

**Poverty Impact and Outreach of Microfinance in Bangladesh:
Current Knowledge, Practices and Moving Ahead**

**A Background Paper Prepared for the
Review of the Microfinance Sector in Bangladesh:
Issues and Options**

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I. Changing Microfinance Landscape in Bangladesh and Implications for Research

Even as late as the early 1990s, scaling up the success of a handful of microfinance institutions in Bangladesh to serve the vast majority of the poor in Bangladesh was one of the big challenges. The rest of the 1990s, saw a massive expansion of microfinance all over the country with the scaling up of existing providers, entry of new players and emergence of supra level institutions, such as Palli Karma Sahayak Foundation (PKSF), and Credit and Development Forum (CDF). Today, impact assessment researchers have great difficulty in finding control villages--- villages with no microfinance providers.

The worry over scaling up is now a concern of the past—today the concerns are more about managing the negative effects of competition and potential systemic risk to the sector¹. The assumption of stable client participation in microfinance is no longer valid--- today, client participation in microfinance is much more fluid and dynamic throwing up important changes that will have to take place in the methodologies used by researchers in assessing programme impacts.

The elements of the survival and expansion strategy for the microfinance sector discussed today are more in terms of vertical expansion through market segmentation, and product diversification, providing more client responsive services, increasing retention, etc. The changing microfinance landscape that underpins these second generation challenges for the sector thus needs new types of support services. We can broadly categorize the new types of support services from a research point of view into two².

(1) There is a need for much more detailed market research that speaks to the specific needs of the institution, such as product review, exit surveys, client satisfaction, etc. Much of this type of research activities will have to be carried out internally by the institution. However, such research will have to be cost effective and for most institutions it is not feasible to have a division dedicated to this³. One important source of these types of research activities can be the existing data collected by a MFI for its MIS and other monitoring activities. The big constraint here is the capacity of the staff to make more analytical use of such database. Fortunately, significant advancements have been made globally on the theme of cost-effective market research models and methodologies⁴. Donors can invest in creating partnerships between such international centres and local action research agencies to develop

¹ Several of the larger NGO-MFIs have signed MoUs between themselves to avoid overlapping and stealing each other's clients. We however do not have information on the effectiveness of such agreements. PKSF has recently embarked on an ambitious project of creating what they call a 'credit bureau database', which will cover member level information of most MFIs of the country.

² There are other non-research type of very important support services that we are not including here, such as, external auditing, developing customized software, training and capacity building, credit rating, etc.

³ BRAC is probably the only NGO-MFI that has a separate research and evaluation division geared towards providing R&D services to its development programmes.

⁴ The USAID funded Assessment of Impact of Microenterprise Services (AIMS) triggered innovative approaches to doing cost effective yet credible research for improving microfinance operations. The model used by Microsave, Africa is one good example of such innovative approaches to strengthen the capacity of the institution to carry out market research internally.

a sustainable model of building the capacities of NGO-MFIs to carry out market research to better understand impacts and improve their operations to enhance them⁵.

(2) There is also an increasing need for research activities that take the sector as a whole as its unit of analysis. Issues such as monitoring the poverty outreach of the sector, geographical areas where more focus is needed, competition, entry and exit of players and clients to the sector, etc. are some examples where narrow institutional focus is not adequate. Guiding and influencing policy would be an important objective of such a service providers. It would be even more attractive if the knowledge generated out of such a service provision was explicitly linked to creating development professionals through teaching and training activities. The appropriate player for these types of research service has to be one that is independent and collectively owned by the players of the sector. This is also an important area donors should explore and invest.

II. Poverty Outreach of Microfinance in Bangladesh

Compared to the global records, microfinance in Bangladesh is probably the most poverty-focussed in its operations and discourses. This is a crucial strength of the sector as it engages with some of the second-generation challenges, such as professionilization, commercialization, regulation, supervision, etc. Thanks to high population density, relatively easily accessible terrain, and solid institution builders, the debate over trade-off between financial sustainability and serving poor people is less polarized and more consensual. Increasing depth of poverty outreach and enhancing poverty impact are the two fundamental challenges that dominate the microfinance discourses in Bangladesh.

2.1 The Extreme Poor and Microfinance

Figures vary on the extent to which microfinance reaches the extreme poor. Part of the reason for this variation has to do with the definition of the extreme poor. Landlessness is often used sometimes along with low educational levels as a proxy of low human capital to define the extreme poor in most studies. Needless to say, these indicators are rather incomplete, especially in view of the changing rural Bangladesh scenario where the centrality of land and agriculture in describing the current and the future wellbeing prospects is losing ground. The other reason for the variation is fragmented data with varying degrees of quality and differences in sampling.

More often than not, such figures come out of institution specific studies and there is no coordination among the donors funding such initiatives, or among the institutional researchers involved. These studies can potentially be extremely valuable in connecting particular programmatic approaches to the extent to which the extreme poor are served and impacted upon. Such findings can be of great help to practitioners and policy makers in carving out a set of good practices for microfinancing with the extreme poor and investing in these. However, this would require coordination beyond the individual institution level, which is sorely missing.

⁵ BRAC's Research and Evaluation Division is an example of a local partner in such a model.

