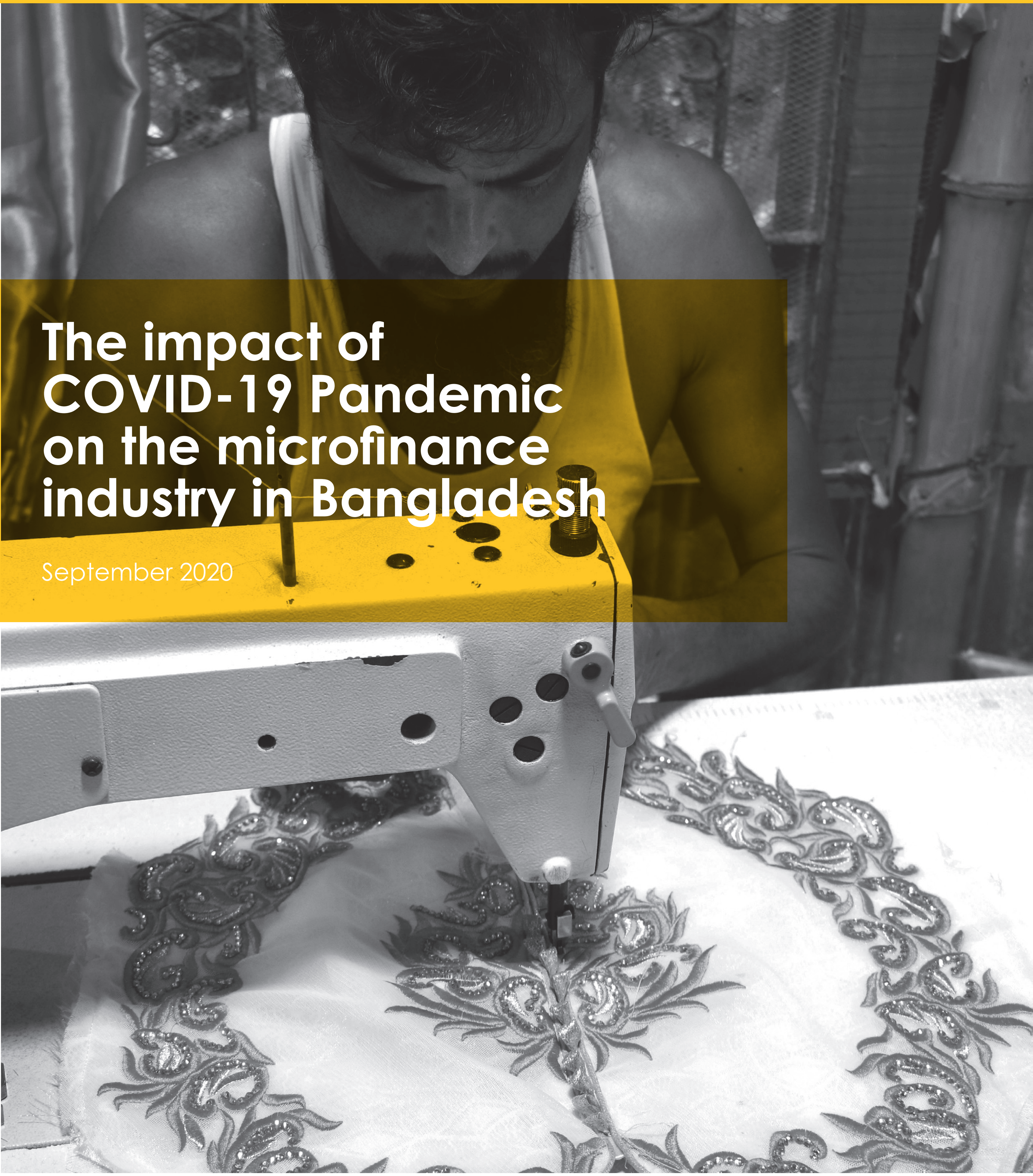
Business Finance for the Poor in Bangladesh



The impact of COVID-19 Pandemic on the microfinance industry in Bangladesh

September 2020

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1. Background to the Assessment

The assessment of the microfinance industry by BFP-B is a much needed and timely initiative to obtan a comprehensive understanding of the impact of COVID-19 on Bangladesh's microfinance institutions, and of this pandemic's impact on development of the Microfinance Credit Information Bureau (CIB), which, BFP-B is assisting Bangladesh Bank and MRA to set up. As part of this exercise, BFP-B has conducted several interviews with small MFIs and reached out to 16 major MFIs through questionnaires to understand:

- The impact of Covid-19 on MFI's loan portfolio
- Liquidity situation of MFIs
- Government policy changes to address challenges of low-income communities

According to latest IMF country focus report, up until the COVID-19 pandemic, Bangladesh's economy had been growing close to 7 percent a year on average over the past decade. In light of the recent events, it is predicted to see a fall-off in grow to around 2 percent. Assuming the impacts of pandemic have curtailed, economic activities are expected to recover near the end of 2020 and 2021, it is predicted that GDP growth will climb back up to around 6 percent in 2021. (IMF 2020)

The microfinance industry remains the key driver of finance for the poor and micro enterprises across Bangladesh, with over 30 million savers and borrowers that rely on the sector. There are two major customer bases for the microfinance industry: ready-made garments (RMG) and migrant workers. RMG workers mainly take loans for consumption smoothing purposes whilst migration workers take loans to cover migration related expenses. Both these groups have been severely affected by the Covid-19 pandemic. Remittances from migrant workers accounts for 5 percent of the GDP in Bangladesh ($16.4 billion in FY 19). Most migrant workers are based in Gulf countries, which have also been affected by the sudden drop in oil prices.

