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An Overview of the Microfinance Sector in Bangladesh

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Abstract

Purpose - While microfinance institutions (MFIs) from Bangladesh, such as Grameen Bank, received worldwide recognition and the Nobel Peace Prize in 2006, however, there is a paucity of research that provided a comprehensive discussion on the characteristics of the microfinance industry. Hence, the aim of this paper is to discuss some important aspects of the microfinance sector in Bangladesh.

Research design, data, and methodology - This study used secondary sources of data, such as annual reports of the Microcredit Regulatory Authority (MRA) and the World Bank database in its descriptive analysis.

Results - This study found that Bangladesh has made remarkable progress in her socio-economic and economic development in the last few decades. It is also generally perceived that microfinance has placed significant contribution on such socio-economic development. While microfinance observed unprecedented growth domestically, however, the regulatory framework is still rather weak, and a majority of the MFIs are found to be concentrated in the well-off areas (e.g., Dhaka, Chittagong etc.).

Conclusions - The findings are significantly important for the parties who are interested to know the microfinance sector in Bangladesh. To some extent, the findings of this study will provide policy implications that may benefit the industry.

Keywords: Microfinance, Microfinance Institutions, Microcredit Regulatory Authority, Governance, Bangladesh.

JEL Classifications: G21, O21.

1. Introduction

Microfinance initiated by a Bangladeshi banking innovator Professor Muhammad Yunus and it becomes an important development tool to alleviate poverty, women empowerment and promote entrepreneurship in the developing world. Microfinance means providing financial services to the impoverished. The novelty of microfinance is to stimulate development by financial inclusion of the commercially excluded people through meeting their financial and non-financial needs. The visible long-term success of microfinance as an attempt to combat poverty and other socio-economic development enlighten the appeal of

microfinance under the aegis of multilateral organisations (e.g., the World Bank, the United Nations, the Aga Khan Foundation), private donors and individual investors. Due to the tangible effect of microfinance on poverty alleviation and socio-economic development, Professor Yunus won the Nobel Peace Prize along with his Grameen Bank in 2006.

Microfinance has been operating in Bangladesh for almost forty years. In 2014, over 33 million of clients (including Grameen Bank) are being served with various financial and non-financial services by over 700 registered microfinance institutions (MFIs) in Bangladesh (MRA, 2015). To examine the effect of microfinance on clients' level, a vast amount of researches have been dedicated and still adding on a regular basis. A simple screening of the existing literature can modestly help someone to draw a conclusion that results are mix. Microfinance has positive (Imai & Azam, 2012; Imai, Gaiha, Thapa, & Annim, 2012; Khandker, 2005; Mazumder & Lu, 2015; Quayes, 2012, 2015; Swain & Floro,

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2012) and negative or no effect on clients level (Bateman, 2012; Ghosh, 2013; Morduch, 1999, 2000; Roodman & Morduch, 2014). However, it should be noted that microfinance is not a 'panacea' or 'utopia' than a bridging gap in the conventional banking system (Singh & Mehta, 2012). While this study agrees that microfinance has been mistakenly introduced in countries without a significant segment of hard-core poor, the empirical evidence from Bangladesh alone is sufficient to reject such claims, especially if it is viewed as a viable instrument to finance the unbanked to uplift them from abject poverty.

Although several MFIs from Bangladesh become a role model in the developing world, such as Grameen Bank and Bangladesh Rural Advancement Committee (BRAC), however, there is a paucity of research that discuss an overview of the microfinance sector at large. Recently, Mia (2016) provided a summary of the microfinance industry in Bangladesh based on the various legal status of MFIs. Nevertheless, there are some other institutional aspects of microfinance that warrants further discussion. Hence, the objective of this study is to provide an overview of the microfinance industry in Bangladesh. In doing so, this study comprehensively discusses the relevance of microfinance by providing an overview of the socio-economic development of Bangladesh, regulatory framework, governance structure and geographical distribution of MFIs. Moreover, Bangladesh became the obvious choice for this study because microfinance in its strict sense originated from there and had the most extensive operations in the world.

