Study Report

Implication of Regulation on THE MICROFINANCE INSTITUTIONS IN BANGLADESH

Conducted By

Bangladesh Academy for Rural Development

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ON
THE MICROFINANCE INSTITUTIONS IN BANGLADESH

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Message from the Executive Vice Chairman, MRA

It is with great pleasure that I convey my heartfelt appreciation to the Bangladesh Academy for Rural Development (BARD) for their diligent efforts in conducting the study on the "Implication of Regulation on the Microfinance Institutions in Bangladesh." This report unveils deep insights into the impact of regulatory measures on microfinance institutions (MFIs) across the country.

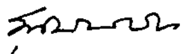
Microfinance plays a pivotal role in driving financial inclusion and socioeconomic development, particularly in a country like Bangladesh, where a significant portion of the population relies on microcredit for their livelihoods. On behalf of the Microcredit Regulatory Authority, I recognise the importance of fostering an enabling regulatory environment that ensures the integrity, stability, and sustainability of the microfinance sector of Bangladesh.

The findings of this study shed light on the compliance levels, performance indicators, and challenges faced by MFIs in adhering to regulatory standards. It is heartening to see the dedication and commitment demonstrated by the team at BARD in conducting this study, which will undoubtedly inform our efforts to enhance regulatory effectiveness and promote responsible microfinance practices.

I extend my sincere gratitude to Dr. Md. Abdul Karim, Additional Director General, BARD and the entire research team for their exemplary work in completing this study. Their meticulous approach and dedication to excellence have contributed immensely to the quality and depth of the report.

Furthermore, I would like to express my gratitude to all stakeholders, including the microfinance institutions, service providers, and participants, whose cooperation and support have been instrumental in the success of this endeavour.

As we move forward, I am confident that the insights gleaned from this report will guide us in formulating policies and strategies that foster a vibrant and inclusive microfinance ecosystem in Bangladesh in the days to come. Together, we can continue to leverage the power of microfinance to uplift communities, alleviate poverty, and foster sustainable development in Bangladesh and other contexts.



(Md. Fashiullah)
Executive Vice Chairman
Microcredit Regulatory Authority

Preface

It is with great pleasure and a sense of accomplishment that we present this comprehensive study, "Implication of Regulation on the Microfinance Institutions in Bangladesh," conducted on behalf of the Microcredit Regulatory Authority (MRA). This study, initiated in July 2023, aimed to delve deep into the impact of regulations enforced by the MRA on the microfinance sector in Bangladesh.

Microfinance has long been recognized as a powerful tool for poverty alleviation and economic empowerment, particularly in developing nations like Bangladesh. The establishment of the MRA in 2006 marked a significant milestone in the regulation and supervision of microfinance operations in the country. Since then, the MRA has played a pivotal role in ensuring good governance and protecting the interests of both borrowers and staff within the microfinance landscape.

Drawing upon a mixed-methods approach, this study sought to assess the extent of compliance of microfinance institutions (MFIs) with MRA regulations, analyze the impact of these regulations on MFI performance, and evaluate their effectiveness in safeguarding employees and customers. Through a combination of quantitative data analysis, surveys, focused group discussions, and key informant interviews, we endeavoured to provide a holistic understanding of the implications of MRA regulations on the microfinance sector. The findings of this study offer valuable insights into various facets of the microfinance sector in Bangladesh. From compliance levels and performance indicators to the perceptions of service providers and the challenges faced by MFIs, this study sheds light on the dynamics at play within the microfinance ecosystem. Additionally, the recommendations put forth aim to inform policy decisions and guide future initiatives aimed at further strengthening the microfinance sector and promoting financial inclusion in Bangladesh.

We extend our heartfelt gratitude to the Microcredit Regulatory Authority for entrusting us with this important study. We also express our appreciation to all the stakeholders, including the microfinance institutions, service providers, and participants, whose valuable insights and contributions made this study possible.

We express our heartfelt gratitude to the former Director General of BARD, Mr. Md. Harun or Rashid Mollah, for his support throughout the research operation. Special appreciation is due to the current Director General, Mr. Subrata Kumar Sikder, for his unwavering guidance and assistance in finalizing the report, as well as in organizing the dissemination workshop for the end of the study. The leadership demonstrated by both individuals served as a source of inspiration, enabling us to navigate this journey with diligence and excellence.

It is our sincere hope that the findings and recommendations presented in this study will serve as a valuable resource for policymakers, practitioners, and stakeholders alike, as we collectively strive towards building a more inclusive and sustainable microfinance ecosystem in Bangladesh.

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Professor Dr. M. Zakir Saadullah Khan

Abbreviations/Acronyms

AGM	Annual General Meeting
AID	Association for Integrated Development
ASA	Association for Social Advancement
ASARRD	Asian Survey of Agrarian Reform and Rural Development
BARD	Bangladesh Academy for Rural Development
BDT	Bangladeshi Taka
BRAC	Bangladesh Rural Advancement Committee
BSEC	Bangladesh Security Exchange Commission
CA	Chartered Accountant
CDF	Credit and Development Forum
CEO	Chief Executive Officer
COVID-19	Coronavirus Disease 2019
DA	Dearness Allowance
DBM	Declining Balance Method
DID	Directly Instructed Deposit
DID	Difference-in-Differences
DPS	Deposit Pension Scheme
EC	Executive Committee
EIR	Effective Rate of Interest
FAO	Food and Agriculture Organization
FDR	Fixed Deposit Receipt
FGD	Focused Group Discussion
FR	Flat Rate
GB	Grameen Bank
GC	General Council
HSC	Higher Secondary Certificate
IPO	Initial Public Offer
IRA	Insurance Regulatory Authority
KII	Key Informant Interview
LLP	Loan Loss Provision
LLPE	Loan Loss Provision Expenses
MC	Management Committee
MFI	Microfinance Institution
MRA	Microcredit Regulatory Authority
NBR	National Board of Revenue
NGO	Non-Governmental Organization
OECD	Organisation for Economic Co-operation and Development
OLS	Ordinary Least Squares
OSS	Operating Self-Sufficiency
PAGE	Poverty Alleviation Gender Equality & Environmental
PKSF	Palli Karma-Sahayak Foundation
RBM	Reducing Balance Method
RIA	Regulatory Impact Assessment
ROA	Return on Assets
ROI	Rationale-Objectives-Indicator
RSS	Rural Social Services
SEEP	Small Enterprise Education and Promotion
SSC	Secondary School Certificate
SSS	Society for Social Service
TA	Travel Allowance
TK	Taka (Bangladeshi currency)
USAID	United States Agency for International Development

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Executive Summary

1. The microfinance sector offers financial products to alleviate poverty, primarily by providing microcredit for income-generating activities to low-income individuals. This sector includes Microfinance Institutions (MFIs), Grameen Bank (GB), Commercial Banks (CB), and various Government Departments (GD). However, MFIs dominate the microfinance sector, serving 67% of borrowers and holding 78% of the loan portfolio in this sector.

2. As of June 2022, 739 licensed MFIs operate alongside CB, GB, and GD, providing microfinance. Based on the number of borrowers, the MFIs were classified into small, medium, large, and very large. It was found that 74 per cent and 19 per cent were small and medium, respectively. Four per cent of those were large, and less than one per cent were very large. However, more than two-thirds of the loan & savings portfolio and loan disbursement of MFIs belong to the top 10 MFIs. As a result, it was essential to bring those MFIs under regulation for their sustained growth in this sector as well as to protect the clients' and employees' interests. With a view to balancing the social and financial goals of MFIs as well as protecting the interests of borrowers, the Microcredit Regulatory Authority (MRA) was established in 2006. MRA rules were promulgated in 2010. As per the requirements, MFIs need to obtain a license and comply with other MRA regulations for operating microfinance. Along with the MRA Act and rules, 73 circulars were issued related to regulations.

3. The regulations can be broadly classified into four dimensions: improving governance, standardization of fund management, client protection, and staff protection. The major issues related to improving governance include the requirement for each MFI to form a General Committee (GC) and an Executive Committee (EC), hire a salaried Chief Executive Officer (CEO), and establish written policies for savings and loan management. These policies specified the maximum tenure of the GC and EC, with a minimum representation of women. The regulations also specify the operational procedures of the policy-making body and management and the nature of financial products MFI can introduce. In the case of standardization of fund management, each MFI needs to maintain a number of accounting books, generate funds from specified sources, maintain a minimum liquidity ratio, institute a reserve fund, make loan loss provisions, and introduce a system of internal and external audits. Capping the service charge of loan products, offering a minimum interest rate for deposits, introducing grace periods for repayment, and

establishing a depositor safety fund are all key MRA initiatives to protect client rights. MRA regulations mandatory service rules that outline both financial and non-financial staff benefits, as well as appointment letters detailing conditions of service to ensure employee protection. To evaluate the degree of compliance with these regulations by MFIs and their impact on the microfinance institution, this study was undertaken by BARD with the assistance of the MRA.

4. The study's general objective was to investigate the effect of a regulation made by the Micro Credit Regulatory Authority (MRA) on the Customer, staff, and financial performance of Microfinance Institutions (MFIs). The specific objectives were as follows: a). assess the extent of compliance of regulation of MFIs by type of M.F.I.s., i.e., small, medium, and large & very large b) examine the influence of microfinance regulation on the performance of the MFIs; c) analyze the provision and practices of microfinance regulation on employee and customer protection

5. This study employed a mixed-methods approach to comprehensively assess the impact of MRA regulations on the microfinance institutions in Bangladesh. This approach combined quantitative data analysis with qualitative insights to capture an in-depth understanding of the issue. Primary data was collected through a survey, Focused Group Discussion (FGD), and Key Informant Interviews (KII). A stratified random sampling technique was used to select MFIs from various categories and locations across Bangladesh. The survey on the MFIs was conducted on 161 MFIs in the following 23 districts covering 08 Divisions of the country: Barisal, Bogra, Chapai Nawabgonj, Chittagong, Cumilla, Dhaka, Dinajpur, Gaibandha, Habigonj, Jamalpur, Jessore, Khulna, Kushtia, Moulvibazar, Mymensingh, Natore, Pabna, Patuakhali, Rajshahi, Rangpur, Sherpur, Sylhet and Tangail.

6. To assess the impact of the Microcredit Regulatory Authority Act 2006 and the Microcredit Regulatory Authority Rules 2010, on microfinance institutions in Bangladesh, this study utilized the Regulatory Impact Assessment (RIA) methodology developed by the OECD.

7. ***Extent of Compliance of MFIs with the Regulations***

7.1 Nearly two-thirds of MFIs got registration under the Social Welfare Act. At the same time, the remaining institutions function under various other acts. The differences in some aspects related to the compliance of governance issues of registration authority and MRA regulations highlight a potential need for greater standardization in legal frameworks MFIs with the rules of registration authority.

7.2 All MFIs have established a General Body, averaging 23 members. These bodies demonstrate satisfactory attendance rates, indicating active member participation in institutional oversight.

7.3 All MFIs comply with MRA guidelines regarding the size and female member representation within their EC. While most adhere to established election and meeting frequency procedures, deviations exist concerning the duration of committee member terms. Addressing these inconsistencies could strengthen governance practices.

7.4 Most MFIs employ salaried CEOs, with their primary salary source being core microfinance activities. However, potential conflicts of interest remain a concern during the decision-making process of the EC as there is no restriction on the number of relatives of the CEO or entrepreneurs who can be members. This necessitates careful monitoring and mitigation strategies.

7.5 Most MFIs have secured approval for their organizational structures and service rules. Larger institutions emphasize clearer reporting lines, ensuring efficient communication and accountability within the organizational hierarchy.

7.6 Many MFIs maintain the required hard copies of financial records, conduct external audits, and possess authorized loan mobilization rules. However, smaller MFIs lag in updating accounting software and establishing and operationalising saving mobilization policies. Bridging this gap is crucial for ensuring transparency and sound financial management practices.

7.7 MFIs leverage various funding sources, with larger institutions demonstrating greater diversification in their funding strategies. However, regulations capping fund mobilization costs at or below client deposit rates can hinder fundraising, especially for smaller MFIs. The MRA might consider reviewing these regulations to strike a balance between safeguarding financial stability and enabling access to capital for all MFIs.

7.8 The number and size of MFIs maintaining reserve funds have significantly increased, reflecting positive strides toward adherence to MRA regulations. However, concerns linger regarding the low returns generated on reserve deposits. Exploring alternative investment options for these funds could ensure their optimal utilization.

7.9 While most MFIs comply with fixed asset regulations, some exceed the stipulated 35% limit. This often stems from pre-existing assets before directives or asset transfers from donors. The regulatory body might consider adopting a more flexible approach, evaluating MFIs on a case-by-case basis to account for these specific circumstances.

7.10 Most MFIs offer insurance products, typically charging a fixed premium based on the loan amount. Collaboration with the Insurance Regulatory Authority is recommended to expand coverage options and enhance financial protection for clients.

7.11 All MFIs provide enterprise loans, and larger institutions generally adhere to MRA's recommended allocation of 60% of their loan portfolio to this category. While term savings products are available, they constitute a smaller share of total savings, particularly among smaller MFIs. Encouraging a wider range of financial products, including diversified savings options, could cater to the evolving needs of clients and promote financial inclusion. The current process for obtaining MRA approval to introduce term savings accounts can be maintained by ensuring prompt decision-making. Moreover, special care needs to be taken to ensure that poor people are not excluded from financial inclusion in the pursuit of enterprise loans.

7.12 Compliance with liquidity regulations proves satisfactory, especially for larger MFIs. However, adherence remains low regarding holding at least 5% of savings in fixed accounts. Strengthening monitoring and enforcement mechanisms can ensure complete compliance and safeguard against potential liquidity risks. Provisions regarding the depositor's safety fund 2014 rule is yet to be introduced.

7.13 MFIs maintain provisions for loan categorization as mandated by regulations, demonstrating responsible management of potential loan losses. The smaller MFIs are struggling to ensure compliance with the loan loan reserve fund.

8. *Impact of Regulations on MFIs*

8.1 Organizational performance: The average number of clients rose considerably across all MFI sizes. However, small MFIs have a slower growth rate than medium and large MFIs due to their limited capacity to cater to the needs of beneficiaries and a shortage of funds. Moreover, it was found that the compulsion of keeping a portion of savings as security, a specific loan-to-savings ratio, and a portion of surplus for security has reduced their autonomy to increase the amount of outstanding loans, thereby hindering their ability to attract more clients. The borrower-client ratio is dropping across all MFI sizes.

8.2 Fund size and composition: The average fund size of all MFIs has grown dramatically. Large and very large MFIs have significantly more funds than small and medium MFIs. This growth is partly due to increased access to bank loans, particularly for medium, large, and very large. MFIs are facilitated by a legal framework that promotes their acceptance to formal financial institutions. However, the percentage of savings as a source of funding for

smaller MFIs has declined slightly, while the use of surplus funds and bank loans, irrespective of the size of MFIs, has climbed dramatically.

8.3 Administrative and operational efficiency: The cost of mobilizing savings increased for large and medium MFIs, while it decreased for small MFIs. One possible reason for the rise in larger institutions might be the introduction of a minimum cap on mobilizing funds as deposits from beneficiaries and increased growth of saving mobilization to small ones. All categories of MFIs except medium-sized ones saw a decrease in their borrowing cost ratio. This increase for medium MFIs could be explained by the higher proportion of bank loans they took compared to the base year. Overall, all types of MFIs experienced a reduction in general and administrative costs, as well as overall operating costs, likely due to compliance with various regulations imposed by the MRA.

8.4 Financial Stability: Operational self-sufficiency ratio (OSS) increased in 2023 for all MFI sizes except small. This can be attributed to the mandatory loan loss provisioning, which impacted smaller MFIs more significantly due to their limited revenue generation capacity from financing compared to larger institutions. Inadequate revenue has an impact on equity, thereby reducing the capacity to borrow money from financial institutions. In 2023, all MFI sizes except small were found to have a higher return on assets (ROA). For smaller MFIs, a lack of funds hinders their ability to expand loan portfolios, which in turn reduces their return on financing and translates to a lower ROA. Portfolio yields decreased for all MFI categories compared to the base year. One potential reason is the MRA's regulation on capping service charges, which limits MFIs' ability to set them according to their discretion.

8.5 Other Activities: Besides microcredit, MFIs provide education and health awareness programs, capacity-building initiatives, social care services, and long-term community development services. Opportunities for engaging in these activities have been rationalized since regulations were implemented, with a few exceptions. Following the rules, MFIs need to get permission from MRA to use surplus funds for social activities, which ensures the effective use of resources. However, this process can sometimes make it difficult to respond quickly in emergencies.

8.6 Variation in Financial Products: Since regulations were implemented, the number of MFIs offering term deposits, voluntary savings accounts, enterprise credit, housing loans, education loans, and insurance has grown. However, due to some preconditions for diversifying financial products, especially introducing term deposits and enterprise credit, some MFIs are struggling to offer a wider variety of financial products.

8.7 Overall, the findings indicate that rules have had a favorable influence on MFI performance in Bangladesh. MFIs have improved their efficiency and profitability and expanded their variety of financial products and services.

8.8 The study witnessed flourishing growth, improved efficiency, and a commitment to social impact. However, addressing the challenges faced by smaller MFIs related to increasing their loan portfolio, gaining wider access to the wholesale microfinance market, navigating variations in regulations that reduce a significant capacity gap compared to large and very large MFIs, and fostering wider participation of very poor in financial activities are essential steps towards ensuring a truly inclusive and sustainable microfinance ecosystem in Bangladesh.

8.9 The MRA regulations have a positive impact on the financial performance of Bangladeshi MFIs, with a higher return on assets (ROA), operating self-sufficiency (OSS), and portfolio yields (P_Yield). However, the positive effect seems to be decreasing over time.

9. *Effects of Microcredit Regulatory Authority: Perception of Service Providers*

9.1 Service providers acknowledge many positive outcomes attributed to the MRA's regulations, including fostering good governance, efficient management practices, and sound institutional frameworks within MFIs. MRA's regular monitoring has obligated them to follow the rules and regulations, which has had a positive impact on improving performance in these areas. This fertile ground has nurtured sustainable growth within the sector, expanding its reach and impact.

9.2 Safeguarding clients' well-being is paramount, and the MRA's regulations are perceived as playing a crucial role in achieving this objective. Measures like standardized service charges, transparent information disclosure, and accessible grievance redressal mechanisms instill confidence and empower clients.

9.3 The MRA's influence extends to uplifting the lives of MFI staff. The regulations mandate the creation of standard service rules, ensuring fair recruitment processes, adequate compensation, and greater opportunities for professional development compared to the situation before the MRA.

9.4 Concerns are raised regarding inadequate policy directives in specific areas. These include: i) Overlapping activities in rural areas leading to unhealthy competition and potential over-indebtedness of clients. ii) Inconsistent regulations for different MFI sizes create an uneven playing field and potentially hinder the growth of smaller institutions. The MFIs' capacity in terms of the loan portfolio, saving portfolio, outreach, and accessibility to low-cost funds differs a lot among the different sizes of MFIs that deserve regulations related to the size

of MFIs iii) Lack of clear guidelines for crisis recovery, posing difficulties in addressing situations like natural disasters and mitigating potential losses. For instance, in some cases, the MFIs need to postpone the recovery of loans during crisis period by complying with the directives of MRA. However, the MFIs have to incur regular administrative costs. A clear directive is needed on how to balance the two goals of client protection and financial stability of MFIs.

9.5 MRA regulations, while emphasizing client protection, can unintentionally stifle the growth of MFI's capital base. This includes restrictions on maintaining the savings loans ratio and mandatory deposits in fixed accounts, potentially limiting resources available for lending activities.

9.6 Implementing an accounting and reporting software program can promote transparency. However, using different types of software can create data security problems. Additionally, making frequent software changes to comply with regulation updates can potentially impact operational efficiency. Furthermore, in some areas, unlicensed clubs, associations, or organizations provide microfinance services without following standardized rules and regulations. This competition from unlicensed institutions offering unregulated services can pose challenges for licensed MFIs in attracting and retaining clients in those areas.

9.7 While regulations mandate organizational structures and service rules, concerns remain regarding: i) Standardization of staff benefits and career development opportunities, particularly for smaller MFIs. ii) Client mobility across MFIs is driven by service charges and loan availability, potentially impacting the sustainability of smaller institutions with limited resources.

9.8 To assess the impact of regulatory changes on microfinance institutions (MFIs), the OECD's Regulatory Impact Assessment (RIA) method is used following six steps procedure: rationale, objectives and indicators defining as Benchmark, and data collection, evaluation and policy prescription defining as Attribution of regulatory impact. Data has been collected from primary and secondary sources. Primary data was obtained from randomly selected 161 MFIs across 64 districts in Bangladesh through questionnaire surveys, Focus Group Discussions (FGDs), and Key Informant Interviews. Secondary information was gathered from annual reports by the Microcredit Regulatory Authority (MRA).

9.9 The study aims to measure the net positive effects of a regulatory intervention on Microfinance Institutions (MFIs) in Bangladesh. It uses a "new-old entrant" approach, avoiding the need for a control group and longitudinal study. The study uses a pooling

methodology, assessing attribute changes at baseline and after the 2010 MRA rule. It employs techniques like Difference-in-difference (DID) Analysis, Pooled Regression, and Panel Data Analysis to provide a comprehensive assessment of the regulatory impact on MFIs' performance. This approach offers valuable insights for policymakers and stakeholders in the microfinance sector.

9.10 Results show that MFIs operating after regulation have a higher return on assets (ROA) compared to those before regulation. The coefficients of variables in the Operating Self-Sufficiency (OSS) and Portfolio Yield models also provided similar results. However, the regulation's effect on these three financial performance variables weakens over time. The significant association between confounding factors (like age, size, location, administrative cost, and the ratio of funding from an internal sources of the MFIs variables) and the financial performance variables are negative, implying that the newer MFIs have better financial performance than the older ones, while bigger MFIs performs better than smaller and MFIs operating in the older divisions in Bangladesh are also performing better than MFIs operating in the newer divisions. However, there are significant and negative associations between the administrative cost and financial performance, except for portfolio yield, and a positive association between the proportion of funding from internal sources and financial performance.

10. ***Microfinance Regulation and Employee Protection***

10.1Positive Impact of MRA Regulations: Participants acknowledged the positive influence of MRA rules in several areas: i) **Formalization of Employment:** Appointment letters, service rules, and standardized recruitment procedures ensure job security and transparency. ii) **Career Development:** Established organizational structures and promotion pathways offer opportunities for career growth. iii) **Financial and Non-Financial Benefits:** MFIs provide employee benefits like gratuity, provident funds, leave policies, and training opportunities. Iv) **Reduced Vulnerability:** MRA regulations have curbed the number of illegal microfinance operations, potentially minimizing employee exploitation in such organizations. During COVID-19, strong monitoring by the MRA ensured that benefits reached staff even though MFIs struggled to earn adequate revenue.