Accounting for over 80 percent of exports, the RMG sector is another major player in the Bangladesh economy. The industry has been hit by cancellations and postponements from major retailers amounting to several billion US dollars. (IMF 2020) Although in recent months, we have seen significant improvements in both of these sectors.

As the global economy is starting back up, Bangladesh's exports in July 2020 reached $3.91 billion, the highest-ever earnings in a single month in the country's history. This increase in exports comes after six months of negative growth in a row since January 2020 and is primarily by retailers reinstating their orders. Orders from before the pandemic are still being processed, so the sustainability of these increased exports is yet to be tested. (RMG 2020)

In the case of migrant workers, remittances also continued to rise for the third consecutive month reaching $2.60 billion in July, once again the highest in recent history. Although there are conflicting theories, economists assume that this increase has to do with migrants sending all their savings back to Bangladesh in preparation to move home as well as migrants sending more to their families for Eid-ul-Azha, a religious celebration. Considering COVID-19 related closures however, the Asian Development Bank (ADB) expects remittances will fall by 27.8% in 2020. (HOSSAIN 2020)

The environmental condition of Bangladesh is yet another challenge hampering the livelihoods of vulnerable groups. Frequent monsoon rains and floods are not only displacing people but also putting agriculture production at risk and possibly leading to higher food insecurity.

Although the Bangladesh economy was functioning well before the pandemic, it can be estimated, that an increase in Covid-19 related borrowing would increase country's debt to GDP ratio to 41%, which was 36% in 2019. Still this acts as a testament to the sound economic and fiscal policies implemented in recent years.

2. Government's Response to the Pandemic and Approach to Protecting Vulnerable Communities in Bangladesh

Several stimulus packages have been instated since March to try and help relieve the effect of the pandemic on vulnerable groups. A $600 million package was put together to support the wages of workers in the RMG sector. This is a crucial initiative because the RMG sector is responsible for employing and integrating large numbers of women into the formal economy.

Another package of nearly USD 150 million will be used to provide cash assistance to nearly five million families displaced by the pandemic. (IMF 2020)

Bangladesh government's measures that directly/indirectly helped MFIs and its clients (KPMG 2020)

Date	Government measures
19 March	Bangladesh Bank (BB) announces moratorium on loan classification until 30 September 2020 and that such borrowers will not be in default
31 March	Government announces details of its BDT 50bn (approx. USD595m) stimulus package for export-oriented industries. This includes assistance towards salaries and funding of 2-year loans to factory owners at 2% interest.
5 April	Prime minister announced another stimulus package of BDT 677.5bn (approx. USD8bn) planned to implement in phases through various programs (increasing public expenditure, widening social safety net coverage and increasing monetary supply).
20 March	**Promotion of payment services**: Mobile financial services - monthly transition limit increased from approximately USD 900 to USD 2,300 and charges waived on cashing out (withdrawal) of up to USD 12 per day
13 April	**Refinance scheme BDT 50bn (approx. USD 595m) for the agriculture sector:** The scheme will be financed from Bangladesh Bank's (BB) own resources. The effected customers will be able to avail up to 20% extra of the existing loan facilities under the scheme. BB will charge interest 1% to banks and banks will charge 4% to customers. The loan will be repayable within 18 months including 6 months grace period.
20 April	**Refinance Scheme of BDT 30bn (approx. USD 357m) for low-income professionals, farmers, and micro entrepreneurs:** The scheme will be financed from BB's own sources. Loan limit to individual customer is BDT 75k to BDT 3 million. BB will charge 1% interest to banks, banks will charge 3.5% interest to Micro Credit Financing Institutions (MCFIs) and MCFIs will charge 9% interest to customers. Customers will repay loan within 1 to 2 years including a grace period
27 April	**Providing agricultural loan at 4% to the crop sector: (Tk. 50 billion)** BB instructed banks to provide loan at 4% interest from banks' own funds. BB will provide banks 5% interest as subsidy
12 May	**Remittance incentives:** Expatriate Bangladeshis can get 2% cash incentives without showing any documents (i.e. copy of passport, employment letter, BMET certificate) on remittance up to $5,000 (earlier $1,500) and for more than $5,000 papers need to be submitted within 2 months (earlier it was 15 days).
14 May	**Disbursement of cash aid:** Prime Minister launched the disbursement of BDT 12.5bn (approx. USD 142m) cash aid for 5 million poor families. Each family will get BDT 2,500 (USD 30) cash through mobile financial services (MFS).

Financing Package: Government to provide BDT 200bn fund for banks to provide working capital loan facilities to Small (cottage industries) and Medium enterprises. These loans will carry an interest rate of 9%, of which 4% to be borne by borrower and 5% by Government as a subsidy. BB has published a circular detailing eligibility, application, conditions, reporting and other terms of the package on 13 April. On 26 April, BB established Revolving Refinance Scheme of BDT 100bn to ensure financing by banks. Banks can borrow 50% of loan disbursed from BB at 4% interest rate.