The organisation of this study is as follows. In section 2, this study briefly discusses the socio-economic and economic indicators of Bangladesh. A comprehensive discussion of the microfinance industry is presented in Section 3. Then, section 4 concludes the study with some policy implications.

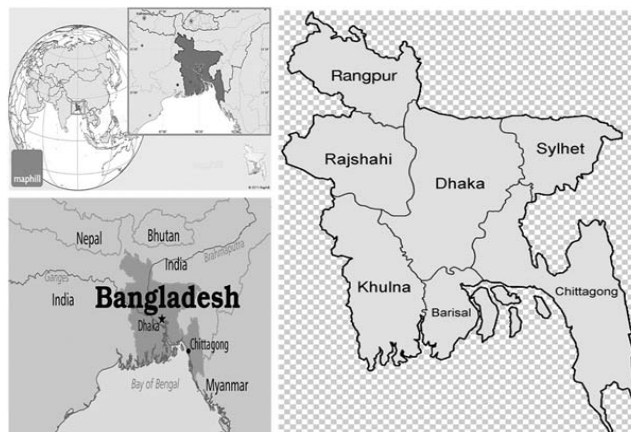
2. Bangladesh at a Glance

Microfinance is an integral part of an economy and the growth of this financial innovation depends to a large extent on the socio-economic, macroeconomic and financial stability of a country. Thus, understanding key characteristics of a country where microfinance is an ongoing policy intervention for poverty alleviation is crucial both for academicians and policymakers. This section briefly discusses key information about Bangladesh, followed by her socio-economic and economic development.

Bangladesh, officially the People's Republic of Bangladesh, is located in South Asia, surrounded by India and Myanmar (Burma) on the west and east, respectively, and by the Bay of Bengal to the South (<Figure 1>). Bangladesh is ranked the 7th most populous country in the world. Bangla is the official language, as well as the 7th

most spoken language in the world, shared by some Indian states such as West Bengal, Assam, and Tripura. The majority of the population is Muslim, accounting for roughly 88% to 90% of the population, and the remaining 10% to 12% are Hindus, Buddhists and others. The Padma, Meghna, and Jamuna, which are the three largest rivers in Asia, pass through Bangladesh, thus creating opportunities for millions of people to make their living in fishing and other related industries.

Politically, the government structure is a 'Unitary Parliamentary Constitutional Republic'. Administratively, Bangladesh has 7 divisions (highlighted in Figure 1). From an economic standpoint, Bangladesh has been included in the Next-11 (N-11) countries identified as having high potential to be the largest economy in the world by Goldman Sachs and 'Frontier Five' by JPMorgan (Rahman, 2013). Moreover, Bangladesh is a founding state of the South Asian Association of Regional Cooperation (SAARC), which was headed by Late President Ziaur Rahman in 1985. Recent papers by Mia, Nasrin, Zhang, and Rasiah (2015) and Noman et al. (2016) could provide important information on the major cities in Bangladesh, Chittagong and Narayanganj, respectively.



Source: Author's compilation

<Figure 1> Geographical Location of Bangladesh

2.1. Socio-Economic Status

Bangladesh has made remarkable strides in socio-economic aspects, including literacy, employment, mortality, fertility and other socio-economic wellbeing indicators. Above all, the most significant improvement has been seen in the areas of poverty alleviation and women empowerment. These socio-economic developments in Bangladesh are remarkable among developing countries, placing Bangladesh in the forefront of the media as a successful development story (Dhume, 2010; Ramesh, Pande, & Bhandari, 2012; The Economist, 2012).

<Table 1> Socio-Economic Status of Bangladesh (1990-2013).

