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The Impact of Regulation in Microfinance Institutions' Performance:

A Case Study of Mongolia

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The Impact of Regulation in Microfinance Institutions' Performance:

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THESIS ACCEPTANCE CERTIFICATE

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ABSTRACT

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This paper attempts to explore the impact of regulation in Microfinance institutions' main performance. This purposed to explore relationship between two of three main participants, Regulators and Institutions of Microfinance except Clients, which have important role in Microfinance development in the world. Using the case study of the Microfinance regulation in Mongolia, Bangladesh, India and Vietnam, this paper argues that appropriate regulation of Microfinance is critically important to improve Microfinance Institution's Performance indicators, which are Breadth of outreach, Depth of outreach, Portfolio quality, Financial sustainability, Efficiency.

In this paper to assess the impact of Regulation in Microfinance performance, we will explore how Countries' implemented Regulation in order to achieve main Regulation objectives in Microfinance impact to Microfinance Institutions' Performance indicators by doing Regulatory Impact Analysis, particularly Multi-Criteria Analysis. From this result, by determinig which kind of regulation policy is more affect to Microfinance performance, the

research therefore concludes with recommendations on to implement appropriate Regulation to improve Microfinance institution's Performance in Mongolia.

Key words: Microfinance Institutions, Microfinance Regulation, Microfinance Institutions' Performance, Regulatory Impact Analysis.

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CHAPTER ONE

INTRODUCTION

Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans; savings, microleasing, micro insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses (Robinson, 1998).

Recently, Microfinance is growing and used as a main forceful tool for poverty reduction in the economy widely. Therefore, Today Microfinance is increasingly seen as a legitimate part of the financial system in many countries. So now that the special features of financial markets and the resultant regulatory needs has looked at the difficulties of translating regulatory plans into policy, we shall now determine the specific regulatory needs of Microfinance Institution (MFI)s as compared with traditional financial institutions.[1]

The Microfinance regulatory framework's main objectives are the same for activities and institutions as for other components and segments of the overall financial system. However, the key principles and standards of a regulatory framework for institutions providing financial services to the Microfinance sector are likely to be different from those for formal banking

[1] *Regulation and Supervision of Microfinance Institutions: State of Knowledge Stefan Staschen Eschborn, August 1999*

and finance institutions, because the design must consider the operational, market, and client characteristics of the Microfinance sector. [2]

Regulation of the Microfinance sector is commonly believed to be both crucial and necessary to protect consumers and stabilize financial markets. Microfinance regulation, however, is not simple process. The Microfinance sector encompasses a wide array of institutes that provide a variety of services to many different customers. [3]

1.1 The Research Motivation

In Mongolia, Microfinance is not a new financial sector and it has several years experience. In the recent years, however Microfinance's key indicators are increasing in generally, total amount of depositors and borrowers are declining slowly since 2008. Also as well as defined, Microfinance is the means of providing a variety of financial services to the poor such as deposits, insurance and other financial services, but Mongolian Microfinance practice today still focus on Microcredit, which is providing the poor with small credit to increace household incomes. Therefore, eventougth Gross loan portfolio is increasing, but there is no significant changes in number of borrowers. It means the poor, and the majority of he middle class have very little access to credit. On the other hand the formal banking sector has usually avoided lending to the poor because of supposed difficulties in collection and lack of collateral. Therefore, the poor must rely on alternative sources for funds, such as relatives or suppliers, or depend on moneylenders who charge extremely high interest rates.

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[2] *Financial sector assessment : A Handbook, World bank, 2005*
[3] *Rural and Microfinance Institutions: Regulatory and Supervisory Issues Financial Sector Assessment: A Handbook*

The reason of above appeared deficiency is that Mongolia lacks a specific Microfinance policy[4]:

- There is not now—nor has there been in the past—a specific National Policy on Microfinance.
- There are no specific laws that directly relate to MFIs, their creation, or their licensing.
- There are no specific tax breaks or other fiscal incentives for Microfinance.
- There is no specific regulatory or supervisory regime for Microfinance.
- There are no provisions in any law or policy that encourage or motivate Microfinance innovation or the role of Non- Governmental organizations (NGOs) in Microfinance.
- There is a near-complete absence of any laws, regulations, or policies related to consumer education, financial literacy, or financial consumer protection.

Also in the recent years, increasing the amount of Microfinance providers requires regulation and supervision in this sector. On the other hand, Governments need to work systematically to ensure that the regulation they develop and implement is high quality, since the costs to society of poor quality regulation are substantial. Poor quality regulation increases compliance costs for business and other groups, leads to unnecessary complexity and associated uncertainty as to regulatory obligations and reduces the ability of Government to achieve its objectives.[5]

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[4] *Microfinance Regulation and Supervision in Mongolia, Nyamaa Togtokhbariul, Central Bank of Mongolia 2007*
[5] *Introductory Handbook for Undertaking Regulatory Impact Analysis, OECD, 2008*

As in most developing countries, there are policy and regulatory shortcomings in Mongolian financial sector in general, and the Microfinance sector in particular. As seen as the above appeared deficiency, it needs appropriate and smart regulation to improve Microfinance sector in Mongolia. Therefore our research identifies the existing regulatory gaps in the microfinance sector in Mongolia and tries to borrow from the findings of the successful regulation practices to improve MFI's performance from other countries.

1.2 The Research Objectives

The purpose of our research is that find out appropriate Microfinance Regulation to improve MFI's performance in Mongolia through doing comparative analysis among three Asian countries' Regulation's successful case.

1.3 Research Questions

Our research seeks to find answers to the following key questions:

- *What is the Regulatory Framework of the four Asian countries (Mongolia, Vietnam, Bangladesh and India) for Microfinance and what is the main differences between them?*
- *How the regulation facilitates to increase Microfinance performance in four Asian countries?*
- *What regulation can generalize and make a case for better regulation of Microfinance institutions in Mongolia from other three Asian countries' good experience?*

Our research progresses to gather information on how to develop appropriate regulations to improve MFI's performance in Mongolia. We chose three Asian countries which is Bangladesh, India, Vietnam to compare Mongolia for Microfinance Regulations in our research.

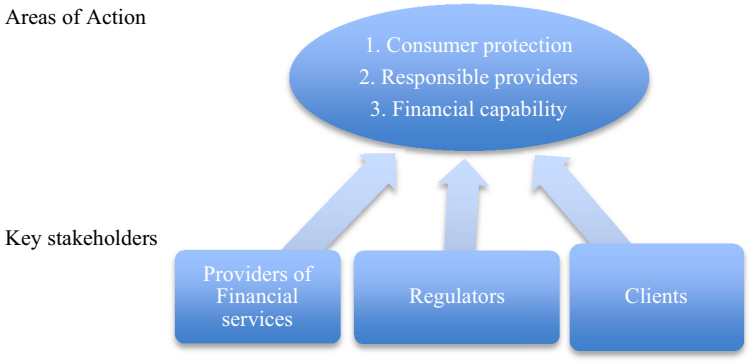
CHAPTER TWO

MICROFINANCE OVERVIEW: FOCUSING ON REGULATION

The Microfinance sector has grown rapidly, for the number of clients as well as the number and type of providers and products and it has not concentrated just on credit in the world: Today there is broad awareness that poor people have many and diverse financial service needs, which are typically met by a variety of providers through multiple financial services. Increasingly, best practice in Microfinance is Responsible Finance (Figure 1), defined as the delivery of retail financial services in a transparent, inclusive, and equitable fashion. Consumer protection and financial capability are now seen as important policy objectives, particularly in a context of new providers, more sophisticated products, and technology-enabled delivery channels. [6]

[6] *The New Microfinance Handbook, A Financial Market System Perspective, Edited by Joanna Ledgerwood with Julie Earne and Candace Nelson*

Figure 1 Responsible Finance: A Multiple- Stakeholder approach



Source: Responsible Finance Forum 2011

Provider of Microfinance Services.

Every country has licensed financial entity and also many unlicensed ones to provide Microfinance services. Any way, Microfinance providers fall into several categories according to the scope of regulation, type of ownership, and type of services offered. The main categories are Development banks; Commercial banks; Thrift, Rural or Cooperative banks; Microfinance Development banks, Microfinance companies; NGO-MFIs, Thrift and Credit cooperatives (Table1). [7]

Table 1 Microfinance providers

Type of Institutions	Description
Development Banks	Usually Government owned institutions charged with responsibility for promoting special interests like agriculture, rural development or small enterprises.
Commercial banks	Either Government or Privately owned banks undertaking commercial banking business and offering a full range of financial services including credit deposits, money transfers, bill discounting, foreign exchange services, and so on.
Thrift, Rural or	Banks with lower minimum capital requirements but accompanied by significant

[7] *Getting the Framework Right, Policy and regulation for microfinance in Asia, Banking with the poor network, 2010*

Cooperative banks	restrictions on areas of operation and financial services they can provide. Services limeted to credit, deposits and transfers but include limitations on checking accounts.
Microfinance Development banks Microfinance companies	Similar to rural banks but with limits on the size of particularly asset accounts to ensure thet the main thrust of their business drected at microfinance clients. Usually for profit companies relativly closely held by promoters or a few equity investors.
NGO-MFIs, Thrift	Not for profit institutions often with a strong social motivation to facilitate the livelihoods of low income families and to reduce poverty. The social motivation can result in a "welfarist" approach that is a constraint in the practice of Microfinance as a business.
Thrift and Credit cooperatives	Usually village or cluster level cooperatives that offer deposit and credit services to their members. Often formed as part of Government programmes.

