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Bridging the "missing middle" between microfinance and small and medium-sized enterprise finance in South Asia

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ADB Working Paper Series

**Bridging the “Missing Middle” between Microfinance and
Small and Medium-Sized Enterprise Finance in South Asia**

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Abstract

With maturity in the microfinance market in South Asia, it is observed that some microfinance members' needs grow beyond the boundaries of traditional microfinance group loans. In addition, there are other small enterprises whose needs are not met by microfinance institutions or commercial banks. It is important to address the financing needs of these firms given their employment potential, and hence this issue is on the policy agenda of the three countries studied in this paper: India, Bangladesh, and Pakistan. Drawing on interviews with chief executives of lending organizations and desk research, this paper reviews the options currently available to such firms in each country, the lending models being used, and recent policy initiatives to promote them. Based on the country experiences, the features of successful lending models for this segment and the specific challenges that need to be addressed are summarized and conclusions drawn.

JEL Classification: L22, L25, O16

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1. INTRODUCTION

In recent times, financial inclusion has been on the policy agenda of many developing countries. An inclusive financial system implies availability of a continuum of financial services for all income groups, namely a seamless range of financial services with no gaps in provision. The idea is that an inclusive financial system provides credit to all bankable individuals and firms, insurance to all insurable individuals and firms, and savings and payment services for everyone (United Nations 2006). Financial inclusion does not imply that everyone will use all available financial services, but rather that everyone has the option to use them.

In the case of enterprise credit, loans of various sizes need to be provided by a range of financial institutions in the system. This implies that if microfinance institutions (MFIs) provide loans up to a certain amount, loans just above that threshold need to be provided by another kind of institution, without a gap in between. Often, the same entrepreneur's credit needs may vary with changes in the size and needs of the enterprise.

As a result of the emphasis placed on financial inclusion, many developing countries in Asia have facilitated the development of microfinance sectors. South Asia, Bangladesh, India, and Pakistan have large and vibrant microfinance sectors. However, not enough attention has been paid in the past to carving out a route for MFI borrowers who outgrow microfinance. With maturity of the microfinance sector, there are likely to be some "MFI graduates" who need to be serviced by another institution in the system. These borrowers are still too small to avail themselves of small and medium-sized enterprise (SME) credit from commercial banks, but their loan sizes are often far higher than the upper threshold of microcredit.

The term "missing middle" is generally used to describe the disproportionately small number of small and medium-sized enterprises as compared with the number of micro and large enterprises in many developing countries (Ayyagari et al. 2005). Here, however, it is used more specifically to refer to the lack of financing options for enterprises whose needs fall in between the typical loan sizes offered by MFIs and commercial banks.

A study in India found that once an individual gains access to microfinance, three kinds of outcomes are possible (Shankar 2015). The first kind of outcome is in the case of MFI borrowers who utilize their loans primarily for their business activity and whose businesses generate sufficient margins after payment of principal and interest. These individuals experience rapid increases in income on account of microcredit and often become eligible for individual loans from their MFI if the organization provides such loans. Such borrowers may be categorized as "effective utilizers." A second category of MFI borrowers utilizes the loan for their own business activity but do not receive sufficient margins and hence do not see rapid increases in income due to microcredit. They primarily use microcredit to smoothen their cash flow. These individuals usually remain in groups and may be referred to as "cash flow smoothers." A third category of individuals use the majority of their loans for nonbusiness purposes (such as repayment of existing loans or consumption expenditures). They also stay within the group framework, but if loan sizes keep increasing, they may find it hard to service the loan and may eventually default or drop out. Such individuals may be categorized as "ineffective utilizers."

This paper focuses on the first category, effective utilizers, which have the potential to act as decentralized sources of employment and economic growth. Two leading urban-based microfinance institutions in India estimate that 15% to 20% of their group borrowers fall in this category. These microfinance borrowers grow at an above-average rate and often eventually reach the upper limit of the loan size provided by the MFI. These upper limits are in turn set by regulatory authorities. This is mainly because microfinance in many countries is directly or indirectly subsidized as it is meant for low-income individuals who are new entrants to the financial system. For example, in India, until April 2015, microcredit loans were required to be lower than Rs50,000. If the microfinance borrower's needs exceed the regulatory limit, they need to look for funding from outside sources.

Drawing on analysis of policy initiatives and discussions with leading microfinance providers, this paper aims to assess if in the mature microfinance markets of India, Bangladesh, and Pakistan there exist specific initiatives to address the needs of microfinance graduates. In all three countries, the percentage of adults (above the age of 25 years) who have a bank account and the percentage who have a borrowing account with a financial institution are both low. Table 1 gives these numbers for the three countries and that of a few other countries in Asia.

Table 1: Financial Inclusion Indicators in Selected Asian Countries, 2014
(%)

Country	Percentage of adults above 25 years of age with an account at a financial institution	Percentage of adults above 25 years of age who have borrowed from a financial institution
India	56.3	8.8
Bangladesh	35.4	12.9
Pakistan	13.0	2.0
Sri Lanka	82.0	21.8
Malaysia	70.5	22.9
Nepal	37.3	13.8
Indonesia	36.3	15.4
Philippines	31.0	15.0

^a The term "financial institution" includes banks, credit unions, post offices, and microfinance institutions.

Source: Global Findex database, World Bank.

While all three countries have fairly well-developed banking and microfinance sectors, the low borrowing rate indicates that there are still gaps in financing. This paper focuses on the lending gap between microfinance loans and SME loans of commercial banks.

The study methodology consisted of interviews with key personnel from the microfinance and banking sectors in each of the three countries. Thirty-two interviews were conducted in all, with at least 10 interviews conducted in each country, mostly with chief executive officers of microfinance institutions and banks. The list of organizations is in the Appendix. In addition, the study involved analysis of research reports, journal articles, and other public sources of information.

The following three sections, 2–4, examine the situation in the three countries. Section 5 summarizes the main challenges in catering to the missing middle and possible ways to address them. The final section draws conclusions.

2. GAP BETWEEN MICROFINANCE AND SME FINANCE IN INDIA

Financial exclusion is a widespread problem in India. According to the World Bank's Global Findex database, in 2014, only 56.3% of individuals above the age of 25 years had an account and only 8.8% had a formal borrowing account.

The Indian microfinance sector comprises self-help groups and MFIs, which together account for 86.06 million members. Table 2 gives the shares of the two models in membership and gross loan portfolio. The self-help group model was originally promoted by the National Bank for Agriculture and Rural Development, the apex development bank for agricultural and rural finance. MFIs, on the other hand, have mainly been promoted by individual entrepreneurs. The lower share of the self-help group model in gross loan portfolio vis-à-vis their share in membership indicates a lower average loan size compared with the MFI model.