Items	1990	2000	2006	2010	2013
Population Indicators					
Population, total (millions)	105.983	131.280	144.839	151.616	157.157
Population growth (annual %)	2.467	1.949	1.327	1.135	1.216
Population density (people per sq. km of land area)	814	1008	1112	1164	1207
Urban population growth (annual %)	4.925	3.608	3.934	3.638	3.573
Social Indicators					
Life expectancy at birth, total (years)	58.418	65.348	68.426	70.080	71.245
Fertility rate, total (births per woman)	4.494	3.169	2.600	2.332	2.209
Mortality rate, under-5 (per 1,000)	143	88	63	49	41
Immunization, measles (% of children ages 12-23 months)	65	74	83	88	89
Prevalence of HIV, total (% of population ages 15-49)	0.100	0.100	0.100	0.100	0.100
Gross enrolment ratio, primary, both sexes (%)	81.048		99.401	100	
Gross enrolment ratio, secondary, both sexes (%)	20.401	48.110	46.098	50.119	58.309
Government expenditure on education as % of GDP (%)	1.519	2.125	2.131		1.966
Health expenditure, public (% of GDP)		0.947	1.039	1.050	0.810
Improved water source (% of population with access)	68.100	76.000	80.600	83.500	85.500
Improved sanitation facilities (% of population with access)	34.400	45.400	51.800	55.800	58.700
Mobile cellular subscriptions (per 100 people)	0.000	0.211	13.206	44.945	74.430
Internet users (per 100 people)	0.000	0.071	1.000	3.700	6.630
Poverty Indicators					
Number of poor at \$1.90 a day (2011 PPP) (millions)		78.729	73.723	66.181	
Number of poor at \$3.10 a day (2011 PPP) (millions)		111.287	116.488	117.670	
Poverty gap at national poverty lines (%)		12.800	9.000	6.500	
GINI index (World Bank estimate)		33.060	32.730	31.980	

Source: Author's compilation from World Development Indicators.

Bangladesh has observed significant improvements in terms of life expectancy at birth from 58 years in 1990 to 71 years in 2013, equivalent to a 22% increase in the last 23 years (roughly 1% increase in life expectancy per year). Despite being one of the most densely populated countries in the world (1,207 people per km²) with a total of 157 million people at the end of 2013, the population growth rate has remained relatively stable at 1.2% to 1.3% in the last decade. However, the urban population growth is double the national average in most of the years, perhaps due to the greater push-and-pull and industrial development in urban areas. Progress can also be seen in the provision of primary and secondary education for both males and females. The government of Bangladesh secured 100% primary education for the people, and the participation in secondary education increased threefold from 1990 to 2013.

In terms of health indicators, remarkable progress has been observed in the areas of immunisation, mortality rate, access to clean water and improved sanitation. Apart from government intervention, NGO-MFIs have placed significant emphasis on such developments (Loewe & Rippin, 2015;

Pronyk, Hargreaves, & Morduch, 2007). However, the public health expenditure of 0.81% GDP remains relatively low (six times lower than the world average) as compared to other countries in the South Asian region. For example, in 2013, the public health expenditure (as a percentage of GDP) was 1% in Pakistan, 1.1% in India, 2.1% in Sri Lanka, 2.2% in Bhutan, 2.2% in Nepal, and 8.3% in Maldives (World Bank, 2015). Interestingly, the HIV prevalence among adults has remained static throughout the years. While looking into the technology usage, almost two-thirds of the total population use cellular phones despite a low level of internet usage. However, the trend of technology usage has substantially increased in the recent years.

2.2. Economic Indicators

<Table 2> reports the recent development of Bangladesh based on economic indicators. Economically, Bangladesh has substantially improved conventional indicators such as GDP per capita and GDP growth. GDP per capita has increased threefold since 1990, standing at US\$954 in 2013. In terms

of purchasing power parity (PPP), the per capita GDP was well over US\$3000 in 2013 and maintain a balanced GDP growth of 5% to 6% per annum in the last decade. The gross domestic savings also increased twofold from 1990 to 2000 and then remained relatively stable at around 20% thereafter. The financial sector development has placed a significant role in mobilising the people's deposits, and MFIs have played a particularly crucial role in increasing domestic savings for the poor. The gross capital formation also shows an increasing trend. However, there is a deficit of government finance for the observed years in 2006 and 2010.