3. Understanding the Microfinance Industry and the impact of Covid-19 pandemic

Microfinance Regulatory Authority (MRA) has licensed 759 institutions to operate savings and credit facilities in Bangladesh. (MRA n.d.). The top 3 MFIs (BRAC, ASA, Grameen Bank) have 58% market share of microfinance loan portfolio. Next 47 MFIs (medium to large) have 32% market share and remaining small MFIs have about 10% market share. (CDF n.d.)

The MFIs in Bangladesh operate through over 21,000 branches and employ around 274,000 people. Although small MFIs have 10% market share of the loan portfolio they employ 24% of industry's staff as they work mostly in rural areas with loans of smaller ticket size, which requires higher staffing levels. (CDF n.d.)

Microfinance portfolio in Billion USD

1 USD = Taka	80.59	83.7	84.5
	June 2017	June 2018	June 2019
Loan Portfolio	9.56	9.73	11.16
Member's Savings	4.33	4.78	5.46
Disbursement (Yearly)	14.98	16.80	18.83
Equity	-	3.45	3.92
Savings/Portfolio Ratio	45.3%	49.1%	49.0%
Equity/Portfolio Ratio		35.5%	35.2%
Borrowers	32,446,130	31,479,974	32,413,689

*Source: Bangladesh Bank

**CDF, Bangladesh Report 2016/17, 2017/18, 2018/19

The loan portfolio grew a healthy 15% from June 2018 to June 2019 compared to only 2% growth in the previous year. Members' saving grew 14% in fiscal year 18/19 compared to 10% growth in the previous year. Borrower numbers remained steady for previous three years around 32 million (this number includes borrower's with multiple borrowing from various MFIs.

In June 2019, Grameen Bank (GB) had about 34% of market share of member's savings and excluding GB industry's savings to loan portfolio ratio decreased from 49% to 39%. On the other hand, ASA had almost 40% of market share of industry's equity balance and excluding ASA industry's equity to loan portfolio ratio decreased from 35.2% to 26%. ASA and GB have no external borrowing and their portfolio are financed through equity and member savings. ASA and GB's equity and member's savings are 35% and 10% higher than their respective loan portfolio.

Those MFIs who are dependent on external financing have on average 35% portfolio financed by external borrowing (savings 39% and equity 26%). In June 2019 these MFIs have TK. 62,319 crores (USD 7.37 billion) portfolio and external borrowing was 21,811 crores (USD 2.58 billion).

Major findings from the surveyed COVID Impacted MFIs

The survey was conducted across 16 MFIs, which have about 62% market share of industry's loan portfolio. The loan portfolio of these MFIs grew by 17% (annualized 23%) from June 2019 to March 2020. The surveyed MFIs are expecting that their portfolio will decline by 9.7% from March'20 to August'20 and then demand for financing will start to pick up from September'20 onwards and by December 2020, loan portfolio will be close to its March' 20 level. If the second wave of Covid-19 hits in the winter, then obviously this projection will need to be revised.

- **Impact on Loan Tenure**- Most of the MFIs (82%) allowed extensions of loan tenures to its clients and a majority (72%) of MFIs allowed this extension across their full loan portfolio. However, a small percentage of the MFIs allowed extension to between 40-70% of their clients (dependent on the institution). MRA has instructed MFIs not to classify loans until September 2020 for non-payment of installments but did not provide any guidelines about loan tenure extensions. As a result, each MFI used its own criteria for tenure extension. The majority of MFIs have extended tenure by two months to all clients (for lockdown period of April and May) so that new equal monthly installment (EMI) will be close to original EMI. While some MFIs have decided only to give this extension to the ones who they felt needed it the most because tenure extension will require clients to pay extra interest for the extension.
- **Interest Relief Initiatives**- More than half of the MFIs (62%) have given interest relief to their clients with the majority of the MFIs (53%) giving interest relief for the excess interest only. The excess interest accumulated as clients were unable to pay loan installments and a reduced principal loan amount in April and May, for which the total interest due on average went up by approximately 17%. However, most MFIs have decided to waive this excess interest. MFI could have given higher interest relief if banks had given them interest relief on their borrowing.
- **Impact on subsidiary programmes, especially around health**- Majority of the MFIs have their own health programs and some are partnered with organizations that provide health interventions. As the Covid-19 crisis hit, 41% of the MFIs intervened by awareness building only. 52% of the MFIs intervened with awareness building and providing masks, sanitizers and soaps. Two of the MFIs have their own hospitals, where they provided services to covid-19 patients.
- **MFIs Debt Servicing**- MFIs received a negligible amount as interest relief from bank borrowings during this crisis. Bangladesh Bank (BB) had initially asked commercial banks to transfer all interest earned from their lending in April and May (i.e. during lockdown period) in a 'blocked account' fund and had also informed the banks that they will give decision about this fund at a future date. Like other bank borrowers, MFIs were hoping to get a substantial interest relief for April and May from the initiative. Subsequently, they were planning to pass on this interest relief on to their borrowers. However, on June 10th, BB announced that borrowers will only get maximum Tk. 1.2 million as interest relief from this 'blocked account' fund and banks will keep rest of the amount themselves as 'interest income'. Considering the maximum limit of interest relief, we can assume that this relief was designed mostly to help SME borrowers of the banks.
- Except one, all the surveyed MFIs have continued repaying their loan installments (16 surveyed) during this crisis, even though BB asked the banks not to classify loans for non-payments until September 30, 2020. Nine of the surveyed MFIs have asked for additional funding with renew/restructuring applications. Banks generally provide short-term loan (1 yr. STL) with quarterly repayments to MFIs. Although the MFIs did not mention in our survey the amount of additional funding requested from the banks, 13 MFIs did mention that they will require BDT 3,483 crores (USD 410 million) in next four months to avoid liquidity problems in early 2021.

