Looking Ahead: Microcredit in Bangladesh

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This brief has three parts, constrained by a limit of 10 minutes of presentation. The first part lists a number of 'facts' – since some degree of inferences are involved, one may consider some of them as testable propositions. The second part draws a number of lessons at the institutional level and deals with future program areas. The third part abstracts to dig underneath the surface, and presents a simple framework to highlight a number of issues that are normally not raised in the discourse. The exercise is incomplete. Yet, I present it to provoke ventures into new thoughts – no conclusion is therefore offered.

Part I: Some Stylized Facts on Microcredit in Bangladesh

For the sake of brevity, let me list the important observations:

1. *Targeting*: Clients from diverse socio-economic groups participate in the programs, even though better-offs among the target group and the worse-off among the non-target group tend to participate in larger proportions. It is widely recognized that the poorest of the poor are left out of the programs.
2. *Territorial coverage*: Most villages[1] in Bangladesh are now covered under one or more MC programs. It is now difficult to get a 'control' village for cross-sectional study!
3. *Client/Household coverage*: Given the most common financial instrument, identified as general loan, the coverage appears to have reached a saturation level. A recently concluded BIDS survey showed net declines in membership during recent past suggesting of increased rationalization in the operations of MCIs.
4. *Stability in Membership*: While a significant percentage of ever participants continue to borrow and repay, the size of occasional participants has been growing.
5. *Multiple Participation/Overlapping*: A sizable proportion of the current participants are members of more than one MCI. There are also many households, which have two or more members borrowing from the same MCI or different MCIs.
6. *Segmentation at the Industry level*: The industry is however increasingly getting segmented into three groups on the supply side: the national level 'large', regional powers 'medium', and the local 'small' ones. Such segmentation and subsequent

[1] Several household clusters, historically tied together as an aggregate social, cultural and economic unit, constitute a village. Normally, it is smaller than the smallest officially recorded unit, *mouza*.

vertical linkages often influence the nature of competition amongst the MCIs. Reportedly, there is also lack of coordination among the MCIs at the field level.

7. *Expanding Roles beyond Credit*: Driven by the urge to get self-reliant as well as pro-active responses to the clients' needs have induced many MCIs to engage in commercial activities.
8. *Increase in Loan Size*: The average size of loans has increased. While part of it arose due to increasing demand from the old clients, the trend may reflect gradual shift towards wealthier community in order to reduce the cost per unit of disbursement.
9. *Gradual increase in male enrollment*: There are early signs of greater interest in forming male groups, which is normally associated with higher loan size.
10. *Changing perspectives on savings*: Savings as a proportion of total revolving fund has exceeded a quarter, and the taboo against withdrawal of savings has been relaxed during the recent past.
11. *Repayments out of current income sources*: Clients' demands as well as criteria applied by MCI field staffs emphasize on current potential of the clients, and repayments are made from current activities in most cases.
12. *Irregularity in short-term Repayments without long–term Crisis*: Recent evidence suggest of more relaxed enforcement of weekly savings and repayments in order to accommodate the seasonality in economic activities and subsequently in cash flows.
13. *Self-employment and vulnerability to natural calamities*: Microcredit is rightly credited for promoting non-farm self-employment activities among the rural poor. However, such activities are quite vulnerable to floods. Thus, MC programs are likely to be adversely affected by floods, which occur on a regular interval in Bangladesh.
14. *Insurance*: Experiments with insurance is yet to settle at a mutually gainful status.
15. *Forward Lending*: Forward lending within the household – husbands using the money borrowed by their wives – is common knowledge. There is now evidence to suggest that in some limited instances forward lending to members outside the household also exists.

Part II: Program-level Issues to be addressed

I had refrained from structuring the 'facts'. Nor do I elaborate on the analytics to link the various 'facts' to infer on future actions. The latter are only highlighted below.

1. *On targeting*: For right reasons, the MCIs do not anymore engage in establishing claims on targeting. The need for designing special program to address the very poor remains. I am not convinced that such a program has to be primarily rooted in credit. On the contrary, one may argue for creating wage employment, which does not raise the risk for the very poor.
2. *On product space*: (i) in order to enforce strict accounting discipline, it is important to devise products for different client groups and find means to segment the market, or, introduce flexibility in prices (interest payments) so that self-selections lead to desired segmentation; (ii) independent probing into the

insurance policies introduced by different MCIs needs to be undertaken – to safeguard clients' interests as well as to devise appropriate policies to sustain credit programs during times of crises.

