

EFFECTIVE MICROCREDIT BANKING TO ALLEVIATE THE POVERTY IN BANGLADESH

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The research focuses on the assessment of the MFIs (Micro Financial Institutes) & Small Business in Bangladesh; it focuses on the impacts of microcredit for growth & development of small businesses and improves the poverty condition. Bangladesh is one of the poorest countries in the world with low GDP/capita and minimum purchasing power. Almost a third of the total population (165 million) of the country lives below the national poverty line (\$2/day). Lifting the vast population out of the poverty conditions and ensuring sustainable economic growth are the most remarkable national objectives in Bangladesh. The development of successful and sustainable small business, which creates employment for low- and semi-skilled workers, mainly self-employed, is considered one of the most effective ways to lift a nation out of the vicious cycle of poverty, and thus is a key policy goal for Bangladesh. Paving the way for MFIs since 1970s, especially during the new wave of microcredit in the 1990s, has come to be seen as an important development policy and a poverty alleviation tool in the country. The aim of the paper is to analyze existing MFIs and their microcredit policies and propose effective microcredit policies for growth and development of small businesses, as well as socio-economic development. The researcher undergoes a field survey using semi-structured questionnaires and scheduled face-to-face interviews in Bangladesh. These analyses and the concept of the method of assessment of the impacts of microcredit determine the research methodology, research questions and the hypotheses which form the ideological basis of the research dissertation as well as its scientific contribution.

Keywords: Microcredit, Micro Financial Institute, Economic Growth, Poverty Alleviation

Tremendous poverty is the cause of permanent economic downturn and social depression in Bangladesh, and its ultimate goal and attention is to lift the vast population out of the vicious cycle of poverty.

To pave the way for first & foremost task is either to create employment directly or provide conditions for job creation to reduce the unemployment rate & accelerate the source and level of disposable income.

POVERTY IN BANGLADESH: HOW TO OVERCOME IT?

Given the predominance of agro-based economic activities, low level of technology presence & lack of availability of highly skilled laborers, small scale businesses, which create employment for non-skilled & semi-skilled workers, especially self-employed, have been most suitable for facilitating sustainable economic growth and improve poverty condition in Bangladesh, thus becoming one of the main policy targets in the country. However, the ways for achieving growth & development of small business are not smooth enough. They are frequently

confronted with infrastructural, financial, entrepreneurial, as well as social challenges.

To prevent the constraints, the government of Bangladesh has taken various initiatives, including policy advocacy & intervention for growth of small business, facilitating financial support for small business investors, providing skill development & capacity building training, facilitating adaptation with appropriate technologies and access to ICT, and providing business support services through the **SME (Small and Medium Size Enterprise) Foundation** created under the ministry of industry in 2007. Along with these, since 1974 many NGOs (Non-government Organizations) and private organizations, especially MFIs (Micro Financial Institutes) have been offering collateral free loans to impoverished investors to involve them in entrepreneurial and various financial activities.

But despite these initiatives, growth &

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Table: Microcredit Sector in Bangladesh (Basic Activities)

Particulars	June 2011	June 2012	June 2013	June 2014	June 2015
No. of NGO-MFIs	576	590	649	742	753
No. of Branches	18,066	17,977	14,674	14,730	15,609
No. of Employees	111,828	108,654	110,734	109,628	110,781
No. of Clients (million)	26,08	24,64	24,60	25,11	26
Total Borrowers (million)	20,65	19,31	19,27	19,42	20,35
Loan Disbursement (BDT milliard)	303,18	456,02	432,28	462	634
Amount of Loan Outstanding (BDT milliard)	173,79	211,32	257,01	282,20	352,41
Amount of Saving (BDT milliard)	63,30	75,25	93,99	106,99	135,43
Loan Recovery (BDT milliard)	271,83	314,11	375,07	447,89	522,47
Recovery Rate	95,52	97,74	97,69	95,64	96,02

Source: MRA-MIS 2015.

