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Microcredit System and Bangladesh

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Abstract

Microcredit is the extension of very small loans (microloans) to impoverished borrowers who typically lack collateral, steady employment, or verifiable credit history. In this article, we will present some specified reports on microcredit. The noble prize winner Dr. Yunus made a revolution in Bangladesh. Here the situation of microcredit in Bangladesh with some data are presented in this article.

Keywords: System; History; Bangladesh; Programs; Issues.

1. Introduction

It is designed to support entrepreneurship and alleviate poverty. Many recipients are illiterate, and therefore unable to complete paperwork required to get conventional loans. As of 2009 an estimated 74 million people held microloans that totaled US$38 billion. Grameen Bank reports that repayment success rates are between 95 and 98 percent. Microcredit is used to describe small loans granted to low income individuals that are excluded from the traditional banking system. It is part of the larger microfinance industry, which provides not only credit, but also savings, insurance, and other basic financial services to the poor. The term 'micro' stems from the relatively small amounts of money that are being borrowed or saved. In recent years, microcredit, in its wider dimension known as microfinance, has become a much favoured intervention for poverty alleviation in the developing countries and least development countries. There is scarcely a poor country and development oriented donor agency (multilateral, bilateral and private) not involved in the promotion (in one form or other) of a microfinance program. Many achievements are claimed about the impact of microfinance programs, and an outside observer cannot but wonder at the range of diversity of the benefits claimed.

2. History of Microcredit System

Microfinance started in Bangladesh and parts of Latin America in the mid-1970s to provide credit to the poor, who were generally excluded from formal financial services. The model gained popularity and has since been replicated in low- and high-income countries. Over time, financial service providers have developed a better understanding of the wide range of financial needs of low-income people in both urban and rural areas. These needs might include asset building, managing irregular income flows, and coping with crises, such as sickness, death, natural disasters, and conflict. Many financial service providers now offer a wide range of products beyond credit, such as savings, insurance, and money transfers, to help poor people manage their financial lives. New technologies continue to create opportunities to broaden the reach and lower the cost of delivering financial services to poor people. Financial services are now available in many markets to anyone with a mobile phone, with innovation driving both improved product design and delivery. Today, microfinance is increasingly seen as one component of the broader financial inclusion system, comprised of various players with the common objective of delivering high-quality financial services to low-income people. Ideas relating to microcredit can be found at various times in modern history, such as the Starr-Bowkett Society. Jonathan Swift inspired the Irish Loan Funds of the 18th and 19th centuries. In the mid-19th century, Individualist anarchist Lysander Spooner wrote about the benefits of numerous small loans for entrepreneurial activities to the poor as a way to alleviate poverty. At about the same time, but independently to Spooner, Friedrich Wilhelm Raiffeisen founded the first cooperative lending banks to support farmers in rural Germany. In the 1950s, Akhtar Hameed Khan began distributing group-oriented credit in East Pakistan. Khan used the Comilla Model, in which credit is distributed through community-based initiatives. The project failed due to the over-involvement of the Pakistani government, and the hierarchies created within communities as certain members began to exert more control over loans than others. The origins of microcredit in its current practical incarnation can be linked to several organizations founded in Bangladesh, especially the Grameen Bank. The Grameen Bank, which is generally considered the first modern microcredit institution, was founded in 1983 by Muhammad Yunus. Yunus began the project in a small town called Jobra, using his own money to deliver small loans at low-interest rates to the rural poor. Grameen Bank was followed by organizations such as BRAC in 1972 and ASA in 1978.

