

## A Study on Participation of Commercial Banks in Microfinance Programs – Perspective Bangladesh

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**Abstract:** *A good number of studies revealed that microfinance has turned into an effective tool to combat poverty in Bangladesh. Traditionally Microfinance Institutions (MFIs) provide microfinance among low income poor people in Bangladesh with a view to alleviating poverty and empowering the poor. In addition to MFIs, commercial banks in Bangladesh are also engaged to offer micro financial services. Given country wide branch network and availability of adequate fund, commercial banks have enormous scope to provide microfinance among the poor. Microfinance programs have also created scope for commercial banks for diversification of deployment of funds as well as further involvement in the financial inclusion process of the country. The paper will analyze advantages and problems of microfinance programs operated by commercial banks in Bangladesh. The paper also provides some policy options for smooth operation of microfinance programs of commercial banks in Bangladesh.*

**Keywords:** Microfinance, poverty, commercial banks, Bangladesh.

### 1. Introduction

A good number of studies revealed that microfinance has turned into as an effective tool to combat poverty in Bangladesh like many other developing countries of the world. Traditionally Microfinance Institutions (MFIs) provide microfinance among low income poor people in Bangladesh with a view to alleviating poverty and empowering the poor. In addition to MFIs, commercial banks in Bangladesh are also engaged to offer micro financial services. Given country wide branch network and availability of adequate fund, commercial banks have enormous scope to provide microfinance among the poor. Microfinance programs have also created scope for commercial banks for diversification of deployment of funds as well as further involvement in the financial inclusion process of the country. In

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Bangladesh, some commercial banks have already started microfinance programs with twin objectives of poverty alleviation as well as achieving commercial viability. The outstanding of microfinance by commercial banks stood at BDT498.25 billion as on December 2013 in Bangladesh.

Though a few years ago, microfinance was the exclusive domain of NGOs and cooperative societies, in 1998 commercial banks have emerged as “new actors in the microfinance world” (Baydas, Graham and Valenzuela, 1998). The commercial opportunity in microfinance is catching the interest of mainstream banking. Now many commercial banks have involved in microfinance programs in many parts of the world. Commercial banks in Bangladesh are also offering micro financial services. The cumulative credit disbursement of four state-owned commercial and two specialised banks stood at Tk. 249.19 billion. On the other hand, Cumulative credit disbursement of five private commercial and Ansar-VDP Development banks stood at Tk.164.46 billion and Islamic private commercial banks have disbursed Tk. 84.6 billion respectively up to December 2013.

## **2. Literature Review**

The engagement of commercial banks in the microfinance field has drawn attention to policy makers as well as regulator. A number of studies have already been done by researchers and academicians to investigate whether commercial bank can provide microfinance in a sustainable way with profitability.

Mayada M. Baydas et al (1997) analyzed the involvement of commercial banks of developing countries in the microfinance market. The paper also reported that banks in some countries have already provided large amount of loans to micro entrepreneurs than NGOs. The paper mentioned the challenges of microfinance for commercial banks under the existing regulatory framework. The paper examined why bankers have not offered microfinance programs under the existing policy environment and key obstacles faced by the banks. The paper mentioned that two institutional challenges remain in the continuing evolution in microfinance programs by commercial banks. The first is the most cost-effective organizational form for large banking institutions to incorporate microfinance. The second is the most appropriate governance structure for former NGOs evolving into banks. The paper also reported that many micro lending NGOs have turned into banks or bank-equivalent institution, consumer lending or housing finance companies following success of microfinance market in many countries across the world. Financial products, innovative credit methodologies, sources of fund, modalities, human capital formation and donor-supported technical assistance have also discussed in the paper.

Jennifer Isern and David Porteous (2005) highlighted that commercial banks played an important role in micro financial programs in many financial markets across the globe. The paper mentioned that some commercial banks have entered

the microfinance market because of sustainable profit and growth opportunities. Some commercial banks realized that the poor can create a new market and asset class. They reported that according to a recent CGAP study, there are up to 3 billion potential clients in the microfinance market, out of them a significant number of potential clients remain unserved.

Greg Chen and Stuart Rutherford (2013) made a diagnosis of microfinance markets in Bangladesh and pointed out five trends: (i) the core microcredit product is holding steady and evolving incrementally (ii) Lending to small enterprise will remain a significant market segment (iii) Client demand for savings services is increasing; but is inadequately met (iv) There is growing momentum to create a special category of deposit-taking MFIs (v) Mobile phone payments services are developing rapidly.