In recent times, MFIs incorporated as nonbanking financial companies (NBFC-MFIs) are the fastest-growing institutional form in the microfinance sector (Nair and Tankha 2015).

Table 2: Microfinance Sector in India
(as of 31 March 2015)

Type	Number of Members (million)	Gross Loan Portfolio (Rs billion)
Self-help group	54.2 (63%)	428.4 (55%)
Microfinance institution	31.8 (37%)	350.5 (45%)
Total	86.0	778.9 (\$11.7 billion)

Source: T. Nair and A. Tankha. 2015. *Inclusive Finance India Report 2014*. New Delhi: Oxford University Press.

While recently the upper limit of microfinance loans has been increased to Rs100,000, the lower limit for SME financing by commercial banks is usually around 10 times this amount (Rs1 million).¹ There is therefore a considerable gap between these two sectors.

According to the 2013 survey of the National Sample Survey Organization, there are 57.7 million small business units, mostly organized as proprietorships in the manufacturing, trading, and service sectors. These units are estimated to employ around 120 million individuals. Inadequate finance is one of the key constraints to growth faced by these units according to a report by IFC (2012). The report estimates that the total finance gap of the micro, small, and medium-sized enterprise sector in India is around Rs3.57 trillion (\$53.6billion).

2.1 Financing Avenues for Microfinance Graduates

The range of credit needs of the missing middle segment is between Rs0.1 million and Rs1 million. The players who cater to this segment in India are certain regional rural banks, some commercial banks, a few large NBFC-MFIs who can lend up to 15% of their net assets in loans that are larger than the limit prescribed for microfinance loans, and some specialized nonbanking financial companies (NBFCs) who cater to specific segments such as financing of commercial vehicles or equipment. However, there is

¹ This was corroborated by interviewees in banking as well as microfinance sectors.

still a large gap in the supply, because of which many missing middle entrepreneurs are unable to reach their full potential. Many of them depend on informal sources of financing. These include family and friends, who usually have a limited pool of funds, or moneylenders and chit funds, who often charge very high interest rates.

2.1.1 Potential and Current Lenders to the Missing Middle Category

The possible providers of finance for the missing middle category are NBFC-MFIs, NBFCs that specialize in certain types of financing, rural banks, and commercial banks.

Microfinance Institutions

The main challenge that NBFC-MFIs or any other form of MFI will face when lending to this segment is that they need to develop the ability to carry out a detailed credit appraisal. MFI loans, being group based, have high repayment rates despite being collateral-free because of peer pressure; collection is in small, frequent installments at regular group meetings (weekly, fortnightly, or monthly). Moreover, there is a dynamic incentive to repay as loan sizes usually increase in subsequent loan cycles. Hence, the appraisal process for microfinance loans is not very detailed. The main steps in the appraisal process are (i) carrying out a group training where basic financial literacy is imparted and loan conditions are explained, (ii) checking the potential borrower's address by visiting them prior to the loan, and (iii) loan utilization checks. Lending to missing middle entities will be on an individual basis and the size of the loans will be larger; this will mean that the appraisal process for the loans will necessarily have to be different and much more detailed. If they want to enter this segment, MFIs need to have training programs for their officers. Given the large numbers of field officers that need to be trained, e-learning programs coupled with classroom training and simulation exercises may need to be considered.

Friends of Women's World Banking (FWWB) India during November 2014 to January 2015 carried out a pilot project in which capacity building and funding support was given to a credit society, Annapurna Mahila Multi-State Co-operative Credit Society, to enable 50 members of the cooperative to avail themselves of larger-value loans. Training was provided both for the members seeking larger loans and to the staff of the cooperative. The repayment of the loans provided is satisfactory and the project is likely to be mainstreamed soon. FWWB believes that capacity building needs to precede provision of larger-value individual loans to group microfinance customers.²

Another challenge that MFIs face is availability of funding, as providing larger loans will require them to access a larger volume of funds. Recent initiatives are expected to help (see Sections 2.2.2 and 2.2.3), including the establishment of a specialized bank, called MUDRA Bank, for the purpose of funding organizations lending to MSMEs and provision of licenses to eight large NBFC-MFIs to start small banks. Once the NBFC-MFIs complete the required formalities and start operations, they will be allowed to accept deposits and as a result will have access to an additional source of funding, which is expected to reduce their average cost of capital. However, the new banks may face challenges in building trust among potential depositors. They may also be constrained in attracting deposits from some kinds of entities who are mandated to place their deposits in only certain kinds of banks.

Some NBFC-MFIs have developed credit appraisal skills and have been providing individual loans within the overall microfinance loan limit set by the Reserve Bank of India (RBI). These loans are usually given to star performers from among their group borrowers who run businesses that have potential to scale up. Some common

² Interview with the chief executive officer, Friends of Women's World Banking, India.

examples of enterprises financed by group microcredit that show potential for scaling up are tiffin stalls, drinking water packaging companies, martial arts schools, and beauty parlors. The loan amount sanctioned is based on an assessment of the borrower's cash flow. Unlike in the case of group-based loans, disbursement is not in cash but to the customer's bank account. The customer is required to give standing instructions for payment of principal and interest.

Given the large market potential, some large NBFC-MFIs have started providing loans higher than the microfinance cap. As per RBI guidelines, they are permitted to lend up to 15% of their net assets in loans that do not fall within the definition of microfinance loans, and so some of them have started providing higher-value loans to microfinance graduates. Grama Vidiyal Microfinance is one such MFI, which has been providing individual-based "business loans" and has found this to be a very good product. Other NBFC-MFIs have promoted an NBFC arm that caters to this segment. For example, Equitas Finance has been lending to this segment for the last 3 years. The loans are given on an individual basis and the tenure is usually 5 years. The experience has been good so far, with a very low level of nonperforming assets of less than 1%. Equitas Finance has trained its field officers on credit appraisal skills. Much of the credit appraisal is based on field visits and through observation and verification. The organization finds the cost of operation in the case of larger-value individual loans comparable with that of lower-value group loans.

Nonbank Financial Companies

Some NBFCs cater to niche segments within the missing middle. For example, there are NBFCs that focus on the financing of commercial vehicles, new and pre-owned. They usually operate through a dense network of branches with credit officers who are responsible for the entire transaction from identifying customers, valuing the commercial vehicle, and financing it to handling collection of principal and interest. These executives meet with the customer at least every month. Electronica Finance is an NBFC that focuses on financing asset acquisition by the missing middle. Appraisal is based on field visits, interviews with promoters, and checking of records and cash transactions. The financial data provided by the firm is cross checked with income tax returns and value-added tax returns (Manickaraj 2010). As loans are only provided for the purchase of equipment, disbursement of the loan is made directly to the equipment supplier. The down payment of 25% is collected up front from the customer and the NBFC pays the amount in full to the supplier.

