Constraints to the Development of Islamic Microfinance: The Case of Bangladesh

By

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Dissertation Submitted
To
Graduate School of Asia Pacific Studies
Ritsumeikan Asia Pacific University

In Partial Fulfillment of the Requirements for the Degree of
Doctor of Philosophy

Declaration

Except otherwise indicated, the thesis is the result of my own work

Helal Uddin
April 2019

To

My Two Aunt Shahida Akter and Halima Akter (Lata) who sacrificed their valuable time, energy and resources to bring me here.

Acknowledgement

[All] praise is [due] to Allah, Lord of the Universe …
[Al-Quran, Chapter 1:2]

This thesis owes a great deal to the thoughts and efforts from a number of people Firstly, I would like to express my enormous gratitude to my supervisor professor **Dr. Suzuki Yasushi** whose continuous supervision and guidance have encouraged me a great deal to write this thesis.

I must express my sincere acknowledgement to the Ritsumeikan Asia Pacific University for all kinds of supports and helps. Special thank goes to Ritsumeikan Center for Asia Pacific Studies (RCAPS), Graduate Student Research Support for providing financial assistance that enabled me to present my research results in various conferences. I also express my sincere acknowledgement to professor **Dr. Barai Munim Kuman**, Professor **Dr. A. Mani**, Professor **Dr. KIM Rebecca Chunghee,** Professor **Dr. A.A.K Majumdar** for their valuable guideline in this journey.

Many thanks to our Seminar members mentionable to Dr. Sigit Promono, Dr. Khan Shoiab and Kamrul Hassain. From this seminar class, I have got many important insights throughout our discussion on Mission Drift. Special thanks go to Kate Inyoung Yoo for her inspirations.

Thanks are due to my cousin Dalower Hossain (Sayeed), Syam and my nephew Farukul Islam (Al-Amin) for their help during my field study. I also acknowledge to the Managers of different microfinance organization who helped me during my field trip in Bangladesh.

I also like to acknowledge the help from Sarker Md Sayem, Farhan Ishraq kingshuk, Shaikat Hasan, Rayhan Hossain, Faiyaz Rahat, Sadman Irtija Ratul, Rafia Farzeen, Tanjil Kai and Ishraque Wajed for reviewing and checking various aspects of the thesis.

Acknowledgements are also due to Muntasir Khalil Farhan, Yatriv Joy, Shahadat Hossain Shawn, Rimon Mahmud, Piash Islam, Shuvo Motahar Hossain, Iftakher Reza Jason, Mehedi Hasan, Tanvir Istiyaq Rhidoy, Junaid Abdullah Saad, Quaze Munier, Sarwar Hossain, Bhuian Mahmud Hasan, and Mahmudul Islam Fahim.

I would like to express my deepest gratitude to my mentor, my idol, provided me unlimited financial support, my elder brother **Dr. Mohammad Dulal Miah** who take cares me like my father. Acknowledge are due to the Suginoi Hotel staffs, HIKARU Akahoshi, RIE Yashida and Mitsuhashi San.

My Acknowledge are due to our Japanese host family Mr. **Kenji Okada** and Mrs. **Chizuko Okada**, for their enormous support in my whole APU life. No words are enough to acknowledge their support.

Finally, I would like to express my gratefulness to my parents and family members for their continuous support in pursuing my higher education in Japan. Who have provided me with moral and financial support and have accepted a lot of toil due to my absence for a long period of time. My sincere appreciation is due to my lovely wife **Jamia Jannat,** for her patience and sacrifice even though no acknowledgement is sufficient enough to justify her sacrifice. She has provided me with the courage and hope to successfully finish this thesis. I must appreciate the support of my son **Obayed Talha**.

List of abbreviations

ABS-Agricultural Bank of Sudan

ABSUMI-Agricultural Bank of Sudan Microfinance Initiative

ADB-Asian Development Bank

AFAUS-Al-Falah A’am Umayan Sangasta

AIM- Amanah Ikhrtiar Malaysia

AMB-Al Amal Microfinance Bank

ASA- Association for Social Advancement

BB- Bangladesh Bank

BBS-Bangladesh Bureau of Statistics

BMT-Baitul Maal Wat Tamwil

BRAC- Bangladesh Rural Advancement Committee

BRDB-Bangladesh Rural Development Board

CGAP- Consultative Group to Assist the Poor

CPD- Centre for Policy Dialogue

CSR-Corporate Social Responsibility

DOTS-Directly observed treatment, short-course (DOTS,

FINCA-Foundation for International Community Assistance

GB- Grameen Bank

GDP-Gross Domestic Product

GNI-Gross National Income

GNP-Gross National Product

GoB-Government of Bangladesh

HDI-Human Development Index

IBBL-Islami Bank Bangladesh Limited

IFAD-International Fund for Agricultural Development

IFC- International Finance Corporation

IFDR- Islamic Financial Development Report

IMF-International Monitory Fund

MD-Mission Drift

MDG-Millennium Development Goal

MFIs-Microfinance Institutes

MIX-Microfinance Information Exchange

MOF-Ministry of Finance

MRA-Microcredit Regulatory Authority

NGO-Non-Governmental Organizations

OECD-Organization for Economic Cooperation and Development

PLS-Profit and Loss Sharing

PPI-Poverty Possibility Index

PPP- Purchasing Power Parity

RDRS- Rangpur Dinajpur Rural Service

RDS-Rural Development Scheme

SDG- Sustainable Development Goal

SHG-Self-help group

SME-Small and Medium Enterprises

SOEs-State Owned Enterprises

SPTF-Social Performance Task Force

TB-Tuberculosis

UN-United Nation

UNDP- United Nations Development Programme

UNESCO- United Nations Educational, Scientific and Cultural Organization

USAID- United States Agency for International Development

WB-World Bank

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Abstract

Islamic finance started its operation in 1975. Since then Islamic scholars and policymakers have been working for the development of this mode of finance on a larger scale. The result of this attempt has been the addition of Islamic Microfinance as a mode of financing the poor. The contribution of Islamic microfinance to poverty reduction as well as empowering the poor are well documented in the existing financial literature. The literature also highlights that there is a huge demand for Islamic microfinance in society. However, the organizations that supply this finance have an outreach that is unexpectedly low compared to the demand for, even in Muslim countries.

Microfinance Institutions (MFIs) are a special type of organizations that works for profit with a specific vision to help the poor to get out of poverty. Though the mission of microfinance is to finance this transition, the current literature, however, does not convincingly argue that MFIs are at par with their stated objectives. Rather, there are plenty of evidence that suggests that most of the conventional microfinance organizations have drifted away from their initial mission. This can be seen in the fact that microfinance organizations at present focus mainly on upper poor or non-poor clients. This can be termed as ‘mission drift.’. Like their conventional counterparts, Islamic MFIs might also have fallen into the mission drift situation. Although the burgeoning literature of Islamic finance identifies various other constraints to the expansion of Islamic microfinance, the mission-drift hypothesis has largely remained under-examined. The current research is an attempt to fill this gap.

To analyze the mission drift of MFIs, this research developed a theoretical framework with the help of the current literature on the two types of mission drift: Type-I mission drift occurs when MFIs fail to reach the poor, and Type-II mission drift typifies a situation in which MFIs fail to serve their clients at a lower interest rate or they exploit their clients by charging astronomical interest rates. In analyzing type-I mission drift, this research sought to identify whether Islamic MFIs reach poor clients compared to their conventional counterparts. In determining their client’s poverty status, a poverty possibility index (PPI) was calculated which was then compared to national poverty levels. To identify Type-II mission drift, this research looked at whether Islamic MFIs exploit

their customers by charging excessive interest rates compared to their conventional counterparts. Present value calculation and effective interest rate methods were applied to calculate interest rate.

The research used Bangladesh as a case study area because the largest Islamic MFI in the world, Rural Development Scheme (RDS), is located there. RDS covers almost fifty percent of the total global Islamic microfinance outreach. Analysis of the data obtained shows that both types of MFIs in Bangladesh have failed to finance the poor, which confirms the existence of Type-I mission drift. In addition, both conventional and Islamic MFIs drift from their mission to *cheaply* finance the poor, which confirms the occurrence of Type-II mission drift. A typical MFI charges an interest rate six to seven times the market interest rate. In addition, their ROA is higher for MFIs than for the banking industry by two to three times.

Even though this study did not find any particular difference between Islamic and conventional microfinance, the analysis was extended to identify what other causes might restrict the growth of Islamic microfinance in Bangladesh. By comparing different financial products offered by conventional microfinance in Bangladesh and Islamic microfinance in Malaysia, this research showed that RDS falls into the Murabaha syndrome, an approach that fails to finance working capital as liquid cash and an important problem for businesses.

Based on the findings, the research offers some policy recommendations, which are expected to help Islamic MFIs to grow.

1 Introduction

1.1 Background

Conventional banks deal with ‘interest’ as profit on loans, while interest is considered by Islamic shariah as socially unjust. Since Islamic finance started its operation from 1975, Islamic scholars and policymakers work for the development of Islamic finance in the global scale. Some of them insist that the Islamic banking shows its sustainability in comparison with the conventional banking (Iqbal and Mirakhor, 2007; Ismal, 2013). They refer to the global financial crisis (the US subprime mortgage crisis) in 2007-08, when almost all of the conventional banks were forced to face the liquidity crisis, some Islamic banks were insulated. Some researchers and policymakers expect that the Islamic banking could be a prescription for preventing the repeated financial crisis observed in the conventional banking industry (Beck et al., 2013).

The Islamic Financial Development Report (IFDR) reports that the growth rate of Islamic financial industry recorded 6.5 percent in 2017 and the total Islamic financial assets stood at US$ 2.4 trillion (IFDR, 2018). It predicts that the total Islamic financial assets will be expanded to US$ 3.81 trillion by 2023. A present, a total of 1,389 Islamic financial institutions operates in 69 countries (IFRD, 2018). The Islamic finance industry assets grew by the compound annual growth rate (CAGR) of 6 percent in 2017 since 2012.

Bangladesh is the world third largest Muslim country; 90 percent of her population are Muslim. Islamic banking industry as a whole showed a rapid expansion over the last three decades. The first Islamic bank was introduced in Bangladesh by Islami Bank Bangladesh

Limited (IBBL), which started its operation on 13th March 1983 as a public limited company under the Bangladesh Companies Act 1913. According to Bangladesh Bank (BB, 2018) at the end of September 2018, eight full-fledged Islamic banks are operating with a total of 10,159 branches covering the whole country. In addition, 19 Islamic banking branches of 9 conventional commercial banks and 25 Islamic banking windows of 7 conventional commercial banks are also providing Islamic financial services in Bangladesh.

Bangladeshi Islamic banking industry plays an active role as an economic player. According to Bangladesh Bank (BB) statistics, deposit mobilization by the Islamic banking industry amounted to BDT 227814.44 Crore (around US $26.96 billion) by 2018 which accounted for 23.31 percent of the total Bangladesh banking industry (BB, 2018). Total investment also amounted to BDT 220343.15 crores (around US $26.07 billion) which constituted 23.93 percent of the total investment.

Some scholars suggest that Islamic banks performed better than conventional banks (Usman and Khan 2012). According to Rahman and Macdonald (2012) Islamic banks in Bangladesh contribute to generating employment, earning foreign remittance, strengthening rural economy, promoting ecology and green banking, boosting industrialization, developing SMEs, assisting in foreign trade (import-export), and developing the housing sector, etc.

Both Islamic and conventional banking industries are successfully meeting the demand of medium to large size industries and to some extent small-sized organizations. However, both types of bank fail to address the needs of the poor. The commercial banking industry mainly concentrates on the wealthy borrowers and easy to reach people. In general, commercial banks are recognized as ‘depository corporations. The core business of commercial banks is to collect deposits from their clients as depositors. Commercial banks are responsible for protecting the utility and right of depositors. On the other hand, considering the socio-political environment bankers feel that it is unsafe to lend to the poor. As a result, commercial banks are ‘conservative’ in extending loans to poor people.

To address the need of the poor some Islamic banks have opened windows that offer microfinance services with the aim to reduce poverty in the society. However, compared to the expectation, Islamic microfinance outreach is unexpectedly low. Where the total global microfinance outreach covered 139.0 million clients with a loan outstanding balance of US $114 billion as of 2017, Islamic microfinance covered only 1.28 million clients at the same time with an outstanding balance of only US $1 billion (only 1 percent of global microfinance outreach). Taking these conditions into consideration, it is important to explore the critical factors that may obstruct the development of Islamic microfinance.

1.2 The puzzle over Islamic microfinance growth

Microcredit or the small loan to the poor borrower with an aim to reduce poverty and enhance economic growth was envisioned by Professor Dr. Muhammad Yunus, the father of microfinance and the founder of the Grameen Bank. The Grameen bank was introduced in Bangladesh in 1976 with a tiny investment of US $27 to 42 poor women in Chittagong (South-east part of Bangladesh). Now the Grameen bank has turned into a hundred billion dollar development organization (GB, 2018). The Grameen Bank is not only recognized in Bangladesh but also in the world at large. It has drawn widespread attention from development organizations as well. Gradually this institution has turned into a role model for microfinance industry all over the world.

The success of Grameen Bank has led other development organizations, including international financial institutes (IFIs), World Bank, International Monitory Funds (IMF) to provide more emphasis on microcredit for enhancing social development. In 2004, the World Bank took an initiative to promote development through microcredit organization. The United Nation (UN) also declared the year 2005 as the year of microcredit by observing the success story of microfinance. Also, Dr. Muhammad Yunus and his microfinance institution, the Grameen Bank, had been awarded the Nobel Peace Prize in 2006 for contributing to social development through microfinance initiatives.

The contribution of microfinance to poverty alleviation is a success story with some controversy though. Most of the impact assessments highlight that it has a positive impact on social wellbeing (see Imei et al., 1999). It creates self-employment opportunity (McKernan, 2002; Erhardt, 2017); increases income, and consumption (Zeller, 2001), improves health, education, and empowerment of women (Nader 2008; Swain & Wallentin, 2009). In addition, microfinance contributes to the development of both individual and national level. For instance, Raihan, Osmani, and Khalily (2015) show that microfinance has a positive effect on GDP. In general, it contributes to both micro and macro level of the economy by creating new employment and empowerment (Suzuki et al., 2018).

Besides the traditional microfinance organization, Islamic society also works to reduce poverty to realize social justice. Poverty eradication in Muslim society is noble work. It is given the utmost priority in Islam. Islam encourages charity and donation that helps to meet the necessity of the poor people. The introduction of compulsory alms-giving concept (Zakat) is considered a sustainable development process that ensures social justice. Compulsory alms-giving ensure poor people to have a right to the wealth of rich:

> *"And in their wealth and possessions (was remembered) the right of the (needy) him who asked, and him who (for some reason) was prevented (from asking)" (Al Quran 51:19).*

Another charitable fund in Islam is *Waqf (endowment).* Waqf is also a kind of *Sadaq-e-Jaria* (endowment fund). This kind of charity is used for some specific purpose to make a better society. However, once a property is dedicated to Waqf, it will remain as a Waqf property until the Day of Judgment. Numerous verses of the Quran urge Muslims to give charity and work toward the welfare of the poor segments of society (Kaleem, & Ahmed, 2010). Many scholars like El-Gamal (2006), Al-Harran (1999), Akhtar (1998), Dhumale and Sapcanin (1998), Ahmed (2001), and others, are of the opinion that Islamic finance has some inherent characteristics which fit it to work with poor people.

There is a long debate in the current literature that emphasizes that charity has some limitations in poverty reduction in the long run. The charity helps the recipient in solving the immediate problem, but it does not do much to deal with the causes of that problem. Charity can have devastating effects on social wellbeing. It robs the recipients' dignity and removes the incentive of having to generate income (Yunus, 1999). King and Winter (2013) mention that no one should survive on charity alone. In the same token, the authors argue that reducing poverty only by charity is a questionable strategy. Nevertheless, charity has some unique characteristics that can help to reduce poverty in immediate necessity like in a natural disaster, and crisis after war but continuous charity reduces the incentive to work and makes people lazy, a poverty trap for the poor. By observing this negative effect, Islamic scholars and policymakers suggest a financing policy that works against poverty and creates social justice. Hence, Islamic microfinance comes to the scene.

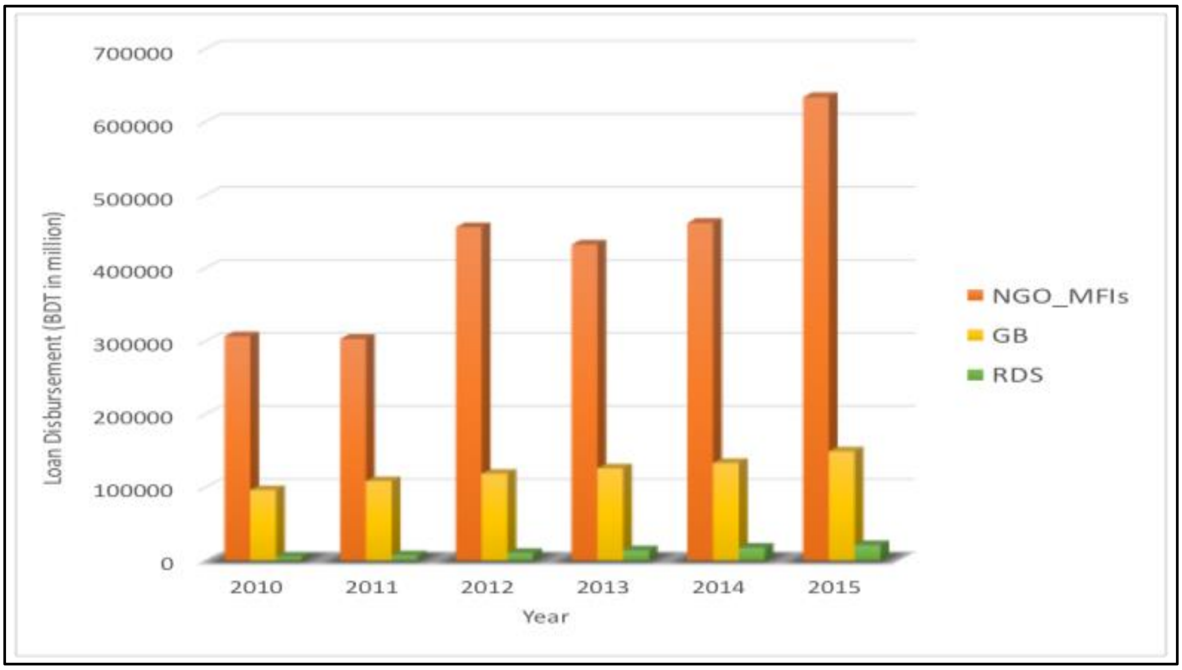
The positive contribution of Islamic microfinance in social well-being is also recognized in the literature (see for example, Kholis, 2009; Segrado, 2005; Norma & Jarita, 2010). Despite the huge success of microfinance in Bangladesh, 24.07 million people still live under the poverty line and are unbanked (ADB, 2016). The current microfinance outreach in Bangladesh is not so much as expected at the outset. Suzuki and Miah (2016) argue that religious faith is one of the critical reasons for low microfinance outreach in Bangladesh. Bangladesh is the world's third largest Muslim country and its official religion is Islam. The Muslim population constitutes 90 percent of the total population and Islam plays a significant role in their social and economic lives. A portion of the Muslim population was not always satisfied by the conventional microfinance services because they involve with interest (*riba*).

According to UNDP (2012), 80 percent of Muslim respondents prefer Islamic MFIs products to conventional products. Also, 45 percent claimed that they will switch to Islamic MFIs even at a higher price. Another 32 percent of the respondents claimed that they never applied for any loans because of religious belief. The study further indicated that 85 percent of the current borrowers from conventional MFIs admitted that they will not apply for another conventional loan and will switch to Islamic products once such products are available.

Consultative Group to Assist the Poor (CGAP) (2008) revealed that there is a strong demand for Islamic MFIs. A study conducted by USAID in Jordan found that 24.9 percent of interviewees did not engage with conventional MFIs because of their religious faith. Another study was conducted by the Frankfurt School of Finance and Management in Algeria in 2006. This study showed that 20.7 percent of microenterprises do not apply for loans from conventional MFIs because of religious reasons. In 2007, one research study conducted by the International Finance Corporation (IFC) in Syria found that 43 percent of the respondents claim that the main obstacle to engaging with conventional MFIs is the religious barrier; 46 percent of the respondents never applied for microcredit because of religious beliefs. UNDP (2012) indicates that 80 percent of the Muslim respondents showed a preference for Islamic products over conventional products due to the existence of interest.

Even though the literature highlights that there is a huge demand for Islamic microfinance in society and Islam teaches its followers to work against poverty through various poverty alleviation tools, the reality is completely different. While it is revealed in the literature that there exists a huge demand for Islamic microfinance, the outreach is unexpectedly low. It was estimated that the global Islamic microfinance institution serves about 380,000 customers through 126 institutions in 14 countries. This level of outreach accounts for an estimated 1.5 percent of total microfinance outreach (CGAP, 2008). Rhule (2016) mentioned that by 2016 Islamic microfinance covered 1.28 million clients with only 1 percent of global microfinance outreach. The global microfinance (conventional) has reached out to 116.0 million clients with a loan outstanding balance of $92.6 billion. Even the world's largest Islamic microfinance institute, the Rural Development Scheme (RDS) established by the Islamic Bank Bangladesh Ltd (IBBL), the RDS only covers 0.94 million clients with an outstanding loan balance of $0.35 billion. In international comparison, RDS covers more than 50 percent of total Islamic microfinance outreach, but compared to total conventional microfinance outreach, RDS covers a tiny percentage. Even though RDS is the world largest Islamic microfinance institution, it contributes only 5 percent to the local market share. As shown in figure 1-A, the MFIs initiated by Non-Governmental Organizations (NGO-MFIs) are dominant in the market. The well-known Grameen Bank (GB) occupies a considerable market share, though its growth has been slowed down recently. Meanwhile, the market share of RDS has been very marginal.

Figure 1-A: Loan Disbursement by different type of MFIs



Source: Author

A review of the literature observes that Islamic microfinance has some competitive advantages over conventional microfinance. Islamic MFI (RDS, for example) charges a lower markup profit compared to conventional MFIs in Bangladesh. For example, the Grameen bank charges at least 15-20 percent interest on loans, NGO-MFIs charges around 18-20 percent without any rebate. In the case of RDS, it adds 12.5 percent markup profit and allows a rebate of 2.5 percent on timely repayment; i.e. its mark-up profit is effectively 10 percent. However, this interest/markup profit does not consider the effective interest rate. All types of MFIs operating in Bangladesh impose some sort of forced deposit. If we consider the cost of forced deposits, the cost will be higher than what we have mentioned. It is observed that all types of MFIs charge almost the same percentage of forced deposit.

The repayment schedule of all types of MFIs like Grameen bank and other NGO-MFIs starts from the next week after the loan has been received; but in case of RDS, the first loan repayment starts from the third week after the loan has been received. Two weeks is considered as gestation period to make an inflow from the investment. By considering all the competitive advantages mentioned above, it can be hypothesized that the client's preference should go to Islamic MFIs rather than conventional MFIs. This creates some puzzle in the Islamic microfinance industry.

Puzzle 1: The Literature Outcome Puzzle

There is a huge demand for Islamic microfinance (see UNDP, 2012). It is argued in the literature that Islamic microfinance has some unique competitive advantages over conventional microfinance. If so, why Islamic microfinance deepening is unexpectedly low? What are the root causes that restrict the growth of Islamic microfinance in comparison with its conventional counterpart?

Puzzle 2: The Islamic Shariah Puzzle

The teaching of Islam addresses the realization of social justice, where the poor have the right to share the wealth of the rich. Then, why do poor people exist in society, especially in Muslim society? Even though the Islamic microfinance has emerged to provide financial service to the poor, why the poor people are hesitating to engage with Islamic microfinance? What is the special market demand that conventional microfinance successfully meets but Islamic microfinance has failed to do so?

The aim of this thesis is to unfold the above puzzles. In so doing, it draws reference from Bangladesh, and in particular some leading microfinance institutes - the Grameen Bank, the BRAC, the ASA, and the RDS. There are some obvious merits of focusing on Bangladesh. For example, Bangladesh is viewed as a synonym to Microfinance (Weber, 2013)[1]. Modern microfinance was born in Bangladesh by the introduction of Grameen Bank (GB). According to the microfinance barometer (MB, 2018), Bangladesh is the second largest microfinance market worldwide next to India, with a total of 25.6 million clients. Among the world's top 5 microfinance organizations, two are from Bangladesh (BRAC positioned at number 3 and the Grameen Bank placed at number 4). Bangladesh is a country where both Islamic and conventional microfinance operate together.

In the case of Islamic microfinance, there are eight Islamic microfinance organizations operating in Bangladesh. Among these, RDS is the largest. It alone covers more than 95% of the domestic Islamic microfinance market and worldwide it covers over 50% of total Islamic microfinance clients.

The microfinance industry in Bangladesh is composed of NGOs, state-owned specialized microfinance banks, MFIs under the patronage of commercial banks, and specialized programs of some ministries of the Bangladesh government. The expansion of microfinance in Bangladesh is phenomenal and the growth pace is still developing. Therefore, this study argues that Bangladesh is the sample country best suited to conducting research focusing on microfinance.

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[1] Weber, O. (2013). Impact measurement in microfinance: Is the measurement of the social return on investment an innovation in microfinance?. *Journal of Innovation Economics Management*, (1), 149-171.

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1.3 Islamic Microfinance Reality and the Literature Gap

Religion plays a vital role in Islamic society. Muslim people consider Islam not only as a religion of spiritual belief but also a complete way of life from individual to social, material to moral, economic to political, legal to cultural, national to international (Nazim, 2013). Islamic banking industry has recorded a steady growth since its inception, but the contribution of Islamic microfinance is very low compared to the total market share (Rhule, 2016)[2]. Of the total Islamic microfinance clients, 82 percent reside in three countries - Bangladesh, Indonesia, and Sudan. In Sudan, the leading Islamic MFI is the Agricultural Bank of Sudan Microfinance Initiative (ABSUMI) funded by three key stakeholders, the International Fund for Agricultural Development (IFAD), the Agricultural Bank of Sudan (ABS), and the Microfinance Unit of the Central Bank of Sudan. As of May 2012, the total outreach of ABSUMI reached 36,000 members through 350 women’s groups. In Indonesia, Baitul Maal Wat Tamwil (BMT) is the leading Islamic microfinance institute. In Bangladesh, it is the Rural Development Scheme (RDS) initiated by the Islamic Bank Bangladesh Limited (IBBL). RDS was established by IBBL to meet the financial needs of the rural poor. Now it has become one of the world’s largest Islamic microfinance providers that alone covers 50 percent of global Islamic microfinance outreach (IBBL, 2013).

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[2] Rhule, K., (2016). "Islamic microfinance: a vehicle for promoting financial inclusion," Law School International Immersion Program Papers, No. 21.

Although the world's largest Islamic microfinance provider, RDS is very small compared to conventional MFIs. The global conventional MFIs reached to a total of 116.0 million clients with a loan outstanding balance of US $92.6 billion, RDS covers only 940,000 clients with a loan outstanding balance of US $0.35 [3] billion. Even in the Bangladesh, RDS contributes only 5 percent to the total market share.

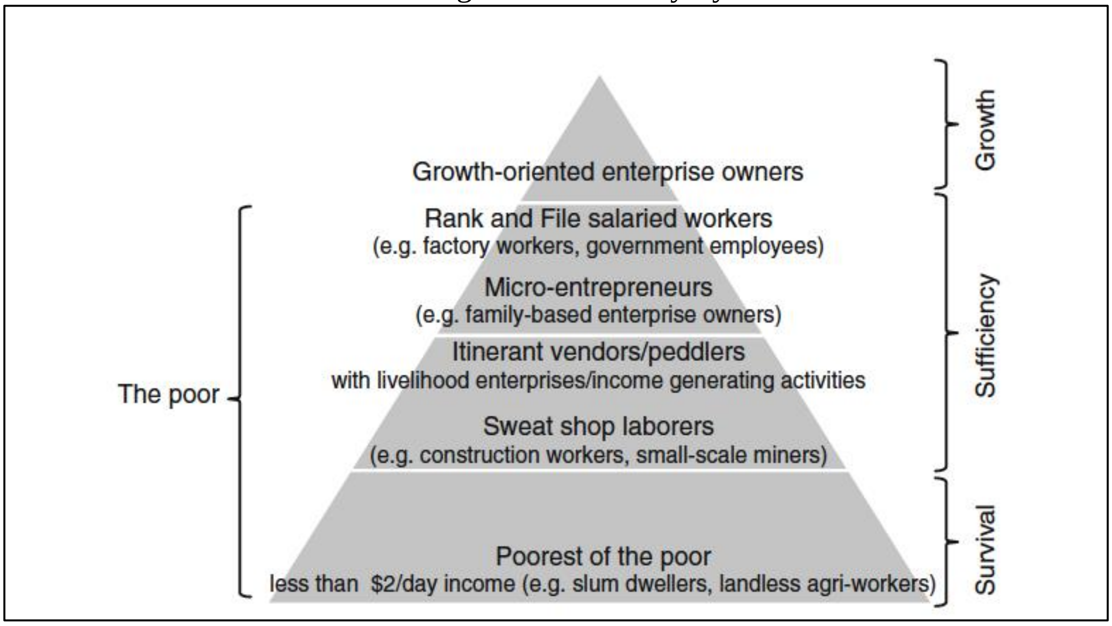
Looft (2014) extended the poverty pyramid like a population pyramid. He divided the poor population pyramid into three segments; survival, sufficiency, and growth. Looft categorizes the poorest of the poor like slum dwellers and landless agri-workers as a group that merely survives. Sweatshop laborers and peddlers are set at the bottom of the sufficiency segment. Microenterprise owners and file salaried employees are the groups who belong to the upper level of the sufficiency group. The top of the pyramid is composed of growth-oriented enterprise owners. Among the three segments, Looft categorizes the bottom two- survival and sufficiency- as poor groups.

Microfinance organizations have emerged to finance the poor who were excluded from the formal financial institute (e.g. bank). As the mission of the MFIs is to serve the poor, they are serving the people who live in the second and third segments as per the categorization of Looft (2014). Researchers are of the opinion that MFIs are serving the upper poor of the poverty pyramid, but they have failed to serve the poorest of the poor or the people belonging to the survival group that Looft identified in his poverty pyramid.

[3] 1 USD = 83 BDT.

This postulates that although microfinance has been considered a success story to upgrade the living standard of the poorest of the poor, it has failed to achieve this stated objective.

Figure 1-B: Poverty Pyramid



Source: Looft, 2014

It can be said that Islamic MFIs are conservative in extending their loans to poor clients. At the same time, Islamic MFIs compete with conventional MFIs to target the better poor and non-poor client. This situation (not-targeting the poor), can be categorized as ‘mission drift’.

Several scholars and researchers have addressed the reasons why the outreach of Islamic microfinance remains at a marginal level. The explanations are: lack of loanable 'microcredit' funds / Problems in funding by Glaubit (2008), and Salehuddin (2009); Improper regulatory frameworks (Muhammad, 2010; Salehuddin, 2009; Dogarawa, 2011; and Marghani et al., 2011); Information problems between MFIs and their clients (Boateng and Agyei, 2013); and Insufficient infrastructure (Boateng and Agyei, 2013; Ali, 2015)

Although microfinance literature sheds some lights on the challenges and obstacles encountered by Islamic microfinance, hardly any study is found to-date which provides a comprehensive analysis on the ‘mission drift' situation of Islamic MFIs. Therefore, the current research is an attempt to fill this gap.

1.4 Research Objective, Main Question, and Hypotheses

1.4.1 Objectives

This research aims to explore the reasons behind the extraordinarily low level of Islamic microfinance penetration with reference to Bangladesh. In addition, this research intends to analyze shariah constraint in dealing with the poor. In doing so, this research aims to-

1. Explore the fundamental constraints that restrict the growth of Islamic microfinance in Bangladesh;
2. Find out to what extent Islamic microfinance reaches the poor to achieve its objective; and
3. Examine the extent to which shariah-based microfinance organizations are able to lift the poor out of poverty.

1.4.2 Research Questions

To achieve these research objectives, the main questions in this research have been proposed in two puzzles as explained in Section 1.2.

1.4.3 Hypotheses

In conducting this research, we predict that Islamic MFIs may fall into the problem of ‘Mission Drift (MD)’ because Islamic microfinance institutions lack a focus on the poorest of the poor (Type-I MD). Also, it may fail to provide a smart income that covers the repayment with some extra revenue, or simply, microfinance has failed to provide credit facilities at a reasonable cost (Type-II MD). As a result, Islamic MFIs face growth constraints. In explaining this growth inertia, the research sets the following hypotheses:

Hypothesis-1: There is no occurrence of Type-I MD in RDS. Relatively, RDS has challenged the credit risk of marginalized clients in comparison with GB and NGO-MFIs. The extraordinary penetration of RDS in this industry can be, to some extent, justified;

Hypothesis-2: There is Type-II MD in RDS. Relatively RDS has been exploiting its clients in comparison with GB and NGO-MFIs; and

Hypothesis-3: There is no occurrence of Type-I and Type-II mission drift in Islamic microfinance. Rather, there is some unique demand that RDS failed to meet, where conventional microfinance already overcome.

1.5 Overview of the Methodology Used

1.5.1 Research Design and sample selection

For the research method, this study is categorized as an exploratory study, which uses the RDS as a case study. The reason behind selecting RDS is that the world’s top Islamic microfinance providers are AIM in Malaysia, BMT in Indonesia, Akhuwat in Pakistan, AMB in Yemen, ABSUMI in Sudan, and RDS in Bangladesh. AIM had a total outreach of 347,970 clients by 2014, and provides loans without any interest to maintain shariah law, but it charges a 10% service fee on its investment for its sustainability. According to AIM (2011) it takes loans from Bank Muamalat Malaysia to run its operation. Hence, AIM can be categorized as a typical Islamic microfinance organization. Because AIM takes loans from other financial institutions like other Microfinance organization and it does not charge any interest, it follows Islamic shariah.

BMT is a community based and cooperative microfinance operation in Indonesia. It supplies both commercial loans and charitable funds such as waqf, zakat, and sadaqat (Kustin, 2015) . So, it can be categorized as a hybrid microfinance organization. Akhuwat is a full flag charitable microfinance organization that uses charitable fund (waqf, zakat, and sadaqat) to extend its loans, and these are supplied without any profit and service charges. Borrowers just need to return the principle amount and make some donation based on their wish or ability.

AMB started its operation in 2009 as an Islamic microfinance organization in the MENA countries. It's a non-profit microfinance finance bank that was established under Yemeni Law No. 23 of 2002. The main objective of AMB is to offer sustainable financial services to limited and low-income households in Yemen who are excluded from the formal banking sector. AMB is a typical microfinance organization owned the Yemeni Government (45%), 35% by the Arab Gulf Program of the United Nations Development Organization (AGFUND), and 20% by the Yemeni and Saudi private sectors (AMB, 2019). ABSUMI on the other hand is a subsidy of the Agriculture Bank of Sudan operated to empower the poor. Based on the available data it was found that ABSUMI has 36,000 microfinance clients with a total amount disbursed of US$72,000. This is a typical Islamic microfinance organization that operates to help the poor with some profit.

Moving now to the RDS case, this organization has as its main objective, according to IBBL (2016), delivering finance to rural areas that creates employment and reduces poverty. It uses IBBL funds when extending its operations and it charges 12.5% on its investments (2.5% reduction for timely repayment). According to Kustin (2015), RDS does not use any charitable funds such as zakat, waqf and/or other form of charitable funds. RDS fully depends on IBBL fund allocations for sustainability. From this, we can say RDS is a typical Islamic microfinance organization that provides financial services based on shariah principle but for profit and is not a special Islamic microfinance organization that uses charitable funds to provide financial services without any profit. This is one of the reasons for selecting RDS.

The other reason is that the global Islamic microfinance outreach is estimated at 1.28 million clients offered by 300 Islamic microfinance organizations in 32 countries. Based on IBBL (2017) data, it was found that Islamic microfinance RDS covers more than 50% of this outreach (p.212). Therefore, this study argues that RDS is a suitable representative of Islamic microfinance.

In an attempt to unfold the two puzzles raised in section 1.2 this research has been conducted in the following manner:

Puzzle 1: Literature Outcome

First, this research explores the historical background of the microfinance industry of Bangladesh. The historical background of microfinance mainly concentrates on the introduction of the Grameen Bank. This will identify the objectives of microfinance organizations. From the analysis, the objectives of microfinance organizations highlight two basic points – ‘finance the poor’ and ‘help them to get rid of poverty’.

It is hypothesized that there is no occurrence of Type-1 mission drift of RDS, rather RDS has challenged the credit risk of marginalized clients. Hence, RDS status in reaching the poor segments of the society is focused on. In analyzing the RDS reaches to the poor, several methods can be utilized but this research uses the Poverty Possibility Index (PPI) scorecard introduced by Schreiner (2012).

This research also hypothesizes that, RDS exploits its members by charging excessive interest rates compared to other types of microfinance organizations. To assess the RDS interest rate, this research employs a present value calculation method as well as the effective interest formula to calculate the effective interest rate. The calculated interest rate is then compared with conventional microfinance. To determine if the RDS charges an excessive interest rate to their loans, the calculated interest rate is further compared with the market interest rate (commercial banking industry) as well as the different laws introduced in Bangladesh that determines the excessive interest rate.

Puzzle 2: Islamic Shariah Puzzle

The study describes the Islamic financial tools that work against poverty. For example, we hypothesize that there is no occurrence of Type-1 and/or Type 2 MD in Islamic microfinance. Rather, Islamic microfinance has failed to meet the current demand. To test this hypothesis, this research analyzes the current practices Islamic microfinance uses to meet the current market demand. Based on demand and supply, the study attempts to identify the mismatch between demand and supply that restrict s the growth of Islamic microfinance. Further it will provide an example of a successful Islamic microfinance from Malaysia.

In unfolding the above puzzles, the chapters of this thesis are structured as follows: at the beginning, the work looks at how the microfinance industry has contributed to poverty alleviation in Bangladesh. Chapters 2 and 3 answer this question. Chapter 2 presents the changes in different microeconomic indicators over time, such as poverty, life expectancy, current poverty status compares to other developing countries as well as other Islamic developing countries. In the last part, this chapter identifies the contribution of microfinance organizations in economic development. Chapter 3 describes the existing literature that focuses on the analysis of the contribution of microfinance organizations to poverty alleviation. It explains both pros and cons of the role of microfinance in contributing to poverty alleviation. This chapter also takes into account if microfinance has failed to achieve its mission objectives (referred as microfinance mission drift).

Chapter 4 describes the limitation of existing literature that failed to analyze the different types of microfinance mission drift. This chapter develops a new theoretical framework by the help of Zhao (2014).

Then the study analyzes why the market penetration by RDS (Islamic MFIs) is extremely low. In doing so, it is hypothesized

H1: if RDS pays its effort to challenge the credit risk associated with marginalized clients, in practices, the low market penetration can be justified.

To prove our hypothesis (H1), Chapter 5 identifies the poverty status of both RDS and conventional MFI through PPI scores. It then compares the PPI of Islamic finance with that of conventional MFIs.

H2: If RDS exploits its clients compare to conventional microfinance organization, the low penetration can be justified.

To prove or disprove our second hypothesis (H2), Chapter 6, explore the nominal and effective interest rates are charged by different types MFIs. To calculate interest, this chapter used present value and effective interest rate calculation methods. The required data were collected from a field study on February and March of 2018.

However, H3: If H1 and H2 can’t be accepted, there is something else that conventional MFIs employ to be successful in reaching the clients which the RDS can’t. To identify new factor(s), this research going to compare different financial product, type of contract offered by Islamic and conventional microfinance, that will discussed in Chapter 7.

1.5.2 Data requirements and Data collection

In the first part of the empirical analysis, this thesis analyzes how microfinance reaches the poor by utilizing PPI, a poverty measuring tool developed by Schreiner (2012). Measuring poverty is very difficult in terms of income and consumption. Therefore, Schreiner (2012) develops a new type of poverty measuring technique by asking only 10 simple questions. Every question is weighted by a certain value through which anyone can measure the poverty condition. This PPI index directly provides the poverty status of Islamic MFIs' clients. Then the calculated PPI score is compared with conventional MFIs. In the next step, both Islamic and conventional MFIs are compared with the domestic and international poverty lines. Based on the comparison between MFIs index with the poverty line, the study finds the answer to the first question- Whether Islamic MFIs is able to reach the absolute poor compared to its conventional counterparts. The required data were collected through in-depth interviews with households using a questionnaire survey developed by Schreiner (2012).

The second part of the empirical analysis identifies whether Islamic microfinance institutions are exploiting their clients by charging excessive interest rates compared to the conventional microfinance operated in the same region. To calculate the Islamic microfinance and conventional microfinance interest rates, we conduct a questionnaire survey regarding client's loan amount, fixed deposit and repayment amount and payment schedule. Using present value and effective interest rate calculation methods, this research identifies the flat interest rate and the effective interest rate charged by different microfinance organizations. Then the calculated interest rate is compared with market interest (commercial bank interest rate). The secondary data is collected from the Bangladesh Bank (Central Bank of Bangladesh). It also compares the interest charged by different microfinance organizations of their loan using the Usurious Loans Act, 1918 (Act No. X of 1918) to identify whether the interest charged is excessive or not.

The third part of the empirical analysis of this thesis analyzes the current demand of the poor people and how Islamic and conventional microfinance deal with that demand. In doing so, this part of the thesis compares the Islamic and conventional microfinance products, and the nature of the financial contract. The required data were collected from existing literature.