3. Microcredit in Bangladesh

During the late 1970s, when the 'Jobra' experiment was underway under Professor M. Yunus, the Dheki Rin Prokolpa was initiated by the Bangladesh Bank in collaboration with the Swanirvar Bangladesh, and several other pilot schemes were initiated by a handful of the NGOs which were active then. At that time, it was difficult to conceive that these initiatives would lead to a major microcredit movement, which would make Bangladesh known to the rest of the world. Even during the 1980s, in spite of Grameen Bank’s success, the main discourse amongst development practitioners in Bangladesh centered around the desirability of microcredit program as opposed to conscientization. By 1990, unhindered experimentation in the fields led to a quiet resolution of the debate and the country experienced a massive expansion of microfinance activities during the 1990s. The devastating 1998 floods have challenged the substantial achievements of Bangladesh's microfinance programs. But many of these programs have proven to be resilient and are now getting back on their feet. A new World Bank study further confirms that microcredit programs can raise living standards - particularly for women and their households - but concludes that microfinance should not be the sole instrument for poverty reduction. The new study, Fighting Poverty with Microcredit: Experience in Bangladesh, assesses for the first time the cost-effectiveness of microcredit programs as instruments for poverty reduction based on the experiences of the Grameen Bank which pioneered microfinance, and two other major microcredit programs: the Bangladesh Rural Advancement Committee (BRAC), the largest non-governmental organization in Bangladesh providing financial services to the poor; and the Rural Development Project-12 (RD-12), a government-run program headed by the Bangladesh Rural Development Board. The study is part of an recently-completed World Bank research project "Credit Programs for the Poor: Household and Intrahousehold Impacts and Program Sustainability." "Microfinance has tremendous potential as an instrument for poverty reduction," says Shahid Khandker, Senior Economist in the World Bank's Poverty Reduction and Economic Management Network and main author of the study. "But complementary efforts such as literacy promotion and training are necessary to help those who lack the skills to make credit work for them. To reach the poorest of the poor, other targeted programs, such as wage employment schemes, are needed for those who cannot make productive use of microcredit," he added. Based on extensive household survey and program-level data, this study shows that microcredit programs are an effective policy instrument for reducing poverty among those poor people with the requisite skills to become self-employed. The report also found that microcredit programs are more cost-effective than formal finance in providing financial services to poor rural clients and are also more cost-effective than some other types of anti-poverty programs. In its analysis, the report confirms that microcredit programs are particularly important for Bangladeshi women, many of whom are restricted by social custom from seeking wage employment. Their only potential source of income is self-employment, and they face difficulty in accessing individual lending programs. Defying conventional wisdom, women, who constitute the vast majority of members, have proven to be excellent credit risks, with a rate of default that is less than one-third that of men. For many of the outcomes examined, credit extended to women has a larger impact than credit to men. For example, for all three of the microcredit programs studied, the impact on household consumption was twice as great when the borrowers were women. Women who participated in microcredit programs also increased their net wealth and their status within the household, and improved the quality of lives of their children as well. Although microfinance generates benefits for the poor and women in particular, it seems to benefit only that portion of the poor that is able to use loans productively. Analysis of household data indicates that many uneducated participants in microfinance programs tend to have special abilities such as oral accounting skills, for example, that enable them to use loans to generate income. Those who are eligible but do not participate in microfinance programs tend to lack these skills. While microcredit programs are worth supporting, they should not be considered a panacea for poverty reduction, the report concludes. Only people who have the ability to be self-employed can borrow, and only about 40 percent of the eligible poor households in Bangladesh participate in microcredit programs. Entrepreneurial ability is unevenly apportioned among any population - including women and poor people. For women who cannot participate because they lack skills or cannot participate in the wage market because of social restrictions, literacy promotion and training are necessary so that they can benefit from microcredit. In addition, other