

# Aid of Microfinance Institutions to the Economic Growth of a Country: A Case Study on Dhaka, Bangladesh

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**Abstract:** *Microfinance refers to small-scale credit services that are provided to people who are running certain business, operating small or micro-enterprises in both rural and urban areas. This concept has already changed the fate of the economy of Bangladesh. For a developing country Microfinance Institutions (MFIs) can be one of the gateways toward its development. Bangladesh is an innovator and home of conceptualizing micro-credit platform. MFIs are playing tremendous role for the insurance of economic progress of Bangladesh especially in rural areas which are the major part of the country. The paper is descriptive in nature and focuses on the impact of MFIs over the economic status of the country as a whole examining significant sector's progress such as SME sector development, unemployment reduction, women empowerment, rural areas development. For the study a field survey with a structured questionnaire has been done. The study reveals that all the selected variables are positively correlated with the MFIs activities. MFIs help to empower women, to accelerate rural sector development, to reduce unemployment and to gear up SME sector of the country. These institutions are helping to increase credit facilities beside the banking industry even in remote areas of the country.*

**Keywords:** *MFIs, economic growth, SME, credit accessibility, rural development, unemployment reduction, women empowerment.*

## 1. Introduction

The pioneer country for microfinance concept, Bangladesh, is using such financial institutions to strengthen the national economy. A decision to start a business or expand an existing firm by increasing the productive assets, involves an implicit decision to raise money capital in order to finance the growth. There are three main sources of funds; namely equity financing, debt financing, and the use of retained earnings. The first two sources, equity and debt financing constitute external financing, while retained earnings are an internal source (Koutsoyiannis, 1982). Microfinance refers to small-scale financial services (credits services) that are provided to people who running certain business;

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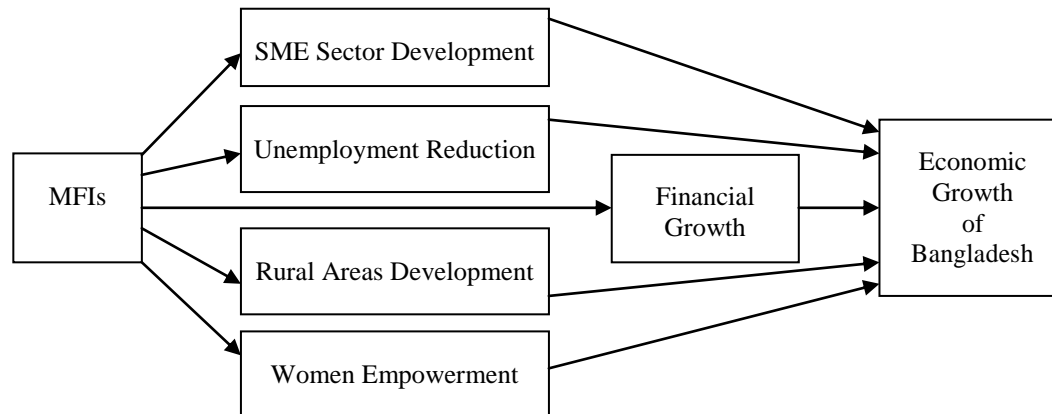
operate small or micro-enterprises where goods are produced, recycled, repaired, or traded in both rural and urban areas (Stanley, 2008). Micro-finance Institutions (MFIs) offer services (not only basic financial services but also savings accounts, loan products and insurance with non-financial services such as education and training or specific programs) to the poor people who are related in micro-finance. Different types of MFIs are - savings and credit cooperatives, NGOs, legally-recognized micro-finance institutions, programs established by international organizations, and micro-finance banks, and their sizes greatly vary, from 100 clients to over 6 million clients for the largest (Ullah & Haq, 2017). Now-a-days the idea has become widespread in many other countries for pulling up their economic growth.

