

Ownership and Governance of the MFIs in Bangladesh

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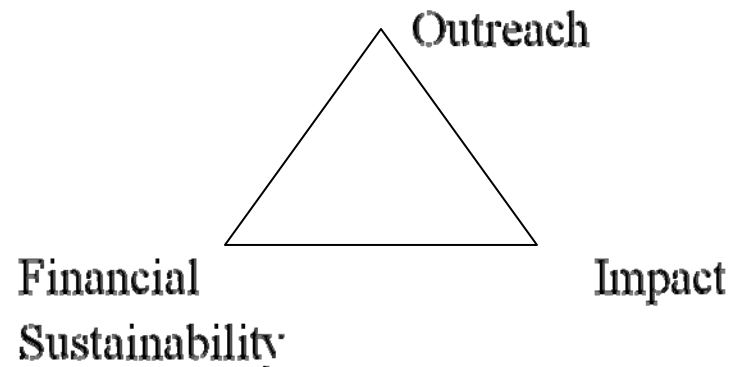
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Different Ownership Models of MFIs in Bangladesh

- Ownership refers to property rights:
 1. Right to invest the capital.
 2. Right to freely exchange the products of that capital.
 3. Right to income or profit from the investment.
 4. Right to accumulate wealth and inherit.
- The capital of MFI originally came from: Donors/Government.
- Now it comes from diverse sources: Savings of borrowers/clients/public, Surplus income reinvested, subsidized credit from wholesale funding agency and commercial loan.
- Ownership right of MFIs over this diverse loanable fund depends on the contractual responsibilities, laws, regulations, customs, etc. of the concerned country, and historical evolution of the MFIs.

An Ideal MFI

- **An ideal micro credit model is to ensure 3 things known as the Golden Triangle Model:**



- **Publicly owned commercial and specialized banks, privately owned commercial banks in Bangladesh failed in all 3 aspects.**
- **Cooperatives, credit unions, community based organizations, self help groups, etc., has a limited outreach and do not cover the poor alone.**
- **The Grameen Bank a unique model that has succeeded in all 3 criteria. Also helped to create many businesses with a social purpose.**
- **NGOs, the performance is mixed.**

Objective of the Study

- To examine the historical pattern of development of the different types of the MFIs and major constraints faced by them.
- To suggest a feasible and desirable mode of ownership and governance of the NGO-MFIs to achieve the golden triangle.
- To Suggest MRA how to facilitate the achievements of the NGO-MFI.

Case Studies of MFIs: Sample & Methodology

- Three types of MFIs: (i) the Grameen Bank, (ii) BRDB and (iii) NGOs.
- Selected 1 large and successful NGO (LS), 1 large and failed NGO (LF), 1 medium successful (MS), 1 medium failure (MF), 2 NGOs with community responsibilities.
- Data gathered through face to face interviews with the top executives.
- Also used reports, documents provided by the org. and official data of the MRA.

Case Studies of MFIs: Major Findings

Large and Successful (LS):

- Tried to become self reliant through surplus generation programmes and then cross subsidize social programmes with surplus.
- LS could not completely fill the fund gap and started to take loans from other costly sources to finance micro loan funds. Preferred Commercial Bank fund to PKSF for more flexibility.
- Board of Governors final decision maker, which is headed by chairman who is the founding father. Under him there are 4 directors. The ED is in charge of microfinance and all social programmes. There is almost absolute authority of the topmost boss, the Chairman.
- Pre condition of Loan: (i) formation of group and regular meeting attendance by members, (ii) compulsory participation in training (iii) Compulsory weekly savings deposit, (iv) regular Accounts maintaining, (v) opening an account in any bank (vi) preparing a feasible and viable project for using loan, (vii) to put at least 10% of loan in collective fund after disbursement.

Case Studies of MFIs: Major Findings

Large and Successful (LS)

- Interest rate on Loan: flat rate -15%, Effective rate -30% percent.
- Interest rate on Savings: 5% rate -general regular savings, 12% - long term fixed deposits (5 yrs term).
- Loan Amount: (i) ranges from 2000 tk to 10000tk. (ii) ranges from 10000tk. to 20000 tk, (iii) above 20000tk.
- Total Operating Cost per 100 tk. loan outstanding = 22.52 tk.
- $OSS = \text{Financial Income} / (\text{Financial Expenses} + \text{loan loss provision} + \text{operating expenses}) = 97.77\%$

Case Studies of MFIs: Major Findings

Large & Failure (LF):

- Major social activities similar to LS: non formal education, training, landless group formation and movement for Khas land, organizing slum dwellers, self help groups with saving and lending provisions, etc.
- Initially LF was ready to accept only logistic support from donor. This didn't sustain for long.
- Later shortage of cheap money forced LF to become more market oriented. Bought land. Invested in many risky commercial enterprises. Some were profitable some loosing.
- Employees of loosing concerns had to be cross subsidized by the profitable sector's surplus.
- Illegitimate use of the surplus. Profitable sector punished, losing sector rewarded.

Case Studies of MFIs: Major Findings

Large & Failure (LF):

- The strength of LF is social network and strategic rapport with local people/leaders and connection with civil society.
- Main weakness was politically ambitious Chairman and lack of power of board of governors. Other factors: Conflict of leadership in the executive board, Lack of formal and impersonal rules of using the surpluses from various sources of income, discriminatory reward and punishment structure, Withdrawal of the support of the donors and the political authority, Breaking the laws, litigation and counter litigation.
- Now Police has taken custody of the head office.