A recent study by Rim Bounouala and Cherif Rihane (2014) examined the advantages and problems of commercial banks in operating microfinance programs. They discussed that commercial banks have entered into the new microfinance market motivated either by the growing competition in the banking sector or pressure of some governments directly or building partnership with MFIs. Risk management procedures and internal factors of success of commercial banks have also been analyzed in the paper

### **3. Objectives and Methodology**

The objectives of the paper are two-fold: first, to review the present status of microfinance programs operated by commercial banks in Bangladesh and second, to put forward policy options for smooth operations of microfinance programs of commercial banks in Bangladesh. The general objectives would include: (i) To analyze present status of microfinance programs operated by commercial banks in Bangladesh (ii) To identify the advantages and problems of commercial banks operating in microfinance programs (iii) To provides policy options for smooth operation of microfinance programs by commercial banks in Bangladesh.

To meet the objectives of the paper, the information/data collected from the secondary source would be employed in the paper. The secondary source will analyze scholarly articles, Bangladesh Economic Survey, Annual Reports of the BB and MRA, various commercial banks and MFIs.

The paper will focuses on the following questions: why commercial banks turned to microfinance sector? What are the advantages and problems of commercial banks operating in microfinance sector? How commercial banks overcome the problems?

### **4. Comparative Advantages of Commercial Banks in Micro-finance**

At first glance, a commercial bank appears well positioned to offer financial services to ever-increasing numbers of micro-finance clients and to earn a profit.

Banks have several advantages over non-bank, micro-lending NGOs:

- Commercial banks are regulated institutions fulfilling the conditions of ownership, financial disclosure, and capital adequacy that help ensure prudent management.
- Commercial banks have their own sources of deposits and equity capital; they do not have to depend on scarce and volatile donor resources like NGOs (MFIs).
- Many have physical infrastructure, including a large network of branches, from which to expand and reach out to a substantial number of micro-finance clients covering all major cities in a country.
- They have well-established internal controls and administrative and accounting systems to keep track of a large number of transactions.
- Their ownership structures of private capital tend to encourage sound governance structures, cost-effectiveness and profitability, all of which lead to sustainability.
- They offer loans, deposits, and other financial products that are, in principle, attractive to a micro-finance clientele.

All of these advantages could give banks a special edge over micro-lending NGOs in providing micro-finance services.

### **5. Problems of commercial banks in delivering of microfinance**

Commercial banks have also some challenges in microfinance operation. The major challenges include: (i) lack of motivated manpower for microfinance, and (ii) narrow mindset of top executive towards microfinance programs. In this regard, Glenn D. Westley<sup>1</sup> opines that, commercial banks often don't really understand microfinance and its mode of operations. He also noted that commercial banks lack sufficient commitment to microfinance programs. According to Mayada M. Baydas<sup>2</sup> et al (2007), the following problems associated with microfinance programs are analyzed below:

**(i) Too Risky:** Bankers perceive small businesses and microenterprises as bad credit risks. Many insolvent state-owned agricultural banks seemed to prove that small farmer clients could not or would not repay their loans. The perception is that small clients do not have stable, viable businesses for which to borrow and from which to generate repayment. Moreover, these potential clients lack traditional collateral to guarantee their loans. Finally, banks no doubt also recognize they do not have appropriate lending methodologies to serve these clienteles (that is, correct screening mechanisms to separate good from bad credit risks).

<sup>1</sup> Glenn D. Westley (March 1997)

<sup>2</sup> Mayada M. Baydas et al (2007)

**(ii) Too Expensive:** Bankers also believe that because microloans are small and have short terms, bank operations will be inefficient and costly. It takes the same amount of time and effort (if not more) to make a US\$1,000 loan as a US\$100,000 loan, but the return on the larger loan is much greater. So why make a small loan?

**(iii) Socio-economic and Cultural Barriers:** According to bankers, micro and small enterprise clients have difficulty approaching a bank because they lack education and do not possess business records to demonstrate cash flow. In many developing countries, social, cultural, and language barriers do not allow for an easy relationship with a modern banking institution. It is hoped, however, that with a more widespread diffusion of innovations in financial methodologies, reducing the risks and costs of microlending, more banks will begin to incorporate micro-entrepreneurs into their portfolios.