10.2Employee expressed Concerns about i) Salary and Benefits: While satisfied with current benefits, some employees expressed a desire for improved salaries through introducing a proportion of highest and lowest positions, group insurance, and pension schemes, particularly in smaller MFIs. ii) **Training and Development:** Employees at all

MFI sizes emphasized the need for more training programs on loan management, MRA regulations, and capacity building. iii) **Standardization:** Some participants suggested MRA establish minimum standards for financial and non-financial benefits, office environments, and employee grievance redressal mechanisms.

11. MRA Regulations and Client Protection

11.1 Positive Impacts of MRA Regulations: i). Transparency and Client Rights: MRA rules have increased transparency in loan processes, service charges, and client rights. Clients now receive passbooks and enjoy benefits like grace periods and flexible repayment options. ii) **Reduced Service Charges:** MRA regulations have capped service charges, making microfinance services more affordable for clients. iii) **Improved Collection Practices:** MRA regulations have curbed coercive collection practices, promoting ethical treatment of clients by MFIs. iv) **Client Protection Funds:** MRA rules require MFIs to maintain Loan Loss Provision (LLP) and establish Security Funds to protect client deposits in case of MFI bankruptcy.

11.2 Challenges i) Limited Financial Literacy: While clients understand loan repayment, they lack knowledge about other terms like interest rate calculations and maximum service charges. FGD participants suggest financial literacy training programs for clients. ii) **Over-Indebtedness:** Some participants reported multiple loan borrowings, which led to potential risks. MRA's role in stricter enforcement against unlicensed lenders and motivational campaigns to promote responsible borrowing were suggested. Iii) Limited Deposit Protection: Concerns exist, especially regarding client deposit security in weak MFIs. Suppose a weak MFI's license is revoked. In that case, clients risk losing their deposited funds, as there is currently no system in place to guarantee their return**.** Some participants suggested flexible MRA rules for large MFIs with robust financial health. Iv) **Grievance Redressal Mechanism:** The lack of a formal grievance redressal system for clients was identified as a gap. Participants recommended establishing mechanisms within MFIs, monitored by independent bodies.

12. *Recommendations*

12.1Regulations according to Size of MFIs: There are a lot of differences among the very large, large, medium, and small MFIs in terms of their fund size, outstanding loan amount, outreach coverage, and capacity. Regulators may consider implementing tiered regulations to encourage smaller microfinance institutions' growth, such as variations in provisioning

for security and liquidity funds, capping service charges and delinquency management. This could help smaller institutions develop their capacity and contribute to a more competitive financial landscape.

12.2 **Management Committee Composition:** The general body and managing committee are governed by rules that limit tenure and prevent relatives of the CEO from serving as chair. Field experience suggests a ceiling of close relatives in the Management Committee. **Security Fund Investments:** The bank's fixed account holds significant security money with a low rate of return. Exploring the bond market, IPO quota negotiation, or national savings instrument with consultation with the Bangladesh Bank or BSEC can be explored.

12.3 **Centrally Designed Accounting Software:** MRA can initiate centralized accounting software to introduce changes in regulations and automate real-time reports for MFIs. This will reduce administrative workload and ensure data security while also ensuring adequate backup and adequate data security.

12.4 **Beneficiary Protection:** Advocates for a mechanism to safeguard beneficiaries' savings in case of MFI license cancellation. The Beneficiaries Savings Security Rule 2014 and the Bankruptcy Act 1997 can be applied with modifications to ensure beneficiaries receive their benefits from the MFIs when MFIs' licenses are cancelled in consultation with MFIs. Moreover, adequate staff needs to be ensured in MRA for regular monitoring of each MFI every year.

12.5 **Social Responsibility Spending:** Although social spending is systemized due to regulation MFIs may be discouraged from introducing innovative social activities due to the requirement for MRA approval for spending surplus. Additionally, responding to natural disasters can be challenging, requiring approval from the MRA. Although MFIs got retrospective approval after spending on COVID-19, a maximum surplus limit against each category of MFIs can be introduced for investing in social activity by obtaining authorization from the General Body.

12.6 **Employee Management:** Mandatory provisions for service rules and appointment letter requirements have improved employee protection. A rational ratio between the highest and lowest benefit packages may be introduced for adequate protection. Staff can be linked to the national pension scheme and require clearance from earlier MFIs for confirmation of services.

12.7 **Alignment of Regulations:** The registration authority's directives and MRA rules are crucial, but there are discrepancies, particularly in the tenure of the General Body and

Management Committee and the position of salaried individuals, which a flexible interpretation could address.

12.8 **Financial Literacy Programs:** The MRA can enhance microfinance beneficiaries' financial literacy by introducing proper guidelines and awareness programmes. This can help them understand loan service charges and protect against unforeseen circumstances, ultimately strengthening their well-being and ensuring they are aware of their loan obligations.

12.9 **Policy for Overlapping Loan Recovery:** A clear policy directive is needed to improve loan recovery efficiency by establishing a collaboration framework between microfinance institutions and other financial institutions, ensuring transparency and preventing duplication of efforts. Legal protection for MFIs is also crucial for the efficient recovery of bad loans.

12.10 **Training Programs:** The Microfinance Regulatory Authority (MRA) is addressing a knowledge gap in microfinance institutions (MFIs) by providing training. The effort can be boosted by organizing training more professionally. Preparing standardized training modules, using certified trainers in the microfinance sector, and decentralizing training by involving established training institutes in different regions may be encouraged.

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CHAPTER 1: INTRODUCTION

1.1 Background of the Study

Microfinance, which has diverse ramifications encompassing microcredit and financial products for the poor and entrepreneurs, facilitates income-generating activities to help reduce the poverty burden and bring development and transformative changes. The evolution of microcredit can be traced back to the early seventies. In 1974, the Bangladesh government piloted a program in 19 selected sub-districts (thanas) across 19 districts. This program offered interest-free loans to marginalized people for income-generating activities, forming them into small groups through the Rural Social Services (RSS) Programme. Concurrently, the Bangladesh Academy for Rural Development (BARD) experimented with the concept of collateral-free credit for landless and small farmers in the early 1970s, following recommendations from the Food and Agriculture Organization (FAO)-sponsored study, "Asian Survey of Agrarian Reform and Rural Development" (ASARRD). The study recommended undertaking programs for neglected segments of the population, such as landless laborers and small farmers. Following FAO's recommendations, Bangladesh, Nepal, and the Philippines implemented programs to address the needs of vulnerable people, particularly in the non-farm sector.

In Bangladesh, FAO provided seed capital as a guarantee fund for commercial banks to lend to beneficiaries. In response, Bangladesh signed a Memorandum of Understanding (MoU) with a commercial bank to provide collateral-free loans to small farmers and landless laborers ten times higher than the size of the guarantee fund. This experiment began in 1975, marking the first initiative of collateral-free credit in the country (Rahman et al., 2020). Subsequently, several Microfinance Institutions (MFIs) and Grameen Bank (GB) operationalized the concept of microfinance on a wider scale, responding to the demands of the poor. Over the years, there has been a significant proliferation of MFIs providing microcredit to people experiencing poverty.

Despite developing innovative financial products in the microfinance sector, the microfinance sector has faced challenges in making a trade-off between two objectives, i.e., strengthening the financial condition of MFIs and reaching the vulnerable section of people. Several research studies found that microfinance has a positive impact on self-employment, increasing income and asset base of the household, protecting households from shocks, taking advantage of economies of scale, contributing to changing societal norms about the role of women in society and facilitating families moving out of poverty (Mollah, 2012); Mamun et

al. 2015; Yunus, 1998; & Rahman, 2013). However, Maitrot (2014) found that in the context of vulnerability, shocks, and seasonality in Bangladesh, the effectiveness of standardized MF for poverty alleviation is questionable. Although the main objective is to reduce poverty, the organizational structure, management pattern, and working culture of MFIs are hardly feasible to attain this mission. Muhammad (2009) found that GB successfully earned a profit, accumulated capital, maintained a reasonable repayment rate, and expanded its business area following the corporate culture. However, the high rate of service charges, inflexible repayment schedule, the multiplicity of credit by different organizations, inadequate amount of loans against investment requirements, and overemphasis on financial viability create problems of livelihood improvements and reducing poverty.

1.2 The Microfinance Sector Today and MRA

Seven hundred thirty-nine microfinance institutions (MFIs) were found operating in 2021-22 and having licenses from the Microcredit Regulatory Authority (MRA). There are also 155 MFIs whose licenses are currently withheld or have been canceled. In addition to the MFIs registered with MRA, different commercial banks, Grameen Bank, and various departments under other government ministries provide microfinance to their beneficiaries.

In 2021-22, a total of 44.6 million borrowers out of 66.39 million beneficiaries received a loan amount of BDT 2260.71 billion. The proportion of borrowers from MFIS and GB is 67% and 15.38 %. In comparison, their share of total loan distribution is 77.82% and 9.15% percent, respectively. The proportion of borrowers against members portrays that GB covers 68 percent of beneficiaries for providing credit. In contrast, the MFIs provide credit to 77.4% of their beneficiaries. Nearly 1.62 lakh people are employed in this sector. Among the MFIs, ten leading MFIs distribute 67% of total loan disbursement, while the two largest NGOs distribute 44.69%. So far, sources of credit funds have found that the contribution of beneficiaries savings, banks credit, and a cumulative surplus are 33.52%, 16.31%, and 28.80%, respectively. Based on the number of borrowers, the MFIs were classified into small, medium, large, and very large. It was found that 74 percent and 19 percent were small and medium, respectively. Four percent of those were large, and less than one percent were very large. However, more than two-thirds of the loan and savings portfolio and loan disbursement of MFIs belong to the top 10 MFIs (MRA, 2022).

MFIs have also been brought under a regulatory framework by establishing the Microcredit Regulatory Authority (MRA) in 2006. MRA is authorized to issue a certificate for operating microcredit, conduct audit functions, establish a security fund for beneficiaries, provide and use money in an approved sector, and maintain accounting in a standard format. Following the Act, some rules specifying the activities and operational procedures of MFIs are prepared under the rules of MRA. These can be classified as governance, fund management, client protection, and staff protection. The common financial products identified by the MRA's rules are providing credit and keeping deposits under various saving products and insurance. The governance issue directives cover MFI organization and management structure, area of operation, capital accumulation and fund utilization, surplus money usage, recovery and disbursement of microcredit, and service charge. Under the Compliance issues, matters related to internal and external audit, liquidity, reserve funds, accounts keeping, and inspection of MFIs are stated.

For instance, regarding fund management, the rules specify internal and external audit matters, liquidity, reserve fund management, accounts maintenance, and MFI inspections. The MRA regulation (2014) mandates that every MFI must establish a borrower safety fund, reserving a specific percentage of total savings to maintain adequate liquidity. Additionally, the provision of funds based on loan product quality and security from surplus amounts was recommended.

Thus, the MRA rules include compliance with some issues in routine management, customer and employee rights & protection, fund management, and governance. The ultimate goal is to assist MFIs in achieving their dual goals of safeguarding their interests and those of their clients. Therefore, it is believed that the regulations made by the MRA will ensure the security of beneficiaries and increase the administrative and management efficiency of the MFIs.

Empirical evidence is galore that regulations have diverse implications on the performance of MFIs. Some studies testified to the fact that there is a relationship between efficiency and regulation (Asaftei & Kumbhakar, 2008; Erbetta & Cave, 2007; Filippini & Maggi, 1993; Filippini et al., 2004). For example, Khalily et al. (2014) assessed the impact of MRA regulation on the cost efficiency of the MFIs using data from 182 institutions covering the period from the pre-regulation year (year preceding the year of licensing) to 2011. This

paper showed that the total effect of regulation was 2.5%, of which the direct impact was 2.1% (Khalily et al., 2014, quoted in Rahman, Khaleque, & Arifuzzaman, 2022). Jackson & Islam (2005) concluded that 'appropriate regulation may give investor confidence and produce sustainability. Regulation of loan appraisal may assist in reducing monitoring and transaction costs and extend the number of loans to the truly poor, thus achieving both bottom-line targets. Badruddoza (2013) analysed the performances of the licensed NGO-MFIs and provided guidelines for correcting identified problems. It is observed that MRA's regulation seeks to maximise the utilisation of resources towards profitability and thereby increase cost-efficiency (Badruddoza, 2013). After the establishment of MRA, a lot of legislation was created to facilitate the MFI sector in Bangladesh. More than one decade has passed since the regulation was made in 2010. Therefore, the prevailing context calls for undertaking an empirical study to look into the implications of MRA regulations on the performance of MFIs. Against the above backdrop, this study seeks to uncover the research question: i) Is there an impact of regulation (of MRA) on the performance of the MFIs and ii) how these regulations have impacted the provision and practices of microfinance regulation on employee and Customer protection?

1.3 Purpose of the Study

It has been seventeen years since the establishment of the MRA, with the MRA rules being enacted thirteen years ago in 2010. Additionally, the MRA has issued numerous other directives over the years. With these regulatory measures in place, MRA regulations are expected to ensure beneficiaries' safety and enhance the administrative and management efficiency of MFIs. Simultaneously, a key research question arises: do licensed MFIs adhere to the rules, and are these rules sufficient to safeguard the interests of clients and staff as well as MFIs? It is also crucial to ascertain whether there are performance differences between the size of MFIs.

In this context, an evaluation study was initiated by MRA to measure the extent of compliance and assess its role in improving the financial strength of MFIs while ensuring adequate protection for customers and staff. Following an Expression of Interest (EoI) initiated by MRA, a team of BARD faculty members actively participated in the bidding process and subsequently submitted a proposal. BARD was later notified of the award and formalized their commitment by signing a contract, pledging to conclude the research work by the stipulated time.

Therefore, the study's main purpose is to assess the impact of the current regulatory framework in terms of the government's desired outcome and inputs to policy planners for overhauling or redesigning the present regulatory framework with the changing perspective**.**

1.4 Objective of the Study

The study's general objective is to investigate the effect of regulations made by the Micro Credit Regulatory Authority (MRA) on the customer, staff, and financial performance of microfinance institutions (MFIs).

The specific objectives were to:

a) assess the extent of compliance of regulation of MFIs by type of M.F.I.s., i.e., small, medium and large & very large
b) examine the influence of microfinance regulation on the performance of the MFIs;
c) analyze the provision and practices of microfinance regulation on employee and Customer protection;

1.5 Scope of the Study

The study aims to unravel the causal factors and impacts of MRA regulations on the microfinance sector in protecting the interest of the MFIs, their staff, and clients. The compliance issues related to the governance of MFIs, customers and staff have been considered variables of interest in the study. The variables associated with the institutional management framework for policy decisions and day-to-day operations have been considered to fulfil the first objective. The variable of interest against each objective can be seen in the following matrix:

Objectives	Dimension	variables identified	Method of Data Collection
Assess the extent of compliance of regulation of MFIs by type of MFIs. i.e., small, medium and large, and very large	Governance	• Percentage of MFIs having all policies approved by GC. • Presence of Institutional mechanisms • Percentage of MFIs have General Body and Managing committee as per MRA Regulations • Percentage of MFIs have permanent CEO appointed as per MRA.	Survey from MFIs

Objectives	Dimension	variables identified	Method of Data Collection
		• Average Number of General body and Managing Committees Meeting last one year • Percentage of member present in the meetings • Percentage of MFIS have Service rule mentioning the Scale of salary, • Percentage of MFIS have approved organizational structure • Percentage of MFIs C.E.O. has dual role as CEO and Chairperson • Percentage of MFIs appointed CA firms by GC approval and report approved by AGM. • Percentage of MFIs giving appointment letters to all employees mentioning all conditions in the letter • Percentage of MFIs having previous CEO as advisor or CEO on contractual basis • Percentage of MFIs appointed CEOs' family members in the organization • Percentage of MFIs have organizational structures approved by the managing committee, • Percentage of MFIs of holding meetings of GC or EC as per MRA Regulations	
	Economical	• Percentage of CEO who got salary more than one source • Percentage of MFIs have approved written policy for credit and saving • Percentage of MFIs following guidelines for service charge, interest rate on deposit	

Objectives	Dimension	variables identified	Method of Data Collection
		• miscellaneous cost, • Purchasing immovable land, saving type, provision of liquidity • Proportion of different types of financial products • Percentage of MFIs spends social development activities from surplus • Percentage of MFIs keeping required liquidity against deposit • Percentage of MFIs keeping statutory reserve maintaining separate account • Percentage of MFIs keeping required LLP.	
	Financial	• Percentage of Accounts maintained by joint signature • Percentage of MFIs maintaining internal and external audit • Percentage of MFIs keep a prescribed number of Books of accounts and head of accounts maintaining updates	
Examine the impact of microfinance regulation on the performance of the MFIs	Outreach	• Percentage of borrowers against clients • Growth of Borrowers	
	Financial	• Growth in loan outstanding • Growth in Savings • Growth in Surplus • Ration of Classified loans • Growth in the security fund • Growth in provisioning fund	Collection from MRA report
	Economical	• Savings Cost Ratio • Borrowing Cost Ratio	
	sustainability	• Portfolio Yield • Return on Asset (ROA), • Operation Self-Sufficiency (OSS.) • Fund Type by the source of fund	

Objectives	Dimension	variables identified	Method of Data Collection
Investigate how microfinance regulation affects the level of employee and Customer protection	Over-indebtedness	• Provisions in MRA and Practices of MFIs for reducing duplication and overlapping of loans to the beneficiary	F.G.D.s and K.I.I. Case Study (One MFI license was cancelled)
	Transparency	• Financial literacy (knowledge of interest rate of loan, saving, the maximum amount needed for loan processing, financial product, grace period of loan repayment,	
	Appropriate pricing	• Cost of credit in rules and practices	
	Appropriate collection practices	• Instalment payment in rules and practices and perception about installment payment	
	Ethical staff behavior clients	• Standard of Staff behaviour during selling products of microfinance, monitoring and realizing loan amount and in rules and practices	
	Redress of grievances	• Mechanism of grievance redressal mechanism in rules and practices	
		• Provision of Service Rules along with Scale of salary • Ensuring Appointment letter every employee clarifying the condition of services, • TA and DA, gratuity and other benefits • Service Rule Approved by GC.	

1.6 Literature Review

1.6.1 Microfinance Institutions in Bangladesh: Origin and its Role in the Economy

Microfinance (MF) is considered one of the most effective initiatives, which was introduced in the 70s as an alternative banking system to extend financial assistance to the destitute poor in a participatory 'bottom-up' manner (Barry, 2012; Siwale & Ritchie, 2012). In many developing countries, access to rural credit has long been considered a potential solution to the liquidity constraints of households that fail to develop livelihoods or improve their welfare (González 2014, Lin et al. 2019, Maîtrot & Niño-Zarazúa 2017).

The main objective of MFIs is to provide financial support to the poor. However, over the years, increasing competition has made MFI financially viable to survive in the long run (Rhyne & Otero 2006). A considerable number of MFIs have suffered from the inability to satisfy the growing demand for financial services in rural areas and consequently have been driven out of the market due to financial insolvency, low productivity and inefficiency, leaving a large number of rural poor, unbanked (without a bank account or a mobile money account). In Bangladesh, a sizeable proportion of the population is still unbanked and lives in poverty.

Despite its recent development, individual moneylenders and other informal credit sources continue to play a role in rural areas, even with higher interest rates, due to their convenient accessibility (Manig, 1996; Mallick, 2012; Hossain & Bayes, 2018). But now it has become an axiomatic reality that microcredit, a great innovation for easing credit access for the poor and offering a pathway out of poverty, has become a debatable topic in recent years because of its differential impact on various welfare outcomes (Banerjee et al. 2015a; Banerjee et al. 2015b).

In the truest sense of the term, Micro Finance Institutions (MFIs) services are an extension of Development Financial Institutions (DFIs) operating for the provision of financial services to the Micro, Small, and Medium Enterprises (MSMEs) that embodies huge activities in developing nation's economies (PIDE, 2021). The prime objective of establishing MFIs was to combat the informal intermediation impeding the economic development of MSMEs, a significant economic sector in the Emerging Markets and Developing Economies (EMDEs) (IBRD, 2022). However, MSMEs that have the potential to contribute to economic growth need financial support, and MFIs serve the goal of integrating impoverished households and MSMEs into the financial sector, contributing to the development of the financial sector

(Falcone, 2020; Jassim & Khawar, 2018; Wu, 2022). According to the World Bank (2015), it is evident that there is a lack of considerable collateral; the problem of borrower's quality evaluation and high expenses associated with processing small loans have rendered MFIs the only source for granting microloans to borrowers without collateral and credit checks, making it difficult to remove credit restrictions on low-income MSMEs.

Over the past thirty years, microfinance (MF) has emerged as a viable development programme by providing small loans to underprivileged people, who have bypassed the commercial banks as being un-creditworthy and unprofitable (Armendáriz & Morduch, 2005; Yunus, 2017). Microfinance mainly assists destitute rural women in scaling up their economic conditions by creating self-employment (Yunus, 2007). It is observed that borrowers of microfinance are mostly rural poor women (Yunus, 2007, 2017). Most MFIs believe that women are more trustworthy and willing to repay loans than men (Kropp et al., 2009). On the other hand, Hassan (2010) came up with counter-productive findings and shared that poor women generally lack formal education, business skills, and market information, and they usually possess little or no knowledge of accounting. Apart from that, they have less control over the borrowed money once they hand it over to the male members of their family and remain detached from the business operations.

In recent days, Bangladesh has witnessed phenomenal growth in microfinance over the past three decades and contributed to resolving the market failure of formal financial institutions by reaching out to the rural poor, especially women who are not covered by commercial banks. A large number of research studies have been done to investigate the effect of microcredit on reducing poverty in Bangladesh. Most of the research findings show that microcredit has a significant role in breaking out of poverty (Khandker & Hussain, 2013; Schroeder, 2012; Tesfay, 2009).

Microcredit is deemed to have positive impacts on poverty reduction, household well-being, and sustainable development (Agbola, Acupan, & Mahmood, 2017; Doocy et al., 2005). It deals with three specific issues: poverty, labour mobility, and repayment (Armendáriz & Morduch, 2005). Including micro-loans, some microfinance institutes (MFIs) offer a range of financial services, such as micro-insurance, micro-savings, micro-pension and money transfer. Some institutes also provide training to improve borrowers' knowledge of health, nutrition, business management and building social bondage (MkNelly & Kevane, 2002; Weber, 2004). Nonetheless, microfinance seems coherent with the World Bank's initiatives of promoting

labour-intensive economic development, rendering basic social services, extending opportunities, enhancing empowerment, and strengthening security (Boer, 2001). By easing liquidity constraints, microfinance helps to generate employment income, as well as improve children's schooling (Khandker et al., 2016).

