Service Charge of MF-NGOs in Bangladesh: A Case Study of Sadar Thana In Tangail District

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1. Introduction

In Bangladesh, according to CDF [5] about 721 Microfinance¹⁾ NGOs (MF-NGOs) are providing micro-credit²⁾ in different parts of the country through its 16.62 million rural poor borrowers acting as a tool for poverty alleviation. From the beginning of the micro-credit operation in Bangladesh, it has been often criticized for its high service charge (interest rate). But still today, there is no standardize interest rates or determination system of service charge³⁾ for MF-NGOs to follow. It always varies within a range of 20–40% [14]. MF-NGOs calculate their services charges by various ways such as flat⁴⁾ rate method and decline⁵⁾ balance method. Charitonenko and Rahman [7] stated that more than 85% MF-NGOs calculates service charge at the rate of 15% (in flat method) in the field level from their member borrowers. Hossain and Ahmed [8] stated that a wide range of interest on loan and variations in applying method on interest creates financial indiscipline in the sector. The result causes the variations of service charges, as well as additional costs imposed on poor rural borrowers [2]. What should be the ideal or optimum rate is a serious question.

Therewithal, Mondal [10] stated that three big MF-NGOs in the country namely BRAC, ASA and Proshika, have a mutual understanding that contains 73% of the total active members and constitute 84% of three total disbursements among all the MF-NGOs. The dominance of these three big MFIs is seen to be an oligopoly structure and the interest rates they charge is “sticky”. It is well known that MF-NGOs were established to help the poor to gain access to resources for productive undertaking or employment and for enhancing the quality of their life. So, the microcredit should be given at a minimum cost (interest rate) for maximizing the benefit to its poor clients. Most recent studies, including those by Devid and Alamgir [11], Alam and Miyagi [6], Islam [9], Uddin [14], The Daily Ittefaq [13], and Asif and Alamgir [3]

stated that MF-NGOs were collecting higher interest rates as service charge along with additional costs, beyond their initial commitment to the rural borrowers. Ahmed [1], Uddin [14], and Charitonenko and Rahman [7] also stated that in Bangladesh, MF-NGOs have been increasing very rapidly as a commercial business by using the poor people, as their capital. Rapid growth of MF-NGOs after 1990s has excavated the same facts (Figure 1). Despite the above facts, a study is yet to show the extent of the actual service charge and what would be the probable service charge. Therefore, this study has been undertaken to identify the extent of actual service charge and what would be the probable service charge for running the microcredit business by MF-NGOs, which is quite relevant and timely in the present contest of Bangladesh.

2. Objectives of the Study

This research was undertaken with the following objectives:

- a) To identify the extent of actual service charge imposed on the member borrowers by one of the big MF-NGOs like BRAC (the topmost MF-NGO) and some other small MF-NGOs;
- b) To compare these service charges between the oldest topmost NGO, i.e., BARC and other newly started small NGOs;

Figure 1.

Ahmed (2004)

- c) To recommend probable service charge for running the microcredit business as well as alleviate rural poverty.

3. Microcredit Activities in Bangladesh

Microcredit was initiated by Grameen bank and was developed by a team led by Professor Mohammad Yunus. The early 1990s was a period of rapid expansion of the Grameen-style micro credit approach. By 1990, unhindered experimentation in the fields led to a resolution of the debate and the country experienced a massive expansion of microcredit activities during the 1990s; and during this decade PKSF[®] also contributed significantly to the expansion of microcredit programs in the country. PKSF is an apex financial institution providing collateral free fund at a nominal service charge of (3%–5%) to various partner organizations that perform grassroots microcredit operations and to develop sustainable microfinance institutions [12].