**(iv) The Policy Environment:** The policy arena is of strategic importance for commercial banks. Non-bank microlending NGOs can operate in a repressed financial market environment because they are not subject to the regulatory interest rate ceilings, high reserve requirements, and selective — that is, targeted — credit policies characteristic of these markets. Commercial banks, however, cannot escape these regulations, which, in the end, reduce their profit margins.

## **6. Means of participation in microcredit/microfinance by banks**

### **(a) Provide services**

- i) An internal microfinance unit: Commercial bank can operate microfinance program through an internal unit under the same bank. The internal unit model is seen throughout the world, including the Akiba Commercial Bank, Tanzania; Bank Rakyat, Indonesia; Banque du Caire, Egypt; Banco Solidario, Ecuador; Cooperative Bank, Kenya and Banco do Nordeste, Brazil. (Jennifer Isern and David Porteous<sup>3</sup>, 2005)
- ii) A specialized financial institution: Many microenterprises lending NGOs have begun offering micro deposit facilities as well as microloan by transforming themselves into regulated banks or specialized financial institution across the globe. The specialized financial institution maintains separate corporate identity, governance, management, staff, and systems from those of the parent bank.
- iii) A microfinance service company: Usually the commercial bank forms the separate service company to provide micro financial services among low income poor people who are registered on the book of the parent bank.

### **(b) Linkage program**

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<sup>3</sup> Jennifer Isern and David Porteous (2005)

- i) Outsourcing retail operations: In this model, the bank contracts with a MFI to provide microfinance products that are registered on the bank’s book. The microfinance services may be branded by the bank or the MFI or a joint brand.
- ii) Providing commercial loans to MFIs: Many commercial banks across the globe provide commercial loans to MFIs. Commercial banks can provide a term loan or line of credit to an MFI for working capital. Commercial banks provide loans for special purpose to promote specific sector with a view to generate income and employment particularly the poorest section of the society.
- iii) Providing infrastructure and systems: In this system, the bank provides access to its branch or network to a microfinance institution or its clients. In return, MFIs or their client gives fees or commissions to bank, depending on the terms of the contractual arrangement with them.

Direct and indirect ways by which commercial banks can operate in microfinance is depicted by flow chart below:

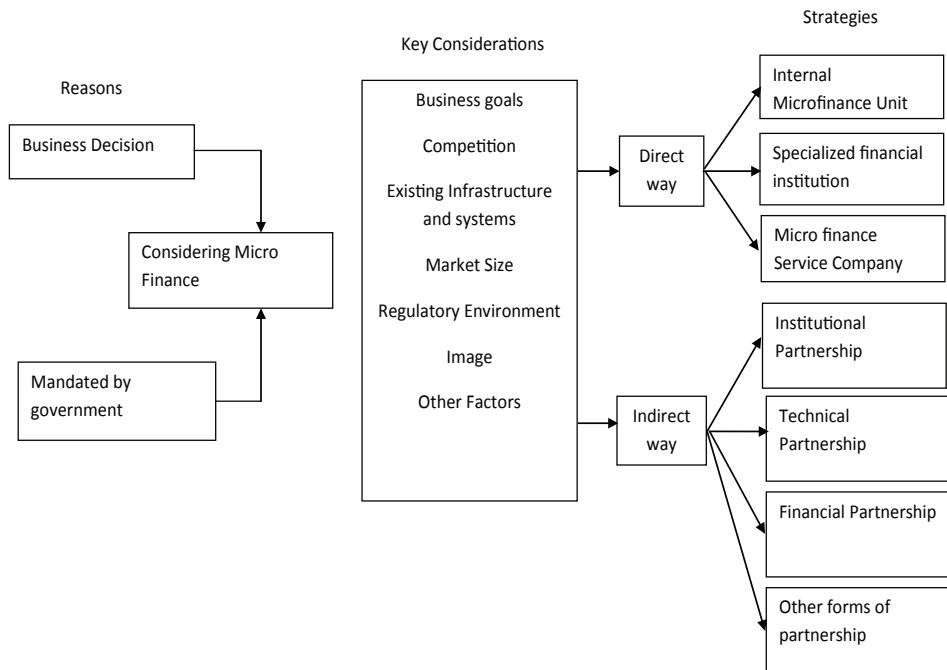


Fig. 1. Reasons and strategies of commercial banks entry into microfinance<sup>4</sup>

