The very poor who participate in microfinance institutions and those who never did: A Comparative Analysis

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Abstract

Despite the general consensus that the very poor have not been adequately reached by existing microfinance institutions, very little focussed research exists on the financial market participation of the very poor in general and their microfinance institutions (MFI) participation, in particular. In this paper, we shed some light on these issues by comparing the very poor who manage to participate in microfinance institutions and those who never did, by making use of a unique dataset that emerged out of the baseline study of a new BRAC programme targeted at the very poor.

We find that the poorest who participate in MFIs are relatively better off than those who never participated, the causal relationship is not clear. In that sense, the targeting exclusion condition used by BRAC to exclude the poorest who were members of MFIs seems to be appropriate. However, we also find that the poorest who participate in MFIs also borrow more from informal sources suggesting that a complementary, rather than a substitution relationship exists between the two sources of finance. Moreover, the intensity of microcredit taking is lower and tendency to drop out from one and not rejoin other MFIs is higher among the very poor who participate in MFIs compared to MFI participants coming from other poverty groups.

Given that reaching the very poor remains to be an important challenge that the global microfinance industry intends to address, a better understanding of the overall financial market participation of the very poor and exploring the differences between the very poor who manage to participate in microfinance programmes and those who do not can be important for guiding policy and practice.

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I. Introduction

Historically, the poor have lacked access to reliable and less expensive financial services. This has been found to act as important constraints for the poor in taking advantage of opportunities, smoothing consumption, and protecting themselves against different types of vulnerabilities (Rutherford, 1999, Matin, Hulme and Rutherford, 1999, Morduch, 1999). The vast outreach of microfinance in Bangladesh has played an important role in improving many of the financial market imperfections that the poor face. However, there is a general consensus that these services in general have bypassed the poorest[1].

Yet, we know little about the financial market participation of the poorest. Most studies either do not adequately distinguish between the various groups among the poor, or do not cover the various sources of financial services. This paper by making use of the targeting of the ultra poor carried out by a new BRAC programme for the ultra poor, allows us to examine various aspects of ultra poor household's financial market participation.

II. Methodology

BRAC introduced a new programme, called, 'Challenging the Frontiers of Poverty Reduction/ Targeting the Ultra Poor' (CFPR/TUP), targeted at the ultra poor since January 2002. As one of the main strengths of this paper is that it makes use of a baseline dataset that emerged out of a carefully selected targeting strategy followed by BRAC for its programme for the ultra poor (CFPR/TUP), it is important to elaborate and show the effectiveness of the targeting strategy used.

The CFPR/TUP programme carried out elaborate targeting combining a range of targeting methodologies to select the ultra poor for the programme (Matin and Halder, 2003). The targeting indicators used in the CFPR/TUP programme are summarized in Table 1.

Table 2 clearly shows that the targeting methodologies used by the CFPR/TUP programme in targeting the ultra poor has been very effective--- in all the variables covering a wide range of well-being themes, the ultra poor selected by the programme fares significantly worse compared to national rural averages. This is a significant advantage enjoyed by the present database on which this paper is based, as most existing profile studies on the extreme poor rely on a far more limited approach in identifying the poorest usually using a few indicators, such as landlessness or poverty self perception. We could thus exploit the integrated and comprehensive targeting approach used in CFPR/TUP programme.

[1] We use the terms 'poorest', 'ultra poor' and 'extreme poor' interchangeably in this paper.

Table 1: Targeting indicators used in the CFPR/TUP programme

Targeting Indicators	Rationale
Exclusion indicators (needs to dissatisfy all)	
Any member of the household has current NGO participation	Targeting those extreme poor who do not/can not participate in existing NGO programmes
Any member of the household receives benefit from GoB programmes (eg.VGD)	Targeting those extreme poor who do not/can not participate in existing GoB programmes
No physically able adult women in household	This is a women targeted enterprise programme
Inclusion indicators (needs to satisfy any 2)	
Owned land of household including homestead less than 10 decimals	Landlessness and extreme poverty highly correlated, though not all landless are extreme poor.
No adult working men in household	Absence of able bodied male labour power is an important characteristic of extreme poor households.
School going aged children working	Child labour is predominant in extreme poor households.
Adult women selling labour	Adult women selling labour is more prevalent in extreme poor households. This also signals the desperation and motivation of the household.
No productive assets	Extreme poor households tend not to own any productive assets.

