World Journal of Social Sciences
Vol. 3. No. 1. January 2013 Issue. Pp. 102 – 108

Micro-credit and poverty alleviation: The Case of Bangladesh

Chowdhury Abdullah Al Mamun*, Md.Nazmul Hasan** and Arif Rana***

This paper attempts to analyze the empirical correlation between microfinance and poverty alleviation in Bangladesh. It argues that microfinance has developed innovative management and business strategies by mobilizing the savings, loan repayment and empowerment of women, but its impact on poverty reduction remains in doubt. Microfinance, however, certainly plays an important role in providing safety-net and consumption smoothening. Further, determining how microfinance can be used as an important vehicle to make an even larger and more critical contribution to alleviating poverty is in need of more careful assessment.

JEL Classification: G21, O16, E24
Keywords: Microfinance, poverty, empowerment, Bangladesh

1. Introduction

Poverty is a pervasive problem in our society. It exists across the world in the different levels. Around 25% of the population in developing regions lives below the poverty line (United Nations, 2009). This figure translates to 1.3 billion people living in poverty, or about 20% of the global population (The World Bank Group, 2010).

Poverty is a pronounced deprivation in well-being. The poor are deprived of basic needs in their daily life, such as food, shelter, clothing, and clean drinking water. They also lack access to health care, quality education and employment opportunities those are important in improving human capital and facilitating social mobility (Khandker& Haughton, 2009).

Momoh (2005) defines, *"poverty is a multi-dimensional phenomenon related to the inadequacy or lack of social, economic, cultural, and political entitlements. Poverty is hunger. Poverty is lack of shelter. Poverty is being sick and not being able to see a doctor. Poverty is not being able to go to school and not knowing how to read. Poverty is not having a job, is fear for the future and living a day at a time. Poverty is losing a child to illness brought about by unclean water. Poverty is powerlessness, lack of representation and freedom."*

*Chowdhury Abdullah Al Mamun, School of Business, University of Information Technology and Sciences, GA-37/1 Progoti Sarani, Baridhara J-Block, Dhaka 1212, Bangladesh. , email:camamun@gmail.com
**Assistant Professor Md. Nazmul Hasan, Head of MBA Program, School of Business, University of Information Technology and Sciences GA-37/1 Progoti Sarani, Baridhara J-Block, Dhaka 1212, Bangladesh.,email:uits.mba700@gmail.com
*** Associate Professor Arif Rana, School of Business, University of Information Technology and Sciences, GA-37/1 Progoti Sarani, Baridhara J-Block, Dhaka 1212, Bangladesh. , email:arif.arifrana@gmail.com

There are different types of poverty such as income poverty, absolute poverty, relative poverty and consistent poverty. Income poverty is a result of lack of money or limited income. Absolute poverty or destitution refers to the deprivation of basic human needs, which commonly includes food, water, sanitation, clothing, shelter, health care and education. Relative poverty is defined contextually as economic inequality in the location or society in which people live. Consistent poverty is the combination of income poverty and deprivation (Momoh, 2005).

The wide-spread poverty is the greatest challenge of our time, as traditional aid has not helped in solving this problem. Over the years, different poverty reduction strategies have been developed in order to improve the poor's standard of living and help the people to alleviate the vicious cycle of poverty (Carr & Tong, 2002, p. 7). One such poverty alleviation tool is microfinance, which has gained worldwide recognition since the 1990s. Besides, it has been proven to have positive effect to reduce poverty in Bangladesh (Hossain & Knight, 2008; Venkataramany & Bhasin, 2009; Chemin, 2008).

In the previous study, researchers studied the relationship between microfinance and income of the borrowers .They also considered improvement in the living standards of family as dependent variable and better access to education, better access to health care, better financial situation of the family as independent variables**.** However, they have not answered the following research question.

What are the differences between microfinance and traditional savings rotating system as well as loan repayment and poverty reduction?

Section one provides the research background, the research problems and questions, importance and significance of study. Section two contains a review of the literatures. Section three is devoted for methodology and section four deals with the analysis of the result. The last section focuses on conclusion and limitation.

