

**The Success of Microcredit in Bangladesh:
Supplementing ‘Group Lending’ Explanation with
Institutional Understanding**

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— *Review of* —
**Integrative
Business &
Economics**
— *Research* —

ABSTRACT

Bangladesh has seen a phenomenal rise of the microcredit sector in terms of outreach, number of borrowers, amount of loans disbursed and institutions engaged. This study regards this as evidence of the institutional and socioeconomic successes of the microcredit model. In the institutional approach of success understanding – by taking a slightly different view than Joseph Stiglitz on the role of group mechanism of homogenous borrowers, the study examines the group formation, monitoring and supervision for explaining the high recovery rate of microcredit. The socioeconomic success of microcredit is assessed on the basis of indicators of the microcredit borrowers. The current debate on microcredit seems to understate these successes.

Keywords: Grameen Bank, microcredit, Bangladesh, institutional success, socioeconomic indicators, women empowerment

1. Introduction

As a country, Bangladesh has long been a paradox. Its burden of poverty is still indeed enormous: 31.5 percent of its 150 million people live below the poverty line (Ministry of Finance 2011), compounded by challenges due to frequent natural disasters, weak governance and the confrontational politics of its young democratic system (IDA 2009). These have not, however, been able to put it off from achieving a modest to fair economic growth and making an impressive progress in social indicators. Over two decades from 1991, economic growth has been steady at 5.0-6.5 percent a year, per capita income has more than doubled and the rate of population growth had declined. A trend of comparative human development index (HDI) over past two decades ending in 2010 of the United Nations Development Program (UNDP) bracketed Bangladesh and Cambodia as the “best improvers” among 24

countries in the Asia Pacific region (UNDP 2010).¹ On balance, part of this economic and social progress in Bangladesh is due to local innovations such as the microcredit initiative and partnerships with NGOs to deliver public services.

Development finance institutions (DFIs) and non-government organizations (NGOs), either under the control and direction of government or on their own, have become involved in various programs aimed at alleviating poverty since the independence of Bangladesh in 1971. But formal financial institutions, mostly based on collateral and codified methods of risk assessment, failed to offer finance to a vast group of people who were thought unfit to be bankable. This market failure led to the emergence of a financial product now famously known as microcredit. Interestingly, the institutional bodies which got engaged in the business of distribution of small loans or microcredit – known as microcredit institutions (MCIs) – were mostly NGOs.

To trace the shaping of the microcredit model, we find that in August 1976, Professor Muhammad Yunus pioneered an approach of lending to the poor, and demonstrated the self-sustainability of such lending under a project. Turning the project into the Grameen Bank (GB) in 1983, he demonstrated that microcredit lenders could ensure higher rates of loan recovery and returns even in the absence of collateral. That was possible in particular by attaching social and psychological proprieties to group formation, whereby repayment of loan became a collective responsibility. Added to that was the economic property of compulsory saving by the borrowers, to serve as a cushion against risk, an inherent part of the model. The success of the project and its subsequent transformation into a bank led to the proliferation of microcredit institutions to crowd the microcredit market in Bangladesh. As a result, Bangladesh has emerged as the “cradle of the microcredit movement” (Develtere and Huybrechts 2005:165)² and is now generally regarded as a mature microcredit market (Bagazonzya et al. 2010).

The success of the model in Bangladesh is supported by the evidence of an impressive growth of microcredit outreach, particularly since the 1990s. For example, as of June 2010, a total of 25.28 million people were the clients of over seventeen thousand branches of NGO-MCIs. Of them, 19.2 million, roughly around 13 percent of total population of 150 million, were microcredit borrowers (see Table 1). Importantly, the mainstay of the borrowers was poor women. Moreover, the MCIs maintained the growth in outreach with a 90 percent-plus recovery rate.

The diffusion of microfinance around the world is another testimony of success of the model, as more and more countries now have adopted microcredit programs to meet the financial needs of the marginalized people. The Microcredit Summit Campaign Report 2011 estimates that by December 2009, 3,589 MCIs reached more than 190 million clients in 58 countries in four continents of the world. Of the total, 128.2

¹ The composite human development index is prepared from respective country's indices of health (average life expectancy), education, income, inequality, poverty, gender, sustainability and human security in the Human Development Report of UNDP. UNDP follows distinctive complex method to calculate indices of the areas listed above.

² In the microcredit literature, Develtere and Huybrechts (2005) are seen to have first used the phrase.

million were among the poorest when they took their first loan and among them 81.7 percent, or 104.7 million, were women. In fact, the 128.2 million poorest clients reached by the end of 2009 might have affected some 641.1 million people all over, assuming that a borrower belongs to a five-member household (Reed 2011: 3).

