

**Exhibit 3**Loan balance as a % of GNI per capita.

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1. Financial analysis was conducted for Grameen Bank, BRAC, ASA, BURO Bangladesh, TMSS, SSS, Shakti Foundation, Uddipan, PMUK and JCF.

**MFIs are diversifying to include micro-insurance services**; 40% of institutions provide insurance for various purposes. A little more than half (55%) of the insurance policies had death cover, another 43% were loan insurance, and the remaining 2% were for varied purposes such as livestock, health and accident cover.

**MFIs provide employment to 242,000 people and, thereby, sustenance to over a million**

Staff are very productive and each serve 252 accounts in the L-3 and 131 accounts per staff member at the other seven (O-7). According to the MIX, the corresponding benchmark for Asia is 163 accounts per staff member. The gross loan portfolio of the L-3 has increased steadily over the last five years while their staff numbers decreased. BRAC staff productivity in particular has increased by over 60% over the past two years.

**Exhibit 4** MIX median OER

| Country | OER |
|---|---|
| India | 11.4% |
| Bangladesh | 14.6% |
| Nepal | 10.3% |
| South Asia | 13.3% |
| Asia | 17.2% |
| Global | 20.0% |

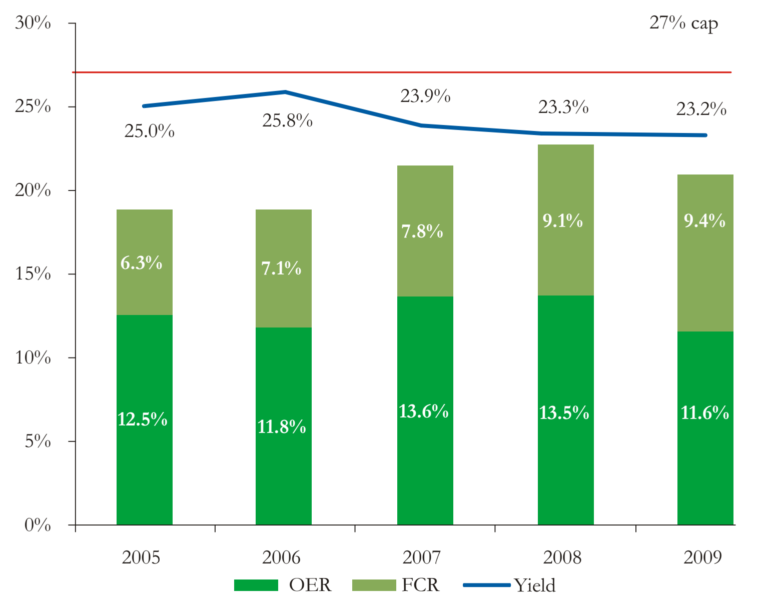
**Cost per borrower is one of the lowest worldwide and operational efficiency is high**

Bangladesh ($14 per borrower), along with India and Nepal, has among the lowest costs per borrower according to MIX benchmarks. The global average is $139 and the Asian median was $51 in 2008 and $27 in 2009. The average Operating Expense Ratio (OER) of the L-3 is around 11% and is comparable only to the average OER for MFIs in India and Nepal and is much lower than the rest of the world (**Exhibit 4**). The O-7 have a higher but still reasonable OER at 14.4%.

**...and the yield has been stable in recent years, well below the interest cap**

The portfolio yield, shown in **Exhibit 5**, has reduced from nearly 26% to just over 23% in the past few years while the OER has been 11.5-13.5%. The average yield of MFIs in Bangladesh is much lower than the Asian and global medians of 29.1% and 31.1% respectively, and also in comparison with the Indian weighted average yield of 27%. Excluding Grameen Bank (19.6% yield in 2009), the consolidated yield for the leading MFIs has increased to 25.1% but is still well within the interest cap announced by the Microcredit Regulatory Authority. [The cap is 27% calculated on a declining balance basis with a minimum of 50 weekly instalments. Since MFIs in Bangladesh have traditionally charged on a flat basis, this translates to an interest cap of nearly 14.5% flat – not 13.5% as is commonly assumed – with a couple of weekly breaks in payment due to festival holidays].

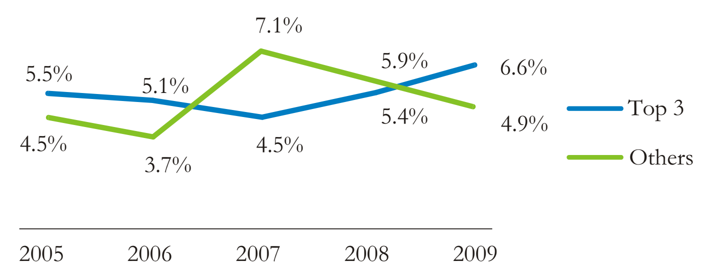
**Exhibit 5**
Consolidated yield & expenses, 10 largest MFIs



The financial cost ratio reflects the cost of deposits (and borrowed funds in a few cases). Excluding Grameen Bank, which pays relatively high interest on deposits, financial cost ratio falls to less than 7% for the leading MFIs.

**Portfolio quality is not so impressive by international standards** with high and variable long-term portfolio at risk (PAR) of Bangladesh MFIs (**Exhibit 6**) around the 5-6% level. The higher PAR for O-7 in 2007 can be attributed to Cyclone Sidr and the floods that affected the country that year. The lower PAR for the largest MFIs in 2007 can also be explained by the cyclone as the MFIs rescheduled the loans of their clients whose livelihoods were disrupted by the cyclone.

**Exhibit 6** Long term trend in PAR




### ...though current reserve rates are more than adequate

The Loan Loss Reserve (LLR) is a provision made from income in order to mitigate the effects of credit risk for MFIs. The adequacy of the reserve can only be assessed relative to the level of risk faced by an MFI. **Exhibit 7** shows that the largest MFIs have reserves that either exceed or nearly equal their portfolio at risk. Generally, an LLR at 75% of PAR is sufficient to cover all possible risks including both the risk posed by natural calamities and the risk of over-indebtedness resulting from multiple loans.

**Exhibit 7** LLR vs PAR-2009

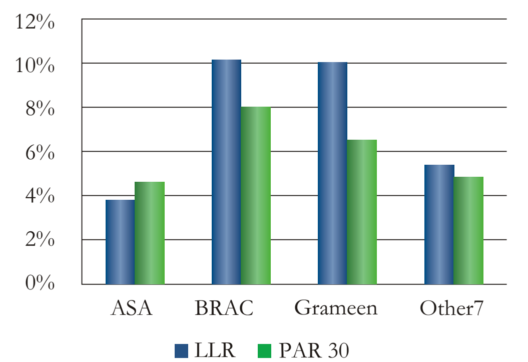
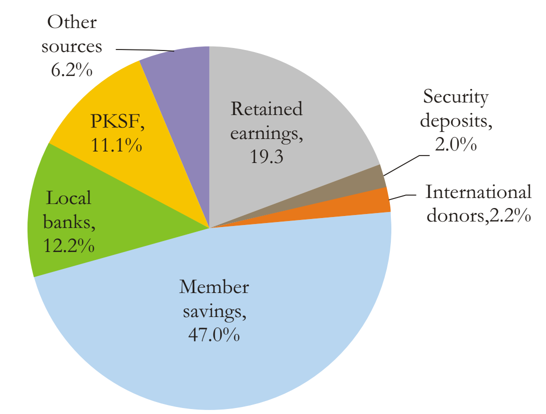



**Exhibit 8** Sources of funds for all MFIs-2009



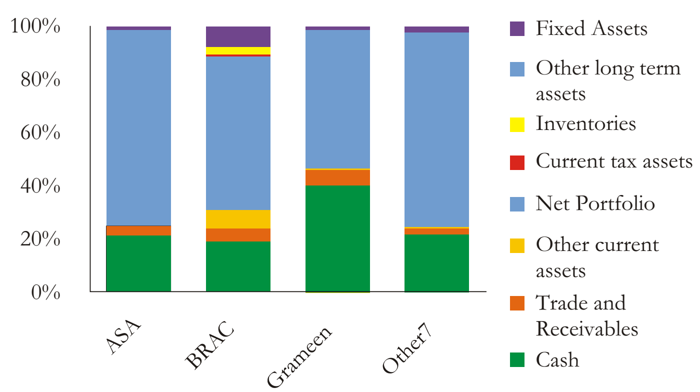

### Member deposits and internal accruals play a huge role in financing MFIs

Given their maturity, the large MFIs in Bangladesh have substantial cumulative client (member) deposits and internal sources of financing to fund their credit activities (**Exhibit 8**). This is in complete contrast to MFIs in India, where there has been a substantial focus on debt financing and other countries such as those in Africa where donor funds still play a significant role in microfinance.

Member deposits have historically been collected in Bangladesh as a mandatory condition for receiving a microfinance loan and have reached nearly 47% of total funds. In recent years, however, Grameen Bank has offered a voluntary deposit facility as well, thereby generating a substantial volume of funds.

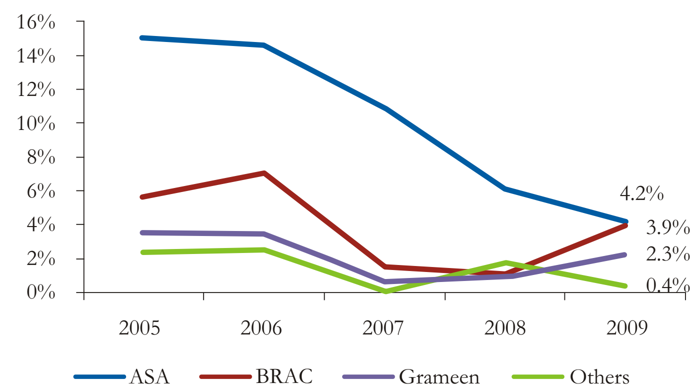
However, the aggregate numbers (above) hide important differences. The segmentation of MFIs in 2009 on the basis of size shows that the L-3, particularly Grameen Bank, now rely more on deposits as funding sources whereas the O-7 raise their funds chiefly from external sources such as commercial banks and PKSF.

**Exhibit 9** Asset utilization of L-3 and O-7, 2009




**The largest Bangladesh MFIs use their assets in a relatively efficient manner** compared to international norms (**Exhibit 9**). The net loan portfolio of the O-7 is 73% of total funds, which is much higher than that of both Grameen Bank and BRAC, though ASA has a high proportion of funds in portfolio. The main under-utilization is by Grameen, which has just over 50% in portfolio and as much as 39% in cash (partly because of the higher liquidity required to service its voluntary savings products). Cash holdings of 16.5% and above are considered high by international standards.

**Exhibit 10** Asset Profitability - return on assets




**...but return on assets (RoA) was affected by the 2007 calamity**

During 2005 and 2006, the MFIs in our sample were very profitable. However, **Exhibit 10** shows that there was a drastic reduction in return on assets (RoA) for the Top 3 MFIs, dropping from an average of 6.3% to just 2.4% in 2009. As expected, a dip in returns occurred in 2007 for both L-3 and O-7. While the profitability of the O-7 recovered to 2.3%, reaching almost pre-calamity levels, the L-3 MFIs have not recovered their profitability to pre-2007 levels.

**Exhibit 11** RoA benchmarks

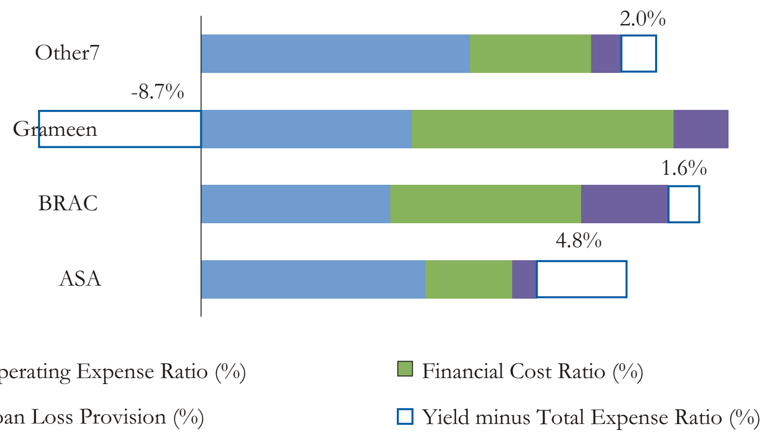
| MIX Global | MIX South Asia | Bangladeshi Banks |
|---|---|---|
| 1.50% | 1.18% | 1.37% |

Only Grameen Bank's financial performance is comparable to the benchmarks shown in **Exhibit 11**. ASA and BRAC, as well as the O-7 in most years, perform much higher than the benchmark levels.

**Investment income compensates for low returns on portfolio**

A detailed breakdown of the cost and return structure (in **Exhibit 12)** shows that Grameen has a substantial portfolio deficit due to its high cost of financing. The two other MFIs in the L-3, as well as the O-7 MFIs, actually had surpluses in their 2009 microcredit portfolio operations. However, these surpluses were still lower than their return on assets, indicating that investment income had a significant impact on profitability; an impact that is substantial in the case of Grameen Bank.

**Exhibit 12** Expenses and reverue realization of Top3 & Other7




The efficiency and profitability of MFIs in Bangladesh suffered a setback in 2007 and 2008 due to Cyclone Sidr. Subsequently, the L-3 MFIs took prudency measures including increasing loan loss provisions to cope with high portfolio risk. In conclusion, **the profitability performance of the leading MFIs in Bangladesh appears to be reasonable**, as **does the interest rate cap** (27% on declining balances equivalent to 14.5% flat); though the cap's impact on the availability of microfinance services in less well-served areas and its impact on loan size (relative to the needs of poorer segments of the potential client group) remains to be seen.

# Section I

## Bangladesh Microfinance – a picture of concentration

### 1.1 The Bangladesh financial system has a dual structure with relatively few banks but over a thousand MFIs

The financial system of Bangladesh is governed and regulated by the Bangladesh Bank and consists of state-owned commercial banks, government-owned specialized development banks, domestic private commercial banks, and foreign banks. The other formal financial service providers are non-banking financial institutions (NBFIs), microfinance institutions (MFIs) and insurance companies. In addition, there are a large number of informal financial service providers such as moneylenders, pawnbrokers and rotating savings and credit associations (ROSCAs). The internationally famous Grameen Bank (GB) is a special case, having been created under a customised ordinance (or law). It is currently the largest provider of microfinance services in the country. **Exhibit 1.1**[1] summarises the financial system of Bangladesh, depicted in more detail in the figure attached to the **Executive Summary**.

