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# Group-based financial institutions for the rural poor in Bangladesh: An institutional- and household-level analysis

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In the last two decades, nongovernmental organizations (NGOs) in Bangladesh have provided millions of poor rural people with savings and credit services at low cost. With these services they have reduced poverty and may have improved food security and nutrition and achieved positive social change as well. These NGOs have different structures, modes of operations, and program goals, and are not legally registered as banks. Unlike the formal financial intermediaries, such as nationalized commercial banks, that lend on the basis of collateral—thus effectively excluding the poor—these microfinance institutions (MFIs) provide services to solidarity credit groups that poor community members have created. Small groups (5 to 10 members) form larger groups that then procure financial services. The NGOs thus make use of joint liability, peer selection, and experience with repeated financial transactions to overcome the informational constraints in formal financial markets. The MFIs harness some of the strengths of local organizations while also practicing sound business management.

Despite these programs and the increases in per capita income, widespread poverty and malnutrition continue to exist in Bangladesh. In 1997, the country was the eighteenth poorest in the world. The level of extreme poverty has hardly changed over time, and the incidence of poverty is greater now in rural areas, where 50% of the households are landless and employment opportunities are low. The natural disasters that Bangladesh experiences have caused even further setbacks in development.

Given the relative success of the MFIs and the pressing need for further poverty alleviation, Manfred Zeller, Manohar Sharma, Akhter U. Ahmed, and Shahidur Rashid undertook a study to examine four issues: (1) the determinants of the formation and outreach of MFIs; (2) the credit group formation process, the determinants of program eligibility, and the implications of eligibility requirements for the structure, conduct, and performance of the groups; (3) the financial sustainability of the lending institutions; and (4) the effects of participation on household resource allocation, income

generation, food and nonfood consumption, and the social attitudes and capacities of their members.

In this report, the authors examine these issues by looking at the workings of three different institutions: the Bangladesh Rural Advancement Committee (BRAC), the Association for Social Advancement (ASA), and the Rangpur-Dinajpur Rural Services (RDRS). These NGOs represent, respectively, the three types of MFI in Bangladesh: those that have transformed their financial programs into banks; those that collect savings and make loans, but rely on the wholesale functions of rural banking networks; and those that do not handle funds, but instead facilitate the formation of members' groups and their linkage with banks.

## Reaching the poor

Overall, the NGOs are highly successful in reaching those rural poor who farm less than one-half acre. They tend to place their offices within more developed rural areas with better access to infrastructure and banks and to avoid areas that are at high risk for flooding and other adverse events. Within the more developed areas, the NGOs provide poorer villages with their services and reach very poor people, mostly women, within the villages. But generally the NGOs have not assisted the ultra-poor of the many agricultural smallholders who farm more than one-half acre.

## Services and sustainability

The selected NGOs exhibit important differences with respect to target groups and the type of services provided. Whereas ASA mainly finances off-farm enterprises for women, BRAC lends to women and men for both agricultural and nonagricultural activities. Households with less than one-half acre may join ASA or BRAC groups. The loans usually have a one-year maturity. Because borrowers must repay in weekly installments, many invest in businesses with a continu-

ous cash return. During the 1990s, ASA focused on providing financial services while reducing its nonfinancial services, such as business management training. It has also begun serving households with more than one-half acre of land. BRAC, in contrast, assists in product marketing and operates as an integrated development organization, providing health services and medium-term investments for community improvement, among other activities.

RDRS promotes income generation within agriculture, animal husbandry, and fish farming. Because many of these enterprises require longer gestation periods, loans with different repayment plans are offered. RDRS also provides nonfinancial services and assists in product marketing. In 1989, RDRS changed the membership eligibility criterion from ownership of less than one acre to a maximum of 1.5 acres.

The MFIs, unlike the government banks that require heavy subsidies to remain solvent, are financially sustainable and among the most efficient credit organizations worldwide. The MFIs charge interest rates from 10% to 20% above the inflation rate, yet they have achieved repayment rates as high as 98%. The large Asian MFIs, including ASA and BRAC, have usually performed their operations without any subsidies. Smaller South Asian MFIs, however, spend about US\$0.17 for each dollar loaned, of which US\$0.05 must be covered by subsidies.

### Impact on the poor

The targeted credit programs have had a positive impact on household welfare in a number of ways. The quantity and quality of food consumed, the health of household members, and children's education have improved. The survey of social attitudes and social capacity shows progress in social change, particularly in the areas of intrahousehold decision-making and wom-

en's coping capacity, physical mobility, and attitudes.

An econometric analysis reveals that access to credit has a significant and strong effect on generation of income and consumption of food and calories. Each Tk 100 (US\$1.80) of credit access generates an additional Tk 37 of annual household income to ASA and BRAC members. This compares favorably with the cost of subsidizing this access. With a social cost of Tk 5 in the case of small and medium-sized MFIs, microfinance NGOs in Bangladesh are producing a net social benefit of Tk 32 for every Tk 100 they lend.

### Policy implications

Group-based financial institutions can contribute greatly to poverty reduction in Bangladesh and offer a viable alternative to state and market failures in rural finance. Therefore, continuing public support for the expansion of these MFIs appears warranted. However, the current subsidy figures underestimate the actual costs of the programs. The study did not conduct a full cost-benefit analysis. The data do not include past subsidies for innovations and expansion phases or for unsuccessful MFIs. These costs would need to be considered in determining whether to invest in MFIs or other avenues for rural development. Nevertheless, the subsidy figures appear quite favorable compared with other capital transfers to the poor. Finally, to replicate the MFIs elsewhere, we must consider that their successful implementation necessarily involves adapting the organizational structure and practices to different socioeconomic and agroecological environments.

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