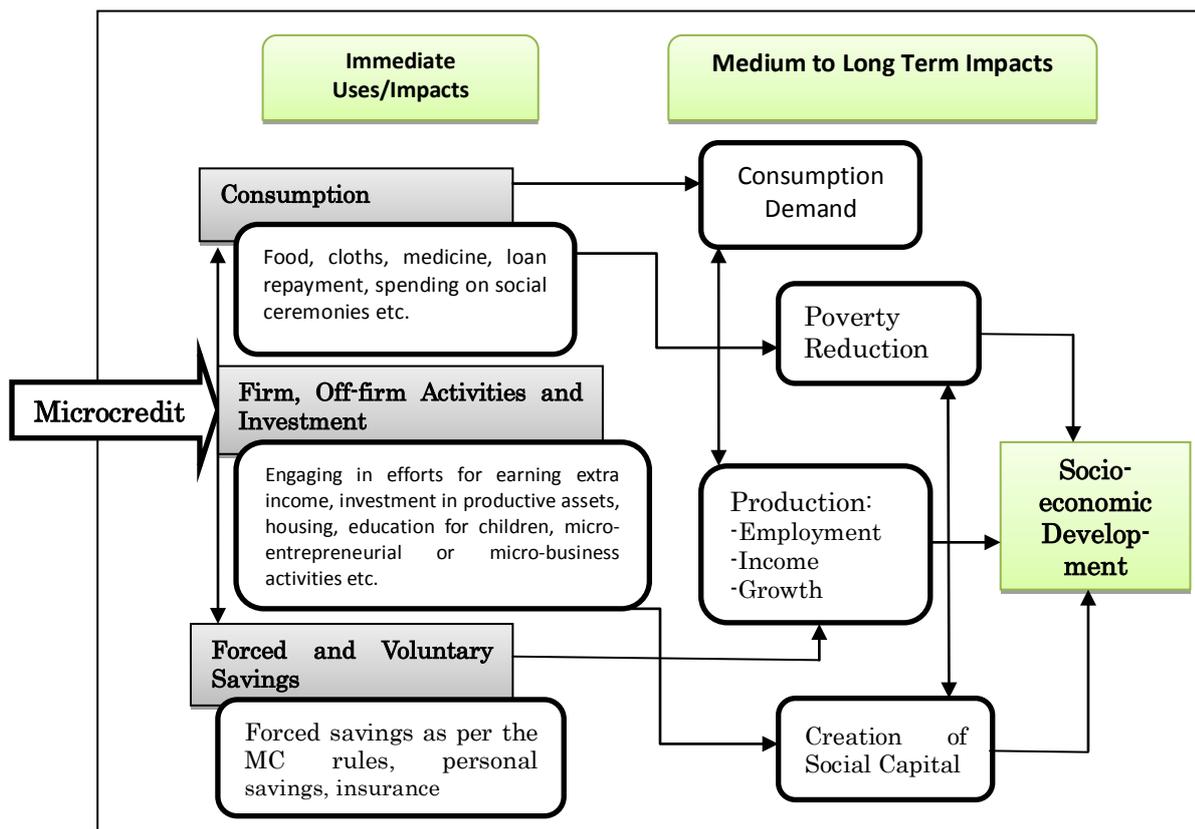
In recent times, however, the functioning of microcredit has come under scrutiny because of the perceived high rate of interest the MCIs charge and the seemingly vicious loan-cycle it creates for some of the borrowers. Despite the criticisms, we believe that the benefits of microcredit outweigh its perceived pitfalls. Our belief is based on the success of the microcredit model in Bangladesh which we attempt to assess from two viewpoints: *First*, the success of providers of microcredit in enhancing franchise value through the creation of an institutional “incentive-sanction” structure. This structure has been successful in eking out space by lowering transaction costs and minimizing the risk of default of distributed loans. *Second*, the impacts of microcredit on recipients in attaining the socioeconomic benefits they are supposed to achieve. A number of economic and social factors of the borrowers like income and consumption, employment and productivity, poverty reduction, household vulnerability, women empowerment, etc. have been examined to evaluate this. We would like stress that these two pronged successes are unique for a credit model which was accepted as a challenge to enter into a market segment where the formal financial institutions failed to play an appropriate role at a crucial time. The current debate seems to understate these successes.

The paper has five more parts. Part two provides a critical view on an existing theoretical explanation for the success of microcredit for both the parties - the providers of funds as well as the receivers of microcredit. Part three explains the “group lending” approach of Stiglitz to identify the recourse of success of the microcredit. The institutional and socioeconomic successes of microcredit are examined in parts four and five. Part six concludes the paper.

2. Theoretical Underpinnings of the Success of Microcredit Model

The microcredit operations in Bangladesh and in a large number of countries in the world owes to the experimentation of the “Grameen” project where borrowers were mobilized in “peer groups” composed of four or five individuals who were jointly responsible for each other’s monitoring and repayment. Several of these small peer groups were organized into a larger unit which would meet weekly with the primary purpose of repaying loan instalments. The demand for loans grew rapidly and Professor Yunus enlisted the support of the Bangladesh Bank and commercial banks to provide the Grameen Project, which was ultimately turned into the Grameen Bank, with resources (Zaman 2004). The operational frame of microcredit is based on collateral free credit to the poorer people, particularly to the economically marginalized women, who were considered non-bankable. The loaned amount is repaid on weekly instalments and all transactions are closed and cleared by the members in their weekly meetings. The core operational mechanism of microcredit of GB, and for that matter most of the NGO microcredit institutions, is dependent on solidarity lending and group hedging.

Let us try to pitch the underlying object of adopting microcredit as a financial instrument for socioeconomic development in Bangladesh. In operational terms, the microcredit model is bottom-up, meeting the credit requirements of the people who are marginalized and often ignored by traditional banks due to perceived high unit costs of transactions and their vulnerability to repay loans. Presumably, these finance-starved people would engage themselves in farm, off-farm and other micro-entrepreneurial activities once a line of credit is opened to them. This, in effect, would result in their increased participation in production and other non-farm activities, leading to a subsequent chain of rise in income and consumption. Towards this end, this should have a positive impact on the overall socio-economic development of the country by reducing poverty and income inequality, and by bringing expansion of entrepreneurial activities. The apparent simple mechanism and interment appeal have made microcredit a popular tool among NGOs and government bodies for reaching the poor to deliver finance, a much needed means for their poverty reduction. The inclusion of microcredit as an element of national development in the Poverty Reduction Strategy papers of various nations perhaps also indicates the relevance and success of the model (Hulme and Moore 2006: 1).



Source: Authors.

Figure 1: Impact flow-chart of Microcredit

Bebbington and McCourt (2005) note that microcredit has led to a “tangible enhancement of the human capabilities” of a significant population of otherwise

disadvantaged people in Bangladesh (cited in Hulme and Moore 2006, p. 7). It has happened either through direct investments and improvements in their assets or through the improvement of the environments in which they pursue their well-being. In that sense, microcredit may be regarded as a development policy success as well. Hulme and Moore (2006) describe that the extent of tangible enhancement of capabilities of the micro-borrowers as a more normative and debated issue. But they argue that, on balance, the evidence suggests that this is the case, “particularly through asset enhancement but also via positive effects on the socioeconomic environments in which the poor work and live” (Hulme and Moore 2006, p. 7). It is not hard to imagine the particularly “tangible enhancement of the human capabilities” of the disadvantaged people due to few if any alternative sources of financial services that are both accessible and affordable as they originally had low and unstable incomes, little or no land or assets and low social status. This very accessibility has changed the landscape for the cash-starved people at the outer margin of the society. Microcredit worked for them as a catalyst to change.

