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# The Financial Institutions for Common People and Socio-economic Development Policies: Lessons from Some Selected Case Studies

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**Abstract**

In addition to the conventional banking financial institutions, various specialized type of financial institutions, commonly known as non-bank financial institutions are seen in the financial system of different countries, contributing significantly in channeling funds to the productive sectors. On this background, the objective of this study is to introduce some special cases and discuss the lessons learned from their experience. In doing so, we have discussed Postal Savings, Japan and Grameen Bank, Bangladesh. The results of the Grameen Bank case study indicated that, proper supervision and policy guidelines could lower bad loans even without having any collateral against loans. On the other hand, Postal Savings experience of Japan indicated that, wide network of post office might be used to mobilize small funds from rural areas. However, it is of great interest to see the impact of self-fund dependency of Grameen Bank and privatization of Postal Savings in future.

**Keywords:** non-bank financial institutions, Grameen bank, postal savings

# 1. Introduction

The financial institutions for peoples including households with low income are seen in various countries of the world operating with divergent objectives, e.g., to mobilize small savings, alleviating poverty, agricultural cooperatives, investment banking and so on. Some of them have kept business on the non-bank style, and sometimes apply non-conventional approach of banking in raising and disbursing of funds specially tuned to the need of the society or the economy. As a result they often achieve significant results by introducing unique banking approaches. In this paper, we have discussed two such cases of the famous financial institutions from Japan and Bangladesh. The objective is to introduce their activities, behind their success and finally to suggest lessons that can be learned by the conventional banking system.

In doing so, we have selected Grameen Bank from Bangladesh and Yucho (Postal Savings) from Japan.

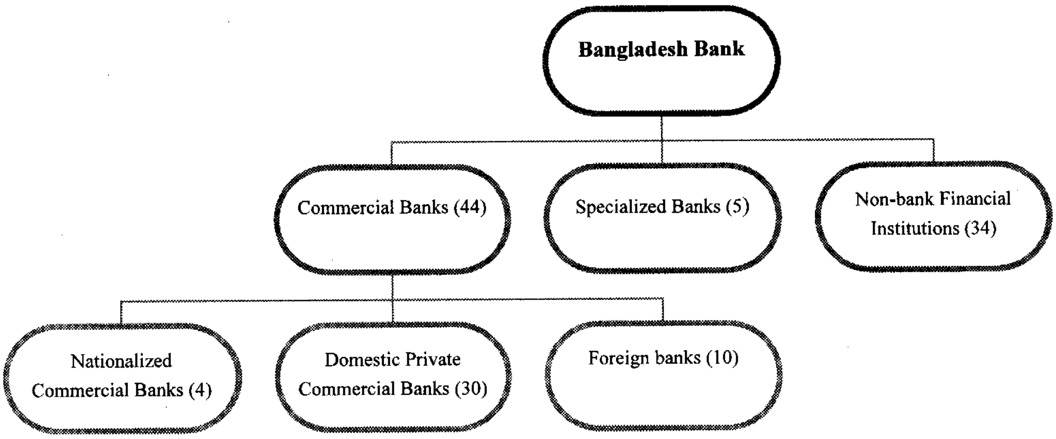


**Fig.1** The financial system of Bangladesh

(Source: MOF (2003))

## 2. Case Study One: Grameen Bank of Bangladesh

There are various non-bank financial institutions (NBFI) operating in the financial system of Bangladesh, e.g., merchant banks, investment company, leasing company, mutual association etc (see Fig.1 showing the financial system of Bangladesh). They are operated under the Financial Institutions Act 1993. Grameen Bank is one of the successful NBFI operating in Bangladesh. This bank is also considered as the most successful antipoverty program in the world. Grameen (meaning 'village') Bank is the outcome of a project initiated in 1976 in the village Jobra of Bangladesh. Later, the success of this program induced other nationalized commercial banks in 1979, to include this project into their own portfolio under the supervision of Bangladesh Bank (Central Bank of Bangladesh). In 1981 Grameen Bank Project got fund from International Fund for Agricultural Development (IFAD). Finally, in 1983 this project was formally transformed into a specialized bank under the special ordinance of the President of the Peoples' Republic of Bangladesh.