(1) Share of Member Savings

Present microcredit intervention has succeeded in infusing savings habits among the poor, no matter how small the amount is and thereafter almost every MF-NGOs mobilizes their collected member savings. For example, BRAC, a finance plus NGO in Bangladesh, has also collecting member saving by various types of programs such as own savings and compulsory savings and has become the largest credit program among all MFIs [4]. Table 1 indicates that the share of member savings of the three largest MF-NGOs, namely BRAC, ASA, and Proshika and the largest funding agency like PKSF, contribute a large amount of disbursement in the microcredit sector. More significantly, the data show that for BRAC, the share of members' savings is 50.03% while PKSF's partner organizations are 80.70%. It has been also seen that in total about 80%

of microcredit disbursement among the poor comes from the members' savings and only the rest 20% of the funds of MF-NGOs has to be collected from other sources. It was found from Ahmed [1] that the cost of fund is 5% to 6% included in the service charge. But MF-NGOs are collecting cost of fund along with the full amount of loan, which might be reduced in some extent. Uddin [14] stated that at present microcredit scenario, a borrower receives loan from MF-NGOs at 15% interest rate or service charge. A member borrower has to deposit a certain amount of savings (forced savings) prior to receiving loan. It is generally assume that the borrowers have to deposit at least 10% of the loan amount as savings prior to getting a loan, and they are not allowed to withdraw any amount of savings before leaving the group. They can only take a loan against their savings, if the need arise.

(2) Risk Associated with Micro credit

Microcredit programs have been shaped from the idea of Grameen Bank's model on the basis of group lending and the group belongs to form voluntarily by the villagers. The group comprises five persons selected by themselves from their peer group. This group selection serves as a screening and monitoring mechanism and replace the need for collateral. If one of the members of the group becomes a defaulter, then the entire group is liable for the default and will be denied subsequent loans. In this way the success of MF-NGOs lies in designing an appropriate credit delivery and monitoring system. This system of joint liability and collective responsibility seems to be working exceptionally well with recovery rates standing at 99% [16]. Table 2 also shows that for MF-NGOs, the recovery rate is about 99%, which signifies that there is no loss or risk of loan. MF-NGOs consider a 2-3% risk [1] in fixing the service charges to borrowers. Considering the higher recovery rate, however, the author points

Table 1. Share of Member Savings of MF-NGOs

Name of Microcredit Providers	No. Of Active Borrowers (M)	Outstanding loan portfolio (US \$ in M)	Mem. Saving (US \$ in M)	Share of Mem Savings (%)
BRAC	4.03	237.62	118.87	50.03
ASA	2.77	196.37	46.2	23.53
Proshika	1.54	11.55	24.75	214.29
PKSF's other partners	1.25	46.33	39.24	80.70
Other NGO MFIs	0.8	54.64	22.19	40.61
Total	10.39	546.51	251.25	79.78

Sources: Computed from World Bank (2005)

* Mem=Member, M=Million

Table 2. Microfinance Statistics in National Level (TK in Million)

Items	December 2004		December 2003	
	Cum loan D.	Recovery rate (%)	Cum Loan D.	Recovery rate (%)
MF-NGOs (721 ^{'04} 720 ^{'03})	338,635.6 (44.4)	98.79	269,472.31 (42.8)	98.76
Grameen Bank	217,313.9 (28.5)	99.05	191,440.4 (30.4)	98.7
PKSF	19,784.5 (2.6)	97.5	15,810.8 (2.5)	99

Sources: CDF- 2004; (D=disbursement, Cum=Cumulative, '04=2004 and '03=2003).

out that there is no need to associate the risk of loan with the service charge more than 1%.

4. Research Methodology

To establish the objectives of the study, information was gathered from multiple sources. Various publications and census data were used. For primary data we prepared a questionnaire consisting of two parts: one is for the MF-NGOs personnel and the other for the member borrowers. The questionnaire was used with a sample of 50 interviewees, 15 from BRAC and 35 from four small MF-NGOs: SSS:-12, SATU:-8, BURO:-10 and PASASHIK PARSA:-5 member borrowers. Thereafter, Tangail district (Sadar Thana) was selected, as it is the oldest program area and has the better communication system by bus from Dhaka, the capital city.

In the study area we found both big and small MF-NGOs operating microcredit activities for more than 15 years. For the study purposes, we chose one big NGO, BRAC and four small NGOs. The small NGOs were also divided into two parts on the basis of service charge (interest rates) as the PKSF partner organizations. The study was conducted from June 24th to 14th July 2006 and the data essentially interpreted through tabulation.