3. *Shift in focus from clients to institutions*: Till recent past, the discourses centered on graduation of clients from poor to non-poor status. While beneficial impact of microcredit is now recognized, the major benefit form the process has been the emergence of a new set of institutions. In order to enhance the size of this benefit, we need to closely look into the graduation process of these institutions. A number of questions in this regard may be flagged: (i) should some of the MCIs consider the possibility of graduating out of microcredit into new activity space? (ii) Is the graduation into 'macro' credit socially optimal move, and should others be also encouraged to take that route? (iii) At the industry level, is there an optimal configuration of the big, medium and the small? Or, should this be left to market forces?
4. *On cooperation*: Is there a non-empty space for mutually gainful cooperation? – horizontally between MCIs of same sizes operating in the same area; and vertically across big, medium and small? The former involves information sharing and social coalitions, while the latter involves specialization by different groups in the activity space.
5. *Rethinking objectives*: At the beginning, proponents of microcredit aimed at alleviating poverty by ensuring access of the poor to credit. In line with the pre-credit era of NGO pursuits in Bangladesh, it was also hoped that accumulation of capital and knowledge at the group and community levels would enable the latter to emerge independently of the MCI/NGOs which had initiated the process. By and large, this objective has not been realized. On the contrary, both internal compulsions and demands from the client groups had induced MCIs to engage in activities, which may have apparently come in conflict with grassroot initiatives. Some such initiatives may be justified in terms of their long-term benefits to the poor, while others may fail the test. It is important that these issues be openly discussed to make MCIs' role more effective.

Part III: Projecting the Future through an Abstract World

The exercise undertaken below has a number of underlying assumptions. They include, (i) a story (model) that explains the success of a program should also be able to explain its failures; (ii) comparative statics, which compares two states of equilibrium in economics, may be used as a tool for qualitative projections; (iii) microcredit deals with financial transactions and therefore any meaningful story on it should be told with the analytical categories used in exercises on banking and financial sector; and (iv) any story on microcredit should attempt to accommodate intermingling of economics and the non-economics.

Prior information: (i) earlier village studies had revealed that the rural women are keen on generating savings; (ii) transaction costs in regular banking are quite high; (iii) the cost is aggravated due to high opportunity cost of time for rural males, while the opportunity cost of rural female time is quite low; (iii) regular banks generate fund through savings of numerous depositors and the latter are not always motivated by the return on savings; (iv) regular banks lend to individuals and want collaterals to safeguard against risk of default; (v) regular banks, governed by the principle of minimum reserve requirement can lend more than the depositors' savings; and (vi) microcredit institutions introduced mandatory savings for the members who later became eligible to borrow, borrowed fund to lend to the members and no collateral is required.

Two *additional pieces of information* are worth sharing. They are, (i) the commercial banks offer loans against long-term deposits. One obvious question arises – why would a borrower avail it instead of cashing the deposits? The 'Sanchay Patra', with interest rates higher than the borrowing rate is one explanation. The other, quite interestingly, is the apparently irrational behavior of the borrowers – the latter prefer to entrap themselves into a situation of forced saving. (ii) A recent BIDS study, sponsored by the PKSF and the World Bank, showed 90 percent of the borrowers to be females. When asked on who used the money and who repaid them (along with weekly savings), the female borrowers can be distributed as follows: husband – 71.5%, son – 5.2%, father – 1.2%, brother – 1.2%, son-in-law – 0.3%, jointly with husband – 6.6%, self – 6.3%, mother – 0.6% and other relatives – 1.8%.

The Story: Rural females want to accumulate savings in their own names and the offer from the MCIs enable them to realize this objective; rural males want credit and upto a level they are willing to tolerate absence of their women folks from household chores, and the MCIs are able to ensure a minimum savings from the same set of members who are borrowing from them which enable them to safeguard against risk.

If the above story, suggesting of compatible interests of the three parties, is considered to underlie the functioning of the MC programs, several conjectures may be forwarded. First, if extra effort is given to involve the women in economic activities, the cost of transactions would increase and this will have to be borne by the MCIs. Second, if economic condition of the borrowing household improves substantially, the males are likely to associate higher cost to female participation in financial transactions, which in turn, will increase the cost. In the absence of support to realize the desired objectives, one may find the MCIs increasingly shifting their focus away from the poor!