In the beginning, microfinance was practised by the not-for-profit organisations. However, by the nineties, policymakers recommended that MFIs be 'financially sustainable' in order to be free from subsidies and donations (Barry, 2012). Likewise, policymakers and the donor community also suggested MFIs be self-sustained by adopting a cost recovery approach (Goetz & Gufta, 1996). Therefore, MFIs adopted the market principle to function self-dependently with no aid budget (Armendáriz & Morduch, 2005). In order to cope with the market forces, MFIs have become utterly business-focused as well as profit-oriented, which is seemingly reflected in the higher rate of interest (Nanayakkara & Stewart, 2015; Roberts, 2013). The market approach has presumably deviated microfinance from its prime mission of poverty alleviation. As a result, microfinance is becoming less effective in poverty alleviation (Sultan, 2012).

The fascinating scenario of MFIs lies in their repayment rate, which is as high as 98 per cent (Aydin, 2015; Yunus, 2017). This achievement has been possible due to following a hybrid mechanism that combines women-focused lending, group guarantee, peer monitoring, peer pressure, weekly meetings, and strict supervision of the loan officers. Most of the MFIs reportedly exert some kind of 'pressure' or 'force' on the borrowers in order to optimise repayment (Kassim & Rahman, 2008). Sometimes, finding no alternative, the borrowers are forced to take extra loans from various other sources while pushing them into a hardly escapable 'loan trap' (Diop, Hillenkamp, & Servet, 2007; Jain & Mansuri, 2003; Karim, 2011). In most cases, if any borrower fails to maintain the due repayment, is forced to sell out their tangible assets or household belongings (Kassim & Rahman, 2008) and sometimes loan officers abused the borrowers by scolding or verbally abusing, insulting in front of other members and compelling them to sell out their tangible assets to repay the loans (Ali et al., 2017; Dixon, Ritchie, & Siwale, 2007). As a result, they turn into impecunious poor.

There are other strategies for realizing the loan from the borrowers. Group guarantee is a commonly used lending technique in the microfinance industry. This technique acts as collateral while being an effective tool to attain optimum repayment (de Quidt, Fetzer, & Ghatak, 2016). Arguably, microfinance institutes utilize the peer group as their 'pressure

group' (Siwale & Ritchie, 2012), and most of the time, this method turns into an obsessive enforcement that works to ensure regular repayment (Besley & Coate, 1995; Churchill, 1999; de Quidt et al., 2016; Velasco & Marconi, 2004).

Concerning the usage of microcredit, Ara et al. (2020) unravel interesting findings that reveal that 96 per cent of participants increased their income and employment increased by 41 per cent, but their housing condition and safe water and sanitary remain unchanged, that is, 68 per cent and 84 per cent, respectively. One of the most important factors in the microcredit programme is compulsory members saving for all members. Still, Ara et al. (2020) find that 20 per cent of households have increased their family saving, whereas 21 per cent have decreased and 58 per cent unchanged. In the same study, it was observed that children's education didn't increase significantly, and 74 per cent of households were not serious about sending their children to school due to lack of financial support. A similar situation is observed in awareness of health. Most members are not taking care of their health, which is evident from their survey. Most of the borrowers invest their borrowed money in the agriculture sector. Therefore, the use of new agricultural technology has increased to 63 per cent. It is a notable indication of microcredit to generate rural income (Ara et al., 2020). It is usually believed that microcredit helps to achieve women's empowerment. Still, Ara et al. (2020), using some factors to measure empowerment, find that a percentage (26%) of female respondents have the power to take family decisions and even a percentage (14%) of respondents have priority to take a family decision, which implies that there is limited progress in the improvement of women empowerment through microcredit.

While studying the performance of Bangladesh's ten largest MFIs (i.e. GB, BRAC, ASA, TMSS, etc), Sinha (2011) found that the number of active borrowers and their portfolio size has increased steadily over time. Their contribution to financial inclusion was substantial, and the average loan balance increased in real terms. Al-Azzam (2016) observed that corruption positively affects the interest rate of unregulated MFIs, and such effects are negligible among regulated MFIs.

Various scholars in their studies underscored the need for regulation and supervision of MFIs, which include protecting the interests of small depositors, ensuring proper terms of credit and financial discipline, and educating consumers so that they are aware of their rights (Ahmed, 2013; Akash et al., 2010; Bakker et al., 2014; Baten, 2009; Charitonenko & Rahman, 2002; Jackson & Islam, 2005; Miah, 2006; Rahman & Luo, 2012; Rashid, 2010; Yuge, 2011). Brix

& McKee (2010) argued that as competition increased, MFIs and their clients have faced a variety of consumer protection challenges, including pricing transparency, appropriate product sales techniques and collection practices, incentives for client over-indebtedness, and poor client financial literacy. Gutiérrez-Nieto et al. (2017) supported the need to improve MFI consumers' awareness (knowledge about their rights and financial literacy), especially of the risks involved in over-indebtedness. Wickramasinghe & Fernando (2017) argued that education of microcredit users is needed to deter borrowing for income and consumption smoothing and encourage the use of funds for income generation. Murendo & Mutsonziwa (2017) found that greater financial literacy positively influenced saving through MFIs.

Nawaz (2015) pinpointed that client awareness (financial literacy) is more important than access to credit itself and should be the focus of all future microfinance programs, consistent with MFIs playing an important role in social development (Jha 2016; D'Espallier et al. 2016). However, client awareness and protection remain comparatively under-researched in developing countries (Sayinzoga et al. 2016; Islam & Simpson 2018). Likewise, Bongomin et al. (2017) shared that it is well-known that financial literacy training culminates in greater financial inclusion while Sayinzoga et al. (2016) addressed the need of greater savings and borrowing, increased likelihood of starting new income-generating activities and Epstein & Yuthas (2017) emphasized the importance of improvement in repayment rates(Godquin, 2004) and productive use of loans (Epstein & Yuthas, 2017). However, it does not necessarily mitigate over-indebtedness (Schicks 2014). MFIs pay utmost attention to optimising repayment barely considering if the borrowers can pay back the debts from their surplus income generated from the loan-based projects (Chowdhury & Mukhopadhaya, 2012).

The operational efficacy of microfinance institutes (MFIs) is generally measured based on the number of clients, amount of disbursed loans and organizational sustainability (Chowdhury & Mukhopadhaya, 2012). Simultaneously, MFIs put stress on minimizing their operational costs (Blanco et al., 2013). Therefore, MFIs avoid paying attention to borrowers' activities and monitoring their progress. Regular meetings with the loan officers improve bilateral relationships and trust while increasing the rate of repayment (Field & Pande, 2008). Some factors, such as adverse borrower selection, low numerical skills of the borrowers, and asymmetric information about the uses of landed money, badly affect repayment (Ahmad, 2012). However, these uneven riddling factors yield negative externalities and back-paddle the repayment process (Godquin, 2004; Khalil et al., 2000).

In fine, it can be summarized that the basic aim of MFIs is to provide banking and financial support to the poor and to expand their activities in poor and vulnerable areas. However, a study reveals that MFIs tend to locate themselves in well-established areas that are financially better off (Mia, 2017). The findings of another study conducted by Mia et al. (2018) reveal that most MFIs in Bangladesh were inefficient in the face of the growing competition because of limited resources to achieve their intended objectives, namely serving the poor people. The study also observed that higher financial inclusion (i.e., serving the highest number of poor people) is significantly associated with enhanced efficiency of MFIs in Bangladesh by means of greater return. In this regard, choice more on financial viability results in reduced client coverage. Hence, it is likely that the efficiency of the MFIs with weaker commercial focus may have decreased as a consequence of maintaining their outreach purposes. It was observed in the study that the MFIs with stronger commercial objectives have expanded their services and their margins of deficiency to compete with other intermediaries. Instead, the MFIs with a more intense social strategy may have suffered a decrease in their operating deficiency due to the recombination of their portfolio in favor of the weaker and riskier customers, probably rationed by the most competitive intermediaries. The study suggests that the MRA and other regulatory bodies should be aware of the consequences of imposing restrictive constraints on the operating mechanisms of the microfinance industry, especially if MFIs have multiple missions.

1.6.2 Microcredit Regulatory Authority (MRA): Its Role and Function for MFIs

The core mission of the MRA is to ensure the transparency and accountability of microfinance operations of NGO-MFIs (MRA, 2011). Alamgir (2009) and Bedson (2009) found that in the absence of any form of accountability to the government or any other authority, particularly for nonprofit NGO-MFIs in the country, there were significant challenges with issues related to consumer protection, institutional transparency, outreach, and sustainability.

The microfinance sector in Bangladesh did not have any regulatory framework until 2006 to control and supervise MFIs. Before 2006, MFIs need to take approval to operate their activities under a number of legal frameworks such as the Societies Registration Act, 1860 (Act XXI 1680); the Trust Act, 1882 (Act II of 1882); the Voluntary Social Welfare Agencies (Registration and Control) Ordinance, 1961 (Ordinance number, XLVI of 1961); the Companies Act, 1994 (Act XVIII of 1994). These multiple acts and rules sometimes create confusion and misunderstanding regarding the proper functioning of MFIs. Therefore, it is felt

that the adoption of a well-defined regulatory framework has been considered for the effective and efficient functioning of MFIs. In line with this thinking, an independent regulatory authority, known as the Microcredit Regulatory Authority (MRA), was established in 2006 under the Microcredit Regulatory Authority Act 2006. With the enactment of the Act, all NGO-MFIs are now under the control of MRA. However, other types of rural institutions, such as cooperatives, credit unions, non-bank financial institutions, and state-owned or commercial banks (that provide microfinance), are not under the jurisdiction of the MRA. Rather, they are supervised under the Acts of their respective authorities, from which they have obtained their registration.

The aim behind the establishment of the MRA was to create a conducive and healthy environment for microfinance practices across the country and to secure the interests of clients of MFIs without altering the long-term sustainability of MFIs. MRA has provided detailed guidelines for MFIs to enhance governance practices to achieve these two goals. Additionally, they advocate prudential policy design, greater competition, productivity, and efficiency for the long-term sustainability of the sector. According to the Microcredit Regulatory Act of 2006, the functions of the Authority include:

- Approval of MFIs for their operation as well as cancellation of approval;
- Supervision of MFIs;
- Amalgamation of MFIs;
- Auditing of MFIs as per their demand;
- Policy formulation for the microcredit sector;
- Protection of microcredit receivers and necessary legal actions against the violators, meaning withdrawing licenses if MFIs fail to comply with requirements set by the MRA;
- Ensuring transparency and accountability in the operation of MFIs;
- Qualitative development of the microcredit sector;
- Empowerment of women through increasing credit facilities for them and
- Formulation of rules and regulations.

Thus, MRA is the only authorised entity that monitors and supervises NGO-MFIs operational activities in Bangladesh. Each MFI requires a license from the MRA to carry out microfinance activities in the country. The registration process of MFIs is accomplished in two steps. First, an MFI should get a license from the registering authority to be eligible to register under MRA. After receiving the application, the MRA designates a provisional period to

observe the performance of the MFI. Depending on the MFI's performance during the provision period, a license to operate microfinance programs may be granted. To ensure transparency and accountability of microfinance operations and activities, the Authority is also in charge of withdrawing licenses if MFIs fail to comply with requirements set by the MRA. There are several criteria for obtaining a license, such as the minimum number of loans outstanding and the number of borrowers that need to be maintained. Moreover, individual MFIs are also obliged to report prescribed data twice a year and financial data once a year to the MRA. These data are consequently published in the MRA's annual reports.

Microcredit regulation is essentially necessary for operational and financial sustainability for both MFIs and their clients as the MFIs clients are from the poorest households of a community, and any loss of their savings due to MFI insolvency or fraud would be detrimental to them. Furthermore, prudential regulation supports building confidence between MFIs and their clients through appropriate capital management, earnings and strong internal control mechanisms. On the other hand, "non-prudential" rules—e.g., screening out unsuitable owners/managers or requiring transparent reporting and disclosure—tend to be easier to administer because government authorities do not have to take responsibility for the organization's financial soundness (Noor, 2015). However, due to factors like information and data collection problems, weak accounting standards, lack of professionalism and political interference, the prudential regulation has often proved ineffective in developing countries. Gallardo (2002) suggests that many countries nowadays are strengthening their prudential standards and extending them to cover other institutions such as MFIs. It is expected that a standard legal framework for the MFIs should be in place that will identify the role of the regulatory Authority, the rules for MFI entry and exit and the boundaries and benchmarks for sustainable operations. An appropriate regulatory setting can create a due environment and encourage these MFIs to raise sufficient cash flow to reduce their donor dependency. Hence, the justification for regulating MFIs should be to protect the interest of the small depositors, enhance liquidity management, develop operational as well as financial sustainability, and to protect against moral hazards. Ideally, regulation should encourage MFIs to avoid excessive risk in microfinance; it helps strengthen MFI's reputation and prevent fraudulent activities through increasing transparency in financial accounting transaction reporting and increasing operational and financial sustainability. Areas of regulation include unsecured lending limits, capital-adequacy ratios, rules for provisioning loan losses, and minimum capital requirements (Noor, 2015).

Microcredit Regulations, 2010 provide a number of directives for MFIs with regard to internal governance mechanisms, such as the nature of the composition of the governing body, protection of depositors, borrowers' responsibilities, utilization fund, and management of deposits of clients. In addition, guidelines adopted to protect depositors have covered several important issues such as the formation of a security fund for depositors; maximum fees chargeable from clients as fees/passbook, etc. [not more than 15 taka], grace period [at least 15 days], number of installments [50 in a tenure of 1 year], embargo on upfront deduction [no money could be cut at source], expected rate of interest to be paid on deposit [minimum 6% per annum], calculation method for service charge through declining Balance Mehod [DBM], and maximum service charge to be charged [not more than 24%].

The adoption of MRA rules/guidelines generated mixed reactions to MFIs in Bangladesh. Large MFIs (ASA, BRAC, and GB) acknowledged that the policies and regulations of MRA benefit both clients and MFIs. However, they are critical to the provision of a service charge ceiling. It is reported that the borrower cannot pay installments due to poor use of the borrowed money. MFIs have shown their positive views with regard to the protection of the interests of poor households by setting several standards set by MRA for MFIs (Noor, 2015).

Before the introduction of MRA Rules in 2010, the MFIs exercised complete freedom in setting service charges for financial products. Usually, MFIs do not explain clearly the amount of money that a client has to pay for his/her borrowing. Simply put, they (MFIs) say it is a loan of 15% flat or so. However, they do not share with the clients' other fees and obligatory deposits over the effective rate of interest (EIR), which causes an effective interest rate quite high for a poor borrower. MRA took a strong stand to stop these practices. It emphasizes the rate and procedure of determining service charges, which must be set according to the policies formulated on the basis of directives. In addition, Microcredit Information Rules 2020 have made some clear directives regarding sharing detain information with borrowers.

The regulation of microfinance services is likely to have a wide-ranging influence on the microfinance sector, particularly on institutions and their clients. This study will assess the impact of a specific regulatory regime, the "Microcredit Regulatory Authority Act, 2006", enacted by the Bangladesh government to monitor and supervise nonprofit nongovernment

organizations (NGOs). It is argued that effective regulatory measures are needed when a market failure exists in order to benefit the public interest (Deegan, 2014). In Bangladesh, the government has introduced a regulatory frame to make client-friendly microcredit operations and ensure the sustainability of MFIs. However, there is a scanty of scholarly research to assess the role of regulation in its association with client outcomes. In this regard, the study will attempt to understand the impact of current rules on clients of both nonprofit microfinance institutions (MFIs) registered under the Act.

1.7 Methods and Materials

To support regulators in the design, development, coordination, and evaluation of regulatory changes, it is essential to conduct a thorough assessment of regulatory reform initiatives. With the aim of evaluating the impact of regulatory change with the Microcredit Regulatory Authority Act, 2006 and the Microcredit Regulatory Authority Rules, 2010 in regulating the microfinance institutions (MFIs), this study uses the "Regulatory Impact Assessment" (RIA) methodological approach propound by OECD. RIA is a systemic, evidence-based approach to critically assessing the effects of regulations.

The RIA encompasses a range of methods that different OECD countries employed in assessing the impact of regulation of financial services. That Rationale-Objectives-Indicator (ROI) method provides a pragmatic framework through which to conduct an examination of the consequences of a policy or regulatory choice(s) and assess the positive and negative impacts of existing or potential regulatory measures. This study adopts the ROI method that comprises the following six steps:

Table 1: Step of ROI Methodology for Regulatory Impact Assessment

Step			Step		
1.	**R**ationale	What is the rationale for the regulation?	4.	Data Collection	Quantitative and Qualitative – on the chosen indicators.
2.	**O**bjectives	What are objectives of the particular regulations?	5.	Evaluation	Assess the impact of the regulation.
3.	**I**ndicators	Which indicators can be used to assess regulatory impact?	6.	Policy Prescription	Apply the findings to policy-making decisions.

To assess the impact of regulation, two basic issues must be addressed: the first is the definition of a **benchmark** against which to measure regulatory success, and the second is the isolation of the impact of regulatory change from other changes in the market occurring at the same time, that is the **attribution** of regulatory impact. The first three steps presented in Table 1 determine benchmarks for success, and the later three steps determine the impact of the regulation(s).

The first three steps that define the assessment benchmark result in a list of impact indicators that can measure market outcomes and institutional change. Based on the economic theory of regulation, the **rationale** for imposing regulations is assumed to be due to market failures. It explains why regulation is needed. Then, the **objectives** define what the regulation is trying to achieve. Performance is assessed based on the attainment of these objectives. The third step identifies the corresponding quantitative and qualitative **indicators** that can be used to measure the achievement of regulatory objectives.

Given the rationale and the objectives, the study identified the corresponding quantitative and qualitative **indicators** that have been used to measure the achievement of regulatory objectives in consecutively Chapter 1.

The latter three steps are related to executing the impact assessment. It starts with **data collection,** which involves gathering relevant information and data to measure the identified indicators. The **evaluation** step involves analyzing the collected data to assess the impact of microfinance regulation on the identified indicators. It may involve comparing pre- and post-regulation data, conducting statistical analysis, econometric modeling, or qualitative research methods to measure changes in the performance, behavior, and outcomes of MFIs and their clients attributable to the regulation. Finally, **policy prescription**, based on the findings of the evaluation, the study makes recommendations for specific actions or adjustments to the regulation to optimize its effectiveness in achieving the desired objectives, which would help policymakers make informed decisions about microfinance regulation. This may include refining regulatory provisions, strengthening supervision and enforcement mechanisms, providing capacity-building support to MFIs, or revising policy incentives to align with the goals of financial inclusion and client protection.

1.7.1 Data Collection

The fourth step of ROI is data collection based on the indicators defined in the third step. Data has been collected from both primary and secondary sources. Primary data has been collected from selected MFIs through questionnaire surveys, employees of MFIs and clients through FGDs, and experts and other stakeholders through KII. Secondary information has been collected from the annual reports of MFIs published by MRA and others. A comprehensive mixed-methods approach has been adopted to accomplish this objective, integrating both qualitative and quantitative methodologies. Quantitative data has been sourced from MFIs through a structured questionnaire survey. Additionally, a crucial repository of quantitative data stems from the published volumes of MFIs in Bangladesh, as compiled by the Microcredit Regulatory Authority (MRA) under the title "Microfinance in Bangladesh (Annual Statistics)." These reports span 15 volumes and offer a detailed statistical account of the microfinance sector's performance in Bangladesh from 2008 to 2022. They not only summarize the financial aspects but also compare the contributions of various organizations within the sector and compile essential information about the MFIs.

On the qualitative front, insights are being garnered through Focus Group Discussions (FGDs) and Key Informant Interviews (KIIs) with clients and staff of the MFIs. This dual-method strategy is designed to furnish a holistic comprehension of the regulatory impact, encompassing both quantitative metrics and nuanced qualitative perspectives from key stakeholders.

Population and the Sample

The population of the study was 703 active MFIs registered under MRA and continuing their operation actively in October 2023, operating throughout 64 districts in Bangladesh. The sample size of the study from this known population is determined using *Slovin's formula*[1]. With a standard 5% margin of error (e = 0.05) and 95% confidence level, the formula gives a sample size of 249 from a population size of 703.

[1] Slovin's formula of sample size determination: $n = N/(1+Ne^2)$

Where:

- n is the sample size,
- N is the *population size*
- e is the desired level of precision (i.e. the margin of error)

However, in selecting a sample size, issues like the spread (*variability*) of the population at a particular level, diversity or uniformity among units (here MFIs), and *practicality*, that is, obtaining precise estimates of the parameters of interest within a practical resource budget, should also be considered. Therefore, this study selected the sample size based on these two main factors.

The margin of error (*e*) is that this formula presents the variability, which is taken as standard 5%. However, a disparity among MFIs is observed where very large and large constitute 84 percent of loans outstanding and medium and small constitute 13 and 2 percent, respectively. Therefore, a higher value of the margin of error (*e*) can be considered, which would determine a smaller sample size using the same formula. Moreover, the MRA Report 2022 contains data on basic information along with other MFIs ranking based on their position according to loan outstanding, revealing that uniformity (sameness) is there among a number of MFIs, e.g., nineteen (19) MFIs were identified occupying the 684th rank and characterized by zero loans outstanding. Therefore, a deliberate decision was made to select only one organization from this subset of 19 and so on from the similar MFIs, ensuring uniformity within this particular sample.

Simultaneously, a distinct approach was taken for the top 60 organizations with outstanding loans. Recognizing the potential for substantial variations among these top-performing MFIs, a deliberate selection process identified 35 organizations.

A nuanced methodology was applied for the remaining organizations, spanning the ranking range from 60th to 683rd. Specifically, six (6) organizations were systematically chosen from every set of 30 organizations. This meticulous selection aimed to capture diverse representations and ensure adequacy in the obtained sample.

These suggest that a smaller sample size, in this case, is statistically representative of the population (with a margin of error of 10%, the determined size is only 89). Finally, the sampling procedure was executed following the agreed-upon strategy, considering the budget and time constraints. The sample survey was conducted on randomly selected 162 MFIs.

Additionally, geographic considerations were paramount in the sampling strategy. Efforts were made to secure representations across the eight divisions of Bangladesh. The final selection encompassed MFIs situated in districts throughout these divisions, further enhancing

the breadth and diversity of the sample. Thus, we selected 161 MFIs of various categories for the survey from 23 districts of all eight divisions to ensure divisional coverage**.** The selected districts were Barisal, Bogra, Chapai Nawabgonj, Chittagong, Cumilla, Dhaka, Dinajpur, Gaibandha, Habigonj, Jamalpur, Jessore, Khulna, Kushtia, Moulvibazar, Mymensingh, Natore, Pabna, Patuakhali, Rajshahi, Rangpur, Sherpur, Sylhet and Tangail.