Source: [1] *Getting the Framework Right, Policy and regulation for microfinance in Asia, Banking with the poor network, 2010*

Consultative Group to assist the poor (CGAP) provided Thirty years of lessons learned, translated into operational advice for development agencies, foundations, social and commercial investors, international NGOs, and others that help build financial systems that work for poor people in 2006. In the Box 1, The lessons of good practices refer mainly to support for individual financial service providers: [8]

[8] *Good practice guidlines for funders of Microfinance, Microfinance Consensus Guidelines, 2006*

Box 1

- The lack of strong, competent retail capacity remains the main bottleneck to extending financial services to large numbers of poor people, especially those in rural areas.
- Designed as inputs to larger multisector donor projects, credit components often perform poorly. They rarely continue beyond the project and thus do not provide permanent access to financial services.
- A wide range of national financial and nonbank financial service providers is required to serve the needs of poor people, including institutions with existing capacity for widespread outreach, such as commercial banks and postal outlets. Specialization allows different institutions to serve distinct market needs.
- Ownership and governance are critical determinants of successful financial service providers.
- Public donors generally are not good owners of financial institutions, and they rarely have the appropriate expertise and capacity to provide adequate board oversight. However, some international financial institutions and investors that invest equity in financial institutions have staff with the sufficient expertise to take on useful ownership and governance roles.
- Financial sustainability is essential to reach significant numbers of poor people and to realize long-term social returns. This means, among other things, charging interest rates consistent with full cost recovery to ensure profitability and growth. Over time, competition, improved efficiency, and increased accountability for results should drive costs (and thus interest rates) down.
- The time required to achieve financial sustainability depends on country context, local market conditions, the capital structure of the retail financial service provider, and the market segment served. Evidence suggests that more recently established institutions achieve financial sustainability much faster than the earlier generation of financial institutions, though some institutions still take up to 5 to 10 years to become sustainable. It is important for donors to specify a time horizon for each institution to encourage the most effective use of donor subsidies.
- Savings-based community-managed loan funds have shown promise, but those that are externally funded with a capital infusion from a donor almost always fail, usually because of poor repayment.
- Improving the efficiency of microfinance operations translates into higher quality, lower cost services for poor people. Institutions can achieve greater efficiencies, and thus reduce costs, by investing in quality management information systems, technological improvements, and well-trained staff.
- Institution building requires a long-term commitment by donors and investors. This commitment should be balanced by a defined time limit for funding support. Ad-hoc technical assistance and abrupt withdrawal, as opposed to long-term strategic commitment, may fail to build domestic capacity. However, long-term dependence on foreign technical service providers rarely builds, and might even replace, domestic capacity.
- If not applied properly, grants, subsidized loans, and excessive guarantees to financial service providers can undermine or crowd out national or international commercial capital markets and/or domestic savers.

Clients

Microfinance clients are poor and low income people commonly that do not have access to other formal financial institutions and their demand for financial services is large and the types of services they demand vary across households and microenterprises. In the past, MFI have focused on Microcredit, but today, that poor people need and use many kind of financial services, which are savings, money transfers, insurance and others.

This large demand and the heterogeneity of services needed across households and microenterprises and over time have created scope for commercial financial intermediation.[9] As shown in the following table, the characteristics of microfinance clients from the literature are different from the conventional credit provided by traditional financial institution. (Table 2)

Table 2 Characteristics of Microfinance Clients

Characteristics	Description
Type of client	Low income Employed in the informal sector Lack of physical collateral Interlinked household and microenterprise activities

Source: From the Literatures

Savings. Poor and low-income households and their microenterprises have a large demand for safe and convenient deposit services. The poor households have the capacity and willingness to save for emergencies, investment, consumption, social obligations, education of their children and other purposes. Savings are important for micro enterprises and provide them

[9] *Developing sustainable Microfinance systems, Ashok Sharma, Asian Development bank, 2011*

with a major source of investment funds. Extensive use of informal savings arrangements by poor households is another indicator of their demand for savings facilities.[10]

Microcredit. Demand for microcredit that originates both from households and micro-enterprises is also large. Poor households require microcredit to finance livelihood activities, for consumption smoothening, and to finance non-food expenses for purposes such as education, housing improvements and migration. Many countries in the region have numerous small farms and their operators also require microfinance services. The other source of demand is non-farm micro-enterprises, which cover a wide array of activities such as food preparation and processing, weaving, pottery, furniture making and petty trading.[11]

Others. The poor are the most vulnerable to economic and physical downturns. As a result, they forego potentially viable income-generating opportunities because of risk aversion. Therefore, the demand for insurance services among the poor is vast. This shows that the supply of such services creates its own demand because the real demand remains hidden in the absence of suitable products.[12]

In the Box 2, The lessons of good practices about Microfinance clients. [13]

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[10] *Developing sustainable Microfinance systems, Ashok Sharma, Asian Development bank, 2011*
[11] *Developing sustainable Microfinance systems, Ashok Sharma, Asian Development bank*
[12] *Developing sustainable Microfinance systems, Ashok Sharma, Asian Development bank*
[13] *Good practice guidlines for funders of Microfinance, Microfinance Consensus Guidelines, CGAP, 2006*

Box 2

CGAP determined some of the key lessons learned about microfinance clients. Many of these lessons are counterintuitive and discredit firmly held beliefs about the poor.

- Poor clients need and are willing to pay for a variety of financial services (e.g., credit, savings, money transfers, payments, insurance), not only microenterprise loans.
- Poor people, even very poor people, save. Often savings are made informally, in kind, or in other relatively insecure ways (e.g., animals, jewelry, cash under the mattress).
- Financial services for the poor should be client responsive,not supply driven.Attempts to import credit methodologies from other contexts have had mixed results.
- Financial institutions and other financial service providers, not their donors and investors, are best placed to understand client needs and design appropriate services because they have direct contact with poor clients on a daily basis.
- The destitute have very limited absorptive capacity for debt and often no income to repay loans. Microcredit thus may not be the most appropriate solution for them. Similarly, microcredit may not be appropriate for every situation (e.g., refugee resettlement).
- Targeted social safety net programs and investments in infrastructure and production technology offer destitute and extremely vulnerable people better alternatives than microcredit (e.g., food security programs, wage employment in small and medium enterprises).
- Consumer protection initiatives (e.g., ensuring the transparency of financial disclosure, financial education) can protect microfinance clients from predatory lenders.

Source: Good practice guidlines for funders of Microfinance, Microfinance Consensus Guidelines, CGAP, 2006

Regulators

The term regulation includes primary legislation (that is, laws adopted by the legislature), secondary legislation (that is, circulars, regulations, or guidelines issued or adopted by the regulator), executive orders, declarations, decrees, and other similar enactments and issuances.[14] Typically primary legislation designates and authorizes a government authority to issue secondary legislation. For example, the banking law may designate the central bank

[14] *The New Microfinance Handbook, A Financial Market system perspective, Joanna Ledgerwood with Julie Earne and Candace Nelson, 2012*

as the regulatory authority for banks. A microfinance law may designate a specialized financial authority as the body responsible for regulating MFIs. Primary legislation typically can be changed only by the legislature, whereas secondary legislation can be changed by the regulatory authority. [15]

'Regulatory policy is formulated by the government; legislative principles incorporating the policy are passed by Parliament; to flesh out the principles, powers are conferred on a Minister to promulgate rules, generally by means of a statutory instrument; those rules are subject to enforcement by a specialized agency; the courts are responsible for the adjudication of disputes and the imposition of sanctions.' [16]

In the Box 3, The lessons of good practices about Microfinance regulations. [17]

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15 *The New Microfinance Handbook, A Financial Market system perspective, Joanna Ledgerwood with Julie Earne and Candace Nelson, 2012*

[16] *The New Microfinance Handbook, A Financial Market system perspective, Joanna Ledgerwood with Julie Earne and Candace Nelson, 2012*

[17] *Good practice guidelines for funders of Microfinance, Microfinance Consensus Guidelines, 2006*

Box 3

- A government's primary role is as an enabler, not a direct provider, of financial services, especially credit.
- A government's most critical contribution is to maintain macroeconomic stability.
- Governments are responsible for ensuring that legal and supervisory systems support and ensure the soundness of a range of financial organizations, including prudential regulation for financial institutions that collect savings from the public.
- Low interest rate ceilings restrict poor people's access to financial services by inhibiting the financial sustainability of service providers, thus choking off the supply of credit and possibly eliminating attractive savings/investment opportunities for clients.
- Government-run credit programs generally distort markets, because they are subject to political rather than commercial imperatives. These political imperatives impair the sustainability of institutions that provide financial services to the poor. Government-controlled apex-lending organizations rarely perform well. However, some government-owned financial institutions offer important deposit services.
- In special situations, such as market failures that the financial system cannot overcome by itself, government funding for sound and independent MFIs may be warranted, if other funds are lacking. In such cases, clear barriers must be put in place to separate political considerations from the provision of financial services.
- Work at the policy level requires public donor staff who have specialized technical capacity and operational experience. Policy changes, especially legal reform, are more permanent than other types of donor projects. They are often irreversible and affect the sector as a whole (for better or for worse). Donors have, in some cases, successfully supported strong, representative national microfinance associations to advocate for policy changes.
- Project implementing units —generally set up by donors and staffed with personnel from a government ministry—usually do not successfully deliver permanent access to financial services for poor people.

Source: Good practice guidlines for funders of Microfinance, Microfinance Consensus Guidelines, CGAP, 2006

2.1 Overview of Microfinance sector in Four Asian Countries: Mongolia, Bangladesh, India and Vietnam

Mongolia

Eventhough Microfinance is not new financial sector in Mongolia, but the history of the Microfinance sector in Mongolia is relatively short and its first stage is characterized by the "project" led approach that facilitated credit delivery based on subsidized resources. Since

1998 that applying "best practices" became a common practice of the main performers in delivering credit to the target clientele.[18] Not surprisingly, very favorable outcomes were obtained in terms of both increased outreach and enhancing the self-sustainability of the MFIs involved. In 2012, the Mongolian Microfinance clients are primarily served by 170 Saving and Credit Cooperatives (SCCs), 192 Non-Bank Financial Institutions (NBFIs), 14 Commercial Banks and also NGOs, Pawnshops, Individuals and traders.[19] But for the commercial banks, it's Microfinance intervention is still low and just three commercial banks actively conducted in Microfinance, which is Khan Bank, Savings Bank and XacBank.