The objectives of the Grameen Bank are as follows (MOF, 2003):

a) Providing banking facilities to the poor having no collateral.
b) Rescuing the poor rural people from the abuses of moneylenders.
c) Creating self-employment opportunities for the rural poor.
d) Organizing the deprived segment of the society under an organizational framework which they can control by themselves.
e) Breaking the old vicious circle of poverty (low income, low savings, and low investment) by providing new loan, new investment and higher income.

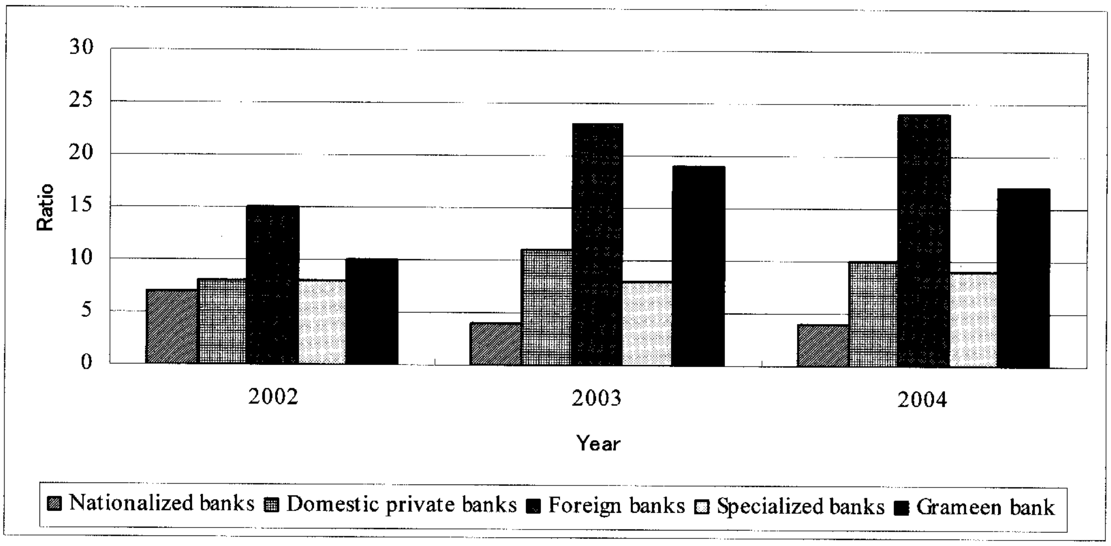


**Fig.2** Capital adequacy ratio of other banks versus Grameen bank

(Source: IMF (2005a, 2005b), MOF (2003))

