

## The Impact of Microfinance in Rural Banking activities in Bangladesh

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### Abstract

*Banks play a vital role to improve the economy of any developing country and in Bangladesh the influence of banking activities could uplift the total GDP of the country. Virtually all banking services were concentrated in urban areas. Bangladesh Bank was responsible for regulating currency, controlling credit and monetary policy, and administering exchange control and the official foreign exchange reserves. The Bangladesh government initially nationalized the entire domestic banking system and proceeded to reorganize and rename the various banks. Foreign-owned banks were permitted to continue doing business in Bangladesh. The insurance business was also nationalized and became a source of potential investment funds. Cooperative credit systems and postal savings offices rendered service to small individual and rural accounts. The new banking system succeeded in establishing reasonably efficient procedures for managing credit and foreign exchange. The primary function of the credit system throughout the 1970s was to finance trade and the public sector, which together absorbed 75 percent of total advances. This paper is partial requirement to fulfill our rural banking activities in context of microfinance. Actually from our country's perspective rural banking and micro finance are two important terms. These two special sectors can play a vital role to eradicate rural poverty and unemployment. In Bangladesh poor people are financed by micro credit program through various organizations. Micro finance can quickly reduce the poverty level by offering various credit programs. After that the present scenario of micro credit program in Bangladesh and bank's method of implementation of the micro finance concept is specified. In this paper banking sector in the context of micro financing system in Bangladesh is analyzed. Why it is important for the development of economy of Bangladesh is described. In this part some constraints of the use of Microfinance is identified for which Bangladesh does not achieve its target goal in the economic sector to reduce the poverty level. Government and other related authorities should take proper and effective steps so that rural banking and micro finance program can play key role to remove poverty.*

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**Introduction:**

Rural banking and microfinance are two important terms from our countries economy perspective. The vast population have remained unutilized due to lack of education and training. Since our economy is agro based economy and major portion of our population are living in the rural area so to ensure balanced geographical growth as well as growth of GDP and to remove poverty, organized sector can play a vital role through rural banking and microfinance .The government's encouragement during the late 1970s and early 1980s of agricultural development and private industry brought changes in lending strategies. Managed by the Bangladesh Krishi Bank, a specialized agricultural banking institution, lending to farmers and fishermen dramatically expanded. The number of rural bank branches doubled between 1977 and 1985, to more than 3,330. Denationalization and private industrial growth led the Bangladesh Bank and the World Bank to focus their lending on the emerging private manufacturing sector. Scheduled bank advances to private agriculture, as a percentage of sector GDP, rose from 2 percent in FY 1979 to 11 percent in FY 1987, while advances to private manufacturing rose from 13 percent to 53 percent.

**Objective of the Report:**

In this report I have tried to identify the factors that influence the development and growth of the rural banking policy of Bangladesh and how microfinance system support to improve rural banking in Bangladesh. Thus the specific objectives of the study are as follows:

- To give an overview of Microfinance in Bangladesh.
- To provide the present scenario of rural banking in the context of Bangladesh.
- To give information about institution that promotes Microfinance in Bangladesh.
- To identify the banking sector all over the country.
- To specify various loans and investment under the Micro financing Institutions.
- To identify the problems of rural banking in Bangladesh.

**Methodology of the study:**

From the secondary data sources all data are collected. Already published information and various features of different institutions which are prescribed by the government and private institutions are used in this report.

**Limitation of the study:**

Time frame for the analysis was very limited.

This analysis only covers various reports published on Microfinance.

In many cases up to date information was not published.

Getting relevant papers and documents were very difficult.

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**What is Microfinance?**

Microfinance services are financial services that poor people desire and are willing to pay. The term also refers to the practice of sustainable delivery of those services. More broadly, it refers to a movement that envisions “a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers”.

Traditionally, microfinance was focused on providing a very standardized credit product. The poor, just like anyone else, need a diverse range of financial instruments to be able to build assets, stabilize consumption and protect themselves against risks. So, microfinance means providing very poor families with very small loans (micro credit) to help them engage in productive activities. Over time, microfinance has come to include a broader range of services (credit, savings, insurance, etc.)