targeted programs, such as Bangladesh's Food-for-Work program, and broad-based economic growth are required for those who cannot make productive use of microcredit to escape poverty. Although the accrued benefits to borrowers and society justify microcredit program interventions, many Bangladeshi programs are subsidized by government and international lenders. Subsidized funds have been crucial for the institutional development of microcredit programs because of the high costs of group based lending, of mobilizing and training the poor to make them creditworthy, and of placing programs in poor agroclimate areas. For microcredit programs to attain full self-sustainability, that is, the ability to provide self-sustainable financial services to clients without help from donors, the report recommends that subsidy dependency should be reduced over time using a combination of policies, raising interest rates, reducing administrative costs, and improving staff productivity. This will help make microcredit programs less vulnerable to shocks such as this year's floods. The World Bank is supporting Bangladesh's microcredit movement through a US$105 million credit for a Poverty Alleviation Microfinance Project through the Government of Bangladesh. The project channels funds to Palli Karma Sahayak Foundation (PKSF), a quasi-government agency, which lends to more than 160 promising NGOs of all sizes to expand their microcredit programs, covering about 1.2 million borrowers. Large NGOs such as BRAC, Proshika, and ASA, covering a total of about 4.2 million borrowers, are also PKSF borrowers. The project also helps strengthen PKSF and partner organizations and ensure their institutional and financial viability through training, research, impact evaluation, and disseminating best practices for increasing cost effectiveness. Through PKSF, the World Bank is working to help shore up beleaguered microcredit institutions and meet the demand for new loans. "As a flood rehabilitation measure PKSF has already disbursed US$26 million to meet the demand for fresh loans from PKSF partner organizations. As a result, PKSF will have disbursed all the microfinance project funds from the World Bank by the end of 1999. To keep funds flowing, the World Bank has responded to the government's request to prepare a second Microfinance project," says Reazul Islam, World Bank Operations Officer and task leader of the Poverty Alleviation Microfinance Project. About the Microcredit Movement The microcredit movement was initiated in the early 1980s by the Grameen Bank, one of Bangladesh's best known providers of microcredit. In late 1980s, institutional credit providers mushroomed when many non-profit NGOs, recognizing the importance of stable income and capital accumulation on poverty alleviation, started targeted savings and credit programs for income generating self-employment. These programs have grown rapidly; during the past five years, the Grameen Bank disbursed about US$2.4 billion to nearly 2.3 million borrowers, while more than 150 NGOs providing microcredit have disbursed about US$260 million to more than 3 million borrowers. While the key operational and financial features of the credit programs are similar, the scope of lending and non-lending services offered by each microfinance institution varies. At one end of the spectrum are institutions whose non-lending services - comprising about half of their activities and credit schemes - include skills training, marketing assistance, and social empowerment. At the other end are institutions where credit activities dominate and technical assistance, if any, is limited. The typical microcredit lending scheme has the following key features: it is targeted to the landless/assetless, borrowers are part of a 15-20 person group which meets regularly; women are given preference (women make up 90 percent of the total borrowers); loans are collateral-free, and usually have a maturity of 50 weeks with weekly repayments, savings is an integral part of the program; financial transactions are recorded in individual passbooks in the presence of the entire group to enhance transparency and self-monitoring. Microfinance institutions start with a small loan (about US$25-$75) and provide repeater loans of increasing amounts as long as repayment of the earlier loan is satisfactory. This repeater feature is critical to the excellent repayment performance (most microfinance institutions have loan repayment rates in excess of 95 percent). More importantly, the basic premise is that the poor need to have continuous access to credit for 8-10 years to accumulate enough savings/assets to escape poverty. Microcredit institutions usually have upper loan limits, but few have a policy of "graduating" a borrower from the program, since borrowers of large loans are low risk after being in the system for several years. Borrowers have full freedom to choose the activity to be financed by the loan, which are mostly rural non-farm activities with short gestation and daily sales such as poultry farming, petty trade and shopkeeping, cattle raising, or handicrafts.

