Microfinance in SAARC Countries: Updates 2011

Badruddoza, S

Institute of Microfinance (InM), Dhaka, Bangladesh

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S. Badruddoza[2]

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[1] This paper has been prepared on the basis of the recorded deliberations of the participants attended in the conference "Microfinance in SAARC Countries: Sharing Lessons & Way forward" organized in November-December, 2010, jointly by the Institute of Microfinance (InM), Bangladesh, and Rural Microfinance Development Corporation (RMDC), Nepal.

[2] Research Associate at Institute of Microfinance (InM), Dhaka, and can be reached at badruddoza@inm.org.bd

Background

The Institute of Microfinance (InM), Bangladesh and Rural Microfinance Development Centre Ltd. (RMDC), Nepal, jointly organized a Regional Conference on "Microfinance in SAARC Countries: Sharing Lessons & Way Forward" in association with the SAARC Secretariat, Nepal, at Hotel Yak & Yeti, Kathmandu, Nepal from November 30 to December 01, 2010.

[i]The conference aimed at disseminating the findings of InM governed research on "Microfinance in SAARC Countries" among the stakeholders in microfinance sector throughout the region. Hence, the conference brought together the eminent people from microfinance sector consisting policymakers, renowned academicians, practitioners, stakeholders and representatives from SAARC member countries to appraise the successes and challenges of the sector.

The Main Objective of the conference is to disseminate the findings of the study and enable the participants, including policy makers, practitioners, and academicians to derive lessons towards future policy and practice orientations.

This paper provides reader with an overview of the discussions, understandings and issues raised at the conference.

Microfinance in Afghanistan

Afghanistan, a landlocked developing country marred by conflicts for years, has significant geo-strategic advantage, benefit of which perhaps still unrealized. Recent reconstruction efforts resulted from influx of development assistance, which resulted in high growth rates (11.4% per annum since 2002). Per capita GDP has been jumped from $124 in 2001 to $466 in 2008, where agriculture sector has the highest contribution (53% as of 2007).

After 2001, Da Afghanistan Bank (DAB) was strengthened for monetary control and banking supervision. As of 2008, there are 15 licensed banks, 3 state-owned banks, 7 private banks and 5 foreign banks. Afghanistan Banking Association was established in 2004. In addition, 1 leasing company and 2 insurance companies are present there. However, informal sector plays the major role, which is “justified” by existence of a large informal economy. Prevailing agricultural credit arrangements includes (1) *Anawat* (2) Commodity credit (3) Family credit and (4) *Salaam* (advance sell of products). Major source of non-agricultural credit is *Hawala*.

Historically, Afghans are famous for their indomitable entrepreneurial spirit. In most cases, it was found that at least one member of an Afghan family has been operating a micro-enterprise for a significant period. These relatively mature enterprises represent a sizable market for micro credit. Besides, for centuries in Afghanistan, traders have been engaged in commerce between regions. Entrepreneurs are highly regarded in the local community.

In the early years, NGOs (out of 500 working in 2002) provided credit services. Later, Microfinance Investment Support Facility for Afghanistan (MISFA) was established in 2003 as an apex body, to co-ordinate donor funds, to help MFIs to scale-up rapidly and to build systems of transparent and accountable reporting.

The delivery methodologies in Afghanistan microcredit market are two: (1) individual loans and (2) group loans that include (a) village organizations (b) solidarity groups (c) self-help groups (d) credit unions and (e) seed banks. Most of the MFIs use the group lending approach and offer credit services in Afghanistan.

The microfinance sector grew at very high rates; the number of active clients and active borrowers grew at an average rate of 30-35% per annum, between 2005 and 2008. Between the same time span, loan outstanding per branch, portfolio per staff and cost per active client have been increased, though active borrowers per staff remained almost the same. Trade and service stand on the top in stated use of funds.

Government of Afghanistan has been very supportive of microfinance sector. MISFA has played important roles by providing subsidized loans and channeling donor funds. Afghanistan central bank provides the regulatory background. In general, specialized banking act permits microfinance institutions to graduate as a commercial bank, if they wish.

Around 70% of the microfinance program beneficiaries are women in Afghanistan. 40% of clients are located in rural areas. More than 80% of the loans were used for setting up business or expanding them. 47% of urban clients and 39% of rural clients generated employment opportunities for others. 72% of clients reported an improvement in their economic situation. 44% women clients reported absolute control over their money. 80% women clients reported 'improved attitude' of their husband and other relatives, both male and female.

The challenges for the microfinance community is to find ways to offer more effective microfinance services that will gain confidence in the community and change some traditional societal norms restricting development process. Challenges for the microfinance sector in Afghanistan also include weak management and implementation capacity, limited source of financing, narrow product range, limited geographical outreach, sustainability issues etc.

Microfinance in Bangladesh

Bangladesh has the highest population density in the world except a few city states. About 40% of 150 million people are living below poverty line: 40% and home to 13% of total South Asian poor. Bangladesh has maintained its GDP growth rate around 5% over the last decade. Currently per capita GDP is USD 750. Poverty declined to some extent, but still remains severe due to population growth and poor governance and social-economic factors. Life expectancy at birth became more than 59 years. Primary education enrollment touches its pick at 90% plus; where girls' attendance exceeds boys' both in primary and secondary level. Overseas remittance (currently USD 12 billion through official channels), agricultural growth and rural infrastructure development, growth in service and manufacturing (garments) sectors and microfinance are the major contributors to poverty reduction. However, poor are still vulnerable due to natural disaster and climate change factors, sluggish job creating growth, sudden high inflation in 2007-08, poor governance and lack of pro-poor growth.

Escalation of poor from poverty trap requires income generating activities. Poor people also have the idea of the business, product and market, technology (whatever rudimentary) and skills to do the business but lacks business capital. Microfinance institutions supply the most critical input—capital, for micro-business or income generating activities that poor families lack; without demanding collateral.

In Bangladesh, the dominant microfinance model is group-based Grameen model with some operational variations. Small number of individual loans or microenterprises is also available. Recovery of loans is generally in weekly and monthly pattern. Re Groups serve several purposes: low-cost operation, self-selection, information and credit history collection. However, many attempts of self-help group approach failed.

At present, there are 514 licensed microfinance institutions (MFIs), but three MFIs mainly dominate the market: BRAC, Grameen Bank and ASA. In 2008, MFIs had 33 million members of which 21 million of them were from three large MFIs. Membership has been doubled between 2003 and 2008. MFI industry had around 26 million borrowers in a total of 14,441 branches with USD 2.5 billion loan outstanding.

