Revised Draft

Improving Access of the Poor to Financial Services

A Report prepared for the General Economics Division of the Planning Commission to serve as a background study for preparing the 7th Five Year Plan (2016-2020) of Bangladesh

Mustafa K. Mujeri

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Acronyms and Abbreviations

A2FS	Access to Financial Services
ATM	Automated Teller Machine
BACH	Bangladesh Automated Clearing House
BB	Bangladesh Bank
BIDS	Bangladesh Institute of Development Studies
BKB	Bangladesh Krishi Bank
CDF	Credit and Development Forum
DFIs	Development Financial Institutions
FCBs	Foreign Commercial Banks
GED	General Economics Division
IFC	International Finance Corporation
InM	Institute of Microfinance
KYC	Know Your Customer
MFIs	Micro Finance Institutions
MF-NGOs	Microfinance NGOs
MNOs	Mobile Network Operators
MoF	Ministry of Finance
MRA	Microfinance Regulatory Authority
NGOs	Non Government Organizations
PCBs	Private Commercial Banks
PKSF	Palli Karma Sahayak Foundation
POS	Point of Sale
RAKUB	Rajshahi Krishi Unnayan Bank
SCBs	State owned Commercial Banks
SMEs	Small and Medium Enterprises
UN	United Nations

Executive Summary

Finance is a powerful intervention for economic growth especially in a resource-constrained developing country like Bangladesh. Access to finance especially to the poor is essential for promoting inclusive economic growth and eradicating poverty in the country. The country's development strategy recognizes that socioeconomic opportunities and development in Bangladesh will be undermined if expanded financial services are not available especially to the poor and other disadvantaged groups who are deprived of access to these services and who need these services. An inclusive financial system provides a number of benefits to the economy. It makes available more resources for investment especially for the promotion of small and medium enterprises (SMEs). It creates employment opportunities, ensures economic and financial stability through reducing vulnerability and contributes to poverty reduction.

Access to a well–functioning financial system can economically and socially empower individuals, in particular poor people and women, allowing them to better integrate into the economy and actively contribute to development. In an inclusive financial system, no segment of the population remains excluded from accessing financial services.

Access to Financial Services

In Bangladesh, financial services are provided by a variety of financial intermediaries that are part of the country's financial system. There are three broad types of providers of financial services—formal, quasi-formal and informal, the distinction is based primarily on whether there is a legal infrastructure that provides recourse to lenders and protection to depositors. Although the formal financial services are provided by financial institutions licensed by the government and subject to banking regulations and supervision, quasi-formal financial services are not regulated by the banking authorities. These institutions are usually licensed and supervised by other government agencies. On the other hand, informal financial services are provided by individuals and institutions outside the structure of government regulation and supervision.

Access to financial services implies the absence of any obstacles (both price and non-price barriers) to the use of required financial services. For policy purposes, exclusion can be voluntary which refers to the case where an individual or firm has access to financial services but it is in no need to use them. Alternatively, exclusion can be involuntary where price and/or non-price barriers prevent the access to these services. Low-income families, especially the poor, have multiple and compelling reasons to smooth their income over short-term fluctuations due to less stable employment and earnings. For the poor, access to financial services is critical both for investing in productive livelihood activities to enhance their incomes and raise resources that can be used to smooth income in response to short-term earning fluctuations.

The poor often lack access to formal financial services that other households may take for granted. There are a number of reasons why the poor households tend to be unbanked. Financial institutions frequently require different documents to open an account, set high minimum account balances, and have high fees and other requirements that are ill-suited to the poor households. The availability of few low-cost and easily accessible savings instruments, credit constraints, and higher cost financial products increases the economic challenges of these households. The quasi-formal financial institutions and the informal market are among the alternative financial services that complement the formal financial sector for the poor households. Though expensive, they are often more convenient and easier to use than the formal financial services. The study suggests that existing financial, credit and payment systems do not serve the poor well, imposing significant costs and reducing opportunities of these households. Many households use both quasi-formal and informal channels to meet their financial service needs which put these households at great disadvantages to improve their livelihood.

According to available data, while the number of deposit and credit accounts per 1,000 population in the country during 2005-2010 increased from 242 to 333 and from 51 to 63 respectively, the increase in the rural areas was from 127 to 189 for deposit account over the same period. On the other hand, similar number for the credit account actually declined from 53 in 2005 to 51 in 2010. This shows that a significant share of the population in Bangladesh do not have access to the formal financial institutions who are mostly the poor in rural and urban areas. In recent years, the access to financial services has steadily increased. The overall access as a share of total population increased from 44 percent in 2005 to 56 percent in 2010. As a share of total adult population, it increased from 71 percent to 87 percent over the same period.

Despite substantial expansion of bank branches and increase in the membership of MFIs and other financial institutions, a significant share of the country's adult population still remains financially excluded. The access to credit for the farmers from the banking system is significantly low relative to their contribution to the GDP. In 2013-14, the share of the agriculture sector in GDP was around 16 percent while agriculture's share of advances in total advances stood at about 6 percent. In Bangladesh, the financially excluded sections of the population comprise different poor and marginal groups including small and marginal farmers, tenant farmers, landless labourers, self-employed and unorganized sector enterprises, urban slum dwellers, migrants, ethnic minorities and socially excluded groups, poor senior citizens and women. While there are pockets of large excluded population in the urban areas, the rural areas contain most of the financially excluded population.

There are a variety of reasons for financial exclusion. From the demand side, lack of awareness, low income/assets, social exclusion, and illiteracy act as barriers to accessing financial services. From the supply side, distance from the branch, branch timings, cumbersome documentation and other procedures, unsuitable products, staff attitudes are common reasons for exclusion. These result in higher transaction cost and lower profitability. On the other hand, flexibility, ease of availability, and other attractive features of informal credit make such credit popular and survive over time despite the fact that informal credit is costlier than other sources of credit.

It is likely that the factors which determine whether or not an individual or enterprise has access to finance will change over time. In such an event, it may be useful to group the banked and unbanked into segments that reflect their current and possible future status as users or non-users of financial services. One approach to such market segmentation is the 'access frontier' which helps to analyze the development of financial markets over time. The access frontier gives the maximum share of the population that has access to a financial service at a given point in time. The frontier may shift over time due, for example, to technological and competitive changes in the market. The access frontier approach distinguishes between users and non-users of a financial service. Further, the segment of non-users may be divided into four groups:

- Those who are able to use the service but choose not to do so (voluntary non-users)
- Those who can currently access the service but do not as yet use it (non-users, lying within current access frontier)
- Those who should be able to use the service in future based on likely changes in the features of the service and the market (non-users, lying inside the future access frontier)
- Those beyond the reach of accessing the service in the near future (the supra-market group, lying beyond the future access frontier).

For policy purposes, it would be important to identify the reasons and take appropriate actions for those who can currently access the services but do not as yet use the services. On the other hand, the policy needs to be focused more on two major groups of non-users: groups who are lying inside the future asset frontier and groups lying beyond the future asset frontier.

The Policy Framework

Bangladesh's development strategies treat financial inclusion as a powerful accelerator of economic progress and development and an effective means for achieving the goals of reducing poverty and building shared prosperity. During the 7th Five Year Plan, the government's strategy should aim at broadening the reach of the digital payment systems, particularly for the poor and in the rural areas, and expanding the range of suitable services for the poor available in the digital systems. The approach should involve three mutually reinforcing objectives:

(i) Reduce the amount of time and money that the poor people spend to conduct financial transactions;

(ii) Increase capacity of the poor people to weather financial shocks and avail income-generating opportunities;

(iii) Generate macro-level efficiency by digitally connecting the poor people, financial institutions, government service providers, businesses, private sector and other stakeholders.

The government effort should focus on expanding innovative ways of increasing the poor's access to financial services and motivating and encouraging the financial institutions to offer these services. Since these interventions often involve technologies that need to be adapted to the targeted clients, the strategy should support, to address this demand-side challenge, product design experiments to specify required design and other features that will encourage the poor people to adopt and actively use digital financial services. The government should also develop policies and regulations that facilitate these developments.

One of the major challenges of serving the poor especially the small and marginal households is a lack of adequate information on the kinds of financial services they need. While progress has been made on understanding the needs of different farmer groups, particularly those with easier access to financial markets, relatively little is known about the financial service needs of harder-to-reach segments including the small and marginal farmers. A detailed understanding of their needs requires comprehensive analysis of the lives of these farmers as both agricultural producers along with participation in other informal sources of income. It is important to understand how the poor farmers manage their cash flows, their preferences, attitudes and behaviours to determine the scope of diversifying income sources as an effective path out of poverty. The financial service providers must also take an active interest in serving these marginalized populations, understand how they access information and adapt existing technologies to make that information available and, in doing so, become productive users of financial services.

Digital Financial Services

Since the digital payment systems have already taken hold in the rural communities, the government should work with banks, insurance companies, and other financial service providers to increase the range of financial services that the poor people, especially the small and marginal farmers and women, can access in digital form. As a reasonable degree of connectivity in the rural areas of the country is already established, the efforts should be to extend the reach of digital payment systems into rural communities and encourage the poor people to adopt these systems through digital interface.

In Bangladesh, digital finance holds an enormous opportunity for greater financial inclusion and expansion of basic services. At present, around 115 million people own a mobile phone. As such digital finance can be used as a powerful means to expand access beyond financial services to other sectors, including agriculture, transportation, water, health, education, and clean energy. Obviously, digital solutions and new technologies will offer great potential to overcome the massive challenge of providing access to financial services to the poor and will contribute towards achieving the goal of universal access to financial services by 2021.

It is also likely that the benefits of digital finance will extend well beyond the conventional financial services: This will also emerge as a powerful tool and an engine for job creation in Bangladesh. The innovations by bKash and other institutions should be further expanded during the 7th Plan for tackling financial access and other major development challenges through adopting various innovative approaches to digital finance. During the Plan period, delivering financial services through technological innovations should act as a catalyst for the provision and use of a diverse set of financial services including credit, insurance, savings, and financial education. The excluded people would come under the purview of expanded access to money transfer services, microloans, insurance and other services.

Digital finance can also play an important role for small businesses. This will provide them with access to finance along with electronic payment systems, secure financial products and a chance to build a financial history. The potential of digital finance is huge especially in developing the rural areas. For example, the government's plan should be to use post offices, most of which are located in the rural areas, in enhancing financial inclusion. These post offices can play an important role in effectively delivering a variety of financial services, including banking, insurance, and remittances even in the most remote areas of the country. The government should encourage close public-private cooperation which will be a key factor in removing such barriers as cost, distance, and regulatory complexities.

Providing Efficient Financial Services and Products

For ensuring productive use of financial services, the government should strive for generating more effective synthesized knowledge about the products that exist for the poor households, institutions that provide these products, understanding the ground level realities for adopting successful and innovative models, and what factors ensure the success of promising ideas, and why some were embraced outside the intended target population. This will involve both development and piloting of more tailored products and services for the poor households. The government should encourage relevant organizations to explore ways to work with mobile network operators (MNOs) and other private-sector actors to identify not only how technology can help drive down costs to more effectively reach poor families, but also how different types of providers can collectively reach these households in an effective manner.

Some recent evidence in digital financial services (DFS) for small and marginal farmers suggests that it is important to (i) identify pain points in serving small farmers such as the cost and risk of making payments to the farmers and delivering subsidized credit; (ii) discuss how DFS are being used to overcome these pain points; and (iii) highlight the initial obstacles and successes. Given the rapidly developing state of DFS for the small farmers, it is important to realize that while DFS via mobile channels offer great promise for improving the lives of small farmers and their families, significant challenges still remain. One key obstacle is the limited penetration of mobile phone among the small and marginal farmers suggesting the need to adopt different forms of technology. Moreover, receptiveness to DFS via mobile channels among the small farmers would vary depending on their experience with mobile phones in general and with mobile money services in particular. This indicates that the success of mobile-enabled DFS would depend in large part on factors such as extent of mobile money adoption and experience of small farmers in using mobile phones for services such as messaging and agricultural information. In addition, there is also a need to complement current DFS innovations with other innovations that are based more solidly on financial needs, behaviours and aspirations of small and marginal farming households.

The fact remains that the specific characteristics of different groups of rural households and their demand for financial services are still not well understood and the risk of extending credit to these groups is perceived to be higher due in part to the inherent risks of agricultural operations. The small size of most of their transactions have also made it very difficult to capture savings, channel remittances, build money transfer systems, and offer individual micro-insurance products. On the other hand, significant opportunities of improving access to financial services do exist, as shown by positive experiences across a wide range of delivery channels, products, and financial service providers. Financial service providers have learned a great deal about how to manage microloans to poor households and get regular repayments. With enhanced effectiveness and profitability, the private sector institutions have also been steadily expanding their role in providing financial services to the poor along with embedding credit within a bundle of other goods and services (e.g. seeds, inputs, weather information, insurance) to secure sustainable agricultural production.

It also needs to be recognized that the challenges of providing financial services that provide effective support to the multiple goals of poor rural households are complex. In view of such complexities, it may be useful to characterize, as precisely as possible, the demand for financial services of the small farmers related to both farm and nonfarm operations within a segmented framework. Now-a-days smart phones and other devices provide useful resources made available by the Internet which are yet to be tapped by the poor and rural agricultural communities. Effective use of these resources can open up tremendous opportunities to increase farm-level efficiency and empower the poor farmers to better use and share data that are critical to their economic and social welfare. More importantly, mobilizing such technologies will facilitate the provision of financial services to the small and marginal farmers.

Developing a broader range of quality, transparent, and affordable financial services, based on informed needs of different poor groups, is an imperative of financial inclusion in Bangladesh society. The government strongly believes that all people should have access to: savings, payments, credit, insurance and other financial services as required by them. Ensuring the availability of a broader range of services and products will benefit both the recipients and the financial service providers. Through effectively responding to the needs of the people with the right range of products, the providers would also be able to deepen their relationships with the service recipients, broaden their market share, expand their business in a socially responsible manner and reduce their own risks. The need for a diverse range of products is not new and the financial institutions in Bangladesh have already started exploring ways to offer a full set of services that the recipients would find useful over time. While the government should encourage such efforts, new ways of thinking about diverse offering of financial services to the low income people should be given priority. In this respect, the relevant strategies should highlight three core requirements for unleashing innovations in product development: (i) **incentives:** encourage the management to invest in research and development for innovation and risk appetite; (ii) **organizational capacity:** provide necessary support for integrating systematic ways to interact and learn from the poor groups of their product development needs and management buy-in; and (iii) **regulatory environment:** bring about required changes, as necessary, in the regulatory environment so that it allows for, and encourages, the development of new products and approaches to financial inclusion and for product innovation to flourish.

Barriers and policies to increase access

Like in most other developing countries, the access to financial services is still limited in Bangladesh. It is estimated that about 46 million of the country's adult population still remain excluded from accessing financial services who are mostly the poor individuals. The lack of financial access for the poor has been addressed, to a large extent, by rapid developments in the microcredit sector and speedy expansion of the microfinance institutions over the past few decades in Bangladesh. These institutions have managed to provide financial services to a significant number of the country's poor including the poorest along with achieving good repayments. However, still significant efforts are needed to build inclusive financial systems in the country. This includes, among others, taking full advantage of the technological advances in developing financial infrastructure and architecture to lower transaction costs, encouraging transparency, openness and competition to encourage the financial institutions to expand service coverage to the excluded groups, and enforcing prudential regulations to provide the financial institutions with the right incentives to move towards developing an inclusive financial sector.

Mechanisms of microfinance

Microfinance supplies small loans and other basic financial services to the poor in recognition of the fact that the poor people need these services (e.g. loans, savings, insurance and money transfer services) for improving their socioeconomic conditions and moving out of poverty. In Bangladesh, a country which is the mother of microcredit and the land for its successful innovation, microfinance has proven to be a powerful instrument for sustainable poverty reduction, enabling the poor to accumulate assets, boost their incomes, and reduce their economic vulnerability.

In Bangladesh, several high-performing microfinance institutions, including government agencies and the NGOs, have developed innovative methodologies to extend credit, savings and other services to the poor clients. Moreover, advances in information technology offer the opportunity to lower the cost and risk of providing microfinance to the poor. The overwhelming majority of the country's microfinance borrowers are women. The microfinance borrowers, however, form a diverse group which includes female heads of households, self-employed individuals or small businesses, pensioners, displaced people, retrenched workers and small/marginal farmers and other informal sector participants all of whom generally remain excluded from the traditional banking system and rely on informal delivery systems for their financial services.

The role of the government should be to assist in improving the functioning of the microfinance sector especially through developing institutional and technical capacities especially at the level of retail microfinance financial institutions (MFIs). This will contribute greatly towards developing the domestic financial systems that serve the poor. The efforts will encourage the microfinance institutions to take on risks that traditional financial institutions would not usually share. Such efforts would enable the poor to push the frontier of poverty outreach away and extend the supply of financial services to people in remote areas. Such efforts would also include mechanisms for adopting digital technologies for improving service delivery and payment systems and further improve the microfinance environment having a sound legal and regulatory framework at the macro level.

Information on Best Practices

Regulatory authorities in the financial sector should document best practices in mobilizing financial resources and providing credit and other financial services especially to the poor and under-served or un-served regions or households. Disclosure of such information among the financial and lending institutions will encourage other institutions to participate in the process.

Financial Literacy

Although intensity of access to financial services is relatively high in the country, it does not necessarily indicate that all households, especially the poor, have complete information and knowledge about financial services. In many cases, they may not be aware of the available services or how to access these services. For instance, literacy level is quite low in the case of insurance services. Awareness about financial services needs to be raised through different programmes including advertisement and campaign.

Partnership between Formal and Quasi-Formal Institutions

In the present situation, formal banks and financial institutions have significant limitations in extending financial services to the unbanked areas and un-served or under-served households due to the dominant production technology they use and the cultural orientation they possess. In this respect, the quasi-formal financial institutions have advantages and they have achieved commendable progress. Thus the formal financial institutions have more resources while the quasi-formal institutions have higher level of capability and efficiency. Developing partnerships between the formal and the quasi-formal financial institutions can create an effective mechanism to reach out to the poor and un-served regions, households and enterprises.

