

Agricultural and Rural Finance

Annual Agricultural Credit Programme

7.1 As lending to agriculture and rural finance remains a less preferred sector for banks, particularly private commercial banks, annual programme based finance from the NCBs and specialized banks still plays dominant role for the growth of agriculture and rural economy. The agriculture sector achieved a moderate growth of 3.2 percent in FY07 as against post flood high growth of 4.9 percent in FY06 due mainly to lower growth of crop production. Lower disbursement of agricultural loan than previous year was also an imperative in this regard. In order to ensure sustainable growth in these sectors annual programme based indicative disbursement targets are designed. Yearly targets of disbursement are set by lending banks themselves taking into consideration expected demand for credit for the year, previous years' disbursements and the availability of fund.

The significant role played by Grameen Bank and large NGOs through their microcredit for revamping the rural economy in the country is widely acclaimed success. With efficient disbursement and recovery position, their disbursement during FY07 amounting Taka 158.4 billion was 199.3 percent higher than the agricultural loan disbursement of the institutional lenders. So as to strengthen the rural economy, attention of the authorities is now being attracted to the development of SMEs for their potentialities in employment generation and output growth. The Government efforts to promote SME have recently gained ground and disbursement to the sector has encompassed more than 15 sub-sectors.

Disbursement

7.2 The actual disbursement of Taka 52.93 billion during FY07 against the disbursement

Table 7.1 Comparative statement of disbursement & recovery of agricultural loan

(billion Taka)			
Disbursement	FY05	FY06	FY07
1	2	3	4
I. Disbursement (Target)	55.38	58.92	63.51
a) Crops loan (other than tea)	27.88	28.50	30.29
b) Purchase and installation of irrigation equipments	0.23	0.25	0.29
c) Livestock	3.84	4.78	5.34
d) Marketing of agricultural goods	1.51	0.45	0.14
e) Fisheries	2.77	3.02	3.54
f) Poverty alleviation	10.95	13.99	12.64
g) Other agricultural activities	8.20	7.93	11.27
II. Actual disbursement	49.57	54.96	52.93
a) Crops loan (other than tea)	21.08	22.04	22.86
b) Purchase and installation of irrigation equipments	0.03	0.08	0.09
c) Livestock	2.85	2.76	2.67
d) Marketing of agricultural goods	5.56	7.55	0.46
e) Fisheries	1.34	2.31	2.41
f) Poverty alleviation	11.92	15.19	11.89
g) Other agricultural activities	6.79	5.03	12.55
III. Term structure of loans disbursed			
Short term	33.93	46.34	38.66
Long term	15.64	8.62	14.27
IV. Recovery	31.71	41.64	46.76
V. Total outstanding loan	140.40	153.76	145.82
VI. Overdues	57.81	66.53	66.35
VII. Overdue as percent of outstanding	41.18	43.27	45.50

Source : Agricultural Credit & Special Programmes Department, Bangladesh Bank.

target of Taka 63.51 billion was 3.69 percent lower than the total disbursement of Taka 54.96 billion of FY06. The target attainment in FY07 was 83.34 percent as against 93.28 percent in the previous year. The disbursement of FY07 fell short the target due mainly to non-achievement of disbursement targets in crops loan, purchase and installation of irrigation equipments, livestock, fisheries and poverty alleviation. On the other hand, disbursements

have exceeded the targets both in marketing of agricultural goods and other agricultural sectors in FY07.

The total outstanding loan in the agricultural sector in FY07 decreased by Taka 7.94 billion or 5.16 percent to Taka 145.82 billion over the previous year's level. The decrease in outstanding balance was due to increase in recovery of the outstanding loan of banks. Table 7.1 shows the comparative position of overall disbursement and recovery of agricultural loans and Charts 7.1 and 7.2 show targets and actual disbursement of agricultural loan respectively in FY07.

Two specialized banks viz. BKB, RAKUB, four NCBs and BRDB played key roles in disbursement of agricultural and rural finance, which fell short of targets by 12.86 percent, 7.88 percent, 33.46 percent and 7.36 percent respectively in FY07 (Table 7.2). About 73.04 percent of disbursement was as short term lending and the rest 26.96 percent was in the form of long-term loans for irrigation equipments, agricultural machinery, livestock etc. The lion's share of the short-term credit was for production of crops and poverty alleviation programmes constituting 59.13 percent and 30.76 percent respectively of total short term loans (Table 7.1).