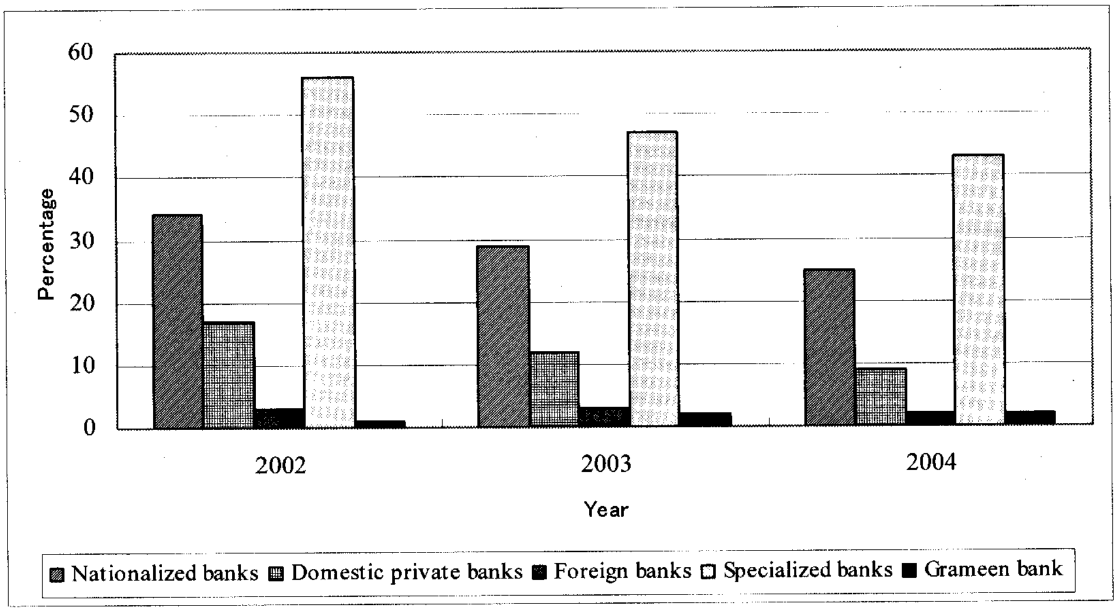


**Fig.3** Classified loans other banks versus Grameen bank

(Source: The same as above.)

## Salient Features of the Activities of Grameen Bank

The performance of Grameen Bank has outperformed all the non-bank financial institutions of Bangladesh. Figures 2 and 3 show the comparative performance of Grameen Bank with other banks operating in Bangladesh. We can see from both the figures that, in terms of capital adequacy ratio and percentage of classified loans Grameen Bank is performing better than those rates of the other banks, except the foreign banks. We should note here that foreign banks running in Bangladesh operate in very selective sectors and mostly serve corporate clients. Now the question is, how Grameen Bank is performing well compared to other banks? Yaron (1994) showed evidence of Grameen Bank subsidy dependence in 1987 and 1989. Morduch (1999) argued that, a part of this success of the Grameen Bank came from subsidies. However, in 1995 Grameen Bank decided not to receive any donor funds. Thus the argument of lending with subsidized funds received from donors will no more be applicable in discussing the performance of Grameen Bank.

On the other hand, Jain (1996) suggested that, strategic credit policies and credit conducive culture among employees and clients are the secrets behind the success of Grameen Bank. Thus there are arguments regarding the reason for the accomplishments of this bank. However, the majority of such reasons lies in the following unique banking policy of Grameen Bank:

**1) Collateral-free lending**

The loans are entirely collateral free and targeted for the poor. Persons holding assets worth more than the price of an acre of land are excluded from the loan program.

**2) Productive loans**

Loans are provided for productive purposes only, not for consumption.

**3) Group lending**

Borrowers of the bank are organized in groups of five people. Six of such groups constitutes a center and ten centers are supervised by a Grameen Bank employee, who is monitored by a branch manager.

**4) Borrowers as owners**

About 94 percent of the total equity of the Grameen Bank is owned by the borrowers and the rest is owned by the government of Bangladesh.

**5) Concentration on women**

Almost 96 percent of the borrowers of the bank are women borrowing money for various productive activities.

**6) Compulsory savings**

All borrowers are required to contribute in savings, group tax and emergency fund, which earns interest at regular commercial banking rates.

**7) Loans compensated at death**

In case of death of the borrower, the outstanding loans are paid off from the emergency fund under the Loan Insurance Program.

**8) Self-adequacy**

Although Grameen Bank had started its operation by receiving fund from IFAD, it had attained self sufficiency now. In 1995, it had decided to continue its operation from deposits.