**Exhibit 1.1** Bangladesh's financial system

| Type of Financial Institution | Institutional Ownership | Regulated by | Number of Institutions |
|---|---|---|---|
| Commercial Banks | Government<br>Private<br>Foreign | Bangladesh Bank | 4<br>30<br>9 |
| Specialized Development Banks | Government | Bangladesh Bank | 4 |
| NBFI[2] | Government<br>Private<br>Foreign | Bangladesh Bank | 1<br>15<br>13 |
| **Microfinance institutions** | | | |
| Grameen Bank<br>NGO-MFIs[3]<br>NGO's[4] | Private/Govt.<br>Private<br>Private | Bangladesh Bank<br>Microfinance Regulatory Authority<br>Not under regulation | 1<br>553<br>~500 |

Microfinance in Bangladesh is overwhelmingly provided by NGO-MFIs with Grameen Bank being the only exception in terms of institutional type. Commercial banks have also initiated direct credit programs along with NGO-MFI linked credit schemes, in order to alleviate poverty. The level of competition in the microfinance sector is evident by the fact that there are now over 550 licensed NGO-MFIs and an almost equal number of NGOs that are presently unlicensed. Most implement a wide range of development programs in addition to microfinance.

1. MRA, March 2010, Microfinance Regulations in Bangladesh: Development and Experiences, Dhaka: MRA
2. Ahmed and Chowdhury, July 2009, Non banking financial institutions: An analytical review, Dhaka: Bangladesh Bank
3. www.mra.gov.bd.org as of November 2010
4. The non MFI-NGOs are termed as maximalist organizations, which are engaged in both microcredit and other activities.

## 1.2 A nature industry whose role as global leader has been diluted

Microfinance has grown tremendously in the past decade and is now practised in some form in almost all regions of the world. Bangladesh, commonly known as the "birthplace of microfinance" has traditionally had the largest microfinance sector in terms of the number of borrowers. In recent years, however, (discussed in the **M-CRIL Microfinance Review 2010**) India has vied with Bangladesh for the leading position (**Exhibit 1.2**). Due to the large number of borrower accounts, both countries rank in the top ten with regards to loan portfolio although loan sizes are relatively small.

**Exhibit 1.2** Country wise ranking by gross loan portfolio in 2009

| Ranking | Country | Active borrowers (mn) | GLP ($ b) |
|---|---|---|---|
| 1 | Bangladesh | 27.05 | 2.70 |
| 2 | India | 26.63 | 4.50 |
| 3 | Vietnam | 7.79 | 3.98 |
| 4 | Mexico | 4.40 | 2.67 |
| 5 | Peru | 3.09 | 5.48 |
| 6 | Philippines | 2.68 | 0.59 |
| 7 | Colombia | 2.23 | 3.94 |
| 8 | Kenya | 1.46 | 1.11 |
| 9 | Pakistan | 1.45 | 0.21 |
| 10 | Egypt | 1.11 | 0.22 |
| | Global | ~100 | 65.1 |

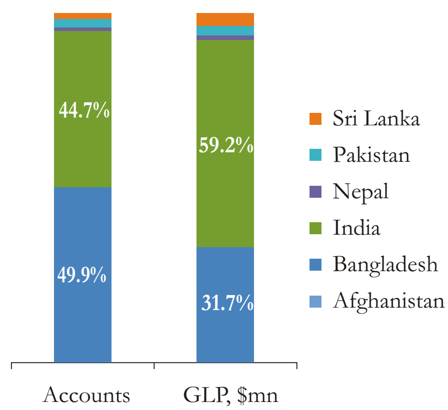
Source: various, including Mix Market

It is apparent from **Exhibit 1.3** that while Bangladesh accounts for nearly 50% of the microfinance clients in the region, its contribution to portfolio size is just 32%. India contributes nearly 60% because of the larger loan size there. This is discussed further in the next section.

## 1.3 ...and the scope for further expansion is limited by the estimated 1.2 borrower accounts for each potential borrowing household in the country

With a population of 165 million and a density of 1,127 persons per square kilometre, Bangladesh is one of the most densely populated countries in the world. While it is one of the poorest countries in the world, Bangladesh has made significant progress in recent decades; achieving an 81% increase in its Human Development Index since 1980. However, it still has a low ranking of 109 out of 135 countries and a composite score of just 0.497 using the revised 2010 version of the index. This compares with ranks of 100, 105 and 107 for neighboring India, Pakistan and Nepal respectively. The improvement in Bangladesh's HDI includes an increase in life expectancy by 23 years since 1980. Bangladesh's per capita Gross National Income (GNI) was $640 in mid-2010, ranked by the International Monetary Fund at 158 out of 182 countries. According to the World Development Indicators database of the World Bank, GNI per capita (at purchasing power parity) was $1,620 in 2010.

**Exhibit 9** South Asia breakdown by country in 2009




Source: various including www.mixmarket.org

# Bangladesh Microfinance – a picture of concentration

Employing the Progress out of Poverty Index (PPI), as formulated by the Grameen Foundation, the coverage of poor households in Bangladesh by microfinance institutions is shown in **Exhibit 1.4**.[5] The extent of poverty is apparent; nearly half of the population lives on less than \$1.25 a day and almost three quarters of the population lives on less than \$1.75 a day.

**Exhibit 1.4** Microfinance coverage by poverty line

| Poverty Line | Poverty Rate | Households below poverty line | Microfinance coverage |
|---|---|---|---|
| National Upper | 37.2% | 11.2 | 242% |
| National Lower | 23.1% | 6.9 | 392% |
| \$1.25/day | 47.5% | 14.3 | 189% |
| \$1.75/day | 72.9% | 21.9 | 124% |
| \$2.50/day | 87.5% | 26.3 | 103% |

For the purpose of determining microfinance coverage, the total number of households in Bangladesh has been calculated using an estimated household size of 5 persons resulting in 33 million households. Bangladesh Microfinance Statistics, 2009 indicates 27.0 million microfinance borrower accounts in the country at the end of 2009. Assuming every household below a poverty line is a potential microfinance borrower, the extent of microfinance coverage would be very substantial with 220% coverage of all households below the upper national poverty line.

In practice it is well known that:

- Households that are above the national or the \$1.25 per day poverty lines are also microfinance borrowers
- The poorest households in low income countries are usually too poor to use microfinance effectively and are, therefore, excluded by MFIs
- Microfinance borrowing households often have more than one account, usually from different MFIs.

Assuming that most borrowers earn \$1.75 per day or less (and that the bottom 10% of the population in Bangladesh is excluded by MFIs), we can estimate the size of the microfinance market. It is apparent that for each potential microfinance borrowing household in the country there is, on average, 1.4 loans outstanding (according to MFI records). This matches with the finding of InM that there is a 40% "overlap" between MFIs in Bangladesh.[6]

During 2009, a number of leading of MFIs attempted to rationalize their borrower accounts which reduced the number of accounts from 29.8 million in December 2008 to just 27.0 million at the end of 2009. Discussions with microfinance experts suggest that this number may still overestimate the true number of borrowers by about 15-20%. Assuming that the actual number of borrower accounts is 23 million, **the average number of accounts per eligible client household in Bangladesh may be around 1.25, indicating a more moderate level of multiple lending than is generally assumed.**

5. http://progressoutofpoverty.org/system/files/PPI_Design_Documentation_for_Bangladesh_2009.pdf
6. Verbal communication from the Institute of Microfinance, study authored by Dr Baqui Khalily.

## 1.4 Despite the number of MFIs, the provision of microfinance services is highly concentrated

**Exhibit 1.5** shows the concentration of microfinance services in Bangladesh. The largest 3 organisations service ~62% of all microfinance borrower accounts and ~69% of the sector's gross loan portfolio. After the largest 15 MFIs, the remaining 730 MFIs that are covered by the Bangladesh Microfinance Statistics[7] together only service ~18% of borrower accounts and 18% of the sector's gross loan portfolio.

## 1.5 This review of microfinance performance covers a sample of the ten largest MFIs[8]

The group of institutions used for this analysis is comprised mainly of the largest 10 MFIs (L-10), which each have more than 200,000 active borrower accounts. The ten MFIs chosen for this study are not only the largest 10 Bangladeshi MFIs in terms of borrower accounts but also in terms of the gross loan portfolio, according to data reported by them to the Microfinance Information Exchange (MIX). This study uses the term active borrower accounts instead of active borrowers due to the overlap among unique clients discussed above. Much of the data has been obtained from the website of the MIX for the years 2005-10 for the selected ten MFIs but it has been modified where additional data was available from BMS 2009 or from the MFIs own annual reports. Nine of these MFIs are NGOs while the largest is the specially constituted Grameen Bank.

**Exhibit 1.5** Active borrower accounts in 2009

| MFI | Active borrowers thousands) | % | GLP (Taka mn) | % |
|---|---|---|---|---|
| Grameen Bank | 6,426 | 23.8% | 54,715 | 28.9% |
| BRAC | 6,241 | 23.1% | 43,879 | 23.2% |
| ASA | 4,000 | 14.8% | 31,322 | 16.5% |
| Proshika | 1,706 | 6.3% | 3,747 | 2.0% |
| Buro | 621 | 2.3% | 4,051 | 2.1% |
| TMSS | 504 | 1.9% | 3,613 | 1.9% |
| Swanirvar | 452 | 1.7% | 1,828 | 1.0% |
| RDRS | 285 | 1.1% | 1,140 | 0.6% |
| Caritas | 303 | 1.1% | 1,101 | 0.6% |
| JCF, Jessore | 264 | 1.0% | 1,778 | 0.9% |
| SSS, Tangail | 257 | 0.9% | 2,524 | 1.3% |
| Shakti | 336 | 1.2% | 2,368 | 1.3% |
| SATU | 213 | 0.8% | 1,431 | 0.8% |
| BEES | 183 | 0.7% | 1,021 | 0.5% |
| PMUK, Dhaka | 186 | 0.7% | 1,497 | 0.8% |
| All others | 5,077 | 18.8% | 33,252 | 17.6% |
| **Total** | **27,054** | **100** | **189,267** | **100** |

For the purpose of this study, we have divided the top 10 MFIs into the Largest 3 (L-3) and the Other 7 (O-7) MFIs. In addition to this classification, this study also occasionally compares the sample of ten MFIs to all MFIs, when data is made available by Bangladesh Microfinance Statistics.

7. Institute of Microfinance (InM), "Bangladesh Microfinance Statistics 2009".
8. Financial analysis was conducted for Grameen Bank, BRAC, ASA, BURO Bangladesh, TMSS, SSS, Shakti Foundation, Uddipan, PMUK and JCF.

# Bangladesh Microfinance – a picture of concentration

Most of the MFIs covered were founded in the late 1970s and early 1980s when many NGOs were started as relief and rehabilitation organizations after the independence of Bangladesh. These gradually converted to development organizations and many shifted their attention to credit and savings programs following the example of the Grameen Bank. As a result, virtually all MFIs in Bangladesh are 25-35 years old. The average age of the L-3 is 31 years whereas that of the other MFIs is 26 years. There is no significant correlation between age and portfolio size.

**Exhibit 1.6** Growth rate of Largest 10 MFIs

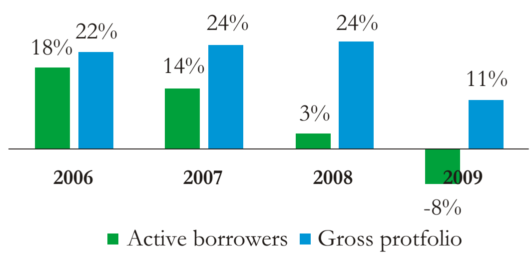



**Exhibit 1.6** shows the annual growth rate of client acquisition of the largest ten MFIs (L-10) by calculating the percentage change in active borrower accounts and in gross loan portfolio. The results show a deceleration in numbers of active borrowers from 2006 to 2008 and a sharp decline in 2009 when numbers dropped by 10% on account of the rationalization referred to above. There has also been a decline in growth rates of gross portfolios over the past four years, which is partly a reflection of the saturation of the microfinance market in the country.

The following sections provide an analysis of the sample with respect to growth, efficiency, risk, profitability and sustainability.

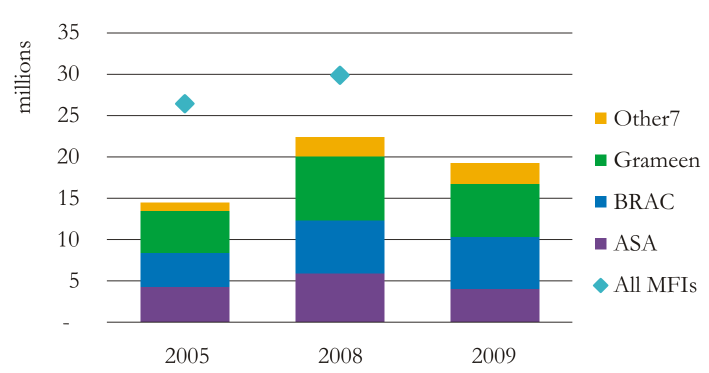
# Section 2

## The contribution of microfinance to financial inclusion

### 2.1 Active borrower numbers and portfolio have increased steadily over time

As shown in **Exhibit 1.5**, the L-10 MFIs accounted for over two-thirds of the 29.8 million borrower accounts on record at the end of December 2008. This number was achieved through a substantial growth spurt by the largest MFIs after 2003. The year-wise presentation of borrower accounts in **Exhibit 2.1** suggests that MFIs grew at an average annual growth rate of 11.6% from 2005 to 2008; consisting of a spurt from 2003 to 2007 and then a slowdown to 3.7% in 2008. As discussed in the previous section, after the 2008 slowdown, the largest 3 MFIs (L-3) experienced a 9.5% drop in the number of borrower accounts in 2009. ASA experienced the greatest drop in number of active borrower accounts (32% between 2008 and 2009) on account of an effort to rationalise its real number of unique clients. The effort to get to real client numbers was motivated by an increase in loans to spouses, which can lead to over-indebtedness and was starting to manifest itself in declining portfolio quality. The other two large MFIs, Grameen and BRAC, also reported minor changes in their client numbers.

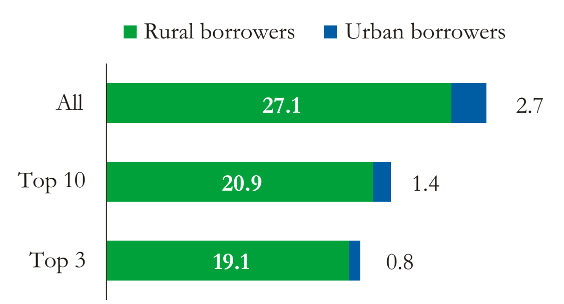
**Exhibit 2.1** Active borrower accounts




#### 2.1.1 A high proportion of the borrowers are based in rural areas

Segmenting active borrower accounts by geography shows that the majority of active borrowers live in rural areas of Bangladesh. As depicted in **Exhibit 2.2**, out of 29.8 million borrower accounts in Bangladesh in 2008, 27.1 million were based in rural areas and just 2.7 million in urban areas. The proportion of rural borrowers was even higher among the L-3, with roughly 19 million (95%) in rural areas and just 0.8 million (5%) in urban areas. The L-3 lend only 4% of their portfolio to urban borrowers and Grameen Bank works exclusively in rural areas. The L-10 MFIs have 94% of their borrowers in rural areas and just 6% in urban areas. The relatively high proportion of urban borrowers in the L-10 sample is due to the Shakti Foundation, one of the few NGOs in Bangladesh that provides microfinance services to women living in the slums of Dhaka; women with limited education, who are subject to frequent eviction from their dwellings.