High expansion of microfinance outreach was fueled by savings mobilization, loan from *Palli Karma Sahayak Foundation* (PKSF) and commercial sources, competition for market share between large MFIs. The Grameen model remains robust, though management system may vary among MFIs. Loan products are segmented and expanding through varied ways like mainstream microcredit, microcredit for ultra-poor, credit for farmers, credit for microenterprise etc. Some emerging services involve livestock insurance, domestic remittance, international remittance through partnership with banks etc.

Bangladeshi MFIs have been focusing on financial viability since mid 1990s. In 2008, most MFIs—small, medium and large, were financially viable taking OSS, FSS, ROA and ROE into account.

MFIs there finance their activities in several ways; for instance, equity (profit and some donor grants), savings, loan from apex agencies (subsidized) and loan from commercial banks etc. Of which, savings is the cheapest and commercial banks are the most expensive source of capital. However, the most desired capital structure policy is to have balance among these sources.

To summarize the impacts of MFIs in Bangladesh, one can find (1) increased income, and consequently, expenses, (2) increased assets in many forms like savings, land, house, livestock etc., (3) improved social indicators, and (4) enhanced management capacity. All these are impacts on families. Other impacts include (1) incorporating the poor under formal financial system, (2) access to savings and finance, (3) information sharing, technology transfer and access to market, (4) non-financial services are also offered through groups, and finally, (5) networking.

Bangladesh microfinance sector expanded under absence of formal regulatory framework; but certain standards and norms were maintained; PKSF acted as de-facto standard and norm setter. Microcredit act in 2006 allows NGO-MFIs registered under five laws: the social welfare act, cooperative societies act, the trust law, the societies act, and companies act (non-profit section) to offer microfinance services. Microcredit Regulatory Authority (MRA) issues license. MRA is an evolving agency, and it is expected to be more active over time. Body of detail regulations are yet to be published. But certain standards about accounting system, financial reporting and auditing are being enforced by MRA.

PKSF is the apex financing agency in the country. PKSF was established in 1990 for wholesale lending to MFIs; provide technical assistance for capacity building, supervision and setting norms and standards (many of them are absorbed by MRA), product development, research. It has more than 250 partner organizations (POs). Other smaller financing agencies are; Anukul Foundation, Sromme Foundation and the two large MFIs, namely BRAC and Grameen Bank. Wholesale lending by commercial banks is limited to only several MFIs and pretty expensive.

Bangladesh has added some lessons to the overall microfinance experience. These can be categorized into (1) targeting the poor—microfinance can reach the poor, (2) group-based lending method remains robust, (3) microfinance has significant impacts on family income, (3) scaling-up and product diversification are important (4) financial viability of MFIs are critical,

(5) regulatory, social and political support are also critical, (6) wholesale lending institutions play significant roles.

Nonetheless, there are certain challenges for Bangladesh. One should take into considerations that, (1) poverty still persists and MFIs will be under pressure to contribute more. Additionally, (2) portfolio quality and financial viability of MFIs, (3) regulatory and political support, (4) Demand for additional services, (5) resource mobilization for MFIs, (6) competition, (7) need for pro-poor growth policies and support are also important challenges.

So, for a better future, MFIs in Bangladesh must have (1) to maintain portfolio quality, viability of institutions, and in some cases consolidation of operations, (2) more planned management, (3) ensure resource mobilization, (4) institutional and human resources development, (5) stable regulatory environment, (6) product innovation and research, (7) application of ICT for efficiency and product delivery.

Microfinance in India

In India, financial sector includes ranges of institutions like commercial banks, development finance institutions, cooperatives, NBFCs, NGO-MFIs etc. The institutional framework there varies from Societies that are not-for-profit and unregulated (eg. Public Charitable Trusts) to NBFCs that are profitable and regulated (eg. LABs). The microfinance sector has two major delivery models: self-help group bank linkage program (SBLP) and MFI model. NBFCs, cooperatives and NGO-MFIs are the key institutional forms of the model. Banks lend to both SHGs and MFIs. The two delivery methodologies are explained here.

SBLP (Self Help Group Bank Linkage Program), supported by NABARD (National Bank of Agriculture and Rural Development) since 1992, is a successful microfinance model striving towards poverty alleviation. SBLP is designed to integrate informal savings and credit groups with the formal banking system. NABARD supports or refinance banks to lend to SHGs.

On the other hand, MFI model is direct lending to clients by microfinance institutions using a variety of methods—SHG, Grameen, IB etc. But over the last few years, most MFIs gravitated to a single joint liability group model (based on the original Grameen prototype).

At present, approximately 38 million households are reached by microfinance operation. Of which SBLP has 35.8 million savers and 7.2 million borrowers, and MFIs have 27 million credit accounts with a portfolio of USD 4.5 billion. Around 3 million had savings accounts under MFIs, which is mostly mandatory. However, there is substantial multiple counting resulting the lower consolidated figure above. Regional coverage of microfinance is dominated by South (about 65%), but gradually declining; while it is increasing in the East (around 25%). Growth of SBLP has been less vigorous in recent years. In March 2009, SBLP had 86 million savers and 59 million borrowers with loan outstanding of around USD 5 billion. The 27 million borrower accounts of MFIs now exceed the 18 million accounts of regional rural banks (RRBs) by 50%, which now rivals the banks, assuming overlaps among SBLP/MFI members and multiple lending. If it is allowed to be seen as an instrument of financial inclusion, the MFI sector would represent 40% of all micro accounts—SBLP + MFIs would be 57%. CRILEX growth index shows that MFI growth is stronger than desirable and the portfolio growth has been faster than client acquisition.

Indian MFIs are the most efficient—average OER of 11.1% in 2008 is now just 8.8%, cost per borrower is less than Rs.500. Staff productivity has consistently improved. Portfolio handled per staff was $29,000 while borrower per staff was 234 in 2008—now 285 and $47,000 respectively. MFIs also managed to maintain good portfolio quality (around 0.5% PAR in 2010) after a drastic fall in 2007. Debt was the dominant source of finance (71%). Productive deployment of funds has been seen—77% in loans. Average RoA now up to 6.8% with average RoE of 25% (10 largest in excess of 30%) indicate high profitability.