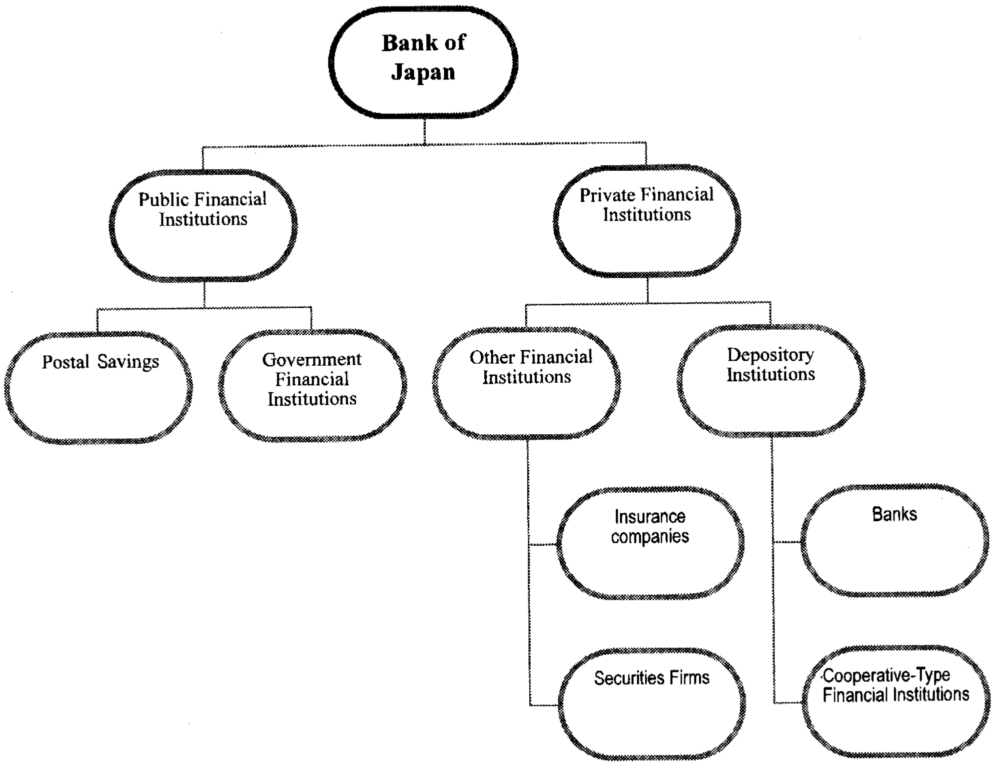


**Fig.4** The financial system of Japan

(Source: The Central Council for Financial Services Information (2005))

## 3. Case Study Two: Postal Savings of Japan

In Japan big businesses have financed loan money mainly from city banks, long-term credit banks and trust banks, and have issued their shares and bonds in the primary markets especially through and/or after high economic growth period. On the contrarily small and medium enterprises have long had the difficulty of such direct financing from the markets, and have financed from small- and medium-sized banks, especially regional banks, credit banks and credit union banks. But some of the companies are in the recent decades getting opportunities to do so in the newly established small and/or medium markets.

Yucho standing for Yubin Chokin (Japan Postal Savings; JPS) has accepted the enormous amount of depositors' money though it has the limit of the amount up to ten million yen per person. JPS has basically aimed promoting development and growth of public capital formation for national economic welfare, and has taken charge of the implementation of basic banking services for people all over the nation including lots of rural areas, and offering its large scale of money to strategically important industries via the Ministry of Finance and public financial institutions, so that it has often been regarded as the second kind of public financial system of Japan (See Fig. 4).

**Table1 Outlook of early history of the Postal Savings services**

| Year | Month | Events |
|---|---|---|
| 1875 | January | Postal money order service established |
| | May | Postal Savings Services established (deposit ceiling: ¥500) |
| 1880 | January | International postal money order service started |
| 1881 | January | Deposit ceiling abolished |
| 1885 | October | Telegraphic Money Order and Postal Order services started |
| 1891 | January | Deposit ceiling restored (¥500) |
| 1906 | March | Postal giro service established |
| 1908 | February | ¥100 million Postal Savings balance reached |
| 1910 | April | Annuity and pension payment service started |
| 1915 | March | National Treasury Fund receipt and payment service started |
| 1919 | July | Government bond subscription service started |
| 1923 | September | Emergency Postal Savings payment implemented following the Great Kanto Earthquake |
| 1931 | April | International postal giro service started |