Transaction Cost of Borrowing

Transaction cost is one of the major determinants of access to finance. Transaction cost of borrowing matters in intensity of access to finance and determining the loan size. For the formal financial institutions, transaction costs may be reduced through adopting a number of supply side actions such as increasing bank branch density and improving efficiency of their operation through innovation in loan production technology e.g. minimizing waiting period for loan sanctioning and focusing on better governance so that efficiency is increased and illegal transaction cost is reduced for the borrowers.

Learnings from MFIs and Informal Market

Experience of the MFIs and the informal market suggests that credit services can be rendered even to the extreme poor households without any collateral and third party guarantee. The reason is that the loans are provided under intensive monitoring mechanisms along with appropriate incentive structures. The experience also suggests that loan products can be diversified in the formal financial sector. The formal financial institutions (especially the banks) may learn lessons from these experiences to adapt their activities accordingly. The risk on the part of the lending institutions can be significantly reduced through strengthening the Credit Information Bureau and decentralising its operation to facilitate quick generation and dissemination of relevant information.

Promoting a Competitive Financial System

Bangladesh Bank should develop an enabling environment for creating a competive financial system with appropriate incentives and governance system so that banks can provide financial services ensuring a high degree of efficiency. In practice, the non-interest cost of borrowing is seen to be higher for the public sector banks relative to the private sector ones. In addition, the moral hazard problem is a dominant issue in the public sector financial institutions especially in the agricultural development banks (BKB and RAKUB). The government and the BB should take prudent action to fix the problem and create a congenial environment so that the borrowers are able to receive services at low cost and the depositors can get a fair return.

In Bangladesh, a number of policies and measures have been taken in recent years for improving the access to financial services especially for the poor which have significantly improved the situation. The SCBs and DFIs have already opened a total of about 9 million new Tk. 10 accounts for the farmers. These accounts will help the government to make direct payments of subsidies or other benefits to the accounts of the recipients. The operation of these accounts will also encourage these basic bank account holders to go on to buy other financial products and thus stimulate the demand for other financial services. It is likely that the opening of farmers' accounts will facilitate these farmers to move to higher levels of financial transition leading to greater financial inclusion. For the purpose, just opening the accounts is not adequate, the challenge is to keep these operational and active.

In addition, several other issues should also be considered during the 7th Plan period for effectively addressing the challenges for promoting adequate access to financial services by the poor.

- The measures adopted so far for enhancing access of the poor to the formal financial system are mostly driven by regulation by the BB or other institutions. These measures seldom reflect the initiatives of the banking and other financial institutions. It is important to promote ownership of the initiatives in order to ensure their sustainability.
- Although the situation has improved significantly, the current measures fall short of satisfactorily addressing the demand side problems of the financially excluded sections of the population. It must be recognized that access to financial services has both demand and supply side dimensions and both need to be recognized.
- The traditional approach of the formal banks and financial institutions under which the clients come to the institutions rather than financial institutions going to the households and firms needs to be reversed with pro-active efforts by the banks to expand access to financial services.
- For improving the access to financial services, the present focus on women needs to be further strengthened along with developing women-friendly financial products and services.
- There is a need to adopt measures to improve financial literacy and establish credit counseling centres especially targeting excluded population groups and regions. Similarly, relevant authorities should organize

regular and extensive training and skill development programmes on different aspects of financial inclusion for the financial service providers.

- The relevant authorities (e.g. BB) should develop financial inclusion programme similar to the mandatory agriculture/rural finance programmes. All banks operating in the country would be required to participate in the programme and each bank should be assigned specific under-banked districts/areas where promoting financial inclusion will be its responsibility which would be monitored by the BB using rational and measurable indicators.

- For promoting access to financial services at the required pace and breadth, BB should develop and adopt a comprehensive and detailed guideline for creating inclusive financial system involving the formal banks and financial institutions.

- New strategies and efforts are needed to enhance the role of the postal banking system as a viable and efficient alternative financial service provider especially in the rural areas of the country.

- A strengthened insurance sector can play an important role in providing financial services to the population including the poor for which huge potential exists. Although more than 60 insurance companies operate in the country, their outreach is quite limited. Efforts are needed to transform the insurance sector into a dynamic one through introducing poor-friendly products and proper monitoring of its operations by strengthening the Insurance Regulatory Authority (IRA).

- For improving the access to financial services in remote and disadvantaged locations including char and haor areas, a number of policy initiatives are needed such as exploring more viable solutions to the problems in char and haor areas, enhancing capacity of the formal financial institutions to serve these areas in a flexible and cost-effective manner, creating partnership between formal and quasi-formal institutions and developing customized financial products to meet the specific needs of the char/haor dwellers based on the experience of the MFIs.

Overall, a wide variety of policy initiatives are needed for scaling up the delivery of formal and quasi-formal financial services to the population. This will help improve the access of the poor and low income families to financial services and prevent serious problems related to non-availability of credit such as falling into debt traps or losing one's productive assets. In this respect, the private sector has an important role to play in better serving the poor households. For example, bank accounts tailored to the needs of the poor households (e.g. low fees, no minimum balance) will expand the poor's use of formal financial services. A greater presence of formal financial institutions in rural areas and low-income neighbourhoods may also be important. Currently quasi-formal and informal financial service providers outnumber bank branches in these areas.

Of course, the public sector can do many things to increase savings and greater use of formal financial services among the poor households. A key public sector role should be to work closely with the private sector encouraging and incentivizing financial institutions to serve the poor and lower-income populations. Greater financial education for these households is a priority. The government and the BB can also play an important regulatory role, which includes overseeing financial providers to ensure that they provide a range of poor-friendly financial services and implement better protections for the poor financial service receivers. The public sector could also encourage saving by low-income families through implementing different incentive mechanisms and matched savings plans. It must also be recognized that the country's formal financial institutions are not well designed to encourage access to financial services by the poor and low-income households. To the extent the relevant policies want the poor households to have the access to financial services to ensure their economic empowerment and better livelihoods, the need would be to create their access to banking, credit, and savings institutions that are available to the rest of the society.

Chapter 1
Introduction

1.1 Background

Finance is a powerful intervention for economic growth especially in a resource-constrained developing country like Bangladesh. Access to finance especially to the poor is essential for promoting inclusive economic growth and eradicating poverty in the country.[1] Financial services cover a host of areas including credit, savings and insurance. There exists a growing evidence of beneficial impact of access to financial services on all aspects of social and economic outcomes at the household and firm level (see King and Levine 1993, Beck et al 2000, Beck and Demirgue-Kunt 2004, Levine 2005, Demirgüc-Kunt et al 2008). The country's development strategy recognizes that socioeconomic opportunities and development in Bangladesh will be undermined if expanded financial services are not available especially to the poor and other disadvantaged groups who are deprived of access to these services and who need these services.

A well-functioning financial system is, by definition, efficient in allocating funds to their most productive uses. It also serves other vital purposes such as offering savings, payment, and risk management products for financing growth activities. While efficiency and stability aspects of financial systems are important considerations, the access to financial services has been emphasized in recent development policies since the lack of access often becomes the critical element leading to rising income inequality and slower growth. Moreover, it is often seen that financial exclusion leads to broader social exclusion. In contrast, inclusive financial system focuses on expanding and equalizing opportunities and creates positive incentive effects.

Financial intermediation is the process by which finance is mobilized and used in the economy. A developed inclusive financial system not only expedites the process of resource mobilization and use, but it also provides financial services to all who need them. An inclusive financial system provides a number of benefits to the economy. It makes available more resources for investment especially for the promotion of small and medium enterprises (SMEs). It creates employment opportunities, ensures economic and financial stability through reducing vulnerability and contributes to poverty reduction.[2] Access to a well–functioning financial system can economically and socially empower individuals, in particular poor people, allowing them to better integrate into the economy and actively contribute to development. In particular, expansion of financial services targeted to the poor and low-income population can play a vital role in enhancing financial access. In an inclusive financial system, no segment of the population remains excluded from accessing financial services.[3] The concept of financial inclusion is quite comprehensive

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[1] In practice, the term 'access to financial services' has multiple connotation. For example, some households may have actual access to financial services at present. On the other hand, there may be households who do not need financial services at present but may need the services in future. Again, there may be other households who would like to access financial services but do not have the access due to absence of the financial market or high transaction cost or high risk or other reasons. In this report, the term access to financial services is used based on current access to financial services in one or more financial markets.

[2] The experience of Grameen Bank, BRAC and other NGOs in Bangladesh suggests that access to credit contributes to poverty reduction, micro enterprise development and social development. Research studies in the area document a host of positive impacts of access to credit. A number of studies document that small enterprises are resource constrained and they have little access to bank credit. See for example, SEDF 2006; IFC 2014.

[3] According to the UN, an inclusive financial system would provide access to credit for all 'bankable' people and firms, to insurance for all insurable people and firms and to savings and payment services for everyone. See, UN 2006. It is widely maintained that financial exclusion is a barrier to economic development. See Beck et.al. 2008. It has been argued that an open and efficient society is always characterized by unrestrained access to public goods

and refers to availability of quality financial services in a convenient way, extending access to all segments of the population, providing equal opportunities and reducing financial inequalities in an economy.

In Bangladesh, the intensity of financial deepening was low, outreach of banks was limited, and the scope of lending was narrow due to limited outreach of the financial institutions in the past. The picture has, however, changed rapidly when micro finance institutions (MFIs) started to operate in the country. Along with the emergence of the MFIs and the government's emphasis on financial inclusion as an explicit development policy, the intensity and the access especially of the poor to financial services has increased rapidly in recent years. At present, the rural financial markets are more deep-rooted and more developed than ever before. The urban financial markets also feature high concentration of formal banks and institutions. At the end of 2013, the banks have expanded their network to nearly 8,700 branches while MFIs have a network of around 17,000 branches. Of the total number of bank branches, more than 57 percent are located in the rural areas.[4]

1.2 Objectives and Structure of the Report

The Government of Bangladesh through the General Economics Division (GED) of the Planning Commission has initiated the process of preparing the country's 7th Five Year Plan (2016-2020) as the main instrument for implementing the Vision 2021 and the Perspective Plan (2010-2021).

It may be noted that the Five-Year Plans provide the framework for launching the country's integrated national development process which guide public investment decisions. However, in view of the dynamic role of the private sector in economic development within the country's market-based development strategy, the focus of the Five Year Plans is mostly on strategic and indicative planning rather than allocating investments through direct interventions. Public sector investments are mostly responsive to the needs of the private sector with the objective of creating a facilitating and enabling environment for the private sector to flourish. These investments are mostly used for removing infrastructural and other bottlenecks in order to attract private investments especially to the priority sectors of the economy in order to attain the country's long term development objectives. In this context, the Plans are more focussed on eradicating poverty and hunger within the shortest possible time by adopting pro-poor and inclusive economic growth and development policies and ensuring social and economic justice to the marginalized and disadvantage groups in society.

Following the recommendations of the Concept Note of the 7th Five Year Plan, GED has commissioned the present background study on 'Improving Access of the Poor to Financial Services' for providing inputs to the Plan document.

In view of the specific purpose of the study, the analysis aims to identify opportunities for the poor and the extreme poor in Bangladesh to have access to financial services through banks/financial institutions to help them open up windows of opportunities by addressing constraints for investments and developing

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and services. As banking services are in the nature of public goods, financial inclusion should therefore be viewed as availability of banking and payment services to the entire population without discrimination of any type. From this perspective, financial inclusion has been defined as 'delivery of banking services and credit at an affordable cost to the vast sections of disadvantaged and low income groups. The various financial services include saving, loans, covers insurance, payments, remittance facilities and financial counseling/advisory services by the formal financial system'. See RBI 2008.

[4] For instance, MFIs alone disbursed around Tk. 350 billion and mobilized a net savings of Tk. 160 billion in 2009. See BB 2014.

their skills for better informed financial decisions during the 7th Five Year Plan period.[5] Within the above broad framework, the study has three major objectives. First, assess the present level of access to financial services especially by the poor; second, identify the major groups especially among the poor who suffer from financial exclusion; and finally, suggest a set of policies and measures for the 7th Plan that will enable the regulatory agencies and the financial institutions to provide access to financial services to the excluded groups. .

The report has been structured into four chapters. After the introductory remarks including objectives and the outline of methodology of the present chapter (Chapter 1), the second chapter provides an overview of the current status of access to financial services with a special focus on the poor and marginal groups. The chapter also explains how financial inclusion--as a process of increasing access to resources, skills and knowledge--enables the poor and the extreme poor to identify and prioritize investment opportunities, develop products and services mix, and identify markets for their products and services. Chapter 3 contains an analysis of the impact of access to finance on different outcomes in Bangladesh based on a review of the development of the process of financial inclusion; identifies the key sources of institutional finance for the poor; assesses the adequacy of the present sources of finance for the poor relative to the demand; and examines the impact on coping and poverty, employment, investment, and other indicators. The chapter also identifies the key constraints to the expansion of financial inclusion in terms of regulations, market participation, risk assessment, transaction costs and institutions.

Finally, Chapter 4 suggests a strategy for strengthening the access of the poor to financial services during the 7th Plan period. In this context, the chapter identifies specific ways especially with respect to the following: (i) how to acquire business entrepreneurship skills which would help the poor and the extreme poor women and men to become better-informed financial decision maker and contribute to their well-being; (ii) how to make the poor people's financial behaviour more pro-active especially in terms of responding to immediate problems and needs with less time devoted to consider options, trade-offs and longer-term consequences of over-indebtedness and erosion of assets; (iii) ways to increase financial literacy and awareness with improved attitudes, knowledge and skills to make decisions about savings, intelligent investments, borrowing and expenditure in an informed manner; and (iv) ways to increase access and reduce transaction cost. Based on the review of the existing microcredit and other specialized programmes of the banking sector including mobile financial services, the chapter also suggests ways to make these institutions more effective to serve the needs of the poor. Finally, the chapter identifies the main institutional and regulatory reforms that are needed to strengthen the financial inclusion process in Bangladesh.

1.3 A Brief Outline of Methodology

Given the nature and the scope of the study, the analysis has been carried out based on secondary data and materials. For the purpose, a detailed stock taking of available research and evaluation studies, relevant documents and other materials has been conducted on all issues on the state of access to financial services especially by the poor in Bangladesh.

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[5] Limited access to finance acts as a significant barrier to improving the quality of life of the poor and disadvantaged people in the country. For example, there has been development of high quality, solar-powered solutions targeting the needs of the energy poor which are being brought to households in the off-grid areas using new distribution models. Yet, affordability remains a significant barrier to its wider adoption. For most of the poor people living off-grid, lack of access to financing options e.g. loans, leasing, payment mechanisms, and so on is a primary barrier to adopting modern solar solutions. These poor households cannot afford to buy the modern energy products on a cash basis while formal finance providers have shown limited appetite to design products that meet the financing needs of the energy poor. One can cite examples of similar disadvantages in the case of other types of services as well.

Chapter 2

Access to Financial Services in Bangladesh: An Overview

This chapter provides an overview of the current status of access to financial services with a special focus on the poor and marginal groups. The chapter also explains how financial inclusion--as a process of increasing access to resources, skills and knowledge--enables the poor and the extreme poor to identify and prioritize investment opportunities, develop products and services mix, and identify markets for their products and services.

Since the study aims to improve the access to financial services of the poor through financial institutions in the formal and quasi-formal financial markets, an understanding of the size and depth of the formal and quasi-formal financial markets is useful. Although informal financial market exists in Bangladesh and is not likely to be fully replaced as a source of finance especially for the poor because of its nature and product features, an inclusive financial system requires wide access for the poor through formal and quasi-formal markets.

2.1 Measuring Financial Access

Various indicators can be used to measure the extent of access to financial services or the status of financial inclusion in an economy (see, for example, Mehrotra et al 2009, Sarma and Pais 2011, UN 2006). Broadly speaking, these indicators refer to two aspects of financial access: (i) outreach dimension; and (ii) actual usage dimension. In the case of outreach dimension, there are two types of indicators: geographical penetration (number of bank branches or ATMs per 1,000 square kilometers) and demographic penetration (number of bank branches or ATMs per 100,000 people). More bank branches and ATMs per 1,000 square kilometers signify lower distances to the nearest physical bank outlets and easier geographical access. Demographic penetration measures the average number of people served by each bank branch or ATM. Higher numbers imply that there are fewer clients per branch or ATM and also indicate easier access to bank services. Sarma and Pais (2011) provide a multidimensional index for measuring the degree of financial inclusion that includes information on bank penetration, availability of banking services and usage of banking system. Demirgüc-Kunt *et. al* (2008) also compile demographic and geographic penetration data on access of general banking branches or ATM booths.

In the case of actual usage dimension, two widely used indicators are: (i) number of loan accounts per 1,000 people; and (ii) number of deposit accounts per 1,000 people. These indicators measure the use of banking services/access to financial services. Another frequently used indicator of usage is the deposit-GDP ratio or credit-GDP ratio or (deposit plus credit)-GDP ratio.

2.2 Structure of Financial Markets

In Bangladesh, financial markets comprise of three broad segments: financial services offered by formal (financial institutions and banks) market; quasi-formal market (micro finance institutions and cooperatives) and informal market (moneylenders, traders, friends and relatives). Financial institutions mobilize resources from households, firms and individuals and lend to institutions and individuals who need credit for productive and other purposes. Insurance companies offer risk minimizing products to individuals and firms.

These three markets differ significantly in terms of their characteristics. Financial institutions in the formal market mobilize deposits and lend to those who need financial resources. Interest rates are generally liberalized, and determined by market forces. Transaction cost of providing financial services in this market is relatively low. Financial institutions in the country include commercial and development banks including agricultural and industrial development banks. There are also non-bank financial institutions. The network of both formal and quasi-formal institutions has expanded enormously over the years. Not only the number of branches has increased, the amount of deposits mobilized and the amount of loans have also grown exponentially over time.[6]

The quasi-formal markets offer financial products mostly to the poor households. Transactions in this market are significantly large in number because of small volume of individual transactions. In most cases, interest rates are perceived as high. Informal market, on the other hand, is diversified in terms of its operation. The interest rates usually vary from a low to very high levels. Although the informal market is widely considered to be exploitative, it continues to exist despite the rapidly expanding network of both formal and quasi-formal institutions because of several advantages such as flexibility, proximity and ease of operation. The informal market generally constitutes informal lenders and informal savings through informal organizations including informal cooperatives and clubs.