Portfolio of the surveyed MFIs

1 USD = Taka	83.7	84.5	84.5	84.95
(In billion)	June 2018	June 2019	March 2020	Dec. 2020
Loan Portfolio	5.92	6.90	8.07	8.17
Member's Savings	2.32	2.63	3.25	3.18
Borrowers	16,905,867	17,042,752	17,963,883	18,187,144
Portfolio Growth		18%	17%	2%
Member's Savings Growth		15%	23%	-2%
Borrower Growth		1%	5%	1%

*Source: Bangladesh Bank

** CDF Bangladesh Reports 2017/18 & 2018/19

*** BFP-B Survey Report

From July 2019 to January 2020 net government borrowing from domestic sources was around 62 thousand crores (USD 7.2 billion) and it was 37 thousand crores (USD 4.3 billion) during the same period in previous year, implying a 68% increase. This considerable increase in borrowing was mainly absorbed by the banking sector as sale of government savings certificates to individuals significantly declined to 7.6 thousand crores (USD 0.9 billion) from 30 thousand crores (USD 3.5 billion) from the previous comparable period. The decrease was mainly due to introduction of automation in the selling process and submission requirements of Tax Identification Number (TIN) certificate by the clients. This led to tightening of private sector lending by commercial banks and thus MFIs had to focus on collecting member's savings to meet its demand for fund requirement. The surveyed MFIs were able to increase member savings by 23% (annualized 30%) from June 2019 to March 2020 by offering long-term fixed deposit saving instruments with 10%-12% interest rate.

Impact of Covid-19 on MFI's loan portfolio

"Bangladesh is one of the largest deltas in the world which is highly vulnerable to natural disasters because of its geographical location, flat and low-lying landscape". (Denissen 2012) Moreover, the adverse effects of climate change – especially high temperature and sea level rise aggravated situations during, cyclones and storm surges, floods, salinity intrusion and heavy monsoon downpours (Denissen 2012). Consequently, the microfinance industry and its clients had faced many adversities in the last forty years. It is also true that people have become better in coping with natural disasters because of improved infrastructure, telecommunication system, early warning system and effective coordination from both central and local governments. MFIs have also become more efficient in handling client's needs during and after natural disasters particularly in identifying and segregating clients based on their actual need of rescheduling, refinancing or writing off loans. The microfinance industry as a whole never had to encounter any kind of major financial distress in the last forty years for natural disaster causes. As a result, commercial banks had also never hesitated to provide loans based on 'corporate guarantee' only and banks do not require MFIs to provide primary or secondary security (i.e. providing clean loans to MFIs).

MFIs and its clients are finding this pandemic difficult to handle mainly because of the duration of economic slowdown, its wider global ramifications, coupled with disruptions in supply chains and loss of purchasing power of its clients.

In the early days of Covid-19 pandemic, Microfinance Regulatory Authority (MRA) had realized that MFI's clients will find it very difficult to make loan repayments due to loss of income and as a preemptive measure loan classification rule was relaxed. MRA had instructed MFIs not to change loan classification for non-payments of loan installments up until September 2020. Bangladesh Bank commonly follows this practice for commercial banks during economic downturn. The logic behind this practice is that by not negatively impacting customer's CIB report, which means that customers will have a better opportunity to get refinancing from banks other than customer's own bank. In addition, relaxation of the loan classification rules helps banks to reduce provisioning cost and thus reduce the impact of the economic slump on profitability. This practice is not as effective in the microfinance sector because MFI clients are yet to be part of any CIB (the MF CIB that is being developed by BFP-B will only be operational by mid-2021). Although this year MFIs will have lower provisioning expenses which help to increase profitability or in some instances reduce net losses. If overdue loans are not significantly reduced in the coming months, then in the next few years provisioning expenses will significantly increase. Thus, the whole exercise doesn't do much to address the fundamental issues.

The microfinance industry is based on strong repayment culture, which in turn helps MFIs to keep its loan loss provision expenses down. PAR>0 in June 2019 was 4.25%. (CDF n.d.) Generally, industry PAR>30 DAYS remains below 4% and PAR>90 DAYS remains below 2%. This picture has completely changed in last few months and the PAR>90 DAYS increased to 39% from below 2% (if we do not consider moratorium and rescheduling of loans).

The surveyed MFIs are trying to address this delinquency based on the client's position in their loan cycle. If a client is almost at the end of her loan cycle, she is expected to pay remaining balance from her savings and if necessary, take a repeat loan to restart her business. If a client is in middle part of the loan cycle, then she can avail a 'top-up loan' to continue her business and pay the EMI. If a client is in the early part of the loan cycle, then she will be given a longer time to pay the past due amount with tenure extension. Clients who are given extensions are encouraged to pay 10% to 15% higher than regular EMI to reduce their past due amount.

Industry experts believe that most of the clients will be able to clear their past due amounts in the next 12 to 18 months, only if MFIs are able and willing to provide 'top-up' loans on time so that clients have enough working capital to restart businesses. MFIs also need to keep higher loan loss reserve than what the regulator has mandated, and most likely lenders of MFIs will have this in loan covenants for future financing.