Looking further into the economic structure, the contribution of industry and services to GDP has gradually increased whereas agriculture has observed a declining trend over the years. The contribution of agriculture in GDP accounted for roughly 16% in 2013, half of the figure

compared to the 1990s. This shows that Bangladesh was once an agrarian economy but is gradually transforming into an industry and service-based economy. Although the net export has remained negative in the selected years, exports have quadrupled from 1990 to 2013, while imports have doubled in the same period. This indicates the openness of the Bangladesh economy, as well as greater vulnerability to international shocks or turbulence.

Developments in the financial sector, as measured by the domestic credit provided by the financial sector, have increased three times since the initial year of 1990. Nonetheless, the broad money that measures the supply of money in a country comprises more than physical money, for example, currency and coins increased threefold between 1990 and 2013.

<Table 2> Economic Indicators of Bangladesh (1990-2013).

Items	1990	2000	2006	2010	2013
Income and Growth					
GDP per capita (current US\$)	298	406	495	760	954
GNI per capita, PPP (current international \$)	850	1350	1980	2600	3180
GDP growth (annual %)	5.622	5.293	6.672	5.572	6.014
Savings and Investment (% of GDP)					
Gross Domestic Savings	9.309	19.175	20.739	20.492	21.169
Gross capital formation	16.459	23.809	26.144	26.247	28.390
Government Finance (% of GDP)					
Revenue (excluding grants)			8.778	9.744	
Tax revenue			7.043	7.835	
Cash surplus/deficit			-1.241	-0.814	
Economic Structure (% of GDP)					
Agriculture, value added	32.753	23.773	19.008	17.810	16.276
Industry, value added	20.697	23.314	25.397	26.144	27.636
Services, etc., value added	46.550	52.914	55.594	56.045	56.088
Trade (% of GDP)					
Exports of goods and services	5.908	12.344	16.353	16.024	19.538
Imports of goods and services	13.058	16.978	21.758	21.779	26.759
Money and Credit (% of GDP)					
Broad money	22.447	30.554	50.476	58.746	61.400
Domestic credit to private sector	16.074	21.779	31.166	40.961	41.795
Domestic credit provided by financial sector	21.631	30.178	50.105	57.408	57.922
Other Items					
Inflation (annual %)	6.127	2.208	6.765	8.127	7.530
Total debt service (% of exports of goods, services and primary income)	34.160	10.601	5.374	4.293	5.283
Personal remittances (current US\$ billion)	0.779	1.967	5.427	10.850	13.866
Net FDI, (BoP, current US\$, billion)	0.324	0.280	0.456	1.232	2.603
Net ODA and official aid received (current US\$, billion)	2.092	1.173	1.221	1.403	2.629

Source: Author's compilation from World Bank database.

Personal remittance has also substantially increased due to the recent increase in export of manpower. Although the net FDI is positive; an indication of better domestic investment opportunities, the net development assistances have shrunk from 2000 to 2010 and slightly increased in 2013. Another good indicator of financial wellbeing could be the debt services that have substantially declined over the years, hinting that Bangladesh has attained a better financial position. However, the inflation rate has remained relatively higher (7.5% in 2013) despite a low level of inflation at 2% in the year of 2000.

3. Microfinance in Bangladesh

In this section, some key characteristics of the microfinance industry in Bangladesh are presented, including the regulatory framework, governance structure of the MRA, and locations of the head offices of MFIs.

