The Use of Financial Inclusion Data Country Case Study: **BANGLADESH**

Determining Appropriate Service Charges Based on Microfinance Institutions (MFIs) Operational Cost Data

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1. Country Context

Bangladesh is a developing country in South Asia with a population of about 155 million and a GDP of USD 115.60 billion in 2012. In spite of global financial volatility Bangladesh has achieved commendable success in maintaining a steady growth rate of around 6% per annum in the last decade and reducing absolute poverty in head count ratio from almost 49% in 2000 to 31.50% in 2010. The current target is to reduce poverty in the country from 31.50% at present to 29% by 2015. Bangladesh's performance has also been impressive according to almost every macroeconomic and social development indicator during the period. Table 1 below, which features selected indicators, shows strong growth in Bangladesh's economy over 2007-2012.

Table 1: Selected Economic Indicators of Bangladesh

Description	2007	2008	2009	2010	2011	2012
GDP (billion USD)	68.42	79.55	89.36	100.36	111.91	115.61
GNP(billion USD)	74.93	83.42	93.41	104.68	117.78	129.19
GDP per capita (USD)	467.14	537.64	597.71	664.06	732.07	747.34
GDP growth rate (%)	6.43	6.19	5.74	6.07	6.71	6.32
Inflation, CP (annual %)	9.11	8.90	5.42	8.13	10.71	8.74

Source: World Development Indicators, World Bank

Financial inclusion activities in Bangladesh can be said to have started even before the independence of the country in 1971 with the establishment of the Bangladesh Academy for Rural Development (BARD), via the cooperative agricultural development model. After independence, the process of including the poor into different financial benefit programmes continued under the central bank (Bangladesh Bank), various government safety net programmes and the activities of the Bangladesh Rural Advancement Committee (BRAC) - a leading NGO. The establishment of Grameen Bank in 1983 by government legislation further paved the way for increased robustness of the microfinance sector in the country.

Bangladesh is a pioneer in empowering the poor by broadening the base of financial access through several types of financial institutions. Along with the formal banking sector, there are non-banking financial institutions, cooperatives, microfinance institutions and other government and non-government financial institutions providing different financial services to the poor population.

The following table depicts the scenario of overall financial inclusion in Bangladesh of people above 15 years in 2011.

Table 2: Percentage of people above 15 years of age having access to various financial services in Bangladesh in 2011

Description	% of population above 15 years of age
Account at a formal financial institution	40
Account at a formal financial institution, female	35
Account at a formal financial institution, bottom 40% income bracket	35
Account used to receive wages	3
Account used to receive government payments	2
Account used to receive remittances	3
Saved at a financial institution in the past year	17
Saved using a savings club in the past year	4
Loan from a financial institution in the past year	23
Loan from family or friends in the past year	11
Debit card	2
Credit card	1

Source: World Bank Findex

Several financial and non-financial institutions are working to reduce the bottlenecks of the financial system and expand financial inclusion through pro-poor development and poverty alleviation programmes. An indication of this is the diversity of lender institutions, from both government and private sector. The table below presents the size contribution by different types of institutions to financial inclusion in Bangladesh.

Table 3: Contribution to Financial Inclusion by types of Institution in 2012

Institution / Programme	Loan Outstanding (Million USD)	Percent of GDP	No. of Clients (Millions)
Financial Banks	54,960.68	47.54	9.67
Non-banking Financial Institutions	3,308.54	2.86	
Microfinance Institutions	2,598.68	2.25	23.82
Grameen Bank	1,038.99	0.89	8.40
Government Programmes	222.00	0.19	0.80
Cooperatives	376.43	0.32	8.50
Mobile Banking	670.01	0.60	2.83
Total	63,175.33	54.64	54.02

Source: MRA-2012, Bangladesh Bank, Grameen Bank, Ministry of Finance

There are five financial regulatory bodies in Bangladesh: Bangladesh Bank (BB); the Microcredit Regulatory Authority (MRA); the Department of Cooperatives; the Insurance Development Regulatory Authority (IDRA); and the Securities and Exchange Commission (SEC). In particular, the MRA regulates microfinance institutions (MFIs), as established under an Act of Parliament in 2006. In 2012, the total number of licensed MFIs was 691 with 17,977 branches and 23.82 million clients.

Apart from the primary task of regulating and monitoring the sector, the regulatory bodies also collect data under their respective jurisdiction. BB and the Ministry of Finance aggregate the data for evaluation and policy decisions at the national level.

2. The Rationale for Data Collection on MFI Operational Cost and Service Charges

One of the tasks that the MRA undertook upon starting its operation was to tackle the issue of interest rates charged by MFIs. The MRA envisaged setting up a uniform rate of interest for the sector that would protect the clients from excessive interest charges and also contribute significantly to the expansion of financial inclusion. This vision - coupled with a growing concern by MFI-sector beneficiaries and stakeholders regarding the high level of service charges - inspired the MRA to formulate an appropriate policy to determine suitable service charges for the sector.

It should be noted that the assessment of interest rates and policies based on this assessment will always take into account the twin factors of existing market practices/outcomes and the cost of doing business for the MFIs. The different tenure of loans is not a major factor, as most loans are for a one year period.