Note: BDT (Currency of Bangladesh); \$1 = 83,17 BDT.

development of desired scale of small business is still lagging behind, as the ministry of industry's SME Foundation 2007 is yet to make any noticeable progress in identified areas, and MFIs in Bangladesh are not effective enough to reach the economic growth and poverty alleviation goals due to their ineffective policies & high interest rate of loan capital.

To get the real development, actual needs of small business are required to be addressed and effective policies are needed to be adopted including good micro economic policy, entrepreneurial knowledge & training to entrepreneurs, SMEs development programs & use of changing pattern of technology.

The research is to propose effective microcredit policies for growth & development of sustainable level of small business and improving socio-economic conditions in Bangladesh.

MICROCREDIT & RELEVANT SCENARIOS IN BANGLADESH

With a view to lift the vast population out of the vicious cycle of poverty through involving it in income generation activities, Dr. Muhammed Yunus, a social entrepreneur, banker and a professor of economics at Chittagong University, initiated a microcredit program named "Grameen Bank" in Bangladesh in 1974 to provide initial investment capital without collateral to underprivileged population, primarily targeting the poorest of the society, to bring economic and social development. In 2006, jointly with the Grameen Bank, Dr. Muhammed Yunus was awarded the Nobel Peace Prize for founding the Grameen Bank and pioneering

the concepts of microcredit and microfinance. Now, microcredit is a widespread program in Bangladesh and a household name.

The major objectives of microcredit schemes are:

A. To provide microcredit to poor people at relatively low interest rate compared to formal lenders.

B. To finance economically & socially durable projects which would not be financed otherwise.

C. To provide small credit without collateral to the impoverished investors who can't secure loan from conventional banks.

D. To empower women through involving them in economic activities.

E. To accelerate economic growth activities and employment opportunities.

With regard to income generation opportunities of Bangladeshi poor, microcredit emerges as the most unique innovation of credit delivery system in the last four decades. The basic activities of MFIs in Bangladesh are shown in *table*.

For various reasons, obtaining loan from formal financial institutes is very difficult for the underprivileged, and it is an emerging agenda for development in Bangladesh to gain access to credit. MFIs provide easy accessible small credit to the impoverished people to establish small businesses or other income generation activities. As of June 2015, 753 licensed NGO-MFIs are operative in Bangladesh with BDT 634 bln in disbursed loans and BDT 352,41 bln in outstanding loans [16] (*table*). According to Microcredit Regulatory Authority (MRA) 2015, MFIs serve around 26 mln poor (*table*) that is accounting for 15,76% of the total population

of Bangladesh (165 mln) [23], whereas government sector serves 12 mln poor that is accounting for about 7,27% of the total population [16].

An increasing trend was noticed in the number of clients and in the volume of loan disbursement over the period between 2011 & 2015 (see details in *table*).

The main obstacle for impoverished individuals and small enterprises to access formal financial service, which has turned their attention to MFIs, is the credit with collateral. MFIs provide easy accessible loan to the impoverished investors without collateral. As of 2015, 42,000 SMEs have joined the loan programs of MFIs.

MFIs have spread their operation throughout the country & created direct and indirect employment during last 4 decades. As of June 2015, in its countrywide 15,609 branches, the sector has created jobs for 110,781 people [16].

The sector has also contributed to introduce micro & small scale businesses and indirect employment, basically self-employment, through BDT 634 bln in loan disbursement to its 20.35 mln borrowers [16] (*table*). As of 2015, 13,5 mln small businesses were created by the microcredit of MFIs which created self-employment for business owners and almost the same number of jobs for others employed by these businesses.

Microcredit has become to be seen as an important development policy and enabler for growth and development of small businesses and various income generation activities through easily accessible credit programs, as only below 10% of the adult population in Bangladesh has bank accounts and literally has access to formal financial services. Microcredit programs of MFIs prevent the impoverished investors' liquidity constraints and make them more active in financial activities.

One of the significant roles that microfinance has in local economies is providing credit to low-income and poor families to start up financial activities with the means to become financially stable, which helps breaking the cycle of poverty in the current generation and work toward ending poverty for the future generation. A study conducted by Khandker M. and Shahidur R. (2005), on 1000 microcredit recipients of three major MFIs of Bangladesh (ASA, BRAC & Grameen Bank) between 2003 & 2004, noticed that clients who joined and stayed in microcredit program had better economic condition than non-clients, suggesting that programs contribute to these improvements [11].