The Banking Sector

The banking sector in Bangladesh consists of four types of banks: state-owned commercial banks (SCBs), state-owned development financial institutions (DFIs), private commercial banks (PCBs), and foreign commercial banks (FCBs). At the end of June 2013, there were a total of 55 scheduled banks including four SCBs, four DFIs, 38 PCBs, and nine FCBs. These banks had a total number of 8,427 branches at the end of June 2013 (Table 2.1). Although the number of bank branches has increased substantially over the years (from 6,119 in 2000 to 8427 in 2013), the share of rural bank branches in total has, however, declined. In 2000, the share of rural branches was 60 percent in total which declined to 57 percent in 2013 (BB 2014).

The existing rural-urban distribution of bank branches suggests that banks are largely concentrated in the urban areas. It also shows that the intensity of access of rural households and enterprises to banks has not kept pace with their urban counterparts. It may, however, be noted that the number of branches per 100,000 population has increased and the number of branches per 100 square kilometer has risen since 2003. These indicate that the access to financial services from the banks has not improved to any significant level especially for the rural households.

Table 2.1: Structure of the Banking System in Bangladesh, 2013

Bank type	Number of banks	Number of branches	Total assets		Deposits	
			Billion Tk.	% of assets	Billion Tk.	% of deposits
SCBs	4	3520	2108.5	26.4	1631.2	26.0
DFIs	4	1494	454.8	5.7	343.0	5.5
PCBs	39	3602	4948.2	61.9	3939.2	62.8
FCBs	9	69	488.7	6.1	359.5	5.7
Total	56	8685	8000.2	100	6273.0	100

Source: BB 2014

[6] The total bank deposits (excluding inter-bank items) of the scheduled banks have increased from Tk. 1970.1 billion at the end of June 2007 to Tk. 5729.7 billion in June 2013. Over the same period, bank credit (excluding inter-bank items and foreign bills) of these banks rose from Tk. 1614.2 billion to Tk. 4370.2 billion. See, BB 2014.

When the Information on the number of scheduled bank branches by rural and urban locations in different administrative divisions of the country is considered, it appears that bank branches are mostly concentrated in Dhaka and Chittagong divisions accounting for nearly 60 percent of total bank branches in the country in 2013 (Table 2.2). Of the total, 43 percent of the bank branches are located in the urban areas although only around a quarter of the country's population lives in the urban areas. This shows that bank density is much higher in the urban areas compared with the rural areas.

Table 2.2: Scheduled Bank Branches by Division

Division	2011			2012			2013		
	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total
Chittagong	742	1034	1776	781	1089	1870	815	1146	1961
Dhaka	1523	1287	2810	1591	1385	2976	1675	1482	3157
Khulna	311	503	814	324	511	835	333	524	857
Rajshahi	315	587	902	321	605	926	331	611	942
Barisal	121	286	407	128	295	423	137	307	444
Sylhet	210	452	662	220	463	683	231	472	703
Rangpur	188	402	590	197	412	609	201	420	621
Total	3410	4551	7961	3562	4760	8322	3723	4962	8685

Source: Bangladesh Bank

The ability of the formal banking system to provide financial services and mobilize financial resources varies widely across different divisions as reflected in differing bank density in the divisions (Table 2.3). The number of bank branches per 100 sq. km. was 5.9 in the country in 2013 which varied from a high of 10.1 in Dhaka division to a low of 3.4 in Barisal division. Similarly, the country had 6.0 branches per 100,000 population in 2013 with a variation from 7.1 branches in Sylhet division to 3.9 branches in Rangpur division.

Table 2.3: Scheduled Bank Density by Division, 2013

Division	Branch per 100 sq.km.	Branch per 100,000 population
Chittagong	5.8	6.9
Dhaka	10.1	6.7
Khulna	3.8	5.5
Rajshahi	5.2	5.1
Barisal	3.4	5.3
Sylhet	5.6	7.1
Rangpur	3.8	3.9
Total	5.9	6.0

Source: Bangladesh Bank

Both bank advances and deposits have also increased in urban and rural areas over the last two decades (Table 2.4). In the rural areas, however, advance as a share of rural deposit has declined from 79 percent in 1991 to less than 48 percent in 2009. In the urban areas, advance as a share of urban deposit appears to have been utilized almost fully after accounting for statutory and cash reserve requirements. The declining share of rural advances indicates that the banks tend to lend more in the urban areas, and rural deposits are transferred to the urban areas for the purpose. Such a rural-urban structure of lending can probably be justified from growth, equity and welfare grounds only when the demand for rural credit is met by the banking institutions. Although no direct evidence is available, the rapidly growing demand for microcredit in the rural areas indicates that the rural areas need injection of more financial resources and any constraint in this respect is likely to undermine rural growth.

Moreover, the reality within the existing socioeconomic structure is that the poor and the low income marginalized households have little access to formal financial services. As a matter of fact, the major factor behind the emergence of the quasi-formal financial institutions (e.g. MFIs) in Bangladesh is the failure of the formal financial institutions to provide access to financial services to the poor and the low income households.

The Microfinance Sector

The limitations of the formal financial market to cater to the needs of the poor led the MFIs to operate especially in the rural areas since the 1970s. These initiatives included provision of credit for the poor including other development inputs. It is perceived that microcredit can create economic opportunities for the poor households and can contribute to their graduation out of poverty in the long run. Over the years, microcredit programmes have been taken up by the non-government organizations (NGOs) including the Grameen Bank, BRAC and others as well as state-owned commercial banks, private commercial banks, and under specialized programmes of different ministries.[7] Innovative models of microcredit delivery have also been developed including those for the extreme poor and other marginalized groups.

Over the years, the microfinance sector has expanded rapidly in Bangladesh in terms of number of microfinance NGOs (MF-NGOs), number of branches and active membership. There was no formal regulatory framework for the MFIs until 2006. The government established the Microcredit Regulatory Authority (MRA) in 2006 to bring transparency and accountability and enhance the efficiency of the MFI operations in the country. By 2014, a total of 719 MFIs have been granted licenses for the operation of microcredit. However, there are many more institutions who are conducting microfinance operations and the MRA is in the process of granting licenses to these organizations (MoF 2014).[8] Table 2.5 shows that there are a total of 24.60 million clients in 649 licensed NGO-MFIs having a total of 14,674 branches in June 2013.[9] Despite the existence of over-estimation, the figures show that the intensity of access of the members to financial services of the MFIs has been rising over the years.

The microfinance sector is financed by several sources such as savings collected from the clients, cumulative surplus (profit) of the organization, concessional loan received from sources such as the Palli Karma Sahayak Foundation (PKSF), grants received from national and international donors and

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[7] In June 2013, the microfinance sector had a total loan outstanding of around Tk. 341 billion (including Grameen Bank Tk. 84 billion) and savings of Tk. 226 billion along with a total client of 33 million (including 8.04 million clients from Grameen Bank). Credit services of this sector can be categorized into six broad groups: (i) general microcredit for small-scale self employment based activities; (ii) microenterprise loans; (iii) loans for the ultra poor; (iv) agricultural loans; (v) seasonal loans; and (vi) loans for disaster management. A loan amount up to Tk. 50,000 is generally considered as microcredit while loans above this amount are considered as microenterprise loans. See, Microcredit in Bangladesh, MRA website.

[8] Under the law, it is mandatory for all NGO-MFIs to procure licenses from the MRA. Till May 2014, MRA had approved licenses in favour of 742 NGOs and canceled licenses of 44 NGOs. At the time, there were another 43 applications under process for a final decision although these were mostly small organizations with some potentiality to become viable in course of time. Until May 2014, a total of 3,456 applications for registration were rejected for failing to meet the required criteria. In practice, thousands of MGO-MFIs operate in the country though their scale of operation is relatively small.

[9] But these numbers should be treated with caution since there is considerable double counting in the numbers reported by the MFIs. Such double counting takes different forms such as multiple memberships, multiple borrowing within the same institution and inclusion of drop-out members. One study estimates that multiple borrowing from different institutions is around 42 percent. The study estimates that the actual number of members will not exceed 20 million in 2009 when the reported number was 35.71 million. According to the study, the individual membership overlapping has been around 8.6 percent in 2000 which is 31 percent in 2009. See Khalily 2013.

commercial bank borrowing. In 2013, the most important source of fund for the NGO-MFIs was clients' savings (33 percent) followed by cumulative surplus (30 percent) as the second most important source of fund. Loans from commercial banks had a share of 15 percent while funds from PKSF (the micro finance wholesale funding agency) provided 12 percent of the loan fund at a subsidized rate. Grants from the donor agencies constituted less than 3 percent of the total loan fund.

Along with a widening network of MFIs, the sector has also witnessed rising volume of loan disbursement and increasing number of outstanding borrowers (Table 2.4). During the end of 2011, the amount of loans outstanding was nearly Tk. 290 billion, around 64 percent of the annual loan disbursement in the year. It may be mentioned that these outstanding borrowers include multiple borrowing. On the whole, the figures reflect high microcredit deepening in the country. Some information on rural-urban division shows that the overall volume of microcredit services is relatively high in the rural areas (Table 2.5). It shows that more than 89 percent of the MFI loans disbursed in 2011 and 90 percent of the outstanding loans were in the rural loans. This suggests that micro credit deepening has taken place enormously in the rural areas. These figures indicate that the access of the poor households to microcredit particularly in the rural areas is relatively high in Bangladesh.

Table 2.4: Trend in Deposit and Advances by Region, 1991-2013

(in billion Tk.)

Year	Urban			Rural			Total		
	Deposit	Advance	Advance-deposit ratio (%)	Deposit	Advance	Advance-deposit ratio (%)	Deposit	Advance	Advance-deposit ratio (%)
1991	197.3	176.9	89.7	53.3	42.2	79.1	250.6	219.1	87.4
2000	549.2	493.5	89.9	160.6	100.1	62.3	709.8	593.6	83.6
2005	1197.8	999.7	83.5	218.3	117.6	53.9	1415.9	1117.3	78.9
2010	2942.3	2367.5	80.5	436.9	206.9	47.4	3379.2	2574.4	76.2
2012	4011.0	3453.7	86.1	853.1	405.6	47.5	4864.1	3859.3	79.3
2013	4988.2	3987.8	79.9	1117.1	450.6	40.3	6105.3	4438.4	72.7

Source: Bangladesh Bank

The Cooperatives Sector

Despite significant potential, the cooperatives sector does not have a notable presence in the financial market in Bangladesh. Although comprehensive information on the sector is lacking, available information shows that the total number of central cooperatives was 1,099 in 2009-10 which remained at 1,103 and 1,101 in 2010-11 and 2011-12 respectively (BBS 2013). The number of primary cooperatives is reported to be 168,184 in 2009-10 which slightly increased to 175,839 in 2010-11 and 183,363 in 2011-12. The information on the number of members also shows a similar picture. In 2009-10, the number of members was 132,550 for central cooperatives and 8.7 million for primary cooperatives. The numbers were 132,372 for central cooperatives and 9.0 million for primary cooperatives in 2010-11 and 133,288 for central cooperatives and 9.2 million for primary cooperatives in 2011-12. These show that much of the potential of the cooperatives sector remain untapped and a renewed and refocused approach to the cooperatives sector is needed to transform the sector into a dynamic and vibrant route to expanding the access to financial services to the poor.

Overall, the foregoing analysis of financial services shows that although the formal financial institutions have a wide network in the country, these institutions show a declining ratio of rural advances to rural deposits over time which has undermined rural investments through formal credit. This, however, does not necessarily indicate low demand for credit services in the rural areas as evidenced by rapid growth in quasi-formal credit in the rural areas. Nearly 700 licensed MFIs have a network of over 18,000 branches along with outstanding borrowers of more than 34 million. Around 90 percent of micro finance operations take place in the rural areas. These developments show that, with limited role of the formal banks, higher access to financial services especially by the poor in the rural areas has largely been achieved through deepening of micro finance operations in the country.

Table 2.5: NGO-MFIs in Bangladesh

	2009	2010	2011	2012	2013
No. of licensed NGO-MFIs	419	516	576	590	649
No. of branches	16,851	17,252	18,066	17,977	14,674
No. of employees	107,175	109,597	111,828	108,654	110,734
No. of clients (million)	24.85	25.28	26.08	24.64	24.60
No. of borrowers (million)	18.89	19.21	20.65	19.31	19.27
Loan outstanding (billion Tk.)	143.13	145.02	173.80	211.28	257.01
Amount of savings (billion Tk.)	50.61	51.36	63.30	75.21	93.99

Note: Figures refer to June of each year. The statistics cover those NGO-MFIs which are registered with the MRA.
Source: Microcredit in Bangladesh, MRA website.

Recent statistics show that savings per member has been increasing over the years. In 2009, savings per member was Tk. 1,735 which increased to Tk. 3,820 in 2013 (Table 2.5). The loan outstanding per borrower also increased over the years. The rising trend of these two indicators is perhaps due to increase in the income level of the poor resulting in an increase in their need for higher amount of loans from the MFIs. On the other hand, the ratio between borrowers to clients remained steady (70 to 80 percent) over the last few years and savings to outstanding loan ratio also remained stable. In addition, the number of members and borrowers per branch decreased mainly due to rapid horizontal expansion of branches in new geographical areas. Rapid increase in the size of loans per borrower and savings per member has resulted in a rise in the total loan outstanding and savings in the MFI sector.

The Insurance Sector

There are a total of 77 insurance companies operating in the country of which 31 are life insurance companies and the remaining 46 are non-life insurance companies. The total number of insurance policy holders was 17.1 million in 2013 of which 16.0 million had life insurance policies. The total number of insurance policies was 17.97 million in the year including 16.50 million life insurance policies. The insurance industry has the potential to emerge as the premier financial service provider in the country and a vibrant component of the country's capital market. The insurance industry needs to be regulated under comprehensive laws and guidelines and supervised by a strong regulatory authority. The Insurance Act 2010 maintains that the sector needs to be managed properly and strengthened by reducing business risks and through harmonizing local and international insurance laws considering the socio-economic realities of the country and for protecting the interests of the policy holders and other beneficiaries.

Despite the existence of a large number of insurance companies (with about 15 million life insurance and 1 million non-life insurance policy holders) in the country, the sector has marginal coverage of micro-insurance activities for the poor. For providing access to insurance services to the poor, an important agenda is to develop micro-insurance products (with certain special characteristics such as coverage, premiums, delivery channels, terms and benefits) which are of value to the poor. The challenge would be to design micro-insurance services (e.g. micro life insurance, micro health insurance, crop insurance, livestock insurance, micro enterprise insurance) which would be risk shifting devices offered by the insurance companies especially suited to the needs of low income households and which would be affordable. At present, a group of mainstream insurance companies, MFIs and professional organizations (e.g. International Network for Alternative Financial Institutions) are offering some 'micro-insurance' products which need to be re-designed to better serve the poor. The Seventh Plan should look upon micro-insurance as an important potential means of minimizing the risk of future poverty due to personal disasters to various idiosyncratic shocks.

2.3 Access to Financial Services: Current Status

In Bangladesh, indicators of both outreach and actual usage dimensions show that the overall access to financial services of the population has increased rapidly especially in recent years.

Table 2.6: Loan Disbursement by and Loan Outstanding of MFIs

Year	Annual disbursement (billion Tk.)	Loan outstanding (billion Tk.)	Outstanding as % of disbursement	Outstanding borrower (million)
2000	33.17	21.90	66.02	7.98
2005	92.60	55.68	60.13	13.94
2008	311.06	134.68	43.30	17.79
2009	370.80	143.13	51.04	18.89
2010	383.60	145.02	38.60	19.21
2011	406.18	246.09	60.59	29.02
2013	553.09	340.95	61.64	27.66

Note: Figures for 2000 and 2005 do not include Grameen Bank data.
Source: Institute of Microfinance

Access to Banks

The geographical penetration indicator shows that the number of bank branches per 1,000 square kilometer has increased from 44.2 in 2005 to 59.0 in 2013. On the other hand, the number of ATM booth per 1,000 square kilometer has risen at a fast rate from 0.8 in 2005 to 14.4 in 2010 (Islam and Mamun 2011). In terms of demographic penetration, the number of branches per 100,000 population has increased from 4.7 in 2005 to 6.0 in 2013. Similarly, the number of ATM per 100,000 population has risen from 0.1 in 2005 to 1.4 in 2010. These trends in geographical and demographic penetration indicate that the access to banking services is rising rapidly in Bangladesh.

Table 2.7: Selected Statistics of MFIs in Rural and Urban Areas, 2011

	Rural areas	Urban areas	Total
Savings behaviour			
Net savings (billion Tk.)	175.99	10.16	186.15
Borrowers of MFIs			
Active borrowers (million)	24.75	2.43	27.18
Loan disbursement and recovery			
Disbursement (billion Tk.)	393.75	46.54	440.29
Recovery (billion Tk.)	382.61	48.45	431.06
Outstanding (billion Tk.)	250.93	28.89	279.82

Note: The close correspondence between disbursement and recovery figures does not imply that all loans disbursed during the year are repaid. The recovery figure includes repayment of past loans as revealed by the higher figure of recovery relative to disbursement during the year.
Source: Institute of Microfinance

Another positive aspect of these developments is that the access to banking services in the rural areas in terms of several indicators like bank branch expansion and the number of deposit and credit accounts has risen quite impressively over the last decade. During 2005-2010, total rural bank branches increased at an average annual rate of more than 3 percent while, during the same period, the number of deposit accounts grew by 12 percent in the rural areas compared with 8 percent in the urban areas. The number of credit accounts during the period increased by 0.5 percent in the rural areas relative to 4.4 percent in the urban areas (Islam and Mamun 2011). In the rural areas, the number of deposit account per 1,000 people was 127 in 2005 which rose to 189 in 2010, while the number of credit account marginally declined from 53 in 2005 to 51 in 2010. Overall, the number of deposit and loan accounts per 1,000 population was 242 and 62 respectively in 2005 which increased to 333 and 63 in 2010. On the other hand, the deposit-GDP ratio increased from 42 percent in 2005 to 53 percent in 2010 while the loan-GDP ratio increased from 32 percent to 43 percent over the same period.

