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Microfinance in Bangladesh: Growth, Achievements, and Lessons

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Executive Summary

It is truly remarkable that the microfinance industry in Bangladesh has been able to provide access to credit to around 13 million poor households. There are hundreds of organizations offering microcredit, although the bulk of the clients borrow from a handful of large organizations—Grameen Bank, BRAC, ASA, and Proshika.

This growth in access took place during several distinct phases over the last three decades. The origins of the current microcredit model can be traced back to action research in the late 1970s, carried out by academics as well as practioners in organizations that were created to deal with the relief and rehabilitation needs of post-independence Bangladesh. The 1980s witnessed a growing number of non-governmental organizations (NGOs) experimenting with different modalities of delivering credit to the poor. The various models converged around the beginning of the 1990s toward a fairly uniform "Grameen-model" of delivering microcredit. This last decade, especially, saw a sharp increase in access to microcredit. And in recent years, the standard Grameen-model has undergone greater refinement in order to cater to different niche markets as well as to different life-cycle circumstances.

Looking at the Bangladesh experience in perspective, one can argue that the current, remarkable scale of access is attributable to specific factors. First is visionary leadership within the pioneering microfinance organizations. The founders and leaders of Grameen Bank and BRAC, in particular, created decentralized structures with appropriate incentives that encouraged high staff performance, which in turn underpinned rational expansion based on existing capacity and client demand. Second, the government of Bangladesh created a conducive macro-environment and implemented a "hands-off" regulatory policy. Third, donors played a constructive role by providing resources at the appropriate time. This included funding the initial expansion phase of several microfinance institutions and then building the institutional capacity and systems needed to ensure sustainability. Fourth, high population density and relative ethnic, social, and cultural homogeneity made "franchising" the microcredit model less difficult, and significantly propelled its expansion. Fifth, the public-private microcredit "wholesaler," PKSF, was far-seeing enough to take advantage of already-established retail capacity to scale up the microcredit industry, as well as demand professional standards and a focus on sustainability.

The consensus in the literature holds that access to these micro-loans has considerably reduced the vulnerability of poor households in Bangladesh. Poor households are able to smooth their consumption more dependably, thereby limiting the hardships arising from seasonal shortfalls of income. Unanticipated shocks such as natural disasters can be better absorbed by building up assets. Female borrowers are less vulnerable and more empowered within their households and the wider community.

The availability of microcredit has indirectly affected social conditions—for instance, children of borrowers are more likely to go to school, have better sanitation facilities, and better nutrition.

These impacts are due to the "increased income effect" of microcredit as well as the "social mobilization effect" of borrower group meetings.

This paper proposes five lessons from Bangladesh that are relevant to microfinance growth and impact in other countries. First, an "enabling environment" for microfinance is critical, especially maintaining a stable macro-environment where both interest rates and inflation are kept at reasonable levels. Government regulations and policies are needed to create an appropriate environment for the growth of the sector, where regulatory policies strike a balance among protecting the interests of depositors, supervising microfinance institutions that collect savings, and not excessively regulating the sector with unnecessary red tape.

A second lesson is that microcredit may be a more effective remedy against poverty and vulnerability if it is complemented by other interventions. These interventions may be especially important for the poorest households, which face the greatest risk of income fluctuations and have the greatest need for a range of financial and non-financial services.

Third, there is a role for donor financial assistance in expanding the capital base of emerging microfinance institutions, as well as developing the technical capacity necessary for organizational sustainability. Hence, subsidies can be justified to support microfinance institutions in their earliest stages, as long as there is a viable route to institutional sustainability.

A fourth lesson is that, while visionary leadership cannot simply be "franchised," the systems and formal rules that govern the successful microfinance industry in Bangladesh can to an extent be replicated. These may vary according to the size of the organization, but by and large, the successful organizations delegated significant decision-making authority away from head offices, monitored individual staff performance, and linked staff incentives to program targets. Client feedback and program monitoring are also crucial. As organizations grow, the willingness to change products based on client need and demand and to create products tailored to niche markets is crucial for success.

Fifth, one of the lessons unique to the Bangladesh experience was the critical role played by a microfinance wholesaler, in expanding access and developing professional standards. However, apex bodies are not a panacea, and a rigorous analysis of the underlying retail capacity and demand for funds must be carried out before they are established.

Introduction

The fact that the microfinance industry has been able to provide access to credit, currently, to nearly thirteen million poor households in Bangladesh is truly remarkable. There are around twelve hundred microfinance institutions (MFIs) operating in Bangladesh,[1] but the industry is dominated by by four large MFIs—BRAC, Grameen, ASA (Association for Social Advancement), and Proshika—that serve around 11.5 million, or 90 percent of all MFI clients.[2] After the "big four," the next largest NGO, Swarnivar Bangladesh, has 0.7 million clients, and then there are probably only ten NGOs that have more than 100,000 borrowers. The bottom line is that the majority of the MFIs are small (fewer than 5,000 borrowers), and that the bulk of the access to microcredit is supplied by four MFIs. As such, the experiences of scaling up discussed here draw primarily upon these large MFIs.