4. Coverage Under Microcredit Programs in Bangladesh

Microcredit programs (MCP) in Bangladesh are implemented by various formal financial institutions (nationalized commercial banks and specialized banks), specialized government organizations and semi-formal financial institutions (nearly 700 NGO-MFIs). The growth in the MFI sector, in terms of the number of MFI as well as total membership, was phenomenal during the 1990s and continues till today. The total coverage of MCP in Bangladesh is approximately 13 million households. Table -1 gives the coverage of major institutions in the formal and semi-formal sectors. There is debate, however, on the extent of overlap-one borrower taking loan from more than one microfinance institution. The general consensus is that a national average would be that 15% of all borrowers are borrowing from more than one MFI. In that case the effective coverage is about 11 million households. Out of 11 million households covered by MCP, about 80% are below poverty line and so about 8.8 million poor households are covered by MCP. With an estimated households of 26 million, out of which about 46% are poor households, the total number of poor households is approximately 11.96 million. Therefore, there is still scope of extending the coverage of microcredit programs to an approximate 3.16 million households.

Table - 1: Coverage of Microcredit Program as of June 2002

Name of the Organization	No. of Outstanding Borrowers	Disbursement Amount (Tk. in million)	Outstanding Amount (Tk. in million)
PKSF Partner Organizations' Borrowers funded by PKSF	3569565	67066.22	11912.45
PKSF Partner Organizations' Borrowers not funded by PKSF	4000979	90584.00	13880.68
NGO-MFIs not Partner Organizations of PKSF	1118931	29689.03	3503.925
Grameen Bank	2367641	161411.20	12218.7
BRDB	634500	26500.48	2148.20
Department of Youth Development	352956	4713.27	274.47
Palli Daridra Bimochon Foundation	276923	9158.18	1164.84
BARD	41494	734.33	167.88
Department of Social Services	49452	N.A	139.71
Bangladesh Small and Cottage Industries Corporation	46002	N.A	359.09
Manpower, Employment & Training Bureau	1912	N.A	131.04
Jatiyo Mohila Sangstha	3052	N.A	27.50
Janata Bank	129920	16240.40	991.364
Rupali Bank Limited Bangladesh Krishi Bank (BKB)	1519 418797	16.77 8346.00	9.09 3113.10
Agrani Bank	516241	19188.40	5528.52
Rajshahi Krishi Unnoyan Bank	11615	N.A	468.20
Total	***13541499***	***433648.26***	***56038.75***

Sources : *PKSF Statistics, CDF Statistics*

NGO-MFIs are the major providers of microcredit in Bangladesh. Table 2 depicts the sources of fund of NGO-MFIs in Bangladesh.

Table- 2 : Sources of Micro Credit and Revolving Loan Fund of NGOs.

(Fund : Taka in million)

Source	June '98		June '99		June '00		June '01		June '02	
	Fund	%	Fund	%	Fund	%	Fund	%	Fund	%
PKSF	2880.80	18.70	4784.00	23.48	6597.70	24.03	7598.70	23.50	8829.80	23.64
Local banks	1833.60	12.07	2343.00	11.50	3100.00	11.29	2959.60	9.51	3359.20	8.99
Foreign donation	3942.90	25.96	4157.00	20.41	4648.20	16.93	5633.00	17.43	6160.00	17.50
Members savings	3020.20	19.89	4813.00	23.63	6943.50	25.29	8321.90	25.74	9518.10	25.49
Service charge	2275.30	14.98	2338.00	11.48	3862.10	14.06	5563.30	17.21	6194.90	16.59
Others	1235.50	8.13	1936.00	9.50	2309.00	8.40	2251.80	6.97	3285.40	7.79
Total	**15188.00**	**100.00**	**20371.00**	**100.00**	**27460.00**	**100.00**	**32328.30**	**100.00**	**37347.40**	**100.00**