As the missing middle is heterogeneous in nature, other niche segments within it need to be identified and specific products to cater to them need to be developed along with built-in risk mitigation measures.

Rural Banks and Commercial Banks

While currently 87% of the formal finance being accessed by the micro, small, and medium-sized enterprises is provided by banks, there is still a big gap in financing.

In general, the biggest barrier to banks in catering to this segment is the high-cost nature of their operations. As catering to missing middle customers typically involves considerable investment of employee time, it is often unviable given the small loan size.

While there is a provision for banks to use banking correspondents (or direct sales agents) to reduce their costs, it is often challenging to arrive at a satisfactory arrangement that is fair to both parties with equitable sharing of risk and return.

Another initiative of the RBI is permitting the issuance by banks of the Kisan (meaning farmer) Credit Card and the General Credit Card. These are credit facilities extended in the form of sanctioned limits for farmers and nonfarm small entrepreneurs, respectively.³ In December 2013, the RBI issued guidelines directing banks to ensure that these facilities were directed to cater to entrepreneurial needs and not consumption needs. There are still no reports available on how effective this initiative is.

Rural banks cater to micro, small, and medium-sized enterprises in rural areas. The experience of the banks with such loans is mixed. Often it is found that loans given under government-sponsored programs have very low repayment rates. However, loans sourced by the bank officers that are not part of a government program have a good repayment rate.⁴

Regional rural banks that have been successful in this segment rely on field staff for identifying potential borrowers. For example, Pallavan Grama Bank in South India has periodic loan campaigns when officers from the regional office are in the branches expediting approvals for higher-value loans. For smaller loans up to a value of around Rs0.2 million, financial information is not relied upon and sanction of the loan is based on needs assessment by the field staff. For larger loans, sales tax registration details, income tax returns, and approvals from industry associations are mandatory. Part of the due diligence may also involve an assessment of suppliers and customers.

2.2 Policy Initiatives to Address the Gap

The Government of India has taken cognizance of the missing middle, especially in view of its potential for employment generation, an important policy objective to take advantage of the country's demographic dividend.⁵ A number of recent policy initiatives have sought to address this segment.

2.2.1 Broadening the Focus of the Microfinance Sector

Microfinance policy initiatives in India have focused on directing credit toward individuals with income below a certain minimum threshold and aimed at reaching underbanked areas in the country. For example, the guidelines for creation of special microfinance-focused nonbanking financial companies (NBFC-MFIs) issued in December 2011 specifically mentioned that 85% of their net assets⁶ should consist of "qualifying assets." Qualifying assets were in turn defined as loans given to individuals with income lower than a defined limit.⁷ The loans had to be lower than Rs35,000 (\$525) in the first cycle and Rs50,000 (\$750) in subsequent cycles, within an overall limit of Rs50,000 on the total indebtedness of the borrower (Reserve Bank of India 2011). It was clear that the guidelines sought to ensure availability of credit to very low-income individuals at reasonable terms. Moreover, there were specific initiatives to encourage the development of credit in underserved areas. While NBFC-MFIs were required to have net owned funds of at least Rs50 million (\$0.75 million), the

³ Limits are fixed for a 3-year period and unlimited withdrawals can be made within the limit. Each withdrawal needs to be repaid within 12 months.

⁴ Discussion with Pallavan Grama Bank official.

⁵ This refers to a situation when the working age population is larger than the nonworking age population.

⁶ Net assets are total assets minus cash and bank balances and money market instruments.

⁷ The annual income limit was Rs60,000 (\$900) in rural areas and Rs120,000 (\$1,800) in urban and semi-urban areas.

requirement was relaxed to Rs20 million in the northeast as it was one of the most underbanked areas.

Recently however, policy prescriptions have sought to broaden the target market of microfinance providers. These measures may have been prompted by the realization that given the low levels of formal borrowing in the country, it is quite likely that many individuals with income higher than that envisaged for microfinance customers may also be unbanked. The loan volumes required by such individuals are also likely to be higher than the upper end of microfinance loans.

In April 2015, the country's central bank, the Reserve Bank of India (RBI) issued guidelines that permitted NBFC-MFIs to lend to individuals with rural household income of up to Rs100,000 (\$1,462) and semi-urban or urban household income of up to Rs160,000 (\$2,339) as against the limits of Rs60,000 and Rs120,000 previously noted. Similarly, the limit on the size of the microfinance loan was raised to Rs60,000 (\$900) in the first cycle and Rs100,000 (\$1,500) in subsequent cycles as compared with the previous guidelines of Rs35,000 and Rs50,000, respectively. Microfinance Institutions Network, the self-regulatory organization of the NBFC-MFIs, has currently suggested to its members to exercise caution in increasing loan sizes up to the revised cap of microfinance loans and only gradually increase loan sizes beyond Rs50,000. However, the average value of loans given by the microfinance sector is far lower than the prescribed limit. In 2014, when the upper limit for lending was Rs50,000, the average loan outstanding per self-help group was Rs102,273. As each self-help group on average had 13 members, the average loan per individual member was Rs7,867. The average loan per individual MFI member is Rs9,961, though in the case of NBFC-MFIs, the average loan size is around Rs17,000. The upper limit for microfinance loans is relevant only in the case of a minority of MFI members whose needs are growing rapidly as their enterprises scale up.

2.2.2 MUDRA Bank Initiative

To address the need for funding for micro, small, and medium-sized enterprises, in April 2015 the Micro Units Development and Refinance Agency (MUDRA) Bank, a public sector financial institution, was launched with funding of Rs200 billion for onlending and Rs30 billion for provision of credit guarantees. MUDRA Bank is a subsidiary of Small Industries Development Bank of India, the apex bank for the development of small industries in the country. The apex bank has assisted many MFIs, though going forward it plans to mainly act as a market maker for small industries and focus on providing venture capital for start-ups (*Economic Times* 2015). MUDRA Bank is to provide refinance to last mile⁸ providers of finance for microenterprise loans. Commercial banks, regional rural banks, cooperative banks, NBFCs, and microfinance institutions are eligible to obtain refinance for loans under three categories: up to Rs50,000, Rs50,000 to Rs0.5 million, and Rs0.5 million to Rs1 million. The three categories are expected to cater to microenterprises at different stages of development, though 60% of MUDRA Bank's funding is earmarked to cater to the first category. The loans are meant to be for nonfarm income-generating activities. By September 2015, in the first 6 months of operation, MUDRA Bank had reported disbursement of Rs240 billion. MUDRA Bank has also been envisaged as the unified regulator of the microfinance sector, though the legislation in this regard is yet to be passed.