The consensus across the studies is that the extreme poor are less than proportionately covered by the microfinance programmes at large⁶. There are variations across programmes, however. For instance, some studies find BRAC to be better in terms of reaching the extreme poor⁷. However, this is disputed by more recent studies that find that smaller and more local NGO-MFIs are better in working in poorer areas and in reaching the poorest⁸.

Targeting and Methodologies

Defining the target group is important not only for methodological reasons of being able to draw comparative picture across institutions, but also because, targeting indicators is an expression of organizational commitment to serving a particular group⁹. Poverty is multidimensional, heterogeneous, and relational. As such, composite indices work much better in defining the poor, including the extreme poor. Participatory wealth ranking (PWR) is a relatively less costly way of identifying and distinguishing between the various levels of the poor within a community. Studies on the accuracy of the PWR in Bangladesh and elsewhere have found it to be quite robust¹⁰. However, there are problems with comparability and a lot depends on the process through which the PWR exercise is conducted. In order to address these areas of concern, BRAC's Targeting the Ultra Poor (TUP) Programme uses a combination of PWR and indicator based targeting. The indicators used comprise of two sets—the first is a set of 'exclusion criteria' and the second is a set of 'inclusion criteria'. While all the exclusion criteria will have to be fulfilled, at least two of the five inclusion criteria have to be fulfilled before a household is considered for the programme¹¹. Results suggest that this combination yields superior targeting of the extreme poor outcomes, though more expensive compared to other methods. However, for programmes that use a grants based mechanism to build the foundations before linking them to mainstream development programmes such as microfinance, targeting the extreme poor effectively is extremely important and needs to be done seriously.

⁶ The definition of the extreme poor is not consistent across the various studies. Given the costs and expertise needed in constructing a consumption or income based extreme poverty line, most use landlessness or the lowest level in participatory wealth ranking exercises.

⁷ Hashemi, S.M., S. Schuler, and A.P. Riley, 1996, 'Rural Credit Programmes and Women's Empowerment in Bangladesh', *World Development*, **24(4)**, 635-53. They find that 39% of BRAC microfinance programme beneficiaries are extreme poor. Results from the Second Round of BRAC Research and Evaluation Division conducted Impact Assessment Study finds that in the BRAC microfinance working areas, the coverage of the extreme poor is proportional to its share in the local population.

⁸ Sen, B., 2001, "Poverty reduction and Graduation: Emerging Trends from PKSf supported Programmes", in S.Zohir, et. al.(eds), *Monitoring and Evaluation of Microfinance Institutions*, Final report, Bangladesh Institute of Development Studies. Halder, S., 2003, "NGO Services for the Extreme Poor", *mimeo*, Research and Evaluation Division, BRAC. This study finds that specific programmes for the extreme poor are more likely to be operational in poorer areas of the country and by smaller and local institutions.

⁹ On this perspective of targeting, see, Abed, F.H., 'Programmes for the Extreme Poor: BRAC Experiences', Paper prepared for the International Workshop on Chronic Poverty, University of Manchester, UK

¹⁰ (1) Adams, A., et al. 1997, 'Socioeconomic Stratification by Wealth Ranking: Is it Valid?' available at: http://www.hsph.harvard.edu/Organizations/healthnet/HUPapers/97_02.pdf. (2) Simanowitz, A., et al., 2000, 'Overcoming the Obstacles to Identify the Poorest Families', <http://www.microcreditsummit.org/papers/povertypaperH.html>

¹¹ For details of the TUP targeting process, see Matin, I., and S. R. Halder, 2003, 'Combining Targeting Methodologies for Better Targeting of the Extreme Poor: Preliminary Lessons from BRAC's CFPR/TUP', *CFPR Working Paper 1*, Research and Evaluation Division, BRAC.

As regards to *why* there is less than proportionate microfinance coverage of the extreme poor, studies highlight demand and supply side factors¹². Interestingly, much of the demand side factors listed, such as ‘lack of regular income flow’, can have implications for supply side responses, such as product innovations. However, such interlinkages between demand side constraints and how the supply side could respond to them have not been well specified in the existing studies.

One important missing perspective in many of the studies exploring microfinance participation of the extreme poor is the question of their ‘willingness to participate’. The PKSFBIDS longitudinal study uses an interesting approach to throw light on this area by categorizing the households into three groups: (a) willing participants (currently participating households); (b) willing but currently non-participating households; and (c) non-willing households. Given the representativeness and the innovative conceptual categories used in this study, it is worth discussing the results in detail.

Comparing the ‘willing group’ (i.e. groups a and b above) to the non-willing group of households (i.e. group c above), the study finds the probability of willingness to participate for a household that is chronically deficit falls by 12 percent compared to those who are not chronically deficit. Thus, the study concludes that, ‘the allegation that the poorest among the poor are left out of the MFI programmes is true possibly because they do not *demand* such services’. (:43. Emphasis added). Comparing willing and participating (group a above) and willing but not participating (group b), the study finds that, ‘[i]t is not only that the chronic deficit are less willing to participate, but even when they are, they are significantly less likely to be enrolled as participants by the MFIs’ (:46).