Table 2: Effectiveness of CFPR/TUP targeting

Variables	BRAC targeted ultra poor	National rural average
Demographic structure		
% of female headed households	40%	8%
% of single member households	12%	2%
Land ownership		
% of landless households	98%	6%
% of households not owning their homestead land	54%	NA
Food consumption		
% of households who cannot afford two meals a day	48%	8%
Average per capita daily calorie intake (Kcal)	1911	2163
Average per capita daily food expenditure (Taka)	9.65	16.10
Nutrition status		
% of 12-59 months children who are wasted (Wt for Ht = -2z)	14%	12%
% of 12-59 months children who are stunted (Ht for Age = -2z)	53%	49%
% of 6-59 months children who are underweight (Wt for Age = -2z)	64%	51%
% of 15-49 years women who are chronic energy deficient (BMI=Wt(Kg)/Ht(Metre)^2<18.5)	48%	45%
Education		
% of children going to primary school	87%	108%
% of population (7+ years) literate	9%	37%

For the ultra poor households, we collected data on various aspects of all cash and in-kind loans reported as outstanding by the household at the time of the survey[2] (loans taken from formal, NGO and informal sources were considered.) Informal sources were further disaggregated into moneylenders, friends and relatives, and local informal institutions. For each of these outstanding loans data was collected on the source of loan, loan amount (imputed monetary value for in kind loans), loan use, how many months ago loan was issued, whether or not interest was levied on the loans, and description of loan contract.

[2] In-kind loans were monetized using market price of in kind items at the time when the loans were taken. In-kind loans having a value less than 100 taka were excluded.

III. Findings

Though most NGOs in Bangladesh provide microcredit, the correspondence between NGO participation and microcredit borrowing may not be complete, i.e. there may be households reporting current NGO participation but not reporting current microcredit borrowing. The following Table shows that about 28% of the ultra poor households reporting current NGO participation did not report outstanding microcredit at the time of the survey. This yields a borrower to member ratio of 0.72, which is lower than the average borrower-member ratio we obtain for the microfinance industry of Bangladesh, which is close to 0.90 (Sultan and Matin, 2002). This suggests that the microcredit borrowing intensity of the ultra poor NGO participating households is lower than that of other poor groups.

Table 3: Ultra poor groups based on microcredit and NGO participation

	Current MC	Current no MC	Total
Current NGO HHs	329	129	458
Past but not current NGO HHs		345	345
Never NGO HHs		4823	4823
Total	329	5297	5626

We can thus categorize the sampled households into four mutually exclusive groups based on their NGO participation and microcredit borrowing status (Table 3). We see that the large majority of our ultra poor household sample never had any NGO affiliation. In the BIDS-PKSF nationally representative study, the percentage of 'never participated household' is slightly over 28% corroborating the general consensus that the existing microcredit programmes have by and large by passed the very poor (Zohir, et al, October 2001: table 3.11, page 33).

Table 4: Distribution of groups

Group Description	Group	Number (%)
Current microcredit borrowing HH	1	6%
Current NGO but not microcredit borrowing HH	2	2%
Past but not current NGO HH	3	6%
Never NGO HH	4	86%

We present two broad sets of findings. The first addresses the question, 'in what ways are those among the ultra poor who are taking on microcredit different from those who are not'? The second theme explores the informal financial market participation of the various groups of the ultra poor households based on their microcredit participation. The main question here is, 'in what ways are the informal financial market participation different for the ultra poor who are taking on microcredit from those who are not'?

3.1 How different are the ultra poor households who take microcredit?

In Table 5, we examine the differences among these groups on a number of key variables. In general, the group of ultra poor households who have never had any NGO participation (group 4) are significantly worse off than ultra poor households who reported current microcredit borrowing (group 1). This differential pattern holds for variables reflecting physical assets such as land and homestead land ownership, demographic assets such as female headedness of households, and adult male labour availability of households, food security, and change in overall economic status over time.

Table 5: How different are the groups?