Access to Micro Finance Institutions

The access to financial services through the MFIs is remarkable in Bangladesh. As noted earlier, a total of 649 MFIs (registered with MRA) were operating in Bangladesh with 14,674 branches throughout the country (mostly in the rural areas) in 2013 having 24.60 million clients of whom the vast majority are women. Total savings mobilized by the MFIs rose to Tk. 226.2 billion in 2013 from Tk. 47.4 billion in 2008 while total loan disbursement stood at Tk. 553.1 billion in 2013. In addition, thousands of small NGOs (not registered with the MRA) are operating in the country providing financial services to the poor especially women in the rural areas.

Overall Access to Financial Services

The overall access to financial services is shown in Table 2.8. The numbers indicate a steady and modest increase in the access to financial services. The overall access as a share of total population increased from 44 percent in 2005 to more than 65 percent in 2013. As a share of total adult population, it increased from 71 percent to 101 percent (including multiple account holders and multiple memberships in NGO-MFIs and cooperatives) over the same period especially due to the opening of a significant number of Tk. 10 accounts for the poor farmers.

2.4 Regional Variation in Access to Financial Services

The Institute of Microfinance (InM) conducted the Access to Financial Services (A2FS) Survey, a comprehensive national survey of all major financial services (savings, credit and insurance), between October 2009 and April 2010. The survey shows that around 77 percent of the households have access to any financial services in Bangladesh (Table 2.9).[10] However, the access to formal financial services is only 37 percent and that to quasi-formal finance is 43 percent. A total of 26 percent of the households have access to informal finance.

Moreover, the access to financial services varies over different administrative divisions in the country. It may be noted that Barisal and Rajshahi divisions have relatively high dependence (53 percent and 56 percent respectively) on quasi-formal finance, while formal finance dominates in Dhaka and Chittagong divisions (41 percent and 42 percent respectively). Despite higher intensity of access to quasi-formal and formal finance, the size of informal market is still large. The access to any informal finance is high in all divisions except in Khulna and Dhaka divisions.

[10] The survey covered all regions of Bangladesh except Rangamati district. Total sample size was 8,936 households of which 6,636 were rural and the rest 2,300 were urban. For details see Khalily and Khaleque 2013.

The survey shows that the poor and the rural households have higher access to quasi-formal finance (52 percent and 46 percent respectively). On the other hand, the non-poor (44 percent) and the urban households (54 percent) have higher access to formal finance. This is not surprising as the MFIs provide services mostly to the poor in the rural areas and the non-poor have better ability to meet the requirements of accessing formal finance. It is seen that although nearly 52 percent of the poor households have access to quasi-formal finance, 40 percent of the non-poor also have access to quasi-formal finance. Such a high presence of the non-poor in the quasi-formal market may be due to two factors: first, mistargeting by the MFIs such that the non-poor households also get entry into the targeted programmes for the poor; and second, rising access to quasi-formal finance by the poor households who have eventually graduated above poverty but prefer to use the financial services.[11]

In terms of specific financial services such as credit, savings and insurance, the survey shows that 57 percent of the households have access to savings while 54 percent have access to credit in any financial market (Table 2.9). The higher intensity of access to savings services may be explained by the more intensive intermediating role of the financial institutions to mobilize resources in all markets. The results show that financial institutions mobilize savings from a relatively large number of savers and lend to a smaller number of borrowers. The insurance service is rather limited with only 11 percent of the households having access to the service.

Table 2.8: Trends in Access to Financial Services

Year	Population (million)		Population per bank branch (thousand)	No. of bank deposit accounts (million)	Deposit accounts as % of adult population	No. of members in MFIs (million)	MFI members as % of adult population	No. of members in cooperatives (million)	Cooperative members as % of adult population	Access to financial services (%)	
	Total	Adult								Adult population	Total population
2000	111.46	75.16	18.4	28.40	37.8	…	…	…	…	…	…
2005	137.00	83.80	21.4	33.10	39.5	18.82	18.8	7.9	9.5	71.4	43.7
2008	142.40	89.62	20.6	37.60	43.8	23.53	23.5	8.4	9.8	77.6	48.9
2009	144.20	92.24	19.7	38.97	42.3	24.90	24.9	8.6	9.4	78.6	50.3
2010	146.10	94.50	19.0	48.68	51.5	24.94	24.9	8.8	9.3	87.2	56.4
2013	153.7	99.4	17.7	66.68	67.1	24.60	24.8	9.3	9.4	101.2	65.4

Note: The figures need to be interpreted with caution since these are not corrected for multiple accounts held by single individuals or multiple memberships in NGO-MFIs and cooperatives. Available evidence shows that the incidence of such multiple memberships is quite high among those having access to financial services.
Source: Islam and Mamun 2011, BBS 2013

The survey indicates that the poor households have higher access to credit (59 percent) relative to the non-poor households (52 percent) while the non-poor households have greater access to savings (61 percent) relative to 47 percent for the poor and insurance services (13 percent) compared with 7 percent for the poor. It is also seen that the urban households are mostly (67 percent) savers and the rural households are mostly borrowers (56 percent). These urban-rural differences are linked with higher coverage of the formal market in the urban areas and the greater presence of the quasi-formal market in the rural areas. The expansion of MFIs and the wide coverage of poverty-targeted programmes both by the government and the NGOs have no doubt contributed to high intensity of access of the poor and the rural households to financial services. In terms of geographical location, the access to savings is relatively high in Dhaka, Chittagong and Rajshahi divisions while the access to credit is high in Barisal and Rajshahi divisions.

[11] One may, however, argue over the issue of mistargeting since these non-poor households get financial services from the quasi-formal market. If they do not have access to this market, these households might have been left out of the financial system.

2.5 Progress in Technology Adoption

For providing financial services more efficiently at lower costs and at shorter time especially in remote areas, recent technological innovations in the ICT sector has been playing a significant role. In Bangladesh, financial institutions especially the banks have rapidly adopted various modern technology such as installation of ATM, POS, introducing credit and debit cards, use of mobile phone, internet banking, on-line banking and tele-banking in providing banking and other financial services. In recent years, mobile banking has emerged as the potent instrument for increasing outreach of financial services.[12]

Table 2.9: Access to Financial Services in Bangladesh, 2009-10

Location	Access to any financial services in any market	Access to any financial services (excluding insurance)	Access to quasi-formal finance	Access to formal financial services	Access to informal finance
National	76.8	73.4	43.2	37.0	26.2
Division					
Barisal	80.6	77.2	53.3	37.9	29.3
Chittagong	78.6	75.1	36.1	41.7	33.6
Dhaka	78.9	76.1	41.4	41.1	22.2
Khulna	63.8	56.5	35.4	36.6	12.0
Rajshahi	79.7	77.1	56.2	28.7	32.1
Sylhet	70.3	68.7	24.7	35.5	30.6
Poverty Status					
Non-poor	79.4	76.0	39.7	44.4	21.7
Poor	70.6	67.1	51.7	19.4	27.4
Area					
Rural	75.5	71.9	46.4	32.8	27.4
Urban	81.7	79.0	30.9	53.5	23.6

Source: Khalily and Khaleque 2013

At present, mobile phone has emerged as an ideal platform for increasing outreach of financial services to the rural population as mobile phone penetration is already high and rapidly growing in the country (Mehrota et al 2009).[13] Recent statistics indicate that the adoption of modern technology in banking services is quite impressive in Bangladesh. The number of ATM booth has increased from 118 in 2005 to 2,855 in 2011. On the other hand, the number of POS has increased impressively from 3,121 in 2005 to 17,183 in 2011. The total number of debit and credit card clients has increased from 0.11 million and 0.15 million in 2005 to 6.0 million and 0.61 million respectively in 2011. Over the same period, the number of

[12] It may be mentioned here that the first mobile financial service deployment was launched in Bangladesh in mid-2011 and, by the end of 2013, the technology is being used by 22 percent of the country's adult population. Till now, Bangladesh Bank has approved more than 20 licenses to offer mobile financial services in the country.
[13] For further discussion on the issue, see Section 4.2.

mobile banking clients grew by around 62 percent to 0.21 million in 2011. The statistics show that, out of 47 banks, 38 banks use modern facilities such as internet banking, online banking and tele-banking.

In particular, recent trend in mobile banking indicates that financial inclusion is scaling up rapidly in the country especially in the rural areas and locations where no bank branches are now available. The rapidly rising number of mobile phone subscribers and increasing tele-density are now creating new opportunities for the banks and the MFIs to use the mobile technology in improving access to financial services and serve the unbanked people at lower cost especially in the rural areas.

In addition, agencies like the Bangladesh Post Office also provide financial services to the people with its wide network of post offices across the entire country. Its services include savings bank, saving certificate and life insurance services. During 2012-13, total deposits in the Post Office Savings Bank amounted to Tk. 50.57 billion along with a withdrawal of Tk. 57.75 billion. The value of saving certificate sold in 2012-13 was Tk. 69.48 billion. The Bangladesh Postal Department has introduced electronic money transfer service (EMTS) in 1,150 post offices throughout the country including all district Head Post Offices and Upazila Post Offices.

Table 2.10: Access to Specific Financial Services in Bangladesh, 2009-10

Location	Access to credit	Access to savings	Access to insurance
National	54.1	56.5	11.1
Division			
Barisal	66.4	42.5	14.4
Chittagong	48.2	60.4	13.3
Dhaka	50.6	60.8	10.4
Khulna	41.1	35.5	15.7
Rajshahi	68.5	64.0	8.1
Sylhet	45.4	47.8	8.5
Poverty Status			
Non-poor	52.1	60.5	12.7
Poor	59.0	47.0	7.3
Area			
Rural	56.2	53.9	10.9
Urban	46.1	66.7	11.9

Source: Khalily and Khaleque 2013

Chapter 3

Access to Finance for the Poor and Impact on Socioeconomic Outcomes

This chapter provides an overview of poor's access to financial services and analyzes the impact of access on different socioeconomic outcomes in Bangladesh based on a review of the progress in financial inclusion. It also identifies the key sources of institutional finance for the poor. The chapter identifies the key constraints to the expansion of financial inclusion in terms of regulations, market participation, risk assessment, transaction costs and institutions.

3.1 Characteristics of Households Excluded from Financial Services

The survey results mentioned earlier show that that 77 percent of the households in Bangladesh have access to any financial services in any market which includes formal, quasi-formal and informal markets. Alternatively, this indicates that 23 percent of the households do not have access to any kind of financial services from any market. For policy purposes, it is important to identify the households who have access to financial services and those who do not have such access. Based on the survey findings, three characteristics of the households who have access to financial services--occupation, education and income--are presented in Table 3.1.

Table 3.1: Characteristics of Households with Access to Financial Services, 2009-10

Characteristics	Access to any financial services	Access to formal services	Access to quasi-formal services	Access to informal services	No access to financial services
Occupation					
Service holder	76.7	54.8	22.9	19.4	23.3
Self-employed	77.0	31.7	48.0	29.8	23.0
Day labour	66.3	13.6	51.9	24.5	33.8
Education					
Illiterate	68.7	17.8	50.0	25.8	31.3
Up to grade 5	73.1	25.1	48.8	28.0	26.9
Up to grade 9	74.5	36.5	38.9	30.0	25.6
S.S.C	78.1	51.7	32.7	26.8	21.9
H.S.C	82.4	66.5	22.2	18.4	17.6
Above H.S.C	90.1	85.7	12.0	15.6	9.7
Income quintile					
Lowest	64.6	18.5	43.3	24.7	35.4
Second	67.8	14.9	51.9	24.7	32.2
Third	73.0	25.2	49.3	27.1	27.0
Fourth	76.0	35.9	40.9	26.2	24.0
Highest	86.0	63.2	30.5	28.6	14.0

Source: Khalily and Khaleque 2013

The results also show that the characteristics of the households who are excluded from the financial markets or have varying access to various markets (e.g. formal, quasi-formal and informal) are different. It is seen that nearly 34 percent of the day labour headed households do not have access to any financial services. Similar shares are 23 percent for the self-employed households and 23.3 percent for the service-holder households. In the case of education, there seems to exist an inverse relationship between the level of education of the household head and the degree of access to financial services. In particular, household heads with less education are more likely to be excluded from accessing financial services. More than 31 percent of the households headed by illiterates have no access to financial services. Similarly, households belonging to lower income quintiles are less likely to have access to financial services compared with households of higher income quintiles.

Overall, the results show that household heads having higher education and belonging to higher income quintiles are likely to have better access to the formal financial services. On the other hand, households with illiterate or less educated heads and having low income have higher access to quasi-formal financial services. On the whole, households have more access to quasi-formal and informal financial services than formal financial services. This is particularly observed for the households having heads who are less educated or are self-employed or belong to low income quintiles.

3.2 Access to Credit for the Poor

For the poor households in Bangladesh, access to credit is critical for improving their livelihood through undertaking higher level of economic activities especially nonfarm income-generating activities for increasing the level of their household income. It is seen from the above analysis that the poor and low income households are mostly excluded from the formal financial services and they are mostly located in the rural areas. Access to credit eases the capital constraints of the poor households and helps to minimize production vulnerability, increase labour and capital productivity through accessing better inputs and adopt higher-yielding technologies (Eswaran and Kotwal 1990, Zeller et al. 1997). Credit increases the risk bearing ability and changes the risk-coping strategies of the poor households. It also improves consumption smoothing ability of the households.

With the limitations of the formal financial market to meet the credit needs of the poor, MFIs emerged in Bangladesh especially to provide credit to the poor women. The formal credit market could not provide adequate access to credit for the poor for several reasons e.g. lack of collateral, high income variability of the borrowers, small size of loans and high transaction cost. On the other hand, informal credit failed to service the poor mainly because of small size of the loan and high lending rate. The above analysis shows that, in practice, the formal and the quasi-formal financial markets have different and distinct dominant clientele groups in Bangladesh. The major borrowers in the formal market are the non-poor who have the ability to provide collateral or third party guarantees. The excluded poor from the formal market are the dominant group in the quasi-formal financial market. Often the borrowers from the informal market comprise of the poorest who are excluded from both the formal and the quasi-formal markets. In addition, the borrowers in the formal and the quasi-formal markets may often borrow from the informal market for meeting unforeseen needs, and due to its convenience and flexibility.

The overall picture on access to credit in the country can be seen in Table 3.2. It shows that 54 percent of the households have access to any credit while 12 percent of the households have access to multiple credit sources.[14] The survey data also show that the rate of borrowing from multiple sources is 21 percent and 47 percent of the informal borrowers and 40 percent of the formal borrowers also borrow from other credit markets (Khalily and Khaleque 2013).

The results show that, at the national level, the households have extremely limited access to formal credit with only 8 percent having access to formal credit. The picture is similar in both in urban and rural areas. Less than 10 percent of the urban households and 7.6 percent of the rural households have access to formal credit. In terms of poverty status, 9 percent of the non-poor have access to formal credit while similar share in the case of the poor is 5.4 percent. In the case of geographical location, the access to

[14] In this context, one should note that demand side statistics alone should not be used to justify the supply side information regarding access to finance. One should also be careful about using the demand side statistics at the household level to assess access at the population level.

formal credit is 17 percent in Barisal division followed by 9.4 percent in Khulna and 8 percent in Dhaka division.

The access to quasi-formal credit is reasonably high. As a source of credit, quasi-formal market dominates both in urban and rural areas. In the rural areas, it accounts for 39 percent compared with 27 percent in the urban areas. The presence of quasi-formal credit is also high among the poor and the non-poor households. The survey shows that 45 percent of the poor households and 33 percent of the non-poor households have access to quasi-formal credit. It equally holds at the division level but not at the same level. More than 50 percent of the households in Barisal and Rajshahi divisions have access to quasi-formal credit with lower access in Chittagong (25 percent) and Sylhet (24 percent) divisions.

Table 3.2: Access to Credit in Bangladesh, 2009-10

Location	Access in any credit	Access to quasi-formal credit	Access to formal credit	Access to informal credit	No access to credit
National	54.1	36.6	8.0	21.8	45.9
Division					
Barisal	66.4	50.3	16.7	27.1	33.6
Chittagong	48.2	24.7	6.5	27.8	51.8
Dhaka	50.6	33.3	8.1	17.3	49.4
Khulna	41.1	31.2	9.4	8.7	58.9
Rajshahi	68.5	51.5	7.0	28.0	31.5
Sylhet	45.4	23.7	3.9	27.2	54.6
Poverty Status					
Non-poor	52.08	32.9	9.1	22.3	47.9
Poor	58.97	45.4	5.4	20.6	41.0
Area					
Rural	56.2	39.1	7.6	23.1	43.8
Urban	46.1	27.0	9.6	16.8	53.9

Source: Khalily and Khaleque 2013

Despite the rapid expansion of formal and quasi-formal credit market, the importance of informal credit is still significant. Overall, 22 percent of the country's households have access to informal credit. More than a fifth of the poor and non-poor households have access to informal credit while 23 percent of the rural households have access to informal credit compared with 17 percent in the urban areas. The access to informal credit is more than 27 percent in all divisions except in Dhaka (17 percent) and Khulna (9 percent) divisions.

In terms of borrowing households, the picture is similar. According to the above mentioned survey, 55 percent of the borrowing households report credit from the quasi-formal market followed by 33 percent from the informal market. The share of formal credit is only 12 percent for the borrowing households.

The share of the three markets in the total volume of credit disbursed to the borrowers is shown in Table 3.3. It can be seen that the share of formal credit in the total volume of credit is 24 percent. Similar share of informal credit is 40 percent. One may note that these shares are much higher than the corresponding shares of households having access to each type of credit (as given in Table 2.9). As expected, the volume of formal credit has a higher share (42 percent) in the urban areas relative to similar share (13 percent) in the rural areas. Similarly, informal credit has a share of 45 percent in the rural areas compared with 30 percent in the urban areas. The quasi-formal credit has a share of 37 percent at the national level, which varies from 28 percent in the urban areas to 41 percent in the rural areas. The above results indicate a relatively high average loan size of formal and informal loans compared with the average size of quasi-formal credit. One important implication of the above results is that the households, particularly those in the rural areas, still remain credit constrained in the formal and quasi-formal credit markets.