When the ‘accessibility’ of microcredit invites little debate, the ‘affordability’ of it does and from many. The single most important element that becomes the subject of criticism is the interest rate of microcredit, which may range from 25-65 percent (Molla and Alam 2011). High cost of delivery and supervision of the lenders is argued to be behind the escalation of interest burden for operating microcredit. Moreover, most of the practitioners of microcredit format their credit delivery in a standardized system, particularly in respect of gender preference, credit volume, credit disbursement and repayment schedules. Molla and Alam (2011, p.6) criticize this as “a strong limiting factor for effectively serving and promoting the microenterprises which required a more flexible credit package” and suggest “a methodological modification is necessary to accommodate flexibility in microcredit delivery system.” The authors of this paper are willing to accept their argument to a limited extent as they want to make a separation between microcredit and microfinance. While microcredit should serve as a seed capital for microenterprise, for their graduation to small and medium enterprises (SME), the role and responsibility of financing them should be shifted to a different set of formal financial bodies like the banks and SME Foundation in Bangladesh.³

The institutional understanding of success of microcredit model begets another kind of theoretical explanation that we can do in the following way. The theory of ‘information asymmetry’ can be considered as a root to explain the behavior of transaction costs of monitoring and supervision in lending activities. The by-products of information asymmetry are the ‘adverse selection’ and ‘moral hazard’, and they are integral to monitoring and supervision costs of a lending transaction. In general, the higher is the loan monitoring and supervision costs, the lower is the ‘bank rents’ or ‘incentives’ in intermediating finance unless a compensation is awarded in the form of increased interest rate. Unfortunately, an increased interest rate tends to generate ‘lemon problem’ or ‘Nash Equilibrium’ in the financial market by increasing

³ Bangladesh government has established the Small and Medium Enterprise (SME) Foundation in 2007 with the objective to finance grassroot level entrepreneurs for setting up their enterprises. These entrepreneurs generally do not fall in the category of microcredit borrowers. With their enterprises, the entrepreneurs are expected to help employment generation and industrialization of Bangladesh.

additional risk in the lenders portfolios followed by the higher rate of ‘non-performing loans’ and ‘credit crunch’. From this vintage point, an increased interest rate may not necessarily provide a good solution to curb increased monitoring costs which arises due to increased information asymmetry. Therefore, as an alternative, commercial banks usually rely on collateral in the form of land and building in order to reduce their transaction costs of monitoring and non-performing loans as well. This behavior of the commercial bank is logical in the sense that they (commercial bank) deal with contractual funds (depositors’ money) that need to be protected in order to ensure trust and confidence in financial transactions, and to avoid contagious bank runs. However, the collateralized financing technique may provide a safeguard against loans but not necessarily reduce the monitoring costs because of the fact that the repayment behavior of the borrowers depends on their business future cash inflows, and in the worst case, banks may wind-up with negative returns on loans despite having collateral. Further, the reality is that a vast majority of the clients cannot offer required collateral against loans and as such, credit becomes limited in the economy, and this becomes severe in the context of rural credits in developing economies.

In understanding the success of operations and positive impacts of microcredit, a bit of idea on social structure of Bangladesh could also be helpful. The World Bank (2008) points out that the structure of Bangladeshi society provided a unique context for change. Unlike other countries in South Asia, Bangladesh’s predominantly rural society has a high degree of linguistic, religious and ethnic homogeneity. While there are small ethnic minorities in the form of tribal groups and a large Hindu minority, the country does not have the level of ethnic or sectarian tensions that can create a substantial barrier to developmental activities. While *gushtis* (kinship based groupings) in Bangladesh do exercise a hold on their members, they do not fragment in the same way as caste, clan, *biradari* or linguistic affiliations do. This homogeneity makes it easier to organize women and contributes to the success of development campaigns by the working of microcredit. A segment of the population, though, resents the liberalization of women from the purda system Government programs are similarly easier to design and deliver.

3. Group Lending Explanation of Success

Hoff and Stiglitz (1990) mention that the rural financial markets of developing countries suffer from three types of problems: a ‘screening problem’, an ‘incentives problem’ and an ‘enforcement problem,’ which cannot be resolved through the traditional collateralized financing technique, but can better be resolved by the ‘group lending’ approach of informal institutions like non-government organizations (NGOs) and the Grameen Bank. According to Hoff and Stiglitz (1990:40), “*information is a by-product of living near the borrower or being part of the same kinship group or a party to some other transaction with him.*” From this perspective, informal players can do better screening and monitoring, as they have more detailed knowledge of the borrower’s character and skill. However, a borrower’s loan repayment behavior depends on his future business cash in-flows, and not on collateral. So it is very difficult and costly to ascertain which activities of borrowers will make repayment most likely. This problem is referred to as the ‘incentives problem’ in credit markets. To deal with the incentives problem, Stiglitz (1990) mentions that a ‘peer monitoring’ system, as developed by the Grameen Bank, creates an incentive structure wherein

each member of the group does the necessary monitoring functions for others in order to qualify loans at subsequent stages. Such a peer mentoring system not only reduces transaction cost of monitoring but also increases productivity of the investment, and thereby creates incentives for the financial players to disburse additional credits. Stiglitz offered following illustrations to explain these (for details, see Stiglitz 1990, p. 357-358).