Traditionally rural outreach, MFIs expanded to urban/city areas in recent years. Depth of outreach (% of BPL clients) is around 60%. M-CRIL social ratings indicate that 20% of new MFI clients are below $1.08 per day line, and 62% below $2 per day line. There is moderate coverage of marginal communities around 30%. An estimated 62-63% credit was used for productive investment, 37-38% used for household needs. Annual client dropout rates are 8-10%. Some evidence of poverty reduction was found for those who stay with microfinance – based on member recall of SBLP, comparison of longitudinal wealth rank data for MFI clients. Nearly 2/3rd of women clients (who for more than 90% of MF clients), report positively on qualitative indicators of empowerment. Competition among MFIs is leading to multiple lending. Overlaps among MFI & SBLP clients limits the extent of financial inclusion achieved at household level.

Regulation on MFIs seems both too little and too late. (1) MFIs have various regulators based on their legal forms: NBFCs by RBI, Sec-25 Co., which is also covered by RBI rules. Societies, Trusts, Cooperatives regulated by their respective Registrars and specific Acts. However, RBI can supersede any norm to protect client rights in case of financial intermediation activities. (2) no separate regulations for the microfinance sector yet—Bill introduced in March 2007, (3) The Bill when enacted will empower NABARD as the regulator of MF sector, but leaves out the NBFCs which cover more than 3/4th of the sector, (4) the recent AP crisis could fast track the enactment but what is really required is the mainstreaming of MF.

Indian MF sector faces several challenges; like (1) mission drift of MFIs—in a quest for growth & profitability, (2) sector slowdown in 2008 due to global economic crisis – banks became cautious in lending, (3) lack of deposit services—has indirectly contributed to mission drift, if allowed will help in lowering the cost of credit to clients (4) social reporting—limited attention by MFIs till recently. In 2010 SPM & reporting seems to have gained momentum with active backing of social investors and government pressure. (5) Capacity building—growth has not been accompanied by trained field staff/professionals; high attrition rates are common across sector. (6) Multiple lending—a high risk factor for the sector.

Microfinance in Maldives

Maldives archipelago has only 309 thousand population, one third of which lives in the capital city *Male'*. *Male*' is 2. 5 square kilometer and densely populated. It is the administrative and business center of the country. There are 26 natural atolls, almost 12 hundred islands spread over an area of 90 thousand sq. km. with an 856 thousand sq. km. area of exclusive economic zone. 200 islands are populated.

Maldives has an open economy with a narrow export base and high dependency on imports. Main exports are fish products. Tourism and fisheries are the largest industries and account for a big portion of the economic activities. Other important industries are agriculture, construction and manufacturing.

There are 6 commercial banks up to 2010; and one more bank is expected to join them in 2011. Non-bank financial institutions involve two insurance companies and several agents and brokers for foreign companies, Maldives Finance Leasing Company and Housing Development Finance Corporation. The Development Banking Cell (DBC), set up within the Banks of Maldives, has special focus on developing the livelihood in island communities. The BML has established 25 branches, spread over the country, with almost one branch and ATM in each atoll. Mobile banking units, by means of mechanized small boats do rounds in the different atolls, traveling from island to island to provide banking services. DBC has been carrying out the task of disbursing loans ranging from micro to medium loans, creating awareness, and developing the business knowledge in island communities where there is a need for it. The various ministries and organizations disperse funds for development of related areas as microcredit projects through the DBC. As at the end of 2009, DBC lending amounted to $ 16.7 million, which was 3% of BML's total loan portfolio and 1% of the total industry's loan portfolio.

Some of the current projects by DBC include (1) Island Revitalization and Development (ILRDP), coordinated by the National Disaster Management Center, (2) Loan Scheme of the Fisheries Development Program (LSFDP) and Loan Scheme of the agricultural development program (LSADP) coordinated by Ministry of Fisheries, Agriculture and Marine Research Center, and (3) Loan Scheme of the Livelihood Revitalization Program (LSLRP) an initiative by BML, Maldives Chamber of Commerce and Industries and the Maldives Association of Tourism Industry.

Various government authorities have been carrying out microcredit projects with the focus on developing different sectors. For instance, the Ministry of Gender together with UNDP has been carrying out different projects to develop and empower women and youth through involvement in economic activities, among others, similar projects have been carried out by the Ministries of Fisheries, Atolls development as well. Such projects are financed mostly by donor funds received from international organizations like ADB, IFAD, UNDP, UNICEF etc. These projects are targeted at the different government authorities' respective areas of concern. Funds have been disbursed by the authorities through island offices or atoll offices or through Bank of Maldives plc. These projects lent out small scale loans without collateral. Loan recovery has been noted to be good (at or above 84% at worst).

From 2006, to conform to the Finance Act, the Ministry of Finance and Treasury directs donor funds received from international organizations to BML's DBC for the purpose of streamlining and disseminating funds through an institution. Projects that have been in-place from earlier on, too, are now directed through BML's DBC. There is now a shifting of concentration from micro-credit to financing small and medium size enterprises (this does not mean that financing micro-credit will cease.)

The underlying objectives are: (1) to focus on negating the gap created by income inequality as there is a great concern in providing for relative poverty and (2) economic diversification. The Ministry of Economic Development (MED) is working on streamlining the financing of SMEs and to regulate it. During the year, the ministry has: (1) increased the threshold of SME loans granted through BML's DBC to $ 3.9 thousand from $ 1.2 thousand which can be lent without keeping a collateral, (2) set up an SME advisory council (consisting of representatives from various ministries and other stakeholders), (3) set up two business development centres in the northern and southern regions.

Plans for 2011 include, government's budget to have an allocation to finance SMEs along with donor funds (in the past years, the contribution from the government to the SME financing was included under sector-wise development activities in the budget, e.g.: fisheries sector development, agricultural development, etc.)

The SME funds are to be focused in the areas of fisheries, agriculture, arts and crafts: there are numerous areas in these industries which can potentially be developed into small or medium enterprises. There are also existing small enterprises which can be developed in to medium sized enterprises.

However, microfinance sector in Maldives will have to encounter some challenges. Among the uses of microfinance, there is a need to develop knowledge and skills in the areas of business development and sustainability. Diversification of micro and small economic activities is also needed. More programs are needed to raise awareness, to school people in the areas of developing micro, small and medium income generating projects. Not enough banking services are conveniently available for a large portion of the population, which limits access to credit and microcredit. Challenges are faced because of the geographical structure of the country have limited most banks from setting up branches or offices in the islands. It has been considered difficult due to the expenses it would cost and the resources it would require and the dearth of sufficient infrastructure. Banking services need be made more available and accessible to those who are in need of microfinance.