2. Literature Review

Microfinance's worldwide recognition has been credited to Muhammad Yunus who is the founder of the Grameen Bank in Bangladesh and recipient of the 2006 Nobel Peace Prize. Although microfinance was not his original idea, Yunus pioneered the implementation of group based lending and collateral free loan. As a consequence, the poor women are able to manage credit and organize microenterprises (Engler, 2009, p. 82). He founded the Grameen Bank in the 1970s as an effort to ameliorate the destitute poverty that plagued his country (Yunus, 2007, p. 20). Grameen Bank has more than 1,000 branches and 6 million members. Besides, the loan repayment rate of Grameen Bank is 98 percent (Midgley, 2008, p. 471).

Elahi and Demopoulos (2004) differentiate several key features of microfinance from commercial banking procedures. They mention five characteristics of poverty alleviation tool: 1) small loan size, which is determined by micro lending institutions and dependent on the country's socio-economic development 2) focus on women borrowers, who have little access to credit 3) emphasis on the utilization of loans to start microenterprises, as they provide employment opportunities to clients 4) absence of tangible collateral, and formation of joint-liability groups to enforce payment, and 5) savings mobilization programs, which require borrowers to open savings accounts and accumulate financial assets (Elahi & Danapoulos, 2004, p. 62). Rotating Savings system is a group of individuals who agree to meet for a particular period in order to save and borrow together (Yunus, 2007, p. 20). So microfinance is the strategy for providing to the poor in rural and urban areas, especially women with savings and credit facilities to expand business, invest in self-employment activities and increase household security.

Aside from obtaining access to credit and other financial services, MFI’s assists to create employment that contributes to their overall economic improvement and social mobility. Besides, women empowerment is one of the most important effect that microfinance generates in the rural communities. By acquiring access to financial capital and starting their own family business, women increase their decision-making power in the household and are able to possess skills in entrepreneurship and financial management. They gain more knowledge in terms of running their own source of livelihood and do not remain as ordinary housewives solely tied to the responsibility of taking care of their families. They play an important role in their communities and receive respect from other people for proving their great capacity to manage resources and organize microenterprises effectively. They obtain not only the financial benefits but also encompass gender empowerment and self-actualization. Besides, they are given the opportunity to uplift their status in the society and prove their worth as capable members of their community. Also, by providing access to finance, the financial sector has direct effects on the economic condition of the poor women (Imboden, 2005, p. 68).

Training and group meetings are the essential elements in microfinance. If a client chooses to borrow loans from MFI’s, he or she is required to attend these activities and participate in capacity building programs. Entrepreneurship, risk management skills, credit discipline, values formation, information on health and family planning are discussed and taught to equip the borrower with proper knowledge. As a result, these training programs help the poor borrowers to manage their small businesses and control their families effectively (Dowla & Barua, 2006, pp. 18-19).

Additionally, microfinance provides psychological benefits to its poor clients by promoting a sense of self-respect and dignity. The poor are able to take out a loan, start their own business, and repay the loan through their own efforts and hard work. They can convince themselves and are capable of doing something that could certainly change their lives. Moreover, they become self-employed through their own businesses and allow them to have a more stable source of income. As a result, they do not constantly rely on welfare programs or financial support.

One of the major challenges for loan repayment and poverty reduction is the failure of clients to honour their indebtedness. While some people find it difficult to access loans, others who have the opportunity to access the loans fail to pay back the loans on time. Many rural banks, credit unions and financial NGOs have expressed their disappointment of clients' inability to pay back loans on time. This unfortunate revelation undermines the purpose of the credit and loan schemes, hence led to the decline of economic development and poverty reduction (Elahi & Danapoulos, 2004).

Moreover, MFI's charge higher interest rates to the poor. They start charging their customers higher rates in order to cover costs, and perhaps even earn more profit. Customers suffer and are faced with increased difficulty in repaying loan with higher interest rates. Besides, few poor borrowers get the loan only for survival and do not engage in generating income. As a consequence, MFI's apply a variety of systems of repressions to raise the loan repayment (Ali, 2011).