Projection upto December 2020 (surveyed MFIs)

		April 2020	May 2020	June 2020	July 2020	Aug 2020	Sept 2020	Oct 2020	Nov 2020	Dec 2020
Average loan realization per month from Jan to Mar 2020	9,948 crores 1.17 (USD billion)									
Loan realization as % of (average loan realization per month of Jan- Mar 2020)		0%	3%	61%	81%	71%	80%	84%	91%	94%

The average monthly loan realization in Jan to Mar 2020 was 9,948 crores (USD 1.17 billion) and because of Covid-19, surveyed MFIs are expecting average monthly realization from Apr to Dec 2020 will come down to 6,250 crores (USD 736 million) – a 37% fall in anticipated realizations.

Based on these first three months of realization, it was expected that in Apr to Dec 2020 total loan realization will be 89,536 crores (USD 10.54 billion) but after Covid-19 this projection was lowered to 56,251 crores (USD 6.62 billion) i.e. past due amount will increase to a staggering 33,285 crores (USD 3.9 billion).

Typically, 20%-30% of the clients do not borrow after paying off the loan. If they have seasonal businesses, they wait for the next peak season or for major religious holidays before taking another loan. On the other hand, 70%-80% borrowers will pay their last few installments as prepayments from their savings or profit and immediately take another loan. These borrowers take loans not only for working capital but also for smoothing consumption. Under the current crisis, many such borrowers will not have enough liquidity to make prepayments and take another loan. As mentioned earlier, it is important that MFIs are able and willing to finance these clients with 'top up' loans so that they have sufficient working capital to restart businesses and pay regular EMI. In this scenario, microfinance practitioners believe that clients will need 12 to 18 months to pay off their existing past due amounts.

Generally, monthly loan repayments in microfinance industry are much higher in relation to portfolio balance as loan repayments includes interest amount and about 15% to 20% repayments come as prepayments by borrowers. Almost all the loans are 12 months duration and borrowers prepay their loans in 9 or 10 months and take another loan.

4. Key Concerns of MFIs

In the survey the MFIs were asked to rank the following issues as (very worried =5, somewhat worried=4, not worried = 3, don't know=1).

	Cumulative Points
Client's ability to repay loan installments	75
Financial loss of your organization	72
Demand for loans disbursement not increasing	65
Liquidity of your MFI	58
May have to reduce staff salary	55
May have to retrench staff	43

As indicated in the above table the most pressing issue for MFIs for next six months are client's lack of repayment ability and consequent financial loss for the organization. MFIs do not foresee liquidity problem for next six months due to massive slowdown for demand for new and/or repeat loans. This also reflected in CGAP pulse survey https://www.cgap.org/blog/there-liquidity-crisis-among-mfis-and-if-so-where

Looking at the trend of repayment and disbursement for June to August, most of the surveyed MFIs are predicting that from October onwards demand for loans will reach pre-Covid-19 level. They foresee that they have enough liquidity to sustain client's loan demand for last quarter of this year. As they do not see any growth of member's savings this year, they believe that they would have to arrange more institutional financing by end of this year so that they can meet loan demands for 2021. They are concerned that in case they are unable to meet loan demand in early part of 2021 then client's loan repayments will again slowdown and most likely start a liquidity crisis in the industry.

Despite this uncertain situation, MFIs have no plans for any significant staff retrenchment, moreover they feel that under the present situation they need to reduce the clients to staff ratio as pool of past due clients are growing; more of follow up visits are needed by the field officers. However, they do feel that if things do not improve by end of this year, they may have to reduce salaries of the staff.

The situation is quite different and much worse for the smaller MFIs (i.e. those outside the top 50 by size of their portfolios) as most of these MFIs do not have the ability to borrow from commercial sources and solely dependent on member's savings and loan repayments to maintain liquidity. They are already in liquidity crisis and unless PKSF or any other government agencies intervene, many of these MFIs will cease to exist in 2021.

Implementation of Microfinance Credit Information Bureau

As reported earlier, Bangladesh currently has 759 licensed MFIs. These MFIs implement their programs through a network of over 21,000 branches. Such mammoth coverage has made the industry extremely competitive in the last 5 years. Typically, an MFI provides 30%-40% loans to new clients in any given month although total client base of the industry remained the same around 32 million for last 3 years. MFIs very aggressively target each other's clients by offering higher loan amount and/or better terms and conditions to ensure steady portfolio growth. Usually a client closes a loan account with existing MFI and moves to a new MFI to obtain a better deal.

Going forward, there is a high chance that there will be a significant increase in clients with past due payments because of this pandemic and if client's existing provider is unable or unwilling to provide refinancing then clients approach another MFI without closing the existing loan. This will create high indebtedness among microfinance clients and hamper loan recovery by MFIs. Managing this risk will be the main challenge for the industry for next few years.