**Growth of micro financing in Bangladesh:**

According to Bangladesh Bureau of Statistics (2009), the area of Bangladesh is 147,570 sq km with population of about 145 million and population growth rate is 1.39. Agriculture is the main occupation of the population. Almost 63% people lives on this occupation and 40% of total population lives below the poverty line. To improve this poverty level credit is provided to make them creative and micro financing program provide loan to help this disadvantaged group. This loan is provided to promote income creation along with self employment. To achieve this purpose SME financing is necessary for the development of poor people of Bangladesh.

The concept of micro credit system originated from this country and 160 billion Bangladeshi taka has been provided to the 30 million of poor people of the country. The government and non-government institutions are considering the SME as tool to reduce the poverty of the country. Due to high population growth rate the poverty is high in Bangladesh and it is worse in rural area. There is high unemployment rate and illiteracy rate. For this reason, most of the poor people fail to increase their economical condition. To mitigate this problem SME program came forward and is playing important role in the economy of Bangladesh.

Quite simply, a microfinance institution is an organization that offers financial services to low income population. Almost all of these offer micro credit and only take back small amounts of savings from their own borrowers, not from the general public. Within the microfinance industry, the term microfinance institution has come to refer to a wide range of organizations dedicated to providing these services: NGOs, Credit Unions, cooperatives, Private commercial banks and non-bank financial institutions (some that have transformed from NGOs into regulated institutions) and parts of state-owned banks, for example. For our purposes, we refer to them as MFIs, even though only a small portion of their assets may actually be tied up in financial services for the poor. In both cases, when people in the industry refer to MFIs, they are referring only to that part of the institution that offers microfinance.

### **Working Procedure of Microfinance**

Local Microfinance Institutions reach out to the very poor and deliver microfinance services to local clients daily. They educate local communities about the opportunity to improve their lives with microfinance; make micro loans and provide other financial services such as savings accounts and insurance; collect weekly loan payments; and assist clients in solving some of the life challenges they may face. Many also provide social services

Most micro credit borrowers have micro enterprises—unsalaried, informal income-generating activities. However, micro loans may not predominantly be used to start or finance micro enterprises. Scattered research suggests that only half or less of loan proceeds are used for business purposes. The remainder supports a wide range of household cash management needs, including stabilizing consumption, education fees, medical expenses, or lifecycle events such as weddings and funerals.

Majority of the microfinance institutions offer and provide credit on a solidarity-group lending basis without collateral. There is also a range of other methodologies that MFIs follow. Some of these are:

#### **Group Lending**

Group based lending is one of the most novel approaches of lending small amounts of money to a large number of clients. Most group contains four to eight members. The group self-selects its members before acquiring a loan. Loans are granted to selected member(s) of the group first and then to the rest of the members. The entire group will be disqualified and will not be eligible for further loans, even if one member of the group becomes a defaulter.

#### **Individual Lending**

Unlike MFIs, there are very few conventional financial institutions which provide individual loans to low-income people because poorer clients are considered higher risk clients due to their lack of collateral, plus the labor-intensive nature of the credits and hence the lack of profitability of small-credits. BASIC BANK (Bangladesh), Bank Rakyat Indonesia (BRI) in Indonesia, ADEMI in the Dominican Republic and are some examples of successful lenders to poor clients.

#### **Credit Unions**

Credit unions are the organizations that are formed on the basis of financial relation of savings and loans between its members. They accumulate savings from its members and provide short-term credit to the needed members. The demand for loans in general exceeds the supply of savings. Credit unions have achieved financial self-sufficiency within the last few decades.

#### **Village Banking**

Village banking is a kind of financial service model that assists poor communities to establish their own credit and saving associations, or village banks. Village bank provides non-collateralized loans to its members and a place to invest savings and promote social solidarity. The sponsoring agency provides loan for the village banks and village banks in turn provide individual loans to its members.