The various components of the MED’s plans are paving the way to a more structured channel in which to operate microfinance. There is expected to be better delivery of the services of microfinance to those whom it is intended. MMA's mobile phone banking project that is underway, once active, would have presence all over the country. The agency network and the technical aspects of the system would be ideal for the intentions of microfinance in a country like Maldives. The Credit Information Bureau projected that MMA is undertaking, once set up, with credit information available on a larger cope, is designed to minimize the dependency on the need for collateral with regard to bank credit. The increase in inclusion in banking services is expected to eventually lead increased availability to credit, especially microfinance.

Microfinance in Nepal

Nepal is a small land locked country with 1,47,181 square k.m. area between India and China. Total population is 28 million; 31.8% of which lives below the poverty line. About 80% of the population lives in rural areas and depends upon agriculture. The country has 52.8% economically active population (15-59) with the average family size of 5.3 members. Annual per capita income (in 06-07) of country is $ 383. Agriculture, tourism, hydropower and forestry are the major areas for broad based development of country.

Microfinance history in Nepal dates back to 80’s like in other SAARC countries. Small Farmers Development Program (SFDP) was launched by the Agricultural Development Bank of Nepal in 1975. Intensive Banking Program (IBP) and women focused Production Credit for Rural Women

(PCRW) were commenced through the support of two government owned commercial banks with the directive of the Central Bank.

In 1990s, Rural Self-reliance Fund (RSRF) was established to provide small loan to Co-operatives and NGOs. Two NGOs – Nirdhan and CSD started microfinance replicating the Grameen model. Five Regional Grameen Bikas Banks (GBBs) were established with over 70% ownership of the Central Bank & the Government following Grameen model of microfinance. Rural Microfinance Development Centre Ltd. was established in 1998 to provide wholesale finance and capacity building and institutional strengthening supports to MFIs. SFDP sub-projects have been converted into small farmer co-operatives (SFCLs). In the same period Sanakisan Bikas Bank Ltd.(SKBL) was establish in 2001, to provide wholesale fund to SFCLs. Till Nov. 2010, 65 MFIs have been developed from scratch with RMDC supports. As of date, RMDC has 88 Partner MFIs. Out of about 88 MFIs, about 67 MFIs have been following the Grameen model of microfinance.

The prevailing microfinance models include: (1) Co-operative model, (2) Small Farmer Co-operative Limited (SFCL) model, (3) Grameen Bank model, (4) Self-help Groups (SHGs) or Community Organizations (COs) Model, and (5) Village Bank model. As per July 2008, PMFBs and FINGOs stand first and second in outreach; with members 318,112 (30.08%) and 260,983 (24.68%) respectively. Microfinance sector in Nepal established some wholesale lending institutions like: (1) Rural Self-reliance Fund in 1990, (2) Rural Microfinance Development Centre Ltd. (RMDC) in 1998, (3) Sana Kisan Bikas Bank Ltd. (SKBBL) in 2001 and (4) Commercial Banks (CBs) since 1992. Impact assessment of microfinance in Nepal showed (1) decreased dependency on money lenders, (2) increased income and savings of the clients (3) escalation of living and non-living assets of clients, (4) improved housing conditions, (5) increased land holding, (6) improved condition in food self-sufficiency and consumption of nutritious food, (7) increased in use of safe drinking water, sanitary toilets, DPT, Polio, Vitamin A and number of visits to doctor, (8) women empowerment in social and financial aspects, (9) improved social integration etc. These studies were conducted by National Planning Commission (2004), SAP-INAFI (2006) and RMDC (2007).

Several regulatory regimes took place in microfinance sector of Nepal. Among which Co-operative Act (1992), Financial Intermediaries Act (1998), Nepal Rastra Bank Act (2002), NRB Directives for Microfinance Institutions (2003), Bank and Financial Institutions Act (2006), National Microfinance Policy (2008) and Central Bank directive allowing microfinance banks to mobilize public deposits (2010) are prominent.

Though the study showed so many impacts, some problems and challenges prevail. For instance, Mission drift, Financial viability and sustainability of new MFIs, Governance and management in MFIs, Regulation and Supervision of MFIs, Scarcity of fund and increasing cost to MFIs, Outreaching the far-flung remote areas, Outreaching the poorest of the poor, Very low economic activities in the high hills and mountain areas, Limited trained manpower in MFIs, Limited technology use and innovations in microfinance, Limited Capacity of Borrowers, Lack of national database of microfinance, Fragile security situation, Over financing and over indebtedness etc. are the major challenges for microfinance sector in Nepal.

However, lessons learned from the Nepalese experience indicate that the poor are also bankable, they can save, they do possess potentials for development, micro-credit has direct impact on income generation, collateral free lending is essential to reach the poor and the ultra-poor (Business on trust), loan size should be initially small and be increased gradually commensurate with the clients' capacity, programs should attempt to reach the poorest first, group approach is effective in reaching the poor and the poorest, MFIs can be financially viable and sustainable, startup MFIs need institutional capacity building and soft loan supports for 2-3 initial years, and professionalism is a must for the success of an MFI. Commercial banks have been lending hugely to the MFIs to complement the initial fund provided by the RMDC. They became the largest supporters. It has brought a tremendous change in the lives of people. But resources are not properly channelized.

For future, these lessons suggest building co-operation and coordination among MFIs, sensitizing MFIs on risk management (reducing client overlapping and over-financing), deepening of microfinance services down to the poorest and the destitute, developing second generation of microfinance clients, financing unemployed youth in the rural areas, enhancing access to financial services in hilly regions, providing advocacy for conductive policy environment, expanding services to hills and mountains, strengthening institutions and building capacity of MFIs, conducting research on key issues, and finally, strengthening and monitoring supervision and follow-up of MFI activities.