3.1. Regulatory Framework

The microfinance sector has flourished as a private initiative all around the world and in Bangladesh in particular. Initially, the sector was not regulated, and there was neither a stratagem nor an independent regulatory authority to control and supervise microfinance in Bangladesh. Before 2006, MFIs were registered under different acts. Following remarkable success and spectacular growth, the microfinance sector worldwide has gradually come under regulations, either through existing bank legislations or independent regulatory authorities. In 2006, almost three decades after the initiation of microfinance in Bangladesh, an independent regulatory authority was established, known as the Microcredit Regulatory Authority (MRA) (Law 32 of the year 2006). The original aim behind the establishment of the MRA was to create a conducive and healthy environment for microfinance practices across the country and to secure the interests of clients of MFIs without altering the long-term sustainability of MFIs. To achieve these two goals, MRA has provided detailed guidelines for MFIs to enhance governance practices. Additionally, they advocate for prudential policy design, greater competition, productivity and efficiency for long-term sustainability of the sector (MRA, 2015).

The MRA was set up in 2006 as a culmination of several short-term regulatory committees and commissions. For example, in 1997, the Central Bank of Bangladesh commissioned a study to examine the viability of regulatory aspects of MFIs and a formal committee was formed in 2000 for this purpose. Based on the recommendation of the commission, the government then took necessary steps to establish a formalised independent authority to monitor and control the sector. Six years after forming the committee, the

government finally enacted the 'Microcredit Regulatory Authority Act 2006' in 2006. Since then, the MRA has been responsible for bringing the microfinance sector under a full-fledged regulatory framework.

With the enactment of the Act, all NGO-MFIs are now under the control of MRA. However, other types of MFIs, such as cooperatives, credit unions, non-bank financial institutions, and state-owned or commercial banks (that provide microfinance) are not under the jurisdiction of the MRA. Rather, they are supervised under the Acts of their respective authorities, from which they have obtained their operating licenses. These types of MFIs are also beyond the scope of this study as they do not have comprehensive data. Thus, constitutionally, MRA is the only legal entity that monitors and supervises NGO-MFIs operational activities in Bangladesh.

Each MFI requires a license from the MRA to carry out microfinance activities in the country. The registration process of MFIs is accomplished in two steps. First, an MFI should get a license from the NGO Affairs Bureau of Bangladesh to be eligible to register under MRA. After receiving the application, the MRA designates a provisional period to observe the performance of the MFI. Depending on the MFI's performance during the provision period, a license to operate microfinance programs may be granted. NGO registration can be done under any of the following existing Acts in Bangladesh;

- I. The Societies Registration Act, 1860 (Act XXI 1680)
- II. The Trust Act, 1882 (Act II of 1882)
- III. The Voluntary Social Welfare Agencies (Registration and Control) Ordinance, 1961 (Ordinance number, XLVI of 1961)
- IV. The Companies Act, 1994 (Act XVIII of 1994)

To ensure transparency and accountability of microfinance operations and activities, the authority is also in charge of withdrawing licenses if MFIs fail to comply with requirements set by the MRA. There are several criteria to obtain a license, such as the minimum number of loans outstanding and the number of borrowers that needs to be maintained. Moreover, individual MFIs are also obliged to report prescribed data twice a year and financial data once a year to the MRA. These data are consequently published as annual reports by the MRA.

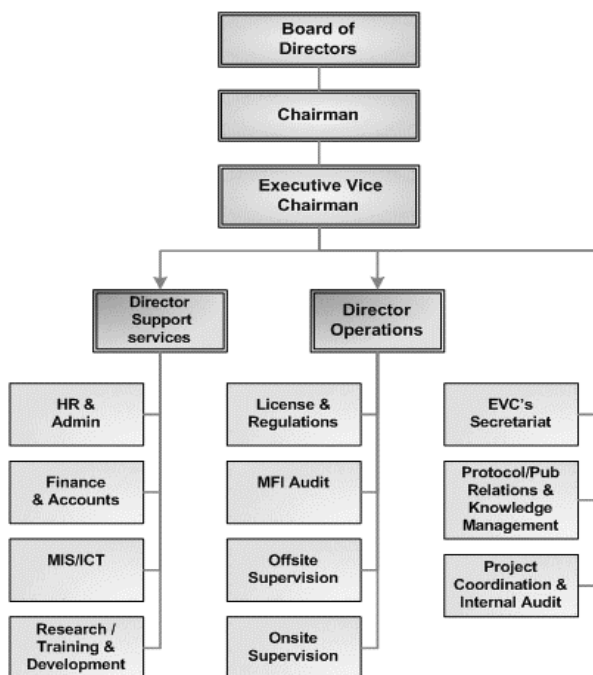
3.2. Governance Structure and Scope of the MRA