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**Need of Microfinance:**

Bangladesh, with a population of more than 140 million, is one of the most densely populated countries (1061 persons per square kilometer) in the world. Poverty is pervasive. Almost half of the total population is still living below the poverty line - earning less than \$1 a day. The various dimensions of the country's poverty are manifested in terms of inequality in income distribution (in favor of urban areas), wage differentials between the formal and informal sectors, dramatic increases in the cost of living, less than adequate calorie intake by the vast majority of the population, unemployment and internal migration. The UNDP's Human Development Index for Bangladesh was just 0.52 in its 2005 report, resulting in an extremely low international ranking of 139th out of 177 countries. However, progress on a range of social indicators in Bangladesh over the last fifteen years has been striking in certain areas, and these have been accredited substantially to the mix of public and private service provision, including the pioneering approach of microfinance institutions (MFIs).

The banking sector in Bangladesh is dominated by the four state-owned commercial banks, known as NCB, and there are five government-owned specialized banks, 30 domestic private banks, and 12 foreign banks (2008). The specialized agricultural banks and NCBs have been lending extensively to the rural area but most of their lending is not targeted to the poor. The foreign banks and the PCBs have simply stayed away from rural lending. The poor people do not get access to formal financial institutions because of lack of physical facilities. The informal moneylenders, on the other hand, charge an exorbitant rate of interest. Against the backdrop of a relatively undeveloped formal financial system, a strong NGO microfinance system has developed in Bangladesh.

**Products of Microfinance:****Credit Products**

Credit is given for both individual and group activities and there is no collateral requirement. The types of loans include general loans, program loans, housing loans, etc. General Loans are made for any profitable and socially acceptable income generating activity. Group members can obtain sector program loans in areas such as poultry, livestock, agriculture, sericulture, fisheries and social forestry. Besides, there are various forms of credit such as: flexible credit services, supplementary credit services, micro enterprise credit services etc.

**Savings**

For almost every MFI, there are now savings opportunities for their borrowers. A large share (30 percent) of the sources of funds for micro-credit now comes from member savings. Currently, the savings products available in the microfinance NGO sector (for members only) include mandatory savings, special savings, contractual savings, time deposits, and daily savings.

### **Insurance and Social Services**

Microfinance NGOs in Bangladesh are gradually becoming interested in offering insurance products, particularly life insurance, to their existing credit and savings clients. Interest has been generated following the successful micro insurance experiences of a private sector provider, Delta Insurance. There are various kinds of products offered under life insurance and social services programmes by MFIs. They are health insurance, life insurance, credit insurance, property insurance, crop insurance, etc.

### **Innovations**

Even with the huge expansion of micro credit in Bangladesh the poor households were struggling to benefit from the standard micro credit model despite joining the programs. To cater for the constraints hindering poor households, some programs have introduced innovations. These are:

- Introduction of more flexible repayment schedules such as ASA's Flexible Loan Program.
- Lowering first loan levels so that amounts as small as \$8 can be borrowed,
- A Grameen program that offers zero interest loans to beggars
- The Resource Integration Center's program that specializes in offering loans to a specific vulnerable group – elderly poor.
- Various programs that combine food aid with micro credit and training e.g.; BRAC's IGVDG program, and
- Targeting remote areas through for instance ASA's cost-effective mini branch system and integrated development foundations work in the Chittagong Hill Tracts.

Furthermore, there are several other innovated programs such as: flexible savings and credit shift towards 'enterprise loans', micro-insurance, linking MFIs with formal financial markets, private sector involvement in the microfinance distribution, individual financial products.

### **Training/Counseling/ Marketing/ Institution Building:**

Some MFIs offer services for business planning & management, entrepreneurship development, basic accounting & cash management, product diversification, innovation, research. Some others offer services in the area of marketing outlay, production center, promotional activities, infrastructure support, while there are some MFIs who work in the areas of group formation, awareness raising, leadership development, linking/networking, information sharing.