Microfinance in Pakistan

Pakistan, the South-Asian country has the area of 796,095 Square km. with 184 million population. Per capita income is USD 1051. There are 40 commercial banks, 8 development finance institutions and 8 microfinance banks. These banks have 10,000 branches, 26 million bank accounts, 4,000 ATMs and 18000 persons per bank branch. However, 56% of the adult population does not have access to financial services. Only 11% of them is formally served while 32% is served informally. (Access to Finance survey)

Barriers to financial inclusion work from both demand and supply side. The demand side barriers are mainly lack of branches in remote/rural areas and lack of basic and financial literacy. On the other hand, the supply-side barriers are the deficiency of funding facilities for priority sectors, under-developed institutional capacity of financial service providers, lack of interest by mainstream commercial banks to serve the lower end of the market, Lack of demand-driven products for low-income people, Limited management capacity for Innovative and technology driven delivery channels, High cost structures of microfinance providers posing challenge to sustainability, Weak governance and management structures of microfinance institutions, Lack of effective implementation of Consumer Protection codes and policies, Risk aversion of conventional banks to explore new markets etc.

Pakistan entered the microfinance sector relatively late to other South Asian countries. Although, microfinance started during 1980s in Pakistan, it saw the entry of some major player in the sector in 1990s. By mid 1990's microfinance attracts tremendous interest from the donor community as a tool for poverty alleviation with a unique promise of financial sustainability, hence a "double bottom line" was experienced. However, microfinance took its momentum in 2000 when the government formally entered the microfinance as a regulated financial institution established under the new Microfinance Ordinance of the State Bank of Pakistan. The microfinance movement in Pakistan followed a unique evolutionary path over the last decades. Pakistan Poverty Alleviation Fund is the apex body of the microfinance in Pakistan. The year 2000 was the major year when numbers of microfinance evolved in the financial services. As of now, there are 8 microfinance banks, 4 Rural Support Programs, 8 specialized microfinance institutions, 8 NGOs, 2 commercial players serving the microfinance market. The average annual growth rate of microfinance credit outreach during 2005-08 witnessed a modest 45 percent. The recent slowdown in the growth momentum is due to funding constrains and overall microeconomic environment.

Microfinance policy focuses on institutional sustainability (product pricing on cost covering basis, innovative delivery channels, deposits are key for self-funding), client protection (MFBs to educate/inform clients on effective interest rate, voluntary consumer protection code) with private sector led, multi-institutional approach.

Microfinance outreach in Pakistan increased from 68,561 in December 1999, to 1,975,820 clients in June 2010. Average annual growth rate was over 45% during 2005-08. Recent slowdown in growth momentum is experienced due to funding constraints and overall inconvenient macroeconomic environment. From Rs. 0.06 billion (December 2001), deposits have been increased to Rs. 8.33 billion (September 2010). However, portfolio at risk (PAR) remained between the international benchmark of 5% and South Asian benchmark of 2%, reaching 4.77%

(September 2007) at top and falling up to 2.25% (September 2008) at the lowest. This reflects the credit-worthiness of Pakistani borrowers and their re-payment capacity.

There are some challenges for Pakistani microfinance sector that should be looked at. Floods, catastrophe is expected to push people towards poverty and exclusion posing challenge in fresh lending in affected areas. Loss of assets and livelihoods, destruction of national infrastructure are also huge. Sudden drop in growth of Private Sector Credit during the last few years made development financial institutions suffering as a consequence. As a result underserved sectors are facing severe credit rationing. Moreover, high inflation made policy makers to revisit the size of micro loan due to loss of relevance. For the same reason micro borrowers are facing serious hardships resulting in increased credit risk. Safety Nets are not strong enough. And the risk mitigation instruments such as micro-insurance is under-developed (micro-insurance largely covers credit). Social safety nets need more public investment. OSS/FSS are underdeveloped. Lack of adequate deposit-mobilization and small loan size (US$160) are two prominent reasons. Regulating MFIs is also crucial. High operating costs and the guaging Impact of microfinance are no smaller challenges for the sector.

Recently SBP has undertaken several initiatives for Pakistani micrfinance sector. Deposit mobilization through access to payment system of microfinance banks is one of them. Industry infrastructure/risk management is handled through exclusive Credit Information Bureau (CIB) for regulated microfinance banks and unregulated microfinance institutes. CIB report has been made mandatory for loans exceeding Rs. 50,000. Top external auditors and credit rating agencies are expected to be assigned for annual audit. Microfinance banks are supervised by SBP using quarterly offsite analysis and annual onsite assessment.

Legal and regulatory frameworks that have been well developed are; Microfinance Institutions Ordinance (2001), Prudential Regulations for MFBs (2002), Guidelines for Mobile Banking Operations (2003), Guidelines for NGOs Transformation (2005), Fit and Proper Ctiterion for CEO/Borad members of MFBs (2005), Off site survellance and On-site monitoring systems for supervising MFBs (2005), Guidelines for Commercial Banks to undertake MF Businesses (2006), Branchless Banking Regulations (2008), and Loan Classification and Provisioning Criteria rationalized (2009). SBP follows consultative approach for policy development.

Alternative delivery channels like branchless banking (2009), innovative partnership (2007), service centers and mobile vans (2005) and kiosks at third party premises (2009) have been also developed. South Asia’s first branchless banking initiative ‘Easy Paisa’ launched in 2009. Tameer has developed a network of 11,000 agents, with a monthly transaction volume of 1 million and a cumulative value of Rs 10 billion. Presently there are 68 Pakistan Post offices in partnership with FMFB, with total disbursement of 523 million and more than 40,000 active borrowers.

MFBs' equity base is Rs. 5.5 billion owned by private sector. Shareholders are diversified; including local and international business groups, international financial institutions, banks, social investors etc. SBP is allowing foreign currency borrowing to MFBs/MFIs (2009). MFBs allowed raising subordinated debt to support CAR (2008), credit enhancement mechanisms in place (MCGF, PPAF, PMFF) (2008 -2010), and ISF for capacity enhancement and transformation. SBP has increased loans limits, redefined borrowers Eligibility Criteria and allowed Home Remittance Business to MFBs (2007).

Despite the challenges, SBP regulatory and policy initiatives combined with Sector initiatives and innovation has allowed Pakistan's Microfinance Industry to grow in a sustainable and inclusive manner. In a recent Report by the Economist Intelligence Unit (The Economist Magazine), Pakistan has been ranked: 1st along with Cambodia & Philippines with respect to Regulatory Framework (up 12.5 points from 2009), 5th for overall Microfinance Business Environment, (up 8.4 points from 2009), 12th for Institutional Development (up 8.3 points from 2009) and, 20th for Investment Climate.