The Evolution of the Microfinance Industry in Bangladesh

The growth in the poor's access to credit took place in several distinct phases over the last three decades. The origins of the current microcredit model can be traced back to action research in the late 1970s, carried out by academics as well as practioners in organizations that were created to deal with the relief and rehabilitation needs of post-independence Bangladesh. The 1980s witnessed a growing number of non-governmental organizations (NGOs) which experimented with different modalities of delivering credit to the poor. The various models converged in the beginning of the 1990s toward a fairly uniform "Grameen-model" of delivering microcredit. It sparked a sharp growth of access to microcredit during this decade. In recent years, the standard Grameen-model has undergone more refinements in order to cater to different niche markets as well as to different life-cycle circumstances.

The 1970s

Experimentation in providing credit to households considered "unbankable" by the formal financial system originated a few years after Bangladesh's war for independence in 1971. The independence movement gave rise to a new generation of young activists who were keen on contributing to the reconstruction of this war-ravaged country. The new government and a myriad of aid agencies that arrivedon the scene were unable to cope with the scale of destitution, and non-governmental organizations emerged to meet the challenges. The early years of the NGO movement in Bangladesh focused on relief and rehabilitation with an emphasis on community development. However, by the mid-1970s, two of the NGOs that would subsequently expand in scale, BRAC and Proshika, found that "elite capture" was a serious impediment to their development objectives. As a result, a separate focus on the poor through a "target-group" approach was introduced. Moreover, an ideological debate within both these organizations began to brew, between those who favored economic tools (credit, savings, etc.) to support poverty reduction and those who believed that social mobilization against existing injustices would suffice and financial services were unnecessary.

Around the same time, a team of researchers at Chittagong University, led by Professor Yunus, began an action-research program that provided loans to poor households in a few villages. Borrowers were mobilized in "peer groups" composed of four to five individuals who were jointly responsible for each others repayment. Several of these small "peer monitoring groups" would be organized together into a larger unit which would meet weekly with the primary purpose of repaying loan installments. The process of trial and error initially combined males and females in the same credit group, but then changed to separate gender groups. It also included "occupational groups," but this was dropped in favor of village-based groups. The demand for loans grew rapidly and Professor Yunus enlisted the support of the Bangladesh Bank and other commercial banks to provide the Grameen Project—as it was then called—with resources. The success of this experiment paved the way for the establishment of the Grameen Bank under a special ordinance in 1983.

The 1980s

In the early 1980s, several NGOs experimented with different ways of delivering credit. One important mode tested was the efficacy of providing loans for group projects compared to offering loans to individuals with peer monitoring. The broad lesson was that the latter was more effective because of its incentives, and it lacked the "free-rider" problems seen in lending to a group. Hence, by the late 1980s, the predominant model became providing individual loans to a target group of poor households, with peer monitoring and strong MFI staff follow-up.

The Association for Social Advancement (ASA) is a classic example of this shift. Its initial emphasis was on forming "peoples' organizations," mobilized for social action against oppression. It changed to target groups and then to provision of financial services in the late 1980s. Now ASA is the fourth largest MFI in Bangladesh in number of clients, and its unique low-cost credit delivery mechanism is being replicated in several other countries. ASA keeps paperwork requirements to a minimum, has decentralized most decision making to the field, and overall has a very lean operation.[3]

The 1980s and early 1990s were also important to the development of management capacity within several of the large MFIs, which allowed them to expand their microcredit programs. What is particularly interesting is that the development of the know-how and confidence to implement large programs arose, in some cases, from the experience of scaling up programs not related to microcredit. For instance, in the case of BRAC, its first major experience with a nationwide program came when it implemented an oral rehydration program to combat diarrheal disease. Thirteen million women were trained to use a simple but effective rehydration solution, and BRAC staff were paid based on how many of their trainees used and retained this knowledge.[4]

Early to Mid-1990s

The early 1990s was the period of rapid expansion of the Grameen-style microcredit approach.[5] The growth was fueled largely by "franchising," whereby new branches replicated the procedures and norms that prevailed in existing branches. It was clearly aided by the high population density and relative ethnic, social, and cultural homogeneity in Bangladesh. A notable shift occurred during this expansion phase to placing a greater emphasis on individual borrower accountability for loan repayment and less reliance on peer monitoring. Staff follow-up of loans became more rigorous and professional with the use of computerized management information systems. Donor funds helped in varying degreesto expand the revolving loan funds for MFIs, particularly during expansion phases of the various institutions. Moreover, PKSF emerged during this period as a wholesale financing institution. Following this expansion, a geographical mapping of microfinance suggests that all districts in Bangladesh now have microcredit services, although there are many smaller pockets with little or no coverage (e.g., Chittagong Hill Tracts). A closer look shows that there is somewhat greater coverage of poor households in the central and western districts. The southeast and pockets of the northeast still have room for expansion of coverage.[6]

Mid-1990s Onward

Feedback from the field, academic research, and international experience contributed to an increasing emphasis on providing diversified financial services for different groups of households from the mid-1990s onwards. The benefits of a narrow focus on microcredit during the expansion phase was that it kept costs low, operations transparent, and management oversight relatively straightforward. However, it became clear that the standard Grameen model of providing microcredit with fixed repayment schedules, and standard floors and ceilings on loans sizes, was not sufficient to meet the needs of the extreme poor or the vulnerable non-poor.