In 2008, the MRA prepared a draft policy that recommended a 24% declining rate service charge based on the analysis of the MFI sector. However, representatives of the MFI sector expressed concern about the validity of the analysis. A consensus was reached to formulate an appropriate policy based on more robust facts and findings from the sector. Until such time, service charges were to be based on either a 15% flat rate or a 30% declining rate.

Based on this decision, the MRA hired Microfinance Transparency (MFT) - a US-based consultancy firm - in 2009, to determine an appropriate interest rate for MFIs by studying the income and cost structures of the sector. MFT developed and presented a technique of calculating the effective service charge, based on not only the direct rate of interest charged on loans but also indirect charges to clients such as registration fees, processing charges, loan insurance etc. However, it later appeared that some MFIs lacked the proper understanding of cost components. As a result MFT was unable to confirm the robustness of their calculations of the effective service charge.

In response, a committee consisting of members from the MRA, the Palli Karma-Sahayak Foundation – a wholesale government funding agency for the sector – and the Institution of Microfinance (InM) – a research organisation focusing on capacity building in the MFI sector – was formed in April 2010. The committee was assigned to provide recommendations on service charges by collecting and analysing data on MFIs.

3. Data Collection Process

Based on MFT’s recommendations, the committee designed a simplified format for collecting data of existing loan practices and cost structures of the MFI sector. The data came from three major sources:

- Audited annual financial statements of MFIs

- Half yearly MIS reports from MFIs
- Field visits and onsite inspections

Information collected included:

(1) Interest rate of various types of loans
- General microcredit
- Extreme poor credit
- Microenterprise loans
- Agricultural microcredit
- Seasonal microcredit
- Disaster management microcredit

(2) Operational costs
- Contribution of client savings as a source of funding for MFIs
- Interest rate paid by MFIs on client savings
- Financial cost structure of MFIs
- Administrative cost structure
- Losses due to non-performing loans
- Total costs

4. Main Findings

The main findings on service charges and operational costs by MFIs are summarised below.

Table 4: Annual Interest Rate, by Loan Type

Types of Loan	Range of service charge		Comment
	Including savings and insurance	Excluding savings and insurance	
General microcredit	28%-70%	25%-33%	Found to be more than 100% including savings and insurance in some cases
Microenterprise loan	22%-65%	26%-40%	Found to be more than 93% including savings and insurance in some cases
Extreme poor credit	22%-28%	22%	
Agricultural microcredit	28%-65%	22%-33%	Found to be more than 100% including savings and insurance in some cases
Seasonal microcredit	28%-55%	26%-33%	Found to be more than 100% including savings and insurance in some cases
Disaster management	2.46%-11%	2.46%-11%	

Table 5: Operational Cost, by Type

Description	General breadth	Weighted average based on MFI size
Return on loan outstanding	19.28%-28.5%	
Financial cost	1%-9%	2.98%
Administrative Cost	11%-21%	13.14%
Total cost	12%-30%	16.09%
Loan loss	1%-6%	1.97%
Profit		8%

In addition to above information inflation has been considered in the calculation process. The main findings of the study also brought out the following:

- Almost 75% of MFIs charged around 25% - 28% interest.
- Very few charged above 30%, and those who did were actually enjoying a higher profit margin.
- Few MFIs were able to charge below 25%, and their cost was low due to increased operational efficiency.

5. Setting Appropriate Service Charges and Market Conduct

Based on these findings the committee made the following recommendations:

- Interest rates for loans to clients should be set in the range of 25% - 30%
- Imposition of multiple charges should be stopped and MFIs should charge clients only according to the declared interest
- Flat rate calculations of interest should be replaced by the declining balance method
- There should be a minimum initial grace period after loan disbursement before repayments are due
- The minimum number of instalments for repayment of the entire loan should be 46

After several discussions with MFIs it was agreed that the interest rate would be set at 27%. Other recommendations of the committee were also introduced and the MFIs were instructed, through a circular addressed to all MFIs, to adhere to the directives. MFIs were supported through training and monitored through regular MIS reporting.

At present, all MFIs are following the MRA policy decisions introduced for the sector. Interest rates are set at 27% and calculated on a declining balance method. There is a mandatory grace period before repayment of loans is started. Multiple charges to clients have been eliminated entirely.

In 2012 two research studies were conducted to assess the efficiency and effectiveness impact of the MRA regulations. Significant positive impact of MRA regulations has been found. A 4% reduction in inefficiency of MFIs due to MRA regulations has been observed. It can be concluded that consumers have benefited and that the efficiency of MFIs have improved because of the regulations.

6. Key Lessons

This policy decision was quite important and difficult. On the one hand the interest rate charged was a critical issue for client welfare and protection, while on the other hand it was also important to set an appropriate rate of interest so as not to affect sustainable operations of the MFIs in the sector. Striking a balance was quite a difficult task in an environment where some of the world's largest MFIs are operating alongside very small MFIs who have, quite naturally, significantly varying cost structures. The wide range of data available, together with systemic and rigorous data analysis, helped the MRA to formulate and implement the policy successfully.

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