⁸ The term "last mile provider" refers to the entity that ultimately interfaces with the customer as against other entities who merely act as financial intermediaries in the process of financial service delivery to unbanked populations.

The refinance facility from MUDRA Bank is expected to make available larger sums of money to enterprises in the missing middle. It is also expected to bring down the cost of the loans availed by them. The self-regulatory organization of NBFC-MFIs, Microfinance Institutions Network, estimated that MUDRA Bank finance could lower the cost of funds of MFIs by 3% to 4% from the current level of 12% to 14%. This in turn will lower the interest rate charged by MFIs from the current level of 24% to 22% as there is a cap on the interest rate margin that MFIs can charge.⁹

2.2.3 Provision of Banking Licenses to Small Finance Banks

In September 2015, the RBI gave licenses to 10 private entities to start small finance banks to cater to the financial needs of underserved segments such as small business units, small and marginal farmers, microentrepreneurs, and unorganized sector entities. Small finance banks are expected to have high-technology, low-cost operations. Eight of the entities that received licenses are NBFC-MFIs. The minimum paid-up capital of these banks is Rs1 billion (\$15.0 million). Small banks must direct 75% of their adjusted net bank credit¹⁰ to sectors eligible for classification as “priority sector lending” by the RBI, while at least 50% of the loan portfolio is required to comprise loans and advances of value of up to Rs2.5 million. As a result of these requirements, small finance banks are expected to cater to the missing middle for whom these loan sizes would be appropriate. The sources of funds for these banks include deposits and refinance from MUDRA Bank.

2.2.4 Redefining Micro, Small, and Medium-Sized Enterprises

In April 2015, a bill was introduced in Parliament that seeks to amend the definitions of micro, small, and medium-sized enterprises. In the manufacturing sector, investment in plant and machinery for micro, small, and medium-sized enterprises is currently capped at Rs25 million, Rs50 million, and Rs100 million, respectively. The bill proposes to increase these limits to Rs50 million, Rs100 million, and Rs300 million. Similarly, it seeks to increase the caps of Rs1 million, Rs20 million, and Rs50 million in plant and machinery for micro, small, and medium-sized enterprises in the services sector to Rs2 million, Rs50 million, and Rs150 million respectively. The bill is currently pending in Parliament (PRS 2015). As the earlier definition was set in 2006, amending the definition is a reasonable measure in view of inflation. Amendment of the definition will broaden the range of enterprises that can be classified as a micro, small, or medium-sized.

Banks in India need to lend 40% of their loan portfolio¹¹ to the RBI-designated “priority sector.” A subtarget of 7.5% of adjusted net bank credit or credit equivalent amount of off balance sheet exposure, whichever is higher, has been set for lending to microenterprises, to be achieved in a phased manner by March 2017 (RBI 2015). Lending to micro and small enterprises is considered part of the priority sector, and expanding the definition of these entities will enable more missing middle entities to become eligible for lending from banks under this category. Assuming that the pool of

⁹ The cap is 10% for large MFIs (i.e., MFIs with loan portfolios higher than Rs1 billion) and 12% for others. The interest rates charged by MFIs will need to be the lower of the cost of funds plus the applicable maximum margin (10% or 12% as the case may be) and 2.75 times the average base rate of the five largest commercial banks by assets.

¹⁰ Computation of adjusted net bank credit is defined by the RBI in its circular dated 23 April 2015.

¹¹ Priority lending refers to directed lending by commercial banks to certain sectors of the economy that are considered important from the development perspective such as agriculture, microenterprises, renewable energy, education, housing, and social infrastructure.

funds available to banks to lend to this segment increases as a result of the MUDRA Bank initiative, an increased volume of funds may be expected to flow to these firms.

3. GAP BETWEEN MICROFINANCE AND SME FINANCE IN BANGLADESH

In Bangladesh too, financial exclusion is widespread. According to the World Bank's Global Findex database, only 35% of individuals above the age of 25 have an account and only 13% borrow from a formal financial institution.

Bangladesh's Grameen Bank is a pioneer in the field of microfinance, having its origins in a small action research program of Prof. Muhammad Yunus in 1976, and hence the country is considered as the birthplace of microfinance. The microfinance sector in the country grew considerably in the 1990s and saw high growth until 2007. By 2008, there were signs that the market was nearing saturation (Chen and Rutherford 2013). During the years 2004–2007, 15% to 28% of active borrowers were added annually; thereafter, the four largest MFIs—ASA, BRAC, BURO (Basic Unit for Resources and Opportunities of Bangladesh), and Grameen Bank—consciously decided to slow down and stopped adding branches and staff. Chen and Rutherford (2013) describe this development as “a crisis averted” as the cutback on the part of these MFIs, which accounted for two-thirds of the microfinance supply in the past decade, prevented issues arising from aggressive growth in a saturated market from spiraling out of control.

In addition to Grameen Bank, which is incorporated as a bank, there are around 676 licensed nongovernment organizations involved in microfinance (NGO-MFIs) in the country that cater to a total of 33.73 million members as of June 2014. The total loans outstanding amount to Tk403 billion (\$5.1 billion)

All microfinance providers in the country can also accept deposits, and the total savings as of June 2014 was Tk237 billion (\$3 billion). Borrowers, however, usually account for 70% to 80% of the membership of MFIs. The average microcredit loans size is Tk13,917 (\$177.3).

Even though there are a large number of microfinance providers in the country, the supply of microcredit is highly concentrated with the three largest ones. These three providers, Grameen Bank, ASA, and BRAC, account for roughly 61% of the members and around 60% of the loans outstanding (Table 3).

Table 3: Microfinance Sector in Bangladesh
(as of June 2014)

	Number of Members (million)	Gross Loan Portfolio (Tk billion)	Total Savings (Tk billion)
Grameen Bank	8.6 (30%)	87.7 (24%)	150.9 (57%)
ASA and BRAC	8.9 (31%)	140.4 (38%)	59.3 (22%)
Other nongovernment organization microfinance institutions (674 in number)	11.0 (39%)	137.6 (38%)	53.6 (20%)
Total	28.5	365.7 (\$4.7 billion)	263.8 (\$3.4 billion)

Tk = Bangladesh taka.

Source: Based on data from Microcredit Regulatory Authority MIS database and Grameen Bank website.

Grameen Bank's deposits are significantly higher as it is permitted to accept deposits from members and nonmembers, while the others, being NGO-MFIs, can only accept deposits of members. This is because Grameen Bank is regulated by the central bank, Bangladesh Bank. The main regulator for the NGO-MFIs is the Microcredit Regulatory Authority (MRA), which was established in 2006.