Variables	Current MC	Current NGO but no current MC	Past but no current NGO	Never NGO	Differences*
	[1]	[2]	[3]	[4]	
% of landless HHs	85%	93%	93%	96%	[4,1], [2,1], [3,1]
% of HHs with no homestead land	20%	32%	40%	49%	[4,1], [2,1], [3,1]
% of FHHs	16%	23%	23%	37%	[4,1], [4,2], [4,3]
% of HHs having adult male working	88%	76%	81%	67%	[4,1] [43]
% of HHs having only one member	2%	9%	5%	14%	[4,1] [43]
% of HHs reporting that they cannot afford two meals a day regularly	25%	24%	24%	43%	[4,1], [4,2], [4,3]
% of HHs who reported that their economic condition improved over the last year	22%	23%	16%	12%	[4,1], [4,2]
% of HHs who reported that their economic condition deteriorated over the last year	27%	28%	37%	42%	[4,1], [4,2]

* All differences between groups noted in square brackets are significant at level 5% or less .

Even among the ultra poor population then, those who have household characteristics more favourable to managing microcredit loans with its regular repayment schedule, are more likely to take microcredit. Such a differential pattern of household profile reflects the interplay of demand and supply side forces that ultimately result in households' participation in microcredit programmes.

Several studies argue that among the ultra poor, there are those who are more upwardly mobile than others (Sen and Hulme, 2004). It appears from the Table above that taking advantage of microcredit may be one such strategy used by the upwardly mobile ultra poor--- a significantly larger (lesser) proportion of the ultra poor who had current microcredit borrowing reported that their economic situation improved (deteriorated) over the last one year compared to those who never had any NGO participation.

3.2 How different is informal borrowing of the ultra poor who take microcredit?

The extent and pattern of informal financial market participation is underpinned in important ways by the overall economic conditions, opportunities and constraints of the household, and the general pattern of economic activities of an area. As the most important differences appear to be between ultra poor households who were taking microcredit at the time of the survey (group 1) and those who reported never having any NGO affiliation (group 4), for the sake of simplicity, we explore informal financial market participation question for these two groups of the ultra poor.

We note from Table 6 that the extent of informal borrowing measured by percentage of households reporting outstanding informal loan at the time of the survey is significantly lower for 'current microcredit taking' ultra poor households compared to the ultra poor households who never had any NGO affiliation. This is expected, as the ultra poor who have access to microcredit will generally have less frequent need for informal credit.

Table 6: Informal credit and the ultra poor groups

Variable	Current MC	Never MC	Difference
% of HHs reporting outstanding informal loan	16%	22%	2.53**
Average size of loans (in Tk) taken from…			
Mohajon	3542	1832	2.25**
Shops	983	384	3.89***
Friends and relatives	2068	1277	2.52**

However, irrespective of sources of informal loans, current microcredit taking ultra poor households manage to borrow significantly larger amounts than the ultra poor households who never had any NGO affiliation. The relatively higher levels of creditworthiness we find among the microcredit taking ultra poor households could be due to their relatively better economic conditions.

However, there could be independent effect of microcredit participation of these ultra households--- informal lenders are more likely to lend to the ultra poor households who are already borrowing from microcredit sources. This can be due to two reasons—firstly, ability of a household to manage regular microcredit loan instalments signal its creditworthiness and secondly, repayment of informal loans is more likely by households who have access to microcredit as they can cross finance the informal loan with microcredit. Such cross financing between informal and microcredit and its affect on informal creditworthiness of microcredit borrowers have been reported in other studies (Sinha and Matin, 1998).

To test for this, we carry out a multivariate OLS regression analysis (Table 7). The dependent variable is the total informal loan amount reported to be outstanding at the time of the survey. We find that even after controlling for some key background variables affecting informal loan amount, the ultra poor households' current microcredit borrowing status remains to be an important determinant suggesting that microcredit borrowing status of the household has an independent effect on its the ability to borrow from the informal credit market.

Table 7: Does microcredit participation matter for informal loans?