The next leap toward excellence of the Pakistani microfinance sector depends on promoting market-oriented approaches, such as: Continuously Improving Regulatory Framework in line with market conditions, Building Inclusive Financial Services, Use of technology led models (mobile phones) to expand financial services, Promoting innovative partnerships and leveraging agents' networks, Strong institutions with good governance standards, Pro-Consumers policies and practices, and Subsidies to be phased out.

Microfinance in Sri Lanka

Sri Lanka has better socio economic indicators than other SAARC countries but poverty is still significant. 20.5 million people live there of whom 5.6% lives with below USD1 per day, 42% lives below USD2 per day and 15.2% of them is under the national poverty line. GDP per capita is USD 2,053 at market prices. Sri Lanka stands at position 102 in HDI ranking.

There are several models of MFIs in Sri Lanka. Such as; Individual lending using a group (centre, cluster) as a focal point, Village banking, Self help groups and Individual lending. Loan guarantees are provided using two members guarantee method, Grameen type group collateral etc. However, recent trends involve less paper work, quick lending and recoveries in structured manner.

MFIs in Sri Lanka can be broadly categorized into two parts (1) Microfinance as core business and (2) as an ancillary business. The first one covers MFIs (National/Regional/local and NGO's /Private), Government MFIs (Samurdi/Agrarian Services), Village banks, Co-operative establishments and Specialized (Development) Banks; where the latter one covers Regulated Development Banks, Commercial banks and Finance/leasing companies.

In 2008, National/Regional/Local MFIs had the highest USD96 of average savings per member. However, CRB (deposit accounts) had the highest savings of 31,998 million SLR in 2007. RDB's had Rs. 32 billion savings, 50% of this estimated to have micro savings. In case of borrowers and loan outstanding in 2008, National/Regional/local MFIs topped at USD164 average loan outstanding per borrower. Loan outstanding of CRB (loan accounts) in 2007 was SLR21,711 million. Over 65% of members were females. Approximately 30% of the total population and 50% of the population below national poverty line was reached. Nonetheless, some critical issues are multiple borrowing, lack of accurate data, significant number of members in CRB and some members of VB and MFIs (less) are not poor, reach in North and the East are weak and reliable data is not available.

Acceptable data on the overall sector is not available. However, case load is very low; average 60 loans per staff member, Rs 620,000 ($ 5,586) outstanding loan balance per staff member. Samurdi and village banks are at lower ends (17 loans) and CRB is at higher end (192 loans). Very few MFIs are financially and operationally sustainable. MIX reports 16 cents to maintain each Dollar in Sri Lanka MFIs. Lack of tools for sustainable operations like business planning and costing together with high level of investment in social mobilization and credit plus services mixed with credit are some of the reason. Nevertheless, the efficiency and sustainability are in increasing trends during the recent past.

Certain level of information on impact of microfinance in Sri Lanka is available. It is evident that 71% of borrowers increasing income. Establishment of livelihoods, Improved housing and sanitary facilities, Household and business assets building, Empowering women and poor, Environmental impact (for example, Loans for solar panels reduced use of 19 million liters Kerosene, that is, 54.5 million Kg of CO), Reconstructing lives after Tsunami, Supporting living under conflict. However, systematic and much focused SPM is not commonly practiced by MFI's. But there is an increasing trend in willing to use SPM including use of PPI at present.

Microfinance in Sri Lanka is financed by multiple methods. First of all, saving; that involves credit unions, cooperatives, Samurdi and certain NGO/private MFIs. Historically many MFIs received grants but depleted now due to unsuitability of MFIs. These are limited to certain TA's to MFI and sector development now. NDTF used to provide low cost funding but it is becoming very limited at present. Other lenders such as SMAGL and Etimose play a significant role today.

PAMP-2 is low cost funding to regulated banks and finance companies. Other credit lines of CBSL are available only for regulated banks. However, financing is a major issue for MFIs due to several reasons; like- inability to mobilize savings by themselves, interest rate cap by NDTF and decision to merge NDTF to SLSB, PAMP-2 and other CBSL credit lines are accessible only by regulated banks and finance companies but not by dedicated MFIs, not allowing MFIs to obtain foreign loans, severe restriction of foreign equity financing etc.

MFIs are not regulated in Sri Lanka. There are more than 14 different acts of parliament applicable to MFIs. Of them following 6 are related to primary registration: (1) NGO act (VSSO act), (2) Companies act, (3) Cooperative Societies act, (4) Societies Ordinance, (5) Samurdhi Authority act and (6) Agrarian Services act. Number 1, 2 and 4 under which most of true MFIs are registered are not allowed deposit mobilization. There is a trend among Regulated Banks and Finance companies to move in to MF.

The proposed microfinance act provides increased visibility and recognition to MFIs, authority for deposit mobilization, access to foreign loans, increased transparency and accountability. The main issue that attracts attention is following. First, national level licensing is provided only for public companies which would provide collateralized loans for non-poor. And second, NGOs/GTE companies/ co-operatives who are in lending to poor with no collateral will be licensed only at provincial and district level. Hence, access to microfinance by poor could be reduced by the act.

Further, the key issues in the microfinance sector of Sri Lanka are; lack of proper regulation and weaknesses in the proposed act, weak efficiency, portfolio quality and sustainability, government involvements in microfinance business, governance issues in the village banking model, weak funding (NDTF, small funders, foreign loans and guarantees), lack of transparency, inadequacy in IT for MF, inadequate sustainable credit plus services, inadequate capacity of the microfinance network for sector development etc.

New microfinance act will address many issues in the sector if the act is amended to accommodate industry concerns. Microfinance industry will work in hand in hand with the new microfinance authority through its network. Government should provide industry friendly support and avoid industry damaging actions like unreasonable interest rate caps. Increasing outreach for the poor and vulnerable, who still does not have access to microfinance, especially in the North/East/plantations, is urgent. Increased involvement of formal banking sector in microfinance is also a future challenge. Provided that these challenges are handled well, microfinance will play a greater role in employment generation; improve the life quality, GDP growth and distribution across the nation.

Microfinance in Bhutan

Bhutan located in the southern slopes of the eastern Himalayas, China to the north and the India in the East, West, & South. Around 683,407 people live in 38,392 sq. km in Bhutan. The country has mainly agrarian economy with approximately 70% of population dependent on agriculture. GDP is Nu. 40650.64 million with 6.73% growth rate and Per Capita Income of Nu. 89,639. Formal financial system currently caters to only about 10% of the total population. Current poverty rate is 23.2% and unemployment rate is 3.7%. The payment system is largely cash based. People have limited access to rural credit. However, increasing developmental activities in the country has driven high demand for rural credit.