1.6 Significance of the Study

The success of conventional microfinance in eradicating poverty is widely accepted, with some controversies though. This calls for the attention of development strategists to think more on such models to accelerate the rate of poverty alleviation and lift the poor out of poverty. Islamic microfinance can be considered a complementary institution that has an ample ability to contribute to this objective. However, the underdevelopment of the institute is seemingly a paradox in the sense that Islam encourages giving and spending for equality and justice of society, but Islamic MFIs are not thriving. According to Islamic conventions, the poor are considered to have a share of the wealth of the rich. Poverty in the society is considered as a serious problem which calls for strong attention by wealthy people to break it. In this sense, it is a moral obligation for wealthy individuals to finance an entrepreneur who is having financial difficulty in materializing his entrepreneurial skill. However, the reality is different. At the same time, where mainstream Islamic finance is prospering at an amazing pace, its complementary institute, Islamic microfinance, is falling apart. It is timely a question to ask: why? By answering this question, this research aims to contribute new facts and information to the existing literature of Islamic finance in general, and Islamic microfinance in particular.

1.7 Limitations of the study

This research is focused on explaining the phenomena of the extraordinarily low level of Islamic microfinance outreach and the slow growth trend of Islamic microfinance, particularly in Bangladesh. However, there is some limitations involved with this study. First, this research considers Islamic microfinance as the only financial inclusion method that facilities the financial services to the Islamic poor, especially the Muslims who hesitate to engage with interest-based microfinance organizations. Second, this research considers the RDS as the dominant Islamic microfinance institution and it focuses only on why Islamic microfinance is not growing. Nevertheless, the results of this research may be generalized to all Islamic microfinance, particularly, those operated in the same socio-economic condition as those of RDS.

1.8 Chapter outline

The thesis consists of eight chapters. After the introduction, Chapter 2 deals with the current Bangladesh microfinance industry and its status. At the beginning of this chapter, some basic statistics regarding Bangladesh socio-economic condition are provided. Then it provides the historical background of microfinance institutions and the introduction of Grameen bank and other dominant microfinance organizations in Bangladesh. After that, it provides the coverage of the microfinance industry countrywide and the last part of this chapter discusses the governing and monitoring body of different types of microfinance organizations. It also provides a comprehensive analysis of microfinance contribution to the economic development of Bangladesh.

Chapter 3 reviews the relevant literature. At the beginning, it provides some basic definitions regarding microcredit and microfinance, Islamic microfinance and the features of microfinance organizations. It analyzes the mission status of microfinance organizations and introduces the mission drift concept from the literature. Then, it engages with the existing debate regarding microfinance mission and mission drift and identifies the current literature gap. Chapter 4 draws the theoretical framework. This research develops a new theoretical framework based on Zhao (2014) to analyze the different types of mission drifts which is considered the main theoretical contribution of this research.

Chapters 5 to 7 represent the empirical results of the study. Chapter 5 presents the result of testing the first hypothesis of this thesis. This chapter deals with microfinance contribution to the economy. Specifically, it examines whether microfinance is serving the poor clients or not. The chapter also provides a short review of the related works followed by a discussion on the analytical frameworks and data collection. Finally, it presents the empirical results. Chapter 6 also provides empirical results relating to the interest charged by different microfinance organizations. In the beginning, it provides microfinance promises and their fundamental assumptions regarding microcredit. Then it provides a detailed analysis on whether microfinance works for profit or social wellbeing. After that, it presents the empirical result regarding microfinance interest, and finally presents a comparative study with commercial banks and Bangladesh Usurious Loans Act, 1918. Chapter 7 provides comment on the current demand from microfinance clients and how conventional microfinance can fulfill the demand. Then it identifies the limitation of Islamic microfinance organizations that restrict the growth of Islamic microfinance. In the final chapter, Chapter 8, some policy recommendations are offered based on the results of this thesis and highlights the study's contribution. Finally, the chapter presents some insights for future research.

2 The Microfinance Industry in Bangladesh: From past to present

2.1 Introduction

Before beginning the empirical analysis on the mission drift situation of the microfinance sector, it is important to understand the socio-economic context and the nature of the microfinance sector in Bangladesh. Therefore, this chapter presents an overview of the Bangladesh microfinance industry as a whole and is organized in the following order: Section 2.2 provides the basic information of a short profile of Bangladesh; Section 2.3 delivers the development and historical background of the microfinance industry in Bangladesh; Section 2.4 covers the geographical coverage of the microfinance industry in Bangladesh; Section 2.5 discusses the regulation of the microfinance industry in Bangladesh and the related formal institutions; and Section 2.6 provides a summary of the whole chapter.

2.2 Country Profile

Bangladesh is one of the densely populated countries in the world with 167 million people (August 2, 2018) in a total area of 144,000 km^2. The population density is 1,160 per km^2. According to World Bank data, around 65percent of the population live in rural areas and the rest in urban areas. It has many rivers, therefore, Bangladesh is called a land of rivers. In 1971 Bangladesh experienced a war of liberation. The war lasted for nine months and incurred a huge loss in both physical as well as economic infrastructure. After independence it faced great shortages of food, famines have become a phenomenon of the country in the subsequent years. Therefore, as some scholars like Mahmud (2008) mentioned, after independence

Bangladesh was designated as a 'test case[4]' for development while Henry Kissinger called it 'an international basket case'.

In the year of independence, the total GDP was US $8.752 billion, and Bangladesh was able to gain quick recovery of its war affected economy with sustained growth in food production, and a good record of disaster management. Bangladesh has experienced a constant GDP growth of more than 6 percent in the last decade and in 2016 the total GDP stood at $686.5 billion. Life expectancy has increased to 63 years, in the 1970s it was only 50 years. Bangladesh has thus showed remarkable growth in all the dimensions (socio economic) over the last 40 years. More about the economic, employment, social conditions and the poverty levels of the country are briefly discussed below.

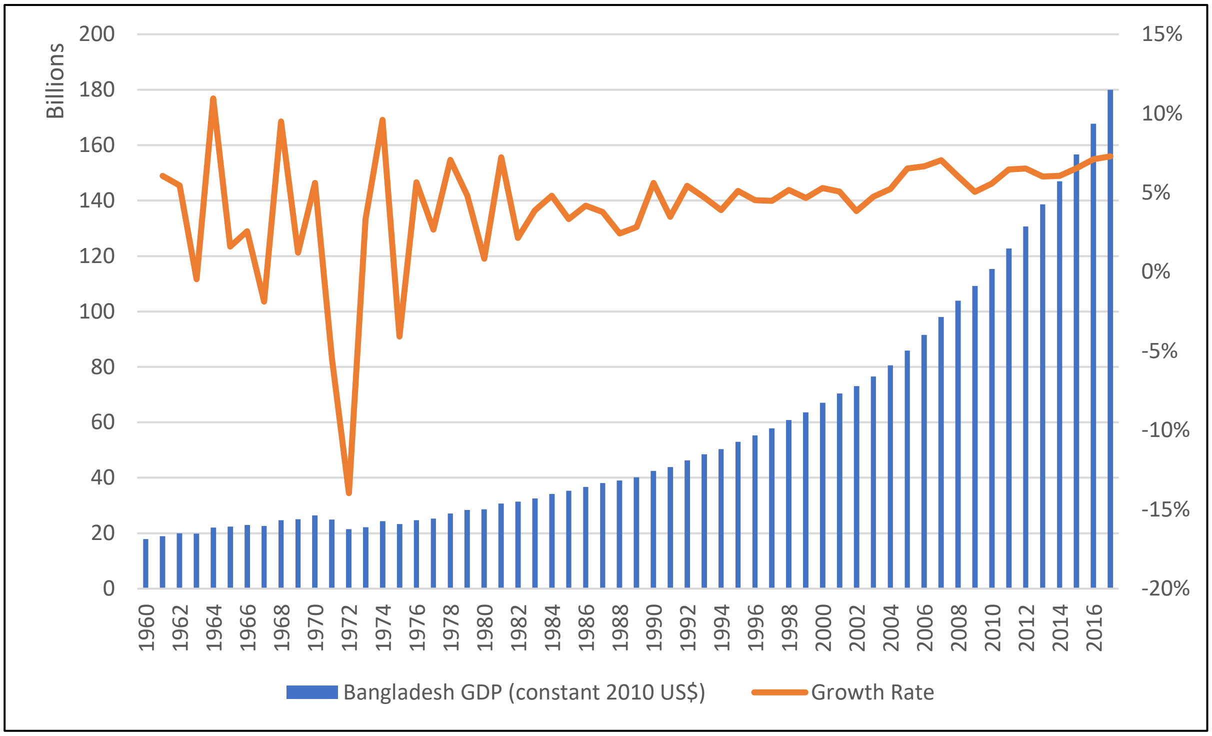
2.2.1 Economic Growth, Inflation and Employment

Based on data from the Bangladesh Bureau of Statistics (BBS), Bangladesh has experienced a constant GDP growth for last eight years. Indeed, it's considered as one of the best performing countries of the world. There are not many countries that have grown consistently at rate of more than 6.0 percent for one decade in a row, as experienced by Bangladesh. Therefore, the Business Insider, UK, in April 2017 declared Bangladesh the fifth Asian Tiger after Hong Kong, Singapore, South Korea and Taiwan. The total GDP of Bangladesh in 2017

[4] When Just FAALAND and Jack R. PARKINSON published their book "Bangladesh. The test case of development." (London: Hurst. 1976) the title stuck. It was in response to Henry Kissinger calling Bangladesh a "basket case", i.e. a hopeless case. A "test case of development" meant that if "development" would "work" in Bangladesh, it would work everywhere. And "development" in the 1970s meant foreign capital, foreign aid and foreign know-how. Although development was slow, Bangladesh certainly has not been a "hopeless" case and Bangladeshis today enjoy a higher level of economic and social well-being than at any time since the colonial days, at least on an average basis (Islam and Zingel (2012, p.1).

was contributed by the service sector (56.5 percent), followed by industry (29.2 percent) and agriculture (14.2 percent).

Figure 2-A: Bangladesh total GDP and GDP growth rate (from 1960-2016)



Source: World Bank

After independence in 1971 the per capital GDP was only US$131 but this gradually increased to double in 1980 at around US $222. In 1990, per capital GDP was US $297, in 2000 it stood up to US $405, and in 2010 it became US $757. The last seven years from 2010 to 2017, the per capital GDP become almost double. At the end of 2017 the per capital GDP became US $1516. Based on per capital GDP, the World Bank upgraded Bangladesh economic status from lower income to a lower middle-income country.

Table 2-A: Sector wise GDP growth Rate (2011-2017)

Industry (in percent)	**FY-11**	**FY-12**	**FY-13**	**FY-14**	**FY-15**	**Fy-16**	**FY-17**
Agriculture	0.78	0.52	0.41	0.70	0.53	0.43	0.50
Industry	2.31	2.47	2.59	2.27	2.74	3.24	3.18
Manufacturing	*1.64*	*1.69*	*1.80*	*1.60*	*1.93*	*2.26*	*2.11*
Service	3.25	3.3	2.88	2.92	3.00	3.21	3.31
Whole sale and Retail trade	*0.89*	*0.90*	*0.83*	*0.90*	*0.86*	*0.88*	*0.92*
Public Administration and Defense	*0.27*	*0.24*	*0.21*	*0.22*	*0.32*	*0.38*	*0.34*
Education	*0.12*	*0.16*	*0.13*	*0.16*	*0.17*	*0.26*	*0.26*
Health and Social Works	*0.12*	*0.07*	*0.09*	*0.09*	*0.09*	*0.13*	*0.13*
Tax and Subsidy	0.12	0.10	0.13	0.16	0.28	0.24	0.25
GDP Growth	**6.46**	**6.52**	**6.04**	**6.06**	**6.55**	**7.11**	**7.24**

Source: CPD (2017): State of the Bangladesh Economy in FY2017

Inflation rate in Bangladesh is about 5.44 percent in 2017. It decreases from the previous three years 2014, 2015 and 2016. The inflation rate in these three years was 7.35, 6.40, and 5.92 percent respectively. In the national inflation rate, food items constitute 56.18 percent and non-food items constitute 43.82 percent. Beside the national level inflation rate, urban inflation rate is higher than rural areas. In 2017, the inflation rate of urban area was 6.35 percent compared to rural inflation was 4.95 percent. In urban area food items constituted 46.52 percent and non-food items constituted 53.48 percent. In rural area food items constitute 61.41 percent and non-food items constitute 38.59 percent.

Table 2-B: Annual Average CPI base Inflation (FY 2006=100)

Group	Weight	FY-2014	FY-2015	Fy-2016	FY-2017
A. National Level					
General Index	100.00	195.08 (7.35)	207.58 (6.40)	219.86 (5.92)	231.82 (5.44)
Food	56.18	209.79 (8.57)	223.80 (6.68)	234.77 (4.90)	248.90 (6.02)
Non-Food	43.82	176.22 (5.54)	186.79 (5.99)	200.74 (7.47)	209.92 (4.57)
B. Rural					
General Index	100	196.90 (7.07)	209.10 (6.20)	220.12 (5.27)	231.02 (4.95)
Food	61.41	207.72 (8.11)	221.02 (6.40)	230.31 (4.20)	243.08 (5.55)
Non-Food	38.59	179.69 (5.21)	190.13 (5.81)	203.92 (7.25)	211.83 (3.88)
C. Urban					
General Index	100	191.72 (7.89)	204.76 (6.80)	219.37 (7.13)	233.29 (6.35)
Food	46.52	214.85 (9.66)	230.56 (7.32)	245.66 (6.55)	263.09 (7.10)
Non-Food	53.48	171.61 (6.01)	182.32 (6.24)	196.50 (7.77)	207.38 (5.54)

Source: BB, 2017

According to World Bank data, the unemployment rate of Bangladesh increased to 4.37 percent in 2017 from 4.35 percent in 2016. The average unemployment rate was 3.59

percent from 1991 to 2017. The rate reached an all-time high of 5.00 percent in 2009 and a record low of 2.20 percent in 1991.

2.2.2 Social Indicators

Bangladesh has a good track record in achieving social performance compare to its past position. Based on the Social Progress Imperative, a US based non-profit ranking organization, ranked, Bangladesh as 101st out of 133 countries. Even though Bangladesh is categorized as a ‘low social country,’ it is one of the best performing countries in the world.

Bangladesh is also one of the countries that has made wonderful progress in MDG achievement. It achieved several MDGs like reducing the prevalence of underweight children, reaching gender parity in education both in primary and secondary, reduce significantly child mortality under-five, containing HIV infection with access to antiretroviral drugs, children under five sleeping under insecticide related bed nets, cure of TB under DOTS and others. UNDP assess human development index under three dimensions; a long and healthy life, access to knowledge and a decent standard of living. Life expectancy at birth used as a proxy for long and healthy life, the average year of schooling (people aged 25 years and older) are used as a proxy for access to knowledge and decent standard of life are measured by Gross National Income (GNI)[5] per capita using purchasing power parity (PPP) conversion rates.

The Human Development Report 2016, published by UNDP measured the HDI value for Bangladesh at 0.579, which categories Bangladesh as a medium human development

[5] GNI calculated in constant 2011 in dollar (USD) terms.

country. It ranked 139 out of 188 countries and territories. Between 1990 and 2015 the HDI value increased by 50 percent from 0.386 to 0.579, the life expectancy increased by 13.6 years and average schooling increased by 2.4 years. The Gross National Income (GNI) per capital of Bangladesh increased by about 159.8 percent between 1990 to 2015.

Table 2-C: Human development Index (1990-2015)

Year	Life Expectancy at birth	Expected Years of Schooling	Mean years of Schooling	GNI per capital (2011 PPP$)	HDI Value
1990	58.4	5.7	2.8	1,286	0.386
1995	61.9	6.6	3.3	1,435	0.423
2000	65.3	7.5	4.1	1679	0.468
2005	68.0	8.4	4.5	2036	0.506
2010	70.1	9.4	4.9	2652	0.545
2011	70.5	9.4	4.9	2652	0.557
2012	70.8	10.0	5.2	2943	0.565
2013	71.2	10.0	5.5	2071	0.570
2014	71.6	10.2	5.2	3179	0.575
2015	72.0	10.2	5.2	3341	0.579

Source: Human Development Report 2016

According to UNESCO, Bangladesh has an adult literacy rate of 72.76 percent. While the male literacy rate is 75.62 percent, for females it is 69.9 percent. In 1980, the adult literacy was 29.35 percent where male literacy rate was 39.75 percent and female literacy was 17.97 percent. Women's participation in the labor force has increased over time in Bangladesh. The female participants was only 4 percent in 1974, but increased to 35.6 percent in 2016. Women labor participation increases faster than male participation. The male labor force participation was 81.9 percent in 2016, whereas in 1974 it was 80.4 percent. Even in the Bangladesh parliament 30 seats are reserved for female besides the elected parliamentary members.

2.2.3 Bangladesh Poverty Scenario

Bangladesh is a poverty-stricken country but has been successfully able to reduce her poverty level from the 1980s. According to the World Bank (2019), in 1972 the poverty rate was 82 percent and by 2010 it was only 31.5 percent, it further reduced to 24.3 percent in 2016 (ADB, 2016). Although poverty is still very high, Bangladesh has continued to make an impressive progress in reducing poverty. Measured against the international extreme poverty line, poverty fall from 18.5 percent in 2010 to 13.8 percent in 2016, and the country is on track to reach the first of the more recent Sustainable Development Goals (SDGs) of eradicating extreme poverty by 2030. Progress on reducing poverty measured by the national upper poverty line has been equally strong. In 2010, almost one third of the country's population lived in poverty; by 2016 this had fallen to less than one-fourth. Since 2010, 8 million Bangladeshis have moved out from poverty.

Table 2-D: Bangladesh poverty Scenario

Indicator Name	2000	2005	2010	2016
Urban poverty headcount ratio at national poverty lines (percent of urban population)	35.2	28.4	21.3	
Urban poverty gap at national poverty lines (percent)	9.1	6.5	4.3	
Poverty gap at $5.50 a day (2011 PPP) (percent)	51.4	47	43.4	39.2
Poverty headcount ratio at $5.50 a day (2011 PPP) (percent of population)	91.6	89.3	87.7	84.5
Rural poverty headcount ratio at national poverty lines (percent of rural population)	52.3	43.8	35.2	
Rural poverty gap at national poverty lines (percent)	13.7	9.8	7.4	
Poverty headcount ratio at national poverty lines (percent of population)	48.9	40	31.5	24.3
Poverty gap at national poverty lines (percent)	12.8	9	6.5	
Poverty gap at $3.20 a day (2011 PPP) (percent)	27.8	22.7	19	15.6
Poverty headcount ratio at $3.20 a day (2011 PPP) (percent of population)	72.7	66.3	60.4	52.9
GINI index (World Bank estimate)	33.4	33.2	32.1	32.4
Poverty gap at $1.90 a day (2011 PPP) (percent)	8	5.1	3.6	2.7
Poverty headcount ratio at $1.90 a day (2011 PPP) (percent of population)	34.8	25.7	19.6	14.8

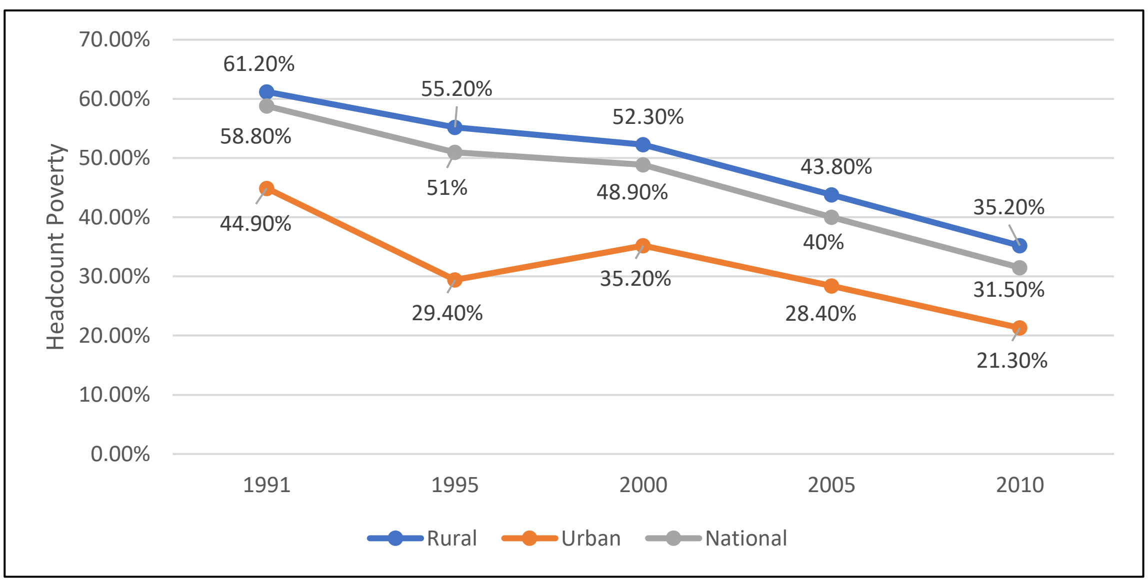
Source: World Bank, 2019

Table 2-E: Wealth hold by different segment of the population

Indicator Name	2000	2005	2010	2016
Income share held by lowest 20 percent	8.6	8.8	8.9	8.6
Income share held by lowest 10 percent	3.7	3.8	3.9	3.7
Income share held by highest 10 percent	27.9	28	26.9	26.8
Income share held by highest 20 percent	42.7	42.5	41.5	41.4
Income share held by fourth 20percent	21	20.9	21.2	21.4
Income share held by third 20 percent	15.6	15.6	16	16.1
Income share held by second 20 percent	12.1	12.2	12.5	12.4

Source: World Bank, 2019

Figure 2-B: Poverty status of Bangladesh from 1991 to 2010



Source: World bank, 2019

Based on Human Development Report 2016, the multidimensional poverty it higher than the national poverty line. Where the national poverty drops to 24.3 percent in 2016 but based on the most available data 40.7 percent of the population (64,816 thousand people) are multidimensional poor while an additional 19.6 percent lived near the multidimensional poverty (31,172 thousand people) line in 2014.

Table 2-F: Multidimensional Poverty Index

Particular	Bangladesh	Nepal	Pakistan
MPI Value	0.188	0.116	0.237
Head Count (percent)	40.7	26.6	45.6
Intensity of Deprivations (percent)	46.2	43.7	52.0
Population Share (percent)			
Near Poverty	19.6	14.4	14.9
In Severe Poverty	16.0	9.3	26.5
Below income poverty line	18.5	15.0	6.1
Contribution to overall poverty of Deprivation (percent)			
Health	26.1	25.6	32.3
Education	28.4	32.2	36.2
Living Standard	45.5	42.2	31.6

Source: Human Development Report 2016

Table 2-G: Poverty status of developing countries and Islamic Developing countries

Type[6]	Country	Population below national poverty line (%)[7]	World Poverty Rank (in 2018)	GDP-PPP per capital ($) (in 2018)
Sample Country	Bangladesh	24.3 (2016)	50	4,993
I-DC	Afghanistan	54.5 (2016)	16	2,086
I-DC	Indonesia	10.6 (2017)	94	14,019
I-DC	Jordan	14.4 (2010)	75	9,651
I-DC	Pakistan	24.3 (2015)	54	5,839
I-DC	Sudan	46.5 (2009)	8	1,613
I-DC	Yemen	48.6 (2014)	20	2,404
DC	Brazil	26.5 (2017)	107	16,662
DC	Cambodia	17.7 (2012)	49	4,643
DC	Colombia	27 (2018)	104	15,576
DC	India	21.9 (2011)	68	8,484
DC	Mexico	43.6 (2016)	124	21,107
DC	Peru	21.7 (2017)	99	14,892
DC	Philippines	21.6 (2015)	74	9,494
DC	Vietnam	9.8 (2016)	65	8,063

Source: Author's collection

Table 2-F represent the poverty status of different developing countries including selected Islamic developing countries. The table also represent a country's poverty ranking based on PPP per capital in US dollar terms. From the table, it can be seen that in Bangladesh 24.3% of the population lives under the national poverty line. Among the non-Islamic countries, Vietnam has the lowest population living under the poverty line (9.8%) and Mexico has the highest portion at around 43.6%. On the other hand, in Islamic developing countries, Jordan has the least number living under the national poverty line (14.4%), While Afghanistan has the highest number at around 54.5%, after Yemen (48.6%), and Sudan (46.5%).

[6] I-DC means Islamic developing countries and DC means developing countries

[7] Inside the parenthesis represent the most recent year data available in the World Bank database

Based on the PPP per capital Bangladesh ranks as the 50th poverty prone country. Among the developing countries listed in table 2-G, Jordan has the highest PPP among the Islamic developing countries and compared to all listed developing countries Mexico has the highest PPP per capita at US $21,107.

2.3 Development of the Microfinance industry

It is considered that Prof. Dr. Muhammad Yunus is the ‘Father’ of Microcredit and won a Nobel Peace Prize jointly with the Grameen Bank that was established in 1976 by providing 856 Taka (less than $27) to 41 members (Looft, 2014. p.31). But as the literature review discloses, microcredit was exercised long before the introduction of the Grameen bank.

In 1720, the Irish loan fund was emerged as a charitable organization. Initially, the Irish loan fund was mainly supported by donation with the aim of providing loans to the poor people without any interest. Loans were provided to the poor borrower for a maximum of one year and installments were collected by weekly repayments. The Dublin Musical Society began its operation in 1747 and was incorporated in 1756. It started providing loans from £2 - £4 to the borrower. By the end of 1768 it was providing more than £15,000 in loans to the 5290 members. The Wilson Charity was established in 1766, in London by Samuel Wilson. Based on its history, it was the first charitable organization established in London with an amount of £20,000. The loans were targeted to young people who wanted to setup a new business. Initially they, provided small amounts (less than £100) with a maturity period of one year and later it extended its loans from £100 to £300 with a maturity period of up to 5 years. Even though it was a charitable organization, it charged interest on loans. Interest was charged based on the maturity period. When the maturity period was one year or less they charged 1 percent interest, on the other hand if the maturity period was more than one year, it charged 1 percent for the first year and 2 percent thereafter (Hollis & Sweetman, 1998).

In 1840s, a disastrous harvest in Germany ruined the economic condition of many poor farmers. Herman Schulze-Delitzsch took an initiative to help these poor farmers. Therefore, in 1850 Herman Schulze established the first thrift and loan association for German poor farmers and craftsman who did not have access to formal financial institutions. By the end of 1860s, it had expanded its operations and become a network of 364 units with 50,000 members.

Microfinance has a much longer history in Asia then in Europe, though little is documented in the early history of indigenous institutions like Arisan in Indonesia, Hui in China, Chits in India, or Paluwagan in the Philippines, to name but a few (Seibel, 2010. p.3). Microfinance in the Indian sub-continent emerged almost two or three millennia before Europe and Africa (Seibel, 2010). According to Seibel (2010) the microfinance served in this area in three phases – Moneylenders, Rotating Chits and the Merchant Bank. Moneylenders providing loans dates back to the prehistoric period. The main sources of their loan funds were their own resources. Money lending becomes an organized and structured profession in the Indian subcontinent from 2000 years ago, and such lending still exists in India, Bangladesh and Pakistan. Based on the timely demand, many moneylending businesses have now turned into Chit funds or a Merchant Bank. In 1900s in Punjab (India) moneylenders disagreed to provide loans in the agricultural sectors because based on the Punjab state law moneylenders can't use the farmers land as mortgage for loan. Moneylenders restricted their loans to the agriculture sector. However, the demand created from the agriculture sector saw the government of Punjab passing an Act called 'Land Improvements Loans Act of 1883'. In 1904, the Land Improvements Loans Act of 1883 was transferred to the Cooperative Credit Societies Act 1904. Under this Act, Indian first ‘Urban Cooperative Credit Society’ was registered in Kanjivaram in 1904; in 1905, Pioneer Urban Cooperative Society in Bombay (Now in Mumbai); in 1906 Military Accounts Mutual Help Co-operative Credit Society in Poona and in 1906 Cosmos Cooperative Society in Pune were set up.

Chit funds also known as chitty, Kuri or cowry are well-known institutions in India, but still the main origin of chit funds is unknown. The mechanism of chit funds is very simple. A group of people join together and contribute equal amounts regularly, selecting a member from them to take the whole amount by lottery or demonstrated need or in an agreed-upon pre-scheduled where every member receives their contribution. The chit fund may dismiss or restart again. In this form, members have no loss or gain. In 1945, the Travancore Chit Act of 1945 introduced regulating minimum capital, ceilings on aggregate chit amounts, and procedures of dispute settlement. This Act worked well to grow licensed chit’s funds. Still, a lot of chit funds are exercised in Indian subcontinent without any license.

Merchant banks emerged in the Indian subcontinent during the first millennium BC as seen in the Vedic script (a Hindu script) which deals with both goods and money. Between 200 BC and 300 AD a differentiation took place between a group of moneylending and traders. As a result, Merchant Banks emerged, and banking become a profession of the Vaisay caste. Regulation of merchant banks was also introduced during the first two centuries A.D. when a law code, Dharmashastras, was written regulating loan deeds, law courts, and debt procedures. Moneylending and banking became licensed and tax-paying professions. In secured loans the interest rate was 15 percent p.a. and for unsecured loan interest was charged based on repayment ability or caste system. A priest (Brahmins) was considered as a wealthy person and charged 2 percent per month, but on the other hand 5 percent p.m. to a cultivator (shudra) because they are considered as lower caste and poor groups (Seibel, 2010). In Merchant banks overdue loans were written off after 10 years (Bhargava 1934; Schrader 1997). In the period between mid-thirteenth and eighteenth-century merchant banks were boosted because of the trade between Indian subcontinent and the outside world, especially from Europe and Asian countries. At that time, they charged 6 percent to 18 percent interest on their secured loan and 40 percent to 60 percent on risky investments (Seibel 2005)

Informal sector financing can be traced to the fourth century B.C. in Nepal. But the first cooperative was formalized by Cooperative Legislation in 1911 and start formal financing operations by providing small loans in 1950. Outside, in Indonesia, formal micro financing began in 1970 by the establishment of a private bank, Bank Dagang Bali (BDB) in Bali. Modern Microfinance starts from the introduction of Grameen Bank by Professor Dr. Muhammad Yunus in 1976 in Chittagong, Bangladesh. He is called the father of modern microcredit.

2.3.1 Introduction of the Grameen Bank (1976-1982)

It was in 1976 that a 21-year young and energetic lady named Ms. Sufia Begum lived in a village named Jubra, near the University of Chittagong. Ms. Sufia was a talented lady in making bamboo stools. She was trying hard to help her family by her talent. Ms. Sufia don’t have any assets to buy her raw materials for making bamboo stools. Therefore, every day she borrowed 25 cents from a local trader in the condition that she would sell her bamboo stools to that trader at a lower price compared to market price and the money lender charged a usury level interest rate of around 10 percent per day. By selling her bamboo stools she could make a profit of 2 cents per day. As the money lender charged usury level interest rate, Ms. Sufia was unable to become self-dependent in buying her raw materials, what Mainsah et al., (2004) called 'bonded labor'. This is not the only case in Jubra village, similar experiences were found with all of the inhabitants in the same village.

This pathetic scenario was observed by an economics professor of the University of Chittagong. The professor lent $27 to 42 poor villagers to get out of this vicious cycle and he observed that all the borrowers were successfully able to repay his $27 loan within a short time. The name of the professor was Dr. Muhammad Yunus, the Nobel laureate and the father of microfinance. This was the beginning of the Grameen Bank. Professor Yunus shared his success story of Jubra village to the formal commercial banks to finance the poor, but they refused to finance poor people. The primary reasons were: poor people require small loans which is costly for banks, and do not possess any collateral assets. But with the help of the central bank, and Bangladesh krishi (agricultural) bank Professor Yunus could answer all those question by introducing the Grameen bank. He proved that poor people are bankable even though the main fear of commercial banks was the repayment rate, because the repayment rate was sky high, the recovery rate was almost 100 percent.

This successful story in Jubra village was ignored by several banks in Bangladesh, especially the larger state-owned commercial banks. Bank management, even central banks, argued that Jubra village was a small project with few clients and being a professor in a public university, Muhammad Yunus had utilized his face value in that village. But operating the same lending method in the countrywide would ultimately fail. Professor Yunus was confident in his success, he asked all bankers to select any place for another feasibility test. All bankers agreed to extend the project in the Tangail district (a district north of Dhaka, near the capital city of Bangladesh). In 1979, professor Yunus extend his project in Tangail district and within two years, he proved his success story in extending loans to the poor.

After this successful feasibility test in the Tangail area, the central bank and the commercial banks, as well as some international donor organizations came forward to help the Grameen project. In 1982 by an official legislation Grameen bank became an independent government bank in partnership with its borrower. The government owned 60 percent of the Grameen bank and borrowers owned the rest. Now Grameen bank is a public bank with 90 percent owned by its borrower and 10 percent owned by the government. From the tiny investment of US $27, now Grameen bank has become a thousand-billion-dollar organization that provides microcredit services in different parts of the world.

The Grameen bank maintains an opposite strategy to that of commercial banks. Where in commercial banks the borrower come to the nearest bank branch for loan application, Grameen bank provides the services to the client’s doorstep. Commercial banks provide loan to the rich wealthy people but Grameen bank offers loan to poor and vulnerable people. Commercial bank provides loans basically to men, Grameen bank provides loans to women. Nearly 90 percent of Grameen bank borrowers are women.

The Loan repayment schedule for commercial banks is low (monthly or yearly basis), therefore, client have huge amounts of repayment at once, but the Grameen bank repayment schedule is very high (weekly or bi-weekly). Therefore, the repayment amount per installment is low. The Grameen bank was established with some other core objectives as follows:

- Extend banking facilities to poor men and women;
- Eliminate the exploitation of the poor by money lenders;
- Create opportunities for self-employment for the vast multitude of unemployed people in rural Bangladesh;
- Bring the disadvantaged, mostly the women from the poorest households, within the fold of an organizational format which they can understand and manage by themselves; and
- Reverse the age-old vicious circle of ‘low income, low saving and low investment’, into the virtuous circle of ‘low income, injection of credit, investment, more income, more savings, more investment, more income.’

2.3.2 Grameen Bank; an overview

Grameen bank (GB) has become a role model for all microfinance institutes. In 1982 the government of Bangladesh passed an ordinance that transfer Grameen NGO assets to an independent Grameen Bank. For several years it depended on local government subsidy, foreign donation and the soft loan. Now GB is one of the successful MFI in the world, and is financially and economically sustainable. Grameen bank’s financial statements express its assets, capital adequacy and internal resources increases over time. Total assets were BDT 229,351 million (around US $3058.01 million) as of 2016, three times higher than 2008 (BDT 82,801 million or US $1035 million). But, in the case of branches and employees there were no significant changes observed from 2008 to 2016. In 2008, its total branch network was 2539 and in 2016 it had 2568 branches. In case of sustainability assessment however, the ROE of Grameen bank is not so stable. The range of ROE is from 0.22 percent to maximum 17.10 percent. In case of operational sufficiency, from 2008 to 2016 its operational sufficiency score was more than 100 percent and for financial self-sufficiency it became self-sufficient in 2008 but then slightly decreased to 95.8 percent in 2015. It successfully recovered in 2016, when its economic self-sufficiency score became 101.23 percent. From this analysis it can be said that GB is self-sufficient both operationally as well as economically (see Table 2-G).

Table 2-H: Grameen Bank Self-sufficiency score

Year	2011	2012	2013	2014	2015	2016
Total assets amount BDT in million (US $ in million)	140,441 (1959.67)	158,952 (1928.43)	178,937 (2294.07)	200,961 (2609.88)	220,885 (2831.88)	229,361 (2867.01)
Number of Branches	2,565	2,567	2,567	2,568	2,568	2,568
Return on equity (ROE) (%)	8.97	17.10	13.65	4.15	0.22	11.82
Operating self-sufficiency (%)	103.31	106.17	105.15	101.53	100.08	104.53
Financial self-sufficiency (%)	95.79	99.62	99.59	96.51	95.80	101.23
Recovery rate (%)	96.75	98.63	98.81	98.85	98.47	99.05

Source: GB, 2016

2.3.3 Growth of Mainstreaming Microfinance Institution in Bangladesh

The progress of microfinance operations has been continuous since their inception. The growth of microfinance was steady till 1990s. After 1990, the country experienced a huge expansion of microfinance operations which drew the attention of all interested parties such as donors, developing partners and policy makers all over the world. Observing the success of Microfinance by Multilateral development organization (such as the World bank, IMF, the United Nations) provide more emphasis on microfinance for development initiatives. Microfinance contributes on socio-economic development and poverty alleviation, and Professor Yunus along with Grameen Bank won the Nobel Peace Prize in 2006. There are four types of microfinance organization based on their operations, operated in Bangladesh. Those are NGO-Type MFIs, State Owned MFIs, Commercial Bank operated MFIs and Special type of MFIs initiated by drfferent ministry of Finance.

NGO-MFIs in Bangladesh

Non-government organization (NGO) type microfinance is prominent in Bangladesh. This type of MFI is operated under Microcredit Regulatory Authority (MRA). MRA became the prime authority to monitor and supervise all NGO type MFIs. As of 2015 there were 659 NGO-MFIs operating in Bangladesh. Most of them are conducted and funded by domestic entrepreneurs and some of them are directly funded and operated by foreign organization. According to MRA (2015), total loan disbursement by NGO-MFIs was BDT 634 billion (around US $ 8.13 billion) in 2015 double the BDT 303.18 billion (around US $4.21 billion) in 2011. According to Bangladesh Bank, by the end of June 2016, there were 680 licensed

MFIs and 191 Provisional licensed MFIs serving over 26.3 million clients. Some of the big NGO type microfinance groups in Bangladesh are Rural Advancement Committee [BRAC] (worldwide ranked 21), Association for Social Advancement [ASA] (worldwide ranked 1), and BURO (worldwide ranked 46).

According to MRA, (2016), among the top 10 NGO type MFIs operated in Bangladesh are, the BRAC (Bangladesh Rural Development Committee) is the first position (Table 2-H) in terms of loan outstanding and loan disbursement. The second position is in ASA, the third place is taken by BURO Bangladesh (Basic Unit for Resources and Opportunities of Bangladesh). The rest are as follows, TMSS, SSS, the Jagorani Chakra Foundation, UDDIPAN, the Paddakhep, Sajida Foundation, and the Shakti Foundation.

Table 2-I: Bangladesh Top Ten NGO Microfinance Organocation (FY 2015-16)

Name of MFIs	Total No. of Branch	Total Members	Total Active client	Loan outstanding (billion BDT)	Loan disbursement (Billion BDT)	Clients savings
BRAC	2088	5,478,037	5,478,037	127.83	218.51	43.36
ASA	2933	7,428,597	6,207,689	120.28	209.05	50.68
BURO-Bangladesh	648	1,356,572	921,924	24.43	39.52	7.69
TMSS	634	860,728	736,983	14.82	26.20	8.99
SSS	305	546,126	832,869	10.62	19.72	4.61
Jagorani Chakra Foundation	300	468,228	395,497	9.14	13.3	3.57
UDDIPAN	300	463,957	327,823	7.35	12.18	2.82
Poddokhep	299	318,161	278,289	6.20	10.92	2.45
Sajida Foundation	162	200,504	165,883	4.61	7.45	1.64
Shakti Foundation	378	896,859	456,315	4.39	7.46	1.47

Source: MRA 2016

BRAC is one of the largest NGOs worldwide and in Bangladesh itself is the largest microfinance organization. It started operations in 1972 after the independent war 1971. The objective of BRAC NGO was to work with war affected people. BRAC started its microcredit services to the poor people in 1974 before the Grameen bank (Amin & Sheikh, 2011, p.351). BRAC covered all 64 districts by 1974. By the end of 2016, BRAC's total loan outstanding value was BDT-127.84 billion. BRAC provides two types of microcredit to its clients; Micro loans with the title of '*DABI*'[8] that range from BDT-3500 to BDT 49000 and Micro enterprise Loans with the title of '*PROGOTI'*[9]. Besides micro credit BRAC also offers various development programs as listed in Table 2-I.

Table 2-J: Different services offered by BRAC

Savings and Credit	Sector Programs	Social Development
❖ Compulsory Savings ❖ Income generation and housing loan ❖ Life insurance	❖ Poultry and livestock ❖ Fisheries ❖ Sericulture and silk development ❖ Social forestry ❖ Agriculture extension	❖ Essential health care ❖ Education ❖ Environment awareness ❖ Group theatre ❖ Gram Shabha ❖ Human rights and legal services

Source: Amin and Sheikh, 2011

ASA is the second largest microfinance organization, and it's one of the largest MFIs in the world in terms of members and branch networks. According to Forbes ranking ASA was the top microfinance organization worldwide. ASA was established in 1978 with a pilot project

[8] DABI is a Bangla word, the appropriate meaning of DABI it the "right" to have something.

[9] "PROGOTI" is a Bangla word, the appropriate meaning of PROGOTI is "Advancement".

in a remote village '*Tapra*', under the then Manikganj sub-division, about 80 kilometers away from the capital city of Dhaka. In the early age of ASA, it undertook various development programs like awareness building for social action, training local birth attendants, capacity building of journalists, etc. In the mid-80's it introduced new programs working in the sector of health and nutrition, education, sanitation, etc. After practical experience from pilot projects, ASA realized that microcredit is one of the biggest tools to fight against poverty and hunger. From 1992, ASA solely focused on microcredit.

ASA started to make changes in the microfinance industry as a whole. As ASA experienced, donor led microfinance has some negative impacts in its operation because different parties work based on their self-interest. The interest of ASA is to fight against poverty, whereas donor interest is little bit different. Therefore, it tried to become self-financing. In 2001, ASA declared that it is a donor free microfinance organization. From the literature it seen that, ASA is the only and first microfinance organization worldwide that is declared donor free.