Bangladesh

Bangladesh is the pioneering country of Microcredit. The history of Microcredit in Bangladesh dates back to 19th century. In Bangladesh, there are four main types of institutions involved in microfinance activities. These are: Grameen Bank, more than thousand non government organizations, out of which about 500 are licensed MFIs, commercial and specialized banks, and Government sponsored microfinance programs, which are Bangladesh Rural Development Board, and other government programs under different ministries. Three of them are very large organizations, which are Association for Social Advancement (ASA), Building Resources Across Communities (BRAC) and Grameen Bank dominate the Microfinance sector. [20]

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[18] *Mongolia: The microfinance industry, Jacob Yaron & Nergui Sandagjav, 2005*
[19] *www.frc.mn*
[20] *- Microcredit in Bangladesh : Achievements and Challenges Dr. Salehuddin Ahmed, Managing Driector, Palli Karma-Sahayak Foundation (PKSF) Bangladesh.*
- The Paper Presented in the SAARCFINANCE Seminar on "Regulation and Supervision of Microfinance Institutions (MFIs) in SAARC Region" Nepal Rastra Bank Kathmandu, 2013

India

Microfinance in India can trace its origins back to the early 1970s when the Self Employed Women's Association ("SEWA") of the state of Gujarat formed an urban cooperative bank, called the Shri Mahila SEWA Sahakari Bank, with the objective of providing banking services to poor women employed in the unorganised sector in Ahmadabad City, Gujarat. The microfinance sector went on to evolve in the 1980s around the concept of SHGs, informal bodies that would provide their client with much-needed savings and credit services.[21]

Microfinance institutions in India are registered as one of the following five entities which is NGO-MFIs, comprised of Societies and Trusts; Cooperatives registered under the conventional state-level cooperative acts, the national level multi-state cooperative legislation Act (MSCA 2002), or under the new state-level mutually aided cooperative acts (MACS Act); Section 25 Companies (not-for-profit); For-profit Non-Banking Financial Companies; NBFC-MFIs. [22]

Vietnam

Vietnam's government dominates the delivery of financial services to low-income populations as part of both its social welfare efforts and the Communist Party's political and social stability agenda. The formal financial sector does not provide sustainable and widespread access to microfinance services to the poor. The formal rural financial sector

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[21] - *Microfinance in India: A New Regulatory Structure Kenny Kline, Senior Policy Researcher, Centre for Microfinance, Santadarshan Sadhu, Research Manager, Centre for Microfinance, 2011*

[22] *Microfinance Industry in India, Lok Capital, 2010*

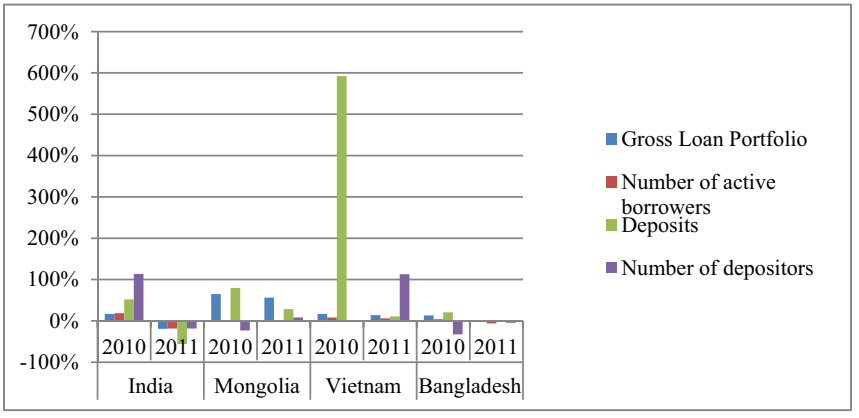
comprises fivestate-owned commercial banks, about 20 rural shareholding banks, about 900 People's Credit Funds (PCFs), and about 70 credit cooperatives. The banking sector has a poor track record in terms of applying microfinance best practices: widespreaduse of subsidized credit, low repayment rates and poor management capacities.[23]

Microfinance key indicators: Mongolia, Bangladesh, India and Vietnam.

Figure 2 is showing the Growth in Microfinance institutions' key indicators, which are Gross Loan Portfolio, Number of active borrowers, Deposits and Number of depositors. Data collected from Microfinance Exchange Information (MIX) and this figure shows data from 2010 to 2011 fiscal year-ends because some data is not completely and missed in some countries in 2012. As shown in following figure, the key indicators' growth rates are mostly decreasing in 4 countries except the number of depositors is increasing in Mongolia and Vietnam.

[23] *Global microscope on the microfinance business environment, Economist intelligence unit, 2012*

Figure 2 Microfinance key indicators



Source : Microfinance Information Exchange (MIX), www.mixmarket.com

2.2 Microfinance Regulatory Framework in Four Asian Countries: Mongolia, India, Bangladesh and Vietnam

In this section, we explored on the current regulatory structure for Microfinance in Mongolia, Bangladesh, India and Vietnam.

Mongolia

The Bank of Mongolia (BoM) is the entity responsible for supervising commercial banks. The Financial Regulatory Commission (FRC) is responsible for supervising nonbank financial institutions, including credit unions and nondeposit-taking lenders, capital markets, and insurance companies.[24] A Financial Stability Board was formed in 2007 to coordinate policy between the BoM, the FRC, and the Ministry of Finance. Both the BoM and the FRC

[24] *Mongolia: Microfinance and Financial sector Diagnostic study final report, MIFA, 2009*

are under the direct supervision of the parliament and are known for their autonomy from the government. There is no specific laws to regulate Microfinance directly in Mongolia, so Microfinance is regulated by the laws and regulations as same as govern other financial system and same as above, there is no specific national policy to support Microfinance. Most relative laws are The law on Credit Information (20 October 2011), The Law on Savings & Credit Cooperatives (SCCs) (27 October 2011), The Law on Legal Status of Financial Regulatory Commission (FRC) (17 November 2011), The Law on Credit Guarantee Fund (CGF) (10 February 2012) acted by Parliament and Supervisory Regulations for SCCs and for NBFIs are approved by the FRC. [25]

Table 3 Significant changes in Regulatory structure in Mongolia:

Year	Changes in Regulation for Microfinance
1996	The cooperative law was renewed.
1996	The Credit Information Bureau was established by the BoM. The CIB operated and tracked information manually until 2001.
1999	The BoM approved the first NBFIs Regulation.
2000	Accounting manual for NBFIs approved by the BoM
2000	Regulation in Prudential ratios of NBFIs approved by the BoM
2002	Law on Cooperatives amended
2002	Law on NBFIs adopted by the Parliament
2002	Regulation on executing consolidated supervision of commercial banks and NBFIs approved by the BoM
2003	The BoM approved the Minimum Capital requirements for NBFIs
2003	The BoM approved the Regulation on Prudential ratios for SCCs
2004	According to the amendment to the Cooperatie Law- The Central bank authorized to supervise the SCUs. Subsequently, The Central bank approved the prudential ratio regulations for SCUs.
2005	The Government declared the year 2005 as the "Year of Cooperatives"
Until 2006	The provision of financial services In rural areas was dominated by the former state agriculture bank now privatized and called Khan bank.
2006	The private Mongol Post Bank began an aggressive rural expasion programm for Saving and Credit unions.
2006	Financial regulatory commission of Mongolia which is regulatory body for all

[25] *Mongolia: Microfinance and Financial sector Diagnostic study final report, MIFA, 2009*

	non banking insurance and stock exchange market established.
2007	The reserve fund rate for banks was reduced in March 2007 from 14% to as low as 5% dependig upon the bank's features and characteristics—in order to encourage banks to usdditional resources, improve their competitiveness, and itroduce new products and services.

Source:
1. Mongolia: Microfinance and Financial sector Diagnostic study final report, MIFA, 2009
2. Mongolia: The microfinance industry, Jacob Yaron & Nergui Sandagjav, 2005
3. Microfinance Regulation and Supervision in Mongolia, Nyamaa Togtokhbariul, Central Bank of Mongolia 2007
4. www.frc.mn

Bangladesh

Regulation and supervision of Microfinance activities in Bangladesh are governed by four regulatory authorities, which are Ministry of Finance, Bangladesh Bank (BB), Ministry of Local Government, Rural Development and Cooperatives and Microcredit Regulatory Authority. On behalf of the government, the Ministry of Finance coordinates the activities of all other regulatory authorities. The Microcredit Regulatory Authority (MRA) has been established in 2006 which is the regulatory and supervisory body of microfinance institutions in Bangladesh. [26] MRA is required license under the Microcredit Regulatory Authority Act to operate Microfinance activities in Bangladesh, but for Grameen Bank, it doesn't responsible to the MRA.