Recovery

7.3 During FY07 recovery of agricultural credit increased by 12.30 percent to Taka 46.76 billion from the recovery made in FY06. The increase in recovery position was attributed mainly due to special drive taken by the banks and concerned institutions for recovery of loans. In the pace of Government decision to reschedule the overdue agricultural loans, particularly in the flood affected areas in 2004, the banks and institutions played praiseworthy role for the recovery of agricultural loans. Recovery of agricultural loans of banks including BRDB, which is also involved in agricultural lending improved in FY07. The percentage of overdue agricultural loan, however, increased from 43.27 percent at of end June 2006 to 45.50 percent at of end June 2007 (Table 7.2).

Chart 7.1

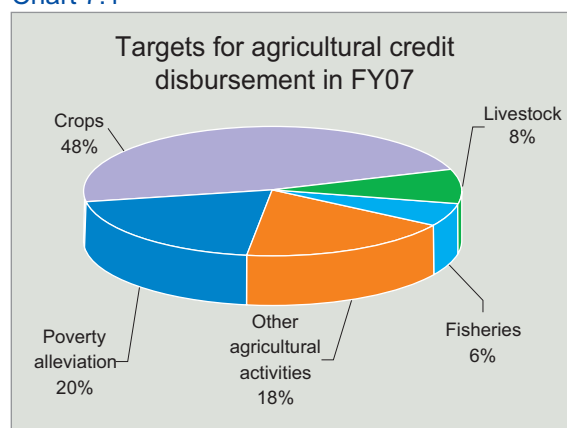
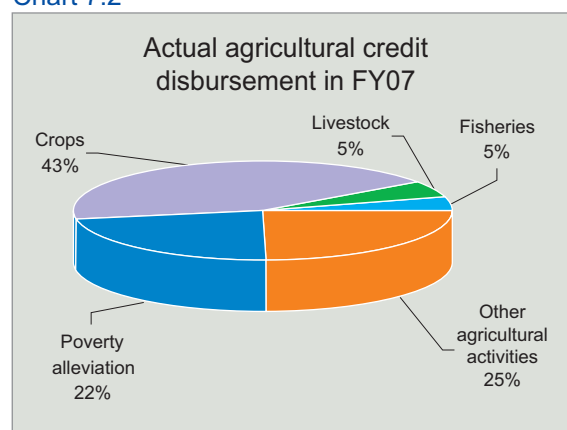


Chart 7.2



The incentive measures introduced previously for recovery of stuck-up loans also continued in FY07, which, inter alia, included persuasion through various types of fairs, negotiations, demand notice, intensive supervision etc. It is imperative that banks should strengthen their recovery drive and continue incentive measures so that the recovery of agricultural loan get improved further in the years to come.

Sources of Agricultural Finance

7.4 The main sources of finance in agriculture are still the state owned banks. As such specialized banks viz. BKB and RAKUB, nationalized commercial banks and BRDB are dominant players in the area of agricultural credit. BKB had the largest share like in previous years in annual disbursement of agricultural loan. In FY07 BKB alone disbursed around

Table 7.2 Agricultural credit performance by lenders – FY07

(billion Taka)						
Lender	Disbursement target	Actual disbursement	Recovery	Overdue	Outstanding	Overdue as % of outstanding
1	2	3	4	5	6	7
NCBs	15.45	10.28	12.46	29.32	49.11	59.70
BKB	31.50	27.45	18.83	26.10	61.44	42.48
RAKUB	8.00	7.37	8.51	5.90	24.45	24.13
BRDB	8.42	7.80	6.90	2.58	8.34	30.94
BSBL	0.14	0.03	0.06	2.45	2.48	98.79
Total	63.51	52.93	46.76	66.35	145.82	45.50
Summary						
FY07	63.51	52.93	46.76	66.35	145.82	45.50
FY06	58.92	54.96	41.64	66.53	153.76	43.27
FY05	55.38	49.57	31.71	57.81	140.40	41.18
FY04	43.79	40.48	31.35	62.65	127.06	49.31
FY03	35.61	32.78	35.16	65.26	119.13	54.78

Source : Agricultural Credit & Special Programmes Department, Bangladesh Bank.

51.86 percent of the total disbursement followed by NCBs at 19.42 percent. The NCBs overdue loan as percentage of their outstanding loan stood at 59.70 percent at the end of FY07, while overdue of BRDB, BKB and RAKUB recorded 30.93 percent, 42.48 percent and 24.13 percent respectively of their outstanding during the year.