Given the emerging body of research suggesting that ‘business as usual’ might not be appropriate as far as the extreme poor are concerned, the action agenda on what to do about the less than proportionate microfinance coverage of the extreme poor is less consensual. There are two broad approaches—one, focussing more on the financial service side emphasizing product innovations, especially more risk responsive products, such as contractual flexibility, insurance, etc. (PKSF, Buro Tangail); the other approach, emphasizing the need to strengthen the physical and socio-political asset base of the extreme poor and then linking them to microfinance (BRAC’s IGVGD, CFPR). These are recent developments and it is too early to reach conclusions on the relative merit of the two broad approaches. However, it is very likely that the approaches are complementary to each other. In some areas, the two approaches could be piloted together with a focus on learning through careful research. Again, such an approach, though intuitively most sensible, fails to materialize due to vertical structure of such programmes and lack of coordination, and dialogue.

¹² Rahman, R.I., 1996, ‘Poverty, Profitability of Microenterprises and the Role of NGO Credit’, in G. Wood and I. Sharif (eds.), *Who Needs Credit? Poverty and Finance in Bangladesh*, Dhaka: UPL

Though microfinance is relatively less attractive to the poorest as a livelihoods-improving strategy, a section among the extreme poor, nevertheless join microfinance programmes¹³. As discussed below, many of them invest in intergenerational assets, through accumulation of physical and human capital and cease to remain in extreme poverty. These investments may not yield short-term improvements in income poverty, but can act as vital assets for the household to overcome poverty and take advantage of new opportunities over the long haul. The BRAC study finds that almost one-fifth of its members were extreme poor in 1997 and this proportion declined by 6 percentage points in 2001. For the comparison group, the rate of decline during the same period was about half¹⁴. However, it is also important to be aware that due to supply side pressures of increasing outreach, adverse inclusion of the extreme poor into microfinance also takes place. Many of them default but in the process accumulate expensive debt and drop out. For some, this process leads to a worse-off situation¹⁵.

2.2 Pockets of Possibilities

There are certain pockets where the scale of microfinance operations is commonly agreed to be relatively sparse. However, good data at this level of disaggregation is not available¹⁶.

The population living in char areas and the haor areas is extremely vulnerable to natural calamities. The economic opportunities are quite low and competition over scarce resources intense leading to frequent violent factional outbreaks centring around winning rights over resources. Livelihoods are more dependent on physical mobility, and migration. Accessibility is poor leading to low morale of staff posted there, and high operating cost. A study on microfinance providers in the Brahmaputra-Jamuna char areas concluded that: 'it is a case of poor service in poor areas'¹⁷.

In addition to some of the realities of the geographically difficult areas alluded to above, there are important ethnic and socio-political issues in areas such as the Chittagong Hill Tracts that microfinance providers will need to consider if they are to increase outreach. In other indigenous community belts, such as the Garo-Hajong belt in the Mymensingh division,

¹³ Targeting indicators used to target the ultra poor in BRAC's new programme for the ultra poor, 'Challenging the Frontiers of Poverty Reduction', includes an exclusion criterion which is that any ultra poor household having current microfinance participation should not be included. This has made targeting a much more time consuming process than it would have been without this exclusion criterion. However, there are important regional variations. For more on this, see Matin, I., and S. Halder, 2003, 'Combining Targeting Methodologies for Better targeting of the Extreme Poor: Preliminary Lessons from BRAC's CFPR/TUP Programme' *CFPR Working Paper, 1*, Research and Evaluation Division, BRAC.

¹⁴ Halder, S., 2003, 'Extreme Poor Households and BRAC Interventions: Is there any Impact?', mimeo, Research and Evaluation Division, BRAC.

¹⁵ Hossain, A, 'Drop out of BRAC Microfinance Members: Process and Consequences', mimeo, Research and Evaluation Division, BRAC.

¹⁶ PKSF is undertaking a very important initiative called the 'Credit Bureau Database'. This database should be used to obtain disaggregated level microfinance outreach information. CDF also has a good database. However, it is too aggregated and with some help this database could be potentially designed to provide much more disaggregated information. Encouraging and building more disaggregated data collection units, especially in the 'pockets of possibilities', such as the chars, haors, and indigenous community belts run by locals could be explored.

¹⁷ Matin, I., E, Hassan, M. Moniruzzaman, and S.K. Sinha, 'Microfinance in the Brahmaputra-Jamuna Chars', Design Phase Study for the Char Livelihood Programme, *DFID*, Dhaka, Bangladesh.

the Santal belt in Rajshahi division, the situation is slightly different as these indigenous communities are historically more integrated with the mainland Bengali community and the politics over ethnicity is less intense. It is likely that the success of the existing microfinance providers in attaining outreach in these indigenous belts is better.

Disaggregated data on MFI outreach is hard to come by. A baseline study on the Chittagong Hill Tracts (CHT) conducted by BRAC's Research and Evaluation Division finds important differences in financial behaviour among the five main ethnic groups used in the study (Banglali, Chakma, Marma, Mro, and Tripura)¹⁸. The tables below provide some information on these differences.