Commercial banks regulated under The Bank company Act, 1991; NGO-MFIs registered as not-for-profit under The Societies Registration Act of 1860, the Trust Act of 1882 or The Voluntary Social Welfare Agencies (Registration and Control) Ordinance of 1961. Specialized bank, Grameen Bank is a bank registered under a special charter. Another

[26] *Regulation and Supervision of MFIsin Bangladesh, BB, 2013*

specialized bank, Palli Karma-Sahayak Foundation (PKSF) is supported by the Government of Bangladesh, as well as by multilateral donor agencies including the World Bank, the European Union, Asian Development Bank (ADB) and the International Fund for Agricultural Development (IFAD). [27]

[27] *Microfinance Regulations in Bangladesh: Development & Experiences, Microcredit Regulatory Authority, Bangladesh, 2010*

Table 4 Significant changes in Regulatory structure in Bangladesh:

Year	Changes in Regulation for Microfinance	Objective of the Regulation policy
1996	The World Bank set up the Consultative Group to Assist the Poorest (CGAP), and committed US$ 200 million to MFI programmes globally. Dr. Fasle Abed, founder of BRAC, was a member of its first Board.	To focus on poverty-reduction.
1996	Bangladesh Bank (BB) announced a new policy on Capital Adequacy along the lines recommended by the Basle Committee on Banking Supervision.	To improve capital adequacy and decline prevent risk.
1997	UNDP and UNCDF launched MicroStart. ASA is a MicroStart International Technical Service Provider.	To foster transparency and good institutional and financial performance among MFIs.
1999	BB's revised policy on loan classification and provisioning for microfinance and agricultural credit issued.	To prevent systemic risk.
2000	BB set up a Microfinance Research and Reference Unit.	To protect the interests of depositors and ensure the transparency and accountability of the MF–NGOs' micro-credit operations.
2001	Grameen Bank began to offer longterm savings products for the poor.	To mobolize deposits.
2002	The Grameen Bank has recently formulated some policy guidelines.	To mobilise deposits from the public since late 2002.
2003	The Money Loan Court Act of 2003 was enacted.	To streamlining of the process of realization of overdue loans and advances by the banks and financial institutions.
2003	The amount of BDT 180.21 billion had been disbursed as credit to about 2.78 million members of Grameen Bank in 390 *upzilas of 60 districts through 1,182 branches.*	To improve outreach of Microfinance.
2003	PKSF established by the government in 1990.	To provide micro-credit to targeted poor people.
2003	The government acknowledged in its document "Interim Poverty Reduction Strategy Paper 2003" that micro-credit would play an important role in the country's poverty reduction strategy.	To improve outreach of micro-credit
2003	BB revised the Prudential Regulations in June 2003.	To protect consumers from risk.
2004	The government created the NGO Foundation under a new Act of Parliament.	To accept funds from the government and donors for disbursement to small NGOs.
2006	The government has recently formulated some policy guidelines.	To streamline micro credit program operated by the different government agencies in 2006.
2008	BB issued a revised draft of the Bangladesh Mobile Payment Guidelines.	To improve consumer knowledge.
2010	2010, for the first time, SafeSave's savings portfolio surpassed its loan portfolio in value.	To decline loan outstanding.

Source:

1. Regulatory Architecture for Microfinance in Asia, Asian productivity organization, 2003-2004
2. Microfinance Regulation in Seven Countries: A Comparative Study, Patrick Meagher Pilar Campos, Robert Peck Christen, Kate Druschel, Joselito Gallardo, Sumantoro Martowijoyo, 2006,
3. Regulatory Architecture for Microfinance in Asia, Report of the APO Survey on Micro-Financing, 2003/2004.
4. Getting the Framework Right, Policy and regulation for microfinance in Asia, Banking with the poor network, 2010

India

Banks are regulated and supervised by Reserve Bank of India (RBI) under the RBI Act, and Banking Regulation Act. For other financial institutions, Regional Rural Banks (RRB) governed by the RRB Act and Cooperative banks governed by the Cooperative Societies Acts of the respective state governments.

For RRBs and District Central Cooperative Banks (DCCB), the supervisory tasks have been delegated to NABARD. NBFCs are registered under the Companies Act, 1956. They are also required to be registered with the RBI under the RBI Act, 1934, and must comply with directions issued by the RBI. Section 25 companies are not-for-profit NBFCs registered under Section 25 of the Companies Act. Under certain conditions, they are exempted from a number of legal requirements under the RBI Act. There is no specific law catering to NGOs. Microfinance NGOs can be registered under the Societies Registration Act, 1860, the Indian Trust Act, 1882, or the relevant State Acts. The grassroots level formations or groups (Self Help Groups or Credit and Savings Groups), through which other financial institutions are channelling their financial services, are informal and unregistered. [28]

Very little regulation exists for NGO-MFIs and Cooperatives, aside from registration with a local or state authority. Currently there is no regulator that oversees NGO-MFIs,

[28] *Emerging Scenarios for Microfinance Regulation in India, Deutsche Gesellschaft fur Technische Zusammenarbeit (GTZ) GmbH, 2004*

Cooperatives, and Section 25s. RBI is the regulator for NBFCs. NBFCs are subject to some prudential regulation, including a minimum capital requirement, a capital adequacy requirement, and foreign investment restrictions.[29]

Recent regulatory discussion surrounds the partial acceptance of the Malegam Report by RBI in May 2011, where RBI created the NBFC-MFI designation. RBI stated that it 'broadly accepts the Malegam Committee recommendations', although specific regulation was released only to determine which institutions qualify for priority sector lending. The new regulation from RBI, currently, only applies to the newly created NBFC-MFI category. Microfinance institutions operating under other legal structures face minimal regulatory requirements, aside from registration, though recent drafts of the pending Microfinance Institutions (Development and Regulations) Bill 2011, has put all microfinance institutions under the jurisdiction of RBI.[30]

Table 5 Significance changes in Regulatory structure in India:

Year	Changes in Regulation for Microfinance	Objective of the Regulation policy
1995	Highly progressive cooperative legislation titled Mutually Aided Cooperative Societies Act (MACS Act) was passed by the state of Andhra Pradesh.	To make the cooperative more operationally free, autonomous, self-reliant and free from state government interference in administrative matters.
1996	The RBI announced the beginning of regulation and supervision ignored component of the financial sector.	To prevent for a couple of major instances of fraud by NBFCs.
1996	RBI issued instructions to the banks to treat the SHG-bank linkage model as part of their mainstream lending.	To improve Bank implementation on Microfinance
1996	RBI started to regulate NBFIs from 1996.	To protect consumers and improve MFIs efficiency.
1999	RBI set up a "Micro Credit Special Cell"	To support Microfinance institutions.
2000	As regards Non-Banking Financial Companies, the RBI issued instructions to the effect that if NBFCs are engaged in 'micro-financing activities', registered under Section 25 of the Companies Act.	To afford the possibility for providing microfinance services without having to comply with the strict regulatory requirements for

[29] *Microfinance in India: A New Regulatory Structure, Kenny Kline and Santadarshan Sadhu, 2011*
[30] *Microfinance in India: A New Regulatory Structure, Kenny Kline and Santadarshan Sadhu, 2011*

		NBFCs.
2000	The central bank advised that banks are free to choose their own model for extending microcredit.	To mainstream microfinance and to enhance the outreach of microfinance service providers.
2000	The RBI recommended simplification of loan documentation and decentralisation of the loan decision by delegating more power to branch managers.	To increase microlending.
2000	Other than for small loans given directly by banks to small borrowers, the interest rate for loans to MFIs and for MFIs lending to the ultimate borrower were fully liberalised.	To increase microlending.
2002	The RBI constituted four informal groups for addressing various aspects of microfinance including regulatory arrangements and funding issues.	To increase Microfinance providers
2006	Interest rate ceilings were made more flexible and each bank was required to limit the rate on small loans to its guideline prime lending rate.	To improve MFIs' efficiency
2008	The work of the Committee on Financial Inclusion (Rangarajan Committee) in 2008 discussed the nature and extent of financial exclusion and suggested suitable measures	To increasing the availability of banking and other financial services such as insurance and remittances at an affordable cost to the low income population.
2010	All ceilings on interest rates have been abolished and banks are free to set rates on all loans on the basis of their own commercial considerations.	To improve MFIs' efficiency
2010	The Government and the Central bank set goals to provide by 2015 all 600,000 villages in India with a banking outlet (either by a branch or a retail agent	To improve poor people access to Microfinance.

Source:

1. Existing Legal and Regulatory Framework for the Microfinance Institutions in India: Challenges and Implications, Sa-Dhan Microfinance Resource Centre, 2006

2. Micro-_nance in the India: the changing face of micro-credit Schemes, Rajat Wanchoo, 2007

3. Getting the Framework Right, Policy and regulation for microfinance in Asia, Banking with the poor network, 2010

4. Microfinance in India: A New Regulatory Structure, Kenny Kline and Santadarshan Sadhu, 2011

Vietnam

In the recent years, Vietnam has one of the most extensive and good systems of Microcredit in the world because of their over the past 10 to 15 year's experience, especially for the Government control and subsidy.

MFIs regulated by State Bank of Vietnam regulates and supervises, but NGOs and other

social organisations providing financial services independently are under central bank licensing and supervision. Vietnam's heavy government involvement in the microfi nance sector precludes a fair and competitive microfinance environment, thus limiting its overall score. [31]

Table 6 Significant changes in Regulatory structure in Vietnam

Year	Changes in Regulation for Microfinance	Objective of the Regulation policy
1995	A not-for-profit Vietnam Bank of the Poor (VBP) was established.	To alleviate poverty.
1997	The Hunger eradication and Poverty Reduction (HEPR) launched by the Vietnamese government.	To improve poor people's access to financial services, especially in rural regions.
1997	The government of Belgium has provided financial support to the strengthening of VWU's institutional capacity in managing credit and savings activities.	To support MFIs' sustainability
2000	The government issued Official Letter to allow the WU to continue implementing the savings program for HEPR.	To mobilize deposits.
2002	The Government announced that credit institutions are free to set their own interest rates (with the exception of VSPB).	To improve efficiency
2003-2005	The "Extension of Microfinance and Micro insurance to informal women workers"project is an action research project.	To tests innovative financial products, such as emergency loans, flexible savings or insurance, which will reduce poor women'svulnerability.
2004	The Microfinance Working Group was established.	To support the approval and implementation of the decree on microfinance.
2005	The Government of Vietnam passed Decree no. 28 on the "Organization and Operation of Micro-finance Institutions" in Vietnam.	To provide a specific legal and regulatory framework for microfinance
2010	The Law on Credit Institutions requires regulated MFIs to publish rates and fees.	