5. Results and Discussions

(1) Some Basic Information of the MF-NGOs

There is now a greater competition in the microcredit market, which is dominated by four large MFIs namely Grameen Bank, BRAC (Bangladesh Rural Advancement Committee), ASA (Association for Social Development) and Proshika. BRAC is originally known

as the largest NGO, in Bangladesh, established in 1972. Table 3 shows some basic information about the 5 studied MF-NGOs: BRAC, SATU (Social Advancement Through Unity), SSS (Society for Social Service), BURO (Bangladesh Unemployed Rehabilitation Organization) Tangail, PASASHIK PARSA (Palli Samonnaya O Shikkha), with name and fame on microcredit activities in the Tangail district (Sadar Thana) for a long time. It is well established that BRAC is one of the topmost NGOs in Bangladesh, whereas the others four NGOs were partner organizations (PO)⁷⁾ of PKSF and these POs were funded partially and monitored by the PKSF.

According to the interview of the four small MF-NGOs personnel, it was established that PKSF imposes 5% interest on their funded money to the POs on declining balance. On the other hand BRAC has its own fund collected from different international donors with zero interest.

Among these POs of PKSF, SATU and SSS were applying a service charge of 12.5% at a flat rate on the total borrowed amount from the rural member borrowers. The rest two (BURO Tangail, and PASASHIK PARSA) were asking at 15% flat rate on the total borrowed money from the rural member borrowers. Thereafter, the POs were named as PO₁ and PO₂, respectively. On the other hand, BRAC was asking service charge at 15% (flat) rate against their capital money borrowed by the poor rural members.

(2) Additional Costs of Member Borrowers

In Bangladesh, microcredit programs are the largest sector. But MF-NGOs charges various types of fees from their beneficiaries. In this study, the analysis about additional costs was made based on the informa-

Table 3. Basic Information of the MF-NGOs (average)

Name of MF-NGOs	Working years in the Study area	SC %	Age of Borrowers (Years)	Borrowed amount (in Taka) Highest	Lowest
BRAC	15	15	41	11462	3615
SATU	15		56	12875	4000
SSS	17	12.5	35	13994	4429
PO ₁	6		45	14050	4450
BURO, Tangail	12		55	8822	4600
P.PARSA	7	15	32	9800	4412
PO ₂			39	9867	4400

Sources: Survey 2006

(PO=Partner Organization, P=PASASHIK PARSA, SC=Service charges)

Table 4. Additional Costs of Member Borrowers (in Taka)

Average//Person	BRAC	POs of PKSF		Proposed additional cost
		PO ₁	PO ₂	
Membership/admission fee	20	10	20	0.50
Application fee	5	10	17	0.50
Revenue stamp	2	4	4	2.00
Saving book fee	5	5	5	5.00
Account closing fee	20	10	12	—
Others	10	10	10	—
RPP	0	115	40	—
Agreement charge	0	35	70	—
Total	62 (0.54)	199 (1.42)	178 (1.80)	8.00

Source: survey 2006, RPP=Risk preventive programs

tion provided by the member borrowers. The additional costs were found the highest in PO₁ followed by PO₂ and BRAC. The table also indicates that there was a vast discrimination among these additional costs collected by the MF-NGOs. RPP (Risk Preventive Program) and cost of agreement were found to be the most unethical among these additional costs charged by the MF-NGOs in the study area.

It is well known that risk of loan has already been covered by service charges. The group liabilities and member savings are treated as quasi-collateral. In addition to account "closing renewal" fee, "others miscellaneous" payments taken from the poor borrowers amount to TK. 20-10, which is the responsibility of MF-NGOs. Moreover, "membership admission" fee and "application" fee should not be more than TK. 0.50 anywhere in Bangladesh, because the cost of printing one form is not more than TK. 0.50. Therefore, our research team suggests that MF-NGOs should not take any money above TK. 8.00 for that purpose.