<Figure 2> shows the organogram of the MRA. Based on data provided by the MRA, there is a total of 63-65 personnel headed by an Executive Vice Chairman and 7-8 members on the Board of Directors. Under the Director of Operations, 9 staff members are responsible for onsite supervision and 4 are in command of audit and offsite supervision. This small human resource pool is certainly

insufficient to supervise and control a sector with over 33 million clients and more than 700 MFIs (MRA, 2015). Implementing the acts and regulations of MRA requires significant manpower, fiscal strength and collaboration of the associated parties.

Generally, MRA announces rules targeted to MFIs or associated parties through circulars. Up to July 2016, there were a total of 36 published circulars, the majority of which are rules and regulations meant for MFIs. However, more comprehensive amendments were published in 2010 and 2014. The 2010 amendment broadly discusses registration procedures, the structure of MFIs and their governing body, operational activities of MFIs (such as sources of funds), rights of the clients, products and services, and other relevant issues in the industry. The 2014 amendment added several clauses related to the governance practices of MFIs and extended rules related to the deposits of the clients. Recently, another important initiative of MRA is to publish legal notices on its official website if the license of an MFI has been cancelled or terminated. The aim of such initiative is to better inform the clients and relevant authorities, such as funders, as the information becomes easily accessible and available to the masses.

Ultimately, the main limitation of the MRA is its weak and low institutional capacity. The microfinance sector is large and scattered across the country, whereas a centralised regulatory authority has limited operational capacity. To achieve its aim, the MRA should have regional offices for effective monitoring and control of microfinance activities.

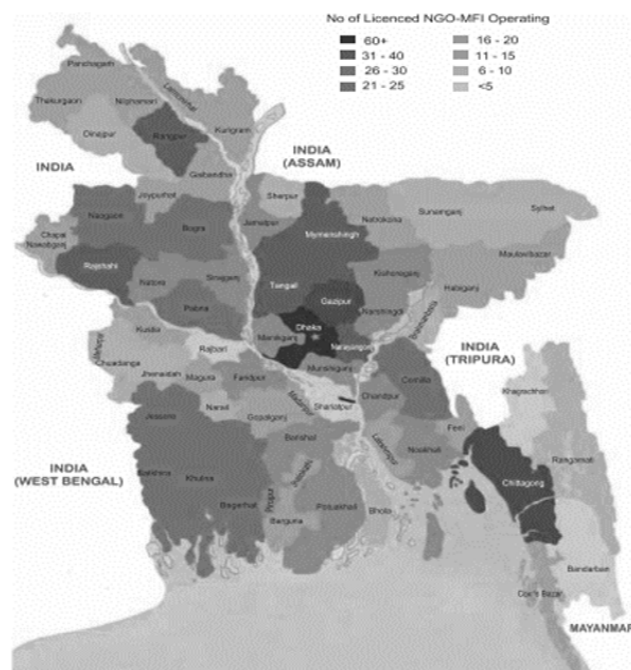


Source: Adapted from MRA (2015)

<Figure 2> Governance Structure of the MRA

3.3. Geographical Distribution of MFIs

MFIs in Bangladesh are scattered across the country. <Figure 3> shows that most of the MFIs are highly concentrated in the capital of regional division such as, Dhaka and Chittagong (the birthplace of microfinance) in 2010. Economically these areas are better than other divisional districts due to their diverse economic activities (Bangladesh Bureau of Statistics, 2011). Although the southern part of Bangladesh is mostly vulnerable to natural disasters and severely poor, the concentration of MFIs is very less to those areas in comparison to other parts of the country.