All NGO-MFIs have to register with the MRA, which oversees them and disseminates data relating to them. The main sources of funding for NGO-MFIs is savings collected from clients, which accounts for around 34% of their funding. Other main sources of funding are loans from commercial banks (16%); Palli Karma-Sahayak Foundation, an apex development organization established by the government (11%); and donor funding (2%). The balance (37%) comes from the cumulative surplus built up as a result of the MRA requirement that all the revenues generated by NGO-MFIs are reinvested into their microfinance programs (MRA 2014). The MRA has set a cap on interest rates of 27% on microloans and microenterprise loans provided by NGO-MFIs and also requires that the interest be calculated on a declining balance basis and not on a flat basis.¹² While most NGO-MFIs charge 27%, BRAC charges a lower rate of 26%, and Grameen Bank, which as a bank has access to more deposits, is able to charge an even lower rate of 20%.

3.1 Financing Options for Microfinance Graduates

In Bangladesh, loan amounts up to Tk50,000 (\$637) are usually considered as microcredit, and loans in excess of this amount are considered microenterprise loans (MRA 2014). Both types of loans may be provided by microfinance providers

Since 2007, Bangladeshi MFIs have realized the need to provide larger loans for some of their group members who have the capability to service them. Such customers are usually in the fields of small-scale manufacturing, retail stores, construction, and transport services. Many group members' children also expressed interest in larger-value individual loans. BRAC and Grameen Bank were the earliest to launch individual loans to cater to them, and some other MFIs followed suit. Once MFIs started offering larger individual loans, they realized that besides some of their own group members, there was demand from other small entrepreneurs. Recently, some of them have also started catering to salaried individuals.¹³

While all MFIs are permitted to offer microenterprise loans, it is observed that only the large and medium-sized players are able to cater more to this segment (Table 4). BRAC and ASA account for 42% of the microenterprise loans of NGO-MFIs and the top 10 MFIs in the country account for around 49%. The paucity of funding for smaller MFIs is the major reason for this skewed distribution.¹⁴

¹² If interest is calculated by the MFI on a flat basis (that is, interest is calculated in every time period on the entire principal without taking into account the installments of principal that have already been repaid by the borrower), then the total interest paid by the borrower is almost double of what it would be if it is calculated on a declining balance basis.

¹³ Typically, this would be for individuals with salaries between \$70 and \$300 per month (communication with BRAC representative).

¹⁴ Interview with the chief executive officer of Pally Bikash Kendra.

Table 4: Microenterprise Loans in Bangladesh
(as of June 2013)

	Total Number of Microenterprise Loan Borrowers (thousands)	Gross Microenterprise Loan Portfolio (Tk billion)
Grameen Bank ^a	704	22.9
BRAC	391	19.1
ASA	178	9.2
Top eight NGO-MFIs (other than BRAC and ASA)	138	5.0
Other smaller NGO-MFIs	246	34.4
Total	1,657	90.0 (\$1.1 billion)

MFI = microfinance institution, NGO = nongovernment organization, Tk = taka.

^a As of 21 December 2015.

Source: Microcredit Regulatory Authority database and correspondence with Grameen Bank, Bangladesh.

3.1.1 Models Used for Microenterprise Loans

The microenterprise loan is usually offered as a distinct product on an individual basis distinct from a group microfinance loan. The rate of interest, however, is often similar for both products. For instance, in the case of BRAC, microloans, which usually range between Tk5,000 and Tk50,000, are termed Dabi (which means demand or what is rightfully ours) while microenterprise loans are higher than them and are called Progoti (or progress).

While BRAC's Dabi loans are provided using the group methodology with repayment typically being weekly at group meetings, the Progoti loans are given on an individual basis with repayments being made at branches on a monthly basis. Moreover, Dabi loans are given exclusively to women while Progoti loans are given to both men and women. Often, husbands of Dabi members take Progoti loans either singly or jointly with their wives. As against collateral-free Dabi loans, Progoti loans have notional security such as deposit of original land documents, trade license, shop owner's agreement, and national identity card. In addition, for Progoti loans, guarantees from one family member and one nonfamily person are sought.

Other MFIs that provide microenterprise loans also have distinct products. Most MFIs provide training to first-time customers of individual loans regarding how the product works. Integrated Development Foundation provides a 3-day training to customers that teaches them the fundamental concepts of costing and accounting. People's Oriented Program Implementation tries to facilitate forward and backward linkages for microenterprises to be financed by them.

3.1.2 Experience of MFIs with Microenterprise Lending

Microenterprise loans represent only a small part of the portfolio of even large MFIs. For instance, in the case of BRAC, they account for only 7.4% of BRAC's loan portfolio and are availed by only 2% of its borrowers. Similarly, ASA offers small business loans, which account for around 3.5% of its portfolio and are availed by a little less than 1% of its borrowers.

Repayment experience with microenterprise loans appears to be mostly good, with the MFIs interviewed (which offered microenterprise loans) reporting repayment rates of 97.0%–99.5%. While one large lender mentioned that its repayment rate on current microenterprise loans was marginally lower than that of group loans, another

medium-sized one mentioned that the repayment rate on its microenterprise loans was marginally higher than that of group loans. Even relatively smaller MFIs¹⁵ that had ventured into microenterprise lending reported that their experience was very good, with a recovery rate of 98.0%–99.5%.¹⁶

A major handicap in the Bangladesh microfinance sector is the absence of a credit bureau. The sector is reported to have numerous cases of multiple borrowing—namely cases where a borrower takes loans simultaneously from more than one MFI.¹⁷ Khallily and Faruquee (2011) estimate that just over 30% of microfinance borrowers have loans from more than one MFI. As there is no credit bureau, MFIs are unable to ascertain precisely the debt levels of potential borrowers and hence they tend to be risk averse. As more MFIs start providing loans in the microenterprise segment, the risks are likely to rise.

BRAC is experimenting with a credit scoring model to examine if its usage can result in a more efficient and robust credit appraisal process.

3.1.3 Financing Gap

It is estimated that there are around 800,000 microenterprises in the country and their demand for loans of Tk50,000–Tk300,000 in size is expected to be around Tk140 billion (\$1.8 billion) according to a paper by Ferarri (2007) based on a World Bank survey conducted in in 2007. This figure is likely to have increased substantially in the last 10 years.

Including the share of Grameen Bank, the supply of funds to this segment is around Tk90 billion. There is hence a significant financing gap for the missing middle.

3.2 Policy Initiatives to Address the Gap

3.2.1 Encouragement for MFIs to Provide Microenterprise Loans

MFIs are permitted to provide larger loans. The Microcredit Regulatory Authority tracks the number and volume of such loans and includes the information in its reports. Microenterprise loans were introduced by BRAC in the late 1990s and over the years more MFIs are becoming active in this segment, though the large players dominate the market.