| | Form of savings (%) | | | | Amount of savings |
|----------|---------------------|-------|--------------|--------|-------------------|
| | Cash | Paddy | Mushti Chaal | Others | |
| Banglali | 65.1 | 5.4 | 0.3 | 29.2 | 4,556 |
| Chakma | 63.3 | 4.6 | 1.9 | 30.4 | 851 |
| Marma | 64.4 | 14.9 | 0.3 | 20.7 | 2,265 |
| Mro | 81.9 | 11.9 | 0.3 | 5.8 | 1,687 |
| Tripura | 63.8 | 24.4 | 4.9 | 6.9 | 562 |

| | % of loans by source (amount) | | | | | | |
|----------|-------------------------------|----------------|----------------|----------------|------------------|-----------------|----------------|
| | Formal (incl. MF) | Coop | Moneylender | Business | Relative | Neighbour | Others |
| Banglali | 4.9 (31,088) | 2.5 (3,736) | 8.2 (2,450) | 5.1 (4,890) | 12.5 (15,051) | 17.1 (8,307) | 0.2 (100) |
| Chakma | 5.9 (4,121) | 1.2 (1,783) | 2.0 (2,450) | 1.4 (3,950) | 8.1 (3,827) | 1.0 (2,840) | 0.2 (900) |
| Marma | 15.5 (4,213) | 1.6 (1,735) | 7.9 (6,213) | 4.9 (1,317) | 5.3 (3,341) | 7.3 (1,689) | 0.6 (1,600) |
| Mro | 0.6 (2,333) | 1.2 (2,000) | 25.9 (9,823) | 0 | 19.2 (7,910) | 13.3 (3,045) | - |
| Tripura | 2.7 (4,536) | 0 | 8 (1,650) | 1.2 (293) | 7.5 (1,172) | 4.3 (2,068) | - |

The outreach of NGO-MFIs is quite low in the CHT region and the ethnic variation in their outreach is also significant. Informal institutions organized by the villagers have also been observed to operate in CHT but these operate mostly on ethnic division lines. Institutions that transcend such boundaries will play an important role in developing bridging social capital, a vital component for development. However, a lot more work in terms of understanding the ethno-political and how such identities affect financial service behaviour and preferences will have to be done before this 'pocket of possibility' is served effectively. Local ownership over institutions possibly operated by the locals will be important in this context where the role of external players will be to develop capacity. Experimentations on developing financial institutions that are more user-owned may be more appropriate.

Microfinancing in such 'pockets of possibilities' will have to pay much closer attention to understanding the context, trends and shocks that underpin the livelihoods of the people living there. New models and approaches may need to be developed and new partnerships

¹⁸ Rafi, M., A.M.R. Chowhury (eds.), 2001, *Counting the Hills: Assessing Development in Chittagong Hill Tracts* Dhaka, University Press Limited.

with other players formed to develop appropriate sectoral development programmes to break into these areas with microfinance.

However, more often than not, breaking into these more difficult markets would require a range of well-sequenced and integrated web of interventions where microfinance will play an important role as a component. The operating concept in these circumstances will be one of area development and investing in microfinance will have to be well coordinated with a range of other intervention packages involving other players. Effective coordination and management of such interrelated area development programme is crucial and should not be directly undertaken by donor agencies. The approach taken in the proposed Char Livelihood Programme funded by DFID and GoB is worth exploring for other pockets of possibilities, such as the Chittagong Hill Tracts.

Urban microfinance needs to be focussed much more than it is now. This is because urbanization is, and going to be even more of an important challenge for development. Urban microfinance however will have to be much more than a mere replication of rural microfinance approaches with larger loan size. It can have an important role to play in developing innovative financing models in partnership with other service providers for community-based infrastructure, housing, etc. Our knowledge about the urban microfinance sector, its poverty outreach and impacts is almost non-existent¹⁹. There are important risks that urban microfinance faces in dealing with a population that have no tenurial rights. Acting on these constraints often requires collective actions beyond the level of the individual institutions.

In addition to geographical ‘pockets of possibilities’, there are of course immense possibilities for microfinancing of financial service needs that to date remains under served. A lot of these are of great importance for the poor and can enhance the overall impacts of microfinance. Some examples include, remittances services, self insurance products that work via savings, insurance, pension, etc. Contractual innovations that allow the clients to save, withdraw, borrow, and repay with greater freedom and choice is another good example.

There are also important sector wide innovations that can enhance impacts. One example is the cost of switching that clients currently face. Though participation in microfinance institutions as more and more choices become available is increasingly becoming dynamic, often, the cost of switching can be high—in other words, shopping around is costly. A client choosing to switch from one provider to another often cannot capitalize on the reputation she has built up with one provider. If this cost can be reduced, the individual providers will face competitive pressures to retain good clients and clients can transfer reputation across providers. The microfinance market is currently segmented making it difficult for providers to engage in mutually beneficial trading. One good example is urban to rural remittances.

¹⁹ Attempts to get information on urban microfinance by communicating with several of the leading urban microfinance players did not yield much. Credit and Development Forum, a network of Bangladeshi MFIs, collect large amount of data on the microfinance sector but the information is in highly aggregate form. Given the strength of the CDF platform and network in collecting this data, a relatively minor investment in refining the model and building the analysis capacity of the staff could be very productive.

Microfinance providers having national level presence can offer remittances services to clients of other more local or regional providers for a charge.

III. Impact Research of Microfinance: The Past and the Future

The Bangladesh IPRSP document describes the Bangladesh recent development performance records as one of ‘silent ascent’ (IPRSP, 2003: 2). The various components of the microfinance process can be mapped at least conceptually to show their positive contribution to the dimensions of what makes up this ‘silent ascent’. The recent CGAP focus note undertakes a similar exercise of mapping with evidence of how microfinance can contribute to the achievement of the MDGs²⁰.