Moreover, existing microcredit borrowers also required complementary financial and non-financial services. The standard practice for MFIs until the late 1990s was to collect compulsory weekly savings from their clients, holding the money as a *de facto* lump sum "pension," which was returned when a client left the organization. Access to these deposits was otherwise limited, which curtailed a potentially important source for smoothing consumption.

Recognizing these limitations, an increasing number of MFIs in Bangladesh have offered savings accounts that clients can withdraw from more freely, in addition to the fixed deposit scheme. Moreover, many MFIs have life insurance products, whereby outstanding microcredit debts are written off and other benefits are paid following the death of a borrower. Non-credit services can also take the form of input supply, skills training, and marketing support for micro-entrepreneurs.[7] A complementary package to microcredit can also take the form of providing education for the children of borrowers. Grameen Bank, for instance, has a scholarship program for secondary education for girls, and a student loan program for tertiary education. Similarly many MFIs have community health programs, legal literacy training, and information on how to access local resources.

MFIs began to experiment with new niche markets as the traditional microcredit business became standardized (and horizontal expansion slowed) and required less attention. For instance, several NGOs began providing larger loans to "graduate" microcredit borrowers, and in some cases to households which were not part of the microcredit system but which wanted a micro-enterprise loan. These loans typically range from 20000 *taka* (around US $320) to 200,000 *taka* (US $3,200). Innovative solutions are also emerging to address the problem of access for the small enterprise sector. For instance, BRAC has established a separate financial institution, BRAC Bank, that focuses on lending to the "smaller end" of the small enterprise sector, with loans averaging 400,000 taka.

Moreover, evaluation studies pointed out that extremely poor households were struggling to benefit from the standard microcredit model, even if they joined the programs. There were a number of factors that kept the extreme poor from borrowing or from benefiting from loans if they obtained them. Minimum loan floors for a first loan sometimes exceeded what clients perceived they needed. Fixed weekly loan repayments could be difficult to commit to in light of seasonal income. Other members of peer-monitored groups sometimes might not wish to guarantee loans for extremely poor households. Residing in remote or depressed areas can also complicate access.

Programs have been developed to make these constraints more manageable. ASA's Flexible Loan Program introduced more flexible repayment schedules. Mimimum loan floors for first loans were lowered so that amounts as small as 500 taka (US $9) could be borrowed. Grameen's program offers zero interest loans to beggars. The Resource Integration Center's program specializes in offering loans specifically to the elderly poor, an unserved vulnerable group. Various programs also combine food aid with microcredit and training, like BRAC's IGVGD program. ASA has targeted remote areas, offering services through its cost-effective mini-branch system, and Integrated Development Foundations work in the Chittagong Hill Tracts.

Factors That Led to Scaling Up

Institution Building—Leadership, Staff Incentives, and Learning by Doing

It is unquestionable that the vision and persistence of the leaders of the NGO/MFI movement are key factors behind the success of the microfinance industry in Bangladesh. Leadership skills were instrumental at initial stages in persuading a skeptical public that providing credit to the poor could become a viable and replicable proposition. These skills were equally important during the process of scaling up—skills such as being able to recruit and motivate staff, decentralizing authority away from the center, building management information systems and internal controls, as well as having the humility to learn from mistakes.

Staff recruitment, motivation, and retention are particularly important for large organizations. BRAC, for instance, employs around 28,000 staff in its various programs; Grameen has around 12,000 in its microcredit program; and ASA's microcredit program employs around 8,000 staff. A critical element in this process is an objective performance evaluation system for staff that is linked to career mobility and other incentives for staff to perform well both individually and in teams. Grameen Bank, for example, has introduced a system for rating branch offices on the achievement of specific targets, which not only include standard loan recovery but also factor in social indicators, such as the proportion of children of Grameen clients going to school.

Staff motivation is also enhanced by decentralizing significant responsibility to the lower tiers of the administrative structure. ASA is the best example of a lean credit delivery structure with high levels of decision-making authority given to field offices, from loan sanctioning decisions to staff human resource issues. Moreover, the structure within field offices is relatively horizontal, with a branch manager who works with individual fieldworkers to resolve problems and typically shares living quarters with other field staff.[8]

Effective internal controls are also important in ensuring effective staff performance. The fact that financial transactions are handled openly, in the weekly meetings and in the branch offices, is a major deterrent to any form of discretionary behavior by field workers. Many NGOs, particularly the ones that have successfully expanded in scale, have developed measures that include frequently rotating staff within and between branches, scheduling regular field visits by senior management, developing a strong internal audit team, and contracting annual external audits.