For quantitative data/information, the sample employees and clients were collected purposively from the randomly selected MFIs of various categories. Information on clients' and staff protection was qualitative, and FGDs and Key informant interviews were used for data collection. Two FGDs in each category of MFIs have been organized separately by engaging the beneficiaries. Besides, two FGDs in each category of MFI's staff have also been organized. Thus, seventeen (17) FGDs have been conducted for the assignment. Eight key informant interviews (KIIs) covered each category of each MFI. The KIIs have been conducted with the high officials of GOs and NGOs relevant to the sector.

Formation of FGDs

Participates in the FGDs	**Number of FGDs**
The staff of MFIs (2 from each category of MFIs)	6
Clientele of MFIs (2 from each category of MFIs)	6
Different Officials with CDF.	1

Participants of KII.

Participants of the KII.	Number of FGDs
Chief Executive / Board of Directors/ key officials/ dealing with of MFI (1 from each category of MFIs)	3
Credit officer at senior level (1 from each category of MFIs)	3
High officials of MRA and Bangladesh Bank	2

Validity and Reliability Test

The validity of the questionnaire is essential to ensure the accuracy of data collection (Saunders et al., 2009). Both the internal (content) validity and external validity of the questionnaires is assessed. The questionnaire is finalized after intensive discussion with faculty members of BARD (internal validity) and development experts from academic researchers and practitioners in the microfinance arena (external validity). All the Validity concerns, i.e. construct, convergent and discriminate validity, is taken care of.

Reliability is concerned with the consistency of questionnaires (Saunders et al., 2009). It will determine whether the findings are consistent or not, even at a different time and in a different situation. For this research, the questionnaires are to be adopted and adapted from the previous study. The reliability test of pre-test questionnaires will be compared to the previous studies/baseline studies. Cronbach's Alpha value and internal consistency are used to measure reliability.

1.7.2 Data Analysis for Impact Assessment

The fifth step of ROI is the actual measurement of the impact. The goal of impact measurement is to be able to clearly identify and measure the net positive effects that result directly from the activities of an initiative/regulation or a program. Clearly, establishing net impact and the influence of regulation/program activities on an outcome has been a huge challenge in this field. Basically, the scientific approach of impact assessment methodologies such as randomized control trait and quasi-experimental is important to assess the impact of microfinance intervention, following the 'gold standard' of research and evaluation. Yet, it is very difficult to employ these types of methods, and they are also costly (Karlan 2001; Swain and Varghese 2009). To isolate the regulatory impact and attribute changes to the regulatory intervention, the study finds a middle method between rigor and expensive methods and reliable methods, using a structural break caused by the treatment in the trend data and using new MFIs as a control group.

Karlan(2001), Samer (2015), and Gaganis (2016)[2] advocated a "new-old entrant" approach, which does not need to identify and survey nonparticipants in order to generate a control group and no need to follow MFIs over time as in a longitudinal study. The new entrant (registered) MFIs after regulation are considered the control group, and the old MFIs (operating before the regulation) are the treatment group. This methodology, according to Karlan (2001), recently gained popularity because they are cheap, easy to implement, and often encouraged by donors like USAID (SEEP Network, 1999). Besides the new-old approach, this study applies a pooling methodology. For this purpose, the structural break is set for the year of regulatory intervention of the MRA rule 2010, and the attribute changes of the sample MFIs based on defined indicators will be assessed at baseline and after intervention. This method can

[2]Gaganis, C. (2016). Assessing the overall performance of microfinance institutions. *International Journal of Banking, Accounting and Finance*, *7*(1), 52-83.

be used if one can claim with some confidence that the most important change during the observation period has indeed been the change in regulatory treatment. The analytical method follows the following steps:

Descriptive Analysis

Descriptive statistics such as mean, median, percentages, and standard deviations are calculated for the outcome variables at both baseline and after the intervention year to get a sense of the initial differences. Inferential statistics is done by testing hypotheses and drawing conclusions based on what is learned.

Visualization of the Data

Visualizations, such as line charts or bar plots, are created to visually compare the trend of outcome variables between the baseline and the after-intervention year to identify obvious changes.

Regression Analysis

A regression analysis is conducted to assess the impact of the intervention (regulation status), controlling for potential confounding factors (variables that are related to both the independent/intervention variable and the dependent/outcome variable) that help isolate the effect of the intervention from other potential causes. Since the objective of this is to examine the impact of MRA regulatory changes on the performance of Microfinance Institutions (MFIs) in Bangladesh, the analysis utilizes a dataset comprising data from 161 MFIs in Bangladesh collected from the Microfinance Regulatory Authority Annual Reports for the years 2010 (year of declaring regulation) or the year of respective MFIs registration year assigning value '0', and 2022 (post-regulation)assigning value '1' in a regression model with an independent binary indicator variable. The other dataset besides regulatory status includes variables related to MFIs' performance like ROA, OSS, portfolio yield, etc., and confounding factors that include other relevant characteristics like age, size, location, general and administrative costs and internal funding source as a percentage of total funding sources of the sample MFIs.The econometric model, therefore, can be presented as:

$$Performanc = \alpha + \beta_1 Regulatory\ status \quad + \beta_i(\ Confounding\ Factors) + \mu$$

The coefficient associated with the post-intervention variable (regulation dummy) indicates the change in the outcome variable after the intervention.

To provide valuable insights for policymakers and stakeholders in the microfinance sector, this study employs a methodology that integrates multiple statistical techniques to offer a rigorous evaluation of the regulatory impact on MFIs' performance. The commonly used techniques for

such purpose include (i) Difference-in-difference (DID) Analysis, (ii) Pooled Regression, and (iii) Panel Data Analysis.

(i) Difference-in-difference (DID) Analysis: The DID approach compares the change in the outcome variable over time between a treatment group and a control group. This method considers MFIs established before the regulation (pre-2010) as the treatment group, while MFIs established after the regulation (post-2010) as the control group. The primary outcome variable is selected to measure MFIs' performance (e.g., Return on Assets – ROA, Operational Self-Sufficiency – OSS, Portfolio yield, etc.).A DID model is estimated using OLS regression, incorporating the treatment group dummy, post-regulation dummy, and their interaction term. Control variables capturing relevant factors (like age, size, location, general and administrative costs, and share of internal funds) are included to mitigate confounding effects. The coefficient of the interaction term provides an estimate of the causal effect of the regulation on the financial performance of MFIs. DID controls for time-invariant unobserved heterogeneity between groups by differencing out the group-specific fixed effects.

As per the Microcredit Regulatory Authority Act, 2006, and the Microcredit Regulatory Authority Rules, 2010, all the MFIs have to be registered following the regulations. Therefore, the dataset used for the study lacks a clear treatment (exposure to the intervention) and control group (not exposed to the intervention). Hence, difference-in-difference (DID) analysis may not provide insights into the treatment effect. Still, it is expected to be constant across all observations. In such cases, pooled regression can provide valuable insights, and there is no need to control for time-specific effects. Pooled OLS regression is conducted to examine the relationship between regulatory status (dummy variable), control variables, and MFIs' performance. The analysis treats all observations as independent. The coefficients of the regulatory status variable provide insights into the average treatment effect of the regulation on MFIs' performance, controlling for other characteristics variables.

However, Pooled regression may not adequately control for time-specific effects or unobserved heterogeneity, leading to biased estimates if there are time-varying confounding factors or if the treatment effect varies over time. Panel data regression allows for the estimation of time-invariant and time-varying effects, controlling for individual-specific and time-specific factors simultaneously. Panel data regression techniques, such as fixed effects or random effects models, are employed to account for both cross-sectional and time-series variations in the data. It can account for unobserved heterogeneity and time-specific effects, providing more

robust estimates compared to pooled regression. Therefore, this study also employed panel data analysis techniques to assess the impact of regulation on MFI performance along with DID and Pooled Regression.

By employing a combination of difference-in-differences analysis, pooled regression, and panel data regression, this study aims to provide a comprehensive assessment of the impact of regulation on the financial performance of MFIs in Bangladesh, accounting for potential confounding factors and leveraging the strengths of each methodological approach.

CHAPTER 2: EXTENT OF COMPLIANCE OF MFIs WITH THE REGULATIONS OF MRA

This chapter deals with the critical issue of Microfinance Institutions (MFIs) adherence to the regulations established by the Microfinance Regulatory Authority (MRA). It comprehensively assesses the level of compliance across various crucial aspects, including Legal Identity Governance, Management Efficiency, Financial Regulation, and Provisioning Compulsion. By thoroughly examining compliance across these key areas, this chapter aims to provide a comprehensive understanding of the current state of MRA regulation adherence within the microfinance sector.

2.1 Legal Identity

Having a legal identity established through registration under the Society Registration Act 1860, the Trust Act 1882, the Social Welfare Act 1961, or the Companies Act is a prerequisite for obtaining a license from the MRA.

Table 2.1 Distribution of the MFIs according to their Registration Authority by Size

Indicators	Small (104)	Medium (31)	Large and Very Large (26)	All (161)
Society Registration Act 1860	20.2%	51.6%	61.5%	32.9%
Trust Act 1882	1.0%	0.0%	11.5%	2.5%
Social Welfare Act 1961	77.9%	45.2%	26.9%	63.4%
Company Act	1.0%	3.2%	0.0%	1.2%

Source: Field Survey, 2023

Nearly two-thirds of MFIs obtained registration from the Department of Social Welfare under the Social Welfare Act of 1961. Others secured registration under the Society Registration Act of 1860, the Trust Act, or the Companies Act. MFIs with project funding from development partners also require registration with the NGO Affairs Bureau.

Focus Group Discussions (FGDs) revealed potential conflicts regarding compliance with the Microfinance Regulatory Authority (MRA) regulations and the Social Welfare Act. The Social Welfare Act stipulates a five-year term for both the Managing Committee and the

General Body. However, the MRA regulations also require a three-year term for these bodies. Furthermore, the Social Welfare Act states that the CEO will be a member and act as the Member Secretary of both the General Body and the Managing Committee. Conversely, MRA regulations prohibit salaried individuals from serving on the Managing Committee and General Body. Additionally, the Social Welfare Act places no restrictions on continuous membership, while MRA regulations bar an individual from serving on these committees for more than three consecutive terms

2.2 General Body

According to Clause 07 of the MRA rules, the organization must form a General Body with 15 to 31 members, including at least two female representatives. This body is responsible for managing the organization's governance. The General Body's key tasks include approving policies set by the Managing Committee, ratifying the organization's yearly budget, and selecting an external auditor to perform financial audits. A quorum must approve meetings and decisions of two-thirds of the General Body's members.

Table 2.2. Formation of General Body and its Functioning by size of MFIs

Indicators	Small (104)	Medium (31)	Large and Very Large (26)	All (161)
Percentage of MFIS has the General Body	100	100	100	100
Average Number of Members in the General Body	24	23	24	23
Average Number of Female Members in the General Body	8	7	8	8
Number of Meetings organized in 2022	2	1	1	1.6
Percentage of MFIs organized Special Meeting	40	26	46	38.50
Number of Special Meeting	1.84	1.5	1.33	1.66
Attendance of Members in the meeting (%)	89.07	89.63	82.82	87.96

Source: Field Survey, 2023

All MFIs, regardless of size, have followed the principles for general body creation and functioning. The average number of members in a general body is 23, which is consistent with

the MRA criteria. Additionally, member attendance is satisfactory at 88%, which is much greater than the minimum quorum (Table 2.1).

2.3 Executive Committee (EC)

. Section 08 of the MRA guidelines stated that there would be an executive committee of 5 to 10 members, including at least two women. They will be elected from the general body, and the EC members will elect the chairman for a three-year term, and s/he will act as chairperson of the General Body. Furthermore, no member is authorized to be a member three times consecutively, and there should be a system in place every three years to register at least half of new members. The position is responsible for developing standard operating procedures for MFIs, preparing budgets, and submitting them to the General Body for approval.

Table 2.3. Formation of EC and its Functioning by size of MFIs

Indicators	Small (104)	Medium (31)	Large and Very Large (26)	All (161)
Percentage of MFIS has the EC	100	100	100	100
Average Number of Members in the EC	7.88	7.55	7.63	7.74
Average Number of Female Members in the EC	2.79	2.87	2.94	2.84
Number of Meeting organized in 2022	4.55	5.03	5.66	4.88
Attendance of Members in the meeting (%)	89	92	93	91

Source: Field Survey 2023

Table 2.3 shows that MFIs are following the directions for forming the Executive Committee with the required number of members. Directives to include two female members are likewise observed, regardless of the size of the MFI. The average number of meetings in a year also indicates that guidelines for organizing quarterly meetings are being implemented. Attendance at the meeting is acceptable, with an average of 91 per cent. However, field observation suggests that there is ample scope to increase the effectiveness of the meeting, especially for small MFIs. Some MFIs organize the meeting to comply with the requirements, but harnessing the benefit of the meeting by undertaking evidence-based decisions requires proper directives for preparing a working paper and recording the discussion in the meeting.

Table 2.4. Duration of Membership by size of MFIs

Indicators		Small (104)	Medium (31)	Large and Very Large (26)	All (161)
Percentage of MFIs have MC member more than 09 years		23.08	[illegible]	[illegible]	[illegible]
Percentage Total Members more than -09 years		37	21	25	29
Average Number of New Members in Current Committee		2.27	2.34	2.28	2.29
Average Duration of Chairmen (Yrs.)		6.39	2.4	5.68	4.86
Procedure of Selecting Member of MC (%)	Elected	63.74	86.84	75.00	71.43
	Selected	36.26	13.16	25.00	28.57
Procedure of Selecting Chairperson (%)	Elected	62.64	86.84	75.00	70.81
	Selected	37.36	13.16	25.00	29.19

Source: Field Survey 2023

The term of participation in the EC explains there is some divergence from the guidelines on membership duration and minimum inclusion of members during the establishment of a new Executive Committee. Nearly two-thirds of MFIs use elections to select EC members and EC Chairmen.

2.4 Management

2.4.1 Chief Executive Officer

Section 09 of the Rule states that there should be a Chief Executive Officer who would function as the chief executive officer. S/he will get a remuneration based on the compensation scale. S/he will carry out the duty as directed by the Managing Committee. The CEO will not be able to earn compensation from many projects. Section 10 further states that close blood relatives or couples are not permitted to serve as chairman and CEOs simultaneously, nor are they authorized to sign any accounts jointly. The CEO will serve as Secretary in the General and EC Committee

Table 2.5. Compliance with the rules related to CEO by size of MFIs

Indicators	Small (104)	Medium (31)	Large and Very Large (26)	All (161)
Percentage of CEO Salaried Person	85.7	100	100	90.1
Average percentage of the salary of the CEO comes from the Micro Finance	86	94	90	89.5
Percentage of CEOs and Chairpersons have close blood relation	3	0	0	1.9
The percentage of CEOs and Chairpersons has a distant relative	9.9	5.3	6.3	8.1
Percetnage of Entrepreneur of MFIs are the CEO	58	68	69	61

Source: Field Survey 2023

According to one survey, 90% of MFIs have salaried CEOs, with just a few smaller institutions failing owing to a lack of funds. Notably, a major amount of CEO pay comes from core microfinance activities. Interestingly, FGDs revealed that some MFIs pay salaries from both project funding and core programs, therefore complying with overall wage structure constraints. Just 1.9% of MFIs reported CEOs and Chairpersons as close relatives, 8% as distant relatives, and 60% identified CEOs as MFI entrepreneurs. This data, together with FGD ideas, underlines the probable need for more stringent restrictions by governing close relatives on management committee membership by introducing a maximum quota..

2.4.2 Organization Structure

Section 12 requires a clear organizational structure that both the management and general committees authorize. Each company must follow this system when hiring officials. Appointment letters should explicitly state the terms of employment. Furthermore, every MFI needs a thorough service rule book that covers hires, dismissals, leaves, and retirements, as well as outlines wage and benefit schedules for permanent employees. This promotes openness, stability, and a fair working environment for all employees.

Table 2.6. Compliance with the rules related to Human Resource Management by the size of MFIs

Indicators	Small (104)	Medium (31)	Large and Very Large (26)	All (161)
Percentage of MFIs have the Approved Organisational Structure	98.9	100	100	99.4
Percentage of MFIs have the Approved Service Rule	100	100	100	100
Average Number of Permanent Staff	26.56	213.61	3208.38	703.12
Percentage of Permanent Staff against Approved Position	97.04	92.87	97.91	97.52
Female staff against per hundred male staff	28	21	23	26
Percentage of Field staff against total staff	73	77	80	76
Percentage of MFIs has the Project Staff	25.27	65.79	96.88	49.07
Average Number of Project Staff	86	61	621	288

Source: Field Survey 2023

With the exception of a few small MFIs, each category of MFIs has an approved organizational structure, while all MFIs have approved service rules established by the General Body. The average number of permanent staff stands at 703, with a higher count among large and very large MFIs. Approximately 49 per cent of MFIs employ project staff, totalling an average of 288 individuals. Large MFIs tend to employ the highest number of project staff, followed by medium-sized ones. When considering the proportion of field staff relative to the total staff, it's noted that smaller MFIs have the lowest proportion, while larger ones, particularly very large ones, have the highest proportion.

While all MFI categories have authorized service guidelines, only a tiny percentage of small MFIs lack a proper organisational structure. This shows that bigger institutions emphasize creating clear reporting lines and duties. Interestingly, the average permanent staff number across categories is 703, with large and very large MFIs leading the way. This is likely due to their larger client base and operational complexity. The presence of project personnel adds another dimension, with an average of 288 and, reflecting the dominance of big and medium-sized financial institutions. This reflects their increased reliance on external finance

and specific activities. Finally, looking at field personnel proportions, we find an inverse link between MFI size and Smaller universities that are more likely to have limited resources, necessitating a smaller field presence. Bigger MFIs, on the other hand, may successfully invest in a bigger field force. This research identifies possible relationships between MFI size, resource distribution, and staffing techniques. Further research might look at how these elements affect performance, efficiency, and client outreach across several categories.

2.4.3 Accounts Keeping

The regulations state that MFIs (Microfinance Institutions) are subject to a number of financial requirements. MRA-approved organizations must conduct yearly external audits. They must also prepare annual reports and carry out semi-annual internal audits. Clause 41 requires MFIs to maintain fifteen distinct registers for accounting purposes. In addition, Clause 39 requires the Management Committee to adopt the annual budget as well as the credit management and savings mobilization plans. Every account has its own ledger, and bank accounts require two signatories for authorization.

Table 2.7. Compliance situation about accounts keeping Guidelines by MFIs

Indicators	Small (104)	Medium (31)	Large and Very Large (26)	All (161)
Percentage of MFIs keep a hard copy of Cash Book and Ledger	100	97.4	100	99.4
Percentage of MFIs completed external Audit during 2022	100	100	100	100
Percentage of MFIs has approved Saving Mobilisation Policy	80.8	100	100	87.6
Percentage of MFIs have approved Loan Mobilisation Policy	99	100	100	99.4
Percentage of MFIs use Software for Account keeping	53.8%	87.1%	100.0%	67.7%

Source: Field Survey 2023

We can observe that the percentage of MFIs who retain hard copies of their cash book and ledger, conduct external audits, and have authorized loan mobilization rules is quite high across all sizes of MFIs. Smaller MFIs, on the other hand, have a lower percentage of authorized saving mobilization strategies and employ accounting software. The MFIs who use the software for account keeping expressed that they are not required to maintain the number of registers mentioned by MRA; however, the smaller ones are very much worried about the security of data. MRA initiatives are essential for implementing a centralized accounting

software system with robust record backup. Typically, MFIs draft annual budgets and seek approval from the general body. At the same time, internal audits are most prevalent among large and medium-sized MFIs. Additionally, there's a widespread request from MRA authorities for a manual on accounting practices.

2.5 Fund Management

Clause 18 describes that the MFIs may receive funding from a variety of sources, including financial institutions, the stock market, clients (who pay lower costs than savings instruments), contributions from group members, and governments and elsewhere (with supporting documentation). Permission is also required for loans from foreign sources. Money can only be used for microfinance projects and other clearly specified aims as outlined in the regulations. Moreover, the person with a relative in the MFIs is disqualified from extending the loan amount.

Table 2.8 Average Number of Sources for Fund Creation by Size

Type of MFIs	Number of Sources
Small	4.0
Medium	5.3
Large and very large	6.15
All	4.06

MFIs secure funding from various sources, such as client savings, loans from organizations like PKSF, government and bank loans, donor contributions, surplus funds, and others. Larger MFIs typically have access to a wider array of funding options. However, regulatory hurdles can hinder fundraising efforts, especially for smaller MFIs. These barriers may include requirements related to delinquency management, which can impact earnings, as well as restrictions on borrowing from relatives of officials and staff, lending to clients with service charges below compulsory savings thresholds, and mobilizing savings below 80 per cent in relation to loan portfolios (Rule 27). It's important to review rules regarding savings caps of up to 80 per cent and the mobilization of loans from individuals with service charges below a certain threshold.

2.5.1 Reserved fund

According to Section 21 of the Rule, each MFI shall establish a reserve fund by allocating 10 per cent of its surplus. This fund must be deposited in a separate bank account with a

scheduled bank located near the MFI's head office. Following the allocation of 10 per cent to the reserve fund, the remaining amount may be utilised for MFI activities. However, prior permission from the authority is required to use surplus funds for other poverty alleviation activities.

Table 2.9 Percentage of MFIs have Reserve Funds from Surplus Before and After

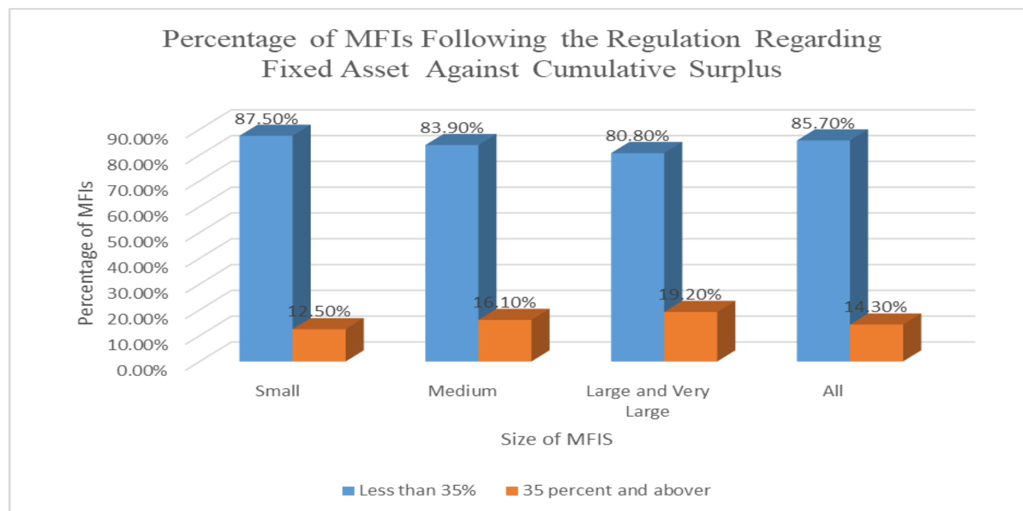
	(Percentage of MFIs)		Average Amount of Reserve BDT. (in Lakh)	
Size of MFIs	Before Regulation	After Regulation	Before Regulation	After Regulation
Small	30.77	90.38	9.30	54.38
Medium	32.26	100.00	21.00	299.00
Large and very large	30.77	100.00	166.35	2188.07
All	31.06	96.79	37.10	446.06

Following regulations, the proportion of MFIs maintaining a reserve fund has notably increased across all sizes. The most significant rise is evident among large and very large MFIs, with an approximate 70% increase. Some small MFIs have yet to establish a reserve fund due to their inability to generate surplus funds after covering operational and administrative costs. The average amount held in reserve funds has also risen for all sizes of MFIs, with the most substantial growth observed among large and very large MFIs. Overall, the data indicate that the legislation has contributed to both the increase in the number of MFIs holding reserve funds and the size of these funds. This suggests that MFIs' capacity to handle crises has greatly improved through the use of reserve funds, fostering sustained growth.