Impact of MC on Household Income/Expenditure

| Source ²¹ | Name of MCI | Income/expenditure per annum (Tk.) | Project (P) | Control (C) | % change $\frac{(P-C) \times 100}{C}$ |
|-----------------------------|-------------|------------------------------------|-------------|-------------|---------------------------------------|
| Hossain 1984 ²² | GB | Income, per capita | 1762 | 1346 | 30.9 |
| Hossain 1988 ²³ | GB | Income, per capita | 3524 | 2523 | 39.9 |
| IMEC 1995 ²⁴ | Proshika | Income, per household | 22244 | 17482 | 27.2 |
| Rahman 1996 ²⁵ | PKSF | Expenditure, per household | 26390 | 23802 | 10.9 |
| Khandker 1998 ²⁶ | GB | Expenditure, per capita | 5180 | 4202 | 23.3 |
| Khandker 1998 | BRAC | Expenditure, per capita | 5050 | 4335 | 16.5 |
| Halder 1998 ²⁷ | BRAC | Expenditure, per capita | 8244 | 6480 | 27.2 |
| IMEC 1999 | Proshika | Income, per household | 48635 | 43584 | 11.6 |

A number of studies on the impact of microfinance highlight the fact that access to microfinance has resulted in an increase in employment and income. Some of the impact assessment studies sought direct opinion of the clients. Majority of the credit recipients of MFIs reported that increases in income had taken place as a result of the use of credit. Results from a few studies have been presented in the two tables below²⁸. The changes in

²⁰ Littlefield, E., J. Morduch, and S.M. Hashemi, January 2003, ‘Is Microfinance an Effective Strategy to reach the Millennium Development Goals?’, *CGAP Focus Note*, **24**, Washington DC (www.cgap.org)

²¹ Each source provides more than one comparison to demonstrate the impact of MF. In this table the control group from control village or from new members has been chosen as the basis for comparison and only one comparison has been shown. Results across studies are not comparable, because of variations in methodology and the areas covered.

²² Hossain, M., 1984, *Credit for the Rural Poor: The Experiences of Grameen Bank in Bangladesh*, Research Monograph No. 4, BIDS: Dhaka.

²³ Hossain, M., 1988, *Credit for alleviation of rural poverty: The Grameen Bank in Bangladesh*, Research Report **65**, International Food Policy Research Institute, Washington, DC.

²⁴ IMEC, Proshika, 1995, *Impact Assessment Survey Report*, Proshika: Dhaka

²⁵ Rahman, R.I., 1996, *Impact of Credit for Rural Poor: An Evaluation of PKSF’s Credit Programme*. Research Report, BIDS.

²⁶ Khandker, S.R., 1998, *Fighting Poverty with Microcredit: Experiences from Bangladesh*, OUP: New York.

²⁷ Halder, S.R., A.M.M. Husain, N. Amin, and F. Farashuddin, 1998, ‘Analysis of member performance and coverage in poverty alleviation and empowerment’, *The Second LAS of BRAC’s Rural Development Programme*

²⁸ This section on the overview of impact assessment results draws substantially from Rahman, R.I., 2003, ‘Future Challenges Facing the MFIs of Bangladesh’, paper presented at the PKF organized International Workshop on *Attacking Poverty with Microcredit*.

income as a result MFI participation range from 8 per cent to 40 per cent. Such evidences provide a strong basis to conclude that MF leads to an increase in household income and employment and results in poverty alleviation.

A Summary of the Findings of Some IAS on Microcredit

| Source | Economic Indicators | Type of Change | Social Indicators | Type of Change |
|-------------------------|---------------------------------------|----------------|--------------------------------|----------------|
| Hossain 1984 | Return on investment | + | | |
| | Household income | + | | |
| | Employment | + | | |
| Hossain 1988 | Working capital | + | Social Investment | + |
| | Non agricultural investment | + | | |
| | Agricultural investment | ? | | |
| | Land force participation rate | + | | |
| | Income | + | | |
| BIDS 1990 ²⁹ | Income | + | Child-woman ratio | ? |
| | Expenditure | ? | School enrollment | + |
| | Employment | + | | |
| | Land purchase | + | | |
| IMEC 1995 | Economic empowerment | + | Social empowerment | + |
| Pitt & Khandker 1995 | Various labour supply | + | Girls schooling | + |
| | Men's labour supply | - | Contraceptive use | ? |
| | Household expenditure | + | Women's non land asset | + |
| Rahman 1996 | Household expenditure on consumption; | + | Number of meals taken by men | ? |
| | Human capital and fixed investment; | + | Number of meals taken by woman | ? |
| | Employment | + | School enrollment rate | + |
| | | | Attitude to education | + |
| | | | Pure drinking water | ? |
| | | | Adoption of family planning | + |

Numerous studies of varying degree of reliability and rigour are now available that show largely positive microfinance impacts on various domains. Thus the problem that we face in using research to move the poverty focussed microfinance agenda forward is not one of generalized evidence, at least not any longer.

