MicroSave India Focus Note 12

Are There Lessons For India From Bangladesh?

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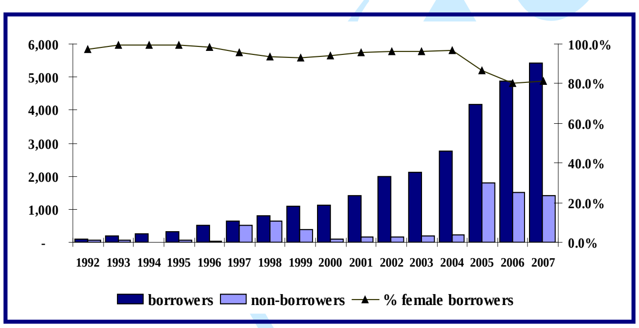
Background: Bangladesh is, in many ways, the most developed microfinance market in the South Asian region. It is therefore appropriate to look at what lessons might lie there for the future of joint liability group-based Indian microfinance. The regulatory environments in the two countries have driven them in very different directions. India has a remarkably sophisticated market for financing MFIs. SIDBI has played a pioneering (and much under recognised) role in using a judicious mix of grant and loan funds to stimulate the MFIs towards a commercial approach. ICICI Bank's lead, together with the Reserve Bank of India's priority sector lending requirements, has meant that many, if not most, major banks are now actively lending to MFIs – even relatively small ones with apparently questionable risk profiles. This in turn has led to MFIs transforming from Societies and Trusts into Non Bank Financial Corporations (a legal form to which banks feel much more comfortable lending). These NBFCs require capitalisation since banks are looking for appropriately structured balance sheets … thus prompting the development of a vibrant venture capital/equity investment market. On the liabilities side, however, little progress has been made to date despite the Banking Correspondent circular of January 2006. This looks set to change with the emergence of e-banking based systems and ICICI Bank's backing for FINO and the off-balance sheet lending-based "partnership model" system.

Bangladesh by contrast, has had no real regulation of savings, and Bangladeshi MFIs have derived very significant proportions of their portfolio from the mobilisation of savings (compulsory and voluntary) from their "members". Recently, the Microcredit Rating Authority (MRA), which is overseen and staffed by the Bangladesh Bank, has started to frame rules to license MFIs. The MCA's conservative nature has led them to question the MFIs' savings mobilisation activities. The first draft of rules, which would (amongst other things) outlaw long term deposit mobilisation and require MRA approval for opening branches, has been met with a barrage of protest from the microfinance sector.

It is therefore in the realm of product offering where India probably has the most to learn from Bangladesh. After thirty years of providing financial services to the poor, the big three MFIs in Bangladesh have evolved in three very distinctive ways. Competition has thus created very interesting choices for the members or clients in the villages of Bangladesh.

ASA – Super-Efficient Microcredit

ASA was recently placed at the top of the list of the world's 50 best MFIs by Forbes magazine and remains one of, if not the most, efficient MFIs in the world. In 2005, the latest year for which there is comparative data from The Microbanking Bulletin, ASA's return on assets was 14.5% (compared to the average for large Asian MFIs of 4%) and its operational self-sufficiency 254.9% (compared to 131% for large Asian MFIs). ASA has achieved this through what Stuart Rutherford refers to as "systematically and relentlessly bearing down on the essentials – getting loans disbursed and then getting them collected"[1].



Beneath the rhetoric of offering a range of products, ASA is almost a mono-product microcredit provider. Its core product, the basic general-purpose loan, repaid in weekly instalments, has scarcely changed in ASA's 16 years of business. Though ASA has experimented with other loan products, none of them are likely to replace this core working capital loan. Similarly, savings mobilised from clients are primarily used to protect the core small loan portfolio, by providing security against default, rather than as a way of raising capital.