However, during focus group discussions (FGDs), participants expressed concerns about the low returns on their deposits in banks. They suggested exploring alternative, secure investment options for their finances. One participant proposed that the MRA authority collaborate with Bangladesh Bank or the Securities and Exchange Commission to invest the surplus funds in bonds or secure a quota for initial public offerings (IPOs) on the stock exchange. This approach aims to maximize returns while ensuring security. Additionally, there is a provision for establishing a borrower safety fund from surplus funds. However, this directive is seldom implemented in practice.

2.5.2 Fixed Assets

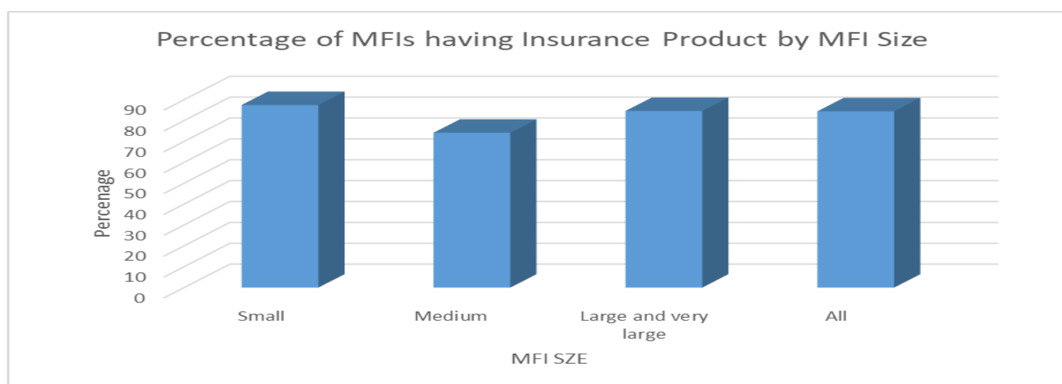
Section 22 of the Rules explains that, in accordance with the Compatibility of MFI resources, fixed assets can be acquired in the name of MFIs. MFIs need permission from the Managing Committee to sell assets and from the relevant authority after liquidation. Circulars 33 and 47 regulate the purchase of immovable assets, capping the amount at a maximum of 35% of the MFI's surplus for operational purposes.



The study found that, on average, 85% of MFIs own fixed assets with a value **less than** 35% of their cumulative surplus. Conversely, 15% of MFIs own fixed assets with a value **exceeding** 35% of their cumulative surplus. These fixed assets include buildings, land, and vehicles. MFIs exceeding the regulatory limit for fixed assets claim they acquired these assets before the regulation was implemented. Additionally, some donors transfer assets to organizations upon project completion, and the value of these assets may increase after purchase. In this context, the regulatory body could consider implementing flexible regulations that are analyzed on a case-by-case basis, taking into account the requirements and capacities of individual MFIs.

2.5.3 Insurance Services

Section 25 of the rules explains that MFIs can introduce insurance services. They must inform clients about the service charges and the benefits they will receive. MFIs are required to send a report of these activities to the relevant authority.



Source: Field Data, 2023

On average, 85 per cent of the MFIs, with the highest participation of small MFIs (88 %), have their own insurance products. The MFIs usually charge Tk. 10 per thousand in loan amounts. In most MFIs, borrowers' households are not required to continue the loan instalments if the borrower expires before full repayment of credit. In such a situation, the MFIs usually adjust the unpaid amount from this fund. However, it would be beneficial to introduce insurance for borrowers to protect against losses from income-generating activities due to natural disasters or the death of livestock in collaboration with the Insurance Regulatory Authority (IRA). Currently, insurance premiums are mandatory and must be paid in cash before receiving a loan. This makes the actual cost of borrowing higher than the advertised interest rate.

2.5.4 Fianacial Product

Microfinance Institutions (MFIs) typically offer two key financial products: savings and credit. While credit plays a vital role, it's recommended that enterprise loans, crucial for business development, don't exceed 60% of the total loan portfolio. To encourage savings, introducing term saving products is permitted following some conditions. This allows clients to deposit funds for a specific period and potentially earn higher interest compared to regular savings accounts, promoting financial security and planning for future needs.

Table 2.10 Compliance with the Regulations on Financial Products by MFI Size

	Small	Medium	Large and very large	Total
Percentage of MFIs has Enterprise Loan	87.50	96.77	100.00	91.30
Share of Enterprise loan of Total Loan Outstanding (%)	14.86	32.27	32.91	21.60

Percentage of MFIs have Term Savings	23.08	64.52	100.00	91.30
Share of Terms saving Total Saving Outstanding (%)	**22**	**17**	**28**	**23**

The study revealed a strong emphasis on enterprise loans among Microfinance Institutions (MFIs), with 91% offering this product category. Notably, large and very large MFIs had the highest participation rate, reaching 22% of their loan portfolio dedicated to enterprise loans. This indicates adherence to the MRA's directives for this segment. However, while 91% of MFIs offer term-saving products, this category only accounts for 23% of their total savings. This distribution is skewed towards larger MFIs (28%), followed by medium (22%) and small MFIs (17%).

2.6 Provisioning

2.6.1 Liquidity

Section 25 of the rules mentioned that 10 % of savings outstanding need to be kept in an account at the branch office. Five per cent can be kept in any bank account and 05 per cent in the fixed account to maintain the adequate liquidity of MFIs.

Table 2.11 Percentage of MFIs following the Regulation related to Liquidity by Size of MFIs

	Small	Medium	Large and very large	All
In Any Account				
Lower than requirement	34	9.7	11.5	25.6
As per Requirement	21.4	29	30.8	24.4
Higher than requirement	44.7	61.3	57.7	50
Fixed Account				
Lower than requirement	74.8	61.3	84.6	73.8
As per Requirement	0.0	3.2	0.0	.6
Higher than requirements	25.2	35.5	15.4	25.6

Source: Field Data, 2023

Three-quarters of MFIs comply with the regulation stipulating that they maintain at least 5 per cent of savings in any bank account as liquidity, with larger and medium-sized MFIs exhibiting higher compliance rates. Smaller MFIs face the greatest challenges in adhering to these liquidity requirements. However, adherence to the rule mandating that at least 5 per cent of savings be held in fixed accounts is poor, with only a quarter of MFIs following this directive.

Focus group discussions (FGDs) revealed that the COVID-19 pandemic disrupted regular MFI activities, leading to a reduction in cash inflow from savings and installment collections. At the same time, there was a notable increase in savings withdrawals. As a result, MFIs were forced to withdraw funds from their fixed accounts. Therefore, the MRA should enhance its oversight role to ensure compliance in this regard, thereby ensuring adequacy in liquidity management.

2.6.2 Credit Depreciation Reserve Fund

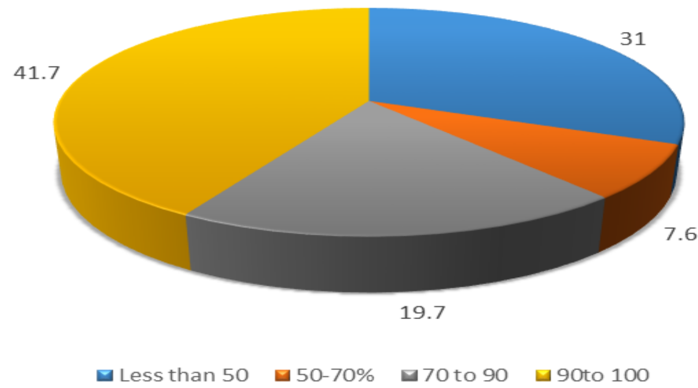
Microfinance institutions (MFIs) set aside provisions for loan categorization. Loans with no missed payments are deemed regular. Loans with payment delays of one to thirty days are observational. The loan depreciation reserve fund receives 1% and 5% provisions for regular and observational loans, respectively. Loans with payment delays of 31-180 days and 181-364 days are deemed unsatisfactory and suspect, necessitating provisions of 25% and 75%, respectively. Loans that have been in default for more than 365 days are classified as bad debts and need a 100% provision in the reserve fund.

Table 2.12 Average Percentage of Loan Fall under Different Categories by Size

	Small	Medium	Large and very large	All
Classification of Loan				
Regular (No installment Default)	77.60	91.27	92.51	82.64
Observational (Installment Default 01-30 Days)	5.66	.75	1.11	3.98
Substandard (Installment Default 31-180 Days)	4.50	2.46	2.27	3.75
Doubtful (Installment Default (181-364) Days)	3.06	2.68	1.50	2.74
Badebt (More than 365 Days)	8.19	2.82	2.59	6.25

Source: Field Survey 2023

On average, four-fifths of outstanding loans are considered regular, with the highest percentage occurring in large and medium-sized MFIs. In all categories (large, medium, and small), roughly 4% of loans fall into the "observational" and "substandard" categories. In comparison, doubtful loans account for around 3%. The overall bad debt ratio, calculated as the amount of bad debt compared to the total outstanding loan amount, stands at 6%. Notably, small MFIs have the highest percentage of observational, substandard, doubtful, and bad debts, followed by medium and large MFIs.



Around 42 per cent of MFIs have the required amount of provision as a Loan Loss Reserve Fund against their requirements. Smaller MFIs are lagging behind in maintaining this provisioning. During FGDs, the respondents, especially the smaller ones, mentioned that the mandatory requirements had reduced their profitability, hence reflecting their lower equity. It becomes difficult to convince loan providers to sanction loans as the value of equity is one of the indicators considered for loan approval.

2.7 Other Requirements

A maximum 24% service charge will be applied based on the reducing balance method. A minimum 6% annual interest rate will be charged to beneficiaries' outstanding savings balance. A rebate will be provided to beneficiaries who pay back their loan before the loan maturity date. A maximum of TK 25 may be charged as an additional cost during loan disbursement. Moreover, for loan repayment, two weeks should be granted as a grace period.

Table 2.13 Compliance of Guideline on Other Issues by Size of MFIs

	Small	Medium	Large and very large	All
Service charge for Reducing Balance (%)	24	24	24	24
Interest for Compulsory Saving (%)	6	6	6	6
Interest paid for Term savings (%)	9.91	10.18	10.28	10.13
Amount taken as additional cost during loan disbursement (tk>)	21	20	19	20.87
Percentage of MFIs provided rebate (%)	77.9%	100.0%	100.0%	85.7%
Average Grace period for instalment collection (Days)	15	15	15	15

Source: Field Survey 2023

Most of the MFIs are found to use the Reducing Balance Method for calculating service charges on the loan. The compliance is consistent across all sizes of MFIs, with a maximum rate of 24%. On Interest for compulsory, there is uniform compliance across all sizes of MFIs, with an interest rate of 6% for both compulsory savings. The data shows a slight variation in compliance with term savings, with medium and large/very large MFIs offering slightly higher interest rates compared to small MFIs. However, the differences are relatively small, indicating overall alignment in compliance.

On the issue of the amount taken as an additional cost during loan disbursement, there is almost no varioation across different sizes of MFIs.

On the percentage of MFIs providing rebates, the compliance with providing rebates is highest among medium and large/very large MFIs, with 100% compliance. Small MFIs also have a relatively high compliance rate of 77.9%. On the average grace period for instalment collection, compliance is consistent across all sizes of MFIs, with an average grace period of 15 days for instalment collection.

Overall, the data suggests a high level of compliance with guidelines across different sizes of MFIs, indicating a standardized approach to regulatory requirements within the microfinance sector. However, there are minor variations in certain aspects, such as interest rates for term savings and additional costs during loan disbursement, which may reflect differences in operational practices or market conditions among MFIs of different sizes.

CHAPTER 3: IMPACT OF REGULATION ON PERFORMANCE OF MFIS

The performance of MFIs was evaluated using several variables relating to organizational, operational, fund generation, and profitability clustering. The organizational performance characteristics relating to outreach, capital accumulation, and lending capability were evaluated. In the instance of fund management, the composition and size of the fund were recognized. Administrative and operational efficiency, as well as turnover and profitability, were evaluated in order to measure operational and profitability.

3.1 Organizational performance

Changes in the number of outstanding clients, borrowers, and savings loans were examined to evaluate organizational performance. In the case of MFIs, increasing outreach by recruiting additional members helps to accumulate money and expand regions of operation. Finally, growth in the number of borrowers contributes to greater loan coverage.

Table 3.1:Comparison of Organizational Performance before and after Regulation by Size of MFIs

Size	2010				2022			
	Large	Medium	Small	All	Large	Medium	Small	All
Average number of clients per MFI (in Lakh)	4.42	.31	.03	.79	7.27	.52	.04	1.29
Borrower Client Rate (%)	81	82	80	81	80	75	78	78
Average Saving portfolio of MFI (lakh. TK.)	8646.24	691.18	59.45	1577.20	93661.85	6564.178	216.9175	16529.55
Average Loan Outstanding of MFI (lakh. TK.)	26723.3422	1866.5713	153.5506	4803.0395	251024	15777.61	601.8806	43964.76
Per Head Saving (TK.)	2200	2200	2000	2200	13000	11000	5000	7600
Loan Outstanding Per Borrower (TK)	7700	7500	8700	8300	42000	37000	24000	29000

Sources: MRA Report on Microfinance in Bangladesh

The data shows that the average number of clients increased by .50 lakh over the years. The increase is 1.69 times greater than the base year. However, the growth rate of clients for a small one is 1.3 times. The borrower-client ratio explains that there was a decreasing trend across the size of MFIs. The average savings and outstanding loan amounts are BDT 16529

lakh and BDT 43964 lakh, respectively, with noteworthy variation across MFI sizes. In both cases, the increase trend is nearly ten times. However, the growth rate for a small one is nearly four times higher than the base year. During discussions in FGDs, the entrepreneurs of small MFIs were informed that the regulations had compelled provisioning and a security fund and introduced a compliance issue for borrowing money with a stipulated rate of service charge and saving products that make it difficult to increase the amount of savings and loan outstanding balance. However, medium and large NGOs have a comparative advantage as their surplus is high, and they can attract more beneficiaries.

3.2 Fund Size and its Composition

According to the rules (18), there are several areas for fund generation. These are donations of general members, donations from home and abroad with documental evidence, savings of clients, credit from financial institutions of home and abroad, capital market, and credit from other than clients having formal contracts.

Table 3.2: Average Size of Fund and Fund Composition:

Mean (In lakh BDT)			
	Base Total	Current TOTAL	Times of increase
Small	158.34	643.24	4.06
Medium	2107.02	17867.11	8.48
Large and very large	29059.22	279326.61	9.61
Total	5232.29	49266.41	9.42

Sources: MRA Report on Microfinance in Bangladesh

The average fund across all MFIs stands at BDT 49,266 lakh, marking a significant 9.42-fold increase from the base year. However, considerable fluctuation is observed across different MFI sizes. The fund size for large and very large MFIs amounts to BDT 2,79,326 lakh, surpassing that of small and medium-sized MFIs by over 400 and 16 times, respectively. Examining the changes in fund size over the years reveals an average increase of 9 times higher than the base year, yet the growth rate for small MFIs remains only four times higher.

Table 3.3: Comparison of share of a source of capital in different periods by Nature of MFIs

	Base Year				Current Year (%)			
	Small	Medium	Large and very large	All	Small	Medium	Large and very large	All
Saving	39.70	34.92	32.88	37.64	35.09	36.57	36.12	35.55
PKSF	8.69	37.54	38.56	19.07	7.44	21.55	10.12	10.67
Government Loan	1.01	2.30	0.02	1.10	2.87	0.26	1.06	2.06
MFIS	2.50	3.52	0.98	2.45	1.06	0.03	0.53	0.77
Bank	1.09	1.84	6.28	2.07	4.94	15.48	22.37	9.91
Other Loan	20.16	4.17	4.07	14.48	14.91	2.68	3.01	10.52
Donor	2.70	2.84	8.78	3.71	3.07	0.53	0.33	2.11
Surplus	20.98	11.79	8.54	17.20	18.96	16.68	20.31	18.73
Other Fund	1.86	3.77	2.87	2.39	11.67	6.22	6.14	9.68

Sources: Calculated from MRA Report on Microfinance in Bangladesh

Fund structure of microfinance institutions (MFIs)

The table illustrates the percentage of funding sources for MFIs in the current year compared to the base year. Funding sources are classified into various categories, including Savings, PKSF, Government Loans, MFIs, Banks, Other Loans, Donors, Surplus, and Other Funds. It is evident that the percentage of funding sources for MFIs varies across different categories and years.

For instance, in the current year, the highest percentage of funding sources for MFIs comes from savings, followed by Surplus and Banks. In the base year, the highest percentage of funds was generated from PKSF, followed by savings and donors. It's clear that after regulation, access to commercial banks and reliance on surplus amounts have increased.

Analysing the fund composition of the current year, it's evident that more than 50 per cent of the funds across MFI sizes are composed of savings and surplus. However, the contribution of PKSF funds to small MFIs is smaller than that to large and medium MFIs. The dependence of small MFIs on other sources is higher than the other two categories of MFIs.

They typically mobilize funds from sources other than members in the form of loans. However, restrictions on charging service fees higher than the deposit rates of clients hinder initiatives to take loans from individuals. People are not inclined to lend money at a lower service charge than the market rate.

3.3 Administrative and operational efficiency

To assess administrative and operational efficiency, four key cost ratios were analyzed: saving cost ratio, borrowing cost ratio, general and administrative (G&A) cost ratio, and operating cost ratio. The saving cost ratio was calculated as the interest on savings divided by the average loan outstanding. This ratio indicates how much it costs the organization to attract and maintain savings deposits. The borrowing cost ratio was calculated as the interest on loans divided by the average loan outstanding. This ratio reflects the organization's cost of borrowing funds. The G&A cost ratio was calculated as the G&A expenses minus loan loss provision expenses (LLPE) divided by the loan outstanding amount. This ratio measures the cost of general administrative activities relative to the loan portfolio. The operating cost ratio was calculated as the sum of financial costs, G&A expenses, and LLPE, all divided by the loan outstanding amount. This ratio provides a broader view of the organization's overall operating expenses in relation to its loan portfolio.

Table 3.4: Administrative and operational efficiency

	Base Year				2022			
	Large	Medium	Small	All	Large	Medium	Small	All
Average Saving Cost Ratio	1.39	1.64	1.90	1.77	2.29	2.37	1.71	1.94
Borrowing Cost Ratio	3.41	2.57	2.21	2.48	2.94	2.93	1.79	2.20
General and Administrative Cost	16.02	16.21	14.40	15.02	10.26	11.77	12.49	11.98
Total Operating Cost	20.82	20.43	18.45	19.23	16.63	18.26	16.92	17.14

Sources: MRA Report on Microfinance in Bangladesh 2022

The Average Saving Cost Ratio increased for the large and medium categories between the base year and 2023. The largest increase was observed in the large category, with a change of 65.41%. Conversely, the smallest increase occurred in the Small category, with a change of -10.01%. In the base year, the Average Saving Cost Ratio for the small category consistently exceeded that of the current year, indicating that beneficiaries of large and medium-sized MFIs received higher interest benefits on savings compared to smaller ones. However, the cost of fund mobilization from internal resources increased significantly for large and medium-sized MFIs compared to smaller ones.

Regarding the Borrowing Cost Ratio, all categories experienced a decrease between the base year and 2023, except for the Medium category, which increased by 13.91%. The largest decrease was observed in the Small category, with a change of -18.84%.

Analyzing the fund composition reveals a notable increase in access to commercial banks for loans among medium-sized MFIs. In contrast, small MFIs have seen increased access to other loans and funds at lower interest rates.

A notable achievement lies in the reduction of administrative and operating costs for MFIs. Across all MFI categories, a decrease in General and Administrative Costs, as well as Total Operating Costs, was observed between the base year and 2023. The most significant decrease occurred in the Large category, with General and Administrative Costs declining by 35.95% and Total Operating Costs by 20.13%. Conversely, the Small category experienced the smallest decrease, with General and Administrative Costs reducing by 13.24% and Operating Costs by 10.87%. The Medium category saw a decrease of 27% in General and Administrative Costs and 10% in Total Operating Costs. Hence, there is a need for additional efforts to reduce administrative and operating costs further for small-sized MFIs.

3.4 Financial Performance

Three major indicators were utilized to determine Financial Performance: operational self-sufficiency, return on assets (ROA), and portfolio yield. Operational Self-Sufficiency consider financial income (revenue from core operations) to financial expenses (interest on deposits and other borrowings), loan loss provisions (reserves set up for probable loan defaults), and operating costs. A ratio greater than 100 implies that the organization earns enough revenue to meet its operating expenses without requiring external support. A ratio smaller than hundred indicates probable financial difficulty, necessitating external assistance to cover costs. Return

on Assets (ROA) assesses how well an enterprise makes surplus from its assets. A higher ROA suggests more surplus, implying that the company is making the best use of its assets to create revenue. A lower ROA shows inefficiencies or asset underutilization, which may need surplus-enhancing actions. Portfolio Yield, on the other hand, indicates the loan portfolio's return. It is computed by dividing total service charge (interest and other fees) by average loan outstanding (total loan value). A greater portfolio yield denotes a more efficient loan portfolio, implying efficient pricing methods and lending terms. Lower portfolio yields may need revisions to pricing or loan terms to boost returns.

Table 3.5: Comparison of Financial Performances before and after Regulations by Size of MFIs

Size of MFIs / Indicators	Base Year				2022			
	Large	Medium	Small	All	Large	Medium	Small	All
Operational Self Sufficiency	107.28	101.12	122.47	115.83	130.08	118.81	108.64	114.17
Return on Asset	3.15	2.26	2.48	2.54	3.95	2.56	1.55	2.15
Portfolio Yield	24.12	22.44	22.28	22.61	20.74	20.70	16.82	18.23

Sources: MRA Report on Microfinance in Bangladesh

The data indicates that in 2022, operational self-sufficiency was higher for Large and Medium-sized MFIs but lower for Small-sized ones. Although small MFIs generate sufficient revenue to cover their operating expenses without external support, there is potential to increase revenue compared to medium and large MFIs. Return on assets was higher in 2022 for all sizes except Small. Specifically, in 2022, the return on assets was higher for Large MFIs but lower for Small MFIs. Therefore, Small MFIs should focus more on effectively utilizing their assets.