Like any other anti-poverty programs, microfinance is not without any criticism with regards to its real impact on poverty levels. Despite anecdotal stories of success from the poor borrowers, there is a doubt that microfinance has positive impact on society in reducing poverty (Midgley, 2008, p. 473). Other critics believe that market-based solutions are still more effective in uplifting the economic status of the poor. Aneel Karnani (2008, p. 23) for instance, indicates that employment and increased productivity are ultimately the most practical solutions in poverty alleviation.

Despite its significant impact on poverty levels in the third world, microfinance faces challenges effectively in alleviating poverty in the developed countries. Although it has been proven to improve the lives and increase the income of people across Asia and other developing countries in the world (Hossain and Knight, 2008; Chemin, 2008), it has faced difficulties significantly in more advanced countries, such as the United States. A study conducted by Schreiner and Morduch (as cited in Carr & Yi Tong, 2002) reveals that two important factors affect the performance of MFIs in the United States. These are: 1) the structure of U.S. economy, which is rather more complicated than those of developing countries and have more barriers to entry for micro entrepreneurs, and 2) the small size of microenterprise sector in the country. So these factors make establishment and management of microenterprises difficult in USA. Besides, a number of MFI's have closed down, as borrowers could not repay their loans.

The two hypotheses have been tested to answer the research question.

Ho_1: There is no significant difference between microfinance and traditional savings rotating system.

Ho_2: There is no significant difference between loan repayment and poverty reduction.

3. The Methodology

The design employed in this study is the descriptive survey method. The method is ideal, as the study involved collecting data from rural community members of microfinance institutions (MFIs) with a view to analyze the relationship between microfinance and poverty reduction. Population comprised four hundreds –fifty rural community members of MFI's which are Grameen Bank, BRAC and ASA. The stratified random sampling technique is used while the convenience sampling is adopted to draw elements or respondents to be included in the study. A total of two hundred and eighty six (286) questionnaires were collected and used for the analysis. The study used ANOVA in testing the research questions. The Statistical Package for Social Science (SPSS Version 15.0) was utilized for data analysis.

4. Result Analysis

This section discusses the analysis of variance results on the impact of microfinance on poverty reduction in Bangladesh. The results obtained from the analysis were used to test the hypothesis of the study which is stated in the null forms as:

Table: ANOVA

Source	Sum of Squares	df	Mean square	F	Sig.
Corrected model	389.126a	14	27.795	2.478	.003
Intercept	49759.820	1	49759.820	4436.587	.000
TSR	389.126	14	27.795	2.478	.003
Error	3039.479	171	11.216		
Total	115877.000	286			
Corrected total	3428.605	285			
Corrected model	418. 161a	14	29.869	2.769	.001
Intercept	37419.857	1	37419.857	3468.688	.000
PR	418.161	14	29.869	2.769	.001
Error	2923.521	271	10.788		
Total	116187.000	286			
Corrected total	3341.682	285			

The table reveals the analysis of variance between microfinance and traditional savings rotation system (TSR). The corrected model gave an f value of 2.478 which is greater than the p-value of 0.003 and the traditional savings rotation system f value of 2.478 which is still greater than the p-value of 0.003, hence we reject the null hypothesis that there is no significant difference between microfinance and traditional savings rotating system and accept the alternative hypothesis that there is significant difference between microfinance and traditional savings rotating system in Bangladesh. Study also shows the analysis of variance between loan repayment and poverty reduction. The corrected model f-value of 2.769 is greater than the p-value of 0.001 and the poverty reduction f value of 2.769 is also greater than the p-value of 0.001. Hence, we reject the null hypothesis and conclude that there is significant difference between loan repayment and poverty reduction in Bangladesh.