ASA provides loans under six categories: first, small loans for women, basically this loan is only for those women who need a small amount of money to earning extra money to help their family. The amount of these loans for women ranges[10] from 70-310 US dollar. Second, small loans for men, this loan was introduced in 2005 to help farmers. ASA's research found that many farmers face a shortage of fund when they want to buy seeds and fertilizer. To contribute to Bangladesh agriculture development ASA introduced this service. The advantage of this loan is that the farmer can decide the repayment schedule, but the amount

[10] The loan range differs based on region, for the rural area, the range is from US $70 to US $110 and in the urban area the range is from US $150 to US $310.

of loan is very low, from $30 to $50. The third is Small Entrepreneurs Lending (SEL). ASA then introduced medium size SELs in 2003. This credit service was introduced with a view to creating employment opportunities for the hard-core poor who want to establish a small manufacturing unit. Fourth, Small Business Loans (SBL) were introduced to support unemployed people and the extension of existing business, with the aim to make more employment or self-employment opportunities. SBL loans range from $250 to $350, the advantage of this loan is that group guarantee is not necessary.

Natural disasters like flood, drought, cyclone, river erosion, etc. have become normal in Bangladesh. In this bad situation, many people in the country can't work and it deters the normal life of poor people. In the same way ASA's customers are also affected by natural disasters. Sometimes members face seasonal poverty and sudden crises, many members cannot repay loans. Their income being blocked the natural disasters, they become unable to repay their installments. To bring back the ASA members from this unfavorable situation ASA introduced Supplementary Loans. ASA refinances the natural disasters affecting clients under the name of Supplementary Loans.

Finally, the Hardcore Poor Loan introduced by ASA is to help the hardcore poor people. The repayment schedule is relaxed in this loan. A borrower can choose any repayment schedule from weekly, monthly, quarterly, semi-annually and annually. Regardless of the repayment schedule the interest rate remains the same.

According to MRA (2016), BURO-Bangladesh is the third NGO type microfinance organization in Bangladesh, starting its operation in 1990 with the aim to reduce both physical and human poverty. It provides high quality flexible financial and social services to one million low-income people, particularly women. By 2017, it served 1.7 million women through 802 branches. Besides this top ten microfinance organization, there are 748 licensed NGO types of microfinanciers operating in Bangladesh. By the year 2016 the total outstanding loans were BDT-787.00 billion to 23.28 million borrowers.

State-owned Microfinance Institutes

Grameen Bank is one of the state-owned microfinance institutions in Bangladesh. GB is a special type of bank which is owned by the borrowers that it serves. Borrowers of the bank own 95 percent and the remaining 5 percent is owned by the government. It was initiated by professor Dr. Muhammad Yunus, a professor of economics at Chittagong University, Bangladesh. GB provides small loans to poor people who are excluded from formal financial institutions. The formal financial institutions provide loans backed by collateral assets but GB provides loan without any collateral. GB started its operation in the east part of Bangladesh with a fund of $27; now its estimated total assets are $2,803 million and its cumulative disbursements amounted to BDT 1,531.24 billion as of 2017. Now GB serves 81,392 villages through 2,568 branches which cover 97 percent of the total Bangladesh landscape.

Table 2-K: GB performance

Particulars	2011	2012	2013	2014	2015
Active borrowers (in millions)	6.58	6.71	6.74	7.03	7.18
Gross loan portfolio (BDT millions)	75,294	80,317	84,381	87,491	96,422
Branches	2,565	2,567	2,567	2,568	2,568
(a) Total assets (BDT billions)	140,441	158,952	178,937	200,961	220,885
(b) Net Profit (BDT billions)	12597.56	27180.79	24424.90	8339.88	485.95
ROA [(b)/(a)] (%)	8.97	17.10	13.65	4.15	0.22

Source: Author created based on GB (2015).

Commercial Bank Operated MFIs

Bangladesh commercial bank is composed of 4 state owned commercial banks, 57 private commercial banks and some 4 specialized state-owned banks. Among the 57 private commercial banks 8 are Islamic and 49 are conventional banks. All those banks meet the financial needs of medium and large enterprises. Now a few commercial banks have introduced small and medium size enterprises (SME) financing schemes to facilitate the financial demand of SMEs. But still poor people remain unbanked by formal commercial banks except for some Islamic Banks taking some steps ahead to cover these poor unbanked people. Among them Islami Bank Bangladesh Ltd. is the pioneer one.

Islami Bank Bangladesh Ltd. (IBBL) is the largest Islamic commercial bank in Bangladesh. It was established with an objective of establishing a balanced economic growth by ensuring balance between rural and urban markets. Commercial banks provide loans to their clients backed by collateral while there are many potential clients particularly in rural area without any collateral status. As a commercial bank IBBL feels difficulties to provide loans to these potential un-bankable clients. To mitigate this dilemma, IBBL introduced a special scheme of microfinance in 1995 named 'Rural Development Scheme'[RDS]. Basically, RDS was introduced to fulfill the financial or investment needs of the poor in agriculture and rural sectors that creates more employment opportunities and generates income to help to reduce poverty.

RDS is the first scheme that facilitated Islamic microfinance in Bangladesh and introduced by a commercial bank. The main funding sources of RDS are its clients' voluntary and forced deposits and IBBL fund allocation. RDS imitates the GB mode of group lending. However, one of the salient features of this scheme is that RDS does not provide any fund directly to the client but sells the goods clients need to get on a deferred payment condition to comply with Shariah principles. To become an eligible member for a loan from RDS, the applicant is observed by the group for eight weeks. After eight weeks observation by the group member as well as field officers on his/her regular attendance in center meetings, one member becomes eligible to apply for a loan. After receiving the application, the field officer and the investment committee thoroughly review the loan proposals. Before receiving the loan, each member must attend training for skills development, environmental awareness and entrepreneurship development to improve proper utilization of funds as well as efficient management and investment.

Table 2-L: RDS performance

Particular	**2012**	**2013**	**2014**	**2015**	**2016**
Villages	15,507	17104	18086	18615	19418
Centre	24,883	26887	27874	28822	28960
Members	733,520	836227	911470	947305	999140

Source: IBBL, 2016

There are some special types of MFIs that operate in Bangladesh. These specialized MFIs are established in some specific locations for some special purposes. For example, the Rangpur Dinajpur Rural Service popularly known as RDRS. It's a special type of MFI that was established after the war in 1971 to help the poor people of the north part of Bangladesh. Another special type of MFI is Bangladesh Rural Development Board (BRDB) which was established by GoB to develop the rural area. BRDB is basically found in Dhaka, and Camilla. Its outreach is very marginal compared to all MFIs in Bangladesh.

2.3.4 Introduction of Islamic microfinance in Bangladesh

After the independence war in 1971, more than 20,000 NGOs and MFIs registered with the Bangladeshi Department of Social Affairs and have been working in poverty reduction. But their success in poverty alleviation as well as reaching to the poor remain somewhat debatable (UNDP, 2012). It can be said that NGOs and Microfinance organizations only reached 50% of poor people especially in the rural agricultural sector. IBBL hypothesis that this exclusion is due to religious faith. To respond the demand of rural poor, IBBL introduced a 'Rural Development Scheme' in 1995 to cater to the investment needs of the rural sector and create employment opportunities and raise the income of rural people and alleviate poverty. The microfinance barometer shows that by 2018 microfinance covered 25.6 million clients. However, based on ADB (2016) almost 40 million Bangladeshi people live under the poverty line. From this statistic, 15 million poor people remain cut off from microfinance services. As a result, SIBL introduced FEIMP, the second Islamic microfinance initiative by an Islamic commercial bank, to finance large numbers of the poor who have not been served earlier by other MFIs/NGOs (SIBL, 2017, p.62). Compared to conventional MFIs, Islamic microfinance is new to Bangladesh. The first Islamic microfinance system was introduced in 1989 and named Al-Falah A'am Umayan Sangasta (AFAUS) in Dinajpur (North side of Bangladesh) at the district level. Islamic microfinance operates at the country level and was first introduced by an international non-government organization (NGO) 'Muslim Aid

Bangladesh' in 1991. Even though the Muslim Aid Bangladesh state that they operate all over the country, they limit their coverage to some specific areas, basically, urban areas. Another Islamic MFI named 'RESCUE' was introduced in the same year 1991. RESCUE operates at the district level and it started its operation in the Rangpur District.

The second country level Islamic MFI introduced in 1995 was named 'Rural Development Scheme (RDS)' and developed by IBBL. According to UNDP (2012) IBBL, a private Islamic bank developed the RDS, an innovative Islamic microfinance channel, in response to the demand of the rural Muslim poor in Bangladesh who were left out of conventional microfinancing due to religious beliefs. Later another two Islamic Banks introduced Islamic microfinance operations; one is the Family Empowerment Islamic Micro-Finance Program (FEIMP) introduced by Social Islami Bank Limited (SIBL) in 2015, and the other is the Krishi O Grameen Khudra Biniog Prokolpo ('Agriculture and Rural Micro Investment Project') introduced by the Al-Arafah Islami Bank in 2016. Presently, a total of eight Islamic microfinance institutions operate in Bangladesh. Among them IBBL-RDS covers 95 percent of the total Islamic microfinance market share and the remaining 7 cover the rest.

Table 2-M: List of Islamic microfinance organizations in Bangladesh

Name	Establish year	Level of Operation
IBBL- Rural Development Scheme (RDS),	1995	Country level
SIBL- Family Empowerment Islamic Micro-finance Program (FEIMP)	2015	Country level
Al-Arafah Islami Bank Microfinance Program	2016	Country level
Muslim Aid Bangladesh	1991	Country level
Al Falah A'am Umayan Sangasta (AFAUS)	1989	Dinajpur District
TMSS Islamic Microfinance (TIMF)	2008	Country level
RESCUE	1991	Rangpur District
Noble Education and Literary society	N/A	Bogra District

Source: Mannan, 2016 (Note: N/A=Not available)

The RDS is the market leader of Islamic microfinance not only in Bangladesh but also all over the world. RDS alone covers 50 percent of global Islamic microfinance market share and in Bangladesh, RDS covers 5 percent of the total domestic MFI industry. RDS was introduced by IBBL in 1995, with an aim to alleviate rural poverty by creating employment opportunities that increase the income of the rural poor. It is considered as the first Islamic MFI initiative by a commercial bank in Bangladesh (IBBL, 2016) that operates across the country.

Table 2-N: Outreach of Islamic Microfinance by Country

Region	No. of Included Institutions	% Female (Avg.)	Total No. of Clients
Afghanistan	4	22	53,011
Bahrain	1	n/a[11]	323
Bangladesh	2	90	111,837
Indonesia	105	60	74,698
Jordan	1	80	1,481
Lebanon	1	50	26,000
Mali	1	12	2,812
Pakistan	1	40	6,069
West Bank & Gaza	1	100	132
Saudi Arabia	1	86	7,000
Somalia	1	n/a	50
Sudan	3	65	9,561
Syria	1	45	2,298
Yemen	3	58	7,031
Total	126	59	302,303

Source: Karim, et al., (2008).

[11] N/A=Not available

But to maintain a strong market share, Islam Microfinance should be financially as well as economically viable. Many scholars, like Bhuiyan et al., (2011) have already found that Islamic microfinance 'RDS' is financially viable. They found that RDS's ROA was 2.21 percent and its ROE was 9.26 percent in 2009, which emphasize the financial self-sufficiency of RDS. Parveen (2009) found RDS's operating profit was increasing over time. In 2003 RDS operating profit was BDT 20.10 million and by 2006 it had become BDT 55.00 million. According to Khandker et al., (1995) RDS's economic sustainability is really good. The average loan recovery rate of RDS is over 99 percent and that ensures a low level of MFI loan losses. RDS charges a 12.5 percent mark-up profit on its investment and timely repayment rebate 2.5 percent, therefore, its return on investment is considered as 10 percent. Table 2-M shows some performance indicators for RDS.

Table 2-O: Performance of RDS

Year	2012	2013	2014	2015	2016
Total Outstanding Inv. (BDT Mil)	10,390.71	13730.92	17379.97	20798.82	24476.99
Total Savings (BDT mil)	3,323.15	4531.46	5727.15	6932.89	7952.64
Recovery Rate (percent)	99.72	99.70	99.50	99.47	99.54

Source: Author based on IBBL, (2016, 2015, 2014, and 2013).

2.4 Microfinance Coverage in Bangladesh

Bangladesh is known as a synonym of microcredit. The first microfinance institute, the Grameen bank was introduced in Bangladesh. Servin et al. (2012) declared that the development of microfinance (Grameen Bank) is one of the main innovations in the past 25 years. Grameen bank started its operation in 1976 and now there are 579 licensed MFIs operating in Bangladesh (MRA, 2016).

The Microfinance industry in Bangladesh provides financial services to remote and destitute people who are excluded from formal financial institutes (bank). Besides Grameen bank, and the MFIs that were licensed from MRA, some organizations under the ministry of finance, and some government and private banks provide microfinance services in Bangladesh. To achieve the SDGs and make a middle-income country, the government of Bangladesh, emphasizes the microfinance industry. In the fiscal year 2015-16, MFIs provided 1005.57 billion in loans to 3.17 million clients (MRA, 2016).

Table 2-P: Members and loan outstanding by different types of MFIs

Details	Members (in million)	Borrower (in million)	Loans outstanding (in billion)	Savings (in billion)	Loans disbursement (in billion)
MRA Licensed MFIs	27.58	23.11	454.01	170.67	782.67
Grameen Bank	6.96	6.96	109.39	183.86	169.33
Govt. MFIs	0.53	0.53	31.33	7.57	23.43
Bank’s operated MFIs	1.12	1.12	24.03	9.90	30.14
RDS	0.99	0.99	24.48	7.95	24.77

Source: Author’s calculation based on MRA, 2016 and IBBL, 2017.

Based on the size of the loan amount the MRA categories MFIs under four different segments. Small loan categories that provide loan on to BDT-10,000; medium loan categories from BDT-10,000 to BDT-100,000, large loan categories from BDT-100000 to BDT-500,000, and very large loan categories above BDT-500,000. Among these categories, small loans are provided by 487 MFIs, Medium loans by 138 MFIs, large loans by 23 MFIs, and only 4 MFIs deal with very large loans.

Table 2-Q: Microfinance Organization based on loan size

Type	Loan Size	No of MFIs	Active Clients	Total Members	Employee	Outstanding Loan (in million)	Savings (in million)
Extra Large	More than 500,000	4	13578560	15988323	58695	318,164.13	123,552.43
Large	100,000 – 500,000	23	4912905	6082963	34315	98237.20	37,009.43
Medium	10,000-100,000	138	4250891	5637994	30975	75,302.91	26,809.84
Small	0-10,000	487	23833733	29156933	132,680	505,622.31	192,776.81

Source: MRA, 2016

Most of the microfinance organization operate in a limited territory like sub-district, district, or even division level. Only a few MFIs cover the whole country. Among these Grameen Bank, BRAC, ASA, Jagorani Chakra Foundation, UDDIPAN, TMSS, and SSS are prominent. Grameen Bank is one of the biggest MFI in Bangladesh. It covers 97 percent of the total landmass by 2,568 branches. BRAC also operate countrywide in all 64 districts including hill track area. ASA operates all over the country with 3042 branches. The Jagorani Chakra

Foundation covers 88 districts by 477 branches offices. and UDDIPAN covers 37 Districts out of 64 through 307 branches.

Except for a few big MFIs, all other microfinance institutes cover only a few districts within their locality. According to MRA (2016) a total of 689 NGO licensed microfinance institutes operate countrywide through 16,204 branches. Among them 25 percent (4126) are located in Dhaka division, Chittagong 17.16 percent (2780), and Rajshahi 17.08 percent (2768). The new divisions have the lowest branches like Sylhet and Mymensingh (See Table 2-J).

Table 2-R: Microfinance Branch offices in different divisions

Division	**No. of Branches**	**Percentage**
Barisal	963	5.94
Chittagong	2780	17.16
Dhaka	4126	25.46
Khulna	2236	13.80
Raj Shahi	2768	17.08
Rangpur	1925	11.88
Sylhet	650	4.01
Mymensingh	756	4.67
Total	16204	100.00

Source: MRA, 2016.

To monitor and supervise all microfinance organizations, GoB introduced the Microfinance Regulatory Authority Act 2006. The next section discusses the Bangladesh Microfinance regulatory framework.

Table 2-S: Top 10 country based on Microfinance clients

Rank	Country	Borrower (in million)
1	India	50.9
2	Bangladesh	25.6
3	Vietnam	7.4
4	Mexico	6.8
5	Philippines	5.8
6	Pakistan	5.7
7	Peru	5.1
8	Brazil	3.5
9	Colombia	2.8
10	Cambodia	2.5

Source: MB, 2018

2.5 MFIs Regulatory Framework

Regulatory framework is a core of formal institutions in terms of rules. A well-designed regularity framework can help to incubate an infant industry. It provides the economic players in the industry with appropriate incentives and sanction mechanisms to its development and further innovation. Apart from that, the financial institution is a highly sensitive industry. One wrong step can ruin a strong economy. Therefore, close observation in necessary, but without a well-organized regulatory framework close observation is impossible. Microfinance also plays an important role in the economy. Therefore, a well-organized regulatory framework is also necessary for the microfinance industry for its development.

The Bangladesh Microfinance industry is operated by NGOs, Grameen Bank, different types of government-owned banks, private commercial banks, and the specialized programs of some ministries of the Bangladesh Government. Based on their nature, different authorities perform the regulatory work for different MFIs. For example, the Grameen bank is a government owned microfinance bank, supervised and regulated by Bangladesh Bank (BB)[12].

To smooth the operation of NGO type microcredit organization in Bangladesh, the government passed a microcredit act known as ‘Microcredit Regulatory Authority Act 2006’ and by this act the Microcredit Regulatory Authority (MRA) was born, which is the prime authority over all NGO type microcredit organizations in Bangladesh. MRA is the regulatory authority that monitors and supervises microfinance operations in Bangladesh. A license from the authority is mandatory to operate microfinance operations in Bangladesh as an NGO.

If any individual, group or organization are willing to operate any microfinance activities in Bangladesh, they must submit an application to the MRA in the prescribed form for their license. But before that, the organization must be registered as an NGO under any of the following acts: (1) The Societies Registration Act, 1860 (Act XXI of 1860); (2) The Trust Act, 1882 (Act II of 1882); (3) The Voluntary Social Welfare Agencies (Registration and Control) Ordinance, 1961 (Ordinance No. XLVI of 1961); or (4) The Companies Act, 1994 (Act XVIII of 1994). Besides the requirement of registration as an NGO, to receive a license from the MRA, the minimum requirement is a 4 million outstanding balance with more than 1000 borrowers.

The MRA has designated the following works by the Microcredit Regulatory Authority Act 2006 as the main responsibilities stated in that Act. The responsibilities and activities are as follows:

[12] Bangladesh Bank is the central bank of Bangladesh.

a. Issue certificates for running microcredit organization to alleviate poverty of the country's poor people and their overall welfare. Cancellation of certificate.
b. Preserve, examine and analyze the data on establishment of microcredit organization and their field level supervision.
c. Image of the microcredit organization.
d. Take necessary steps for auditing of the accounts of the micro credit organization at the request of the financing agency.
e. Send information as sought by the financing agency
f. Formulate policy.
g. Take any step to perform the responsibilities as mentioned above.

The Rural Economics Program (the initial name of GB) worked as an NGO to help the poor by providing small loans but later it converted into an independent bank called 'Grameen Bank' by a Bangladeshi government ordinance on October 2, 1983. Under this ordinance, the Grameen bank goes under central bank supervision like other commercial banks. As an independent bank, Grameen bank must provide its audited financial statements to interested parties. Initially Grameen bank (before it became an independent bank) as well as all NGOs were not allowed to receive deposit from its clients, but after converting to an independent bank, GB got the permission to receive deposits[13] even it can sell bonds to collect funds. In 2013, the Grameen bank ordinance 1983 was revoked by the Grameen Bank Act 2013. But still it enjoys its advantage compared to other MFIs.

[13] The other type of microfinance also eligible to receive deposit only from the members. But GB is permitted to receive deposit both from their member and non-member clients.

To contribute to rural development some commercial banks (both governmental and private) offered the same service. For commercial bank MFIs, no formal regulatory body monitors or regulates the microfinance operation. This can be categorized as a unique MFIs operation, it is neither monitored or supervised by the central bank nor MRA but is by the individual banks. For private commercial banks, BB monitor their activities and indirectly private commercial bank operated MFIs are monitored or supervised by BB. On the other hand, governmental commercial bank is controlled and supervised by the ministry of finance. Therefore, any microfinance operation operated by government commercial banks indirectly goes under the ministry of finance.

Some special programs are also imposed on the MFIs by different ministries. Special MFIs are taken into consideration for special areas and special purposes. For example, RDRS was established to develop the Rajshahi and Dinajpur districts. These types of organizations are monitored and supervised by a specific ministry or the ministry of finance.

2.6 Bangladesh Economic Development and Microfinance Contribution

Bangladesh is seen as a ‘test case’ by the World Bank and IMF. The constant growth rate has surprised these development organizations. Hence many scholars and policy makers are trying to analyze the development case of Bangladesh. A handful of researchers argue that the financial sector development contributes to Bangladesh. There has been ample research available in the literature that analyzes financial sector development and economic growth. For instance, Fry (1988); Ngongang (2015); Ikhide (1993); Beck et al., (2000). Ahmed and Ansari (1998) analyzed the financial sector development and economic growth of south Asian countries and found that financial sector development causes economic growth. Fry (1988) also found a positive relationship between financial development and economic growth. Researchers like Vanroose and D'Espallier (2009)[14] considered microfinance as a financial institution that provides financial services to poor people and this helps in financial development of a country.

However, there are few studies found in the literature that focus on the microfinance contribution to economic development. For example, Raihan, Osmani, and Khalily (2017) estimate the impact of microfinance on GDP of Bangladesh. They conclude that microfinance has contributed positively to GDP growth, the contribution of microfinance on GDP is somewhere in the range of 8.9–11.9 percent. They also found that the contribution of microfinance is high in the case of the rural area. It (microfinance) contributes to Rural GDP growth somewhere in the range of 12.6–16.6 percent. Sultan and Masih (2016) found that there is a significant impact of microfinance on domestic growth (GDP). In this study, we also agree that there is a positive impact from microfinance development on economic growth.

2.7 Summary

Bangladesh is a densely populated country, where the population density is 1,159.9 per km^2. However, even though Bangladesh is one of the most densely populated countries it has experienced a steady GDP growth for decades. The GDP growth rate for the last several years has been more than 6 percent. The total GDP of Bangladesh was US $686.5 billion in 2017

[14] Vanroose, A., and D'Espallier, B., (2009). "Microfinance and Financial Sector Development," Working Papers CEB 09-040.RS, ULB -- Universite Libre de Bruxelles.

(56.5 percent from the service sector, followed by industry at 29.2 percent and agriculture at 14.2 percent). Life expectancy has increased to 63 years in 2018 from only 50 years in the 1970s. Bangladesh has increased its growth in all dimensions over last 40 years. By observing all the development, myriad scholars are of the opinion that Bangladesh is the next 'Asian Tiger' after Hong Kong, Singapore, South Korea and Taiwan.

Even though Bangladesh has a constant and steady growth still a large portion of its population live under the poverty line. According to ADB (2017), more than 24.5 percent of total population of Bangladesh are under the income poverty line ($2 per day per person). On the other hand, if we consider multidimensional poverty, around 40.7 percent of the population are under poverty of some sort, besides, around 19.6 percent live near to the multidimensional poverty line. Different development organizations are working in Bangladesh to reduce both income and multidimension poverty, among them microfinance organization or small loans to poor people is the critical one, a creative innovation for the last 30 years. Even though Bangladesh is considered as the place when microfinance organization developed or specifically the birth place of the Grameen Bank. But microcredit service can be found in the literature long before the Grameen bank was introduced as shown in this chapter.

The Grameen Bank was introduced in a small village in Bangladesh as an NGO with a tiny amount of US $27 to 42 borrowers. The success of that small village was tested by policy makers as well as development organizations in Tangail near Dhaka. After successful replication to that area, the Grameen bank began to be noticed by policymakers and development organizations. In 1982, a president ordinance transferred the Grameen NGO to a state-owned specialized bank as 'Grameen Bank' with 60 percent government ownership and 40 percent owned by its borrower. Now Grameen Bank has become a role model for all microfinance organization and replicated without any modification all over the world.

The progress of the microfinance operations has been continuous since its inception in Bangladesh. Now, there are 705 licensed MFIs operating in Bangladesh (excluding Grameen Bank and other full flagged bank's microfinance windows). Some of them are really large and have developed worldwide. Among the world top 10 microfinance organizations 3 are from Bangladesh like Grameen bank, BRAC and ASA. According to MRA (2016) the top ten MFI are as follows, BRAC is in the first position in terms of loans outstanding and loan disbursement. In second position is ASA, third place is taken by BURO Bangladesh. The remainder are TMSS, SSS, Jagorani Chakra Foundation, UDDIPAN, Paddakhep, Sajeda Foundation, and the Shakti Foundation.

Even though a huge number of MFI operate in Bangladesh, there are still some poor people who don't benefit from traditional microfinance organizations. This is because these former microfinance organizations deal with interest (both deposit and loan) that is banned by the Islamic religion. Therefore, a third organization came forward to cover this segment of the people that did not violate any rule of Islamic shariah. Popularly known as Islamic MFIs. Though the contribution of Islamic microfinance has been recognized by researchers and practitioners, still its depth and breadth is very minimal. The coverage of Islamic Microfinance is only 5 percent in Bangladesh and worldwide is only 1 percent of total microfinance outreach.

As mentioned in the very beginning of this thesis, in Bangladesh, four types of microfinance organization operate together. The state-owned microfinance organization, like Grameen bank, NGO-type microfinance organizations like BRAC and ASA, special development organizations, like RDRS and commercial bank operated MFIs, RDS. These types of microfinance organization are supervised and monitored by different organizations. The Grameen bank is supervised and monitored by Bangladesh Bank (the central bank of Bangladesh), all NGO types of microfinance are licensed by MRA and they are also monitor and supervised by MRA. The special development organizations are monitored and supervised by the ministry of finance, and commercial operated microfinance is neither directly monitored and supervised by Bangladesh or MRA, but by the individual banks and only under indirect monitoring and supervision by Bangladesh Bank.

This chapter has shown that there is a positive relation between financial sector development and economic growth. Microfinance s also providing financial services that extend financial sector development to the poorer group. Therefore, it can be predicted that there is a positive relation between microfinance growth and economic growth.

3 Literature Review

3.1 Introduction

Commercial banks, in general, are shy of financing the poor because this segment of banks' clients lacks tangible collateral which commercial banks require against the loan disbursed to the borrowers. As a consequence, a large section of the poor population, who really need finance to make a discernable change in their livelihood, remains unserved by the mainstream financial system. Different alterative mechanisms have evolved over the years to cater to the financing need of this segment of the population. Microcredit or microfinance is the salient among them. Although the success story of microcredit is not beyond criticism, this mode of financing is arguably reduced rural poverty to a great deal. Scholars are of the opinion that microfinance institutions (MFIs) not only help achieve the Millennium Development Goals (MDGs) but also facilitates greatly to achieve the Sustainable Development Goals (SDGs). In this chapter, we will attempt to discuss the contribution of microfinance in poverty alleviation and economic development. This chapter is organized in the follows: section 3.2 discusses the definition microcredit, microfinance and Islamic microfinance organization, section 3.3 explains the unique features of microfinance organizations that distinguish this mode of financing from commercial bank finance. Section 3.4 provides detail overview of microfinance mission and objectives. Section 3.5 highlights the contribution of microfinance in poverty alleviation as well as its role of empowering the poor. This section also sheds light on the limitations this mode of finance is often attached with. Section 3.6 presents a paradox microfinance institution suffer from in terms of sustainability and exploitation. This is followed by an interim conclusion which summarizes the chapter.

3.2 Concepts and definitions

3.2.1 Microcredit and Microfinance

Microcredit is a multifaceted concept which takes different conceptual forms as found in the literature. According to the Microcredit summit, “microcredit programs extend small loans to very poor people for self-employment projects that generate income, allowing them to care for themselves and their families”. Afrin et.al. (2008, p.171) define microcredit as “… a structured program under which micro-level loans are given to poor people, especially to the poor rural women without collateral security”. It is a group-based and intensively supervised loan program. The unique feature of this loan program is that there is no requirement for collateral security. Anybody can apply for this credit and are eligible to receive credit.

Before initiating microcredit services to the poor, especially before the inception of Grameen Bank in Bangladesh under the initiation of Prof. Dr. Muhammad Yunus, it is thought that the poor segment of the population are unbankable because they don't have sufficient assets to keep as collateral against the loan they wish to borrow. Also, they have little or almost no capacity to save after meeting their basic requirements for livelihood. However, the evolution of microcredit has proved that the poor are also bankable.

Initially, in the 1970s, Grameen Bank and other microcredit organization started their operation by offering only credit facility. Microcredit is commonly known as the banker for the poor. The word ‘micro-credit’ in now very familiar in the financial field. In short, we can say, microcredit is a financial instrument mainly created for the poor and very poor, who were excluded from formal financial institute.

Over the years, microcredit institutions, besides their main activities of lending to the poor, have added a host of other services including saving, insurance, money transfer, and even sometimes remittance service. Hence, the word ‘microfinance’ is widely used to mean microcredit services. Microfinance Information Exchange Inc. [MIX] (2010) refers microfinance to a variety of financial services that target low-income clients, particularly women. Since the clients of microfinance institutions (MFIs) have lower income and often have limited access to other financial services, microfinance products tend to be for smaller monetary amounts than other traditional financial services. These services include loans, savings, insurance, remittances and so on.

It is to be noted that all the definitions cited above emphasize on the poor borrower, without collateral status, small loan, savings, and insurance. In this thesis, we define microfinance as the financial services that include credit, savings, insurances, and all other financial services provided to the poor borrower who are usually excluded from the formal financial system, particularly banks. Also, we use, in this thesis, the word microfinance[15] and microcredit interchangeable.

3.2.2 Islamic Microfinance

The basic definition of Islamic microfinance can be derived from its name, i.e. the way to provide tiny loans within the legitimate boundaries of Islamic jurisprudence called Shariah. It is a set of defined rules applicable to all market transactions without harming the interest of any party. It can efficiently be used to reduce the probability of exploitation by any party involved in a market transaction. The basic difference between conventional microfinance and Islamic microfinance is

[15] In this thesis, the words, microcredit and microfinance used to mean the same meaning that provide all financial services to the poor borrower like credit, savings, insurance, and remittance.

that the conventional microfinance charge interest on its loan and deposit whereas Islamic microfinance do not charge ‘interest’ either on investment or deposit. Even though Islamic microfinance does not charge interest for its sustainability, it charges some markup profit on its sale-contracts. Societal interests is given priority over individual interests in the case of Islamic finance. The concept of Islamic microfinance is principally based on solidarity, consolidation, brotherhood and mutual agreements. Business transactions are not just the profit of one party at the expense of others, because it increases the probability of exploitation and creates an uncomfortable business environment. The Islamic way of business believes in a win-win situation for all the parties involved in the business. There are some basic Shariah principles that must be obeyed when dealing with Islamic microfinance which is known as Islamic jurisprudence (a set of divine principles revealed in the Quran) (Meraj, 2015).

3.3 Features of the microfinance institutions

Commercial banks operate in our society to facilitate or mobilize funds from the surplus sector (Household) to deficit sectors (Firm), and payment settlement. Bank is a depository institution; hence, it must protect its depositors’ interest. As a result, commercial banks hesitate to finance the risky project. Financing to the poor is involved with high credit risk. Hence, commercial banks are conservative to extend their loan to the poor borrowers. Microfinance organizations challenge the credit risk involved with the marginal borrowers and offer financial services. Where traditional economic theory says that poors are not bankable, microfinance has been successfully doing business with the marginal borrowers for the last four decades.

Obviously, microfinance organization is different from the traditional banking industry with some distinct features. For instance, mainstream banking system offers loan to wealthy individuals, and mainly business firms. But microfinance mostly extends loan to the poor. It expects frequent repayment. Their main target customers are women. The unique feature of microfinance found in London Business School Review where Yunus[16] said,

> *"I created a bank that was almost the mirror image of the traditional bank. They go to the rich, we go to the poor. They choose cities, we choose remote villages. They focus on men; we focus on women."*

The primary distinctive features of microfinance institution are the group lending method, frequent repayments, dynamic incentives and targeting women. These features of MFIs distinguish microfinance from the commercial banking industry.

Group Lending Mechanism

Group lending is a fascinating approach, introduced by Grameen Bank, that creates a social asset by arranging a group of people together. This unique feature of MFIs reminds the policymaker as well as academicians to rethink about financing the poor in the absence of collateral assets (Morduch, 1999; Hermes & Lensik, 2007). One of the main barriers to financing the poor is collateral, which is replaced by an artificial social asset. Hence scholars posit that group lending is an innovative technique to mitigate the risk of adverse-selection (Morduch, 1999; Wydick, 1999; Hermes et al., 2005; Ahlin, 2013; Attanasio et al., 2014). Ghatak (1999) argues that one of the key determinants of very high recovery rate of Grameen mode (recovery rate is more than 95 percent)

[16] Muhammed Yunus and Anna Johnston, London Business School Review, January 5, 2017.

financing is group lending. This helps microfinance organization to finance at a lower interest rate that helps poor people to develop themselves. In the same way, Attanasio (2014) argues that group lending mechanism persuades borrower to use their fund in the prescribed (in the loan application form) income generating sectors which reduce monitoring cost.

Initially, in the group lending mechanism, group member was selected and assigned by microfinance officials. However, it has failed to reduce adverse selection problem. Later microfinance officials have shifted their responsibility to the microfinance borrowers to self-selected group lending mechanism. The member of a particular group usually belongs to the same standard and in the same region. In that case, the group was created in a careful way, which helps microfinance organizations reduce adverse selection risk substantially.

One of the prominent and unique features of group lending mechanism is that in case of default of any member of the group, the whole group is marked as a default group and all the group members must withdraw their membership from the program and are restricted for further loan application. As all the members take responsibility and agree to pay the outstanding balance of any default member by the group, all group members are jointly liable to pay the default member's outstanding balance. Therefore, every group member selects other group members based on their confidence and other similar behavioral characters of borrowers (Ghatak, 1999).

It was mentioned in the previous paragraph that the members select their peer members when making the group. This will automatically exclude risky borrower. Therefore, group lending mechanism is considered as a screening instrument to filter out the risky borrower in the initial stage. This leads a particular group less risky which eventually reduces the interest on borrowing based on risk and return assumption (Rahim & Rahman, 2010). It is highly likely that the risky borrowers will be interested to form a group with other risky borrowers; however, the individual borrower still hesitate to default in payment due to the peer pressure and the threat of social sanction or social status.

Research argues that microfinance substantially mitigates the risk of moral hazard, and asymmetry of information by employing group lending method (for more see Hermes et al., 2005; Ibtissem & Bouri, 2013). Moral hazard problem arises when the lender does not know the borrower's true intention and do not have adequate monitoring mechanism. On the other hand, symmetry of information arises when lenders don't know the full information regarding the borrower's project. In this case group lending mechanism works as an alternative approach that reduces the possible risk of moral hazard and asymmetry information. The group member has a close relation with each other and they monitor each other to avoid the possible risk of default. Peer pressure insists the member invest the loan amount in a less risky project. Stiglitz (1990) explains that microfinance institutions design incentives for the group members to keep a close eye on each other and threat of facing social sanctions will ensure cooperativeness among the borrowers, which may keep group members to invest loan amount in less-risky ventures.

In group lending, social capital is used as the replacement of physical or financial collateral. But this social capital does not always make the optimal outputs. Most of the group members are neighbors or friends. Sometimes it becomes difficult to make continuous peer pressure to the friends or neighbors. In some cases, some members, especially safe borrowers, want to withdraw their membership form a particular microfinance institute instead of making continuous peer pressure to their relatives.

Even though the group lending mechanism has a positive impact of microfinance performance, it become difficult to identify the optimal size of the group. The size of the group may vary from microfinance to microfinance. For instance, Grameen bank has a group of 5 members, BancoSol, has three members in a group, Foundation for International Community Assistance (FINCA), has 15-30 members per group, the Self-help group (SHG) has 10-20 members in a group. The optimal size of the group members is still not clear in the literature. But it was said that the Grameen Bank's group size is optimal because the size of the group is formed by trial and error (Shankar, 2011). Buckley (1996) has found that group size as large as 10 or more works effectively.

Frequent Repayment of Installments

Mainstream financial institutions like banks neglect the poor borrower to provide loan. Because it is assumed that the poor are not bankable. Poor people need small loan that requires higher transaction cost. But microfinance organizations have successfully extended credit to the poor which proves that they are also bankable. Traditional banking institutes are of the opinion that a rational individual with full information and less frequent repayment schedule should never increase default rate. Rather, longer term investments may improve clients' long run repayment capacity (Field, & Pande, 2008).

Armendariz and Morduch (2005) find that in Bangladesh microfinance industry's frequent repayment schedule show less client default rate. Field and Pande (2008) also find no effect on client default rate in Indian microfinance industry if they change repayment schedule from weekly to monthly. McIntosh (2008) finds that flexible repayment schedule increases client repayment frequency. McIntosh (2008) find that in Uganda, FINACA changes their repayment schedule from weekly to bi-weekly. As a result, group dropouts fell significantly and repayment performance was also improved slightly.

However, the microfinance experts are of the opinion that a practical model is that which benefits their clients in an affordable manner. Frequent repayment schedule helps clients make habit to save regularly. It also serves as a saving mechanism for clients without access to banking services. Frequent get-together with loan officer improves clients' belief in the loan officer as well as the organization. It also help them to stay on track with repayment. As a result, micro-finance practitioners believe that more frequent repayment schedules improve client repayment rate. Worldwide evidence suggests that almost all MFIs practice weekly repayment. The primary argument is that frequent repayment schedule reduces repayment burden in the monitory term. The frequent repayment also supported by Muhammad Yunus statement-

> *[I]t is hard to take a huge wad of bills out of one's pocket and pay the lender. There is enormous temptation from one's family to use that money to meet immediate consumption needs...Borrowers find this incremental process easier than having to accumulate money to pay a lump sum because their lives are always under strain, always difficult. (Yunus, 1998*, p. 114)

Dynamic incentives

Another unique feature of the microfinance organization is dynamic incentives. Like group lending method, dynamic incentives also help microfinance organization to acquire a higher level of repayment. Besley and Coate (1995) observe that repayment incentives attached with a lending approach could motivate the borrowers to repay on time. Dynamic incentive linked with progressive lending, wherein the initial low amount of loan is offered by microfinance organization. Based on the historical record of the repayment schedule, microfinance increases the next round loan. Form the empirical analysis it was found that microfinance progressive loan increased from 200 percent to 684 percent of the initial loan. The borrower is willing to pay on time because they are going to receive a larger loan amount in the future. Otherwise, borrowers have to give up their future benefits if they become default or have a bad repayment record.

Targeting Women

Fifty percent of the world population consists of women. Keep these 50 percent of women apart from the economic activities, it's difficult to make a better economy. Besides this, among the world poor population, 70 percent are women. Without taking them up, Yunus's dream to put poverty in the museum would not be achieved. To make this dream in reality, Yunus provides loan to women. Now, almost 90 percent of all microfinance clients are women. According to Yunus (2003), women are the most vulnerable in the society; they are always excluded from any kind of financial transaction. Even, traditional bank targets mainly men. Yunus and Jolis (1998) mention that most women in the countryside had never even touched money until Yunus' Grameen Bank flung open its doors to the poor. Another reason is that women have a good track record when it comes to repayment and women utilizes small loan better than men. This hypothesis is also supported by Pitt and Khandker (1998), they find that when loans are provided to men, it increases household consumption by about 11 percent but when it is extended to women it increases household consumption by about 18 percent.

3.4 Microfinance Mission

Two kinds of private organization dominate the economy; for-profit and not-for-profit. Not-for-profit organizations are working for social welfare without any restriction (to maximize the shareholder wealth) by the owner, which reduces managerial rent-seeking behavior (Besley and Ghatak, 2017). On the other hand, for-profit organizations are always looking for maximizing shareholder wealth. Managers are motivated to make the firm wealthier in the form of profit. Managers are rewarded by offering a part of profit as the bonus.

Besley and Ghatak (2017) identify that there is another form of organization's existence that works for profit with some specific purpose, or sometimes called 'profit with purpose'. According to Besley and Ghatak (2017), this hybrid organization commonly known as social enterprise or sometimes referred to as the development organization or what Bacchiega and Borzaga (2001) call 'Third Sector'.

During the last three and a half decades, social enterprises have been engaged in social services to make a better society. The definition of social enterprise is still not clear because it is still evolving (Katz & Page, 2010). However, a social enterprise can be defined as an organization that works under the market mechanism to achieve some specific social mission. It's a special type of institution that works with social problems (Bornstein, 2010; Johnson, 2000) such as community development, poverty alleviation, and socio-economic development. Bornstein and Davis (2010) extend the border of social problems, such as poverty, illness, illiteracy, environmental destruction, human rights abuse and corruption in order to make life better for many (p.1).

Social enterprise is emerging as an innovative approach for dealing with complex social problems/needs (Johnson, 2000), where government (especially the developing countries government) and private sectors have failed to solve those complex problem(s)/need(s) (Valentinov, 2015; Urban, 2015; and El Ebrashi, 2013). Bacchiega, and Borzaga, (2001), and Dorado (2006) contend that social enterprise is completely different from the public and/or private organization or corporate social responsibility. Public or private organizations are those organizations that work for profit and make it as a public organization to maximize shareholder wealth and corporate social responsibility. On the other hand, social enterprises are those organizations that blend business principles and social goals in a new and creative way (Dorado, 2006).