NEGATIVE IMPACTS OF MFIS IN BANGLADESH

Despite these positive statements, the real impacts of microcredit on economic growth and poverty

alleviation are a highly debatable issue in Bangladesh. Since its debut, microcredit has not had very positive impact but rather has led many borrowers into debt trap or in some cases leading to suicide or selling organs [10; 17]. Prof. Mohammad Yunus, the founder of Grameen Bank in Bangladesh, believes that 5% of Grameen Bank's clients exit from poverty each year but there is no credible evidence [1].

A study conveyed by Wastover (2008), noticed that among six representatives, five found no evidence that microfinance reduces poverty, though she found other positive impacts, for example women empowerment and child education [21].

Kathrina Hartman, the German Journalist, told about the trapping in debt of women whom she met in 2012 at Kurigram district in Bangladesh. The rural women who were the borrowers of microcredit told her about the brutal methods of enforcing debt repayment, including being forced to sell cattle, house utensils and land. In order to repay the loans, children are dropped out of school to earn money and food expenditures are cut down significantly [10] and some are even made to sell their body organs [4].

In order to be able to repay loan, newly indebted men and women sold their kidneys, as discovered by the police in summer 2011 [20].

Professor Mohammad Moniruzzaman from the department of Anthropology at Michigan State University, who has been researching the organ trade in Bangladesh since 1990, stated that many sell organs to make repayments, and they had no other choice but to sell a body part [18].

The primary goal & mission of microfinance is to alleviate the poverty and promote the quality of living through various income generation activities and creation of employments. But they are very far from the target as many borrowers have been driven into debt trap or several loan cycles, in some cases have even been led to suicide. [10; 17].

WHY MICROCREDIT DOESN'T WORK

MFIs provide collateral free loan to underprivileged to establish businesses or other income generation activities. A large number of small businesses are introduced by microcredit of MFIs in Bangladesh every year but most of them don't stay afloat for long and the investors fall into deep poverty due to the need to repay the loans. Moreover, credit is very often invested in non-productive sectors, for example, to buy goods, build houses etc. and to repay the loan they are forced to sell cattle, houses and even body organs.

An empirical study conducted by Islam (2010), imposed on 550 small-scale businesses initiated by microcredit taken from several MFIs of Bangladesh between 2008 & 2009, found that microcredit

accelerates a third of new businesses every year but 75% of them fail before their first anniversary, which pushes the clients from poor to ultra-poor due to receiving loan [9]. In their individual studies, Westover (2008), Mia (2000) got almost the same results [21; 14].

THE COMMON CAUSES WHY MICRO CREDIT IS NOT EFFECTIVE IN BANGLADESH

Lack of entrepreneurial & managerial knowledge & skills of MFIs borrowers

Microcredit borrowers, who do not have necessary requirements to receive loans from the conventional banks, are marginal and disadvantaged members of the society. They can't utilize the loan

quoted that loans which are received from microcredit lenders are very often invested in non-productive sectors, for example to buy durable goods, to build houses or to pay for weddings of children. To repay the loan they don't have any other options but to sell their cattle, property, lands and even the body organs [12].

Ineffective Credit giving and repayment policies

Loan functions of existent MFIs in Bangladesh are ineffective. MFIs in Bangladesh form a group of five potential borrowers and train them how to receive and repay the loan (figure 1) instead of providing entrepreneurial, managerial and bookkeeping knowledge & training to make them successful entrepreneurs; these bring no real change