The main problem is that the relationship or impact pathway mapping the various components of the microfinance process to the impact domains is not well specified and researched. Thus, we reach very generalized conclusions about microfinance impacts which serve an important function as far as 'proving' is concerned, but fail to throw much light on what type of microfinance (both process and product) is more important for which dimension of poverty alleviation and impact. The relationship between programme activities and impact indicators is often not made explicit. Thus, such research fails to be very helpful in providing inputs for programmatic actions to attain the desired impacts and/or enhancing

²⁹ BIDS, 1990, *Evaluation of Poverty Alleviation Programmes in Bangladesh*, Main Report, mimeo, BIDS: Dhaka.

them. For instance, we find significant variations in a number of important impact dimensions across the microfinance institutions studied extensively under the massive and sophisticated World Bank study³⁰. The table below is an attempt to highlight some of the major differences we encounter across the three programmes studied³¹. These variations are however not explored in the study. This study in many ways epitomizes the past of microfinance research and what we need to do to move on.

| Variable | Impact differences across programmes |
|------------------------------------|--|
| Employment per worker | Difference largest in the GB area vis-à-vis the control area. Next BRAC and then BRDB |
| Hourly return on wage employment | Lower for GB and BRAC participants compared to non-participants. Higher for BRDB participants. |
| Impact of programme placement | GB or BRAC benefits in terms of raising labour productivity the non-agricultural sector more than the agricultural sector. On the other hand, programme placement of BRDB benefits agriculture more than non-agricultural activities. In their respective programme villages, GB benefits target households most, while BRAC and BRDB through village level induced impacts, benefit the non target households the most. |
| Contraceptive use | Credit programme placement increases contraceptive use in BRAC and GB villages and the impact is greater in BRAC areas. The credit programmes however have significant impact on fertility. |
| Household wealth and empowerment | Credit provided by GB had the greatest positive impact on variables typically associated with household wealth and women's power and independence than credit from other sources. |
| Meeting calorie requirement | Women met a higher proportion of their calorie requirement when the participating member was a woman rather than a man. Interestingly, women's participation reduced men's calorie consumption, while vice versa. The extent of this gender difference was least pronounced for female GB participants. |
| Health and nutrition | Compared to BRAC villages, both the GB and BRDB villages averaged better calorie and protein intake among both boys and girls from target households. Incidence and length of illness (morbidity) was lower in GB and BRDB villages compared to BRAC. However, compared to children in the BRAC villages, both GB and BRDB villages had lower nutritional status in terms of weight for height. |
| Poverty outreach | The gap between the % of extreme poor among non-participants and the % of extreme poor among participants in the programme villages is the lowest for BRAC. |
| Rate of moderate poverty reduction | 6% per year for BRDB participants, 4% per year for GB participants, and 1% per year for BRAC participants. The average length of programme participation required for a household to rise above poverty line is slightly more than 5 years for GB participants, and less than 5 years for BRAC and BRDB participants. |

The next generation of microfinance research in general and impact research in particular will thus have to go beyond an assessment of these averages. It has to increase our knowledge about the variations and the differences across the different ways of doing microfinance (both process and products) and whether and how they matter for which types of impacts. For this, the research will have to pay much more attention to the 'black box' of microfinance practice and map the various components of the microfinance practice to the impact assessment exercise. Such research will not only be helpful for practitioners but will also go a long way in helping decisions of resource allocation for donors.

This focus is even more important for programmes that draw on donor support for developing innovative approaches. Paradoxically, research activities and resources tend to concentrate more on established programmes where innovations are relatively less likely. For

³⁰ Khandker, S.R., 1998, *Fighting Poverty with Microcredit: Experiences in Bangladesh*, New York: OUP for the World Bank.

³¹ The table is based on Latif, M.A., S.R. Khandker, and Z.H. Khan (eds.), 1996, *Credit Programmes for the Poor: Household and Intrahousehold Impacts and Programme Sustainability*, Volume II, BIDS: Dhaka.

instance, the CGAP/IFAD Rural Pro-Poor Innovation Challenge Fund has no research focus. This could potentially have been a good platform for dovetailing a serious research component³². PKSF's 'Microfinance for the Hard Core Poor' fund similarly can benefit tremendously the microfinance community both in Bangladesh and beyond through research. However, as argued in this section, this would require a reorientation of research focus from just 'proving' that impacts exist, to more operational research that is geared towards 'improving' the programmatic basis of impacts.

The basic premise that relaxing credit constraint will lead to welfare gain is obvious enough. If there is no serious dispute over this basic assertion, then, there is an important need to rethink the need for undertaking costly household level impact assessment studies. Moreover, there are serious methodological challenges that have been thrown up in the recent years, such as selectivity bias (that programme participants may self-select) and non-random programme placement (that programmes may not be randomly placed). The ground reality of the changing microfinance landscape of Bangladesh makes new exercises of assessing programme level impacts from household level data extremely dubious. Such exercises should be limited to programmes using innovative approaches to serve existing client group or those that break into new markets. Wherever possible, such innovative approaches should be randomised at least over areas during pilot phase with careful controls so that meaningful assessments can be done³³.

IV. Microfinance Impacts and Enhancing Impacts

We know that on average microfinance delivers on poverty alleviation. It does so on many different dimensions of wellbeing and according to a recent study, has important positive spill over effects for the local economies, thereby increasing village level welfare³⁴. This is probably one of the first formal attempts to capture the wider level impacts of microfinance and in the future this will be an important research theme to pursue.