Microcredit programs in Bangladesh have been implemented by NGOs, Grameen Bank, state-owned & private commercial banks, and specialized programs of different ministries of Bangladesh government. In the microfinance sector as of June, 2014 total loan outstanding is around BDT 403 billion (including Grameen Bank, 10 Government project and Commercial Banks) savings BDT 237 billion. The total clients of this sector is 33.73 million (including 8.62 million clients from Grameen Bank) that accelerates overall economic development process of the country (Ullah & Haq, 2017). Credit services of this sector can be categorized into six broad groups: i) general microcredit for small-scale self-employment based activities;

ii) microenterprise loans; iii) loans for ultra-poor; iv) agricultural loans; v) seasonal loans; and vi) loans for disaster management. Loan amounts up to BDT 50,000 are generally considered as microcredit; loans above this amount are considered as microenterprise loans. Main MFIs clients are - Lower income group people (such as farmers, village-dwellers etc.), Women entrepreneurs (such as boutique owner, Saloon owner etc.), Small business enterprises.

The Microcredit Regulatory Authority (MRA) has been established by the Government of the People's Republic of Bangladesh under the "Microcredit Regulatory Authority Act 2006" to promote and foster sustainable development of microfinance sector through creating an enabling environment for NGO-MFIs in Bangladesh. MRA is the central body to monitor and supervise microfinance operations of NGO-MFIs. License from the Authority is mandatory to operate microfinance operations in Bangladesh as an NGO.

This study mainly focuses on the overall impact of MFI's activities on the economic growth of Bangladesh examining significant sector's progress such as financial sector development, SME development, Poverty reduction, unemployment reduction, women empowerment, rural areas development and so on.

**Figure-1: Impact of MFIs on the Economy**

Source: Authors

The problem statement of the current research is to identify whether the activities of MFIs have significant impact on the total economic growth of Bangladesh. The research gap between the current study and previous relevant literatures is that this study analyses the impact of MFI on the economy as a whole. Previous researchers showed its impact on SME or financial development mainly.

## 2. Literature review

### 2.1. MFIs and SME development

Christopher (2010) confirmed a positive and significant relationship between MFIs loans and SMEs performance by examining positive contributions of MFIs loans to accelerate SMEs market share, production efficiencies and competitiveness. Due to limited growth of SME most of the skilled employees leave SMEs. SMEs are knowledge creators but poor at knowledge retention (Levy, 2003).

MFIs consider client's ability to repay debt and assess the minimal sum small scale businesses can contribute as equity before offering a loan. Banks are reluctant to expand their SME credit portfolio because they do not consider SME lending an attractive and profitable undertaking. Relevant studies on Bangladesh SMEs identified the major constraints of this sector such as resource scarcity, high employee turnover, absence of modern technology, poor physical infrastructure, financial constraints, lack of uniform definition, lack of information, lack of entrepreneurship skills, participation of women entrepreneurs, access to market and lack of awareness regarding the importance of marketing tool, bureaucracy, fierce competition with the cheaper foreign goods, lack of research and development facilities, lack of quality assurance, lack of commitment to innovation and customer satisfaction, absence of transparent legal system, low access to business services, constraint of quality of human resources, low awareness, low lobbying capacity, rapid changes in policy environment etc. (Ahmed, 2006; Miah, 2006; Ahmed &

Chowdhury, 2009). All these require fund investment which mainly depends on their credit accessibility.

## **2.2. MFIs and rural development**

Even few decades ago, credit facilities had not been preferred to provide to a poor pretending they are not creditworthy, have limited or no collateral, and do not generate sufficient income with which to repay a loan. More recently the traditional view of credit worthiness has been challenged. Nowhere has this been more apparent than the activities of Bangladesh's Grameen Bank that in 1978 started providing microcredit to poor households in rural areas. The escalation of microcredit and microfinance institutions (MFIs) throughout the developing world has resulted in a burst of growth in some rural communities providing benefits in terms of rural entrepreneurship, growth, income enhancement, poverty reduction and increased food security and livelihoods (Hartarska and Holtmann 2006; Meyer and Nagarajan 2006; Zeller 2006). Yunus (1999) argued that the poor are creditworthy because they are trustworthy.