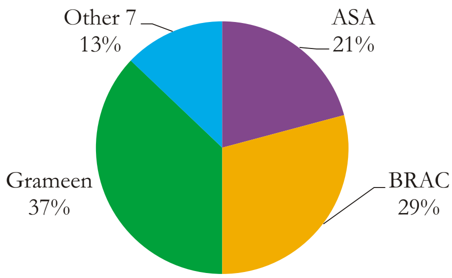
**Exhibit 2.2** Urban/Rural Segmentation of Borrower Accounts



### 2.1.2 Most of the portfolio is managed by the largest 3 MFIs

At the end of December 2009, the total outstanding microfinance portfolio of the 745 Bangladeshi MFIs reporting to CDF was Taka189 billion or $2.70 billion, of which the L-10 accounted for $1.97 billion (73%). The biggest MFI in 2009 in terms of gross loan portfolio was Grameen Bank with nearly 29% of the portfolio of all reporting MFIs in the country and 37% of the total portfolio of the sample of 10 largest MFIs.

**Exhibit 2.4** Distribution of outstanding portfolio, 2008



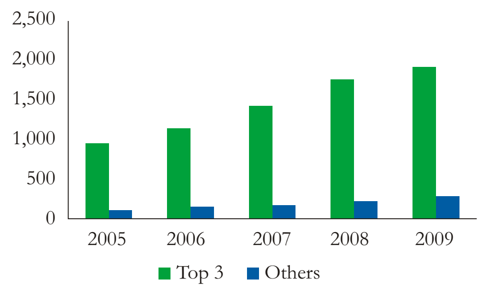

| Gross loan portfolio (US$ million) | 2009 | % |
|---|---|---|
| L-3 | 1,910 | 70.6 |
| O-7 | 282 | 10.4 |
| L-10 | 2,192 | 81.1 |
| Bangladesh (2009)* | 2,704 | 100.0 |

*Source: Bangladesh Microfinance Statistics, 2009.

In 2009, the L-3 MFIs had 87% of the sample's outstanding portfolio with $1,910 million, whereas the O-7 MFIs had a combined portfolio outstanding of $282 million. The growth of the microfinance sector in Bangladesh has been tremendous; achieving an average annual growth rate of 20% over the past five years. However, portfolio growth of the L-10 in 2009 was moderate at just 11%.

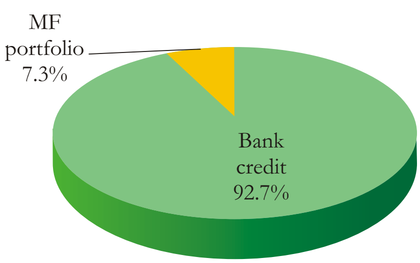
**Exhibit 2.5** shows a constant increase in gross loan portfolio of the L-10 in recent years. Portfolio growth was highest in 2007 at 24.4% and slowest in 2009 at 11.1% due to a 2% fall in each of the portfolios of ASA and BRAC from 2008 to 2009. The fall in ASA's portfolio is linked to the sharp decrease in the number of borrower accounts in 2009.

**Exhibit 2.5** Distribution of outstanding portfolio of the L-3 and O-7




### 2.1.3...and its contribution to financial inclusion is substantial

**Exhibit 2.6**
Microfinance as part of the financial system




According to the Bangladesh Bank Annual Report, 2010 total bank credit in the financial system amounted to Tk2,719 billion ($38.84 billion) at the end of June 2010. Adjusting for growth total credit was estimated to be $34.4 billion at the end of December 2009. Thus, the $2.70 billion credit of the microfinance sector amounts to 7.33% of the $37.1 billion outstanding in the financial system (**Exhibit 2.6**). The magnitude of this contribution is apparent from the fact that the (almost) equally large Indian microfinance sector contributes just 0.64% to the Indian financial system. Though the number of borrower accounts in the Bangladeshi banking system is not available, it is likely that the nearly 30 million borrower accounts generated by Bangladeshi MFIs constitutes a higher proportion of total accounts than the 40% of all small borrower accounts contributed by Indian MFIs. Thus, it is apparent that Bangladeshi MFIs make a substantial contribution to financial inclusion.

### 2.1.4 Average loan balance has increased in real terms over the years

**Exhibit 2.7** shows that the average loan balance per borrower has increased from $71 in 2005 to $115 in 2009. **Exhibit 2.8** shows that the average loan balance per borrower is roughly the same for the L-3 and the O-7 MFIs in the sample. Loan balance grew relatively steadily from 2005 to 2007 and shows a steep increase thereafter.

**Exhibit 2.7** GLP and loan balance of L-10 ($)

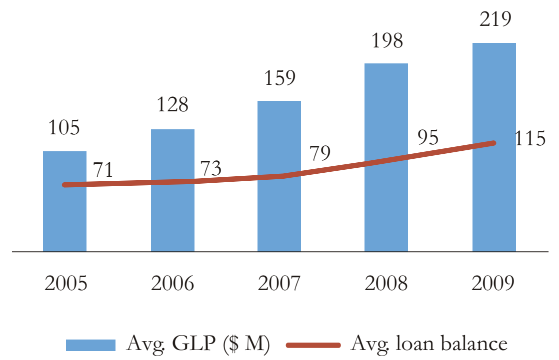
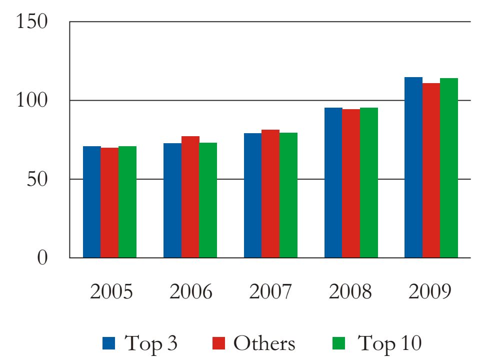



**Exhibit 2.8** Average Loan Balance ($)




## 2.2 ...with loan balance as a proportion of GNI per capita increasing steadily

The GNI per capita of Bangladesh has increased by 23% from $470 in 2005 to $580 in 2009. As seen in **Exhibit 2.9**, on average, loan balance is just 17% of the GNI per capita. A time series analysis shows statistically insignificant increases in average loan balance. In 2005, the average loan balance as a proportion of GNI was 15%, which increased to 17%, and to 20% in 2007 and 2009 respectively. Loan balances over 2005 to 2009 increased by a few percentage points relative to gross national income per capita, possibly making a greater contribution to the economic lives of their clients today than five years ago.

The savings balance per depositor is, however, a very small proportion of GNI **(Exhibit 2.10)**. With the growth of Grameen Bank's deposit initiative, there has also been an increase in the average deposit balance as a proportion of GNI, from 7.7% in 2005 to 11.6% in 2009. However, it is worth remembering that a significant part of the Bank's deposits come from non-microfinance depositors and that this deposit service does not extend to the clients of other MFIs who are actually saving smaller absolute amounts than five years ago.

**Exhibit 2.9** Loan balance as a % of GNI per capita

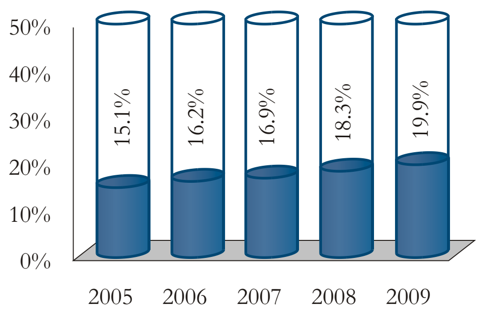
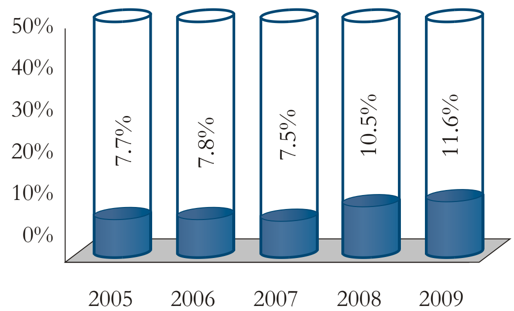


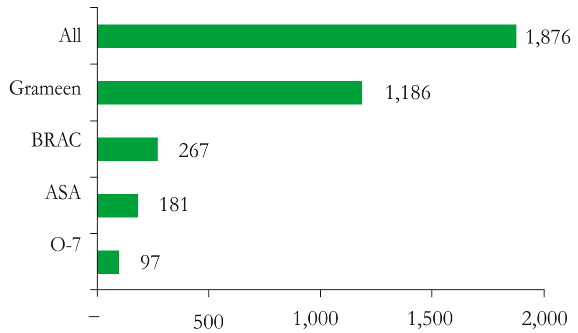

**Exhibit 2.10** Deposit balance as a % of GNI per capita




## 2.3 ...and deposits have grown fast too

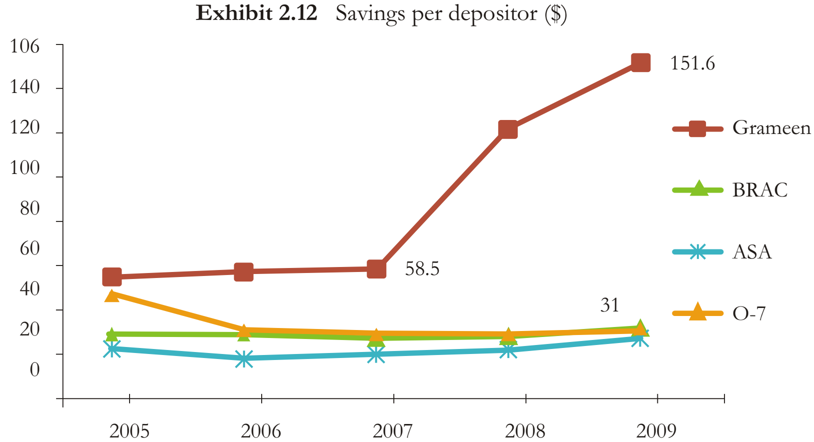
Savings are an essential financial service for all people regardless of their poverty level. Savings can play a vital role in enabling low-income families to cope with emergencies such as natural disasters, a death of a family member, and medical illness. MFIs in Bangladesh, unlike their Indian counterparts, are allowed to accept deposits from their members. According to BMS 2009, the number of depositors in Bangladesh has increased substantially from 15.5 million in 2005 to 22.9 million in 2009, almost a 50% increase. **Exhibit 2.11** shows that the Top 10 MFIs in the sample contribute 92% of the total client deposits accumulated by Bangladesh MFIs. The Top 10 MFIs raised $1,731 million in thrift and deposits by the end of December 2009 with 63% contributed by the Grameen Bank.

**Exhibit 2.11** Deposits (million $ 2009)




The MIX data for the Top 10 MFIs shows a sharp increase in average savings per depositor from 2007 to 2009. In 2005, individual MFI members had $37 in savings on average, whereas in 2007, this number nearly doubled to $72. The breakdown of L-3 and O-7 MFIs in **Exhibit 2.12** shows that this steep increase is largely driven by an increase

**Exhibit 2.12** Savings per depositor ($)



in deposits at the Grameen Bank, whereas average **deposits** in the other MFIs had decreased from $44 in 2005 to $31 in 2009.

**Exhibit 2.13** compares deposit levels with credit outstanding (or average loan size per borrower). Despite increasing loan sizes from 2005 to 2009, deposits as a proportion of loans in Grameen Bank have increased from 52% to 63%. In the case of the other MFIs in the sample, deposit levels have drastically reduced from 63% to a low 28%. If savings had remained the same as 2005 levels, the savings level would still have been 40% of the higher 2009 loan size.

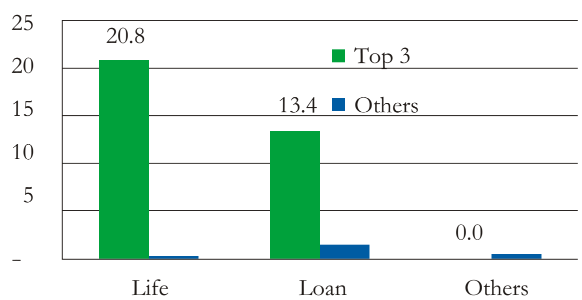
**Exhibit 2.13** Savings as a % of loan balance

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| Top3 | 52% | 49% | 45% | 60% | 63% |
| Other7 | 63% | 40% | 36% | 31% | 28% |

Other than helping clients cope with cash flow constraints or emergencies, savings can play a huge role in minimizing repayment risk for an MFI when underwriting loans.

## 2.4 MFIs are diversifying through the provision of micro-insurance services

**Exhibit 2.14** Insurance clients




MFIs in Bangladesh are increasingly diversifying their services and are providing insurance (life and non-life) under the umbrella of microfinance. According to the data in BMS for 2008 (**Exhibit 2.14**), 40% of the MFIs are providing insurance coverage for various purposes. A little more than half (55%) of the insurance policies have death cover, another 43% are loan insurance and the remaining 2% are for varied purposes such as livestock, health and accident coverage.

In spite of the provision of insurance by 38% of MFIs, the majority of policy holders are clients of the L-10 MFIs, which provide 97% of life insurance and 87% of loan insurance policies to microfinance borrowers. This can be explained by the fact that the ten sample MFIs have two-thirds of borrowers and combine long-term savings products with insurance. The MFIs offering insurance products have to work with insurance companies and invest in research, development, piloting of products, and develop specialised teams to manage insurance products. Since these activities require large investments, most MFIs shy away from providing insurance.

The next chapter analyses the efficiency of microfinance operations in Bangladesh relative to portfolio quality and the risk factors involved in the functioning of MFIs.

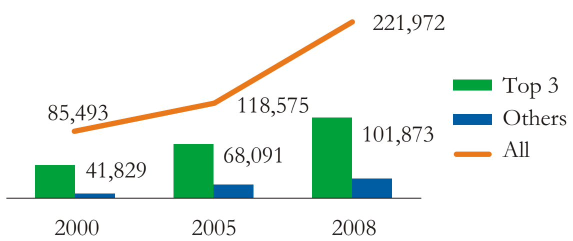
# Section 3

## Efficiency and portfolio risk of Bangladesh MFIs

### 3.1 MFIs provide employment to 242,000 people, and sustenance to over a million

Microfinance was initiated as a development intervention and is rooted in a "high touch" model where loan officers serve as mentors and advocates, as well as bank representatives. Relative to their counterparts at commercial banks, microfinance loan officers invest a significant amount of time with each of their clients. Therefore, staff productivity is an important determinant of MFI performance; while low productivity drives up costs, productivity that is too high can lead to increased risk of default by clients who have an inadequate relationship with the institution and their loan officer.

**Exhibit 3.1** Staff growth

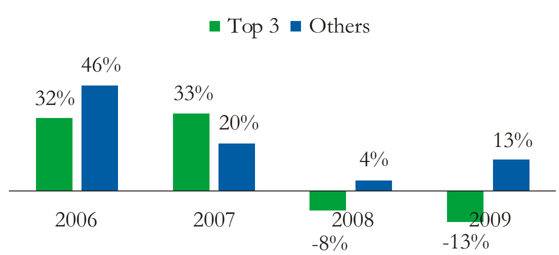



According to 2008 numbers from BMS, the L-3 microfinance giants employ approximately half of all microfinance personnel in Bangladesh. Employment in the sector has grown by 150% in the past eight years and the L-10 employ around 60% of the total (**Exhibit3.1**). At the end of 2009, the L-10 employed 242,000 people directly and indirectly supported 1.2 million people though the delivery of microfinance services.