Table 3.3: Share (in percent) of Different Markets in Total Volume of Credit, 2009-10

Market	Total	Rural	Urban
Formal credit	23.9	13.3	41.9
Quasi-formal credit	36.6	40.7	28.2
Informal credit	39.8	45.3	29.5

Source: Khalily and Khaleque 2013

3.3 Key Constraints to Improving Financial Access

For policy purposes, it is important to identify the key barriers that prevent the people especially the poor and the low income and disadvantaged groups from accessing financial services which is critical for raising their productivity and income. In this respect, in addition to accessibility, affordability and eligibility are also important considerations which indicate the nature and significance of the barriers to accessing financial services.

One important consideration in this context is the inadequate banking infrastructure**.** In view of the large number of financially excluded people (nearly half of the country's adult population is unbanked) in terms of deposit accounts, one of the major barriers is the low geographical or physical access such as average distance from household to the bank branch. For example, Bangladesh has less than 7 branches (or ATM) per 100,000 population and only 67 branches (or ATM) per 1,000 square kilometer. It should also be noted that a large section of the population who do not have any physical access to banking services lives in the rural and remote areas.

Another important barrier is the requirement of documentation including ID, proof of domicile and reference letter to open an account in the bank, which many people do not possess. Financial literacy and awareness are also low for most people especially in the rural areas which make it difficult for the large segment of the households to access financial services from the banking system. Moreover, many banks have a minimum account balance requirement or fee for opening an account. This prevents many lower income people to access financial services from the banks as they face difficulty in maintaining such balances. Although the minimum amount needed to open an account is relatively low, such conditions can be withdrawn for the poor people for broadening the access to financial services.

The bank and other financial institutions mostly focus on large scale loans as a component of their competitive and cost effective business strategy. Under the situation, small sized loans including SME and agricultural loans receive low priority from the mainstream banking institutions which make it difficult for a large share of small businesses and SME entrepreneurs to access loan services. The promotion of small-scale business friendly technological and institutional innovations could expand the access and usage of financial services for these groups of people. The low level of income of the large section of households including the poor and those living in the rural areas prevents these individuals from accessing financial services. Similarly, there is a lack of suitable product structure of the banks and MFIs suitable for these groups. For enabling the currently unbanked poor and low income population to access financial services from the formal financial system, the development of appropriate financial products is necessary. The high cost of products, especially the cost of products of the MFIs, is another major hurdle in accessing financial services by the poor. Although the outreach of the MFIs is quite impressive especially in the rural areas, there is an absence of credit bureau which could have helped in identifying overlapping borrowers and their indebtedness. At the same time, there is no micro insurance for the borrowers.

The Bangladesh Bank (BB) has been pursuing financial inclusion as a policy priority while maintaining monetary and financial stability. For the purpose, BB has urged the banks and financial institutions to follow BB's financial inclusion initiatives by engaged themselves in increased lending to the under-served/un-served economic sectors and population segments, including micro and SME entrepreneurs, agricultural and other rural and urban farm and non-farm productive activities. Credit facility to the farmers and small entrepreneurs, who are identified as the 'missing middle' in the case of financial inclusion, is also a policy priority for the BB's financial inclusion initiatives. For deepening and broadening financial inclusion, BB has also been motivating the banks and financial institutions to extend their services to the physically and mentally disabled people. In other words, these initiatives conform with their corporate social responsibility (CSR) obligations and creates new opportunities of viable business for these new clients. In these respects, BB prioritizes cost saving innovative partnerships and introduction of technology based financial services.

3.4 Existing Institutions for Accessing Credit

The structure of the credit market in terms of the existing institutions is important for expanding the network of financial institutions for delivery of credit services. Some information on the credit market structure is given in Table 3.4. As we have noted before, formal institutions involve commercial banks (both public and private), development banks, and other institutions. On the other hand, quasi-formal institutions include the Grameen Bank, BRAC and other MFIs including the cooperatives. As shown earlier, about 48 percent of the households have access to formal and quasi-formal credit markets.

Table 3.4 shows that about 11 percent of the borrowers report access to public financial institutions (SCBs and DFIs). Only 1.6 percent of the borrowing households have access to PCBs. The MFIs/NGOs and the Grameen Bank are the dominant institutions providing access to credit to over 86 percent of the borrowers. Similar trends are observed in all administrative divisions.

In terms of rural-urban divide, it is seen that credit advanced by the SCBs and PCBs are mostly concentrated in the urban areas, having a share of nearly 15 percent of the borrowers in the urban areas and 5 percent in the rural areas (Table 3.5). In the case of DFIs, the situation is reverse with the rural areas having a share of 6 percent. The share of urban areas is 3 percent. This is largely due to the operation of the Bangladesh Krishi Bank (BKB) and the Rajshahi Krishi Unnayan Bank (RAKUB) which mostly operate in the rural credit market. For the Grameen Bank and the MFIs/NGOs, the share is nearly 88 percent in the rural areas and 80 percent in the urban areas.

With poverty incidence of around 32 percent in the country, the number of borrowers in the credit market is dominated by the non-poor households. The number of non-poor borrowers is almost double the number of poor borrowers in the sample. For the non-poor borrowers, the joint share of SCBs and PCBs is 8 percent and it is 7 percent for the DFIs. The share of Grameen Bank and MFIs/NGOs is 84 percent. Such a high proportion of non-poor borrowers of the quasi-formal institutions is probably explained by a large share of graduating members of the Grameen Bank and MFIs/NGOs who continue to avail credit from these institutions as well as some mistargeting. The share of these institutions is more than 91 percent in the case of poor borrowers. Almost 92 percent of the poor borrowers have access to Grameen Bank and other MFIs. As expected, the combined share is only 4 percent for SCBs and PCBs and less than 4 percent for the DFIs in the case of poor borrowers.

Table 3.4: Share (in percent) of Institutions in Total Credit, 2009-10

Institutions	National	Division					
		Barisal	Chittagong	Dhaka	Khulna	Rajshahi	Sylhet
SCBs	5.2	3.0	9.3	6.9	5.7	2.8	2.6
PCBs	1.6	1.7	1.8	1.3	2.5	1.4	2.4
Grameen Bank	21.6	13.0	25.4	22.5	8.2	24.2	40.6
MFIs/NGOs	64.6	73.1	57.3	63.1	70.9	65.7	49.6
SFIs	5.7	8.2	3.9	5.2	11.8	4.4	4.9
Cooperatives	1.3	1.1	2.4	1.0	0.8	1.5	0
Total borrowers	7,631	936	970	2,202	620	2,614	289

Source: Khalily and Khaleque 2013

The results of the survey conducted by the Institute of Microfinance (InM), mentioned in earlier sections, show that about 77 percent of the households have access to any financial services while 54 percent have access to credit. Alternatively, the above means that 23 percent and 46 percent of the households do not have access to financial services and credit respectively. For both financial services and credit, the dominant market is the quasi-formal financial market in both rural and urban areas. Thus the fact remains that a substantial proportion of the households do not have access to credit which, as we have seen earlier, include around 23 percent each of the service holder and self-employed households and 34 percent of the wage labour households.[15] Moreover, those having access to credit depend mostly on the quasi-formal market. Although there exists a wide network of formal and quasi-formal institutions, nearly one in every four households in all occupations and income levels have access to informal credit.

3.5 Factors Constraining Access to Credit

The high access to informal credit that prevails among different groups of households may result from a number of factors, such as perceived advantages of the informal credit market e.g. flexibility, proximity, easy access and other unique features of informal credit; unmet demand for credit of the borrowers in the formal and quasi-formal credit market; and similar other reasons. Thus, from a policy perspective, there

[15] In rural Bangladesh, the overwhelming majority of small and marginal farming households rely to various degrees on agricultural production for their livelihoods. These people represent the largest segment by livelihood of those living on less than $2 a day. Moreover, the small and marginal families are not just agricultural producers. Due to small size of their landholdings, these households also participate in off-farm activities for their livelihood. These people have diverse financial needs since typically they earn income from a variety of nonagricultural sources, including labour and off-farm enterprises. Since the financial service needs of these families are diverse and there is a need to understand these better, the policies should encourage relevant organizations to better understand their needs, preferences, aspirations and behaviours as a first step towards reaching these groups successfully. With better understanding, financial service providers and other stakeholders can develop and pilot more effective financial services and products designed to enhance the use value of financial services for small and marginal families, focusing on improving their income enhancing and risk management ability and lowering delivery costs through the use of appropriate technologies.

are two major groups of households who do not have access to credit: first, households who are excluded (either partly or fully) from the credit market; and second, households who need credit but do not or cannot access for some reasons or constraints. In practice, the households may face demand-side or supply-side or both types of constraints.

In reality, mere access to credit does not necessarily mean that the borrowing households are not credit-constrained since the credit requirements may remain under-fulfilled for many households. The existence of credit constraint could generate adverse impact on optimal use of resources, income, productivity, and poverty (for details see, Eswaran and Kotwal 1989, 1990; Boucher et al. 2009). It has been argued that, in a situation of excess demand for credit, information asymmetry is a major factor that underlies the credit rationing behaviour of the lending organizations that lead the lenders to adopt credit rationing for reducing the probability of loan default (Gonzalez-Vega 1976, Stieglitz and Weiss 1981, Jaffee and Stieglitz 1990). It is observed that the lenders may use both price and non-price mechanisms to eliminate excess demand for credit. Price rationing occurs when interest rate is increased or terms and conditions of loan contract are made more stringent. On the other hand, non-price rationing takes place when borrowers are either willing to pay higher interest rate to get a loan or accept rationing of credit as lender is not willing to sanction the full amount of the loan.

Table 3.5: Rural-Urban Division of Share (in percent) of Institutions in Total Credit, 2009-10

Institutions	National	Area		Poverty status	
		Rural	Urban	Non-poor	Poor
SCBs	5.2	3.9	11.2	6.0	3.4
PCBs	1.6	1.1	3.7	2.1	0.6
Grameen Bank	21.6	23.3	13.6	21.9	21.1
MFIs/NGOs	64.6	64.3	66.2	61.6	70.3
DFIs	5.7	6.2	3.1	6.8	3.5
Cooperatives	1.3	1.1	2.2	1.6	0.8
Total borrowers in sample	7,631	5,714	1,917	5,023	2,608

Source: Khalily and Khaleque 2013

Three types of potential borrowers are classified in the literature (see Barham, Boucher and Carter 1996): (i) fully constrained borrowers: this refers to the borrowers who apply for loans but do not get the loan or who prefer not to apply due to high risk or high transaction cost; (ii) partially constrained borrowers: these borrowers receive lower than the desired amount of loan; and (iii) unconstrained borrowers: borrowers who receive the required amount of loan.[16]

The empirical analysis by Khalily and Khaleque (2013) on supply-side constrained households shows that 78 percent of the borrowers are not constrained while 12 percent of the borrowers are partly credit rationed.[17] The share of the rejected applications is 10 percent. The analysis shows that around 25 percent of the borrowers are supply side credit constrained at the national level (Table 3.6). The rate is relatively low (8.8 percent) in Khulna division and high (43.1 percent) in Sylhet division. The nature of credit constraint is slightly higher in rural than in urban areas and for the poor than the non-poor households.

[16] Later on, Boucher, Guirkinger and Trivelli (2009) introduced two new types of credit rationing – risk rationing and transaction cost rationing to highlight underlying reasons that could have important policy implications. Risk rationing occurs when constrained households do not apply for loans due to perceived high risk. Transaction cost rationing takes place when households do not apply for loans because of high transaction cost of borrowing which may arise because of distance of the branch or high non-price cost of processing loan application.

[17] In reality, the high rate of absence of the supply side constraint may reflect other factors such as setting of loan ceiling and known prior information on loan characteristics of the potential borrowers especially in the quasi-formal credit market.

The dominant reasons behind the fully and the partially rationed out borrowers or applicants are the lack of collateral and absence of third party guarantor. These two reasons account for 28 percent of the rejected applications. However, these two reasons explain 35 percent of the rejected applications in the formal financial market. While these factors reflect the lender's behavior, the major factors from the side of the potential borrowers are insufficient documents (16 percent), inadequate income (13 percent) and poor loan repayment history (9 percent). It is also reported that land is an important determinant in all markets and the zero rationed out borrowers have higher land size.

Table 3.6: Distribution of Supply-Constrained Borrowers, 2009-10

	As % of respective totals		% of supply constrained borrowers
	Unconstrained supply	Constrained supply	
National	42.3	10.71	25.3
Divisions			
Barisal	53.1	15.06	28.37
Chittagong	35.9	8.27	23.05
Dhaka	41.0	11.37	27.7
Khulna	43.8	3.87	8.84
Rajshahi	49.4	14.09	28.55
Sylhet	23.0	9.9	43.12
Area			
Rural	43.4	11.38	26.23
Urban	38.2	8.08	21.18
Poverty status			
Non Poor	41.2	9.92	24.1
Poor	45.1	12.59	27.93

Source: Khalily and Khaleque 2013

In the case of demand-side constrained households, about two-thirds of the non-applicant households are observed to be constrained. These households perceive that they would not receive loans if they apply. About 35 percent of the non-applicant households are identified as unconstrained households. It is important to note that nearly two-thirds of the non-applicant households in the rural areas are classified as constrained despite the wide expansion of the network of formal and quasi-formal credit markets. In this respect, the extreme poor households are observed to be more constrained (56 percent) compared with the moderate poor and the non-poor households.

3.6 Transaction Cost of Borrowing

The transaction cost of borrowing is one of the key determinants of access to credit. The access to credit, as we have discussed earlier, is determined by both demand and supply side considerations. The transaction cost involves both interest and non-interest cost. If firms or households have access to different credit markets, average cost of borrowing in each credit market becomes an important consideration determining the decision to access a specific market.

The credit markets in Bangladesh have unique features in terms of sanctioning loan and the lending system. Usually, the formal credit market requires much paper work, documentation and collateral such that the non-interest cost of borrowing often becomes higher than other markets for a given loan size. Moreover, not all households have access to the formal credit market. On the other hand, the informal credit market exists in almost every village or location. In this case, the non-interest cost is likely to be low and the potential borrower can have relatively easy access to this market. The quasi-formal credit market is also widespread especially in the rural areas and can be accessed at a low non-interest cost.

In the case of lending, the interest rate is usually lower in the formal credit market and it is highest in the informal credit market. The quasi-formal credit market also offers loan at reasonably high interest rate because of high operating cost; but in most cases it is lower than the lending rate at the informal credit market. Thus, given the lending interest rate and expected average borrowing cost, transaction cost of borrowing (interest plus non-interest cost) is likely to be higher in the informal credit market than in other two markets. The normal expectation is that, with homogenous products, borrowers are more likely to access credit from the quasi-formal market. In reality the products across markets are not homogenous; they vary in terms of loan conditions and size. As such, firms or individuals would behave in a way to optimize transaction cost of borrowing.

The study by Khalily and Khaleque (2013) brings out several characteristics of the transaction cost of borrowing from different markets (Table 3.7). It is observed that the non-interest cost is higher in the formal credit market but the average nominal interest rate is lower. The quasi-formal market is featured by low transaction cost but high interest rate compared with that in the formal market. On the other hand, the average lending rate is higher in the informal credit market but explicit non-interest cost falls between the cost of the formal and the quasi-formal credit markets. Although the above results show that the interest cost of borrowing is lowest in the formal credit market and highest in the informal credit market, it may be concluded that the total transaction cost of borrowing is similar for the formal and the quasi-formal credit markets. The transaction cost of borrowing is highest in the informal credit market.

It is seen that the non-interest cost as percentage of average total transaction cost is the highest in the formal credit market which is above 16 percent of the total transaction cost.[18] On the other hand, the informal credit market has the lowest (6.4 percent) non-interest cost. Similar share is 9.3 percent in the quasi-formal credit market.

3.7 Impact of Credit on Selected Socioeconomic Outcomes

Improving the access to credit for the households especially for the poor households cannot be justified if such access fails to bring socioeconomic benefits and improve the quality of life of the borrowing households. This section examines the issue based on impact evaluation of credit on selected socioeconomic outcomes especially on poverty.

It is likely that productive use of credit will have larger impact on expected outcomes.[19] In reality, most of the borrowers probably use some portion of the loan amount for 'unproductive' purposes but this does not

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[18] One of the important elements in high non-interest transaction cost is the cost of bribing. The survey shows that more than 50 percent of the non-interest cost is bribing, while it is negligible in the quasi-formal credit market. It is also observed that the non-interest cost varies by lending institutions. Among the commercial banks, average non-interest cost is lower for the PCBs. Among the public banks, SCBs are more efficient relative to BKB and RAKUB with non-interest cost being almost 50 percent less for the SCBs. The difference is the cost of bribing. The average cost of bribe is reported to be 3.7 percent of the loan in BKB and RAKUB compared with 1.3 percent in SCBs. For details, see Khalily and Khaleque 2013.

[19] For our purpose, 'productive' use is defined as expenses on those heads that contribute to income generation such as financing of income generating activities (e.g. SMEs), investment in trading and livestock and others. On the

necessarily mean that credit is not utilized for productive purposes. In this context, the desired productive outcomes would depend on the share of the loan which has been used for productive purposes.

Table 3.7: Transaction cost of borrowing from Different Market, 2009-10

Borrowing cost (in Tk.) per Tk. 100

	Credit market		
	Formal credit market	Quasi-formal credit market	Informal credit market
Conveyance cost	0.61	0.62	1.57
Cost of loan fees	0.52	0.69	…
Cost of informal payment (bribe)	1.20	0.03	…
Total non interest transaction cost	2.33	1.34	1.57
Interest cost	12.14	13.07	22.94
Total borrowing cost (Interest + Non-interest cost)	14.47	14.41	24.51
Non-interest cost as % of total transaction cost	16.1	9.2	6.4

Source: Khalily and Khaleque 2013

The numbers in Table 3.8 show that formal and quasi-formal credit is mostly (72 percent and 63 percent respectively) used for productive purposes while nearly three-fourths of the informal credit is used for non-productive purposes. It is also seen that rural loans are utilized more for productive purposes than urban loans. There is not much difference between the poor and the non-poor in terms of actual use of credit for productive and unproductive purposes. Most of the informal credit is, however, used for unproductive purposes. These results indicate that since the major portion of the formal and quasi-formal credit is used in productive activities, it is likely that access to credit will have positive impact on different socioeconomic outcomes.