The private sector banks' lending to agricultural sector in FY07 increased significantly to Taka 11.17 billion from Taka 3.34 billion in FY06. The contribution of the private sector banks in agricultural lending, however, still remained modest compared to agricultural loan disbursement of Taka 52.93 billion by the NCBs and specialized lenders. In addition to risk and uncertainties associated with the agricultural and rural finance, the shortage of required manpower, high cost of undertaking intensive supervision and monitoring and lack of information or wrong information about customers/borrowers may have discouraged private commercial and foreign banks to dispense agricultural/rural credit. As there are ample opportunities of investment in agro based sector, these banks should include the sector in their business plan by removing aforesaid bottlenecks.

The burden of unrealized large amount of agricultural loan is responsible for acute shortage of resource base of the NCBs and specialized banks which construed obstacles in their policies

of recycling of resources for this sector. These banks should therefore, gear-up recovery drive to minimize their resource gap not only for extending more support to agricultural sector, but also to do away with the policies of resorting to refinance from the central bank in this regard.

Bangladesh Bank's Refinance against Agricultural Loans

7.5 No banks or institutions availed of refinance facilities from Bangladesh Bank in FY07. An amount of Taka 3.47 billion was recovered against past refinance loan due from different banks and institutions leaving an outstanding balance of Taka 55.07 billion at end of June 2007 for future recovery. Details of Bangladesh Bank's refinance to different institutions are shown in Table 7.3.

Agricultural Credit Projects/Programmes under Bangladesh Bank Supervision

7.6 Some self as well as donor financed agricultural projects/programmes, of national interest, were under active supervision of Bangladesh Bank during FY07. A total of Taka 0.09 billion was disbursed and Taka 0.05 billion recovered during FY07 under a few such ongoing projects/programmes viz. the Marginal and Small Farm Systems Crops Intensification Project (MSFSCIP) and Crop Storage Credit Project. Apart from these, credit disbursement

Table 7.3 Bangladesh Bank's refinance against agricultural loans

Particulars	(billion Taka)								
	FY05			FY06			FY07		
	Refinance	Repayment	Outstanding	Refinance	Repayment	Outstanding	Refinance	Repayment	Outstanding
BKB	5.00	3.00	39.35	-	1.77	38.79	-	2.23	37.75
RAKUB	2.66	1.15	15.16	1.43	1.01	17.04	-	1.20	16.82
BSBL	-	-	0.57	-	0.14	0.43	-	0.04	0.38
BRDB	-	-	0.12	-	-	0.12	-	-	0.12
Total	7.66	4.15	55.20[@]	1.43	2.92	56.38[@]	-	3.47	55.07[@]

Source : Agricultural Credit & Special Programmes Department, Bangladesh Bank.
[@] =Include interest.

under the Northwest Crop Diversification Project started in FY04. The Project was launched in December 2000 and was scheduled to be completed in 2008. On the success of the project, ADB extended the project scope and loan closing date from 31 December 2008 to 31 December 2009. The project was funded by ADB (Taka 2.5 billion) with a credit component of Taka 1.2 billion for financing production and marketing of high value crops in sixteen northwestern districts. The fund has been provided to RAKUB for distribution among the farmers and agro-based enterprises through four NGOs on reimbursement basis. Under the project a total amount of Taka 1.26 billion has been disbursed and Taka 0.41 billion was recovered up to the end of June 2007. In FY07 recovery of Taka 1.52 billion was also made under a number of closed projects (Second Aquaculture Development Project, Shrimp Culture Financing Scheme and North-west Rural Development Project) leaving an outstanding balance of Taka 1.47 billion as of end June 2007 for future recovery.

SMEs and Microfinance Development

7.7 Despite high dependence on agriculture, manufacturing sector is growing significantly in Bangladesh. Over the years share of agriculture in GDP is declining with manufacturing sector being the driver of growth. Manufacturing sector especially Small and Medium-sized Enterprises (SMEs) in manufacturing has been contributing at a consistent rate over the last decade. Growth of SMEs can reduce poverty through acceleration of economic growth, removal of biases against labour intensive production, creation of employment opportunities for the

low skilled workers and formation of linkage with small suppliers. Therefore SME sector deserves more attention and focus to foster economic growth, employment generation and poverty reduction (Box 7.1).