Source:
1. Quach Manh Hao, Towards a sustainable microfinance in Vietnam, 2002
2. Patrick Meagher Pilar Campos, Robert Peck Christen, Kate Druschel, Joselito Gallardo, Sumantoro Martowijoyo, 2006, Microfinance Regulation in Seven Countries: A Comparative Study
3. Report of the APO Survey on Micro-Financing, 2003/2004, Regulatory Architecture for Microfinance in Asia

[31] *Ha Noi, Promoting Sustainable, Market-Based Microfinance: Viet Nam Case Study and Lessons Learned for APEC Economies, Workshop on Microfinance Best Practices, 2011*

CHAPTER THREE

THEORETICAL FRAMEWORK

3.1 Regulatory Impact Assessment: Multi-Criteria Analysis

Main instument that Governments assess the Regulation changes effects is Regulatory Impact Assessment (RIA). One of the advantages of an RIA is that it requires policy makers to clearly articulate the objectives of a regulatory change and the expected impact it will have and they can play an important role in creating a proportional regulatory framework.[32] RIAs have gained in popularity in developed countries but are also slowly picking up in developing countries (Kirkpatrick and Parker 2007). RIA can help to ensure that regulations are as efficient and effective as possible. Effective regulation is regulation that achieves the policy objective that led to it being made. Efficient regulation achieves these objectives at the lowest total cost – to all members of society.[33] The regulatory change could be either broad (for example, the creation of a new institutional type such as a deposit-taking MFI or a non-bank e-money issuer) or narrow (for example, the change of a specific prudential standard).[34] An RIA can compare different options of regulatory change or assess one particular reform proposal in comparison to a situation without any regulatory change. There are vaiety of RIA, which is Cost benefit analysis, break even analysis, cost-effectiveness analysis, Multi-Criteria Analysis (MCA).

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32 *Building an Institutional Framework for Regulatory Impact Analysis (RIA): Guidance for Policy Makers, OECD, 2008*

33 *Introductory Handbook for Undertaking Regulatory Impact Analysis (RIA), OECD, 2008*

34 *The New Microfinance Handbook, A Financial Market system perspective, Joanna Ledgerwood with Julie Earne and Candace Nelson, 2012*

MCA is a methodology that allows systematic and transparent decisions to be made even where quantification of major regulatory impacts is not possible.[35] For doing MCA, first of all determine the main objectives of the Regulation policy, after that determine all of the the criteria which could evaluate those objectives' achievement. These criterias are then ranked in terms of their relative importance. At the end, each of the available policy options can be "scored" on each individual criterion. The weighted scores can then be added together to determine which option best meets the policy objectives.

3.2 Microfinance Regulation Objectives and Measures

In the Table 4, summarizes the main regulatory objectives for financial services for the poor.[36]

Table 7 Regulation objectives of Microfinance

Objective	Main reasons for including objectives	Type and scope of regulation	Examples for regulatory masures
Promote safe and sound financial service providers	Information problems in deposit and lending business and negative externalities affect safety and soundness of providers	Prudential regulation required only for deposit taking institutions	Capital, liquidity, and provisioning requirements; management and government satandards
Guard against systemic risk	Risk of contagion exists among providers caused by negative externalities both among deposit taking institutions and to a lesser extent among credit only institutions	Systemic regulation mostly for deposit taking institutions	Lender of last resort; deposit insurance; payment system oversight
Establish a competitive market	Regulation can establish barriers to entry and providers might benefit from market power when operating in unsaturated markets	Competition regulation considering market ower in certain locations and newly created entry barriers	Mergers and acquisition, interoperability, anticartel and anticollusion rules

35 *Introductory Handbook for Undertaking Regulatory Impact Analysis (RIA), OECD, 2008*

36 *The New Microfinance Handbook, A Financial Market system perspective, Joanna Ledgerwood with Julie Earne and Candace Nelson, 2012*

Protect consumers	Negative consequences of market failures may hurt loan and saving clients	Conduct of business regulation for all types of financial institutions	Disclosure and fair treatment rules; resource mechanisms
Improve access	Transaction costs, informaion problems, and externalities as well as regulation itself are all reasons for lack of access	Enabling regulation for all types of financial insttutions	Removal of existing barriers; adjusting norms to suit microfinance[1]

Source: The New Microfinance Handbook, A Financial Market system perspective, Joanna Ledgerwood with Julie Earne and Candace Nelson, 2012

Each of the objectives is based on an economic reason for regulation and can be addressed by a specific type of regulation. The most widely discussed types of regulation in microfinance are prudential regulation, which is about the safety and soundness of financial institutions, and conduct of business regulation, which focuses on how providers conduct business with their clients (Christen et al. 2012). The five regulatory objectives are subject to trade-offs (for example, strict safety and soundness rules curtailing access), but also to supportive relationships (for example, safety and soundness rules improving the safety of clients' deposits and thereby contributing to the consumer protection objective). Regulation primarily supports the development and expansion of the core, that is, transactions between providers and clients. [37]

3.3 Microfinance Institutions' Performance indicators' Measures

CGAP provided Technical guide on "Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track" in 2009. This Guide offers

[37] *The New Microfinance Handbook, A Financial Market system perspective, Joanna Ledgerwood with Julie Earne and Candace Nelson, 2012*

basic tools to measure Microfinance Institution's Performance indicators (Performance indicators) in a few critical areas:[38]

1. Breadth of outreach: How many clients are being served?

2. Depth of outreach: How poor are the clients?

3. Portfolio quality: Hoe well is the lender collecting its loans?

4. Financial sustainability: Is the MFI profitable enougth to maintain and expand its services without continued injections of subsidies?

5. Efficiency: How well does the MFI control its operating costs?

1. Breadth of outreach

The best measurement of outreach is "The number of clients or accounts that are active at a given point in time". The number of active clients includes borrowers, depositors, and other clients who are currently accessing any financial services. [39]

Condition: Most MFIs tend to expanding the number of Microfinance clients, so it is mostly good condition that increasing in Breadth of outreach. But rapid expansion of Microfinance clients sometimes exposed to be unsustainable, especially during an MFI's early years.

2. Depth of outreach

Many, though not all, microfinance projects have poverty reduction as an explicit objective,

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[38] *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

[39] *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

and are thus expected to reach poor clients. For such projects, eventhough there are various techniques for measuring client poverty levels, it should at a minimum report the following very rough proxy for the poverty level of loan or savings clients at a point in time:[40]

$$\text{Average Outstanding Balance} = \frac{\text{Gross amount of loans or savings outstandi}}{\text{Number of active clients or accounts}}$$

This indicator is often shown as a percentage of per capita Gross National Income (GNI):

$$\frac{\text{Average outstanding loans or savings balance per client}}{\text{GNI per capita}}$$

Condition: Expressing average balance as a percentage of GNI per capita allows for a comparison of how deeply MFIs from different countries reach down in their own national income distributions. Some regard an average outstanding loan balance below 20 percent of per capita GNI as a rough indication that clients are very poor. The Microfinance Information Exchange (MIX) classifies lenders as being MFIs if their average outstanding loan balance is not above 250 percent of per capita GNI.[41]

3. Portfolio quality

A retail lender's ability to collect loans is critical for its success: if delinquency is not kept to very low levels, it can quickly spin out of control. Loan collection has proved to be a strong proxy for general management competence. More than any other indicator, this one deserves special care to ensure meaningful and reliable reporting. The standard international measure

[40] *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

[41] *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

of portfolio quality in banking is ***portfolio at risk (PAR)*** beyond a specified number of days:[42]

$$\text{PAR (x days)} = \frac{\text{Outstanding principal balance of all loans past due more than x d}}{\text{Outstanding principal balance of all loans}}$$

The number of days (x) used for this measurement varies. In microfinance, 30 days is a common breakpoint.

Some young or unsophisticated MFIs, and many revolving funds, do not yet have loan tracking systems that can produce a PAR figure. Most of these, however, should be able to calculate ***loans at risk (LAR)***, a simpler indicator that counts the number of loans instead of their amounts:[43]

$$\text{LAR (x days)} = \frac{\text{Number of loans more than x days late}}{\text{Total number of outstanding loans}}$$

PAR and LAR can be manipulated not only by excluding renegotiated loans, but also by aggressive use of write-offs, which remove past due loans from the books. When an MFI writes off a delinquent loan, that loan disappears from the MFI's books and therefore from PAR or LAR, which automatically makes the ratio look better. Thus it is useful when reporting these measures to include a description of the MFI's write-off policy. [44]

$$\text{Write-off Ratio} = \frac{\text{Value of loans written off during perio}}{\text{Average gross loan portfolio during peri}}$$

Condition: For MFIs, as like as Bank and other financial institutions, repayment of an MFI's loans is the most important. Especially, for MFIs, it caused that they would not collect the

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42 *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

43 *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

44 *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

loans in many times. Poor collection of microloans is almost always traceable to management and systems weaknesses. High delinquency makes financial sustainability impossible. As a rough rule of thumb when dealing with uncollateralized loans, PAR or LAR (30 days or one payment period) above 10 percent, must be reduced quickly or they will spin out of control.[45]

4. Financial sustainability

In banks and other commercial institutions, the most common measure of profitability is return on assets (ROA), which reflects that organization's ability to deploy its assets profitably, and return on equity (ROE), which measures the returns produced on the owners' investment. [46]

$$ROA = \frac{\text{After - tax profits}}{\text{Starting (or period - average) assets}}$$

$$ROE = \frac{\text{After - tax profits}}{\text{Starting (or period - average) equity}}$$

Now that microfinance knowledge and expertise are more widely available, MFIs should seldom take more than five years at most to reach sustainability, with the possible exception of MFIs working in rural areas with very low population density.[47]

Condition: Every MFIs want to work with more profit and reach financial sustainability. It takes some sophistication to judge whether an MFI's sustainability is improving "fast

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45 *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

46 *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

47 *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

enough." Most MFIs that have become profitable have done so within 10 years of start-up. However, now that microfinance knowledge and expertise are more widely available, MFIs should seldom take more than five years at most to reach sustainability, with the possible exception of MFIs working in rural areas with very low population density.