A fundamental part of the scaling up of Bangladesh's NGOs, and more specifically the microfinance movement, has been the ability to learn from experiences and adapt programs accordingly. This learning process takes place both through informal feedback by field staff during regular interactions with management, as well as through a formal monitoring and evaluation process. BRAC's Research and Evaluation Division has around 20 professionals whose key function is to evaluate BRAC's multi-dimensional programs and give timely feedback to program staff and management. This feedback process occurs in longer term research as well as assessments with quick turnaround. The shift to more flexible financial services, that took place in recent years, was largely based on client feedback and analysis of the limitations of a uniform microcredit model.

A Constructive Donor-Client Relationship

External resources played an important part in the experimentation, subsequent growth in outreach, and institutional strengthening of the microfinance industry. At the same time, the large microfinance institutions have been successful in "managing donors."

International NGOs, such as the Ford Foundation, Oxfam, and the Aga Khan Foundation, played an important role in the initial stages of the NGO/MFI industry in Bangladesh. The subsequent expansion and consolidation was funded largely by official bilateral agencies, and later by multilateral agencies, when international NGOs could not match the growing resource requirements of the larger MFIs. The 1990s have seen dependence on donor resources progressively decline for the large MFIs. Grameen Bank, ASA, and BRAC do not receive any grant financing for their microcredit operations. Moreover, out of BRAC's total $160 million expenditure on development programs in 2002, more than 80 percent was financed from its own resources, through the interest income on microcredit as well as surplus from its commercial enterprises. Two facets of these trends are worth highlighting.

First, the decisions to subsidize these operations were not free from controversy. Donor advocates for these loan funds had to argue their case with officials within their own agencies who believed that the capital base for loan operations ought to be enhanced only by savings mobilization or borrowing from commercial sources. In retrospect, these decisions to contribute to MFI loan funds were by and large correct, as almost all of the MFIs that received this support have either attained financial self-sufficiency or are well on their way to doing so. Donors also invested in organizational systems and MFI staff training in order to strengthen the capacity to administer these growing programs.

Second, large NGOs in particular have been reasonably successful in managing donors. BRAC, with its large multi-faceted programs, has a long history of working with donors, and the evolution of this relationship is worth highlighting. Donors, who have their own incentives to commit resources and demonstrate results on the ground, have been eager to provide resources to organizations with proven track records. Hence, the likes of BRAC have had to deal with multiple donors who each wanted to fund specific projects. These uncoordinated donor missions and disparate disbursement and reporting arrangements taxed BRAC's internal capacity and led to its management proposing changes for how donors ought to operate.

In the early 1990s, donors shifted their approach from financing specific BRAC projects to financing BRAC programs. Donors also formed a "consortium" that pooled funds, negotiated jointly with BRAC, and agreed to common reporting requirements. An important part of the consortium funding arrangement and the move toward program funding has been an improvement in the predictability of resource flows. For instance, BRAC secured financing for its Rural Development Program for a five-year period from the donor consortium. Moreover, the establishment of a donor liason office for BRAC also acts as a buffer between BRAC staff and the various visitors, consultants, and evaluators.

A Progressive Government Stance

The appropriate "enabling environment" that existed in Bangladesh greatly aided the early experimentation and later scaling-up of the microfinance industry. The macro-economy of Bangladesh has, by and large, been soundly managed, and the significance of this should not be underestimated. The rate of inflation has been kept to single digits, and economic growth over the past decade has averaged around 5 percent per annum, thereby creating economic opportunities for microcredit-financed investments.

It is also significant that the government of Bangladesh has thus far maintained a balanced approach towards regulating and supervising the activities of the NGO sector. This has been critical in ensuring the operational flexibility that is the cornerstone of service delivery by NGOs. While this long relationship has not been free from tensions on both sides, the government of Bangladesh has thus far been able to place the interests of the poor foremost when dealing with NGO issues. A recent example is the decision to release donor funds earmarked for Proshika, even though it was being investigated for alleged irregularities in the use of its funds.

Ultimately, though, the relationship between the government and the NGOs depends on individual personalities and social ties[9] as there have always been widely varying individual views regarding NGOs within the civil service and the Cabinet. Individuals in key positions within the government have time and again been 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,[10] as was the establishment of PKSF with a strong, autonomous board. However, the prevailing consensus is supportive of NGOs, although accusations of involvement in party politics by a handful of NGOs have strained the overall government/NGO relationship of late.

Looking forward, it is clear that the regulatory framework for microfinance needs to be strengthened, particularly in light of the large amounts of deposits mobilized for the poor. The Central Bank, PKSF, and representatives of MFIs are currently working to produce a set of guidelines and standards to strengthen the regulatory framework.