ASA's focus on efficiency has led to very high profitability and given it the ability to keep reducing interest rates. ASA's flat rate was 15% (approximately 32% APR) until July 1995, when it dropped to 12.5% at a time when MFIs were coming under increasing criticism in the press for their prices. Currently, ASA is contemplating lowering the interest rate still

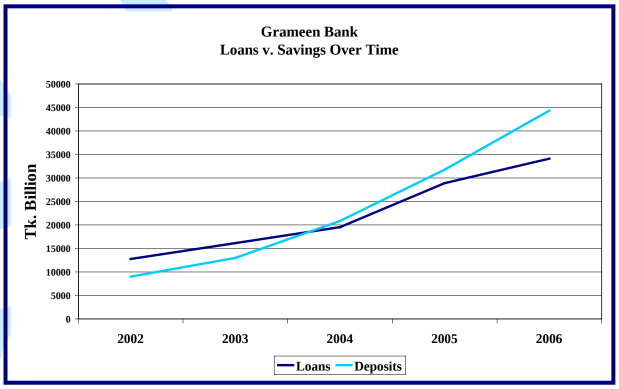
[1] For more on ASA see "ASA Bangladesh: Single Minded Growth" by Stuart Rutherford in the Study Programme section on www.*MicroSave*.net

further, perhaps to Grameen's 11% , as well as adding more comprehensive health care provision to its members (who are already insured against a dozen or so major diseases such as cancer etc.) through setting up hospitals and health clinics.

BRAC - Comprehensive Development

In contrast to both Grameen Bank and ASA, BRAC offers a "comprehensive development" or credit "plus" approach. In addition to microcredit, with very limited savings facilities, BRAC members have access to basic health care and education; human rights and legal counselling; children's primary education through 32,000 primary schools; and (in some cases) livelihood activities such as poultry raising, handicrafts and dairy. As of June 2007, BRAC was lending to 5.57 million, out of its 6.37 million, members and had Tk.32,074 million (average loan size Tk.12,351, approximately $179 or Rs.6,980) outstanding.

BRAC's livelihood support activities hold important lessons for India because BRAC has found that only by providing the full range of services from inputs to outputs are livelihood interventions really effective. Thus, for example for its dairy activities, BRAC provides animal husbandry and veterinary services; 67 milk chilling and processing plants; and the wholesale marketing activities … BRAC branded milk, yoghurt, butter etc. products are available in almost every shop in the major towns and cities of Bangladesh.



Grameen Bank – Comprehensive Financial Services: Grameen Bank now offers integrated financial services under its market-led Grameen II programme[2]. No longer does Grameen Bank just offer the basic working capital credit, repayable over a year - it has evolved to offer a range of diverse financial services. On the asset side it offers its famous basic loan, but has supplemented this with top-up loans to protect the working capital in its borrowers' businesses as they pay off their loans. In addition, a growing proportion of its portfolio comprises larger individual loans to small enterprises – a product that requires a very different approach to loan assessment and credit risk management. On the liability side, Grameen Bank offers a fully open access voluntary savings ("current account") service. This has been supplemented by the Grameen Pension Scheme (GPS), a recurring deposit product that has proved immensely popular, not least of all because of the generous rate of interest paid on these deposits. The GPS has attracted not just the poor, but also the better off, in the villages and as a result Grameen Bank has an alarmingly widening gap between the deposits it has mobilised and the loans it has made. The balance of these funds is largely on fixed deposit with banks and probably earning little more (if not less) interest than is paid to the GPS depositors. This gap reflects the huge popularity of the GPS product … and it is widening: in 2006 loans outstanding increased by 18.1%, whereas savings liabilities grew by 39.6%.

Overall, the Grameen II has proved immensely popular with its clients – and many of the bank's previous clients have repaid their delinquent loans to rejoin and get access to the bank's new services. Even in Bangladesh's fiercely competitive environment Grameen continues to grow at a remarkable rate with its clients increasing by a staggering 5 million since 2002 - by December 2007 Grameen Bank had over 7.4 million members. In the four years to December 2006, Grameen's deposit base increased five fold and its loans outstanding more than doubled.

Where To India?

While India's microfinance market is remarkably sophisticated in terms of capital/financing, it remains largely nascent in terms of the services offered to clients. The Bangladesh experience suggests that MFIs can seek to differentiate themselves in terms of the range/nature of services offered (Grameen and BRAC) or price, efficiency and reliability of service (ASA). Interestingly, in response to competitive forces, both Grameen and ASA have formally renounced joint liability. As the Indian market matures and competition increases, MFIs will need to take strategic decisions along these lines and to re-engineer their business strategies accordingly. These changes are already underway – to the benefit of clients who are thus offered valuable choice in a market hitherto largely deprived of basic services.

[2] For more on Grameen II see the *MicroSave* Grameen Bank Briefing Notes available under the Briefing Notes section of www.*MicroSave*.net.