In FY07 production under the following SME units registered robust growth; dairy product, leather product, footwear, wooden furniture, paper and paper product, mineral product, agro processing food, software, plastic goods, pharmaceuticals, knitwear, light engineering etc. However, SMEs in Bangladesh are dominated by trading. The key reasons for SMEs not entering the manufacturing sector in a major way are financial constraints, dismal state of utilities, technology and policy discriminations. Bank and other financial institutions generally prefer large enterprise clients because of lower transaction costs, and greater availability of collateral. SMEs also fall outside the reach of microfinance schemes, and are thus compelled to depend more on formal sources of funds at much higher interest rates. Other interrelated problems like shortage of short and long-term finance, lack of modern technology, lack of skilled manpower, marketing problem, lack of promotional support service etc. still stand as obstacles to its faster growth. Moreover, their development faces serious competition in open economy regime of the country. Bangladesh Bank has adopted preferential lending policy to promote SME sector in line with the Government development policies.

Financing of Small & Medium Scale Enterprises

7.8 An amount of Taka 2.27 billion has been refinanced to different banks and financial Institutions under some schemes in FY07 and

Box 7.1

Role of Banking Sector in Financing SMEs

In Bangladesh, financing small and medium enterprises (SMEs) from banking sector is a long-standing demand that has been high on the agenda of the economists and the policymakers. There are certain recurrent themes in this demand:

History shows that the Asian tigers such as Singapore, Taiwan, South Korea, Hong Kong, Malaysia and Thailand, which were once economically similar to the majority of the LDCs, have made giant strides on the path of economic development by establishing and promoting SMEs.

In Bangladesh the SMEs account for about 45% of manufacturing value addition. They account for about 80% of industrial employment, about 90% of total industrial units and about 25% of total labor force. Their total contribution to export earnings varies from 75-80%. Based on the Economic Census, 2001-2003, the total number of SMEs is estimated at 79754 establishments, of which 93.6% are small and 6.4% are medium. The 2003 Private Sector Survey estimated about 6 million micro, small, and medium enterprises defined as enterprises, with fewer than 100 employees which contributed around 20-25% of GDP.

The financing of SMEs is all the more important in a fast-changing emerging economy because of the speed of innovation and adaptability. Innovative SMEs with high growth potential (many of them in high-technology sectors), have played a pivotal role in raising productivity and maintaining competitiveness in recent years.

Obstacles to SMEs accesses to Bank Financing: The SMEs' demand for bank loan, especially, medium and long term financing is relatively high. However, banks are reluctant to extend loans, especially, term loans to SMEs. The reasons for banks' reluctance to extend loans to SMEs are : (1) perception that the current legal system is unable to protect their interests; (2) funding costs are relatively high (3) shortage of access to long-term capital; (4) inability to conduct proper due diligence and the current unavailability of information (such as, corporate records and audited financial information) on loan applicants; and (5) inability to assess, manage and price risks associated with term loans due to lack of experience and skills.

Banks Credit to Small Scale Industries, 2001-2006: Limitations to the analysis of bank credit to SMEs originate from the lack of data, precisely, on banks' allocation of credit to SMEs. Without appropriate data, no analysis will be able to identify and resolve the problems. This is true in the absence of clear definition of SMEs in the banking circle relative to national definition. However, we can assume that there is a strong positive correlation between scheduled banks advances to small, cottage and service industries, and financing and economic development of SMEs, which can be thought of as "trend" of the bank financing for SMEs.

From the analysis of data, we found that of the total outstanding level of scheduled bank advances to small, cottage and service industries account for around 2-3%, while large and medium industries account for around 16-18%. In addition, small, cottage and service industries suffered from wide fluctuation of credit growth, 9.8% in June 2002, 17.8% in June 2003, 36.3% in June 2004, 6.0% in June 2005 and 20.7% in June 2006. The total outstanding bank advances to small, cottage and service industries increased to Taka 3890 crore in June 2006 from Taka 1725 crore in June 2001. In contrast, large and medium industries enjoyed a steady growth of bank credit inflow, total outstanding bank advances to large and medium industries increased to Taka 46382 crore in June 2006 from Taka 22639 crore in June 2001, indicating a growth of 14.8% in June 2002, 14.0% in June 2003, 10.8 % in June 2004, 18.2% in June 2005 and 19.5% in June 2006.