A Professional Apex Body for Microfinance

The Palli Karma Sahayak Foundation (PKSF) was created in 1990, and is governed by a board composed of both public and private sector representatives. It is a public-private apex body that channels funds for microfinance to MFIs, and has been critical to the expansion and improved professionalism of the microcredit industry in Bangladesh. PKSF's core functions include (1) lending money to MFIs, which meet certain eligibility criteria, to expand their microfinance operations; (2) building capacity and giving hands-on assistance to strengthen MFIs and move them towards financial sustainability; (3) advocating microfinance issues and helping develop an appropriate regulatory framework for the industry.

PKSF played an instrumental role in contributing to the sharp increase of access to microcredit that took place in the 1990s by expanding the capital base for MFIs to onlend to the poor. For instance, as of December 2003, PKSF loans constitute around 30 percent of ASA's current revolving loan fund. PKSF is also widely credited for sharpening the focus of many MFIs on financial sustainability and in setting appropriate standards to pave the way to a strengthened regulatory structure for microfinance.

There is a growing experience with setting up apex institutions worldwide, e.g., PPAF in Pakistan, RMDC in Nepal, FONCAP in Argentina, LID in Bosnia-Herzogovina, and MISFA in Afghanistan. One of the fundamental factors behind the success or failure of an apex is the underlying retail capacity in a particular country. The overall strength of the MFIs in Bangladesh has been key to PKSF's success. Overestimating the capacity to absorb funds by the MFIs on the ground can lead an apex body to fail. However, if a realistic assessment of the underlying retail capacity is made, then apexes offer many benefits, such as being able to screen MFIs on standard criteria and creating a "level playing field."

The Impact of Microfinance in Bangladesh

The evidence of the impact of microcredit can be assessed from two interrelated angles. First, who does credit reach, and second, how does it affect the welfare of different groups of individuals and households?

Land ownership, occupational criteria, and asset valuations are standard targeting tools used by microcredit providers in Bangladesh in order to direct resources to the rural poor. These indicators have been shown to be relatively accurate correlates of poverty by program administrators who do not have the time, resources, or expertise to carry out more sophisticated calculations of poverty for each household in their targeted area.

In practice, the land criterion is the one that is more closely adhered to in the field. Several studies show that between 15–30 percent of members of microcredit programs are from "non-target" households as measured in terms of land.[11] However, they typically are marginal farmers and can still be considered part of the vulnerable non-poor, prone to transient bouts of poverty.[12] On the other hand, there is also evidence that a large proportion of extremely poor households join microcredit programs.[13] For instance, in Khandker's sample, 65 percent of BRAC households had no agricultural land, compared to 55 percent for Grameen members, and 58 percent for a comparable government-run microcredit program.

Not only do the poorest join BRAC's credit program, but their borrowing pattern is similar to better-off members.[14] In other words, the presence of wealthier households does not appear to affect the credit supply to poor households; however, there is evidence to suggest that poorer households use a larger share of their loans for consumption purposes, compared to better-off households.[15] Noting that the poorest join BRAC's credit program and that they also actively borrow after they join, it must also be mentioned that there is evidence which suggests that households who join microcredit programs a few years after the village group has been established tend to be less poor, compared to the members who join at the start of the program.[16] This feature of better-off households joining over time has also been noted as a general rule of thumb in many targeted anti-poverty programs worldwide.[17] The bottom line is that the literature on targeting suggests that microfinance programs are reasonably successful at reaching the poor, and that those households who fall above the stipulated landholding criterion tend to be marginally above the poverty line and are susceptible to transient poverty in certain years.

The literature broadly supports the hypothesis that access to microcredit contributes to poverty reduction in Bangladesh, although the evidence is not entirely clear-cut.[18] For instance, data collected by the World Bank in 1992 have been used to show widely varying results depending on the methodology chosen to assess impact. Khandker estimates that for every 100 taka lent to a woman, household consumption increases by 18 taka; interestingly, the figure is 11 taka if the same amount was lent to a man.[19] Moderate poverty falls by around 15 percent, and ultra-poverty by 25 percent, for households who have been BRAC members for up to three years (controlling for other factors), according to the author. Similar results are found for Grameen Bank and Bangladesh Rural Development Board (BRDB) members.

On the other hand, using the same data and a different way of correcting for selectivity bias, Morduch finds that microcredit does not have a significant impact on consumption levels and therefore on income poverty.[20] Consumption data from 1,072 households in one district of Bangladesh is used to show that the largest effect on poverty occurs when a moderate poor BRAC client borrows more than 10,000 taka ($200) in cumulative loans.[21] In other words, there may be a threshold level of credit above which a household gains most in terms of increases in income. The Bangladesh Institute of Development Studies (BIDS) carried out an extensive study of the impact of PKSF PO's microcredit program using longitudinal data of 3,000 households between 1997–2000. One of the key findings was that "microcredit has a positive and significant effect on poverty status of the program households…"[22] The study also finds that members of microcredit programsare less vulnerable when faced with crises. Moreover, improvements in other social indicators (child immunization, use of sanitary latrines, prevalence of contraception) are also more noticeable for microcredit program members compared to non-members.