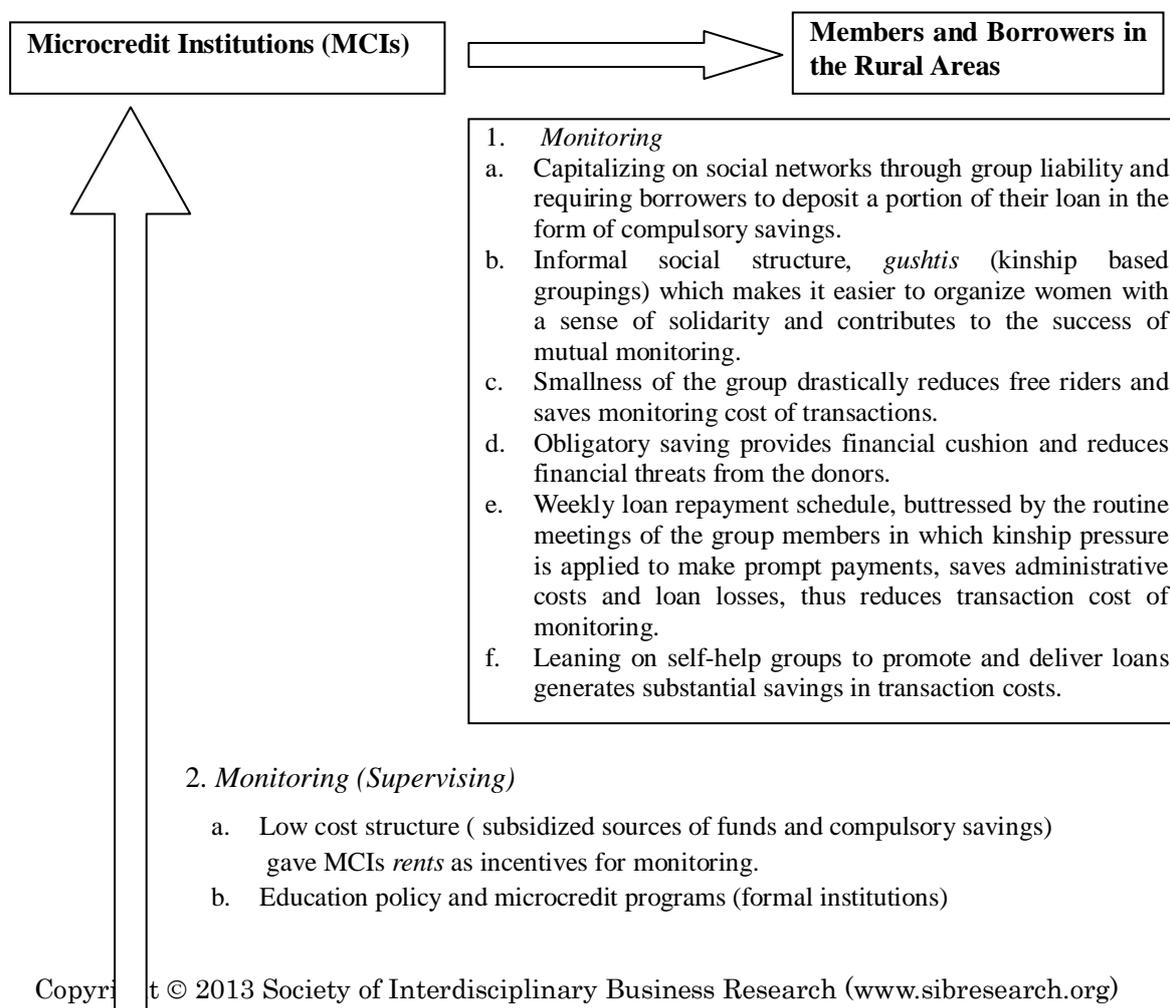
Figure 3A in the paper of Stiglitz (1990, p. 357) shows the indifference curves for the safe project (S) and the risky project (R). The switch line is defined as those combinations of loans (L) and interest rates (r). At a larger loan size, individual usually undertakes risky project which provides the indifference curves to have an escalloped shape (for detail mathematical derivation, see Stiglitz 1990). Considering the probability of success, it is assumed that the safe project will yield a better return than the risky project. Now, an increase in r will cause the risky project to dominate the safe project. However, an increase in L at a fixed r will increase the expected utility for the risky projects over the safe project. Therefore, an increase in L must be compensated by a decline in r to leave the borrower indifferent between the two projects. If the bank clearly understands the action of the borrower, it can motivate the borrower to select the safe project in order to ensure fair repayment.

Unfortunately, bank cannot directly control the actions of the borrower, and this creates incentives problem in credit markets. In this case, banks usually rely on loan covenants to induce borrower behavior to select the safe project, meaning that the bank must offer a contract which will lie on or below the switch line (Stiglitz 1990). The zero profit locus is introduced in figure 3B (dashed line) to understand the credit market equilibrium. Based on the commitment of the borrowers, the bank will offer the amount of loan below or above the market rate, which means credit rationing will take place and ultimately, the lender will limit his loan size. In order to increase monitoring activities of the bank, figure 4 (Stiglitz 1990, p. 358) incorporates a neighbor as a new borrower in which he agrees to cosign the loan contract in order to receive lower interest rate and additional funds. In this case, the expected utility of the cosigner depends on the actions of first borrower - to commit in risky project or safe project. If it is assumed that they will cooperate, then, the information symmetry between them will lead to undertake relatively safe projects and their joint utility will be higher and vice versa. It is to be noted that the cosigning of loan will add additional risk for the cosigners that needs to be compensated by providing additional loans. Figure 4 depicts that at $q = 0$, and given the banks zero profit condition, the risk burden imposed on the borrower by cosigning will exactly be compensated in the competitive interest rate charged by the lenders (Stiglitz 1990, p.358). Clearly, peer monitoring shifts up the switch line, and at low levels of q, the shift up in the switch line exceeds the shift needed to keep the borrower's utility unchanged, and thus, increases the borrower's total utility (Stiglitz 1990). In essence, the peer monitoring devices can reduce the problems of screening, incentives, and enforcements in the rural financial transactions, which are virtually impossible to adopt by the traditional banking mechanism. In the Grameen Bank model, these problems (screening, incentives and enforcement) have been successfully tackled by creating a small homogenous group of borrowers, designing incentives for extending or threatening loans at subsequent stages, and imposing joint liability mechanisms for monitoring and repayments, inter alia.