5. Efficiency

Two indicators are recommended to measure whether a retail microfinance provider is cost effective. Both ratios focus on nonfinancial operating expenses.They do not include interest paid on the MFI's liabilities or loan loss provision expenses. Any type of institution can calculate both:[48]

$$\text{Operating expense ratio (OER)} = \frac{\text{Personnel and administrative expense}}{\text{Period - average gross loan portfolio}}$$

OER is the most widely used indicator of efficiency. It allows a quick comparison between an MFI's portfolio yield with its personnel and administrative expenses—how much it earns on loans versus how much it spends to make them and monitor them.

$$\text{Cost per client (or loan)} = \frac{\text{Personnel and administrative expense}}{\text{Period - average number of active clients (or loans) [x GNI pe}}$$

This indicator shows how much it costs the retail financial service provider to serve each client. [49]

Condition: Measured in terms of costs as a percentage of amounts on loan, tiny loans are more expensive to make than large loans. Only a few extremely efficient MFIs have an OER

48 *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

49 *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

below 10 percent; commercial banks making larger loans usually have OERs well below 5 percent.[50]

CHAPTER FOUR

ASSESSMENT OF MICROFINANCE PERFORMANCE IN FOUR ASIAN COUNTRIES' MICROFINANCE INSTITUTIONS.

In this Chapter, we assessed the Microfinance performance indicators, which explained in Chapter 3, for four Asian countries from 1998 to 2012. For doing assessment, we used the data from Microfinance Information Exchanges (MIX), which provides information on the performance of MFIs, funders, networks, and service providers serving low-income clients. Incorporated in 2002, MIX collects and reviews financial, operational, product, client, and social performance data, standardizing the information for comparability.

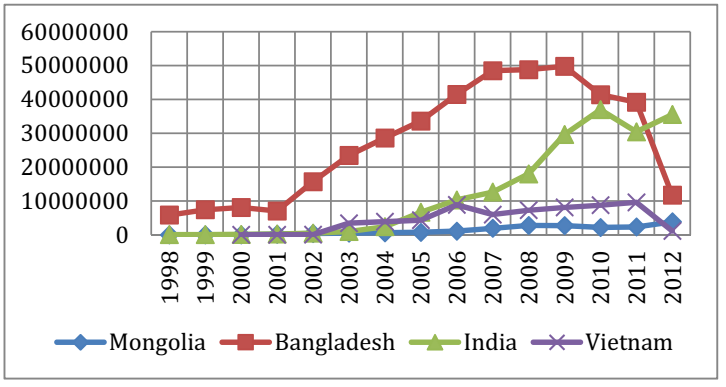
4.1 Breadth of outreach

As explained in Chapter 3, the common indicator of Breadth of outreach is the Number of Active clients and this is the main indicator to assess MFI's performance. From Figure 3, this indicator was increasing rapidly in India from 2004 to 2010, and same result in Bangladesh from 2002 to 2007. For Mongolia, this indicator is increasing since 2006, but growth rate is

50 *"Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track", CGAP, 2009*

too slow. Also for Vietnam, this was increasing from 2003 to 2006 and 2008 to 2011. In 2012 this indicator increased in India and Mongolia, but decreased in Bangladesh and Vietnam.

Figure 3 The Number of Active clients

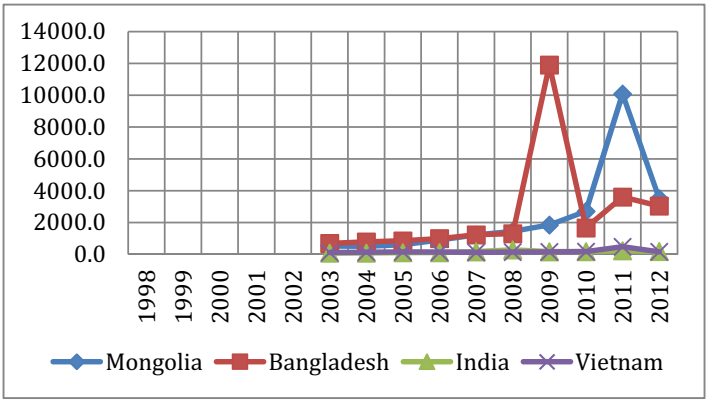


Source: MIX, www.mixmarket.org

4.2 Depth of outreach

There are 2 main indicators to measure Depth of outreach, which are Average outstanding balance and Average outstanding balance per clients divide by GNP per capita. Those indicator allows for a comparison of how deeply MFIs from different countries reach down in their own national income distributions. In Figure 4, Average outstanding balance increased in Mongolia from 2008 to 2011, especially it increased rapidly in 2011 and also in Bangladesh, there is big fluctuation in Average Outstanding balance. From this result, in the recent years, Microfinance providers can not access to poor people in Mongolia and Bangladesh. Fortunately, Average Outstanding Balance stabilized in India and Vietnam during this period and according to MIX classifies that lenders as being MFIs if their average outstanding loan balance is not above 250 percent of per capita GNI, these 2 countries' MFIs can access to the poor people.

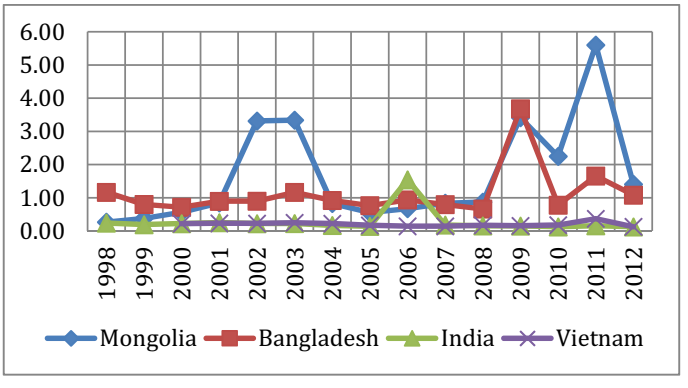
Figure 4 Average Outstanding Balance



Source: MIX, www.mixmarket.org

Same with Average outstanding loan balance, from Figure 5, the percent of Average outstanding loan balance for per capita GNI is increasing from 2009 in Mongolia and Bangladesh, and is still low in India and Bangladesh. Since some regard an Average outstanding loan balance below 20 percent of per capita GNI as a rough indication that clients are very poor, the clients of loans are very poor in India and Vietnam.

Figure 5 Average Outstanding loans per client/ GNP per capita



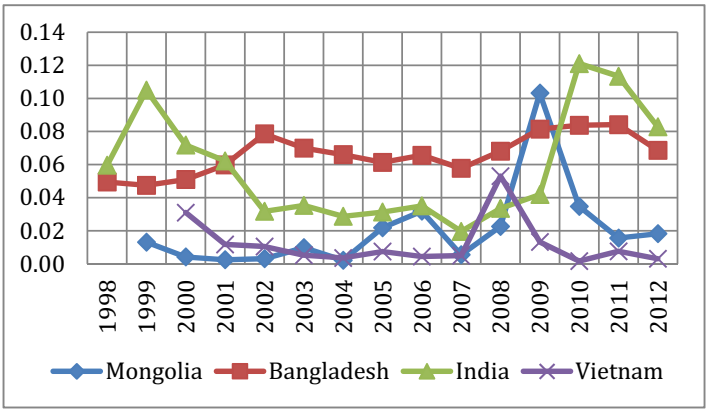
Source: MIX, www.mixmarket.org

4.3 Portfolio quality

As a rough rule of thumb when dealing with uncollateralized loans, PAR or LAR above 10 percent, must be reduced quickly or they will spin out of control. From Figure 6, eventhough In India, PAR was very high which is 10 percent in 1999, but this was decreasing quickly during 2000 and 2002 same with this result the ratio was very high in 2010, and from this year the ratio is decreasing. Furthermore, Average porfolio at risk is decreasing in Vietnam from 2010, and in Mongolia from 2009.

Generally, Average porfolio at risk is higher in Bangladesh and lower in Vietnam compare to other countries' during this period.

Figure 6 Portfolio at Risk

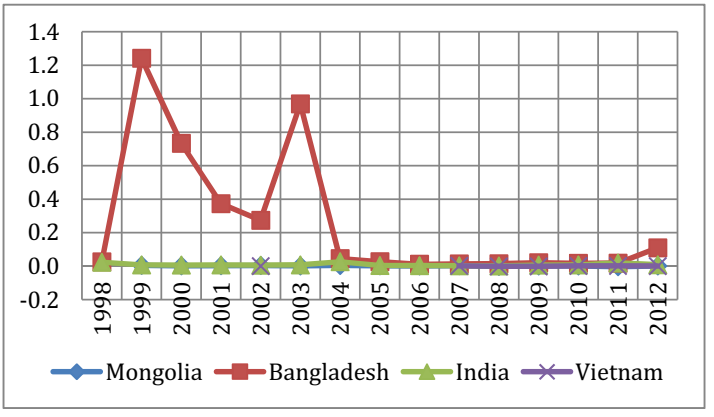


Source: MIX, www.mixmarket.org

Figure 7 shows, Loan Loss Rate stabilized relatively in Mongolia, India and Vietnam. However, this indicators is more complicated in Bangladesh. For instance, this ratio was 124%

in 1999, and eventhough from 2000 was decreasing, but in 2003 this again increased sharply. However, Loan Loss Rate is decreasing from 2004.