(3) Actual Service Charge Collected by MF-NGOs

The MF-NGOs officials did not give us access to their financial statements; therefore the analysis was based on the information available from the member borrowers only. Table 5 shows that, as 1st June 2005 members' savings were TK. 3969, TK. 4415 and TK. 2667 on for BRAC, PO₁ and PO₂ respectively. The MF-NGOs were applying interest at the rate 5% on the saving amount and on average the total amount of saving per member borrower were Tk.198.45, TK.220.75 and Tk.133.35 for BRAC, PO₁ and PO₂ respectively. For the above charges, the borrowed amount per member was Tk.11462, TK. 14050 and Tk.9867 respective-

ly for BRAC, PO₁ and PO₂ on average in the study area. As the members' saving was mobilized by the NGOs for microcredit activities, then the actual money involvement by the NGOs per member borrower would be calculated by deducting members' saving from the borrowed amount. And per member the actual service charge would be calculated deducting the amount of interest on saving from the sum of service charge and additional cost collected from the borrowers. Then, the actual interest per member borrowers was calculated on the money involved by the MF-NGOs. Therefore, the actual service charges per member borrower' collected by BRAC, PO₁ and PO₂ were 21%, 18% and 21%, respectively.

Accordingly, it may be concluded that the MF-NGOs were collecting much more than the initially said interest rate on flat a method basis. It is generally known that the operational cost will reduce with the size of loan increased. BRAC is the topmost MF-NGO working all over the country since 1972, whereas the other NGOs were local, small in size and working since 1994. But the actual service charge was found to be the highest for BRAC than the small MF-NGOs of the study area, which is not rationale.

(4) Dependency of the member borrowers on MF-NGOs

To find out the dependency on the MF-NGOs by the member borrowers, the average loan from the Microfinance NGOs was shown in Table 6 since fiscal year 2001-02. It was found from the data that the amount of loan gradually increased from 2001-02 to 2005-06 for all the Microfinance NGOs in the study area, which indicates that the dependency of member borrowers on Microfinance NGOs has increased from 2001-02 to 2005-06.

Thus, it may be concluded that the member borrowers are the capital of NGOs and poverty is the sample, which will never be reduced under the present circum-

Table 5. Estimation of Actual Service Charge

Average/person	BRAC	POs of PKSF	
		PO ₁	PO ₂
a. Member saving (as on 1 st June '06)	3969 (35%)	4415 (31%)	2667 (27%)
b. Borrowed amount	11462	14050	9867
c. Service charge	1719 (15%)	1756 (12.5%)	1480 (15%)
d. Additional costs	62 (0.54)%	199 (1.42)%	178 (1.80)%
e. Interest on savings	198.45	220.75	133.35
f. Total cost of borrowing (c+d-e)	1583	1734	1524
g. Actual money involvement by NGOs (b-a)	7493	9635	7200
h. Actual service charge % (c+d-e)/g	21	18	21

Sources: Survey 2006

Table 6. Average Loan sizes of the Member Borrowers from 2001-02 to 2005-06

MF-NGOs	Fiscal year and loan sizes of member borrowers				
	2001-02	2002-03	2003-04	2004-05	2005-06
BRAC	5385	7692	9000	9538	11462
SATU	6375	8625	11125	11250	12875
SSS	6667	9083	11083	13500	14833
BURO, Tangail	6000	6500	7600	8900	8800
PASASHIK PARSA	5750	6656	7725	8994	9800

Sources: Survey 2006

stances. Consequently, poverty remains for the rural borrowers while the NGOs are becoming wealthier.

(5) Projection of Service Charge

In this section an effort was made to project the service charge that may be recommended. For this purpose the POs of PKSf were considered. POs usually get fund from the PKSf at the 5% interest rate in declining basis (for the simplicity of our analysis we used the flat method) and also the actual money involvement by POs, which considered to be taken from the PKSf. PKSf collect money from different sources such as government and donors. PKSf also raise fund from lending the money to the POs and running their business activities. Thus, PKSf collect less than 5% interest rate. Therefore, the following interests paid to PKSf by member borrower were found to be Tk.482 and Tk.362 for PO₁ and PO₂ respectively. By deducting these amounts from the total cost of borrowing (Table 7), we got the real service charge earned by the PO₁ and PO₂, which were 9.12% and 11.43%, respectively to run the microcredit business successfully in the study area. Hence, if the POs have their own source of fund they could run their microcredit business within the service charge ranges from 9.12% to 11.43%. Beside this, the big NGO (BRAC) was collecting service charge at the rate 21%. Thus, comparing with the studied small MF-NGOs, it might be concluded that big NGOs having own source of fund must not raise their service charge above 9%, which may be considered as a standard for MF-NGOs to run their business successfully.