<sup>4</sup> Mayada M. Baydas et al (2007)

**Table 1. Largest Four MFIs and the Microfinance Market (2012)<sup>5</sup>**

	ASA	BRAC <sup>a</sup>	BURO	GRAMEEN	4 MFIs as % of All MFIs <sup>b</sup>
Loan Portfolio (\$US Millions)	636	750	110	997	65
Saving Deposits(\$US Millions)	262	311	42	1,628	86
Branches	3,025	2,120	625	2,567	49
Active Borrowers(Millions)	4.2	4.4	1.0	6.7	72
Microfinance Staff	20,969	17,700	5,447	22,621	53
Year of Launch of Microcredit	1991	1974	1991	1976	-

Source: *A Microcredit Crisis Averted: The Case of Bangladesh* (Greg Chen and Stuart Rutherford, July 2013)

- BRAC's figures include only full-time microfinance staff, though shared services staff (e.g., accounting and finance) would increase the full-time equivalent head count.
- Percentages based on large four MFI figures for 2011 as a proportion of industry totals from Bangladesh Microfinance Statistics, 2011, Credit and Development Forum & Institute of Microfinance

### 7. Present status of Microfinance Operated by Commercial Banks in Bangladesh

At present state-owned four commercial and two specialised banks are offering microcredit among poor people regularly. The cumulative credit disbursement and recovery stood at Tk. 249.19 billion and Tk.245.36 billion respectively since operation in microfinance sector up to December 2013. In addition to this, private commercial banks have also come forward to delivery microcredit. The recovery rate is very high than any other sector operated by commercial banks. Now the recovery rate against the disbursed credit stood at 98.0 percent. During FY 2013-14 (up to Dec 13) total 2,59,029 beneficiaries have been offered for credit facilities but on cumulative basis the number of beneficiaries stood at 11,007,242.

**Table 2.1: Performance of 4 state-owned commercial banks\*, BKB & RAKUB**

Bank	2003-2004 cumulative	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14 (Dec 13)	Cumulative upto Dec 13
Disbursement	105.47	9.35	9.91	14.34	16.01	20.15	15.35	23.98	23.33	16.90	249.19
Recovery	119.64	8.80	12.72	16.44	15.69	15.91	14.85	23.74	19.31	18.19	245.36
Rate of recovery	169	78	99	85	73	60	94	101	102	108	98
No of beneficiaries	5584740	491848	415736	486875	542087	596250	315510	414967	409638	259029	11007242

Source: *Bangladesh Economic Survey 2014, Ministry of Finance, The People's Republic of Bangladesh.*

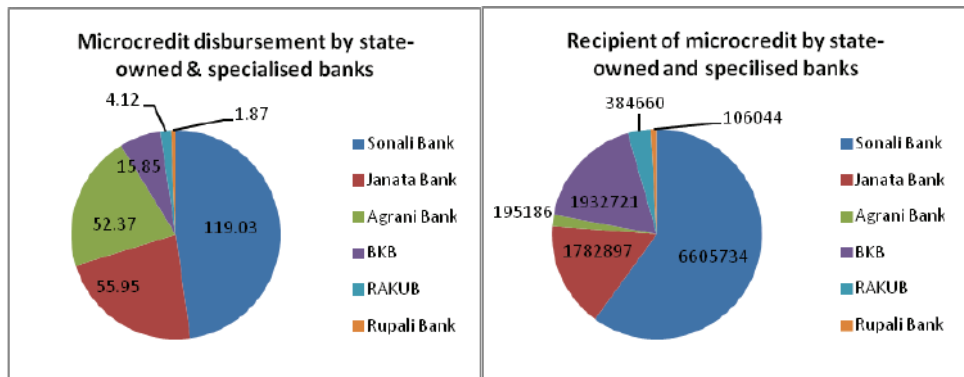
\*= Sonali Bank Ltd., Agrani Bank Ltd., Janata Bank Ltd., Rupali Bank Ltd.