The literature also suggests that moderately poor microcredit borrowers benefit more than extremely poor borrowers, in terms of reduction in income (consumption) poverty. The basic premise is that the poorest have a number of constraints (fewer income sources, worse health and education, etc.) which prevent them from investing the loan in a high-return activity. This could be due to the higher risk associated with a high-return activity or because of a long gestation period for the returns to accrue.[23] This is borne out by detailed case-study evidence[24] and by comparing participants of credit programs who cater to different socioeconomic groups.[25]

There is strong evidence that microcredit contributes to reducing household vulnerability. Morduch shows that consumption *variability* is 47 percent lower for eligible[26] Grameen households, 54 percent lower for eligible BRAC households, and 51 percent lower for eligible BRDB households, compared to a control group.[27] This consumption smoothing is driven by income smoothing as evidenced by the significantly lower labor supply variability experienced by microcredit members compared to the control group.[28] The importance of this result cannot be over-emphasized, given the fact that seasonal deficits play a key part in the poverty process in Bangladesh.[29] Essentially, Morduch's results indicate that program participants do not benefit in terms of greater consumption levels, but they participate because they benefit from risk reduction.

Asset creation is important to reduce household vulnerability to various livelihood risks. The findings of an impact assessment of ASA borrowers, conducted in 2003, suggests that the average value of physical assets increased by 127 percent in rural areas, and grew by about 150 percent in urban areas over a five-year period. Moreover, the average increase in cash savings rose by 133 percent and 111 percent in rural and urban areas, respectively, over this same five-year period. Similar evidence is found in studies of BRAC, Grameen, and PKSF's partner organizations.

Another pathway by which microfinance appears to reduce vulnerability is through the emergency assistance provided by many microfinance organizations during acute natural disasters, such as the recent floods in Bangladesh. The fact that these organizations turn into *de facto* relief agencies is crucial to sustaining these households in the immediate aftermath of a natural disaster. Moreover, post-disaster rehabilitation assistance, in terms of both financial and other services, is also highly valued by microcredit clients.

The pathways by which microcredit reduces vulnerability, that have been discussed here, relate to income and consumption smoothing and asset building. However, the impact of credit on women's empower-ment, or reducing female vulnerability, has also received considerable attention. Empowerment of women in Bangladesh can be viewed against the backdrop of patriarchy, defined by Cain et al. as a "set of social relations with a material base that enables men to dominate women."[30] Hence, it can be thought of as an improvement in intra-household gender relations.[31] Moreover, given the institution of *purdah* (loosely translated as "veil"), a pervasive social construct which restricts the female sphere within a typical Bangladeshi household, empowerment can also be viewed in terms of a woman's interactions outside the homestead and the acquisition of skills, knowledge, and confidence that such interactions can bring.[32]

The work by Amin et al. in 36 villages in Bangladesh showed that membership in microcredit programs positively affected a woman's decision-making role, her marital stability, her control over resources, and her mobility, but had less impact on her attitude regarding marriage and education of daughters.[33] Naved finds that the women participants in credit programs, in her sample, felt their status had improved due to the fact that they were seen as income earners for the family because of their access to credit.[34]

Hashemi et al. developed an "empowerment index" based on eight empowerment indicators. Their analysis establishes that contributing to her household's income is a significant factor contributing to a woman's own empowerment. However, Hashemi et al. also show that credit programs can empower women independently of whether they contribute to family income or not, after controlling for other factors.[35]

Those who are skeptical about the empowering effect of microcredit have focused on the issue of women's control over loans. Goetz et al. used a sample of 253 female borrowers from four rural credit providers in Bangladesh. Their investigation of loan histories led the authors to conclude that "about 63 percent of the cases fall into the three categories of partial, very limited, or no control, indicating a fairly significant pattern of loss of direct control over credit." The authors disaggregated their data in terms of loan activity and concluded that investing in traditional women's work increased their chances of being able to control the loan.[36] Montgomery et al. also have reservations about the empowering effect of microcredit. Their argument is based largely on secondary sources and a small field survey focusing on the issue of control over loans.[37] While the authors admit that their sample is small, they on balance support Goetz et al. that microcredit reinforces existing gender patterns and inequalities by promoting traditional income generation activities,[38] which they believe do little to alter the social status quo.

On the whole, the evidence presented by those who argue that microcredit improves the status of females within a household appears more convincing that that argued by the skeptics' camp. There are two main reasons for this contention. First, the underlying thread of the argument, that access to an important household resource (credit) enhances a female's status within the household, is both intuitively appealing and resonates with the theoretical literature on bargaining models of the household.[39] Second, the focus on female control over loans, as a key component of the skeptics' argument, fails to recognize that credit enters the overall household income pool and that household members jointly participate in the loan investment.