4. The Institutional Understanding of the Success of Microcredit

In this paper, we take a slightly different view of the argument put forward by Stiglitz in tackling the problems related to asymmetry of information through the creation of “small homogenous group of borrowers”. We argue that the asymmetry of information between the lender and the borrower (or informal players) is not always attenuated by the group mechanism of homogenous borrowers. In other words, important market failures in credit markets are caused by divergences in the state of *confidence* of lenders and borrowers in the information used to assess risk or in the reliability of instruments for monitoring risks. The difference in the degree of confidence emanates intrinsically from differences in the market perspectives of borrowers and lenders. Under conditions of uncertainty, swings of confidence are apt to be substantial and volatile (Suzuki 2011: 29).

Thus, the peer monitoring devices are not so always expected to reduce the problems of screening, as argued by Stiglitz. In our view, the incentive (sanction) and enforcing problems are much more important issues for microcredit business. Thus, addressing the asymmetry of information *per se* becomes a minor issue in explaining the success of the model. So far as the screening is subject to fundamental uncertainty, the monitoring upon *gushtis* (kinship) based groupings does not always attenuate the asymmetry of information. The system can provide a positive incentive at subsequent stages, but the main institutional feature of this system provides a “sanction” mechanism of giving threat against the non-repayment during the loan period.



- which contributed to improving gender equality.
- c. Large NGOs roles in managing donors.
 - d. Strengthening the regulatory framework on MCIs' portfolio.

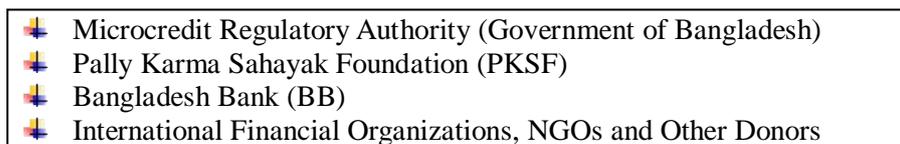


Figure 2: Microcredit - Monitoring and Supervision system in Bangladesh

Source: Modified, Suzuki et al. (2011).

With a huge membership base, GB and other MCIs are continuously facing the classic problems of informational asymmetries while offering microcredit to poor people. These problems are as classic and similar as they are with other formal financial institutions: screening the borrowers to avoid adverse selection, taking those actions or creating those incentives for making repayment most likely and overcoming the enforcement problem by compelling repayment (Hoff and Stiglitz 1990). A recovery rate of 90 percent-plus exemplifies how much successful the MCIs have remained in overcoming the incentive and enforcement problems to lower the transaction costs.

There are many overlapping explanations of why the microcredit model of financing worked in Bangladesh. These hang around the qualitative and quantitative attributes of microcredit – its utility to meet client needs, relatively low cost delivery mechanisms, generated resources that permitted it to survive and expand, and so on (Hulme and Moore 2006: 15). We, however, are trying to offer an institutional understanding of the success of microcredit model, by examining and explaining some of the important modes and factors that play an active role in reducing the impact of “incentive and enforcement” problems.

4.1 The foundation of microcredit is based on solidarity lending and group hedging. Smallness of the group consisting only five members has impacts on the screening of the good borrowers from the bad borrowers and the subsequent repayment of loans as the group is jointly held responsible for any lapses of repayment of credit. The group mechanism is also interlinked to social networks which are of vital importance in the society of Bangladesh. Within the group, peer pressure and group solidarity drastically reduce free riders and save monitoring cost of transactions as the group itself becomes an effective body of overseeing the borrowings related activities of the intra-group members. In the end, this may increase productivity of the investment; which in turn should create incentives for the financial players to provide additional loans. Supposedly, the members of a group can borrow for a wide range of activities. The opportunity to be engaged in those activities helps reduce their poverty and they can become regular installment payees. Though diversion of fund for different uses is not uncommon, the peer pressure plays a vital role for paying back the credit amount on time. Therefore, the peer group is a key factor to explaining the 90%⁺ repayment success of the microcredit sector. Moreover, group hedging has also helped the lending institutions to devise risk-insurance schemes against unanticipated shocks and uncertainties.

However, a number of other factors as explained next do influence the reduction of “incentive and enforcement” problems as well.

- 4.2 In most of the cases, there is no written contract or legal instrument between MCIs and their borrowers; the system works based on trust. Breaching trust brings stigma on one in the society and women want the least to bring it on them. As noted earlier, most microcredit borrowers in Bangladesh are women; for Grameen Bank they constitute 97 percent of the total. In a group composition, all members are generally known to each other or some of them could be kin. Thus information could be a by-product of such groups combining kins or transactions between intra-group members exist. That makes the space for breaching trust further squeezed in this functional set-up. As a set of personal, economic and social information rounds through the group most of the time, which ultimately reduces the information costs of lending to the group.
- 4.3 To supplement the lending, all the MCIs also require the borrowing members to save very small amounts regularly in a number of funds like emergency fund, group fund, etc. This obligatory saving provides rent opportunities and financial cushion to the MCIs. Ultimately, this reduces financial threats to their disbursed credits. Different funds so created in the operating process help serve as an insurance against contingencies. So the enforcement uncertainties and risk related to a member’s or group’s default in the repayment becomes lower due to availability of substitutable fund.
- 4.4 In practice, the group members often contribute the defaulted amount with an intention of collecting the money from the defaulted member later. Such behavior is necessitated by MCIs’ policy of not extending any further credit to a group in which a member defaults. This indirectly helps to overcome the enforcement problem as peer pressure becomes an incentive to make the repayment of the borrowed money more likely.
- 4.5 MCIs try to influence the psychological properties of the borrowers by inducing the borrowers to some principles. The GB, for example, has incorporated a set of *Sixteen Decisions* – based on the core values embodied in the Bangladeshi society. At every branch, the borrowers recite these Decisions and vow to follow them. As a result of the Sixteen Decisions, Grameen borrowers have been encouraged to adopt positive social habits. Similarly, BRAC has 17 promises that form the ‘Codes of Conduct’ for the participants of its microcredit program. The inducement factor of these ‘Decisions’ or ‘Codes of Conduct’, which are very much close to very deep psychological properties and common social values, can again help mitigate the “incentive and enforcement” problems of microcredit.
- 4.6 The internal mechanism of the group formation for reducing the “shirking” problem and hence the transaction costs of the micro-lending has been working well. This mechanism is endorsed and supplemented by vigorous monitoring by the MCI staffs, who remain present in every weekly meeting of each group. Their physical presence, advice and sometimes coercive tactics not only help the enforcement process but also reduce the shirking problems

and give MCIs confidence in their mode of monitoring the borrowers.