### **Launching of Rural Banking System:**

The World Bank advised the third world countries to implement overall development planning based on rural area. The World Bank gave strong advice on implementation of overall development planning by coordinating various sectors of rural economy. This development strategy is called as multi-sectoral rural development strategy. In the multi-sectoral development strategy, production sector has been joined not only with service sector

but also with infrastructure development sector. Production sector can be divided into poultry, livestock, fisheries, handicraft, small business etc. besides crop production. Other than these, health, family planning, education, communication, good provision of housing and entertainment may seem to include service sector for the time being. Actually in the final analysis, the development of all these sectors contributes greatly to the growth of productivity of developing financial sector. Similarly, development of infrastructure for example roads and highways, markets etc. in a planned way accelerates the development of production sector.

There is no doubt that the mentioned multi-sectoral development strategy will be able to improve the economic condition of rural people. However, implementation of all these projects will require huge amount of money which is impossible for rural people to supply. So, these require invention of successful organizations that shall have abundant deposits and high numbers of branches present everywhere and above all of them shall be operated with clearly defined policy and strategy and by keeping achievable goals in front and above all by favorable well-trained workforce.

### **Agriculture Industry:**

Agriculture and industry are both production related activities and dependent on another. If agriculture is neglected, importance of industry may be reduced due to shortage of necessary raw materials and need for sufficient local market for industrial products. This is because neglected agriculture reduces income of rural people and this makes them incapable of consuming industrial goods despite the high demand.

On the other hand, industry cannot progress in due rate if priority to the agriculture and industry is neglected, as necessary equipment, fertilizers, pesticides, medicine etc. are produced in industry. On the other hand, if rate of agricultural production remains unhindered still lack of marketing of agricultural product will hinder agricultural production remarkably.

Therefore, because agricultural and industrial developments are reciprocal, so investment limits in these two sectors should be set with importance.

### **Expanding Banking Service in Rural Areas:**

In our business environments, a bank is still trusted as one of the few institutions where people get a little bit of service like depositing money, drawing cash, availing of a loan, etc. Well, at least it was so a few years back. Of course, the services, in terms of catering banking facilities to quality clients, have deteriorated recently, especially in state-owned banks. On the other hand, exorbitant fees are being charged in private banks, to the detriment of fixed income groups.

With the introduction of online and Automated Teller Machine (ATM) banking services in the city and urban areas in Bangladesh there have been significant improvements in the over-the-counter banking services. With an ATM card a bank client can now enjoy fast and convenient banking round-the-clock. Thanks to ATM, an account holder, without having to go to the bank premises, can step onto an ATM booth and use the keypad of the machine to withdraw cash, transfer funds, enquire about his balances, and ask for other online services --

24 hours a day, 365 days a year. There would soon be a time, hopefully, a bank client, like in the western countries, will be able to deposit even cash and cheques and get authenticated receipts of the respective deposits through the same ATM machine. What is needed is efficient maintenance of the ATM machines through seamlessly wired and wireless networking so that an ATM card-holder is never frustrated for any breakdown of an ATM machine.

.Given the inefficiency of some banks in implementing their production plans, Bangladesh Bank should examine technical and scale efficiency of all the banks in urban and metropolitan areas which is characterized by an over-banked system and identify the differences in efficiency between domestic and foreign banks as well as small and large banks before determining where the new banks should be allowed to operate, and in what scales, in different phases of their growth with a view to developing a homogenous enlargement of our banking industry and outlets in urban areas.

### **The concept of microfinance use in the banking activities in rural area:**

In Bangladesh there are mainly four types of institutions involved in micro-finance activities. These are 1) Grameen Bank, a member owned special , 2) around 1500 Non- Governmental Organizations (NGO) like BRAC Proshika, ASA, BURO-Tangail, BEES, CODEC, SUS, TMSS, Action- Aid etc. 3) Commercial and Specialized banks like Bangladesh Krishi Bank (BKB), Rajshahi Krishi Unnayan Bank (RAKUB) and 4) Government sponsored micro finance projects/ Programs like BRDB, Swanirvar Bangladesh, RD-12 and others which are run through several ministries viz., Ministry of Women & Children Affairs, Ministry of Youth & Sports, Ministry of Social Welfare etc. All the programs are targeted the functionally landless rural poor. All the MFIs provide mostly small, un-collateralized one-year term loans to individuals belonging to jointly liable peer groups, and they use similar on-site loan disbursement and weekly collection methods by forming village organizations or centers.