Lessons Learned

The importance of an enabling environment for microfinance cannot be underestimated. A critical part is maintaining a stable macro-economic environment with both interest rates and inflation kept at reasonable levels. The lack of macro-stability has seriously constrained the growth of microfinance in several countries, e.g., Malawi. Government regulations and policies are also crucial in creating the appropriate environment for the growth of the sector. These policies need to strike a balance between protecting the interests of depositors, in microfinance institutions that collect savings, and not regulating the sector excessively (i.e., strangling it with unnecessary red tape).

Microcredit may be a more effective remedy against poverty and vulnerability if it is complemented with other interventions. These interventions may be particularly appropriate for the poorest households, which face the greatest risk of income fluctuations and have the greatest need for a range of financial and non-financial services. Moreover, while the provision of microcredit can enhance a woman's status in the eyes of other household members, social mobilization and legal education interventions in conjunction with credit are likely to have a more significant effect than credit alone. However, this does not imply that microfinance institutions ought to provide these services. In many cases, organizations may prefer to specialize in providing microfinance and facilitate linkages to providers of other non-credit interventions.

There is a role for donor financial assistance in expanding the capital base in emerging microfinance institutions, as well as in developing technical capacity that leads to organizational sustainability. Hence, subsidies can be justified to support "infant" microfinance institutions, as long as there is a viable route to institutional sustainability. The duration of these subsidies would vary according to local conditions and level of poverty of the clients.

The systems and formal rules that govern the successful microfinance industry in Bangladesh can, to an extent, be replicated. These vary according to the size of the organization, but by and large, these organizations delegate significant decision-making authority away from head offices, are able to monitor individual staff performance, and have linked staff incentives with program targets. Client feedback and program monitoring are also crucial. As organizations grow, the willingness to change products based on this feedback and to tailor or create products for niche markets is critical for success.

The creation of a microfinance wholesaler, like PKSF in Bangladesh, has the potential to play an important role in expanding access and developing professional standards. However, apex bodies are not a panacea, and a rigorous analysis of the underlying retail capacity and demand for funds needs to be carried out before they are established.

End Notes

1 Credit and Development Forum, "CDF Microfinance Statistics," (Dhaka: CDF, 2002).

2 The latest figures indicate that BRAC has 3.5 million borrowers, Grameen Bank has 3.1 million clients, Proshika 2.9 million, and ASA 2.1 million clients.

3 S.H. Choudhury, "Financing the Poor: ASA Experience," *The Daily Star* (Dhaka), March 13, 2003.

4 In addition to this innovative staff incentive system, a detailed evaluation of the oral rehydration experience also points to a number of other success factors: systematic recruitment and training of staff, an effective feedback loop, the willingness of senior management to learn from the lessons from the field, and support from the government, donors, and professional experts. See M. Chowdhury and R. Cash, *A Simple Solution: Teaching Millions to Treat Diarrhoea at Home* (Dhaka: UPL, 1996).

5 S. Ahmed, "Microcredit and Poverty: New Realities and Strategic Issues," in *Attacking Poverty with Micro-credit*, (Dhaka: UPL, 2003).

6 PKSF, "Maps on Microcredit: Coverage in Bangladesh," (Dhaka: PKSF, 2003).

7 For instance, to support sericulture, BRAC trains the entrepreneur in silkworm farming, supplies the silkworm eggs, plants the mulberry trees, arranges for extension services by a BRAC specialist, purchases the cocoons from the farmers at their homesteads, and supplies cocoons to a BRAC-run silk-reeling center.

8 P. Jain, and M. Moore, "What Makes Microcredit Programmes Effective? Fashionable Fallacies and Workable Realities," IDS Working Paper 177, University of Sussex, 2003.

9 N. Hossain, "Elites and Poverty in Bangladesh," DPhil thesis, University of Sussex, 2003.

10 M. Yunus, *Banker to the Poor* (Dhaka: UPL, 1998).

11 It is interesting to compare this figure with Copestake's (1992) evaluation of India's Integrated Rural Development Project, where the proportion of non-poor households ranged upto 36 percent. See S. Mustafa, et al., "Beacon of Hope: An Impact Assessment Study of BRAC's RDP," Research and Evaluation Division, BRAC, Dhaka, 1996; R. Montgomery et al., "Credit for the Poor in Bangladesh: The BRAC Rural Development Programme and the Government Thana Resource Development and Employment Programme," in *Finance against Poverty*, vol. 2, ed. D. Hulme and P. Mosely (London: Routledge, 1996); H. Zaman, "Assessing the Poverty and Vulnerability Impact of Microcredit in Bangladesh: A Case Study of BRAC," Policy Reseach Working Paper Series 2145, World Bank, 1999; and S. Khandker, *Fighting Poverty with Microcredit*, (Oxford: Oxford University Press, 1998).

12 Zaman, "Assessing the Poverty and Vulnerability Impact," 1999.

13 Khandker, *Fighting Poverty with Microcredit*; and Zaman, "Assessing the Poverty and Vulnerability Impact."

14 Zaman, "Assessing the Poverty and Vulnerability Impact"; and S. Halder and A.M. Husain, "Indentification of the Poorest and the Impact of Credit on Them: The Case of BRAC" (mimeo, BRAC Research and Evaluation Division, Dhaka, 1999).