These modes and factors combine various organizational, economic, social and psychological elements in the institutional management process of microcredit. Together, they have played a unique role in reducing the effects of “incentive and enforcement” problems of the MCIs, which cannot be overcome through the creation of “small homogenous group of borrowers” alone. Paradoxical enough, the failure of the formal financial institutions to envision the problems and design a mechanism to handle them had made one market segment a “no-go zone” which created space for the MCIs to enter with microcredit and at the end they have come out successful with their venture.

Thanks to an enabling socioeconomic and regulatory environment also that has helped the NGO-MCIs and semi-formal institutions like GB to grow and mature with microcredit operations. The government of Bangladesh followed a least interference approach in their functioning as they were seen as important partners in the effort of poverty reduction and economic development. Zaman (2004) notes that, “[i]ndividuals in key positions within Government have time and again proved instrumental in facilitating the growth of the microcredit sector. The early development of the Grameen project, its registration as a bank and the decision to grant it managerial autonomy are clear examples, as was the establishment of PKSF with a strong autonomous board.” Not only that, the large NGOs in Bangladesh had been reasonably successful in “managing donors” at their initial stage of operation when their strategic sustainability required investment in the capital base for expansion. They had to convince the donors of the soundness of their strategy to use their fund. The donors with a long-term vision, also in their part, crucially required MCIs who were able to deliver. MCIs in Bangladesh conformed to their strategic view. So, along with the institutional factors, the conducive role played by the government and the strategy of managing the donors have to be credited for the successful inception and expansion of microcredit programs by so many MCIs in Bangladesh.

The explanation above may underline why microcredit has no longer remained limited to a few NGOs specific or region based financial instrument in Bangladesh. Rather, it has been experiencing a nationwide “microcredit movement”. According to Zohir (2010: 9), major microcredit institutions have reported the growth of numbers of borrowers around 10 percent on average, particularly since the early 1990s. This growth is impressive as it has been continuing for more than a decade.

Table 1: Microfinance Sector in Bangladesh – A Brief Account

Particulars	CDF, Dec 2003	MRRU, Dec 2004	June 2005	June 2006	June 2007	June 2008	June 2009	June 2010
No. of MCIs	720	352	469	641	425	453	489	482
No. of branches	5,642	6,106	7,733	12,156	11,461	13,636	18,022	17,252
Total clients (Million)	14.63	14.40	18.82	22.89	20.83	25.13	24.77	25.28
Total borrowers	10.65	11.14	13.98	17.18	17.01	20.40	19.50	19.21

(Million)								
Total Savings (Million Tk.)	15,561.0	17,293.7	21,005.4	27,636.1	37,759.4	36,397.3	43,668.6	51,362.9
Loan outstanding (Million Tk.)	36,493.5	43,406.4	56,058.8	75,198.7	85,872.9	114,536.8	121,881.9	145,022.7
% of Loan Repayment of 9 NGOs ¹	88.1	91.3	87.6	87.7	94.7	93.4	104.2	95.2
% of Loan Repayment of Grameen Bank (GB)	100.0	99.0	98.5	98.6	98.1	98.1	97.8	97.2

Note: ¹ These include the repayment status of BRAC, ASA, Poshika, Swanirvar Bangladesh, Caritas, TMSS, Shakti Foundation, BURO Bangladesh and Society for Social Services (SSS).

Source: Compiled. Microcredit Regulatory Authority. NGO-MCIs in Bangladesh, Various issues and Ministry of Finance (2011), Bangladesh Economic Review 2011.

Table 1 shows that a total of 19.2 million people were microcredit borrowers from 482 NGO-MCIs all over the country as of June 2010. Factoring in the overlapping number of borrowers, whereby one person can borrow from multiple microcredit lending organizations, could bring down the actual number of borrowers to some extent. But the aggregate figure shows the level of outreach of microcredit among the poor in Bangladesh. At the end of June 2010, on balance, the outstanding loan of the MCIs stood at BDT 145 billion while they collected BDT 51.4 billion as micro-savings. Furthermore, from December 2004 till June 2010, the number of branches of NGO-MCIs increased to 17,252 from 6106, whereas the number of borrowers increased by 72.4 percent. Available figures indicate that this growth was maintained with a very high rate of repayment of the MCIs. Table 1 has also listed the recovery rate of top 10 MCIs including GB and BRAC during the period. Evidently, the rate ranged between 88 to 104 percent. The national average rate of recovery for all the MCIs should also fall within the range.

5. Socioeconomic Impacts of Microcredit

The baseline question of researchers, policy planners and development agents becomes relates to economic and social welfare effects of microcredit on the individuals concerned (members, borrowers or customers) and the underprivileged people as a whole in Bangladesh. In fact, the number of individuals and households who have taken the recourse of microcredit is huge in the society. So any discourse on economic and social effects of microcredit tends to draw diverse views. Here we will devote a little space on that discussion.