A research reveals that NGOs started credit program in mid eighties and their activities increased noticeably higher after 1990 (CDF, 2000). With the increasing number of collateral free micro credit disbursement by MFIs, some Nationalized Commercial Banks (NCBs), and Specialized Banks like BKB and RAKUB have been encouraged to provide a considerable amount of their rural credit to the poor without security. However, the amount is much less compared to the deposit mobilization from the rural sector of the country. Today, some of the Private Commercial Banks (PCBs) have also started direct and linkage programs with NGOs. Total loan disbursement (cumulative) by these four kinds of institutions till December 2001 was taka 434.55 billion; of which disbursement under Government program was taka 37.77 billion (8.69%), Grameen Bank disbursed taka 154.11 billion (35.46%), other Banks and MF-NGOs disbursed taka 78.41 billion (18%) and taka 164.26 billion (37.80%) respectively (figure-1). Recovery rate of all these organizations excluding formal banks and government sponsored programs stood at 95 percent

Microfinance has expanded more in areas that were poorer, presumably because the better-off geographical areas were covered in the previous decade. Secondly, the reduction in poverty in rural Bangladesh has been much more in upazilas where microfinance membership increased more rapidly. There are other published papers which go beyond the geographical variation of microfinance coverage and effects.



Two well known studies assess short and medium-term microfinance impacts from the borrowers' point of view, using repeated household surveys carried out in rural Bangladesh. Using nationally representative data, their findings suggest that poverty reduction among the borrowers due to microfinance is 1.6 percentage points per year. Moreover, microfinance program have spillover effects on the non-borrowers -- their poverty level goes down by 0.3 percentage point a year.

These schemes are characterized by relatively small loans, a few hundred dollars at most. The repayment period is relatively short, about a year or so. Women are a major beneficiary of their activities, and the destination of the funds primarily includes agriculture, distribution, trading, small craft and processing industries. The administrative structure is generally light and the entire process is participatory in nature. The impact of microcredit lending varies widely between rural areas and urban areas.

Helping to alleviate poverty is the key aim of any individual or group involved in development. The classic diagram of the poverty trap is frequently used to explain why it is so difficult to break out of the cycle of poverty.

Low productivity means that there is no money to invest in those things that could increase output. Banks will not lend even the small amounts required to invest in the means to increase productivity because those on such low incomes can provide no security against the loan. The only money available is often from local moneylenders who charge exceptionally high interest rates that only make the situation worse. In the last 30 years there have been some attempts to change the situation and microfinance is a term used to describe how financial services can be made available to poor people. It has received a lot of support from people involved in international development because it has been seen as an important way of helping millions of people out of the poverty trap. However recent criticisms by some politicians and development experts mean that the advantages and disadvantages of microfinance have been the subject of many discussions and debates. The discussion on the impact of microcredit would be incomplete without referring to the broader package of interventions that are provided with it. MFIs in Bangladesh vary significantly in terms of their noncredit services though they typically include training, related business development services and social messages on education, health and civic rights. One published paper finds that these noncredit interventions raise self-employment profits in rural Bangladesh by 125% while the combined impact of credit and noncredit interventions on self-employment profits is 175%.

### **Rural banking in rural development:**

Like other loan term the rural loan also the same. Here also one party gives loan to another party by consuming less or sale of the assets. When one party need any asset or consumable think then other help this family. This help can be monetary or non monetary. So which goods, money or technology not in the hand of any rural people, they avail it with an agreement to back it is called the rural loan.

In which persons or institutions give money to purchase the above things and collect that money with the interest is called the bankers or Banks. For this which activities are taken by the bank is totally called the rural banking. But interest collect is depending on the bank.