#### 3.1.1 Staff strength and growth patterns

Time series data for employment in the sample MFIs from 2005 to 2009 shows that the average number of staff has increased from 5,788 employees per MFI in 2005 to 8,558 in 2009. The L-3 MFIs had an average of 22,675 per MFI in 2009, whereas the O-7 had a much lower average of 2,222.

**Exhibit 3.2** Staff growth rates of sample MFIs




Employment in the O-7 grew 102% over the past five years, whereas the L-3 had an average growth of 37% from 2005 to 2009. The L-3 MFIs cut down their staff levels in 2008 and 2009, by 8% and 13% respectively. The average growth of staff of O-7 has also been much slower over the last two years (**Exhibit 3.2**).

#### 3.1.2 Staff productivity is high but is it effective?

The two key indicators of staff efficiency are borrower accounts per staff and portfolio serviced per staff (**Exhibit 3.3** & **Exhibit 3.4** respectively).While the O-7 have 131 borrower accounts per staff member, L-3 staff cater to 252 accounts each. The number of borrower accounts and staff numbers of the O-7 MFIs have increased in tandem over the past five years, hence their staff productivity has not changed much. The O-7 are also unproductive compared to the MIX Asia benchmark of 163 accounts per staff member.

# Efficiency and portfolio risk of Bangladesh MFIs

In the case of the L-3, over the past couple of years, staff numbers of Grameen and BRAC (but not ASA, **Figure 3.3a**) have decreased much more than the number of active borrower accounts resulting in a significant increase in the staff caseload.

**Exhibit 3.4** shows that the staff of the L-3 has consistently catered to larger portfolios per staff member, almost 75% to 100% larger than those of the O-7 MFIs. The gross loan portfolios of the L-3 have increased steadily over the last five years while their staff numbers have gone down. BRAC staff productivity, in particular, has increased by over 60% in the past two years.

**Exhibit 3.3** Borrower accounts/staff member

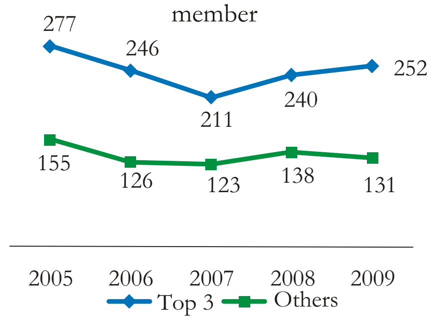



**Exhibit 3.4** GLP/staff member

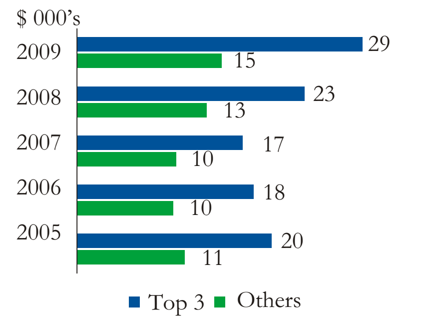
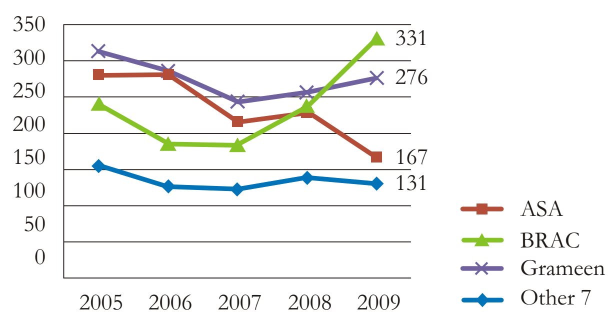



**Exhibit 3.3a** Borrower accounts/staff member



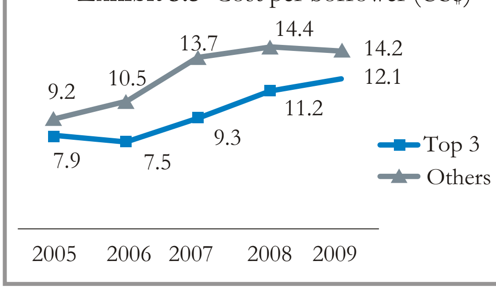

Serving a larger base of clients with more limited resources means the MFI reduces its costs per loan by spreading expenses across more loans. However, this is not always good for performance as lower costs may also signal less investment in building relationships with clients. For example, at 331 clients per staff member, each loan officer is probably serving 450 clients. This number seems very high, but the impact of this workload on the long term relationship of BRAC with its clients remains to be seen.

### 3.1.3 Cost per borrower is amongst the lowest worldwide

**Exhibit 3.5** shows that the cost per borrower for the L-3 is consistently $2-4 less than that of the O-7. This follows directly from the superior staff productivity seen above.

Over the past five years, cost per borrower has increased for both the L-3 and the O-7 by approximately 50%. Total personnel expenses have remained stable, even though the number of staff of L-3 has decreased sharply. This suggests that unit staff costs have gone up as staff productivity has increased resulting in a muted impact on costs per borrower.

**Exhibit 3.5** Cost per borrower (US$)



Nonetheless, Bangladesh along with India and Nepal have among the lowest costs per borrower when compared to the global benchmark of $139 and the Asian medians of $51 in 2008 and $27 in 2009, as reported on the MIX (**Exhibit 3.6**).

## 3.2 Operational efficiency

### 3.2.1 Operating efficiencies are high

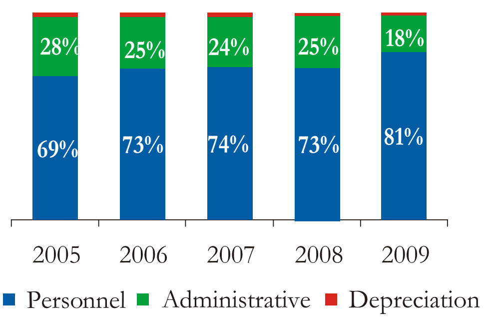
Operating expenses have three basic components:

- personnel expenses,
- administrative expenses, and
- depreciation.

**Exhibit 3.6** MIX 2008 benchmarks for Asia

| Country | Cost per borrower ($) |
|---|---|
| Afghanistan | 99 |
| **Bangladesh** | **15** |
| Cambodia | 75 |
| India | 15 |
| Indonesia | 98 |
| Nepal | 16 |
| Philippines | 77 |
| Sri Lanka | 27 |

**Exhibit 3.7** Cost distribution of the L 10




*The operating expense ratio does not take into account any financial expense or provisions for risk.*

As expected, the bulk of costs are for personnel, from 69% to a high of 81% in 2009 (**Exhibit 3.7**). Administrative expenses have decreased by around 10% over the past five years. The reduction in administrative expenses could be an indication of maturity; that the MFIs now have all essential infrastructure in place, and are streamlining their operations. The average OER(operating expense ratio) of the L-3 is around 11% and is comparable to the average for MFIs in India and Nepal and is much lower than the rest of the world. The O-7 have a higher but still reasonable OER at 14.4% (**Exhibit 3.8** & **Exhibit 3.9**).

**Exhibit 3.8** Breakdown by loan balance and OER

| MFI | OER | Loan size ($) |
|---|---|---|
| ASA | 12.0% | 114 |
| BRAC | 10.1% | 102 |
| Grameen | 11.2% | 127 |
| Others | 14.4% | 111 |
| **L-10** | **11.4%** | **114** |

**Exhibit 3.9**MIX median OER

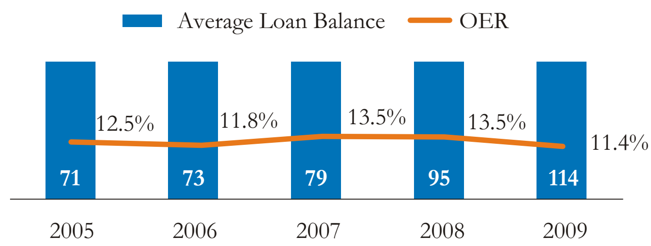
| Country | OER |
|---|---|
| India | 11.4% |
| Bangladesh | 14.6% |
| Nepal | 10.3% |
| South Asia | 13.3% |
| Asia | 17.2% |
| Global | 20.0% |

The OER of the O-7 increased significantly in 2007 mainly on account of an increase in personnel expenses. In 2007, the O-7 MFIs increased their combined staff strength by approximately 20% and increased their personnel expenses by 46%. The OER of the L-3 has come down steadily from 13% in 2007 due to a reduction in their staff numbers and a more controlled growth rate of personnel expenses.

In addition, **Exhibit 2.8** in **Chapter 2** shows that loan sizes of the L-3 increased significantly from 2007 to 2009, also contributing to the reduction in OER from 13.5% to 11.4% in 2009.

Under normal circumstances, as clients reach their fourth or fifth loan cycles, their loan sizes increase. Simultaneously, as the incremental costs of growing MFIs decrease, the OER also decreases. Overall we would expect to see a lower OER. However, this is not consistently apparent for the leading 10 Bangladesh MFIs, since the OER does not significantly reduce as loan size increases, as shown in **Exhibit 3.10**. It is apparent that the lending technology has not been stable over the years and other factors than pure economies of scale have affected the efficiency of the large MFIs.

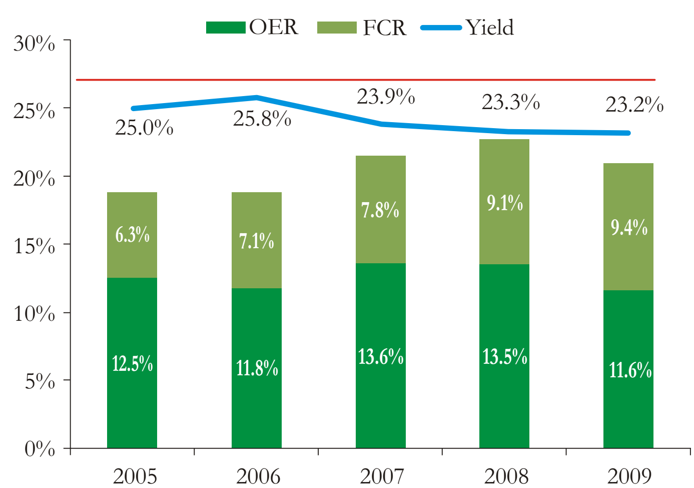
**Exhibit 3.10** Average loan balance and OER




### 3.2.2 ...and the yield has been stable in recent years, well below the interest cap

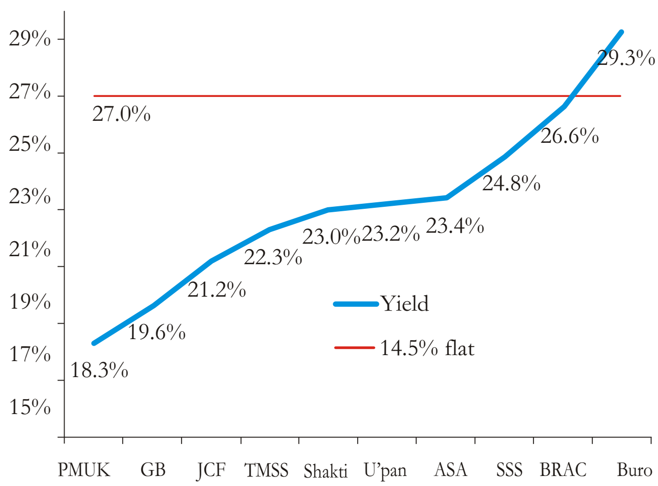
The portfolio yield, shown in **Exhibit 3.11**, has reduced from nearly 26% to just over 23% over the past few years, while OER has been between 11.5-13.5%. The average yield of MFIs in Bangladesh is much lower than the Asian and Global MIX medians of 29.1% and 31.1% respectively, and also in comparison with the Indian weighted average yield of 27%. Excluding Grameen Bank (19.6% yield in 2009) the consolidated yield for the leading MFIs reaches 25.1% but even that is well within the interest rate cap announced by the Microcredit Regulatory Authority. [The cap is 27% calculated on a declining balance basis with a minimum of 50 weekly instalments. Since MFIs in Bangladesh have traditionally charged on a flat basis, this translates to an interest cap of nearly 14.5% flat not 13.5% as is commonly assumed with a couple of weekly rests in payment resulting from festival holidays; depending on when the 2 or 3 rests are taken]. The financial cost ratio reflects the cost of deposits (and borrowed funds in a few cases). Without the relatively high interest paid by Grameen Bank on deposits, operating expense ratio reduces to under 7% for the leading MFIs.

**Exhibit 3.11** Consolidated yield & expenses, 10 largest MFIs




Only one of the largest MFIs (BURO Bangladesh) currently has a yield that exceeds the interest rate cap (**Exhibit 3.12**). BURO has invested significantly in expanding in recent years and also relies extensively

**Exhibit 3.12** Yield levels of sample MFIs in Bangladesh, 2009




on borrowing from commercial banks. Both of these factors add to its expenses. Lending at BURO constitutes 53.6% of total funds compared to BRAC's 19.3%. While BURO's OER was 16.3% in 2009, BRAC's was only 10.1%. Even with a relatively high yield, therefore, BURO had a margin of just 1.8% in 2009 compared to BRAC at 6.3% and the sample average at 2.2%, as shown in **Exhibit 3.11**.

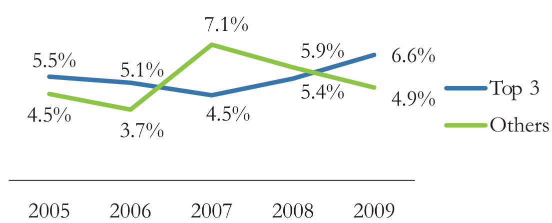
The cost and return structure over the period 2005-2009 of each of the 10 MFIs covered by this study is shown in the graphs in the annex tables at the end of this report.

## 3.3 Portfolio quality is not so impressive by international standards

### 3.3.1 Natural calamities affect the sector and increase risk

PAR (portfolio at risk of more than 30 days) is regarded as one of the key indicators of credit risk. It is apparent from **Exhibit 3.13** that the long-term performance of Bangladeshi MFIs in terms of PAR for the L-3 and the O-7 is highly variable. Cyclone Sidr and the major floods that affected the country that year can explain the high PAR rate for the O-7 in 2007.The following paragraphs provide an analysis of how the large MFIs were affected by the cyclone.

**Exhibit 3.13** Long term trend in PAR




In the wake of Cyclone Sidr on 15 November 2007, BRAC temporarily suspended loan payments and only requested payment from those who could afford to do so. More than 150,000 homes belonging to BRAC borrowers were destroyed and another 270,000 borrowers were severely affected. To revive businesses, BRAC issued fresh loans to cyclone-affected borrowers, which drove its gross loan portfolio up by 51% in those areas.