Bhutan Development Finance Corporation is mandated to provide credit to small and medium-scale industrial and agricultural activities — particularly in rural areas. Lending activities are dominated by industrial loans. BDFC issued specialized banking license in March, 2010 (Deposit taking & Lending).

Microfinance in Bhutan is necessary because there are (1) huge mismatch in demand and supply for financial services, (2) need for increased access to diverse range of financial services to the underprivileged, (3) promotion and mainstreaming of informal sub-sector into the national financial system, (4) majority of poor are excluded from the financial services mainly due to collateral based lending and huge transaction cost.

In Bhutan, there are 101 branches of bank with 14.78 branches for each 100,000 people. Total number of deposit accounts is 314,951 and that of credit accounts is 75,234. Insurance market entails life insurance (17,281), and non-life insurance (97,448). Rural life insurance is currently managed by Home Ministry. Compensation in insurance services needs to be enhanced. The system does not cover receipt and delivery of small value remittance of the marginalized group.

Possible measures for promoting Microfinance in Bhutan are: Financial literacy, Priority sector lending, Institutional Subsidies from the RGOB to develop the MFI sector, Encouraging Branchless Banking (mobile banking), Encouraging Group Lending Model, Providing simplified products etc.

Challenges for the microfinance sector are mainly Accessibility; Formulation of appropriate and efficient delivery model, Institutionalizing strong collaboration among Banks, Specialized Institutions and MFIs, Changing the mindset of the financial sector and Moving away from collateralized based lending to cash flow or project viability.

Future steps can be taken considering Adoption of Financial Inclusion Policy, Setup an Apex MFI in Bhutan and license/register MFIs with the objective to achieve inclusive growth as well as to improve access to finance for MFIs clients, Promoting NGO-based MFI, Establishing appropriate legal framework, MFI regulation, Licensing regulation for MFIs, Supervision like formulate supervisory tools/methodologies and approaches in monitoring and supervising MFI, Capacity building of the RMA Supervisors, and Collaborate with donors, coordinate and monitor donor assistance in microfinance.

Lessons Learned, Emerging Challenges & Directions for the Future

In SAARC countries microfinance programs started at different points of time. And pattern of evolution of these programs also have not been uniform. There are some common features, but also some interesting differences in models and approaches adopted. The microfinance industry varies in maturity across the region. Bangladesh and India have most advanced programs. Pakistan, Nepal and Sri Lanka are in the next category. The variety of experiences in these countries offers a unique opportunity to learn from each other experiences.

Major lessons Learned from these varied experiences can be categorized into following topics; Targeting the poor, Product diversification and scaling-up of microfinance programs, Varied models/approaches of MFIs, Competition and overlapping, Interest rate issue, Resource mobilization and Portfolio quality.

Target groups for microfinance include very poor, moderately poor, near poor or vulnerable poor and some non-poor families in rural areas. The coverage of poor by MFIs varies a great deal among countries. In India all microfinance programs are for the poor and members involved with the program are primarily in the “low income” category. In Bangladesh, the biggest segment of rural households falls under moderately poor category. In Nepal, the poorest and the vulnerable groups of hills and mountains have less benefited from MFIs. There is significant divergence regarding estimates about the extent to which micro-finance actually reaches the poor in Pakistan. In Sri Lanka, program seems to have served many non-poor households.

As MFIs have gathered more experience, these have diversified products and services. In Bangladesh, special micro-enterprise and agriculture loans are available for eligible clients. The size of loan is determined by demand and nature of loan. In Nepal, lack of market for products and suitable technology, low density of population have posed problem for scaling-up. Similarly the range of financial products in Pakistan and Afghanistan offered by most MFIs is not very wide. In Sri Lanka, product diversification has been limited. The market is mainly limited by the availability of financial resources than the demand for credit. The Indian microfinance sector is tilted towards credit and deposit services do not feature prominently, though there are institutions experimenting with products such as insurance using MFIs as a delivery channel.

In India, there are the government run SHG Bank Linkage Programs and the MFI models. Many MFIs now follow a mixed approach customised to their target segment and area of operation. In Sri Lanka, there are many models being practiced by MFIs, of which the most prominent one "Community Banking Model" is facing problem. In Nepal, there are quite a few models of microfinance e.g. Cooperative models, Grameen Bank model; Community based organizations or Self-Help Groups model etc. In Bangladesh, microfinance industry is dominated by Grameen model. In Afghanistan, most are following group methodology (solidarity groups). Despite wide variety of microfinance providers in Pakistan, the lending methodology is surprisingly uniform.

All countries in the region have faced increased competition in the microfinance market. New entrants in the industry have shifted the landscape of the industry to further outreach and product diversification. Competition is good for extending outreach. It leads to greater choice for clients. To create competition on a level playing field, transparency and easily accessible information to clients would be necessary. Overlapping, in the sense of borrowing from multiple MFIs, has not been a problem until now. However, increasing use of regulatory framework and technical tools would be desirable.

Achieving an overall reduction in interest rate in microfinance is accepted as desirable, but this cannot be effectively or efficiently accomplished by imposing interest rate caps. However, there is room for giving relief on interest rate to most borrowers by increasing efficiency of its operations and by introducing variations in pricing. There is also a need for transparency and clarity in fixing interest rate charges for better understanding of poor borrowers.

India and Bangladesh seem to be most successful in mobilizing funds and their examples are worth emulating by other SAARC countries. In India, microfinance is clearly experiencing a surge of interest from the private sector, which needs to be encouraged and expanded. In Bangladesh, savings from members provide a useful source of funds for lending, but careful prudential regulation will have to be put in place.

Database analysis indicates that the Grameen organisations in India have been the best performers in the previous years, except in 2007 due to political problems occurred in South India. In Bangladesh, the portfolio quality of very large and other smaller MFIs have been declining over the last 2-3 years mainly because of disproportionate expansion, economic shocks, multiple borrowing, lack of managerial capacity etc. In Bhutan, the overall quality of the group loan portfolio is poor and they vary a lot across branches. In Sri Lanka, the weak portfolio quality has been an issue in the industry for many years. In Pakistan, apart from a few outliers, this has generally remained at acceptable levels in the past.