Regarding portfolio yield, all types of MFIs reported lower yields compared to the base year. One reason may be the imposition of service charge limits by the MRA, which restricts MFIs from setting service charges according to their preferences. Nevertheless, the portfolio yield remains reasonable, as the outstanding loan amount generates an average return of more than 18 per cent.

Overall, the analysis suggests that Small MFIs need to concentrate on enhancing their operational efficiency, maximizing asset utilization, and exploring alternative strategies to increase portfolio yield.

3.5 Other Activities

Aside from the primary activity of providing microcredit, each MFI provides services linked to human capital formation through awareness development and support in education, health, and sanitation. They also help increase productivity via capacity building through providing training in the agricultural and non-farm sectors. Providing social care to disadvantaged groups of individuals, as well as various activities that promote cultural and environmental development, are also found to be other activities of MFIs.

Table 3.6: Comparison of Other Activities Before and After Regulation by Size of MFIs

(%)

		Small			Medium			Large and Very Large			All		
	Code	*1*	*2*	*3*	*1*	*2*	*3*	*1*	*2*	*3*	*1*	*2*	*3*
A	Education and Health Service												
A.1	Educational Activites	5.8	12.5	7.7	-	16.1	58.1	3.8	30.8	65.4	4.3	16.1	26.7
A.2	Health Awareness	4.8	8.7	27.9	9.7	12.9	61.3	0.0	11.5	80.8	5.0	9.9	42.9
A.3	Adolscent programme	5.8	3.8	7.7	3.2	6.5	51.6	0.0	26.9	53.8	4.3	8.1	23.6
A.4	Sanitation	7.7	3.8	7.7	9.7	9.7	45.2	3.8	34.6	53.8	7.5	9.9	22.4
A.5	Water Supply	1.0	1.9	5.8	3.2	0.0	12.9	0.0	7.7	23.1	1.2	2.5	9.9
B.	**Capacity Building**												
B.1	Crop	3.8	6.7	16.3	0.0	6.5	48.4	3.8	15.4	61.5	3.1	8.1	29.8
B.2	Treatment for Cattle	5.8	3.8	8.7	16.1	16.1	19.4	19.2	19.2	30.8	9.9	8.7	14.3
B.3	Extension services of Fishery	4.8	6.7	9.6	0.0	6.5	41.9	3.8	15.4	53.8	3.7	8.1	23.0
B.4	Training	3.8	8.7	18.3	3.2	9.7	61.3	0.0	26.9	57.7	3.1	11.8	32.9
B.5	Youth Development	4.8	6.7	6.7	0.0	16.1	48.4	0.0	23.1	53.8	3.1	11.2	22.4
C	**Social Care**												
C.1	Support to Elderly	1.9	5.8	8.7	0.0	12.9	51.6	0.0	34.6	46.2	1.2	11.8	23.0
C.2	Distribution of winter clothes	7.7	5.8	24.0	9.7	12.9	54.8	0.0	30.8	61.5	6.8	11.2	36.0
C.3	Food Distribution	10.6	8.7	12.5	16.1	9.7	38.7	11.5	11.5	57.7	11.8	9.3	24.8
C.4	Donation	1.9	8.7	21.2	3.2	9.7	51.6	3.8	15.4	73.1	2.5	9.9	35.4
D	**Sustainable Community Service**												
D.1	Promotion of Cultural and Environmental Activities	1.0	5.8	9.6	3.2	9.7	38.7	0.0	26.9	42.3	1.2	9.9	20.5

Code: 1= Previously it was but does not prevail now 2= It wasn't before but prevailing now ৩=It was in the past and also prevails at present

Source: Data Collected From MFIs

When considering the programmes related to human capital creation in MFIs, it is noticed that one-half of them provide education-related support, while two-fifths have health-related initiatives. One-third of them have an adolescent and sanitation program, but just 10% have programme realted to access to drinking water. MFIs with a larger size tend to have a higher frequency of these activities compared to their medium-sized counterparts. While smaller MFIs have significantly lower participation rates, most programs, regardless of MFI size, are experiencing growth, except for the adolescent program, sanitation for small-scale, and drinking water initiatives for medium-sized MFIs**.** FGD discussions highlight that collaboration with other development partners or organizations significantly impacts both program coverage and financial resources available in the field.

Two types of activities are carried out to increase productivity: capacity development for beneficiaries via enhanced knowledge and awareness and boosting production in the farm and non-farm sectors through the use of new technology, inputs, and methods. More than two-fifths of MFIs have a training programme. One-third of organizations have programs relating to agriculture, fisheries, and youth development. Only 23% have programs in place for animal treatment facilities. Large and medium MFIs are the most likely to participate in these programmes, followed by medium MFIs. Smaller organisations have the lowest involvement in these programmes. Notably, except for livestock treatment programs given by small MFIs, all other activities have shown an increase in participation compared to before regulation.

Over two-thirds of MFIs (Microfinance Institutions) offer programs to aid the underprivileged. These programs include distributing winter clothes and one-time grants to lessen hardship as well as providing social care and food aid for the elderly during crises. This trend is expected to continue, with larger MFIs generally having more involvement in all aspects of social care programs, followed by medium-sized MFIs. As usual, participation by small MFIs is minimal. It's important to note that compared to before regulations, involvement in most activities has increased for all MFI sizes, with the exception of a decrease in participation in the food distribution for small and medium MFIs, and winter clothes distribution for small MFIs.

In the case of sustainable community services, awareness programme related to upholding the culture and heritage and environmental protection have increased irrespective of MFIs.

Overall, larger and medium-sized MFIs play a bigger role in offering various programs than smaller ones. However, it's important to note that most programs are experiencing growth regardless of size, except for a few specific instances. Collaboration and increased participation since regulations suggest a positive trend in MFI involvement in various social and development initiatives.

3.6 Variation of Financial Products

Table 3.6: Comparison of Financial Products Before and After Regulation by Size of MFIs

	Before				After			
	Small	Medium	Large	All	small	Medium	Large	All
Saving Products								
Term Saving	12.5	38.7	69.2	26.7	24.0	74.2	96.2	45.3
Compulsory Saving	77.9	100.0	96.2	85.1	85.6	100.0	100.0	90.7
Voluntary Saving	27.9	67.7	65.4	41.6	49.0%	77.4%	84.6%	60.2
Loan and other products								
Micro Credit	92.3%	100.0%	100.0%	95.0%	95.2%	100.0%	100.0%	96.9%
Enterprise Credit	25.0%	87.1%	96.2%	48.4%	40.4%	100.0%	92.3%	60.2%
Housing Loan	17.3%	38.7%	38.5%	24.8%	26.9%	41.9%	57.7%	34.8%
Education Loan	4.8%	19.4%	19.2%	9.9%	3.8%	22.6%	26.9%	11.2%
Insurance	68.3	77.4	69.2	70.2	76.9	83.9	76.9	78.3

Source: Data Collected From MFIs

The table illustrates the percentage of microfinance institutions (MFIs) offering various financial products, comparing the "Before" and "After" periods based on MFI size. It indicates a notable increase in the percentage of MFIs offering term deposits compared to the base year. Adoption of term savings is the lowest among small MFIs in both periods, while large and medium-sized MFIs demonstrate the highest adoption rates. However, medium-sized MFIs show the most significant increase, with a change of almost 36 percentage points, compared to 26 percentage points for large and very large MFIs and 11.5 percentage points for small MFIs.

The adoption rate of mandatory savings is steadily increasing. Currently, around two-fifths of MFIs offer voluntary savings products, compared to approximately three-fifths in the

base year. Growth is sustained across all MFI sizes, with small MFIs experiencing the highest rate of growth.

The loan products that MFIs offered before and after regulation are displayed by size in the above table. The share of MFIs offering Enterprise Credit has changed the most, rising by 11.8 percentage points following regulation. The percentage of MFIs providing housing loans (10.0 percentage points) and insurance (8.1 percentage points) has also significantly increased. The fact that these improvements are averages for all MFIs of a specific magnitude should be noted. The specific modifications for every MFI could differ. All things considered, the data points to a beneficial influence of regulation on the range of credit products that MFIs provide. Borrowers may have easier access to credit as a result of having more options available to them.

3.7 Impact of Regulation on Performance of MFIs in Bangladesh

As discussed earlier, to have a comprehensive assessment of the impact of regulation on the performance of MFIs in Bangladesh, this study employs a combination of difference-in-differences analysis, pooled regression, and panel data regression, accounting for potential confounding factors and leveraging the strengths of each methodological approach. Table 1, Table 2, and Table 3 present the estimates of the impact of regulation on different financial performances (ROA, OSS, and P_Yield, respectively) of MFIs in Bangladesh, controlling different characteristics variables (confounding factors).

Table 3.7: Estimates of the Return on Asset (ROA) Model

Variables	Difference-in-Difference		Pooled Regression		Panel EGLS	
	Coefficient	P-value	Coefficient	P-value	Coefficient	P-value
REG_DUMMY	1.387120	0.0513	1.872082	0.0036	1.387120	0.0523
INTER_DUMMY	-1.123198	0.1518	-1.919890	0.0083	-1.123198	0.1535
AGE	-0.065740	0.0031	-0.060922	0.0032	-0.065740	0.0032
SIZE	-1.177572	0.0002	-1.351864	0.0000	-1.177572	0.0002
LOCATION	-0.175174	0.1028	-0.167651	0.1185	-0.175174	0.1043
ADMIN_C	-0.150191	0.0010	-0.118754	0.0072	-0.150191	0.0010
INTER_FUND	0.039134	0.0001	0.041625	0.0000	0.039134	0.0001
C	7.933057	0.0000	8.242962	0.0000	7.933057	0.0000
F-statistic	8.747930	0.0000	8.998688	0.0000	8.747930	0.0000
Log-likelihood	-853.4334		-852.6851			

Variables	Difference-in-Difference		Pooled Regression		Panel EGLS	
	Coefficient	P-value	Coefficient	P-value	Coefficient	P-value
Durbin-Watson stat	2.033109		2.003341		2.033109	

Table 3.7 shows that a positive coefficient for the regulation dummy (REG_DUMMY) from all three types of estimates indicates that, on average, MFIs operating after the regulation have a higher level of the ROA (e.g., better performance with 1.39 to 1.87 times) compared to MFIs operating before the regulation, holding all other variables constant. The p-values indicate the significance of these findings. The coefficient of the regulation dummy variable in the DID estimate represents the positive causal effect of the regulation on the ROA of MFIs. In contrast, the positive coefficient in the pooled regression represents the average change in the ROA (e.g., MFIs' performance) associated with the implementation of the regulation, controlling for other variables. The panel regression presents the same controlling for time-invariant characteristics of MFIs and time-varying factors.

The negative coefficients of the interaction term (INTER_DUMMY) in all three estimates suggest a decreasing effect of the regulation over time (at the rate of 1.12 to 1.92 between the investigation periods), that is, a diminishing impact of the regulation on the ROA as time progresses, within the same regulatory regime. In other words, it suggests a weakening impact of the regulation on the ROA of MFIs in Bangladesh as time progresses. However, other than the pooled regression, the p-values do not confirm the significance of this finding.

Among the confounding factors (relevant characteristics variables), the association between the variables and the ROA is found to be negative except for the internal sourcing of funds (INTER_FUND) by the MFIs in Bangladesh. At the same time, the p-values indicate significant relationships between ROA and the confounding factors other than the geographic location of the MFIs. The negative and significant value of the coefficient of AGE suggests that the older MFIs get less ROA than the newer MFIs. However, the rate is estimated to be less than one in all regressions. However, the significant negative value of the size implies that the larger the size of the MFIs, the higher the chances in ROA (with a rate of 1.18 to 1.35), since the size is denoted by the dummy 1 to 4 with the very large = 1, large=2, medium =3 and small =4. The negative, though not significant, values of location mean that the MFIs operating in the older divisions in Bangladesh got higher ROA with Dhaka division =1 and the newest division Maymanshing = 8.

It is usually expected that with the increase in general and administrative costs (ADMIN_C), the return on asset (ROA) will decrease and vice versa. The rate of such decrease between different estimates varies from 0.11 to 0.15 and is found to be highly significant. However, the change in ROA with respect to the internal sourcing of funds (INTER_FUND) is positive and highly significant, with a rate of 0.39 to 0.42.

The highly significant F-statistics of all three estimates imply that estimators of the regression are jointly substantial, and the high values of likelihood confirm the right specification of the model.

Table 3.8 shows that the coefficients of the variables in all three estimates of the Operating Self-Sufficiency (OSS) model were found to be similar to the ROA, with the exception of the significant value of interaction dummy (INTER_DUMMY) and the significant F-statistics and high log-likelihood value confirm the joint significance and correct specification of the model. Almost similar results are produced by the three estimates of the portfolio yields (P_YIELD) in Table 3, with the exception of a positive and significant relationship with the general and administrative cost (ADMIN_C).

Table 3.8: Estimates of the Operating Self-Sufficiency (OSS) Model

Variables	Difference-in-Difference		Pooled Regression		Panel EGLS	
	Coefficient	P-value	Coefficient	P-value	Coefficient	P-value
REG_DUMMY	22.19196	0.0197	27.69131	0.0013	24.21760	0.0136
INTER_DUMMY	-18.45696	0.0775	-27.32705	0.0048	-20.09014	0.0358
AGE	-0.753913	0.0106	-0.729120	0.0081	-0.658358	0.0312
SIZE	-8.009362	0.0540	-10.10721	0.0219	-7.826240	0.0821
LOCATION	-0.562695	0.6931	-0.472609	0.7407	-0.564356	0.7166
ADMIN_C	-3.724807	0.0000	-3.383750	0.0000	-3.528474	0.0000
INTER_FUND	0.248170	0.0601	0.266495	0.0369	0.254957	0.0560
C	192.0931	0.0000	197.4943	0.0000	186.0513	0.0000
F-statistic	10.60877	0.0000	10.71221	0.0000	9.822056	0.0000
Log-likelihood	-1670.048		-1669.750			
Durbin-Watson stat	1.624464		1.825268		2.019226	

These results imply that the positive and significant coefficients for the regulation dummy (REG_DUMMY) of financial performance models of ROA, OSS, and P_Yield indicate that, on average, MFIs operating after the regulation (irrespective of their establishment date) have a higher level of the ROA, OSS and P_YIELD (e.g., better performance) compared to MFIs operating in Bangladesh before the regulation, holding all other variables constant. However, the negative coefficients of interaction (INTER_DUMMY) suggest a decreasing effect of the regulation over time or a diminishing impact of the regulation on the financial performance ROA, OSS and P_YIELD of MFIs in Bangladesh as time progresses within the same regulatory regime.

Table 3.9: Estimates of the Portfolio Yield (P_Yield) Model

Variables	Difference-in-Difference		Pooled Regression		Panel EGLS	
	Coefficient	P-value	Coefficient	P-value	Coefficient	P-value
REG_DUMMY	2.214604	0.0189	3.149475	0.0003	2.176061	0.0234
INTER_DUMMY	-3.626871	0.0005	-4.796709	0.0000	-3.607043	0.0004
AGE	-0.102970	0.0005	-0.060864	0.0272	-0.104812	0.0005
SIZE	-1.806144	0.0000	-1.836502	0.0000	-1.807859	0.0000
LOCATION	-0.370723	0.0091	-0.364515	0.0114	-0.374052	0.0114
ADMIN_C	0.486233	0.0000	0.532761	0.0000	0.482457	0.0000
INTER_FUND	0.022766	0.0841	0.028879	0.0252	0.022878	0.0863
C	22.03832	0.0000	20.60631	0.0000	22.14542	0.0000
F-statistic	22.35172	0.0000	21.02205	0.0000	22.53917	0.0000
Log-likelihood	-941.0164		-944.2053			
Durbin-Watson stat	1.624464		1.557097		2.020236	

Overall, the findings suggest that the regulation implemented in Bangladesh has had a positive impact on the financial performance of MFIs, as evidenced by improvements in key performance metrics. This indicates the effectiveness of regulatory measures in enhancing the stability and sustainability of the microfinance sector in Bangladesh.

CHAPTER 4: EFFECTS OF MICROCREDIT REGULATORY AUTHORITY: PERCEPTION OF SERVICE PROVIDERS

The Microcredit Regulatory Authority (MRA) was established in 2008 through the promulgation of an act, with the rules being publicized in 2010. According to the act, obtaining a license is mandatory for operating microfinance at the grassroots level. Furthermore, these rules play a crucial role in addressing various issues to ensure the proper growth of Microfinance Institutions (MFIs), taking into consideration the interests of both staff and clients. An initiative was undertaken to gather the perspectives of Microfinance organizations regarding the benefits and shortcomings of the MRA, aiming to enhance the prudence of the microfinance sector.

4.1. Benefits of MRA

The perception of the benefits of MRA has been categorized into three broad themes. These are as follows:

a) Sustained growth of MFIs: Addressing challenges and fostering the continuous development of Microfinance Institutions.
b) Protecting the Client's interests: Ensuring measures are in place to safeguard the rights and well-being of the clients involved in microfinance transactions.
c) Welfare of the Staff: Focusing on the well-being and professional growth of the staff associated with Microfinance Institutions.

The issues related to these three themes are elaborated upon below:

4.1.1 The Sustained Growth of MFI.s: To ensure the sustained growth of Microfinance Institutions (MFIs), respondents highlighted the influence of the Microcredit Regulatory Authority (MRA) in fostering good governance, management efficiency, sustainability, and a strong identity. The decision-making process and compliance with various operational issues in microfinance, supported by legitimate institutional backup, have contributed to the continuous expansion of the microfinance sector.

4.1.1.1 Good Governance: Good governance underscores the decision-making and implementation processes in real-world situations, taking into account the interests of both service providers and recipients. Analyzing the responses of service providers, it can be concluded that the institutional framework developed through the MRA legitimizes the

provision of services to economically disadvantaged individuals through financial products. Compliance with various rules, including the formation of the general body, managing committee, separation of ownership from management, periodic changes in the management committee, and the implementation of decisions by the Executive Director with the support of staff, ensures active participation in the decision-making process. Transparency is maintained through the flow of reliable information within different levels of management and stakeholders. The participation of various committees, mandatory meeting proceedings, and regular reporting of operational activities to the authority facilitates this. Monitoring the activities of MFIs by the MRA and compliance with various issues related to a maximum ceiling of service charges and minimum service charges for deposits, along with providing proper information to clients, are instrumental in ensuring the accountability of MFIs.

In terms of predictability, every MFI is obliged to provide services following the same guidelines and a standardized set of rules. Consequently, beneficiaries are now in a position to predict the expected benefits, and MFIs can align their services with the expectations of the beneficiaries. Establishing client-centric rules, considering the perspective of service providers and ensuring compliance with these rules is essential for upholding the rule of law. The rules promulgated by the MRA can be classified into two broad categories: permanent and temporary. To address the effects of a crisis, the MRA has introduced temporary instructions, such as suspending installments for a few weeks or months and providing flexible loans to meet emergencies. On the other hand, MFIs need to adhere to permanent instructions outlined in rules and different circulars unless they are amended. One of the respondesnt told that " *MRA was succeded by stoping the activities of fake MFIs theryby increased the acceptance of MFIs has increased. Otherhwise, there was every possibility to be cheated by unaninomus mushrroms of MFIs*".

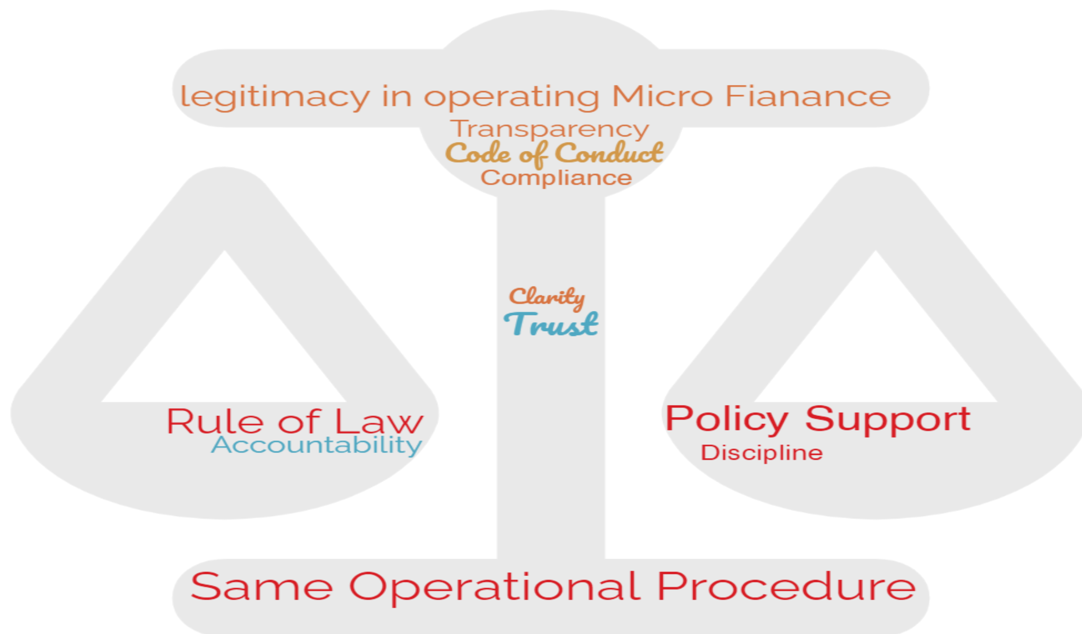


Fig 01: Elements of Goof Governance Influenced by MRA.

4.1.1.2 . Management Efficiency: Management efficiency is related to the idea of proper use of different resources. For MFIs, resources related to finances, manpower, technology, and information are significant. The mandatory provision of organizational structure, along with specific authority and responsibilities of each position, helps to obtain the right person for the right position. Besides, the target of the loan disbursement and loan recovery of each field worker assesses the performance of each staff member, which ensures the proper use of the manpower of the MFIs. For using financial resources, the instruction for using the maximum amount of saving for loan amount, prior permission for investing in fixed assets and social activities ensures proper use of financial resources. Additionally, the institutions always emphasize reducing administrative costs by analyzing different ratios, i.e., operational and sustainability ratios, by competing with each other. Most organizations are using software for account keeping, which helps policy planners get real-time and proper information. The information related to compliance issues is uploaded regularly to the MRA website. So everybody has access to the proper information and there is little scope for any person to work against the instruction the authority provides. Most importantly, some basic information about each MFIS is incorporated and circulated through preparing the annual report. Every organization can use its information for benchmarking and take the initiative to attain the

position of a high performer. By competing with each other, the MFIS is trying to reduce the administrative costs of competing with the competitors. Easy communication with different MFIs and government and local government sectors becomes easy due to their legitimate existence. This has broadened their horizontal and vertical communication, ultimately helping to coordinate properly within their areas of operation.