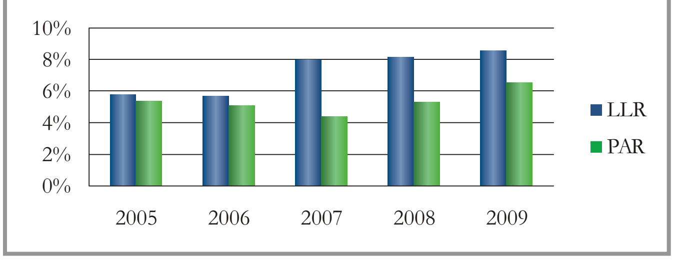
In the case of Grameen Bank, 10% or 675,000 borrowers were affected by the cyclone. In order to protect its borrowers, all old loan repayments were rescheduled to June 2008. Furthermore, fresh loans were provided for income generation activities, education, and for village phones. Consequently, the PAR of Grameen in 2007 decreased from 7% to 3.9%.

As a result of BRAC's steep increase in portfolio and Grameen's rescheduling of loans, the average PAR of the L-3 actually reduced to 4.5%. Strictly, however, the exclusion of rescheduled loans from PAR does not conform with best practice.

### 3.3.2 Current reserve rates are more than adequate

The Loan Loss Reserve (LLR) is a provision made from income in order to mitigate the effects of credit risk for MFIs. The adequacy of the reserve must be related to the level of risk in an MFI. **Exhibit 3.14** shows that the L-3 have consistently maintained reserves that exceed their portfolio at risk. In 2007, the LLR was increased by 40% presumably on account of the natural calamities that occurred during the year, and remained at that level until 2009.

**Exhibit 3.14** LLR vs PAR for L-3




According to **Figures 3.14a & 3.14b** ASA has changed its provisioning policy so that LLR no longer exceeds PAR as of 2009. **Exhibit 3.15** shows the opposite trend for the O-7 MFIs. From 2005 to 2007 the O-7 reserve amounts did not cover all the portfolio at risk. There was a substantial increase in the reserve rate in 2007, most likely due to the natural calamity discussed above, and they remained high as of 2009.

Due to the nature of the country's geographical location and its continual flood and cyclone cycle, a conservative provisioning policy is logical though it is generally considered unnecessary to have an LLR

**Exhibit 3.14a** LLR vs PAR-2005

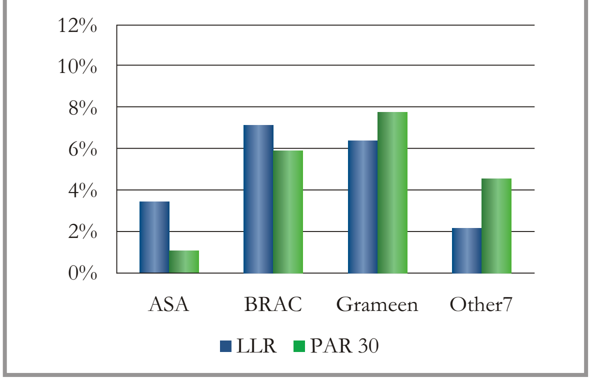
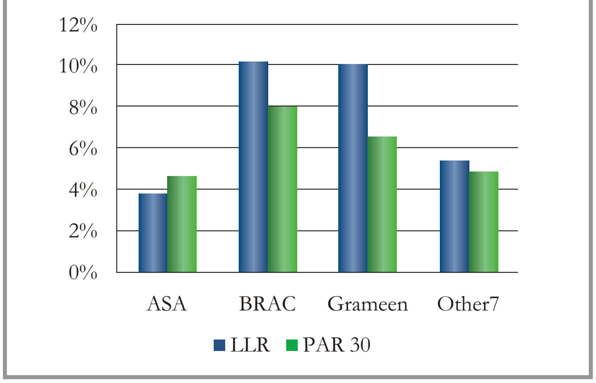
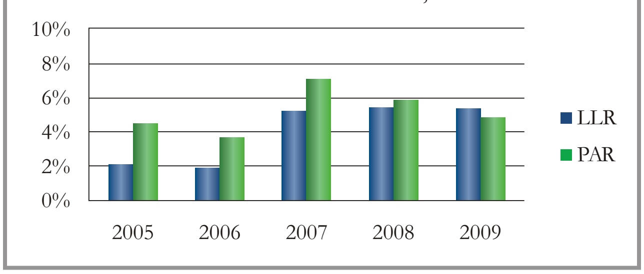



**Exhibit 3.14b** LLR vs PAR-2009




in excess of PAR. Generally, an LLR at 75% of PAR is thought to be sufficient to cover all risks including those posed by natural calamities and that of over-indebtedness of clients resulting from multiple borrowing. The latter is now as much an issue in Bangladesh as it is in neighbouring countries like Nepal and India, though the over-indebtedness may be less severe since the average loan balance in Bangladesh is only $114 compared to $176 in India.

**Exhibit 3.15** LLR vs PAR, O-7




The following section discusses the varied financing strategies of the Top10MFIs and their subsequent fund utilization.

# Section 4

## Member deposits are an important source for financing lending

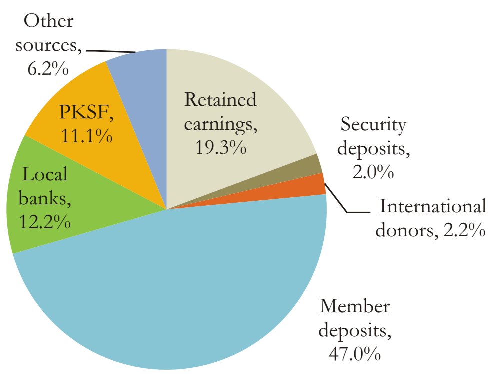
### 4.1 Member deposits and internal accruals play a huge role in financing MFIs

Given their maturity, the large MFIs in Bangladesh have substantial client (member) deposits and internal sources of financing for their credit activities. This is in contrast to MFIs in India, where there has been a substantial focus on debt financing, and also in contrast to countries in Africa where donor funds still play a significant role in microfinance.

#### 4.1.1 Sources of funds all Bangladesh MFIs

Information on sources of funds for the 745 reporting Bangladeshi MFIs for 2009 is presented in **Exhibit 4.1**. Member deposits have historically been collected by MFIs in Bangladesh as a mandatory condition for receiving a microfinance loan and, as a result, have reached $1.87 billion (47% of total funds). In recent years Grameen Bank has also offered a voluntary deposit facility, which has generated a substantial volume of funds. Not only do deposits help members save for personal use, but mandatory deposits also benefit many MFIs by acting as collateral and providing a relatively inexpensive source of funds. The interest expense that MFIs face on deposits is on average 5.5%, (BMS, 2008) while banks wholesale lending rates to MFIs are 10-12%.

**Exhibit 4.1** Sources of funds for all MFIs-2009




PKSF, a not-for-profit organization funded by the Government of Bangladesh (GoB) and the World Bank to alleviate poverty through employment generation, is another key source of funds. It lends to small MFIs at a rate of 4.5%, which is even lower than the average rate paid by MFIs on deposits and is much lower than the wholesale rate charged by commercial and other banks, which lend at variable rates moreover. As the pie chart shows, 11% of all funds in Bangladesh microfinance is contributed by PKSF and 12% (of the total) is provided by local banks (which have become more interested in microfiance in recent years), which means that institutional debt now constitutes over 23% of the total while internal sources of funds ("excess income" and "own fund") contribute another 19%. International donor funds once dominant in Bangladeshi microfinance have, in the meantime, been reduced to a very small amount (just 2.1% of funds). Bangladesh's dependence on institutional debt (23%) is quite low in comparison to Indian MFIs, which are, in aggregate, 70% dependent on debt funds. However, it is interesting to note that total commercial bank lending to MFIs now exceeds lending by PKSF, once a dominant factor in Bangladesh microfinance.

# Member deposits are an important source for financing lending

### 4.1.2 Client savings (member deposits) are the most important component of the funds of large MFIs

MFIs usually have three main sources of financing: deposits, borrowing and equity. As discussed in the MIX Asia Benchmarking report, deposits grow mainly through outreach to clients; borrowings grow through outreach to lenders; and equity grows through retained earnings or equity investments (which is not possible for the NGO-MFI legal form prevalent in Bangladesh). The evolution of the distribution of sources of funding for the sample of the ten largest MFIs is presented in **Exhibit 4.2**. It shows the extent to which client savings (or deposits) have been the largest source of funding for MFIs in Bangladesh in recent years, accounting for more than half the funds on an aggregate basis. Institutional debt has increased as banks have become more liberal in their lending to MFIs, while retained earnings have been stable as a proportion (18%) of the total. The small proportion of paid-in capital shown in **Exhibit 4.2** and **Exhibit 4.3** is for Grameen Bank alone, which is owned 95% by its members and 5% by the Bangladesh government.

**Figure 4.2** Evolution of portfolio financing, sample MFIs

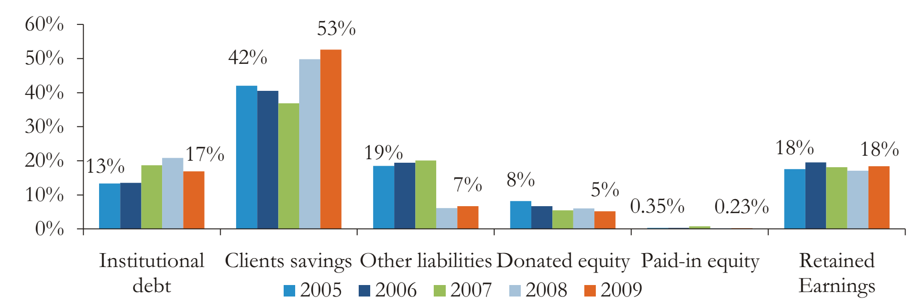
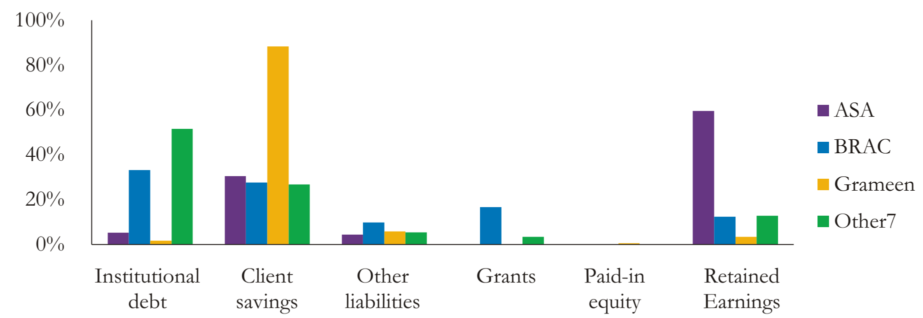


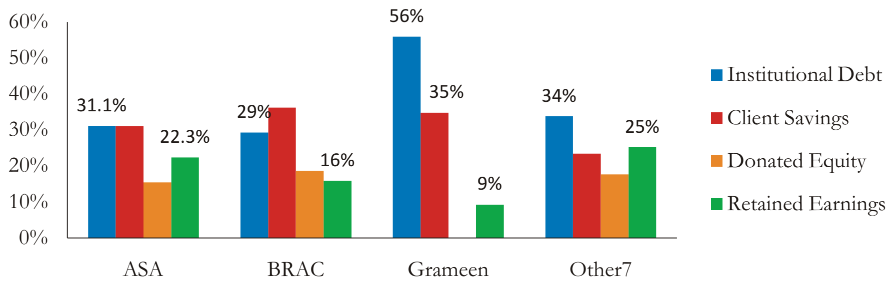

**Exhibit 4.3** Financing Strategy of sample MFIs-2009




## 4.2 The O-7 MFIs are still reliant on debt financing

The aggregate numbers (above) hide some important differences. Segmenting MFIs in 2009 on the basis of size shows that the L-3, particularly Grameen Bank, now rely more on deposits, whereas the O-7 raise their funds chiefly from external sources such as commercial banks and PKSF. The financing of the L-3 MFIs is sufficiently different from each other to warrant a separate discussion below based on **Exhibit 4.4**.

**Exhibit 4.4** Sources of funds, 2000




### 4.2.1 Grameen Bank

The financing strategy of Grameen Bank has, in recent years, become similar to that of a commercial bank and relies heavily on client deposits as the main source of funding. In 2009, 83% of the liabilities consisted of deposits and just 2% of institutional debt. Such a financing structure is possible because of its legal status as a bank and the permission granted to it under the Grameen Bank Ordinance. A timeline analysis of balance sheets from 2005 to 2009 as shown in **Figure 4.2** indicates that dependence on client deposits as a source of funding has increased from just 42% in 2005 to the 2009 level. This compares with its 56% dependence on institutional debt and only 35% on client deposits in Year 2000 (**Exhibit 4.4**). As a result, client savings as a proportion of loan portfolio has increased from 72% in 2005 to 142% in 2009.

### 4.2.2 ASA

The financing strategy of ASA relies extensively on retained earnings for financing its loans. Earnings financed 22% of the portfolio in 2000, 49% in 2005 and reached 60% in 2009. In the meantime, ASA's dependence on external borrowings has decreased from 31% in 2000 to just 10% in 2005 and down to 5% in 2009. The reduction in institutional debt is mainly a reduction in borrowing from PKSF since 2005. The proportion of client savings has hovered around 31% in the past five years. Its low financial expenses and lower provisioning than the other large MFIs has enabled it to build up its retained equity.

### 4.2.3 BRAC

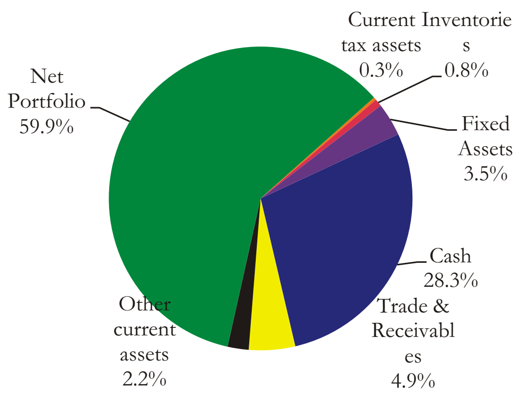
The financing strategy of BRAC is radically different from that of ASA and Grameen Bank. BRAC relies more on external borrowings. Its institutional debt as a proportion of loans outstanding has increased steadily from 24% in 2005 to 43% in 2008 and dropped to 34% in 2009. BRAC obtains loans from commercial banks and PKSF to finance its microfinance operations. Deposits are another funding source that have built up over the years and amounted to 42% of the loan portfolio in 2009.