Case Studies of MFIs: Major Findings

Medium and successful (MS) & Medium and failure (MF):

- MRA defined the medium NGO in terms of their borrower outreach between 50000 and 100000. Large NGO-MFIs have more than 100000 borrowers.
- **MS** has lower cost ratios than MF and financially MS is sounder and more viable. MS has a mission of a pure financial institution.
- MF has overspent on social services, suffered from miscalculated investments and have become non viable.

Case Studies of MFIs: Major Findings

Comparative Picture: MS Vs. MF

Cost and Profit Ratios of the Sample Medium NGO-MFIs (2008)

Ratios	NGO-MFI	
	MS	MF
Total Financial Cost	3.59	4.05
Total Operating Cost/100 tk. Outstanding Loan	12.25	27.63
Operation Self Sufficiency	114.16	59.28
Return On Asset	1.91	{-} 2.85

Note: Financial Cost Ratio = Financial Cost/ Av. Outstanding Loan

Total Operating cost = Financial Cost + General Administrative Cost.

Operation Self Sufficiency = Financial Income/ (Financial Expenses + Loan Loss Provision + Operating Expenses) * 100.

Return on Asset = Net Profit / Av. Total Asset. [Source: MRA, June 2008]

Case Studies of MFIs: Major Findings

Community based NGOs (C1 & C2)

- C1 works among the members of a religious community scattered all over the country. It has also international connections and fund support. It is a part of an international religious net work.
- Because of completely cost less donation financial cost burden of micro credit is minimum. It has not taken any loan from PKSF or any other commercial bank loan to expand its outreach.
- Most of the employees and the chairman of this organization are religiously motivated and CEO ship is not considered a matter of privilege.
- Alarmingly low rate of repayment, average repayment rate only 91 percent but still financially viable..

Case Studies of MFIs: Major Findings

Community based NGOs (C1 & C2)

- For C2 initially targeted the extreme poor people of the tribal community only and indigenous people were given loans at a flat rate of 10 percent interest per year and loan size ranged from 500tk. to 2000 tk. only. But the poor Bengali neighbours had to pay 12 % interest rate and loan size (3000 to 3500 tk.). General repayment rate is 98%.
- The salary structure of C2 does not follow the government scales. The highest salary paid is reported to be 70000 tk. per month and the lowest is 5500 tk..
- Financial viability at strain. Started taking loan from PKSf at only 1 percent rate of interest.

Policy Recommendations

Turning NGO-MFI into Poor owned banks

- GB model: Poor borrowers and government owned bank. Achieves all three goals.
- Main strength: Savings mobilization, lowest rate of interest, Government salary structure, a benevolent leadership. Earning profit and distributing dividend.
- Democratically elected representatives and Government nominated chairman in the 13 member governing board. 9(borrowers)+3(Government)+1(MD)
- Large NGO-MFI by turning themselves into poor man's corporation can achieve all these advantages.
- Weakness: Who Owns GP like other sister concerns? Very indirectly by GB! Tele Nor (A MNC) and Grameen Telecom (35%) set up by dint of grameen kallyan's bank guarantee ie. will accept liabilities of GT---- grameen kalayan is an endowment fund set up by GB with foreign grants----GT is run by a board of directors coming from GB employees and the chairman is Dr. Yunus.
- Huge profit of GT is presently being used for social purposes eg. Grameen Health Care project, Grameen IT initiatives and GB tel. ladies.
- Social benefit largely depends on one man.

Policy Recommendations

Ownership & Governance Aspects:

- The composition of the members of the board of directors. Ornamental or effective?
- The power of the CEO and the Chairman and how far they can be controlled by the board of directors.
- The mode of control of other commercial sister organizations under the NGO. Trust/Not for profit Company/ For Profit company/Mixed ownership
- The M.O.U. between the NGO-MFI and those commercial sister organizations must be examined.
- Need to know the pattern of internal flow of money to find out who supports whom or/and who draws money from whom.

Policy Recommendations

Financial Sustainability

A final result dependent upon a complex set of financial variables:

- Donation plus fund formed out of retained earnings.
- The nature of the savings portfolio and interest paid.
- The use of those savings. Micro Credit or elsewhere?
- The other sources of fund of micro credit and their rates of interest.
- Financial cost ratio.
- Portfolio yield. May be high or low? Function of interest rate.
- Interest spread of the NGO-MFIs. = Portfolio yield-fund cost=Must cover administrative cost plus profit margin.
- **Determination of the normal average profit margin prevailing in the sector.**
- **Determination of the average general Administrative cost per 100 tk. outstanding credit.**

The self sufficiency ratio= Financial Income/ (Financial Expenses + Loan Loss Provision + Operating Expenses) * 100.

Policy Recommendations

Broader Outreach

- The Average loan size and what proportion of loanees are coming from the relatively poorer sections of the community.
- Extent of especial area coverage e.g. rural areas, remote areas, crisis prone areas, etc.
- Coverage of desirable sectors e.g. “missing middle”, etc.
- List of indirect social services and/or projects. Who are getting the benefits and the number of beneficiaries?
- Direct Complains received from the two neglected stakeholders: employees of the NGOs and the client borrowers of the NGOs.

Policy Recommendations

Future challenge before MRA :

- To build up a capacity to collect and process all these information with an absolute uncontroversial credibility.
- To make a comprehensive multi dimensional credit rating of all the licensed NGO-MFIs on the basis of all these information and regularly publish them in the market.
- Independent Communication Channel with the employees and borrowers.