## **2.3. MFIs and financial growth**

Poverty alleviation is the cornerstone of many microfinance initiatives (Khandker, 1998, 2005). The majority of microfinance is aimed at the estimated 2.8 billion people who live on less than \$2 a day in the developing world. Increasingly, microfinance is also being offered in developed countries to those who want to become micro-entrepreneurs but cannot access credit. Previous solutions to end poverty in the developing world have been the purview of large intergovernmental institutions such as the World Bank, where development economists working with donor and recipient governments formulated strategies to stimulate economic growth (Easterly, 2006; Sachs, 2005). Indeed, with more than half of the world's population living without access to banking or other financial services (Beck, Demirguc-Kunt, & Peria, 2008; Chaia et al., 2009), the potential market for micro-financing is substantial. The number of microlending organizations has expanded with the supply of microcredit around the world (Swibel, 2007).

Financial institutions in developing countries have limited information on the creditworthiness and reliability of specific individuals. Institutional tools on which financial organizations rely in the developed world (e.g., credit scores) are simply not available in the developing world. When such information exists informally, it is embedded in the local social networks to which traditional formal banking institutions do not have access (Portes, 1998; Smith-Doerr & Powell, 2005). Thus, the first barrier that traditional banks face when lending to the poor is how to overcome the asymmetry of information—how to figure out who is a good risk and who is not. Next, financial institutions in developed economies typically go through an information-intensive process of due diligence ex-ante and monitoring ex-post in order to avoid agency risks. After all, the role of banks is not to provide risk capital (generally the domain of equity investors) but to make money on the spread between the interest they pay out on savings

deposits and the interest they charge for loans. When lending to the poor, traditional banks find themselves exposed to multiple risks what they can neither afford to assess nor differentially price. This presents opportunities for ex-ante moral hazard in the choice of projects funded by the microloan and ex-post moral hazard in the non-repayment of the loan (Armendariz de Aghion & Morduch, 2005).

Finally, the transaction costs associated with banking to the poor are non-trivial given the small size of the loans involved and the geographic dispersion of rural borrowers. On the one hand, the cost of servicing small loans is high and this may drive up interest rates or lower profitability (Ahlin et al., forthcoming). Borrowers pay the price in terms of the cost of capital, but they also incur additional transaction costs when they forgo new income or pay to travel to loan centres to make payments. On the other hand, financial institutions need distribution networks that reach the poor, which raises costs. In addition, most transactions are cash based, which creates a potential for fraud. As they scale up, financing institutions have to design processes and procedures that facilitate monitoring and compliance. It is not difficult to see why traditional banking has neglected the poor and why informal means of financing and saving have been the norm in impoverished communities.

### **3. Objectives of the study**

The broad objective of the study is to analyse the overall impact of MFIs on the national economy in Bangladesh. Specifically,

- To identify the impacts of MFIs on the economic growth especially by accelerating the rural and lower middle income group of people.
- To focus on the influence and significance of relationships between the selected factors and the lending activities of MFIs.

## **4. Methodology**

### **4.1. Sample Size and Nature of Data**

The motive behind picking general people as a sample rather than workforce is that they will provide information based on recent scenario and based on their experiences. Most of our respondents have economic and business background by profession or by educational background. Since the study is concerned with the economic growth of Bangladesh, all the people of Bangladeshi are theoretically constituted the sampling frame as a population. A standard non-comparative questionnaire has formed using five-degree Likert Scale [Strongly Disagree (1), Disagree (2), Neutral (3), Agree (4) and Strongly Agree (5)] and given to the selected sample for collecting information which is considered as a source of primary data.