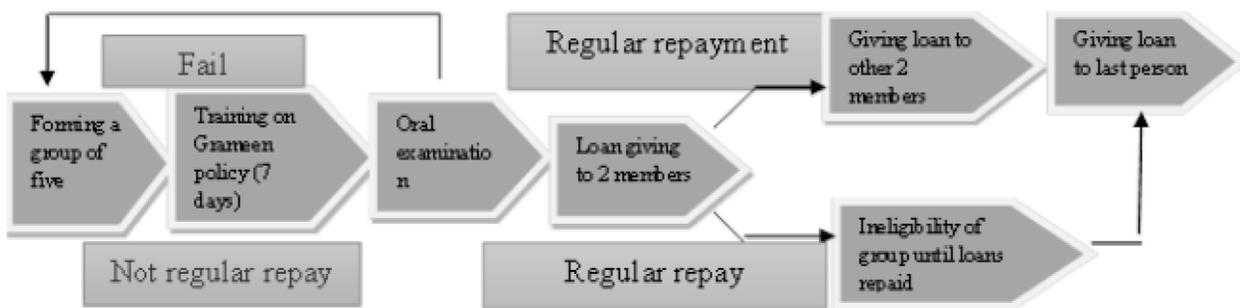


Figure 1. Loan functions of first modern micro credit institute 'Grameen Bank'.

Source: Computation by the author 2015.

capital effectively & manage the newly introduced financial institutes perfectly, causing landslide investment failure which leads them into deep poverty.

A study conducted by Abhijit Banerjee of MIT poverty action lab in the slums of Hydrabad first evaluated the impact of microcredit in new markets in 2012 and indicated that microcredit increased the number of businesses by 1/3, but 2/3 of them are not very profitable and cannot survive longer than six months due to the lack of entrepreneurial knowledge of impoverished investors and non-effective investment [2].

Ineffective investment

Microfinance borrowers are marginal and lack entrepreneurial and managerial knowledge and experience. They don't know how to invest and in which sectors the capital should be invested for an appropriate rate of return. Most often, the borrowed money are invested either in least profitable or non-productive sectors to earn a decent return on investment; as a result, borrowers fall into loan traps or several loan cycles.

Nicholas Kristofer, a Pulitzer Prize winner,

but pulls large number of borrowers into tremendous poverty and loan traps every year. Figure 1 shows the ineffective character of MFIs loan function in Bangladesh.

High interest rate

Interest rates of existent MFIs are relatively higher, which limits their ability to facilitate growth and development of small business and fight against poverty. For microcredit, 27% is the average interest rate [6; 15]. 27% interest rate means that if borrowers don't manage to earn at least 27% rate of return, they eventually end up poorer as a result of accepting loans, which is a very common scenario in Bangladesh.

Inconvenient Repayment structures

Repayment policy of NGO-MFIs in Bangladesh is also not effective for growth of small business and fight against poverty; rather, it is a kind of debt trap. The MFIs get their loans back with 46 installments a year. First installment is due on the 15th day of receiving loan; the next ones are due every week subsequently. It is too little time to invest the small investment capital into a profitable sector to get return on investment. If borrowers can't manage to