Of the outstanding advances to industries, even though small, cottage and services industries exhibited higher growth in "other than working capital" financing compared with that of large and medium industries, small, cottage and service industries had a wide fluctuations in credit growth. On the other hand, in case of "working capital" financing both types of industries showed a declining trend in recent years. The share of "other than working capital" for the small, cottage and services industries in total outstanding advances to industries increased to 10.0% in June ,2006 from 5.6% in June 2001, while the share working capital slipped to 4.7% in June 2006 from 11.3% in June, 2001. The main factors were the sharp slowdown in the growth of "working capital" financing for small, cottage and services industries, which was 15.3% per annum for the period of 2001-2006 compared with annual growth of 19.2% of "other than working capital", and a sharp increase in the annual growth of "working capital" for large and medium industries, which was 34.6% against 5.1% growth of "other than working capital".

The Role of Bangladesh Bank: Considering the "financing gap" in the SME sector, Bangladesh Bank among other initiatives, introduced a refinance scheme to increase the SMEs' access to bank finance with lower cost. Bangladesh Bank's refinance scheme for SMEs started with Taka 100 crore (with effect from 2 May 2004) which was later increased to Taka 200 crore. To support the promotion of SMEs, the International Development Agency (IDA) of the World Bank Group provided USD 10 million to Bangladesh Bank under the 'Enterprise Growth and Bank Modernization Project

Role of Banking Sector in Financing SMEs

Contd.

(EGBMP). These initiatives were joined by the Asian Development Bank (ADB) at the beginning of FY06. The ADB provided USD 30 million under 'Small and Medium Enterprise Sector Development Programme. At the end of June 2007, the amount of refinances from all the institutions (BB, ADB, and IDA) stood at Taka 453.91 crore, of which, amount from BB is Taka 251.25 Crore (55.4%), from IDA Taka 125.28 Crore (27.6%) and from ADB Taka 125.28 Crore (17.0 %).

The term-wise analysis of refinance statistics up to the end of June 2007 shows that medium term loans constitute the largest share of refinancing (Taka 204.26 crore) followed by long term loans (Taka 136.14 crore) and working capital (Taka 113.50 Crore). Most of the SME finances availed by banks went into working capital and medium term loans whereas those availed by NBFIs went into long term and medium term loans. On the other hand, sector wise analysis of refinance statistics of the same period shows that commercial loans make the largest share of refinancing followed by industrial sector and service sector credit. Although NBFIs are the major players in SME finances from the funds provided by BB, IDA and ADB, banks are seen to have financed more enterprises than NBFIs.

Conclusion: The financing of SMEs by the scheduled banks is explicitly supported by the refinancing facilities provided by Bangladesh Bank. The scheduled banks generally avoid working capital financing for SMEs, while the refinancing facilities help in favor of term loans. However, compared to their contribution to the economy, the term financing is also quite low in relation to investment demand in this sector. It is, therefore, crucially important to fill up the gap in financing SMEs in order to unleash the full potential of SMEs.

total refinance under these schemes stood at Taka 4.54 billion up to end June 2007. Bangladesh Bank's refinance facilities to banks during FY07 for promoting small and medium scale industrial enterprises under some special schemes and programmes are shown below:

a) Refinance Scheme for Agro-processing Industries

For financing establishment of agro-processing industries in the areas outside of Divisional Head Quarters and Narayanganj town, Bangladesh Bank launched a scheme of Taka 0.5 billion from November 2001 out of its Industrial Credit Fund. Refinance facilities under the scheme were provided to banks and financial institutions at the Bank Rate. An amount of Taka 0.64 billion has been disbursed under this scheme till end June 2007.

b) Refinance for Small Enterprises

Bangladesh Bank introduced a refinance scheme named Small Enterprise Fund (SEF) of Taka 2.00 billion out of its own fund for supporting the development of small enterprises in the country. Refinance facilities under the scheme were extended for the banks and financial institutions at Bank Rate against their financing to the small entrepreneurs, usually left out by the formal sector financing. The scheme demonstrated a high market demand. Recovery made out of the refinanced loan will be used as a revolving fund for financing SME sector. An amount of Taka 1.15 billion has been refinanced

to different Participatory Financial Institutions (PFIs) under this fund in FY07 and total refinance under this fund stood at Taka 2.51 billion upto end June 2007.