3.2.2 PKSF Soft Loans for NGO-MFIs for Microenterprise Lending

Palli Karma-Sahayak Foundation (PKSF) is an apex development organization established by the Government of Bangladesh in May 1990. The organization provides funding to microfinance institutions. Besides the government, it also received funding from the World Bank and donors (Chen and Rutherford 2013). In 2001, the foundation started a program called Agrasor, under which it provides loans to its partner MFIs¹⁸ for onlending microenterprise loans of up to Tk1.0 million. Microenterprises are defined as having investment up to Tk1.5 million (excluding land and building). The cumulative lending under this program until November 2015 is Tk34.0 billion (\$433 million). The lending during the fiscal year (FY) 2014–2015 was Tk5.5 billion and the loans outstanding under this program in June 2015 totaled Tk10.1 billion (\$128.6 million).

¹⁵ These MFIs did not feature in the list of top 10 MFIs in Bangladesh.

¹⁶ Interview with chief executive officers in February 2016.

¹⁷ This phenomenon is referred to as overlapping in Bangladesh (Chen and Rutherford 2013).

¹⁸ MFIs who have entered into a partnership agreement with them.

3.2.3 PKSF–IFAD Funded Training Programs for MFIs and Microentrepreneurs

Two programs to facilitate microenterprise loans have been implemented jointly by Palli Karma-Sahayak Foundation (PKSF) and the International Fund for Agricultural Development (IFAD). Finance for Enterprise Development and Employment Creation was implemented between 2008 and 2014 at a cost of \$57.8 million and involved training for MFIs on microenterprise appraisal and lending, strengthening microenterprise value chains, and business management training for microentrepreneurs (IFAD website).

A follow-on project, Promoting Agricultural Commercialization and Enterprises, is being implemented between 2012 and 2018 at a cost of \$92.7 million. It involves financing for onlending to microenterprises, value chain strengthening in more geographic locations, and technological and product adaptation assistance for microenterprises.

4. GAP BETWEEN MICROFINANCE AND SME FINANCE IN PAKISTAN

In Pakistan financial exclusion is higher than in the other two countries studied in this paper. According to the World Bank's Global Findex database, only 13% of individuals above the age of 25 have an account and only 2% have a formal borrowing account. As a result, policy makers have tried to develop the growth of microfinance in the country.

Pakistan Microfinance Network, a national network of retail players in Pakistan's microfinance sector that collects and disseminates information on the sector, classifies the sector participants into three main categories: MFIs, rural support programs, and microfinance banks.

MFIs are nonbank, nongovernment organizations typically incorporated as trusts, societies, or nonprofit companies. Accordingly, they are registered under the Societies Act, Trust Act, or Companies Ordinance. This group also includes multinational NGOs such as BRAC Pakistan and ASA Pakistan. MFIs are not allowed to take deposits and are primarily involved in microcredit activities. However, in order to inculcate savings discipline in their members, some MFIs mobilize savings from their members for deposit in savings accounts of commercial banks. MFIs obtain their funding mostly from the Pakistan Poverty Alleviation Fund, a national-level independent agency set up to channelize funds from World Bank and donor agencies. While it originally provided subsidized funding, since 2012 it has been giving funds at market-related rates of interest.

Rural support programs (RSPs) are NGOs registered under the Companies Ordinance. They are differentiated from MFIs by the purely rural focus of their credit operations (Pakistan Microfinance Network 2011). RSPs are registered with and supervised by the Securities and Exchange Commission of Pakistan. They provide microfinance as part of a multidimensional program for rural development though they are not allowed to take deposits.

MFBs are licensed and supervised by the State Bank of Pakistan (SBP). They have to comply with minimum capital requirements¹⁹ and have to have a capital adequacy ratio of 15% of risk-weighted assets. The first MFB was established in 2000 under a presidential decree, and since then another nine have been licensed under the Microfinance Institutions Ordinance, 2001. MFBs are authorized to accept and intermediate deposits from the public.

At the end of March 2014, the Pakistan microfinance sector had a gross loan portfolio of PRs61.1 billion (\$0.6 billion) and served 2.9 million active borrowers (Pakistan Microfinance Network 2014).²⁰ The sector is reported to have achieved a penetration of around 13.6% of the estimated microfinance market of 20.5 million. The estimate of the market size was made by Ghanghro and Khan (2015).²¹ Table 5 gives the shares of the different segments of the sector.

Table 5: Microfinance Sector in Pakistan

	Members (million)	Gross Loan Portfolio (PRs billion)
Microfinance institutions	0.9 (31%)	12.9 (21%)
Microfinance banks	1.2 (42%)	36.8 (60%)
Rural support programs	0.8 (27%)	11.4 (19%)
Total	2.9	61.1 (\$0.6 billion)

PRs = Pakistan rupees.

Source: Based on Pakistan Microfinance Network. 2013. *Pakistan Microfinance Review 2012*. www.microfinanceconnect.info/assets/articles/PMR_2012_new.pdf

Of the three main kinds of players in the Pakistan microfinance sector, only MFBs come under the supervision of the country's central bank, SBP, while the other two, RSPs and MFIs, register with other regulatory authorities. While RSPs and MFIs register with regulatory authorities, unlike MFBs, they are not actively supervised by the authorities they register with. It is expected that soon these entities will be brought under the supervision of the Securities and Exchange Commission of Pakistan.²²

This dichotomy has created an uneven playing field. MFBs have the disadvantage of incurring higher costs for compliance with regulatory requirements than do RSPs and MFIs. For example, besides conducting an annual audit and preparing an annual report, MFBs have to build up reserves, contribute to a depositor protection account, provide for doubtful loans, and establish branches with sufficient security and vault features. On the other hand, MFBs have the advantage of being able to raise deposits unlike RSPs and MFIs.

4.1 Financing Options for Microfinance Graduates

Given MFBs' higher cost structure, in 2011 SBP permitted MFBs to seek approval to extend microenterprise loans of up to PRs500,000, as against the limit of PRs150,000 set earlier for general purpose loans (SBP 2012). SBP also provides a credit guarantee scheme to banks under which up to 40% of principal amounts are

¹⁹ These range from 300 million Pakistan rupees (PRs) for districtwide MFBs to PRs1,000 million for nationwide MFBs.

²⁰ All figures quoted in this section are from Pakistan Microfinance Network (2013b).

²¹ Some observers attribute the low penetration to the fact that currently only around 1% of microfinance in Pakistan is offered on Islamic finance principles (Ali 2013).