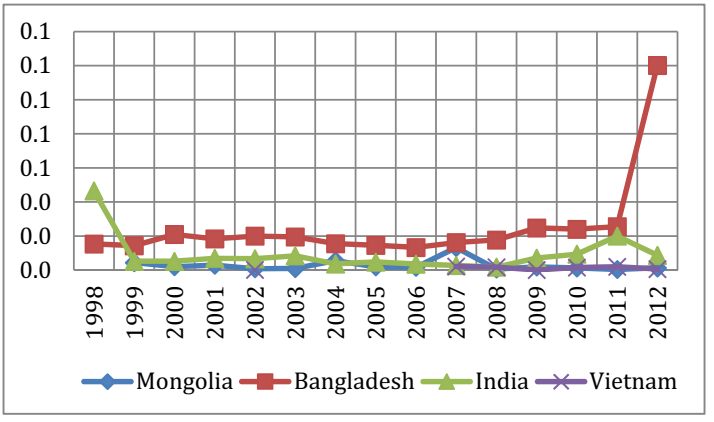
Figure 7 Loan Loss Rate



Source: MIX, www.mixmarket.org

In Figure 8, fortunately, however repayment of an MFI's loans is still low, Write-off ratio is not such a bad in Mongolia, India and Vietnam. But same as the result of other 2 indicators of Portfolio quality measurement, Write-off ratio is still high in Bangladesh compare to other three countries'. Especially, in 2012, this ratio increased rapidly. From this end,

Figure 8 Write-Off Ratio

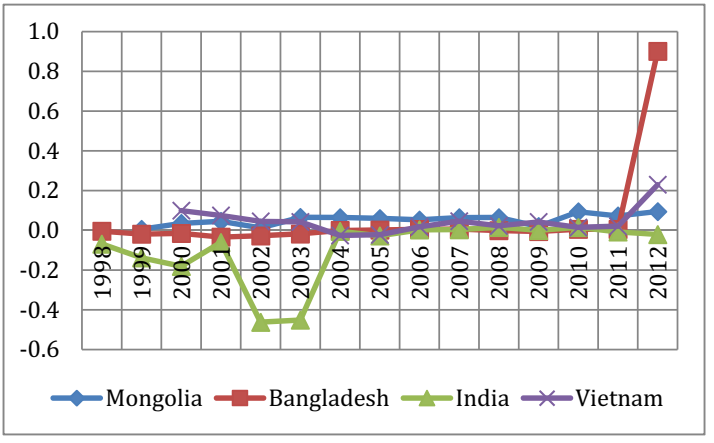


Source: MIX, www.mixmarket.org

4.4 Financial sustainability

Financial sustainability, sometimes called profitability indicators included 2 main indicators, which are Return on assets (ROA) and Return on equity (ROE). From Figure 9, ROA was increasing from 2005 to 2007 in all countries. Generally, this ratio is higher than others in Mongolia and Vietnam.

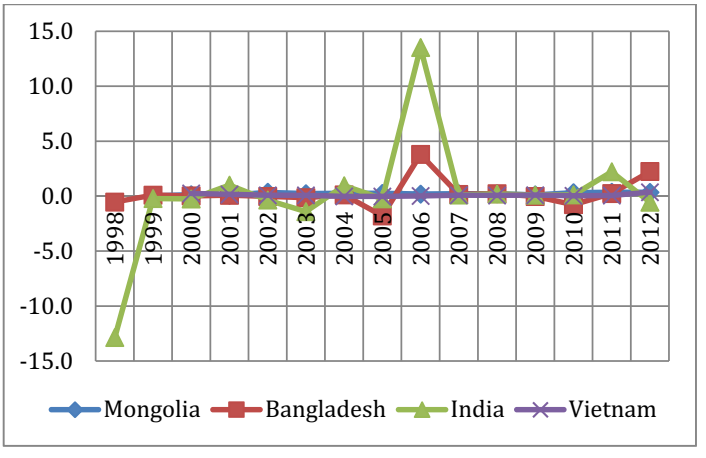
Figure 9 Return on assets



Source: MIX, www.mixmarket.org

In Figure 10, ROE ratio increased rapidly in 2006 for two countries, Bangladesh and India, also in 2011, this increased for both countries. Until 2006, ROE was very low, but after that year ROE was more stabilized in India. In Mongolia, ROE is more stabilized rather than other countries, there were some significant changes in ROE in 2002, 2007 and 2010.

Figure 10 Return on equity



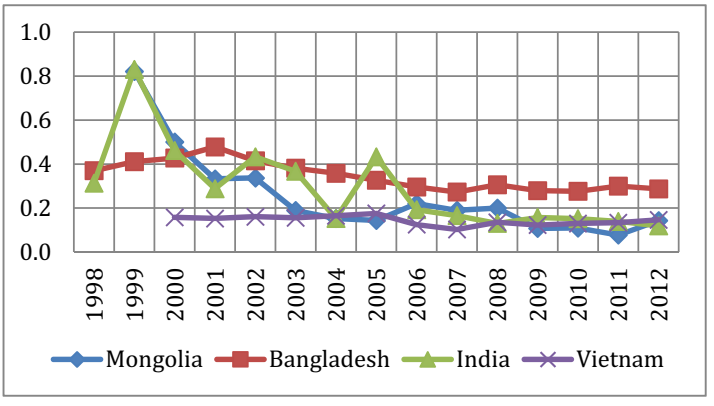
Source: MIX, www.mixmarket.org

4.5 Efficiency

In Chapter 3, we mentioned Efficiency indicators try to answer how well does the MFI control its operating costs. In this regard, from Figure 11, Operating expense ratio is decreasing for all countries. For instance, the ratio is decreasing significantly in Mongolia from 2008, as well as India from 2005. For Bangladesh, the ratio was decreasing continously from 2002 to 2007, and after that year, the ratio was more stabilized until now.

But in practice, efficient MFIs have an OER below 10 percent, so OER should continue to decrease for Efficiency cost.

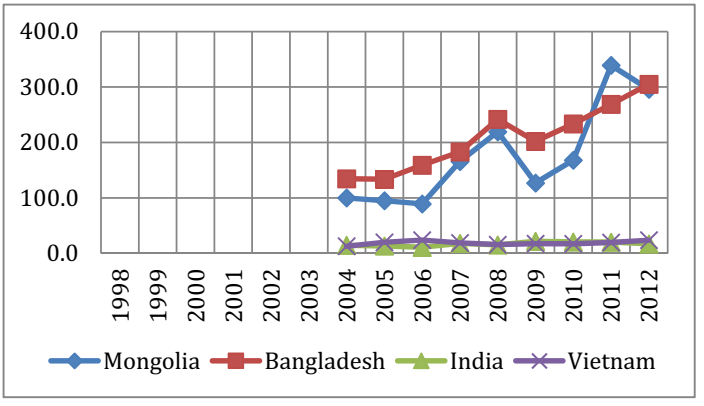
Figure 11 Operating expense ratio



Source: MIX, www.mixmarket.org

Figure 12 shows Cost per Client or Loan indicator which shows how much it costs the retail financial service provider to serve each client. For India and Vietnam, this indicator is lower than Mongolia and Bangladesh and more stabilized. For Mongolia and Bangladesh, this indicator is higher and still increasing continuously.

Figure 12 Cost per Client or Loan



Source: MIX, www.mixmarket.org

Finally, from above results, we tried to seek Regulation policy, which can improve the Performance indicators in the next Chapter.

CHAPTER FIVE

REGULATORY IMPACT ANALYSIS OF MICROFINANCE REGULATION IN FOUR ASIAN COUNTRIES

Since our study is trying to recommend good regulation policy in Mongolia by doing comparative analysis among other three Asian countries, we should determine what kind of regulation affected to Performance indicators from previous period analyze. Therefore, in this Chapter, in order to analyze linkage between Microfinance regulation and MFIs performance indicators we used RIA, particularly MCA according to explained each of them in Chapter 3.

This Chapter seeks to find how Performance indicators' condition increase by Regulation policies' changes to achieve main objective of our study. One thing is, of course, there is many kind of factors affect to Performance indicators, but in our study, we just tried to explore the impact of Regulation policy in Microfinance Performance.

5.1 Regulatory Impact Assessment of Microfinance Regulation in Four Asian Countries

As explained in Chapter 3, RIA is a methodology to measure the success of specific regulatory reforms. Particularly, we used MCA, which involves identifying the underlying policy objectives and then determining all of the indicators that would indicate achievement of these objectives.

First of all, we tried to find Regulation policy to achieve Regulation objectives. For doing so, we matched implemented Regulation policy, which explained in Chapter 2 to appropriate Microfinance Regulation objectives, which explained in Chapter 3 for Bangladesh, India and Vietnam.

Table 8 Regulation objectives of Implemented Regulation Policy in Bangladesh

Regulation Objective	Implemented Regulation Policy	
	Year	Policy determination
Promote safe and sound financial service providers	1996	Bangladesh Bank (BB) announced a new policy on Capital Adequacy along the lines recommended by the Basle Committee on Banking Supervision.
	1997	UNDP and UNCDF launched MicroStart. ASA is a MicroStart International Technical Service Provider.
Guard against systemic risk	1999	BB's revised policy on loan classification and provisioning for microfinance and agricultural credit issued.
	2003	The Money Loan Court Act of 2003 was enacted.
	2010	For the first time, SafeSave's savings portfolio surpassed its loan portfolio in value.
Establish a competitive	2004	The government created the NGO Foundation under a new Act of Parliament to accept funds from the government and donors for disbursement to small NGOs.

market	2006	The government has recently formulated some policy guidelines to streamline micro credit program operated by the different government agencies
Protect consumers	2000	BB set up a Microfinance Research and Reference Unit.
	2003	BB revised the Prudential Regulations in June 2003.
Improve access	1996	The World Bank set up the Consultative Group to Assist the Poorest (CGAP), and committed US$ 200 million to MFI programmes globally. Dr. Fasle Abed, founder of BRAC, was a member of its first Board.
	2001	Grameen Bank began to offer longterm savings products for the poor.
	2002	The Grameen Bank has recently formulated some policy guidelines to mobilise deposits.
	2003	The amount of BDT 180.21 billion had been disbursed as credit to about 2.78 million members of Grameen Bank in 390 *upzilas of 60 districts through 1,182 branches.*
	2003	PKSF established by the government in 1990.
	2003	The government acknowledged in its document "Interim Poverty Reduction Strategy Paper 2003" that micro-credit would play an important role in the country's poverty reduction strategy.
	2008	BB issued a revised draft of the Bangladesh Mobile Payment Guidelines.

Source: Table 4 and Table 7 in this research.