In the meantime, the IDA wing of the World Bank has provided an additional amount of USD 0.01 billion (Taka 0.58 billion) to reinforce this scheme under a Development Credit Agreement signed with the Government of Bangladesh for financing the development of small enterprise sector of the country. In addition, Government of Bangladesh allocated an amount of Taka 0.58 billion under the said agreement. An amount of Taka 1.01 billion has been received combining the IDA credit fund and Government of Bangladesh fund for refinancing. An amount of Taka 0.54 billion has been refinanced to different PFIs under this fund in FY07 and total refinance under this fund stood at Taka 1.25 billion upto end June 2007.

Apart from these, Asian Development Bank has also agreed to provide an additional amount of USD 0.03 billion into the scheme under a Loan Agreement with the Government of Bangladesh to develop the SME sector in Bangladesh. Refinance out of ADB fund was about Taka 0.58 billion in FY07 and total refinance under this fund stood at Taka 0.77 billion upto end June 2007.

Microcredit Operations of NGOs and the Grameen Bank

7.9 Originating from Bangladesh, microcredit turned into microfinance by now has evolved as

a very effective instrument of poverty eradication, hitherto helped much in the achievement of MDGs and improvement of the quality of life of the rural poor throughout the world. Microcredit programme however, have proven to be effective against poverty, as they address the problems at the grassroots level. In Bangladesh, Microcredit Programmes (MCPs) are implemented by various formal institutions (nationalized commercial banks and specialized banks), specialized government organizations and Non Governmental Organizations (NGOs). The total coverage of MCP is approximately 30.09 million borrowers while near about 90 percent of the clients of this sector are female. Microcredit is increasingly gaining credibility in the mainstream finance industry and many traditional large finance organizations are contemplating microcredit projects as a source of their future growth.

Like earlier years microcredit operations grew significantly in FY07 with efficient recycling of lending resources, higher disbursement and recovery, though the MFIs are now facing a number of problems, such as, absence of /or little accountability of their operation, no linkage among the stakeholders/providers of microcredit, relatively higher interest rate for microcredit etc.

Microcredit of Grameen Bank and NGOs like; BRAC, ASA and Proshika (the three big NGOs-MFIs) have got coverage all over the country. These three organizations and Grameen Bank together occupy more than 80 percent of the total market share of microcredit both in terms of coverage and disbursement (Table 7.4).

It appears from Table 7.4 that microcredit operations grew rapidly in the country like previous years with 22.9 percent and 38.8 percent increase in disbursement and recovery in FY07 compared to 41.6 percent and 47.7 percent increase respectively in FY06. Their overdue as percentage of outstanding loan marginally decreased from 4.1 percent in FY06 to 3.6 percent in FY07.

Recycling of lending resources of the microcredit providers in FY07 like previous years was about 1.6 times of their outstanding loans. The microcredit providers own resources

Table 7.4 Microcredit operations of the Grameen Bank and large NGOs

(billion Taka)			
	FY05	FY06	FY07
1. Disbursement	91.0	128.9	158.4
i) Grameen Bank	31.5	45.9	50.2
ii) BRAC	29.1	36.9	52.7
iii) ASA	27.7	43.0	52.3
iv) PROSHIKA	2.7	3.1	3.2
2. Recovery	78.6	116.1	161.2
i) Grameen Bank	25.8	37.7	48.0
ii) BRAC	25.8	37.5	62.6
iii) ASA	24.2	37.4	47.1
iv) PROSHIKA	2.8	3.5	3.5
3. Outstanding loans	59.4	80.6	100.8
i) Grameen Bank	23.5	31.7	33.8
ii) BRAC	16.6	20.9	32.0
iii) ASA	15.7	23.2	28.0
iv) PROSHIKA	3.6	4.8	5.0
4. Loans overdue	3.1	3.3	3.6
i) Grameen Bank	0.2	0.7	0.8
ii) BRAC	1.8	0.9	0.9
iii) ASA	0.1	0.2	0.3
iv) PROSHIKA	1.0	1.5	1.6
5. Overdue as percentage of outstanding	5.2	4.1	3.6
i) Grameen Bank	0.9	2.2	2.4
ii) BRAC	10.8	4.3	2.8
iii) ASA	0.6	0.9	1.1
iv) PROSHIKA	27.8	31.3	32.0

Source : Grameen Bank and respective NGOs.

and PKSF (Palli Karma Shahayak Foundation) respectively account for nearly half and about one quarter of their resources; rest of their funds come from loan from banks, large NGOs and external donors. The loans given by PKSF to 248 POs (Partner Organizations or NGOs) stood at Taka 13.5 billion in FY07 against Taka 6.9 billion in FY06.