<sup>5</sup> Greg Chen and Stuart Rutherford (2013)



It is evident from the table 2.1 and Annex1 (A) that Sonali Bank Ltd disbursed Tk. 119.03 billion up to December'13 which is the highest among the 4 state-owned commercial banks and 2 specialised commercial banks. Janata Bank Ltd disbursed Tk.55.95 billion which was followed by Agrani Bank Ltd (Tk.52.37 billion), Bangladesh Krishi Bank (Tk.15.85 billion), Rajshahi Krishi Unnayan Bank (Tk.4.12 billion) and Rupali Bank Ltd (Tk.1.87 billion) respectively up to December 2013. In terms of number of beneficiaries, Sonali Bank Ltd also secured the top position and the number stood at 6605734 persons. The number of beneficiaries of Bangladesh Krishi Bank, Janata Bank Ltd, Rajshahi Krishi Unnayan Bank, Agrani Bank Ltd and Rupali Bank Ltd stood at 1932721, 1782897, 384660,195186 and 106044 respectively. The comparative position of state-owned banks in terms of microcredit disbursement is depicted in pie-chart:

### 3.1 Microcredit Disbursement & beneficiaries of 4 State-Owned Commercial Banks, BKB & RAKUB



Source: Bangladesh Economic Survey 2014, Ministry of Finance, The People's Republic of Bangladesh.

Bank	Sonali Bank	Janata Bank Ltd	Agrani Bank Ltd	Bangladesh Krishi Bank	Rajshahi Krishi Unnayan Bank	Rupali Bank Ltd
Disbursement (in billion taka)	119.03	55.95	52.37	15.85	4.12	1.87
No of beneficiary	6605734	1782897	195186	1932721	384660	106044

Following microfinance programs of state-owned commercial banks, some private commercial banks including Islamic banks and specialised commercial bank are also conducting microfinance programs with a view to alleviate poverty and create self-employment opportunities for the low income poor people in Bangladesh. Cumulative credit disbursement of private commercial banks stood at Tk.164.46 billion. The number of beneficiaries stood at 15,15,125 persons of which 9,85,907 persons were female (65.07%) up to December 2013.



**Table 2.2: Performance of private commercial banks\* & specialised bank\*\***

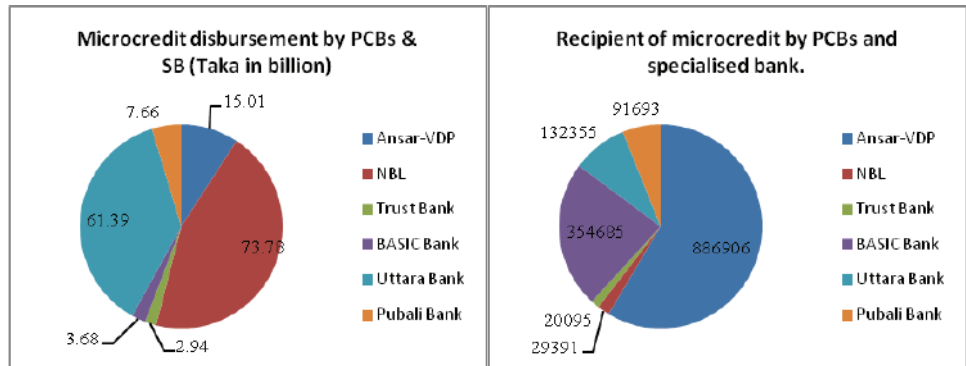
Period	Ansar-VDP Development Bank	National Bank Ltd	The Trust Bank Ltd	BASIC Bank Ltd	Uttara Bank Ltd	Pubali Bank Ltd
Cumulative upto December 13						
Disbursement	15.01	73.78	2.94	3.68	61.39	7.66
Rate of recovery	97.54	94.82	93.06	96.15	69.50	100
No of beneficiaries	886906	29391	20095	354685	132355	91693

Source: Bangladesh Economic Survey 2014, Ministry of Finance, The People’s Republic of Bangladesh.

\*=National Bank Ltd, The Trust Bank Ltd, BASIC Bank Ltd, Uttara Bank Ltd, Pubali Bank Ltd.

\*\*= Ansar-VDP Development Bank

3.2 Microcredit disbursement & beneficiaries of Private Commercial & specialised Banks.



Source: Bangladesh Economic Survey 2014, Ministry of Finance, The People’s Republic of Bangladesh.