Microfinance came into operation as a social enterprise that works to achieve some specific mission(s). According to Yunus (1998) "Grameen Bank, a for-profit bank, could also be organized as a for-profit enterprise of a non-profit organization." It specifies that Grameen Bank is a mixture of both for-profit and not-for-profit organization which we call a 'social enterprise'. Every social enterprise has some specific missions/ objectives related to the social problem. The objective of Grameen Bank stated by Yunus (1998: p.218)

> *"Grameen Bank is committed to social objectives eliminating poverty, providing education, health-care, employment opportunities, achieving gender equality by promoting the empowerment of women, ensuring the well-being of the elderly. Grameen dreams about a poverty-free, dole-free world."*

Table 3-A: Mission Statement of Selected Microfinance organization

MFI	Mission Objective
Grameen Bank	*By providing comprehensive financial services, empowering the poor to realise their potential and break out of the vicious cycle of poverty.*
BRAC	Our mission is to empower people and communities in situations of poverty, illiteracy, disease and social injustice. Our interventions aim to achieve large scale, positive changes through economic and social programmes that enable men and women to realise their potential.
ASA	The vision of ASA is to establish a poverty free society. And the mission of ASA is to support and strengthen the economy at the bottom of the socio-economic pyramid by facilitating access to financial services for the poor, marginalized and disadvantaged.
UDDIPAN	UDDIPAN's mission is to alleviate poverty and improve quality of life of the disadvantaged poor through providing them employment and income generating activities (IGA); facilitating development of their potentials and skills through capacity building; empowering them to claim their rights and entitlements through awareness raising, motivation, institutional development, advocacy, lobbying and collective social actions.
BURO-Bangladesh	An independent, sustainable, cost-effective microfinance institution that provides diverse, appropriate and market responsive, quality financial and business development services at competitive prices along with other social development programs to very poor, poor and vulnerable non-poor customers.
Proshika	PROSHIKA's mission is to conduct an extensive, intensive, and participatory process of sustainable development through empowering of the poor.
TMSS	TMSS provides its best efforts in bringing the poor Women to a better life with dignity in the family and society through their capacity building, adaptability, responsiveness, optimum use of their own/available resource, participation in development activities, good

	governance, establishment of their legitimate rights on a sustainable footing.
RDS (IBBL)	Objective ⇒ Extend investment facilities to agricultural, other farming and off-farming activities in the rural areas. ⇒ To finance self-employment and income generating activities of the rural people, particularly the rural unemployed youths and the rural poor. ⇒ To alleviate rural poverty through integrated rural development approach. ⇒ To extend investment facilities for rural housing, keeping in view the needs of housing facilities of the rural dwellers. ⇒ To provide educational services and safe drinking water, sanitation & Medicare facilities to the down trodden people.

Sources: Authors collection from the respective microfinance organization

3.5 Microfinance contribution to social wellbeing

As mentioned in chapter 1, the traditional banking system is very shy to finance the poor due to their principal obligation of protecting the depositor interest. Professor Yunus, in regard to the mainstream banking system states "…it is designed to be biased against the poor, and it is also designed to be biased against women" (Yunus, 1996)[17]. Professor Yunus also further explains the logic behind the banking and economic systems that it is not in favor of the poor. Professor Yunus'

[17] Retrieve from <http://www.grameen.com/fighting-poverty-from-the-bottom-up-timeline-2>, Access date June, 29, 2018.

argument is a bit vague. The objective of the banking industry is to collect the fund from household as deposit and provide the accumulated fund mainly to the corporate sector. Therefore, it is justified that the banking industry chooses not to focuses on poor people. But Professor Yunus further argues that economic theories and economic textbooks create the mindset of the population that creates the world where we live in. Mohammad Yunus also argues that all economic theories that mislead people's mindset fall into three categories (i) credit is a neutral tool, (ii) entrepreneurs are selected groups of people, and (iii) capitalism only concerns profit maximization (Elahi, 2004).

Credit plays an important role in our society. It provides economic power to borrowers. According to Yunus (1998) economists cannot adequately address poverty in social and political economics and economists ignore the impact of credit in poverty. Credit is perceived as a neutral tool that stimulates commerce, trade, and industry. But according to Yunus (1998) credit works as a lubricant in the economy. If a person wishes to become self-employed or wishes to buy materials /capital to set up a new departmental store and/or any other economic activities that requires resources especially economics resources. Therefore, the person must convince any financial institution to grant his/her credit because credit creates an entitlement to resources.

The second most important mindset created by the economics theory is that entrepreneurs are entitled to some special groups of people and the rest are considered as labor. The fundamental economic theory 'the production function' that identifies an entrepreneur makes an optimal mix of labor and capital to make the maximum outputs under given technology. This production function ignores the self-employment probability. This makes a mindset to all; only small portions of the society can acquire the entrepreneur who owns or have access to large amounts of capital and rest work as salary workers (Yunus 1998).

The third, profit maximization, is a proposition where the economic theory is concern about the maximization of firm values without considering any other social factors. This theory makes the mindset of the people that an entrepreneur is one who always looks for financial returns. Even though it shares some benefits with society in the name of Corporate Social Responsibility (CSR), a lion share is kept for fulfilling the entrepreneur's self-desire.

The introduction of Grameen Bank in Bangladesh was a great innovation in the last 30 years. Grameen bank or so-called microfinance institution came forward to finance the poor with an aim to help the poor to get rid of poverty. The main argument of Grameen Bank is,

> *"…the poor are poor not because they are untrained or illiterate but because they cannot retain the returns of their labor. They have no control over capital, and it is the ability to control capital that gives people the power to rise out of poverty. Profit is unashamedly biased toward capital. In their powerless state, the poor work for the benefit of someone who controls the productive assets".*

As previously mentioned, Yunus (1998) argues that credit provides some economic power to the poor by which they can acquire capital and capital in turn, earns some extra profit by which they can lift out of poverty. From this viewpoint, Grameen Bank extends its credit to the poor and poorest of the poor.

Grameen Bank's Group lending mechanism, that works to minimize the transaction cost, information asymmetry, and moral hazards, also helps recovery process of the loan. By observing the success of the Grameen Bank, the Grameen model of microcredit mechanism (group lending) has been replicated in Bolivia, Chile, China, Ethiopia, Honduras, India, Malaysia, Mali, the

Philippines, Sri Lanka, Tanzania, Thailand, the United State, and Vietnam. Suzuki at el., (2011) identify that Grameen mode of microcredit, without much modification, has been prevailing all over the world, from Ecuador to Eritrea, from the Norwegian polar circle to Papua New Guinea, from Chicago's inner-city ghettos to remote mountain communities in Nepal. By 1998, fifty-eight countries have Grameen clones (Yunus & Joils, 1998).

There is a long debate about the success of microfinance in social well-being. Some argued that there is a positive impact of microfinance in social wellbeing like Schuler, Hashemi and Riley (1997); Pitt and Khandker (1996); Imai et al. (2010); Montgomery and Weiss (2011); DeLoach and Lamanna (2011); Imai, Gaiha, Thapa, and Annim (2012); Mazumder and Lu (2015). Others like Adams and Von Pischke (1992); Rogaly (1996); Garikipati (2008); Annim, Dasmani, and Armah (2011); Maldonado and Gonzάlez-Vega (2008) argued inversely. A third group of researchers including Coleman, (2006); Ganle, Afriyie, and Segbefia, (2015); Rooyen, Stewart, and Wet, (2012) shows a mixed effect in social wellbeing. Others have found that there is no impact of microcredit program in socio-economic development (MkNelly et al., 1999; Coleman, 1999). Even though it's very complicated to come out with a concrete conclusion about the microfinance impact on social wellbeing, the subsequent subsection provides some empirical evidence of microfinance contribution on different social outcomes.

3.5.1 Poverty alleviation through microfinance

The laudable work of Pitt and Khandker (1998), one of the first and most cited microcredit impact assessment initiatives, examines the microcredit impact on poverty. They find that there is a positive impact of microcredit on poverty reduction and microcredit loan to women is more effective than men. They have also identified that every TK100 loan to the women increases household consumption by TK18. In contrast, household consumption increases by TK11 if the loan is extended to men. On the other hand, Morduch (1998) uses the same dataset that Pitt and Khandker (1998) use. Morduch result is directly opposite to that of Pitt and Khandker (1998). Morduch finds that there is no impact of microcredit loan on household consumption. Those two-research outcomes further question the actual microfinance impact of social wellbeing. Because the same data provides opposite results.

Shaw (2004) examines the impact of microfinance to the poor household by drawing sample from Hambantota, which is one of the poorest region in Sri Lanka where household income is below the national average, has lower employment and low literacy rate, and there is no access to electricity, safe water, and sanitation. The result shows that the microenterprise credit is not a broadly effective solution to fight poverty, though it works well with clients who are close to the poverty line.

Khandker (2005) further examines the impact of microcredit on the poverty reduction covering 1,798 households from 87 villages in 29 Thanas. Samples are drawn from those who are the members three MFIs- BRAC, Grameen Bank, and the Bangladesh Rural Development Board (BRDB). Data are collected from 4 surveys from the same households. In 1991/92, the first survey was conducted during the *Aman*[18] rice season (November–February), the second round during the *Boro* rice season (March–June), the 3rd round during the *Aus* rice season (July–October) and the last one was a follow-up survey conducted in 1998/98 period. The results show that microfinance continues to reduce poverty among poor borrowers and within the local economy, albeit at a lower rate. Khandker (2005) applies consumption as a measurement tool to determine the poverty level.

[18] Aman, Boro and Aus are all Bangla words, this identifies different kind of rice produce in different time in a year-round.

His basic assumption was that the 1991/92 loan had an effect on the 1998/99 consumption level. The contemporary researcher feels this assumption is a bit questionable because within the period between 1991/92 to 1998/99 the economy of Bangladesh developed substantially (see chapter 2). As a result, the consumption increased mainly due to economic development of the country not because of the expansion of microcredit. This is a quite unreasonable assumption that a tiny loan has a consumption effect on poor households after 9 years.

Imai et al. (2010) analyze the impact of microfinance on poverty reduction in India by using national level data. To estimate the poverty reduction effect, they use Treatment Effect Model (TEM). Their results support the view that there is a significant positive relation between microfinance and multidimensional poverty reduction. Imai et al. (2010) use basic needs, wealth, type of housing, job security, sanitation, and food security, to capture the multidimensional aspect of poverty. They have also mentioned that the sample covers only those borrowers who use microcredit only for productive purpose. Loan that goes to self-consumption or nonproductive purposes is intentionally excluded. This exclusion provides with the evidence that the research may be biased in its sampling technique. As the study has intentionally excluded the borrowers who have used their loan for consumption and non-productive purposes such as medical expenses, funeral, and children educational expenses, it is expected that the sampling method is not the appropriate one to represent the target population. Therefore, it is expected that the study does not provide a clear picture of the impact of MFIs on multidimensional poverty.

Nawaz (2010) also evaluates the impact of microfinance on multi-dimensional poverty drawing sample from a village in Bangladesh where three microfinance organizations operated for the last five years. His study finds that microfinance is successful in reducing poverty to that group of poor people which is near the poverty line. To examine the impact of loan on multidimensional poverty, Nawaz (2010) collects primary data from a field survey. Data contained the status of land ownership, housing, assets, and a poverty index of the households before and after joining MFIs. Any difference between these two study periods is considered the impact of MFIs loan.

Imai et al (2012) further analyze the role of microfinance on poverty eradication using time series data from 48 developing countries. The cross-sectional data are supplemented by a two-period (2003 and 2007) panel covering 61 countries. Data collected from two sources, Microfinance Information Exchange (MIX) and the World Development Indicators in 2011 (World Bank, 2011). They apply both OLS (Ordinary Least Squares) and IV (Instrumental Variable) model or 2SLS (Two Stage Least Squares) to estimate the effect of gross loan portfolio per capita of MFIs on poverty. Their econometric results consistently confirm that microfinance per capita is significantly and negatively associated with poverty, that is, a country with higher MFIs' gross loan portfolio per capita tends to have lower poverty after controlling for the effects of other factors. The negative relationship remains unchanged even after the poverty headcount ratio is replaced by the poverty gap and squared poverty gap.

Agbola, Acupan, and Mahmood (2017) assess the impact of microfinance on poverty reduction and living standards in Northeastern Mindanao, the Philippines drawing samples from a survey of 211 microfinance clients and non-client households. Their results suggest that microfinance has a positive impact on poverty reduction. Ihugba, Bankong, and Ebomuche (2013) find that microfinance is able to increase the income of the poor borrowers which, in turn, leads to poverty alleviation.

Matovu (2006) attempts to answer a self-imposed question, 'can microfinance help the poor get out of poverty?'. His analysis shows that the registered members of microfinance program have improved their income leading to improving their standard of living, which indicates microfinance helps the poor to get out of poverty. From the above empirical results, it can be said that microfinance organization contributes to poverty alleviation (with some controversy).

In the case of Islamic microfinance, Hassan (2014) examines the growth of Islamic microfinance scheme in the Andaman Islands and how the Islamic microfinance sector and social capital contribute to poverty alleviation. The author develops a questionnaire and conducts non-random survey drawing samples from Islamic microfinance group members to examine the effect of Islamic microfinance and cash awqaf on the development of the local common resources (LCRs) in general, and financial, physical, and social and human capital of the group members, in particular. This study finds that collective action through Islamic microfinance groups actually helps to increase environmental awareness, economic betterment of the members and fruitful management of LCRs. Adnan and Ajija (2015) investigate the effectiveness of Baitul Maal wat Tamwil (BMT) in reducing poverty. Using headcount index, poverty gap, Sen index, and Foster, Greer, and Thorbecke Index they find that BMT financing is effective in reducing poverty. Most of the respondents have increased their income after receiving BMT financing.

Obaidullah (2007) explores the role of BMTs in microenterprises development and poverty alleviation in East Java. Eleven BMTs in six cities/towns have been selected as samples of Islamic MFIs. Primary data were collected from 179 respondents through a questionnaire survey. The Wilcoxon Signed Rank Test finds statistically significant improvement in the value of annual sales, net income, business expenditure, household expenditure, and employment. It also finds a minor positive effect on business activities and monthly household expenditures of food, education, and household utensils. Moreover, the poverty line, set up by BPS in 2012, reduced from 44.4 percent to 36.3 percent after receiving the loan. This research also uses Spearman Rank Order Correlation analysis. The results suggest that there are positive significant relationships between economic impact variables and productive assets. Uddin and Barai (2016) explore the role of Islamic microfinance in Bangladesh and find that the loans provided by the Islamic microfinance significantly increase income of the respondents. Frasca (2008) takes two Islamic MFIs case studies- the Sanduq project in Jabal Al-Hoss, Syria and the Hodeidah Microfinance Program (HMFP) in Hodeidah, Yemen. Frasca (2008) concludes that Islamic MFIs can be both competitive with conventional MFIs in the region and it fulfills the financial needs of the lower income groups. Frasca (2008) also mentions that Islamic MFIs can improve the standard of living as well as poverty alleviation. Akhter, Akhtar, and Jaffri, (2009) examine the effectiveness of Islamic microfinance in poverty alleviation. They took Akhuwat as a case study of an Islamic MFIs and conclude that Akhuwat provides loan to all poor people without any interest which helps the poor to lift themselves out of poverty.

Even though the literature has shed lights on analyzing the impact of microfinance (both Islamic and conventional) on poverty reduction or whether microfinance clients get rid of poverty after participating in microcredit program, such an evacuation will be meaningless if microfinance fails to reach to poor clients. The current literature provides some evidence that conventional microfinance reaches to the poor people. Imai et al. (2012) use gross loan portfolio per capita on poverty gap (which measures the depth of poverty) and squared poverty gap (which measures the severity of poverty) to measure the poverty. Their result indicates that MFIs reach the poorest of the poor (its depth and severity). On the other hand, Nawaz (2010) and Morduch (1999) also argue that even though MFIs portfolio and outreach are growing fast, they fail to reach the poorest of the poor. Current literature does not provide a sensible answer as to whether microfinance, particularly Islamic microfinance, reaches the poor, Therefore, this research contributes to the current literature by filling this research gap and provide empirical evidence to determine if microfinance truly reaches the poor.

3.5.2 Empowering through Microfinance

Several organizations, especially the development organization or sometimes we call them social organizations, have been working constantly with the aim to empower the women. Social organizations work under the market condition with some specific social goal or mission. When the mission of any organization is to empower individuals or simply, if an organization provides an opportunity to individuals to gain control over their lives, they are known as empowering organization. Microfinance organizations can be categorized as social organizations that work for women empowerment (one of the main missions of microfinance organizations). Therefore, we can categorize microfinance organization as an empowering organization.

Microfinance is viewed as a tool to empower poor people, especially in developing countries by providing a small loan to create entrepreneurship. Women are half of the society. So, Prof. Muhammad Yunus, the founder of Grameen Bank, realized that without empowering women it would be impossible to develop a nation (Bhuiyan et al., 2013). He focused only on women empowerment from his fundamental observation that the male is naturally empowered whereas women are not. Male can sell their labor to become empowered. That provides them with the access to financial resources that they can control; or even on worse case, men can borrow financial resources from either relatives or financial institutions like bank. In contrast, women are considered fundamentally unempowered. Many social barriers surface if women, like their male counterparts, intend to sell their labor. Even, women in most often are restricted to borrow money from relatives or financial institutions because they are typically considered an idle portion of the society which only consumes. This typical plight of women has influenced Muhammad Yunus to try to focus only on women. Now the proportion of women clients in the Grameen Bank is more than 90 percent. Paxton (1995) points out that microfinance which focuses on the empowerment of women would enable them to gain a greater degree of control over their destinies.

Empowering female has increasingly become a policy goal, both as an end to itself and as a means to achieving other development goals (Ashraf, Karlan and Yin, 2010). Providing small loan to women is likely to improve women's household decision-making power, their access to financial and economic resources, their social networks, their bargaining power vis-à-vis their husbands, and their freedom of mobility (Haile, Bock and Folmer, 2012). Several empirical studies provide evidence on the empowering effects of microfinance on women (Hashemi, Schuler and Riley, 1996; Kabeer, 2001; Lakwo, 2006; Osmani, 2007; Pitt, Khandker and Cartwright, 2006). Microfinance is found to improve women's ability to contribute to household income (Johnson, 2005) and increase their own assets (Kabeer, 2001; Osmani, 2007; Pitt and Khandker, 1996).

Weber and Ahmad (2014) analyze the impact of microfinance on women empowerment in Pakistan and compare women empowerment based on the repeated loan disbursement. They find a mixed result in their analysis; the first loan disbursement had limited or no effect on women empowerment, but the repeated disbursements had a positive impact of microcredit on empowerment.

Bhuiyan et al. (2013) find a positive impact of Grameen Bank's loan on women empowerment, women health safety, child education, engagement in family decision making, knowledge, and women status compared to their non-borrower members. Ashraf, Karlan, and Yin (2010) examine the relationship between access to Green Bank of Caraga and female decision-making power within the household. They find that access to microfinance has empowered women in two particular areas, the role of the female member in decision-making within the household, and second, the purchase of female-oriented durable goods in the household. Female-oriented durables goods include washing machines, sewing machines, electric irons, kitchen appliances, air-conditioning units, fans, and stoves. Haile, Bock and Folmer (2012) analyze two MFIs- the Amhara Credit and Saving Institution (ACSI) and the Omo Microfinance Institution (OMFI) in Ethiopia. They examine the empowerment effect on women under four dimensions- women's ability to influence expenditure outcomes, their ownership of assets and savings, shared division of domestic labor, and reduction in marital conflict. They find that microfinance has empowered women in those dimensions except the shared division of domestic labor. Similarly, Hunt and Kasynathan (2002) provide evidence that microfinance has a positive impact on economic empowerment.

Ganle, Afriyie, and Segbefia (2015) examine the empowerment effects of rural women's access to NGO micro-lending program in Ghana. They find that some women were fully empowered, some are moderately, and some are disempowered. They point out that those who become empowered tend to have been engaged in business before they joined in the microcredit organization, while those who become disempowered tend to either start up a new business without experiences or failed their business before, which might make a pressure on the latter borrowers.

In the case of Islamic microfinance, Hassan and Mollah (2018) assess the contribution of Islamic microfinance on social wellbeing of women in the society. The results show that Islamic microfinance enhances the growth in women's income and played an important role in improving women's financial freedom and sense of self-possession.

The existing literature on microfinance mainly concentrates on assessing the impact of microfinance in empowering the poor. However, much less attention has been given on the issue as to whether microfinance empowers the poor by offering a lower interest rate. In other words, it is evident that microfinance helps their clients to get rid of poverty by creating an opportunity to earn an extra income through investment. But it is less evident whether microfinance offers borrowers a lower cost of funding or it exploits the clients by offering excessive interest in exchange of creating opportunity to earn extra through investment. As mentioned by Professor Yunus 'microfinance must charge interest as low as possible'. Literature also provides some evidence on simple interest rate. However, the literature does not provide a good number of sensible studies that identify the effective interest charged by different microfinance organizations.

Also, the literature mentioned above mostly concentrates on poverty alleviation and empowering the poor. Very few studies, however, focus on identifying the low market penetration of Islamic microfinance. There are few studies available in the current literature that identify the growth constraints of Islamic microfinance. Among them, Wulandari, and Kassim (2016), Ali (2015) and Rahman and Dean (2013) are noteworthy. Wulandari and Kassim (2016) analyze the issues and challenges of Baitut Mal-wat Tamil (BTM) an Islamic microfinance in Indonesia. They find that sources of fund is the main cause that restricts the growth of Islamic microfinance. Ali (2015) also mentions the same reason, limited sources of funds. However, it would be naive to simply assume that MFIs would increase the exposure to their clients if the availability of loanable funds is increased. Rahman and Dean (2013) identify that the high administrative costs is the growth constraint of Islamic MFIs. But the administrative cost is also high for conventional MFIs. So, it would be naïve to accept this proposition. Boateng and Agyei (2013) argue that insufficient infrastructure is one of the main causes of low market penetration of Islamic MFIs. But both Islamic and conventional MFIs operate in the same socio-economic condition. Dogarawa (2011) contends that lack of proper market penetration is the main barrier for Islamic microfinance. In line with the same argument, we hypothesize that improper market penetration is the main cause of extraordinary low market penetration of Islamic MFIs.

In the Islamic microfinance literature, most studies concentrate on identifying the challenges and barriers of Islamic microfinance; but less focus has been given to identify whether Islamic microfinance is successful to fill the current market demand. Therefore, it is the current demand that is required to be analyzed to identify the reason for low outreach of Islamic MFIs.

3.6 The paradox of Microfinance Performance- Sustainability vs Exploitation

Over the last few decades, research on microfinance has been increasing tremendously due to the sensitivity of this issue to the development of marginal population. Moreover, this area of research has turned into a focal point in the broader development agenda of underdeveloped and developing economies (Mersland, 2013). Similarly, research on assessing the performance of microfinance industry has also been increased commensurably. Studies focus on several aspects in assessing the performance of microfinance industry. First, some studies focus on microfinance organization which mainly focuse on the poor and vulnerable poor. This type of MFIs has become one of the largest financial industries in terms of customer. Also, they are expected to continue with their growth next several decades (Mersland, 2013). Second, more than hundred types of microfinance organization operate worldwide under the auspices of government, commercial banks, and self-managed small savings. All types of microfinance are not equally performing. Therefore, it is necessary to identify the best and poor performing microfinance organization. Third, microfinance is not simply involved in providing small loan to the poor; it has already accumulated a vast array of financial services in its portfolios such as savings, money transfers, payment systems, and insurance. Such a vast area of services renders a huge risk in microfinance organization. Hence, assessing the risk of microfinance organization has become an essential part of microfinance management. Hence, managing risk has turned into a performance indicator of microfinance organizations. Finally, to attract international fund providers (grant, donation and soft loan), performance analysis MFIs is essential.

Performance and efficiency analysis are common in the banking industry. According to Mersland, and Strøm, (2014) microfinance is considered as a banking industry that provides small loan to the poor people. Loan size is between US$50 to US$5000 and it is to be repaid by 2 to 24 months. Usually, the repayment starts from the next week after the loan has been received (with some exception). Performance analysis of the banking industry can be measured from various different points of views. For instance, a typical industry performance can be measured based on economic, social or environmental point of view; or it can be measured based on individuals, firms and/or government points of view. Whatever the focal point of performance analysis is, the objective of performance analysis always remains the same. The objective of any performance analysis is to identify whether business organization is in the right path to achieve its stated objectives. Wale

(2009) mentions that it is better to analyse the performance of any firm based on their (firms) own objective or point of view. Otherwise, performance analysis would be totally misleading.

The objective of microfinance institutes like the Grameen Bank is to provide credit facility to the poor at a reasonable cost with the aim of alleviating poverty. Hence, one of the main performance indicators would be: to what extend MFIs are able to reach the poor; and to what extent this loan are able to lift the poor people out of poverty. Now, MFIs is growing rapidly, and they have expanded their operations worldwide. As a result, they require more funds. But the availability of donor funds is unpredictable. MFIs that rely only on donor funds are highly vulnerable. As a result, most microfinance institutions try to cover its own operating cost with some extra profit from its own operation. This extra profit can be utilized to finance its business expansion. In simple, MFIs try to become self-sustainable without any subsidy or donation. Recent research indicates that sustainability analysis of MFIs has become one of the core criteria to evaluate the performance of MFIs (Wale, 2009). Without sustainability, MFIs are not a 'going concern', making the goal of poverty alleviation unreachable (Otero, 1999).

3.6.1 Microfinance Sustainability

The definition of sustainability is complex, and its interpretation is multidimensional. The term sustainability interrelates economic performance with social welfare, of both society and individuals (Brundtland, 1987), to protect and respect environmental by reducing negative environmental and social externalities, creating a positive society (Boons and Lüdeke-Freund, 2013). Thapan (2007) argues that microfinance sustainability is related to its organizational, managerial, and financial sustainability. Mahajan and Nagasri (1999) point out that microfinance sustainability can be reflected by mission sustainability, financial sustainability, demand sustainability, ownership structure sustainability. Among all sustainability mentioned by Mahajan and Nagasri (1999), financial sustainability received the most attention in the current literature. According to Marakkath (2013)[19] MFI's financial sustainability can be denoted under three prominent matrices; Operational Self-Sustainability (OSS), Financial Self-Sustainability (FSS) and Subsidy Dependence Index (SDI). The OSS refers to the microfinance ability to cover their cost of core activities by its income. Meyer (2002) defines operational sustainability of MFIs by their ability to cover only the operational cost. Microfinance Information Exchange (MIX)[20] market is one of the biggest microfinance data management sources that defines financial sustainability like that of Meyer (2002). They use the ratio between revenue and expense to calculate OSS. If the ratio of revenue over expense becomes more than one, a MFI is considered operationally sustainable.

The financial self-sustainability on the other hand, refers to the ability of any microfinance institute to cover both its operational and financing cost. Khandker et al. (1995) divide financial sustainability under two categories- operating sustainability and economic sustainability. Operating sustainability can be measured based on the financial performance of MFIs; on the other hand, economic sustainability can be measured based on management performance. SDI is another subsidy-dependent sustainability metric for MFIs, developed by Yaron (1992). SDI is a ratio that indicates the percentage increase required in on-lending interest rates to completely eliminate all subsidies received by an MFI.

[19] Marakkath, N. (2013). *Sustainability of Indian microfinance institutions: A mixed methods approach*. Springer Science & Business Media.

[20] Microfinance Information Exchange, Inc. (commonly known by its acronym MIX) is a non-profit organization that provides market data and intelligence on financial service providers catering to low-income populations around the world. Founded by the Consultative Group to Assist the Poor (CGAP) and sponsored by the Citi Foundation, CGAP, The MasterCard Foundation, MetLife Foundation, Bill & Melinda Gates Foundation

Microfinance financial performance empirical investigation was conducted by Kinde (2012), Tucker and Miles (2004), Kereta (2007), and Meyer (2002). Kinde (2012) analyzes the financial sustainability of microfinance institute of Ethiopia. Using a balanced panel data set of 126 observations from 14 MFIs over the period 2002-2010, the research finds that the selected microfinance are financially self-sustainable. In other words, the selected MFIs are able to cover all the operating costs and costs of capital without depending on subsidies. Tucker and Miles (2004) examine the financial performance under five financial ratios, operating expenses to assets, return on assets, return on equity, and net profit margin and leverage. They utilize data from a total of 148 MFIs constituting 59 from Latin America, 36 from Africa, 29 from Asia, and 24 from eastern Europe. They conclude that 57 microfinance organization are self-sufficient and profitable and even perform better than any banks in developed economies. Hossain and Khan (2016)[21] study the sustainability of Bangladesh microfinance institute drawing a sample of 29 leading microfinance institutes including Grameen Bank, BRAC, and ASA. They find that out of 29 microfinance organizations, 25 are financially sustainable. Bhuiyan et al. (2011) find that Islamic microfinance, particularly, RDS is financially viable. They also find that RDS's ROA was 2.21percent and ROE is 9.26percent in 2009, which confirm the financial self-sufficiency of RDS. Parveen (2009) finds that RDS's operating profit has been increasing over time. In 2003, RDS operating profit amounted to BDT20.10 million. In 2006, it increased to BDT55.00 million. According to Khandker et al. (1995), RDS is an economically sustainability Islamic microfinance institute operating in Bangladesh. The average loan recovery rate of RDS is over 99 percent, that ensures a low level of MFI loan loss.

[21] Hossain, M. S., & Khan, M. A. (2016). Financial sustainability of microfinance institutions (MFIs) of Bangladesh. *Developing Country Studies*, *6*(6), 69-78.

From the above discussion, it can be concluded that most of the microfinance organizations operate in Bangladesh are financially self-sustainable. However, most of the existing debates on the financial performance or sustainability of MFIs still miss the analysis of the social impact by MFIs.

Microfinance social impact is mostly measured by microfinance outreach. Outreach is the depth and width of the major microfinance services that includes credit (loan), savings, microinsurance, remittance services, and international payment services (Rao and Fitanmo, 2014). Anne-Lucie et al. (2005) and Yaron (1997) describe outreach as the measurement to what extent microfinance reach the poor people who are excluded by other financial institutions. They further explain that outreach can be measured by the breadth of outreach (total number of clients served) and depth of outreach (reaching the poor clients). Rhyne (1998) mentions that the two most usual aspects of microfinance outreach are the breath of outreach and depth of outreach. Rhyne again defines the depth of outreach as the poverty level of clients served whereas the breadth of outreach refers to the scale of operations of an MFI. Quayes (2012) identifies another type of microfinance outreach, outreach to women.

The breadth of outreach is measured by the number of people a particular MFI includes in its investment portfolio, or simply, the total number of borrowers on a specified time. The depth of outreach is measured based on the average size of the credit and outreach to the women measured by the proportion of women borrowers in comparison with the total number of clients. Even though there are some controversies regarding the measurement technique of measuring the poor and microfinance outreach, the ultimate target of outreach is to identify whether the microfinance reaches the poor clients. The logic is, if the microfinance has a long breath of outreach, it expands its loan to an extended number of people that includes the poor people as well. On the other hand, the average size of loan also measures the microfinance outreach to the poor. The assumption is that poor people require small credit on a frequent basis. If the size of the loan is small, it is assumed that microfinance reaches the poor clients. The outreach to women also measures the poverty level of microfinance clients. According to Yunus (1999) women are the most disadvantaged people in our society; they are kept apart from many financial services. Hence, they are considered the poorer group in our society.

There are arguments and counter-arguments regarding microfinance outreach to the poor. Research that argues that microfinance reaches the poor is Imei et al. (2012). Some studies also conclude that microfinance has failed to reach the poor (Aguilar, 2006[22]; Mosley, 2001). As the mission of microfinance organization is to finance the poor, any failure of microfinance to achieve its (microfinance) mission can be deemed as 'mission drift'. We can categorize such MFIs as mission drift organizations. Researcher often call this type of drift as Type-I[23] mission drift.

3.6.2 Balancing the Dual Goals of Microfinance Institutions

Literature provides diverse views regarding the ability of MFI to pursue the dual goals-sustainability (financial goal) and outreach to the poor (social goal). Copestake (2007) mentions that financial performance of MFIs has an opposite relation with outreach. When MFIs concentrate on financial performance, it intends to sacrifice its social performance. Christen et al. (1995) and Otero and Rhyne (1994) also share the similar thoughts as that of Copestake (2017) who postulates

[22] Aguilar, V. G. (2006). Is micro-finance reaching the poor? An overview of poverty targeting methods. *Retrieved September, 12*(2009), 2009.

[23] The detailed discussion of Type-1 mission drift will be discussed in chapter 4.

that microfinance sustainability is complementary with outreach. To meet the microfinance objective- finance the poor to get out of poverty- microfinance must be in a tradeoff between financial and outreach. There is empirical evidence that confirms the tradeoff between sustainability and outreach (Conning, 1999). Thus, from the literature, it can be argued that microfinance sustainability and poverty alleviation is not totally complementary to each other. In the same line, research view is also to be a tradeoff between both financial performance and outreach. Otherwise, microfinance objective will remain unmet.

Nwachukwu (2014) identifies a negative relationship between microfinance financial sustainability and interest rate. To become financially sustainable organization, microfinance must charge a high interest rate. The logic is that microfinance clients require small loan on a frequent basis that incurs huge transaction and administrative cost; hence microfinance needs to charge high interest on its loan to cover the operational costs. It was evident that microfinance is trying to become self-sustainable in the current cost of outreach or social impact. Several studies have already analyzed the current practices of microfinance which mainly focuse on financial self-sustainability rather than outreach. The assumption is that once MFIs become self-financial sustainable it will help them to serve more clients in the future leading eventually to cover the whole population.

But charging high interest on the loan is a kind of exploitation. Acclassato (2006) notes that in West Africa, financially sustainable MFIs have had to apply interest rates as high as 84 percent, and in Indonesia, the Bri Unit Desa charges interest rates between 35 percent and 60 percent. Similarly, in Bolivia, the BancoSol Corposol applies an effective rate of 52 percent to attain a real return of 4.9 percent on its total assets (CGAP, 1995). BancoSol in Bolivia charges interest rate as high as 65 percent. It is 30-70 percent (nominal rates) in the Philippines (Fernando, 2006), and Mexico's Compartamos Banco charges as high as 100 percent (Hamm, 2008). Microfinance is viewed as a poverty alleviation tool; but charging high interest is considered an exploitation. Where the goal of microfinance is to make society poverty-free, charging high interest or exploiting their customer will hamper the chances of poor people to get out of poverty. Sometimes microfinance exploitation puts poor people in a credit trap which they cannot break over their lifetime. That is against the mission of microfinance organizations. This can be called another mission drift, what researchers entitle Type-II mission drift[24].

Literature provides a strong position of MFIs contribution to poverty reduction. But this positive impact can't guarantee that microfinance organizations reach the poor. There is a chance that microfinance contribute to poverty reduction only on the upper poor, without concentrating on the lower poor and marginal poor, which we can say, microfinance may fall into Type-1 Mission Drift (MD). On the other hand, a handful researches supports MFIs financial self-sufficiency. Some researchers like Beg (2016) argue that microfinance can't become self-sustainable without charging high interest. This scenario we can label as Type-2 Mission Drift.

Study that provides empirical evidence of mission drift of microfinance are Cull et al. (2007), Olivares-Polanco (2004), Schreiner's (2002) and Hermes et al. (2007). One of the main objectives of Cull et al. (2007) is to assess if any mission drift has occurred in microfinance industry. To answer this question, they collect 124 microfinance institutions (MFIs) data from 49 developing countries and covers the period between 1999 and 2002. Based on profitability and outreach of microfinance institute, they conclude that there is no mission drift. Mersland and Strøm

[24] The detailed discussion of Type-II mission drift will be discussed in chapter 4

(2009) explore the existence of mission drift in microfinance institute by taking a sample of 379 MFIs from 74 countries over the period 2001-2008. They use average loan size as a proxy of outreach to poor clients. Their results show the existence of MD in microfinance institute among the sample organizations. Christen (2001) argues that big loan sizes are not necessarily an indication of mission drift. Armendáriz and Szafarz (2011) also argue that MFIs extending larger loan sizes to borrowers does not necessarily mean that those MFIs have shifted away from their social mission.

Even though literature provides some evidence on the analysis of microfinance mission drift, no research provides any evidence regarding the type of mission drift. On the other hand, researchers observe that most researches that concentrate on identifying the MFIs mission drift such as Mersland and Strøm (2009) and Cull et al. (2007) only consider the supply side data (microfinance data) to determine the demand side characteristics. Based on the best of our knowledge of the current literature on MFIs, no sensible research that identifies MFIs mission drift based on demand-side perspective is available. This is a big lacuna in the current literature to be addressed. Therefore, this research is an initiative to fill this research gap.

3.7 Summary

This chapter starts with defining the microcredit and microfinance. Different authors define microfinance differently. But in this thesis, we define microfinance as the financial services that include credit, savings, insurances, and all other financial services provided to the poor borrowers who are excluded from the formal financial institutions. Even though some researchers distinguish microcredit with microfinance such as Looft (2014), we in this thesis use microfinance and microcredit interchangeably.

There are some unique features in microfinance organizations that separate microfinance organizations from formal financial institutions like banks. Banks provide loan on an individual basis. On the other hand, microfinance provides loan on the basis of group lending method. A group is formed usually by 5-20 members. Every member receives loan by rotation. If any member of a particular group fails to repay the loan, the whole group is liable to pay the loan. This process reduces the MFIs credit as well as monitoring risk. The next unique feature of microfinance is frequent repayment schedule. Microfinance provides loan to the poor and the repayment is schedule mostly weekly. The logic behind the system of frequent repayment is that the frequent repayment reduces the repayment burden of the poor people. Because poor people don't have enough savings, if repayment schedule is low the repayment burden will be high. For example, if any borrower needs to repay \$100 per month it's a bit difficult for the poor people because \$100 is a huge amount for the poor people to pay once. On the other hand, if the borrower pays \$25 per week it's the same amount that the borrower pays for a month. But now physically \$25 seems a bit lower amount than \$100. The last unique feature of microfinance organizations is the women borrower. Banks always target male borrowers, but microfinance extends its loan to the poor women. Even today more than 80 percent members of microfinance organizations are women.

Next, this chapter shed a light on Islamic microfinance. Islamic microfinance is defined as the microfinance services that provide loan based on shariah principle or complying with shariah guideline. The main difference between conventional microfinance and Islamic microfinance is the interest. Where conventional microfinance deals with interest, Islamic microfinance don't charge and pay interest. For sustainability, Islamic microfinance earns profit based on profit or loss sharing methods. There are some shariah principles which Islamic financial organization must comply with when contracting for any financial transactions. Those principles forbid Riba (usury or interest), prohibits Gharar (Risk and Uncertainty), Prohibit Misir (Gambling), encourage the sharing of business profits and risks. These principles are derived from Quran and Sunnah, the primary sources, and Ijma, Qiyas, and Ijtihad, the secondary sources of Islamic principle.

Part 3.4 describes financial inclusion and its limitations. Although the definition of financial inclusion refers to the financial services for all, financial inclusion faces some barriers when it comes to poor people. The formal financial institutions provide loan based on collateral, but poor people don't have any collateral. Therefore, the poor remain unbanked. Thus, financial exclusion is seen not only in developing or poor countries but also in developed economies. Whether it is developed or developing country, financial exclusion is only experienced by the poor who don't have a fixed income over the year round.

To tackle the problem of financial exclusion, MFIs have emerged. According to the Yunus (1998) microfinance is the mirror picture of formal financial institutions in the sense that banks provide loan to the rich whereas microfinance provides loan to the poor. Banks finance mostly male borrowers whereas microfinance mainly targets the poor women. Microfinance organization provides loan based on group lending methodology. Also, the main objective of microfinance organization is to finance the poor to alleviate poverty.

There is a long debate in the literature regarding the contribution of microfinance on poverty reduction and empowerment. Literature provides some strong arguments for the positive contribution of MFIs to poverty reduction as well as empowering the poor. But much less attention has been paid on evaluating the performance analysis of MFIs juxtaposing financial and social performances. Microfinance indeed, faces a dilemma whether to concentrate on financial performance or social performance. If microfinance prioritizes financial performance, it must sacrifice social performance and *vise-versa*. Even though the existing literature sheds some light on microfinance financial and social performances, analysis of microfinance mission drift has largely remained unexplored. This is the main literature gap that the current research is aiming to fill.

4 Conceptual Framework and Review of Empirical Works

4.1 Introduction

The objective of microfinance organizations is to finance the poor with an aim to reduce poverty in society. The objective specifies that microfinance organization is for the poor. Even Yunus (1998) specifies that microfinance or broadly, Grameen Bank, is the bank for the poor. Several empirical studies proved that microfinance clients are better off (with some controversy). But recently, a number of researchers have argued that microfinance targets the well-off clients, hence, most of the microfinance clients are either upper poor or non-poor. What several studies mentioned is that microfinance shifts from their initial mission, or as Zhao (2014) put it 'mission drift'. To analyze the microfinance mission drift situation, this chapter develops a conceptual framework based on Zhao (2014). For proper understanding of the microfinance conceptual framework, this chapter is organized in the following order. Section 4.2 deals with the conceptualization of poverty, defining poverty under different levels, introducing the poverty line and how one poverty line is distinguished from another. Section 4.3 provides the concept of microfinance mission drift. Section 4.4 deals with the dilemma of specifying the microfinance mission under different schools of thought. Based on the knowledge acquired in section 4.4, a conceptual framework is developed in section 4.5. Section 4.6 provides the empirical literature of mission drift and identifies the literature gap and section 4.7 provides a summary of the whole chapter.

4.2 Conceptualization of Poverty and the Poverty line

The definition of poverty differs based on times and region (Khan, 2001). Business dictionaries define ‘poverty as the condition where people's basic needs for food, clothing, and shelter are not being met’. Khan (2001) defines poverty as a situation where people lack economic resources to realize a set of basic functions.

The World Bank Organization notes, “Poverty is hunger. Poverty is lack of shelter. Poverty is being sick and not being able to see a doctor. Poverty is not having access to school and not knowing how to read. Poverty is not having a job, is fear for the future, living one day at a time”. Sen (1999) argues that poverty is the deprivation of basic capabilities (p87). A person whose income is not sufficient to meet basic necessities. Deprivation includes social inferiority, isolation, physical weakness, vulnerability, seasonal deprivation, powerlessness and humiliation (Chambers, 1995). One of the prominent definitions of Poverty is highlighted by Narayan et al., (1999) where they collected the definitions of poverty from a poor man of Kenya in 1997. The poor man categorized poverty as:

“*Don’t ask me what poverty is because you have met it outside my house. Look at the house and count the number of holes. Look at my utensils and the clothes that I am wearing. Look at everything and write what you see. What you see is poverty”*.