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|---|---|---|
| 1937 | December | Telegraphic Transfer service started |
| 1941 | October | Teigaku Savings established |
| | December | Collection Savings (two-year) established |
| 1942 | May | ¥10 billion Postal Savings balance reached |
| 1948 | July | Government bond subscription service abolished |
| 1949 | June | Postal agency system started |
| | September | ¥100 billion Postal Savings balance reached |
| 1951 | April | Postal Savings Special Account system established |
| 1956 | July | Summary payment system established |
| 1958 | July | Telegraphic money order home payment service started |
| 1960 | June | ¥1 trillion Postal Savings balance reached |
| 1961 | July | Postal order system established |
| | September | Mutual relief annuity payment service started |
| | October | Time Savings (one-year) established |
| 1962 | March | Child support allowance payment service started |
| 1963 | April | Postal Savings Women's Monitoring system started |
| 1964 | November | Welfare pension payment service started |
| 1971 | August | National pension payment service started |
| 1972 | January | Housing Collection Savings started |
| | June | ¥10 trillion Postal Savings balance reached |
| 1973 | January | Depositor Loan system established (loan ceiling: ¥100,000; loan period: six months) |
| | December | Deposit ceiling raised from ¥1.5 million to ¥3 million |

Source: Japan Post (2005)

Table 1 shows the early history of postal savings service in Japan. In Meiji era JPS offered financial services to Japanese people and help them to make much of savings to activate it for investment within the country towards economic development. As is well-known one of the equilibrium condition in the closed macro-economy could be S=I, i.e. total amount of savings would equal to that of investments, it would become evidently efficient with reutilize of return of interest on the deposits of the household saving behavior, so that the nation could realize the self-finance to large extent for domestic investment.

Recent figures of households' financial assets portfolio at the end of fiscal year of 1985 and 2004 (tentative) respectively are as follows; JPS: 103 trillion yen (16%) and 213 trillion yen (15%), private financial institutions: 215 (34) and 521 (36), trust: 29 (5) and 10 (1), investment trust: 14 (2) and 38 (3), insurance and pension: 102 (16) and 375 (26), stocks: 53 (8) and 82 (6), bonds: 23 (4) and 29 (2), cash: 12 (2) and 42 (3), others: 79 (13) and 106 (8). The profit of JPS in 2004 was 1209 billion yen and its total amount of capital i.e. net assets volume was 5272 billion yen while the total assets amounted 264865 billion yen.[1)]

In 2005 Japanese Diet has decided the privatization of Japan Post including JPS, Japan Postal Insurance, Japan Postal Mail and others. Moreover the government is going to privatize other public financial institutions in the near future. The possible impacts of the privatization of JPS and others would later be discussed in other papers referring Uchida (1995, 2003) which touched upon the competition topics with respect to the relationship banking especially in regional markets.

## 4. Concluding Remarks

A brief literature survey-based study has been conducted in this paper for introducing the experience of selected financial institutions for common people and others from Japan and Bangladesh. The findings of the study might be summarized and concluded as follows:

(1) The success of Grameen Bank as a micro-credit providing institution is needless to be mentioned here again. But what is important is that,

conventional banking institutions can also apply the technique and approach of Grameen Bank to make their credit programs effective and lower the bad loans. For example, developing the credit supervision culture among the employees and clients by forming groups, lowering the administrative costs by keeping the number of the bank staff lower, encouraging savings etc.

(2) Postal Savings experience of Japan might be also very effective, especially for developing countries, to mobilize funds from rural areas where conventional banks find it difficult and expensive to get involved.

Finally, the need of the economy or society in different countries has led to the formation and establishment of various types of financial institutions for people and/or NBFI's. Their experience and cooperation might be helpful for the conventional banks to reach wider part of the financial markets

**Remarks**

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1) See Japan Post (2005) in details.

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