For the survey questionnaire has given to the 300 respondents. For the survey the questionnaire has given to the 300 respondents' related to business or financial background at random basis. Among these 240 were returned fully completed and usable for data analysis. It represents response rate 80%, which is significantly higher than the average response rate (10%-20%) for such surveys involving senior management (Menon, Bharadwaj and Howell, 1996). The survey has done at Dhaka city only. A face-to-face interview has done with SME business persons to identify the impact of MFIs over the small business development. The demographic information is given below:

**Table-1: Demographic Information of the Respondent**

Factors	Segmentation	No. of respondents
Occupation	Service holder	67
	Businessman	54
	Student	109
	Others	10
Gender	Male	185
	Female	55
Age	18-24 years	112
	25-34 years	73
	35-44 years	40
	45-54 years	10
	55 years and above	5
Educational background	SSC	2
	HSC	24
	Graduate	181
	Postgraduate	30
	M Phil / PhD	3

#### 4.2. Mode of analysis

To justify the impact of MFIs over national economy following variables have been selected:

- i. Contribution in SME business development
- ii. Contribution in Women empowerment
- iii. Contribution in Rural development
- iv. Contribution in Unemployment problem reduction

For this study authors use different statistics like as mean, standard deviation, regression analysis and so on. Principal Component Analysis technique is used to test the accuracy

of data and selected items under each variable. Cronbach alpha is used to verify the reliability. For such analysis SPSS 16.0 is used as a statistical tool.

### 4.3. Research Hypothesis

The following hypotheses are developed to test the prevailing scenario;

**H1:** MFIs Contribution in SME business development influences the economic growth of Bangladesh.

**H2:** MFIs Contribution in women empowerment development influences the economic growth of Bangladesh.

**H3:** MFIs Contribution in rural development influences the economic growth of Bangladesh.

**H4:** MFIs Contribution in unemployment problem reduction influences the economic growth of Bangladesh.

### 5. Findings

To test the accuracy of data, Principal Component Analysis has been used and the following results are found.

**Table-2: Results of Principal Component Analysis and Reliability Test**

Variable	Items	Factor Loading	KMO Test of Adequacy	Bartlett's Test of Sphericity	Sig.	Cronbach Alpha
Contribution in SME business development	Q1	0.697	0.595	31.069	.000	0.652
	Q9	0.667				
	Q12	0.711				
Contribution in Women empowerment	Q3	0.803	0.500	20.811	.000	0.649
	Q6	0.803				
Contribution in Rural development	Q2	0.790	0.614	91.216	.000	0.625
	Q4	0.813				
	Q8	0.658				
Contribution in Unemployment problem reduction	Q5	0.807	0.500	22.680	.000	0.664
	Q7	0.807				
Economic growth	Q10	0.808	0.500	23.211	.000	0.758
	Q11	0.808				

Extraction Method: Principal Component Analysis

Source: Field survey, 2016

Kaiser-Meyer-Olkin (KMO) test of adequacy for individual variance is found 0.500 & above in each case refers sufficient correlation exist among the items of each variable and

certifies the suitability of the data set for further analysis. Bartlett's test of sphericity shows the overall importance of the correlation matrices and is found satisfactory as  $\alpha$  is nearly zero. Reliability test is very essential to conduct a scientific research to identify the consistency of measures. In this study, Cronbach alpha values of all constructs are above 0.6 which represents good internal consistency.

**Table- 3: Model Summary**

Independent Variable	Dependent variable	R	F	Sig.	D	VIF	Tolerance	Condition Index
Contribution in SME business development	Economic growth	0.654	43.912	.000	1.716	1.764	0.567	14.179
Contribution in Women empowerment						2.037	0.491	16.858
Contribution in Rural development						1.750	0.571	18.355
Contribution in Unemployment problem reduction						1.420	0.704	20.710

Source: Authors

The result of F-test (table 3) shows that contribution of MFIs in all independent variables has joint significant positive impact over the economic growth. The level of significance is also near to zero. The D test shows that there is no autocorrelation problem exists in this analysis.