Unlike many of the developing countries, Bangladesh lacks a Credit Information Bureau (CIB) service for microfinance clients. Both domestic and foreign lenders would be interested in, how the microfinance industry will manage deteriorating portfolio quality going forward. Setting up CIB will not only help the MFIs and its clients in managing risks but this will also give assurance to domestic and international lenders. Fortunately, MRA and Bangladesh Bank with the assistance from BFP-B have taken the initiative to develop the country's first 'CIB for microfinance sector'. Currently the project is in the 'pre-pilot phase'. It is imperative to restart the implementation of the "Microfinance CIB" as soon as possible. To implement the CIB project faster, it can only start with 'negative information' during the first phase. This method is also referred to as 'black list'. This type of credit history only contains information of default clients. The CIB tracks outstanding loan amount at the time of default and the date of last payment. When the debt is repaid, information on delinquency is removed from CIB record. 'Positive Information' tracking means keeping track of existing and past repayments history of all the borrowers. Although CIBs which consist of 'negative information' are not as effective as CIBs with a combination of 'positive and negative information' but considering the current situation, it would be advisable to start with 'negative information' CIB as it would be easier and take less time to implement. The first phase can include only the top 50 MFIs (including Grameen Bank) as these MFIs have 90% market share of the industry's loan portfolio. If MRA and the microfinance industry wants to fast track the implementation process then they must provide technical assistance to MFIs as most of the MFIs lacks required personnel to implement such a project.

Liquidity situation of MFIs

"Unlike previous natural disasters or financial crises, lockdowns to contain the Covid-19 outbreak have resulted in both a supply-side shock with people unable to go to work to supply or produce goods and services, and a demand-side shock with households and businesses unable to buy goods and services for extended periods" (Tayor 2020). This coupled with dramatic slowdown in loan repayments resulted in significant slowdown of loan disbursement.

Projection upto December 2020 (surveyed MFIs)

		April 2020	May 2020	June 2020	July 2020	Aug 2020	Sept 2020	Oct 2020	Nov 2020	Dec 2020
Average monthly loan disbursement from Jan to Mar 2020	9,948 crores 1.17 (USD billion)									
Loan disbursement as % of (average monthly loan disbursement of Jan- Mar 2020)	10,233 crores 1.21 (USD billion	0%	4%	32%	55%	46%	84%	94%	100%	103%

The surveyed MFI's average monthly loan realization (principal + interest) was 9,948 crores (1.17 billion USD) between January 2020 to March 2020 (pre covid-19). The projected average monthly loan realization from April 2020 to December 2020 is 6,250 crores (735 million USD) i.e. 63% of January to March average. Total past due amount is projected to increase by approximately 33,285 (3.9 billion USD) by December 2020. In spite of such a dramatic shortfall of loan realization, microfinance industry has not encountered a liquidity crisis yet. The CGAP survey also came with the same conclusion about liquidity. This is because unlike previous natural disasters, during Covid-19 pandemic there was also prolonged lack of demand for financing due to lockdown and loss of income among customers of micro entrepreneurs. The surveyed MFIs average monthly loan disbursement was 10,233 crores (1.21 billion USD) between January 2020 to March 2020 (pre covid-19). The projected average monthly loan disbursement from April 2020 to December 2020 will be 5,887 crores (693 million USD) i.e. 58% of January to March average. The lack of demand for financing helped MFIs to avert a liquidity crisis for now.

However, liquidity issues still do not seem likely for the industry until December 2020 because it is expected that the demand for new financing will gradually increase and so far this year projected loan repayment is on par with projected loan disbursement.

A looming liquidity crisis

MFIs are expecting that from October 2020 onwards loan demand will be at par with pre-Covid-19 level of disbursement. The liquidity challenge will come in 2021 as there will be bottled up demand for new loans. Generally, MFIs disburse loans from the amount they realize as loan repayments from clients and if they want to expand their portfolio then extra funds are generated by increasing microfinance member's savings balance and from external borrowing. As the surveyed MFIs will have close to 34,000 crores (4 billion USD) less in collections due to significantly lower loan realization rate, it will be impossible for the industry to meet the demand for loans if the demand reaches pre-Covid-19 level, unless funds are generated through member's savings and external borrowing. As the industry is projecting no growth in member's savings since March 2020, the funds will need to come from external borrowing.

How effectively MFIs will be able to recover the past due loans will mostly depend on MFIs willingness and ability to meet the demand for new loans. Past experience shows that with natural disasters that the clients are generally able to pay their past due loans only when MFI's assist the clients with new financing to restart their businesses.

The main source of external financing for MFIs in Bangladesh are commercial banks and PKSF (wholesale financing wing of government). The total external borrowing is approximately 21,811 crores (USD 2.58 billion) of which 75% are coming from commercial banks and remaining 25% from PKSF. Banks mostly finance MFIs with Short Term Loan (1 year STL) renewed annually. The banks provides 'clean' loans to MFI with corporate guarantee and due diligence process mostly concentrate on MFI's portfolio.

Bangladesh government borrowed around 82,000 crores (9.65 billion USD) from the banking sector in FY 19-20 against target of 47,000 (5.53 billion USD) crores due to shortfall in revenue target as pandemic halted all kind of business activities in April and May. Government is planning to borrow from banking sector around 85000, 80,000, 90,000 (10, 9.41, 10.59 billion USD) crores in fiscal years 2021, 2022 and 2023 respectively. It is expected that public sector credit growth will increase by 44% and private sector by 14.8% in fiscal year 2021. Many experts are predicting a liquidity crisis in banking sector in near future because of excessive government borrowing, capping banking sector savings and borrowing rate to 6% and 9% respectively and large increase of non-performing loans.

The microfinance industry in Bangladesh will need major cash infusion in 2021 and beyond. However, it is very unlikely for both domestic banks and international development financial institutions (DFIs) to commit major funding to the industry due to the interest cap of 9% enforced by the government. To add on to that, the seriously deteriorating portfolio quality and lack of CIB for managing risk will make it even more difficult to place future funding requests.