Impact on Productivity, Poverty and Risk Coping

Access to credit makes important contributions to enterprise development. Enterprises generally are credit constrained especially micro, small and the new ones. Moreover, micro and small enterprises have very little access to the formal credit market. Empirical results show that, while the medium and large enterprises are not generally credit constrained in the formal credit market, small enterprises are more constrained in the specialized banks and the SCBs (Khalily and Khaleque 2013). In fact, these institutions constitute the country's 'missing middle' of enterprises. On the other hand, the micro enterprises are constrained in almost all credit markets.

Available evidence also suggests that access to credit contributes to higher productivity and efficiency. With better access, credit constrained enterprises become less constrained so that their iso-cost curves shift outward. If input price-ratio remains unchanged, increase in availability of financial resources would lead to higher level of output due to scale effect. With access to credit, firms are likely to incur higher cost of fund such that there will be input substitution with changed input price-ratio, Such a substitution is

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other hand, 'unproductive' use includes regular food and non-food consumption and irregular expenses on idiosyncratic or covariate shocks. However, such a distinction can be criticized on the ground that poverty and welfare impacts also depend upon consumption. For example, any credit used to smooth consumption or meet a contingency (e.g. illness or other shocks) has a direct positive impact on poverty. However, for the present analysis, we have restricted the definition of productive use to only those activities that lead to asset accumulation and increase in productive capacity resulting in increase in income.

likely to be more in favour of inputs that have higher productivity (Blancard et. al. 2006). Empirical analysis in Bangladesh shows that firms with access to credit have higher average profit and sales volume along with greater average productivity of labour and capital as well as efficiency compared with firms with no access to credit.

Table 3.8: Share of Total Loan used for Productive and Unproductive Purposes, 2009-10

	Source	Productive	Unproductive
National	Formal	71.5	28.5
	Quasi-formal	63.2	36.8
	Informal	26.9	73.1
Rural	Formal	75.6	24.4
	Quasi-formal	70.7	29.3
	Informal	63.6	36.4
Urban	Formal	56.6	43.4
	Quasi-formal	24.7	75.3
	Informal	35.3	64.7
Poor	Formal	77.3	22.7
	Quasi formal	62.2	37.8
	Informal	18.1	81.9
Non-poor	Formal	70.6	29.4
	Quasi formal	63.6	36.4
	Informal	29.5	70.5

Source: Khalily and Khaleque 2013

Empirical research shows that microcredit intervention plays an important role in reducing vulnerability through a number of channels—by smoothing consumption, building assets, providing emergency assistance during natural disasters, and contributing to female empowerment (see, Zaman 1999, Sebstad and Cohen 2000, Khandker et.al. 1998, Kabeer 2001, Bastiaensen 2009, Goetz and Sen Gupta 1996, Harper 2007, Islam 2009, Hulme and Arun 2011). One must, however, recognize that microfinance is diverse, complex and context specific. For poverty reduction and social equity, the role of the state is very vital for creating an enabling framework where development interventions including microfinance can enhance and produce expected outputs. It must also be admitted that microfinance is not a panacea to tackle all the causes of poverty. Therefore, it needs a comprehensive strategic and long-term policy package to reduce poverty and gender inequalities with the involvement and strong commitments from all pertinent stakeholders like the government, non-governmental organizations, private sector and the development partners.

In developing countries like Bangladesh, lack of credit is considered as one of the critical impediments to creating employment, mobilizing savings, raising investment and improving economic well being of individuals. In addition, it is widely accepted that credit markets help individuals to cope with income shocks while smoothing consumption and acting as a safety net device. Access to financial services contributes positively towards building up assets and raising income/expenditure level of the borrowing households and thereby bringing people out of poverty. In the case of crisis coping, the households, especially the poor households, face different types of shocks, both idiosyncratic and systemic. In a situation of crisis, households take strategic decisions and adopt coping strategies depending on the type of the crisis and opportunities available to the households. In this respect, empirical results show that hosueholds with access to savings and credit are better equipped to cope with any shocks.

3.8 Recent Policy Measures for Improving Access to Financial Services

In recent years, the government especially the Bangladesh Bank (BB) has taken several strong initiatives for enhancing the coverage of financial services in the formal financial system especially through expanding the coverage to the poor and disadvantaged section of the society. For the purpose, BB has taken a number of policy measures covering both deposit and credit products in addition to extensive moral suasion. Many of these measures are quite innovative for the country's banking industry.

The country's agricultural credit policy provides an impressive framework for stimulating financial inclusion with priority to the marginal and women farmers and based on an 'area based approach' to farming. For the purpose, agricultural credit policies and norms have been appropriately adjusted and re-formulated. The policy aims at reaching out to relatively underdeveloped areas for timely and hassle free delivery of adequate agricultural/rural credit to the small farmers and the share-croppers.

One of the significant efforts of the BB is to expand the availability of the highest quality banking services to the farmers. . For bringing the un-served farmers within the network of the commercial banks, a programme has been undertaken under which farmers showing their National Identity Card/Birth Registration Certificate and Agriculture Inputs Assistance Card issued by the Agriculture Extension Department can open bank accounts by keeping only Tk. 10 as the initial deposit and banks are not required to fill the Know Your Customer (KYC) form for the purpose. No condition of maintaining a minimum balance is applicable in this regard and these accounts remain free of any additional charge or fees, A total of 9.5 million accounts have already been opened under the programme. These accounts are used to disburse government input subsidies to the farmers. So far Tk. 7.22 billion of diesel subsidy has been disbursed by the government to the farmers using these accounts. These accounts also facilitate mobilization of small savings, disbursement of revolving loans, receipt of remittances, and access to other financial services.

The participation of all commercial banks including the PCBs and FCBs has been made mandatory in agricultural/rural credit programme by the BB. As per the requirement, each bank will have to allocate a certain share of its total loan portfolio for disbursing in the agricultural sector at the beginning of every financial year and each bank will have to inform the BB its targeted amount of rural credit. The target by the banks in this regard must be realistic and implementable and must be regularly monitored by the banks. Banks having no rural branch will disburse agricultural credit through linkage programme with the NGOs /MFIs.

Another innovative step taken by the BB is the provision of agricultural credit for the sharecroppers. A detailed guideline has been issued by the BB to the banks to facilitate agricultural credit for the farmers identified as sharecroppers. In order to ensure a smooth and increasing flow of credit towards the priority sectors, a number of refinancing schemes, some of which are managed by the BB itself, are currently in operation.

Under the programme, BB has adopted a Tk. 5 billion refinancing line against loans to the landless sharecroppers in partnership with a MFI (BRAC). A comprehensive monitoring strategy for agricultural credit system has been devised for monitoring the agricultural credit system at the bank level and an 'Agricultural Credit Monitoring System' in BB has been formed to monitor credit disbursement and recovery process. The mobile phone number of each borrower is collected for direct monitoring by BB. As a result, the disbursement of agricultural credit has increased significantly in recent years. During 2012-13, a total of Tk. 102 billion has been disbursed as agricultural credit. The SCBs and DFIs disbursed Tk. 4.70 billion to a total of 3.75 million sharecroppers in 2009-10 and Tk. 7.44 billion to 4.27

million sharecroppers in 2010-2011. On the other hand, till June 2011, BRAC disbursed Tk. 2.65 billion to 0.234 million sharecroppers in 171 upazilas under 37 districts of the country.

In issuing new branch licenses to the banks, BB follows a policy of requiring at least one in every five new branches to be opened in rural locations with a view to pushing banking services physically closer to the rural population. The government and the BB have adopted several remedial and promotional measures to bridge the gaps in financial inclusion. In the case of SME financing, BB has made available refinance lines to the banks against their loans to the SMEs which are co-financed by multilateral development partners such as IDA and ADB. In addition, banks are allowed to open SME service booth in areas with no branches of the banks concerned.

There are three refinancing schemes of BB which are directed to the SME sector. The BB has also formulated elaborate guidelines for SME credit. A separate department named 'SME and Special Programmes Department' has been created in BB to accelerate SME activities and provide effective monitoring. BB has arranged refinance scheme of Tk. 6 billion for the SMEs with 15 percent of the refinance fund earmarked for women entrepreneurs. For encouraging women entrepreneurs, a provision has been kept under which SME credit up to Tk. 2.5 million can be disbursed against personal guarantee. Till September 2011, 0.24 million entrepreneurs (0.22 million men and 0.02 million women) received SME loan. The cumulative SME loan disbursement stood at Tk. 399.41 billion up to September 2011.The BB also gives emphasis on developing women entrepreneurship. To this end, 15 percent of the above three refinancing funds have been allocated for the women entrepreneurs involved in SME business. A detailed set of operational procedures for financing women entrepreneurs has also been adopted.

For providing banking services through the SME Service Centre and to ensure smooth and increasing amount of credit flows to the priority sectors like SMEs and agriculture, BB has issued license to all these centres as 'SME/Agricultural Branch'. The relevant regulation requires that at least half of the deposit of all these branches must be invested in SMEs/agriculture sector and these branches must be set up in areas outside the divisional cities and upazila headquarters where no banking services are available. The provision of easy and effective access to banking services for the physically handicapped people has been made mandatory by the BB. For the purpose, the banks are required to designate a bank official as the 'Focal Point' at each branch of a bank.

In times of natural calamities and disasters which significantly affect the agriculture sector and the small farmers, BB's response has been through relaxing the conditions of loan repayment (e.g. extension of the loan period), making available fresh loan facilities to the farmers, and similar measures. For ensuring smooth and continuous flow of agricultural credit to the farmers, BB has introduced a 3-year term revolving crop credit limit system. Under the system, farmers engaged in successive crop production avail credit facility without requiring re-documentation. In addition, the documentation process has been made as simple as possible and credit approval power has been delegated to the respective Branch Manager.

The BB has also been encouraging creative partnership between banks/MFIs and mobile phone and smart card technology platforms for innovating cost effective financial service packages for various client segments. Further, BB has been urging the banks and financial institutions to embrace specific commitment to financial inclusion as a corporate social responsibility (CSR) obligation. In addition, BB occasionally organizes cross country banking sector road show to connect and interact with the general people, providing information and receiving feedback about deposit, lending, remittance and payment services, building up general financial literacy and awareness against money laundering and illegal hundi channels in remittance delivery.

The automation of the payments system of the BB provides impetus to initiatives for designing faster and cheaper remittance and money transfer services as well as broadening and deepening financial inclusion particularly of rural recipients of remittances from family members working elsewhere within or outside the country. The initiative has already spawned and introduced a number of new IT based remittance delivery processes that are superior to previous arrangements in speed and affordability of the users. Online automated clearing and settlement of cheques and electronic fund transfers by the Bangladesh Automated Clearing House (BACH), under the BB management, have been made operational. The ground is now prepared for triggering innovation of further new service packages better tailored to specific needs of different customer segments, thereby widening and deepening their financial inclusion.

The government is providing funds for lending resources to the MFIs (through the Palli Karma Sahayak Foundation, PKSF, the apex financing agency for the MFIs) for rural on- and off-farm self-employment, micro and SME credit, along with gender bias towards empowering women. Financing lines from the government budget have also been made available against loans to rural poor for their construction of basic shelter housing under different programmes including 'One Home-One Farm'.

The Post Office Department is also taking new initiatives, in association with banks and other external and internal remittance intermediaries, to offer faster remittance deliveries to the recipients. The role of the postal services is especially important in catering to the needs of the remote, sparsely populated areas that are considered as expensive and unprofitable to reach by the private sector.

For providing access to financial services to the physically handicapped people, all scheduled banks have been advised to designate an official as 'Focal Point' in each branch of their banks. The SCBs and the two agricultural banks (BKB/RAKUB) have also been instructed to disburse agricultural credit giving priority to the physically handicapped people individually/jointly as well as follow the regulations for special microcredit for ensuring their access to financial services and bring them in the main stream of economic activities.

It needs to be recognized that Bangladesh has a high concentration of poor people including small and marginal farmers, informal sector participants, and micro and small entrepreneurs. Despite substantial expansion of microfinance and SME activities in the country over the last few decades, access to financial services is still low especially among the poor and in the rural areas. It is important therefore to initiate more effective policies for improving access to financial services targeting the poor and low income populations through introducing appropriate measures under a comprehensive financial inclusion strategy. Innovative programmes like credit to the sharecroppers and small enterprises introduced by the BB not only contribute towards achieving wider access to financial services but also to reducing the high dependence of small and marginal farmers on non-institutional sources which, in most cases, are highly exploitative in nature.

For ensuring improved access to financial services, the policies must also recognize the weaknesses of financial markets deeply rooted in institutional flaws like absence of good credit appraisal and efficient risk management as exemplified by the recent global financial crisis. An efficient and organized financial sector can make significant contribution to economic growth for which the government and BB will have to play their due role to avoid pervasive market failures. Increased financial inclusion and access to required financial services can help overcome frictions in the market mechanism especially through expanding financial coverage to the poor and underprivileged people.

In the process, technology has a key role in providing access to cost-effective and timely delivered financial services. In particular, the vexing problems of raising the outreach and credit delivery in the rural areas can be effectively addressed through adopting appropriate technologies. One of the key priorities of the 7th Plan should be to address the issue of technological innovation and ensure the development of the associated infrastructure for reaching to the people who are now deprived of access to financial services from the formal and quasi-formal institutions.

Despite rapid progress over the last decade, the country's financial sector is still small and relatively underdeveloped. Although the banking system has progressed relatively fast, the capital market is still nascent and in an early stage of development. The root causes of slow development and problems of the financial sector include a number of factors such as inadequate market discipline due to lack of competition and other factors in the financial sector, operational and managerial inefficiency and ineffectiveness of the financial institutions, slow implementation of effective and prudent regulation and oversight, economic and political linkages and corruption in the financial sector. The pervasive default culture has resulted in high loan pricing creating a vicious circle of loan default. The lack of ethics in the financial sector is a part of wider and long-lasting culture that pervades almost all segments of the economy.

Despite significant recent progress, the current programmes have limitations in providing access to financial services to all groups of the population. As we have noted earlier, the aggregate access to any financial services is estimated at around 77 percent of which access to formal services is about 37 percent and access to quasi formal (MFIs and co-operatives) is about 43 percent. Another major feature is the existence of significant market overlapping both in formal and quasi formal markets (Table 3.9).

Table 3.9: Market Overlapping of Financial Services

Market	in percent
Formal market only	20.1
Quasi formal market only	23.8
Informal market only	5.6
Both formal and quasi formal markets	6.7
Both formal and informal markets	6.9
Both quasi formal and informal	9.4
All markets	3.4
Do not have access	23.2

Source: Khalily and Khaleque 2013

Moreover, the existing programmes could not fully resolve the barriers that prevent the lower income people in accessing financial services from the formal and quasi-formal markets. In this context, measures for accessibility, affordability and eligibility are major indicators that reflect the nature of barriers to accessing the financial services in terms of deposits, loans, payments, locations and technology. Poor banking infrastructure, lack of proper documentation, inadequate financial literacy or education, high requirement of minimum balance, inadequate technological infrastructure, low income, limited availability of suitable product structure of banks and MFIs, relatively high product costs, and absence of credit bureau and insurance for MFI borrowers are some of the areas where new initiatives are necessary to overcome the existing barriers.

The strategies during the 7th Plan should carry out the needed reforms, many of which have already been initiated. These and other necessary ones should be implemented at a faster pace along with strengthened financial regulations. The Plan needs to recognize that a competitive financial sector will deliver better financial services and diversified financial products especially to the poor.

Chapter 4

Summary and Conclusions

4.1 Summary of Major Findings

Access to financial services (or financial inclusion) implies the absence of any obstacles (covering both price and non-price barriers) to the use of required financial services. In this context, it is important to distinguish between access to (e.g. possibility of use) and actual use of financial services. For policy purposes, exclusion can be voluntary which refers to the case where an individual or firm has access to financial services but it is in no need to use them. Alternatively, exclusion can be involuntary where price and/or non-price barriers prevent the access to these services.

Low-income families, especially the poor, have multiple and compelling reasons to smooth their income over short-term fluctuations due to less stable employment and earnings. As a result, they have an urgent need for financial services that can make it easier for them to save or to access credit. For the poor, access to financial services is critical both for investing in productive livelihood activities to enhance their incomes, increasing savings and raising resources that can be used to smooth income in response to short-term earning fluctuations.

The poor often lack access to formal financial services that other households may take for granted. There are a number of reasons why the poor households tend to be unbanked. Financial institutions frequently require different documents to open an account, set high minimum account balances, and have high fees and other requirements that are ill-suited to the poor households. The availability of few low-cost and easily accessible savings instruments, credit constraints, and higher cost financial products increases the economic challenges of these households. The quasi-formal financial institutions and the informal market are among the alternative financial services that complement the formal financial sector for the poor households. Though expensive, they are often more convenient and easier to use than the formal financial services. The findings suggest that existing financial, credit and payment systems do not serve the poor well, imposing significant costs and reducing opportunities of these households. Many households use both quasi-formal and informal channels to meet their financial service needs which put these households at great disadvantages to improve their livelihood.

For improving access to financial services, the need is to address the issue of exclusion of people who require financial services but are denied access to these services. There are a variety of reasons for such financial exclusion. From the demand side, lack of awareness, low income/assets, social exclusion, and illiteracy act as barriers to accessing financial services. From the supply side, distance from the branch, branch timings, cumbersome documentation and other procedures, unsuitable products, staff attitudes are common reasons for exclusion. These result in higher transaction cost and lower profitability. On the other hand, flexibility, ease of availability, and other attractive features of informal credit make such credit popular and survive over time despite the fact that informal credit is costlier than other sources of credit.

In Bangladesh, the financially excluded sections of the population comprise different poor and marginal groups including small and marginal farmers, tenant farmers, landless labourers, self-employed and unorganized sector enterprises, urban slum dwellers, migrants, ethnic minorities and socially excluded groups, poor senior citizens and women. While there are pockets of large excluded population in the urban areas, the rural areas contain most of the financially excluded population.

Despite substantial expansion of bank branches and increase in the membership of MFIs and other financial institutions, around one-fourth of the country's adult population still remains financially excluded. In terms of access to credit from the banking system, the state of financial inclusion is low. For example, the access of the farmers who mostly live in the rural areas to banking services is significantly low relative to their contribution to the GDP. In 2013-14, the share of the agriculture sector in GDP was around 16 percent while agriculture's share of advances in total advances stood at about 6 percent. A substantial share of the households, especially in the rural areas, still remains outside the coverage of the formal banking system who are unable to access mainstream financial products. It has been made mandatory to open at least one in five branches in the rural areas to encourage rural banking. But although 57 percent of the total bank branches were located in the rural areas in 2012, the shares of rural bank branches in total deposits and advances were 17 percent and 12 percent respectively which indicate very low exposure of rural people to the formal banking system.