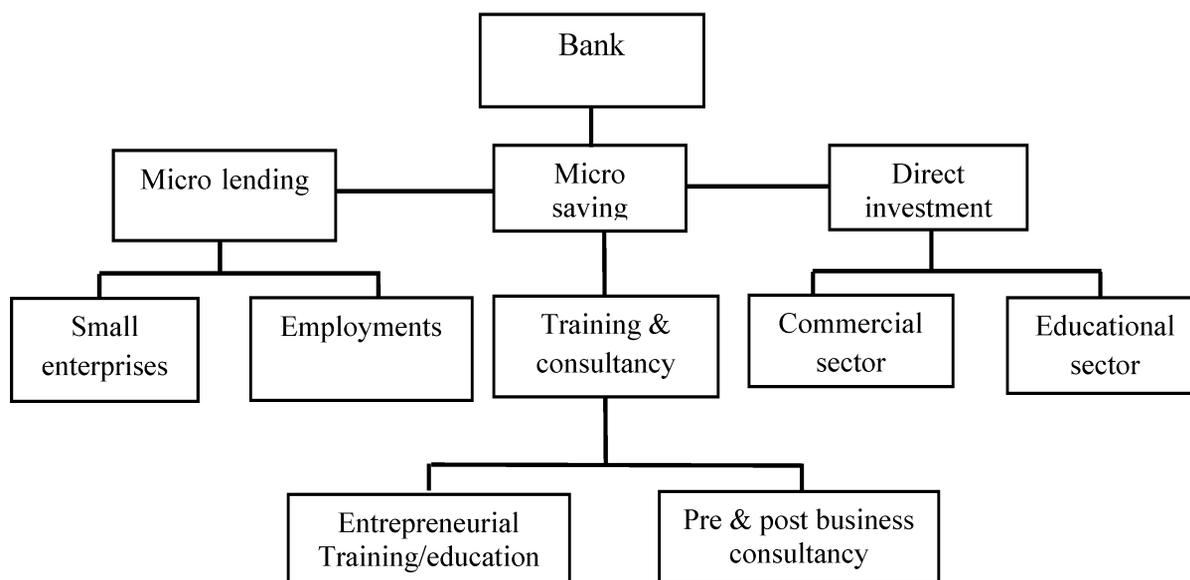


Figure 2. Banking structure.

Source: Computation by the Author 2015.

earn at least 27% rate of return every week, they are confined in loan traps or several loan cycles as they take the 2nd loan to pay out the 1st loan.

How Microcredit will succeed

Microcredit is a very effective tool for growth & development of micro and small scale business and alleviates the poverty. But it doesn't work by itself. Just providing a loan to its clients is not good enough to reach the poverty alleviation and socio-economic development goals. To reach the poverty alleviation goal, microcredit policies are needed to be implemented and managed effectively & services are needed to be designed to meet the needs of clients, thereby not just only clients but also their families and the wider communities can benefit. Sustainable development can't be achieved unless large population groups find ways for their own development.

The most important task is to find the ways how banking & investing can:

- Strengthen local community
- Support good green business
- Lift families out of poverty &
- How can it be started effectively today

When loans are associated with an increase in assets and money liquidity is accelerated effectively, when borrowers are encouraged to invest in low risk income generation activities and when very poor are encouraged to save; the vulnerability of the poor people is reduced & the poverty condition improved [7]. So, together with credit, other complementary factors are vital, including selection & motivation of entrepreneurs, identification of

livelihood opportunities, business & technical training, establishing of market linkage etc.

The following reformation of MFIs could be a viable alternative to reach its economic growth and poverty alleviation goals:

Banking Structure

The main objective and focus of MFIs is to lift the poor out of vicious cycle of poverty through growth & development of small businesses and various income generation activities. To pave the way for this, effective banking structure & investment policy are especially significant. The MFIs can pursue the 3 functional micro financial activities: Micro lending, Micro saving, Direct Investment. The loan must be easily accessible with low interest rate which will reduce underprivileged peoples' liquidity constraints and accelerate the growth of small enterprises and employment generation. The Micro saving will create the saving habit of the impoverished population which will accelerate their money utilization and resistance for the rainy day. The direct investment policy of the MFIs will accelerate the revenue & leverage of MFIs. Moreover, training and consultancy program of MFIs will increase the entrepreneurial skills of underprivileged investors (credit recipients). The persuaded banking factors will encourage and increase entrepreneurial activities and reduce the small business failure rate and bring socio-economic sustainability. The recommended banking structure of MFIs (*figure 2*) could be a potential breakthrough to this objective.

Collateral free loan programs

Access to easy financial services is very significant

for growth and development of small business [1; 13]. But access to formal financial services is one of the most remarkable constraints for small business investors, especially who are with lack of assets [8; 14]. Less than 20% of small businesses in Bangladesh have access to institutional financial services [8]. The main obstacle to access to institutional finance by small entrepreneurs is the credit with collateral [8].

If MFIs introduce collateral free microcredit program with effective credit giving and payback principle to curb the financial access interruption of underprivileged entrepreneurs, it will be very effective to enhance the growth and development of small enterprises and to alleviate the poverty in Bangladesh.

Credit giving policy

The ultimate goal of MFIs is to accelerate the economic growth activities and to lift the impoverished people & areas out of the vicious cycle of poverty through providing easily accessible low interest loan to its credit recipients for entrepreneurial activities. As loan giving policy, if MFIs first surveillances the projects of the loan applicants and provides knowledge & training in the areas including entrepreneurial, managerial, marketing and bookkeeping spheres before providing them loan capital, it'll be very effective to accelerate the small business's growth potentiality & success rate.