We however need to know more to *enhance* the impacts of microfinance. For this, we need to know more on what are the aspects of the microfinance programme both in terms of

³² Among the winners of this Fund, there are many using microfinance extremely innovatively for addressing a range of poverty dimensions. For instance, the latest winners include, (1) **International Justice Mission (India)** working to reverse the exploitation of bonded labor. RPPIC funds will allow IJM to obtain the legal release of individual victims and facilitate prevention by offering microfinance and microenterprise opportunities, through local finance institutions, to formerly bonded laborers and those at risk; (2) **MAFF (Albania)** provides financial services to those in remote highland areas with little access to financial institutions, by targeting isolated villages and adapting services to the needs of the people. The RPPIC award will be used to expand their geographical outreach, and to support the provision of a more diversified range of products (for more on the winners, see, http://www.cgap.org/html/mfis_funding.html). These are bold initiatives and experimentations to broaden the use of microfinance as a poverty alleviation tool. However, we know little about the approach these institutions are taking to address the problems, their effectiveness and the challenges faced.

³³ Programmes during pilot phase can randomly choose from a list of equally desirable pilot areas to start pilots and keep the other areas as controls. In the control areas, programme can select potential clients using the same criteria as they would use in the pilot areas but not serve them for a specified period, say five years. Such an approach allows a very robust impact assessment framework to address a range of impact assessment questions credibly. Investing in such piloting approach and involving researchers to develop simple instruments to collect information over period of time can be great value for money.

³⁴ Khandker, S.R., 2003, 'Microfinance and Poverty: Evidence Using Panel Data from Bangladesh', *World Bank*.

products and processes that contribute to what type of impact. We also need to know what other interventions work well with microfinance to produce robust and sustainable impacts. These are important questions that those with responsibilities over decisions to allocate resources will need to know to do their jobs better.

Let me give a good example of such a research. The PKSF-BIDS study used a very interesting and policy relevant categorization of microfinance clients into regular and occasional. Analysis of the longitudinal data collected using this categorization yields extremely useful results. Very broadly, the regular microfinance participants do much better than those who are not. Now, such a finding provides an additional rationale from a poverty alleviation perspective to focus the attention of practitioners on client retention.

The PKSF-BIDS study chapter on poverty impacts argues for a different kind of perspective on poverty impacts and graduation. They see graduation as a process of ‘accumulation of physical and human capital by the poor members as a way of climbing out of poverty’. The idea is that traditional impact indicators that focus on current outcomes may be missing the point that some poor microfinance households maybe pursuing strategies as optimisers over generations. Thus, for instance, they may choose to consume less food and allocate more resources to investment in say education of their children. The proportion of households making such choices may be larger among the microfinance participants. The study finds evidence to support that regular microfinance clients do invest more in accumulation of human and physical capital and have better ability to secure themselves against shocks compared to non-participants.

A panel data study carried out by the Research and Evaluation Division of BRAC finds similar evidence for extreme poor BRAC microfinance members. It is interesting to note that using current period outcome variables such as consumption or income, we get very different results. For instance, one study using quantile regression method that allows examining the determinants of poverty at different points of the income distribution rather than only at the mean, as is the case with standard linear regression techniques, finds that microfinance borrowing has no significant impact for those in the lower quartiles of the income distribution³⁵. The intergenerational choice-based understanding of impacts is thus an important conceptual advancement. It enables us to gain a much more nuanced understanding of impacts from the vantage point of the clients themselves. It also means that the impact indicators we use need to be sensitive to such longer- term outcomes.

In the final analysis, enhancing impacts of any development intervention will have to strengthen the capacity of the poor to compete in the market place. Microfinance contributes in an important way to strengthening that capacity. However, strengthening this capacity needs a range of other ingredients, which the market does not readily provide. Many a times, microfinance institutions have to intervene—a recent survey on NGOs in Bangladesh found that over 80% of the NGOs were involved in microfinance, yet more

³⁵ Cortijo, M.J.A, 2002, ‘Does Quantile Regression help us Better Understand Poverty Determinants?’, Chapter from PhD Thesis, *Rural Poverty, Growth and Inequality in Rural Bangladesh*, University of Sussex:UK.

than 95% of those who were doing microfinance were doing more than only microfinance. Most of them had some sector programmes³⁶.

The current consensus on not directing loan use is the right way forward, but that should not preclude building the right types of sector programmes to increase the returns from the activities of the poor. There are good examples of developing effective and viable agricultural (both crop and non crop) and non-agricultural sector programmes in Bangladesh. Donors can help develop the capacity of NGO-MFIs, especially the smaller ones, in this area by involving the more experienced players.

Till recent past, the discourses centred on graduation of clients from poverty. While the beneficial impact of microfinance is now recognized, the major benefits from the process, that have not been adequately discussed, have perhaps been the emergence of a new set of institutions. We now need to look closely into the graduation process of these institutions. The institutional capacity that has developed in some of the leading microfinance institutions in Bangladesh can be further leveraged for enhancing poverty impacts and generating faster rates of poverty reduction. This has been strongly advocated for in the Citizen's Task Force Report on Poverty and Employment Generation and also echoed in the text of the Bangladesh IPRSP³⁷. Though this takes us beyond microfinance services per se, it is an important agenda that microfinance institutions in their capacity as strong institutions for the poor have expressed.

There are currently two broad proposals on this. One, is 'taking microcredit out of the ghetto', where the proposal argues that, 'organizations of the maturity of the Grameen Bank, should be allowed to graduate into the macro finance system by acquiring the deposits of the public, including the urban middle class and even market its assets at the global level, through such financial instruments as securitisation'³⁸. This proposal takes the idea of poor people as formidable savers several steps ahead by challenging microfinance institutions and the monetary policy makers to design financial mechanisms that will 'tap the small savings of the poor and channel it into productive investments where the poor can share in the ownership and profits'.