²² Discussion with Pakistan Microfinance Network officials.

covered. These developments have enabled MFBs to expand their services to the low end of the SME segment. Microenterprise loans can be extended up to a maximum of 40% of the MFB's loan portfolio to keep its focus on smaller microfinance loans. MFBs are, however, approaching this opportunity with caution due to the different appraisal skills required for it.

Tameer Bank and FINCA Bank were the earliest entrants and are now in the process of expanding their microenterprise lending. Few other banks are piloting programs. The Pakistan Microfinance Network has so far not released data regarding total microenterprise loans in the country but is expected to include reporting on these loans soon.²³

4.1.1 Models Used for Microenterprise Loans

Tameer Bank commenced giving microenterprise loans in 2012. At present it has a loan portfolio of around PRs1 billion. Some of the loans are secured by deposits, government securities, or gold ornaments. Unsecured loans are also given based on the borrower's cash flow. As many of the customers did not keep proper records and did not prepare accounts, Tameer Bank set up a verification department and trained its officers to ascertain the cash flow based on observation and detailed discussions with the potential borrowers. The verification officer spends time in the field educating potential customers on how to differentiate between personal expenses and business expenses and other such matters. Then together with the potential customer, they draw up a cash flow statement for the enterprise. A decision regarding the loan application is made thereafter. As a result, even customers who are eventually declined are given some basic training that may help them improve their financial management. The bank has consciously separated the sales and verification functions so that the verification officer is not under the pressure of sales targets. Verification officers specialize in specific industries from which Tameer Bank often receives loan applications. Examples include furniture manufacturing, steel frame making, craftsmanship, and apparel. For each industry, senior management studies a sample of firms and helps draw up a typical cash flow statement. Verification officers are carefully selected from existing loan officers based on performance and temperament. Their performance is monitored on a continuous basis. If there are concerns regarding performance, further training is provided. The model has shown satisfactory results with defaults of around 0.2%. The average loan size is around PRs200,000 though loans go up to PRs450,000. The average loan size is observed to be rising year on year. Even though the detailed verification process leads to a higher cost structure, the bank benefits by way of low loan recovery costs.²⁴ Based on its experience with lending to microenterprises, the bank officials feel that the electricity shortage in the country is a big constraining factor in the performance of small enterprises as they usually do not own backup electricity sources.

FINCA Bank launched microenterprise loans in September 2014 on a pilot basis. Both secured and unsecured loans were offered. Unsecured loans were given on the basis of the cash flow of the business. The bank has had good experience with its microenterprise loans, with defaults less than 0.5%, and hence has applied for permission to offer the product on a formal basis in all its branches.

Khushhali Bank also commenced microenterprise lending on a pilot basis in January 2015. Similarly, the product is being piloted by a few other banks.

²³ Conversation with chief executive officer, Pakistan Microfinance Network.

²⁴ Discussion with the deputy chief executive officer of Tameer Bank.

4.1.2 Financing Gap

While estimates of the financing gap are not available, there are an estimated 3.8 million micro, small, and medium-sized enterprises in Pakistan, of which 70% are small enterprises (Pakistan Microfinance Network 2013a). Most of these small enterprises are expected to be unbanked.

4.2 Policy Initiatives to Address the Gap

4.2.1 Acknowledgement of the Need for Larger Microenterprise Loans

The State Bank of Pakistan in its 2011 document entitled *Strategic Framework for Sustainable Microfinance in Pakistan* acknowledged the importance of microfinance providers offering enterprise loans so as to promote employment generation. This later resulted in permission for MFBs to seek approval to extend microenterprise loans of size up to PRs500,000 (SBP 2012).

In May 2015, the State Bank of Pakistan released the National Financial Inclusion Strategy in collaboration with the Ministry of Finance and the Securities and Exchange Commission of Pakistan. The document notes the decline of private sector credit in real terms over the last 5 years and its skew in favor of large enterprises. The document calls for an increase in lending to micro and small enterprises and emphasizes the need to provide training for officials of MFBs and MFIs in order to enter this segment.

4.2.2 Promotion of Initiatives to Finance Low-Cost Private Schools

In 2013, the Pakistan Poverty Alleviation Fund supported the provision of a microcredit product through its partner MFIs for establishment of low-cost private schools. The product has a tenure of 12 to 24 months with a 3-month grace period and carries an annual interest rate of 27% (Haq and Ali 2014). Sometimes technical assistance in development of curriculum and training of teachers is also provided. The low-cost private school segment has been recognized as an important part of the microenterprise landscape due to the challenge faced by the country in increasing school enrollment and literacy. This microfinance product has been successfully piloted by Kashf Foundation and Tameer Bank.

4.2.3 Pakistan Microfinance Investment Company

In July 2016, the Pakistan Microfinance Investment Company—promoted jointly by the Pakistan Poverty Alleviation Fund, the UK's Department for International Development (DFID), and KfW Development Bank—is expected to be operational. The company will help mobilize funds from investors to channelize into MFIs. This is expected to eventually reduce the interest rate on microfinance loans, which currently ranges from 23% to 30% per annum. The greater availability of funding to MFIs through this initiative is also expected to increase the penetration rate of microfinance in the country from the current rate of 13.6%. The Microfinance Growth Strategy 2020 had estimated a requirement of \$3 billion by the sector in order to reach 10 million borrowers (around 50% of the potential market). To start with, the Pakistan Microfinance Investment Company will have funding of PRs6 billion (\$57.3 million), though this amount may increase as more investors are expected to contribute (Ahmed 2016).

5. CHALLENGES IN LENDING TO THE MISSING MIDDLE AND POSSIBLE WAYS TO ADDRESS THEM

The biggest challenge faced in lending to the missing middle firms in the three countries is the high degree of informality of their operations. In India, a survey of 13,177 potential missing middle customers by a large urban-based NBFC-MFI, Janalakshmi Financial Services, found that 90% of them had never filed an income tax return, 67% had not maintained a book of accounts, and 65% had no enterprise registration of any form (Jana Foundation 2013). This informality is a primary reason for their financial exclusion, as banks typically ask for various documents and records before lending.

Another important reason for the lack of finance for missing middle entities is that they are unable to offer collateral to lending institutions. Even if they have property, often the accompanying papers and documents may not be complete, making it hard for lenders to create a title and mortgage it. As a result, lending to them has to be based on an assessment of their cash flows.

However, assessment of cash flows of these entities is not easy because there is information asymmetry with regard to their transactions; because they are cash based, there are often no records. This makes it hard for financial institutions to obtain a clear picture of their volumes.