There are some researchers that argue that the income-based poverty level will not provide an actual measurement of poverty (Stoyanova and Tonkin, 2018)[25]. Stoyanova and Tonkin (2018) argue that the income of every person is not the same, there are some with

[25] Stoyanova and Tonkin (2018), An expenditure-based approach to poverty in the UK, Office of National Statistics, UK.

seasonal income, or sometimes seasonal unemployment influence, or short-term unemployment or sickness may cause a temporarily reduction in income which will not necessarily be matched by a corresponding drop in consumption or well-being. Therefore, consumption-based analysis serves as the best measurement of the poverty level. However, even though the consumption-based poverty measure provides a better picture of poverty, it becomes difficult to specify the consumption variables. Such as, if one household buys a durable good such as a washing machine it will use in the next few years, in this case expenditure-based poverty calculation becomes difficult. Therefore, in this research, the income-based poverty measurement was considered to best fit the research objective when measuring poverty. Also, the data is readily available, and it is easy to identify the poverty level.

The world bank determines the level of poverty based on income. They (World Bank) specify that people whose income is less than $2 per day should be considered as the poor or live under the poverty line. But the celling changes based on region and time. As poverty differs based on time and region, therefore, some researchers define poverty as a certain amount of income that is below the 60 percent of the national median income.

The poverty level can be classified into 3 categories; Extreme poverty, Moderate poverty, and Relative poverty. According to the World Bank (2019) people whose income is less than $1.25 are considered as extreme poverty. Based on a World Bank report of 2013, there are 767 million extreme poor living in the world (10.7percent of the total world population). The Moderate poor are those poor whose income is below the poverty line. As World Bank determined, the minimum incomes that identify the poverty line is $2 per day.

So, whose income is more than \$1.25 but less than \$2 dollar per day are considered as the moderate poor. Relative poverty or the relative poor are those group of people whose income is more than \$2 per day but still, their income is insufficient to meet basic demands are categorized as in relative poverty. This group of poor is basically seen in developed countries. For example, in Bangladesh by \$2 is equal to BDT-160, which is sufficient for one person to feed him/her three meals per day. But \$2 is equivalent to JYP 225, by that one can only buy bread in Japan. In that case, people whose income is \$2 per day in Japan are considered to be the relative poor.

Even though there is an international or universally applied poverty measuring line, every country uses their own poverty measurement technique or line when measuring poverty. For example, in Bangladesh, the Bangladesh Bureau of Statistics (BBS) used two poverty lines based on the Cost of Basic Needs (CBN) Method; National Lower poverty (considers only food poverty[26] line) line and National Upper Poverty line (considers the food and non-food poverty line[27]).

This thesis defines poverty as 'an economic situation where the income of a person or a family fails to meet their minimum expenses, these expenses include both minimum required food and non-food expenses.'

It is obvious to ask the question, 'Why does poverty exist?' There was no single answer found in the literature. Different poverty theories describe different variables causing

[26] Food poverty line 1) A basic food basket (eleven food items) is selected. 2) The quantities in the basket are scaled according to the nutritional requirement of 2,122 k.cal per person per day. 3) The cost of acquiring the basket is calculated. This estimated cost is taken as the Food Poverty Line (FPL).
[27] Non-food poverty line: A nonfood poverty line is calculated by estimating the cost of consuming nonfood items by the households close to the food poverty line.

poverty. Bradshaw (2007) underlined that poverty is the cause of lack of income and economic assets at that time when they are necessary, and lack of skill and education. Ukpere, and Slabbert, (2009); Xue, and Zhong, (2003) also identified that unemployment is the one of the main causes of poverty. Yunus (1998) identified the lack of liquid resources that would destroy the vicious cycle of poverty. Several attempts have been taken by different government and development organizations to destroy the vicious cycle of poverty by providing these liquid assets. Among them, microfinance credit facilities provides a great contribution to reducing poverty. The main motivation of microfinance is to finance the poor to eradicate poverty.

4.3 Conceptualization of mission drift

The Microfinance industry exists across the world and has become a mainstream financial industry in line with the other financial actors, like bank and non-banking financial institutions, co-operative and insurance companies. Recently, one question arises in the literature, whether the microfinance industry is commercially viable or not. Because most of the world MFIs still depends on funds from local government as well as international donors. According to Hermes and Lensink (2011) significant number of MFIs are still dependent (sometimes heavily) on subsidies. To become a commercial viable MFI they focus on their financial performance rather its outreach. Mersland and Strøm (2010) found that MFIs are far behind achieving their objectives or are in a *mission drift* situation.

Mission drift occurs when a MFI deviates from its mission statement (Armend´ariz & Szafarz, 2011). The mission of all microfinance is to provide microcredit (small loans) to the poor client that may help them to lift out of poverty. Small loans may increase their (poor borrowers) income by raising their investment in income generating activities and/or diversification of sources of income; may contribute to an accumulation of assets; may smooth consumption; may reduce the vulnerability due to illness, drought and crop failures, and may contribute to the better education, health and housing of the borrower. In addition, access to finance may contribute to an improvement of the social and economic status of the poor borrower (Hermes & Lensink, 2011).

The mission of all microfinance might be to help the poor people by providing small loans to start a new course (investment) of poor borrower life that raise income of the poor borrower (Table 3-A provides the mission statement of few selected MFIs in the previous chapter). But still a large portion of the poor people are deprived of any kind of financial services. It is claimed by several researchers, for instance, Nawaz, (2010) that microfinance institutions focus on the upper poor who have a fixed income that ensures the repayment of the loan. But most microfinance research finds that most microfinance fall into a mission drift situation worldwide.

There is not that much theoretical contribution in the current literature that analyzes microfinance mission status. Zhao (2014) is one of the prominent theoretical contributors that helps us to analyze the different situation of microfinance mission status. Zhao developed the theoretical contribution base on two prominent performance factors, financial and social performance. Based on social and financial performance Zhao (2014) identifies four ideal types of MFIs situation; (Table 4-A) self-sustainable, mission-drifting, failing, and subsidized. Self-sustainable MFIs are those MFIs that achieve a higher level of financial and social performance. Those types of MFIs actively work to reduce poverty by generating self-generated profit. Self-generated profit also reduces the dependency of MFIs on external funds, which are uncertain. Therefore, this kind of MFIs extends their services to the poorer segment without any outside support. Prahalad and Hart (2002) argued that these MFIs are the most promising type of MFIs to eradicate poverty through profits.

According to Zhao (2014) mission drift is a microfinance situation that focuses more on its financial performance and has a low concentration or sometimes ignores social performance. Some authors called this situation the ‘commercialization process’. In this stage MFIs are more concerned about their financial performance rather their social performance, this leads MFIs to drift from the initial mission of ‘poverty alleviation’. Instead of serving the poor, they cater to the rich who are more profitable to them. Failing is another situation of microfinance because it has lower performance in both financial as well as social dimensions. Those types of MFIs neither fulfill the financial nor the social performance. In the long run these types of MFIs exit from the industry, if they do not improve either one or both of their performances. The last type of MFI is called subsidized MFIs. This type of MFI has higher social performance but relatively low financial performance. Subsidized MFIs are committed to social performance rather financial performance through grants, donation or government support.

Table 4-A: Four Ideal Types of MFIs

		Social Performance	
Financial performance	High	Mission-drifting	Self-sustainable
		This type of MFOs has high financial performance but low social performance. It gives priority to financial targets and may drift away from the original social mission to achieve financial goals.	This type of MFOs achieves high financial and social performances and is considered the most sustainable model for microfinance. It has the greatest potential to eradicate poverty through profits.
	Low	Failing	Subsidized
		This type of MFOs, because of low performances on both financial and social dimensions, is failing and likely to exit the industry if there is no improvement on either dimension.	This type of MFOs performs well on the social dimension but not the financial dimension. Despite the relatively low financial performance, it continues to survive and fulfill the social missions probably due to the continuing inflow of donations, grants, and government subsidies.
		Low	High

Source: Zhao (2014)

Even though Zhao (2014) explains that microfinance has 4 identical states based on financial and social performance. But one major limitation of Zhao (2014) is that it fails to describe the different type of mission drift situation a microfinance organization might fall into. For example, in Chapter 3 we found two types of mission drift situation in an microfinance organization, but Zhao (2014) failed to explain those two type of mission drift. To overcome this limitation of Zhao's (2014) theoretical framework, this research developed a new theoretical framework based on Zhao with the help of microfinance financial and social performance. That is the theoretical contribution of this research.

4.4 Microfinance Objectives and their Duality

Poor people possess no collateral assets, hence financing to that group becomes riskier. Based on the risk return assumption, to absorb the high risk, microfinance requires a high return on loans. But high interest rates are a kind of exploitation, which is against the microfinance objective. Interest rates play an important role for microfinance institutions. High interest rates to the MFIs client, increases the financial performance of a Microfinance organization, which is the objective of any financial organization. But microfinance came forward with another motives, not to become financially heavy weighted, but to serve the poor people. From this analysis, we can say that, microfinance emerged to finance the poor at lower interest rate.

Different schools of thought measure MFI performance differently. The two prominent schools of thought are ‘Institutionalist’ and ‘Welfarists’ (Basu and Woller, 2004) and provide different arguments when it comes to microfinance sustainability. Institutionalists federate upon the studies of the World Bank, the Consultative Group to Assist the Poor’s (CGAP), USAID and the Ohio State University Rural Finance Program. The institutionalist school of thought argues that to become a sustainable microfinance organization; first, it must acquire financial self-sufficiency. Being dependent on others (grant and donation), MFIs can’t act or work only to fulfill their own vision. To continue its financial support from others (grant and donation) it must fulfill some criteria that fulfill the vision of the donor to receive its next round of grant and donations, because all players respond based on their individual incentives (Levitt & Dubner, 2014). Grant and donor organizations also have their individual incentives, to receive those incentives, grant and donor organizations provide funds to the MFIs.

Welfarists are inspired by the studies of Morduch (1998), Dunford (1998), Hatch and Frederick (1998), Woller et al. (1999), Simanowitz and Walter (2002) and Brody et al. (2003). The Welfarists school of thought argues that to become a sustainable MFI, it's not required to become financially self-sufficient. According to the Welfarists view, grant or donation is a kind of equity financing, that can be categorized as a social investment. Social investment is different from private investments, social investment is always looking for social welfare regardless of monetary return, whereas private investment is always looking for monetary returns. Hence social investment is required to extend low cost loans to the poor borrower that help them to lift out of poverty. As grant and donation is considered low cost financing, that helps MFIs to extend loans to the poor at a lower cost.

Table 4-B:Difference between Welfarist vs Institutionalist schools of thought

School of Thought	Welfarist (Also known as Non-for-profit Model)	Institutionalist (Also known as Commercial Model)
Source	Originated from the works of the founder of microfinance, Professor Mohd. Yunus.	Evolved from the non-for-profit model by claiming that lending to the poor can be profitable by charging sufficient interest rate.
Objective	Aims to reduce absolute poverty	Aims to reduce poverty
	Views the unavailability of financial services to the core poor as "market failure".	More interested in sustainability of the microfinance institutions, assumes the effect of poverty reduction.
Targeted Clients	Targets the core poor.	Prefers microentrepreneurs/clients that slightly above the poverty line.
Dependence on Subsidy/Grants	Highly dependent on grants and subsidies.	Shuns subsidies and grants. Attracts private investors with profit sharing possibilities.
Performance Measures	Interested in whether the clients are better off after borrowing microloans.	Interested in the sustainability and financial performance of MFIs.
Examples of Prominent MFIs	Grameen Bank, FINCA-style village banking programs in Latin America.	Bank Rakyat Indonesia (BRI), Banco Solidario (BancoSol).

Source: Yeoh, 2017[28]

Institutionalists argue that donor funds are unpredictable. Therefore, MFIs must by themselves generate enough revenues to cover costs and earn some extra profit. Out of this extra profit, they serve the poor clients at a lower interest rate. On the other hand, Welfarists argue that to cover its own cost MFIs must charge high interest rates in contradiction of microfinance objectives. Instead of providing low cost funds, charging high interest would be a disastrous situation for poor borrowers. Therefore, to charge low interest on its credit, MFIs must depend on low cost funds like soft loan, grand and/or donations. Basically, the

[28] Yeoh, Y. H., (2017), Microfinance: The Impact of Institutional Environment in Latin America and South Asia, Masters Thesis, RMIT university.

institutionalist school deals with financial performance, whereas the Welfarists school deals with social performance.

The debate on performance analysis institutionalist vs welfarists has not yet come to an end, a few studies like Hishigsuren, (2007) and Rhyne (1998) are in favor of institutionists, the others, for example, Woller et al., (1999) are in favor of the welfarists' approach. The researcher believes that the primary objective of microfinance is to finance the poor to eradicate poverty and without financial self-sufficiency, microfinance organization is unable to fulfill its fundamental objectives. Hence, a tradeoff between institutionists and welfarists is required, what the current research terms as 'Institutional-welfarists' that helps microfinance to become self-sufficient at the same time it fulfills its fundamental objective.

4.4.1 Financial Performance of the Microfinance industry

Financial performance as the ability to pay their employees, lenders, and other suppliers, in short, their ability to produce a profit from their operations (Mersland & Strøm, 2013, p.12). The traditional financial measurement methods are financial self-sufficient (FSS), return on assets (ROA), return on equity (ROE). Kinde (2012) divided financial performance into two parts; operational and financial self-sufficiency (OFS). Meyer (2002) defined operational sustainability as referring to the ability of a microfinance institution that covers only its operational cost, on the other hand financially self-sufficient refers to the ability of any microfinance institution that covers both its operational and financing costs. Khandker et al., (1995) also divided financial sustainability under two categories; operating sustainability and economic sustainability. Operating sustainability can be measured based on the financial performance of MFIs, on the other hand economic sustainability can be measured based on management performance.

Kereta (2007) states that operational sustainability can be measured by returns on asset (ROA) and returns on equity (ROE). The Microfinance Information Exchange (MIX) market is one of the biggest microfinance data management sources, defines financial sustainability like Meyer (2002) as operational sustainability; hence they used the ratio between revenue and expense. If the ratio of revenue over expense becomes one or more, then it is considered as operationally sustainable. Khandker et al., (1995) used employee and capital productivities to measure economic sustainability. They used loan recovery rate as a proxy for employee and capital productivity because it minimizes the default risk and ensures economic sustainability. Copestake (2007) used operational self-sustainability (OSS) as an indicator of financial performance, Xu, Copestake and Peng (2015) used OSS, ROA, FRA (financial revenue divided by average total assets) and PAR 30 (Portfolio at risk >30 days) as a financial performance. Adair and Berguiga (2014) used Adjusted return on Assets (AROA) and Financial Self-sufficiency (FSS) as a proxy for financial performance.

All financial performance can be categorized under three categories. First is Self-sufficiency; financial self-sufficiency, operating self-sufficiency. Second, Profitability; return on assets (net income divided by total assets), return on equity (net income divided by total equity), and Net profit margin (net profit divided by sales), and the last is Portfolio at risk.

Table 4-C: MFIs Financial performance indicators

Financial Performance	Items includes
Self-sufficiency	Operating self-sufficiency Financial self-sufficiency
Profitability	ROA AROA ROE Net profit margin
Risk	Portfolio at risk under 30 days Portfolio at risk under 60 days Portfolio at risk under 180 days

Source: Author, based on literature

Every measurement technique has its own advantage. For instance, self-sufficiency, either financial self-sufficiency or operating self-sufficiency measures if the microfinance organization is able to pay their costs by their earnings. Operating self-sufficiency is the ratio between operating income and operating expenses. This measure shows whether microfinance organization are able to pay their operating expenses by their operating income.

When the OSS score is one (100 percent) or more than one is categorized as operating self-sufficient organizations. FSS is an extended term of OSS, Christen et al. (1995) introduced the FSS measure with the intention of restating financial results in terms of market values. Christen et al., (1995) suggest two major adjustments, that is, one for the inflation in each country, and the second for implicit and explicit subsidies. This kind of adjustment is necessary when the research tries to analyze cross country comparison.

Profitability such as ROA, AROA, ROE, Net Profit Margin measures how much profit the microfinance organization earns from its investment, such as how much profit is earnt by using a certain amount of assets, Equity. The last one is the risk measurement, that measures the microfinance loan and the risk exposure.

All these measurement techniques are based on supply side data (microfinance financial reporting data). The income or operating revenue is the core determinant of the financial performance of microfinance organization. For instance, OSS, FSA deal with Operating revenue which is nothing, but the total interest earned by the MFIs. The ROA, AROA, ROE, or net profit margin also deals with net income which is nothing, but the total profit charged by MFIs less operating and other expenses. Therefore, this research uses interest charges in percentage form as the financial performance indicator in analyzing the finance performance of a microfinance organization. Even though the total revenue considers the interest rate with quantity (volume of outstanding loans). As the loan size has varied from microfinance to microfinance. Hence, in a comparative sense, interest rates provide an appropriate performance measurement for microfinance organizations.

4.4.2 The Social performance of Microfinance industry

Social performance is a complex measurement technique in the field of social science, there is no exact definition of social performance, but most agreeable definitions of social performance are provided by Sinha (2006). Sinha (2006) defines social performance “as the effective translation of an institution’s mission into practice”. Copestake (2007) mentioned that social performance can be defined in a large number of ways, for example, how well an organization meets its social goal, how an organization works for social welfare, how much welfare is added to the society by an organization etc. Basically, social performance is measured for social organizations that works for society. For microfinance institutions widely used social performance indicators are the number of people using services in a given period (breadth of outreach); their social status including poverty status at the beginning of the period (depth of outreach); and net benefit to each, including indirect benefits to other household and even non-household members during the period (quality of outreach or impact).

Over the years several attempts have been taken to identify the perfect measurement technique for the social performance of MFIs (CGAP 2007). Scholars have proposed different measurement frameworks, to measure the social performance of MFIs. Gutiérrez-Nieto, Serrano-Cinca, and Mar Molinero (2009) provide a summary of all microfinance social impact measurement methodology (Presented in Table 4-D)

Table 4-D: MFI Social assessment methodologies

Name	Description	Analysis
IMP-ACT	International action-research program that aims at improving the quality of micro financial services and their impact on fighting poverty. (http://www.imp-act.org)	It relies on the collection of quantitative and qualitative information from MFI clients. Descriptive statistics, test of differences in means and medians, correlations and hypotheses tests are generated from data obtained.
AIMS	Assessing the Impact of Microenterprise Services (AIMS) tries to measure how microfinance interacts with their borrowers' lives. (http://www.msiworldwide.com/gral/nwproductsinfo/aims_page.htm>	It places families at the center of its analysis. It uses qualitative and quantitative techniques. It considers hypotheses at household, individual, enterprise and community levels.
SROI	Social Return on Investment (SROI) attempts to measure in the form of an investment ratio the social and environmental value created by an organization, (http://sroi.london.edu)	The methodology is still under construction. For example, the income generated by enterprise tries to be measured through savings to donors.
ACCION PAF	Action Poverty Assessment Framework (PAF) has been created by Action not-for-profit North American organization that groups MFIs, many of which are in Latin America. It compares socio-economic characteristics of its clients against national and international poverty lines (eg: 1 $ a day). http://www.accion.org)	The data it employs at the moment are the data available within the MFI. Income or expenditure is compared with poverty lines. It analyses correlations and multivariate regressions to assess the potential of some variables as proxies of poverty level. For example, loan size.
PAT	The Poverty Assessment Tool of CGAP (PAT) measures poverty outreach by placing the clients of an MFI in the context of the non-clients. This is the same methodology used by United Nations Human Development Index (HDI). (http://www.microfinancegateway.org/poverty/pat/pat.html)	The analysis is done on the basis of 300 poverty indicators that are reduced to 30 by means of principal components analysis. A poverty index is finally constructed from these indicators.
SPI	The Social Performance Indicators Initiative (SPI) goes beyond poverty outreach. Social performance would have four dimensions: outreach to the poor and excluded, adaptation of the services and products to the target clients, improving social and political capital of clients and communities, and social responsibility of MFIs. (http://www.spifinance.com)	Four dimensions are collected by a questionnaire. The answers receive a weighting system from a principal components analysis. The results are represented by means of a rhombus, whose four vertices give a measure of MFI social performance.

Source: Gutiérrez-Nieto, Serrano-Cinca, and Mar Molinero (2009)

Different methods required different data set and variables to measure social performance of microfinance organization. For example, Copestake (2007) used breath of outreach (the number of active loan clients), and depth of outreach (outstanding loan per clients) as social performance. Xu, Copestake and Peng (2015) used depth of outreach (Average loan balance per borrower / GNI per capita) as social performance. Abrar (2018) used social performance indicator as breadth of outreach, measured by the number of credit clients (women and men borrowers) served by microfinance institutions.

Schriener (2002) proposed a framework for outreach, which measures the social benefits of MFIs for the poor borrowers under six characteristics; worth to clients, cost to clients, depth, breath, length, and scope (p.1). The worth of outreach is the client's emergency whether they need credit and is set against how much clients are willing to pay or in simple how much interest the client's willing to pay. The cost to clients is defined as the cost charge to the clients based on interest and transaction costs. The depth of outreach is the net added value of an active microfinance client to the society as a whole. 'In welfare theory, depth is the weight of a client in the social-welfare function', with this weight depending on the preferences of the society (Schreiner, 2002, p. 7). The commonly used proxy of depth of outreach is the 'average loan size (ALS)'. The common assumption is, the smaller the average loan size, the more an MFI has reached to wide range of poor clients. The breath of outreach is the total outstanding loan divided by the average loan size. The breath of outreach is nothing but the total clients under the microfinance umbrella. Lastly, the scope of outreach is determined by the number of microfinance products provided to microfinance clients.

The Social Performance Task Force (SPTF) provided a framework to determine the social performance of MFIs in 2009 in an attempt to standardize social performance. According to the SPTF, 'social performance is the effective translation of an institution's social goals into practice in line with accepted social values; these include sustainably serving increasing number of poor and excluded people, improving the quality and appropriateness of financial services, improving the economic and social conditions of clients, and ensuring social responsibility to clients, employees and the community they serve' (CGAP, 2007, p.3).

Whatever is the measurement technique, if the microfinance organization did not reach to the poor, its social performance will not be achieved. Therefore, this research uses client poverty status as a social performance indicator for microfinance organizations.

4.5 Conceptual Framework

It was mentioned in the previous sections that this research borrows the Zhao (2014) framework in analyzing microfinance mission drift. Zhao (2014) developed this framework based on financial and social performance. In this research, interest rate is used as a proxy for financial performance and poverty status is used as a social performance indicator. Based on the interest rate and client's poverty status the new research framework s presented in Figure 4-A. In the conceptual framework the study identifies microfinance status under one four segments: 1). Expected Domain, 2). Focused Drift (Type-I MD), 3), Exploitation (Type-II MD), and 4). Overlap of Type-I and Type-II Mission drift.

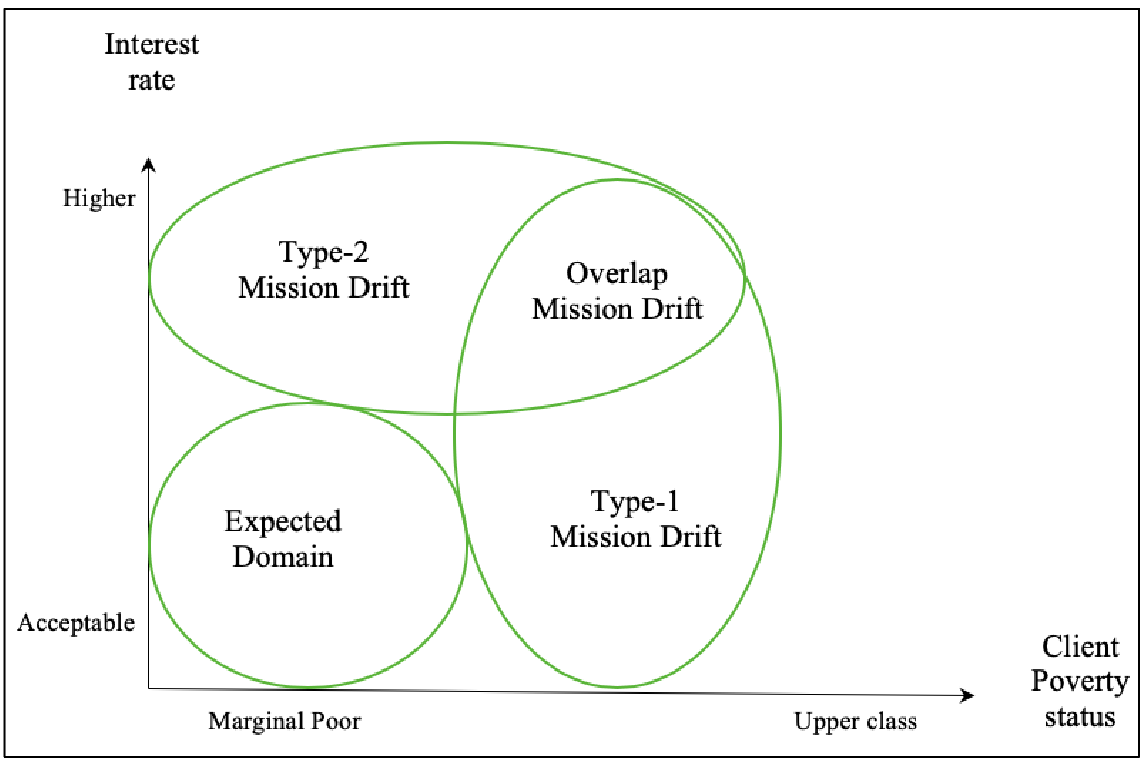
Microfinance mission in expected domain: financial inclusion faces some difficulties when it comes to the poor and vulnerable poor. The main barrier is the risk, return and transaction cost. Banks hesitate to finance the poor due to their high-risk exposure. To mitigate this high interest rate banks must charge higher interest rates. That will push poor people into another vicious cycle of poverty. In consideration of all these circumstances, banks exclude the poor from their services. To include the poor and vulnerable poor microfinance came into operation. Microfinance mission expected domain is thus the condition of a microfinance organization, that it (microfinance organization) serves the poor at a lower interest rate. Under this category, microfinance organizations work for the poor as their main objective. Another feature of microfinance in expected domain is that they also finance the poor at a reasonable cost (lower interest rates) compared to market interest rates to empower poor people.

Type-I Mission Drift: The mission of microfinance is to finance the poor at a lower interest rate. The mission of microfinance organization can be divided into two main parts. The first part is to serve the poor. Microfinance Type-I mission drift is a situation where microfinance organizations have failed to finance the poor or are not willing to service the poor. In this situation, microfinance targets the upper poor or non-poor people. But microfinance do provide their financial services at a lower interest rate.

Type-II Mission Drift: Type-II mission drift is a microfinance situation where microfinance organizations finance the poor, but they fail to provide the fiancé at a lower interest rate. They charge more than the market rate or sometimes charge usury level interest. This type of mission drift can be categorized as exploitation. Even though they try to finance the poor to reduce poverty, but due to the high interest rate poor borrowers fall into another vicious poverty cycle. That keeps the poor people in the same condition forever.

Mission drift overlap: Mission drift overlap is a microfinance situation where microfinance organizations neither serve the poor people nor serve them at a lower interest rate compared to market interest rate. They serve upper poor or non-poor clients at a high interest rate.

Figure 4-A: Theoretical framework



Source: Author

To analyze the Islamic microfinance mission drift this research considered the Rural Development Scheme (RDS) as a case study. RDS is an Islamic microfinance organization operated by Islamic Bank Bangladesh Ltd (IBBL). IBBL is the one of the largest banks in Bangladesh. It's the market leader in terms of loans outstanding and profit and it (IBBL) became the number one banking organization in Bangladesh in 2015 regardless of banking methods (Islamic or conventional). IBBL works with the aim of socioeconomic development irrespective of caste, creed, religion and gender, and wants to make an ever-caring, ever-cooperative and ever-trusted banking relationship with its clients. IBBL primarily works to ensure reduction of rural-urban disparity and the equitable distribution of income.

Bangladesh has been a poverty-stricken country since its independence and poverty and hunger had become a natural phenomenon. Various policy measures have tried to take into consideration the reduction of poverty and hunger, some are contributing effectively, and some are not. But poverty has been reduced dramatically from the 1980s. Even though the poverty rate decreased substantially from early 1980s to 2010s, roughly 25percent of people live still under the extreme poverty line (ABD, 2017).

IBBL as a mainstream financial institution faces some structural barriers (risk return assumption and transaction costs) in financing the poor like other conventional banks to fight against poverty. To reach this segment of poor, IBBL introduced RDS in 1995 as an Islamic microfinance organization. The aim of RDS is to finance the poor to help them to get rid of poverty. RDS mainly finances the poor, and young unemployed to make them self-employed.

The reason behind selecting RDS as a case study was that RDS is the market leader of Islamic microfinance. It (RDS) is not only a leader of Islamic microfinance in Bangladesh but also all over the world. RDS alone covers 50 percent of global Islamic microfinance market share (IBBL, 2016). To make the analysis more meaningful, it is instructive to compare Islamic microfinance with other types of conventional microfinance organizations. This research as done so. In comparing Islamic microfinance with other types of microfinance organizations some baseline indicators must be considered. The two types of microfinance organizations must operate in similar economic conditions. Otherwise it will not make any meaning of a comparison. For example, if one organization received more facilities compared to others, it will create some positive incentive for that particular microfinance organization in the economy.

The other two types of microfinance organization are State-owned and NGO-types microfinance and have been considered in this research. The Grameen Bank is a government owned conventional microfinance organization introduced in 1982 in Bangladesh. Initially, the Grameen Bank starts its operation as an NGO in 1973. By a governmental ordinance Grameen NGO was turned into a state own microfinance bank. Now it serves almost all over Bangladesh. The BRAC, ASA, Buro-Bangladesh, Uddipan, and SSS considered as sample of NGO type MFIs.

4.6 Review of the empirical literature

Generally speaking, providing small loans at affordable interest rates, focusing more on women clients, emphasizing operations in rural areas, and adopting group lending methodology have been the original social missions of microfinance organizations (Kar 2013). Many scholars consider microfinance as a development tool that helps the poor to get rid of poverty (Abeysekera, Oguzoglu, & Le, 2014). Even though several scholars have tried to see the contribution of microfinance from different points of view, their central focuses have been on how to finance the poor or how financial services reach to the poor on a sustainable basis. Microfinance as a social organization has at its main focuses to reach to the poor but to be a sustainable microfinance organization, microfinance must focus on financial performance. When microfinance solely focuses on financial performance, it may be forced to shift its original focus from poor households to rich clients. which is popularly known as mission drift. Mia and Lee (2017) define mission drift as shifting from the original aim of MFIs; that is, to turn away from the poorest of the poor who deserve microfinance services. According to Abeysekera, Oguzoglu, and Le (2014) the analysis of mission drift is complicated due to lack of suitable data and the complexity of measuring clients profile and poverty status.

The most prominent mission drift analysis was conducted by Mersland and Strøm (2010). Mersland and Strøm (2010) analyzed whether microfinance organizations have been experiencing mission drift or not. They selected 379 MFIs from 74 different countries. By using average loan size as a proxy that microfinance has reached to the poor households, they conclude that they did not find mission drift in the microfinance industry. One of the main limitations of Mersland and Strøm (2010) is that they excluded the loan portfolio where loan amounts were over US $10,000 and they mentioned that they excluded this variable to reduce the outlier effect. But there is doubt regarding their assumption. If any research intentionally excludes the big loan amount then obviously, it will show a lower average value when calculating the average loan. Abrar and Javaid (2014) analyzed the microfinance mission drift status by taking a sample of 382 Microfinance Institutions from 72 countries over a period of 7 years (2003 to 2009). Based on their analysis they find that microfinance has been experiencing mission drift situations. They used average loan size as their proxy for mission drift.

From the literature it was found that microfinance mission drift has been measured in a number of ways, especially when measuring clients poverty level by average loan size (Mersland and Strøm, 2010), average loan size, percentage of loans to women, and percentage of loans to rural population (Serrano-Cinca, and Gutiérrez-Nieto, 2014), average size of first loans as a percentage of GDP (Hishigsuren, 2007) and so on. Mersland and Strøm (2010) argued that average loan size is an accurate proxy of mission drift. To be more specific, loan size can roughly represent client poverty status and a poor person usually requires a small amount of loans. Campion and White (1999) however, argued that average loan size is not an appropriate proxy of mission drift. For example, an increase in loan size can be due to entrance into new markets, that does not mean that the microfinance shifts from poorer to rich groups. The current research also argues that small average loan size is not an appropriate proxy for mission drift. Ghosh and Van Tassel (2008) suggest that the most accurate measure of mission drift is the poverty gap ratio, but they themselves suggest that it is difficult to obtain in practice.

Where one group of researchers has been arguing the appropriate measure of poverty to determine microfinance mission drift another group of researchers has tried to identify the reasons behind microfinance mission drift. For instance, Mia and Lee (2017) explore the factors that force microfinance organization to shift from their initial mission. To identify the factors, Mia and Lee (2017) took a sample of 169 MFIs in Bangladesh over the period 2009 to 2014. Their analysis suggests that, commercial purpose or simple support, microfinance organizations that are looking for profits or maximizing their shareholder value have the tendency to drift from their initial mission. Abrar and Javaid (2014) identify how the commercialization of microfinance forces microfinance organizations to drift from their mission.

When research concentrates on microfinance mission drift by exploring microfinance reach to the poor and what is the possible reasons of that mission drift, few have explored the other microfinance mission drift. Microfinance organizations came to help the poor to get rid of poverty. Hence, microfinance must provide loans to poorer clients at a reasonable cost which is less or equal to market interest. If microfinance organizations charge excess interest it can be categorized as exploitation, that is type -2 Mission drift.

Mitra (2009) said that microfinance lenders always say they charge a fixed percentage of interest on a flat basis, but microfinance institutions never express their effective interest rate to their clients. Only Roberts (2013) has calculated the effective interest rate of 358 MFIs. In this study the average effective interest rate was around 28.06percent. Here, the effective interest rate is characterized as the total earned interest income and fees divided by the average gross loan portfolio. Which is an erroneous calculation of effective interest. By this formula one can calculate a flat interest rate.

Even though the literature explores microfinance flat interest rates, it has failed to reveal the effective interest rates charged by different microfinance organizations. This is one current literature gap that still remains unexplored. Hence, this study had an initiative to take the challenges and open a new door to discuss this matter further.

4.7 Summary

Microfinance or small credit service has become a part of mainstream financial institutions in today's economic life especially for the poor people. When bank and other financial organizations ignore financing the poor, microfinance organizations are challenged to finance them. But it was highlighted that microfinance has moved from its main objective, finance the poor. Now microfinance organizations also focus on the non-poor people like as banks.

In the beginning of this chapter we highlighted the concept of poverty. It was argued that poverty has a distinct characteristic that changes based on time and region. Even though several scholars define poverty in different ways, the best accepted definition of poverty is 'one's income has failed to meet his daily basic necessity'. Different authors have tried to measure poverty status based on different methodologies, among these income and expense-based poverty measurement has become prominent. Even though both have their own pros and cons, but research agrees that income-based poverty is providing a better picture than expense-based poverty measurement.

Microfinance organizations are a special type of organization in our current economy, where for profit and non-for-profit organizations dominant the economy. This special type of organization is a combination of both for profit and non-for-profit. For profit organizations operate for maximization of profit and not-for profits operate for solving social problems. On the other hand, microfinance or social enterprise operates both for profit and social problems. Microfinance operates in the current economy for profit, but it also finances the poor in their aim of reducing the rural poverty which is the main mission of microfinance organizations.

But several studies have claimed that microfinance falls into a mission drift situation, where microfinance is not focusing on the poor very much.

This mission can be divided into two. One is financial mission and the other is social mission: financial mission specifies that it works for profit, on the other hand social mission specifies that microfinance also works to finance the poor. Different authors provide different opinions regarding the preference one over another. A group of researchers (Institutionalists school) claimed that financial mission or performance should give preference over social mission/performance, another group of researchers (Welfarists school) claimed social performance should be prioritized over financial performance. In the present study we claim that there should be a tradeoff between financial and social performance. Based on social and financial performance, this chapter developed a conceptual framework with the help of Zhao (2014). Interest rates are used as a proxy for financial performance and clients credit worthiness is used as a proxy or social performance. Based on interest and clients credit worthiness, this study identified four different type of microfinance organization - mission related, Type-1 MD, Type-2 MD, and Mission unrelated microfinance organizations.

There is not much research covering microfinance mission drift. Among the research that focuses on microfinance mission drift is that searching whether microfinance reaches poor clients or not. Most of the researchers have used different types of proxy in analyzing this. Based on the researcher's best knowledge, no research is taking care of client's portfolios in searching whether microfinance organizations reach poor people, they all used microfinance information only. This study claims that those estimations do not provide an actual picture of whether microfinance reaches the poor. On the other hand, all research tries to find out if microfinance reaches the poor, but not that much research has been conducted that identifies how microfinance helps poor people to get rid of poverty without exploiting them and pushing them into another vicious poverty cycle. This research claims that these two are the current literature gap, where research take the challenges to fill those research gaps.

5 Is Islamic Microfinance Serving the poor people compared to conventional microfinance? Evidence from Bangladesh.

5.1 Introduction

There are two types of microfinance organization operating in our society. One deals with interest and the other does not. The former is known as conventional microfinance and the latter one is called Islamic microfinance. There is a significant demand in the society, especially in Muslim society, regarding Islamic microfinance. But compared to demand the current outreach is very minimal. It can be hypothesized that Islamic microfinance may serve clients who are upper poor or non-poor, where all the microfinanciers compete with each other to cover those segments. To explore whether Islamic microfinance serves the poor, this chapter is designed in the following order. Section 5.2 discuss the Islamic microfinance reality. Section 5.3 deals with the existing debate on the dilemmas of microfinance, and Section 5.4 deals with analytical frameworks. Section 5.5 deals with the results and the last section provides a summary of the whole chapter.

5.2 Islamic microfinance reality

The microfinance industry in Bangladesh is a success story, nevertheless, the current microfinance outreach is not as much as it was expected at the outset. Almost 24% population still live under the poverty line and are unbanked (ADB, 2016). In Muslim countries especially in Bangladesh, Islam plays a significant role in social and economic life. Suzuki and Miah (2016) arises the point that religious faith can explain low microfinance outreach in Bangladesh. The answer lies in the fact that Muslim people hesitate to engage in any activities that are prohibited by the *Shari'ah*. According to UNDP (2012) based on a survey conducted by Muhammad Sayeedul Haque in Bangladesh, some Muslim borrowers are not always satisfied with conventional microfinance service partly because it involves interest (*riba*). That survey reported that 80 percent of the Muslim respondents replied that they preferred Islamic microfinance products to conventional products. Among them, 45 percent claimed that they would switch to Islamic microfinance institutions (MFIs) even at higher cost if the Islamic microfinance products are accessible. 32 percent of the respondents claimed that they never applied for any conventional loan because of their religious belief. The survey also reported that 85 percent of the current borrowers from conventional MFIs replied that they would switch to Islamic products once such products are available.

In theory, the expansion of Islamic microfinance outreach may bring a positive outcome in terms of social well-being (Kholis, 2009; Segrado, 2005; Saad, and Duasa, 2010). Despite the seemingly mammoth demand, Islamic microfinance outreach is extraordinarily low in the world. Islamic microfinance institutions are estimated to serve about 380,000 customers through 126 institutions in 14 countries. However, this level of outreach accounts for no more than 1.5 percent of total microfinance outreach (Nimrah, Michael, and Xavier, 2008). Rhule (2016) reports that in 2016 Islamic microfinance covered 1.28 million clients with only 1 percent of global microfinance outreach. It is worth noting that among these clients, the Rural Development Scheme (RDS), the major Islamic MFI in Bangladesh, covers 0.582 million (45.54 percent) of global Islamic microfinance clients. But even in Bangladesh, RDS covers only 5 percent of total microfinance outreach. We should ask why Islamic MFIs have failed to penetrate in the microfinance industry and failed to meet the seemingly huge demand for Islamic microfinance products.

In general, RDS offers the lower rate of interest (markup profit) compared to conventional MFIs in Bangladesh. For example, Grameen bank charges the interest of no less than 15 percent on their loan amounts, while typical NGO-MFIs charge around 18 to 20 percent on loans without any rebate. RDS offers markup profit of 12.5 percent and allows a rebate of 2.5 percent on the timely repayment, that is, the effective mark-up profit is 10 percent[29].

Credit to poor people is by nature risky because the chance of default is very high. Usually poor people do not have enough assets to any to be provided as collateral. The Grameen bank introduced a new lending method which significantly increased the financial inclusion of poor people. The method is known as the group lending method. As a requirement by the bank, a group is to be formed consisting of 5 to 15 members. Members in the group watch each other's activities. When a member of the group receives a loan from the bank, all the members of the group are jointly liable to repay the loan. If any member of the group defaults, the other members are responsible for the repayment of the defaulted amount and the whole group is considered as a default group. Under this case, no member of the group would receive any further services from the MFI. The group lending method functions as a sanction and incentive mechanism for reducing the default rate. On the other hand, though RDS also provides loans based on a similar group lending method, the difference is that in case of the default of any

[29] In addition, we should note that all types of MFIs operating in Bangladesh impose some sort of forced deposit. If we count the opportunity cost of forced deposits, the effective cost for borrowers becomes higher. It is observed that all types of MFIs charge almost the same percentage of forced deposit.

member in group, RDS separates the default member from the rest. Only the defaulted member is penalized. The rest of the members of the group is still eligible to receive services from RDS.

Apparently, the loan conditions and requirements by conventional MFIs are more severe and tighter than those of Islamic MFIs. Despite this, conventional MFIs are growing rapidly whereas Islamic MFIs are lagging far behind. Even though its market penetration is still very limited, the *reason d'etre* of Islamic MFIs can be justified if the Islamic microfinance is reached to the marginalized people. This chapter aims to discuss about the *reason d'etre* by investigating how Islamic and conventional microfinance are reaching to the poor people.