5. Conclusion and Policy Implications

Microfinance has been a very significant tool of reducing poverty in the developing countries like Bangladesh. Poverty is an extreme threat to the vulnerable people, as they cannot fulfill their basic needs of life. This research has been carried out to evaluate the differences between microfinance and traditional savings rotating system as well as loan repayment and poverty reduction. From this study, it contributes to assess the Rotating Savings System which assists to mobilize the savings. This will also increase the capital and income of the poorest borrowers. As final studied, loan repayment has major correlation with poverty alleviation. Due to the loan failure of clients, this contributes to the decline of national economic development and poverty alleviation. So Microfinance Institution's should have initiative to take innovation and adaptation techniques for the adoption of new product that will help to increase the income, savings and empowerment of poor women for the alleviation of poverty.

6. Further Research for this Study

Time constraint was another factor that limited this study. Since there is a short timeframe to complete this research, only necessary areas were analyzed. The questionnaires were distributed in few branches of only three MFI institutions. Therefore, it was likely to be impossible to know the whole scenario of microfinance and poverty alleviation as well as the results cannot be generalized with other MFI's of Bangladesh. Further research can be done on economic and social performance of poor women.

References

Ali, M 2011, 'Microcredit is a myth and not a magic in reducing poverty' The Financial Express 2011,www.thefinancialexpress-bd.com/more.php?news_id=120487.

Carr, JH & Tong, ZY 2002, *Replicating microfinance in the united states.* Baltimore, MD: The Johns Hopkins University Press.

Chemin, M 2008, 'The benefits and costs of microfinance: evidence from Bangladesh', *Journal of Development Studies,* Vol.44,no.4, pp. 463-484.

Dowla, A & Barua, D 2006, *The poor always pay back: the grameen II story.* Bloomfield, CT: Kumarian Press, Inc.

Elahi, KQ & Danapoulos, CP 2004, 'Microfinance and third world development: a critical analysis', *Journal of Political & Military Sociology,* Vol.32,no.1,pp.61-77.

Engler, M (2009, Fall). From microcredit to a world without profit?*Dissent,* Vol.56,no.4, pp, 81-87.

Hossain, F& Knight, T 2008, 'Can microcredit improve the livelihoods of the poor and disadvantaged?', *International Development Planning Review,* Vol.30,no.2, pp.155-175.

Husain, J 2008, 'Role of micro-finance institutions in reducing world poverty: an overview', *The Business Review, Cambridge,*Vol.11,no.1,pp. 38-42.

Imboden, K 2005, 'Building inclusive financial sectors: the road to growth and poverty reduction', *Journal of International Affairs,* Vol.58,no.2,pp.65-86.

Karnani, A 2008, 'Employment, not microcredit, is the solution', *The Journal of Corporate Citizenship,* Vol. 32, pp.23-28.

Khandker, S & Haughton, J 2009, *Handbook on poverty and inequality.* Washington, DC: The World Bank.

Midgley, J 2008, 'Microenterprise, global poverty and social development', *International Social Work,* Vol. 51,no.4,pp. 467-479.

Momoh, J 2005, 'The Role of Microfinance in Rural Poverty Reduction in Developing Countries'. Retrieved on September 02, 2010
From on 2/9/2010 from http://www.wi.hswismar.de/diewismarerdiscussionpaper

The World Bank Group 2010, PovcalNet. Retrieved January 15, 2010, from http://iresearch.worldbank.org/PovcalNet/povDuplic.html

UNCDF 2005, *Microfinance and the millennium development goals: a reader's guide to the millennium project reports and other UN documents.* Retrieved January 17, 2010, from http://www.yearofmicrocredit.org/docs/mdgdoc_MN.pdf

United Nation 2009, *The millennium development goals report 2009.* New York, NY: United Nations. Retrieved January 15, 2010,
from http://www.un.org/millenniumgoals/pdf/MDG_Report_2009_ENG.pdf

Van Maanen, G 2004, *Microcredit: sound business or development instrument.* The Netherlands: A-D Druk.

Yunus, M 2007, 'Credit for the poor: poverty as a distant history', *Harvard International Review,* Vol.29, no.3, pp. 20-24.