4.1.1.3. Sustainability: Sustainability refers to the institutional perspective of continuing the operation from their initiatives. For MFIs, adequate capital for earning, delinquency management, reasonable profit, prevention of irregularities, and stability of financial performance are essential for sustainability. The formal institutional framework of MFIS, as instrumented by the MRA Act and its rules, has increased the acceptance of this institution in the public, private, and social sectors. This level of acceptance has increased the scope for increasing outreach and access to formal financial institutions for raising and investing capital in the micro fiancé sector. Participation is in different dialogues organized by different MFIS and MRA, and working with commercial banks encourages them to facilitate the enterprises fostering green development. Standard delinquency management and restrictions on operational profit also help to develop the organization's capital base. The compulsion to acquire a license from MRA and the closure of non-performing MFIs have increased the recognition of this sector for service recipients and financial institutions. This ensures stability through adequate fund mobilization and disbursement of loans by introducing market-based financial products. Moreover, MRA plays a crucial role as a facilitator, promoter, and persuader if any government policy goes against the interests of the sector. If needed, policies are changed in consultation with the different stakeholders to address the changed situation under the leadership of MRA, which is instrumental for the sustainability of the organization.

4.1.1.4. Solid Identity: For the sustainable growth of any institution, a solid identity having acceptance to the local administration and the general public is essential. In the case of MFIs, licenses from regulatory bodies like MRA have increased the recognition to all concerned. The values and culture that have been developed in every organization by complying with the rules and regulations help achieve the solid identity of the microfinance sector in the economy. The guiding principles that have evolved over the years for serving people by protecting their interests, as well as organizational management, are distinct in nature. Moreover, the behaviour of the staff, their relation with clients and staff, and the responsibility of management for satisfying the demands of staff and clients have created a distinct culture of the MFIs. They are

now in a position to get guidance and support from the field administration and local government and communicate easily with the field administrator for any kind of emergency. The government is also encouraging them to provide support through building partnerships with the government. During COVID-19, the government channelled a lot of money to the poor people as flexible credit for smoothing the livelihood of rural people triggered by the crisis. Some NGOs have developed partnerships with the government to extend support related to implementing social safety net programs, primary health care programs of the government, providing housing to the people, and awareness development on crucial issues. These sorts of recognition boosted the morale of filed functionaries of MFIs, who believed that they were also strong proponents of the development of the economy. Moreover, the standard values and culture of each MFI has increased the image of MFIs in the economy. The misunderstanding about the role of MFIs is reduced a lot at the local level due to solid identity instrumented by the influence of MRA act rules and circulars.

4.1.2. Client Security

Microcredit borrowers come from the lower economic strata of society. They prefer to access the financial market at an affordable cost and in a timely fashion. Moreover, they demand that the conditions of financial instruments be respected. Generally, they are the clients of two types of products: saving instruments and credit. If the service-providing organizations are in line with the government directives, there is little scope for being cheated. When clients see that financial institutions are affiliated with MRA, they have a lot of confidence to make transactions as they believe that if they are cheated, the government will take the proper steps to protect their savings. Introducing the lower limit of service charge for the saving instrument, the upper limit of the service charge of credit, and a special type of instruction for meeting the crisis protect the interest of clients. The MRA has made a compulsion to have a written policy of saving and micro-credit for each of the institutions approved by the general body of the organization. The written policy has standardized the loan disbursement and collection of money for different types of financial products. As a result, the loan disbursement becomes smothered, and the loyalty of the clients toward the MFIS increases by getting services according to their commitment.

4.1.3 Welfare of the Staff

Following the instructions of MRA, every organization needs to prepare the service rules for its staff and get approval from the General Body. The recruitment procedures,

compensation, development, and placement are written in the document. Following those conditions, most organizations are trying to attract the right people by the wide circulation of vacancy announcements. The prospective candidate is also encouraged to apply for the position, believing that the service condition will be reverent as they are affiliated with the MRA. The organizations also play an important role in their career development by arranging demand-based training, seminars, and conferences. Some of the new entrants join the organization to get experience and go for more attractive jobs by utilizing their first-hand knowledge. As the rules and regulations are standardized, it is very easy for them to perform higher responsibilities by utilizing the knowledge they have gained. Moreover, learning from interacting with the same type of organization and other organizations helps them continue their learning.

4.2 Challenges for Introducing Regulations under MRA

The challenges of MFIs for introducing regulations under MRA can be classified as the inadequacy of policies, operational deficiency, limitation in own fund mobilization, and inadequate concern about staff and client protection. The issues under each theme are described as follows:

4.2.1 Inadequacy of policies

The respondents claimed that there are no clear-cut directives from MRA to reduce overlapping activities in rural areas. Many MFIs are working in the same areas without proper coordination among them. As a result, the beneficiaries can choose to select more than one organization for financial support. One founder of a MFI in North Bengal told that "some people borrow from a bunch of different places, using one loan to pay back another. But when one organization stops giving them money after they've borrowed all they can, it becomes impossible to keep up with the payments on the others. This can get so bad that sometimes families have to move to another district altogether. In the end, the lenders lose out on the money they're owed, and the borrowers end up worse off too".

Other areas of concern, especially for small MFIs, are related to introducing the same type of regulations irrespective of the size of MFIs. Specifically, they mentioned that competing with large or medium NGOs with the same regulations is difficult. Specifically, they said that the requirement of provisioning for liquidity, bad loans, and savings made it difficult to compete with them—the inadequacy of policy directives for recovery from the crisis due to natural and geographical vulnerabilities. For example, they said that they need to comply with

the directives of MRA for suspending instalment collection after any catastrophic disaster, but there are no clear directions on how the organization will recover losses by observing the instructions. One partner organization of PKSF said, "*After COVID, they got a loan fund for giving loans at a low rate of service charge to the beneficiaries. However, as it is not possible to cover all beneficiaries, it creates conflict between MFIs and beneficiaries. Moreover, PKSF has been providing financial services under different projects with different rates of service charges. In such a situation, misunderstanding also prevails in the field*". Some regulations are needed to coordinate the condition of funder and MFIs.

Moreover, some NGOs work in geographically vulnerable areas like coastal and river erosion; the context is different from the other areas of Bangladesh. The displacement of some of the beneficiaries is particularly common in other areas. Some guidelines are needed to address these issues. One respondent said that " *the clients and staff hardly get their benefit if the license of any MFIs is cancelled. As a result, the clients sometimes lose their confidence in the total microfinance sector. In such a case, MRA should ensure that all benefits are maintained."*

Some respondents believe that there is regulation for keeping a portion of the provision for addressing the issue of bad debt; however, there are no guidelines and assistance for the recovery of the default loan from the beneficiaries. Some of the beneficiaries also said that emphasizing the regulations that need to be followed sometimes discourages innovative work. Citing an example, they said that before regulation, the management had the opportunity to design a social development programme from their initiative to meet people's emergency needs. The issues related to delays in changing the policies or instruction according to the needs of the are also hampered. Other policy issues need to be addressed, like service charges related to the collection of fixed funds and other saving instruments. Besides, a quota for distributing the incentives package from the government and MRA needs to be introduced to ensure equity.

In some cases, it is found that there are some mismatches between the instruction of MRA and the authority of registration giving authority. For example, the management committee needs to be formed for two years for the organizations affiliated with the Social Welfare Department, while following the MRA instructions, the duration of the committee will be three years. So, initiative is needed to match the conditions of each authority.

4.2.2 *Slow Growth of Own Fund*

Following the MRA rules, an institution can increase the amount of outstanding loans by increasing the amount of savings, or a surplus of the. However, the restriction to use a stipulated amount of savings for outstanding loan amounts and keeping a certain percentage of savings in the fixed account of the bank, conditions for introducing special credit and restriction to borrow from individuals restricted the initiative to form own capital. Moreover, the increased operating costs due to the inability to charge members for the digitization of transactions have reduced the autonomy of limiting the operational cost. Moreover, the requisite idle money for liquidity in the fixed account and renewal fee for a license every year are problems, especially for small MFIs. The crucial issue is that due to inflation in the economy, the inability to increase the service charge has been decreasing the real value of the outstanding loan amount. The MFIS has very little opportunity to raise funds by introducing several types of saving products that limit fundraising from its initiative.

4.2.3 *Operational*

Issues related to the introduction of software for accounting and excessive reporting necessitate additional time and skilled staff to address them, leading to increased operational costs and extra efforts. One staff member mentioned, *"After receiving certification from MRA, we are required to submit various reports frequently, which creates pressure for us to comply with the instructions. MRA could develop a central software for accessing real-time reports centrally."*

Furthermore, MFIs need to compete in the market with other institutions. Some organizations are conducting micro-credit operations without proper licenses or under the auspices of other government departments. One respondent noted, *"An organization operating under the guise of a society provides loans on a daily instalment basis, which we are unable to do due to regulations. Licensed MFIs face uneven competition in such cases."*

Several MFIs stated that MRA advocates for grievance redress mechanisms by addressing stakeholders' complaints. However, it was observed that stakeholders sometimes raise grievances over minor issues, requiring additional efforts from MFIs to address them. Additionally, some small MFIs mentioned facing challenges in gaining recognition from local administrations due to credibility issues. Organizing programs with field administrations could help these MFIs garner support from local authorities.

4.2.4 *Staff and clients*

Due to MRA regulations, the organizational structure of the organization and the service rules of the employee are there. However, due to a lack of central directives, each organization is preparing these following their choices. In such a case, a rational ratio between the highest and lowest benefit packages may be introduced.

Similarly, there should be central directives about the office environment of the MFIs. Not all staff members have training facilities, which ultimately hampers capacity building and career growth initiatives. A minimum portion of the surplus can be regularly allowed for regular training in a renowned training institution each year. MRA should monitor the committed salary and other facilities regularly.

In some cases, it is found that some clients are moving to other MFIs without any notice and have some financial obligation to the organization where they are serving. There should be a mandatory system for recruiting in other organizations to get clearance about their dues. One founder of a small MFI said,

" *Staffs are using small MFIs as stepping stones for moving from large to medium MFIs. Although small MFIs put a lot of effort into their career development, they don't even inform employees when they leave the organization. If there was a system for taking clearance, their dues could be collected.* "

When it comes to addressing clients, small MFIs struggle to retain their existing clientele. Larger MFIs can offer financial services at a reduced service charge due to their substantial outstanding amounts. However, small NGOs encounter difficulties in providing loans according to customers' demands, as a significant portion of funds is required to remain idle for compliance purposes. Moreover, these organizations are unable to mobilize savings exceeding 80 per cent of their loan outstanding amount.

Furthermore, the criteria for selecting beneficiaries are not outlined in the directives, leading MFIs to focus more on enterprise loans for financial sustainability and to mitigate the risk of loan recovery. Additionally, MFIs cannot intervene promptly in response to the demands of time. Consequently, clients often switch from one organization to another.

CHAPTER 5: MICROFINANCE REGULATION AND EMPLOYEE PROTECTION

5.1 MRA Regulations on Employee Protection

According to the Annual Statistics of the Microcredit Regulatory Authority, as of June 2022, 739 MFIs have employed 207,000 individuals. The Microcredit Regulatory Authority Rules of 2010 stipulate that each MFI must appoint a Chief Executive Officer, who will serve as the Principal Executive Officer and receive compensation according to the respective MFI's salary structure (Rule 9). Furthermore, the MRA Rules of 2010 specify that each MFI must establish a specific organizational structure, which must be approved by the Governing Council (Rule 12). This organizational framework must be submitted to the MRA in writing. To manage the MFI effectively, the necessary number of employees will be hired based on demand, and they will be recruited through the issuance of appointment letters detailing terms and conditions. Additionally, each MFI must have Service Rules outlining all personnel-related matters, including recruitment, leave, termination, and a comprehensive salary package encompassing both financial and non-financial benefits.

5.2 Organizing FGDs with Employees

The study team conducted six FGDs with permanent employees currently working in six MFIs in different districts of Bangladesh. The MFIs in Cumilla include AID Cumilla and PAGE Development Centre, Society for Social Service (SSS) in Tangail, Shataphool Bangladesh in Rajshahi, and Chetona Manabik Unnayan Sangstha in Chapainababgong. Thirty-nine officers and staff at different levels participated in these FGDs. A wide range of issues were raised and discussed in these FGDs, which include length of service, appointment letter, service rule, terms and conditions of appointment, training, scope of promotion, financial and non-financial benefits, retirement benefits, grievance redress mechanism, salary structure, challenges and constraints as well as future expectation from MFI.

5.3 Discussion and Analysis of Findings

Participants in all FGDs mentioned that the regulations adopted by the government through the Microcredit Regulatory Act, 2006 and Microcredit Regulatory Authority Rules, 2010, have brought a positive change in the personnel management system of MFI and have guaranteed certain rights of employees working in MFIs. Before the introduction of MRA Rules 2010, the terms and conditions of services were volatile. Due to MRA rules, every MFI

is now required to have a service rule for its employees, and they receive an appointment letter before joining their services. Service rules have ensured their job security.

It was found in the FGDS that all employees have now received appointment letters. In case of fresh recruitment, for example, PAGE Development Centre, an employee has to keep a deposit in the concerned MFI amounting to Tk. 10,000 as security money, which is refundable when the employee leaves the job. It is learnt that the employees do not mind this matter. The appointment letter specifies the job title, responsibility and procedures to follow to get his/her job permanent. There is a career path to having the opportunity to go to a higher position from an entry position. In PAGE Development Centre, all who join as junior field officers are required to act as apprentices for 6 months and then their job performance is monitored for six months and it has a Promotion Committee for the Staff, which is responsible to recommend for promotion.

Employees enjoy different types of leaves. It is learnt that generally, MFIs follow government rules. In the case of SSS, all women are entitled to enjoy maternal leave of 3 months with all benefits. There is also paternal leave of 7 days. Moreover, an employee obtains 30 days of earned leave in a year, and an employee can cash a maximum of 500 days of earned leave. The amount is fixed with the amount of the last basic.

In terms of financial benefits, it has been noted that employees receive TA/DA, along with a well-structured salary package that includes gratuity, a welfare fund, and a leave encashment system. At PAGE Development Centre, the retirement age limit is set at 65 years, with the possibility of extending job duration by another year if the employee is capable. Additionally, all permanent employees are required to contribute 10% towards gratuity for retirement benefits, although employees are advocating for this contribution to be increased to 15%. Furthermore, there is a desire among PAGE staff for pension benefits in line with the government's new initiative, such as the Mass Pension Rule.

In the case of SSS, employees are entitled to four festival allowances per year. Moreover, each employee receives 30 days of earned leave annually, with the option to cash in a maximum of 500 days of earned leave. SSS also boasts good job security, with promotions occurring every three years for grades up to the 6th, and every four years for grades from the 7th onwards. The starting salary for the 1st grade is Taka 36,000.

SSS, one of the largest MFIs, employs a total of 4875 individuals, comprising 4325 males and 550 females. During an FGD with its employees, they were queried about their familiarity with the MRA Rules of 2010. Few responded affirmatively, with most mentioning the existence of service rules predating the establishment of the MRA. These rules have been amended twice since their inception. To attain permanent employee status, individuals must undergo training in loan management, entrepreneurship development, and loan management from the PKSF.

Regarding financial benefits, SSS employees contribute a basic amount of 12,000 Tk at the conclusion of their service, entitling them to a return 240 times higher than their deposited amount. The salary structure commences at 12,000 Tk, increasing to 25,526 Tk after orientation and initial training, and further rising to 36,860 Tk after confirmation and successful completion of six years. Female staff receive higher salaries due to a 20% house rent allowance. Additionally, employees are provided with a lunch allowance of 65 Tk and a mobile bill allowance. SSS maintains a robust TA/DA system.

Furthermore, employees have the option to deposit between 10,000 and 20,000 Tk per month as a fixed deposit, with returns ranging from 9% to 13% interest. They also benefit from a provident fund, with all employees required to save 10% of their basic salary each month. In response to employee demands, SSS seeks to introduce a pension scheme and organize relevant training courses through the MRA.

Shatophool Bangladesh, a mid-sized MFI, employs a total of 388 individuals, with 246 males and 142 females. An FGD was conducted with employees currently serving in various positions, possessing job experience ranging from 11 months to 24 years. They noted that their organization had service rules in place before the establishment of the MRA. According to their feedback, there were no unfavourable conditions within these service rules.

The introduction of new Promotion Rules occurred subsequent to the implementation of the MRA Rules in 2010. Under the new promotion policy, candidates are required to undergo a VIVA voce exam. The hierarchical structure includes positions such as the Credit Officer, Junior Area Manager, and Senior Area Manager. Promotion is contingent upon factors such as job experience, performance in interviews, and overall job performance. For instance, a Field Credit Officer is promoted to Senior Credit Officer after five years in the role. Although there

is no formal grievance redressal system for individuals who are not promoted, it was expressed during the FGD that qualified and experienced employees are not overlooked for promotion opportunities.

In terms of leave entitlements, employees benefit from 15 days of medical leave, with additional provisions for maternal leave for female employees and paternal leave for male staff, introduced following the implementation of the MRA rules in 2010. When asked about further leave demands, staff expressed a desire for 'recreation leave' and leave to pursue higher education. However, a manager noted that it is customary for the organization to grant leave for staff appearing in SSC or HSC exams and other major exams. They expressed the view that the MRA rules have bolstered job security, which is beneficial for the MFI as a whole.

All staff members unanimously affirmed receiving an appointment letter. This letter outlines the job title, duties and responsibilities, work area, salary, and benefits. They also mentioned undergoing training provided by PKSF. Upon joining Shatophool, new employees are required to work for two months in the field and then undergo a four-month apprenticeship. Following a satisfactory performance over six months, they attain permanent status.

Staff members express satisfaction with the current salary structure. However, some believe that salaries should be more competitive within Shatophool. Presently, newly appointed Field Credit Officers receive 20,000 Tk, up from 10,000 Tk previously. Additionally, staff enjoy benefits such as gratuity, provident fund, and welfare fund. Each employee is required to save 500 Tk per month, with the organisation contributing 150,000 Tk annually. In case of accidents, the organisation covers costs up to 1 lakh Tk. There is also a gratuity system wherein employees receive a payout every five years, doubling after ten years and tripling after fifteen years. The provident fund is accredited by the NBR, and employees can borrow up to 15% of their fund balance. Staff members advocate for the introduction of group insurance and a pension system in the future.

Chetona Manabik Unnayan Sangstha, a small-sized MFI located in Chapainababgong, employs 13 male employees. The organisation has implemented service rules to comply with the MRA rules of 2010. Employees receive a job offer with an appointment letter detailing the job title, conditions, and salary. Promotion within the organisation is based on performance, with salary increments occurring annually in October according to their internal system.

Although Chetona Manabik Unnayan Sangstha does not currently offer a gratuity system, staff express a desire for its implementation. The provident fund is calculated as 10% of the basic salary and doubles every five years. Employees at Chetona Manabik Unnayan Sangstha feel secure in their positions, with job loss only occurring in cases of unlawful activity. They commend the organisation for adhering to established systems.

However, Chetona Manabik Unnayan Sangstha faces challenges in fully implementing MRA provisions due to its small size. The employees believe that larger MFIs such as ASA/BRAC can more easily adhere to MRA rules. They suggest that the MRA could provide training on loan management, collection of outstanding loans, and MRA regulations and governance issues for MFIs in Bangladesh.

One positive impact of MRA rules highlighted by employees is the reduction in the number of NGOs operating microcredit without legal permission in Chaipai Nababgong. Prior to MRA implementation, there were 375 such organisations, but this number decreased to 18-19 due to MRA regulations.

In sum, findings in FGDs with employees indicate that MRA rules have made a positive impact on ensuring employee protection in their service. Now, employees are recruited according to service rules as guided by MRA instructions. Their job is now secured. They have career development opportunities based on an organisational structure. Employees expressed no dissatisfaction in any of the FGDs discussions. MFIs which were visited are paying financial and non-financial benefits to their employees. One common expectation expressed in the FGDs is to introduce a pension system for all employees and conduct training programmes for their capacity building.

To enhance the personnel management system of MFIs, the MRA could implement several measures. Firstly, it could issue directives addressing the disparity between the highest and lowest salaries, as well as other financial and non-financial benefits. Secondly, central directives regarding the office environment of MFIs could be established to ensure consistency and compliance across the sector. Thirdly, the MRA could initiate capacity-building programmes to enhance the skills and competencies of MFI personnel.

Additionally, the MRA should regularly monitor the implementation of committed salaries and other facilities to ensure compliance with regulations. Moreover, to address the

issue of clients moving to other MFIs without notice and leaving financial obligations behind, a mandatory system for recruiting in other organizations could be implemented. This would require clearance about outstanding dues from the previous organization.

Lastly, integrating MFIs with the national pension scheme could provide long-term financial security for employees and contribute to a more sustainable workforce in the microfinance sector. By implementing these measures, the MRA can further streamline the personnel management system of MFIs and promote greater accountability and transparency within the industry.

CHAPTER 6: MRA REGULATIONS AND CLIENT PROTECTION

An effective regulatory framework for client protection is essential for creating clients' confidence in the financial system and protecting them from any fraud and unscrupulous activities. Because the sustainability of the microfinance sector is highly related to client protection. Hence, protecting rights of microfinance clients needs a coordinated role of regulatory authority, MFIs and clients. This chapter highlights existing regulations and their impact on client protection according to the views of participants of FGDs conducted at different levels. In fact, theoretically, client protection is related to a number of issues, which include over-indebtedness, meaning duplication and overlapping of loans to the beneficiary; transparency, meaning financial literacy and opening information pertaining to an interest rate of loan, saving, loan sanction process, financial products, a grace period of loan repayment; appropriate pricing of financial products and services determined transparently; appropriate collection practices meaning fair and respectful treatment to clients by MFIs; ethical staff behaviour that is ensuring clients from any sort of abuse and malpractice; and redress of grievances through a proper mechanism to address client complaints.

6.1 Existing Legal Framework and client Protection

According to the MRA Act of 2006, some provisions directly or indirectly help ensure client protection. First, having a license from MRA is mandatory for MFIs to operate microfinance activities in Bangladesh. Second, MRA will create and maintain a 'Security Fund' in order to protect the deposit of MFIs' clients. Third, every MFI will have a security fund, and the MFI will not incur any expenditure without prior approval from the MRA. Fourth, in case of defaulting MFIs, the MRA will provide necessary instructions to the concerned MFI to take measures to protect clients' interests and, finally, cancel the license. Fifth, MFIs will take various insurance schemes and social activities for their clients in addition to micro-credit operations.