5.3 Existing Debate on Dilemmas of Microfinance

Several studies find that though the objective of microfinance is to help the poor and vulnerable, now it goes far beyond this to achieve its objective (see Lønborg and Rasmussen, 2014). This is because MFIs face a dilemma in undertaking the higher credit risk of the poor who are more vulnerable in the society while maintaining financial sustainability (Schreiner, 2002). Basically, microfinance is costly because MFIs must deal with small and short term (usually from 3 months to the maximum of one year) loans on a frequently repeated basis (Kaur, 2016). Hence, microcredit tends to be rationed, particularly to the poorest and most vulnerable people.

Several studies have investigatd whether microfinance reaches the poorer and more vulnerable people. Lønborg and Rasmussen (2014) suggest that the current practices of the microfinance sector in Malawi target only the upper class in poor people. Gulli and Berger (1999) found that MFIs failed to reach many of the poor households in six countries in Latin America. Mosley (2001) also found that microfinance is successful in reducing poverty for those who are near the poverty line, but ineffective in reducing extreme poverty. Kaur (2016) analyzes the efficiency of MFIs under financial and social perspectives. This study revealed that although Indian MFIs are financially efficient, their efficiency in reaching to the poorest is low. In the case of Bangladesh, Amin, Rai and Topa (2003) found, by looking at 12 months' income and consumption data from two villages of Rajshahi, Bangladesh, that even though the Grameen bank successfully reached into poor households, it was less successful in reaching out to vulnerable people[30]. Nawaz (2010) argues that the largest three MFIs in Bangladesh, Grameen Bank, BRAC and ASA, failed to reach the poorest of the poor in their village samples.

The existing debate suggests the reasons behind the credit rationing by MFIs to marginalized people. One reason is from the demand side: the poorest are not willing to take loans from MFIs (Mosley, 2001). The poorest lack of confidence in whether they are able to repay their loan. Besides, they know that the treatment towards default clients by MFIs may be harsh and cruel. Also, under the group lending method as mentioned earlier, group members are not willing to include someone from the very poor category. The other reason is from the supply side; MFIs are not willing to provide loans to the poorest. This is because the

[30] According to Amin, Rai and Topa (2003, p. 60), a 'poor' household is defined if it has low consumption levels, and a 'vulnerable' one if it is unable to smooth consumption in the face of idiosyncratic income fluctuations.

poorest are considered one of the most vulnerable client segments associated with higher default risk.

The existing debate on the outreach of microfinance to the poor mainly uses the following methodology to quantify the poor: average loan size (depth of outreach), percentage of women clients (breath of outreach), outreach ratio on levels of income or consumption, outreach ratio using poverty headcounts, and outreach ratio based on the poverty gap. But those indicators do not always provide actual information on whether MFIs reach the poor. For instance, average loan size does not provide the information on the actual poverty profile of each client (Gulli, 1988, p. 21). We believe that the overall or average level of outreach does not sufficiently explain the poverty profile of the borrowers.

Measuring poverty by survey must tackle the difficulties of determining what types of question should be asked, what kind of measures can be taken, and how to measure the accuracy of the information. For example, the evaluation of the following questions is very difficult: "What was the value of firewood consumed that was bought in cash/credit or wages in-kind? What was the value of firewood consumed that was produced by the household or received? What was the sum of these?" (Chen and Schreiner, 2010). Besides, with any survey method, data collection is time-consuming and very costly (Suzuki et al., 2018).

Having faced the difficulties, many researchers as well as organizations try to identify easy and appropriate poverty measurement techniques. Grameen bank has taken the first attempt to develop a measuring technique that provides nformation on the absolute poverty status of their clients. Based on this research the Grameen bank developed a 10-scale indicator to measure poverty status (Table 5-A).

Table 5-A: GB's 10 indicators to evaluate poverty level of the borrowers

1) *The family lives in a house worth at least Tk. 25,000 (twenty five thousand) or a* house with a tin roof, and each member of the family is able to sleep on bed instead of on the floor. 2) Family members drink pure water of tube-wells, boiled water or water purified by using alum, arsenic-free, purifying tablets or pitcher filters. 3) All children in the family over six years of age are all going to school or finished primary school. 4) Minimum weekly loan installment of the borrower is Tk. 200 or more 5) Family uses sanitary latrine. 6) Family members have adequate clothing for everyday use, warm clothing for winter, such as shawls, sweaters, blankets, etc, and mosquito-nets to protect themselves from mosquitoes. 7) Family has sources of additional income, such as vegetable garden, fruit-bearing trees, etc, so that they are able to fall back on these sources of income when they need additional money. 8) The borrower maintains an average annual balance of Tk. 5,000 in her savings accounts. 9) Family experiences no difficulty in having three square meals a day throughout the year, i. e. no member of the family goes hungry any time of the year. 10) Family can take care of the health. If any member of the family falls ill, family can afford to take all necessary steps to seek adequate healthcare.

Source: Yunus 1998.

The Grameen Bank considers that a member is poverty free when all the answers are "yes", however, the methods were developed only for their own purposes and it's not acceptable to measure the poverty level of other people who did not join any kind of microfinance organization. For example, questions 4 and 8 are only applicable to microfinance clients, for those who did not join any kind of microfinance organization, this method is not applicable.

Like the Grameen bank, Barua and Sulaiman (2006) develop a poverty measuring index for BRAC which is called the "Ultra-poverty measuring technique" to measure the poverty status of the BRAC Ultra Poor Program (Table 5-B).

Table 5-B: BRAC Ultar Poor Program Poverty measuring index

Poverty Attributes	Indicators
Demographic	Education of Household Head
Housing	Housing Condition (4=Very Good … 1= Very Bad)
Land Ownership	Own Cultivable land (decimal)
Housing Assets	Value of Furniture (Tk.) Value of Operational Items (Tk.)
Food Consumption	Sufficiency in food intake over the year Number of days eggs served in the last week Number of days took only rice in the last week Seasonality in food intake
Clothing and Footwear	Having at least one set of good cloths Having shoed/sandals Per capital expenditure on clothing and footwear (Tk.)
Financial Strength	Self-perceived financial status (3=surplus … 1= deficit Crisis coping ability (3 =can cope easily …… 1= never cope)

Source: Barua and Sulaiman (2006).

After developing this index Barua and Sulaiman (2006) tested the poverty status of BRAC clients. The limitations of Barua and Sulaiman (2006) are, first, they developed the index based on poor clients who live under extreme poverty and members of BRAC ultra poor program, then they analyzed the data based on the index they developed and found a significant number of clients living under poverty. Here, this study was uncomfortable in accepting the result of Barua and Sulaiman (2006), instead we argue that the model was developed from the data that they collected from the BRAC ultra poor program. After that they used the same data to see the result of the poverty status of the same clients (a case of circular reasoning at least). It is the general perception, if the same data are used to develop a poverty index is then used the same data to test the model, it will always provide the expected results. Second, Barua and Sulaiman (2006) only considered the BRAC' ultra-poor program, which is a selected group of the poor population under BRAC MFIs, and does not represent the whole population. Third, In Barua and Sulaiman (2006) the poverty index is not presented in a ready-to-use form. Except for BRAC or the authors (who developed the method) researchers can't use this measuring technique. Finally, the valuation of some values is difficult like when indicators are subjective (condition of residence, sufficiency of food intake, assessment of vulnerability), and finally, some indicators are not verifiable (sufficiency and seasonality of food intake, consumption of eggs and rice, per-capita expenditure on clothing and footwear).

Like Barua and Sulaiman (2006), Zeller et al. (2006) also conducted research with the aim of predicting household poverty status and to monitor the poverty rates of groups of households with easy-to-collect indicators. Zeller et al. (2006) used their own nationally representative survey of 800 households in Bangladesh, carried out from March 15 to April 17, 2004. Based on their data they developed poverty status indicating tools based on 10 indicators (Table 5-C).

Table 5-C: Zeller et al. PCA-based poverty indicator for Bangladesh

1) Number of household members who are literate
2) Characteristics of the residence:
    i) Area in square feet
    ii) Legal socket connection to public electrical grid
    iii) Type of toilet arrangement
3) Ownership of consumer durables:
    i) Black-and-white television
    ii) Number of poultry
    iii) Number of saris
    iv) Logarithm of the value of kantha, a digging tool used for farming
4) Financial status
    a) Ownership of a checking account
    b) Ratio of remittances received to remittances sent

Source: Zeller et al., 2006

According to Zeller et al. (p. 12), “the 10 indicators are fairly easy to measure in household surveys.” But some indicators seem to be difficult to measure or identify. For example, the number of poultry, and saris are difficult to count. Others are difficult to measure such as the Ratio of remittance received to remittance sent. Because, if a family did not send and received any remittances, the question will be invalid for them.

The World Bank has also developed a poverty assessment methodology known as the Living Standards Measurement Studies (LSMS), while another poverty assessment tool developed by the Consultative Group to Assist the Poor (CGAP) and known as the Poverty Assessment Tool (PAT). However, both LSMS and PAT use huge amounts of data that require time and money and advanced analytical tools to obtain (CGAP, 2003).

Chen and Schreiner (2010) challenged this situation and developed an effective and less costly poverty measuring technique for Bangladesh based on HIES 2005 conducted by the Bangladesh Bureau of Statistics (BBS). This technique is popularly known as the Poverty Possibility Index (PPI). They used 10 questions and created a scorecard of each answer in each question. Suzuki et al. (2018) mention the characteristics of the scorecard: first, a parameter is to be selected to simplify the questions of respondents understanding; Second, each parameter is quantified using a non-negative-integer score ranging from 0 (suggesting a significant correlation with living most likely below a poverty line) and 100 (least likely below a poverty line); third, the parameter is selected and provides a score based on the transformed function of statistical Logit coefficient which addresses the discriminatory power. Discriminatory power separates the poor from the non-poor. For example, the highest number is assigned to Question 1: “How many household members are 12-years-old or younger?” and 4 answers are prepared; (a) Three or more, (b) two, (c) One, and (d) none. The points are assigned to each answer are 0 to answer (a), 10 to answer (b), 16 to answer (c), and 32 to answer (d). Finally, the total score (PPI Score) is linked to the so-called percentage of purchase power parity (PPP) (see Tables 5-D and 5-E).

Table 5-D: PPI Scorecard for Bangladesh

Indicator	**Response**	**Points**	**Score**
1. How many household members are 12-years-old or younger?	A. Three or more	0	
	B. Two	10	
	C. One	16	
	D. None	32	
2. Do all household members' ages 6-to-12 currently attend a school/educational institution?	A. No	0	
	B. No one 6-to-12	0	
	C. Yes	6	
3. In the past year, did any household member ever do work for which he/she was paid on a daily basis?	A. Yes	0	
	B. No	8	
4. How many rooms does your household occupy (excluding rooms used for business)?	A. One	0	
	B. Two	3	
	C. Three or more	5	
5. What is the main construction material of the walls of the main room?	A. Hemp or hayor bamboo, or others	0	
	B. Mud brick, or C.I. sheet or wood	2	
	C. Brick/cement	9	
6. Does the household own any televisions?	A. No	0	
	B. Yes	7	
7. How many fans does the household own?	A. None	0	
	B. One	4	
	C. Two or more	7	
8. How many mobile phones does the household own?	A. None	0	
	B. One	8	
	C. Two or more	15	
9. Does the household own any bicycles, motorcycle/scooters, or motor cars etc.?	A. No	0	
	B. Yes	4	
10. Does the household own (or rent/sharecrop/mortgage in or out) 51 or more decimals of cultivable agricultural land (excluding uncultivable land and dwelling-house/homestead land)?	A. No	0	
	B. Yes	7	

Source: Schreiner (2010)

Table 5-E: Look-up table for Converting PPI Scorecard to Poverty Likelihood (%) for Bangladesh

	National	National Upper			USAID	Intl. 2005 PPP			
Score	Lower	100%	150%	200%	Extreme	$1.25	$1.75	$2.00	$2.50
0–4	76.2	87.3	98.4	100	65.8	97.9	98.8	100	100
5–9	70.6	84.6	97.7	99.5	65.6	89.3	98.2	98.7	99.7
10–14	63.6	82.1	97.6	99.5	57.2	88.8	98.2	98.7	99.7
15–19	46.4	68	96.2	99.5	42.5	81.6	96.9	98.6	99.7
20–24	37.1	62.7	96.1	99.5	32.7	78	96.3	98.4	99.7
25–29	26.6	50.4	88.7	97.9	22.9	65.8	91.6	95.3	98.7
30–34	19.1	40.9	84.3	96	16.9	57	87.9	93.5	98.2
35–39	15	36	80.8	93.6	13.8	50.3	83.6	90.7	96.9
40–44	12.7	26.7	76.1	91.9	11.1	40.8	79.6	87.4	94.9
45–49	6.6	19.6	65.8	86.6	5.4	33.5	68.8	79.6	91.5
50–54	3.9	14.7	55	81.3	4.5	24.2	60.3	74.2	87.9
55–59	1.5	7.1	42.6	75.6	1.8	14.5	50.4	65.2	84.3
60–64	0.9	5.3	34.8	64.9	1	10.9	40.4	54.6	73.2
65–69	0.4	4.4	28.6	52.5	0.1	8.7	32.2	44.5	63.3
70–74	0.2	2.3	24.6	51	0	5.6	31.5	42.9	60.4
75–79	0	1.2	21.4	40.3	0	4.3	25.8	34	50.7
80–84	0	0.5	17	32	0	2.7	19.7	26.7	40.9
85–89	0	0	8.3	24.9	0	0	10.7	14.6	33.3
90–94	0	0	3.9	9.9	0	0	5.1	6.6	12.3
95–100	0	0	0	0	0	0	0	0	0

Source: Chen and Schreiner, 2010

This research analyzes how microfinance (both Islamic and conventional) is made available to the poor and poorest of the poor clients in Bangladesh. The important objective of microfinance is to empower poor clients. This important mission would drift if the MFIs serve only the upper poor or non-poor clients. To detect potential mission drift, we use the technique of PPI to investigate the poverty status of their clients including Islamic MFIs.

5.4 Analytical frameworks and Data Collection

5.4.1 Data Collection

A field study was carried out in Bangladesh on February 2018. The study selected three *Thana* (sub-district); *Daudkandi*, *Meghna* and *Titash* under the *Comilla* district to collect the primary data. Almost all the types of MFIs operate in all three Thana. The Grameen bank started its operation in 1980s followed by BRAC and ASA, UDDIPAN. The other conventional MFIs have been also operating there for the last 5 to 15 years. Islamic MFI started its operation here after the establishment of a branch office of IBBL, the parent Islamic bank of RDS, at Gouripur, Daudkandi, Comilla in 2006. Face to face interviews were conducted with clients to collect 122 conventional and 88 Islamic MFIs (total 210) respondents in the three Thana[31].

To check poverty status, this research used four PPI scorecards: (1) National Lower poverty line, (2) National upper line at 100%; (3) USAID extreme poverty line; and (4) International Standard Income US $1.25 (2005 PPP). In selecting the input parameters, this research used the Schreiner (2012) parameters. The parameters are as follows: Household members are 12-years-old or younger (Q1); all household members ages 6-to-12 currently attend a school/educational institution; (Q2), has a household member ever done work for which he/she was paid on a daily basis; (Q3), rooms occupied by Household; (Q4), construction material of the walls of the main room (Q5); ownership of television; (Q6), ownership of fan; (Q7), Ownership of mobile phone; (Q8), ownership of bicycles, motorcycle/scooters, or motor cars etc; (Q9), Ownership of cultivatable land; and (Q10).

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31 Current researcher has a good understanding in the study area. Therefore, research did not face any critical difficulties in collecting data. But this does not guarantee that all other researcher gets the same facility when conducting any field trip.

5.4.2 Fundamental information of parameters

Table 5-F represent the descriptive statistics of clients PPI score's The minimum value of Islamic and conventional MFIs clients score was the almost same except on Q5 and Q7. As for Q5, the minimum value from conventional MFIs clients was 0, whereas the Islamic MFIs clients score was 2. In Q7, the conventional MFIs clients score showed 0, while the Islamic MFIs clients score represented 4. The maximum value of their score was the almost same except for Q7 and Q10. Where the conventional MFIs clients score showed 15, the Islamic MFIs clients score showed 7 on Q7. And in Q10, the value of the conventional MFIs clients' score showed 0, while the Islamic score showed 7. The median value was the same except for Q1, where the score of conventional MFIs clients was 16, whereas the Islamic MFIs clients score was 13. The average values for 8 out of 10 questions show a higher value for conventional MFIs. In the total score column, the minimum value of the conventional one was 11 whereas it was 24 from Islamic MFIs clients. The maximum value of conventional MFIs clients score was 81, whereas that of the Islamic MFIs clients score was 76.

Based on the distributions of both Islamic and conventional MFIs clients scores, this survey suggests that conventional MFIs are serving over a greater number of the border segment of clients than Islamic MFIs. In the Thana surveyed, we can see this tendency such that conventional MFIs covered a relatively wider range of clients (from the poorer to the upper class) where Islamic MFIs rather concentrated on the middle segment of the clients. The total average value of conventional MFIs clients score was 53.87, where the Islamic MFIs client's value was 50.91, and the standard deviation of the value from convention MFIs clients was 13.49, while it was 15.18 from the Islamic MFI clients.

Table 5-F: Descriptive Statistics of MFIs Parameters

Descriptive Statistics	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Total
Minimum	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (2.00)	0.00 (0.00)	0.00 (4.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	11.00 (24.00)
Maximum	32.00 (32.00)	6.00 (6.00)	8.00 (8.00)	5.00 (5.00)	9.00 (9.00)	7.00 (7.00)	15.00 (7.00)	15.00 (15.00)	15.00 (15.00)	0.00 (7.00)	81.00 (76.00)
Median	16.00 (13.00)	0.00 (0.00)	0.00 (0.00)	3.00 (3.00)	2.00 (2.00)	7.00 (7.00)	7.00 (7.00)	15.00 (15.00)	0.00 (0.00)	0.00 (0.00)	53.00 (48.50)
Average	17.34 (15.55)	2.95 (2.45)	3.67 (3.64)	3.10 (3.23)	2.97 (2.95)	5.23 (4.77)	6.30 (5.91)	11.82 (11.45)	0.49 (0.32)	0.00 (0.64)	53.87 (50.91)
Std. Dev	9.98 (11.36)	3.01 (2.97)	4.00 (4.10)	1.75 (1.57)	2.45 (2.42)	3.02 (3.28)	1.90 (1.45)	4.30 (4.23)	2.68 (1.47)	0.00 (2.02)	13.49 (15.18)

Source: Authors Computation

(Note: Scores represent the conventional MFIs clients and the number inside parenthesis represents the scores of Islamic MFIs clients)

5.5 Results and Discussion

Let us analyze the above answers by applying PPI scorecards with four poverty lines: National Lower, National Higher at 100%, UNAID and International poverty line (US $1.25 per day) as of 2005 PPP, respectively. Table 5-G and Table 5-H represents the PPI comparison with the poverty level based upon National Lower and National Higher at 100%. Upon the PPI scorecard with National Lower, we find that conventional MFIs financially included clients in the category of 63.6 percentage probability who live under poverty line but with only 1.64 percent (n=2). Islamic MFIs financially included the client in the category of 37.1 percentage probability for those who live under the poverty line but with only 5 percent (n=4). We also found that conventional MFIs included the upper-class client in the category of 3.9 percentage probability to live under poverty line with the maximum number of 18.03 percent (n=22) clients (in the score of 50 to 54 range). Islamic MFIs included the upper-class client in the category of 26.23 percentage probability with the maximum number of 18.18 percent clients in the score of 40 to 44. We should note that Islamic MFIs did not financially include any client who lived under the National Lower poverty line. In the same way, we can apply the other PPI scorecards for analyzing our case (see Tables 5-G and 5-H).

Table 5-G: Poverty status under Bangladesh National Lower and National Upper 100%[32]

Score	*National Lower*	*Conventional MFIs*		*National Upper (at 100%)*	*Islamic MFIs*	
		Frequency	*Percentage*		*Frequency*	*Percentage*
0–4	76.2	0	0.00%	87.3	0	0.00%
5–9	70.6	0	0.00%	84.6	0	0.00%
10–14	63.6	2	1.64%	82.1	0	0.00%
15–19	46.4	0	0.00%	68	0	0.00%
20–24	37.1	0	0.00%	62.7	4	4.55%
25–29	26.6	2	1.64%	50.4	4	4.55%
30–34	19.1	2	1.64%	40.9	8	9.09%
35–39	15	10	8.20%	36	4	4.55%
40–44	12.7	16	13.11%	26.7	16	18.18%
45–49	6.6	12	9.84%	19.6	8	9.09%
50–54	3.9	22	18.03%	14.7	4	4.55%
55–59	1.5	14	11.48%	7.1	12	13.64%
60–64	0.9	12	9.84%	5.3	12	13.64%
65–69	0.4	16	13.11%	4.4	8	9.09%
70–74	0.2	6	4.92%	2.3	0	0.00%
75–79	0	6	4.92%	1.2	8	9.09%
80–84	0	2	1.64%	0.5	0	0.00%
85–89	0	0	0.00%	0	0	0.00%
90–94	0	0	0.00%	0	0	0.00%
95–100	0	0	0.00%	0	0	0.00%

Source: Authors Computation

[32] National Lower poverty line: The extreme poor households are those households whose total expenditures on food and nonfood combined are equal to or less than the food poverty line.
The National upper poverty line is estimated by adding together the food and nonfood poverty lines. Food poverty and nonfood poverty are defined in note no 31 and 32.

Table 5-H: Poverty status under USAID Extreme[33], Int. 2005 PPP ($1.25 & $2.00)

Score	USAID Extreme	Conventional MFI		Int. S. 2005 PPP ($1.25)	Islamic MFI	
		Frequency	Cumulative Freq.		Frequency	Cumulative Freq.
0–4	65.8	0	0	97.9	0	0
5–9	65.6	0	0	89.3	0	0
10–14	57.2	2	2	88.8	0	0
15–19	42.5	0	2	81.6	0	0
20–24	32.7	0	2	78	4	4
25–29	22.9	2	4	65.8	4	8
30–34	16.9	2	6	57	8	16
35–39	13.8	10	16	50.3	4	20
40–44	11.1	16	32	40.8	16	36
45–49	5.4	12	44	33.5	8	44
50–54	4.5	22	66	24.2	4	48
55–59	1.8	14	80	14.5	12	60
60–64	1	12	92	10.9	12	72
65–69	0.1	16	108	8.7	8	80
70–74	0	6	114	5.6	0	80
75–79	0	6	120	4.3	8	88
80–84	0	2	122	2.7	0	88
85–89	0	0	122	0	0	88
90–94	0	0	122	0	0	88
95–100	0	0	122	0	0	88

Source: Authors Computation

[33] USAID defines extreme poverty as ‘the inability to meet basic consumption needs on a sustainable basis’. It often refers to living on less than $1.90 per day per person.

To sum up, we calculate the average poverty likelihood or poverty rate of the clients of Islamic MFIs and Conventional MFIs, respectively, using the average poverty rate calculation method derived by Schreiner (2013). The formula of average poverty likelihood or poverty rate calculation is as follows:

$$APL = \sum_{i=1}^{n} \frac{PLV_i}{n} \qquad \text{(EQ 5-1)}$$

Where,

$APL = A$verage poverty likelihood or poverty rate

$PLV_i = Poverty\ Likelihood\ Value\ of\ Clients\ i$

$n = Sample\ size$

Table 5-I: Average poverty rate under different types of poverty line

Types of Poverty Line	Islamic MFIs	Conventional MFIs
National Lower	8.76%	6.36%
National Upper @ 100%	20.00%	15.97%
USAID Extreme	7.80%	5.84%
International Standard US $ 1.25 (at 2005 PPP)	30.21%	25.01%

Source: Authors Computation based on Primary Data

Table 5-I shows the average poverty likelihood or poverty rate of the clients served by Islamic and conventional MFIs in Bangladesh. Even upon the strictest poverty line, the international standard poverty line at the US $1.25 (2005 PPP), no more than 30.21 percent of the clients of Islamic MFIs and 25.01 percent of clients of conventional MFIs, on average, are estimated to live under the poverty line. Upon the Under National Lower poverty line, only 8.76 percent of clients of Islamic MFIs and only 6.36 percent of conventional MFIs are estimated to live below this poverty line. Apparently, the outreach level to the poorer or vulnerable people by MFIs is very low in Bangladesh.

In table 5-I the national upper poverty line at 100 percent also represents the national poverty line. From this table we can calculate that Islamic microfinance outreach loss is 80 percent (0.792 million clients) because it reaches only 20 percent of the possible poor clients and the rest are non-poor clients. On the other hand, conventional microfinance outreach losses are 84.03 percent (30.41 million clients), where conventional microfinance reaches only 15.97 percent of the possible market.

Microfinance organization (both conventional and Islamic) has emerged to finance the poor and vulnerable poor to help them to get rid of poverty. But it appears that most MFIs now drift from this important objective. This research aimed to investigate how the MFIs, in particular, Islamic MFIs have fallen into the 'drift of mission' by looking at the case of Bangladesh. The study is also aimed at discussing the *raison d'etre* of Islamic MFIs by investigating how Islamic microfinance is reaching out to the poorer people, because their *raison d'etre* can be justified if Islamic microfinance reaches marginalized people.

One of our findings is that both conventional and Islamic MFIs are still too conservative to undertake the credit risk of the poorer segment, that is, the 50 percent who live under the poverty line in Bangladesh. We cannot say that Bangladeshi MFIs fulfill the mission to fully empower the poorer and marginalized people. Another one is that Islamic microfinance has not reached marginalized people in Bangladesh. As was mentioned earlier, conventional MFIs are growing rapidly whereas Islamic MFIs are lagging far behind in Bangladesh. The hypothesis that Islamic MFIs' very limited market share in the microfinance industry is attributable to their outreach to marginalized people cannot be accepted. It may be too early to conclude; however, we cannot find the *raison d'etre* of Islamic MFIs in Bangladesh in the dimension of empowering marginalized people. Poorer people including Muslims are still out of any financial service in this country.

It is extremely difficult for MFIs to absorb the higher credit risk of the poorer clients while sustaining their financial performance. Perhaps, the 'gradual' penetration into the poorer client segment is necessary to keep a delicate balance. We assume that Grameen bank and NGO-MFIs attempt to fulfill their mission to empower the poor through gradual penetration. On the other hand, within the scope of our investigation, we cannot find a reason for the stagnant performance of RDS in the microfinance industry in Bangladesh.

5.6 Summary

From the literature survey it was found that there is a demand for Islamic microfinance at the global scale. We have reported a survey reports which shows that 80 percent of the Muslim respondents replied that they preferred Islamic microfinance products to conventional products. Among them, 45 percent claimed that they would switch to Islamic microfinance institutions (MFIs) even at higher cost if the Islamic microfinance products are accessible. A total of 32 percent of the respondents claimed that they never applied for any conventional loan because of their religious belief.

Despite of its seemingly mammoth demand, Islamic microfinance outreach is extraordinarily low worldwide. Islamic microfinance institutions were estimated to serve about 380,000 customers through 126 institutions in 14 countries. This level of the outreach accounted for no more than 1.5 percent of total microfinance outreach. Rhule (2016) reports that, at the point in 2016, Islamic microfinance covered 1.28 million clients with only 1 percent of global microfinance outreach. It is worth noting that, among the clients of 1.28 million, RDS, a major Islamic MFI in Bangladesh, covers 0.582 million (45.54 percent) of global Islamic microfinance clients. Even in Bangladesh, RDS covers only 5 percent of total microfinance outreach. Even though its (Islamic Microfinance) market penetration is still very limited, the very reason of establishing Islamic MFIs can be justified if they reached the marginal borrowers.

Several studies have examined if microfinance really addresses the financing needs of the poor and vulnerable segments of the society. These studies have applied different methodologies and measurement yardsticks. For example, average loan size (depth of outreach), percentage of women clients (breath of outreach), outreach ratio on levels of income or consumption, outreach ratio using poverty headcount ratio, and outreach ratio based on the poverty gap have been used in the existing literature as a proxy to measure the poverty level. Unfortunately, those indicators do not always provide the actual information on the question as to whether MFIs reach the poor or not. Average loan size does not provide information on the actual poverty profile of each client whereas overall or average level of outreach does not sufficiently explain the poverty profile of the borrowers.

Having faced many difficulties, researchers as well as organizations have attempted to invent an easy and appropriate poverty measurement technique. Grameen bank took the first attempt to develop a measuring technique that provides absolute poverty status of their clients. However, Grameen Bank's poverty measuring techniques are applicable for their clients only. Barua and Sulaiman (2006) developed a poverty measuring index for BRAC, 'Ultra-poverty measuring technique', to measure the poverty status of BRAC Ultra Poor Program. There are few limitations involved with BRAC's 'Ultra-poverty measuring technique'. The primary among them is that the method is not universally applicable, and the format is not yet ready to be used.

On the other hand, the World Bank has developed a poverty assessment methodology known as the Living Standard Measurement Studies (LSMS), and another poverty assessment tool developed by the Consultative Group to Assist the Poor (CGAP) known as Poverty Assessment Tool (PAT). However, both LSMS and PAT require huge amount of data that calls for time and money as well as advance analytical tools.

Chen and Schreiner (2010) developed an effective and cost-efficient poverty measuring technique for Bangladesh, based on HIES 2005, conducted by the Bangladesh Bureau of Statistics (BBS). This technique is popularly known as Poverty Possibility Index (PPI). They used 10 questions to prepare a scorecard for scoring each answer in each question. It was also found that the measuring technique provides 95 percent accurate result. Hence, this research uses PPI technique to measure the poverty status of Islamic microfinance clients.

The primary data of this research is collected through questionnaire survey of 210 respondents consisting of 122 conventional and 88 Islamic microfinance clients. Based on the collected data, an index is calculated which is then compared with four poverty lines, (1) National Lower poverty line, (2) National upper line at 100 percent, (3) USAID extreme poverty line, and (4) International Standard Income US $1.25 (2005 PPP).

Using the average poverty rate calculation method based on Schreiner (2013), this research finds that by the international standard poverty line at US $1.25 (2005 PPP), no more than 30.21 percent of clients of Islamic MFIs and 25.01 percent of clients of conventional MFIs live under the poverty line. Upon the National Lower poverty line, only 8.76 percent of clients of Islamic MFIs and only 6.36 percent of conventional MFIs are estimated to live below the poverty line.

From the above results, this research concludes that both conventional and Islamic MFIs are still conservative to undertake the credit risk of the poorer segment. Both microfinance organizations fall into the problem of mission drift, and they have failed to cover the marginalized poor. Hence, our hypothesis that MFIs serve the marginal segment of the society, cannot be justified.

6 Is microfinance helping or exploiting poor? Emperical evidence from Bangladesh

> *"Giving the poor access to credit allows them to immediately put into practice the skills they already know—to weave, husk rice paddy, raise cows, peddle a rickshaw. And the cash they earn is then a tool, a key that unlocks a host of other abilities and allows them to explore their own potential."* - *Yunus (1998)*

6.1 Introduction

Microfinance has been considered as a poverty reduction tool with some exception. Several researchers such as Bateman (2014) claim that the contribution of microfinance in social wellbeing or poverty reduction is a myth. They are charging exorbitant interest on their loan which emphasizes that, microfinance exploit the poor clients. This chapter of the thesis deals with the microfinance interest charged by different microfinance organization in reference to Bangladesh. This chapter is organized in the following orders. Section 6.2 deals with microfinance promise and its fundamental assumption, how it works and what is the role of microfinance in empowerment. The section 6.3 describe whether profit matters for microfinance or not. The next section, section 6.4 present the calculation interest and the interest rate charged by different microfinance organization. Section 6.5 provide microfinance interest rate comparison with commercial banks and the following section, section 6.6 provide microfinance interest rate comparison with Usurious Loans Act, 1918 (Act No. X of 1918) and the last section, section 6.7 provide a summary of this chapter.

6.2 Literature survey

Several scholars define microfinance as a financial institution that provide financial services to the poor household caught up in the vicious poverty cycle. Those financial services include, savings, insurance, pension funds, remittance and small credit. However, the main focus of microfinance still remains in microcredit. Microfinance provide loan to the poor people who were officially not qualified to take loan from formal financial institute like banks.

The poor households are in a serious vicious poverty cycle, where poor only has own labor resources that utilize to reduce the poverty level. But the labor productivity is locked up with some key constraint that includes capital and technology. For example, a poor household own a pace of land and they want to grow sufficient food crops for their family. Labor being the only factor in this case, makes it still questionable how much they can produce a certain amount of foods crop in their filed. To grow extra food crops in the same field, they need other factors of production that helps them to grow more food in the same field. It may include, better seeds, fertilizer or sometimes they need new technology. All of these requires financial resources or what Kiiru (2007)[34] called as liquid constrains, which poor people are deprived of.

Scholar and development organization believe, liquidity constraint is one of the biggest challenges in reducing poverty cycle from the poor segment. Many scholars argue that to break the vicious poverty cycle, it is necessary to remove the liquid constrain and needed some outside force that will break the constrains by injecting some liquid assets. Many government

[34] Kiiru, J. M. M. (2007). Microfinance: getting money to the poor or making money out of the poor?. *Finance & Bien Commun*, (2), 64-73.

and development organization try to inject liquid assets through “Aid or Donation” and “Charity”. But there is a long debate in the current literature that emphasis on charity. Charity has some limitation in destroying liquid constrain in the long run. The charity helps the recipient to overcome immediate problem, like, in case of natural disaster, crisis after the war, but it has devastating effects on social well-being. It robs the recipient dignity and removes the incentive of having a stable income source (Yunus, 1999). On the other hand, aid has a positive but diminishing impact on economic growth (Hansen and Tarp, 2000; Dalgaard and Hansen, 2001; Lensink and White, 2001; Easterly et al., 2004; Hansen and Tarp, 2000). Collier and Hoeffler (2004) identify that without good policies and institutions, aid become unproductive and rent-seeking activities.

It has been established in the current literatures that, aid and charity failed to break the liquid constrain but Kiiru (2007) are in the opinion that microfinance promises to provide loan to deprived people. Literature argue that initiative of microfinance was a new step that play an active role to break the vicious chain of poverty by creating a new financial system. That inject huge amount of liquid money to the poor household and create new cycle of self-enforcing economic empowerment that leads to increased household well-being.

The fundamental assumption of microcredit is, it helps poor people to create employment or self-employment by creating a new business or expending the existing business. Simply, microfinance helps the poor people to make them entrepreneurs. The micro loan that poor household receive, will invest to any sectors that will increase the household income. From that income, they repay their loan and rest is spent for household expenses. But there are few evidences that argue whether this tinny loan be able to make anyone an entrepreneur. Even though, if that assumption become true, microfinance assumption of the market being vibrant for all goods and services is not certain. If not, then how will it increases the poor householder's income. One of the indicators of microfinance performance is loan repayment rate which is more than 95percent (sometimes even 100 percent). Kiiru (2007) highlighted that, the repayment doesn't mean that the microenterprise is successful, rather some hidden principle works to remain a high repayment rate whike dealing with poor people. Kiiru (2007) mention four hidden principle that helps microfinance to keep sky high recovery rate. First, dynamic incentives which means, the microfinance organization always prospect a larger amount of loan after the current repayment. For instance, borrower "X" received a loan of $100 and after successful repayment of $100, next time the borrower are allowed to receive a higher loan than $100. Which provide a dynamic incentive to the borrower to repay the loan on time. The second principle is group responsibility, a group of 5 to 20 member are jointly liable for loan repayment. If any borrower becomes default, the other group members are responsible to repay the loan. The third principle is, peer monitoring and pressure, which ensure timely repayment and the last principle is forced savings. According to Kiiru (2007) neither group nor individual have access to the forced deposit. This works as a security of the next round loan. The forced deposit is paid back only when the member drops out from the particular microfinance.

Even though the microfinance promises and emerges to finance the poor, but they include non-poor clients in their investment portfolio. The fundamental assumption of microfinance is to create self-employment. But the tiny amount is not enough to start a new business venture. The CEO of *Banco Wal*-Mart (a microloan provider in Mexico) stated that "We are not saints…We've come into this business for volume and profitability similar to our other businesses, or else we wouldn't invest". From this statement we can say, microfinance work only for their own benefits, they work simply to "earn profits".

6.3 Microfinance Profits matter

"If you want to become rich, sell to the poor" said by the grandfather of Ricardo Salinas, CEO of one of the biggest microfinance's organization in Mexico. Mr. Ricardo Salinas also utilize this word fully. He starts microfinance business in Mexico with an aim to become rich at the cost of poor people but, not to aid the poor. Whether microfinance is helping or exploiting people is a long debate, but, if we see the microfinance behavior in Mexico, definitely we can say microfinance is not helping the poor rather exploiting them. The microfinance exploitation behavior came forward against two big microfinances in Mexico Financiera Independencia (FI) and Compartamos in 2007. Yunus was one of the first to speak out against Banco Compartamos's Initial Public Offering (IPO), he said,

> *"I was always [. . .] vocal on that issue, saying that microcredit should be done as a social business, meaning that it is not an area where investor or promoter would like to get a big amount of money [or] profits. So that way the [. . .] interest rate can go as low as possible, because making money is not their goal. It's reaching people and helping them get out of poverty [that] is the goal." (Sandberg, 2012 p.171)*

The Mexican MFIs are not the only case that exploited the poor borrowers but also exploited other parts of the world. The same incident took place in India, where more than 200 poor, debtridden residents of Andhra Pradesh killed themselves in late 2010. The main reason found by Andhra Pradesh government was, private sectors like MFIs are exploiting India's poor by charging usurious interest rate (Ventures, 2011). The interest rate sometime charge as high as 100 percent or more.

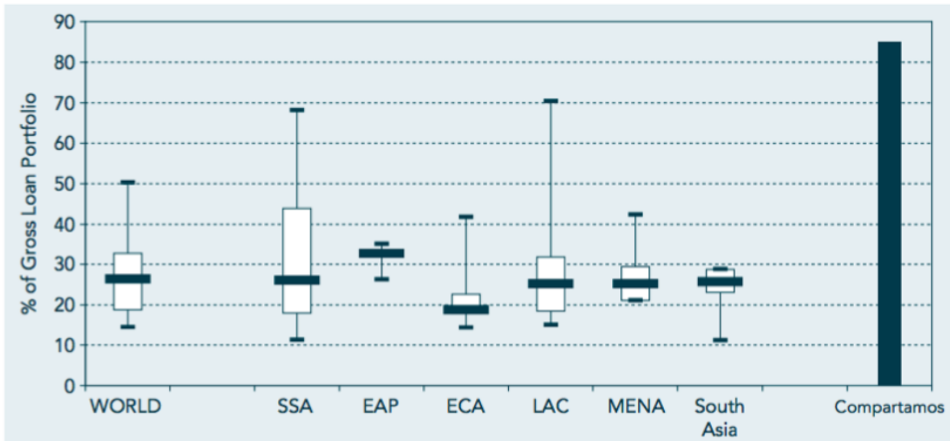
Is charging high interest by MFIs compared to market interest fair? When market interest rate is 8-10 percent, the microfinance charge 20 percent -120 percent interest on their loan. Authors like Schmidt, (2010) said that, charging high interest is unfair and, it's kind of exploitation. On the other hand, Sandberg (2012) said, charging high interest by microfinance organization is not wrong anyway. Julio B. Gomez the CEO of *Banco Wal*-Mart (a microloan provider in Mexico) stated that

> *"We are not saints…We've come into this business for volume and profitability similar to our other businesses, or else we wouldn't invest"*[35].

Charging high interest by MFIs become a fashion in this industry. Although some authors claimed it as unethical. The figure 6-A shows the interest charged by microfinance institution in different reasons.

[35] Geri Smith and Ketih Epstein. "Wal-Mart Banks on the 'Unbanked." *Business Week.* 13 Dec. 2007. www.businessweek.com.

Figure 6-A: Interest income percentage of gross loan portfolio



The thick horizontal bars represent medians; the top and bottom of the white boxes represent the 75th and 25th percentiles, respectively; and the high and low short bars represent the 95th and 5th percentile respectively.

Source: Rosenberg, Gonzalez, and Narain, (2009b)

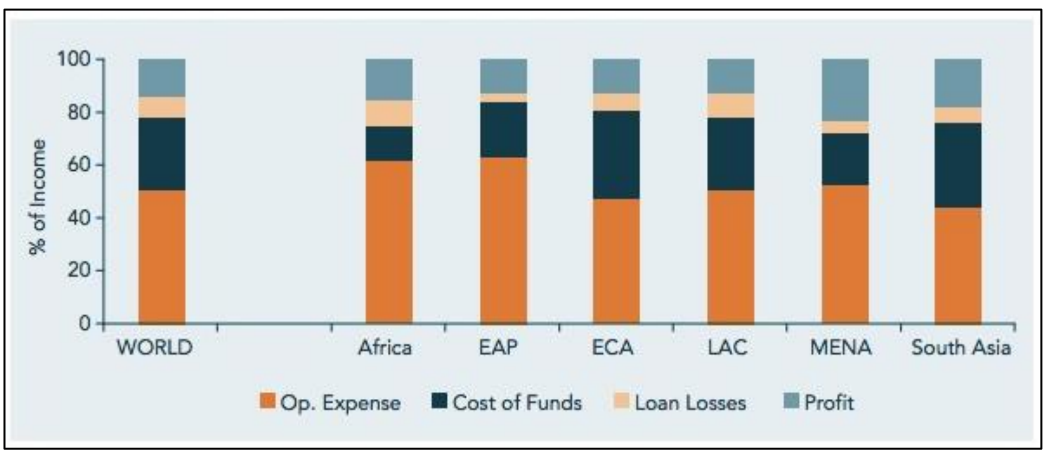
The above figure shows that the microfinance institute charge interests as much as 70 percent of their gross loan portfolio.