The other proposal involves more direct investment. There are two ideas. One is investing in the poor to develop their financial and organizational capacity to sell their products and services at a time and in a market, which offers them the best terms. This would require investments in the micro as well as the macro credit market to underwrite such marketing ventures, as well as deployment of professional management skills, to assist the poor in participating in the market place (ibid: 10). The second one is to help the poor add value to their labour by linking their activities to higher-levels of the value chain.

³⁶ Halder, S.R., 'NGO Services for the Extreme poor in Bangladesh', mimeo, Research and Evaluation Division, BRAC.

³⁷ The Citizen's Task Force Report on Poverty and Employment Generation is available on the web at: www.cpd-bangladesh.org/pubonline.html#taskforce

³⁸ CPD, July 2002, 'A Work Programme for Eradicating Poverty in South Asia through Economic and Political Empowerment of the Poor', CPD:Dhaka. Such a view has also been aired very strongly by Muhammad Yunus in his recent speech made at the PKSF organized International Workshop, 'Attacking Poverty with Microcredit'.

Most of these ideas are not new, even in the context of Bangladesh and there are probably many examples of failed previous attempts. However, what is probably new is the development of a strong third sector, which also happens to provide microfinance. Thus, the role of microfinance *institutions* in enhancing its poverty impacts has to be seen within a larger institutional canvass that at times transcends pure microfinance activities, at least in the conventional sense.

V. Role of Donors

- The new microfinance landscape and the ground realities facing the sector demand new knowledge. The existing knowledge service providers and the structures that create this knowledge need to face up to this challenge. There are two important considerations here:
 - One, the new knowledge demands of the sector are more about ‘improving’ existing services and enhancing impacts rather than only ‘proving’. This would require closer relationships between the practitioners and the researchers. For this, most research will be internal and donors can invest in building partnership to transfer the international expertise in more operational type of microfinance research. Local action research institutions, such as BRAC’s Research and Evaluation Division can be involved as the local partner.
 - Two, research needs to pay a lot more focus on sector wide rather than being just institutions specific. Comparative institutional studies to increase knowledge of what works and how will be of course important, but these will have to pay greater attention to relating outcome to programme components and processes³⁹. This is because some of the most pressing issues facing the individual providers operate at the sector level, such as overlapping, but also because old questions of impact now need to be explored at levels beyond the individual institution and its programmes. Both the considerations above require that the structures that create knowledge be institutionalised at levels beyond individual organizations. Donors have an important role to play in supporting investment in the creation of such sector level knowledge creating institutions.
- If the claim by the PKSf-BIDS study that smaller and more local providers are as good and at times better in delivering on both depth of poverty outreach and poverty alleviation, then donors may have a role to play in finding good mechanisms to support such initiatives. Moreover, due to the smallness of their operations, it is easier for them to carry out innovative experiments with new types of products and services. PKSf despite being an extremely well managed and successful microfinance apex is not a possible funding source for many of these smaller institutions. Intensive capacity building along with access to subsidized revolving loan fund will be needed to develop the scalability of these initiatives. Some of the more established and capable national providers having large scale outreach can be used to manage such a process. BRAC’s NGO Cooperation Project (BNCP) can be one of the models that may be explored further⁴⁰.

³⁹ The idea here is not to engage in costly (and often impossible) attribution exercise of separating impact effects of various programme components. This is difficult enough for the programme as a whole. What is being suggested is mapping exercises, which will map what are the expected types of impacts from programme components; say group formation, savings withdrawal facilities, etc.

⁴⁰ BNCP currently supports over 100 local NGOs with intensive capacity building, mentoring and providing small revolving fund. Almost 20 of these have already been considered by PKSf as partner organizations.

- Investments in innovative approaches will need donor support, and the sector needs to innovate both for its survival and enhancing its impact. However, there are a few considerations that donors will need to pay closer attention to. First, innovative approaches undertaken by weak institutions can do more harm than good. Second, given the strong size polarization of the microfinance sector in Bangladesh, innovative approaches, to have any large-scale impact, will have to capture the imagination of the larger players. Donors will have a role to play here in the form of creating honest knowledge brokering institutions. Third, innovation will have to have strong built-in knowledge component. Wherever possible, such innovative approaches should be randomised at least over areas during pilot phase with careful controls so that meaningful assessments can be done. Careful process documentation of such experiments can also be extremely useful for know-how transfer. This is important if innovative approaches are to be taken to scale.
- Relatively small investments in the form of technical assistance can add a lot of value to existing initiatives. One good example is Credit and Development Forum, which manages a very important database on the microfinance sector of the country. However, it is reported in highly aggregated form. Improving the data management and analysis capability of CDF and allowing user-friendlier public access to it (through the web, for instance) can be extremely useful.
- The idea of enhancing poverty impacts by leveraging the *institutional* capital of larger microfinance institutions as opposed to just microfinancial services in order to strengthen the capacity of the poor to compete in the marketplace needs to be considered seriously by the donors. The possibilities definitely need serious analysis and a detailed workable proposition will have to be developed. Donors can initially start participating in the further shaping of these ideas and help by drawing on international experiences.