### **Difference between rural loan and agricultural loan**

Rural loan is wider than the agricultural loan which they can use for ant purposes. So rural loan can be 3 types and they are: for productive agriculture, small cottage and small business for consumption of goods or any type of arrangement such as marriage purpose and infrastructure development such as roads, schools, hospitals, mosques, madrasahs, and culverts. On the other hand agricultural loans are sanctioned for agricultural investment purpose investment in seeds, fertilizer, machinery, insecticides etc. with a view to increase the production.

### **Some recommendation to stimulate microfinance properly in rural banking act:**

In recent times, the global microfinance industry has faced a crisis because of the heads-on clash between their original goal of poverty elimination and profit maximization goals of formal financial farms that have brought about a scale-up of the micro finance business. In our country, this crisis is compounded because these forms appear to maximize profits simultaneously borrowing funds at Priority Sector Lending rates which have been set very low in order to benefit the poor micro-borrower. However, this is just one factor that caused the recent liquidity crisis in microfinance. Microfinance institutions have been accused of lending practices that adversely affected the lives of the poor borrower, to the extent that they have been driven to suicide. This has led to government intervention with an ordinance that stopped collection of micro-debt and prohibited any new micro-loans in. The more systemic outcome from this was the lending-freeze by the banks to the micro-finance sector, not just in the state but all across activities:

An examination of the current complaints against microfinance industry practices identifies three problems:

- a) Mis-selling of micro-credit products,
- b) Usurious interest rates, and
- c) Coercive debt collection practices.

From the perspective of financial regulation like commercial and specialized banks; these issues pertain to the distribution of credit services by the MFI to the borrower. This is very different from the issue of prudential regulation of micro-finance that have been proposed as the solutions for the micro-finance crisis. Moreover, if the policy debate is to focus on achieving financial inclusion through the growth of the micro-finance industry, it must address the issue of facilitating a stable own of funds for micro-credit transactions. Thus, banks policy must to focus on improving the linkages of the terms with their customers by strengthening the rights of the micro-finance customer, and simultaneously, of strengthening the linkages of the forms with various funding agencies. Collective experience from financial regulation suggests the following broad focus:

1. Protect the rights of the micro-finance consumer with a primary focus on ensuring quality of financial services distribution.
2. Monitor and supervise the level of disclosure by micro-finance forms to ensure transparency about the risks in the micro-credit portfolios. This would assist funding agencies make informed decisions.
3. Promote the development of the sector by innovations in (a) Linkages between customer and MFI, creating an enabling framework where all types of financial services can reach those who are not financially included. (b) Linkages between funding agency and MFI, creating an enabling framework for all types of formal financial forms to fund micro-finance activities, not just banks.

More innovations are required to strengthen this crucial risk-reduction role of banks that pursue microfinance policy, and in general to offer flexible financial services catering to different types of poor households, in particular for the extreme-poor. One example is a micro-finance programme known as PRIME, implemented by PKSF, which offers a flexible repayment schedule and consumption smoothing, as well as production loans. As a result, a recent evaluation shows that PRIME is more effective than regular microfinance in reaching the ultra-poor, as well as the seasonal-poor.

The rates charged by micro lending schemes are quite high when the risk premium is added. Many of these micro-institutions claim a high rate of repayment. This is attributable to the informal participatory structures, which create an atmosphere in which debtors respect their obligations. While this phenomenon is certainly true of the better-run institutions, it is not possible to verify whether this is a universal feature. There is little by way of "global" research in this area, even though the literature on microcredit has proliferated in recent years.

### **Conclusion:**

Different organized sector can contribute more to reduce poverty and unemployment problem through rural banking and microfinance programmes. Since major portion of our total population are living in rural area and most of them are unskilled people so to convert this vast population into resources and to ensure overall development of our country, rural banking and microfinance can be the solution . But for this our government and other related authorities should take effective and efficient steps so that rural banking and microfinance programmes are expanded more in rural area and the programme design can play a key role to ensure the economic development and socio - economic empowerment . One thing should be remembered that good governance is a primary key of eradicating poverty.



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