## 4.3 The largest 10 MFIs maintain high cash holdings

An analysis of the assets of MFIs shows that in 2009, the L-10 Bangladeshi MFIs performed below international best practice norms (**Exhibit 4.5**) in terms of the use of funds. The Top 10

# Member deposits are an important source for financing lending

**Exhibit 4.5** Use of funds by large MFIs

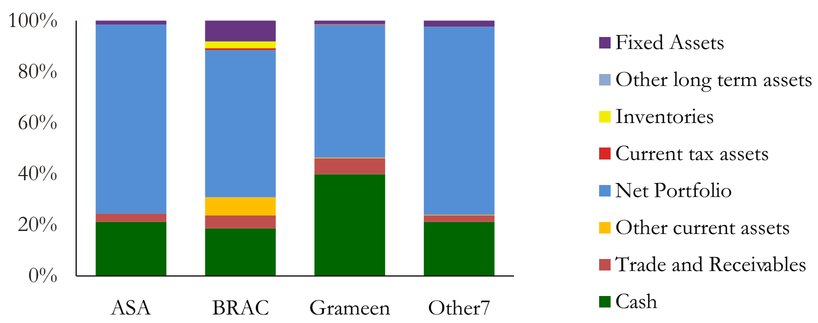



| Assets | Amount ) (US$ million | % |
|---|---|---|
| Cash | 949.25 | 28.3 |
| Trade & Receivables | 165.23 | 4.9 |
| Other current assets | 85,61 | 2.6 |
| Net Portfolio | 2,011.71 | 59.9 |
| Inventories | 26.63 | 0.8 |
| Fixed Assets | 118.64 | 3.5 |
| **Total** | **3,357.07** | **100.0** |

MFIs in the sample deployed nearly 60% of their funds in the net loan portfolio. This is much lower than the international median of 76.8%. The sample MFIs have more than a quarter (28%) of their assets as cash and demand deposits in banks, which is around three times higher than international standards. Cash does not generate any income and is usually kept to ensure adequate liquidity to disburse loans on time and for savings withdrawals particularly important for Grameen Bank with its voluntary savings products but not so important for the others for whom at most 15% cash holdings should be sufficient.

An analysis of asset utilization by the L-3 and O-7 as depicted in **Exhibit 4.6** shows that O-7 and ASA utilize their assets in a relatively efficient manner compared to international norms. The net loan portfolio of O-7 is 73%, which is much higher than that of both Grameen Bank and BRAC, while ASA also has a high proportion of funds in portfolio. The main underutilization is by Grameen, which has just over 50% in portfolio outstanding with as much as 39% in cash (albeit because of the higher liquidity required for servicing voluntary savings products). The cash holdings of O-7 are, on average, 16.5%, which is still high by international standards.

**Exhibit 4.6** Asset utilization of L-3 and O-7, 2009

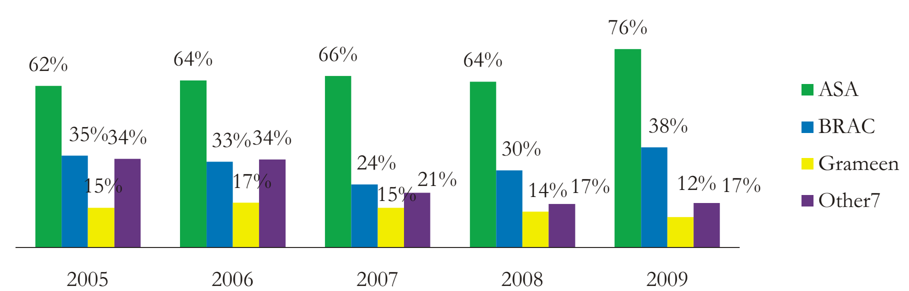


## 4.4 MFIs meet Basel II minimum capital adequacy requirements mandated by Bangladesh Bank for scheduled banks

The Capital Adequacy Ratio (CAR) measures net worth as a proportion of risk weighted assets; it is a measure of the risk taken by the owners/promoters of an institution relative to that of their creditors. Assets are applied a risk weight that is inversely proportionate to their level of liquidity and the risk of loss in a time of crisis.

The time series analysis shown below indicates that the CAR for ASA has been quite high in comparison with the other sample MFIs over the past five years. This is a reflection of its substantial retained earnings, which add to its equity reserves. In the case of BRAC, its CAR increased in 2008 and 2009 mainly due to large donations received for its non-operational activities. CAR for Grameen has remained relatively stable at ~14% whereas the O-7 average CAR has dipped from 34% to 17% in the past five years.

**Exhibit 4.7** CAR by Top3 & Other7




Like other central banks, the Bangladesh Bank has adopted the Basel II framework on risk measurement as of 2010. The CAR ratio required for all scheduled banks is 9% and will increase to 10% on 1 July 2011. Average CAR ratios of banks in the Bangladeshi system range from 0.4% to 28%, as shown in **Exhibit 4.8**. As for MFIs, MRA currently does not provide any formal guidance on capital adequacy. Nevertheless, as seen in **Exhibit 4.7**, MFIs in the sample comfortably satisfy the 9% requirement of Bangladeshi banks and also largely meet the 15% CAR requirement that is typical for non-bank financial institutions. The O-7 MFIs had a CAR of 17% at the end of 2009, which is only slightly lower than the 18% weighted average CAR of Indian MFIs on 31 March 2010.

**Exhibit 4.8** CAR of Bangladeshi banks

| Type of bank | CAR% |
|---|---|
| Scheduled Commercial Bank | 9% |
| Private Commercial Banks | 12% |
| Foreign Commercial Banks | 28% |

The following section analyses the financial performance of the sample MFIs over the five-year frame of reference of this review.

# Section 5

## Financial performance is marked by low returns on portfolio

### 5.1 Yield has been steady over the years except that ASA reduced its service charge

As shown in **Exhibit 5.1**, the portfolio yield has remained stable over the past five years. Interestingly, despite their significantly smaller size, the portfolio yield of the O-7 MFIs has remained stable and more or less matches that of the larger MFIs, although Grameen has remained significantly below the others.

Data on “service charge” (or interest charged to borrowers) for 2000, 2005, and 2008 from BMS and the Grameen Bank's website shows that the average service charge has fallen from a flat rate of 13.4% to 12.3%. However, as mentioned in **Chapter 3**, there has not been a dramatic dip in yield for 2007 and 2008 despite the high PAR resulting from Cyclone Sidr and the South Asian floods.

**Exhibit 5.1** Yield (%)

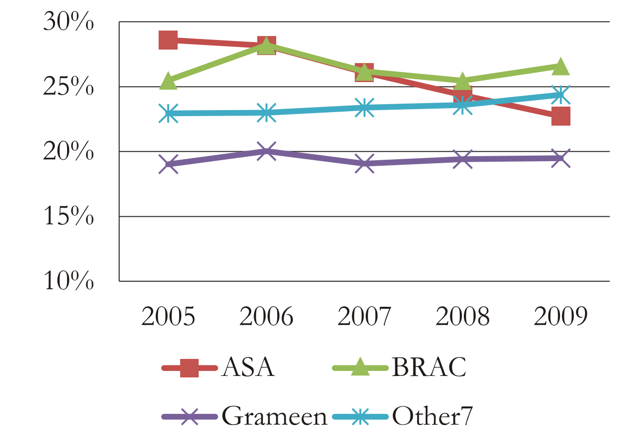
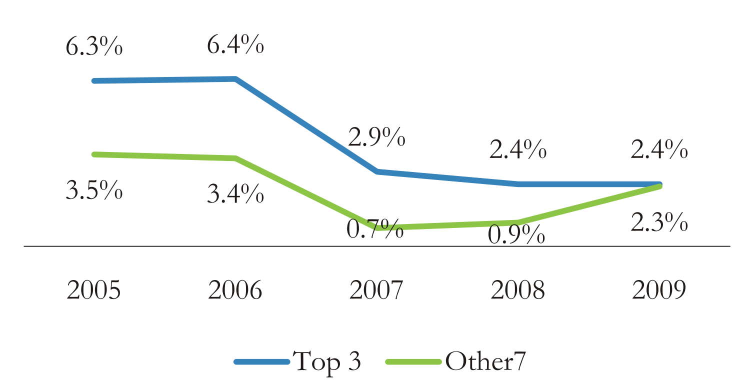



**Exhibit 5.2** Service charges of Top3 (CDF 2008)

| Flat Svc Charge | 2000 | 2005 | 2008 |
|---|---|---|---|
| ASA | 15% | 13% | 13% |
| BRAC | 15% | 15% | 15% |
| Grameen | 10% | 10% | 10% |

### 5.2 …return on assets (RoA) was affected by the 2007 calamity

**Exhibit 5.3** Return on assets of L-3 & O-7

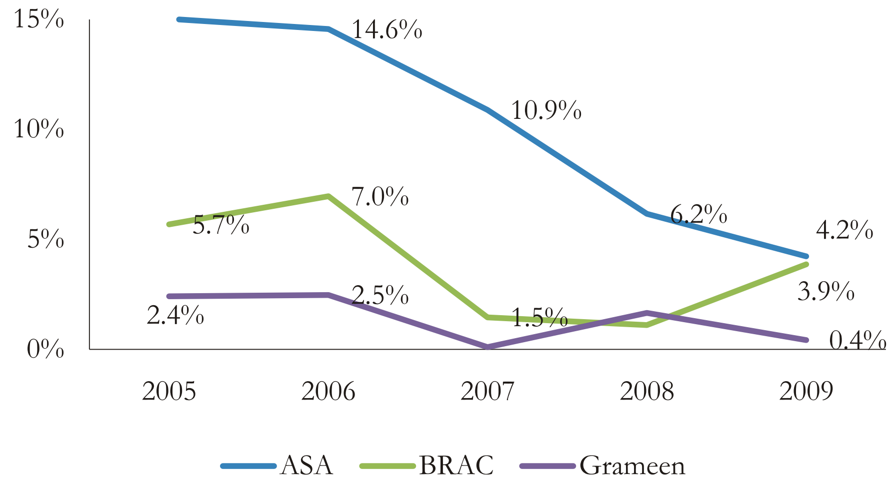



During 2005 and 2006, the MFIs in the sample were running very profitable microfinance operations (**Exhibit 3.11**). However, as **Exhibit 5.3** shows from 2007 onwards there was a drastic drop in return on assets (RoA) for the Top3 MFIs, from 6.3% to 2.4%. As expected, a corresponding dip in returns occurred in 2007 for both groups. While the profitability of the O-7 recovered to 2.3%, reaching almost pre-calamity levels, in 2009 the L-3 MFIs had not yet improved their profitability to pre-2007 levels.

# Financial performance is marked by low returns on portfolio

A disaggregated analysis of RoA, as shown in **Exhibit 5.4, reveals that** ASA had a high RoA previously, which dropped dramatically from 15% to 4.2% over the 2005-2009 period. The other two of the L-3 have also had some fluctuations in their financial performance but from a lower base. Each of the L-3 experienced a dip in 2007 due to the natural calamities in Bangladesh but rose again in 2008.

**Exhibit 5.4** Return on assets breakdown




| RoA | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| ASA | 15.0% | 14.6% | 10.9% | 6.2% | 4.2% |
| BRAC | 5.7% | 7.0% | 1.5% | 1.1% | 3.9% |
| Grameen | 2.4% | 2.5% | 0.1% | 1.7% | 0.4% |
| Others | 3.5% | 3.4% | 0.7% | 0.9% | 2.3% |

Grameen Bank is the only Bangladeshi MFI that is comparable to international and regional benchmarks, as shown in **Exhibit 5.5**, though all three benchmarks are quite similar. ASA and BRAC, as well as the O-7 in most years, perform much higher than the benchmarks presented.

**Exhibit 5.5** RoA benchmarks

| MIX Global | MIX South Asia | Bangladeshi Banks[1] |
|---|---|---|
| 1.50% | 1.18% | 1.37% |

1. Bangladesh Bank, 2010. **Annual Report 2010**. Dhaka: Bangladesh Bank.

### 5.3 An analysis of financial performance shows that low returns on portfolio are compensated for by investment income

Revenue and expenses as a proportion of average portfolio from 2005 to 2009 are depicted in **Exhibit 5.6**. Operating expenses have fluctuated between 11-13.5% of average portfolio for the past five years, and loan loss provisioning has been between 2-3% of average portfolio. Meanwhile, the financial cost ratio has increased steadily for the largest 10 MFIs, moving from 6 up to 10%. The change in the financial cost ratio is mainly due to Grameen Bank's high level of deposits. Interest on borrowings increased by ~50% from 2007 to 2008 and jumped another 30% from 2008 to 2009. The increase in Grameen Bank's interest expense on deposits caused the financial cost ratio for the Top10 to increase by an additional ~2%. As a result, portfolio yield minus the total expense ratio for 2007 to 2009 shows the L-10 have a deficit of 1-2% on portfolio operations. For the largest MFIs, comparing return on investments to interest and fees, it is apparent that income from investments, approximately 40-50% of interest and fee income from microcredit operations, makes up for this deficit.

**Exhibit 5.6** Expenses and Revenue of Top 10

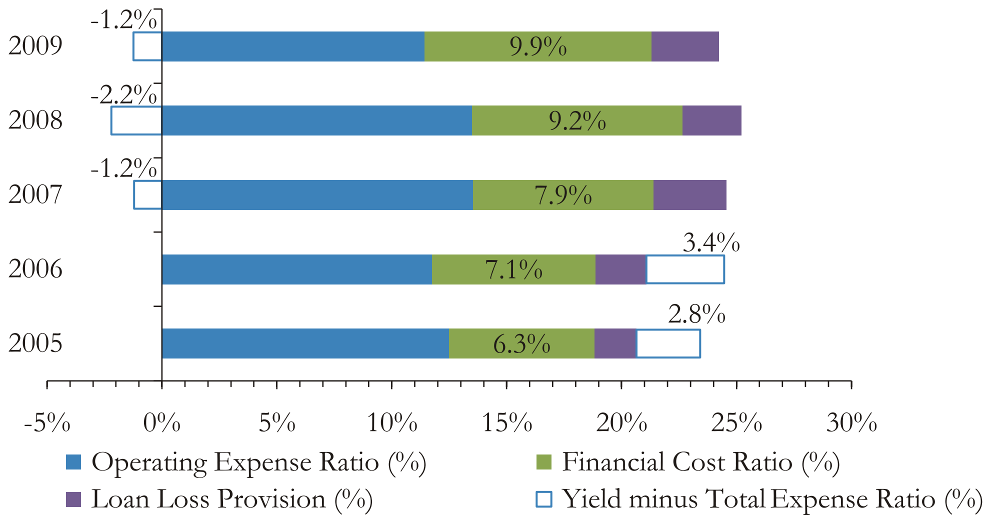
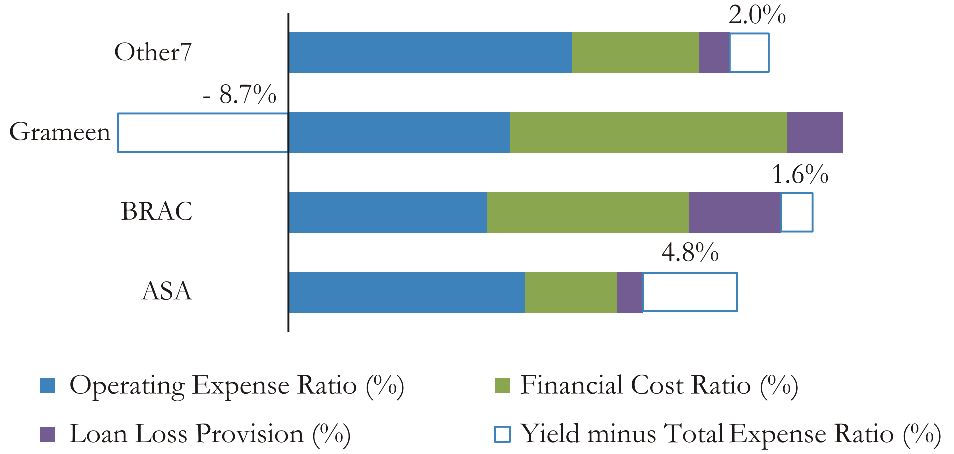



**Exhibit 5.7** provides a more detailed breakdown; it is clear that a substantial portfolio deficit at Grameen Bank is driving a deficit in the sample as a whole. The two other MFIs in the L-3 as well as the O-7 MFIs actually have surpluses for their 2009 microcredit operations.