The Challenges

Increasing the access to financial services for the people especially for the poor in the rural areas is critical for Bangladesh for helping them to adopt new and more productive income earning opportunities and technologies, weather personal financial crises and unforeseen risks, and increase their chances of moving out of poverty. Despite significant progress and adoption of new and innovative digital technologies, many of the country's poor adults do not have bank accounts or they do not use other formal financial services, not only because of poverty but also due to costs, travel distance, and other barriers which preclude them to access formal financial services.

In this respect, the government's strategy should aim to capitalize on rapid advances in mobile communications and digital payment systems to connect the poor households to affordable and reliable financial services. For the poor people, access to financial services would support them to successfully adopt new farming technologies, invest in new business opportunities, or find new and more productive jobs. At the same time, the access would prevent a large number of people to fall back into poverty or into deeper poverty due to health problems, financial setbacks, and other shocks. Thus making available effective tools for savings, payment, credit, and insurance, especially at critical moments, should be adopted as an effective strategy for the 7th Five Year Plan to help the poor households capture an opportunity to move out of poverty or weather a crisis or emergency.

According to available data, while the number of deposit and credit accounts per 1,000 population in the country during 2005-2010 increased from 242 to 333 and from 51 to 63 respectively, the increase in the rural areas was from 127 to 189 for deposit account over the same period. On the other hand, similar number for the credit account actually declined from 53 in 2005 to 51 in 2010. This shows that a significant share of the population in Bangladesh do not have access to the formal financial institutions who are mostly the poor in rural and urban areas. As a result, most poor households operate almost entirely in the cash economy using cash and physical assets (e.g. jewelry and livestock) or borrow from informal money lenders to meet their financial needs. In many cases, these informal mechanisms tend to be insecure, expensive, and complicated; and in most instances, they offer limited support in the case of major problems such as a serious illness in the family.

The Opportunities

Over the past few years, the government has taken unprecedented steps to provide access to financial services for the poor, including those living in rural and remote areas. Financial inclusion policies, coupled with the explosion of mobile penetration and the launching of Mobile Financial Services (MFS), have now created an environment for reaching unbanked populations in all locations.[20] However, a growing body of evidence in Bangladesh suggests that these developments have not trickled down to all populations and that gaps continue to exist due to education, income, urbanization and gender.[21] Some evidence over the past few years shows that mobile use in Bangladesh, like in other developing world, remains highest among male, urban and youth populations. Mobile phones pose a particular challenge to poor women, and especially poor rural women, as their ability to access and utilize mobile phones can be very limited due to the lack of literacy and numeracy including social and cultural barriers. The MFS pose an even greater challenge to poor women as they require a level of familiarity with the use of a mobile device, as well as the confidence to use it, which women generally lack as a result of educational, social and economic constraints.[22]

Available evidence suggests that increasing poor people's access to better financial tools can help accelerate poverty reduction through supporting higher economic gains. The experience also suggests that serving the poor people with effective financial services is costly, in part because most of their transactions are conducted in cash. Storing, transporting, and processing cash is expensive for banks, insurance companies, utility companies, and other institutions, and they pass on those costs to the clients. On the other hand, in advanced countries, people conduct most of their financial transactions in digital form and the value is stored virtually and transferred instantaneously. In Bangladesh, the scope of harnessing such advantages is expanding rapidly as the revolution in mobile communications and rapid advances in digital payment systems is creating opportunities to connect the poor households to affordable and reliable financial tools through mobile phones and other digital interfaces.

The past experience in Bangladesh shows that digital means are the most effective way to significantly expand the poor people's access to formal financial services. In addition to cost savings, digital financial services have many other advantages such as (i) they connect the poor people to the formal financial sector and with the wider economy; (ii) financial flows can be accurately tracked through digital means enabling safer and speedier transactions which are less susceptible to corruption and theft; (iii) deposit of loans and other transfers directly to the banks helps the recipients to often save more along with giving women more financial authority within the household and helping their empowerment; (iv) financial institutions can use financial histories of the poor clienteles to develop products that are better suited to their needs, cash flows and risk profiles; and (v) information sharing such as sending reminders, providing default options and other choices is convenient and saves time if performed through mobile phone and/or other digital means.

4.2 The Policy Framework

Bangladesh's development strategies treat financial inclusion as a powerful accelerator of economic progress and development and an effective means for achieving the goals of reducing poverty and building shared prosperity. During the 7th Plan, the government's strategy should aim at broadening the reach of the digital payment systems, particularly for the poor and in the rural areas, and expanding the

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[20] We adopt the World Bank definition of Mobile Financial Services (MFS) which refers to a range of financial services that can be offered across the mobile phone. Three of the leading forms of MFS are mobile money transfer, mobile payments, and mobile banking. See http://blogs.worldbank.org/psd/e-money-mobile-money-mobile-banking-what-s-the-difference.

[21] The GSM Association (GSMA, a global association for mobile operators and related organizations) argues that worldwide, women are 21 percent less likely to own a mobile phone than men, and that the gender gap is particularly steep in South Asia, at 37 percent. See, *Women and Mobile: A Global Opportunity*, GSMA, 2012.

[22] See, *Unlocking the Potential: Women and Mobile Financial Services in Emerging Markets*, GMSA, 2013.

range of suitable services for the poor available in the digital systems. The approach should involve three mutually reinforcing objectives:

(iv) Reduce the amount of time and money that the poor people spend to conduct financial transactions;
(v) Increase capacity of the poor people to weather financial shocks and avail income-generating opportunities;
(vi) Generate macro-level efficiency by digitally connecting the poor people, financial institutions, government service providers, businesses, private sector and other stakeholders.

The government effort should focus on expanding innovative ways of increasing the poor's access to financial services and motivating and encouraging the financial institutions to offer these services. Since these interventions often involve technologies that need to be adapted to the targeted clients, the strategy should support, to address this demand-side challenge, product design experiments to specify required design and other features that will encourage the poor people to adopt and actively use digital financial services. The government should also develop policies and regulations that facilitate these developments.

One of the major challenges of serving the poor especially the small and marginal households is a lack of adequate information on the kinds of financial services they need. While progress has been made on understanding the needs of different farmer groups, particularly those with easier access to financial markets, relatively little is known about the financial service needs of harder-to-reach segments including the small and marginal farmers. A detailed understanding of their needs requires comprehensive analysis of the lives of these farmers as both agricultural producers along with participation in other informal sources of income. It is important to understand how the poor farmers manage their cash flows, their preferences, attitudes and behaviours to determine the scope of diversifying income sources as an effective path out of poverty. The financial service providers must also take an active interest in serving these marginalized populations, understand how they access information and adapt existing technologies to make that information available and, in doing so, become productive users of financial services.

In Bangladesh, financial services are provided by a variety of financial intermediaries that are part of the country's financial system. There are three broad types of providers of financial services—formal, quasi-formal and informal, the distinction is based primarily on whether there is a legal infrastructure that provides recourse to lenders and protection to depositors. Table 4.1 gives the grouping of potential clients into users and non-users including the groups of non-users and the three zones that enable the government policies to better match interventions to the requirements of financial market development. Although the formal financial services are provided by financial institutions licensed by the government and subject to banking regulations and supervision, quasi-formal financial services are not regulated by the banking authorities. However, these institutions are usually licensed and supervised by other government agencies. On the other hand, informal financial services are provided by individuals and institutions outside the structure of government regulation and supervision.

Digital Financial Services

Since the digital payment systems have already taken hold in the rural communities, the government should work with banks, insurance companies, and other financial service providers to increase the range of financial services that the poor people, especially the small and marginal farmers and women, can access in digital form. As a reasonable degree of connectivity in the rural areas of the country is already established, the efforts should be to extend the reach of digital payment systems into rural communities and encourage the poor people to adopt these systems through digital interface. In this respect, payment systems would be crucial since they enable people to collect payments, purchase goods, pay for water, electricity and other services and send money to family and business partners. They also enable the government to collect taxes and disburse social payments. When these transactions are costly and inconvenient, economic activity is impeded.

It is well established that access to finances is necessary to promote the growth of enterprises through the provision of credit to both new and existing businesses. It benefits the economy in general by accelerating economic growth, intensifying competition, as well as expanding employment opportunities. With proper targeting of financial services, incomes of those in the lower end of the income ladder will typically rise hence reducing income inequality and poverty. The lack of financial access limits the range of services and credits for households and enterprises. Poor individuals and small enterprises need to rely on their personal wealth or internal resources to invest in their education and businesses, which limits their full potential leading to the cycle of persistent inequality and diminished growth. Moreover, if individuals are to become self-reliant and institutions to become productive and sustainable, they need access to finance.

In Bangladesh, digital finance holds an enormous opportunity for greater financial inclusion and expansion of basic services. At present, around 115 million people own a mobile phone. As such digital finance can be used as a powerful means to expand access beyond financial services to other sectors, including agriculture, transportation, water, health, education, and clean energy. Obviously, digital solutions and new technologies will offer great potential to overcome the massive challenge of providing access to financial services to the poor and will contribute towards achieving the goal of universal access to financial services by 2021.[23]

It is also likely that the benefits of digital finance will extend well beyond the conventional financial services: This will also emerge as a powerful tool and an engine for job creation in Bangladesh.[24] The innovations by bKash and other institutions should be further expanded during the 7th Plan for tackling financial access and other major development challenges through adopting various innovative approaches to digital finance. During the Plan period, delivering financial services through technological innovations should act as a catalyst for the provision and use of a diverse set of financial services including credit, insurance, savings, and financial education. The excluded people would come under the purview of expanded access to money transfer services, microloans, insurance and other services.

Digital finance can also play an important role for small businesses. This will provide them with access to finance along with electronic payment systems, secure financial products and a chance to build a financial history. The potential of digital finance is huge especially in developing the rural areas. For example, the government's plan should be to use post offices, most of which are located in the rural areas, in enhancing financial inclusion. These post offices can play an important role in effectively delivering a variety of financial services, including banking, insurance, and remittances even in the most remote areas of the country. The government should encourage close public-private cooperation which will be a key factor in removing such barriers as cost, distance, and regulatory complexities.[25]

[23] However, a growing body of research suggests that developments in the digital financial system (DFS) have not trickled down to all population and that gaps continue to exist due to education, income, urbanization and gender.

[24] It may be added that a single company, bKash Limited launched in the second half of 2011, grew to 2 million accounts by the end of 2012, and shot up to 11 million registered accounts by the end of 2013. Unlike large mobile money businesses in other countries, bKash is not a mobile network operator (MNO) and did not have an existing customer base to which it added mobile financial services. bKash acquired each client on its own. Three factors have combined to drive bKash's fast start: a specialized organization built to deliver mobile financial services, a shared vision for scale among a diverse investor group and an enabling and flexible regulatory environment.

[25] It is likely that simple yet powerful innovations in the use of mobile phones would unleash a process of aggregating farmers and driving down transaction costs to levels that could pave the way for effective use of financial products and applications that had been previously unprofitable. This may lead to modify savings products

Mobile Banking Services

Through active support of the Bangladesh Bank, mobile operators and MFIs have emerged as active partners in providing financial services. The BB has provided 10 licenses to the banks to provide a full range of mobile financial services. Mobile phone companies have now adopted the technology and developed the networks that reach even the most remote parts of the country. With a large part of the population having access to cell phones, it is convenient for them to perform financial transactions through retail outlets now available even in village shops.

By 2012, bKash Service and Dutch Bangla Mobile have emerged as having the largest customer bases and agent networks in the country. The bKash Service is provided by the BRAC Bank in cooperation with its subsidiary bKash. The Dutch Bangla Mobile is a service of the Dutch Bangla Bank Limited. These two providers are the largest providers of nearly 500,000 new mobile accounts and more than 9,000 new agents. These services are also provided by others including the Trust Bank Limited, Bank Asia, UCash service from United Commercial Bank Limited, MyCash from the Mercantile Bank Limited and the Fast Cash service from E-Cash Limited.

Bangladesh's first complete mobile financial service provider, bKash Limited has been designed to provide financial services via mobile phones to both unbanked and banked people providing a convenient place to store money; a safe, easy way to make payments and money transfers. The bKash mobile wallet is a VISA technology platform, which is fully encrypted to ensure most secure transactions. The mobile wallet is essentially the customer account into which money can be deposited and out of which money can be withdrawn or used for various services. Customers will be able to receive electronic money into their bKash accounts through salary, loan, domestic remittance, and other disbursements and eventually

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to allow users to accumulate towards specific household goals in practical ways that fit with their cash flows and future spending needs. Financial service providers now know a great deal about how to manage microloans to poor families and get them repaid profitably. Private-sector agricultural businesses are also steadily expanding their role in financial services, embedding access to credit in the production chain within a bundle of other goods and services (e.g., seeds, inputs, weather information, insurance) to secure steady supplies of raw materials and higher value crops. The challenge would be to further develop and expand financial services that support the multiple goals of rural households, including those related to their more universal, general household needs and those linked to their agricultural and nonagricultural activities. In recent times, smart phones and tablets provide portable computing power *en masse* in many places and rural agricultural communities are yet to fully tap the near infinite resources made available by the Internet. Here lies a tremendous opportunity to increase farm-level efficiency and empower the farmers and other rural producers to better use and share data that are critical to their business. Importantly, mobilizing such technology will facilitate the provision of financial services to the poor and small and marginal farmers.

[25] It is widely believed that developing a broader range of quality, transparent, and affordable financial services is an imperative for financial inclusion in the country. Responding to client needs with the right range of products will help ensure that the service providers can deepen their client relationships, broaden the market share, grow responsibly and reduce their own risk. Three core requirements are needed for unleashing innovations in product development: (i) providing incentives through investing in research and development when core business is growing; (ii) organizational capacity especially through integrating systematic ways to listen to and learn from clients to guide product development; and (iii) conducive regulatory environment which allows for, and encourages, the development of new product approaches to financial inclusion.

will cash out the electronic money from bKash authorized agents/ATM. There are four mobile operators in Bangladesh but till now all mobile operators are not covered by bKash.

The Dutch-Bangla Bank Limited (DBBL) is the first bank in Bangladesh, which introduced mobile banking service to bring poor people from remote areas under smart banking service. The DBBL is operating this new innovative banking service through Banglalink and Citycell mobile operators and their approved agents throughout the country. One can create a bank account visiting any of the approved agents showing proper documents with a fee of Tk. 10. The subscriber must own a mobile phone to get the service. Once the account is created, a four digit mobile banking PIN code will be provided to perform all banking activities securely and secretly. The subscriber can withdraw and deposit cash from his mobile going to the agents.

At present, the mobile financial services market is at an early stage of development and the providers are working to improve the technology, expand agent networks and acquire new customers. A study conducted by the Bangladesh Bank reports that these new services are spreading to different parts of the country and most clients and agents express cautious optimism regarding the prospects of mobile financial services. The vast majority of the clients use this service is to send or receive payments. Rural users specifically mentioned the benefits of receiving payments. The value and the volume of mobile money transactions have grown rapidly over the last three years (Table 4.1).

Table 4.1: Growth of Mobile Banking, 2011-2013

	2011	2012	2013
No. of registered mobile money accounts (thousand)	125.5	3,229.6	13,173.4
No. of active mobile money accounts (thousand)	7.2	989.1	4,472.3
No. of registered agent outlets (thousand)	5.7	54.6	185.0
No. of active agent outlets (thousand)	2.6	45.2	136.3
No. of mobile money transactions (thousand)	229.6	25,895.7	228,601.8
Value of mobile money transactions (in million Tk.)	476	63,809	516,648
Outstanding balances on active mobile money accounts (in million Tk.)	44	746	3,141

Source: Financial Access Survey, IMF

Providing Efficient Financial Services and Products

For ensuring productive use of financial services, the government should strive for generating more effective synthesized knowledge about the products that exist for the poor households, institutions that provide these products, understanding the ground level realities for adopting successful and innovative models, and what factors ensure the success of promising ideas, and why some were embraced outside the intended target population. This will involve both development and piloting of more tailored products and services for the poor households. The government should encourage relevant organizations to explore ways to work with mobile network operators (MNOs) and other private-sector actors to identify not only how technology can help drive down costs to more effectively reach poor families, but also how different types of providers can collectively reach these households in an effective manner.

Some recent evidence in digital financial services (DFS) for small and marginal farmers suggests that it is important to (i) identify pain points in serving small farmers such as the cost and risk of making payments to the farmers and delivering subsidized credit; (ii) discuss how DFS are being used to overcome these pain points; and (iii) highlight the initial obstacles and successes. Given the rapidly developing state of DFS for the small farmers, it is important to realize that while DFS via mobile channels offer great promise for improving the lives of small farmers and their families, significant challenges still remain. One key obstacle is the limited penetration of mobile phone among the small and marginal farmers suggesting the need to adopt different forms of technology. Moreover, receptiveness to DFS via mobile channels among the small farmers would vary depending on their experience with mobile phones in general and with mobile money services in particular. This indicates that the success of mobile-enabled DFS would depend in large part on factors such as extent of mobile money adoption and experience of small farmers in using mobile phones for services such as messaging and agricultural information. In addition, there is also a need to complement current DFS innovations with other innovations that are based more solidly on financial needs, behaviours and aspirations of small and marginal farming households.

In addition, many small and marginal farmers have relationships with middlemen and other agents who provide credit to purchase inputs and meet other costs in exchange for a promise to sell their crops after harvest. Since most small farmers lack access to formal financial accounts and services, they are typically paid in cash. This system has a number of weaknesses both for the farmers and the agents. For the farmers, cash disbursement poses security and liquidity management problems. So efforts at digitizing financing for inputs and other farming activities should be attempted. So far, despite rapid progress, there are millions of small farmers who need improvement in their access to general financial services, including financial services specific to their agricultural activities.