Microfinance is now globally recognized as an effective tool for reduction of poverty. It has shown positive results in many countries. However, microfinance services have not yet deepened down to reach the neediest poor. There are still huge masses of people who are deprived of financial services in most developing countries. There are a number of challenges facing the microfinance industry. The review of experiences and lessons from country reports particularly illustrate some key challenges for microfinance programs in the future. These are: Sustainability of MFIs, Appropriate microfinance regulation, Institutional and HR development and finally, Increasing use of IT in managing MFI programs.

Indian MFIs have become increasingly sustainable over the years, as these have gained experience and some have become commercially oriented. In Nepal, most MFIs have been running at profit and have achieved operational self sufficiency but they heavily depend on external sources. In Pakistan a heavy reliance on donor financing in the sector prevails. Despite the exponential growth in the NGOs providing microfinance services in the last few years, the sector lags behind most countries. The overall operational self-sufficiency of the leading MFIs in Afghanistan was reported to be 80% at the end of December 2008. In Bangladesh, strong viability was achieved due to subsidized cost of capital from PKSF and relatively low level of staff salary. Lack of sustainability in MFIs is noticed in Sri Lanka.

In most of the SAARC countries, regulation is yet to be enforced by the respective governments. Some progress has been made in few countries. There has to be a transformation process of the MFIs into graduated legal entities, which is still lacking in these countries. This issue has emerged a critical challenge to be dealt with in future.

The capacity building of MFIs is needed from two standpoints – one is staff capacity and another is institutional development in terms of policies, practices, methods, procedures, etc. Capacity building is a continuous process. Investment in human resources and institution developments need increased attentions to enhance the productivity of staff and effective functioning of the systems. Although some of these countries like India and Bangladesh are gradually improving, adequate quality institutions for capacity building are yet to be developed in all SAARC countries.

The use of IT in microfinance among the SAARC countries is very limited. To make microfinance services faster and reliable, there is no alternative to make it technology based. Fortunately technologies are available to transform microfinance. The process of using available technologies has begun in some countries like Bangladesh, Sri Lanka and Bhutan, but it has to be accelerated. In the long run, this system will help reduction of costs. Right at the moment, this has emerged as an important issue requiring immediate attention.

Microfinance programs in SAARC countries have come a long way. In particular, Bangladesh has made most impressive progress, starting from a mono-lending product with required savings in small amounts. Over time, more flexible products emerged to meet the various financial-service needs of the poor better. Introducing more flexible financial products would help address a broader set of critical needs, including managing cash flows, coping with risks, and accumulating large sums over time. Sri Lanka and India have also done well going somewhat in different routes, where all other countries are in different stages of progress. The reviews clearly establish that microfinance has still chance for further advancement—even in Bangladesh. So the milestones in the way forward for South Asian microfinance sector are: Ensuring sustainability of MFIs, Scaling up microfinance and catering to needs of poor more comprehensively, Extending beneficiary target and development of new products and services, Linking with formal financial system, Improving regulatory frameworks, Increasing use of new technologies, Creating favorable political and social environment for expansion of microfinance.

South Asian experience implies that the dependence on subsidized funding will have to end some day and it would be vital to worry about sustainability of the MFIs in future. Most MFIs in South Asia are still dependants on the external sources of funds, subsidy from foreign donors (Afghanistan, Pakistan and Bangladesh) and from Governments (Sri Lanka, India, and Bhutan). MFIs can develop additional savings products geared to the general public, make securitization etc. which has started to happen in limited way in South Asia (India, Bangladesh), but can be done in a more extensive manner as in Latin America. The MFIs must try to generate their own funds and build up their equity if they want to remain in the industry and become financially viable.

The available evidences show that poor people indeed manage their money; but the portfolios they manage are often fragile and incomplete. We need to determine how a high-quality, basic financial services could be made available to the poor on a near-universal basis. In this way, providing universal micro-banking could perhaps become an indicator of broad-based development and poverty reductions. In essence, this would mean that the poor would need reliable access to three key services: (i) day-to-day money management, (ii) building of long-term savings, and (iii) general-purpose loans. The challenges are how to develop and provide frameworks that give the poor chances at better access to financial services to improve their lives.

A new definition of 'target recipient' is now emerging—anyone in the rural or urban areas who wants to take a small loans by accepting the institutional arrangements of the MFIs—group meetings, mandatory savings deposits and repayment schedules—can be a 'member' or 'client'. In the expanded outreach programs, micro-enterprise developments would feature prominently. Further, some of the most useful new products and services would include Remittance Services, Micro-insurance etc.

So far microfinance has provided most of the access to financial services available to low-income people in South Asia, but it is still largely separate from the overall financial systems. There are only few examples of direct service provisions to the poor by mainstream commercial institutions. The microfinance movements of past few decades have fundamentally changed the financial sector, and this change process is gathering momentum. Now there are opportunities to take the microfinance move to the next stage of its development—a stage in which a more inclusive financial sector can be shaped to better serve the needs and interests to the poor. This process is beginning to happen in Bangladesh and such opportunities should expand in other countries as well.

Microfinance can only progress if the enabling environment is supportive. The progress in policy and regulatory environment have until recently come from movements from state-controlled and distorted financial markets toward more liberalized financial markets, and this has been good for microfinance. Microfinance has flourished in settings where the government did not follow directed credit policies, allowed interest rates to be market-determined, kept credit allocation separate from politics, and was not itself involved in direct lending. In some countries, special microfinance regulatory frameworks have been very helpful, supporting the particular needs of microfinance institutions in countries like Indonesia and Bolivia.

New technologies promise new ways to improve efficiency and expand outreach faster. Already, some MFIs are using ATMs and handheld computers, but more significant changes might become possible as mobile telephones outreach and internet access expand more widely and become less expensive. This could lead to new kinds of microfinance service providers that are based on mobile banking or online transactions with MFIs. The benefits will be dramatic. They would include greater convenience and lower costs for customers, ability to reach more remote customers, and increased security.

A critical step in the region's financial liberalization could occur if the wider political and social environment changes to recognize that economies of scale that exists in financial service delivery—cost is inversely proportional to the size of accounts. Central banks and finance professionals including researchers will need to take the lead to urge politicians and media to help changes the conservative economic environment relative to the poor. Countries where microfinance is developing actively, governments should provide at least some of the ground rules that favor financial sector development and microfinance. Most of the countries that have liberalized their financial systems during the past decades have established these conditions, or are well on their way to do so.

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