5. Micro-Entrepreneur

Informal businesses are the basis of economic life in the developing world. Markets in the centre of town are the main distribution centres, similar to supermarkets in the developed world, while street vendors take the place of our local shops and stores. Production of goods is usually local and artisanal, rather than large-scale industrialised. Part of the reason for this small geographic spread of activities is the lack of good transport infrastructure, lack of public transport, and relative high cost of private transportation. A micro-entrepreneur is an individual who either runs, or works in, the small businesses that constitute the informal sector of the economy. These businesses can be in a variety of sectors and industries, ranging from agriculture, farming, or fishing, to transportation, small shops or stalls, food production, or artisans. The structure of these micro-businesses may be individual, familial or collective. Some individuals may be entrepreneurs by choice, while others have become entrepreneurs through necessity due to a lack of employment opportunities. Levels of poverty can also differ from person to person, from the vulnerable non-poor to the very poor. While micro-entrepreneurs are a very diverse group, they have one thing in common: they are unable to access financial services through formal routes, such as traditional banks, because they do not meet the requirements that many of these institutions set, such as minimum deposits, collateral, a steady income, or a proven credit record. Today, more than 150 million people worldwide, served by more than 10,000 Micro-finance Institutions (savings and credit cooperatives, NGOs, micro-finance banks…) and commercial banks, benefit directly or indirectly from micro-finance activities. It is estimated that over 500 million entrepreneurs remain excluded from financial services.

6. Social and Other Development Impacts

(a) Health and Nutrition

There is positive program placement effect on nutrition status.

(b) Sanitation and Drinking Water

The BIDS study finds small positive influence of participation on waste disposal and use of sanitary toilets among the land-poor households with no clear evidence of program impact on hand-washing. The use of pure drinking water from hand tublewell was found universal.

(c) Literacy and School Enrollment of Children

Adult literacy rate is significantly higher among the eligible participants. The BIDS study also found that program participation increases the chance of both boys and girls to be enrolled in schools.

(d) Empowering Women

Microcredit programs' main target is women. There are strong evidences that, microcredit programs contribute to women's empowerment. One consistent finding is the increased selfconfidence and increased self-esteem. Another is women's increased in decision making in the areas of family planning, children's marriage, buying and selling of properties and sending daughters to school. There have been some evidences that members of microfinance institutions are able to stop domestic violence due to personal empowerment and through group action. In Bangladesh, microcredit programs have also increased women's participation in the activities of local government. Some women microcredit clients have been elected as Chairpersons and Members of various Union Parishads, the lowest and most vibrant tier of local government. Now women microcredit clients take greater roles in community activities and organizing for social change.

7. Important Issues

(a) Targeting the Poorest Versus Achieving Financial Sustainability: The Dilemma in Microcredit Studies of microcredit programs show that these have been successful in improving the economic condition of the members. Macro studies, however, show that there has not been any significant decline in the overall levels of poverty. This apparent contradiction may be partially due to the fact that the microcredit programs have not been very successful in including the hard core poor, who constitute about half of the poor in Bangladesh. The poorest may have been left out because quite often the destitute themselves feel they are not credit worthy and the microcredit programs also do not judge them to have the entrepreneurial ability necessary to handle money properly. Perhaps microcredit, especially in the form that is currently in practice, is not the answer for the hard core poor. Normally, the MFIs have been successful in expanding their outreach by providing microcredit to increasing numbers of borrowers who are near the poverty line, not well below that. The MFIs adopt this approach to reach financial viability within a reasonable time frame. If the MFIs are to borrow (from PKSF and other sources) at a rate close to market rate of interest, the effort to reach financial viability may become difficult and delayed. The partner organizations (POs) of PKSF have achieved financial viability at the present (subsidized) rate of service charge of PKSF. Therefore, in the context of Bangladesh there seems to be a trade-off between outreach and sustainability of MFIs and they should strike a judicious balance between the two which may enable them to achieve financial sustainability. Experiences suggest that the financial needs of the poor are best served by encouraging a broad range of institutions to provide efficient and responsive lending, savings, insurance, and other financial services that poor people need to build their business, increase income and assets, and reduce risks. Poor people need sustained access to an evolving set of financial products and services. These can only be provided by financially sustainable institutions, dealing with diverse segments and products, each in the position to increase outreach and grow with their clients.