Bank	Ansar-VDP Development Bank	National Bank Ltd	The Trust Bank Ltd	BASIC Bank Ltd	Uttara Bank Ltd	Pubali Bank Ltd
Disbursement (in billion taka)	15.01	73.78	2.94	3.68	61.39	7.66
No of beneficiaries	886906	29391	20095	354685	132355	91693

Islamic Private commercial banks have also been playing significant roles in microfinance sector, Islami Bank Bangladesh Limited (IBBL) in particular. IBBL has been playing a praiseworthy contribution in microfinance sector in Bangladesh by introducing and implementing Rural Development Scheme (RDS). IBBL alone disbursed Tk. 81.92 billion among low income poor people for income generating activities and betterment of their living condition and the number of beneficiaries stood at 854263 persons up to December 2013. Following the activities of RDS of IBBL, Social Islami Bank Ltd disbursed Tk.2.68 billion and the number of beneficiaries stood at 769 persons up to December 13. Comparative position of disburse-

<sup>6</sup> Bangladesh Economic Survey (2014)

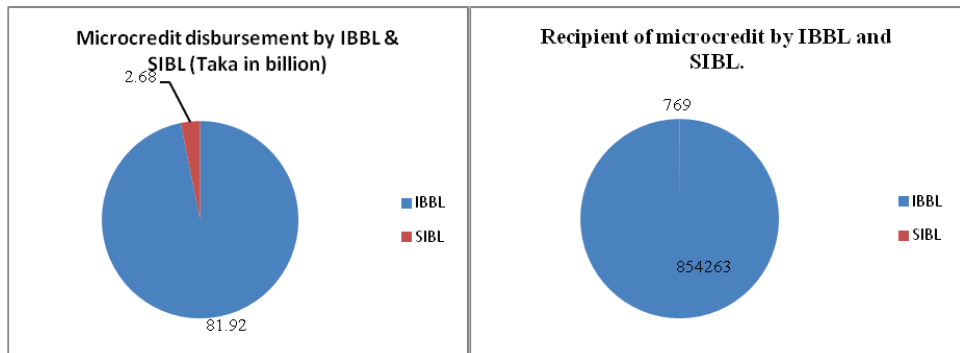
ment and number of beneficiaries of IBBL and SIBL are depicted in Table and pie-chart:

**Table 2.3: Performance of Islami Bank Bangladesh Ltd & Social Islami Bank Ltd<sup>7</sup>.**

Period	Islami Bank Bangladesh Ltd	Social Islami Bank Ltd
Cumulative up to December 13		
Disbursement	81.92	2.68
Rate of recovery	99.61	98.0
No of beneficiaries	854263	769

Source: Bangladesh Economic Survey 2014, Ministry of Finance, The People's Republic of Bangladesh.

### 3.3 Microcredit disbursement & beneficiaries of Islami Bank Bangladesh Ltd & Social Islami Bank Ltd.



Source: Bangladesh Economic Survey 2014, Ministry of Finance, The People's Republic of Bangladesh.

## 8. Future policy options

Commercial banks need to diversify funds as well as meet social obligations. Following actions may be undertaken by commercial banks to enter into microfinance market successfully:

- **Commitment:** Commercial banks must have strong commitment to deploy a portion of funds in microfinance program.
- **Organizational structure:** Microfinance programs need to be inserted into the larger bank structure in such a way that they have relative independence and, at the same time, have the scale to handle thousands of small transactions efficiently.
- **Financial methodology:** Banks need to acquire an appropriate financial methodology to service the microenterprise sector— financial innovations that permit a cost-effective analysis of creditworthiness, the monitoring of a large

<sup>7</sup> Bangladesh Economic Survey (2014)

number of relatively poor clients, and the adoption of effective collateral substitutes.

- **Human resources:** Commercial banks need a good number of dedicated skill manpower for microfinance programs who can accelerate the microfinance programs taken by banks efficiently. Given that microfinance programs differ so radically from traditional banking, banks must recruit and retain specialized staff to manage these programs because microfinance operation are labour-intensive and require special people skills. So recruitment, training, motivation of staffs and performance-related incentives require special consideration for smooth operation of microfinance programs of commercial banks.
- **Cost-effectiveness:** Microfinance programs are costly because of the small size of their loans and because banks cannot operate them with their traditional mechanisms and overhead structures. Strategies must be found to minimize processing costs, increase staff productivity, and rapidly expand the scale of their microenterprise portfolios — that is, increase the number of loans. Here group approach rather than individual may be more effective to reduce the cost for loan. Banks must cover the costs of microfinance operations and specialized training through scale economies.
- **Regulation and supervision:** Commercial banks must communicate with banking authorities to ensure that reporting and regulatory requirements take into account the specialized nature of microfinance programs. Three things have to take into account for the regulator for those commercial banks want to take part in microfinance program are legal reserve requirements, reporting requirements and loan classification and provisioning.