5.1 A number of measures applied to assess income and consumption of the households who now have access to microcredit - including the analysis of “before-after” situation, gauging of borrowers’ perception and by regressing the changes in income and consumption to the changes in receipt of microcredit (Develtere and Huybrechts 2005: 168-69). Using both “before-after situation” and “gauging of borrowers’ perception” techniques for the Grameen Bank members, Hossain (1984,1998) finds a positive association

between income and economic condition of households and the amount of credit obtained. In a survey he finds that 91 percent of GB members perceived that economic conditions improved after joining GB. Similarly, a survey of Bangladesh Institute of Development Studies in 2001 shows that the nominal household income increased by 19 percent in villages where a microcredit program was operational vis-à-vis only 13.5 percent in control villages. Another survey on 300 households by Haque and Yamao (2008) concludes that after joining NGO-MFIs, nominal monthly income of the participant households increased compared to their income level before joining, though inflation adjusted income did not indicate any significant rise.

- 5.2 On employment and productivity, Rahman and Khandker (1994) demonstrate that the members both GB and BRAC were successful in expanding the opportunities of their self-employment. Further, self-employment activities had more than 50% contribution to total income for the participants, as against 43 percent in case of non-participants (Ahmed 2004). In addition, the average returns of the members are higher from non-agriculture activities compared with those in livestock and agriculture. Khandker (1998: 53) points out that microcredit could reduce the supply of wage laborers by increasing opportunities for self-employment, possibly leading to a rise in the wage rate. Moreover, microcredit programs significantly impacted total production as average household production increased 56 percent for Grameen Bank and 57 percent for BRAC in program villages. Appendix table 1 shows the estimation of Molla and Alam (2011) that for each Bangladeshi Taka (BDT) 1,000 microcredit invested for a year, a 31.7-mandays of job was created. This questions the significance of microcredit for job creation through promotion of self-employment. Moreover, the segregated figures for men and women bring out further the dismal show of women's position in terms of job creation. But clearly they have used a small base of microcredit for their inference. Now that the minimum amount of loan size in Bangladesh is BDT 5,000, investment of that amount for a year should create a total of 158.5 days of job for a borrower, making a ratio of 0.51:1.00 between microcredit induced labor-days and actual work days in a year.⁴ This is no mean achievement.
- 5.3 Most of the earlier studies on microcredit, like Khandker (1998, 2005), BIDS (2001), Zaman (2004), corroborate that the method has contributed to the reduction of poverty in Bangladesh. Khandker (2005) notes that “[i]n 1991/2, the average return to women's cumulative borrowing was 18%, and by 1998/9 this had risen to 21%; this resulted in an annual decline of the poverty rate among programme participants of five percentage points in 1991/2, and two percentage points in 1998/9” (cited in Hulme and Moore 2006: 10). A key finding of the BIDS study is that microcredit had a positive and significant effect on the poverty status of the program households (BIDS 2001: 155). The study of Haque and Yamao (2008), however, highlights an unwelcome development that under the group mechanism, the group leaders often ignore the bottom poor for the risk potential they would carry to the group at any point in time. In a sample of 500 microcredit borrowers, they find that the top 70% of the members were richer, with alternative sources of livelihood

⁴ 310 labor-days constitute a work year.

(Haque and Yamao 2008: 653). The bottom eight percent extremely poor members at one point became delinquent and defaulted in payment of installments. Ultimately they dropped out by self-exclusionary process from mainstream of microcredit programs and further trapped into the vicious circle of poverty (Haque and Yamao 2008: 653). Nevertheless, findings from a study administered between February and August 2009 in Bangladesh, presented in Appendix Figure 1, show the positive results of microcredit on poverty. The study on a nationally representative sample of 4,000 microcredit clients estimated that between 1990 and 2008 a net of 1.8 million microcredit client households, including 9.43 million household members, crossed the \$1.25 a day poverty threshold (Reed 2011: 10-11). The very small or slow graduation of the clients from below the poverty line to above the line in the years 1998-02 and 2003-08 coincided with the flood of 1998 and the food price crisis of 2008. Many households under microcredit program might have slid below the \$1.25 threshold due to those incidents, the study apprehends. On balance, however, the graduation results have remained positive.

- 5.4 Though on some of the impacts researchers are divided in their stands, there seems to be little disagreement among them on the issue that microcredit institutions are helping to reduce the vulnerability of their clients. Zeller et al. (1997) identify three pathways through which improved access to finance through microcredit could improve household food security, well-being and thus the overall vulnerability when struck by crisis or livelihood risk. These pathways for the household are: (1) additional capital led more income, credit, investment that enhance the level of productive human and physical capital and risk bearing capacity, (2) the positive effect on the composition of assets and liabilities, and (3) consumption smoothing (Hulme and Moore 2006). As evidence, Morduch (1998) shows that when compared with a control group, consumption variability from season to season reduced by 47 percent for eligible GB households and 54 percent for eligible BRAC households. In addition, microcredit members become less vulnerable when struck by crisis or livelihood risk (BIDS, 2001). The help of the MCIs in the overcoming of the 1998 flood (Zaman 2004), which submerged about two-thirds of Bangladesh, and the sailing of 2008 food inflation, which shot as high as about 15 percent, without any major social upheavals indicate the resilience developed by the lower segment of the society in Bangladesh.

Table 2: Impacts of Microcredit (compared to non-participants)

Broad Category	Indicators	Type of Change	Cause of Change
Economic Impact	Income	+	Self employment activities
	Food Security	+	Greater access to cultivable land through the rental market
	Wage (land poor)	+	Transport and other non-agri activities support by microcredit
	Employment (land poor)	+	? better access to the land rental market ? wage employment in non-agri sector

	Assets (land poor)	+	? average low land size than non-participants ? larger operational holding ? impact of MF (poultry livestock, bi-cycles, rickshaw/van)
Social and other development impacts	Fertility and contraceptive use		+ ? program participation ? female methods dominate
	Health and Nutrition	+	? program placement effect
	Sanitation and drinking water	+	? program participation
	Literacy and school enrollment of children	+	? program participation
	Social mobility	?	? do not vary significantly
	Women participation and HH welfare	+	? participation in a microcredit program ? increasing women's income

Source: Ahmed 2004.