**Table-4: Results of Hypothesis Testing**

Independent Variable	Dependent variable	Mean	Standard deviation	Beta	T	Sig.
Contribution in SME business development	Economic growth	3.7472	0.70066	0.341	5.195	.000
Contribution in Women empowerment		3.8986	0.72698	0.239	3.392	.001
Contribution in Rural development		3.9188	0.72512	0.079	1.208	.228
Contribution in Unemployment problem reduction		3.9312	0.75328	0.145	2.461	.015

Source: Authors



The standard deviations are also reasonable which refers data is more concentrated. Hypotheses' testing has done by generating T-Statistics for significance testing. The significance level for two-tailed t-test was 5% and the path coefficient will be significant if the T-Statistics is larger than 1.96. H1 identifies contribution in SME business development positively and significantly influence the economic growth (table 4). H2 is accepted contribution in women empowerment and economic growth has strong positive relationship. H3 is rejected as the p value of t test is higher than 0.05. It can be said that rural development is positively correlated with economic growth but relationship is not significant. H4 is also accepted which means there is strong positive correlation between contribution in unemployment problem reduction and economic growth.

## 6. Concluding Remarks

Everything has its own good and bad sides. MFIs are not an exception. The SWOT analysis for each independent variable can accelerate MFIs for future strategic decisions and thus is depicted here.

### SME & MFIs

<p><b>Strengths:</b>          Help in fund raising;          Credit facilities;          Collateral requirement is low;          Help in business survival;          Increase SME growth rate.</p>	<p><b>Weaknesses:</b>          Deal with illiterate people in general;          Lack of managerial skills;          Risk of loan default;          High risks.</p>
<p><b>Opportunities:</b>          Majority of our population is poor;          Easy Access to Small businesses;          Small loan is popular among poor people and illiterate as well.</p>	<p><b>Threats:</b>          Unskilled people deals with such loans.</p>

### Women Empowerment & MFIs

<p><b>Strengths:</b>          Easy loan access for women;          Help to raise funds for home business;          Increase economic development by increasing working opportunities for women.</p>	<p><b>Weaknesses:</b>          Sometimes fraudulence occurs;          Illiteracy is a big hindrance.</p>
<p><b>Opportunities:</b>          Women are half of our population.</p>	<p><b>Threats:</b>          Credit worthiness is questionable.</p>

### Women Empowerment & MFIs

<p><b>Strengths:</b>          Scope for new ideas and projects;          Need no previous background for granting loan;          Giving chance to fresh grades;          Creating new scope for employment in newly established businesses.</p>	<p><b>Weaknesses:</b>          Managerial skills is not good in case of handling loans          Lack of experiences to handle loans</p>
<p><b>Opportunities:</b>          Lack of experiences.</p>	<p><b>Threats:</b>          Sometimes vulnerable for economy;          Higher loan default.</p>

### Rural development & MFIs

<p><b>Strengths:</b>          Help to reduce poverty;          Easy formation of business due to microcredit;          Credit accessibility for poor;          Help to increase the living standard of rural people.</p>	<p><b>Weaknesses:</b>          Credit goes to inexperienced hand;          Business started by using such micro-loans;          Sometimes vulnerability increases.</p>
<p><b>Opportunities:</b>          Rural economic situation can be accelerated.</p>	<p><b>Threats:</b>          Increasing loan default;          Velocity of fund may be manipulated.</p>

MFIs are one of the prime parts of the financial system in Bangladesh no doubt. The study reveals that all the selected sectors have been influenced positively by the activities of MFIs. The empirical study shows that only rural development does not have strong influence by the MFIs activities. Thus through creating significant impacts on specified sectors MFIs are influencing positively the economic growth at national level, both directly and indirectly. Products and services manufactured by the SME industries are accelerating the national GDP. So it can be said that Bangladeshi national economy has significantly influenced by the MFIs and micro-credit. Further research can be possible to identify the individual development of each variables mentioned in this study.

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