Source: Adapted from MRA (2010).

<Figure 3> Geographical Concentration of NGO-MFIs (2010)

This is very much similar to the findings of Sharma and Zeller (1999) where the duo claimed that most of the MFIs or their branches have a tendency to locate in well-established developed areas compared to very remote and poor region. However, MFIs may also find it easy for setting their businesses in those areas for greater connectivity, easy accessibility to the resources and other economic synergies.

3.4. Locations of the Head Offices of MFIs

The majority of the head offices of MFIs are located in the Dhaka division, particularly in Dhaka districts, including Grameen Bank, BRAC, Association of Rural Advancement (ASA), Thengamara Mohila Sabuj Sangha (TMSS), Basic Unit for Resources and Opportunities of Bangladesh

<Table 3> Division Wise Head Office of the MFIs.

Division	June, 2009		June, 2010		June, 2011		June, 2012		June, 2013		June 2014	
	MFIs	%	MFIs	%	MFIs	%	MFIs	%	MFIs	%	MFIs	%
Dhaka	195	46.6	240	45.78	269	46.38	273	44.17	294	42.61	302	43.33
Rajshahi	78	18.2	97	19.06	105	18.1	86	13.92	95	13.77	95	13.63
Rangpur							34	5.5	36	5.22	36	5.16
Khulna	64	15.53	73	14.34	82	14.14	91	14.72	107	15.51	109	15.64
Chittagong	51	12.14	66	12.79	81	13.97	92	14.89	106	15.36	101	14.49
Barishal	23	5.58	30	5.89	33	5.69	32	5.18	38	5.51	39	5.60
Sylhet	8	1.94	10	1.96	10	1.72	10	1.62	14	2.03	15	2.15
Total	419	100	516	100	580	100	618	100	690	100	697	100

Source: Authors compilation from various MRA annual reports.

(BURO-Bangladesh) and other leading MFIs. Although some of the MFIs originated from other parts of the country, they have established their head offices in Dhaka (for example, TMSS and Grameen Bank, Gram Unnayan Karma – GUK). This is due to the accessibility, facilities and other associated locational advantages that enhance MFIs' domestic and international connections. The second largest number of MFIs was once in the Rajshahi division. With the emergence of the new Rangpur Division in 2010, the Rajshahi division stood at 4th place after Khulna and Chittagong in 2014. The number of head offices in Khulna gradually increased and exceeded the Chittagong division in 2014, while the number of MFIs in the Sylhet division remained stable from 2009 to 2012 and increased slightly in 2013 and 2014.

4. Conclusions

This study provided a comprehensive discussion on the microfinance industry in Bangladesh which is one of the largest and oldest in the world. In doing so, some key characteristics of Bangladesh that includes socio-economic macroeconomic indicators are discussed. Based on the discussion, it is observed that Bangladesh has made remarkable progress in both dimensions. However, since the poverty remains acute in Bangladesh (Mia, 2016), the importance of microfinance is crucial. Hence, this study discussed some of the key characteristics of the

microfinance industry of Bangladesh.

One of the remarkable institutional developments in the microfinance industry is the establishment of the MRA in 2006. The MRA now controls and supervises the industry to ensure smooth flow of credit and sustainability of the sector. However, this study pointed out the weak institutional and fiscal strength of the MRA, which is insufficient to control such a vast sector. The government should expand the activities of the MRA and allow it to exercise its fiscal strength to promote sustainability in the industry. Nonetheless, the study also found that MFIs have a tendency to locate themselves in well-established areas that are financially better off. However, as the original aim of MFIs is to provide banking and financial supports to the poor, relocating MFIs in a poor and vulnerable areas, such as to the northern and southern of Bangladesh is deemed to be necessary.

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