5.5 The issue of “women empowerment” impact of microcredit deserves special attention because of the uniqueness of the issue in the context of socio-religious condition of Bangladesh. Still a segment of the population here resents the liberalization of women from the *purda* system. Whereas microcredit programs of the MCIs are essentially based on women members, for example constituting about 97 percent in GB. So making especially poor women the thrust of the microcredit movement was a serious challenge in the very first place. Arguably, microcredit programs have contributed to women's empowerment as on the “empowerment index”,⁵ a microcredit recipient female member enjoys more say than a non-recipient, including decision making in the areas of family planning, children's marriage, buying and selling of properties and sending daughters to school (Ahmed 2004). A number of activities like weekly meetings, interaction with inside and outside group members, and exposure to different ideas and information should have profound impact on the knowledge, awareness and behavior of the program members. These may help them to become confident, speak in public and take up a leadership role. Ahmed (2004: 9) observes that microcredit programs have enhanced women's participation in the local government activities as members are getting involved and elected as Chairpersons and Members of various Union Parishads.⁶ With those responsibilities, women microcredit clients are playing greater roles in community activities and mobilizing women's opinion for social change.

⁵ The index may focus on different criteria based on the social context. For the developing countries, the five criteria that are commonly used for index measurement include decisions over agricultural income, power over productive resources, use of time, leadership in community and decisions over income.

⁶ Union Parishads are the lowest and most vibrant tier of local government where members are elected directly by the voters. Each Union is constituted by few villages and the Union Parishad comprises elected ward members headed by an elected Chairman.

Though Molla and Alam (2011:1) in their survey find an unclear picture of women empowerment at the family level, they assert that “microcredit is seen as a means of protecting and enhancing socio-political empowerments of the low income and distressed people in the society and is appraised as a credible social [rather] than economic institution.”

The summary of the BIDS study in Table 2 indicates the improvements in other social indicators like penetration of sanitary latrines, schooling of children, child immunization, and use of contraceptives are more prevalent among the microcredit program members than non-members. So the socioeconomic impacts of microcredit seem to have become deep rooted among the program members in particular and the society as a whole.

6. Conclusion

Microcredit as an economic model of delivering small credits to the poor is assessed here from the impact on the emergence of a social economy, whereby an increased space has been created for their social and economic mobility into different classes. This has happened as a result of the reduction of their poverty and improvement in social indicators. Moreover, microcredit has not only succeeded in increasing the income and consumption of the poor, but has also impacted empowerment, in particular of poor women. Other spill-over effects of microcredit in different spheres of economic and social life are many.

On the institutional aspect, however, criticisms of the model as a neoliberal approach of development – and much more for its control and disciplinary imperatives to sustain the operational mechanism – are growing. The subsidized system of lending that the model has been benefited to thrive on is another area where the criticisms are harsh. Nevertheless, none can disregard the fact that a huge number of people got the support of microcredit when even the minimal finance was important to them. This happened at a time when the rural financial markets, dominated and exploited by the informal money lenders, failed to fill the vast financial vacuum.

Due to microcredit program of MCIs and various other intervention measures both by the government and NGOs, the rural economy of Bangladesh has been transformed and now seems to have achieved a set of preconditions to take-off. This we may argue by borrowing the Rostovian structuralist model of growth.⁷ These preconditions include the growth of the domestic demand for widespread goods and services, increased investments to change the physical environment and soft infrastructures (irrigation, ports, roads, bridges, educational institutions, etc.) for expanding production and the development of more productive, commercial agriculture and cash crops not consumed by producers. Not only that, the social structure in Bangladesh is changing rapidly with the individual social mobility, putting previous social equilibrium in flux. Moreover, with the spread of and access to mobile-phone based information, the “microcredit generation” is also getting ready to adopt newer

⁷ W.W. Rostow developed a major economic growth model that postulates that economic growth occurs in five stages, of varying length: traditional society, preconditions for take-off, take-off, drive to maturity and age of high mass consumption. The model is popularly known as Rostow's Stages of Growth Model, Rostovian Take-off Model or Rostovian Structuralist Model.

production technology without much shock. Thus, the role of microcredit has to be judged as a financial innovation that has penetrated a huge number of disadvantaged people in partnerships with NGOs to bring about those changes.

Thus, the role of NGOs along with government, to uplift the rural society to the present stage is too much visible and impossible to ignore. And the core of the NGO activity in Bangladesh still remains microcredit. Whatsoever the criticisms against microcredit, this will remain the single biggest contribution of the model to the post-independent society of Bangladesh.

Appendix

Table A1: Job creation of microcredit investment
(Per BDT 1,000 for a year)

Types of Labor	Labor Hours (Average)	Labor Days ³
Job Creation for Man	200.77	28.68
Job Creation for Woman ¹	25.06	3.58
Total Job Creation ²	221.88	31.70

Notes:

¹Woman spend time for receiving and submitting credit, that assume 50 hours annually, is not included here. Only average job hours that women spent for the microcredit investment activates are consider here.

²Average of the jobs created by individual borrowers

³Full-time labor day is considered as 7 working hours per day

Source: Modified. Molla and Alam (2011:6).

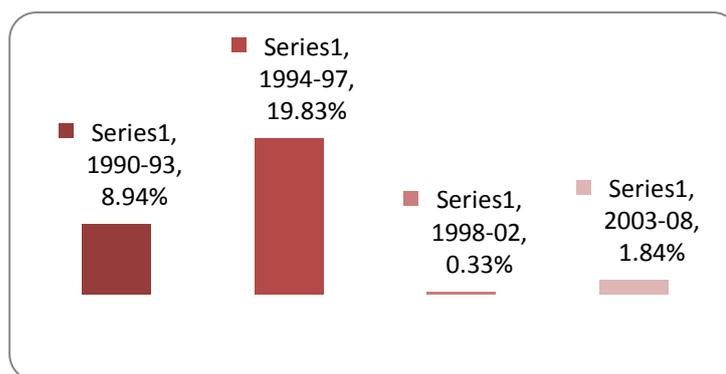


Figure A1: Net Percentage of Client Households Crossing the US\$1.25 Threshold in Bangladesh (Measured in PPP)

Source: Reed (2011), p. 11.

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