The only way domestic or international lenders will be willing to commit major funding is if government provides some kind of credit guarantee and participates in emergency liquidity funding.

5. Conclusion and recommendations going forward

A major takeaway from the survey of MFIs, is that the microfinance providers are very worried about client's future repayment capacity considering liquidity position is already tightened at the client level. The clients will need access to finance more than ever before to restart their businesses so that they can stabilize their livelihood as well as pay down their debts.

In Bangladesh, microfinance providers are very dependent on member's savings for their revolving funds and the surveyed MFIs are predicting that there will not be any growth in savings in the foreseeable future and MFIs will need more institutional financing to inject liquidity at client level. As credit risk is heightened and microfinance industry's own portfolio is deteriorating, lenders will become more risk-averse, especially when it comes to lending to the MFIs.

It is crucial to create a conducive atmosphere for both local and international institutional lenders so that the microfinance industry can access necessary liquidity to support their huge clienteles. For this, a uniform 'stress test for MFIs' and a 'Credit Guarantee Fund' should be considered. It is similar to what Bangladesh Bank has offered to commercial banks for Cottage, Micro and Small (CMS) entrepreneurs.

Stress Test: Stress testing helps gauge investment risk and the adequacy of assets, as well as helps to evaluate internal processes and controls of financial institutions. The stress test is designed to ensure banks are taking necessary measures to withstand itself during sever economic crisis. The MFI industry needs a 'Stress Test Simulation' similar to banks but modified to take into consideration the operating environment and norms of the microfinance industry. This kind of test will give confidence to both lenders and individual microfinance institutions about its ability to withstand current and future economic crisis. It would be prudent if government certify one uniform model of "Stress Test Simulation for MFI" and ask all lenders to use that simulation in their due diligence process.

- 12 out of 16 surveyed respondents highlighted "Very Important" when asked to rate "Increase liquidity support to MFIs by government through commercial banks".
- 11 out of 16 surveyed respondents highlighted "Very Important" when asked to rate "Bring regulatory changes so that international lenders start operation in Bangladesh.

Emergency Liquidity Fund & Credit guarantee scheme: A 'Partial Credit Guarantee for MFIs (PCG-MFI)' similar to what Bangladesh Bank is offering commercial banks for Cottage, Micro and Small (CMS) entrepreneurs should also be considered (Bangladesh Bank (SMESPD Circular #3 2020). This Partial Credit Guarantee (PCG) for 'hybrid portfolio' is mostly designed in line with international best practices. The proposed PCG-MFI will be aligned with microfinance providers and their client's needs. The main recommended difference will be:

- PCG-MFI should guarantee MFI's portfolio rather than individual loans otherwise it will very costly and time consuming to manage the guarantee program for 32 million clients.
- This publicly funded national scheme should be managed by a private entity under the supervision and direction of Bangladesh Bank and MRA. A private entity will be more effective in mobilizing and deploying experts for managing such a large credit guarantee schemes.

Some of the other recommended differences:

	Highlights of Existing Credit Guarantee Scheme for CMS	Proposed PCG-MFI
1	This CGS for banks and NBFIs only i.e. those within the jurisdiction of Bangladesh Bank	PCG for MFIs those within the jurisdiction of Microfinance Regulatory Authority (MRA)
2	Total scheme amount: 20,000 crores (about 2.4 billion USD). Financial Institution (FI) will need to sign 5 years agreement with BB	The amount and duration can be determined at some later date after consulting regulators and MF providers
3	Maximum 70% of CMS portfolio of FI will be guaranteed for manufacturing and service sector.	30% for manufacturing and service sector
4	Maximum 30% of CMS portfolio of FI's will be guaranteed for trading sector.	MF has 80%-90% portfolio under trading sector. Guarantee scheme needs to be 70% for trading portfolio.
5	80% of principal amount of individual loan will be guaranteed.	No change
6	Non-performing loans (NPL) of FI has to be lower than 10% in previous year (Dec. 31st). This will not be applicable for Government banks.	NPL limit: 5% for MFIs with portfolio above Tk. 5 billion NPL limit: 7% for other MFIs
7	Loan amount to individual borrower (200,000 to 5 million). Loan has to be collateral free and for working capital.	As majority of the MF loans are below 200,000, this limit can be 10,000 – 2 million.
8	1% guarantee fees and subsequent year: if NPL is <5% than .5%, if NPL is >5% and <10% than .75%.	1% guarantee fees and subsequent year: if NPL is <2% than .5%, if NPL is >2% and <5% than .75%.
9	FI can claim reimbursement under CGS after loan is classified as Bad Loan	No change
10	Take legal action against borrowers who are classified as Bad Loan through Money Suits Act 2003.	This is not practical for MFI's because of litigation expenses. MFI can be required to take legal action for loans above Tk. 500,000 under Negotiable Instrument (NI) act.