(b) Widening the Target Group:

New Products and New financial Technologies The MFIs have some scope to expand horizontally-devising ways to include more people from the target group. More important is, as older borrowers graduate to higher income brackets, new products need to be devised to meet their changing needs. These new products may also help the MFIs to expand vertically by tapping borrowers outside the target group. A possible way to expand horizontally is to include more men. Research in Bangladesh and elsewhere show that men usually borrow larger amount. However, their repayment record is not as good as women. Including more men will allow MFIs to attain sustainability quickly, but it will also mean that the repayment performance of an institution will suffer as well. As the microcredit movement matures it faces the varied requirements of the borrowers and the need to offer a larger package of products.

(c) Accessing Non-Donor Source of Financing It is fair to say that donor funding and enthusiasm for microcredit will diminish in the future. This means that MFIs have to look for new avenues to fund their activities, potential source of fund will be to mobilize saving deposits of members and non-members. Another alternative is to try to tap commercial source of funding such as commercial banks, the local stock market and financial market. This option might be open only to large and wellestablished MFIs and may not be feasible for small MFIs.

(d) Internal and External Governance Issues Research in Bangladesh and other places show that a crucial element for the success of a credit granting NGO-MFI is the quality of leadership and management. The governance of NGOs is increasingly being discussed nowadays. Research findings indicate that governance and financial sustainability are closely interrelated. Weak governance and management characterize many microfinance NGOs in Bangladesh. It is commonplace to find friends, close relatives, retired bureaucrats, and such other persons in the governing bodies. They are mere onlookers and remain uninvolved with the board's business. The chief executives are said to overpower the boards. If this is the situation, goodgovernance will not occur by just inducting good people in the governing body. The essence of governance is to ensure an overall system of structuring accountability and transparency in an organization. The problems of governance are mostly due to the inadequacy of the existing laws and regulations and lack of reporting, supervision and monitoring. The MFIs are not to blame fully for this.

(e) Sustainability of Microcredit Borrowers An individual member may be considered as sustainable when he/she is capable of meeting the basic needs of his/her family without borrowing money/capital from the project or any other sources like banks etc. for consumption purposes. However, loans can be taken for IGAs. Most people are of the opinion that a member's sustainability should be judged by two separate but inter-dependent criteria, viz, (i) social development and (ii) economic development. Controversies, however, exit as to which of the two criteria should go first. Some people argue that economic development is a pre-condition for social development while some others consider social development as a prerequisite for economic development. Most people, however, are of the opinion that the two interactive and therefore be pursued simultaneously. Sustainability of borrowers is also linked with some programme challenges of MFIs, like devising appropriate microinsurance schemes and social protection schemes, providing other financial services to the poor.

(f) Service Charge of MFIs The MFIs in Bangladesh usually charge flat rate of 12 to 15% per annum from the microcredit borrowers. The effective rate becomes about 20 to 28% at the borrowers' level. Recently, there has debate whether this rate is too high or not. The critics of service charges of MFIs compare, somewhat erroneously, with interest rates of the conventional formal banking system. Microcredit is "banking at the doorstep" of the poor borrowers. The monitoring and supervision are quite intensive and costly. Therefore, the comparison with formal banks is not proper. There are several other factors like risks associated with collateral free loan, provisioning for doubtful and bad loans, compulsion to build up MFI's equity and attaining financial sustainability also are determinants of service charge of microcredit programs, Bangladesh microcredit sector has relatively lower rate of service charge compared to many other countries. However, social obligations, political realities and credit at a competitive rate may require consideration of reducing the rate by MFIs. But that should not be done by resorting to capping the rate. The actions to increase efficiency in the credit operation of MFIs, information flow at grassroots level regarding charges of various MFIs, increasing the loan size for the borrowers and healthy competition among MFIs may lead to competitive rates acceptable to all concerned.

8. Conclusion

Thus Governments can determine the rate of growth of the micro-finance industry within their country through the regulations they enforce. Many regulations designed for the banking industry may not be appropriate for the micro-finance industry, and therefore can be restrictive unless sector-specific regulations are introduced. Governments often also provide financing to the micro-finance sector within their country, something which can be both positive and may also harm the industry, for example by discouraging private-sector delivery of services.

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