## 9. Conclusion

Results of many studies reveal that microcredit has become an effective tool to reduce poverty by increasing income, consumption, and assets of the poor borrowers. In addition to operations of MFIs, commercial banks in Bangladesh are also offering micro financial services in a small scale. They have further scope to expand the programs to achieve the twin objectives of profitability and social mission of poverty alleviation. In this regard, they need to have firm commitment towards microfinance programs, recruit proper staff and design proper area based programs.

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**Annexure-I(A)**
**Present Scenario of banks engaged in microcredit/microfinance programs:**

Bank	Cumulative 2003- 2004	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14 (up to Dec 13)	Cumulative upto Dec13
<b>Sonali Bank</b>											
Disbursement	6163	457	410	557	617	756	676	724	669	666	11903
Recovery	8004	486	677	921	744	678	812	851	470	863	13178
Percentage of recovery	260	107	165	34	30	30	35	39	30	32	70
No of beneficiary	0	201841	199190	179188	208478	251856	164906	159045	137206	151010	6605734
<b>Agrani Bank</b>											
Disbursement	1345	182	211	290	340	488	34	847	798	602	5237
Recovery	1321	212	268	289	337	400	67	879	830	528	5229
Percentage of recovery	227	116	127	99	99	82	96	87	88	86	98
No of beneficiary	2984784	104387		115383	139903	158978	5944	11866 6	117236	77950	195186
<b>Janata Bank</b>											
Disbursement	1869	194	290	498	561	632	722	727	736	366	5595
Recovery	1726	107	250	356	413	400	512	553	526	383	4324
Percentage of recovery	177	55	86	71	74	63	71	76	71	105	77
No of beneficiary	835399	100073	145080	124483	124653	130921	93030	88254	100756	460	1782897
<b>Rupali Bank</b>											
Disbursement	29	16	11	17	17	23	22	16	17	5	187
Recovery	23	10	12	12	15	19	24	18	17	9	163
Percentage of recovery	142	63	108	72	88	83	109	113	100	173	87
No of beneficiary	33977	5431	2804	4242	3458	5672	7520	9134	13554	14850	106044
<b>Bangladesh Krishi Bank</b>											
Disbursement	982	57	55	53	48	98	53	55	74	50	1585
Recovery	828	43	52	51	46	76	51	54	51	35	1325
Percentage of recovery	152	76	95	96	95	77	96	97	70	69	84
No of beneficiary	1535905	50083	52028	47761	49356	35044	31849	28535	28284	14759	1932721
<b>Rajshahi Krishi Unnayan Bank</b>											
Disbursement	158	29	15	18	18	19	28	29	39	0	412
Recovery	61	21	13	14	16	17	19	20	37	0	316
Percentage of recovery	104	73	88	80	88	93	69	68	95	0	77
No of beneficiary	194675	30033	16634	15818	16239	13779	12251	11333	12602		384660
<b>Total</b>											
Disbursement	10547	935	991	1434	1601	2015	1535	2398	2333	1690	24919
Recovery	11964	880	1272	1644	1569	1591	1485	2374	1931	1819	24536
Percentage of recovery	169	78	99	85	73	60	94	101	102	108	98
No of beneficiary	5584740	491848	415736	486875	542087	596250	315510	414967	409638	259029	11007242

Source: Bangladesh Economic Survey (2010), Ministry of Finance, The People's Republic of Bangladesh.

**Annexure-I(B)****Fund Composition of NGO-MFIs in Bangladesh**

Source of Fund	June 2008		June 2009		June 2010	
	(Million)	(%)	(Million)	(%)	(Million)	(%)
Clients' Savings	36397.32	29.66%	40526.91	29.73%	47436.35	31.15%
Loan from PKSF	22708.58	18.50%	22666.20	16.63%	24484.12	16.08%
Loan from Commercial Banks	23487.03	19.13%	23896.37	17.53%	23006.41	15.11%
Donors' Fund	4549.07	3.71%	4110.29	3.02%	4109.29	2.70%
Cumulative Surplus	31170.02	25.39%	36261.74	26.60%	42339.27	27.80%
Other Funds	4435.49	3.61%	8847.97	6.49%	10907.40	7.16%
Total	12747.51	100.00%	136309.48	100.00%	152282.84	100.00%

Source : MRA (2010)