Table 9 Regulation objectives of Implemented Regulation Policy in India

Regulation Objective	Implemented Regulation Policy	
	Year	Policy determination
Promote safe and sound financial service providers	1996	RBI started to regulate NBFIs from 1996 to protect consumers and improve MFIs efficiency.
	1999	RBI set up a "Micro Credit Special Cell" to support MFIs.
	2000	As regards Non-Banking Financial Companies, the RBI issued instructions to the effect that if NBFCs are engaged in 'micro-financing activities', registered under Section 25 of the Companies Act.
	2000	The central bank advised that banks are free to choose their own model for extending microcredit.
	2006	Interest rate ceilings were made more flexible and each bank was required to limit the rate on small loans to its guideline prime lending rate.
	2010	All ceilings on interest rates have been abolished and banks are free to set rates on all loans on the basis of their own commercial considerations.
Guard against systemic risk	-	-
Establish a competitive market	1996	RBI issued instructions to the banks to treat the SHG-bank linkage model as part of their mainstream lending.
	2002	The RBI constituted four informal groups for addressing various aspects of microfinance including regulatory arrangements and funding issues.
	2008	The work of the Committee on Financial Inclusion (Rangarajan Committee) in 2008 discussed the nature and extent of financial exclusion and suggested suitable measures
Protect consumers	1996	The RBI announced the beginning of regulation and supervision ignored component of the financial sector.
Improve access	2000	The RBI recommended simplification of loan documentation and decentralisation of the loan decision by delegating more power to branch managers.
	2000	Other than for small loans given directly by banks to small borrowers, the interest rate for loans to MFIs and for MFIs lending to the ultimate borrower were fully liberalised.
	2010	The Government and the Central bank set goals to provide by 2015 all 600,000 villages in India with a banking outlet (either by a branch or a retail agent

Source: Table 5 and Table 7 in this research.

Table 10 Regulation objectives of Implemented Regulation Policy in Vietnam

Regulation Objective	Implemented Regulation Policy	
	Year	Policy determination
Promote safe and sound financial service providers	2002	The Government announced that credit institutions are free to set their own interest rates (with the exception of VSPB).
Guard against systemic risk	2010	The Law on Credit Institutions requires regulated MFIs to publish rates and fees.
Establish a competitive market	1997	The government of Belgium has provided financial support to the strengthening of VWU's institutional capacity in managing credit and savings activities.
	2005	The Government of Vietnam passed Decree no. 28 on the "Organization and Operation of Micro-finance Institutions" in Vietnam to provide a specific legal and regulatory framework for microfinance
Protect consumers	2003-2005	The "Extension of Microfinance and Micro insurance to informal women workers"project is an action research project.
	2004	The Microfinance Working Group was established to support the approval and implementation of the decree on microfinance.
Improve access	1996	A not-for-profit Vietnam Bank of the Poor (VBP) was established to alleviate poverty.
	1997	The Hunger eradication and Poverty Reduction (HEPR) launched by the Vietnamese government to improve poor people's access to financial services, especially in rural regions.
	2000	The government issued Official Letter to allow the WU to continue implementing the savings program for HEPR.

Source: Table 6 and Table 7 in this research.

After determining Regulation objectives of implemented Regulation policy in each countries, we made MCA by indicating impact of Regulation objectives. We supposed that any performance indicators' changes affected by previous 2 years and current year Regulation policy changes.

For instance, In Table 11, The Number of Active clients are increasing from 2002 to 2007 in Bangladesh, so we supposed the increase in the Number of clients was affected by Regulation policy of three years, which is from 2000-2002. In this period Bangladesh Regulatory took attention on Regulation objective 5 which is Improve access.

Table 11 The impact of Regulation policy in Performance indicators

		1996	1997	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Regulation objectives	Bangladesh	O 1, O 5	O 1	O 2	O 4	O 5	O 5	O 2, O 4, O 5	O 3		O 3		O 5	O 5	O 2		
	India	O 1, O 3, O4		O 1	O 1, O 5		O 3				O 1		O 3		O 1, O 5		
	Vietnam	O 5	O 3, O 5		O 5		O 1	O 4	O 4	O 3, O 4					O 2		
The Number of Active clients	Bangladesh						+	+		+	+	+					
	India									+			+	+	+		+
	Vietnam							+			+		+	+		+	
Average Outstanding Balance	Bangladesh														+		+
	India													+			+
	Vietnam										+	+					+
Average Outstanding loans per client/ GNP per capita	Bangladesh			+					+	+		+	+		+		+
	India			+					+			+					+
	Vietnam								+	+							+
Portfolio at Risk	Bangladesh							+				+					+
	India				+	+	+		+			+				+	+
	Vietnam					+		+						+	+		
Loan Loss Rate	Bangladesh				+	+	+		+	+	+						
	India			+						+							+
	Vietnam												+				
Write-off Ratio	Bangladesh					+			+								
	India			+					+								+
	Vietnam													+			
Return on equity	Bangladesh																+
	India					+			+								
	Vietnam				+												+
Return on equity	Bangladesh										+					+	+
	India			+		+			+		+					+	
	Vietnam																
Operating Expense Ratio	Bangladesh						+	+		+	+			+			
	India				+	+		+	+		+	+	+				
	Vietnam										+						
Cost per client or Loan	Bangladesh													+			
	India										+		+				+
	Vietnam											+	+				

* O 1 - "Regulation Objective 1" which is Promote safe and sound financial service providers;
O 2 - "Regulation Objective 2" which is Guard against systemic risk;
O 3 - "Regulation Objective 3" which is Establish a competitive market;
O 4 - "Regulation Objective 4" which is Protect consumers;
O 5 - "Regulation Objective 5" which is Improve access.

From the result of Table 9, we matched Regulation objectives to Performance indicators, which can assess directly if implemented regulation policy achieve to that Regulation objectives. From Table 9, We can use implemented regulation policy to achieve objective that Promote and sound financial service providers to improve Financial sustainability indicators.

Table 12 The linkage between Regulation objectives and Performance indicators

Regulation objectives	**Performance indicators**
Promote safe and sound financial service providers	Financial sustainability
Guard against systemic risk	Portfolio quality
Establish a competitive market	Efficiency
Protect consumers	Financial sustainability
Improve access	Depth of outreach
	Breadth of outreach

Source: Table 11 in this research

5.2 Policy Recommendation in Mongolia

Our study's final goal is that find out appropriate Regulation policy to increase Microfinance Performance. In Chapter 4, we assessed Microfinance Performance indicators in four countries and now we should demonstrate the recent fact of Microfinance Performance indicators to recommend Regulation policy.

However the number of active clients is increasing, but Depth of outreach indicators are still very high, it means Microfinance sector don't achieve to its main goal, which provide financial services to the poor people in Mongolia. For Portfolio quality indicators, Portfolio at

risk ratio was very fluctuating early years of our study, and this was decreasing from 2010 to 2011, but in 2012, this ratio increased again. Fortunately, Financial sustainabilty indicators are very good in Mongolia compare to other three countries. For the last indicator, eventhough Operating expense ratio is decreasing year by year, Cost per Cleint is increasing a lot. On the other hand, the result of Section 5.1, we determined which kind of Regulation policy more affect to Microfinance Performance indicators.

Thus, we can recommend Regulation policy which can improve Performance indicators by using a view of the fact of Performance indicators in Mongolia from above results, and the linkage between Regulation policy and Performance indicators. Also from the fact of Mongolian Performance indicators, we took attention more on the Regulation policy, which can improve the indicators that Breadth of outreach, Depth of outreach, Portfolio quality, Efficiency.

Policy recommendation:

Generally, Regulation authority, which is FRC provide sound and supportive regulation for Microfinance. Herein:

To Improve Breadth of Outreach:

- Microfinance regulation policy should not focus on just on strict regulation, but should ac t as an support for sustainable Microfinance. FRC should maintain its public support for t he policies of the National Strategy for Microfinance and, in particular, the need to provid e an enabling environment so that the private sector might;

- Issue a deposit insurance for the poor;
- Should pay attention on support to rural branches to provide Microfinance;

To decrease Depth of Outreach:

- Implement special programm or project under the Government control, because Governm ent subject to political rather than commercial imperatives. These political imperatives im pair the sustainability of institutions that provide financial services to the poor.
- Support and promote to implement Microfinance for the Banks;
- Implement a successful social mobilization and empowerment program to precede the cre dit delivery, even the poorest of the poor stand to benefit from microfinance;
- Promote NGO-MFIs activities to achieve to the very poor people.

To decrease Portfolio Quality:

- Regulators should promote market driven interest rate and credit policies;
- Improve the control on MFIs' loans size and demonstrate limitation on loans;
- Promote self regulation within MFIs, checked by market discipline.

To increase Efficiency:

- Support to Banks which provide Microfinance;
- Facilitating regulatory framework for mobile banking that is yet to emerge;
- Recommend to simplification of loan documentation decentralisation of the loan decision by delegating more power branches.

CHAPTER SIX

CONCLUSION

Generally, the Microfinance sector in Mongolia, Bangladesh, India and Vietnam has grown significantly in the last decade. From the result of Performance indicators, the indicators are very fluctuating year by year and there are not stabilization in Microfinance sector. On the other hand, these 4 countries' regulatory framework improved compare to the decade before last decade, but it does not seem to have got the regulatory framework right. It does not meet the sector's needs for sustainable growth.

Our paper assessed the impact of the regulatory policy of the MFIs in Microfinance Performance indicators in four Asian countries, which are Bangladesh, India and Vietnam. From Cross comparison analysis, we seek to find out appropriate Regulation policy to improve Microfinance Performance indicators in Mongolia.

From the results, MFIs have good fact for just one indicator, which is Financial sustainability, but other four Performance indicators, which are Breadth of outreach, Depth of outreach, Portfolio quality, Efficiency do not have good improvement from 1998 to 2012 in Mongolia. Therefore, we took more attention on those Performance indicators that do not have good improvement to recommend policy recommendation. We had good oportunity to recommend Regulation policy for Microfinance because of determining which kind of Regulation policy more affect to Microfinance Performance indicators.

Finally, we tried to recommend main regulation policy that can generalize and make a case for better regulation to improve Microfinance institutions' Performance in Mongolia from other three Asian countries' good experience by doing comparative analysis in Chapter 5.

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