Successful models in all three countries have the following two features in common:

- (i) Credit appraisal of potential borrowers involves a lender's officers spending considerable time in observing the business, interviewing the promoters, cross checking records, analyzing the business model, and assessing the suppliers and customers. Often the lender's officers have to themselves draw up cash flow statements for the potential borrowers.
- (ii) Assessment often involves customer education on financial accounting practices, either formally or informally.

Other factors that have contributed to the success of some lenders include the following:

- (i) acceptance of notional security such as original land documents and identity cards,
- (ii) separation of the credit function from the sales function within the lending organization,
- (iii) developing in-house model cash flow statements for specific sectors that are commonly financed, and
- (iv) creation of forward and backward linkages for potential customers (i.e., facilitating partnerships of customers with input suppliers and end users on favorable terms).

These measures call for upfront investment in employee time before obtaining any financial returns from the enterprise, and hence will require top management commitment to building a robust microenterprise lending model. In the long term the benefits of this strategy can pay off by way of potential repeat business as well as savings in recovery and loan write-off costs.

Given the high-touch nature of the lending to this segment and the kind of hand-holding and guidance it requires, MFIs are well placed to handle this challenge. However, many of them have for many years based their operations on the one-size-fits-all group model, and therefore moving to individual lending may require considerable investment in training and developing new management information systems. Women's World Banking, a global not-for-profit organization, has developed resources for this purpose. For example, a detailed how-to guide on introducing individual lending in institutions that currently provide group loans has been made available (Dellien et al. 2005).

The following measures could help increase availability of finance to missing middle enterprises:

1. In all three countries it has now become easier for microenterprises to open and operate bank accounts due to the availability of mobile-based digital finance and debit cards.²⁵ Hence, it should be possible for them to switch to account-based transactions, though they may not do so immediately as their entire ecosystem, including suppliers and customers, needs to change. Intervention from NGOs and government may be required to effect this change.
2. Another way of financing small enterprises is to analyze their value chains and finance the various participants in the chain with a view to improving the overall efficiency of the chain. This is referred to as value chain financing. It involves assessing the enterprise's suppliers and customers and financing all of them as a cluster so as to reduce overall risk for the lender.²⁶
3. Missing middle entities may often need new customized financial products to address their needs and constraints. For instance, given their tight financial situation, they may need an arrangement in which excess cash flow in their accounts at any point of time can be used to reduce their loan liability and save on interest payments.²⁷
4. Many missing middle entities are run by one or two individuals and hence are exposed to key person risk. Potential lenders may require them to seek key person insurance or require them to develop a succession plan.
5. In India and Pakistan, as most large microfinance providers are now reporting to credit bureaus, if the individuals have borrowed from these institutions in the past, their credit histories will now be available. Another way in which identities and creditworthiness can be checked is by looking at utility and mobile telephone bills and their payment history.
6. Over time, specialized credit rating agencies focusing on small firms may be expected to develop. In India, SMERA—a joint venture between the Small Industries Development Bank of India, Dun and Bradstreet, and some commercial banks—has been set up for rating micro, small, and medium-sized enterprises (ASSOCHAM– SMERA 2015).

²⁵ In India, a Rupay debit card is provided to every adult savings account holder; in Pakistan, digital finance has grown considerably; and in Bangladesh, bKash, a mobile banking initiative of BRAC Bank, is growing fast.

²⁶ Discussion with the chief executive officer of Samunnati Financial Services.

²⁷ Discussion with the chief executive officer of BASIX group.

6. CONCLUSIONS

All three countries have sizable missing middle segments with considerable employment potential. As employment generation is an important goal for all three countries, catering to the missing middle is a priority and this is why it is on the policy agenda.

In India, the infrastructure to cater to this segment is being put in place. With the MUDRA Bank initiative, funding is not expected to be a major constraint. With nine new MFIs-turned-small-banks entering the scenario, the high-touch microfinance model can be combined with the resources of a bank. As all large MFIs and banks report to credit bureaus, sharing of information should not only prevent multiple lending but also help first-time borrowers build credit histories. Because lending to this segment is relatively new in the country, market studies and experimentation with various models may be required. Unlike in the case of group lending, variations in models in different regions of the country may be required, as business practices may vary.

Bangladesh, being the earliest microfinance market, has rightfully been the first to observe and address the needs of microfinance graduates. Larger MFIs dominate the segment as smaller ones are constrained by availability of funds. While MFIs are trading carefully in this segment, the experience with the loans seems mostly positive. The lack of a credit bureau increases risk levels considerably and is a significant drawback in the Bangladesh microfinance sector. This preexisting high risk reduces the incentive for lenders to provide larger-value loans. It is important that this lacuna is addressed early. The prevailing uncertain political climate in Bangladesh also increases the riskiness of microenterprise loans as small businesses are often adversely affected by shutdowns and sometimes sustain damage during political disturbances.

In Pakistan, microfinance banks have commenced providing microenterprise loans and two banks are in the process of scaling up the product due to the success of their early initiatives. As the loan sizes and number of loans increases, the availability of a credit bureau in the country should help lenders. An area for concern is that the overall penetration of the microfinance sector in the country is low. The recent efforts being made to increase funding for MFIs may be helpful in this regard. The political disturbances in the country and the prevailing shortage of electricity are risk factors that could affect the performance of microenterprise loans.

In all three countries, governments need to support lenders with funding options, make reporting to credit bureaus compulsory, fund financial literacy campaigns targeted at microenterprises, introduce measures to reduce use of cash-based transactions, and make registration of enterprises easy and universal.

Catering to the financing needs of missing middle firms has great potential to invigorate South Asian economies, making them more inclusive and dynamic.

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APPENDIX: LIST OF ORGANIZATIONS WHOSE CEOS AND OFFICIALS WERE INTERVIEWED

India	Bangladesh	Pakistan
<ul style="list-style-type: none"> • BASIX Microfinance • Janalakshmi Financial Services Limited • Equitas Microfinance Limited • Grama Vidiyal Microfinance • Ujjivan Microfinance • Pallavan Grama Bank (Regional Rural Bank) • Hand in Hand India (nongovernment organization active in microfinance) • Microfinance Institutions Network • Ananya Finance Limited • DCB Bank • Samunnati Financial Services 	<ul style="list-style-type: none"> • Safesave • ASA • BRAC • Bangladesh Bank • Grameen Bank • Buro Bangladesh • Bangladesh Bank • Pally Bikash Kendra • Integrated Development Foundation • People's Oriented Program Implementation • Sajida Foundation 	<ul style="list-style-type: none"> • Akhuwat Microfinance • Standard Chartered Bank (Pakistan) Limited • Pakistan Microfinance Network • Khushhali Bank • FINCA Bank • Tameer Bank • Kashf Foundation • UK Department for International Development, Pakistan Office • BRAC, Pakistan • SAFCO Support Foundation