To go a deep analysis regarding microfinance interest rate, it is necessary to show, how microfinance interest is composed. Rosenberg, Gonzalez, and Narain, (2009a) provides a breakdown equation of how microfinance charges their interest. They state, interest charged by MFIs are composed of; cost of capital, loan loss, operating expenses and profit. Among all the components, operating expenses as percentage of interest income is always high. Because MFIs engaged with small loan that required high transaction cost. One example given by CGAP as, the cost of providing $10,000 loan to one person and providing same amount to 100 people is not same. The operating cost of proving loan to 100 people is higher than providing to one person. The next bigger portion composed by operating expenses. Microfinance organizations provides their services to the doorsteps of the clients. The frequency of repayment schedule is also high for microfinance organizations compared to commercial bank. Hence, it incurred huge operational cost (see on figure 6-B).

The cost of fund, or the finding cost of microfinance organization is composed as of 8 percent to 10 percent of their gross loan portfolio (see figure 6-B). Microfinance can't do anything to reduce their operational cost, but it may reduce its cost of funds. Because if microfinance can diversify its resource dependency, it may be able to reduce its funding cost significantly by diversifying its capital structure.

Bogan, (2012) explores, how changes in capital structure could improve MFI efficiency and financial sustainability. In analyzing Bogan (2012) used life cycle theory. Bogan said, the sources of financing are linked to the stages of MFI development. Donation, grants and soft loans comprise the majority of the funding in the formative stages of the organization. As the MFI matures, private debt capital becomes available, and in last stage of MFI evolution, traditional equity financing becomes available.

Figure 6-B: Cost and profit as percentage of Gross Loan Portfolio



Source: Rosenberg, Gonzalez, and Narain, (2009) Even though the founder of Grameen bank professor Yunus argue the main objective of microfinance is to reach poor people and helping them to get out of poverty. According to some researches, it has been said that the microfinance or Grameen bank as a reference doesn't help poor people at all to get rid of poverty (Bateman, 2014)[36].

Kiiru (2007) provided an example regarding microfinance activities. Microfinance make some strict rules that separate rich and poor, rich are excluded from the microfinance organization. They provide loan to the poor, but one member stays continuously for more than ten years meaning that the members still remain poor. Where the first loan was only a few dollars and later it became thousands of dollars. This has been emphasized through the last ten years, microfinance helps the poor people to increase their loan portfolio, not to reduce any poverty status. A study conducted by Salim (2013) in Bangladesh. Salim (2013) finds that the Grameen Bank and the BRAC extend their branch network, they choose the branch location in such a way that will maximize their profit, which exemplify, microfinance works only for their own interest "making profit" because for them "Profit Matters".

6.4 Microfinance Interest: Evidence from Bangladesh

What is the difference between microfinance and moneylender? The answer is interest rate. If microfinance charge high interest like as moneylenders, then there is no motivation for existing microfinance organization in our society. On the hand, the difference between conventional MFIs and Islamic MFIs is the interest, where former microfinance organization

[36] Bateman, M. (2014). The rise and fall of Muhammad Yunus and the microcredit model. IDS, working paper #001.

engaged with interest and Islamic MFIs not. Several researchers argue that the conventional MFIs interest charge and Islamic MFIs markup profit on its loan is the same concept under two different names. One called interest like conventional MFIs, another called “profit”. Till now only few Islamic MFIs engaged with *Musaraka* (PLS) transaction, rest of them are using M*udaraba* contact. This make the tension where Islamic MFIs charging their profit as high as, same as conventional microfinance interest.

This research takes an initiative to see the difference between Islamic and a conventional MFIs interest. It was said that the conventional microfinance charges a minimum interest to become a sustainable organization. They charge flat interest rate from 12 percent to a maximum of 15 percent on their loan.

Table 6-A: Stated Interest rate by different MFIs

MFI	Stated interest/profit rate per years	Interest/Profit per period[37]	Effective Interest/Profit Rate
GB	15.00	2.22 (0.59)	30.12 (32.34)
BRAC	14.00	2.08 (0.55)	27.96 (29.99)
ASA	13.50	2.00 (0.53)	26.89 (28.83)
RDS	12.00	1.79 (0.47)	23.70 (25.38)
UDDIPAN	15.00	2.22 (0.59)	30.12 (32.34)
SSS	13.40	1.99 (0.53)	26.67 (28.60)
BURO_BD	14.30	2.12 (0.56)	28.61 (30.60)
CMS	13.90	2.06 (0.54)	27.74 (29.76)

Source: Authors Calculation based on survey 2018

[37] Interest per period means, interest per month and interest rate within the parenthesis as weekly basis. All interest is calculate based on principle amount, without considering fixed and forced deposit.

Their calculation methods are very simple. They calculate the interest by simple calculation methods, for example, if any member want loan for Tk-12,000 at 12% interest, then the total payment will be Tk-12000 principle and interest Tk-1440 (12000×12%), Total Tk-11500. This Tk-11500 can be paid either 12 month or 48 weeks. Then the total Tk-13440 can be divided either 12 (Tk-1120) month or 48 (Tk-280) weekly. In this case the real interest become 1.79 percent per month equivalent to 21.46 percent (effective interest rate 23.73 percent) per year, or 0.47 percent per weeks that is equivalent to 22.67 percent (effective interest rate 27.61 percent) per year.

Another concern in loan agreement, the lender must pay a fixed deposit against the loan and a forced deposit. The deposit vary from one MFIs to another, but the range from 4 percent to 10 percent of total loan receive (deducted from loan amount or pay in advance)[38] and force deposit from Tk-20 per weeks to Tk-50 or sometimes the forced deposit is 0.2 percent of the loan amount per week. If the fixed and forced deposit are considered when calculating the interest rates, the interest rate become as much as high as moneylenders[39]. Even though it’s seems that the microfinance exploiting the customer by fixed and forced deposit, but microfinance employee justifies this deposit by saying that they also pay the interest as both fixed and forced deposit. But the interest on deposit is too low like 3 percent to 5 percent a year and compounded yearly.

To conduct this research, researcher, collect 122 conventional and 88 Islamic MFIs clients detailed interviews including their loan amount, repayment schedule and amount of

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[38] This is one of the crucial rules exist in microfinance industry. The fixed deposit kept from the loan, for example if one member received a loan of Tk-10000 then the member received Tk-9000 (Tk-1000 deducted from the loan when fixed deposit rate is 10%) or member must deposit Tk-1000 at least one week before the loan disburse.

[39] The Effective interest become 51.74% on monthly basis and 55.97% in case of weekly basis.

installment, fixed deposit rate were collected from respected microfinance official. Based on collected data, researcher calculate the interest rate individually.

Researcher found that the force deposit vary from client to client and even in case of same clients the forced deposit varies from period to period. Therefore, in calculation of interest, this research did not consider the forced deposit effect. To calculate the interest rate per period this research used present value methods. The formula is as follows,

$$PV_L - PV_{FD} = PMT \times \frac{1-(1+i)^{-n}}{i} \text{ .... EQ-6.1}$$

where,

PV_L=Present value of loan amount.

PV_{FD}=Present value of fixed deposit

PMT=Installment per period

i= Interest rate per period

n= no. of period.

For effective interest rate calculation, the following method is going to use

$$E = (1+i)^n - 1. \text{ .... EQ-6.2}$$

Where,

E= effective interest

i= interest rate per period

n=number of periods

Table 6-B: Flat interest rate charged by different MFIs

	Islamic	Conventional					
Measure	RDS	All conventional together	ASA	BRAC	BURO-BD	GB	Others
Maximum	**10.00%**	**24.80%**	**24.80%**	**24.80%**	**24.80%**	**24.80%**	**24.80%**
Mean	10.00%	20.26%	17.82%	21.07%	20.30%	21.03%	20.80%
Median	10.00%	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%
SD	0.00%	2.59%	3.70%	2.02%	1.20%	1.87%	1.82%
Minimum	10.00%	12.50%	12.50%	20.00%	20.00%	20.00%	20.00%
N	88	122	24	36	16	16	30

Source: Authors Calculation based on Primary Data

From table 6-C represent the flat interest charged by different microfinance organization in Bangladesh. The maximum interest charged by conventional microfinance which is same for all conventional microfinance organization. The maximum interest charged by conventional microfinance is 24.80 percent. In the conventional microfinance, lowest interest charged by ASA which is 12.5 percent and the rest conventional microfinance organizations charges a minimum interest rate of 20 percent. In case of Islamic microfinance organization, the maximum and minimum flat interest rate is 10 percent.

Table 6-C: Effective interest charge by different MFIs[40]

Measure	Conventional (in percent)	ASA (in percent)	BRAC (in percent)	BURO-BD (in percent)	GB (in percent)	Others (in percent)	RDS (in percent)
Maximum	96.96 (56.92)	96.96 (56.92)	96.96 (56.92)	96.96 (56.92)	92.23 (53.31)	96.96 (56.92)	61.54 (25.07)
Mean	79.11 (43.50)	81.43 (46.06)	80.58 (44.36)	77.21 (43.08)	79.02 (44.62)	71.13 (45.30)	58.24 (23.88)
Median	74.11 (41.30)	80.79 (44.52)	80.79 (44.52)	74.11 (41.30)	74.11 (41.30)	80.79 (44.52)	61.54 (25.07)
SD	7.29 (6.37)	8.12 (5.62)	7.55 (8.64)	6.04 (3.96)	7.20 (5.09)	7.97 (5.49)	4.86 (1.76)
Minimum	65.48 (26.48)	74.11 (41.30)	65.48 (41.40)	74.11 (41.30)	74.11 (41.30)	74.11 (41.30)	51.16 (21.31)

Source: Authors Calculation based on Primary Data (inside the parenthesis show effective interest rate without any fixed deposit)

Interest that present in table 6-D were calculate based on data collected in the filed study on February 2018. From the table it was found that conventional MFIs charges interest (effective interest) as high as 96.96 percent, minimum is 65.48 percent. Mean value is 79.11 percent and median value is 74.11percent. Almost all conventional MFIs except Grameen bank charge the highest interest at 96.96 percent, where Grameen bank charge 92.23 percent as their highest interest. Data also show that all MFIs charged 74.11 percent as their lowest interest, except BRAC. BRAC charge 65.48 percent as their lowest interest rate.

[40] Fixed deposit rate used for BRAC is 4% and rest is at 10%

Islamic MFIs charge highest at 61.54 percent, where minimum is 51.16 percent. Average interest (effective interest) rate for Islamic MFI is 58.24 percent and median value is 61.54 percent.

BRAC is considered as one of the largest NGO type microfinance organization in the world. It spread its microfinance operation 11 countries over the world. The main objective[41] of BRAC is "to empower people and communities in situations of poverty... achieve large scale, positive changes through economic and social programmes…….". But it seems that BRAC is drift from its initial mission. The common perception of microfinance activities is, small loan invested by poor borrower giving a handsome income that covers installment with some extra. This extra return helps microfinance borrower to improve their current economic condition. But the reality is different than expected. BRAC as a microfinance organization charge exorbitant interest on its MFIs loan minimum 65.48 percent to maximum 96.96 percent.

Grameen bank also charge exorbitant interest to its clients compare to all other microfinance organization in Bangladesh. Even though Grameen bank is a state-owned commercial bank that emerged to finance the poor at a lower cost. But it may shift from its objective. In Bangladesh the commercial bank charged (effective interest) from 10 percent to 16 percent on its loan, where Grameen bank charged 92.23 percent. The mission of Grameen bank is to "create a world without poverty and hunger" by offering small credit to the poor women. But this is really tough for poor women to invest this tiny amount to any sectors that give return more than 92.23 percent. If, the investment does not provide enough return, or at least the amount that MFIs charged interest on its loan, it will provide a negative incentive for

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[41] The objective of BRAC collected from BRAC NGO official website: <http://www.brac.net/vision-mission-values?view=page> accessed on September 9, 2018.

the poor borrower. Negative impact creates a pressure for the borrower, which leads the borrower to engage with another microcredit organization which might fall them in a vicious cycle of poverty and remains the same as they were before (Haque &Yamao, 2008).

The case of ASA and all other conventional MFIs charged similar interest like BRAC and/or even to some extend same as GB. Even though MRA declared that no MFI were permitted to charger more that 25 percent interest (declining methods). But maximum MFIs do not follow the declaration of MRA.

In case of Islamic MFI (RDS), the maximum profit (interest) charged 61.54 percent and minimum is 51.16 percent. Among the several objectives of RDS, Finance self-employment and income generating activities of the rural people, particularly the rural unemployed youths and the rural poor and alleviate rural poverty through integrated rural development approach" are considered two main objectives. But financing to unemployment, poor and seeking high profit is ridiculous. Even if the invest in highly profitable sectors, it's almost impossible for any investor to earn more than 61.54 percent profit in initial years.

This results emphasis that, if the hypothesis is correct that "microfinance organization exploiting the poor and very poor people", then what was the problem with literature, that shows positive impact of microfinance organization on social wellbeing. Because, microfinance working only for profit. In this line to support our argument, Bateman (2010), Klas (2011) and Sinclair (2012) pointed out that microfinance has a decidedly negative impact on poor. This all result was supported by a Duvendack et al., (2011) where they mention that "virtually all the evidence suggesting a positive impact from microcredit was either biased, methodology flawed or otherwise not reliable"

From all those discussions, it seems that, both Islamic and conventional MFIs shift from their initial objective. Charging high interest as high as moneylender was not considered as helping the poor, rather it seems to exploit them. Identifying this exorbitant interest rate charged by both types of MFIs, researcher is in opinion that, the hypothesis taken by commercial bank was wrong. In considering the bankable status, poor people are one step ahead of the rich people. Because rich people are afraid to challenge this exorbitant interest (52 percent to 92 percent), where poor people already challenged and doing well. It can be hypothesis that MFIs charged high interest rate to recover their operational cost. As MFIs provide small loan to the poor people at their door step and challenges huge credit risk, hence it charges high interest. But it is the fundamental dilemma, microfinance emerged as an alternative of commercial bank. Where commercial bank intentionally excludes poor people, who don't possess any collateral assets. To finance this group of people required high return (based on risk return assumption). The other alternative for this poor people is moneylender, who charge exorbitant interest, in most cases 100 percent interest per year. To save this segment of people from moneylender, MFI came forward to serve with a commitment, MFI serves its clients by providing financial service at a lower interest rate in comparison to moneylenders. Now, it can be said that MFI is another form of moneylender with official approval.

6.5 Microfinance Interest rate, Comparison with commercial Bank

It is obvious to ask the question, to what extend this exorbitant profit seeking is logical or in simple, what is the accepted rate of interest in case of microfinance organization. To answer this question, this research is going to compare MFIs interest rate with commercial banks interest rate. The logic is, both offer the same services throughout the country and by comparing MFIs with bank it can analyze how much excessive interest charged by MFIs compare with market interest rate. There is a long debate in comparative study between bank and microfinance organization. Comparing microfinance interest rate with bank interest rate is not logical (Fernando, 2006). Because, the customer segments and operational activities of MFIs are totally different from banks. Providing large loan to a small number of customers requires less operating and transaction cost, where providing small loan to a large number of customers required high operating and transaction cost (Fernando, 2006; Rosenberg, Gonzalez, & Narain, 2009). Therefore, it can be hypothesized that, even though banks charges lower interest rate in lending activities, their net profit will be high. Because compare to MFIs, banks operating, and transaction cost is low. On the other hand, even though MFIs charge higher interest rate, their net return will be low in comparison to bank, because their (MFIs) operating and transaction cost is high. Therefore, it would be appropriate if we compare not only interest, but also total income, expenses, or other performance indicator, like ROA, ROE etc. Comparing total income, or total expenses will not provide a true picture, the reason behind, both are operating in two different segments, their income and expense will be different. Therefore, ratio analysis or performance indicator like ROA and ROE will be suitable to determine, whether MFIs charges excessive interest on their loan or not. The another limitation in comparing ROE is, most of the microfinance operate with the help of donor money that is considered as hybrid equity and some use soft loan. Therefore, compering ROE in both organizations will not fulfill our objective. As a result, this research is going to use ROA as a performance indicator. The rationality of using ROA is, ROA is the comparison of both net profit and total assets, that provide the income and assets utilization to make the new income, which will provide us the true picture for both industries.

Table 6-D: Weighted Average interest rates of Schedule Banks

Items	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Deposit Rate	8.15%	8.54%	7.79%	6.80%	5.54%	4.84%
Lending Rate	13.73%	13.67%	13.10%	11.67%	10.39%	9.56%
Spread	5.60%	5.13%	5.31%	4.87%	4.85%	4.72%

Source: BB, 2017

Table 6-E shows average deposit and lending rate in last six years (2012-2017) of all schedule banks of Bangladesh. The highest lending rate was charged in 2012 at 13.75 percent and lowest in 2017 at 9.56 percent. So, if we compare the interest charged by bank and MFIs, then we can say that, the MFIs charge much higher than commercial banks. Where commercial bank charges highest 13.75 percent, microfinance charges on an average 79.11 percent (highest 96.96 percent). if we considered, the commercial bank is the baseline of interest, it can be said that MFIs charges 7 times higher from the baseline.

Table 6-E: ROA of different types of Bank

Types of Bank	2009	2010	2011	2012	2013	2014	2015	2016	2017 June
SCBs	1.0	1.1	1.3	-0.56	0.59	-0.55	-0.04	-0.16	-0.63
DFIs	0.4	0.2	0.1	0.06	-0.40	-0.68	-1.15	-2.80	-1.60
PCBs	1.6	2.1	1.6	0.92	0.95	0.99	1.00	1.03	0.68
FCBs	2.92	2.9	3.2	3.27	2.98	2.38	2.92	2.56	2.15
Average	1.4	1.8	1.5	0.64	0.90	0.64	0.77	0.68	0.34

Source: BB, 2017

On the other hand, if we compare ROA of both types of industry we see, highest ROA earned by foreign commercial banks (FCBs) and the public commercial banks (PCBs). Among them all banking institute, FCBs shows highest ROA at 3.27 percent where, interest spread was high. FCBs provide their service only in urban area (BB, 2017) and their customer segments are selected basically, the rich people. Therefore, FCBs able to acquire highest ROA compare to other banking institute. On the other hand, if we look ROA of MFIs, we see the minimum ROA earn by selected MFIs is higher than any commercial bank in Bangladesh. The minimum ROA earned by SSS at 4.25 percent, then UDDIPAN are able to achieve at 4.85 percent. The highest ROA achieved by Grameen bank (11.82 percent) followed by BRAC (10.48 percent), ASA (9.92) and BURO Bangladesh (7.07 percent).

Table 6-F: ROA of different MFIs (2016)

MFI	ROA (in percent)
GB	11.82
BRAC	10.48
ASA	9.92
RDS	N/A
UDDIPAN	4.85
SSS	4.25
BURO_BD	7.07

Source: MRA 2017 (Note: N/A=Not Available)

From the above comparative study we can say, the microfinance industries current practice is a bit strange. Both the parameter interest rate and the ROA, result specify that microfinance charging higher interest, hence the industry able to show the higher performance. If the assumption was correct, the transaction cost of microfinance is far higher than the microfinance industry. Then the performance indicator ROA would be higher for banking industry than microfinance industry. As the microfinance show a better performance in profitability, therefore, it can be said that the excessive interest charged by microfinance organization directly contribute to its profit function which can be categories' of the profit maximization or shareholder wealth maximization. Hence, we can say microfinance organization charges excessive interest compare to market interest rate.

6.6 Microfinance and Usurious level of Interest

As mentioned in chapter 2, the regulatory framework is a core of formal institutions in terms of rules in Bangladesh, MRA is the prime authority that introduce new rules, modify or even revoked the old rules and regulations. MRA also the prime authority to monitor and control all MFIs in Bangladesh (some exception is there). MRA provides guidelines regarding MFIs interest. This can be considered as the baseline of MFIs interest. According to MRA (2017), MRA has have the right to issue new rules and update any existing rules. It issues an order for all microfinance organization by fixing the maximum celling of interest. According to MRA (2017) the maximum celling for general loan is 27 percent decaling balance methods and agriculture related loan maximum at 25 percent decaling methods. If we convert the 27percent decaling balance methods to effective interest rate it become 30.60percent (monthly basis) and 30.90 percent (weekly basis). But compare to MRA (2017, p.38) maximum celling 30.90 percent, where MFIs in Bangladesh charges more than twice of MRA maximum celling. Therefore, it is for sure that MFIs charge excessive interest on its loan. Another important point based on MRA (2017) any deduction or any fixed deposit against loan is strictly prohibited. Even though fixed deposit or deduction on loan are prohibited (MRA, 2017, p.38), but MFIs still deduct the fixed deposit and force deposit to maximize their return.

Besides the MRA, there are some acts that specify the maximum interest and the excessive or usury level of interest. To determine whether microfinance industry in Bangladesh are charging excessive interest rate, this thesis further discus with “The Usurious Loans Act, 1918” Bangladesh. In the beginning of 1910s, moneylender was always charging usury level interest. To save the borrower, the Usurious Loans Act was 1918 introduced. According to the Usurious Loans Act, 1918, usurious level of interest in loan is illegal. But the law itself did not mention the acceptable level of interest in any transaction. Therefore, there was a demand to determine the acceptable interest and the Usury level interest. In 1933 another act introduced based on interest rate that is acceptable by the government. The act named as “The Money Lenders Act 1933”. The Money-Lenders Act, 1933 specify the acceptable interest on loan. According to the Money-Lenders Act, 1933, section 3, interest charged exceeds the rate of fifteen percent per annum in the case of a secured loan or twenty-five percent per annum in the case of an unsecured loan is considered as Usury.

Based on the existing Bangladeshi law, it can be said that the acceptable interest is less than 25 percent. Even though the law specifies the maximum acceptable interest rate, the law also said the even its less than 25 percent, still there is a chance that the interest rate is excessive.

In the Bangladesh microfinance industry, the interest rate was presented in table 6-D. From that table it can be said that, the average conventional microfinance charged 79.11 percent and Islamic microfinance charged 61.54 percent. Based on the data (presented in table 6-D), we must say that Bangladesh microfinance industry charge excessive interest on its loan. It can be categorized as a poor customer exploitation.

One of our major findings is that both conventional and Islamic MFIs are charging excessive interest. This is for sure that Bangladeshi MFIs are not actually working to fulfill their mission to empower the poorer and marginalized people. Another one is that Islamic microfinance has not reached to the marginalized people in Bangladesh. Islamic Microfinance has been exploiting its clients in comparison with conventional MFIs cannot be accepted. Even though the conventional microfinance exploiting more than Islamic microfinance but both charges excessive interest. It may be too early to conclude; however, we cannot find the *reason d'etre* of Islamic MFIs in Bangladesh in the dimension of helping the marginalized people rather both type of microfinance exploits the poor people.

It has been proved that Microfinance is charging excessive interest rate to their loan. The question arise, is this excessive interest experienced by only Bangladesh microfinance industry? Based on the literature, the answer is no. The excessive interest charges by all microfinance institution over the world. For instance, Acclassato (2006) notes that in West Africa, financially sustainable MFIs have had to apply interest rates of 84 percent, and that in Indonesia the Bri Unit Desa charges rates of between 35 percent and 60 percent. Similarly, in Bolivia, the Banco Sol. Corposol applied an effective rate of 52 percent (CGAP, 1995).

Lenton, and Mosley (2012) experienced that the annual interest rate charge by 13 percent can be an effective interest rate between 100 and 500 percent. Lenton and Mosley (2012) also finds that some microfinance organization charges from 1000 to 8000 percent effective interest on their loan. Collard and Kempson (2005, p. 2) quote the interest rate range from 100–400 percent.

From the all discussion throughout this chapter, it is proved that microfinance are charging excessive or usury level interest on their loan, which we can say that microfinance are exploiting the poor. But still the microfinance is growing rapidly.

> *MFIs charging very high interest rates almost always find that demand far outstrips their ability to supply it. Most of their customers repay their loans and return repeatedly for new loans: this pattern demonstrates the customers' conviction that*

the loans allow them to earn more than the interest they have to pay (Rosenberg, 2002. P.10)[42]

Rosenberg (2002) argues that as the microfinance clients paying their loan repayment which on specifies that, microfinance clients successful invest their loan and received a smart profit by which clients pay their loan. But the reality is completely different. On time repayment does not mean that microloan provide a positive benefit, but the other factors that helps microfinance organization to keep a repayment rate, the factors are group lending methods and dynamic incentives (chapter 3 discuss more about group lending methods and dynamic incentives).

Then what is the rationality for the poor people to engage with microfinance organization at an excessive interest rate. Should this excessive interest be justified? The objective of microfinance is to serve the poor at a reasonable or market interest rate to genuinely help the poor to come out of poverty and not to make money by lending them at exorbitantly high interest rate. Poor people have few or sometime no alternative method that provide them access to financial resources. Even though at an excessive interest rate poor people must stay with it. Another concern is that, microfinance borrower are mostly illiterate women, it’s very difficult for them to understand various financial jargons and their effective cost, which is out of the knowledge. Mitra (2013) said the fancy financial terms like, membership fees, service charges, flat or effective rate of interest, interest bearing capital (savings), Insurance are quite confusing to many of the poor borrower (if not all). Therefore,

[42] Rosenberg. R., (2002), ‘Microcredit interest rates’, CGAP Occasional Paper 1 (2002).

without thinking the future outcome, most illiterate poor borrower engages with microfinance organization, even though they charged excessive interest rate.

From the above discussion it is clear that microfinance charges excessive interest, on the other hand to save the poor clients, there is some strict rules in Bangladesh. But why it's not working well. Why microfinance still be able to charge high interest rate. The answer is the policy implementations. The poor borrower doesn't have sufficient knowledge regarding the rules and regulations of microfinance interest, on the other hand the regulatory body like MRA are ineffective in their monitory activities what Winston, (2007)[43] named as government failure and weak institutional framework. If proper action can't take on time, the country like Bangladesh, have to pay a higher cost in future. If this excessive interest continues, near future we may experience another Andhra Pradesh Incident in Bangladesh.

6.7 Summary

Microfinance can be defined as a financial institution that provide financial services to the poor household who catch up by a vicious poverty cycle. Those financial services include, savings, insurance, pension funds, remittance and small credit. Recently the trend of microfinance commercialization especially the Mexican microfinance, the Banco Compartamos went to IPO, these activities of microfinance came into the question. Whether microfinance is working for poor to rid out of poverty or it came to make its own fortune.

[43] Winston, C. (2007). *Government failure versus market failure: Microeconomics policy research and government performance*. Brookings Institution Press.

It was said that, the poor people locked in a vicious poverty cycle, which they want to destroy. But the poor people own only on labor, but they require capital to come out of those vicious cycle. Different government and development organization try to inject capital to that poor segments of the people through aid and charity. But literature found that there are some limitation of aid and charity in breaking out those vicious cycle. Without appropriate policies and institutions, aid became unproductive, continuous charity robs the poor people dignity and reduce motivation to work hard. The next best alternative was the commercial bank, to inject liquid assets to the poor segment. But it engages with high risk. So, commercial bank intentionally excludes the poor borrower from their portfolio.

Observing this vicious cycle, microfinance emerged with the promise of serving the poor at a reasonable price. In the same way, many scholars argue, the microfinance organization become an appropriate institution that break the vicious poverty cycle. The fundamental assumption of microfinance organization is, the loan is investing in any income generating sector or borrower become a entrepreneur that provide a smart return. By that return, borrow repay the loan installment and keep some extra profit for their own consumption. By this mechanism, one day they will lift up themselves and their family.

The microfinance assumption is really convincing for everyone, and if its works in the real life. That would be a great mechanism to lift poor people out of poverty. But literature found some limitation of this mechanism. The law of diminishing return does not consider in this hypothesis and its impossible in an economy that everyone become entrepreneur. What Batemen (2014) identify that the- Says of Law; “supply would create its own demand” the main mistake in microfinance assumption.

It is too early for this research to conclude that whether microfinance works for poor or not. But based on the activities and dialog of different microfinance organization, say for, the CEO of *Banco Wal*-Mart (a microloan provider in Mexico) quantified that "We are not saints…We've come into this business for volume and profitability similar to our other businesses, or else we wouldn't invest". This specify the main motivation of microfinance organization. For microfinance organization profit is matter, rather than helping the poor. Even though, the father of microfinance Dr. Muhammad Younus, argued "I was always [. . .] vocal on that issue, saying that microcredit should be done as a social business, meaning that it is not an area where investor or promoter would like to get a big amount of money [or] profits. So that way the [. . .] interest rate can go as low as possible, because making money is not their goal. It's reaching people and helping them get out of poverty [that] is the goal." (Sandberg, 2012 p.171). For his statement it is difficult to identify what would be the appropriate interest rate when lending to the poor. But as Younus is the founder of Grameen bank, may the Grameen bank interest be the bench mark for all microfinance organization.

In this chapter, researcher provide an empirical evidence regarding the interest charged by different microfinance organization. Research also compare the interest rate between Islamic and conventional microfinance. The conventional microfinance includes, Grameen bank, BRAC, ASA, UDDINPAN, BURO-Bangladesh and other three microfinance organization. The RDS initiated by IBBL represent as Islamic MFIs. Based on the data researcher collected in a field study, researcher finds that on a flat rate basis, conventional microfinance charges on an average 20.26 percent (highest 24.80percent and lowest 12.50percent), in Islamic microfinance the average flat rate profit is 10 percent (highest and lowest is same). If we calculate the effective interest of those microfinance organization, the scenario become opposite. The highest interest charged by conventional microfinance is 96.96 percent and lower is 65.48 percent and the average interest is 81.43 percent. On the other hand, Islamic microfinance charges 61.54 percent as highest profit rate and 51.16 percent as lowest and average profit rate is 58.24 percent.

This result again raises the question, whether microfinance organization is helping the poor or exploit them. Charging interest on small loan more than 90 percent, even in Grameen bank is just exploitation. They (MFIs) are making money at the cost of poor people. Therefore, Batemen (2014) said Grameen Bank and other Grameen affiliates as the most successful examples of the concept. As we have pointed out, however, the poverty reduction 'success' of the Grameen Bank (and every other MFI) is very much a myth, which is rather awkward to say the least.

This chapter also compare the microfinance interest rate with commercial bank that operate in Bangladesh. Some author said comparing interest rate between bank and microfinance is not an appropriate comparison because this tow industry dealing with two different customer segments. therefore, we compare both their interest rate and ROA. Results shows that microfinance charges six to seven times higher interest to their client, on the other hand, ROA of microfinance organization also become 3 to 4 time of commercial banks which operates in Bangladesh.

From this discussion, it can be concluded that, microfinance is like a business-like other business. They want to maximize their wealth at the cost of poor people.

7 Comparative Study of Islamic Microfinance regulatory frameworks and financial product in RDS and AIM

Allah has permitted trade and forbidden usury. Allah destroys usury and gives increase for charities (Quran 2:275)

1.1 Introduction

Islamic finance is a relatively new concept in the history of modern economics and finance. It came to light with a new rigor after the US subprime crisis in 2007-08, when practically all conventional banks suffered, in varying degrees from the crisis. However, Islamic banking industry not only proved its resilience in this crisis but also successfully grew in the post crisis period. The total assets of the Islamic finance industry amounted to US $1.8 trillion in 2014. Even though Islamic finance is doing well in terms of coverage and outstanding loans though, one of its financial products, Islamic microfinance, faces a growth constraint. This study hypothesizes that Islamic microfinance falls into the problem of 'mission drift' compared to conventional microfinance.

According to Yunus (2003, p225) "Giving the poor access to credit allows them to immediately put into practice the skills they already know—to weave, husk rice paddy, raise cows, peddle a rickshaw. And the cash they earn is then a tool, a key that unlocks a host of other abilities and allows them to explore their own potential." Muhammad Yunus also argued "I was always [. . .] vocal on that issue, saying that microcredit should be done as a social business, meaning that it is not an area where investor or promoter would like to get a big amount of money [or] profits. So that way the [. . .] interest rate can go as low as possible, because making money is not their goal. It's reaching people and helping them get out of poverty [that] is the goal." (Sandberg, 2012 p.171).

Based on the above two-statements it can be argued that microfinance emerged with two mission, 'giving the poor access to credit' and 'interest rates can go as low as possible.' So, if microfinance drift any of the mission, we categorize this situation as microfinance mission drift.

Chapter 5 discussed whether microfinance organization fulfill their first mission of 'giving the poor access to credit.' Chapter 4 defined poverty as 'an economic situation where the income of a person or a family fails to meet minimum expenses, these expenses including both minimum required food and non-food expenses.'

There are several methods that have been introduced by academics, as well as different institutions to determine the poverty level of any region. Among these methods, this research found that Schreiner (2012) Poverty Possibility Index (PPI) Scorecard for Bangladesh is the best one (see Chapter 5) in terms of use and collection of data (10 simple questions were used in this study to determine poverty status). Based on the collected data, Chapter 5 concluded that, based on the International Standard Poverty line ($1.25 at PPP 2005), conventional microfinance covers 15.97% of the poor clients in their client's portfolio and 20% is covered by Islamic microfinance. In Chapter 5, the researcher did not find any difference between Islamic and conventional microfinance. Both fall into Type-I Mission Drift.

Chapter 5 did not find any significant differences that describe the low market penetration of Islamic microfinance in Bangladesh. Hence, the hypothesis that Islamic microfinance may exploit its clients by charging high profit rates compared to conventional microfinance interest was raised. Chapter 6 provided empirical evidence regarding the interest charged by different microfinance organizations. In Chapter 6, the Grameen bank, BRAC, ASA, UDDINPAN, BURO-Bangladesh and another three microfinance organizations were characterized as conventional microfinance and the RDS initiated by IBBL represented Islamic MFIs. Based on the data, on a flat rate basis, conventional microfinance charges an average of 20.26 percent (highest 24.80 percent and lowest 12.50 percent), while in Islamic microfinance the average flat interest is 10 percent (highest and lowest is the same). If we calculate the effective interest considering 'fixed force deposit,' the scenario is opposite. The highest interest charged by conventional microfinance on average is 81.43 percent (highest 96.96 percent and lowest 65.48 percent). On the other hand, the Islamic microfinance average profit rate is 58.24 percent (highest 61.54 percent and lowest 51.16 percent). However, from these data we still cannot identify the reasons behind the low penetration of Islamic microfinance in Bangladesh, because there is no difference between Islamic and conventional microfinance on this measure. Both are charging usurious level of interest/profit. Based on the theoretical framework presented in Figure 4-A, we can therefore say that all microfinance organizations overlap both MD-1 and MD-2, this is an important research outcome in the literature but failed to achieve our objectives, which fails to explain the extremely low market share. Therefore, we hypothesize that there are some other unique factor(s) restricting the growth of Islamic microfinance.

From the literature it was found that Amanah Ikhtiar Malaysia (AIM) is one of the successful Islamic microfinance organizations in Malaysia. Even though the Malaysian microfinance market is not that big, the total market size of US $1.253 million (NGM, 2018)[44], the AIM remained microfinance market leader in Malaysia for the last three decades with 40%

[44] NGM (2018), Financial stability and Payment System report 2018, Published by Bank Negara Malaysia Retrieve from <http://www.bnm.gov.my/index.php?ch=en_publication&pg=en_fspr&ac=27&en> access on June 19, 2019.

domestic market share (Mason, Azmi, and Madden, 2018)[45]. Hence, we can ask, 'why has AIM been increasing market share in Malaysia, while the share of RDS remains marginal?' In answering this question this chapter is dedicated to identifying the reason(s) behind the extremely low market share of RDS in Bangladesh. In doing so, it looks into the different financial products provided by each MFIs as well as the differences in the regulatory framework in both countries.

For detailed analysis, this chapter is organized as follows: section 7.2 provides an overview of Amanah Ikhtiar Malaysia. Section 7.3 discuss the major differences between AIM and RDS. Section 7.4 discusses the different types Islamic financial products that help to finance in working capital. Section 7.5 discusses one of the updated Islamic financial products already accepted by the Malaysian Central bank in financing working capital as liquid cash 'Tawarruq' and the final section, 7.6 provides a summary of the chapter.

1.2 Amanah Ikhtiar Malaysia: an overview

Malaysia is a multiethnic diverse advanced and developed economy in the southeast Asian countries. Since its independence in 1957, Malaysia has successfully been able to develop its economic condition from low income country to upper middle-income country with a per capita GDP of US$9,944.90 in 2017 (World bank, 2018). Malaysia has also been successful in transferring its economic dependency from agriculture and mining to manufacturing, and in trying to move forward the next transformation into service sectors. Along with economic

[45] Mason, C., Azmi, W. N. W., & Madden, R. (2018). Aiming for Greater Financial Inclusion through Sustainable Development: The Story of AIM (Amanah Ikthiar Malaysia).Asian Institute of Finance, Retrieved from <http://fsi.org.my/wp-content/uploads/2019/03/Case-Study-Aiming-for-Greater-Financial-Inclusion-through-Sustainable-Development-1.pdf>. Access date June 20, 2019.

development Malaysia has successfully been able to accelerate its human development index through increases in education, nutrition and life expectancy.

Economic growth, structural transformation and human development do not always reduce poverty and inequality in a society (Hashim, 1998). Hence, many government try to introduce new ways to fight against poverty and inequality. With the inspiration and success of the Grameen bank in Bangladesh, *Amanah Ikhtiar Malaysia (AIM)* started its operation in Malaysia. Besides AIM, there are a few NGOs and microfinance organizations that operate in Malaysia. Among all other microfinance organizations, Yayasan Usaha Maju (YUM) and The Economic Fund for National Entrepreneurs Group (TEKUN) are the most prominent. Based on number of clients and outstanding balance, AIM is the market leader, YUN is the second and TEKUN is the third largest microfinance organization in Malaysia (Revindo and Gan, 2017).

Table 7-A: Top three MFIs in Malaysia

Particular	AIM (2014)	YUM (2014)	TEKUN (2013)
Number of Borrower	347,907	55490	262497
Number of Branch	138	24	194
Total loan disbursement (RM billion)	11.3	0.248	2.7
Repayment rate (%)	99.14	96.7	85

Source: Revindo and Gan (2017)[46]

Amanah Ikhtira Malaysia (AIM) was the first microfinance organization introduced in 1986 by two social scientists with the inspiration of Grameen bank Bangladesh, Prof. David Gibbons and Sukor Kasim from the Universiti Sains Malaysia (Revindo and Gan, 2017). The

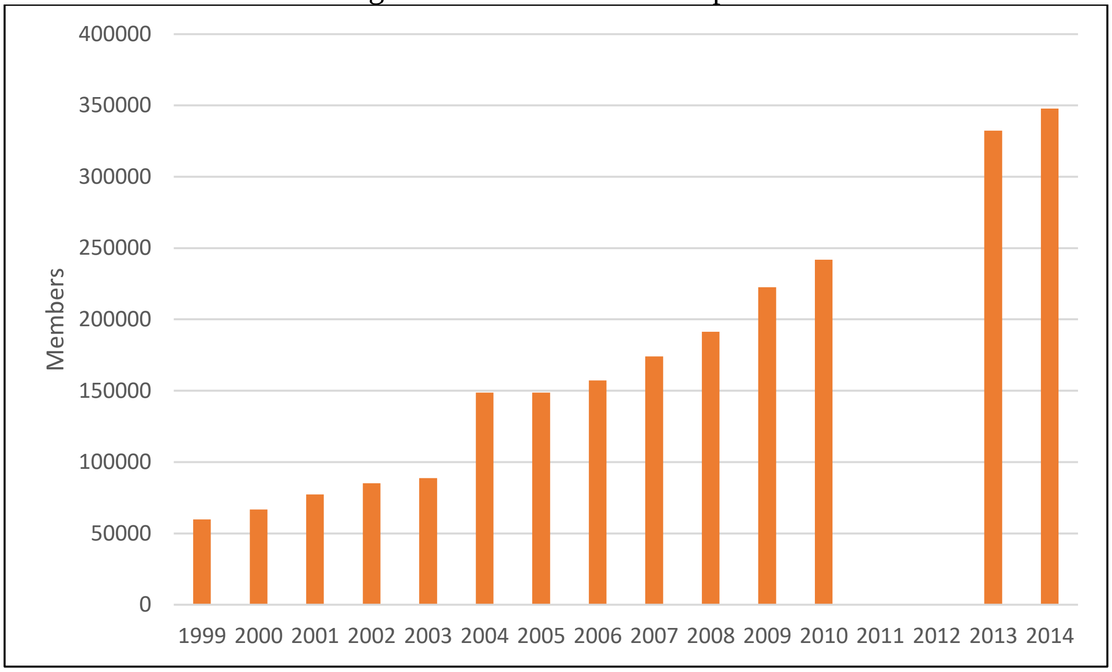
[46] Revindo, M.D., Gan, C (2017). Microfinance institutions in Malaysia. In Gan, C and Nartea, G. V. (Eds), Microfinance in Asia, pp. 47-91 (2017)

initial project's name was *Projek Ikhtira* and it provided small credit to the poor of Selangor, Malaysia. The project is considered as one of the most successful poverty reduction tools in Malaysia. Almost 90% of borrowers were able to become successful entrepreneurs and repay their loans on time. By observing the success of this pilot project, *Projek Ikhitar* was transferred to a new NGO type microfinance institute in 1987 under the Trustee Incorporation Act 258 (revised in 1981) and renames as Amanah Ikhtira Malaysia.

AIM offers three types of loan. The first type is for economic purpose, which directly involves any kind of investment that generates further income. The second type of loan is for non-economic purposes, such as consumption in an emergency situation, such as medical expenses, children education expenses etc. The last type of loan is for recovery purposes. In case of natural disaster and other emergency case AIM provides loans to its clients to recover their economic condition in critical situations. Another special type of microloan introduced by AIM is the Urban micro loan for poor living in urban area. The aim of this type of loan is to produce more entrepreneurs in the city to increase their income and have a better life. The size of these loans, their repayment and their duration are determined based on individual client's profile (Mokhtar, Nartea, & Gan, 2012)[47].

[47] Mokhtar, S. H., Nartea, G., & Gan, C. (2012). The Malaysian microfinance system and a comparison with the Grameen Bank (Bangladesh) and Bank Perkreditan Rakyat (BPR-Indonesia). *Journal of Arts and Humanities*, *1*(3), 60-71.