Consistent with the MRA Act, 2006, Microcredit Regulatory Authority Rules, 2010 are promulgated. Some rules are related to client protection. First, MFIs cannot collect deposits from non-clients or term deposits. Second, 70% of total clients must be provided with the loan, and the maximum amount of savings an MFI will have is 80% of its outstanding loan. Third, short-term liabilities, especially deposits, cannot be used to purchase assets. Fourth, MFIs have to maintain reserve by 10% of their accumulated surplus, liquidity by 10% of their deposits

and a certain percentage of Loan Loss Provision. Fifth, ensuring depositors' interest with regard to repayment of deposits will get the highest priority in case of bankruptcy of an MFI. Sixth, every MFI will disclose its terms and conditions related to micro-credit operation and deposit management. Seventh, MFIs will determine their loan size according to the capacity of the client's ability to use loan money as well as repayment. Eighth, every MFI will ensure some rights of clients, such as the right to have information related to loan products and their terms and conditions, withdrawal of deposits, claim of insurance, interest on deposits and receipt documents for savings and loans.

6.2 Discussion and Analysis of Findings of FGDs

6.2.1 Loan Management

One important service received by clients is a loan from MFI. Clients receive different types of credit services, such as yearly-basis, short-term, seasonal, entrepreneurship, **disaster** response loan, welfare credit (loan for installation of tubewell and toilets) etc. Loans are received individually or on a group basis. For example, PAGE provides group loans and it does not provide individual loans. The number of group members varies from MFI to MFI. In the case of medium-size MFI, a group consists of 10 to 35 members.

To obtain a loan from their respective MFI, individual borrowers are required to deposit a certain amount of savings. Repayment of the loan can be made either on a weekly or monthly basis. According to the Circular issued by the MRA, borrowers are entitled to a minimum grace period of 15 days, with a requirement of at least 46 installments for one-year loans paid on a weekly basis. Additionally, the maximum miscellaneous costs, such as form fees, passbook charges, and entry fees, are capped at Tk. 25.

It was observed that borrowers appreciated the 15-day grace period, which proved beneficial and contributed to their satisfaction. Some participants noted the flexibility in installment payments, which they found useful. Moreover, it was noted that 1% of the total allocated loan amount by the MFI was deducted as insurance, with this insurance fund being retained by the respective MFI. In most cases, beneficiaries were reported to be exempt from repaying the loan if they passed away during the loan repayment period.

Furthermore, certain MFIs have introduced rebates for early repayment of loan amounts, providing additional incentives for borrowers.

The size of loans varies according to the capacity of MFIs, with larger and medium-sized MFIs typically offering larger loan amounts. A participant in an FGD associated with a large MFI mentioned receiving a loan of Tk.4,60,000 to support her husband's migration to a foreign country. Conversely, loans provided by small MFIs were observed to be smaller compared to those offered by larger MFIs. In the case of medium-sized MFIs, loan sizes typically range between Tk. 30,000 and Tk. 1,00,000.

During the FGDs, almost all participants expressed a strong desire to access larger loan amounts from MFIs. It was noted that MFIs generally take into account the capacity of clients when determining the amount of credit they can provide.

6.2.1 Transparency and Financial Literacy

It was noted that beneficiaries were well informed about the loan repayment system, particularly regarding repayment through installments. However, participants in the FGDs displayed insufficient knowledge regarding other terms and conditions for obtaining loans, such as the calculation of service charges, including the maximum rate of service charge. As per the Circular issued by the MRA, the maximum rate of service charge is set at 24%, with a maximum of 46 installments for a one-year loan paid on a weekly basis.

During the FGDs, some long-standing beneficiaries mentioned that the cost of loans had slightly increased compared to previous years. They recalled that prior to MRA regulation, the cost of borrowing was lower. For instance, previously, beneficiaries were required to pay Tk.150 per year for a Tk.1000 loan, whereas now they need to pay Tk.127 for the same amount. Additionally, participants recalled that many years ago, borrowers had to pay around Tk.160-170 for a Tk.1000 loan per year.

Furthermore, some participants highlighted that the loan approval process has become somewhat more complicated since the implementation of MRA regulations, as borrowers are now required to submit a greater number of documents. Consequently, many participants suggested that they would benefit from orientation or training programmes on financial literacy. It was noted that SSS had organised such programmes for its clients, prompting suggestions that the MRA could also organise similar training sessions. Participants suggested that these programmes could cover topics such as loan management, strategies for collecting outstanding loans, and governance issues specific to MFIs in Bangladesh.

6.2.3 Over-indebtedness

Some participants in the FGDs reported instances of borrowers taking loans from different MFIs, leading to over-indebtedness, although they perceived this phenomenon to be relatively minor. Among the 30 beneficiaries who participated in one FGD, it was reported that 3 of them had acquired loans from other MFIs. In certain cases, borrowers may obtain loans at different times or simultaneously from the same MFIs, exacerbating the risk of over-indebtedness. On the supply side, it was observed that multiple micro-financers targeted the same clients, increasing the likelihood of borrowers accumulating excessive debt. Conversely, from the demand side, clients expressed a significant need for financial support to address various needs, contributing to over-indebtedness.

However, participants noted that MRA regulations have played a significant role in curbing the proliferation of non-viable MFIs, which has helped reduce over-indebtedness. As evidence, they cited the case of Chaipai Nababgong, where there were 375 NGOs operating microfinance activities. Thanks to MRA initiatives, 16 MFIs have been officially recognised, 40 have become inactive, 2 have ceased operations, leaving only 10 active MFIs. Additionally, some FGD participants highlighted that credit operations by non-MFIs could also lead to over-indebtedness.

In light of these observations, participants suggested organising motivational campaigns at the district and Upazila levels to raise awareness about responsible borrowing practices. They also stressed the importance of strict compliance with MRA rules, proposing that institutions without MRA licenses should not be permitted to engage in credit operations.

6.2.4 Collection Practices and Ethical Issues

From the insights gathered during the FGDs, participants reported that they did not encounter any coercive behaviour from MFI staff regarding loan repayment. Instead, some MFIs employ a team-based approach or peer pressure to encourage repayment of overdue loans. Additionally, social institutions are sometimes utilized to mediate any repayment issues (referred to as "samajik den darber").

It was noted that the large MFI, SSS, follows a compassionate policy: if a borrower passes away during the loan period, they are relieved of the loan burden, and the MFI contributes Tk. 7000 towards the funeral expenses. Similarly, Shatophool, a mid-sized MFI, has a comparable policy: if a borrower dies during the loan period, their family receives Tk.

5000, and if a borrower falls ill during the loan period, the MFI provides financial assistance for treatment.

Moreover, Shatophool, the mid-sized MFI, has a policy whereby borrowers who repay their loans ahead of schedule may have their interest waived for the remaining months, demonstrating flexibility and support towards proactive loan repayment.

6.2.5 Protection of Clients' Savings or Deposits

Savings is one of the main activities of any MFIs in Bangladesh. MFIs mobilize their fund, to a great extent, from collecting different types of savings from their clients. According to MRA Rules, 2010 (Rule 27), an MFI will receive a fixed amount of savings from each member as compulsory deposit. In addition, MFIs can take voluntary and long-term deposits from their clients subject to some conditions fulfilled. For example, an MFI has to make surplus for last three years for taking voluntary savings and five years for long-term deposits (Rule 28 and 29). According to Circular of MRA, an MFI will must pay minimum 6% interest on deposits.

The average savings of small MFI is found to be smaller than medium and large size MFI. According to Annual Statistics of MRA, upto June 2022, total savings of small MFI, Chetona Manabik Unnayan Sangstha, Chapai Nawabgonj was Tk. 81,01,989 (average Tk. 4036), total savings of medium MFI, Shataphool Bangladesh, was Tk. 42,03,49,948 (average Tk. 6,484) and total savings of large MFI, Society for Social Service (SSS), was Tk.1620,84,33,423 (average Tk. 17,111). In FGD with SSS participants at client level, the lowest and highest amount of individual savings was reported Tk. 25,000 and Tk. 37,000 respectively. They also mentioned that all of them have DPS, a fixed monthly saving scheme of at least Tk. 500. It was learnt that SSS had a long-term deposit scheme. According to the FDR system of SSS, the amount kept will double within 7.5 years. If anyone make a fixed deposit of 1 lac, they get Tk. 9000 interest rate in a year. But if anyone wishes to take interest monthly, he will get Tk.780 against 1 lac taka. It was learned from FGDs that clients of MFIs were paid 6% interest on savings as per circular of MRA.

Some participants of FGDs critically reviewed MRA rules regarding savings. According to their views, savings or deposits by clients is the most significant source of MFI's fund mobilization. However, current regulations on keeping deposits within a certain limit create hindrances to increasing their financial capacity. In this regard, they suggested that the

saving condition of the MRA can be different in the case of large-scale MFIs. They have identified that one size does not fit all and that very large MFIs should not follow the same conditions as small MFIs. Some participants in FGD with a small MFI expressed that large MFIs like ASA/BRAC can follow MRA rules easily. Still, it is sometimes tough to follow MRA provisions for small MFI. Some participants in FGDs argued that investors or entrepreneurs did not feel much interest in investing their capital in MFIs as the 6% interest rate was not a competitive service charge with the prevailing market rate. According to their views, they have access to other deposit policies which will bring them more return, for example, saving schemes of Sanchaya Buro. Shortage of fund was found more acute in smaller MFIs than large and medium MFIs. In this regard, some participants suggested that the idle money of the big NGOs/MFIs can be given to the small MFIs with low interest rates. Some participants opined that MRA should use their substantive rationality infixing the interest rate for the MFIs.

A general view expressed by participants of FGDs regarding the positive impact of MRA rules on increasing client protection as a result of MRA Rules. The rules have increased the transparency of MFIs regarding savings collection, service charges, and clients' rights. It was expressed in the FGDs that before MRA rules, the service charge was higher, but it has now been fixed. Now, a passbook is available, but previously, some MFIs could not provide one. Some participants emphasized on more transparency of MFIs regarding information of their microfinance products and services. In this regard, they suggested that MFIs can have a display board highlighting various information on their products and services, such as service charge of products, terms and conditions of having access to loans etc. It was pointed out in FGDs that MRA should check whether rules are followed in all aspects related to the operational and financial performance of MFIs on a regular basis. In this regard, MRA should be more professional, like PKSF, as it checks offline and online performance.

6.2.6 Bankruptcy of MFIs and Client Protection

According to MRA rules, clients are entitled to withdraw their savings as like as he or she likes to withdraw when necessary. But it may be problematic in a situation when the clients face a very vulnerable situation while an MFI falls in bankruptcy. According to MRA rules, among others, license has been cancelled, if an MFI becomes bankruptcy. A case on a bankruptcy MFI has been documented (Box-1). The case shows that as a result of bankruptcy, clients could not be paid back their savings deposited to concerned MFI. It was learnt form

FGD-participants that small MFIs are in more deplorable conditions to be bankruptcy than large and medium MFIs. It was learnt that large MFIs like SSS, PAGE response promptly, if anyone beneficiary needs to withdraw his/her deposit money, it is instantly given back on a particular day when the date is fixed to repay back the deposit of the members.

Participants in different FGDs pointed out some measures and issues for stopping bankruptcy which include:

First, certification from local MFIs can be taken while giving license to new MFI at pre-approval stage.

Second, MRA could strengthen monitoring system at local level through introducing a District level committee.

Third, bigger ratio of outstanding loans compared to savings could be good for protection of clients' deposits for MFIs. Some participants expressed in one FGD that if an MFI invested its 70% amount of total operating capital in the field, that MFI can never flee away or bankrupted.

Fourth, to check whether an MFI is good or bad, the MRA should consider how much money the applicant MFI has invested in the field.

Fifth, MRA could establish a new organization or department which will be responsible to monitor any fraud activities on both online and offline.

Sixth, for ensuring clients' interest as well as for safeguards of clients, some participants suggested for inclusion of the beneficiaries' representatives in the governing council and executive committee. At least two members in Governing Council and one member in Executive Committee could be included.

Seventh, some participants in FGDs opined that to stop bankruptcy, cancelling license is not a good system. They opined that MRA could appoint an administrator in defaulted MFI who can find out sufficient information from the current focal point of district and other MFIs so that MRA can take good decision in favour of the clients.

Eight, it is very risky of involvement of multipurpose cooperative societies in financial services, particularly taking fixed deposits providing more than Tk. 2000 in a month against one hundred thousand taka. As opined by the participants of FGDs, it creates greediness in clients to earn more return, though not financially viable for both providers and receivers.

Ninth, current Loan Loss Provision (LLP) system as per MRA Rules has positive impact on client protection. In addition, participants in FGDs expressed strong opinion to introduce Security Fund for every MFI as per MRA Act. They suggested that the management of the

fund should be given to independent authority rather than in respective MFI. Some participants opined that LLP should be fixed at flexible rates and should be related to outstanding loans **Tenth,** Local oversight committee can be established to curb bankruptcy. In this regard, some participants pointed out that PKSF has a good on-sight oversight system and they monitor the organization in a rigorous manner that helps reduce fraud. Local MFIs can act as watch dog to the new MFIs so that some sort of social accountability can be ensured for the new MFIs.

Eleventh, some participants opined that if MFIs have more loan investments in the field that savings of their clients, MFIs cannot be traceless.

Twelfth, according to views of some participants of FGDs, **t**o stop pilferage and bankruptcy of MFIs, there will have to be notified to all about MRA and mass advertisement should be pronounced from the administration so that without MRA license nobody is allowed to do credit operation in Bangladesh. After the initial application to get a license from MRA, there should be thoroughly checked.

Box 1: Mission for Development: A Case of Bankruptcy

Mission for Development, a small MFI located in Cumilla, received a license from MRA in 2015 for doing micro-credit activities. According to a statistical report published by MRA in June 2017, its total clients were 1549, of which 1370 were total borrowers. Total savings and outstanding loans were Tk. 507088 and Tk.1,37,52,654, respectively. According to MRA statistics, its total fund was Tk. 7,45,73,138, which was accumulated from different sources. These sources include mainly client's savings (29.17%), loans from PKSF (9.32%), loans from Government (7.34%), loans from commercial banks (38.56%) and cumulative surplus (14.21%).

MRA canceled its license on October 03, 2018, following an allegation of fraud activities and absconded with depositors' money, which was collected through a two-year based different interest-basis saving programme. The research team made an effort to understand the causes and consequences of such a bankrupt MFI. Through discussion with some depositors of Mission for Development as well as some officials of local MFIs, it was learnt that FDR system for raising funds of MFI was mainly responsible, though too much greediness of clients was also liable. Some members who lost their deposits mentioned that they were motivated to have a monthly profit from Tk. 1500 to tk. 2000 for a FDR Tk. 1,00,000.00. It was also reported that its activities were not properly

monitored with regard to fund mobilization through deceitful saving schemes. It was learnt that Mission for Development had repaid its bank loan but did not pay back members' savings. It seems that clients were powerless compared to other formal funders. It was expressed that bankruptcy has a long-term negative effect on the microfinance sector as it creates less confidence in MFI. In such a case, the Bankruptcy Act 1997 should be applied following section 25 of the MRA Act 2006.

6.2.8 Grievance Redress and Client Protection

It is essential to have a grievance redressal mechanism for client protection. At present, the existing MRA rules do not specify any particular provision for this issue. However, in the government sector there is an online-based grievance redress management system. It was reported by a large MFI that it pays attention to solving complaints lodged by any client. Field observations show that clients were less aware how to complain and less confident on the respective MFI if they make any complaints against their organization. Many participants suggested that every MFI should have a mechanism of lodging complaint and it should be monitored by other independent authority regarding actions taken against those complaints.

In sum, ensuring client protection needs a well-designed legal framework as well as effective role of all concerned stakeholders. MRA Act and its rules have provided a number of measures for the protection of clients in many respects that were not found before. These regulatory measures have definitely contributed positively to discipline in the microfinance sector and to increasing clients' rights. However, the great challenge to client protection lies with clients with small MFIs. Large and medium MFIs have more trustworthiness than small MFIs due to their some own self-regulatory capacity. Therefore, MRA can give special attention to small MFIs to improve their loan management capacity, financial literacy, regulatory compliance and oversight, including issues pointed out by participants in different FGDs. At the service provider level, it is highly important to increase transparency and accountability on constant basis to protect clients from any human-induced mishaps. At the client level, an informed client can be better protected as it was observed that dealings between clients and MFIs are basically done on a good faith basis.

CHAPTER 07: CONCLUSION AND RECOMMENDATIONS

This chapter culminates the insights gathered from this comprehensive study by presenting a series of recommendations designed to propel the microfinance landscape in Bangladesh towards a more inclusive and sustainable future. Recognizing the multifaceted nature of challenges faced by the sector, this chapter delves into diverse areas, ranging from regulatory refinements to capacity-building initiatives. The following recommendations address issues pertaining to MFI size differentiation, governance practices, security fund management, data management, beneficiary protection, social responsibility, employee benefits, regulatory alignment, financial literacy, overlapping financial activities, bad loan recovery, and MFI staff capacity building. Through the implementation of these multifaceted recommendations, stakeholders can work collaboratively to cultivate a thriving microfinance ecosystem in Bangladesh, one that fosters not only financial sustainability but also empowers both service providers and clients.

7.1 Regulations related to the size of MFIs: There are a lot of differences among the very large, large, medium, and small MFIs in terms of their fund size, outstanding loan amount, outreach coverage, and capacity. In such a situation, variations in regulations for developing the capacity of small MFIs may be considered. Some potential areas are the distinction in the provisioning of security and liquidity funds and delinquency management, especially in reducing the provision of regular and observational loans. Eventually, these MFIs will be able to fulfill their potential role in making the MFI sector competitive. There might be some variations in the security amount, liquidity amount, and bad debt depreciation fund. For instance, at present, all MFIs charge service charges a maximum of 24% with minimum deviations. However, this could be different for different MFIs based on the cost of operation and the maximum margin.

7.2 Introducing ceiling on membership of close relatives of general and managing committee: The formation of the general body and managing committee is governed by a set of rules that prohibit certain actions, such as allowing a maximum tenure period and preventing any related of the chief executive from serving as chair of the general body. Field experience suggests that there should be a ceiling of close relatives of the Chairman and CEO in the Management Committee.

7.3 Innovative areas for investment of security fund: There is a good amount of security money kept in the bank's fixed account. As the service charge is very minimal, alternative areas of profitable and secured investment need to be explored. The bond market or negotiating for a quota in the initial public offer (IPO), even in a national savings instrument, may be explored in consultation with the Bangladesh Bank or the Bangladesh Security Exchange Commission (BSEC).

7.4 Centrally designed software: MRA may implement centrally built accounting software. This attempt will enable MRA to implement the required adjustments in accordance with the changed regulations. Additionally, the MFIs will be able to produce some automated reports in real-time, which will lessen the administrative load of regularly providing a large number of reports to the Authority. The security of data, along with adequate backup, needs to be considered in such a case.

7.5 Ensuring Beneficiaries' Interests: In cases where MFIs lose their licenses, mechanisms should be in place to safeguard the interests of beneficiaries. Introducing regulations like the Beneficiaries Savings Security Rule 2014, with amendments made in consultation with MFIs, can address this concern effectively.

7.6 Setting Limits for Social Programmes: The requirement to seek permission from the MRA before spending surplus funds sometimes hampers MFIs from initiating innovative social activities or responding promptly to natural disasters and other climatic hazards. In such instances, setting a maximum limit for surplus expenditure, subject to approval from the General Body, can alleviate these challenges.

7.7 Centralised Personnel Management Guidance: While mandatory provisions for service rules and issuing appointment letters have enhanced employee protection, further improvements can be made by providing central guidance on salaries and other benefits offered by MFIs. Connecting staff with the national pension scheme and establishing directives for obtaining clearance from previous MFIs before confirming their employment are also essential steps.

7.8 Alignment with Other Regulations: Ensuring alignment with both registration authority directives and MRA rules is crucial. Discrepancies between MRA rules and registration authority requirements, especially regarding the tenure of the General Body and Management Committee, need to be addressed. Additionally, provisions regarding salaried positions such as the CEO within the General Body or Managing Committee should be clarified to avoid contradictions.

7.9 Effective Implementation of Financial Literacy: The MRA can significantly contribute to the financial empowerment of microfinance beneficiaries by implementing programs to enhance their financial literacy. Many beneficiaries lack awareness of service charges associated with their loans, focusing solely on the installment amount. Introducing insurance options alongside proper guidance can address this vulnerability, with involvement from the Insurance Regulatory Authority ensuring comprehensive financial education and protection against unforeseen circumstances.

7.10 Policy Support for Overlapping Reduction and Bad Loan Recovery: Clear policy directives are needed to address issues of overlapping and facilitate efficient loan recovery. Establishing a framework for collaboration between MFIs and other financial institutions, along with legal protection for MFIs in bad loan recovery, can prevent duplication of efforts and promote a healthy microfinance ecosystem.

7.11 Development Role of MRA: The MRA plays a vital role in providing training for licensed staff members, but there is a pressing need for more extensive and professional training programs tailored to the needs of MFIs, especially smaller ones. Bridging this knowledge gap can be achieved by utilising standardized training modules from the MRA and decentralising training programs through the hiring of certified trainers in various regions, ultimately strengthening the MFI workforce and the microfinance sector as a whole.

Conclusion

This study investigates the link between the Microcredit Regulatory Authority's (MRA) rules and the Bangladeshi microfinance sector. While the MRA's standards have clearly enhanced the industry's general health, resulting in a stronger financial foundation, more diverse financing sources, and more efficiency, difficulties persist. Smaller MFIs, in particular, struggle with profitability. Despite the legislation's favourable impact on employee security through structured employment arrangements and lower exploitation risks. However, variations in remuneration norms and limited chances for staff development continue, particularly in smaller institutions. Similar improvements have been made in customer protection, with improved transparency, cheaper costs, and a crackdown on unethical collection tactics. However, deficiencies exist in areas such as financial literacy, over-indebtedness, deposit protection, and clear mechanisms for handling consumer complaints.

To move forward, a collective effort is critical. The MRA can collaborate with partners to improve rules, investigate capitalization possibilities for MFIs, simplify operating

requirements, standardize employee benefits, and create tools to manage customer mobility. MFIs, particularly smaller ones, must address legal and organizational inconsistencies while investing in staff development and maintaining consistent benefits. Policymakers may play an important role by looking at the integration of MFIs with national pension systems, developing legal frameworks for integrating with other regulatory bodies and increasing financial awareness among consumers. Furthermore, having a formal grievance-redressed framework will empower consumers while ensuring equitable treatment. To foster better collaboration and address remaining challenges, the Microfinance Regulatory Authority (MRA), microfinance institutions (MFIs), and policymakers can leverage the positive impacts of regulation. By working together, they can enhance the resilience and effectiveness of the microfinance sector.

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