Bangladesh Government in collaboration with local banks and Development Financial Institutions can setup Emergency Liquidity Fund (ELF). "This worked well during the 2008 crisis when an Emergency Liquidity Fund for Latin America (ELF) was funded by several DFIs and foundations. Unlike large banks, which can usually tap government-sponsored emergency loans to overcome liquidity shortages, MFIs are exposed to severe disruptions during crises. ELF's short-term financing allows otherwise solvent MFIs to meet sudden spikes in credit demand or bridge temporary arrears in repayments during crises. To qualify for assistance, microfinance institutions must comply with strict criteria concerning solvency ratios, management, governance and transparency." (IDB fund provides emergency liquidity facility for microfinance institutions 2008)

“The facility can also provide its clients technical assistance to strengthen their administration, risk management and contingency planning capabilities, preparing them to resume operations quickly after emergencies.” (IDB fund provides emergency liquidity facility for microfinance institutions 2008).

April - Refinance Scheme of BDT 30bn (approx. USD 357m) for low-income professionals, farmers, micro entrepreneurs: the microfinance industry has highly appreciated this low rate refinancing scheme for clients. Considering the size of the industry, more funds need to be available under this scheme.

Mobile Financial Service (MFS): Among the developing countries, Bangladesh has one of the highest penetration levels for both MFS and Microfinance services but unfortunately, microfinance industry has used MFS service for transaction processing at a very limited scale.

The microfinance industry always looks for ways to reduce transaction processing cost and transaction processing time because efficiency in processing means Field Officers (FO) will have more time for client relation management and business development and which in turn will increase productivity. In the last five years, many MFIs in Bangladesh have significantly reduced their transaction processing cost and time with some operational changes e.g. replacing “paper based repayment collection sheet” with “app based electronic collection sheet”, changing frequency of loan repayments from weekly to monthly, providing FOs motorcycles instead of bicycles. Some of the MFIs are already taking steps to replace “paper-based client passbook” with an “E passbook”. Industry actors believes that by adopting MFS facility it can reduce transaction processing cost and time further. Five out of 17 surveyed MFIs have used MFS in very limited scale during the pandemic but 100% of the respondents are willing to adopt MFS in larger scale if regulatory changes make the service financially viable for MFIs.

In the last few years, a number of MFIs have successfully piloted the MFS for loan repayments and savings collection. However, none of these MFIs has fully adopted MFS in their operations. The main hindrance being transaction fees and transaction limit.

BFP-B has done extensive research on MFS in Bangladesh. The survey highlighted that among MFI clients, 63% feel “cash out” cost is a barrier and 43% feel transaction limit” is a barrier. “The research scope included discussion with representatives of several leading MF providers who have partnered with MFS providers for payment digitization. A common theme that emerged from these discussions were that the MFS transaction limit and transaction charges are two major impediments for greater proliferation of payment digitization through the medium” (BFP-B 2019).

BFP-B has given some specific recommendations that will encourage MFI and its clients to widely use MFS services. Although the recommendations addressed the barriers related to “transaction limit” only.

Some of the major recommendations are:

1. Three tier transaction limit with higher level of KYC requirement for higher transaction limit.
2. Introduce different transaction limit for MFI clients compared to regular MFS users to address problems related to receiving loan disbursement amounts through MFS.
3. Develop a regulatory environment under which various players can innovate new products and services for the micro and small enterprise.

Almost 80%-90% microfinance clients pay their installments in group meetings but for the remaining 10%-20% clients, field officers need to go to various locations for arrears collection which is a costly and time-consuming exercise. Both microfinance and MFS providers should explore options to develop a system to address this type of collection first.

Funding for very small MFIs: There are about 700 very small MFIs, which were licensed by MRA. These MFIs together have about 10% market share but employs almost quarter of industry’s staff. They work mostly in rural areas with loans of smaller ticket size, which requires more staff. Generally, these MFIs operates through 1 to 3 branches. About 250 of these MFIs are funded by PKSF and rest are funded through equity and member’s savings, rarely do these MFIs qualify for bank loans because of their small size.

Through the Key Informant interviews, it came out that some of these small MFIs are already struggling with liquidity and many of them will not survive unless funding is available. These MFIs can be financed through PKSF. All the interviewed respondents want PKSF to ease the admission requirement to PKSF and the loan application process during the current crises.

PKSF not only lends to MFIs but also diligently performs financial, operational and overall institutional reviews at regular intervals. Over the years, PKSF has done outstanding work to build and strengthen the institutional capacity of the partner organizations (POs). They have also sponsored several innovative programs for microfinance clients through POs. Many of the POs have been supported by PKSF for last 10-20 years and most of these POs now have the ability to obtain funds from commercial sources. Given this situation, it may be prudent for PKSF to disengage from some of these older POs and admit the smaller struggling MFIs.

In many countries, it is customary for smaller organizations to merge or integrate to increase market share, improve stability and operational efficiency. The possibility of such merger or integration of smaller MFIs is unrealistic in Bangladesh because there is limited experience and appetite for this both in the private or non-profit sector. Moreover, current regulatory framework does not allow such measures. An MFI in Bangladesh is registered as an NGO. The NGOs are registered under any one of these acts.

1. The Societies Registration Act, 1860
2. The Companies Act, 1994
3. The Trust Act, 1882
4. The Voluntary Social Welfare Agencies Ordinance, 1961

NGOs also need to get license from NGO Affairs Bureau and with this license they can apply to Microfinance Regulatory Authority (MRA) for registration to commence saving and loan activity.

Except 'The Companies Act, 1994', none of the above Acts has any condition under which an organization can merge or integrate with other organizations. Moreover, NGO Affairs Bureau and MRA do not have any specific clause about merger/integration. Any discussion about merger/integration will require a whole set of regulatory changes at various levels, which we believe will be crucial to ensure that this can be enacted.

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