Therewithal, the income of NGOs, are tax-free. BRAC has buildup multi-stored commercial building in the heart of capital city of Dhaka and runs a private university and industries. The students of these universities are from the richest class of the society and pay comparatively costly fees. The other two big NGOs also have multi-stored commercial building in

Dhaka. So, the question has been arisen, whether the MF-NGOs were really helping the poor or earning from them to nurse the rich? On the other hand, it has been seen that the expansion of PKSf's activities is remarkable in the whole of the country but they are also taking a 5% interest from POs on the loan, which should be reduced. Thus, the small NGOs (POs) too could reduce their rate substantially.

6. Conclusions and Recommendations

It was found from the study that 80% of microcredit disbursement came from the poor members' savings and the remaining 20% of the funds was provided by the MF-NGOs. But, They were collecting service charge on the whole disbursed amount, which may be reduced to some extent. Beside this, the finding of the study (Table 2) signifies that there is no loan risk in the microcredit activities in the country. Hence, the 2% to 3% loan risk included in the service charge should be reduced to 1%.

On the other hand, the findings of the survey showed that the studied MF-NGOs were collecting unethical additional cost along with the service charge and these additional costs between the MF-NGOs. It was also found from the study, that MF-NGOs should not take more than TK.8 as additional fees other than service charge from the poor rural microcredit borrowers. The actual service charges collected by MF-NGOs were much more than their initially said interest or service charge. Comparatively, small NGOs were collecting lower service charge than the big NGO (BRAC). In the study area, the actual service charge was found to be the highest for BRAC, which is irrational with the contest of other small MF-NGOs. So the big NGOs should reconsider their service charge because of their wide expansions. The result of projection showed that the real service charge earned by the PO₁ and PO₂ were 9.12% (the initial rate was 12.5%) and 11.43% (the initial rate was 15%), respectively to run their micro credit business successfully in the study area. Thus, it may be concluded that the studied MF-NGOs could reduced their service charge by at least 3% from the present level. Lowering the service charge of microcredit would maximize the benefit to the poor borrowers to come out from poverty.

Note

- 1) Microfinance means a system of credit delivery and savings mobilizing scheme specially designed to meet the unique financial requirement of the poor and

Table 7. Projection of Probable Service Charge

Items	PO ₁	PO ₂
Total borrowed money	14050	9867
Borrowed from PKSf	9635	7200
Interest paid to PKSf@5% (cost of fund at the flat basis)	482	360
Service charge	1756	1480
Projected on additional costs	8	8
Real service charge by MF-NGOs	1282	1128
Projected service charge for those have own source of fund	9.12%	11.43%

Source: Survey 2006

allowing them to improve the status of their living.

- 2) Microcredit emphasizes the provision of credit services to low-income clients, usually in the form of small loans for micro enterprise and income generating activities.
- 3) The word 'service charge' was called interest rate and still is today in formal banking. For MF-NGOs service charge is the cost of fund for borrowers as well as MF-NGOs from their respective positions. The term is widely used in microcredit programs as a synonymous of interest.
- 4) Flat method means that interest is always calculated on the total amount of the loan initially disbursed, though periodic payments cause the outstanding principal to decline [15].
Formula of flat method: Total amount of interest = (Principal loan amount × Rate of interest) / 100.
- 5) The declining balance method calculates interest as a percentage of the outstanding amount for the loan term. Interest calculated on the declining balance means that interest is charged only on the balance loan repayable by the borrower [15]. Formula of declining method: Total amount of interest = (Outstanding principal loan × Rate of interest) / 100 × (Due days or Payable days) / 365
- 6) PKSf means Palli Karma Shahayak Foundation. It is a Bengali name that can be translated in English as "Rural Employment Support Foundation" PKSf was established in 1990 as an independent organization under the management and guidance of some professionals on rural development and poverty alleviation.
- 7) POs means Partner Organizations. They are broadly used in the funding agency of PKSf. PKSf gives fund to the POs and monitor their activities.

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