# Financial performance is marked by low returns on portfolio

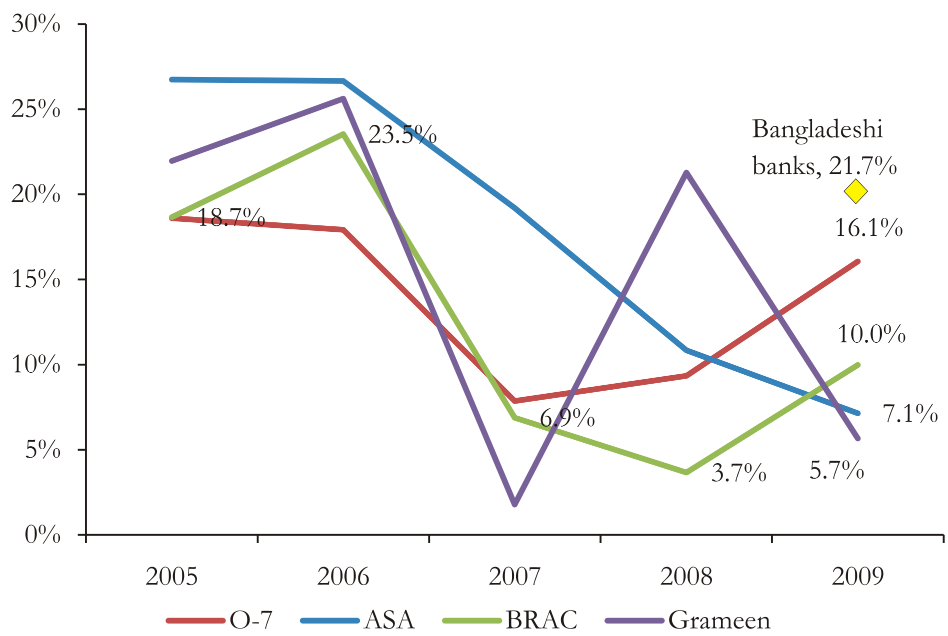
**Exhibit 5.7** Expenses and revenue realization of Top3 & Other7




## 5.4 Return on equity (RoE)

Similar to the RoA analysis, from 2005 to 2007, return on equity (RoE) for the largest MFIs follows a downward trend (**Exhibit 5.8**). The performances of the three large MFIs and the O-7 category are unique.

**Exhibit 5.8** Trend in Return on Equity



# Financial performance is marked by low returns on portfolio

### ASA

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| ASA | 26.7% | 26.6% | 19.2% | 10.8% | 7.1% |
| BRAC | 18.7% | 23.5% | 6.9% | 3.7% | 10.0% |
| Grameen | 21.9% | 25.6% | 1.8% | 21.3% | 5.7% |
| Others | 18.6% | 17.9% | 7.9% | 9.3% | 16.1% |

ASA's RoE dropped substantially from 2005 to 2009 from 27% to just 7%. While its yield dropped from 28% in 2005 to 22% in 2009, its OER increased steadily from 8.5% to 12-15%. Portfolio at risk quadrupled from 1.1% to 4.7%. All three factors: a reduction in income, increase in expense, and increase in risk led to a lower rate of return and consequently the drastic dip in ASA's RoE and RoA. In addition, equity more than doubled from 2005 to 2009 from $160m to $353m.

### Grameen

Grameen Bank's RoE trend line fluctuates with troughs and peaks ranging from 25.6% to 1.8%.

Net worth has remained relatively stable whereas returns have fluctuated. In 2007, Grameen's surplus dipped quite low to $1.5m. As explained in earlier sections, Grameen's interest on deposits has increased substantially as deposits have been considerably higher than the gross loan portfolio. From 2008 to 2009, interest on deposits increased by ~30% causing the surplus to dip to $5m thereby reducing RoE.

### Other Seven (O-7)

The RoE of the Other 7 MFIs in the sample reduced significantly in 2007 but picked up in the next two years. In 2007, two MFIs: JCF and UDDIPAN suffered heavy losses on account of the calamity but earned high profits in the subsequent years (2008-09).

**Exhibit 5.9** RoE benchmarks

| MIX Global | MIX South Asia | Bangladeshi Banks[2] |
|---|---|---|
| 7.3 | 10.5 | 21.7 |

Bangladeshi microfinance institutions have largely saturated their market of financially excluded families. Over the years, as the microfinance sector has grown, MFIs have continued to work primarily in the rural areas of the country. Microinsurance services have diversified over the past few years to comprise of coverage for various purposes such as life, loan, health, and agriculture. The L-10 MFIs in Bangladesh have increased staff efficiency in terms of borrower accounts.

The efficiency and profitability of MFIs suffered a setback in 2007 and 2008 due to Cyclone Sidr in November 2007. Subsequently the L-3 MFIs took prudent measures including high loan loss provisioning to cope with increased portfolio risk. The large MFIs in Bangladesh have largely recovered their profitability in the past couple of years (at least partly because of high investment income) but they continue to be below the returns average Bangladeshi banks earn. However, their returns are similar to MFIs in South Asia as a whole (**Exhibit 5.9**).

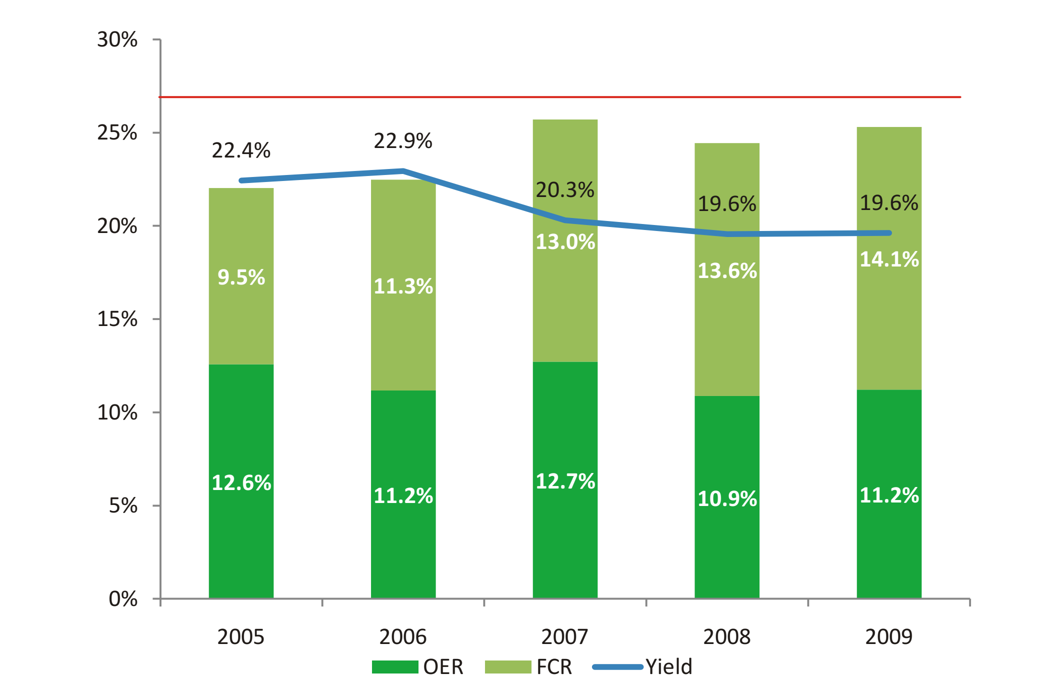
The **profitability performance of the leading MFIs in Bangladesh appears to be reasonable**, as **does the interest rate cap** (of 27% declining translating to 14.5% flat) now imposed on the microfinance sector. However, the cap's impact on the availability of microfinance services in less well served areas and its impact on loan size (relative to the needs of the poorer sections of the potential microfinance client group) remains to be seen.