15 Halder and Husain,"Indentification of the Poorest."

16 I. Matin, "Mis-targeting by the Grameen Bank: A Possible Explanation," *IDS Bulletin* 29, no. 4 (1998).

17 M. Lipton, "Successes in Anti-poverty," Issues in Development Discussion Paper No. 8 (Geneva: International Labour Office, 1996).

18 The methodological problems associated with assessing the impact of microcredit are complex. The literature typically uses "control groups," usually "eligible non-members," or "recently joined members" in order to address the problem of the counter-factual. There have been attempts to account for selectivity bias with varying degrees of success.

19 Khandker, *Fighting Poverty with Microcredit*.

20 J. Morduch, "Does Microfinance Really Help the Poor: New Evidence from Flagship Programs in Bangladesh," (paper, Department of Economics and HIID, Harvard University, and Hoover Institution, Stanford University, 1998).

21 Zaman, "Assessing the Poverty and Vulnerability Impact."

22 Bangladesh Institute of Development Studies. “Monitoring and Evaluation of Microfinance Institutions.” (paper, BIDS, Dhaka, 2001).

23 G. Wood and I. Sharif, eds., *Who Needs Credit? Poverty and Finance in Bangladesh* (London: Zed Books, 1997).

24 F. Farashuddin and N. Amin, *Poverty Alleviation and Empowerment: An Impact Assessment Study of BRAC’s RDP—Ten Qualitative Case Studies (*mimeo, BRAC Research and Evaluation Division, 1998).

25 R. Montgomery, et al., “Credit for the Poor in Bangladesh.” Montgomery et al. compare the performance of BRAC borrowers with the borrowers from a government-run microcredit scheme, the Thana Resource Development and Employment Programme (TRDEP). The initial endowment conditions of TRDEP’s borrowers are higher than BRAC’s (average pre-loan landholding is 46 and 30 decimals* for TRDEP and BRAC members, respectively, and the percentage of income derived from daily labor is 5 percent and 32 percent, respectively), while the credit-delivery mechanism and average loan size are, broadly speaking, very similar. The typical TRDEP borrower’s increase in assets and income during the course of the most recent loan is higher than for BRAC clients, giving rise to the author’s contention that better-off borrowers benefit more than poorer borrowers. (*Note: A decimal is 1/100 of an acre.)

26 Morduch only includes households that fulfill the targeting criteria of the three organizations and labels them “eligible households.”

27 These results are statistically significant at the 95 percent level.

28 Morduch’s estimate of labor supply variability is 39, which is 46 percent lower for microcredit members compared to a control group.

29 H. Rahman, “Mora Kartik: Seasonal Deficits and the Vulnerability of the Rural Poor,” in *Rethinking Rural Poverty: Bangladesh as a Case Study,* ed. H. Rahman and M. Hossain (Dhaka: UPL, 1995).

30 M. Cain, S.R. Khanum, and S. Nahar, “Class, Patriarchy and Women’s Work in Bangladesh,” *Population and Development Review* 5, no. 3 (1979): 405-38.

31 R. Naved, “Empowerment of Women: Listening to the Voices of Women,” special issue on Women, Development, and Change, *Bangladesh Development Studies* 22 (2 & 3): 155-79; N. Kabeer, *Reversed Realities: Gender Hierarchies in Development Thought* (Dhaka: UPL, 1994); S. Hashemi, S. Schuler, and I. Riley, “Rural Credit Programs and Women’s Empowerment in Bangladesh,” *World Development* 24, no. 4 (1996): 635-53.

32 S. Amin and A. Pebley, “Gender Inequality within Households: The Impact of a Women’s Development Programme in 36 Bangladeshi Villages,” special issue on Women, Development, and Change, *Bangladesh Development Studies* 22 (2 & 3): 121-54; S.C. White, *Arguing with the Crocodile: Gender and Class in Bangladesh* (London: Zed Books, 1992); and S. Mahmud, “From Women’s Status to Empowerment: The Shift in the Population Policy Debate,” Bangladesh Development Studies 22, no. 4 (1994): 77-99.

33 Amin and Pebley, “Gender Inequality within Households.”

34 Naved, “Empowerment of Women.” Naved uses Participatory Rural Appraisal (PRA) techniques to identify the effect of participation in Save The Children’s savings and credit program in Manikanj.

35 Hashemi et al., “Rural Credit Programs and Women’s Empowerment.”

36 A. Goetz, and R. Sen Gupta, “Who Takes the Credit? Gender, Power, and Control over Loan Use in Rural Credit Programmes in Bangladesh,” *World Development* 24, no. 1 (1996): 49.

37 Montgomery et al., “Credit for the Poor in Bangladesh.”

38 Goetz, “Who Takes the Credit?”

39 S. Lundberg and R. Pollak, “Separate Spheres Bargaining and the Marriage Market,” *Journal of Political Economy* 101, no. 6 (1993): 988-1010.

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