On the other hand, agricultural credit disbursements by the NCBs and specialized loan providers, in line with the previous trends, remained constrained at around 36.3 percent of their outstanding loans in FY07 against 35.7 percent in FY06. This is because a large portion of their loans to agricultural sector was stuck-up. Overdue as percentage of outstanding of institutional agricultural loan providers increased from 43.27 percent in FY06 to 45.50 percent in

FY07. However, Microcredit programme has to be integrated with macroeconomic policies. Growing evidences of the beneficial impact of microcredit are found in the areas such as healthcare, family planning and schooling behaviour, especially for female children. The phenomenal growth of this sector both in terms of outreach and product development encouraged the Government to form a unit namely Microfinance Research & Reference Unit (MRRU) in 2000 under the supervision of a National Steering Committee headed by the Governor of the Bangladesh Bank to formulate some guidelines and to suggest a regulatory framework for this sector. As per suggestions given by the committee the Government passed

a law known as "Microcredit Regulatory Authority Act 2006, effective from 27 August 2006 (Box 7.2).

According to the law no MFIs are allowed to work in the country without getting license from the Authority. The Authority has also been given power to monitor and supervise all licensed MFIs. The former MRRU has been transformed into a secretariat of the "Microcredit Regulatory Authority (MRA)" which has started working separately as an independent body. A multi donor supported project (PROSPER), led by British DFID, will provide financial support to the MRA for seven years to build up the institution and formulate its policies.

Box 7.2

Microcredit Regulatory Authority Act, 2006

As microfinance has, by now, become a nationwide activity in Bangladesh, the issue of a regulatory framework has come to the forefront. The Microcredit Programme (MCP) in Bangladesh has been implemented by various formal financial institutions (nationalized commercial banks and specialised banks), specialised government organizations and Non Governmental Organizations (NGOs). These organizations, in a body, constitute Microfinance Institutions (MFIs) sector which, in turn, form the most important segment of the rural finance market in the country. The sector witnessed spectacular growth in terms of both the number of MFIs and MFI-membership during the last two decades. The growth rate was over 70 percent in terms of horizontal expansion of microcredit borrowers during June 2003-06, and the overall coverage of MCP borrowers nationwide stood to the tune of 30.09 million since the inception of the programme.

Up until 27 August 2006, NGO-MFIs as financial institutions remained outside any formal supervisory or monitoring system. However, the phenomenal growth of this sector, as described above, both in terms of outreach and product development encouraged the government to form an outfit namely 'Microfinance Research and Reference Unit (MRRU)' in 2000 under the supervision of a National Steering Committee headed by the Governor of Bangladesh Bank to formulate guidelines and suggest a regulatory framework for this sector. Initially this Committee prepared a set of guidelines which was implemented by the Unit. This helped the sector to get prepared for future regulatory environment that would be in place and to build up a friendly communication between the sector and the policy-makers. Again, the Committee prepared a draft of another regulatory mechanism for the sector after consultation with the sector representatives and submitted the same to Government for approval. The Government passed the law in July 2006 which came to be known as Microfinance Regulatory Authority Act, 2006 and came to be effective from 27 August 2006. Under the law, Government have established an independent Microcredit Regulatory Authority and constituted its Board of Directors, the Governor of Bangladesh Bank acts as the ex-officio chairperson. The law is mainly divided into two parts: the first part describes the functions of the Authority while the second describes the functions and duties of the MFIs.

According to the law all active MFIs (including those started working before the effective date of the law) should apply for license from the Authority within six months from the effective date of the law (within 26 February 2007). The law mentions that no MFI would be allowed to work within the country without getting license from the Authority that has been given power to monitor and supervise all licensed MFIs. It also has the power to devise elaborate rules and policies related to the operations of microcredit including conditions of licenses, policies related to spending surplus income, area of operations, guidelines of internal and external audit and accounts, collection of deposits etc. The Authority has the mandate to take punitive measures if any institution does not comply with any of the provisions of the law. The former MRRU has been transformed into the Secretariate of the Microcredit Regulatory Authority. Bangladesh Bank has been providing support to the Authority to attain its full institutional shape.