2. Bangladesh Bank, 2010, op cit

# Annex

## Annex 1

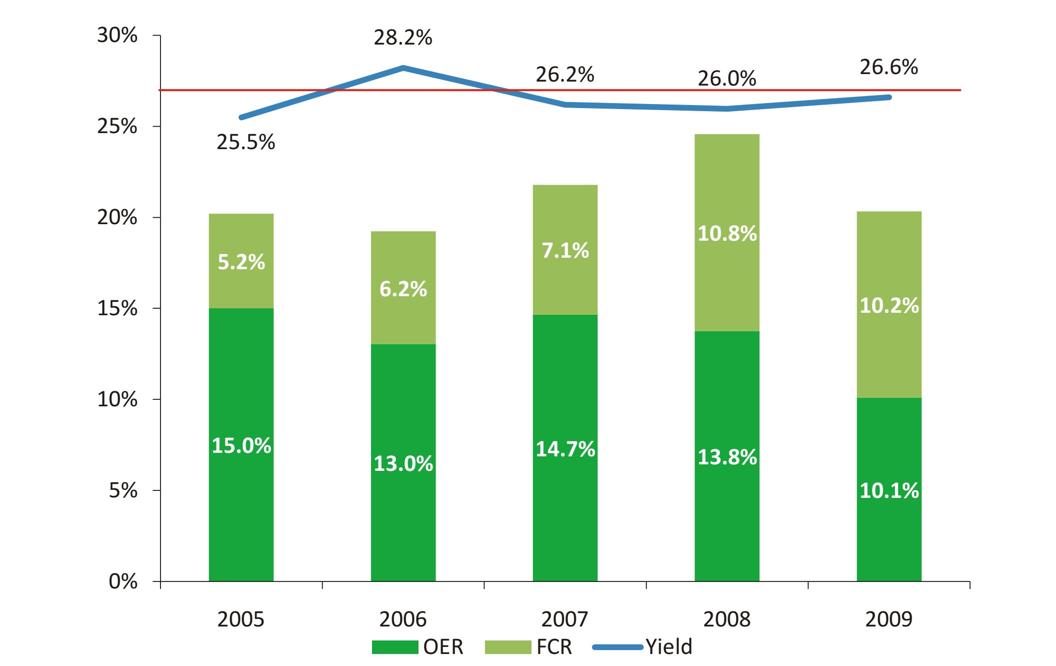
Costs and Returns of Grameen Bank




**Red line** = 27% interest cap

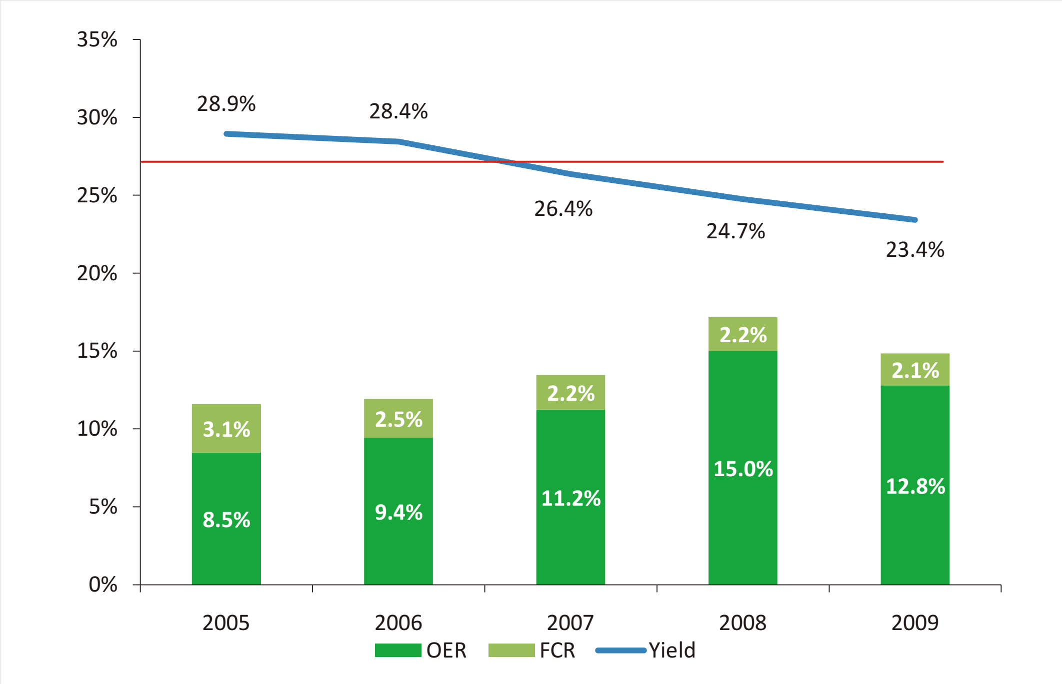
## Annex 2

Costs and Returns of BRAC



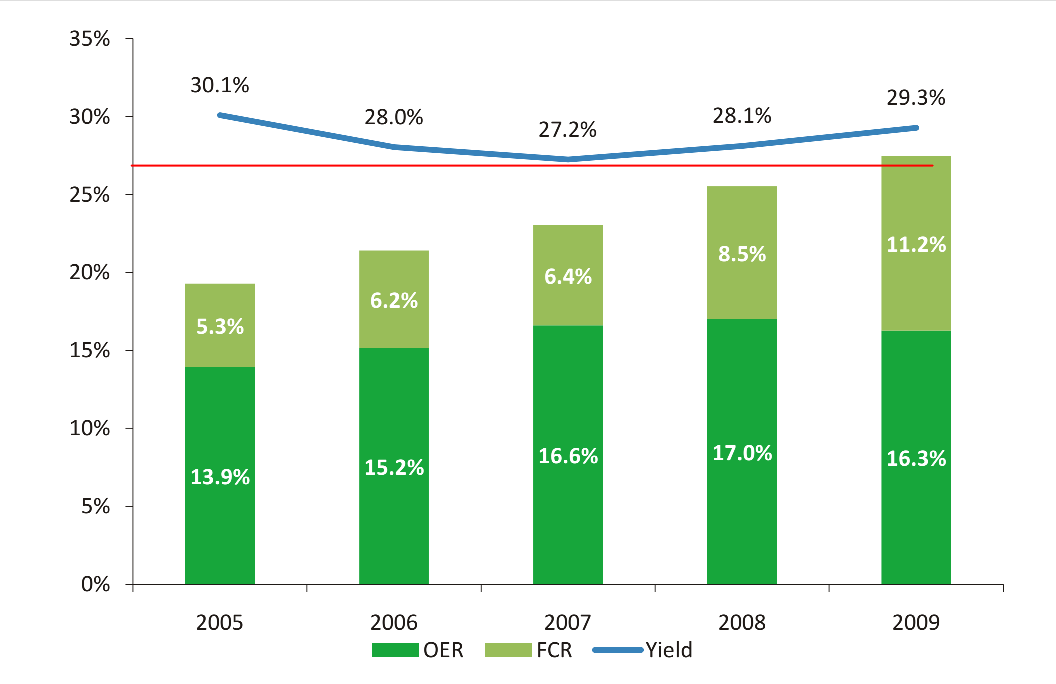
## Annex 3

Costs and Returns of ASA



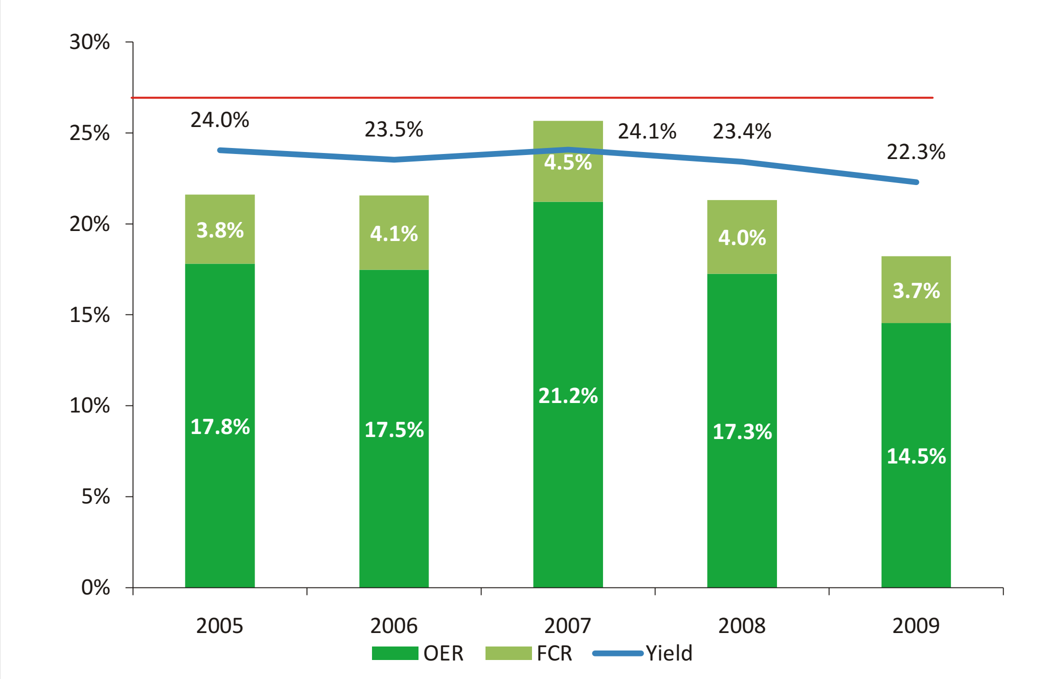

## Annex 4

Costs and Returns of BURO Bangladesh



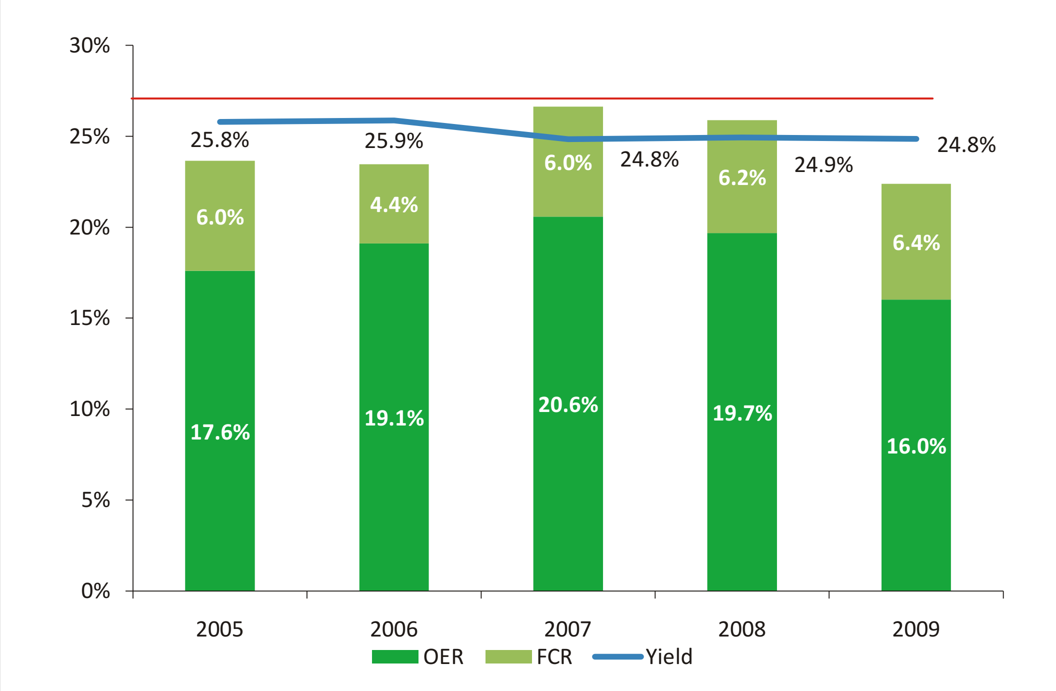
## Annex 5

Costs and Returns of TMSS



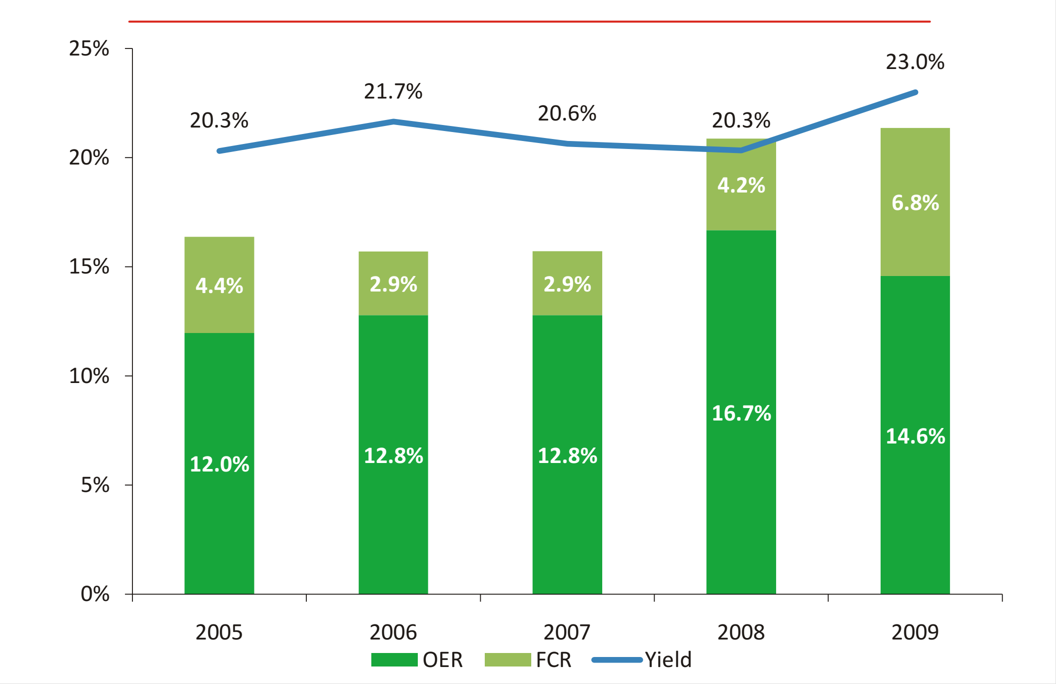

## Annex 6

Costs and Returns of SSS



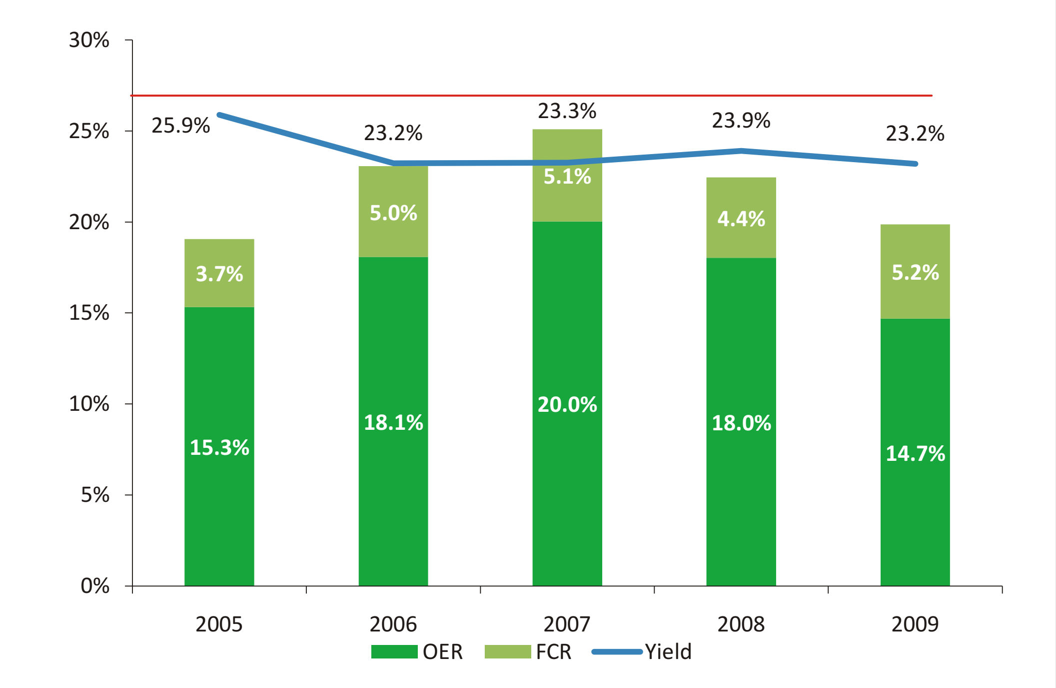
## Annex 7

Costs and Returns of Shakti Foundation



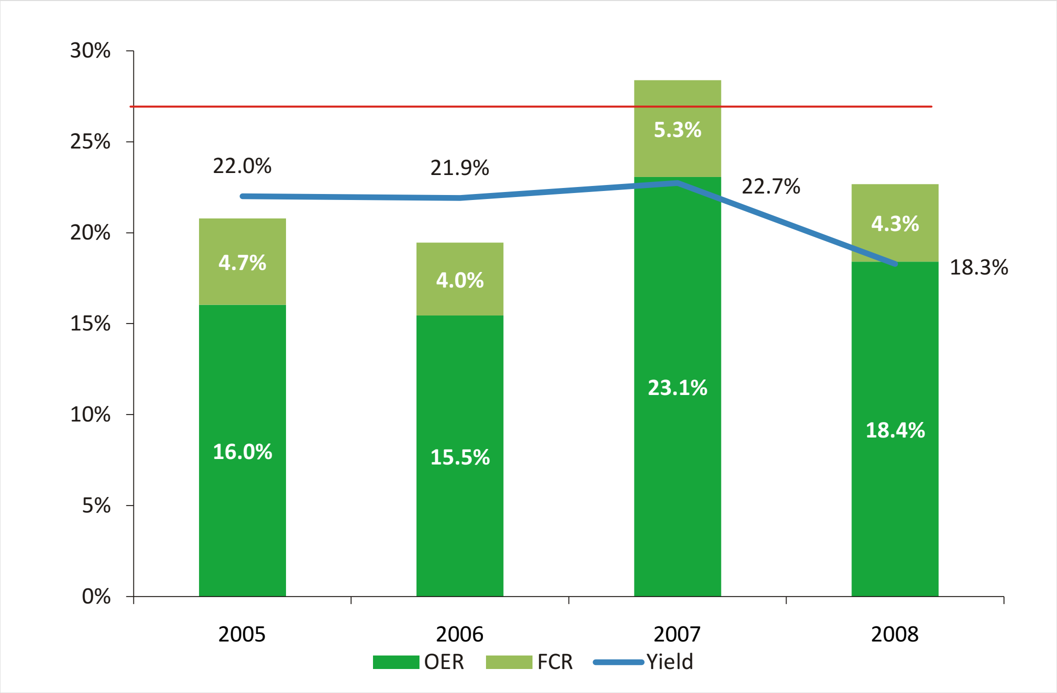

## Annex 8

Costs and Returns of Uddipan



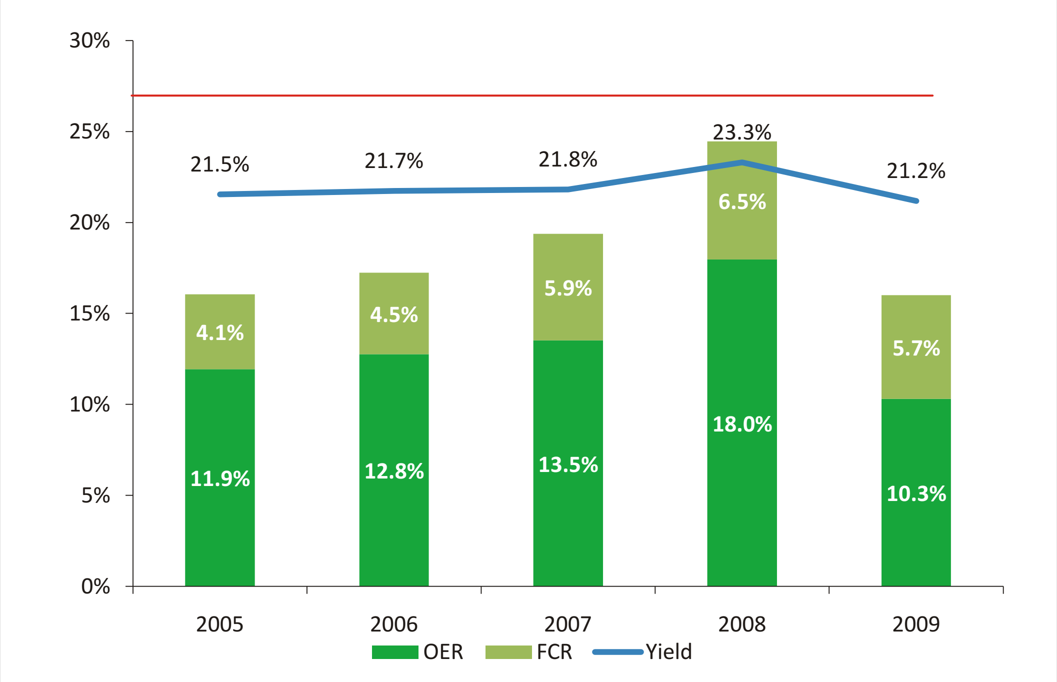
## Annex 9

Costs and Returns of Padakhep (PMUK)




## Annex 10

Costs and Returns of Jagorani Chakra Foundation



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