Figure 7-A: AIM membership over time



Source: Author's calculation-based MIX and Mokhtar, Nartea, and Gan, (2012)

From Figure 7-A it can be seen that membership growth remained the same from 1999 to 2003, then in 2004 AIM membership increased but plateaued until 2006. From 2007 onward, the membership has been growing at a substantial rate. AIM started offering Tawarruq from 2007, hence, it can be said that growth after 2007 is the result of a new financial product that AIM offered to their clients.

AIM was established with the aim to fight against poverty in Malaysia through the provision of interest free or Islamic microfinancing to the poor and low-income households to improve their living standard. In the last three decades of its operation, AIM has proved to be a success story and has become a benchmark all over the world as interest free microfinance. Saad (2011)[48] also has provided evidence on the positive contribution of AIM to improving

[48] Saad, M. N. (2011). Selecting high-income generating activities for micro-entrepreneurs: The case study of Amanah Ikhtiar Malaysia. *International Journal of Humanities and Social Science*, *1*(5), 258-264.

client’s living standard. Today AIM reaches 347,907 clients through 135 branches nationwide and its total accumulated loan disbursement amounts to RM11.3 billon. AIM is the market leader in the Malaysian microfinance industry, with a market share of 40 percent in 2013 that is expected to increase to 50 percent market share by the end of 2019 (Mokhtar, Nartea, & Gan, 2012).

1.3 Comparison between Amanah Ikhtiar Malaysia and Rural Development Scheme

AIM is one of the leading Islamic microfinance organizations operating in Malaysia. It covers more that 40 percent of the total Malaysian microfinance market share. On the other hand, the world largest Islamic microfinance organization, RDS, covers a tiny share (only 5 percent) in its domestic market. Different authors have attempted to figure out the constraints that restrict the growth of Islamic microfinance organizations. For instance, Wulandari and Kassim (2016) identify the issues and challenges of Baitul Mal-wat Tamil (BTM) and found that client collateral status and mode of financing were the main growth barriers for Islamic microfinance. Suzuki, Uddin and Miah (2018) summarize the obstacles that restrict the growth of Islamic microfinance under four explanations: (1) lack of loanable 'microcredit' funds; (2) information asymmetry between MFIs and their clients; (3) improper regulatory frameworks; and (v) failure to materialize economies of scale by creating appropriate incentives for the borrower.

Insufficiency of loanable funds might be one of the causes of the marginal outreach of microcredit. However, it would be naïve to simply assume that MFIs would increase the exposure to their micro-clients if the availability of loanable funds is increased. On the other hand, Islamic microfinance, in general, faces the same problem in allocating funds. Then, why have some Islamic microfinance institutions become successful for a long time and some have failed? We note here that the asymmetry of information between MFIs and their clients is severe. The efforts of attenuating the asymmetry (closer monitoring) would contribute to facilitating more financial resources to their clients. However, this explanation also understates that the business is always exposed to high risk and fundamental uncertainty by their marginal clients. Closer monitoring therefore does not necessary reduce the risk and uncertainty associated with business.

The last two explanations are agreeable. Improper regulatory frameworks, and failure to materialize the economies of scale, could be the main barriers that restrict the growth of Islamic microfinance in Bangladesh. This section discusses how well the AIM has mitigated these obstacles and why the RDS has yet to manage these dilemmas.

1. Appropriate Regulatory Framework

Regulatory frameworks are the key to financial stability and development. A well-designed regulatory framework can help to incubate an industry. It provides economic players in the industry with appropriate incentives and sanctions leading to its development and further innovation. A well-organized regulatory framework is necessary for the microfinance industry and its development.

AIM started its operation as an interest free microcredit facility to the poor. The economic environment of Malaysia helped it to become the market leader. On April 7, 1983, the Malaysian government enacted the Islamic Banking Act (IBA). Under the IBA, the government has authorized the Bank Negara Malaysia[49] to act as an authority and supervisor for the Islamic banks' operations. Under the IBA act, the first Islamic bank started its operation

[49] Bank Negara Malaysia is the central bank of Malaysia.

in the same year under the name of Bank Islam Malaysia (BIMB). In 1984 government introduced the Takaful (Insurance) Act which was the foundation of Islamic insurance (see table 7-B).

Table 7-B: Important Milestone of the Malaysia Islamic Banking Policy and Regulation

Year	**Banking Policies and Regulations**
1983	On 7 April 1983, the Malaysia government enacted the Islamic Banking Act (IBA). The first Islamic commercial bank in Malaysia was established Bank Islam Malaysia Berhad (BIMB).
1983	The Malaysia government has ratified the Government Investment Act (GIA) which authorizes the government to be able to issue government investment facility based on *Shariah* principles.
1984	The Malaysian government issued Takaful (Insurance) Act.
1993	On 4 March 1993, the Malaysian government introduced the Interest Free Banking System (IFBS, Skim Banking without Benefit / SPTF). Under this policy, the conventional banks are allowed to offer Islamic banking products.
1994	On 4 January 1994, the government has established the Islamic Interbank Money Market (IIMM).
1997	On 1 May 1997, the government has established the National *Shari'ah* Advisory Council (NSAC).
2001	The government issued the Financial Sector Master Plan that covered the period of 2001–2011.

Source: Promono, 2016

AIM was developed in 1988 under the Trustee Incorporation Act 258. AIM is monitored and supervised under that Act. On the other hand, AIM is also supervised and monitor under the independent Central Shariah Board. In 2009, the AIM established its own Syariah Advisory Board with 5 key members. Those members are highly experienced in Syariah and Islamic studies and/or Islamic finance.

RDS is a unique microfinance organization in Bangladesh, operating directly neither under the Bangladesh Bank nor the MRA. RDS is a subsidiary of IBBL, that is, the only microfinance organization run by a commercial bank. RDS is also unique because it has neither a central body to monitor and supervise its operation nor does it have an independent or central Shariah Board to ensure the compliance with Shariah. IBBL also faces some dilemmas when it plays its role as a monitoring and supervisory authority because the operation of a commercial bank is totally different from that of a microfinance organization.

2. Response to the market demand

Another successful factor for AIM is their focus on the market. According to Kazemian, Rahman and Ibrahim (2014) AIM always focuses on their customer demand and tries to fulfill their customer demands as fast as possible. As mentioned earlier, for smooth business operation business organizations required working capital not only inventories but also required liquid cash. Where conventional financial institutes are ready to finance cash, Islamic financial institutes hesitate to do this. By identifying the huge demand from business organizations, the Malaysian Central Shariah Board permitted 'Tawarruq' as a cash financing tool. Like other big financial institutions' clients, microfinance clients also require liquid cash as working capital. Where most of the world Islamic microfinance failed to fulfill this demand, the AIM has implemented Tawarruq after approval in 2007. AIM started its Tawarruq operation gradually since 2007 and by 2014 operations extended through all branches and reached 30% of the total outstanding loan of AIM (AIM, 2015). It is forecast that this contribution will increase gradually over time.

On the other hand, in Bangladesh Islamic microfinance RDS has failed to create appropriate incentives for its clients. There is no central shariah board in Bangladesh that monitors Islamic financial institutes. Moreover, the independent shariah board of IBBL has not approved the 'Tawarruq' as a financial product. Hence, we see that RDS investment is basically based on Murabaha contract which means that the RDS has failed to meet customer demand by offering different financial products like Tawarruq.

In conclusion, we can say that Islamic microfinance also falls into the Murabaha syndrome. In a business organization, firms require working capital on a frequent basis. But in Islamic microfinance, RDS fails to provide working capital to their clients. Hence, the client segments become limited. Within this limited customer segment, RDS competes with other conventional microfinance providers. The Islamic microfinance only provides consumption loans or provides raw materials (based on a Murabaha contract). In this situation, Islamic microfinance particularly, RDS has devalued its franchise value, and that is considered one of the reasons for the low penetration of Islamic microfinance in our society. On the other hand, if Islamic microfinance is not acting in proper Islamic ways, it may lose client confidence as mentioned by Suzuki and Uddin (2014). Which can be considered a major growth constraint for Islamic microfinance.

1.4 Financing in Working Capital by Islamic Finance

In corporate finance, working capital management is considered a key component that directly deals with firms' profitability and liquidity. Sometimes it is called the life blood of business. Basically, working capital management deals with current assets and current liabilities

(Raheman and Nasr, 2007). Working capital varies based on the firm's business structure, for example, in manufacturing firms half of their assets are constituted as working capital, the working capital of a distribution company may be more than half of their total assets, on the other hand service organizations like Hotels need only a small amount of working capital. There is no actual theory that determines the working capital amount, but excessive working capital incurs huge costs, and too little working capital may mean shortages of funds to meet current obligations, which in turn may mean bankruptcy (Horne and Wachowicz, 2000). Therefore, managers always try to keep an optimal level of working capital.

In a competitive business environment, every business organization tries to optimize utilization of their working capital. But, they may face some difficulties, especially in times of the shortage of working capital, in paying their obligations due to natural calamities, political and industrial relations developments, or disputes, business slowdowns and economic downturns, sudden variations in costs, prices, availability and demand, etc. In this situation, most firms rely on conventional banks to obtain their working capital as 'cash.' 'Cash' is readily available to use as working capital (Hasan and Mollah, 2018). But in the case of Islamic finance, institutions fail to provide cash to their clients in emergency situations.

In Islamic finance 'inah[50]' is considered the most prominent cash financing tool but shariah law prohibits that transaction. On the other hand, some Islamic financial institutions practice Tawarruq as a cash financing tool, even though there is some controversy regarding

[50] Inah is an Islamic financial contract that is prohibited in Islamic shariah. In the inah transaction, the lender sells a commodity to the borrower at a price with deferred payment and buyer (borrower) and seller (lender) agree to buyback the same product at a lower price. In this way the borrower receives the cash and the lender get the profit. This is considered as the acceptance of the "riba" in a modified way.

its acceptability. But this is the only mode of finance that works when Islamic financial institutions' clients require cash.

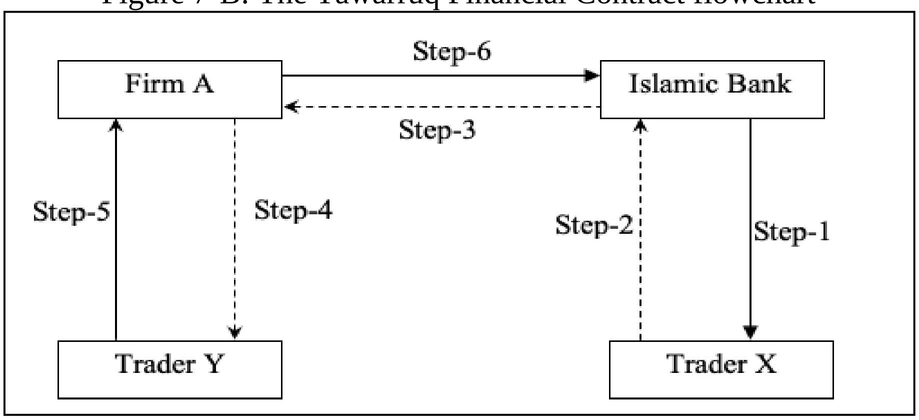
1.5 Tawarruq

Researchers like Moghul (2017) have come up with a new Islamic financial instrument to finance working capital. This financial instrument is known as a Tawarruq or reverse Murabaha contract. Tawarruq was introduced to finance working capital. A tawarruq is an Islamic financial product that allows clients to raise money quickly and easily, in theory without breaking the law of prohibition of interest. A customer buys an easily saleable asset from an Islamic bank at a marked-up price, to be paid at a later date, and quickly sells the asset to raise cash (Financial Times, n.d). The first Tawarruq was introduced in the Kingdom of Saudi Arabia (KSA) in 2000 (Ahmed, 2009, p.1). Tawarruq has operated under different names, such as blessed Tawarruq, easy Tawarruq, charitable Tawarruq. After this the Tawarruq was adopted by different Muslim countries such as Bahrain, Kuwait, Qatar and the United Arab Emirates.

According to Al-Zuhaili (2006), Tawarruq is a sale contract that provides cash to their clients that conventional banks term debt. In the first instance, if any client organization approaches an Islamic bank seeking funds to invest in their working capital, the Islamic bank will buy any product (popularly, Islamic financial institutes use gold, silver or oil) with the same value as the clients request from the Islamic bank as a loan. After purchasing these goods, the Islamic bank sells those goods to client with profit payable as a deferred payment. Then those good are sold by the clients to a third party for cash and that cash is used in their business.

For example, if a firm approaches an Islamic bank for $1000, then the bank will buy gold worth $1000 from trader X. Immediately, trader X transfers the gold to the Islamic bank. Then the bank transfers the gold to firm A with a cost of $1000 and a profit (say $100) at a future payment. After that firm A sale, the gold is sold to a third party say trader Y at $1000 and used in their working capital. In the last step a firm will pay the Islamic bank debt with the profit at a future date and the sales contract is over.

Figure 7-B: The Tawarruq Financial Contract flowchart



Source: Author

1) Bank buys gold worth of $1000 from Trader X,
2) In the next step Trader X transfers the gold worth of $1000 to the Bank,
3) Bank sells and transfers the gold to Firm A at a price of cost $1000 plus a profit (say $100),
4) Firm A sells and transfer the gold to Trader Y at a price of $1000 (market price),
5) Trader Y transfers the $1000 to Firm A and Firm A uses this cash based on demand,
6) Firm A pays the deferred amount to bank (determined at step 3).

According to Dabu (2007) there are two types of Tawarruq practiced in Islamic society. Those are real Tawarruq and organized Tawarruq. Real Tawarruq is a financial contract where the borrower buys a product from the bank on a deferred payment basis and sells it back to the bank or third party to receive cash. On the other hand, in the organized Tawarruq contract, a borrower buys a product from the Islamic bank, and makes the bank an agent on behalf of the buyer to sell that product and deposits the amount to the borrower's account. The basic difference between these two types of contract is, in real Tawarruq the buyer receives the goods and the buyer has the rights to do something with it according to his demand (whether buyer keeps or further sells those goods). On the other hand, in the organized Tawarruq, the borrower does not deal with any product, the banks manage all the dealings in the physical product and the borrower directly receives the cash. Hence, Tawarruq contracts can be quite controversial depending on the situation.

There are several thoughts regarding Tawarruq contracts. The Tawarruq contract was introduced by the Hanabi school of thought. In the early stage of the Hanabi school of thought, there was not much talk regarding these contracts as they are a shariah prohibited financial product. Institutions like the Fiqa institutions who declared that the Tawarruq contract is prohibited, such as the OIC Fiqh Academy as well as the Shari'ah boards of the Dubai Islamic Bank and Emirates Islamic Bank have taken this view. The OIC Fiqh Academy declared any Tawarruq with pre-planned orchestration as unlawful (organized Tawarruq). In view of the Malikis and Hanabi school of thought, this type of sale is prohibited because it leads to the corrupting practice of riba. In this regard, the Hanabi school of thought argues however that if two or more third parties are included in the transaction (real Tawarruq), this transaction can be considered as permitted when any firm approaches an Islamic financial institution for working capital.

There are therefore two different scholarly opinions existing in the literature. One group argues that Tawarruq is permitted and another group argues that its prohibited. The evidence behind these two different opinions is:

1. Evidence for permitting Tawarruq

a) The Qur'an - Allah says, 'Allah has allowed trade and has prohibited riba' (surah Al-Baqarah: 257). Scholars who argue in favor of the tawarruq, say that the word 'trade[51]' denoted that all types of trade are permissible. For them, tawarruq is also a sales contract with two or more parties. Such as one party buys a commodity in exchange for cash and another party receives cash in exchange for goods;

b) The Shunnah, a hadith quoted Abu Hurirah when the Prophet (SM) appointed a person as the governor of Khaibar, that governor brought to him an excellent type of dates (from Khaibar). The Prophet (SM) asked, "Are all the dates of Khaibar like this?" He replied, "By Allah, no, O Allah's Apostle! But we barter one Sa' of this (type of dates) for two Sa's of dates of ours and two Sa's of it for three of ours." Allah's Apostle said, "Do not do so (as that is a kind of usury) but sell the mixed dates (of inferior quality) for money, and then buy good dates with that money." So, they (the scholars who permit tawarruq) said, this tradition is from the Prophet's (SM) time, thus two separate contracts are permitted in Islamic shariah. Hence, the tawarruq contract when two or more parties together execute the contract is permitted in Islamic shariah;

c) Dr. Wahabah, a shariah scholar said, "The original rule about all useful things is permissibility and the original rule about all harmful things is prohibition." Tawarrqu

51 Here the word "trade" means transfer commodity into cash and vice-versa.

is executed to provide liquid cash to the borrower. There is nothing harmful related to the tawarruq contract. Based on that argument the tawarruq is permitted.

2. The evidence regarding the prohibition of Tawarruq

a) Tawarruq is kind of exploitation. The person who possesses surplus money does not provide liquid cash to the deficit side, instead of that surplus side faces forced sales of a commodity and the deficit side must buy the product at a higher than market price which is considered as exploitation. Sometimes referred to as interest, which is prohibited in Islam;

b) The intention of tawarruq is not to sell a commodity rather the intention is to add to sale money with extra money, which is directly considered as riba. Hence, tawarruq is prohibited.

There is different evidence found in the current literature regarding the acceptance of tawarruq. By analyzing their opinions, this study must say that tawarruq is permissible. The main concept of Islam is to make people's life easy, hence they can move around without harming the social elements. The concept of real tawarruq is not to accept riba, rather people go to tawarruq to avoid riba. Hence the current research argues that tawarruq is a permissible contract, that makes people's lives easier. Hence, RDS must accept and offer Tawarruq contracts to meet its current market share.

1.6 Summary

Islamic financial institutions, especially the Islamic banks have proved their competitiveness during the period of recent financial crises that started from the US subprime mortgage problem. When the conventional banking industry faces systemic problems due to the shortage of liquid assets, Islamic banking organizations made profits. This proved the long-term sustainability of Islamic banks in the economy. In the conventional banking system, the bank simply transfers the risk to the borrower where Islamic banks share the client's risk. Hence, the acceptance of Islamic banks has been increasing day by day. The growth rate also supports the acceptance of Islamic banks and financial institutions in our society. The growth rate between 2009 to 2013 was around 17 percent and their total assets stood at US $1.8 trillion by 2014.

Even though the Islamic banking industry is growing at a remarkable rate, there are some controversies arising from Islamic banking financing methods. Islamic banks provide loans to their clients on the basis of their mark-up and PLS. Some scholars thus argue that no difference exists between conventional banking debt finance and Islamic banking mark-up finance. Both are charging fixed interest rates, one is called interest, and another is called profit. Some scholars have said that the true Islamic investment is not debt financing rather it is equity financing.

Among the total global Islamic financial industry, 75 percent of all investments are made through Murabaha contracts and only 10 percent is undertaken by PLS contract. Many scholars call this situation the Murabaha Syndrome. The Murabaha Syndrome is experienced by the Indonesian and Bahraini Islamic financial industry. Recently Suzuki and Uddin (2014) mentioned that Islami Bank Bangladesh Limited also falls into the Murabaha syndrome. In fact, this research identifies that the whole Islamic financial industry in Bangladesh falls into the Murabaha syndrome, because, in the last three years, Murabaha investment is around 80 percent and total markup profit investment is around 90 percent. That shows that Bangladesh Islamic financial institutions have fallen into a serious Murabaha Syndrome.

This chapter has analyzed the third hypothesis (mentioned in Chapter 1), as we do not find any particular difference between Bangladesh conventional and Islamic microfinance. Then there is something that restricts the growth of Islamic microfinance organizations particularly RDS. To identify the obstacles, we compared RDS with AIM, one of the most successful Islamic microfinance organizations in Malaysia. Based on this comparative analysis, we found that the lack of an appropriate regulatory framework and failure to respond to the appropriate market demand of MFI clients have become the biggest obstacles to RDS growth.

In conclusion it can be said that micro enterprises that are served by microfinance organizations require working capital frequently. Conventional microfinance funds are readily available to use as working capital, but in that case, Islamic microfinance faces a strong barrier in financing working capital, and this is one of the constraints to Islamic microfinance growth. However, AIM has been successful in financing working capital through Tawarruq that meets the demand of working capital as liquid cash. Therefore, it can be recommended to the policymakers of the Islamic microfinance organizations like RDS that it’s time to stop mimicking the conventional microfinance product based on shariah compliance. It is high time to introduce or adopt new financial methods that will help Islamic microfinance organizations to finance working capital. Otherwise, in future there will be no place for Islamic microfinance in our society.

8 Findings, Recommendations, and Conclusions

8.1 Introduction

The aim of this research was to identify the constraints that hinder the growth of Islamic microfinance. This chapter discusses the major findings regarding microfinance mission drift. This research develops a new theoretical framework with the help of Zhao (2014) to analyze the status of Bangladesh microfinance mission drift. It was found that mission drift may be the cause of the low market penetration of Islamic microfinance. But Islamic microfinance also falls into the Murabaha syndrome, and this is one of the main causes of the low penetration of Islamic microfinance outreach.

The rest of the chapter is organized as follows, Section 8.2 discuss the major findings of the research. Section 8.3 revisits the research question and answers all the questions based on section 8.2 findings. Section 8.4 issues some policy implications, Section 8.5 discuss the contribution of the current research, Section 8.6 provides the limitations of the current research and future research potential, and the last part provides the summary of the whole thesis.

8.2 Summary of Key Findings

Chapter 2 provide an overview of Bangladesh’s socioeconomic condition. It was identified that Bangladesh is a poverty striving country. It reduced its poverty rate from more than 50 percent in 1980s to 25 percent by 2016. This is one of the greatest achievements for Bangladesh. GDP growth rate became almost constant at more than 6 percent over a decade, which is a rare case in developing countries. As a result, Bangladesh is declared as the next Asian tiger after Singapore, Taiwan, Hongkong and South Korea. The GDP growth rate was

6.46 in 2011 and in 2017 it had become 7.24 percent. Total current GDP is US $2497.23 (billion, at current dollar prices), Service Sector contribute 56.5 percent, followed by industry 29.2 percent and agriculture 14.2 percent. Life expectancy has increased to 63 years in 2018; in the 1970s it was only 50 years.

Even though Bangladesh has had a constant and steady growth for the past decade, a large portion of its population live under the poverty line. According to ADB (2016), more than 24.5 percent of total population of Bangladesh are under income poverty line ($1.25 per day per person). On the other hand, if we considered multidimensional poverty, around 40.7 percent of the population under multidimensional population, besides, around 19.6 percent live near to the multidimensional poverty line.

To challenge rural poverty, the Grameen bank started its journey with a tiny investment of $27. Now it’s become a billion-dollar development organization and provides service all over the world (through Grameen bank or its similar type of organization). The Grameen mode of microfinance has been copied without any further modification. In Bangladesh, besides Grameen bank, more than 700 licensed (issued by MRA) and 3 commercial banks operate, and few special type microfinances operate in Bangladesh. This thesis also identifies the contribution to current Bangladesh economic development from the microfinance industry. It was found that the contribution of microfinance organization to current GDP growth is between 8.9 and 16.6 percent.

In Chapter 3, it was identified that the literature provides some different opinions regarding microcredit and microfinance; where microcredit only focuses on credit facilities and microfinance is a border term which includes small credit with other facilities like savings, insurances, pension scheme and remittance services. In this chapter Islamic microfinance was identified as a microfinance organization that is operated in accordance with Islamic shariah. The main differences between Islamic and conventional microfinance are that one charges interest on its loan and the other charges a profit levy on sales. Conventional microfinance organizations directly deposit money to their clients' accounts, but Islamic microfinance provides goods or in kind resources instead of cash. The chapter also identifies that microfinance whether Islamic or conventional has some unique features that separate microfinance organizations from commercial banks. These are group lending methods (one of the unique methods that reduces the transaction and monitoring cost substantially, frequent repayment schedules, dynamic incentives, and they basically target women. These features are common both in Islamic and conventional microfinance.

Besides the features of microfinance organization, this research identifies that the mission of microfinance as a social enterprise is to 'serve the poor and disadvantaged people to help them to get out of poverty'. There has been ample research conducted on the contribution of microfinance on poverty and empowerment. It has been established that microfinance has a positive contribution (with a few controversies) in the relief of poverty and women's empowerment. But few observers have analyzed whether microfinance reaches the poor. The research that has concentrated on analyzing the microfinance reach to the poor used different proxy measures to measure the poverty status of their clients. For example, using average loan size, which is the wrong proxy to estimate impact on poverty. On the other hand, microfinance organizations empower their clients, but it is not evident that microfinance organizations offer their services at a lower cost.

While the microfinance mission is to serve poor clients, recent trends of microfinance (commercialization) show that it has shifted its mission. Now microfinance organizations offer their services to the non-poor or upper poor, a microfinance mission drift. On the other hand, microfinance came to help poor people to get rid of poverty, but exploits its clients - another microfinance mission drift.

It was also identified in Chapter 3 that, in analyzing microfinance mission drift a theoretical framework is provided by Zhao (2014) but this fails to identify the different types of microfinance mission drift. This is the main limitation of the current literature.

Chapter 4 concentrated on developing an alternative theoretical framework to analyze microfinance mission drift. To develop a conceptual framework, it is necessary to provide some overview of the required concept. In the beginning of this chapter we explain the concepts of poverty and the poverty line, and the initiatives that have been taken to reduce poverty. This review found that among the all poverty alleviation programs, microfinance provides a method that helps to reduce poverty. This is the main objective of microfinance organizations: 'help the poor people to get out of poverty through finance'.

In financing the poor, microfinance faces a dilemma, it must concentrate on financing the poor, but on the other hand it must concentrate on its financial performance for its own sustainability. It was identified in the literature that financial performance has an opposite relationship with social performance (help the poor). Therefore, two schools of thought provide two different opinions. The institutional school is concerned about financial sustainability and argues that if microfinance becomes financial self-sufficient, later it may focus on social performance. On the other hand, the welfare school is concerned more about social performance (serves the poor). Welfarists argue that microfinance must focus on social performance, and need not focus on its financial performance, because it may depend on grants, donations and/or soft loans for its financial resources. But like several authors, this study argues that grants, donation or soft loans are limited and unpredictable. Hence, dependence on those resources becomes risky for microfinance organizations, but we should not ignore social performance. The current research argues that there should be a tradeoff between social and financial performance. Otherwise, microfinance will fail to fulfill its objectives in the long run.

Based on social and performance Zhao (2014) identified four ideal types of microfinance institute. To develop a conceptual framework the current study borrowed the Zhao (2014) framework and developed a new conceptual framework on top of it. In this research, we used interest rates as a proxy for financial performance and client credit worthiness as a proxy for social performance. Based on this framework, this research identified four ideal types of microfinance mission status. These are: Expected domain, Out of Focus (Type-1 MD), Exploitation (Type-2 MD), and Overlapped mission drift. In the final stage, this chapter looked at empirical studies and identified literature loopholes in line with Chapter 3.

The empirical analysis of this research started from Chapter 5. This chapter dealt with the analysis of microfinance that reaches to poor people. In doing so, this chapter used the Chen and Schreiner (2010) PPI score card to identify the poverty status of microfinance organizations. It then compared the collected poverty score with different poverty lines such as the Bangladesh Lower poverty line, the Upper Poverty Line, the USAID poverty line, and the international extreme poverty line $1.25 per day per person (constant at 2005 PPP). Some important findings were:

1. Microfinance organizations (both conventional and Islamic) emerged to finance the poor and vulnerable poor to help them to get rid of poverty. But it appears that most

MFIs now drift from this important objective. Both conventional and Islamic MFIs are still conservative in relation to underwriting the credit risk of the poorer segment, that is, the 50 percent that live under the poverty line in Bangladesh;

2. Bangladeshi MFIs have failed to fulfill the mission to fully empower the poorer and marginalized people. Especially, Islamic microfinance has not reached out to the marginalized people in Bangladesh. As was mentioned earlier, conventional MFIs are growing rapidly whereas Islamic MFIs are lagging far behind in Bangladesh.

Chapter 6 dealt with microfinance interest rates. This chapter provides a comprehensive analysis of Islamic microfinance interest compared with conventional microfinance interest. Microfinance interest is compared with market interest taken as a benchmark of commercial banks. In the last part, the calculated interest rate is compared with existing Bangladeshi law to identify whether the interest rate charged by different microfinance organizations is excessive or usurious. The main findings of this chapter are as follows:

1. Fixed deposits on loan vary based on microfinance organizations. Different microfinance organizations charge different rates of fixed deposit, for example, BRAC requires 4 percent fixed deposits on their loans, ASA requires 10-15 percent and all other sample microfinance organization require 10 percent fixed deposits on their loan. This fixed portion can be deposited with MFIs either one week before or the required amount is kept back at the time of loan disbursement.

2. According to Yunus, microfinance emerged to finance the poor, and after the Mexican microfinance incident, Professor Yunus argues that microfinance must charge as low as possible interest on their loans. But in Bangladesh the microfinance industry is

charging interest from 10 percent to 25 percent flat. This interest calculation did not consider any forced fixed deposit. Whereas Islamic microfinance charges low interest rates compare to conventional microfinance, if we calculate the effective interest considering only the fixed deposit, the interest rate becomes three-fold of its flat rate interest. For example, we find the maximum effective interest rate charged by conventional microfinance to be more than 96 percent. Even Professor Yunus' GB charges an effective interest rate of more than 95 percent.

3. In comparison with microfinance interest at market interest rates, the microfinance organizations charge excessive interest rates compared to banks. To analyze whether MFIs charge this high interest rate to maximize shareholder wealth, the ROA of both industries was compared. The results revealed that microfinance ROA is more than three times that of the banking industry. It was also found that the microfinance organization that charges high interest is able to acquire a high ROA.

4. To analyze whether the high interest rates charged by microfinance organizations is excessive or usury level interest, the interest rate described by different formal body (state or other state agency) were compared. In Bangladesh, the MRA is the highest authority dealing with NGO-Type microfinance organizations. They fixed the maximum interest a microfinance organization can charge as 25 percent on a declining balance method. On the other hand, the Bangladesh Lending Act 1933 specifies that the maximum acceptable compound interest is 27 percent. Therefore, microfinance organizations charges are almost fourfold higher than specified by law and state body. That is an excessive interest rate and in Bangladesh microfinance both Islamic and conventional exploit their clients.

Chapter 7 deals with a fundamental structural dilemma. The last two chapters (chapter 5 and 6) did not find any particular differences, but still conventional microfinance shows a steady growth while Islamic microfinance is lagging behind. Therefore, this chapter was challenged to find any fundamental constraint that Islamic microfinance faces, that restricts its growth. The findings are as follows:

1. It is true that not every microfinance client requires working capital in the form of raw materials or a work in progress form, they also require liquid cash, which is the life blood of any business. Most microfinance clients are looking for working capital in the form of cash rather than in-kind. While Islamic microfinance has some policies that help to provide liquid cash such as Musharaka and Tawarruq, in the case of RDS almost every investment was in Murabaha. This is what this research specifies as the Murabaha Syndrome. This research argues that the Murabaha Syndrome is the fundamental constraint that restricts the growth of Islamic microfinance organizations.

2. Even though Islamic finance has some provision to provide cash to their clients through different financial contracts, but this requires high transaction costs that reduce the confidence of the microfinance clients.

In conclusion, it can be said that the aim of the Grameen bank is to provide access to financial resources so that the poor people can utilize this credit facility with their skill and knowledge to get rid of poverty. As Professor Yunus mentioned, microfinance 'interest rates must go as low as possible, because making money is not their goal. It's reaching people and helping them get out of poverty [that] is the goal.' If microfinance fails to fulfill its objective or mission, we can say it suffers from mission drift. The Yunus statement regarding microfinance activities was divided into two parts, one is serving the poor and the second is to have interest rates as low as possible. If this failed to focus, its first aim ‘serving the poor’ is considered as Type-I mission drift, and its 2nd mission ‘charging interest as low as possible’ is considered as Type-II mission drift.

From the above discussion we see that even though the current economic structure provides incentives for microfinance organization to operate their business in Bangladesh, they have failed to create appropriate incentives to the society. In case of taking the poor clients credit risk, both Islamic and conventional microfinance have failed to assume poor people’s credit risk. Even though Professor Yunus (1998) said the Grameen bank is the bank for the poor, evidence suggests an opposite scenario.

So, we can conclude the argument that microfinance organizations, whether Islamic or conventional, have failed to focus on or take the credit risk of the poor. They are mostly focusing on non-poor or upper-poor borrowers. Which is a sign of Type-I mission drift. Credit risk is a matter for them, and they are not willing to challenge the poor people’s credit risk. Even though Professor Yunus said that credit is the fundamental right of every people the Grameen bank itself focuses on non-poor or upper poor borrowers. Other arguments regarding the microfinance interest rate can be identified, for example whether microfinance emerged to help poor people lift themselves out from poverty. Poor people are in a poverty-based vicious cycle, without any outside support they will fail to develop their livelihood. Therefore, microfinance is viewed as one of the outside supporters that can break this vicious poverty cycle by providing low cost finance.

From the above discussion, it can be concluded that microfinance charges high interest rate to earn profits. Microfinance exploits more than it helps. Therefore, we can say that microfinance organizations fall into the Type-II mission drift situation. In comparing whether profits matter for them, data suggest that there is no difference between Islamic and conventional microfinance, both are looking for profits. Thus Bateman (2014) claims that the contribution of microfinance to social wellbeing or poverty reduction is a myth.

However, when critics arise regarding microfinance contributions Yunus replies as follows:

> *"Critics often argue that micro-credit does not contribute to the economic development of a country. And even if it does contribute something, that something is insignificant. But it all depends on what one considers economic development. Is it per capita income? Per capita consumption? Per capita anything? I have always disagreed with this kind of definition of development. I think it misses the essence of development. To me, changing the quality of life of the bottom 50 percent of the population is the essence of development. To be even more rigorous, I would define development by focusing on the quality of life of the lower 25 percent of the population. This is where growth and development part their ways. Those who believe that growth and development are synonymous, or move at the same speed, assume that the economic layers of society are somehow linked to each other like so many railway carriages, and that one only need stoke the engine for the entire train and everyone in it to move forward at the same speed."*

Professor Yunus does not believe the traditional definition of development with respect to per capita income and consumption. For the sake of argument, we should also forget the definition of development like per capita income. This is because traditional economists do not fully consider poverty and finance is considered as a neutral tool in poverty alleviation (Yunus, 1998). According to Yunus, development is something that changes the '*quality of* *life of bottom 50 percent or even 25 percent'*. But current research argues that if Professor Yunus or microfinance focuses on the bottom 25 percent or 50 percent then we can say there is a chance that it will change lives (whether positively or negatively). However, this study found that on average 8 to 30 percent of microfinance clients live under the poverty line. And, on the other hand, microfinance organizations charge excessive interest on their loans, which is a kind of exploitation. Hence, this research argues hat they are not changing the quality of life of the bottom 50 or 25 percent, rather they exploit the poor by charging excessive interest rates.

Nevertheless, the author expresses an opinion in line with Younus that the economic layers of society are somehow linked to each other like so many railway carriages, and that one only (Grameen Bank) can stoke the engine for the entire train (*Microfinance industry*) and every carriage (*other microfinance organizations*) move forward (to *charge*) at the same speed (*same excessive interest rate*) to exploit the poor.

8.3 Revisit the research question and hypothesis

Why is the market penetration of Islamic microfinance (RDS) extraordinarily low?

(1) If the conventional MFIs fall into 'type-I' mission drifting (MD), in other words, if the RDS challenges to empower marginalized clients rather than the conventional MFIs, a low level of market penetration could be justified.

While many researchers suggest a positive (social and economic) impact of the microfinance industry, fewer have addressed how the microfinance (credit) reaches out to marginalized clients. Even though the 'upper' poor class has been empowered by the MFIs, type-I MD may occur. How severely has the type-I MD occurred in the Bangladeshi microfinance industry?

The thesis suggests that the MFIs in Bangladesh - not only the conventional MFIs but also RDS - have fallen into the type-I MD situation. In this investigation it appears that the credit policy of RDS is more risk-averse to marginal clients rather than the conventional MFIs. The low level of RDS cannot be explained from the above-mentioned hypothesis. Rather, we may say that the conventional MFIs are expanding their business faster than RDS partly by trying to empower the marginalized client. Thus, it is difficult to find the reason *d'etre* for RDS in the industry.

(2) If the conventional MFIs fall into Type-II mission drifting (MD), in other words, if the RDS hesitates to exploit the clients as the conventional MFIs are doing, the low level of market penetration could be justified.

While many researchers identify the fairly good financial performance of conventional MFIs, few have investigated how the microfinance (credit) organizations have exploited their clients. While the MFIs earn profits to maintain their reputation and sustainability, type-II MD cannot be justified. How often has type-II MD been occurred in the Bangladeshi microfinance industry? The thesis suggests that RDS is also exploiting, or at least seeking a 'usurious' rate of profit from its clients. Still we wonder why the conventional MFIs could expand their business so rapidly in Bangladesh. We may say that the usurious rate of profit offered by RDS is not so attractive to the potential clients. It is difficult to find the reason *d'etre* for RDS in the industry.

RDS is the late comer in the microfinance industry in Bangladesh. The credit policy of RDS is quite risk-averse and not so innovative in comparison with the rival conventional MFIs. There is no significant difference in the allocation (purpose) of microcredit [Chapter 5] and the offered rate [Chapter 6] between the conventional MFIs and RDS, which implies that

RDS is just following the way pioneered by GB and the other conventional NGO-MFIs. As a result, RDS may have lost its reason *d'etre*, and lost the opportunity to increase its market share as well.

Can we say that the typical financial scheme of ‘Murabaha' in Islamic finance is not always suitable for microfinance? Chapter 7 suggests that the purpose of borrowing microcredit may vary, that is, the poor clients need to get cash money not always opportunities for doing the 'trade' in a broader sense. If Islamic MFIs hesitate to share the uncertainty through the scheme of Musharaka or through the scheme of ‘Tawarruq’, they would lose their competitiveness with the conventional MFIs in the market. Rather, it might be better for society to delegate the microfinance business to those conventional MFIs that can meet the demand for ‘working capital’ by the clients.

8.4 Policy Recommendations

This research was based on the idea that microfinance reaches to poor people and is willing to support them. Based on the results, the following recommendation may be made:

1. It was found that microfinance organizations, both Islamic as well as conventional, are hesitating to engage with poor people, which is the main objective of microfinance organizations and distinguishes them from traditional the commercial banking industry. Therefore, as the state permits this type of organization to help the poor people, a proper monitoring system is needed for MFIs. Based on this criterion, whether it reaches to poor or not, state agents must take effective action. If

microfinance fails to reach to the poor, there is no reason for the existence of microfinance organizations in society.

2. From the research it was found that microfinance organizations charge excessive interest rates. Even though the state body, MRA, specifies the maximum celling or interest rate, microfinance organizations still charge excessive interest rates. The MRA must take its responsibility and punish the bad organizations from the good ones. On the other hand, microfinance organizations deal with poor and illiterate people, and for them the effective interest and deposit rates are jargon. Hence, the MRA should issue some policies that will help microfinance clients to understand the basic financial terms and their calculation policy. Or the MRA may issue some policy by prescribing that the real interest rate must be disclosed in the application form (for example, how much a microfinance organization can charge based on flat rate, effective rate, etc).

3. This research also found some deficiencies in the MRA monitoring system. Even though the deduction of loans is strictly prohibited based on MRA regulations, MFI clients must deposit a certain percentage of fixed deposit based on the loan amount. Which is the same as deduction at source. MRA monitoring policy does not consider this as a deduction. Hence, MRA may need to revise policy to save the poor.

4. Microfinance, especially the Islamic microfinance falls into the Murabaha syndrome. But Murabaha is not a sharia based financial product. This product is specially designed for commodity sales contracts. The true Islamic financial contract is Mudaraba and Musharakah. Hence, Islamic finance, especially Islamic microfinance must focus on Musharaka, or Tarawarruq financial products or develop a new financial

instrument that can resolved the current barriers. Otherwise, it will remain same as it is now.

5. If we see the current microfinance in another way, we can say that the same microfinance organizations fail to serve the poor and charge interest. Based on our conceptual framework, microfinance falls into a Mission unrelated sector. They operate like a bank. If so, government should stop the microfinance operations in Bangladesh and identify a mission focused, alternative, low cost financial system such as fintech or blockchain technology.

8.5 Contribution of Current Research

According to Glatthorn and Joyner (2005, p.19) research can contribute in the following ways: testing a theory, contributing to the development of theory, extending existing knowledge, changing prevailing beliefs, suggesting relationships between phenomena, extending a research methodology or instrument, and providing greater depth of knowledge about previously studied phenomena. This research contributes to the current literature in the following ways:

1. Contribution to the methodology

To analyze microfinance mission drift, a theoretical framework was developed by Zhao (2014) but it failed to explain the different types of drift. This research developed a new theoretical framework through which different types of mission drift can be analyzed.

2. Contribution of the empirical study on the low penetration of Islamic Microfinance

    - finding both type-I and Type-II mission drift in RDS

- Conventional microfinance organizations are challenging (somewhat) to undertake the credit risks of the poor people, this might be one of the reasons for their successful expansion
- There is a strong demand for 'Working capital' by microfinance clients, this demand also came from Muslim clients.

8.6 Future research directions

Referring to the limitations of the study as described in Chapter 1, there are some potentials that should be proposed as directions for future research:

1. It was identified that few Muslim poor engage with interest-based microfinance institutes. To cover these Muslim people, the only way is through Islamic microfinance. Maybe there are some other alternatives in the society or in the near future some will appear. But this study failed to propose any alternatives of Islamic microfinance, so this is for future research.
2. This research only considered commercial Islamic microfinance organizations. No charity based Islamic microfinance organization has been included in this research. This can be considered as a limitation of this research which needs to be covered in future research.

8.7 Summary

This chapter has presented a number of fundamental constraints for and the reasons behind the extraordinarily low level of Islamic microfinance and its slow pace of growth. This chapter also provided some policy recommendations to resolve the constraints of Islamic microfinance. In addition, this chapter also provided some directions for future research.

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