The fact remains that the specific characteristics of different groups of rural households and their demand for financial services are still not well understood and the risk of extending credit to these groups is perceived to be higher due in part to the inherent risks of agricultural operations. The small size of most of their transactions have also made it very difficult to capture savings, channel remittances, build money transfer systems, and offer individual micro-insurance products. On the other hand, significant opportunities of improving access to financial services do exist, as shown by positive experiences across a wide range of delivery channels, products, and financial service providers. For example, simple yet powerful innovations in the use of mobile phones have rallied the small farmers together and driven down transaction costs to levels that could pave the way for making financial products and applications profitable which were considered unviable and uneconomic earlier. Similarly, savings products have been tailored to allow the users to accumulate towards meeting specific household goals that fit with their cash flows and future spending needs. Financial service providers have learned a great deal about how to manage microloans to poor households and get regular repayments. With enhanced effectiveness and profitability, the private sector institutions have also been steadily expanding their role in providing financial services to the poor along with embedding credit within a bundle of other goods and services (e.g. seeds, inputs, weather information, insurance) to secure sustainable agricultural production.

It also needs to be recognized that the challenges of providing financial services that provide effective support to the multiple goals of poor rural households are complex. In view of such complexities, it may be useful to characterize, as precisely as possible, the demand for financial services of the small farmers related to both farm and nonfarm operations within a segmented framework. Now-a-days smart phones and other devices provide useful resources made available by the Internet which are yet to be tapped by the poor and rural agricultural communities. Effective use of these resources can open up tremendous opportunities to increase farm-level efficiency and empower the poor farmers to better use and share data that are critical to their economic and social welfare. More importantly, mobilizing such technologies will facilitate the provision of financial services to the small and marginal farmers.

Developing a broader range of quality, transparent, and affordable financial services, based on informed needs of different poor groups, is an imperative of financial inclusion in Bangladesh society. The government strongly believes that all people should have access to: savings, payments, credit, insurance and other financial services as required by them. Ensuring the availability of a broader range of services and products will benefit both the recipients and the financial service providers. Through effectively responding to the needs of the people with the right range of products, the providers would also be able to deepen their relationships with the service recipients, broaden their market share, expand their business in a socially responsible manner and reduce their own risks.

The need for a diverse range of products is not new and the financial institutions in Bangladesh have already started exploring ways to offer a full set of services that the recipients would find useful over time. While the government should encourage such efforts, new ways of thinking about diverse offering of financial services to the low income people should be given priority. In this respect, the relevant strategies should highlight three core requirements for unleashing innovations in product development: (i) **incentives:** encourage the management to invest in research and development for innovation and risk appetite; (ii) **organizational capacity:** provide necessary support for integrating systematic ways to interact and learn from the poor groups of their product development needs and management buy-in; and (iii) **regulatory environment:** bring about required changes, as necessary, in the regulatory environment so that it allows for, and encourages, the development of new products and approaches to financial inclusion and for product innovation to flourish.

The Bangladesh Bank can request the commercial banks to extend the banking network to all places and villages having a minimum level of population. This would facilitate the opening up of an impressive number of ‘No Frills Accounts’ (NFAs), which may serve as basic savings accounts that require no minimum balance. This would also facilitate the wide adoption of the banking correspondent model, an agent-based model, as well as to the development of mobile banking as banks scramble to serve the villages around the country.[26] These efforts should also be supplemented by supportive policies such that these accounts do not become inactive or dormant.

Defining and measuring access to financial services

For policy purposes, access to finance needs to be distinguished from actual use of financial services, because non-use of finance can be either voluntary or involuntary. Voluntary non-users of financial services have access to but do not use financial services either because they do not need those services or do not intend to use those services. It is the involuntary non-users who are important for policy and those who involuntarily have no or only limited access to financial services may be termed as un- or under-banked and they need support to access financial services for raising productivity and incomes. Although involuntary non-users need financial services, they do not have access due to a variety of reasons. For instance, they may be unbankable as they are not being served by the financial institutions due to their low income or social and other grounds. Further, they may be considered unbankable since prevailing contractual arrangements (e.g. high collateral requirements) prevent financial institutions from commercially serving these non-users. Similarly, the cost or other features of financial services offered by the institutions may not be considered appropriate by the specific population groups of the non-users.

It is likely that the factors which determine whether or not an individual or enterprise has access to finance will change over time. In such an event, it may be useful to group the banked and unbanked into segments that reflect their current and possible future status as users or non-users of financial services. One approach to such market segmentation is the ‘access frontier’ which helps to analyze the development of financial markets over time. The access frontier gives the maximum share of the

[26] In India, the banks have extended the banking network to almost all villages with a population of over 2,000 as a part of RBI’s financial inclusion policy.

population that has access to a financial service at a given point in time. The frontier may shift over time due, for example, to technological and competitive changes in the market. The access frontier approach distinguishes between users and non-users of a financial service. Further, the segment of non-users may be divided into four groups:

- Those who are able to use the service but choose not to do so (voluntary non-users)
- Those who can currently access the service but do not as yet use it (non-users, lying within current access frontier)
- Those who should be able to use the service in future based on likely changes in the features of the service and the market (non-users, lying inside the future access frontier)
- Those beyond the reach of accessing the service in the near future (the supra-market group, lying beyond the future access frontier).

For policy purposes, it would be important to identify the reasons and take appropriate actions for those who can currently access the services but do not as yet use the services. On the other hand, the policy needs to be focused more on two major groups of non-users: groups who are lying inside the future asset frontier and groups lying beyond the future asset frontier.

Barriers and policies to increase access

Like in most other developing countries, the access to financial services is still limited in Bangladesh. It is estimated that about 46 million of the country's adult population still remain excluded from accessing financial services who are mostly the poor individuals. There are many reasons for their exclusion. For instance, the poor lack the education and knowledge needed to access financial services that are available to them which by the very nature of the existing institutions are extremely limited.[27] Moreover, the institutions often find it unprofitable to serve the small credit needs and transaction volume of the low income population and small institutions especially in the rural areas. Additionally, financial institutions including the banks may often not be geographically accessible for the poor since financial institutions are mostly located in urban agglomerates and rich neighbourhoods. The poor are also constrained by lack of collateral and inability to borrow against their future income because their income streams tend to come mostly from informal activities which are hard to track and predict.

The lack of financial access for the poor has been addressed, to a large extent, by rapid developments in the microcredit sector and speedy expansion of the microfinance institutions over the past few decades in Bangladesh. These institutions have managed to provide financial services to a significant number of the country's poor including the poorest along with achieving good repayments. However, still significant efforts are needed to build inclusive financial systems in the country. This includes, among others, taking full advantage of the technological advances in developing financial infrastructure and architecture to lower transaction costs, encouraging transparency, openness and competition to encourage the financial institutions to expand service coverage to the excluded groups, and enforcing prudential regulations to provide the financial institutions with the right incentives to move towards developing an inclusive financial sector.

[27] Empirical research shows that many poor rural residents especially women remain unaware of the financial services available to them especially women who are stuck at home tending to domestic duties. In addition, poor women often lack access to a mobile phone or do not own one. The cost of opening a mobile money account often prohibits customers from accessing mobile financial services. Network strength can also be problematic. Women are also challenged by mobile literacy, MFS language, terminology and literacy.

Table 4.2: Tiers of Financial Institutions and Their Principal Clients

Tier	Definition	Institution(s)	Principal clients
Formal commercial banks	Licensed by Bangladesh Bank	Commercial and development banks	Government, large and formal businesses and enterprises, SMEs, agriculture, households
Non-bank financial institutions	Licensed by Bangladesh Bank	Leasing and loan companies,	Formal private sector businesses and enterprises, private individuals
Quasi-formal institutions	Legally registered, but not licensed as financial institution by Bangladesh Bank	Credit unions, microfinance NGOs, cooperatives	Microenterprises, private small entrepreneurs, households
Informal institutions	Not legally registered; though may belong to a registered association	Savings and credit associations, private moneylenders	Small and marginal farmers, self-employed and informal sector participants, households

Mechanisms of microfinance

Microfinance supplies small loans and other basic financial services to the poor in recognition of the fact that the poor people need these services (e.g. loans, savings, insurance and money transfer services) for improving their socioeconomic conditions and moving out of poverty. In Bangladesh, a country which is the mother of microcredit and the land for its successful innovation, microfinance has proven to be a powerful instrument for sustainable poverty reduction, enabling the poor to accumulate assets, boost their incomes, and reduce their economic vulnerability.

In Bangladesh, several high-performing microfinance institutions, including government agencies and the NGOs, have developed innovative methodologies to extend credit, savings and other services to the poor clients. Although initially microcredit was mostly the domain of NGOs, government agencies and formal financial institutions have now engaged themselves in microfinance along with active interest in reaching the poor households. Moreover, advances in information technology offer the opportunity to lower the cost and risk of providing microfinance to the poor.

The overwhelming majority of the country’s microfinance borrowers are women. The microfinance borrowers, however, form a diverse group which includes female heads of households, self-employed individuals or small businesses, pensioners, displaced people, retrenched workers and small/marginal farmers and other informal sector participants all of whom generally remain excluded from the traditional banking system and rely on informal delivery systems for their financial services.

The role of the government should be to assist in improving the functioning of the microfinance sector especially through developing institutional and technical capacities especially at the level of retail microfinance financial institutions (MFIs). This will contribute greatly towards developing the domestic financial systems that serve the poor. The efforts will encourage the microfinance institutions to take on risks that traditional financial institutions would not usually share. Such efforts would enable the poor to push the frontier of poverty outreach away and extend the supply of financial services to people in remote areas. Such efforts would also include mechanisms for adopting digital technologies for improving service delivery and payment systems and further improve the microfinance environment having a sound legal and regulatory framework at the macro level.

In general, the MFIs have limitations in expanding access to financial services to the poor because of limited funds. This is particularly true for the small MFIs. Although the PKSF has been playing a major role, its limited ability is unable to finance all MFIs. Since the issue might emerge as a major future policy concern, alternative options of financing should be explored including replicating wholesale lending agencies like PKSF.

Information on Best Practices

Regulatory authorities in the financial sector should document best practices in mobilizing financial resources and providing credit and other financial services especially to the poor and under-served or un-served regions or households. Disclosure of such information among the financial and lending institutions will encourage other institutions to participate in the process.

Financial Literacy

Although intensity of access to financial services is relatively high in the country, it does not necessarily indicate that all households, especially the poor, have complete information and knowledge about financial services. In many cases, they may not be aware of the available services or how to access these services. For instance, literacy level is quite low in the case of insurance services. Awareness about financial services needs to be raised through different programmes including advertisement and campaign.

Partnership between Formal and Quasi-Formal Institutions

In the present situation, formal banks and financial institutions have significant limitations in extending financial services to the unbanked areas and un-served or under-served households due to the dominant production technology they use and the cultural orientation they possess. In this respect, the quasi-formal financial institutions have advantages and they have achieved commendable progress. Thus the formal financial institutions have more resources while the quasi-formal institutions have higher level of capability and efficiency. Developing partnerships between the formal and the quasi-formal financial institutions can create an effective mechanism to reach out to the poor and un-served regions, households and enterprises.

Transaction Cost of Borrowing

Transaction cost is one of the major determinants of access to finance. Transaction cost of borrowing matters in intensity of access to finance and determining the loan size. For the formal financial institutions, transaction costs may be reduced through adopting a number of supply side actions such as increasing bank branch density and improving efficiency of their operation through innovation in loan production technology e.g. minimizing waiting period for loan sanctioning and focusing on better governance so that efficiency is increased and illegal transaction cost is reduced for the borrowers.

Learnings from MFIs and Informal Market

Experience of the MFIs and the informal market suggests that credit services can be rendered even to the extreme poor households without any collateral and third party guarantee. The reason is that the loans are provided under intensive monitoring mechanisms along with appropriate incentive structures. The experience also suggests that loan products can be diversified in the formal financial sector. The formal financial institutions (especially the banks) may learn lessons from these experiences to adapt their activities accordingly. The risk on the part of the lending institutions can be significantly reduced through strengthening the Credit Information Bureau and decentralising its operation to facilitate quick generation and dissemination of relevant information.

Promoting a Competitive Financial System

Bangladesh Bank should develop an enabling environment for creating a competive financial system with appropriate incentives and governance system so that banks can provide financial services ensuring a high degree of efficiency. In practice, the non-interest cost of borrowing is seen to be higher for the public sector banks relative to the private sector ones. In addition, the moral hazard problem is a dominant issue in the public sector financial institutions especially in the agricultural development banks (BKB and RAKUB). The government and the BB should take prudent action to fix the problem and create a congenial environment so that the borrowers are able to receive services at low cost and the depositors can get a fair return.

In Bangladesh, a number of policies and measures have been taken in recent years for improving the access to financial services especially for the poor which have significantly improved the situation. The SCBs and DFIs have already opened a total of about 9 million new Tk. 10 accounts for the farmers. These accounts will help the government to make direct payments of subsidies or other benefits to the accounts of the recipients. The operation of these accounts will also encourage these basic bank account holders to go on to buy other financial products and thus stimulate the demand for other financial services. It is likely that the opening of farmers' accounts will facilitate these farmers to move to higher levels of financial transition leading to greater financial inclusion. For the purpose, just opening the accounts is not adequate, the challenge is to keep these operational and active.

In addition, several other issues should also be considered during the 7th Plan period for effectively addressing the challenges for promoting adequate access to financial services by the poor.

- In Bangladesh, the issue of access to finance needs to be examined mostly from the perspective of the rural financial markets as the rural poor population is the major group who remains under-served. The policies therefore should largely be directed towards developing the rural financial markets.
- The measures adopted so far for enhancing access of the poor to the formal financial system are mostly driven by regulation by the BB or other institutions. These measures seldom reflect the initiatives of the banking and other financial institutions. It is important to promote ownership of the initiatives in order to ensure their sustainability.
- Although the situation has improved significantly, the current measures fall short of satisfactorily addressing the demand side problems of the financially excluded sections of the population. It must be recognized that access to financial services has both demand and supply side dimensions and both need to be recognized.
- The traditional approach of the formal banks and financial institutions under which the clients come to the institutions rather than financial institutions going to the households and firms needs to be reversed with pro-active efforts by the banks to expand access to financial services.
- Although the initiative of BB to open Tk. 10 accounts by the commercial banks has contributed to broadening the intensity of access to finance, most of these accounts are reported to be dormant. Efforts are needed to make these accounts active especially to serve the larger utility for the government to transfer subsidy to the accountholders. It must be realized that higher rates of dormant accounts do not add to any effective expansion of access to finance for the poor.
- For improving the access to financial services, the present focus on women needs to be further strengthened along with developing women-friendly financial products and services.
- One of the major factors of not having access to finance for the poor is the high transaction costs. As discussed in the paper, transaction costs can be reduced through taking financial services to

the door steps of the poor households, and also through better use of the technologies. The author has highlighted the role of technology in reducing transaction cost. In this respect, one of the limiting factors is the high transaction costs and high degree of risk in providing services to the vulnerable poor households especially in the inaccessible areas. In this context, the role of the government (e.g. through providing subsidies) in expanding services to the vulnerable poor households needs specific consideration in the Seventh Plan.

- There is a need to adopt measures to improve financial literacy and establish credit counseling centres especially targeting excluded population groups and regions. Similarly, relevant authorities should organize regular and extensive training and skill development programmes on different aspects of financial inclusion for the financial service providers.
- The relevant authorities (e.g. BB) should develop financial inclusion programme similar to the mandatory agriculture/rural finance programmes. All banks operating in the country would be required to participate in the programme and each bank should be assigned specific under-banked districts/areas where promoting financial inclusion will be its responsibility which would be monitored by the BB using rational and measurable indicators.
- For promoting access to financial services at the required pace and breadth, BB should develop and adopt a comprehensive and detailed guideline for creating inclusive financial system including the formal banks and financial institutions.
- New strategies and efforts are needed to enhance the role of the postal banking system as a viable and efficient alternative financial service provider especially in the rural areas of the country.
- A strengthened insurance sector can play an important role in providing financial services to the population including the poor for which huge potential exists. Although more than 60 insurance companies operate in the country, their outreach is quite limited. Efforts are needed to transform the insurance sector into a dynamic one through introducing poor-friendly products and proper monitoring of its operations by strengthening the Insurance Regulatory Authority (IRA).
- For improving the access to financial services in remote and disadvantaged locations including char and haor areas, a number of policy initiatives are needed such as exploring more viable solutions to the problems in char and haor areas, enhancing capacity of the formal financial institutions to serve these areas in a flexible and cost-effective manner, creating partnership between formal and quasi-formal institutions and developing customized financial products to meet the specific needs of the char/haor dwellers based on the experience of the MFIs.
- One of the core policy issues is the future status and role of the licensed MFIs. One option could be to transform these MFIs into rural banks. While the unlicensed MFIs may continue with their present functions within broad guidelines and supervision of the MRA.
- The regulatory agency does play an important role in developing a sound financial market. In the context of providing financial services to the poor households, the role of MRA needs significant strengthening through enhancing the effectiveness of the organization which should be taken up as a matter of policy.

Overall, a wide variety of policy initiatives are needed for scaling up the delivery of formal and quasi-formal financial services to the population. This will help improve the access of the poor and low income families to financial services and prevent serious problems related to non-availability of credit such as falling into debt traps or losing one's productive assets. In this respect, the private sector has an important role to play in better serving the poor households. For example, bank accounts tailored to the needs of the poor households (e.g. low fees, no minimum balance) will expand the poor's use of formal financial services. A greater presence of formal financial institutions in rural areas and low-income neighbourhoods may also be important. Currently quasi-formal and informal financial service providers outnumber bank branches in these areas.

Of course, the public sector can do many things to increase savings and greater use of formal financial services among the poor households. A key public sector role should be to work closely with the private sector encouraging and incentivizing financial institutions to serve the poor and lower-income populations. Greater financial education for these households is a priority. The government and the BB can also play an important regulatory role, which includes overseeing financial providers to ensure that they provide a range of poor-friendly financial services and implement better protections for the poor financial service receivers. The public sector could also encourage saving by low-income families through implementing different incentive mechanisms and matched savings plans. It must also be recognized that the country's formal financial institutions are not well designed to encourage access to financial services by the poor and low-income households. To the extent the relevant policies want the poor households to have the access to financial services to ensure their economic empowerment and better livelihoods, the need would be to create their access to banking, credit, and savings institutions that are available to the rest of the society.

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