Variable	t stats	Sig.
Landlessness dummy [1=if landless, 0 otherwise]	-7.80	***
Homesteadlessness dummy [1=if doesn't own homestead, 0 otherwise]	-2.96	***
Adult male labour dummy [1=if HH has adult working male labour, 0 otherwise]	2.54	**
Female headedness dummy [1=if female headed HH, 0 otherwise]	-3.45	***
Current MF borrowing dummy [1=if HH reportedc current MF borrowing, 0 otherwise]	4.39	***
Adjusted R Squared	0.24	

The contractual terms and conditions of informal loans reflect the general pattern of the informal financial market and the rural economy. Generally, a wide range of contracts exists in the informal financial market. We can broadly define them as loans on interest and loans without interest. We find that some informal interest bearing cash loans have a well specified contract in terms of repayment of principal and interest while some do not.

Table 8: Informal loan contracts

Variable	Current MC HH	Never MC HH
% of informal loans that are…		
Interest free	40%	35%
With interest	60%	65%
With interest and having specified contract	15%	22%
With interest but no specifies contract	45%	43%

We do not find much difference between the two types of households considered in this paper in terms of the contracts of the informal loans taken. Most of the informal loans taken are on interest, though most of these on interest informal loans are flexible in terms of repayment. However, it important to contextualize these contracts, especially that are on interest and yet do not appear to have any specified contract. Several studies of the rural financial market find that for the very poor, financial transactions are part of the moral economy that sustains and also at times reproduced extreme poverty (Bhaduri, 1983, Udry, 1997). It is thus problematic to assess credit contracts that the very poor are offered only by confining our analysis on the financial obligations of the contract--- more often that not, apparently benign credit contracts underpins potentially exploitative and costly obligations in other non-financial dimensions which required detailed ethnographic research to unpack and understand.

IV. Conclusion

Despite a general consensus that the very poor are left out by existing microfinance interventions in Bangladesh, not much is known about financial market participation of this group of the poor. Moreover, there is a significant minority section among the ultra poor who do participate in existing microfinance programmes. Given that reaching the very poor remains to be an important challenge that the microfinance industry in Bangladesh intends to address, a better understanding of the overall financial market participation of the ultra poor and exploring the differences between the ultra poor who manage to participate in microfinance programmes and those who do not can be important for guiding policy and practice.

This paper by making use of a unique baseline dataset emerging out of a new BRAC programme targeted at the ultra poor examines these questions. We find evidence to the view that the general microfinance participation of the ultra poor is much lower than other poverty groups. However, we also find that the ultra poor who do participate in microfinance NGOs are less likely to be regular borrowers. Given the credit-centricness of existing microfinance programmes, the generally lower credit taking intensity of the ultra poor needs has important implications if existing programmes are to include the very poor. This point has been made in several other studies, most notably in Rutherford (XX).

We find that ultra poor households who were borrowing from microfinance institutions were significantly better off over a range of well-being indicators than the ultra poor households that reported never affiliation with NGO-MFIs. Given that a significantly larger (lesser) proportion of the ultra poor who had current microcredit borrowing reported that their economic situation improved (deteriorated) over the last one year compared to those who never had any NGO participation, it is likely that the subset of the ultra poor who manage to participate actively in microfinance programmes are more upwardly mobile. However, given the generally poor health and nutritional status we find among the ultra poor (see Table 2), such upward mobility is likely to be extremely fragile requiring additional health and nutritional interventions.

Though the general level of informal borrowing is low among the ultra poor, those who are currently borrowing from microfinance institutions are less likely to borrow from informal sources than those who never had any NGO affiliation. However, borrowing from microfinance institutions seem to matter in terms of the size of informal loans--- ultra poor households who had microfinance borrowings were more likely to manage larger informal loans, irrespective of sources. This on the one hand reflects greater creditworthiness of the ultra poor microfinance members but may also lead to cross financing, which could become unmanageable for the client and lead to eventual default on microfinance loans (Matin, 1998).

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Variables	Current MFI participating HHs	Never MFI participating HHs
Gm/capita/day consumption of….		
Cereal	530	505***
Pulses	10	7***
Fish, meat and egg	26	21***
Milk	8	6***
Fruits	30	23**
Total intake (Gm/capita/day)	827	789***
Per capita daily food expenditure	11.20	10.33***