MFIs can pursue the following pre & post credit allocation policy:

- Forming a group of five potential borrowers
- Surveying their planned projects and projects' survival & growth potentiality
- Effective entrepreneurial and managerial training
- Loan allocation according to plan project

Credit giving & repayment reformation

Credit policies and repayment structure of existing MFIs are ineffective for sustainable economic growth by marginal entrepreneurs and improvement of the poverty conditions. MFIs receive their loan back with 46 installments in a year and 1st installment is started on the 15th day of receiving loan, then every week subsequently. It is type of 'cat-and-mouse game' as it is too little time to invest a micro credit into a profitable sector for a good return on investment.

If MFIs diversify the loan functions to **Short term** & **Long term** credit programs, and introduce different interest rates and repayment strategies for different loan functions, it will be more effective.

Short term credit: For short term credit, if MFIs impose 7% annual interest rate and apply flexible installment based repayment principle, it will bring

positive outcome. The MFIs will get the loan back with 12 monthly installments over a year, and the first installment will be due a month after receiving the loan when they start receiving revenue from their portfolios.

Long term credit: In the case of long term loans, if MFIs set 10% annual interest rate and get the total loan back with the interest in single installment after a year of receiving loan it'll be very positive.

The low interest rate of MFIs loan will minimize the pressure on credit recipients and payback principle will enlarge the time to invest and make profit which will accelerate the small business's profitability and success rate.

In Bangladesh, impoverished investors invest in mainly 2 types of income generation activities: firstly, to introduce small businesses wherefrom revenue and profit comes daily basis and secondly, to introduce farming including cattle fostering, poultry farming, fisheries etc. which take 9-12 months to get return on investment. Due to the investment failures of the small investors in Bangladesh, the MFIs should pursue the different loan functions for better outcome.

Entrepreneurial training

Every year 1/3 of new small business is set up with the help of MFI microcredit in Bangladesh, but 2/3 of them can't survive longer than 1 year [2].

The lack of entrepreneurial, managerial, marketing and bookkeeping knowledge and experience of small business investors is accountable for that [8; 14; 19]. Most of the small businesses in Bangladesh are introduced without any plan, outline or framework, which lead to the high rate of small business failure. A survey conducted by Bangladesh Bank (2012), showed that 89% of owners of small businesses practically do the business plans by themselves without seeking consultation from professionals or experts. This has resulted in incompetence, inefficiency, wastage and under-utilization of resources available to the organization [3].

To counter the impediment, MFIs have to ensure basic knowledge & training to small business investors in the identified areas including, entrepreneurial, managerial, marketing and bookkeeping spheres before providing them with loans to reduce small business's failure rate & increase the profitability.

CONCLUSION

When and how MFIs will accelerate economic growth & improve poverty condition depends among the other things on whether and how successfully microcredit policy address the real constraints faced by the poor in a certain context & area and how effective measures are taken to overcome the

impediments. Effective strategies and proper implementation are indispensable to reach its economic growth and poverty alleviation goals.

Lack of entrepreneurial & managerial knowledge & experience of MFIs' borrowers and their low working skills; high interest rate of microcredit, ineffective credit giving and payback policies & ineffective investment of microcredit are mostly accountable for low profitability & high rate of small business failure in Bangladesh.

The recommended banking structure of MFIs, which is designed to provide microcredits to encourage and increase entrepreneurs and entrepreneurship training and business consultancy

to borrowers before granting them loan, will help to minimize the level of business disruptions and increase profitability.

Direct investment policy of MFIs will accelerate leverage and revenue of MFIs and create more employment opportunity.

'Short term' & 'Long term' loan programs will bring dynamism and diversification in investments. Recommended interest rate will minimize pressure on credit recipients and payback reformations will provide longer time to invest and get return on investment, will escalate investment success rate. The recommended banking functions will bring a positive change in MFIs activities.

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